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A FLIGHT PLAN TOWARDS FINANCIAL STABILITY—THE HISTORY AND FUTURE OF FOREIGN OWNERSHIP RESTRICTIONS IN THE UNITED STATES AVIATION INDUSTRY

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THE AMERICAN AVIATION industry is a curious paradox. On the one hand, since deregulation, certain aspects of the industry are relatively *laissez faire*. For example, entry into the domestic U.S. aviation market is freely allowed, provided only that a proposing carrier can prove financial and safety fitness and U.S. ownership. On the other hand, even following deregulation, the industry remains very highly regulated in many aspects of its business. One area where this paradox is apparent is in the debate regarding foreign ownership and control of airlines in the United States and the European Union ("EU"). Most recently, European negotiators have insisted upon the relaxation of current foreign ownership restrictions in the United States, making it almost (but not quite) a prerequisite for an open skies agreement¹ between the United States and the EU.

An open skies agreement between two parties is the epitome of a liberalized industry, particularly impressive given the importance of the international context.² However, the reluctance of

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¹ An open skies agreement is a bilateral or multilateral air transport agreement that opens markets, eliminates capacity restrictions, promotes competition, and allows air tariffs to be determined by market forces. Open skies agreements are based upon the model open skies text, which can be found at <http://www.state.gov/e/eeb/rls/othr/2008/19514.htm>.

² Recent open skies agreements have provided for an unprecedented level of liberalization. For example, the recently concluded bilateral agreement between

the United States to relax the ownership and control restrictions indicates exactly how regulated the industry still remains. This paper will explore whether the United States should relax its restrictions on foreign ownership of U.S. airlines. The first section will outline the history of foreign ownership restrictions in the U.S. airline industry from 1926 to the present. The second section will outline the history of ownership restrictions in the European airline industry. The third section will outline the legal and economic arguments in favor of, and against, relaxing the restrictions. The fourth section will outline the arguments in favor of, and against, relaxing the restrictions with respect to defense and national security. The discussion in the last section will center on the mechanics and function of the Civil Reserve Air Fleet ("CRAF") program in the United States. As a comparative point, the Voluntary Intermodal Sealift Agreement ("VISA"), a parallel program that applies in the maritime context, will be discussed to extract principles which could be applied to the aviation context. To conclude, this analysis indicates that on balance and in the aggregate, the United States should liberalize its foreign ownership restrictions.

I. HISTORY AND REGULATORY FRAMEWORK OF OWNERSHIP AND CONTROL RESTRICTIONS IN THE UNITED STATES

A. STATUTORY HISTORY

In 2001, private investors owned 166 of the world's 984 airlines.³ But foreign ownership restrictions persisted in many countries around the world, with some of the most restrictive found in the United States.⁴ Initially, in the 1920s, Congress limited foreign investment in U.S. air carriers mainly for national security purposes.⁵ Particularly, Congress feared that German investment in U.S. airlines would give Germany the

the United Kingdom and Singapore provides for unlimited fifth freedom rights, as well as cabotage rights within the U.K. for Singaporean carriers. Ven Sreenivasan, *Skies Open for SIA Flights to Britain and Beyond; Unfettered Flying Rights for Singapore Carriers Include Bases in UK, Trans-Atlantic Route*, BUS. TIMES (Sing.), Oct. 4, 2007.

³ ISABELLE LELIEUR, LAW AND POLICY OF SUBSTANTIAL OWNERSHIP AND EFFECTIVE CONTROL OF AIRLINES 31 (2003).

⁴ *Id.*

⁵ *Id.* at 32.

opportunity to use aircrafts as instruments of war.⁶ In addition, Congress wanted to ensure that only U.S. citizens received benefits accruing from the carriage of mail (the initial purpose of commercial aviation).⁷ This led to the passage of the 1926 Air Commerce Act⁸ which stated that aircraft could only be registered in the United States if owned by U.S. citizens, and further required that U.S. citizens have fifty-one percent voting interests in U.S. carriers and comprise two-thirds of the membership of the boards of directors.⁹

During the Depression years that followed, America often chose protectionism as its principal means of strengthening the American economy.¹⁰ The aviation industry was no exception to this general principle, and the Civil Aeronautics Act of 1938¹¹ increased the minimum required percentage of voting equity held by U.S. citizens from fifty-one percent to seventy-five percent¹² (note this provision paralleled the Shipping Act of 1916¹³ which already had a seventy-five percent requirement).¹⁴ The 1938 Act was followed by the Federal Aviation Act of 1958¹⁵ (re-enacted into the Airline Deregulation Act of 1978,)¹⁶ which specifically set out the definition of "citizen of the United States" as:

- (A) an individual who is a citizen of the United States;
- (B) a partnership each of whose partners is an individual who is a citizen of the United States; or
- (C) a corporation or association organized under the laws of the United States or a State, the District of Columbia, or a territory or possession of the United States, of which the president and at least two-thirds of the board of directors and other managing officers are citizens of the United States, and in which at least 75 percent of the voting inter-

⁶ 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).

⁷ *Id.* at 305–06.

⁸ Air Commerce Act of 1926, Pub. L. No. 69-254, 44 Stat. 568.

⁹ LELIEUR, *supra* note 3, at 32.

¹⁰ *Id.*

¹¹ Civil Aeronautics Act of 1938, Pub. L. No. 75-706, 52 Stat. 973.

¹² 52 Stat. at 978, § 1(13)(c).

¹³ Shipping Act of 1916, Pub. L. No. 64-260, 39 Stat. 728.

¹⁴ Kirsten Böhmman, *The Ownership and Control Requirement in U.S. and European Union Air Law and U.S. Maritime Law—Policy; Consideration; Comparison*, 66 J. AIR L. & COM. 689, 696 (2001).

¹⁵ Federal Aviation Act of 1958, Pub. L. No. 85-726, 72 Stat. 731.

¹⁶ Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705 (codified as amended in scattered sections of 49 U.S.C.).

est is owned or controlled by persons that are citizens of the United States.¹⁷

This framework has been only slightly modified by a 2003 revision to the law which states that the definition of a citizen expressly requires that a corporation be “under the actual control” of U.S. citizens.¹⁸

B. DEPARTMENT OF TRANSPORTATION APPLICATION

Having described the law and relevant statutes, the seminal question is how the law is applied. The most serious problem with this statutory framework as it stands is that the statute provides little guidance on the issue of what constitutes effective (or actual) control under U.S. law.¹⁹ “The issue of control as it relates to the percentage of non-voting shares of an airline that may be held by foreigners thus remains ‘a matter of policy, not law.’”²⁰ Indeed, this problem of interpretation has been evidenced in the historical rulings of the Department of Transportation (“DOT”), its predecessor, the Civil Aeronautics Board (“CAB”), and the courts.²¹

1. *Application Through the Twentieth Century*

Since 1958, the CAB and DOT have applied a “two-pronged” approach to defining citizenship under the 1958 Federal Aviation Act.²² First, a person or entity must satisfy the ownership percentages enumerated in the statute to qualify as a U.S. citizen. Second, only those corporations or companies that qualify as U.S. citizens can exercise actual control over a U.S. carrier.²³ From the 1960s until the late 1980s, the DOT applied an “actual control” test, whereby merely meeting the statutory percentages was not necessarily sufficient to be considered a U.S. citizen.²⁴ The first case that applied the test was *Willye Peter Daetwyler*.²⁵ Here, the CAB held that Interamerican did not qualify as a li-

¹⁷ 49 U.S.C. § 40102(a)(15) (2000).

¹⁸ 49 U.S.C. § 40102(a)(15) (2000 & Supp. 2004).

¹⁹ LELIEUR, *supra* note 3, at 33.

²⁰ *Id.* at 33–34 (quoting Henri Wassenbergh, *Towards Global Economic Regulation of International Air Transportation Through Inter-Regional Bilateralism*, 26 ANNALS AIR & SPACE L. 237, 244 (2001)).

²¹ *Id.* at 33.

²² *Id.* at 35.

²³ *Id.*

²⁴ *Id.*

²⁵ *Willye Peter Daetwyler*, 58 C.A.B. 118 (1971).

censed U.S. air carrier.²⁶ Even though Interamerican met the statutory percentage requirements, the CAB held that:

where an applicant has arranged its affairs so as to meet the bare minimum requirements set forth in the Act, it is the Board's view that the transaction must be closely scrutinized and that the applicant bears the burden of establishing that the substance of the transaction is such as to be in accordance with the policy, as well as the literal terms of the specific statutory requirements.²⁷

The next case in the chronology is *Premiere Airlines*.²⁸ Similar to *Daetwyler*, the CAB held that there was no doubt that Premiere met the statutory percentage requirements.²⁹ However, the fact that the founder of Premiere, Joseph Cicippio, had taken a \$2.5 million loan from his Saudi Arabian employer left him, and Premiere, under foreign control in actuality.³⁰ Similarly, in *Page Avjet*, the CAB and DOT determined that foreigners had actual control of the carrier.³¹

In Page's proposal, the nonvoting stockholders do not have day-to-day operational control; however, they have the right to influence many of the crucial decisions of the company. They have the power to block any proposal by the voting stockholders for a company consolidation, merger or acquisition. Similarly, they have the power to dissolve the company and liquidate its assets. If the nonvoting stockholders disapprove of the way that the officers and directors conduct the company's affairs, they can vote for dissolution of the company.³²

Although some saw the ultimate outcome of *Page Avjet* as a temporary relaxation of the actual control standard, the DOT dispelled any doubt that it was relaxing standards by its 1987 decision in *Intera Arctic Services, Inc.*³³ There, the DOT held that "[i]f persons other than U.S. citizens, individually or collectively, can significantly influence the affairs of [the carrier], it is not a U.S. citizen."³⁴

²⁶ *Id.* at 119.

²⁷ *Id.* at 121.

²⁸ *Premiere Airlines*, 95 C.A.B. 101 (1982).

²⁹ David T. Arlington, Comment, *Liberalization of Restrictions on Foreign Ownership in U.S. Air Carriers: The United States Must Take the First Step in Aviation Globalization*, 59 J. AIR L. & COM. 133, 146-47 (1993).

³⁰ *Id.*

³¹ *Page Avjet*, 102 C.A.B. 488, 490 (1983).

³² *Id.* at 491.

³³ *Intera Arctic Servs., Inc.*, 1987 DOT Av. LEXIS 337 (Aug. 18, 1987).

³⁴ *Id.* at 9.

