2002

Prospects for Changing Airline Ownership Rules

Yu-Chun Chang

George Williams

---

Follow this and additional works at: https://scholar.smu.edu/jalc

Recommended Citation
https://scholar.smu.edu/jalc/vol67/iss2/2

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in Journal of Air Law and Commerce by an authorized administrator of SMU Scholar. For more information, please visit http://digitalrepository.smu.edu.
PROSPECTS FOR CHANGING AIRLINE OWNERSHIP RULES

Yu-Chun Chang*
George Williams**

I. INTRODUCTION

IT IS PERHAPS reasonable to wonder that if the United States can achieve the goal of liberalizing air services with other countries through ‘Open Skies’ policies, whether there is any real likelihood that its airline ownership rules will be relaxed?

A key reason why foreign ownership rules remain in place is that they protect national airlines. In doing so, they also limit the strategies available to governments whose flag carriers are in difficulties. This was the situation the Philippine government found itself in 1998 when Philippine Airlines halted most of its flights due to a financial crisis. The option to designate another country’s airline to fly in place of Philippine Airlines was not

* Yu-Chun Chang, Air Transport Group, College of Aeronautics, Cranfield University.
Ms. Yu-Chun Chang completed her Ph.D. in Air Transport at the College of Aeronautics, Cranfield University in March 2002. She has a Master’s in Transport Engineering and Management from National Taiwan University. Her research interests are airline ownership rules, airline strategy and air transport policy. Before joining Cranfield, she was a researcher at the Institute of Transportation, Ministry of Transportation and Communication, Taiwan for five years.

** George Williams, Air Transport Group, College of Aeronautics, Cranfield University.
Dr. George Williams is a Senior Lecturer in Air Transport at the College of Aeronautics, Cranfield University. A transport economist, by profession, he has written a number of articles and books exploring the impact of deregulation on the airline industry. He has led major studies into airline service and airport provision in the domestic markets of Norway and Spain for the respective Civil Aviation Authorities of these countries. He has also been involved in research undertaken for the European Commission, Government departments, airlines and airport authorities. In 1998, he was appointed Special Adviser to the U.K. House of Lords European Communities Committee enquiry into the Commission proposals to extend its powers to apply existing competition provisions to air services between the EU and third countries.
possible. Even if a foreign airline had taken the majority shareholding of Philippine Airlines, the problem would still have remained. The only way this would work is if the bilateral partners had been willing to amend the nationality clauses in their Air Services Agreements ("ASAs").

Nationality clauses often work against the interests of less developed countries, especially those faced with economic crises (like those in Asia in 1997). In such countries, there are usually very few individual investors or organizations with sufficient capital to invest in a relatively risky enterprise such as an airline. One option for these countries is to sell their airlines to foreign investors, a policy that has been pursued by Korea, Malaysia, and China. However, as most countries restrict foreign shareholdings to less than 50% due to the nationality clauses contained in ASAs, they are unable to get the large financial injections they need.

Most countries have favored privatization of their national airlines, with the prospect of reducing financial dependency and enhancing efficiency. Governments have often stated that they find the financing of their airlines' expansion difficult. Most also believe that their airlines will perform more efficiently and will be able to adapt to change more quickly under private ownership. Without a change in the ownership and effective control restrictions contained in bilateral ASAs, however, foreign investors will not be interested in purchasing majority shareholdings in airlines.

Not all countries are in favor of allowing their national airlines to be owned by foreign interests. For states that are heavily dependent on high value tourism and have established national airlines, there is a danger that they would lose the ability to directly influence the pace at which their tourist sectors will develop.

Professor Wassenbergh has commented "State-interest in aviation is based on State sovereignty over the national air space and the total control of foreign access to the national market. That sovereignty represents money and status." Some countries, with strong economies and successful, well-established, national airlines have been strong advocates of liberalization, while others in less advantageous positions have been fearful of the consequences. The pressures for change that deregulation has

---

unleashed have affected all carriers virtually irrespective of their own governments’ stance. Airlines have little choice but to seek structural adjustments in order to survive in the new millennium.

II. THE U.S. PERSPECTIVE

Since January 1991, seven large U.S. airlines have declared themselves bankrupt, four of them ceasing operations. These bankruptcies have raised congressional concerns about the effects of industry consolidation on domestic and international competition. In 1992, the United States General Accounting Office (“GAO”) undertook research to provide information on the effect of restrictions on foreign investment in U.S. airlines by analyzing the potential impact of relaxing them.

