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AIRLINE DEREGULATION DESERVES ANOTHER SHOT: HOW FOREIGN INVESTMENT RESTRICTIONS AND SUBSIDIES ACTUALLY HURT THE AIRLINE INDUSTRY

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WHEN THINKING of the United States economy, many people's first thoughts are of capitalism and free markets. Many Americans believe that such a system led the United States to the prominent position that it currently enjoys in the world economy. A prominent part of the United States economy, however, does not enjoy the benefits of such ideals. United States airlines still operate under a veil of quasi-regulation that has been largely responsible for the historically poor performance of the industry as a whole.[1] These regulations and policies are commonly thought and intended to aid the airline industry, but their actual effects contribute to incredibly poor performance industry wide.[2]

One particularly damaging regulation that is holding airlines back is a legislative restriction on foreign investment in United States air carriers. The United States government mandates that foreign parties may not own more than 25 percent of any United States air carrier,[3] and also severely restricts the right of control that any foreign investor has in a United States airline.[4] This comment seeks to show that in the modern globalized economy, not only is the restriction on foreign investment un-

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[1] *See* Paul J. Gessing, *Time to Re-deregulate the Airline Industry*, NAT'L TAXPAYERS UNION, 2005, http://www.ntu.org/main/press.php?PressID=739&org_name=NTU.

[2] James Bernstein, *JetBlue Expects Quarterly Loss*, NEWSDAY, January 17, 2006, at A38.

[3] 14 C.F.R. § 47.8(c) (2006).

[4] *Id.*

necessary, but it is also responsible for many of the difficulties the entire airline industry faces.

This comment also focuses on the United States government's policy of providing massive subsidies and bailouts to airlines when they face financial trouble.[5] This practice, while intended to help the fragile airline industry, is actually part of a destructive cycle of government sponsored overcapacity. By keeping too many airlines afloat through such subsidies, the government promotes excess capacity, which in turn creates a competitive passenger airline market where it is extremely difficult for any airline to profit.[6]

Part I of this comment will explore the legislation that establishes the restrictions on foreign ownership in United States airlines. This part of the comment begins by reviewing the history of the legislation, noting that the restriction is actually intended to protect the airline industry, save jobs, answer national security concerns, and promote safety.[7] Each of these intentions is examined individually, and investigation reveals that not only are such concerns largely groundless, but in many instances the situation is actually worsened by denying struggling United States air carriers access to this source of capital. Examples are given of how this is hurting United States airlines in very real ways.

Next, a section of this comment is devoted to exploring the idea that these restrictions on foreign investment are actually a new form of regulatory taking under the Fifth Amendment.[8] This part of the comment puts the regulation through the regulatory taking balancing test of *Penn Central Transportation Co. v. City of New York*[9] to analyze whether these restrictions constitute a taking. While an interesting thought, this comment comes to the ultimate conclusion that the balancing test does not show the regulations to be a taking and lobbying efforts must be undertaken to encourage Congress to change this detrimental legislation.

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5 Andrew Stephen, *America – Andrew Stephen Fears the Worst for US Airlines*, NEW STATESMAN, May 23, 2005, http://www.newstatesman.com/life/200505230014.

6 James Bernstein, *JetBlue Expects Quarterly Loss*, NEWSDAY, January 18, 2006, http://www.newsday.com/business/printedition/ny-bzside4591682jan18,0,5866356,print.story?coll=ny-business-print.

7 *See* U.S. GEN. ACCOUNTING OFFICE, *infra* note 10.

8 Ryan S. Holtan-Murphy, Comment, *Flying the Unfriendly Skies: Federal Aviation Regulations as Regulatory Takings*, 2003 WIS. L. REV. 699, 702 (2003).

9 438 U.S. 104, 124 (1978).

Part II of this comment will deal with government induced overcapacity in the United States air carrier market. This section will explore how government subsidies to struggling airlines intended as assistance are actually part of a destructive cycle that sponsors excess capacity in the United States air passenger market. As part of this analysis, bankruptcy processes for airlines will be critiqued for allowing airlines to consistently enter into bankruptcy, only to emerge again to contribute to more overcapacity issues for the entire industry. Along with recommending that all airline subsidies cease and that failing airlines should be allowed to fail, consolidation of the airline market through mergers and the United States government's changing approach to this practice, is also discussed.

I. RESTRICTIONS ON FOREIGN INVESTMENT IN THE UNITED STATES AIRLINE INDUSTRY

Foreign investment in United States airlines is restricted by protectionist legislation to a very high degree. This stands in stark contrast to other United States markets that welcome capital investments regardless of geography, helping to make the United States economy a major destination for foreign funds. Although this comment argues that the reasoning behind such protectionist policy is flawed, it is helpful to look at the justifications and history behind its implementation.

A. How Foreign Investment Became Restricted in the Airline Industry

1. *The Air Commerce Act*

The first piece of legislation to deal with citizenship requirements for United States airlines was the Air Commerce Act of 1926 ("ACA").[10] The Act specified that in order for an aircraft to be registered in the United States, and thus operational in the United States, the owners of the aircraft must be United States citizens.[11] In order to be considered a citizen under the ACA, United States citizens had to own at least 51 percent of the

[10] U.S. Gen. Accounting Office, Issues Relating to Foreign Investment and Control of U.S. Airlines 1 (2003). The General Accounting Office issued this report to Senator Trent Lott in October of 2003 after the Bush Administration proposed legislation that would raise the total foreign ownership allowed in the stock of a United States airline to 49 percent. *Id.* at 1.

[11] *Id.*

aircraft.[12] The ACA also mandated that the president and two-thirds of the board of directors of every United States based airline be U.S. citizens.[13] The principal purpose behind the ACA was primarily national security.[14] At the time, Congress was concerned that the United States Air Force would need support from the commercial aviation industry and that a foreign power, namely Germany, could use their investments to gain control of United States airlines and use them against the United States.[15]

2. *The Civil Aeronautics Act of 1938*

Foreign investment in United States airlines was further restricted when Congress passed the Civil Aeronautics Act of 1938 ("CAA"). This act required that U.S. citizens own or control at least 75 percent of the voting rights in United States airlines.[16] In order to justify such a restrictive measure, Congress cited national defense and economic interests.[17] One such economic interest that Congress wished to protect was ongoing subsidies to the airline industry through airmail contracts from the government.[18] Congress felt that restricting foreign investment in United States airlines would keep these government subsidies from benefiting the unintended audience of foreign investors and foreign corporations.[19]

The CAA also created the Civil Aeronautics Authority.[20] The agency's name was later changed to the Civil Aeronautics Board

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12 *Id.*

13 Holtan-Murphy, *supra* note 8, at 704.

14 *See* Seth M. Warner, Comment, *Liberalize Open Skies: Foreign Investment and Cabotage Restrictions Keep Noncitizens in Second Class*, 43 AM. U.L. REV. 277, 305 (1993).

15 *Id.* at 305-06.

16 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 2.

17 *See* Holtan-Murphy, *supra* note 8, at 705-06 (noting that "the first and perhaps most important of these policy concerns was the protection of United States economic interests"). *See also* U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 2 n.2. Foreign Investment and Control Limits on United States Airlines (1992). "The United States has restricted ownership and control of U.S. airlines for four primary reasons: (1) protection of the then-fledgling U.S. airline industry, (2) regulation of international air service through bilateral agreements, (3) concern about allowing foreign aircraft access to U.S. airspace, and (4) military reliance on civilian airlines to supplement airlift capacity." *Id.* at 2 n.2.