These decisions carried the day until 1989, when the changing realities of the world economic climate trumped many decades of protectionist precedent.³⁵ As Lelieur points out, "[p]rotecting the nation from its political enemies was no longer a major concern of the DOT; instead, [the] DOT's focus shifted to the formation of new economic partnerships to sustain U.S. dominance of international civil aviation."³⁶ Three cases illustrate this shift: *Northwest I*,³⁷ *U.S. Airways-British Airways*³⁸ and *Continental-Air Canada*.³⁹

In *Northwest I*, KLM aimed to make a major investment in the fourth largest American carrier, Northwest Airlines.⁴⁰ In its decision regarding KLM's investment in Northwest, the DOT reinforced its precedent of being restrictive with respect to foreign ownership.⁴¹ KLM claimed it would have less than a five percent voting interest in Northwest, even though it owned over 56.74% of the equity in a company called "Wings," which was formed to invest in Northwest.⁴² This led the DOT to conclude: "it is clear from our precedent that a large share in a carrier's equity poses citizenship problems, even where the interest does not take the form of voting stock, particularly if there are other ties to the foreign entity."⁴³ Likewise, KLM was allowed to name a member of Wing's board and set up a three-member committee to advise Northwest on financial affairs.⁴⁴ For these reasons, the DOT concluded that this investment would not be permissible under U.S. law.⁴⁵

However, DOT reconsidered the Northwest-KLM case at Northwest's request later in 1991.⁴⁶ In its reconsideration, the

³⁵ LELIEUR, *supra* note 3, at 36-37.

³⁶ *Id.* at 37.

³⁷ *In re The Acquisition of/by Wings Holdings, Inc., Northwest Airlines*, 1989 DOT Av. LEXIS 643 (Sept. 29, 1989) [hereinafter *Northwest I*].

³⁸ There was no reported decision in this case as British Airways withdrew its offer on December 22, 1992. See Arlington, *supra* note 29, at 133.

³⁹ The DOT did not formally review the Continental-Air Canada transaction. For further discussion of this case, see Howard E. Kass, *Cabotage and Control: Bringing 1938 U.S. Aviation Policy into the Jet Age*, 26 CASE W. RES. J. INT'L L. 143, 176 (1994).

⁴⁰ LELIEUR, *supra* note 3, at 37.

⁴¹ Arlington, *supra* note 29, at 152.

⁴² *Id.* at 153.

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *In re Northwest Airlines, Inc.*, 1991 DOT Av. LEXIS 55 (Jan. 23, 1991) [hereinafter *Northwest II*].

DOT changed course based upon new economic concerns.⁴⁷ It stated that it would now make a distinction between voting and non-voting equity, and would allow foreign interests to have up to a forty-nine percent equity stake in a U.S. carrier provided that it is non-voting.⁴⁸ Likewise, they allowed KLM to maintain three members on Northwest's board, saying that the other twelve members would be sufficient to offset any potential adverse effects.⁴⁹ However, the DOT did state that the Chairman must be a U.S. citizen and committee composition would be carefully scrutinized.⁵⁰ Ultimately, this decision, obviously favorable to KLM, paved the way for both an open skies agreement between the United States and the Netherlands⁵¹ as well as a pricing, marketing, and strategic joint venture alliance between the two airlines.

Two other cases attempted to build off of the DOT's decision in *Northwest II*: the *USAir-British Airways* case and the *Continental-Air Canada* case. The essential facts of the *USAir-British Airways* case were that British Airways ("BA") was to make a \$750 million investment in USAir in exchange for a total stake of forty-four percent in the company.⁵² The most controversial aspect of this deal, however, was that the USAir board would be expanded from thirteen members to sixteen members, with four representatives from BA, and up to two interlocking directors who could serve on both boards.⁵³ Although the agreement ultimately failed due to opposition from American Airlines ("AA"), United Airlines ("UA"), and Delta Airlines ("DL"), there were indications that the DOT did raise some concerns regarding ownership and control issues, specifically the fact that BA would have effective veto power over USAir decisions via BA's board membership.⁵⁴

⁴⁷ Arlington, *supra* note 29, at 157-58.

⁴⁸ *Id.* at 156.

⁴⁹ *Id.* at 157.

⁵⁰ *Id.*

⁵¹ Air Transport Agreement between the United States of America and the Kingdom of the Netherlands in Respect of the Netherlands Antilles Relating to Air Transport between the Netherlands Antilles and the United States of America, July 14, 1998, available at <http://www.state.gov/e/eeb/rls/othr166084.htm>.

⁵² Arlington, *supra* note 29, at 159.

⁵³ *Id.* at 160.

⁵⁴ Jeff Peline, *British Airways-USAir Deal is Dead*, S.F. CHRON., Dec. 23, 1992, at C1.

USAir-BA certainly met the letter-of-the-law requirements by having only twenty-one percent of USAir voting stock owned by BA and one-quarter of the board under BA control.⁵⁵ However, because many corporate decisions required a supermajority vote, AA, UA and DL argued that BA would have effective control over the USAir board.⁵⁶ This concern did enter in to the DOT's considerations but as Arlington points out, AA, UA, and DL were able to tie together the issues of foreign ownership and bilateral liberalization.⁵⁷ In other words, because the United States did not have an open skies agreement with the United Kingdom, U.S. investors would not be able to enjoy reciprocal investment access to British carriers and, more importantly, U.S. airlines would not receive access to the U.K. market that equaled the access that BA would receive to the U.S. market by virtue of its control of USAir.⁵⁸

Finally, in the *Continental-Air Canada* case, the DOT approved a new financing plan for Continental Airlines in which Air Canada would invest \$235 million and receive 27.5 percent of the total equity and twenty-four percent of the voting stock of Continental.⁵⁹ Air Canada would also be able to select six of Continental's eighteen board members.⁶⁰ The DOT approved this plan exactly two weeks after it had given the indication that it would not approve the USAir-BA deal because the United States and Britain could not "agree on steps to permit greater competition [among] their airlines."⁶¹ As Lelieur states, "[b]ecause Air Canada's partner was a major US investment group and the US-Canada bilateral was less offensive than the US-UK relationship, the control prong of the US citizenship test was not violated and the DOT ultimately approved Air Canada's proposal."⁶²

2. *Three Recent Ownership and Control Cases*

Just as there was a steady progression towards increased liberalization of the DOT's interpretation of actual control, the events of September 11, 2001 ("9/11") put aviation security

⁵⁵ Arlington, *supra* note 29, at 175.

⁵⁶ *Id.* at 175-78.

⁵⁷ *Id.* at 178-79.

⁵⁸ *Id.* at 184-85.

⁵⁹ Kass, *supra* note 39, at 176.

⁶⁰ *Id.*

⁶¹ Martin Tolchin, *U.S. Approves Financing for Continental Airlines*, N.Y. TIMES, Jan. 8, 1993, at D3.

⁶² LELIEUR, *supra* note 3, at 38.

back into the limelight. As mentioned earlier, in 2003 Congress amended existing legislation to incorporate into the statute the “actual control” requirement that the DOT had been enforcing in some form since the 1960s. Three subsequent decisions in the aftermath of 9/11 cast doubt on what the trend of the DOT’s posture has been on this subject since 9/11. In the first case, *DHL Airways*, the DOT, in reviewing the decision of the administrative law judge (“ALJ”), stated that exercising actual control over the airline implies having “a substantial ability to influence the carrier’s activities.”⁶³ Also, the DOT applied a totality of the circumstances test in determining actual control.⁶⁴ Ultimately, the DOT and the ALJ concluded that the dependence on the DHL network for the large majority of their business would not give the DHL (the foreign parent) substantial influence over ASTAR (the American subsidiary).⁶⁵ This decision has been questioned by some commentators, including Lelieur, who points out that even during the proceedings, Deutsche Post (the parent of DHL) announced its intention to considerably increase its share in the U.S. carrier: “The question to be raised is whether DHL Airways passed the DOT control test because of [DHL and its professional advisors’] political influence.”⁶⁶

The second recent case which sheds uncertainty on the DOT’s current posture in ownership cases is the contentious decision to permit Virgin America to be considered a U.S. citizen.⁶⁷ In its initial review of the *Virgin America* case, the DOT concluded that the limited liability company holding seventy-five percent of the voting equity in Virgin America, VAI, was itself not a U.S. citizen.⁶⁸ In arriving at this conclusion, the DOT reasoned that more than forty-nine percent of VAI’s total equity was held by Cayman Island entities or foreign limited partnerships (specifically by Sir Richard Branson and the Virgin Group).⁶⁹ One key part of the ownership debate in this case concerned the existence of hedge funds, comprised of foreign

⁶³ *In re* The Citizenship of DHL Airways, 2004 DOT Av. LEXIS 404, at *22 (May 13, 2004).

⁶⁴ *Id.*

⁶⁵ *Id.* at *65.

⁶⁶ LELIEUR, *supra* note 3, at 34 n.18. In this instance, the ALJ likewise concluded that there was no control.

⁶⁷ *Virgin America Inc.*, 2007 DOT Av. LEXIS 386 (May 18, 2007) (final order).

⁶⁸ *Id.* at *1.

⁶⁹ *Virgin America, Inc.*, 2007 DOT Av. LEXIS 237, at *50 (Mar. 20, 2007) (order to show cause).

investors, which owned a large share of VAI (even though the two hedge funds involved, Black Canyon and Cyrus, were both U.S. citizens).⁷⁰

Between the initial denial and the tentative approval of its application, Virgin America offered assurances to the DOT that the foreign investors in these hedge funds would be totally excluded from investing in Virgin America.⁷¹ The DOT, in its order to show cause, then mandated that:

[A]ll non-U.S. investors in VAI must be completely walled off from investment in Virgin America. To the degree that such foreign interests maintain investments in the hedge funds, those interests must be limited to investments unrelated to Virgin America, and they may not receive benefits from the investment in Virgin America.⁷²

Ultimately, the DOT tentatively approved the new format of the Virgin transaction because it required that the equity held by the Virgin Group be placed in an irrevocable voting trust subject to strict conditions, and also because Virgin agreed to the aforementioned walling off of foreign investors within the hedge funds.⁷³ With respect to actual control, in its initial determination, the DOT found:

[B]ecause certain of Virgin America's agreements that predated U.S. investment (including its aircraft lease agreements with Airbus and GECAS, entered into and negotiated by the Virgin Group prior to VAI's involvement) remained in place, and because the terms and conditions of these agreement [sic] did not appear to provide the U.S. investors the ability to alter independently or revise these agreements, Virgin Group appeared to have a degree of influence over the applicant that, given the totality of circumstances then presented to us, suggested U.S. citizens were not actually controlling the applicant.⁷⁴

In response, Virgin America proposed removing the Virgin Group's "veto power over pre-existing and future material contracts or capital expenditures and has provided multiple affidavits from GECAS, Airbus, and its non-Virgin Group directors affirming that, in fact, various amendments were made to the

⁷⁰ *Id.* at *62.

