The Ownership and Control Requirement in U.S. and European Union Air Law and U.S. Maritime Law - Policy; Consideration; Comparison

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THE OWNERSHIP AND CONTROL REQUIREMENT
IN U.S. AND EUROPEAN UNION AIR LAW
AND U.S. MARITIME LAW—POLICY;
CONSIDERATION; COMPARISON

Kirsten Böhmann*

I. INTRODUCTION

THE NATURE of international trade has significantly changed over the last decades. Government-imposed barriers to the free trade of goods and services have been reduced, and that has contributed to the development of a unified global market economy. Considering the increasing importance of services, many nations are trying to enhance their participation in the free trade of services, particularly in the international air services market.

For decades, many countries owned and controlled their national airlines, mainly for reasons of national prestige and security. They viewed their “national air carriers” as vital to their national economic interests and, consequently, they supported and sustained their aviation industry. Many states maintained state-owned carriers that operated unprofitably and required subsidization. In order to protect national airlines, many countries were reluctant to open their domestic commercial air routes to foreign competition. However, more and more European countries have begun wholly or partially to privatize their national carriers¹ and to liberalize their markets. Similarly, the United States deregulated its domestic air transportation market

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¹ For example, British Airways and Lufthansa have been completely privatized, while Air France, Alitalia, Sabena, and Iberia have been partially privatized, mainly because of the high pressure on state-aids exercised by the European Commission.
in 1978 to promote competition and, as a result, to provide better services and lower air fares for the American consumers.\(^2\)

Ownership requirements, often also called citizenship or nationality requirements, refer to two different levels of air transportation, namely domestic air services within a country ("cabotage")\(^3\) and international air carriage. The vast majority of countries traditionally reserve their respective domestic market for national carriers. The United States has maintained strict foreign investment restrictions on industries that are important for the infrastructure, such as broadcasting, electric and nuclear power, as well as aviation and shipping. Similarly, the European Union ("EU") limits the investments of third countries in Community carriers. The current international regime consists of bilateral agreements with the general idea that only "flag carriers" that are substantially owned and effectively controlled by the designating state and/or its nationals can be designated to exploit their country's traffic rights.

Despite the worldwide liberalization of the aviation market, ownership requirements in national laws and bilateral air services agreements still remain and present an obstacle to the further opening of the aviation markets and, hence, a barrier to the free flow of international trade. While the rest of the corporate world pursues cross-border mergers and acquisitions, the aviation industry is tied up by these decades-old ownership laws that prevent airlines from merging.

Nevertheless, the international airline community favors the cooperation of airlines, which could well have an effect on the nationality of any of the airlines involved in such cooperation. As long as the international aviation market was dominated by restrictive bilateral agreements, predetermining capacity and frequency, ownership requirements did not create any particular problems. The liberalization and deregulation of the international air services market, however, allowed the increase of international competition and the desire of many air carriers to cooperate with foreign carriers in any given form. The uncertainty created by ownership requirements and nationality clauses in bilaterals has caused concerns as to whether these provisions will impede the economic need for liberalization and


\(^3\) Cabotage is commonly defined as carriage of passengers or goods between two points within the territory of same nation for compensation or hire.
industry restructuring, namely substantial investments in foreign carriers and the merger between carriers.4

This article discusses the different ownership and control requirements in the aviation sector in the United States as well as in the European Union. It gives an overview of the historical background of ownership and control requirements in international aviation. The article then outlines the statutory ownership and control requirements both in the United States and in the European Union. It particularly focuses on the notion of 'control' in both systems and whether any numerical differences actually lead to different practical results. The article also analyzes the external relationships of the United States and the EU Member States, which are still governed by bilateral air services agreements and heavily affected by nationality clauses. In its second part, the article examines the ownership requirements in U.S. maritime law in order to show potential similarities or differences between the maritime and aviation legal schemes.

II. AVIATION

A. HISTORICAL BACKGROUND OF OWNERSHIP REQUIREMENTS

In order to understand ownership requirements and the position the United States and the European Union take, it is important to be aware of how ownership requirements have emerged and developed in the legal regime of domestic and international air services.

1. Chicago Convention

The Chicago Convention on International Civil Aviation, signed in Chicago on December 7, 1944 ("Chicago Convention"5), established the basic rules for international civil aviation. Article 16 of the Convention established the principle that "every State has complete and exclusive sovereignty over the airspace above its territory."7 Article 7 of the Chicago Convention recognizes that each nation has a right to reserve for its national

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4 See H. Peter van Fenema, Ownership Restrictions: Consequences and Steps to be Taken, 28 AIR & SPACE LAW 63 (1998).
6 See id. at 296.
7 The principle of sovereignty was already mentioned in the Convention of the Regulation of Aerial Navigation ("Paris Convention"), Oct. 13, 1919, 11 L.N.T.S. 173.
airlines the carriage of passengers, mail, or cargo transported for compensation between two points within its territory. Thus, each nation may reserve its domestic traffic (cabotage) to domestic carriers. Article 17 of the Chicago Convention attributes to every aircraft a particular nationality, namely, the nationality of its place of registry. Although Article 17 does not directly address the question of who may own aircraft, it makes clear that the Convention considers commercial air services closely linked with a particular "home country" that has a particular "flag carrier." The Chicago Convention thereby implicitly approves a nation's right to establish citizenship requirements for its airlines.

On the other hand, the Chicago Convention did not establish an international regulatory body and also did not grant traffic rights for international scheduled air services. Although certain rights are contained in the International Air Services Transit Agreement, there is no multilateral agreement on international commercial air traffic rights. The concept of sovereignty over national airspace established by the Chicago Convention, therefore, forced the development of a bilateral system, in which airlines must rely on bilateral agreements to determine traffic rights, capacity, and frequency of services.

2. Bilateral Agreements

The vast majority of international scheduled flights are regulated by bilateral air transport agreements, which are generally made by executive agreements, treaties, or exchanges of diplomatic notes. In the United States, bilateral air transport agreements have the status of executive agreements, which are signed

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8 Article 17 of the Chicago Convention states "aircraft have the nationality of the State in which they are registered." Chicago Convention, supra note 5, at art. XVII, 15 U.N.T.S. at 308.

9 See Joachim Rosengarten and Klaus-Dieter Stephan, The Licensing of German Air Carriers in Germany under Regulation 2407/92, 23 AIR & SPACE LAW 67, 133 (1998).


11 International Air Services Transit Agreement, opened for signature Dec. 7, 1944, 84 U.N.T.S. 389 (granting the first and second Freedoms of the Air, the privilege to fly across over foreign territory without landing and to land for non-traffic purposes). Today, 100 countries are members of the Agreement. See German Federal Gazette (BGBl.) 1998, II-254.

12 E.g., Germany is party to 110 bilateral air transport agreements, and a similar number is true for many other countries.
by the president without requiring congressional ratification.\textsuperscript{13} Bilateral agreements used to follow a model, in particular the model of the so-called Bermuda Agreement. In 1946, the United States and the United Kingdom entered into a bilateral air transport agreement, commonly known as “Bermuda I,”\textsuperscript{14} which for the next 30 years served as the model for the United States and other countries in negotiating bilateral air transport agreements. After the United Kingdom denounced Bermuda I in 1976, a more restrictive agreement between the United States and the United Kingdom became effective, known as “Bermuda II”\textsuperscript{15}—which, however, was never as influential as Bermuda I.\textsuperscript{16}

It is a general concept of bilateral agreements that only carriers that are designated by the respective contracting party can exercise and exploit the traffic rights granted in the bilateral agreement. In addition, airlines must have a clear national identity in order to use the traffic rights of a state. Since the mid-1940s, almost all bilateral air transport agreements, including the Bermuda agreements, contain nationality clauses that follow the model of the IASTA (International Air Services Transit Agreement), which addressed the issue of airline nationality. It reserves the right of a contracting state to withhold or revoke the certificate or permit of an airline of another state in any case where the contracting state “is not satisfied that substantial ownership and effective control are vested in nationals of [the other] State.”\textsuperscript{17}

Thus, the nationality of the air carrier guarantees that each state gets, or at least has the possibility to get, its own share of the market, with no third parties being allowed to benefit from


\textsuperscript{14} Agreement Between the Government of the United States of America and the Government of the United Kingdom Relating to Air Services Between Their Respective Territories, Feb. 11, 1946, U.S.-U.K., 60 Stat. 1499 [hereinafter Bermuda I].

\textsuperscript{15} Agreement Between the Government of the United States of America and the Government of the United Kingdom Relating to Air Services Between Their Respective Territories, July 23, 1977, 28 U.S.T. 5367 [hereinafter Bermuda II]. Bermuda II restricted capacity and significantly reduced U.S. air carriers’ fifth-freedom rights.

\textsuperscript{16} Basically, bilateral agreements consist of three principles: (1) bilateral exchange of traffic rights, (2) rights are only granted on a reciprocal basis, and (3) fair and equal opportunities for each contracting party.

\textsuperscript{17} International Air Services Transit Agreement, Dec. 7, 1944, Art. I, § 5, 84 U.N.T.S. 389, 394.
the bilateral exchange of traffic rights. Therefore, as a general rule, it is impossible for an air carrier under the currently prevailing bilateral regime to sell a majority of its shares to a foreign carrier and still qualify as a designated air carrier of its state, or to buy a majority share of a foreign air carrier and to exploit the traffic rights of the acquired carrier. The nationality clause establishes a link between the air carrier using international commercial rights and the state designating these rights, thereby implementing a balance of benefits and preventing a situation of non-reciprocal benefits. The practice of entering into bilateral agreements with reciprocal nationality clauses remains current. As a result of this regime, a situation has emerged where all major carriers are either state-owned or owned by a majority of their home country's nationals. Moreover, by adopting bilateral provisions on ownership and control the contracting states are able to prevent the development of "flags of convenience" in international air transport, i.e., the registry of an aircraft in a country with less burdensome regulations, which is very common in the maritime sector.

3. Current U.S. Policy

A major task of the Clinton administration is to establish worldwide open-air transport markets on the basis of Open Skies agreements. "Open Skies" is a model set of provisions set forth by the Department of Transportation (DOT), which the United States currently uses in negotiating bilateral agreements with other nations. An Open Skies agreement may provide for open entry on all routes to the U.S. market and vice versa, unrestricted capacity and frequency, flexibility in pricing, and code-sharing opportunities. The United States has incorporated the elements of its Open Skies concept in several bilateral agreements with members of the European Union, such as the Netherlands, Germany, Italy and Portugal, and is seeking

19 An exception is carriers with a multinational ownership, involving ownership by several governments. These are designated as national carriers by the different countries and accepted as such by those countries that have bilateral agreements with the owning countries. Examples are Gulf Air, Air Afrique, LIAT, and SAS, which have a fictitious "Scandinavian" nationality.
20 See infra § VI(A)(2).
to export its deregulation policy worldwide. Since the bilateral agreements are all based on the DOT's notion of "Open Skies," they show a great similarity and, therefore, the U.S.-European air services market can be described as a relatively unified regime.