18 *See* Holton–Murphy, *supra* note 8, at 705.

19 *See id.*

20 Ved P. Nanda, Comment, *Substantial Ownership and Control of International Airlines in the United States*, 50 AM. J. COMP. L. 357, 365 (2002).

("CAB"), which is responsible for regulating market entry and exit, anti-competitive behavior, and airfare pricing.[21]

3. *The Federal Aviation Act of 1958*

The next significant piece of legislation that Congress passed regarding foreign investment in United Airlines was the Federal Aviation Act of 1958.[22] The Federal Aviation Act kept intact the restrictions on foreign investment began under the ACA and CAA by requiring that all United States carriers be a "citizen of the United States."[23] In order for a carrier to be a "citizen," United States citizens must own 75 percent of the voting interest in the carrier.[24] Additionally, The Department of Transportation ("DOT") has interpreted the law to require that United States citizens actually control U.S. air carriers.[25]

4. *The Airline Deregulation Act of 1978*

The CAB continued to regulate the aviation industry until 1976,[26] at which point the CAB suggested to Congress that the aviation industry be deregulated in order to combat poor profitability in United States airlines. Congress responded by passing the Airline Deregulation Act of 1978 ("Deregulation Act").[27] This act, while a step towards liberalization, was limited in scope. The Deregulation Act encouraged competition by subjecting

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21 *Id.*

22 Federal Aviation Act of 1958, Pub. L. No. 85-726, 72 Stat. 731 (codified as amended at 49 U.S.C.A. §§ 130–1557 (West 1988 & Supp. I 1989, Supp. II 1990 & Supp. III 1991)).

23 *See id.* § 1301(16). The Federal Aviation Act of 1958 mandates that U.S. air carriers must be U.S. citizens. According to the statute a "citizen of the United States" means:

> (a) an individual who is a citizen of the United States or of one of its possessions, or (b) a partnership of which each member is such an individual, or (c) a corporation or association created or organized under the laws of the United States or of any state, territory, or possession of the United States, of which the president and two-thirds or more of the board of directors and other managing officers thereof are such individuals and in which at least 75 per centum of the voting interest is owned or controlled by persons who are citizens of the United States or of one of its possessions.

Id. § 101(6).

24 49 U.S.C.A. § 40102 (West 2006).

25 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 2.

26 *See* Angela Edwards, Comment, *Foreign Investment in the U.S. Airline Industry: Friend or Foe?*, 9 EMORY INT'L L. REV. 595, 604 (1995).

27 Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705 (codified as amended at 49 U.S.C.A. §§ 1301–1542 (West 1988 & Supp. III 1991)).

pricing, route designations, and market entry to market controls,[28] but foreign investment restrictions found in the earlier legislation remained completely unchanged.[29]

5. *The Current State of Foreign Investment Restrictions in United States Airlines*

In response to heavy losses suffered by the United States aviation industry in 1990 and 1991, the DOT recommended easing restrictions on foreign investment in United States airlines by allowing foreign investors to own up to 49 percent of the voting rights in a U.S. airline.[30] The DOT reported that this proposal would help the financial health of the airline industry due to the access to additional financial capital, make the airline industry more efficient, and help conform United States ownership limitations with European laws.[31] However, Congress did not act on this recommendation and rejected the DOT's proposals.[32]

Most recently, in 2003, the Bush Administration revisited the idea of loosening the restrictions on foreign investment and proposed allowing 49 percent of voting stock to be owned by foreign entities, an increase from the current maximum of 25 percent.[33] Unfortunately, this proposal was rejected by Congress.[34]

B. EXAMPLES OF THE FOREIGN INVESTMENT RESTRICTION PROBLEM

Beginning in the 1980s, foreign airlines attempted to invest in the United States airline industry.[35] Due to investment restrictions, these foreign investors were either discouraged from investing, or invested and then eventually disinvested after their investment efforts were frustrated by the regulations.[36] According to the United States General Accounting Office, the nonpartisan audit, evaluation, and investigative agency of the United States Congress, a major reason for this frustration and

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28 *See* Angela Edwards, *supra* note 26, at 605.
29 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 2.
30 *Id.* at 3.
31 *Id.*
32 *Id.*
33 *Id.* at 1.
34 Gessing, *supra* note 1.
35 *See* U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 4.
36 *Id.*

eventual disinvestment was United States policies regarding airline control.[37]

1. Wings Acquisition, Inc.

An illustrative example of how restrictions on foreign investment actually hinder the airline industry instead of helping it is the case of Wings Acquisition, Inc. In 1989, NWA, Inc. (the parent company of Northwest Airlines) announced that it was going to be acquired by Wings Acquisition, Inc. ("Wings").[38] NWA believed that this takeover would provide a helpful infusion of capital and create market opportunities in Europe.[39] A Dutch corporation, KLM Royal Dutch Airlines ("KLM"), owned roughly 57 percent of the equity in Wings, but only 5 percent of the voting interest.[40]

In order to satisfy the U.S. foreign investment restrictions, Wings negotiated with the DOT and took a number of steps to comply.[41] First, Wings placed the amount of KLM's equity above 25 percent in Wings in a voting trust.[42] Next, KLM's right to appoint a financial advisory committee was terminated.[43] Finally, KLM agreed to disqualify its board member from participating in all decisions on competitive and international aviation matters.[44]

In 1991, NWA petitioned for reconsideration to allow increased equity investment in Wings by KLM.[45] At this time the DOT made a distinction between voting equity and nonvoting equity that had not been made before.[46] In its decision, the DOT allowed KLM to acquire up to 49 percent total equity in Wings, but limited KLM's voting equity to 25 percent.[47] This decision, which allowed KLM to increase its ownership stake in Wings without increasing its voting equity power, represented a step toward liberalization for the DOT.[48] However, in 1997

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37 *Id.* at 4.

38 *Id.* at 5.

39 *See* Holtan-Murphy, *supra* note 8, at 708 (citing Acquisition of Northwest Airlines, Inc. by Wings Holdings, Inc., DOT Order No. 91-1-41, at 2.)

40 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 5.

41 *Id.*

42 *Id.*

43 *Id.*

44 *Id.*

45 *Id.*

46 *See* Warner, *supra* note 14, at 309.

47 *Id.*

48 *Id.*

KLM disinvested from NWA in order to take advantage of the international market without direct financial investment.[49]

2. *British Airways' Attempted Acquisition of US Airways*

In 1992, British Airways desired to invest $750 million in US Airways (later changing its name to US Air).[50] In exchange for the capital infusion, British Airways would have received 44 percent of US Airways' total equity, 21 percent of the voting equity, representation on US Airways' board of directors, and substantial control over US Airways' managerial and financial decisions.[51] The DOT started a review of the transaction,[52] but the Bush Administration ultimately denied this proposal due to foreign investment issues and conflicts of air agreements between the British Government and the United States[53] Eventually, British Airways eliminated the governance condition in their original plan and only invested $300 million.[54]

After the investment, US Air ran into severe financial trouble,[55] and British Airways withdrew from its relationship with US Air in 1997.[56] US Air's largest problem was its market position.[57] US Air was too large to be a discount airline, but too small to be a major national airline.[58] The airline was also hindered by a fleet of old, expensive aircraft.[59] Finally, in 2002, US Air filed for bankruptcy.[60] As part of the bankruptcy workout, US Air received $500 million in debtor financing from two investment banks, and a $200 million equity investment from an investment group.[61]

The question must be asked whether the bankruptcy could have been avoided if US Air had been able to receive more equity financing from foreign investors prior to bankruptcy. While impossible to answer for certain, the original planned contribu-

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49 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 5.
50 *Id.*
51 *Id.*
52 *Id.*
53 *Standing Firm for Open Skies*, N.Y. TIMES, Dec. 24, 1992, at A16.
54 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 6.
55 US Air Files for Bankruptcy, CNN MONEY, Aug. 12, 2002, http://money.cnn.com/2002/08/11/news/companies/usair/.
56 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 6.
57 US Air Files for Bankruptcy, *supra* note 55.
58 *Id.*
59 *Id.*
60 *Id.*
61 *Id.*

tion of $750 million from British Airways and the option to obtain even more financing from foreign sources above the government mandated 25 percent maximum would have certainly helped.[62] With access to much needed foreign capital, US Air might have become a national player in the airline market and upgraded its fleet of aircraft.[63] Instead, at least partly because of the restrictions on foreign investment in United States airlines, US Air declared bankruptcy and received funding from domestic sources.[64] In the case of US Air, restrictions on foreign investment actually hurt the airline rather than protect it as the legislation intended.