⁷¹ *Id.* at *122.

⁷² *Id.*

⁷³ *Id.* at *124-*25.

⁷⁴ *Id.* at *129.

applicant's aircraft lease agreements since Virgin America's U.S. investors joined the company."⁷⁵

Virgin America also agreed to replace Fred Reid as CEO within the first six months of the carrier's operation.⁷⁶ Reid was suspected of having ties too close to the foreign principals of the Virgin Group.⁷⁷ It also agreed to remove and replace any other officer as the DOT required, to permanently relinquish one of the Virgin Group's board designees, reducing the number from three to two, and to amend its bylaws to remove the voting powers from some non-U.S. interests.⁷⁸ The DOT had been concerned that the Virgin Group's (a UK citizen) 24.9 percent stake in Virgin America constituted pervasive control because of the degree to which the Virgin Group was involved in the carrier's management.⁷⁹ Therefore, the removal of Reid and possibly other officers was a move aimed at allaying these fears. On May 18, 2007, the DOT granted final approval to Virgin America to begin operations.⁸⁰ Following this, on July 11, 2007, the DOT permitted Virgin America to begin selling tickets.⁸¹ Virgin America made its inaugural flights on August 8, 2007, with two flights departing New York and Los Angeles and landing at San Francisco simultaneously.⁸²

Finally, the third case involved the reorganization of Hawaiian Airlines. The structure of the Hawaiian Airlines transaction involved interposing new U.S.-citizen limited liability companies between that corporation and existing offshore investment enti-

⁷⁵ *Id.* at *130 (citations omitted).

⁷⁶ Ultimately, the DOT allowed Fred Reid to remain with Virgin America as a consultant for a three month period beyond the six months that he was permitted to remain as CEO. On December 10, 2007, C. David Cush replaced Fred Reid as CEO. See Press Release, Virgin America Inc., Virgin America Appoints C. David Cush as Chief Executive Officer (Nov. 26, 2007), available at <http://www.virginamerica.com/va/meetVaPress.do?method=showMeetVa&NavChImage=Press>.

⁷⁷ *Virgin America*, 2007 DOT Av. LEXIS 237, at *132.

⁷⁸ *Id.* at *132-*33.

⁷⁹ *Id.*

⁸⁰ *Virgin America Inc.*, 2007 DOT Av. LEXIS 386 (May 18, 2007) (final order).

⁸¹ Press Release, Virgin America Inc., Virgin America Gets the Go-ahead for Ticket Sales (July 11, 2007), available at <http://www.virginamerica.com/va/meetVaPress.do?method=showMeetVa&NavChImage=Press>.

⁸² Press Release, Virgin America Inc., Virgin America Opens for Business (July 19, 2007), available at <http://www.virginamerica.com/va/press/2007/Jul/Vir-America-First-Day.html>.

ties.⁸³ The U.S. LLCs would hold voting stock in Hawaiian's parent corporation.⁸⁴ "Under this arrangement, the U.S. managers of the existing offshore entities [would] own the voting stock of each new LLC reflecting a genuine financial interest therein, while the existing offshore entities [would] own only non-voting stock in the new LLCs."⁸⁵ The two key questions about this approach were whether the U.S. managers would be independent and not beholden to the offshore entities they manage, and whether the LLCs would be structured like corporations, rather than partnerships, so that no single foreign investor could taint the LLCs as a partner.⁸⁶ Ultimately, the DOT decided to accept Hawaiian's proposal to "multiply out" the foreign interests in each investor to reflect the foreign ownership, rather than examining each entity in the hierarchy separately to determine its citizenship based on actual control.⁸⁷ In answering both key questions, the DOT concluded that the foreign interests were genuinely passive, and that those interests were so highly diffuse such that no single foreign investor would have more than a small ownership interest.⁸⁸

Taken collectively, the *DHL*, *Virgin America*, and *Hawaiian* decisions indicate that the DOT, albeit slowly, may be continuing its progressively liberal reading of the statutory ownership and control requirements. This is despite the fact that Congress has seemingly been unwilling to make statutory modifications to loosen the ownership and control requirements. Indeed, when the DOT attempted to circumvent statutory modifications by introducing a notice of proposed rulemaking ("NPRM") to modify the ownership and control requirements,⁸⁹ Congress indicated its position in a June 22, 2006 letter signed by relevant House Committee Chairmen and Ranking Members indicating Congress' "strong disapproval of the Department of Transportation's (DOT) proposed rulemaking."⁹⁰ Furthermore, prior to

⁸³ See Letter from Karan K. Bhatia, Assistant Sec'y for Aviation and Int'l Affairs, to Jonathan B. Hill, Dow Lohnes & Albertson, PLLC (undated), available at <http://ostpxweb.dot.gov/aviation/busrevletters/hawaiianair.htm>.

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ Actual Control of U.S. Air Carriers, 70 Fed. Reg. 67,389 (proposed Nov. 7, 2005).

⁹⁰ See Letter from James L. Oberstar, et. al. Ranking Democratic Member, Comm. on Transp. & Infrastructure, to Norman Y. Mineta, Sec'y of Transp. (June

that, a bill co-sponsored by 190 members of the 108th Congress, House Bill 4542, indicated that the rulemaking was “contrary to the plain language of the aviation statutes.”⁹¹ The NPRM was withdrawn on December 8, 2006.⁹² Absent a major DOT effort to secure the cooperation of Congress, it is unlikely that any major statutory or administrative change will occur in the near future.⁹³

II. REGULATION IN EUROPE

A. EUROPEAN REGULATORY HISTORY

The history of regulation in Europe is somewhat different than in the United States, but has been guided by similar goals. Following World War II, the most important policy goal throughout Europe was to maintain peace among the individual nations, which had not happened since the Pax Romana during the Roman Empire. The method to achieve a more lasting peace in Europe has been monetary and, to a lesser extent, political integration. Within the context of aviation, major developments began to occur in the 1980s and early 1990s with the passage of the Single European Act⁹⁴ in 1986, and the formation of the Single European Market in 1992. Meanwhile, the landmark decision from the European Court of Justice in this area, *Nouvelles Frontières*,⁹⁵ applied the European Community (“EC”) competition rules, particularly Articles 81 and 82 of the EC Treaty, to air transportation.⁹⁶ These treaty provisions, and indeed all provisions of the EC Treaty, could be applied to air transport even in the absence of an implementing regulation.⁹⁷

22, 2006), available at https://crewroom.alpa.org/DesktopModules/ALPA_Documents/ALPA_DocumentsView.aspx?itemid=3933&ModuleId=1316&TabId=256.

⁹¹ *Foreign Investment in U.S. Air Carriers: Hearing Before the S. Comm. on Commerce, Science, and Transportation*, 109th Cong. 3 (2006) [hereinafter *Hearing*] (statement of Jeff Smisek, President, Continental Airlines, Inc.).

⁹² Actual Control of U.S. Air Carriers, 71 Fed. Reg. 71,106 (withdrawn Dec. 8, 2006).

⁹³ Some commentators believe that if the Bush Administration elected to solicit the cooperation of Congress and enact foreign ownership and control modifications legislatively rather than through rulemaking, Congress might well allow the statutory limits to be loosened, especially if accompanied by appropriate labor protective provisions. See Allan I. Mendelsohn, *U.S. Aviation Policy—A Critique*, 31 *AIR & SPACE L.* 309, 309–10 (2006).

⁹⁴ Single European Act, 1987 O.J. (L 169) 1.

⁹⁵ Joined Cases 209-213/84, *Ministere Public v. Asjes*, 1986 E.C.R. 1425.

⁹⁶ ANGELA CHENG-JUI LU, *INTERNATIONAL AIRLINE ALLIANCES: EC COMPETITION LAW/US ANTITRUST LAW AND INTERNATIONAL AIR TRANSPORT* 107 (2003).

⁹⁷ *Id.*

Furthermore, they could be enforced to a certain extent by the Commission and the competition authorities of the Member States.⁹⁸ Following this decision in 1986, the Council of Ministers approved two rounds of aviation liberalization within the Community: the First Package in 1987 and the Second Package in 1989, "neither of which had a significant impact on the European air services market."⁹⁹

The Council adopted the Third Package in 1992, which effectively created a completely open market within the EU with respect to airfare approval, routes, and slot access.¹⁰⁰ For the first time, this package marked a departure from the traditional system of bilateral agreements among Member States.¹⁰¹ As Böhmann points out, "[a]fter the 'Third Package,' the European regulatory regime no longer distinguishes between domestic or international services within the European Community market."¹⁰² Furthermore, as of January 1, 1997, any EU carrier can operate any scheduled services within the Community, including what was previously thought to be cabotage (flights within one EU nation).¹⁰³ In practice, however, although airlines have tried to establish subsidiaries outside of their home countries by virtue of this liberalization within the EC, none of the major carriers have successfully maintained them.¹⁰⁴ Perhaps the most well-known example was Deutsche BA, a subsidiary of British Airways, which operated mostly flights within Germany.¹⁰⁵ Once Rod Eddington became CEO of BA, however, Deutsche BA was gradually eliminated, reportedly because it was not profitable.¹⁰⁶

B. EUROPEAN STATUTORY FRAMEWORK

There is debate as to whether the statutory language covering European restrictions on airline ownership is more restrictive than such language covering U.S. restrictions. On the one hand, it seems as though the European regime is more transpar-

⁹⁸ *Id.*

⁹⁹ Böhmann, *supra* note 14, at 717.

¹⁰⁰ *Id.* at 718.

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Id.* at 728.

¹⁰⁵ See *British Airways Sells its German Subsidiary*, AIRLINE INDUSTRY INFO., June 3, 2003, available at http://findarticles.com/p/articles/mi_m0CWU/is_2003_June_3/ai_102716273.