However, the DOT refused to include provisions in its Open Skies definition that would promote the liberalization of foreign investment or cabotage restrictions. It determined that these matters are governed by statute, which can only be amended by Congress. The reluctance of the United States to relax its ownership requirements, i.e. its foreign investment and cabotage laws, has caused the failure so far of the bilateral negotiation between the United States and the United Kingdom who have been unable to reach an Open Skies agreement.

B. OWNERSHIP REQUIREMENTS IN THE UNITED STATES

1. Ownership Requirements in the Cabotage Laws

Despite its efforts to liberalize air services markets generally, the United States continues both to protect its domestic aviation industry against significant foreign control and to preclude foreign air carriers from obtaining cabotage rights. Congress first enacted citizenship requirements for U.S. carriers in the Air Commerce Act of 1926, which provided that an aircraft could be registered in the U.S. only if owned by U.S. citizens. The Act


26 As of April 2000, the United States has concluded forty-one Open Skies agreements. The latest of these agreements was concluded with the Slovak Republic. See Department of Transportation, United States, Slovak Republic Reach First Open Skies Agreement of the 21st Century, Jan. 10, 2000, available at <http://www.dot.gov/affairs/2000/dot0700.htm>.


28 See Open Skies, supra note 21, at 12.
clarified that U.S. citizens must control a minimum of 51% of the voting interest and that the air carrier's president and at least two-thirds of the carrier's board members must be U.S. citizens. The Civil Aeronautics Act of 1938 increased the minimum percentage of voting equity required to be held by U.S. citizens from 51% to 75%. The Civil Aeronautics Act was based on the Shipping Act of 1916, which already required 75% U.S. citizen ownership.

Congress' purpose in limiting foreign investment in U.S. carriers was primarily one of national defense. In 1925, Congress feared that foreign countries could gain control over U.S. airlines and use them against the United States. Thus, Congress included the citizenship requirement in the Air Commerce Act in order to provide the military with access to commercial aircraft, which, in the event of a national emergency, could supplement its military aircraft fleet. A more elaborate program was set up during the Korean War in 1951, the Civil Reserve Act Fleet (CRAF) program.

After the Depression of the 1930s, another aspect of ownership requirements emerged, and this aspect remained valid until today. Due to the consequences of a largely unregulated world economy, Congress shifted its economic position from proposing free trade to reliance on governmental intervention

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32 Another reason was that the Federal Government subsidized all U.S. airlines through contracts to provide airmail service. Congress wanted to make sure that only U.S. citizens would receive such financial support.
33 See H.R. Cong. Rep. No. 1262 (1925); see also H.R. Rep. No. 1653, 68th Cong. at 527 (1925) (quoting Major General Patrick, "We will never have a military Air Service sufficient to meet a major war emergency. We will have to depend upon civilian agencies to supplement our needs in such emergency.")
34 See Defense Production Act of 1950, ch. 932, 64 Stat. 798 (1950) (codified as amended at 50 U.S.C. §§ 2061-2170 (1994)); under the CRAF's three stage program, carriers that have contractually committed to the Department of Defense (DOD) to provide civilian support for emergency military airlift operations, must make planes available for the program's activation. The DOD pays the airlines on a sliding scale for each international trip, depending on the distance, the cargo, and the number of troops carried. Currently, 35 carriers with 729 aircraft participate in the program. The program was activated for the first time in August 1990 to shuttle troops and supplies to and from Saudia Arabia as part of the U.S. operation against Iraq.
through tariffs and quotas. Thus, Congress intended to support the economic welfare of U.S. air carriers and to protect the aviation industry from foreign competition.\textsuperscript{35} The citizenship requirement was a subtle way to pursue that goal, which could be done without openly declaring quotas and tariffs.

The United States was also concerned about the fact that outside of its borders a majority of the world’s air carriers were often state-owned and heavily subsidized. The statutory requirement of U.S. citizenship was intended to prevent a state-owned carrier from buying a U.S. carrier and competing unfairly in the U.S. domestic market to the detriment of other U.S. carriers.

The Federal Aviation Act of 1958, which further modifies the provisions of the prior acts, governs who may operate a commercial aircraft in the United States. A person wishing to operate an aircraft within the U.S. is required to apply for a “certificate of public convenience and necessity” (analogous to a license) from the DOT. To obtain such a certificate, the airline must be in compliance with 49 U.S.C. § 41102(b) (1996), which stipulates that the Secretary of Transportation may issue a certificate only to a U.S. citizen if the citizen is fit, willing, and able to provide the proposed transportation. The Federal Aviation Act thereby reserves the domestic air services market, i.e., the cabotage rights, for carriers that are owned by U.S. citizens.\textsuperscript{36} The Act defines a citizen of the United States as:

(a) an individual who is a citizen of the United States or of one of its possessions, or

(b) a partnership of which each member is such an individual, or

(c) a corporation or association created or organized under the laws of the United States or any State, Territory, or possession of the United States, of which the President and at least two-third or more of the board of directors and other managing officers thereof are such individuals and in which at least 75 percent of the voting interest is owned or controlled by persons that are citizens of the United States or one of its possessions\textsuperscript{37}

The DOT and its predecessor, the Civil Aeronautics Board (CAB), have consistently interpreted this section to mean that


\textsuperscript{36} See 49 U.S.C. §§ 41703(b), 41102(a), 41103(a) (1994).

the carrier must actually be controlled by U.S. citizens in order to qualify for a certificate of public convenience. Despite a possible literal interpretation of the section, which provides that 75% of the voting interest must be owned or controlled by U.S. citizens, the agencies have consistently held that the definition should be interpreted conjunctively requiring that carriers must be owned and controlled by U.S. citizens. The DOT, however, has not defined the notion of "control" or established a "checklist" standard in order to determine whether a U.S. airline is actually controlled by U.S. citizens. In its 1989 *KLM/Northwest* decision, the DOT explained the analysis of "control" as follows:

[It] has always necessarily been on a case-by-case basis, as there are myriad potential avenues of control. The control standard is a de facto one—we seek to discover whether a foreign interest may be in a position to exercise actual control over the airline, i.e., whether it will have a substantial ability to influence the carrier's activities.

The DOT further clarified that foreign influence need not be identified with any particular nationality nor with any "sinister intent." Essentially, the DOT distinguishes between two types of foreign control, namely financial control through equity ownership and control through personal relationships.

2. Control Through Equity Ownership

According to the Federal Aviation Act, a corporation is considered a U.S. citizen if at least 75% of the voting interest is owned and controlled by a U.S. citizen. Thus, a foreign investor can only acquire a voting interest in a U.S. carrier of up to 25%. Since the law is silent as to the amount of non-voting equity capital and debt that a foreign carrier can invest in a U.S. airline, it is possible for the DOT to conclude that the defini-

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42 See supra at §II(B). By restricting foreign investment to 25%, the United States and Canada have among the most restrictive regulations. Australia has recently lifted its foreign ownership restrictions up to 49% in an international airline and up to 100% in a domestic carrier. See Australian Government to Ease Foreign Ownership Restrictions, *AVIATION DAILY*, Aug. 19, 1999, at 3.
tional reference to “voting stock” permits foreign investors to hold non-voting stock in a larger percentage than voting stock. Despite its generally minor power, non-voting equity capital or debt can also allow a foreign investor to exercise a certain degree of control and to neutralize the U.S.-owned voting stock. Therefore, the critical issue is how much non-voting equity capital or debt a foreign investor can hold in a U.S. carrier and what other factors may be relevant in order to determine whether the carrier is still in compliance with the statutory requirement. Several decisions by the CAB and the DOT address this issue.

a. The Decision in Page Avjet, et al.

In Page Avjet, the CAB approved a non-U.S. citizen holding about 9% of the outstanding stock of all classes of a U.S. air carrier, but also stated that a dominating influence may be exercised in ways other than through voting. The case involved a foreign investor who acquired 100% of the non-voting shares, which gave him the right to vote on company mergers, acquisitions, consolidations, and the company liquidation. The CAB concluded that the non-voting shareholder had the right to influence many of the crucial decisions of the company. In particular, they had the power to block any proposal by the voting-shareholders on the above-mentioned issues. The Board approved the deal, however, but only after Page Avjet had established a buy-out provision according to which the voting shareholders could buy back the non-voting shares if the latter blocked a corporate action.

In a more recent decision, Intera Arctic Services (“IAS”), the DOT restated that “a corporation must not only meet the explicit numerical requirements of [the Federal Aviation Act] but must also, as a factual matter, actually be controlled by U.S. citizens.” The DOT ruled that IAS, which held about 82% of the outstanding stock of all classes, failed to show its independence from foreign control in two respects. First, the bylaws of the carrier allowed the foreign non-voting interests to force the company to buy them out. Second, in the event the carrier

44 See id. at 491; see also DOT Order 93-7-26, supra note 39, at 15 (stating “veto control over substantive management decisions . . . by “supermajority veto”.
45 See Page Avjet, supra note 43, at 492.
would be profitable, the foreign non-voting interests would receive most of the reward.\textsuperscript{47}

In another decision, \textit{Transpacific Enterprises and America West Airlines},\textsuperscript{48} the DOT permitted an Australian corporation to acquire 20\% of the voting stock of America West Airlines. Despite the fact that the parties to the transaction had taken different steps to prevent a future violation of the citizenship requirement (such as amending the charter to prohibit foreign citizens from owning more than 25\% of the voting stock), the DOT inquired into other links between America West and affiliates in the Australian investor's corporate structure before approving the deal.\textsuperscript{49}

These decisions reflect a very restrictive form of interpretation, which goes beyond the wording of the statutory requirement of 75\% U.S. citizen ownership. The DOT views the limit of 25\% of voting equity as merely a threshold issue. It then concentrates on the question whether the foreign investor can actually exercise control in any given form, not only through vote. However, these decisions do not allow the formulation of any precise standard to determine under what circumstances a carrier is able to maintain its U.S. citizenship status.