Most issues of control restrictions deter foreign investors from even reaching the stage described in the Wings and US Airways situations.[65] As a result, foreign investment in United States airlines is minimal.[66] The General Accounting Office reported that "as of May 2003 no major stockholders – U.S. or foreign – owned more than 20 percent of any major U.S. network carrier."

C. Issues and Concerns Regarding Lifting Foreign Investment Restrictions

As discussed earlier, the primary purposes behind the original legislation placing restrictions on foreign investment in U.S. air carriers were of national defense[67] and fear of foreign entities profiting from government subsidies intended for domestic airlines.[68] When considering whether such restrictions on United States airline investment are prudent, it is necessary to analyze the restrictions in terms of their original purpose and any issues regarding the legislation that may have occurred over time.

1. *Domestic Competition*

Currently, United States airlines have more capacity than demand.[69] This situation has led to substantial financial difficulty for the airline industry as a whole.[70] In fact, the U.S. commercial airline industry is faced with a number of problems, includ-

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62 *See* U.S. Gen. Accounting Office, *supra* note 10, at 5-6.
63 *See* US Air Files for Bankruptcy, *supra* note 55.
64 *See id.*
65 U.S. Gen. Accounting Office, *supra* note 10, at 4.
66 *Id.*
67 *See* Warner, *supra* note 14.
68 *See* Holtan-Murphy, *supra* note 8.
69 U.S. Gen. Accounting Office, *supra* note 10, at 7.
70 *Id.*

ing a weak economy, high fuel prices, and uncertainty in the Middle East.[71] Reacting to these conditions, many airlines laid off employees, delayed new aircraft purchases, and implemented cost cutting programs.[72] For example, United Airlines and American Airlines both experienced massive layoffs, and Continental Airlines postponed the planned purchase of new Boeing aircraft until their situation improved.[73]

Despite these actions and reductions in service, many airlines are still in need of additional capital.[74] Airlines seek this additional capital to upgrade their aircraft fleets and provide day-to-day operating funds.[75] In fact, most airlines want greater access to foreign investors, some even going so far as to call for complete removal of restrictions on investment.[76] Access to this capital may be necessary to keep airlines running and out of bankruptcy.[77] In fact, in September of 2005, both Delta and Northwest Airlines filed for Chapter 11 bankruptcy.[78] A major reason for both the bankruptcies was high fuel prices and heavy competition.[79]

Northwest and Delta are not the only airlines in financial trouble. Most large airlines are having difficulties.[80] The DOT has suggested that allowing U.S. airlines increased access to international capital markets could help alleviate the airlines' problems in these times of distressed markets.[81] Perhaps the Northwest and Delta bankruptcies could have been avoided if they were able to receive sufficient funding from international sources to pay for their day-to-day operations and survive the increased fuel costs.[82] On the whole, it seems that United States airlines struggling to compete domestically would greatly benefit from increased access to foreign investment.

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71 *Id.*

72 *Id.* at 7-8.

73 *Id.* at 8.

74 *Id.*

75 *Id.*

76 *Id.* at 4.

77 *See id.* at 7.

78 Chris Isidore, *Delta, Northwest File for Bankruptcy*, CNN MONEY, Sept. 14, 2005, http://money.cnn.com/2005/09/14/news/fortune500/bankruptcy_airlines/index.htm.

79 *Id.*

80 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 7.

81 *Id.* at 8.

82 *See* Isidore, *supra* note 78.

2. *National Security*

Another concern voiced by many proponents of restriction on foreign investment is that foreign investors may pose a national security risk.[83] However, while security risks are a valid concern, not only are such concerns largely unjustified, but there are also ways to limit and contain such risk. Overall, once appropriate measures have been taken to alleviate the security risks, the advantages of allowing greater foreign investment in United States airlines far outweighs the possible detriments.

The most frequently voiced concern regarding allowing greater foreign investment and its effect on national security is with the viability of the Civil Reserve Air Fleet ("CRAF") program.[84] The CRAF is a Department of Defense ("DOD") program that provides the United States military with extra airlift capacity in emergency situations.[85] Under CRAF, the DOD contracts with United States airlines for the use of their aircraft and crew during times of emergency.[86] Under the contract, the airlines are not compensated unless their services are actually used.[87] In return for their pledge of availability, participating airlines are eligible to bid for DOD's routine airlift business.[88] In the event that an airline's aircraft and crew are activated, they are paid at predetermined rates based on the airline's cost plus a specified return on investment.[89] According to the United States Air Force, there are currently forty air carriers and 1,126 aircraft enrolled in the program.[90]

Concerns over the continued effectiveness of the CRAF program can be allayed by looking at the current state of the program and by taking appropriate steps to ensure its continued effectiveness. First, according to the General Accounting Office, there are already questions as to the viability of the CRAF program's incentives to participate, and it is unclear whether a change in foreign investment restrictions in United States airlines would affect the CRAF program at all.[91] Another factor

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83 *See* Edwards, *supra* note 26, at 639-42.

84 *See id.*

85 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 7.

86 *Id.* at 7 n.17.

87 *Id.*

88 *Id.*

89 *Id.*

90 Air Force Link, Civil Reserve Air Fleet Factsheet, http://www.af.mil/factsheets/factsheet.asp?fsID=173 (last visited Jan. 21, 2006).

91 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 7-8.

worth examining is the potential availability of aircraft under CRAF. For the invasion of Iraq in 2003, the DOD activated forty-seven passenger planes from twenty-two different airlines.[92] Comparing the forty-seven aircraft activated for a major operation such as the invasion of Iraq with the over 1100 aircraft available, it is apparent that the CRAF program has a high degree of excess capacity.[93] While still a valuable tool for the United States military, even in a worst case scenario a reduction in participation in the CRAF program simply does not pose a substantial risk due to the advanced development of the United States Air Force.[94]

Regardless of the actual effect on the CRAF program, if foreign investment restrictions were abolished, there are steps that can be taken to ensure continued participation in the program. First, the United States government should review any potential foreign investor looking to make a substantial investment in a United States air carrier. This type of review is already done by the government in other industries such as the telecommunications industry.[95] Any government or investor deemed hostile could be denied the opportunity to invest. If such a review system is still not sufficient to safeguard the security risk, agreement to future CRAF participation could be linked with government approval of the investment.

Threats to national security, while a very legitimate concern, are simply not a realistic reason to block United States airlines increased access to foreign capital. Not only would the changes most likely have no impact on security issues such as CRAF, but any issues could easily be dealt with by a review system already in place in other industries.

