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Commentary

In Praise of Law’s Cosmos: Reflections on the Entrepreneurial Spirit in Aviation Law and Policy

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Professor Havel delivered the keynote address at the International Air Transport Association’s Legal Symposium 2009, held in Bangkok in February. The speech emphasizes the airline industry's continuing ability to respond to decades of regulatory and economic challenges with fresh ideas, innovations, and a nearly inexhaustible reservoir of creative thinking.

Aviation is a challenging place to be right now.

Not just from the perspective of aviation lawyers, but from my perspective as someone trying to pursue an academic career in this field.

It's late, you know, for those of us toiling as aviation law professors. The field peaked in the 1930s. Since then, the number of full-time professors teaching aviation law has dropped from 30 to only four.

Yes, it's true. I discovered recently, as I did some research on the history of aviation law as an academic specialty, that my life as an aviation law academic is in many ways just a recapitulation of what went on in the 1930s. We're still trying, like my predecessors back then, to justify to the University that there is an exciting new field called aviation law, and that we need an aviation institute and more aviation law professors.

Meanwhile, the University administrators keep opening the newspapers or browsing the Internet and seeing that, as one of
them said to me at lunch last week, your friends in the airline business have developed a business model that fails under all circumstances. What’s to study?

Really, as we look at what U.S. chief aviation negotiator John Byerly called turbulent times for the industry - the theme of your Symposium – as the U.S. economy turns in its worst quarter since 1982 and even Davos has been abandoned to vanity appearances by those two relics from the good times, Tony Blair and Bill Clinton, we have got to engage in some serious self-interrogation about the business model but also to recognize again what makes this industry worth studying and worth thinking about: its remarkable ingenuity as it invents new and interesting business models - sometimes in partnership with academics – in response to suboptimal economic and regulatory pressures.

We academics and policy pundits have indeed joined you in this enterprise. We have tried to supply ideas to generate the kinds of business models that the industry needs. For 15 years I have advocated for open skies and a completely deregulated air transport industry. Even in an era when deregulation may be at its reputational nadir, we can still all agree that the Chicago system of bilateral treaties – with its restrictions on cabotage and its anachronistic citizenship purity tests – is just about the most absurd system of regulatory control that could have been imposed upon the world’s most technologically advanced and visible service industry.

The system was imposed, as you may recall, in 1947, when the most advanced airplanes in the world were the Douglas DC6 and Lockheed Constellation and when socialism, not capitalism, was the expected wave of the future. There was actually a proposal from the Australians to set up a common international airline under the collective ownership of all States. Come to think of it, isn’t that the kind of thinking we’re witnessing here in the 21st century with respect to the banking system?

As Leo van Wijk, former President and CEO of KLM, once remarked, if the Hollywood movie industry had been governed by the same rules as the international airline industry, we’d still be watching silent movies.

So academics and pundits and even government policymakers have given some interesting ideas to the industry. I mentioned open skies, but before that there was the push towards U.S. airline deregulation, an initiative almost entirely promoted by aca-
demics and described by former U.S. Under Secretary of Transportation Jeff Shane as the political equivalent of the bumble bee flying. As Jeff remarked, it’s entirely against the laws of nature that the voluptuous bumble bee can actually attain liftoff, but it happens. So did airline deregulation.

U.S. deregulation begat EU deregulation and then open skies, and allowed all kinds of interesting business models to develop. Despite all of this intellectual ferment, there is still the knotty problem of what happens to these business models. The question is, must they fail in all circumstances? Are efforts to make money by carrying air passengers destined only to lead, as my friends at the McGill Institute in Montreal seem to believe, to dissolution and entropy? No!

I am fascinated by the resilience and ingenuity of airline business people. I remark on it all the time in my conference speeches. Because it’s not enough for pundits and academics to spout ideas. No government or academic decreed the code-share, and no government or academic decreed the alliance, both of which are clever devices to circumvent the no-merger rule in international air transport. And the U.S. Government never thought of applying that legal loophole called antitrust immunity to alliances between U.S. and EU airlines until KLM’s Paul Mifsud was at a lunch meeting with some colleagues from Northwest in 1992 and doodled the whole thing on his napkin.

There is a huge reservoir of creative thinking in the airline industry. Indeed, the industry’s historical exceptionalism – ironically the result of the special treatment received at Chicago in the 1940s – is what I think must give us confidence that we are not approaching “the end of aviation” – something The New Republic magazine predicted a year or so ago at the height of the oil price spike.

