A NEW LINE IN THE SAND?
By Lori Ranson on February 9, 2010

Long-time industry analyst Jim Parker offered an interesting point in his opening remarks recently at the Raymond James Growth Airline conference.

Parker thinks as employee groups seek to regain some concessions made early last decade as a host of carriers spent time in Chapter 11, there could be some leeway in the size of jets flown by mainline regional partners.

He sees a potential to renegotiate current scope clauses to move the dial from 70-seats to 90-seats.

--- excerpted from Airline Business blog
What the Hell Is Scope?

**Scope:** Simply, the definition of work for class and craft of employees governed by the provisions of a collective bargaining agreement

**Purpose of Scope:** Job security for the class and craft of employees governed by the provisions of a collective bargaining agreement
## Select Scope Clause Limitations

<table>
<thead>
<tr>
<th>Carrier</th>
<th>Up to 50 Seats</th>
<th>51 - 76 Seats</th>
<th>77+ Seats</th>
<th>Some Key Limitations</th>
</tr>
</thead>
<tbody>
<tr>
<td>American</td>
<td>May not exceed 110 percent of mainline narrowbody aircraft. May not exceed 64,500 pounds</td>
<td>Exception for CRJ-700s flown by American Eagle</td>
<td></td>
<td>Flying between listed cities may not exceed 1.25 percent of mainline block hours</td>
</tr>
<tr>
<td>Continental</td>
<td>Limit of 274. Additional RJs may be added with mainline growth</td>
<td></td>
<td></td>
<td>No Express flying between hubs</td>
</tr>
<tr>
<td>Delta</td>
<td>No Limit</td>
<td>255 aircraft between 51-70 seats. 120 with 71-76 seats (may increase with mainline fleet).</td>
<td>85 percent of flying less than 900 miles. 90 percent of flying will be to/from hubs</td>
<td></td>
</tr>
<tr>
<td>United</td>
<td>No limit</td>
<td>No limit up to 70 seats</td>
<td></td>
<td>Regional block hours less than mainline block hours. No new feeder flying on UA routes flown in last 24 months unless UA could not earn an adequate return</td>
</tr>
<tr>
<td>US Airways East</td>
<td>150 Small RJs. Defined at max weight of 53,000 pounds. Small RJs seat 40-44</td>
<td>Medium and Large RJs up to 315. Can be expanded based on mainline fleet</td>
<td>See below</td>
<td>Limits on flying for US Airways or another carrier. 80 percent of nonstop flights limited to less than 950 miles</td>
</tr>
<tr>
<td>US Airways West</td>
<td></td>
<td>Permitted up to 88 two-class or 90 one-class</td>
<td>Merger agreement allows up to 93 CRJ-900 or equivalent aircraft</td>
<td></td>
</tr>
</tbody>
</table>

Source: Regional Horizons, F&H Solutions, Inc., October 2009
The Right Intentions Producing Unintended Consequences?

- **Between 2000 - 2008:** 797 legacy carrier small narrowbody aircraft were parked

- **Between 2000 - 2008:** 14,352 legacy carrier pilot jobs lost

- **Between 2000 - 2009:** Express ASMs increased 178 percent
  - Mainline Domestic ASMs decreased 27 percent

- **Between 2000 - 2009:** Express RPMs increased 243 percent
  - Mainline Domestic RPMs decreased 16 percent

- **In 2000:** Express ASMs as percent of domestic total were 5.4 percent
  - In 2009, Express ASMs as a percent of domestic total were 17.8 percent
Economist **Henry George**, outspoken on protectionist policies said:

“**What protectionism teaches us, is to do to ourselves in time of peace what enemies seek to do to us in time of war**”
An Industry That Grew Too Big
Decreasing real fares became the “Great Enabler”

Unsustainable Economics

Graph showing inflation-adjusted cents per revenue passenger mile (1982 = 100) for domestic, international, and system categories.
The Relationship in Revenue to GDP
Another New Norm?

Source: MIT Airline Data Project
Annual Net Profits
1978 – 2009E
We finally can define over-capacity.

The correct term should be **uneconomic capacity**, an **inherent weakness** that is compounded by an **industry practice** that emulates other capital intensive, commodity industries. The US airline industry has **too often expanded too much** during the up cycles and **kept uneconomic capacity** in place in the down cycles -- **all in the name of market share**.
Domestic Capacity Reduced in 7 of Last 10 Years

Pct Chg ASMs

Note: 1987 = 15%
The Decrease in Mainline Capacity Is Significant…. As Is The Shift of Flying to the Regional Sector
Tipping Point: the critical juncture in an evolving situation that leads to a new and irreversible development.
History of Bubbles

- The roaring 1920’s, the crash of ’29
- US domestic airline capacity
- High tech/ IPO’s
- US regional airline capacity
- Housing
- Oil prices
A Regional Bubble?
Regional Carrier Revenue Passenger Miles (in Billions)
The Evolution of Scope Language
From 1 Paragraph (Mid 1980s) to More Than 60 Pages (the Growth of the 50-Seat Jet)

Some Examples:

- Airline XX cannot fly RJs with more than 50 seats
- To operate RJs at all, Airline XX must maintain at least YYY larger aircraft
- The company may operate more than XX RJs only if it maintains a fleet of YYY aircraft
- The number of available seat miles that United can schedule for RJs is limited to a percentage of ASMs for Airline XX’s mainline aircraft, which varies depending on the number of RJs
- Ninety percent of RJs nonstop flights must arrive or depart from a specified list of airports. RJs cannot fly between airports on the list
- Airline XX cannot reduce its number of mainline pilots below Z,ZZZ because of RJs
One of my favorites . . .