3. *Impact on Employment*

Another issue that must be addressed when considering easing foreign investment restrictions is the impact it would have on employment in the United States. Some parties worry that allowing increased foreign investment would put jobs at risk.[96]

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92 Raymond W. Copson & Paul Gallis, *Iraq War? Current Situation and Issues for Congress*, CONG. RESEARCH SERV., Mar. 4, 2003, http://fpc.state.gov/documents/organization/18698.pdf.

93 *Cf.* Air Force Link, *supra* note 90.

94 *See* Holtan-Murphy, *supra* note 8, at 725.

95 *Id.* at 726.

96 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 7-8; *see* Angela Edwards, *supra* note 26, at 636–39.

Proponents of this theory suggest that the jobs of pilots and crews on international flights could be put at risk, or that other airline related jobs may be transferred overseas if increased foreign investment is allowed.[97] Also of concern are labor rights. Some have suggested that allowing foreign parties to invest in United States airlines would "lead to a deteriorating working environment for airline professionals."[98] However, this comment will argue that airline industry employees' job security will in fact be increased and labor rights will not be negatively affected if foreign investment restrictions are removed.

As shown by the Northwest and Delta bankruptcies, protectionist policies regarding foreign investment actually jeopardize jobs rather than protecting them.[99] Denied access to sufficient capital, many airlines implement cost cutting efforts that include the termination of large numbers of employees.[100] Allowing United States airlines greater access to foreign investment would help stabilize financially weak airlines and help protect employees' jobs and retirement plans.[101]

In contrast to the claims of labor unions[102] and other protectionists' claims,[103] workers' rights will not be negatively affected by easing restrictions on foreign investment in U.S. airlines.[104] In fact, there is no evidence that allowing greater foreign investment in United States airlines would affect labor at all.[105] According to the DOT, current collective bargaining agreements and other regulations governing United States airlines and their employees would prevent investors from changing the labor rights of airline employees.[106] Thus, not only will easing restric-

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97 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 7-8.

98 Angela Edwards, *supra* note 26, at 638.

99 *See* Isidore, *supra* note 78.

100 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 8.

101 Gessing, *supra* note 1.

102 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 4.

103 Edwards, *supra* note 26, at 638.

104 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 8.

105 *Id.*

106 *Id.* The United States General Accounting Office reported that

> DOT indicated that there is no evidence to suggest that increased foreign investment in U.S. airlines would have any effect on labor. DOT commented that, due to existing collective bargaining agreements and other regulatory requirements governing U.S. airlines and their employees, the administration's proposal would not affect the rights of labor or the obligation of airlines with respect to labor.

Id.

tions on foreign investment in United States airlines actually help protect airline employees' jobs, but no employee protections will be lost in the process.[107]

4. *International Competition*

Besides the infusion of much needed capital into weak balance sheets,[108] allowing greater access to foreign investment for United States airlines could be utilized as a tool to persuade other nations to liberalize their aviation markets.[109] The United States government could use the potential ability for a particular nation to invest in the United States airline industry as a bargaining chip to encourage that particular nation to allow United States airlines increased access to their markets or to discourage that nation from subsidizing its own airlines.[110] However, in order to understand the type of concessions the United States might receive from other nations in exchange for investment rights in U.S. airlines, a quick historical overview of bilateral agreements is necessary.

The primary means of negotiating terms of international commercial air service between nations is through bilateral agreements.[111] Such agreements can concern, among other things, air traffic rights, capacity, and frequency of international flights.[112] In the United States, the President can enter into such agreements without submitting them to the Senate for ratification.[113]

The first bilateral agreement entered into by the United States was with the United Kingdom in 1946.[114] This agreement is commonly known as Bermuda I.[115] Bermuda I appointed an international body, the International Air Transport Association, to set international tariffs and allowed each country to determine its own passenger capacity and frequency of service.[116] Bermuda I became a model agreement that the United States

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107 *See id.*; Gessing, *supra* note 1.

108 *See* U.S. GEN. ACCOUNTING OFFICE, *supra* note 10.

109 *Id.* at 7.

110 *See id.*

111 *See* Edwards, *supra* note 26, at 600.

112 Nanda, *supra* note 20, at 372–73.

113 *Id.*

114 *Id.*

115 Edwards, *supra* note 26, at 601.

116 Nanda, *supra* note 20, at 373.

used to engage in bilateral agreements with roughly seventy-five other countries.[117]

The United Kingdom withdrew from Bermuda I in 1976 due to concerns that the U.S. was allowing too many air carriers on routes to London.[118] In response, the U.S. and the United Kingdom negotiated a new bilateral agreement called Bermuda II.[119] Bermuda II limited the number of air carriers that either country could authorize to operate between the countries and gave each country control over passenger capacity.[120]

Eventually, bilateral agreements began to fall out of favor in the United States[121] Facing a distressed airline market,[122] the Clinton Administration began seeking to establish more liberal aviation agreements with other countries.[123] This initiative, known as the "Open Skies" program,[124] aimed to liberalize many aspects of international aviation, including open entry on all routes between countries and unrestricted capacity and frequency of flights.[125] One of the main advantages of an Open

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117 Edwards, *supra* note 26, at 601.

118 *Id.*

119 *Id.*

120 Nanda, *supra* note 20, at 373.

121 *Id.*

122 *Id.*

123 Edwards, *supra* note 26, at 602.

124 Nanda, *supra* note 20, at 374.

125 *Id.* at 374-375, (citing U.S. Department of Transportation (DOT), In the Matter of Defining "Open Skies," Order 92-8-13, Aug. 5, 1992, DOT Av. LEXIS 568, at *3.) The DOT defined "Open Skies" as an agreement that included the following elements: (1) Open entry on all routes; (2) Unrestricted capacity and frequency on all routes; (3) Unrestricted route and traffic rights, that is, the right to operate service between any point in the United States and any point in the European country, including no restrictions as to intermediate and beyond points, change of gauge, routing flexibility, coterminalization, or the right to carry Fifth Freedom traffic; (4) Double-disapproval pricing in Third and Fourth Freedom markets and (a) in intra-EC markets: price matching rights in third-country markets, (b) in non intra-EC markets: price leadership in third-country markets to the extent that the Third and Fourth Freedom carriers in those markets have it; (5) Liberal charter arrangement (the least restrictive charter regulations of the two governments would apply, regardless of the origin of the flight); (6) Liberal cargo regime (criteria as comprehensive as those defined for the combination carriers); (7) Conversion and remittance arrangement (carriers would be able to convert earnings and remit in hard currency promptly and without restriction; (8) Open code-sharing opportunities; (9) Self-handling provisions (right of a carrier to perform/control its airport functions going to support its operations); (1) Procompetitive provisions on commercial opportunities, user charges, fair competition and intermodal rights; and (11) Explicit commitment for nondiscriminatory operation of and access for computer reservation systems.