¹⁰⁶ *Id.*

ent than that of the United States. The seminal regulation that was part of the Third Package, 2407/92, enumerates the four fundamental requirements that an applicant for an air carrier license must satisfy:

1. the principal place of business must be located in the licensing Member State;
2. the main occupation of the carrier must be air transportation;
3. the holder of the license must be owned and continue to be owned directly or through a majority ownership of EU nationals;
4. the holder of the license must at all times be effectively controlled by such EU nationals.¹⁰⁷

First, it is apparent that instead of using the term substantial ownership, which in this case implies near total ownership, the European statute requires only "majority ownership," and the majority may be made up of citizens of one or more EU Member States.¹⁰⁸ Second, unlike its U.S. counterpart, the regulation goes on to define effective control.¹⁰⁹ Dealing first with the issue of majority ownership, this requirement has been somewhat clarified by the Commission in its *Swissair-Sabena* decision, in which the Belgian government and Swissair entered into an agreement under which Swissair would take a 49.5 percent total equity stake in Sabena, the Belgian state airline.¹¹⁰ The Commission did not challenge this transaction, thereby legitimizing the presence of a non-majority ownership stake by a non-EU member interest (though Switzerland does have an aviation specific association agreement whereby Switzerland takes over the provisions of the internal EU air transport market).¹¹¹ The Commission also specifically stated that it is irrelevant whether the shares of the "majority owner" are held by a single EU national or by a dispersed group of shareholders so long as they are all EU nationals and their interests add up to a majority.¹¹² Finally, and in direct contrast to U.S. law, the percentage thresholds in the EU provision are strictly equity thresholds, not voting thresholds.¹¹³ Thus, a forty-nine percent non-EU voting stake in

¹⁰⁷ Council Regulation 2407/92, art. 4, 1992 O.J. (L 240) 1.

¹⁰⁸ *Id.* art. 4(2).

¹⁰⁹ *Id.* art. 2(g).

¹¹⁰ Commission Decision 95/404, 1995 O.J. (L 239) 19.

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ *Id.*

an EU carrier alone is not enough to prevent the granting of a license by a national authority in the EU. Traditionally, the United States has been more restrictive than the EU in this regard. However, the new U.S.-EU Open Skies Agreement states that a 49.9 percent non-voting interest held by EU nationals in a U.S. airline would not, by itself, constitute control of that airline.¹¹⁴ In fact, even EU nationals owning a non-voting interest of fifty percent in a U.S. airline would not be sufficient to constitute control under the new Agreement. “[O]wnership by nationals of a Member State or States of 50 percent or more of the total equity of a U.S. airline shall not be presumed to constitute control of that airline. Such ownership shall be considered on a case-by-case basis.”¹¹⁵

With respect to effective control, the EU provides more detailed guidelines than the United States. However, in practice, the application may not be very different. Article 2(g) of Regulation 2407/92 defines the considerations for effective control as:

a relationship constituted by rights, contracts or any other means which, either separately or jointly and having regard to the considerations of fact or law involved, confer the possibility of directly or indirectly exercising a decisive influence on an undertaking, in particular by:

- (a) the right to use all or part of the assets of an undertaking;
- (b) rights or contracts which confer a decisive influence on the composition, voting or decisions of the bodies of an undertaking or otherwise confer a decisive influence on the running of the business of the undertaking.¹¹⁶

The Commission stated that the ultimate goal of air transport policy is to safeguard the interests of the Community air transport industry.¹¹⁷ EU nationals must be able to make final decisions regarding business plans, annual budgets, investments, and appointments to the boards of directors.¹¹⁸ Moreover, Böhmman points out that “effective control is not inevitably linked [to] majority interest,” provided that the minority share-

¹¹⁴ Air Transport Agreement between the United States of America and the Parties to the Treaty Establishing the European Community and the European Community, Annex 4, art. 1(1)(a)(ii), Apr. 2007, available at http://eur-lex.europa.eu/LexUriServ/site/en/oj/2007/l_134/l_13420070525en00040041.pdf.

¹¹⁵ *Id.* Annex 4, art. 1(1)(b).

¹¹⁶ Council Regulation 2407/92, *supra* note 107, art. 2(g).

¹¹⁷ Commission Decision 95/404, *supra* note 110; Böhmman, *supra* note 14, at 722.

¹¹⁸ Böhmman, *supra* note 14, at 722.

holders are dispersed.¹¹⁹ Also, the national authority must examine the possible implications of supermajority voting (as in the *USAir-BA* case in the United States) to determine whether such provisions could lead to a *de facto* effective control by non-EU nationals.¹²⁰

Comparing the approach of Europe with the approach of the United States, Lelieur believes that the increased transparency and definition inherent in the European regulations render those regulations less cumbersome and restrictive to foreign investment.¹²¹ However, Böhmman reaches a different conclusion. Both regimes require the licensing authority to determine whether a foreign interest is able to exercise effective or actual control in any form, and neither the United States nor the EU view debt as a relevant factor in determining control.¹²² The biggest difference is the lack of differentiation between voting equity and non-voting equity by the European regulators.¹²³ This means Europe would not object to a voting share of forty-nine percent, even though such a combination would be disallowed by the DOT in the United States.¹²⁴ However, Böhmman states that despite this seemingly large divergence,

[t]he crucial factor in determining the ownership status in both the U.S. and the European system is not the permissible voting interest, but the actual control situation in the company, namely who is able to exercise decisive influence on the carrier. In the vast majority of cases a voting interest of 49% is likely to enable its holder to exercise such influence, in particular if the rest of the shares are widely dispersed. Therefore, in those cases, even with a higher numerical requirement, a foreign voting equity of 49% in a EU carrier would not be permissible. One can therefore conclude that the U.S. and the EU system are not as different as their numerical ownership requirements facially suggest.¹²⁵

Which interpretation is correct? Only further cases will answer this question because these types of cases are relatively new in the EU. Experience from other industries would lend credence to Böhmman's view, given the propensity of Europe to

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ LELIEUR, *supra* note 3, at 41.

¹²² Böhmman, *supra* note 14, at 723.

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ *Id.*

protect its own corporations from global competition. A recent example of this protective behavior occurred when PepsiCo announced that it intended to engage in a hostile takeover of French company Danone SA.¹²⁶ The French government aimed to stop the takeover by claiming that the recipe for Danone's yogurt was a strategic asset.¹²⁷ In reality, however, it appears the French government wanted to do nothing more than protect one of the French "national champion" companies that is large enough to compete with U.S. and Asian counterparts.¹²⁸ This example illustrates that, despite the fact that Europe has consistently cast the United States as protectionist in aviation and other industries, Europe has a history and penchant for protectionism that may well be carried over into aviation if Europeans deem it necessary.

C. 2002 EUROPEAN COURT OF JUSTICE DECISION AND THE ONGOING DEBATE OVER RIGHT OF ESTABLISHMENT

Adding to the uncertainty is the November 2002 decision of the European Court of Justice ("ECJ") with respect to the legality of the bilateral open skies agreements that have been negotiated between the United States and individual Member States of the European Union.¹²⁹ The ECJ did not render the individual bilateral agreements with the United States invalid.¹³⁰ The court did, however, rule that four particular types of provisions contained within the bilateral open skies agreements were contrary to EU law.¹³¹ Among these were provisions that "reserved the right to grant permission under the . . . agreements only to airlines substantially owned and effectively controlled by nationals of the EU Member States that are party to a particular [bilateral] agreement."¹³² Hence, under the old regime, the U.S.-Belgium bilateral could have stipulated, as it did, that only carriers that are substantially owned and effectively controlled by citizens of Belgium (and the United States) could enjoy the benefits of the open skies agreement. As all the bilateral open

¹²⁶ Mark Landler & Paul Meddler, *Unity in the European Market, Except When it Comes to Takeovers*, N.Y. TIMES, Mar. 14, 2006.

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ Case C-466/98, *Comm'n v. United Kingdom*, 2002 E.C.R. I-9427.

¹³⁰ Ruwantissa Abeyratne, *The Decision of the European Court of Justice on Open Skies—How Can We Take Liberalization to the Next Level?*, 68 J. AIR L. & COM. 485, 489 (2003).

¹³¹ *Id.*

¹³² *Id.*

skies agreements of that era contained such a specific national ownership requirement, the ECJ's conclusion that all such provisions are contrary to EU law was of major significance. The main issue is whether this type of provision would be contrary to Article 52 of the EC Treaty by not according to all EU nationals the treatment that the Member States accorded to their own nationals.¹³³ Therefore, as Abeyratne points out:

The court followed its argument that Community airlines may always be excluded from the benefit of the air transport agreement between an EU Member State and the United States while that benefit is assured to airlines of that State. Consequently, Community airlines suffer discrimination which prevents them from benefiting from the treatment which the host Member State accords to its own nationals. Contrary to what a respondent State of the EU may maintain, the court found that the direct source of that discrimination was not the possible conduct of the United States, but instead the clause on the ownership and control of airlines, which specifically acknowledges the right of the United States to act in that way.¹³⁴

Hence, the ECJ held that these provisions were contrary to EU law.¹³⁵

The ECJ concluded that clauses in bilateral agreements that required ownership and control to be in the designating state or its nationals were inconsistent with and hence in breach of Member State obligations under the Treaty of Rome.¹³⁶ This determination created a series of exchanges between the United States and Europe that could not help but raise questions for the United States as to European intentions. In response to the ECJ ruling, the United States proposed a system that would allow multi-EU national ownership of any EU member state-designated airline, provided that the airline has its principal place of business in the designating state and the designating state maintains effective regulatory control over the airline, including issuance of a valid operating license or permit.¹³⁷ In response, the European Commission referred to the U.S. proposal as "minimalist" and reiterated that the only permissible interpretation of the ECJ decision is that Member States should denounce ex-

¹³³ *Id.* at 491–92.

¹³⁴ *Id.* at 501.

¹³⁵ *Id.* at 488–89.

¹³⁶ *Id.* at 489.