\textbf{b. The Northwest-KLM decisions}

In the 1989 buyout of the then-failing Northwest Airlines, KLM Royal Dutch Airlines (KLM), through its subsidiary Wings Holding, contributed $400 million of the $705 million in equity involved in that transaction. According to the terms of the agreement, KLM would, together with all other foreign shareholders, hold less than 25\% of the voting stock, but would have the right both to block any amendments to the certificate of incorporation and to appoint one of the airline holding company's twelve directors. Furthermore, KLM would be able to name a three-person financial advisory committee to advise Northwest on management and financial affairs.\textsuperscript{50}

Despite the fact that KLM would own far less than 25\% of the voting stock, the DOT found that KLM would be in a position to exercise control over Northwest through KLM's subsidiary Wings, Northwest's holding company, and prohibited the

\textsuperscript{47} See \textit{id.} at 11-12.
\textsuperscript{48} Transpacific Enter., Inc., D.O.T. Order No. 87-8-31 (1987).
\textsuperscript{49} See \textit{id.} at 4.
buyout from proceeding under its original terms. In its consent order, the DOT stated that in order to determine whether a U.S. carrier could maintain its U.S. citizenship status, it would consider "whether a foreign interest may be in a position to exercise actual control over the airline, i.e., whether it will have a substantial ability to influence the carrier’s activities." The DOT restated that it would decide citizen status on a case-by-case basis, looking at the multiplicity of contacts between the foreign and the U.S. air carriers. The DOT believed that a large share in a carrier's equity posed citizenship problems, even when the interest did not take the form of voting stock. It concluded that KLM's non-voting stock was equity, and, as such, represents a genuine ownership interest. Thus, KLM would closely follow the fortunes of Northwest and would have a strong incentive to influence the airline’s business decisions.

In order to eliminate the DOT's concerns, Northwest and KLM (Wings) agreed to reduce KLM's share to a maximum of 25% of total equity. Furthermore, the parties agreed to terminate KLM's right to appoint a financial advisory committee and to recuse KLM's representative on Northwest's board in specified circumstances. In addition, Northwest and Wings agreed to file regular reports concerning their ownership structure. Ultimately, the DOT approved the transaction, concluding that KLM's ability to influence Northwest had been significantly reduced.

In 1991, Wings Holding requested a modification of the original consent decree, asking to permit KLM to increase its non-voting equity investment up to 49% with just over 10% held as voting shares and also to permit KLM to designate three members of the holding company's board after the board was increased from twelve to fifteen members. The DOT permitted the modification, basing its change in policy on its "reassessment of the complexities of today's corporate and financial environment, a reexamination of the relationship between nonvoting equity/debt and control in light of recent experience in this area." The DOT then stated that it would allow a total foreign equity investment of up to 49%, including both voting

51 Id. at 5.
52 See id. at 6.
53 See id. at 8, 9.
54 See id. at 10, 11.
56 Id. at 7.
and non-voting stock, so long as the foreign equity did not exceed 25% of voting shares and U.S. citizens actually control the air carrier.\textsuperscript{57} Moreover, the DOT noted that U.S. carriers have taken on sizable amounts of debts from foreign sources and also noted that debt arrangements pose little risk for foreign control. It concluded that, absent loan default, unless the loan agreement provides special rights to the debtor, it would not consider debt to be a factor in evaluating foreign control.\textsuperscript{58}

Summarizing this significant decision, the DOT made a distinction between voting equity on the one hand and non-voting equity and debt on the other, and acknowledged their differences in terms of influence and power. By making this clear distinction, the DOT has liberalized its foreign investment policy significantly, as foreign carriers may invest up to 49% in total equity. The DOT also clarified that, absent extraordinary circumstances, it would not consider debt to be a factor in determining control. In doing so, the DOT has eliminated the uncertainty as to the significance of non-voting equity at least to some degree. However, it did not depart from the statutory limitation on foreign investment, which only allows a voting equity of up to 25%.

It is worth noting that the then-ongoing bilateral negotiations between the U.S. and the Netherlands and the fact that both parties had entered into an Open Skies agreement, thereby providing U.S. carriers with access to the EU market, were decisive for the DOT in subsequently authorizing the deal.\textsuperscript{59} It is significant that the DOT considers U.S. foreign aviation policy as a legitimate criterion when evaluating an investment by a foreign carrier when the Federal Aviation Act itself does not mention it.

c. The USAir-British Airways Transaction

In 1992, the DOT addressed the USAir-British Airways (BA) deal in which British Airways would make an investment of $750 million in USAir, gaining 44% of USAir's total equity, including 21% of its voting stock, and representation on the USAir board. The airlines would coordinate their operations and eventually

\textsuperscript{57} See id. at 9.

\textsuperscript{58} See id.

\textsuperscript{59} See id. at 7-8. "We reached these decisions in the context of the liberalized aviation relationship that prevails between the United States and KLM's homeland."
merge into one brand name. The proposal caused a major controversy because British Airways would gain both greater access to the U.S. market and control over a U.S. airline—while the access of U.S. carriers to the British market would continue to remain very limited. Moreover, the ongoing bilateral negotiations between the United States and Great Britain had failed to provide U.S. carriers additional access to London’s Heathrow Airport. After it was reported that the DOT would disapprove the deal (because of the violation of the foreign ownership restrictions), British Airways withdrew its original proposal rather than face the anticipated rejection of the agreement. In 1993, the parties returned with a new investment arrangement, which included an investment by BA of $300 million for a 19.9% stake in USAir and excluded the common branding proposed in the first deal. This time, the DOT approved the transaction under the condition that every further BA investment would be subject to DOT approval.

Although the DOT did not rule on the original proposal, it was generally assumed that the DOT would not approve it. Significantly, the terms of the original transaction (44% total equity, 21% voting equity) did not exceed the equity stakes that had emerged from the 1992 KLM/Northwest decision as the general standard the DOT would follow (49% total equity, 25% voting equity). But one can presume that the DOT had also paid attention to the failing bilateral negotiations between the United States and Great Britain regarding additional access for U.S. carriers to Heathrow. Like in the KLM-Northwest decision, which was favorably affected by the U.S.-Netherlands Open Skies agreement, the DOT seemed to be influenced by political factors in the BA-USAir case and, therefore, did not follow the standard developed in KLM-Northwest. Consequently, it would seem that although the KLM-Northwest decision appeared to state a clear standard, the determination whether a carrier is able to maintain its U.S. citizenship status still cannot be reached without considering certain uncertainties.

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60 Clock is running on DOT to review BA/USAir Deal, Aviation Daily, July 31, 1992, at 186.

61 As of April 2000, the U.S. and U.K. negotiators were still not able to agree on a new bilateral agreement.
d. Publicly Traded Companies

In the case of a publicly traded carrier, the ownership of the carrier may be very dispersed, and the nationality of the stockholders unclear. U.S. laws provide two mechanisms to keep track of the ownership status of publicly traded carriers.

Pursuant to 49 U.S.C. § 41110 (e), a carrier must continue to be fit to conduct the transportation authorized and to comply with the statutory requirements. According to the DOT's administrative rules, when an air carrier proposes to undergo a substantial change in operations, ownership, or management, it must notify the DOT of the proposed substantial change. A substantial change in ownership is defined as "[t]he acquisition by a new shareholder or the accumulation by an existing shareholder of beneficial control of 10% or more of the outstanding voting stock." Changes in a carrier's ownership structure occur in various ways for various reasons. According to the DOT, the frequent sales and acquisitions of relatively small percentages of stock, such as occur with large carriers whose stocks are publicly traded, usually do not meet the DOT's definition of 'substantial' and do not result in a change in control of the company. However, even a minimum change of only 10% of the stock ownership in a widely held company, where the largest shareholder may beneficially control a relatively small percentage of the company, can lead to a change in influence, if not in outright control, of the company's policies and operational decisions.

The second mechanism, the Securities Exchange Act of 1934 provides for the disclosure of smaller percentages traded. According to § 13 (g) (1) of the Act, any person who is directly or indirectly the beneficial owner of more than 5% of any security is required to send to the issuer of the security and to file with the Securities Exchange Commission a statement describing the person's identity, residence, and citizenship. Any smaller number of shares acquired is, therefore, not considered to impose a risk of foreign control.

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64 Notification requirements concerning substantial changes in ownership and operations pursuant to §§ 41110(e) and 41708 of Title 49 of the United States Code and Section 204.5 of the Code of Federal Regulations, D.O.T. Notice, July 21, 1998.
3. Control Through Personal Relationships

In terms of personal relationships, the DOT examines the organizational configuration of an air carrier, namely potential relationships of directors and officers with foreign air carriers, and whether these relationships would allow the foreign carrier to exercise—either directly or indirectly—a degree of control that would outweigh the otherwise U.S. controlling interest.\(^6\) In an early decision, the CAB determined that a carrier failed to meet the citizenship requirement because several of its officers and employees enjoyed long-standing personal and professional relationships with the Swiss investor.\(^6\) The CAB clarified that it would look beyond corporate structures and U.S. “citizen front men” in order to ascertain who actually runs the company. It held that the definition of a U.S. citizen does not embrace corporations that formally meet the requirements of the law but that are actually controlled and run by a foreign national. In a subsequent decision, *Intera Arctic Services*,\(^6\) the DOT placed heavy emphasis on the fact that two IAS directors were also directors of a foreign carrier. Despite their U.S. citizenship, the DOT characterized these two directors as “ready conduits” for exercise of control by the foreign interest. In contrast, in *Page Avjet*, the DOT found the carrier to be a U.S. carrier because its bylaws prohibited the affiliation of its directors with its foreign parent.\(^6\)

In a 1989 decision, *Discovery Airways*, the DOT raised no objection to an Italian shareholder holding about 15% of both voting and non-voting stock, but required him removed from all executive functions to reduce his executive control.\(^7\) In its 1991 decision concerning the KLM investment in Northwest Airlines, the DOT made it clear that it “would not allow a foreign citizen to hold the position of chairman of the board” or a “disproportionate number of foreign director representatives to [be on] important committees, such as the executive committee, nominating committee, or finance committee.”\(^7\)

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\(^7\) See 58 C.A.B. at 120.

\(^8\) See *Intera Arctic Services*, supra note 41, at 120.


\(^11\) *Northwest Airlines*, supra note 55, at 11.
In its 1992 *Executive Air Fleet* decision, the DOT objected to the influence of the Swiss minority shareholder, Jet Aviation, on the senior management. Several of Executive's principals were former employees of Jet and had acted as consultants of Jet. Moreover, "Executive and Jet [had] shared undifferentiated office space as well as the same telephone number." The cross-hiring and the close proximity of Executive and Jet led the DOT to conclude that the key employees of Executive were reporting to Jet, thereby allowing Jet to control Executive.

Thus, in determining who is to be considered a U.S. citizen, the DOT closely examines whether the U.S. citizens—shareholders, directors, management—have strong ties with foreign interests and whether these ties might weaken the individual's ability to exercise independent control over the U.S. carrier. The DOT has recognized that personal relationships between U.S. citizens and foreign purchasers can provide a more subtle method to exercise control. As a general rule, it can be stated that, although foreigners are not totally prevented from serving on the board or as management, they may not generally serve as chairman of the board or in other key functions. Former links, such as employment contracts, or a spatial proximity with the foreign investor may also impair the U.S. citizenship status.