Skies agreement is that airlines of both countries involved are able to fly from any point in one country to any point in the other.[126] Due to this advantage, greater opportunity for strategic networking between international airlines is possible.[127]

The first Open Skies Agreement was signed in 1992 between the United States and the Netherlands.[128] Since that time, the United States has entered into seventy-four Open Skies agreements with various countries.[129] However, more restrictive aviation agreements based on the older Bermuda bilateral agreements still exist, limiting the efficiency of international aviation.[130]

It is in the precise situation of a country that still has a restrictive bilateral agreement with the United States that easing restrictions on foreign investment in U.S. airlines could help the U.S. airline industry win greater access to foreign markets. Because foreign countries want their investors to be able to invest in the U.S. airline market, they may be willing to enter into an Open Skies–type agreement in order to acquire this investment access to the U.S. airline industry.[131] In this situation, not only would U.S. air carriers benefit from the increased access to capital that foreign investors could provide, but they would also reap the benefits that come with Open Skies agreements. Under these agreements, U.S. airlines would have the opportunity to bring their expertise to compete in foreign markets that were previously barred to them, with the added bonus of capital contributions from foreign sources with which to do so.[132] Another new opportunity to be taken advantage of for U.S. air carriers would be international strategic alliances made possible by the combination of reduced foreign investment restrictions and Open Skies agreements.[133] Overall, using foreign investment as a bargaining tool with other countries could allow U.S. air carriers to apply their superior productivity to presently untapped markets, while using foreign investors' funds to finance the ef-

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U.S. Department of Transportation (DOT), In the Matter of Defining "Open Skies," Order 92-8-13, Aug. 5, 1992, 1992 DOT Av. LEXIS 568, at *3.

126 OPEN SKIES AGREEMENTS, UNITED STATES DEP'T OF STATE, http://www.state.gov/e/eb/tra/c661.htm.

127 *Id.*

128 Nanda, *supra* note 20, at 375.

129 Open Skies Agreements, *supra* note 126.

130 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 8.

131 *See id.*

132 *See* Open Skies Agreements, *supra* note 126.

133 *See id.*; U.S. GEN. ACCOUNTING OFFICE, *supra* note 10.

fort.[134] Such a win-win situation for the U.S. airline industry can hardly be overlooked.

5. *Effect on Safety*

A final concern when considering whether easing restrictions on foreign investment in U.S. air carriers should be implemented is safety. In reality, the effect on the safety of the U.S. airline industry will be negligible.

One such potential safety issue is that removing or loosening restrictions on foreign investment will cause foreign aircraft to be added to the U.S. registry.[135] The concern with adding aircraft to the U.S. registry is that that the additional oversight responsibilities caused by the additional aircraft may become too much for the Federal Aviation Administration ("FAA") to handle.[136] However, this concern is baseless. The U.S. General Accounting Office reports that there is no reason why foreign aircraft would be transferred to the U.S. registry, even if foreign investment restrictions in U.S. airlines were removed.[137] Further, even if aircraft were added to the U.S. registry, the FAA would be able to handle the increased workload.[138] Thus, because no noticeable effect will take place regarding airline safety, it is definitely not a concern that should hold back support for reducing foreign investment restrictions in U.S. air carriers.[139]

D. Foreign Investment Restrictions on U.S. Air Carriers as Regulatory Takings

As discussed above, there are abundant legitimate policy reasons why restrictions on foreign investment in U.S. air carriers should be lifted, or at the very least reduced. However, there may even be a successful legal argument that restrictions on foreign investment are an invalid regulatory taking. At least one commentator has suggested that such a restriction "represents a taking of property without just compensation in violation of the

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134 *See* Gessing, *supra* note 1, at 5.

135 U.S. Gen. Accounting Office, *supra* note 10, at 7.

136 *Id.* at 9.

137 *Id.* The United States General Accounting Office noted, "In addition to any legal obstacles to transferring foreign aircraft to U.S. registry, it is not clear what incentives exist that would encourage a foreign investor to do so." *Id.*

138 *Id.*

139 *See id.*

Constitution."[140] This theory may be a new avenue that U.S. air carriers suffering from a lack of foreign investment may use to rid the industry of the counter-productive restrictions.

The Fifth Amendment protects private property from being taken by the government except for public use, and then the government must provide "just compensation" to the owner of the property.[141] The Supreme Court has interpreted the Takings Clause to apply to situations where governmental regulations so severely hinder the use of private property that the regulations become a "regulatory taking."[142] A brief history of this Regulatory Takings Doctrine is necessary to examine how it can be applied to foreign investment restrictions in U.S. airlines.

1. *Penn Central as the Benchmark for Regulatory Takings*

In *Penn Central Transportation Co. v. City of New York*, the owners of Grand Central Station were prevented from constructing a fifty-story office building over the station by a landmark preservation ordinance.[143] The ordinance was aimed at protecting landmarks in New York for historical reasons, to encourage tourism, and for the general welfare of the city.[144] The owners of Grand Central Station contended that the ordinance constituted a "taking" because the value of the station was "significantly diminished" due to the ordinance and their property was singled out for preservation.[145]

The Court did not agree with the owners' contention that the landmark law constituted a regulatory taking.[146] The majority determined that the preservation ordinance was not a regula-

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[140] Holtan-Murphy, *supra* note 8, at 727.

[141] U.S. CONST. amend. V. The Fifth Amendment provides:

> No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Id.

[142] *See generally* Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104 (1978).

[143] *Id.* at 107.

[144] *Id.* at 109.

[145] *Id.* at 131.

[146] *Id.* at 138.

tory taking because the law was substantially related to a legitimate government interest, and because the regulation still allowed for some productive economic uses of the property.[147]

The effect of *Penn Central* was to create an ad-hoc subjective balancing test for regulatory takings, evaluating 1) the balance of economic impact, 2) the level of interference with investment-backed expectations, and 3) the character of the governmental action.[148] This test is employed whenever a government regulation diminishes the value of a citizen's property.[149] Essentially, a court will generally not deem legislation a regulatory taking if the legislation regulates a legitimate government interest and has a sufficient relationship to that interest.[150] Additionally, the *Penn Central* test suggests that a court will further scrutinize the legislation if the legislation affects the economic viability of the property in a severe manner.[151] While court-employed takings analysis is much more complex, this brief summary is sufficient for our purpose of determining whether foreign investment restrictions constitute a regulatory taking.

2. *Applying the Penn Central Test to Foreign Investment Restrictions in U.S. Air Carriers*

Despite the ill-advised nature of restrictions on foreign investment in U.S. airlines, such restrictions are unlikely to be found as regulatory takings under the Fifth Amendment, for the legislation appears to pass muster under the *Penn Central* test. In order to reach this conclusion, it is necessary to analyze each factor of the test in light of the current legislative situation regarding airline investment.

a. Economic Impact of Foreign Investment Restrictions in U.S. Airlines

The first part of the *Penn Central* balancing test requires a measurement of the economic impact of the investment restrictions. This part of the test is most likely factored in favor of determining that the restriction is a regulatory taking due to the magnitude of the adverse impact on the airline industry. As dis-

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147 *Id.* at 137-138.

148 *Id.* at 124.

149 Chris J. Williams, Comment, *Do Smart Growth Policies Invite Regulatory Takings Challenges? A Survey of Smart Growth and Regulatory Takings in the Southeastern United States*, 55 ALA. L. REV. 895, 905 (2004).

150 Holtan-Murphy, *supra* note 8, at 712–13.

151 *See* Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 138 n.36.

cussed above in the Wings and US Air examples, the lack of access to capital that results from the restrictions can have a huge impact on the airline industry.[152] Such impacts can include loss of jobs,[153] delay of aircraft purchasing,[154] and even bankruptcy.[155] Because of these negative consequences, one might think that the economic impact factor has been satisfied.[156] However, the economic impact factor still favors the investment restrictions.