¹³⁷ See Allan I. Mendelsohn, *The USA and the EU—Aviation Relations: An Impasse or an Opportunity?*, 29 AIR & SPACE L. 263, 264 (2004).

isting bilateral air service agreements with the United States and move towards a system where the Community speaks with one voice.¹³⁸ In fact, in June 2003, the EC did receive a broad mandate from the EU and Member States to negotiate virtually all aviation issues with the United States.¹³⁹

Even today, it is hard to be certain whether the Commission is or is not contemplating a very broad definition of the right of establishment in which a German carrier like Lufthansa would need to do no more than maintain a ticket office in London to operate non-stop service between London and New York. Such a broad reading could be problematic. Nor is it possible to know how the United States would react to such an interpretation. Beyond that, it is likewise not possible to predict how the British government would react to such a proposal. On the surface, it seems difficult to believe that the British government in this example would not raise an objection to Lufthansa flying routes that had previously been reserved only for American and British carriers. It seems that the British government would aim to protect its carriers as it would do for its firms in any industry. In practice, recent events show that these concerns may be overstated. Air France has begun operating flights between Heathrow Airport in London and Los Angeles as of April 1, 2008.¹⁴⁰ Likewise, BA has begun operations between New York and Paris (Orly) and will begin operations between New York and Amsterdam on October 15, 2008.¹⁴¹ These new services seem to represent a major advance in the unification efforts of the EU, although this unification promises to be tested in the near future as Alitalia faces dissolution and purchase by non-Italian EU carriers (*e.g.*, Lufthansa, Air France/KLM).¹⁴²

¹³⁸ *Id.*

¹³⁹ *Id.* at 268.

¹⁴⁰ Press Release, Air France, Delta Air Lines, Sign Trans-Atlantic Joint Venture Agreement (Oct. 17, 2007), *available at* http://www.airfranceklm-finance.com/sysmodules/RBS_fichier/admin/forcedownload.php?id=837.

¹⁴¹ See Open Skies, <https://www.flyopenskies.com/os/home> (last visited Sept. 23, 2008).

¹⁴² For a more comprehensive treatment of this debate, see *e.g.*, Allan I. Mendelsohn, *The United States and the European Union in International Aviation*, FED. LAW., 2008, at 36–44; Allan I. Mendelsohn, *Myths of International Aviation*, 68 J. AIR L. & COM. 519, 523–27 (2003); and Mendelsohn, *supra* note 137.

III. ECONOMIC ANALYSIS OF LIBERALIZATION OF OWNERSHIP AND CONTROL RESTRICTIONS

Having described the relevant history and current standards upon which foreign ownership decisions are made by regulatory authorities, the larger question is whether the restrictions on foreign ownership should be relaxed, particularly in the United States. In analyzing the economic consequences of liberalizing foreign ownership, it becomes apparent that several parties would be affected including passengers, employees, suppliers/contractors, and the airlines themselves.

A. EFFECT ON AIRLINES

Undoubtedly the most significantly affected of the relevant stakeholders in question are the airlines themselves. The first and most popular argument made by airlines in support of easing the restrictions is that doing so would increase their access to foreign capital.¹⁴³ Before addressing the importance of this argument, it must be noted that the airline industry is very unique in its structure. As Lelieur points out, “[the industry] suffers from severe business risks [including] high fixed costs, highly cyclical demands, and intensive competition.”¹⁴⁴ Due to this unique business structure, airlines have significant capital needs. According to a 1990s study, the world’s airlines have capital needs of around \$815 billion as compared to \$147 billion ten years ago.¹⁴⁵ Undoubtedly, these needs have grown in the wake of economic downturn and the events of 9/11.

Since 2001, airlines have faced significant financial crises throughout the world and particularly in the United States. Four major U.S. airlines have filed for protection under the reorganization provisions of the U.S. Bankruptcy Code (UAL Corporation, Delta Airlines, Northwest Airlines, and U.S. Airways), and many have even asked the government for loan guarantees before the Air Transport Stabilization Board.¹⁴⁶ More recently,

¹⁴³ LELIEUR, *supra* note 3, at 69.

¹⁴⁴ *Id.*

¹⁴⁵ *Id.* at 70 n.39.

¹⁴⁶ It is necessary to point out that while some of these requests were granted, particularly very close to September 11, 2001, the last request of United Airlines before the Board on June 17, 2004, was denied by the Board in large part because it determined that United had access to other sources of capital, which in some ways undermines arguments in favor of foreign ownership. See Press Release, Office of Public Affairs, ATSB Decision on United Air Lines (June 17, 2004), available at <http://www.treas.gov/press/releases/js1733.htm>.

four low-cost carriers, ATA Airlines, Skybus Airlines, Aloha Airlines, and Frontier Airlines have filed for bankruptcy protection as well.¹⁴⁷ This financial difficulty for airlines has not been limited to the United States. Indeed, two European national flag carriers, Swissair and Sabena (Belgium), both collapsed in the fall of 2001.¹⁴⁸ Likewise, the same period saw the collapse of Ansett Australia, the second largest Australian carrier.¹⁴⁹ These failures led governments around the world to rethink their strategy on foreign ownership. Relaxing foreign ownership restrictions would give airlines access to capital that would allow them to make investments in order to offer more competitive products. Most notably, this was seen in New Zealand (Air New Zealand had been an investor in Ansett Australia) where the government ultimately relaxed foreign ownership restrictions after a few months of debate.¹⁵⁰

In the United Kingdom, signatory to the most restrictive bilateral agreement with the United States, the calls for the relaxation of foreign ownership restrictions to allow airlines to access new sources of capital have been voiced perhaps the loudest.¹⁵¹ It is important to note that many observers believe that the U.K. took this position only to prevent the conclusion of an EU-U.S. open skies agreement that may have opened access to London's Heathrow International Airport.¹⁵² The U.K. now seems to be taking the position that if the U.S. ownership and control laws are not liberalized within the next few years then the agreement should be denounced and not be allowed to enter into permanent effect.¹⁵³ The United States has presumably been attempting to allay the fears of the Europeans that Congress would try

¹⁴⁷ *Trouble in the Air; Airline Mergers*, ECONOMIST, Apr. 19, 2008.

¹⁴⁸ See Imogen Foulkes, *Trial Examines Swissair Collapse*, BBC NEWS, Jan. 16, 2007, <http://news.bbc.co.uk/1/hi/business/6265289.stm>; *Belgian National Airline Bankrupt*, BBC NEWS, Nov. 7, 2001, <http://news.bbc.co.uk/1/hi/business/1642507.stm>.

¹⁴⁹ Terry Cook, *Australia's Second Biggest Airline Collapses* (Sept. 15, 2001), <http://www.wsws.org/articles/2001/sep2001/anse-s15.shtml>.

¹⁵⁰ *The New Zealand Government Relaxes Foreign Ownership Limits in Air New Zealand*, AIR TRANSP. WORLD, Oct. 1, 2001, at 12.

¹⁵¹ See *UK Says Airline Merger and Acquisition Rules Should Be Relaxed*, AIRLINE INDUSTRY INFO., Oct. 3, 2001.

¹⁵² See *EU-US Land 'Open Skies' Agreement*, BBC NEWS, Nov. 18, 2005, <http://news.bbc.co.uk/1/hi/business/4451440.stm>.

¹⁵³ See *UK Says Airline Merger and Acquisition Rules Should Be Relaxed*, *supra* note 151.

to put the agreement into jeopardy (by taking an aggressive stance against ownership and control liberalization).¹⁵⁴

In addition to providing sources of much needed capital, relaxation of foreign ownership restrictions would have other effects on the airlines themselves. First, cross-border investment would enlist market forces to stabilize an increasingly global industry.¹⁵⁵ The airline industry is particularly sensitive to regional economic cycles and vulnerable to unpredictable geopolitical events. Hence, global diversification among airlines would allow "carriers in one region to broaden their financial exposure to other regions where growth and demand may be relatively strong," and thus spread the risk inherent in the industry.¹⁵⁶ In fact, while North America's share of world air traffic is expected to decline over the next two decades, intra-Asia and trans-Pacific Asia traffic are expected to grow at double the rate of North American traffic.¹⁵⁷ Access to foreign capital would allow airlines to make investments in new technology, most notably new-generation aircraft.¹⁵⁸ Thus far, U.S. airlines have not placed significant orders for either the Airbus A380, A350, or the Boeing 787 aircraft.¹⁵⁹ Finally, if ownership and control restrictions were relaxed, airlines might not be as identifiable with nationalities, and hence, may be less of a target for terrorism.

Some opponents of relaxing liberalization, such as Continental Airlines President Jeff Smisek, argue that relaxing such restrictions would actually discourage total investment in U.S. airlines because many liberalization approaches may allow foreign investors to hold voting rights disproportionate to their ownership interests through the presence of super-majority rights.¹⁶⁰ In such a case, Smisek argues that although liberalizing foreign ownership restrictions may increase U.S. airlines' access to foreign capital, this increase would be offset by a reduction in domestic capital.¹⁶¹ This reduction in domestic capital may occur if foreign investors are allowed to use super-majority rights to exercise control of U.S. carriers that is dispro-

¹⁵⁴ See Madhu Unnikrishnan, *Proposed Ownership Rule Changes "Unnecessary,"* AVIATION DAILY, July 19, 2007, at 1.

¹⁵⁵ *Hearing, supra* note 91, at 6 (statement of Michael Whitaker, Vice President, United Airlines).

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* (statement of Jeff Smisek).

¹⁶¹ *Id.*

portionate to the foreign equity interests.¹⁶² One such example is the DOT's proposed rulemaking referenced earlier,¹⁶³ which essentially sets out to create a dual class structure that would differentiate the control rights from proportional share ownership. The Securities and Exchange Commission, the New York Stock Exchange, courts, and shareholders all view dual class shares with some degree of skepticism, so this may be a negative consequence of liberalizing foreign ownership restrictions. In practice, this concern might be overstated by Smisek because the DOT appears to review super-majority rights, and other control mechanisms, carefully when analyzing airline ownership structures (*e.g.*, *Virgin America*).

Opponents of relaxing the restrictions, from the point of view of the airlines, also point to potentially large operational costs and a potential loss of traffic rights. With respect to operational costs, because eighty-five percent of an airline's cost structure is fixed to its schedule,¹⁶⁴ the cost of trying to consolidate schedules among carriers as a result of foreign investment might be very expensive. While consolidation is not a necessary consequence of liberalization of foreign ownership restrictions, often times, foreigners who invest capital into U.S. airlines do so in hopes of being able to influence the operations of the U.S. carrier (particularly if the foreign source of capital is a foreign airline). Thus, for example, if Lufthansa were to invest in United, Lufthansa may use the influence gained from its investment in United to seek consolidation of common routes to eliminate excess capacity. This type of arrangement would be very beneficial to both carriers, and to the extent that liberalizing foreign ownership restrictions could engender these arrangements, consolidation could certainly result. Although Lufthansa recently purchased a nineteen percent stake in JetBlue, this purchase raises fewer consolidation concerns because Lufthansa and JetBlue do not overlap on routes the way United and Lufthansa do.¹⁶⁵ The other potential operational cost stems from the daily consequences of internal operation; however, consolidation would allow airlines to focus resources on the most profitable

¹⁶² *Id.* at 20.