4. *Conclusion*

It can be concluded that, while the DOT adheres to the statutory limitations imposed by Congress and the Federal Aviation Act, it allows itself great latitude in interpreting those limitations. Considering the DOT's decisions, the general rule emerges that in the case where numerical requirements are met, the following factors in foreign hands may nevertheless jeopardize U.S. citizenship:

1. "a supermajority voting power, a block voting power or a veto power associated with ownership;"
2. a shareholder agreement that entitles the foreign shareholder to any rights beyond its equity interest;

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73 See id. at 2; see also Wrangler Aviation, Inc., D.O.T. Order 93-7-26, at 5 (1993) ("pervasive financial and employment relationships with the Singapore interests").
75 See id.
3. foreign debt or foreign lines of credit in the extraordinary case only, as when the loan agreement provides special rights to the debt holder;\textsuperscript{76}
4. close links of shareholders, directors, or management with the foreign investor.\textsuperscript{77}

Despite these criteria, however, the notion of effective control remains, to some degree, uncertain.\textsuperscript{78} As seen in the \textit{KLM/Northwest} and \textit{USAir-British Airways} cases, the DOT also takes into account political factors, such as the willingness of other countries to enter into favorable bilateral air services agreements. Therefore, the standard set out in the 1992 \textit{KLM/Northwest} decision, which allows a total foreign equity of 49% so long as the voting-interest does not exceed 25%, cannot serve as a general standard applicable to all cases regardless of their specific circumstances.

\section*{III. OWNERSHIP REQUIREMENTS IN BILATERAL AIR SERVICES AGREEMENTS}

The ownership and control requirements not only influence the domestic cabotage laws, but also play an important role in the bilateral context. Under its traditional bilateral agreement, the United States has the right to withhold or revoke the rights of foreign carriers if they are not substantially owned and effectively controlled by nationals of the state that has designated them to exploit the air traffic rights granted under the bilateral agreement. However, both the CAB and DOT, waived this right in many decisions. In a 1969 decision, \textit{Air Jamaica Ltd.},\textsuperscript{79} the CAB waived the right because it considered the applicant to be a "friendly, neighboring" country that does not present a threat to national security. In \textit{Seagreen Air Transport, Ltd.},\textsuperscript{80} the CAB stated that it would be willing to waive the nationality requirement "in appropriate circumstances."\textsuperscript{81} The Board reasoned that its policy is directed against the "absentee ownership" and a waiver

\textsuperscript{76} See id.
\textsuperscript{77} See id.
\textsuperscript{79} \textit{Air Jamaica Ltd.}, Foreign Air Carrier Permit, 44 C.A.B. 169, 171 (1966).
\textsuperscript{80} \textit{Seagreen Air Transport, Ltd. Foreign Permit}, 53 C.A.B. 235 (1970)
\textsuperscript{81} \textit{Seagreen Air Transport, Ltd. Foreign Permit} at 245; \textit{Seagreen Air Transport, Ltd. Permit Renewal}, 59 C.A.B. 462, 467 (1972).
would be appropriate when the owner is a resident of the designating state.\footnote{See Seagreen Air Transport, Ltd. Foreign Permit at 246.}

The DOT did not restate the policy indicated by the CAB and seemed to change its criteria for whether a waiver should be granted. In a case concerning the U.S.-Argentine bilateral agreement, Spain's Iberia has acquired a majority ownership (85\%) in Aerolíneas Argentinas, enabling it to effectively control the carrier.\footnote{On the privatization of Aerolíneas Argentinas, see Rogelio N. Maciel, Aerolíneas Argentinas Goes Private, 15 AIR LAW 93 (1990).} Aerolíneas Argentinas has kept its principal place of business in Buenos Aires and will possibly establish a main place of business in Madrid. Yet the DOT, without articulating a justification for the waiving its right, did not challenge Aerolíneas Argentinas' nationality and the DOT accepted that it remains an Argentinean designated air carrier under the U.S.-Argentine bilateral agreement—although the carrier had clearly lost its Argentinean nationality and was in fact controlled by Spain.

In Translux International Airlines SA d/b/a Cargo Lion (Cargo Lion),\footnote{See Application of Translux International Airlines SA d/b/a Cargo Lion, D.O.T. Docket 50362, 18 (1996).} the DOT waived the traditional citizenship requirements under the U.S.-Luxembourg bilateral agreement and granted a permit to the carrier to conduct all-cargo charter operations.\footnote{Translux International Airlines SA d/b/a Cargo Lion, D.O.T. Docket OST 98-4329 (1998).} Translux's major shareholders were a German national who owned 49\% and a Swiss national who owned 41\% of the stock. The DOT reasoned that it found it appropriate to waive the ownership and control requirements when "there [was] nothing in the ownership and control of [the carrier] that would be inimical to U.S. aviation policy or interest[s]."\footnote{Id.; see also Applications of Various Foreign Air Carriers, D.O.T. Order 95-3-7 (1995).}

There appear few rational justifications under which the DOT could refuse to waive the ownership and control requirements in bilateral agreements. Unless the carrier is owned by a third party that is presumed to be of sinister intent toward the United States and, as stated in Cargo Lion, toward the U.S. aviation policy, the issue of who owns a designated foreign carrier has no effect on U.S. interests. However, even if it is likely that the DOT would rarely if ever challenge the ownership of a desig-
nated foreign carrier, the legal uncertainty remains since the DOT could, in any case brought before it, refuse to waive the requirements. Moreover, traditional ownership requirements in bilateral air transport agreements constitute a bargaining chip, which the DOT might try to use in bilateral negotiations to achieve greater access for U.S. carriers to foreign markets. As the KLM/Northwest and USAir-British Airways cases have shown, the DOT indeed links the outcome in a particular decision to the U.S. success in bilateral negotiations. Consequently, any investor who is willing to invest substantial equity in a foreign airline, which is designated to operate services to the U.S., encounters the risk that the DOT might on some occasion challenge the carrier's ownership.

In addition, the DOT did not change its policy towards U.S. foreign investment laws in its Open Skies policy. In fact, the Open Skies agreements, which the U.S. entered into since the publication of the Open Skies policy in 1992, still contain the traditional ownership and control clause. A remarkable alteration of Open Skies is contained in the 1996 amendment of the U.S.-German bilateral agreement (the “1996 Protocol”). Since the 1996 Protocol amended the traditional nationality clause, it can therefore be distinguished from other U.S. bilateral Open Skies agreements with European countries. In Article 3 (3) of the 1996 Protocol, both sides agreed reciprocally to waive their right to withhold or revoke operating permission of a third country's carrier, under the applicable article of the relevant bilateral air services arrangement between the contracting party, i.e., the U.S. or Germany, and the third country, “[w]here nationals of either contracting party hold an ownership interest of less than 50 percent in an airline incorporated and having its principal place of business in a third state, . . . solely on the basis that ownership interest . . . constitutes control or effective control.” The provision also requires that “the third state permits airlines of both contracting parties to invest in airlines incorporated and having the principal place of business in that third state on an equal basis, and . . . that the relevant bilateral air services arrangements between each contracting party and that third state are ‘Open Skies’ agreements.”

87 See Bartkowski and Byerly, supra note 23, at 33.
88 See Jung, supra note 27, at 500 (outlining more differences between the traditional 'Open Skies' agreement and the U.S.-German bilateral agreement).
89 Bartkowski and Byerly, supra note 23, at 35.
90 Id.
The provision clarifies that the air services arrangements between Germany and other members of the EU are deemed equivalents of Open Skies agreements and that the current EU legislation governing investment in EU airlines permits airlines of both contracting parties to invest in airlines of EU Member States with an equity of less than 50%. This determination makes clear that both U.S. and German airlines can make investments of less than 50% in other EU carriers without risking their foreign carrier permits under the U.S.-German bilateral agreement. Thus, if Lufthansa were to acquire a 49% stake in Alitalia, the United States would have no right to challenge the nationality of Alitalia under the US-Italian bilateral agreement. But the traditional citizenship clause, authorizing each side to object to operations under the agreement by an airline designated by the other side if that airline is not substantially owned and effectively controlled by nationals of that side, is still part of the U.S.-German agreement.91 Hence, in case a third country's carrier were to acquire an interest in Lufthansa, the 1996 Protocol would not prevent the United States from claiming that Lufthansa has lost its traffic rights under the U.S.-German bilateral.

The explicit provision in the U.S.-German bilateral agreement, waiving the right to object to the nationality of third countries' carrier under certain circumstances, allows the conclusion that there is indeed a distinction between waiving the right to object within the bilateral agreement on the one hand and waiving the right to object to a third country's carrier on the other hand. It can be assumed that the U.S. government intended to maintain its right to withhold or revoke a carrier's operating permit in case it is not substantially owned and effectively controlled by German nationals, and vice versa. This distinction increases the uncertainty as to whether and under what circumstances the DOT is willing to waive its right to object to ownership and control of a designated carrier under a bilateral air services agreement.

Therefore, the DOT's more liberal approach, taken in its Aerolíneas Argentinas and Translux decisions, does not allow the conclusion that the DOT would always, despite the explicit provisions of its bilateral air transport agreements, waive the ownership and control requirements when granting or renewing a foreign air carrier permit. Therefore, uncertainty re-

mains as to when an investor can invest in a foreign airline without risking that carrier's U.S. foreign air carrier permit.

IV. PROPOSALS TO AMEND THE FEDERAL AVIATION ACT

Foreign interests continue to seek investment opportunities in U.S. carriers. It appears as if the idea of opening the U.S. air services market to foreign investment by relaxing the citizenship requirements may be gaining some momentum in Washington. There are proposals to raise the investment ceiling to 49% in voting equity, bringing the U.S. requirements into line with the European Union, which allows non-EU investment in EU carriers up to 49% in both voting and non-voting equity. The major argument in favor of a higher foreign investment limit is that the U.S. airline industry would have access to a deeper capital market, in particular in case of a failing company that is in need of capital. Financially troubled carriers, such as TWA or low-cost start-up carriers, could be supported more effectively by foreign capital and would have a better chance of long-term success, which would further enhance competition among U.S. carriers. This is particularly true after the ValuJet crash of 1996, as since then capital investment U.S. for start-up carriers is extremely scarce.