One hurdle this argument faces is that the foreign investment restriction is broad, covering the entire U.S. airline industry instead of singling out a single party to bear the cost. This aspect makes the foreign investment restriction even more likely to be valid because in *Penn Central*, where the harm was more localized on the owners of Grand Central Station, it was still not considered a regulatory taking under the test.[157] Another important aspect to consider under the economic balancing test is that despite the restrictions in question, the airline industry continues to have significant business. Notwithstanding the lost opportunities and efficiencies that foreign investment restrictions provide, the U.S. airline industry is a huge market that conducts business on a global scale. Based on the *Penn Central* decision, in which the Supreme Court noted that the economic impact was not as great as the owners claimed due to the significant business still operating in the terminal, a court here would likely take account of the size and scope of the continued airline operations despite a lack of foreign funds.[158] Thus, this balancing factor points against the restrictions being a regulatory taking.

b. Investment Restrictions Interference With Investment-Backed Expectations

The next factor to be considered is whether the foreign investment restrictions interfere with "distinct investment-backed

[152] *See* US Air Files for Bankruptcy, CNN MONEY, http://money.cnn.com/2002/08/11/news/companies/usair/; U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 5.

[153] *See* Isidore, *supra* note 78.

[154] US Air Files for Bankruptcy, *supra* note 152.

[155] *Id.*

[156] Holtan-Murphy, *supra* note 8, at 717.

[157] *See* Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 131 (1978).

[158] *See id.* at 137–38.

expectations."[159] This part of the *Penn Central* test is the hardest for the airline industry to overcome should they wish to challenge foreign investment restrictions as a regulatory taking. The restriction on foreign investment has been in place since 1926.[160] Airlines have been operating in the United States under such a restriction for so long it almost seems absurd to claim that the regulation is interfering with an airline's investment-backed expectation.[161] Although this comment argues that the restrictions are actually counter-productive, the regulation was originally implemented to safeguard the U.S. airline industry and protect national security.[162] Given these assumptions and the longevity of the legislation, it would be very difficult for anyone to argue that their investment was based on the expectation that U.S. airlines would be allowed to accept increased levels of capital from foreign investors.[163]

c. Character of Government Action

The final point of analysis in the *Penn Central* balancing test is the character of government action.[164] This factor is also a loser for parties challenging restrictions on foreign investment in U.S. airlines as regulatory takings. In *Penn Central* the majority wrote, "A taking may be more readily found when the interference with property can be characterized as a physical invasion by government, than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good."[165] Congress took action to pass the restrictions at issue with the purpose of protecting national security,

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159 *Id.* at 124.

160 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10.

161 *See Penn Cent. Transp. Co.*, 438 U.S. at 136, 138.

162 *See* Holtan-Murphy, *supra* note 8, at 705–06 (noting that "[t]he first and perhaps most important of these policy concerns was the protection of U.S. economic interests.") *See also* U.S. GEN. ACCOUNTING OFFICE, *supra* note 10, at 2 n.2 (citing U.S. GEN. ACCOUNTING OFFICE, AIRLINE COMPETITION: IMPACT OF CHANGING FOREIGN INVESTMENT AND CONTROL LIMITS ON US AIRLINES (1992)).

> The United States has restricted ownership and control of United States airlines for four primary reasons: (1) protection of the then-fledgling United States airline industry, (2) regulation of international air service through bilateral agreements, (3) concern about allowing foreign aircraft access to U.S. airspace, and (4) military reliance on civilian airlines to supplement airlift capacity.

Id.

163 *See Penn Cent. Transp. Co.*, 438 U.S. at 124.

164 *Id.* at 124.

165 *Id.*

securing jobs in the U.S. airline industry, and maintaining a strong international presence in relation to other nations.[166]

Obviously, these are legitimate governmental interests that are aimed at promoting the common good.[167] Although the regulation does not actually achieve these intended goals as shown earlier in this comment, it does not mean that the character of the government action is without merit. There is rational reasoning behind the regulations and this reasoning is linked to the legislation. It is highly unlikely that a court would operate to second guess the policy decision of Congress in this situation because, despite the viewpoint expressed by this comment, rational minds can differ as to the correct amount of foreign investment that is optimal for U.S. airlines. In this situation, Congress has made a policy decision and adjusted "the benefits and burdens of economic life to promote the common good."[168] Even though the final result of the current foreign investment restrictions on U.S. air carriers may be disagreeable, this doesn't mean that Congress's action was not appropriate or just, especially when there are national security issues at stake. Thus, because Congress's action in passing the foreign investment restrictions in the U.S. air carrier industry was done to promote the common good, this final factor also shows that the legislation does not amount to a regulatory taking.[169]

3. *Summary of Penn Central Takings Analysis*

After applying the *Penn Central* analysis, it becomes clear that the legislation restricting foreign investment in U.S. air carriers is not a regulatory taking. In fact, such a challenge to the legislation probably fails on all three factors. The regulation leaves the industry with a substantial amount of operations, challengers won't be able to claim an investment-backed expectation that they would be able to take advantages of more foreign investment in airlines due to the extraordinary amount of time the legislation has been in place, and, finally, the character of the legislation was rationally passed for the purpose of the common good.

However, just because the legislation does not amount to a regulatory taking does not mean that the legislation is correct or

166 *See* Holtan-Murphy, *supra* note 8.

167 *See Penn Cent. Transp. Co.*, 438 U.S. at 124.

168 *See id.*

169 *See id.*

that it actually achieves its purported purpose. As discussed earlier, the restrictions are actually counter-productive to their stated goal and generally harm the industry. The loosening of foreign investment restrictions on U.S. airlines should still be pursued, but not as a regulatory taking. A lobbying effort toward Congress is in order to acheive the desired legislation change.

D. The Path Ahead

After determining that U.S. airlines would greatly benefit from a reduction in foreign investment restrictions, the next question that must be answered is: what next? An initial reaction would be to propose the complete elimination of all restrictions on foreign investment in U.S. air carriers. The policy and reasoning discussed in this comment would certainly support such a conclusion. In fact, most airlines support the complete removal of all foreign investment restrictions.[170]

Unfortunately, the complete removal of investment restrictions is probably an unrealistic goal, considering that the Bush Administration's proposal that foreign investment restrictions in U.S. air carriers be scaled back to allow up to forty-nine percent of an airline to be owned by foreigners was rejected by Congress in 2003.[171] A more realistic goal is to push for the approval of the Bush Administration proposal allowing forty-nine percent foreign ownership.[172] Once the negative consequences that opponents to the proposal predict fail to materialize, and the airline industry begins to realize the benefits of the additional capital available, it may be easier to lobby Congress for a full removal of the restrictions.

II. GOVERNMENT SPONSORED EXCESS CAPACITY

Another aspect of the U.S. airline industry that is in desperate need of adjustment is the overcapacity of domestic airlines brought about by United States government subsidies. Most Americans believe that subsidies in the airline industry are only a European problem.[173] These Americans may be surprised at

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170 U.S. Gen. Accounting Office, supra note 10, at 4.

171 *Id.*

172 *Id.*

173 Andrew Stephen, *America – Andrew Stephen Fears the Worst for US Airlines*, New Statesman, May 23, 2005, *available at* http://www.newstatesman.com/life/200505230014.

the shocking amount of subsidies the U.S. government hands out to air carriers. However, the real problem is not with the subsidies themselves, but the devastating effects they are having on the struggling U.S. airline industry.

