



**Massachusetts
Institute of
Technology**

The Future of Scope Clauses

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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

Carrier	Up to 50 Seats	51 - 76 Seats	77+ Seats	Some Key Limitations
American	May not exceed 110 percent of mainline narrowbody aircraft. May not exceed 64,500 pounds	Exception for CRJ-700s flown by American Eagle		Flying between listed cities may not exceed 1.25 percent of mainline block hours
Continental	Limit of 274. Additional RJs may be added with mainline growth			No Express flying between hubs
Delta	No Limit	255 aircraft between 51-70 seats. 120 with 71-76 seats (may increase with mainline fleet).		85 percent of flying less than 900 miles. 90 percent of flying will be to/from hubs
United	No limit	No limit up to 70 seats		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
US Airways East	150 Small RJs. Defined at max weight of 53,000 pounds. Small RJs seat 40-44 Medium RJs defined at 45-50 seats. Large RJs: 51-88 seats	Medium and Large RJs up to 315. Can be expanded based on mainline fleet	See below	Limits on flying for US Airways or another carrier. 80 percent of nonstop flights limited to less than 950 miles
US Airways West			Permitted up to 88 two-class or 90 one-class	Merger agreement allows up to 93 CRJ-900 or equivalent aircraft



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

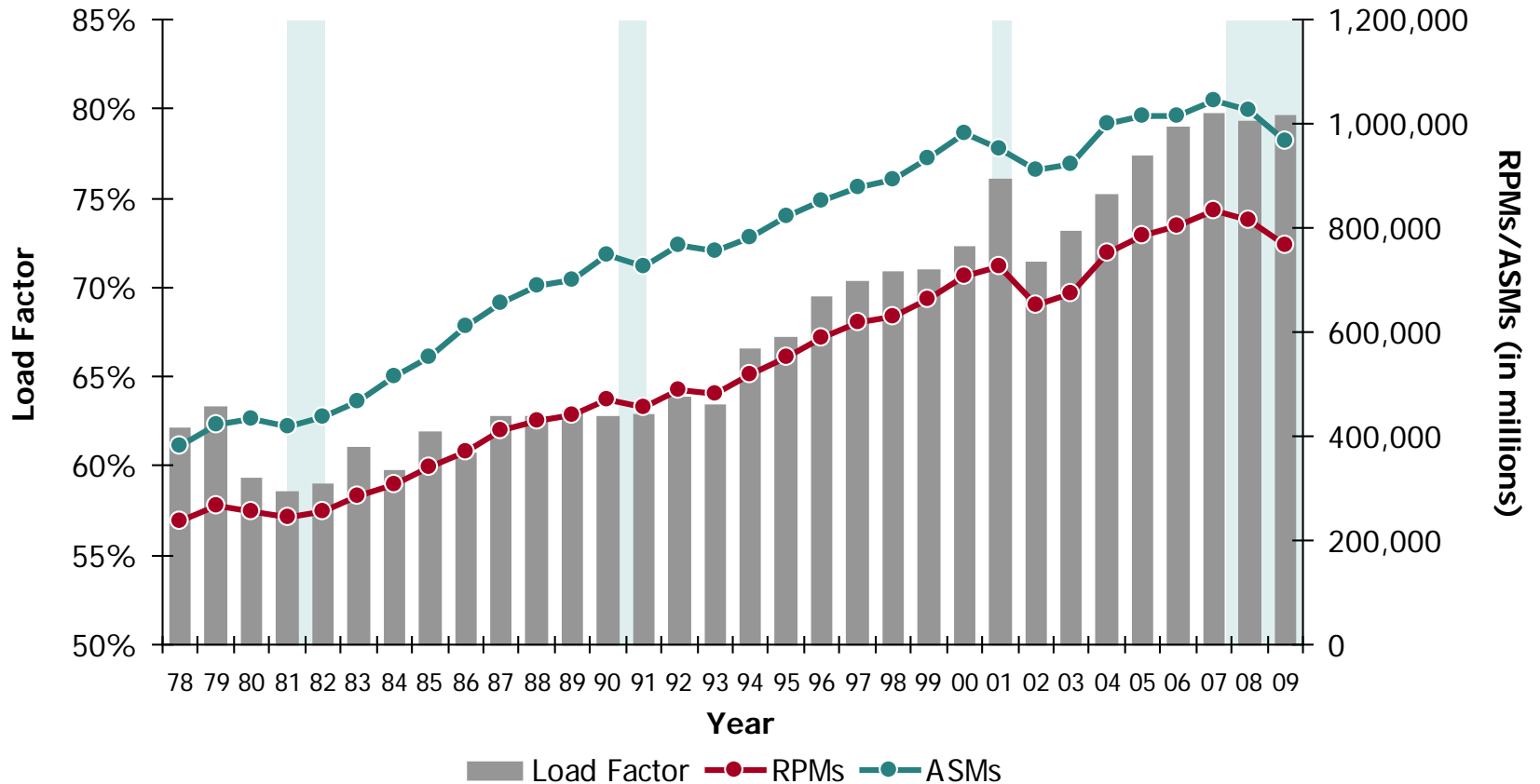
- | **In 2000:** Express ASMs as percent of domestic total were 5.4 percent
 - In 2009, Express ASMS as a percent of domestic total were 17.8 percent