In its report, the GAO stated that foreign investments played an important role in the U.S. economy. Improving access to the world’s capital markets for U.S. airlines by relaxing the current restrictions on foreign investment and control could help them fund the investments they needed to remain viable competitors. However, the U.S. government, concerned that some foreign airlines are still subsidized by their home governments, expressed the view that a foreign carrier could potentially pass on its subsidies to a U.S. airline partner. Moreover, relaxing the restrictions would have implications for U.S. airline employees and the Federal Aviation Authority’s safety engineers and inspectors. The concern of the Department of Defense (“DOD”) for the Civil Reserve Air Fleet (“CRAF”) program provides another powerful reason for not amending the tight ownership restrictions.

In 1992, the United States succeeded in negotiating its first ‘Open Skies’ Agreement with the Netherlands. It later established a series of ‘Open-Skies’ bilaterals in 1995, beginning with

---

2 Braniff, Eastern, Midway, and Pan American ceased operations; three more major airlines, America West, Continental and Trans World, reorganized under court protection.
4 Id. at 12.
5 Id. at 2.
6 Id. at 4.
7 See id. at 4-5.
Switzerland, followed by Sweden, Norway, and Luxembourg. As of November 8, 2001, it had established ‘Open Skies’ Agreements with fifty-six countries around the world. With such a significant number of bilaterals, each of which permits unlimited fifth freedom operations and third country code-sharing, U.S. airlines have an advantage over other carriers. For example, the U.S. government has established ‘Open Skies’ agreements with Singapore and Taiwan. While third and fourth freedom rights between Singapore and Taiwan are still limited by the Taiwan-Singapore bilateral agreement, U.S. carriers already have unlimited frequency between the two countries, as a result of combining their unrestricted fifth freedom rights from Taiwan and Singapore respectively. Indeed, U.S. carriers already have unlimited third and fourth freedom rights between any two countries that have signed ‘Open Skies’ agreements with the U.S., effectively giving them seventh freedom rights. Thus, providing the U.S. government is able to establish a large enough number of ‘Open Skies’ bilateral agreements, there would appear to be little incentive for it to make its foreign ownership rules less restrictive.

III. THE EU PERSPECTIVE

While U.S. carriers have been able to strengthen their positions by merging with other domestic carriers, leading to huge domestic networks, airlines in Europe, Asia, and Latin America are unable to grow in this way. When British Airways was keen to merge with KLM last year, the economic advisor, Dorothy Robyn, said at the International Aviation Club in Washington DC, “If KLM comes under the effective control of BA while Bermuda II still governs US-UK air services, KLM will immediately lose the benefits of the US-Netherlands ‘Open Skies’ agreement.”

---

11 Id.
12 Id.
14 Id.
Even though the ownership rules have been relaxed within the single European market, most non-EU countries have yet to accept the changes. Thus, while Deutsche BA in Germany, the fully owned subsidiary of British Airways, has automatic traffic rights on any intra-EU route, it cannot, as a British-owned airline, fly from its base in Munich to Warsaw while the Germany-Poland bilateral agreement contains a national ownership requirement.

Of Europe’s three largest countries, only Germany and France have signed ‘Open Skies’ agreements with the United States. As for the U.K., attempts to reach a more liberal version of Bermuda II continue. Where the European Commission is concerned, it awaits a mandate from the Council of Ministers to negotiate EU route rights with third countries. It has consistently argued that the ‘Open Skies’ Agreements between the U.S. and individual Member States have resulted in a fragmentation of the common aviation market and therefore infringe EU law.

In September 1999, the idea of forming a ‘Transatlantic Common Aviation Area’ ("TCAA") with the U.S. was put forward by the Association of European Airlines ("AEA"). As part of such an arrangement, airline ownership rules and rights of establishment would be harmonized along the lines of the EU Third Package. While the idea has strong support in Europe, from both the airline industry and some governments, it seems that the U.S. has no intention to join a TCAA given the size of its domestic market and the outcomes of its ‘Open Skies’ policies. Michael Whitaker, vice president for international and regulatory affairs at United Airlines, stated that “the AEA paper was a wrong approach as it reflected European regulatory thinking.”