However, despite various activities and proposals, there are currently no indications that Congress would amend the Federal

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92 Richard Branson, the owner of Virgin Atlantic Airways, "sought to invest $200 million in a low-fare domestic airline based in New York . . . but was blocked from [it] because he is not a U.S. citizen." Kenneth J. Button, Open U.S. Skies to Global Competition, J. of Com., Dec. 23, 1998, at 5A.

93 The former DOT Assistant Secretary for Aviation, Charles Hunnicutt, called for "establishing a single, open worldwide aviation market while questioning existing U.S. restrictions on foreign investment." Id.; see also National Commission to Ensure a Strong Competitive Airline Industry, CHANGE, CHALLENGE, AND COMPETITION: A REPORT TO THE PRESIDENT AND CONGRESS, at 22 (1993); Anna Wilde Matthews, Report on Airlines Urges Government To Take Action to Boost Competition, WALL ST. J., July 30, 1999 at A4 (Report from the National Research Council, calling for an end to restrictions on foreign ownership); Andreas Lowenfeld and Allan I. Mendelsohn, Let Foreigners Own US Airlines, J. of Com., March 26, 1999, at 5A.


95 See Brown, supra note 78 at 1271; See also Gjerset, supra note 66, at 193.

96 Andreas Lowenfeld and Allan I. Mendelsohn, supra note 93. But the recent foundry of well-financed Jet Blue may mean that capital investment for new start-ups may becoming more readily available.
Aviation Act and ease the ownership requirements in the near future, and the proponents of the current statutory regime are strongly lobbying for maintaining the regime. The debate is focusing on the following issues.

A. NATIONAL DEFENSE

The U.S. citizenship requirement is based on one major policy, namely the policy to assure that sufficient aircraft will be available for U.S. national security purposes. The Department of Defense (DOD) opposes any change in the foreign ownership requirements for fear that foreign-owned U.S. airlines may not sufficiently participate or even refuse to participate in the Civil Reserve Air Fleet (CRAF) program or, in the event of an emergency, remove their U.S. aircraft from U.S. territory.97 Moreover, it is argued that airlines that are actually controlled by foreigners "may act as instruments for their [respective] governments."98 In contrast, proponents of higher investment limits consider the national security concern overstated and do not see any "compelling national security reasons for limiting foreign investments."99

To determine the validity of these arguments, it is necessary to examine whether a change in the ownership and control requirements may result in a change in the cabotage laws, allowing foreign airlines to operate within the U.S. Even with higher foreign investments limits in U.S. carriers, airlines operating domestically in the U.S. would still be required to have a certificate of convenience and necessity and to comply fully with all applicable U.S. laws. The major reason to invest in a U.S. air carrier is that foreign carriers, through their respective subsidiaries, want to participate in the U.S. domestic market, which is the largest aviation market in the world. Foreign carriers would not invest in U.S. carriers in order to get access to aircraft and to use these aircraft in their homeland markets. It is, therefore, most unlikely that foreign carriers that have invested in U.S. carriers would, in the event of an emergency, remove the U.S. carriers' aircraft from the U.S. market. Moreover, the use of contracts could safeguard the participation of U.S. carriers in

99 Brown, supra note 78, at 1285; Warner, supra note 10, at 310.
CRAF and the necessary supply of aircraft. Combining a contractual commitment with the personal liability of directors and managing officers would raise the likelihood of compliance with the CRAF program. Even if the DOD is not satisfied with a carrier's contractual commitment to participate in CRAF, the DOD could require a lower foreign investment limit for airlines that want to participate in the CRAF program, such as the current 25% limit. Since participation in the CRAF program is compensated on a regular basis, it can be assumed that several U.S. airlines would still be interested in participating in the program. In order to qualify for the program, airlines then must meet the standard set forth by the DOD. As these different ways of guaranteeing the necessary supply for the CRAF program demonstrate, national defense concerns do not present a valid reason to maintain the current regime.

B. Jobs

The second heavily debated concern, which is mainly emphasized by the labor unions, is the employment of U.S. workers in the aviation industry. The unions fear that major foreign investments in U.S. air carriers and intensified cooperation between U.S. and foreign carriers could eliminate U.S. jobs in the aviation industry. They argue that foreign investors would use their control over U.S. airlines to replace U.S. workers with foreign workers. Moreover, they assert that a higher foreign investment limit would not only lead to the employment of foreign pilots and officers, but would negatively affect the seniority levels of U.S. staff.

As in the national defense debate, it has to be clarified that the opening of the U.S. domestic market, i.e., cabotage, for foreign carriers, which are not subject to U.S. laws, is not at issue here because the suggested higher foreign investment limits would not open the U.S. domestic market for foreign carriers. U.S. airlines receiving a major foreign investment remain U.S. carriers that must register in the U.S.; must comply with U.S. laws including U.S. safety regulations; must pay taxes in the U.S.; and must, in principle, employ U.S. citizens. Even if U.S. carri-

100 See Lowenfeld and Mendelsohn, supra note 93.
ers would have the opportunity to employ foreign crews, it can be assumed that at least in comparison to most of the EU countries, labor costs in the U.S. are lower than in EU countries, such as Germany, the Netherlands, and France. U.S. carriers, even with a substantial foreign investment, would thus have an economic incentive to employ U.S. citizens. Consequently, higher foreign investment limits would not inevitably endanger U.S. jobs.

C. Reciprocity

A third factor for opposing any changes in the ownership laws is the use of ownership and control requirements as bargaining chips in bilateral negotiations.\(^{102}\) By reducing the limitations on foreign investment and allowing a higher foreign equity interest unilaterally, the U.S. would lose leverage and reduce its bargaining strength in bilateral negotiations.\(^{103}\) The fear is that if a foreign carrier were allowed to acquire a major voting interest in a U.S. carrier, such as a voting interest of 49%, it could virtually gain access to the U.S. domestic market and thereby circumvent the cabotage laws "via [the] actual control of U.S. airlines."\(^{104}\) It is argued that foreign governments, whose air carriers are allowed a higher investments in U.S. airlines, would have little incentive to grant U.S. carriers greater access to their own market. Conversely, proponents of an amendment, such as The National Commission to Ensure a Strong Competitive Airline Industry, contend higher foreign investment limits would encourage other countries to open their markets and to enable the DOT to negotiate more liberal bilateral agreements.\(^{105}\)

Equal treatment and reciprocity in international agreements are very important factors guaranteeing both parties' satisfaction and commitment to their contractual obligations. Consequently, it would be in the interest of the United States as well as other countries to liberalize their respective ownership and control requirements on a reciprocal basis. Thus, the U.S. could allow foreign carriers to invest more than 25% of voting-equity in a U.S. carrier if the other country grants the same right to U.S. investors. In the European Union, U.S. carriers may al-

\(^{102}\) Warner, supra note 10, at 320.

\(^{103}\) See Edwards, supra note 98, at 629.

\(^{104}\) Id. at 628.

\(^{105}\) See National Commission to Ensure a Strong Competitive Airline Industry, supra note 93, at 22; see also Warner, supra note 10, at 281.
ready hold a voting interest of up to 49%. In terms of reciprocity, there are therefore no reasons for Congress not to raise the foreign investment limits for EU investors.

D. Competition

The debate finally deals with the issue of whether the current legal regime imposes an obstacle to the development of liberalized and open aviation markets or whether the protection of the domestic aviation industry from foreign competition is still necessary. The proponents of an amendment argue that the airline industry and its customers, i.e., passengers and shippers, would benefit from the access to fresh capital. Foreign capital could enable U.S. carriers to compete more effectively with other carriers, both in the domestic market with other U.S. carriers and in the international market. The enhanced competition would provide lower fares and more choices for customers. Moreover, customers both in the U.S. and in Europe are accustomed to the situation in other industries, such as in the energy and telecommunications sectors, where after the privatization of major providers and the liberalization of the markets the prices declined and the quality of the services improved.

In contrast, some authors go so far as to voice fears that the effects of changing the U.S. laws on ownership and control “could be devastating to the U.S. economy.” Closely linked is the argument that heavily subsidized or even state-owned foreign airlines could invest in U.S. carriers and, due to their state financial support, enjoy a competitive advantage over other U.S. carriers, which have to seek funds in the private capital markets. Carriers receiving a foreign investment could price below cost and thereby distort the competition in the aviation market, which might lead to a loss for other U.S. carriers and, eventually, for the entire economy. At least in respect of EU carriers, the anticompetitive effect of subsidies is not a valid argument anymore. During the last years, the European Commission and the European Court of Justice have focused on the enforcement of the EU State aids regulations (Article 87, 88 EC), which allow

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106 See Gjerse, supra note 66, at 173 (“stifles the economic development of an industry”).
107 Edwards, supra note 98, at 624.
108 Id. at 633.
109 Art. 92, 93 EC-Treaty in its former version; since the Treaty of Amsterdam (1997 O.J. (C 340), 1) has entered into force on May 1, 1999, the articles of the EC-Treaty are renumerated and the European Court of Justice (ECJ) cites its
state aids only under extraordinary circumstances, which regularly do not apply to air carriers. As a result, the formerly common practice of many Member States to subsidize "flag carriers" has ended and, moreover, the Commission has successfully put pressure on the Member States to privatize their carriers.\(^1\) Many Member States, such as France, Italy, and Spain, have in fact begun to privatize their carriers. In any event, the U.S. could always limit ownership liberalization effects to carriers that are not owned or controlled by their governments.

E. Conclusion

The usual objections raised against an amendment to the current ownership and control requirements are, at least in the U.S.-EU context, no longer convincing. However, it is unlikely that the U.S. will change its foreign investment restrictions unilaterally in the foreseeable future. It is more likely that the United States will suspend current foreign ownership and control restrictions through bilateral or multilateral agreements if the other side is equally granting such rights, probably as a part of an Open Skies agreement. The reciprocity issue is even more imminent due to the size of the American market.\(^1\) Under an Open Skies agreement with a small European country, such as the Netherlands, Dutch carriers are allowed to fly from the Netherlands to any point within the U.S. In return, U.S. carriers can also fly to any point in the Netherlands. Despite the legal reciprocity and equal treatment of both parties, the factual disparity in opportunities is obvious in cases where the bilateral partner does not have a significant market to offer in exchange. Therefore, it is much more attractive for the United States to deal with the European Union as a whole in order to gain access to the European market. It is far from clear whether or when the EU Member States may be willing to accept the competence of the Union to negotiate a multilateral air services agreement.\(^2\)


\(^2\) See infra § VI(C) (III).
V. OWNERSHIP REQUIREMENTS IN THE EUROPEAN UNION

A. BACKGROUND

After World War II, nationally owned and operated air carriers, commonly known as "flag carriers," comprised the overwhelming majority of the airline industry in Europe. Despite the Treaty of Rome, signed in 1957, which was intended to promote the establishment of a common market among the Member States, the air transport sector remained virtually unchanged until the late 1980s. Although sea and air transportation were both subject to the rules of the Treaty of Rome, Article 80 (2) EC, it was not until the adoption of the Single European Act in 1986 that the European authorities eventually undertook some efforts to open up the aviation market. The Single European Act set the date for achieving a Single European Market without frontiers at 1992 and provided explicitly for the establishment of a Single European Market for air transport.