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”**



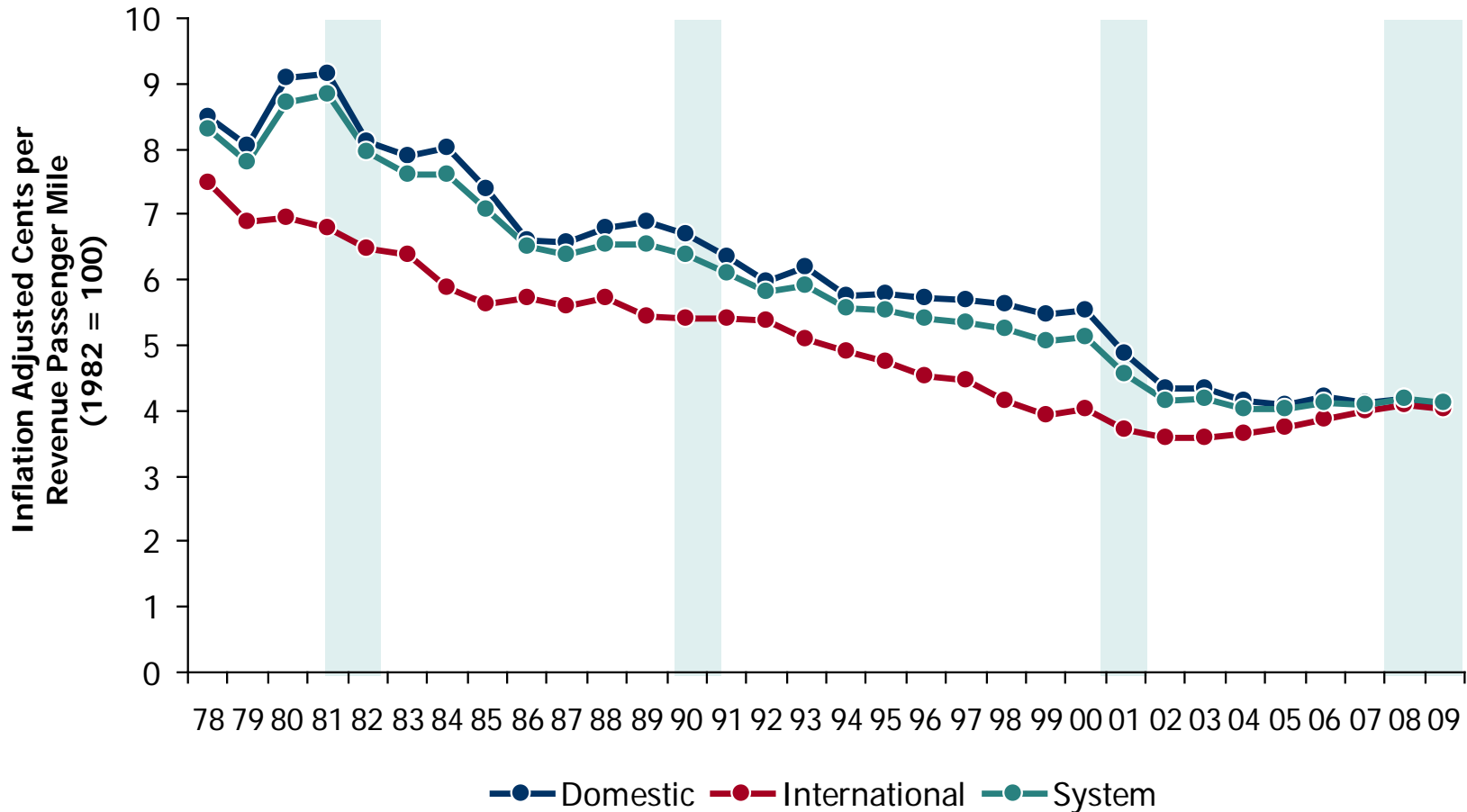
An Industry That Grew Too Big





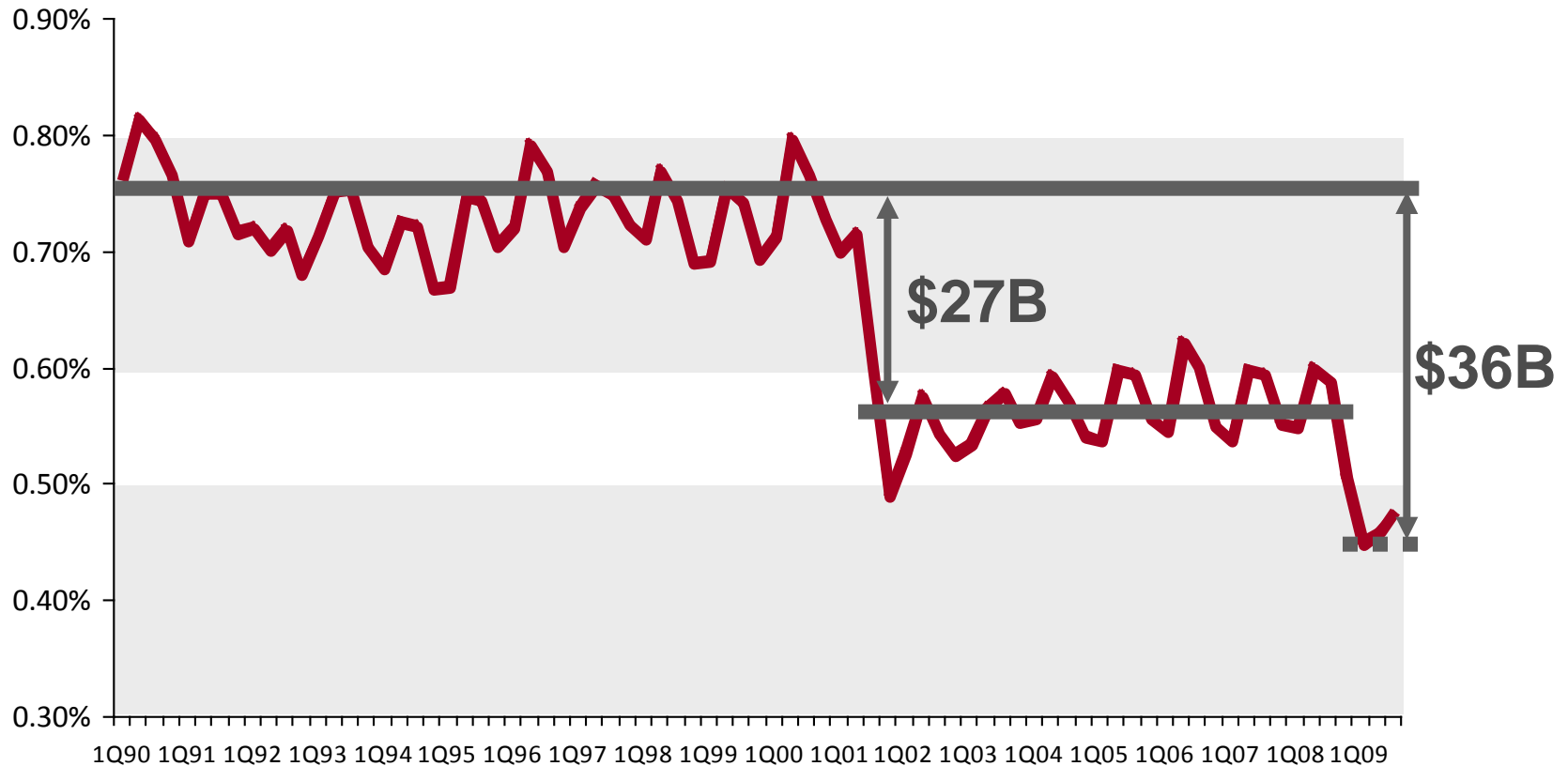
Decreasing Real Fares Became the "Great Enabler"