A. Operating Losses Followed by Subsidies Are a Vicious Cycle

In the minds of many people, giving an airline a little help (or in the case of airlines, a lot of help) after it has gone through a financially tough stretch may seem like a good idea. The problem with this reasoning is that the subsidies have the effect of leaving the airline market as a whole in a worse situation than it was before the individual air carriers began having difficulties and required help. The problem that is created by a situation of constant and massive federal sponsored bailouts of struggling airlines is that because struggling airlines are not allowed to go out of business, an intensely competitive market remains with many air carriers fighting for the same customers, thereby driving down prices.[174]

This airline subsidy issue is no small problem. In fact, since 2001 the airline industry has been given at least $9.5 billion by the federal government in the form of grants, loan guarantees, and tax waivers.[175] Despite such massive government assistance, from 2000 to 2004 airlines have lost more than $30 billion.[176] Things are not exactly looking up either. In the fourth quarter of 2005, every major airline, except for low-cost carrier Southwest, reported a loss.[177] Even one of the few airlines that had been historically profitable, JetBlue, lost money in the fourth quarter of 2005.[178]

The reason that the airlines are continuously losing money despite massive government subsidies is overcapacity.[179] Because every time a U.S. air carrier comes close to going out of business the government bails them out, there are more airlines

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174 Gessing, *supra* note 1.

175 *Id.* at 3.

176 Joel J. Smith, *Airlines Pushed to Brink Over Low Fares*, DETROIT NEWS, January 24, 2005, *available at* http://www.detnews.com/2005/business/0501/24/a01-67893.htm.

177 James Bernstein, *JetBlue Expects Quarterly Loss*, NEWSDAY, Jan. 18, 2006, at A38.

178 *Id.*

179 Gessing, *supra* note 1, at 3.

and airline capacity than the market demands.[180] According to Wharton School of Business professor Elizabeth Bailey, "There are too many carriers and too much capacity. This industry hasn't been in equilibrium as long as I have been watching it."[181] Even airline executives agree with this take on overcapacity.[182] In fact, the CEO of Southwest Airlines cited overcapacity as a concern in a company earnings release.[183]

In order to compete with so many other airlines, most air carriers add more routes, more planes, and cut prices.[184] This only creates a cycle where, because of increased costs due to the increased routes and decreased revenue due to slashed airfares, airlines are forced to rely once again on government handouts.[185] As one airfare analyst aptly put it, "We're at a point where the airlines have created a monster and it's like a runaway train. Nobody is willing to step forward to stop it."[186]

In order to end the above described scenario, airline subsidies must be stopped. Although it will be painful in the short-term to allow a carrier to fail, in the long run the airline industry will benefit from this approach. The remaining air carriers will be stronger and in a significantly better position to take advantage of the new opportunities left behind by the failed airline.[187] With fewer airlines in the market, air fares will gravitate back to a natural market price absent overcapacity. Once this market equilibrium is achieved, a self-sustaining and viable airline industry can be attained that does not need to be backed by United States taxpayers.

B. A Different Approach to Airline Bankruptcy

After eliminating subsidies in order to attain market equilibrium in air fares and reduce overcapacity, a change in how judges approach airline bankruptcy will be necessary. Currently, judges are too lenient while trying to help struggling airlines in

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180 Wharton Strategic Management, *Few Survivors Predicted: Why Most Airlines Are Caught in a Tailspin*, Feb. 9, 2005, http://knowledge.wharton.upenn.edu/article/1124.cfm.

181 *Id.*

182 *Id.*

183 *Id.* Gary C. Kelly, CEO of Southwest, said "the revenue environment continues to be a challenge due to the glut of airline seats." *Id.*

184 Joel J. Smith, *supra* note 176.

185 *See id.*

186 *Id.*

187 *See* Gessing, *supra* note 1, at 1.

bankruptcy.[188] At some point, it is necessary to allow a failing air carrier to fail. While allowing an airline to fail to solve a problem may be counter-intuitive, it is the most sensible approach. Allowing weaker companies to fail keeps markets in equilibrium. One would think that in the United States, a supposed leader in free markets, would readily embrace such a simple resolution.[189]

One specific reform that is necessary to cure the overcapacity problem is how airline bankruptcies are currently handled.[190] Currently, after a distressed airline files for bankruptcy they cut costs, only to come out of bankruptcy and further challenge competitors in an already overcrowded market.[191] This additional pressure from fresh-out of bankruptcy competitors puts immense financial pressure on the other airlines and forces them to cut fares to compete.[192] Predictably, another airline is forced into bankruptcy, only to start the whole process over again.[193] Essentially, the U.S. airline industry is "bleeding itself to death" through bankruptcy.[194]

The problem with airline bankruptcies is that airlines are going bankrupt repeatedly, continuing the cycle.[195] One such example is United Airlines.[196] United Airlines is in Chapter 11 bankruptcy for the second time[197] and is expected to emerge sometime in 2006.[198] The problem is that allowing United to go into bankruptcy for the second time only makes the overcapacity worse.[199] Despite the Chapter 11 process, the future prospects for United do not look good.[200] Low-cost carriers such as Southwest are invading United's service areas and mak-

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188 Wharton Strategic Management, *supra* note 180.

189 *See* Gessing, *supra* note 1, at 1.

190 Wharton Strategic Management, *supra* note 180.

191 *Id.*

192 *Id.*

193 *Id.*

194 *Id.* Wharton management professor Peter Cappelli notes that "the problem is that the government allows a carrier to dramatically cut costs in bankruptcy and then push others into the financial abyss. The industry is bleeding itself to death." *Id.*

195 *Id.*

196 *Id.*

197 *Id.*

198 Ben Mutzabaugh, *United Bankruptcy Exit Pushed Back to 2006*, USA TODAY, Sept. 9, 2005, *available at* http://www.usatoday.com/travel/flights/today/2005-09-08-sky-archivesept07_x.htm.

199 Wharton Strategic Management, *supra* note 180.

200 *Id.*

ing a permanent recovery unlikely for United.[201] Thus, the most likely scenario is that United emerges from bankruptcy, flooding the market further with additional capacity, and then goes bankrupt again, perhaps taking another airline into bankruptcy with it.[202]

Judges currently either do not have the power, or choose not exercise the power, to challenge airlines' reorganization decisions.[203] However, according to Section 1129 of the Bankruptcy Code, a court should only confirm a reorganization plan if "Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan."[204] In other words, a judge should not confirm a plan unless it is feasible.[205] Thus, judges should only allow an airline to emerge from Chapter 11 bankruptcy if the airline has a real chance of surviving upon exit.[206] When deciding whether an airline has a real chance of surviving, a court should look at the airline's business model and whether the airline's re-entry to the market will harm the industry, causing more bankruptcies.[207]

Whether the problem can be solved by courts exercising their power to reject Chapter 11 reorganization plans based on a lack of feasibility, or if new legislation is necessary to stop these destructive reorganizations, the basic premise remains the same, continual bankruptcy and reorganization is crippling the airline industry.

C. Merger Problems

One possible way to help alleviate the airline overcapacity problem would be for some United States airlines to merge. The problem is that U.S. regulations and policy prevent such mergers from taking place.[208] One such regulation, foreign investment restrictions, was discussed in Part I of this comment.

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201 *Id.*

202 *See id.*

203 Daniel P. Rollman, Comment, *Flying Low: Chapter 11's Contribution to the Self-Destructive Nature of Airline Industry Economics,* 21 Emory Bankr. Dev. J. 381, 408 (2004).

204 11 U.S.C. § 1129(a)(11) (2006).

205 *See id.*

206 Wharton Strategic Management, *supra* note 180.

207 Rollman, *supra* note 203, at 411.

208 Gessing, *supra* note 1.

Currently, U.S. airlines are simply not financially strong enough to initiate mergers of any significant size.[209] With access to foreign capital, consolidation could take place within the industry, reducing overall capacity and putting the market back into equilibrium.[210] Once market equilibrium is achieved, air fares could stabilize and airlines could become profitable.

