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## ITALY

Anna Masutti reflects on the most important aspects and developments in the Italian aviation market, including the latest strategies to improve airport capacity

**1. Currently, what are the main issues (strategic and political) affecting those in the aviation sector in your jurisdiction?**

An important issue concerning transnational alliances is that of mergers and acquisitions of air carriers, which are becoming increasingly frequent. These operations have common goals: to boost operational and marketing efficiency; to improve financial results leading to economic and industrial improvements through economies of scale; and to reduce entry barriers. The most significant alliance of the aviation sector to have occurred in Italy is that realised between Alitalia-CAI and Etihad Airways, which received

the green light from the European Commission at the end of 2014. The approval was granted under EU Regulation No. 139/2004, as the new partnership complies with the European regulations on competition and air law. Etihad acquired a 49% stake in Alitalia, which is the maximum allowed by EU law for non-EU residents. The cooperation started in early 2015. Moreover, Meridiana and Qatar Airways are working on a potential partnership. In February 2016, they signed a memorandum of understanding for a strategic partnership to revitalise the Italian airline. The agreement sets the conditions for a transaction that must occur by the end of 2016. According to recent reports, Qatar Airways is ready to become a shareholder of

Meridiana, buying 49% of the share capital.

However, the main operator investing in the Italian market is Ryanair, despite the recent agreement with Etihad and Qatar Airways, which should have pushed the Italian airlines to be more competitive than low-cost airlines. Thus, Ryanair remains the major carrier in Italy and the main provider in terms of future investments. In fact, in August 2016, Michael O'Leary, CEO of Ryanair, announced the company's intention to invest 1 billion dollars in the Italian market, opening 44 new routes with 10 new aircraft. The investment is expected to generate a 10% increase in passengers, from 32 million in 2016 to over 35 million in 2017. Following this initiative, the Italian Government decided to reverse the €2.50 municipal tax increase from 1 September 2016 and the Minister of Infrastructure, Graziano Delrio, revised the airport guidelines, which will enable Italy's regional airports to compete with international airports like Rome and Milan as long as they comply with the EU's Market Economy Investor Principle (MEIP) rules. These initiatives have allowed Pescara and Alghero airports to reach a new operating agreement with Ryanair, which will reverse the decision to close these bases by November 2016. This industrial plan will certainly create new opportunities for tourism in Italy and, consequently, new jobs. The President of ENAC - the Italian Civil Aviation Authority - welcomes Ryanair's investment project, which represents a significant opportunity for the development of air transport, one of the main objectives for the Italian economic growth plan.

**2. Where has your jurisdiction seen the most growth in the aviation sector over the past 12-18 months? And, if any, where do you anticipate growth coming from during the next 12 months?**

Despite the air traffic decrease which took place in 2008-2009, in recent years we can register a positive growth trend. On 30 March 2016, ENAC published the official data on 2015 air traffic through the national airports, which highlighted a positive trend for the aviation industry. In fact, it registered a 4.5% traffic increase compared to 2014, with more than 156 million passengers. The busiest national airports are still Rome Fiumicino, with a market share of over 25% (40.2 million passengers), followed by Milan Malpensa with a 12% market share (18.4 million passengers), Bergamo Orio al Serio with a 6.6% market share (10.3 million passengers), Milan Linate with a 6.1% market share (9.6 million passengers) and Venice Marco Polo with a 5.5% market share (8.6 million passengers). Likewise, freight air transport has grown by 4.3% since 2014, with 941,107 tons carried (on aggregate of cargo and mail). Further air traffic

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growth is also predicted, despite increased competition from high-speed trains.

The Aerospace Industrial Districts, or “Clusters”, which represent one of the main strengths of the Italian industrial system, are undergoing significant growth as well. They are homogeneous local productive systems, characterised by a high concentration of mainly small and medium-sized industries, highly specialised in their business activity. Recently, there has been a significant growth in Industrial Clusters in many fields, bringing new opportunities and benefits to the transport sector. In particular, it is worth mentioning the Lombardy Aerospace Cluster, which is an excellent example of an integrated system of companies, technological expertise and advanced scientific capabilities in the aerospace industry. The Cluster's development in recent years is certified by its sales revenue which, according to the latest calculations of the Lombardy Aerospace Cluster, has now reached record levels. Based on a report published in April 2016, Aerospace Lombard companies have recently generated a turnover of €4.6 billion.

**3. Does the GDS distribution model continue unchallenged as the most popular model for flight distribution?**

Yes. In particular, the national “flag” carrier Alitalia has recently concluded an agreement (“Full Content Option”) with Amadeus, a GDS based in Spain which has a 14% market share

- the others, Sabre and Galileo, are based in the USA. The Amadeus GDS provides the airline's complete public inventory of flights, which travel agents can access more efficiently and quickly. As the GDS is an electronic database, airlines and travel agents are required to set up strategies with the aim of preventing and mitigating the risk of cyberattacks.