The landmark decision in respect to transportation was Nouvelle Frontieres, where the European Court of Justice (ECJ) held that the general provisions of the EC-Treaty, in particular the articles relating to competition, are applicable in the fields of air and sea transport. The decision was significant because it enabled the European Authorities to intervene in the civil aviation policies of the Member States. Beginning in 1986, the European Council enacted a three-phase program to liberalize the air transportation industry within the Community. In 1987, the Council approved the "First Package" of liberalization in the air transport sector, and the "Second Package" in 1989, neither of which had a significant impact on the European air services market.

113 Art. 84 (2) EC-Treaty in its former version.
115 See id. at art (13).
In 1992, however, the Council adopted the “Third Package” consisting, among others, of two Regulations, Council Regulation 2407/92 and 2408/92, which became effective on January 1, 1993. The “Third Package” effectively created for the first time an almost completely open market for air services (airfare approval, route and slot access, and capacity growth) within the European Community, regardless of the bilateral agreements between the Member States. This concept was very modern considering the fact that the first two packages were still based on the idea of bilateral air services agreements between the Member States. The ‘Third Package’ including Council Regulation 2407/92 on Licensing of Air Carriers provides exclusive rules for the granting of operating licenses by the Member States and changed the ownership requirements within the European Union. Until 1992, each Member State had effectively reserved its domestic air services market for carriers owned by that Member State or its nationals. This situation was found to be inconsistent with one of the main principles of the Treaty of Rome, the prohibition of discrimination on the grounds of nationality, laid down in Article 12 EC. After the ‘Third Package’, the European regulatory regime no longer distinguishes between domestic or international services within the European Community market.

The non-discriminatory treatment of EU-carriers within the European Union is even more visible because as of January 1, 1997, all EU carriers can freely operate scheduled and non-scheduled air services within that market, including cabotage, either directly through their own operations or indirectly by setting up a subsidiary. The new regime has thus established a single, almost fully liberalized aviation market within the European Union, which is clearly distinguished from the bilateral regime that governs the rest of the world.

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B. Ownership Requirements: Community Ownership

Like the United States, the Member States of the European Union traditionally reserved their domestic air services market (cabotage) for their 'flag carrier' or carriers that were either state-owned or owned by their nationals. Council Regulation 2407/92 replaced the national statutes dealing with the granting and maintaining of operating licenses in relation to air carriers established in a Member State. Due to the exclusive character of the Regulation, the national license authorities cannot impose requirements or conditions on applicants for air carrier licenses that go beyond those laid down in Regulation 2407/92.124 The national authorities remain in charge of granting operating licenses, as the Regulation did not establish a central European Authority to perform these tasks.

Article 4 of Council Regulation 2407/92 sets forth the following four fundamental requirements that an applicant for an air carrier license must satisfy to be granted such a license:

1. the principal place of business must be located in the licensing Member State;125
2. the main occupation of the carrier must be air transportation;126
3. the holder of the license must be owned and continue to be owned directly or through a majority ownership by EU nationals;127
4. the holder of the license must at all times be effectively controlled by such EU nationals.128

Regulation 2407/92 does not follow the traditional approach of nationality of a single country, as set forth in Article 17 of the Chicago Convention, but establishes an EU ownership system, as required by the anti-discrimination provision of the EC-Treaty. The Regulation allows airlines within the EU to be owned by

123 See Council Regulation 2407/92, supra note 94. The national regulations continue to govern the licensing of non-EU airlines. See e.g., Article 3 of the German LuftVG, which still imposes an ownership requirement and prevents non-EU carriers from operating in Germany.
125 See Council Regulation 2407/92, supra note 94, at art. 4(1)(a).
126 See id. at art. 4(1)(b).
127 See id. at art. 4(2).
128 See id.
nationals or companies from any Member State. A grandfather provision allows carriers with outside control that have been licensed before the enactment of the regulation to continue their operations. The legislative purpose of the community ownership requirement was not only to comply with the requirements of the anti-discrimination provision, but also to prevent third countries from unilaterally taking advantage of the Community's liberalized international air services market. The Commission stressed that the Regulation protects the interests of Community air carriers in an environment where they do not enjoy unrestricted traffic rights in third countries.

1. Majority Ownership

Pursuant to Article 4 (2) of the Regulation, an applicant for an air carrier operating license must be owned, and continue to be owned, directly or through a majority ownership, by EU nationals. In its Swissair/Sabena decision, the Commission took the view that the majority ownership requirement is met if at least 50% plus one share is owned by EU nationals. This decision was the first where the Commission had the opportunity to comment on Council Regulation 2407/92 and to clarify some of the interpretative issues. In 1995, the Belgian State and Swissair entered into an agreement according to which Swissair acquired 49.5% of the equity of Sabena, the Belgian flag carrier. The Commission did not challenge whether Sabena was in compliance with the majority ownership requirement.

Moreover, the Commission determined that it is not relevant whether the shares of the ‘majority owner’ are held by a single EU national or by a dispersed group of shareholders—so long as

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129 The regulation’s introduction of community ownership made it possible for European Airlines to acquire majority stakes in other EU airlines, such as British Airways taking over the French airline TAT.
130 See Council Regulation 2407/92, art. 4(3)(b), supra note 94; Council Regulation 2343/90, supra note 118; Annex I (airlines recognized for the grandfather provision are SAS, Britannia Airways, and Monarch Airways).
131 Commission Decision, supra note 88.
132 Council Regulation 2407 / 92, art. 4(2), supra note 94.
133 Id. It should be noted, however, that the Commission does not have the authority to interpret a Community source of law, since this competence is left with the European Court of Justice. See EC Treaty art. 234(a) EC. Thus, the interpretation exercised by the Commission cannot be considered final.
134 Commission Decision 95/404/EC, supra note 94.
135 Id.
they are EU nationals and their interests add up to a majority. However, the distribution of the shares between non-EU shareholders has to be taken into account in assessing compliance with the effective control requirement. Even a major block of shares, which does not constitute a majority, may nevertheless give its owner effective control over the carrier if the rest of the shares are dispersed.

The Commission further commented on the term "ownership" and stated that, in regard to a company, it only referred to a participation in the capital of the company, not to voting rights. Consequently, "Article 4 (2) of the Regulation refers to a concept of ownership based on the notion of equity capital, [which] implies the right to participate in decisions affecting the management of the company [as well as] the right to share in the residual profits or the residual assets upon liquidation." Thus, preferred stock, even without voting rights, would count as ownership interests, whereas convertible bonds would not count prior to actual conversion into stock. Therefore, as in the United States, foreign investors can hold a total equity interest of up to 49%, including voting and non-voting rights, and debts are generally not considered to constitute control.

2. Effective Control

Pursuant to Article 4 (2), holders of an operating license must be effectively controlled by EU nationals. The notion of EU or Community ownership not only requires a majority ownership by Member States and/or their nationals, but also that such Member States or nationals effectively control the undertaking at all times. Pursuant to Article 2 (g) of the Regulation, effective control is defined 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;

136 Id.
137 Id. at 24.
139 Rosengarten and Stephan, supra note 9, at 1379.
140 See Council Regulation 2407/92, art. 4(2), supra note 94.
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.\footnote{141}

The Commission stated that the notion of effective control must be interpreted and applied in the light of the objective of safeguarding the interests of the Community's air transport industry, preventing third country carriers from taking full advantage, on a unilateral basis, of the liberalized EU aviation market. The Commission stated that the ultimate decision-making power in the management of the carrier must remain with EU nationals. They must be able, either directly or indirectly, to have the final say on such key issues as the carrier's business plan, its annual budget or any major investments or cooperation projects.\footnote{142} This regularly includes the power to appoint a majority of the board of directors or its equivalents (such as the supervisory committee in Germany), who have the right to appoint the management.\footnote{143} Moreover, effective control is not inevitably linked with the majority interest, as a minority shareholder may be able to effectively control a carrier when the rest of the shareholders are widely dispersed. The licensing authority must also examine whether there are any provisions in the articles of incorporation or alliances between shareholders that prevent the EU shareholders from independently controlling the company, such as voting alliances, supermajority voting, or the right of a minority shareholder to block majority decisions.\footnote{144} Finally, the control requirements in Article 4 (2) of the Regulation excludes the formation of a trust with a EU national as a trustee because the carrier must be owned directly or through a majority ownership by EU nationals, which ultimately points to the nationality of the beneficiary.\footnote{145} In contrast, economic dependence through supply contracts or debt is generally not considered to constitute effective control, unless the underlying agreement provides the contracting partner, such as a bank, with special rights that equal a substantial equity interest.\footnote{146}

\footnote{141} Id.\footnote{142} Commission Decision 95/404/EC, supra note 94.\footnote{143} Karl Stefan Eisermann, Grundlagen des Gemeinsamen Europäischen Luftverkehrsmarktes, at 191 (1995).\footnote{144} See id. at 192.\footnote{145} See id.\footnote{146} See id.
The Commission's interpretation of the notion of 'effective control' closely resembles the DOT's view on 'actual control', as required by the Federal Aviation Act. In both systems, the licensing authority must determine whether a foreign interest is able to exercise actual or effective control in any given form. Both systems, absent extraordinary circumstances, do not view debt as a relevant factor in evaluating control. However, unlike the DOT, the Commission does not distinguish between voting equity and non-voting equity. Both the voting and the non-voting equity combined constitute the majority ownership interest that must be held by EU nationals. The Commission does not approve a foreign non-voting interest that exceeds 49%, but also does not object to a foreign voting interest of up to 49%, unless the investor can exercise effective control by different means. However, the question arises whether this deviation from the numerical requirements of the U.S. regime constitutes a substantial difference between the two systems or whether they in fact present more or less identical requirements. The only identified difference is that the EU allows a voting equity interest of up to 49%. Both systems prohibit effective or actual control of the carrier by foreign interests. Consequently, in both systems the contractual rights of the foreign minority shareholders, even if they hold 49% in voting equity, must be formed in a way that the foreign interest is not able to control the company. The 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.