Unsustainable Economics





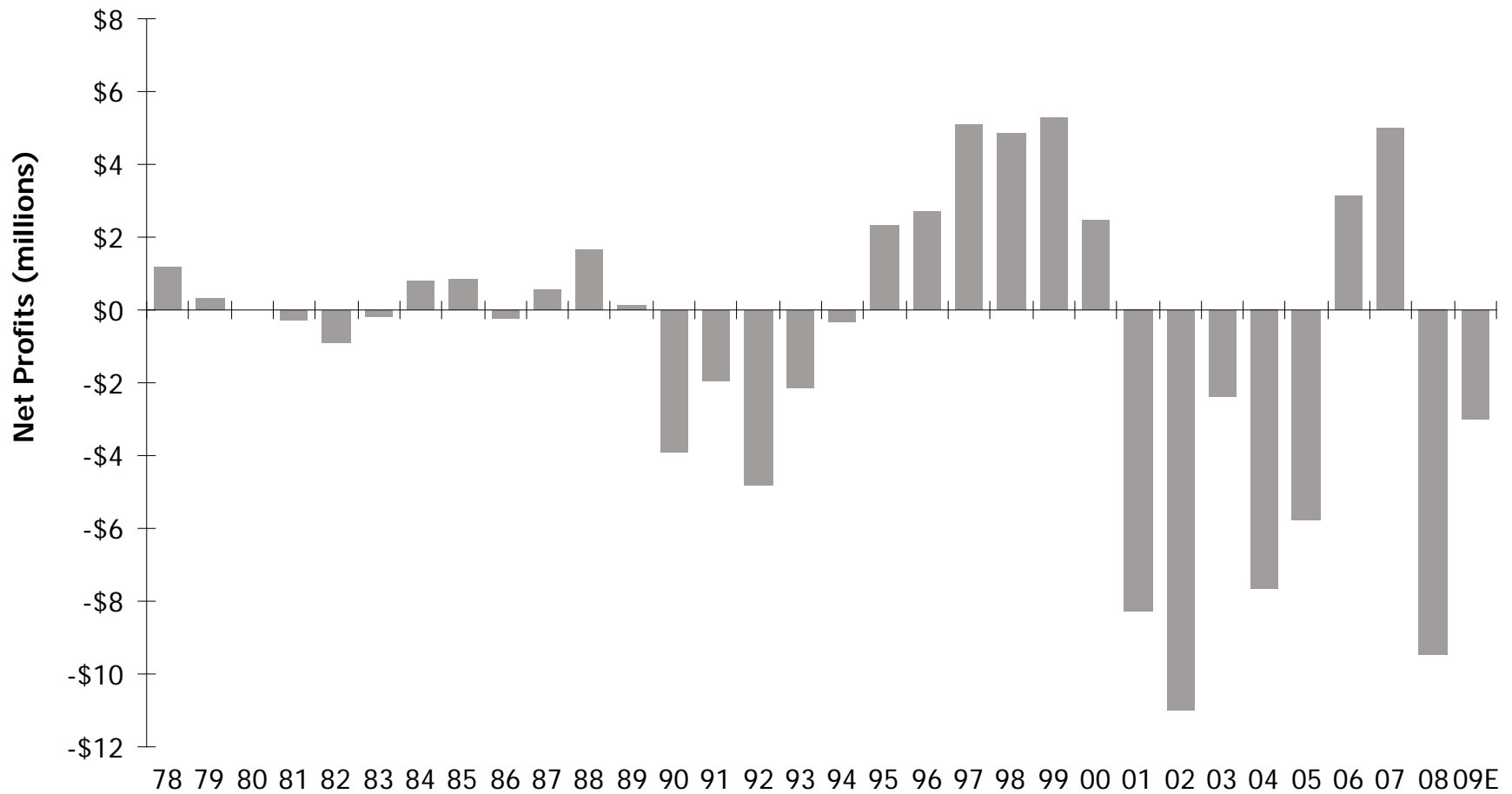
The Relationship in Revenue to GDP Another New Norm?





Annual Net Profits

1978 – 2009E



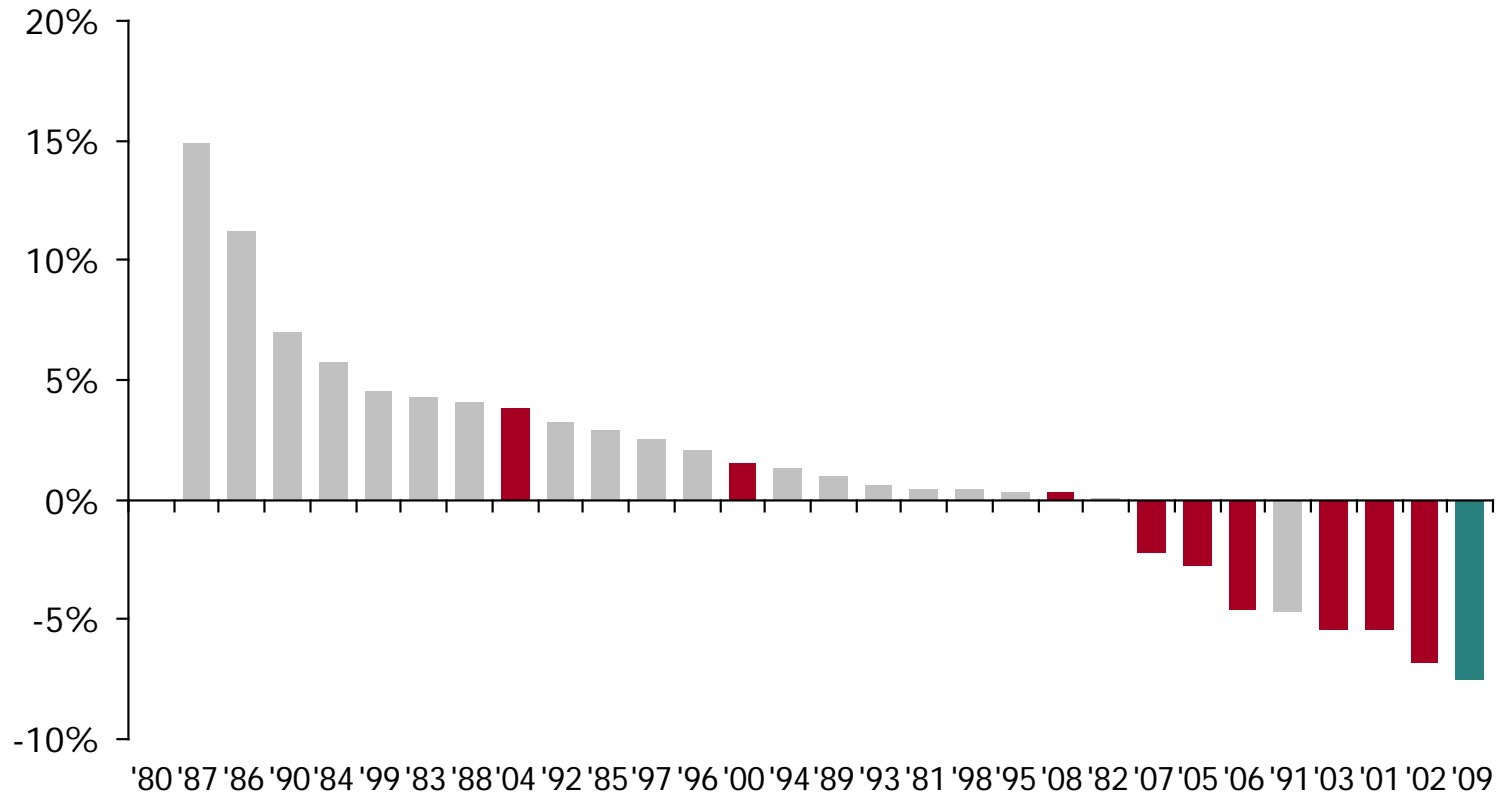
We finally can define **over-capacity.**