My academic colleagues at this gathering, Professor Michael Milde, Professor Pablo Mendes de Leon, Professor Ruwantissa Abeyratne, and Professor Alan Tan, will appreciate a nod to jurisprudential theory here. Thus, the legal/economic responses to changing market conditions rarely come in the first instance from “law’s empire,” that is to say, reform from the top down. These responses tend, rather, to emerge from “law’s cosmos,” the multiplicity of actors – you! – who figure out what the industry needs and who move ahead in that understanding, forcing the regula-
tors to respond and to catch up. That, again, is how code-sharing and alliances emerged.

I have my own way of measuring this ingenuity. I borrow my inspiration here from Andreas Lowenfeld, the great NYU aviation law professor of the 1980s, who swore that he would never again write about aviation law and policy because everything changed too quickly and his writings were constantly, as we say in the academic business, OBE, overtaken by events.

It’s true. No sooner had I dispatched my new book, Beyond Open Skies, to the proofers and typesetters in Chennai, India (yes, almost all Western academic presses have outsourced to India at one-tenth the cost), than Michael Whitaker of United Airlines and Dermot Mannion of Aer Lingus were sealing their new joint venture – some see the United/Aer Lingus deal as a glorified wet-lease, some see it as barefaced anti-labor outsourcing that uses non-union pilots to fly Aer Lingus planes between Spain and the United States, and still others like industry analyst Ray Neidl see it as a game-changer. For me, however, this joint venture is yet another example of industry players taking a specific suboptimal regulatory framework – this time the half-finished U.S./EU open skies process – and bending it and twisting it and molding it to create something nobody thought of before and certainly not the regulators who invented it.

I am impressed by the United/Aer Lingus joint venture because I am responsible for it. A bold claim, you may say, but it’s true. I organized the European Air Law Conference in Dublin, my original home city, in 2007. I invited both Whitaker and Mannion as speakers and introduced them to each other at the cocktail reception and plied them with good Irish whiskey – because that’s how things get done in Ireland. Next thing they were huddled in a corner dreaming up the next big idea in U.S./EU open skies. They probably guessed that someday their crazy scheme for Aer Lingus to use its lower cost base to operate planes between Madrid and Washington, D.C. with non-union crews, while United generated the feeder traffic in the U.S. and Spain, would attract the contempt of another Irish aviation entrepreneur, Ryanair’s Michael O’Leary (as indeed it did). But they’ve done it and now it’s yet another business model, probably an antitrust-proof business model which may be expanded to two more markets by 2011, and one that John Byerly and Daniel Calleja never really imagined when they signed the 2007 U.S./EU agreement.
The United/Aer Lingus plan is actually quite clever, if you think about the fact that the Aer Lingus unions don’t care about, or even think about, services involving points outside Ireland. And also the fact that the United unions seem to be allowing United to negotiate participatory but non-controlling deals with foreign carriers – after United warned them of the need to meet the growing competitive threat from the likes of Lufthansa, a giant merger machine that seems to be buying every airline in Europe. United and Aer Lingus have complied literally with the terms of the U.S./EU agreement, which specifically allows EU airlines to exercise seventh freedom rights (i.e., to fly from any EU Member State airport to any city in the United States) – that’s the whole point of the agreement! But so far other airlines have been reluctant to try unorthodox business models – Air France pulled down its Heathrow/Los Angeles service, and British Airways’ new OpenSkies carrier is facing the twin obstacles of little or no feeder traffic and no brand power for its operations out of Paris and Frankfurt.

And what are the next innovations in legal and economic strategy that the industry might be contemplating? I know it’s hard to believe that Minnesota Congressman James Oberstar, who is sponsoring new legislation to sunset antitrust immunity for international alliances, has more power over the U.S. industry than President Obama. But at least Oberstar is showing resiliency and leadership as a policy vacuum opens up. If the government is in a regulatory frame of mind, however, why should we go Oberstar’s way? Why would it be so outlandish to rebuff Oberstar and for Congress to expand antitrust immunity in these challenging economic times, not restrict it? For example, we could allow temporary immunity for domestic intercarrier agreements as we did in the days of the Civil Aeronautics Board. Lufthansa and Austrian have this privilege (in the context of the EU internal market), so why not in the United States also? It seems extraordinary to me that United can have antitrust immunity with Air Canada that covers the Chicago and Toronto hubs which are only 300 miles apart, but is prohibited from a similar arrangement with Continental even though Chicago and Continental’s Houston hub are three times that distance apart.