¹⁶³ See Actual Control of U.S. Air Carriers, 70 Fed. Reg. 67,389 (Nov. 7, 2005).

¹⁶⁴ Kevin O'Toole, *Making Mergers Work*, AIRLINE BUS., June 4, 2001, at 110.

¹⁶⁵ Press Release, JetBlue, Lufthansa to Make Equity Investment in JetBlue; Will Buy Up to 19% Stake For \$7.27 Per Share (Dec. 13, 2007), <http://investor.jetblue.com/phoenix.zhtml?c=131045&p=irol-newsArticle&ID=1087283&highlight>.

routes and, in the long run, airlines would establish schedules to maximize profitability with or without foreign investment. It is unclear how foreign investment would exacerbate these daily consequences; thus, they are far from a foregone conclusion.

Shifting to the potential loss of traffic rights, the problem is illustrated by the following hypothetical. Suppose that there are three countries: A, B and C. A liberalizes its foreign ownership restrictions. Suppose then that the airline of country B buys the airline of country A. This allows the airline of country B to use the traffic rights of country A that country A had previously negotiated with country C. The problem is that country C had not negotiated rights with country B. There may be reasons why country C would not want country B to have these rights. Country C could then respond by terminating the previously negotiated agreement with country A. This situation actually occurred upon British Airways' purchase of the French airline, Air Liberté.¹⁶⁶ When this occurred, the Moroccan government imposed guarantees on the French government to ensure that the traffic rights that Air Liberté had possessed between France and Morocco would be maintained.¹⁶⁷ Absent these guarantees, the traffic rights between France and Morocco could have been lost, illustrating an instance under which foreign ownership could lead to a loss of traffic rights.

The other interesting possibility that arises with respect to traffic rights and the liberalization of foreign ownership restrictions is the possibility of allowing cabotage. The argument is made that by liberalizing foreign ownership restrictions, cabotage restrictions would become essentially meaningless because non-citizens could gain access to domestic markets by investing in the domestic carrier, or through the right of establishment of a U.S. subsidiary. Though there are reasons why this access to the U.S. domestic market may not have a significant impact (*e.g.*, key business airports such as Ronald Reagan Washington, New York LaGuardia, Chicago O'Hare, etc., are slot constrained, limiting new entries; the U.S. market is incredibly competitive; and the profitability of U.S. domestic routes is far lower than international routes' profitability), liberalizing foreign ownership restrictions by purchase or through the right of establishment would clearly allow cabotage, and thus possibly change the domestic U.S. aviation industry dramatically. On balance, there is

¹⁶⁶ LELIEUR, *supra* note 3, at 77.

¹⁶⁷ *Id.*

little doubt that airlines would stand to benefit a great deal from the relaxation of foreign ownership restrictions.

B. EFFECTS ON CONSUMERS

Looking at the effects on consumers, the first question is whether liberalizing foreign ownership restrictions would have an impact on the way liability is determined. In the past seventy years, aviation liability in cases of delay or accidents has been determined under the original Warsaw system.¹⁶⁸ More recently, the Montreal 1999 update¹⁶⁹ to the Warsaw Convention has begun to replace the Warsaw system. Because these documents constitute an independent international system, the liability regime would remain unchanged under a system of foreign ownership. However, Lelieur points out the concern that if a carrier is owned by nationals who are not citizens of the designating country, it may be difficult from a safety standpoint for the designating government to demonstrate its technical competency.¹⁷⁰ This concern is small because ultimately, the state of registration of the aircraft will be responsible for addressing its oversight and technical defects, so foreign ownership is unlikely to have any impact from the standpoint of liability.¹⁷¹

The uncertainty arising from the debate between the EU and the United States with respect to the right of establishment may raise some safety concerns. The designating country exercises oversight over safety of airlines.¹⁷² No one doubts that if BA starts operating Paris to New York, the French presumably will not question its safety. But if Olympic Airways were to start flights from Paris to New York, would it be the French government or the Greek government which would exercise oversight over safety in that case? To date, no commentator has proposed an answer to this question, which could have significant impacts on consumers if safety concerns are not adequately addressed.

¹⁶⁸ The Warsaw system is composed of eight private international air law instruments including most notably: Convention for the Unification of Certain Rules Relating to International Carriage by Air, Oct. 12, 1929, 49 Stat. 3000, 137 L.N.T.S. 11.

¹⁶⁹ Convention for the Unification of Certain Rules Relating to International Carriage by Air, May 28, 1999, S. Treaty Doc. No. 106-45, 1999 WL33292734.

¹⁷⁰ LELIEUR, *supra* note 3, at 64.

¹⁷¹ *Id.*

¹⁷² *Id.*

The other possible avenue through which consumers stand to be affected by foreign ownership liberalization is potential changes in fares and service levels. On the one hand, the first suspected consequence of allowing greater foreign investment in airlines is that doing so may lead to further consolidation in the airline industry. Ignoring the overall effects of such consolidation, and limiting the present inquiry to consumer welfare for now, the exact impact of consolidation is unclear. Consolidation could give rise to unilateral effects if new entities come to dominate certain routes following consolidation (*e.g.*, Washington-Frankfurt where Lufthansa was allowed to commit a larger capital infusion into its current alliance partner United Airlines). Also, even absent unilateral effects, the potential exists for carriers to reduce consumer welfare through coordinated interaction such as joint pricing. Thus, consolidation engendered by foreign ownership and control restriction liberalization could adversely impact consumers through increased fares or decreased service levels.

In practice, competition authorities have aimed to mitigate the potential for abuse in these situations (*e.g.*, the DOT's carve-out requirements in hub-to-hub markets as a condition for the grant of antitrust immunity).¹⁷³ Even given these potential adverse effects, however, consumers also stand to gain many efficiencies from consolidation that could arise from foreign ownership. Included are demand side efficiencies (*e.g.*, coordinated baggage handling, frequent flyer programs, and schedules), pricing efficiencies (*e.g.*, cross-border investment allowing airlines to become stronger and offer lower fares), and cost side efficiencies (*e.g.*, economies of scale).¹⁷⁴ Opponents of foreign ownership liberalization contend that international airline alliances that possess significant antitrust immunity such as Skyteam or the Star Alliance already accomplish these goals. However, deeper integration through foreign ownership would

¹⁷³ When alliance partner airlines apply to the DOT for antitrust immunity with respect to setting fares, the DOT often grants such immunity, with the exception of hub-to-hub routes where the only nonstop service that is provided between two cities is provided by the airlines seeking the coordinated pricing authority. Although, interestingly, the DOT and the DOJ differ on whether city pairs involving New York should be subject to carve-out in any circumstance, given that New York can generate substantial feed without being subject to domination. Joint Application of Delta Airlines, Inc., Docket OST-95-618 (June 14, 1996), *available at* <http://docketsinfo.dot.gov/general/orders/19962qtr/19962qtr.html>.

¹⁷⁴ See LELIEUR, *supra* note 3, at 64-65.

allow greater gains (*i.e.*, it would be easier to exploit economies of scale with the deeper integration of ownership). It is difficult to say which effects will dominate in the long run and what the impact of foreign ownership liberalization may be on consumer welfare. However, if history is any guide, when privatization and international liberalization have occurred in other industries, such as the energy and telecommunications sectors, prices have generally declined and quality of service has improved.¹⁷⁵

C. EFFECTS ON AIRLINE EMPLOYEES

The next group whose potential welfare may be affected by foreign ownership liberalization is airline employees. Traditionally, employees have strongly opposed foreign ownership liberalization because liberalizing foreign ownership restrictions could impose two broad categories of costs on airline employees.¹⁷⁶ One is a reduction in employment levels, and the other is the "cost" of integrating into a new firm and labor force.¹⁷⁷ The Air Line Pilots Association ("ALPA") has attempted to enumerate these costs.¹⁷⁸ With respect to the first, ALPA points out that increased foreign capital in U.S. carriers may lead to consolidation as described earlier, and that aircraft operating the long haul routes would all have foreign crews and force U.S. carriers to cut their international schedules.¹⁷⁹ Thus, the most likely place where U.S. carriers may cut schedules is in international service.¹⁸⁰ ALPA suggests that cuts in international service would be the most devastating for its members because these are the routes that pilots covet as a result of being able, first, to earn more money flying larger, widebody aircraft and second, to more easily satisfy their flying requirements on longer haul flights.¹⁸¹

Compelling as that argument may be, opponents to that position counter that with essentially free entry existing in the domestic market, airlines have sought to expand international service because it represents the best opportunity for profit. Thus, on the surface, it is unlikely that international services will

¹⁷⁵ Böhmann, *supra* note 14, at 715.

¹⁷⁶ LELIEUR, *supra* note 3, at 65-67.

¹⁷⁷ *Id.*

¹⁷⁸ *Hearing*, *supra* note 91 (statement of Duane Woerth, President, Air Line Pilots Association International).

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

be reduced in large enough proportion to cause significant job loss even accounting for some crew substitution.¹⁸²

Examining the possibility of consolidation more carefully, there are essentially two ways in which international service could be contracted: (1) if a foreign-owned company starts up a U.S. subsidiary or buys a U.S. carrier; and (2) if a code-sharing partner, such as Lufthansa, replaces a U.S. carrier such as United, on long haul routes. As to the first possibility, there are practical limits to the number of jobs that could be transferred. In order to offer service on an international route, an airline must have bilateral route authority. While this is certainly less of an obstacle today with the prevalence of open skies agreements, there are still many jurisdictions that do not have open skies agreements with the United States. Also, to transfer any route rights from one U.S. carrier to another would require DOT approval, and it is possible that the DOT may be hesitant to agree to a transfer of route rights from a U.S.-owned carrier to the U.S. subsidiary of a foreign carrier.¹⁸³ With respect to the second possibility of code sharing and transferring international routes to the foreign carrier (such as the case where United and Lufthansa would agree that Lufthansa would operate all long haul services), international service is simply too profitable to logically see a domestic U.S. carrier willing to cede its long haul operations to a foreign code sharing partner. In addition, the American Bar Association ("ABA") has offered two proposals to allay the concerns of U.S. labor. First, the ABA has suggested that any foreign carrier acquiring a U.S. carrier:

ensure that the U.S. airline maintains at least the percentage of the combined total ASMs [(available seat miles)] operated by both the U.S. airline and the foreign affiliates between the United States and any country or region that it had as of a date six months prior to the announcement of the acquisition.¹⁸⁴

The second ABA proposal involves protecting collective bargaining rights encouraging, "the U.S. government and the ap-

¹⁸² Indeed the recent example of Delta Airlines shifting widebody aircraft away from domestic U.S. services (mostly Atlanta-Florida) in favor of beginning services on nearly fifty new international routes. See Press Release, Delta's Transformation (Mar. 5, 2007), available at http://www.delta.com/about_delta/deltas_transformation.