3. Publicly Traded Companies and Privatization

The general trend of privatization, which can be identified not only in the aviation sector, but also in many other sectors in the EU economy, such as telecommunications and energy, leads to the privatization of many "state carriers." Today, the major European carriers—British Airways, Lufthansa, Air France, and
Alitalia—are fully or at least partially privatized. Air carriers that are public companies will inevitably be owned by a large number of individuals and institutional investors such as mutual funds. The major European carriers already quoted on the stock exchanges—British Airways, KLM, and Lufthansa—and presumably they will not remain the only large European carriers publicly traded. Because ownership in a publicly traded company is generally more diffuse, the nationality of these carriers necessarily becomes less certain, and it might at some point become difficult for them to fulfill continuously the requirement of being substantially owned and effectively controlled by EU nationals. Pursuant to Article 4 (5) of the Regulation, a carrier holding a Community air carrier license shall at all times be able to demonstrate to the Member State responsible for the operating license that it meets the requirements of Article 4 (2). Air carriers are therefore required to keep track of their ownership and control structures.

Applying a restrictive interpretation of Article 4 (5) might cause serious problems for publicly traded carriers trying to meet such a request. Some authors have argued that a pragmatic approach should be taken: if an air carrier is a publicly traded company that is incorporated and resident in a Member State, it should be presumed that nationals of Member States own a majority of its share capital unless there are clear indications to the contrary. The major argument in favor of such a broad interpretation is that the Regulation cannot be expected to run contrary to the concept of air carriers as public companies. Moreover, it can be argued that the company's effective control is not in jeopardy because the ownership is so diffuse that the individual owners, regardless of their nationality, are not able to exercise jointly any substantial control over the company. However, neither the Commission nor the European Court of Justice has yet taken a position on this issue. The continuing privatization of European air carriers that are publicly traded makes it likely that the issue of "effective control" will become a crucial aspect in any determination of a carrier's nationality.

To solve the dilemma between the principle of freely transferable stock and the ownership requirements of the Regulation, the German legislature regulated the traceability of shareholder nationality in the Aviation Compliance Documenting Act (ACDA) before the German government disposed of its remaining shares in Lufthansa in the 1997 global share offering. According to the ACDA, shares in an air carrier in the form of a stock corporation (‘Aktiengesellschaft’) must be registered shares, with transfer restrictions, rather than freely transferable bearer shares, and the shareholders are required to give information to the company regarding their nationality. In addition, the carrier has increased rights to re-acquire its own shares and to issue shares out of an authorized capital, excluding the right of certain shareholders to buy newly issued shares. Finally, as a means of last resort, the management has the right to request shareholders whose ownership may be in conflict with the carrier maintaining its operating license and air traffic rights, to dispose of their shares.

4. Nationality of the Management

As seen above, the law of the United States contains requirements as to the nationality of an air carrier’s management. Regulation 2407/92 does not contain any explicit requirement regarding the nationality of the management. It can be argued that the notion of “effective control” by nationals of Member States requires the management of the carrier to be controlled by these nationals. However, the notion of “effective control” as defined by Article 2 (g) of the Regulation clearly reflects the concept of external control, which is normally exercised by the stockholders of a company as opposed to control through management. Therefore, the Regulation must be interpreted to

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150 Act for procuring proof of ownership position and control of air carriers for maintaining the air traffic operating license and the air traffic rights (Aviation Compliance Documenting Act).

151 British Airways and KLM have chosen similar ways, see also von Ruckteschell, supra note 148, at 372. BA maintains a special registry for shares held by foreigners and requires its shareholders to give notice when they sell their shares to foreigners.

152 49 U.S.C. § 40102(a)(15) (1994); see also § 3(1) of the German LuftVG, which requires a majority of directors or general partners of the carrier to be German nationals.

153 Rosengarten and Stephan, supra note 9, at 137.
mean that the nationality of the carrier's management shall be irrelevant in determining that carrier's nationality.\(^\text{154}\)

5. **Group Structure**

If the carrier belongs to a group of companies, the question arises whether only the ultimate holding company must be controlled by nationals of the Member States or whether all of the upper level companies must fulfill that requirement, namely whether they too must be domiciled within the EU and controlled by EU nationals. Since the wording of the Regulation does not give any clear indication as to the nationality of intermediary companies, one can assume that it is sufficient that the ultimate holding company be in compliance with the Regulation.\(^\text{155}\)

6. **Principal Place of Business**

In addition to the criteria of substantial EU-ownership and effective EU-control, Regulation 2407/92 also requires the carrier to have its principal place of business within the EU. This provision excludes carriers from the EU-market that are substantially owned and controlled by EU carriers, but have their principal place of business outside the EU, such as Aerolíneas Argentinas. Consequently, it is impossible for a non-EU air carrier to sell out to a EU carrier or to buy a majority share of a EU carrier in order to benefit from the liberalized air traffic market within the Union. In other words, despite the fact that Iberia has acquired a majority ownership in Aerolíneas Argentinas, the Argentine air carrier is not entitled to operate within the EU unless it establishes its main place of business within the EU.

Pointing to the trend towards Open Skies agreements and free market conditions, in particular within the European Union, some authors conclude that the requirement of substantial ownership and effective control should be abandoned as the link between a state and the air carrier and be replaced by the criterion of the main place of business.\(^\text{156}\) This proposal bears some similarities to the concept of "flags of convenience," which is already commonly known in maritime law for decades. In maritime law, ship owners can transfer the registration of their

\(^{154}\) See Eisermann, *supra* note 143, at 193 for a different interpretation.

\(^{155}\) Rosengarten and Stephan, *supra* note 9, at 138.

vessels to more favorable countries of registry in order to avoid burdensome taxes, highly unionized workforces, or less stringent safety requirements.\footnote{See infra §VI (A)(2).} Under the current regime, an air carrier cannot easily transfer its registry because the vast majority of countries require that the carrier be substantially owned and effectively controlled by nationals of their state. Under a regime governed by the criterion of "main place of business," it would be possible for an air carrier to transfer its registration if it would also transfer its main place of business. However, there are major differences between aviation and maritime law. In the maritime sector, carriers are not restricted to certain traffic routes that are assigned to them by their country of registry. Any ship owner is allowed to travel freely on the high seas without any restrictions. In contrast, in aviation an air carrier can only exploit traffic rights that are designated to that carrier by the carrier's state of registry. Therefore, the decision what country to choose as the country of registry in the aviation sector could not be governed by factors such as costs or safety standards, but primarily by the factor of whether the country is able to designate attractive and profitable traffic rights. A situation like in the maritime sector is therefore unlikely to develop in the aviation sector.

It should be noted, however, that problems may arise during the transition period when some bilateral agreements have been changed to the notion of "principle place of business" while others maintain the ownership and control requirement. This fact pattern could lead to a situation where a carrier is substantially owned by nationals of state A but registered in state B where it has its main place of business, e.g., Aerolíneas Argentinas, which is registered in Argentina but owned by Iberia. As already indicated above, it is uncertain whether both Argentina and Spain could designate Aerolíneas Argentinas under their respective bilateral agreements.\footnote{Wassenbergh, supra note 157, at 293 (arguing in favor of the designation by two countries).}

Despite this proposal and other proposals on how to adapt the aviation industry to the needs of a liberalized world economy, it seems as if many countries still view air transportation as an industry of national importance and are reluctant to open their markets to foreign competition. It is therefore likely that the ownership and control requirements will continue to re-
main the decisive criteria for determining the nationality of an air carrier in the near future.\textsuperscript{159}

C. EXTERNAL RELATIONS OF THE EUROPEAN UNION

Although the liberalization of the air traffic market has significantly relaxed the ownership requirements within the EU and thereby improved the intracommunity competition, non-EU countries have not yet recognized the changes. The traditional ownership and control requirements remain in many bilateral treaties between Member States and third countries and still entitle the latter to withhold or revoke an operating permit if a carrier is not substantially owned and effectively controlled by the contracting Member State and/or its nationals. Hence, if a carrier from Member State A is taken over by a carrier from Member States B, a third country could withhold or revoke its operating license and prevent the carrier from exploiting the traffic rights granted to carriers of Member State A. The potential for EU carriers to build up a large market through mergers within Europe is therefore still limited.\textsuperscript{160} However, it should be noted that some Member States have recently entered into bilateral agreements that take into account the EU ownership and prevent third countries from objecting to the nationality of a designated carrier, which is owned by EU nationals. For instance, the bilateral agreement between Germany and Brunei explicitly states that either party cannot object to the rights granted under the bilateral agreement if a designated carrier is not substantially owned or effectively controlled by nationals of the other side. The provision further grants Brunei the right to challenge the right of a carrier designated by Germany if the carrier is not able to demonstrate that it is substantially owned and effectively controlled by EU nationals.\textsuperscript{161}

As described above, the majority of the bilateral air services agreements of the Member States contain traditional nationality

\textsuperscript{159} Id. at 291.

\textsuperscript{160} E.g., Virgin Atlantic has acquired a 90% stake in a Belgian airline called EBA. As a British-owned airline EBA cannot fly to a third country as long as the bilateral treaty between Belgium and the third country contains the traditional nationality clause.

\textsuperscript{161} E.g., the air transport agreement between the Federal Republic of Germany and Brunei Darussalam, German Federal Gazette (BGBl.) 1994, II-3670, Art. 3 (4). The last provision refers to Council Regulation 2407/92, art. 4(5), supra note 94, which requires a carrier holding a Community air carrier license to be at all times able to demonstrate to the Member State responsible for the operating license that it meets the requirements of Art. 4 (2).
clauses that may violate the EC Treaty, as they discriminate against other EU carriers on the basis of nationality and undermine one of the fundamental rights, granted by the EC Treaty, the right of establishment. Article 49 of EC Treaty grants the right of establishment in other Member States to nationals of any Member State and requires the Member States to allow the establishment on the same conditions as those, which they apply to companies incorporated in their countries. In the aviation sector, the right of establishment is laid down in Council Regulation 2407/92, which grants EU nationals the right to own and operate a carrier in each Member State. It is obvious that there is a clear conflict between the traditional nationality clause in bilateral agreements and the right, which EU nationals have under the Council Regulation. Article 307 EC protects agreements entered into prior to January 1, 1958, which remain valid regardless of contrary Community law. These agreements, however, represent only a small fraction of the bilateral air services agreements between the current sixteen Member States and third countries. It is uncertain whether Article 307 EC also applies to agreements that were originally entered into before 1956 but amended thereafter, or to agreements that were created after 1956 but at a time when the Community had no exclusive competence to negotiate certain agreements.\(^{162}\) Moreover, there is no common understanding whether the Community has the right to negotiate air services agreements for the EU. The Commission claims to have exclusive competence to negotiate and conclude new bilateral air services agreements between third parties and the EU under Article 307 EC.\(^{163}\) However, neither the Council nor the European Court of Justice have yet approved such competence.