16 DOT, supra note 10.
19 Trevor Soames, UK Air Transport in the Context of Europe, presented at the EU Policy and Programme (June 1, 2000).
21 Id.
IV. THE ASIA-PACIFIC PERSPECTIVE

The Asia-Pacific Economic Cooperation ("APEC") is the most important organization to liberalize Air Services in the region. Eight options for establishing more competitive air services with fair and equitable opportunity for all member economies were identified at its Air Services Group ("ASG") meeting in Singapore in October 1995.\textsuperscript{23} The first option concerned air carrier ownership and control.\textsuperscript{24} The ASG undertook a survey of APEC economies' policies and practices on the issue in 1998 and found that most countries required their national airlines to be substantially owned and effectively controlled by their own nationals.\textsuperscript{25} It also noted that in June 1997, the ICAO Air Transport Panel had recommended the nationality clauses in ASAs be replaced by a requirement that any designated airline should have its principle place of business in the territory of the designating State.\textsuperscript{26} The ASG, therefore, recommended that APEC economies give consideration to relaxing their ownership and control requirements on a case-by-case basis when considering designations made by their bilateral partners.\textsuperscript{27} It was suggested that the ICAO formulation could be used as a guide/option.\textsuperscript{28} The recommendation was categorized as being of medium priority.\textsuperscript{29}

In addition, in order to gradually liberalize air services APEC-wide, the formation of a 'Plurilateral Club' among like-minded economies was proposed.\textsuperscript{30} It was put forward that any three or more like-minded APEC member economies could initiate cooperative arrangements between and amongst themselves, so as to accelerate the liberalization of air services within the region.\textsuperscript{31} The most important suggestion was that if countries felt they

\textsuperscript{24} Id.
\textsuperscript{25} Id.
\textsuperscript{26} Id.
\textsuperscript{27} Id.
\textsuperscript{28} APEC, supra note 23.
\textsuperscript{29} Id.
\textsuperscript{31} Id.
were not yet ready to join the club, they would be able to at a later date.\textsuperscript{32}

In November 2000, a multilateral ‘Open Skies’ agreement was reached between the U.S., Brunei, Chile, New Zealand, and Singapore at a meeting of the APEC group in Brunei.\textsuperscript{33} The key differentiating feature of this multilateral agreement involves the traditional airline ownership requirement being substantially liberalized, thus enhancing foreign carriers’ access to outside investment.\textsuperscript{34} It is the first time that the U.S. Government has signed such an agreement, and if it were to adopt this approach with all its ‘Open-Skies’ partners, it would represent a most effective way of bringing about change in airline ownership rules.\textsuperscript{35} The relevant article concerning designation and authorization states that: “(a) effective control of that airline is vested in the designating Party, its nationals, or both; (b) the airline is incorporated in and has its principal place of business in the territory of the Party designating the airlines.”\textsuperscript{36}

Only nine days after signing the agreement however, the U.S. Department of Transportation ("DOT") announced a Show-Cause Order amending the airline foreign ownership rules contained therein.\textsuperscript{37} The DOT plans to monitor the level of U.S. ownership in the airlines from the other four participating countries by requiring these carriers to notify the agency thirty days in advance of any five percent change in their shareholdings.\textsuperscript{38} Although official translations of the agreement are proceeding, no signing date has been scheduled.\textsuperscript{39} The governments and airlines involved say that the proposal is unworkable because publicly traded companies cannot know a month in advance about share sales by their stockholders.\textsuperscript{40}

\begin{itemize}
  \item [\textsuperscript{32}] Id.
  \item [\textsuperscript{34}] Id.
  \item [\textsuperscript{35}] Id.
  \item [\textsuperscript{36}] Id.
  \item [\textsuperscript{39}] Id.
  \item [\textsuperscript{40}] Id.
\end{itemize}
mation Technology said that the DOT's proposal "kind of makes it difficult to go ahead and sign the agreement." Fortunately, after receiving the responses from related organizations, the DOT decided to modify the order on 18 January 2001.

V. CONCLUDING COMMENTS

The EU was the first region in the world to remove the nationality clauses in Air Services Agreements. While cross-border mergers and acquisitions increased following the Third Package, they have been nothing like the scale witnessed in the U.S. since its domestic market was deregulated. The European market is not large enough to sustain so many 'national' airlines. The formation of a common aviation market with the U.S. could help to overcome this situation. However, there would appear to be little incentive for the U.S. to change its ownership rules and develop a TCAA with the EU. It would appear though that the U.S. is keen to take the lead in APEC, obtaining benefits from the Asia-Pacific market through its 'Open Skies' bilateral agreements.

There is a well-established trend towards global alliances in the airline industry, with mega-carriers waking up to the fact that the aviation market in Asia-Pacific is both large and rapidly expanding. Presently, foreign involvement in the region is relatively small, but it is growing. Equity investment in carriers based in the APEC countries may help in the development of strategic alliances. As IATA's director general, Pierre Jeanniot said at the organization's last annual meeting held in Sydney: "The answer to the challenge of globalization is to encourage flexible and increasingly liberalized developments by like-minded groups of nations and airlines." It may, therefore, be expedient for the EU to look to the Asia-Pacific region to find an alternative way of establishing a Common Aviation Area and in the process help European carriers expand their markets.

41 Id.