¹⁸³ GEN. ACCOUNTING OFFICE, U.S. CONGRESS, AIRLINE COMPETITION—IMPACT OF CHANGING FOREIGN INVESTMENT AND CONTROL LIMITS ON U.S. AIRLINES 61–62 (1992).

¹⁸⁴ *Hearing, supra* note 91 (statement of Duane Woerth).

propriate foreign government(s) . . . [to] establish in advance a legal framework containing fair procedures to regulate labor representation and collective bargaining on such multinational airline systems."¹⁸⁵ Seemingly, any proposal to liberalize foreign ownership restrictions will have to include labor protective provisions to be politically feasible.

ALPA also contends that pilots and other workers would suffer job losses because U.S. labor laws do not apply to foreign air carriers.¹⁸⁶ U.S. air carriers are subject to the provisions of the Railway Labor Act,¹⁸⁷ originally passed in 1926 and amended in 1936, which provides workers far more protections and collective bargaining rights than workers are entitled to in many foreign jurisdictions (most notably in the airline industry—Singapore).¹⁸⁸ Hence, the argument of ALPA is that, by liberalizing foreign ownership restrictions, the U.S. would be inviting a "race to the bottom" with respect to worker protections because carriers could get around U.S. labor laws by becoming foreign and exempt. These arguments may be overstated because a U.S. carrier acquired by a foreign counterpart will almost certainly remain a U.S. flag carrier.¹⁸⁹ Also, because of public image reasons, the provisions of collective bargaining agreements, and U.S. immigration laws, carriers are unlikely to hire a much larger percentage of non-native workers than they do today.¹⁹⁰ The second set of potential effects occurs with the difficulties of integrating into a new firm.¹⁹¹ This is particularly true in the case of an airline because all crew assignments are largely done on the basis of seniority.¹⁹² Further complicating this is the fact that, with foreign investment, potential cultural differences would be even greater than in the case of domestic consolidation. Overall, it appears that some airline employees may stand to lose from liberalization, but the effects may not be nearly as pronounced as many employee representatives fear.

¹⁸⁵ *Id.*

¹⁸⁶ *Id.*

¹⁸⁷ 45 U.S.C. §§ 151, 182 (2000).

¹⁸⁸ *Hearing, supra* note 91 (statement of Duane Woerth).

¹⁸⁹ Retention of U.S. flag status is essential for being able to continue operating U.S. cabotage. Böhmman, *supra* note 14, at 690.

¹⁹⁰ See LELIEUR, *supra* note 3, at 66.

¹⁹¹ *Id.* at 67.

¹⁹² *Id.*

D. EFFECTS ON TANGENTIAL STAKEHOLDERS

The last category of relevant stakeholders consists of the individuals and groups associated tangentially with the airline industry. These arguments are traditional economic multiplier arguments in the sense that every dollar invested in an airline is multiplied to determine its actual impact on the economy at large. For example, if consumers buy airline tickets to travel to a location, that location's entire economy might be the beneficiary of an influx of consumption. Airlines that gain access to foreign capital will be able to expand operations where profitable. Doing so obviously increases the number of people that the airline will employ around the country such as ticketing agents, ramp workers, baggage handlers, etc., but this also has an impact on other employment. With greater air traffic in a particular city, an airport may see increased demand for retail stores, restaurants, etc. Furthermore, airports themselves benefit significantly from greater traffic because airports earn revenue from each ticket sold using a particular airport. Restrictions on foreign ownership negatively affect these interests. If a national carrier were to go bankrupt due to its inability to access capital, this could have a disproportionately negative impact on national tourism.¹⁹³ Also, absent restrictions, airlines could attain the capital they need to naturally run more efficiently, which benefits travelers, shippers, and the aggregate economy.¹⁹⁴ Indeed, the former president of the World Travel and Tourism Council has made calls for the airline sector to be liberalized from its bilateral straitjacket.¹⁹⁵ For these reasons, the pro-growth policy of liberalizing foreign ownership restrictions would work to benefit the aggregate national economy.

Most commentators believe that because of the tremendous benefits that airlines would reap, from an economic standpoint (disregarding security arguments for the moment), liberalization is very beneficial in the aggregate when all interested parties are considered collectively even though certain groups, such as airline employees, may be adversely impacted.

¹⁹³ See *id.* at 68.

¹⁹⁴ *Id.*

¹⁹⁵ G. Lipman, *Multilateral Liberalization—The Travel and Tourism Dimension*, 19 AIR & SPACE L. 152, 152 (1994).

IV. ANALYSIS OF SAFETY AND NATIONAL SECURITY CONSIDERATIONS OF FOREIGN OWNERSHIP AND CONTROL LIBERALIZATION

Having concluded that foreign ownership liberalization is likely a net positive from an economic standpoint, the seminal question is whether the potential security problems and costs that would arise from liberalization outweigh these benefits. Particularly in the wake of 9/11 and global terrorism, safety and security have taken on renewed importance in the foreign ownership and control debate. There are two dimensions to consider on these issues—the safety dimension and the national security dimension.

A. SAFETY CONSIDERATIONS

Dealing first with safety-related issues, a comparison to maritime law and a brief history aids in explaining why aviation safety would not be threatened by a relaxation of foreign ownership restrictions. The United States has always had very restrictive maritime laws—as Böhmman points out:

Vessel registration is governed by the Vessel Documentation Act of 1980. In order to qualify for a registration, a vessel must be owned by an individual who is a citizen of the United States or by an entity, all of whose members are citizens of the United States. Additionally, for vessels registered in the United States, only 25% of the unlicensed crew may be non-U.S. citizens, and only U.S. citizens may serve as high-level crewmembers, such as captains and officers.¹⁹⁶

Because of these stringent requirements, ship owners have looked to obtain “flags of convenience” to register their ships in lower cost jurisdictions.¹⁹⁷ This allows ship owners to avoid union labor costs, which can be a significant savings because crewing costs can be half of a ship’s total operational costs.¹⁹⁸ A second reason flags of convenience are popular is that many countries, such as Panama and Liberia, do not impose taxes on commerce that does not occur in the country.¹⁹⁹ This can be a huge tax savings for ship owners. Finally, flags of convenience became even more attractive following the 1986 Tax Equity and Reform Act, which compelled U.S. shareholders of a “controlled

¹⁹⁶ Böhmman, *supra* note 14, at 731.

¹⁹⁷ *Id.*

¹⁹⁸ *Id.* at 732.

¹⁹⁹ *Id.*

foreign corporation” to include all of their foreign base-company shipping income as income for U.S. income tax purposes.²⁰⁰ The original purpose of this measure was to provide an incentive to shippers to maintain U.S. flags, but in fact it had the opposite effect.²⁰¹ Subsequently, in the American Jobs Creation Act of 2004, Congress reversed course back to its pre-1986 position²⁰² so that “U.S. owners of foreign-flag ships [can now] defer current U.S. taxation of operating income that [i]s reinvested in shipping assets. These provisions allow[] U.S. ship owners to offset earnings from foreign operations against losses or investments in domestic operations.”²⁰³ Though some hope that the change will reverse the decline in U.S. flagships because it will allow the United States to compete with other jurisdictions that allow national-flag carriers to accumulate foreign base company shipping income tax free, the effect of this provision is far from certain. The relevant parallel, then, is whether aviation would experience a similar race towards flags of convenience if foreign ownership restrictions were relaxed; and if so, would this have adverse impacts on aviation security (essentially, would competition inspire a “race to the bottom”)?

Lelieur argues that aviation will not suffer a decline in safety standards if foreign ownership restrictions are relaxed for three reasons. “First, the aviation and the maritime sectors are quite different.”²⁰⁴ The bilateral regime in aviation restricts, and even prevents, mergers of cross-border airlines.²⁰⁵ The DOT closely examines the links between U.S. carriers and foreign interests whereas the U.S. Maritime Administration does not seem to be as concerned about the ownership situation of U.S. vessel operators that receive federal subsidies.²⁰⁶ Also, the aviation sector has traffic right restrictions which the maritime sector does not.²⁰⁷ Second, through the Chicago Convention²⁰⁸ and the Standards and Recommended Practices of the International Civil Aviation Organization (“ICAO”), aviation has an interna-

²⁰⁰ Tax Reform Act of 1986, Pub. L. No. 99-514, § 1221(c), 100 Stat. 2085.

²⁰¹ Böhmman, *supra* note 14, at 733.

²⁰² American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 415, 118 Stat. 1418.

²⁰³ Böhmman, *supra* note 14, at 733.

²⁰⁴ LELIEUR, *supra* note 3, at 83.

²⁰⁵ *Id.*

²⁰⁶ *Id.*

²⁰⁷ *Id.* at 84.

²⁰⁸ Convention Between the United States of America and Other Governments Respecting International Civil Aviation, Dec. 7, 1944, 61 Stat. 1180.

tional framework of uniform standards with respect to safety.²⁰⁹ Aviation retains the requirements that "a carrier's principal place of business be in the country which designates it; and that a carrier hold an Operator's Certificate from the country designating it."²¹⁰ Lelieur argues that because a clause exists in model bilateral agreements that allows a country to withdraw a carrier's operating permit if it fails to comply with international safety standards, aviation safety would not be endangered by further liberalization and relaxation of ownership restrictions.²¹¹ Finally, as a matter of evidence, despite the significant financial difficulties of U.S. carriers in recent years, safety records of U.S. civil aviation as a whole have improved during this period.²¹²

B. NATIONAL SECURITY CONSIDERATIONS

Shifting to national security, the discussion regarding the possible adverse effects of liberalizing foreign ownership restrictions centers largely on the impact on the Civil Reserve Air Fleet ("CRAF") program which is administered by the Department of Defense ("DOD") to ensure that, in a time of war, the U.S. armed forces have the aviation resources necessary to defend national security.²¹³ After describing the structure of CRAF, a comparison with the maritime counterpart program, the Voluntary Intermodal Sealift Agreement ("VISA"), would again be instructive. The DOD established CRAF in 1952 after determining that military airlift capability was insufficient for all contingencies.²¹⁴ In full operation, CRAF aircraft would airlift ninety-three percent of passengers and thirty-seven percent of cargo to a military operation.²¹⁵ To ensure this capability, the DOD enlists the equivalent of 120 Boeing 747-100 cargo planes and 136

²⁰⁹ LELIEUR, *supra* note 3, at 84.