**4. In your jurisdiction, does airport capacity require boosting and, if so (and even if not), what plans and/or processes are in place to address this (or increase or re-organise airport capacity, as the case may be)?**

The Italian market is made up of a network of numerous airports, some of which are relatively small, which frequently compete against each other. This results in a more dispersed system than in other competing European countries, where traffic is concentrated in only a few strategic airports. The result is a system that is highly polarised between Milan and Rome, and other minor airports - with less than 5 million passengers *per annum* - come into play thanks to the low-cost carriers. For this reason, in 2015, the Minister of Infrastructure and Transport, in order to make the air navigation system more efficient, developed a "National Airports Plan" which identifies 10 traffic zones. Airports of "national interest" have been identified inside each area, and among them those with a particular "strategic importance", with the sole exception of the north-central zone, where Bologna and Pisa-Florence operate, provided that Pisa and Florence airports become totally integrated. The 10 strategic airports are: Milan Malpensa (north-west); Venice (north-east); Bologna and Pisa-Florence (north-central); Rome Fiumicino (central); Naples (Campania); Bari

(Mediterranean-Adriatic); Lamezia (Calabria); Catania (east Sicily); Palermo (west Sicily); and Cagliari (Sardinia). Other airports of national interest can be identified, provided that they can actually play an effective role in one zone and can achieve at least a break-even point in their annual accounts. The Plan is intended to focus and address resources and investments towards precise targets, in order to successfully meet the challenge posed of the doubling of air traffic expected by 2030. For the same reasons, the Plan also provides for an increase in the capacity of the existing airports as an irreplaceable element in overcoming the expected crisis of capacity, and offers the necessary support to the country's economic growth.

**5. Does the national "flag" carrier carry the most passengers into and out of the national airports and: (a) if so, what competition exists and how significant is it?; and (b) if not, what are your thoughts on the reasons for this, and why do competing airlines have higher load factors?**

As it is a globalised sector, air transport has been influenced by the general European "trend" of the gradual decline of the national "flag" carrier (in Italy, Alitalia), meaning that less and less public money is being invested and more private capital is entering the sector. Moreover, traditional airlines are losing ground to foreign low-cost carriers. However, in the specific case of Alitalia, a fast recovery, followed by growth, is expected due to the agreement with Etihad Airways. Although the budget in 2015 closed with a loss of €200 million, forecasts show a decrease in losses to €44 million in 2016, and it is expected to be profitable again in 2017. Over the past decade, Alitalia has



had to cope with increasingly aggressive competition from low-cost carriers such as Ryanair and EasyJet, which have gained significant market share, exceeding that of Alitalia itself. Currently, Ryanair is the most important carrier in Italy in terms of the number of passengers carried (over 29,707 million, based on the 2015 data). According to the traffic data recently published by ENAC, based on the number of passengers carried in 2016, the top two positions are occupied by Ryanair, followed by Alitalia-CAI.

**6. What trends, in terms of regulatory intervention and involvement, has your jurisdiction observed over the past 12-18 months in relation to airline acquisitions and alliances? Do you anticipate a change in the regulatory environment of your jurisdiction during the coming 12 months, and if so, how?**

Since the Italian legislation in relation to airline acquisitions and alliances is based on EU law, there has been very little intervention on this issue. Therefore, Italian legislators have very limited discretion on these points or any future amendments. However, as these operations lead to concentrations which could have great repercussions in the national and European market, a set of rules to safeguard free competition could be approved.

**7. What trends are being observed in relation to new technologies – such as UAVs / drones – and what impact are these technologies having on the aviation regulatory environment?**

In general, the unmanned aircraft systems industry is growing rapidly all across Europe, especially for small drones. The civil use of drones could be significant and extensive, including global environmental monitoring- and security-related operations, as well as many other possible applications (e.g. scientific uses). However, these vital activities can only be developed if drones are able to fly with other air traffic, out of segregated areas, which are currently the only areas in which they can operate. The reason for which drones have so far only been allowed to fly in segregated areas is the absence of a regulatory framework establishing certification, licences, responsibilities and safety provisions; thus it is of fundamental importance to provide a set of rules in order to determine what procedures are essential to reach the objective of a safe introduction of drones for civil purposes. As in other European Member States, Italy's civil aviation authority ENAC has recently developed a new Regulation on Remotely Piloted Air Vehicles, setting forth general conditions which have been set up in accordance with Article 743 of the Italian Navigation Code, stating that remotely piloted aircraft are "aircraft", as

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defined by special laws or by ENAC and, for military remotely piloted aircraft, as defined by the Ministry of Defence. The regulation provides distinct norms for "remotely piloted aircraft systems" (RPAS) and recreational model aircraft, establishing the safety rules for flight operations for each category. Sections II and III of the Regulation define the prerequisites for obtaining the relevant authorisation to operate in the airspace and the airworthiness certificate, when applicable, as well as the permitted operations and the terms for special operations. These prerequisites are separately indicated for RPAS with a maximum take-off mass (MTOM) of under 25 kilograms and for RPAS with a MTOM of over 25 kilograms and up to 150 kilograms. RPAS below 25 kilograms do not require an airworthiness certificate and operations are permitted under an ENAC authorisation, available on request by the operator, and auto-certification. Moreover, drones are frequently equipped with cameras, recording devices and on-board memory storage, which potentially allow them to collect a substantial amount of personal data. Nevertheless, the ENAC Regulation does not provide any rule concerning privacy and data protection issues.