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

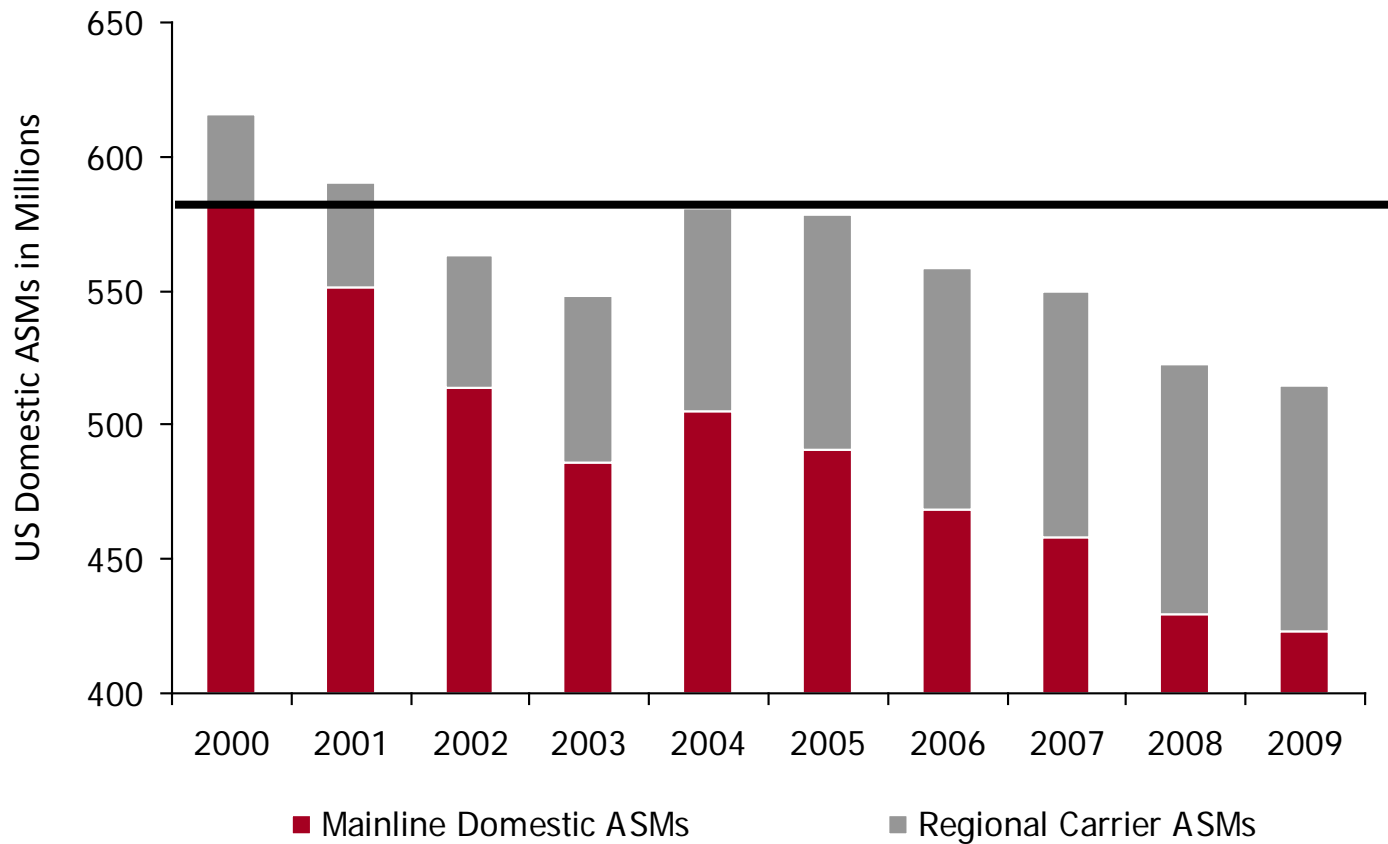
Pct Chg ASMs



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**



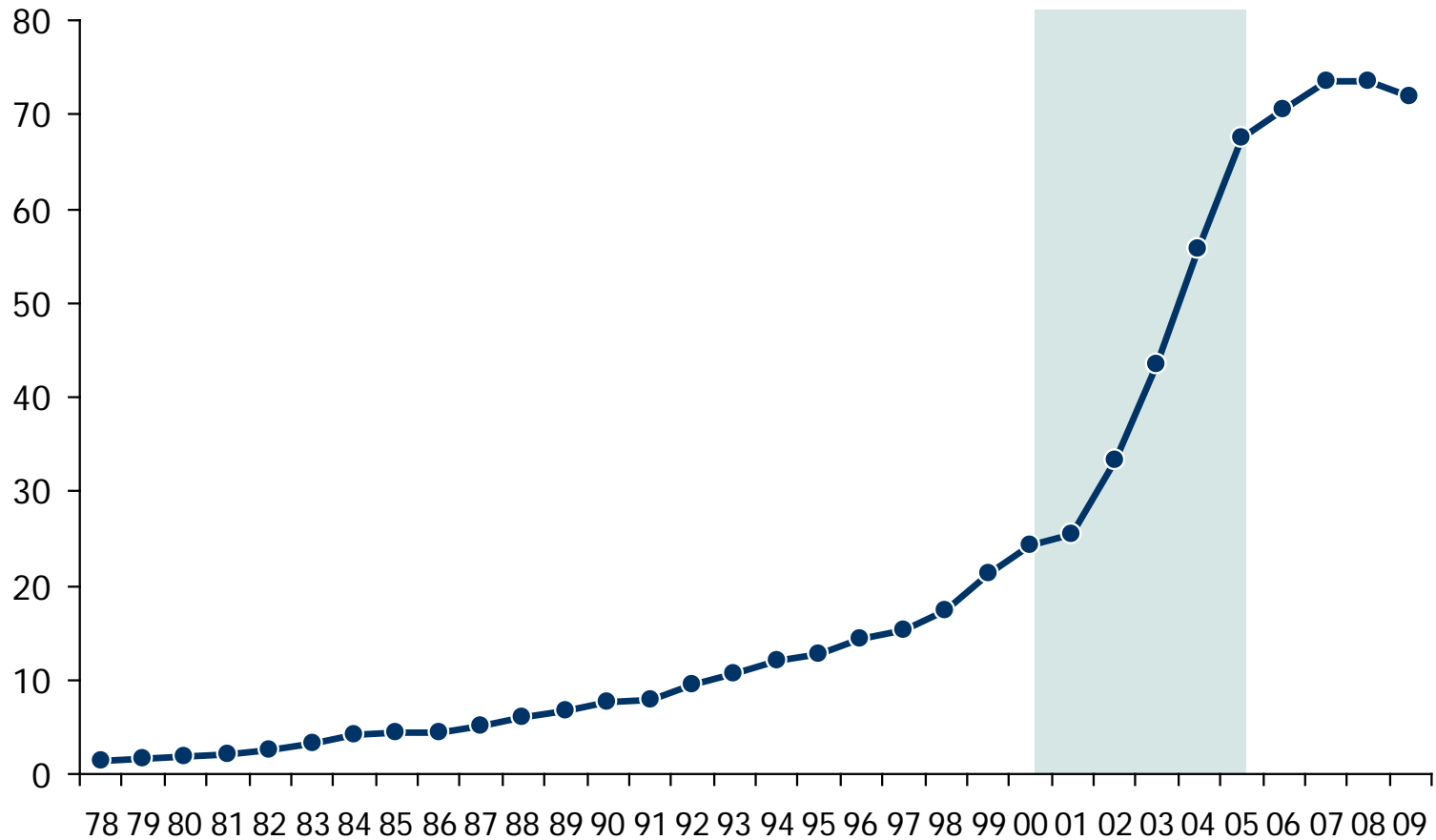
History of Bubbles

- 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

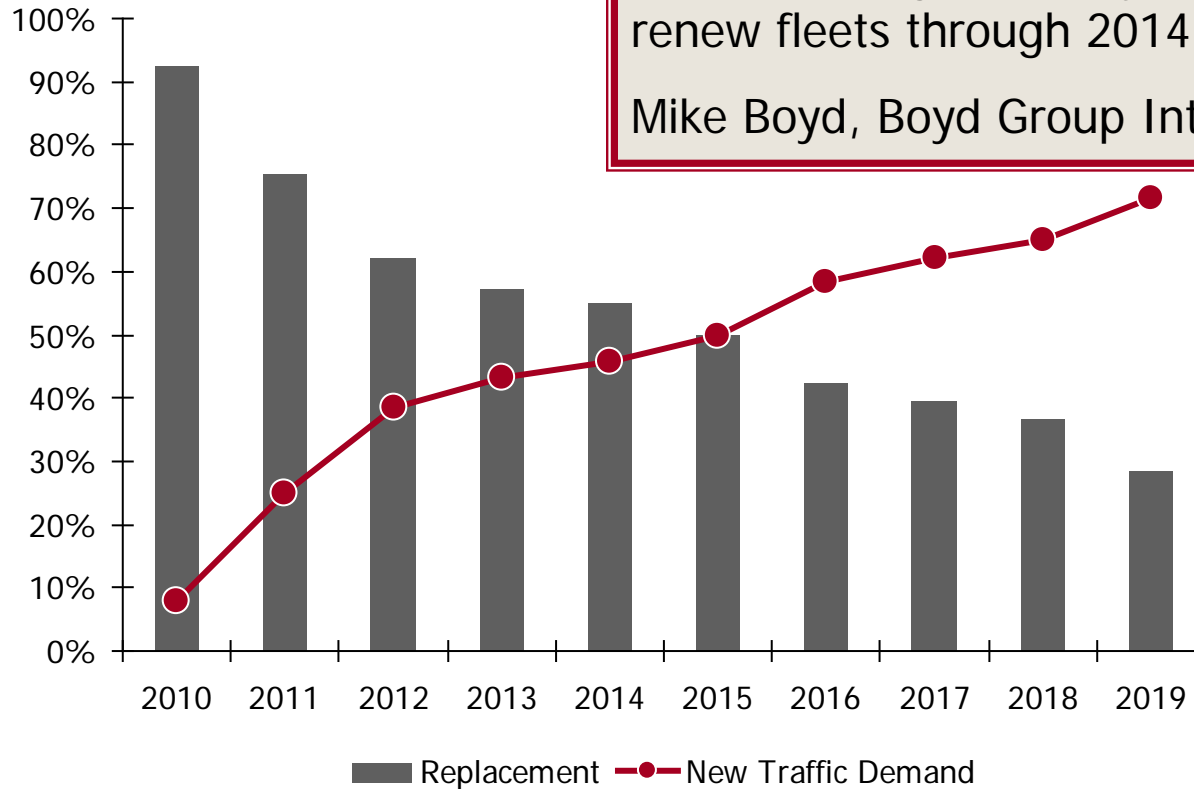
- The growth is forecast to occur in the 75-125 seat category
 - For the mainline to cede this flying, then how relevant are they in tomorrow's US domestic market?