²¹⁰ *Id.* at 85.

²¹¹ *Id.*

²¹² Having stated this, it is important to acknowledge that many countries outside of the United States and Western Europe do not meet international safety standards and that allowing these countries to invest in U.S. carriers may be problematic. See *id.* at 82-83. However, the FAA and the DOT will inspect all U.S. flag carriers regardless of ownership. *Id.* at 83-84. If there are still safety concerns, one possibility is to limit foreign investment and control of U.S. carriers to entities from the International Aviation Safety Assessments Program ("IASA"), the International Air Transport Association ("IATA"), or ICAO-approved countries. This should not be necessary.

²¹³ *Id.* at 86.

²¹⁴ *Id.*

²¹⁵ BRATTLE GROUP, THE ECONOMIC IMPACT OF AN EU-US OPEN AVIATION AREA 7-2 (2002).

Boeing 747-400 passenger jets.²¹⁶ In actuality, approximately forty air carriers participate in the program and have committed approximately 900 aircraft.²¹⁷

There are three stages of CRAF activation—Stage I is minor regional conflicts, Stage II is major regional conflicts, and Stage III is presidentially declared national emergency (which has never been activated).²¹⁸ The benefit to participating carriers is that it guarantees them the very valuable peacetime business of the DOD and also enables them to bid by “city pair” (*e.g.*, New York-Los Angeles) for the business of the rest of the government through the General Services Administration (“GSA”).²¹⁹ The functioning of these beneficial programs could potentially trump any other argument made in favor of (or against) liberalizing ownership restrictions. In other words, the DOD and GSA programs may well be so valuable as to alone induce participation in CRAF by foreigners who either buy control of U.S. airlines or establish their own U.S. flag airlines under U.S. law.

The potential argument that liberalizing foreign ownership restrictions would be adverse to the effective functioning of CRAF is that the United States would have substantially less leverage over a foreign-owned U.S. carrier relative to an American-owned U.S. carrier in a case of non-compliance with CRAF obligations. In the case of an American-owned U.S. carrier, the DOT could revoke the non-compliant carrier’s operating certificate.²²⁰ It could also utilize the Defense Production Act²²¹ to seize its aircraft.²²² Also, it could sue the corporate officers of the carrier and members of its board of directors for breach of contract.²²³ In contrast, in the case of a foreign owner buying or creating a U.S. carrier, while all of these statutory remedies would still be available, it is argued that U.S. action might be limited due to diplomatic concerns with the national governments of the foreign owners involved.²²⁴ Whether this argument has merit, it is important that any liberalization be structured in such a way as to afford the U.S. government at

²¹⁶ *Id.*

²¹⁷ *Id.* at 7-3.

²¹⁸ *Id.*

²¹⁹ *Id.* at 7-4. For a more elaborate primer on the functioning of CRAF, see *id.*

²²⁰ *Id.* at x.

²²¹ Defense Production Act of 1950, Pub. L. 81-774, 64 Stat. 798 (as amended by Exec. Order 10,219 creating CRAF).

²²² BRATTLE GROUP, *supra* note 215, at x.

²²³ *Id.* at 7-9.

²²⁴ See *id.*

least the same amount of control over foreign-owned U.S. carriers as over U.S.-owned carriers.

Perhaps more interesting and difficult than the issue of non-compliance with CRAF obligations is a potential scenario in which an independent minded foreign investor decides to buy or create a U.S. carrier and not join CRAF. While it may be economically unwise for a foreign investor to ignore the benefits of the peacetime business of the U.S. government, there are a few potential solutions to this theoretical possibility. The first is to allow the DOT to make participation in CRAF a prerequisite of obtaining an operating license and registering aircraft in the United States. This suggestion is less than appealing because free market economic principles dictate that private enterprises in the United States be given maximum choice in commercial decisions. Second, the government will always have the ability to commandeer aircraft. This option is questionable for the same reason as the first option. Additionally, this could create negative political consequences with other nations if disputes arose regarding the fulfillment of CRAF obligations by foreign-owned carriers. Finally, the DOD could simply buy aircraft. However, given that the upkeep of the program would cost nearly \$3 billion annually²²⁵ and the CRAF resources have only been deployed on one previous occasion (the Persian Gulf War),²²⁶ this seems like an inefficient use of government resources. It is important to remember that this discussion may, in fact, be moot because the most likely way in which foreign interests would enter the U.S. aviation market is by establishing U.S. subsidiaries and voluntarily joining CRAF because of aforementioned economic incentives of participating in CRAF.²²⁷ Moreover, together with the threat of immediate license revocation by the DOT in the event of non-compliance with CRAF obligations, it is doubtful that the U.S. government should have any real fears with respect to CRAF unavailability.

Adding further credence to the fact that CRAF would not be adversely impacted by liberalizing foreign ownership restrictions is evidence from the maritime arena. The DOD essentially allows participation by *de facto* foreign-owned commercial vessels in the VISA program, the maritime equivalent of CRAF.²²⁸ VISA

²²⁵ *Id.* at 7-2.

²²⁶ *Id.* at 7-3.

²²⁷ *Id.* at 7-10.

²²⁸ *Id.* at 7-12.

was established in 1997 and is jointly administered by the DOD and DOT's Maritime Administration.²²⁹ It operates in essentially the same way as CRAF, in a program where, in exchange for being able to enlist an organic fleet in a time of national emergency, the U.S. government provides subsidies and preference in its shipping to VISA participants.²³⁰ The 1996 Maritime Security Act²³¹ provides that Maritime Security Program ("MSP") contracts to operate U.S. flag vessels go to either "Section 2" or "documentation" citizens.²³² Requirements for a "Section 2" citizen include: "incorporation in the United States;" no more "non-U.S. citizens than would constitute a minority of a quorum"; the "Chairman and CEO must be U.S. citizens;" and "U.S. citizens must hold majority ownership."²³³ The requirements for a documentation citizen are the same "except that there is no U.S. majority ownership" requirement.²³⁴ As almost all U.S. shipping firms that operate in the foreign trades today were sold to foreign owners in the late 1990s, these foreign owners sought permission to operate all of their shipping lines as documentation citizens rather than setting up U.S. citizen intermediaries.²³⁵ Initially led by Maersk, a coalition of foreign shipping companies has convinced DOD that the effectiveness of VISA would not be compromised by allowing these companies to operate as documentation citizens.²³⁶ General John Handy stated:

[MSP] provides the security we, as a nation, must have to . . . go it alone. . . . While foreign companies dominate the world maritime market, MSP ships sail under the U.S. flag, are crewed by U.S. mariners, are operated by U.S. companies, and are subject to U.S. laws. . . . Currently, MSP comprises both Section 2 and Documentation Citizens. Both . . . must execute the same contingency contracts with DOD committing vessels to VISA Stage III and thereby assuring us we will have access to their vessels. . . .

²²⁹ *Id.*

²³⁰ *Id.*

²³¹ Maritime Security Act of 1996, Pub. L. No. 104-239, 110 Stat. 3118.

²³² BRATTLE GROUP, *supra* note 215, at 7-12.

²³³ *Id.*

²³⁴ *Id.* at 7-13.

²³⁵ *Id.*

²³⁶ *Id.*

As a warfighter, my requirements are met by both Section 2 and Documentation Citizens.²³⁷

Given this clear statement, there can be no doubt that liberalization has worked in maritime, and there is no reason why it ought not also work in aviation provided the proper safeguards are retained to ensure proper functioning of the CRAF program. Furthermore, the economic benefits of remaining loyal to the program are probably sufficient alone to seriously discourage breach. Hence, unless the DOD has some explanation not generally known, or unless the DOD wishes publicly to assert a position on those issues which it has not asserted to date, national security justifications should not stand in the way of economically beneficial ownership liberalization in aviation.

V. CONCLUSION

On balance, liberalizing foreign ownership restrictions appears to be very beneficial in the aggregate because while some stakeholders, such as airline employees, could be adversely affected by liberalization, the benefits accruing to other stakeholders, most notably airlines themselves, appear to far outweigh the losses. Furthermore, to the extent that U.S. employee concerns are at issue, labor protective provisions could be adopted to lessen or eliminate the potential losses. Moreover, the U.S. government has enough leverage through economic incentives and assurances through international safety regulations to allay possible safety and security concerns. Ultimately, recent cases such as *DHL*, *Virgin America*, and *Hawaiian* leave unclear the DOT's precise stance on the issue of effective control and ownership in the aviation arena. To be sure, the DOT's proposed rulemaking, since abandoned, seems to indicate that the Department would welcome liberalization and additional sources of capital for the U.S. airline industry. Though the economic arguments on balance seem to indicate that relaxing the restrictions on the foreign ownership of airlines would be beneficial, many in Washington still remain hesitant, more than likely due to fears over national security issues. However, the experience in the maritime arena and the existence of significant economic incentives seem to indicate that these concerns can be more than adequately met if CRAF is managed properly.

²³⁷ *Reauthorization of the Maritime Security Program: Hearing Before the H. Comm. on Armed Servs.*, 107th Cong. 3 (2002) (statement of General John W. Handy, U.S. Air Force).

It is unclear when or how this debate will resolve itself. Indeed, now that an agreement has been reached with the European Union concerning a US/EU Open Skies Agreement, the issue could, once again, fall to the backburner since one of the main arguments made in favor of easing the restrictions was that doing so would help to further open skies negotiations with the Europeans. However, given the current state of the U.S. airline industry and continuing U.K. demands, this outcome is unlikely.²³⁸ Independent of the European Open Skies deal, the foreign ownership restrictions should be relaxed because of the substantial economic benefits that would accrue to U.S. stakeholders.

²³⁸ The U.K. position is that traffic rights could be withdrawn after the Second Stage, whether unilaterally by an individual Member State or through suspension of the Agreement as a whole, if U.S. domestic market access through cabotage or reform of ownership and control laws has not been achieved.