**8. Legal issues in the 'lease-to-part out' market. A major market development is the interest of investors purchasing mid-end life aircraft on lease for the purposes of making returns on a leasetail and component margin model. What challenges are inherent in**



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**this segment of the aviation finance market, and what techniques and disciplines are required to manage the risks involved?**

Alongside the clear operational benefits of aircraft leasing – such as flexibility and significant economic benefits – there are several risks that need to be addressed. Thus there are various steps that airlines can take in order to save money and reduce their exposure to operational and commercial risks, especially relating to the redelivery aspects. In fact, the lessee is obliged to return the aircraft in the same technical condition as it was initially delivered. However, without a proper technical maintenance plan, the redelivery process may render important losses for both the carrier and the lessor. Under the finance lease, the main issue for the lessor is the creditworthiness of an airline; in Europe, it has been proven that even large carriers may face significant financial issues and may lose the capacity to pay under their finance lease obligations. With regard to the operating lease, the main risk for a lessor is related to the technical condition of the asset, in that during its lifetime an aircraft may be re-leased four or five times (or even more in the case of short-term leases). Every redelivery is fraught with asset depreciation risks. Poor aircraft maintenance during the leasing period and repair works prior to the redelivery result in direct losses to the lessor as he may face unforeseen expenses in terms of resource restoration.

**9. Manufacturer support in the new cycle of new OEM products, e.g. MRJ, E2, C-series, etc. In an increasingly sophisticated and competitive environment, in what way is the type of OEM financial and product support for this new era of aircraft more complex and far reaching than in previous cycles?**

The aerospace industry is growing, and aerospace suppliers must become more innovative and flexible to keep up, as the demand for new technologies is increasing. Indeed, the aerospace industry is facing several issues, such as the need to develop more complex parts and systems, with higher technology content, and at a competitive cost. In this context, OEMs are facing challenges in delivering programs within their budget due to constantly increasing expenditure on product development and manufacturing. Thus, OEMs need to methodically invest in and adapt to dynamic, evolving technologies. The good news is that engineering leaders at many OEM companies are aware of these risks and are working successfully to address them. Another important concern is to develop programs that are able to respond efficiently to possible cyber threats, as security will always remain a top priority.

**10. The advent of cheaper oil and the knock-on effects. What are the consequences that arise as a result of the unexpected purchasing power of a number of third/fourth tier airlines? What will challenge lessors and suppliers in particular as they are faced with speculative judgments on an airline's longer-term financial viability?**

As fuel costs represent one of the biggest expenses for the aerospace and airline industries, the decrease in oil prices may pose many risks for airlines. In fact, while weakening crude oil prices enhance profits, they can also lead to lower airfares, spurring demand for travel and pushing airlines to increase capacity. Once they have been drawn into this, airlines may add too many routes and expand their fleet beyond what is necessary. Therefore capacity increases are more likely to be excessive if cheaper fuel pushes companies to invest on the expectation of gaining market share in an expanding market.

**11. Iran and the market return. What remain as barriers, including sanctions-related issues to navigate, where Iran and aerospace and aircraft transactions are concerned? What sort of jurisdiction is Iran from a risk perspective, and what techniques from a supply perspective are likely to be needed so that Iran's potential and promise for OEMs, lessors, suppliers and service providers is realised and does not become the latest example of a disappointing gold rush?**

In January 2016 the European Union lifted its sanctions on Iran in return for Tehran's implementation of restrictions to its nuclear programme. In fact, under the deal negotiated between Iran and six powers (the U.S., the U.K., France, Germany, Russia and China), Iran is required to cut down its nuclear activities considerably. This reduction in sanctions is expected to re-open doors for global companies that have been barred from doing business in Iran. Decades of sanctions – the earliest were imposed in 1979 – have left the country with poor aviation infrastructure and one of the world's oldest aircraft fleets. Moreover, air disasters have occurred with alarming frequency in the country. However, the lift in sanctions

has pushed Iranian officials to start up new relationships with foreign investors and experts with a view to upgrading existing airports and conducting practicability studies on new ones. Thus, it seems that Iran has a strong desire to recover from this difficult time. Recently, Iran has shown its intention to enter into relations with the French airport operator, Aéroports de Paris. The project aims to renovate the existing terminal and also the design, construction and operation of new terminals. Those projects should bring the capacity of the International Airport in Tehran up to 34 million passengers by 2020, the current capacity being 6.5 million passengers. Iran also plans to buy 80 new planes.



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