 - For the mainline to make this flying theirs, a new economic framework will be required to keep the flying in-house v. being outsourced 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



Current Demand

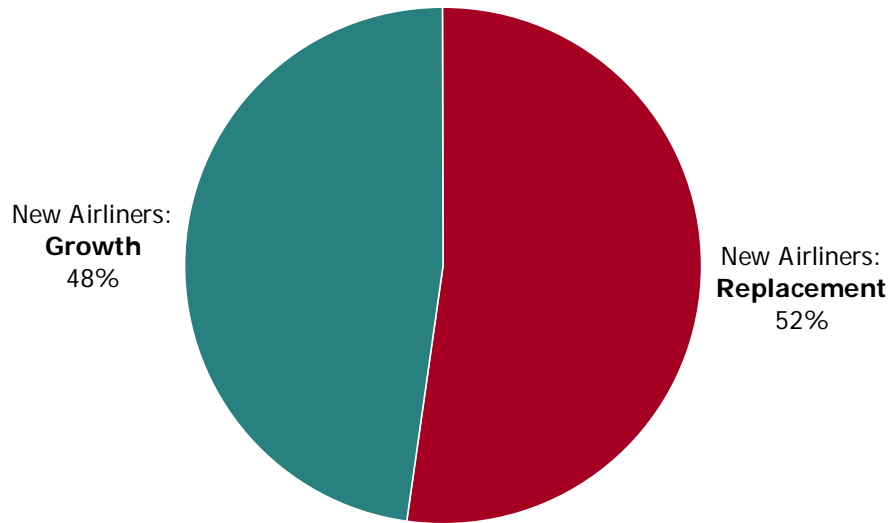
“Slow traffic growth, combined with need for higher fuel efficiency, will result in the majority of new airliner demand being driven by need to renew fleets through 2014.”