If there is a tension between the industry’s need for consolidation and Congress’s understandable fear of reducing the number of domestic airlines, then why not call Congress’s bluff, sideline
Oberstar, and lobby for domestic antitrust immunity? Given the connections that U.S. network carriers have with international alliances, and the proven economic success of those connections, why would this be such a dangerous or even commercially illogical move? As I said, the Europeans are doing it – Lufthansa and Austrian are discussing prices for Vienna/Munich. It is time to recognize that, when Adam Smith meets the airline industry, sometimes classic competition and network competition are not in perfect alignment.

Let us maintain this optimism of business ingenuity and optimism about the future of the business model. I don’t know of any industry that faces quite so much government and interest group interference and yet shows such resilience in building business models to ensure its survival. Jacques Chirac taxed the industry to fund French overseas aid, Silvio Berlusconi taxes the industry to provide social benefits to Alitalia workers, and the European Commission is creating a stupendously arrogant scheme of carbon permits imposed on all airlines from every country flying into and out of Europe. The environmentalists, meanwhile, scream “we fly, we die” while branding the industry as hostis humani generis (the universal enemy of mankind) and predicting a brutish aviation apocalypse as the human race is extinguished in a mushroom cloud of Boeing, Airbus, Embraer, and Bombardier jet fumes.

With all of this opposition, you might think it’s all too much. But the battle is just beginning. The aviation industry is always looking at new business models, but it is not going out of business. That’s why it continues to be compelling as an object of academic study and why we continue to write about it, continue this synergy, and continue to make empathetic suggestions to you.

Michael O’Leary has even championed the ultimate business model where an airline wouldn’t have to charge its passengers any airfares at all. In this scenario (which some might describe as a worst case scenario) tourist and business centers like Dubai or Las Vegas or Shanghai would not allow their airline service completely to disappear. If Las Vegas lost all commercial airline service, for example, the O’Leary model prescribes that the city would have to pay airlines to bring tourists to the desert. Or maybe it would create and fund its own airline. But still other solutions would quickly present themselves. This industry has never been short of people like Bob Crandall or Tony Fernandez
or Stelios Haji-Ioannou or Richard Branson or Vijay Mallya or Steve Miller who have the entrepreneurial insight to quickly lease 25 Boeing 737s and to enter markets themselves. This industry will not fade away even if it has to fuel the jets with bananas and ethanol.

It’s taken a long time, 30 years since U.S. deregulation, but the business structure that lies behind the global alliance system is taking shape through crises and recessions and will come to fruition and stability with the advent of a new foreign investment regime. Has anybody noticed how fast European consolidation is moving? While Congressman Oberstar pines for the era of 41 inefficient point-to-point services serving the transatlantic marketplace, every airline in Europe except the big three – British Airways, Lufthansa, and Air France-KLM – as well as the Portuguese airline TAP, has been acquired or is in negotiations to be acquired or is threatened with acquisition. Those three airlines, with their natural allies in the United States, will form the core of a new post-national commercial order that is reflected in the rumor that Air France-KLM will eventually rebrand itself simply as “blue.” Meanwhile, I am assuming that the point-to-point carriers simply stick to their knitting, as they say in America. But none of this may in fact happen. Yes, it has taken decades to get to this point, but none of it is a Hegelian inevitability.

It’s going to be an exciting five years. In two years, we’ll see the Obama Administration wake up to the existence of an international aviation industry and realize that the tripwires of the 2007 U.S./EU agreement will be triggered and that the Europeans will be demanding open foreign investment. Maybe we will see again what we saw in the 1990s, a retrenchment where States renounce their bilateral agreements, freeze their existing rights, and return to that state of nature known as comity and reciprocity. Maybe we just won’t be able to take any more of this intoxicating market freedom for a while.

Whatever happens, we happy and small band of aviation law academics in Chicago, Montreal, Leiden, and Cologne (and in Singapore and Rio de Janeiro, too) will be watching you and working with you. We feel empathy for you, although not complete empathy – after all, we gave ourselves the brilliant idea of tenure – but enough empathy to hope that we can be of service, to you and to our students, with thoughtful legal and policy analysis.
I believe that the core of this fascinating industry is that it attracts innovative people who are not afraid to reinvent air travel in response to market and regulatory forces. These turbulent times do not portend the end of aviation. Far from it. Like those pioneers in the 1930s must have felt, academics and airmen alike, in many ways this industry is only beginning.