Besides foreign investment restrictions, the federal government sometimes blocks mergers that could achieve the desired consolidation within the airline industry.[211] One such example was a proposed merger between United and US Airways.[212] Unfortunately, in July of 2001, the United States Justice Department threatened to block the merger for anti-competitive reasons.[213] The problem is that allowing the merger to go through would actually be beneficial for the industry by reducing the induced excess competition.[214] Permitting some consolidation activity to occur in the industry would allow newly consolidated airlines to reduce overlapping capacity, and thus reduce overall capacity.

Recent developments in the United States government's approach to mergers are promising. First, America West was allowed to merge with US Airways.[215] Further, after United emerges from Chapter 11, it is expected to engage in merger talks with Continental.[216] The early indication is that the government will not act to block the merger, paving the way for further consolidation within the industry.[217] This new pro-consolidation stance taken by the Bush Administration should encourage mergers and hopefully promote market equilibrium. By eliminating some of the competing airlines through mergers, overcapacity can be reduced and the airline industry can move closer to market equilibrium.[218]

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209 Wharton Strategic Management, *supra* note 180.

210 *See id.*

211 Gessing, *supra* note 1, at 4.

212 *Id.*

213 *Id.*

214 *See id.*

215 Doug Cameron, *United Merger After Chap. 11*, THE AUSTRALIAN, Jan. 21, 2006, at A37.

216 *Id.*

217 *Id.*

218 *See* Gessing, *supra* note 1.

III. CONCLUSION

Despite good intentions, United States lawmakers are hurting the already struggling U.S. airline industry. Protectionist policies and overregulation are robbing U.S. air carriers of the benefits of open markets that the majority of U.S. industries enjoy. Denied such benefits, U.S. airlines as a whole have performed terribly financially.[219] In spite of regulations aimed at protecting U.S. airlines and massive government subsidies, U.S. air carriers have lost roughly $30 billion from 2001 to 2005.[220] Such staggering losses indicate an obvious need for change in the regulatory framework of U.S. air carriers. In short, the United States legislature needs to make another attempt at the deregulation of the U.S. airline industry.

This comment has argued two main areas of United States policy and legislation that must be reformed. The first is legislative restrictions on foreign investment in U.S. air carriers. Currently, the United States government mandates that foreign parties may not own more than 25 percent of any U.S. air carrier,[221] and also severely restricts the right of control that any foreign investor has in a U.S. airline.[222] The purpose behind this legislation and regulatory framework is to protect the airline industry, ensure domestic employment and labor rights, answer national security concerns, and promote safety.[223]

However, as this comment has shown, removal of foreign investment restrictions will either not affect these concerns, or actually improve the situation. One such example is Congress's intention of protecting American jobs in domestic airlines. Allowing increased foreign investment in U.S. airlines would have no effect on labor rights,[224] and the increased access to capital would help struggling airlines to continue avoiding layoffs and funding pension plans.[225] The other purposes behind the foreign investment restrictions are similarly debunked in this comment. Thus, because the intentions of Congress are not being achieved through this protectionist legislation, and U.S. airlines

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219 *See* Joel J. Smith, *Airlines Pushed to Brink Over Low Fares*, DETROIT NEWS, Jan. 24, 2005, *available at* http://www.detnews.com/2005/business/0501/24/a01-67893.htm.

220 *Id.*

221 14 C.F.R. § 47.8(c) (2006).

222 *Id.*

223 U.S. GEN. ACCOUNTING OFFICE, *supra* note 10.

224 *Id.* at 8.

225 Gessing, *supra* note 1, at 5.

would greatly benefit from access to increased foreign capital, foreign investment restrictions for U.S. airlines should be abolished completely, or at least relaxed.

Although foreign investment regulations are unfair and hurt the airline industry, air carriers do not have a legitimate claim under a theory of regulatory taking. The regulation leaves the industry with a substantial amount of operations, any challengers won't be able to claim an investment backed expectation that they would be able to take advantages of more foreign investment in airlines due to the extraordinary amount of time the legislation has been in place, and the character of the legislation was rationally passed for the purpose of the common good. Although an interesting idea, just because a regulatory takings theory cannot be successfully argued in this instance does not mean that the restrictions should be in place. It simply means that efforts should be directed toward the legislature to repeal these hurtful and unnecessary regulations against foreign investment in U.S. airlines.

The other United States policy discussed in this comment that needs to be re-evaluated is the current state of government sponsored overcapacity. This overcapacity is caused by a combination of massive subsidies from the U.S. government, misuse of the bankruptcy system, and the government's denial of potentially beneficial mergers between air carriers. Since 2001, the airline industry has been given at least $9.5 billion by the federal government in the form of grants, loan guarantees, and tax waivers.[226] These subsidies encourage overcapacity in the airline market by propping up airlines that would otherwise fail in the open market.[227] Thus, in order to compete amid a flood of government subsidized airlines, air carriers are forced to cut fare prices.[228] This cut in air fares pushes the market price down to an unnaturally low level, negatively impacting revenues for all airlines.[229] Finally, the destructive process is completed when the artificially low air fares force airlines to once again seek government subsidies, starting the process over once again.[230]

The second part of the government sponsored excess capacity problem is the misuse of the bankruptcy protection regarding failing airlines. As discussed above, after artificially low fares cre-

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226 *Id.* at 3.

227 Wharton Strategic Management, *supra* note 180.

228 Joel J. Smith, *supra* note 219.

229 *See id.*

230 *See id.*

ate a business environment that is unsustainable for airlines, it is inevitable that an airline will fail financially.[231] The problem then becomes that after seeking bankruptcy protection, the previously failed airline will re-emerge only to start another round of fare cutting, starting the whole process over again and causing yet another airline to seek bankruptcy.[232] In fact, airlines sometimes go through this process and into bankruptcy multiple times.[233] The solution to this aspect of the government induced excess capacity problem is simple, judges should not allow failing airlines to emerge from bankruptcy protection unless the airline has a realistic chance of recovery.[234] By allowing such airlines to actually fail and exit the marketplace, the market will eventually reach an equilibrium point where airlines can survive in the open market.

Finally, the last piece of the government induced overcapacity problem is the tendency for the United States government to block mergers in the airline industry that would reduce the number of players in the market, and thus reduce capacity. Although the government has a legitimate interest in blocking mergers between companies that would create a monopolistic environment 2nd therefore would hurt consumers, this is not the case in the airline industry. Permitting some consolidation activity to occur in the industry would allow newly consolidated airlines to reduce overlapping capacity, and thus reduce overall capacity. This reduced capacity would help to bring market fares to a sustainable level. Fortunately, out of all the topics discussed in this comment, this area is the most promising. Recent merger proposals in the industry have been approved,[235] and hopefully this is a sign of a new governmental stance toward airline mergers and overcapacity.

Overall, the level of regulation and protectionism in the United States airline industry is shocking. The airline industry should be able to benefit from an open market system experienced by the vast majority of other U.S. industries. Historically abysmal financial performance by the industry as a whole and the resulting massive government bailouts should be evidence enough that a new approach to the industry is in order. In short, deregulation of the airline industry deserves another shot.

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231 *See id.*

232 *See* Wharton Strategic Management, *supra* note 180.

233 *Id.*

234 *Id.*

235 Doug Cameron, *supra* note 215.

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