Mike Boyd, Boyd Group International



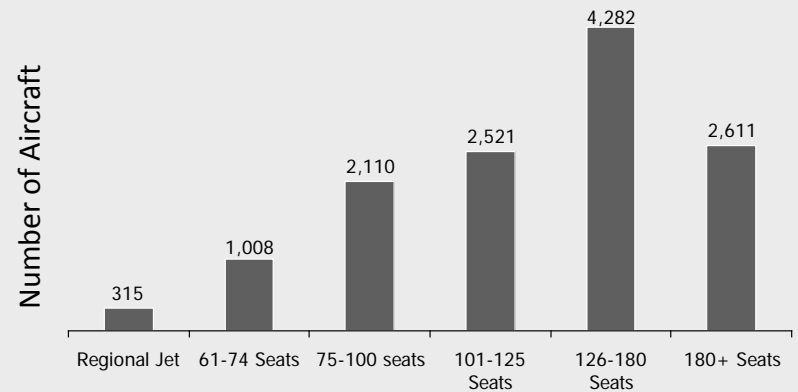


Global Demand for Airliners 2010 - 2019

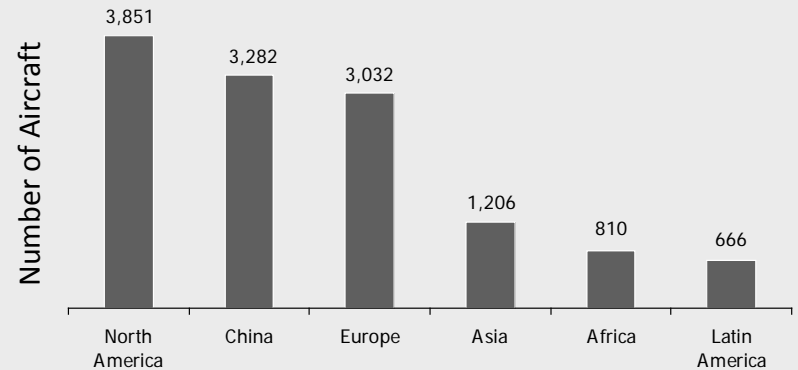


2010 Global Net Increase in Fleets: **24.2%**

New Airliner Demand by Category



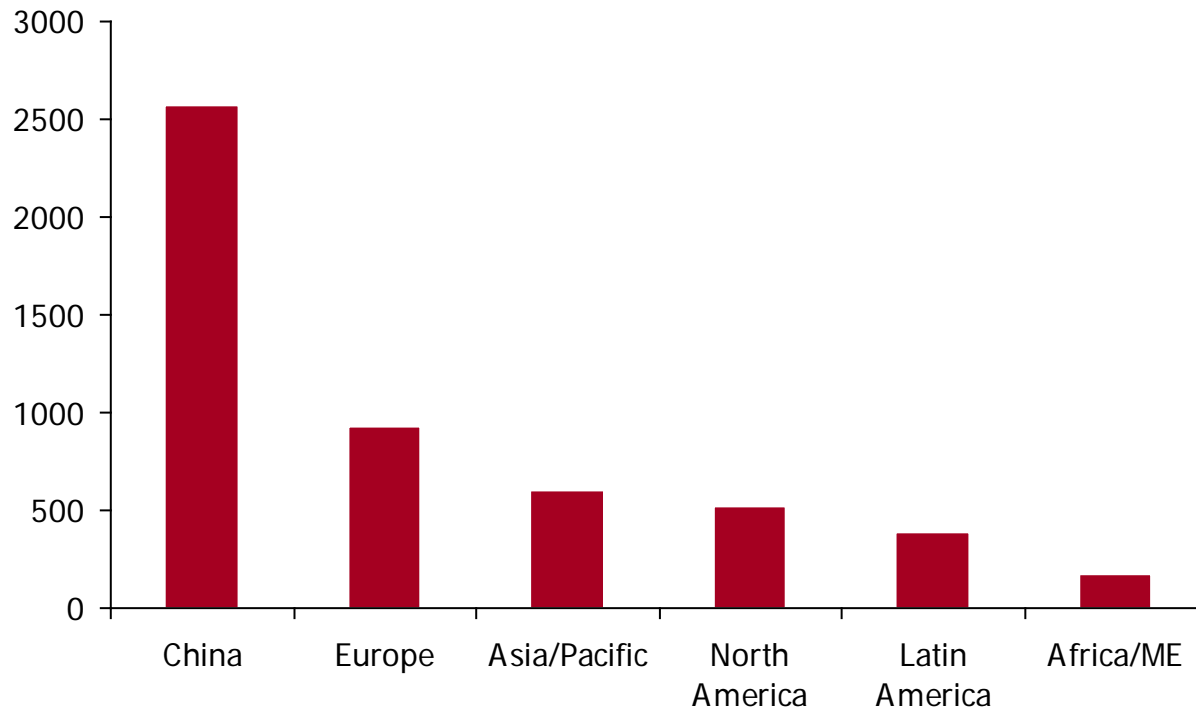
New Airliner Demand by Region





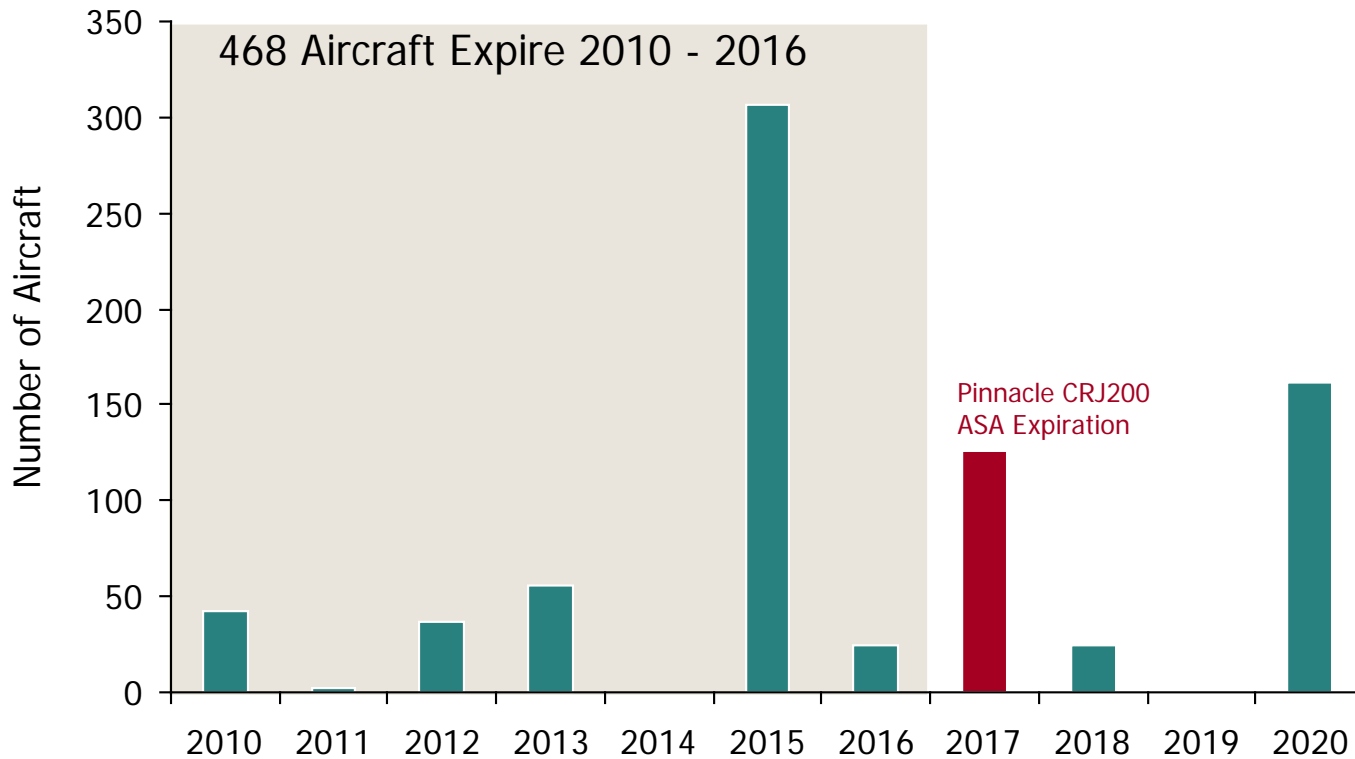
Change in Jet Airliner Fleets by Region

2019 v. 2009





50 Seat Regional Jet Contract Expirations



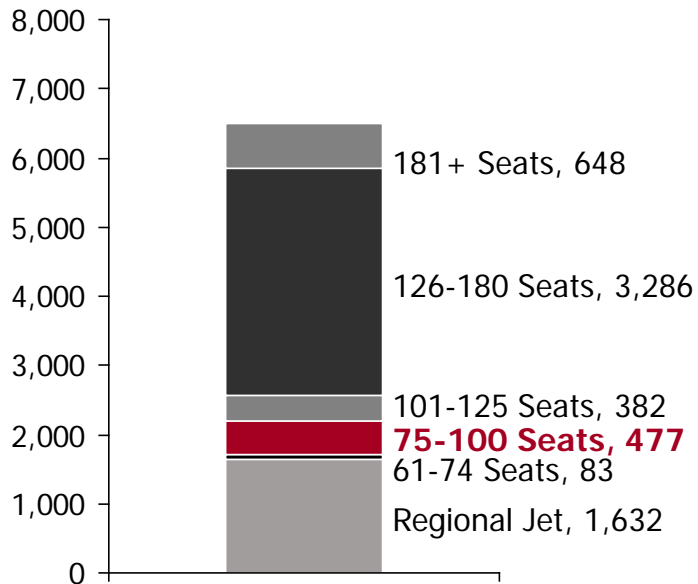
Includes Air Wisconsin, ExpressJet, Mesa, Pinnacle, Republic and SkyWest/ASA
Estimated timing of SkyWest expirations with United
Source: Pinnacle Airlines