American Eagle code share utilizing turboprop aircraft configured for up to 69 seats and limited to connecting US flights from points west of a line formed by the eastern border of the states of Montana, Wyoming, Colorado and New Mexico.

US Airways East Collective Bargaining Agreement, Letter of Agreement #77
This Round of Collective Bargaining Will Draft Tomorrow’s US Industry Architecture

**Significant consequences for organized pilot labor**

- The growth is forecast to occur in the 75-125 seat category
  - For the mainline to cede this flying, then how relevant are they in tomorrow’s US domestic market?
  - For the mainline to make this flying theirs, a new economic framework will be required to keep the flying in-house v. being outsourced to their regional partners
    - The trading currency to improve the wages for mainline pilots flying equipment bigger and heavier than the 75-125 seat products on the market?
    - Still thousands of mainline pilots on furlough
“Slow traffic growth, combined with need for higher fuel efficiency, will result in the majority of new airliner demand being driven by need to renew fleets through 2014.”

Mike Boyd, Boyd Group International

Source: Boyd Group International, Inc.
Global Demand for Airliners 2010 - 2019

New Airliners:
- Growth: 48%
- Replacement: 52%

2010 Global Net Increase in Fleets: 24.2%

New Airliner Demand by Category:
- Regional Jet: 315
- 61-74 Seats: 1,008
- 75-100 seats: 2,110
- 101-125 Seats: 2,521
- 126-180 Seats: 4,282
- 180+ Seats: 2,611

New Airliner Demand by Region:
- North America: 3,851
- China: 3,282
- Europe: 3,032
- Asia: 1,206
- Africa: 810
- Latin America: 666

Source: Boyd Group International, Inc.
Change in Jet Airliner Fleets by Region
2019 v. 2009

Source: Boyd Group International, Inc.
50 Seat Regional Jet Contract Expirations

468 Aircraft Expire 2010 - 2016

Includes Air Wisconsin, ExpressJet, Mesa, Pinnacle, Republic and SkyWest/ASA
Estimated timing of SkyWest expirations with United
Source: Pinnacle Airlines
US/Canada/Mexico Jet Fleet Mix
2009 v. 2019

Source: Boyd Group International, Inc.
North American Annual Demand by Category

Source: Boyd Group International, Inc.
Scope as Currency at the Bargaining Table

Scope only has value when it has been violated

The value of scope has been used as trading currency in mainline pilot negotiations since the mid 1980s
  - With 60+ pages of limitations, violations are inevitable

Mainline pilots have benefited from allowing increased regional flying … Until now?
  - Improved wages and benefits
  - Enhancements to quality of life issues, or to
  - Minimize the level of concessions necessary

But ……. Now, in this upcoming round of negotiations
  - Limited Growth = Limited Arbitrage
  - Limited Arbitrage = Reduced Value of Trading Currency

Reduced Value of Trading Currency = Reduced Likelihood of Further Relaxation
Just How Much Value Is Scope Today As Currency?
Domestic Economics Have Structurally Changed

![Graph showing the trend of inflation-adjusted cents per revenue passenger mile from 1978 to 2009. The graph includes data for domestic, international, and system-wide passenger miles. There are shaded areas indicating 50 Seat Scope Relief and 76 Seat Scope Relief periods.]
Managing Labor Costs
-- This Is Not Post 9/11, or Even the Late 1990s

[Graph showing Total Compensation Index and Consumer Price Index from 1978 to 2010, with annotations for specific years like 1997 and 2005.]

1978=100
Ponzinomics

- The marginal cost model yields no profitability
  - Simply not sustainable

- US domestic airline industry was built too big
  - Just how much access is necessary for secondary and tertiary markets?

- Labor built today’s “regional airline” industry
  - For all of the wrong reasons
  - “Regional airline” industry is too big

- The industry: Airlines and labor have built A Ponzi scheme
  - Forecasts all point to aircraft in the 75-125 seat range for US domestic flying
  - Will the mainline do the flying, or will more flying be outsourced?

My guess is that the MAINLINE PILOTS WILL NOT OUTSOURCE THE 75-125 SEAT FLYING and will create the necessary economics under their existing collective bargaining agreements. THE NEW TRADING CURRENCY for improvements elsewhere.
For More Information on the MIT Airline Data Project

email: swelbar@mit.edu
or visit:
www.airlinedataproject.mit.edu
www.swelblog.com
or find me on FaceBook