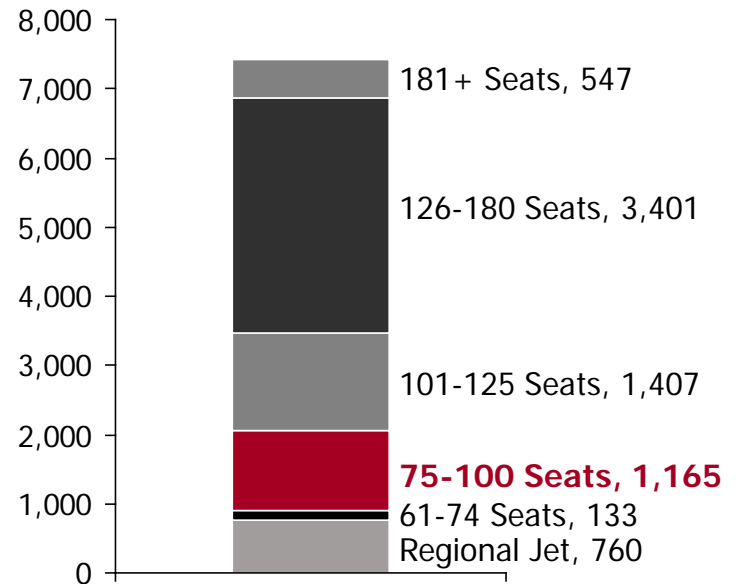
US/Canada/Mexico Jet Fleet Mix

2009 v. 2019

2009

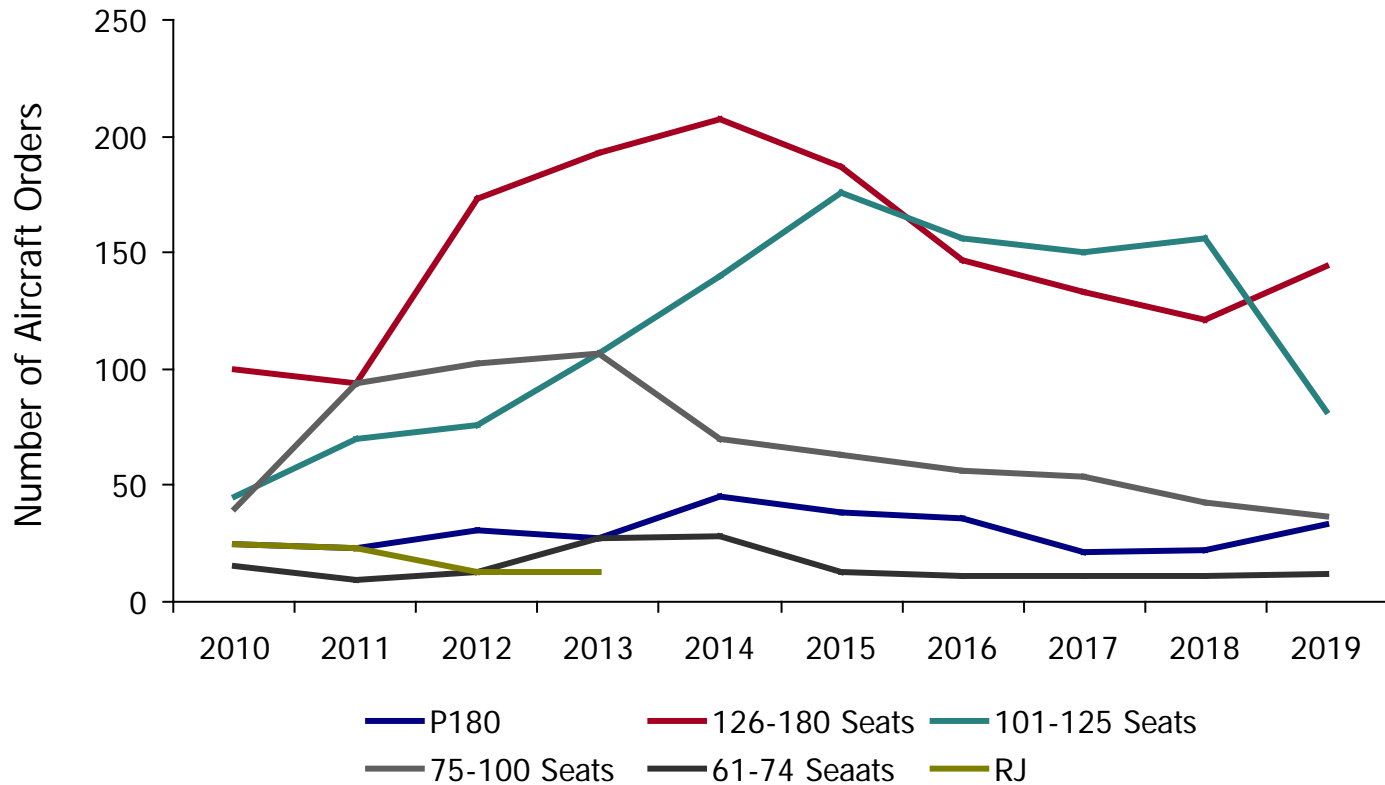


2019





North American Annual Demand by Category





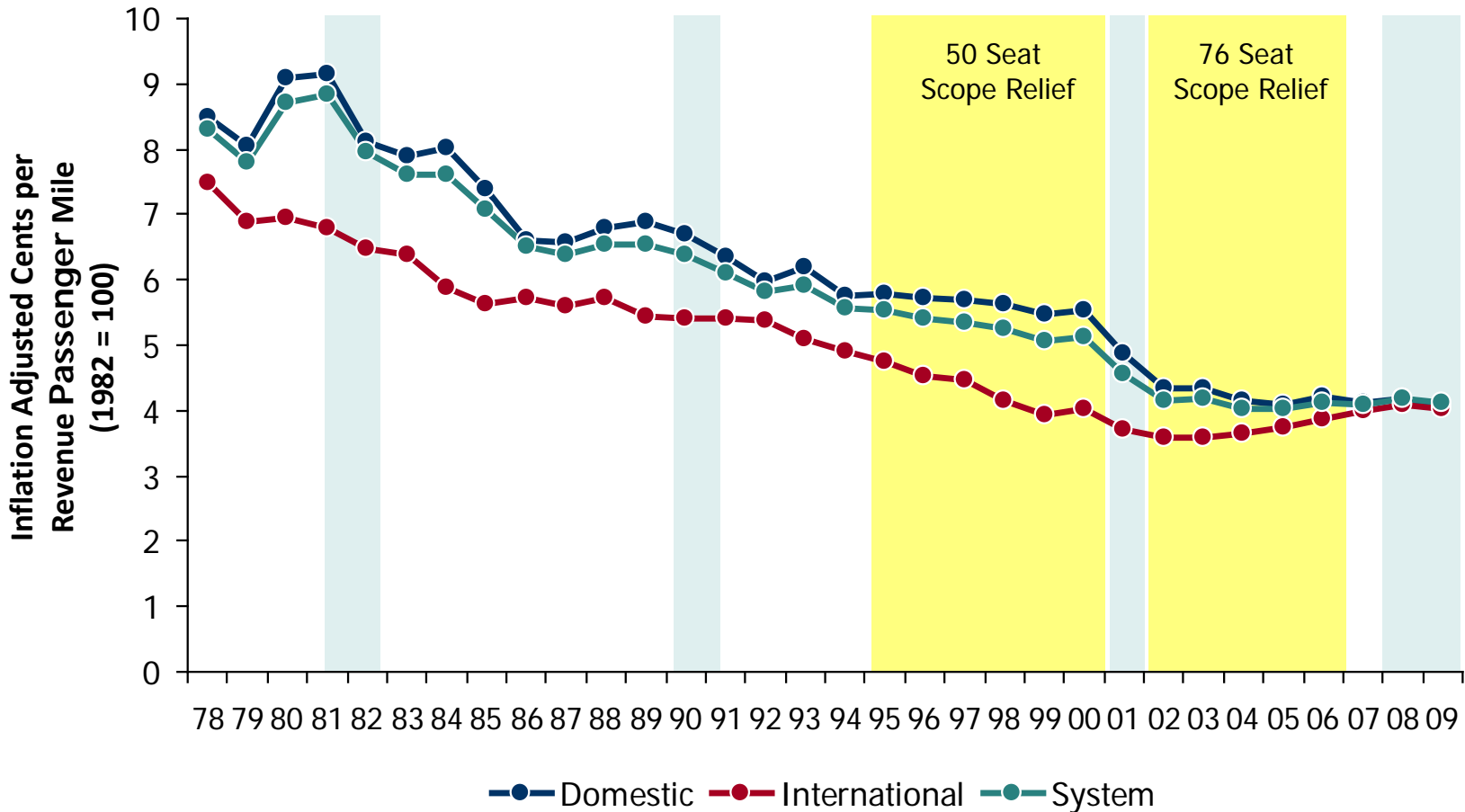
Scope as Currency at the Bargaining Table

- 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?

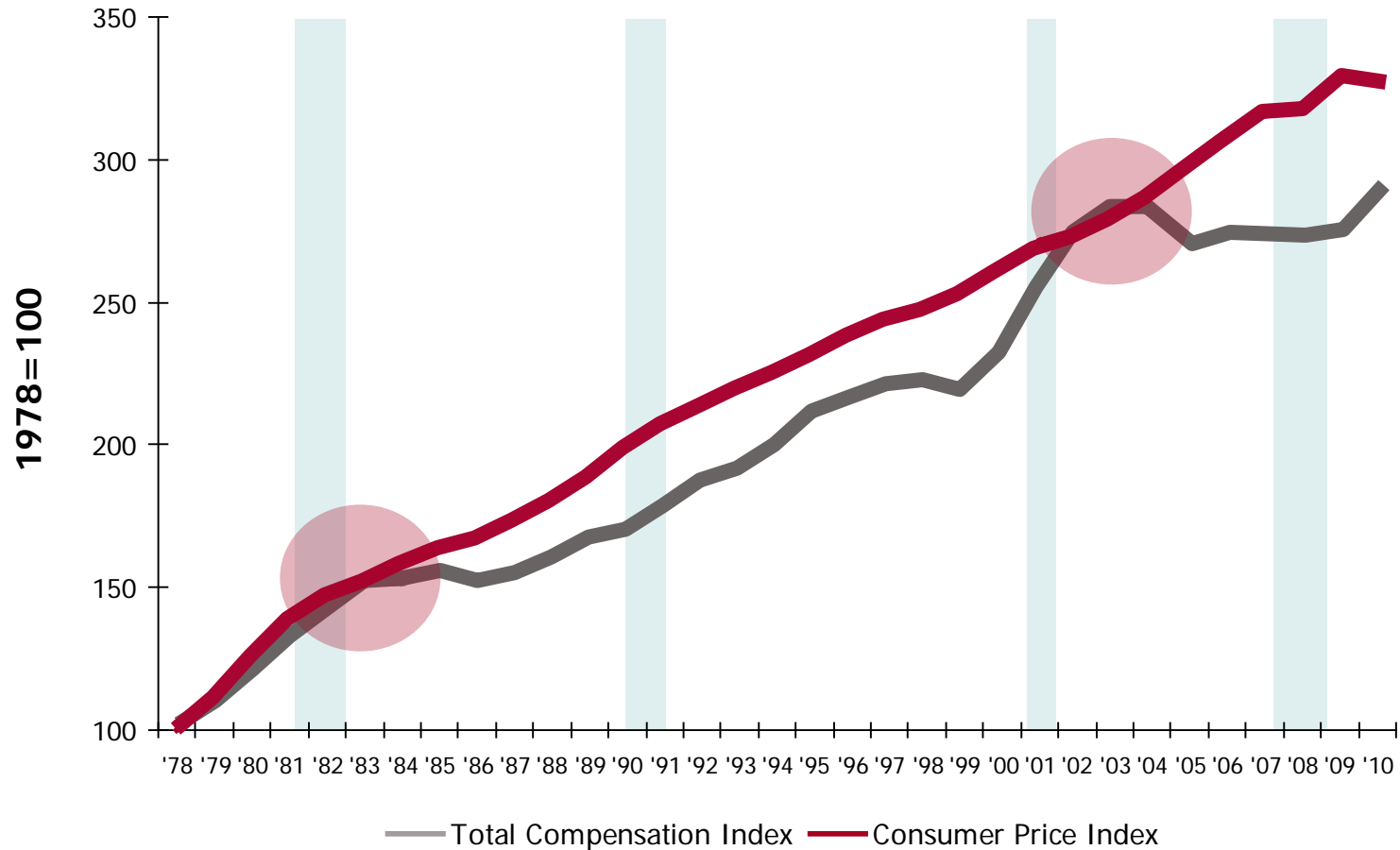
Domestic Economics Have Structurally Changed





Managing Labor Costs

-- This Is Not Post 9/11, or Even the Late 1990s





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.



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