Finally, it remains unclear whether and to what extent the Member States are required to eliminate provisions that are not in compliance with Article 49 EC and not protected by Article 307 EC. Advocate-General Lenz has taken a strong position and demanded that a bilateral agreement has to be denounced “if

\(^{162}\) Left open by the ECJ, see Joined Italian Republic v. Commission cases 3, 4, 6/76, Kramer and others, 1976 E.C.R. 1279; case 41/83, British Telecommunications, 1985 E.C.R. 873 (889 seq. note 36 seq.); Stefan Karl Eisermann, *Die Luftfahrtübergreifende Kompetenz der Gemeinschaft,* EuZW 1995, 331 takes the view that those agreements are also valid.

\(^{163}\) Art. 234 EC-Treaty in its former version, see *supra* note 113; see Jürgen Erdmenger, Hans von der Groeben, Jochen Thiesing, and Claus-Dieter Ehlermann, *Kommentar zum EU-/EG-Vertrag,* Band 1 (1999), Art. 84 note 93.
the non-member country is not prepared to amend the agreement."\textsuperscript{164} Since the European Court of Justice has not taken a position on that issue either, it can only be concluded that the Member States are required to take all reasonable efforts to re-negotiate bilateral agreements, as indicated in the wording of Article 307 EC, in order to replace the traditional nationality with the appropriate "Community ownership" clause.\textsuperscript{165}

Despite the current uncertainties regarding the external relations of the EU in the aviation sector, it nevertheless seems clear that for the European Union and its Member States the future of international aviation lies in multilateral agreements with third countries that accept the "Community nationality." Whether the Commission can negotiate such agreements in the near future, however, remains doubtful, as some Member States still fear that their sovereignty and national interests would be subordinated were they to allow the Commission to negotiate on their behalf. Considering the multiple Open Skies agreement between the United States and many EU Member States and the similar size of the markets, one can assume that changes will first occur in the transatlantic EU-U.S. aviation area.

D. Conclusion

The evaluation of the ownership and control requirements in the U.S. and the EU system has shown that, despite the numerical disparity, both systems prohibit effective or actual control by the foreign investor and view the question of control as the crucial factor. There are many similarities as to how the authorities in charge, namely the DOT and the European Commission, determine whether a carrier is able to maintain its citizenship status.

VI. OWNERSHIP REQUIREMENTS IN U.S. MARITIME LAWS

Following World War II, the United States Merchant Marine had the largest private merchant fleet in the world. Since then, the private merchant fleet has shrunk considerably and today the U.S. is no longer a significant player in international ship-


In 1948, 716 vessels were carrying the U.S. flag, close to one-half the world's shipping fleet. In 1995, less than 150 vessels were flying the American flag on international routes\footnote{H.R. Rep. No. 104-229 (1995).} and the United States controls only 5% of the world's fleet.\footnote{S. Rep. No. 104-167 (1995). This number presumably has further decline since three of the largest container companies, APL Ltd., Lukes Bros. Steamship Co. and the international services of Sea-Land Service Inc., were sold to foreign companies, see infra VI(B) (3).} U.S. carriers encounter diverse problems when competing against foreign-flagged vessels, and these problems have contributed to the steady decline of the U.S. merchant maritime fleet.

A. The Situation of the U.S. Merchant Marine Fleet

1. United States Registry Requirements

Every commercial vessel is attributed a nationality, namely the nationality of its registry. The United States has one of the most restrictive registration requirements of any maritime nation. 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.\footnote{See Testimony of Warren L. Dean, Testimony Before the House Committee on Ways and Means, Hearing on Impact of U.S. Tax Rules on International Competitiveness, June 30, 1999, <http://www.house.gov/ways_means/fullcomm/106cong/6-30-99/6-30dean.htm>; the EU fleet, in contrast, controls approximately 20% of the world's fleet, see Thomas Oppermann, Europarecht (1991), at 524 note 1350.} 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.

2. Flags of Convenience

The costs of compliance with the requirements of registration in the United States are very high and have therefore added to the decline of the fleet registered in the United States. American ship owners have decided to reflag their vessels, i.e., to change the registry of a ship to a different country ("flag of convenience"). Other countries have less strict registration requirements and permit the registration of almost all ships owned by

\footnote{46 U.S.C. § 12102 (1997).}
foreign nationals ("open registry").

One major advantage of reflagging is that a ship owned by a U.S. citizen can employ foreign seamen and can pay foreign, i.e., lower, wages, thereby avoiding the high costs of unionized maritime labor in high wage countries, such as the United States. In addition, the working conditions in flag of convenience countries are generally more favorable to ship owners. Because crewing costs can total as much as half of the ship's operating costs, ship owners can realize substantially higher profits by using a flag of convenience or, in some cases, remain at least competitive.

A second major reason for utilizing flags of convenience is that in 'popular' countries of registry, such as Liberia and Panama, shipping operations that take place outside the country of registry are untaxed. Hence, foreign flagged ships are not required to pay taxes either in the country of registry nor in the United States, even if they operate their businesses to and from the United States. In contrast, U.S. carriers must comply with the U.S. Tax Code, which causes significant disparities between U.S.-flag and foreign-flag vessels. While foreign-flagged ships often enjoy shipping income tax exemptions, deferral devices, and accelerated depreciation, or do not even pay income taxes at all, the U.S. Tax Code imposes high income taxes on U.S. maritime carriers. The United States corporate income tax rate is 35%, though most companies pay a lower rate through various deductions. Unlike the U.S., countries in the European Union and other maritime nations have adopted tax policies

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172 Even maritime nations that are not considered flag of convenience countries, such as European countries, have frequently adopted tax policies that enable their shippers to compete in international shipping.

173 E.g., seventeen major cruise lines benefit from the tax loopholes in the U.S. and pay virtually no taxes although most of their passengers are from the U.S., Today Weekly, March 18, 1999. One of the largest, Carnival Corp. headquartered in Miami and incorporated in Panama, reported only $6 million on taxes while having a pretax income of about $672 million in 1997. The taxes paid reflected work the company did in the United States.

and other means that allow their shipping companies to compete with flag of convenience ships.

Another major tax burden was caused by the 1986 repeal of Subpart F of the 1956 Internal Revenue Code, which permitted U.S. owners of foreign-flag ships to defer current U.S. taxation of operating income that was reinvested in shipping assets. These provisions allowed U.S. ship owners to offset earnings from foreign operations against losses or investments in domestic operations. The repeal was heavily promoted by the American maritime unions that wanted to prevent U.S. owners from operating foreign-flagged ships. However, the unions' desire to oppose a U.S.-owned convenience fleet has resulted in the further decline of the entire U.S. fleet.

Moreover, despite the repeal of Subpart F, "the tax revenues have decreased from $90 million per year before 1975, which equals $250 million today, to less than $50 million." In 1997, a proposal to reinstate the exemption was introduced but has not yet been acted upon.

More recently, ship owners have also sought to utilize flags of convenience to avoid potentially high liability exposure for maritime disasters, such as major oil spills. It is therefore not surprising that flags of convenience, due to their reportedly less strict safety standards, are often linked with major oil pollution, as some of the most devastating spills involved vessels registered under such flags, e.g., the Panamanian registered Amoco Cadiz in 1978.

Overall, it is estimated that U.S. ship owner costs are two-to-three times higher than those for reputable foreign-flag owners. Hence, reflagging under foreign flags such as Panama, Liberia or Greece could be financially very beneficial.

B. The U.S. Statutory Scheme

In order to encourage the maintenance of a merchant marine with U.S.-flag ships and American personnel and to support the shipbuilding industry, Congress has taken a number of steps. Like in the aviation sector, two main policies can be identified:

176 Before Subpart F was extended to shipping in 1976/1986, U.S. corporations owned or controlled more than 25% of the world's fleet; now the figure has declined to 5%. See Testimony of Warren L. Dean, supra note 171.
177 See id.
national defense and national economic interest. The United States as well as the countries of Western Europe have traditionally considered it very important to maintain registries of commercial vessels so as to enjoy access to those ships in the event of war or national emergencies. A substantial merchant fleet is supposed to ensure an adequate sea-lift capability for the carriage of personnel and equipment, as the military merchant marine does not have the ability to carry out these tasks itself.\footnote{See Anderson, supra note 173, at 144; see also Victor G. Hanson and John V. Berry, The Diminution of the Merchant Marine: A National Security Risk, 74 U. Det. Mercy L. Rev. 465, 481-482 (1997).}

In 1920, Congress enacted the Merchant Marine Act, which exclusively reserves the United States domestic trade (cabotage) for vessels built in the United States and owned and crewed by its citizens. The 1936 Act established a number of programs designed to support the U.S. shipping industry to compete effectively in international trade against vessels constructed and manned abroad. The Maritime Security Act of 1996 replaced some of the subsidies provided for in the 1936 Act in order to protect further and support the U.S. fleet against foreign competition.

1. The Merchant Marine Act of 1920

The Merchant Marine Act of 1920, also known as the Jones Act,\footnote{46 U.S.C. § 883 (1994).} reserves the United States domestic trade for vessels that are built in U.S. shipyards, owned and crewed by U.S. citizens, and operated under the U.S. flag, i.e., registered in the U.S. As described above, in order to register a ship in the United States or its territories, officers must be U.S. citizens, and 75% of its stock must be owned by U.S. citizen. Domestic trade is defined as trade “between points in the United States, including Districts, Territories, and possessions thereof embraced within coastwise laws”—in other words, cabotage. The rationale of this Act was to protect the national fleet against lower-cost foreign competition by excluding foreign ships from the domestic market. Hence, all United States shippers that operate exclusively in the domestic trades incur equivalent costs in constructing and operating their fleets. Apart from the requirement that the ships must be built in the U.S., the Jones Act resembles the regulation of the Federal Aviation Act for cabotage.\footnote{Warren L. Dean, Jones Act Reflects Fundamentals of US Legal System, J. of Com., Dec. 1, 1998 at 54.}
2. The Merchant Marine Act of 1936

The Merchant Marine Act of 1936 (hereafter the Merchant Marine Act)\(^{183}\) was intended to foster the development and encourage the maintenance of a large and effective merchant marine capable of meeting the Nation’s future commercial and military needs.\(^{184}\) The Act authorizes the U.S. maritime agency, the Maritime Administration (Marad), to grant subsidies to enable vessels that are built in the United States and staffed with U.S. personnel to compete effectively in the foreign trade. In order to promote the construction of vessels in U.S. shipyards, a carrier could receive “construction-differential subsidies” (CDS),\(^{185}\) if in return it agreed that it will operate that vessel exclusively in the foreign trade. Constructing ships in American shipyards was, and continues to be, much more expensive that constructing ships in foreign shipyards.\(^{186}\) Under the CDS program, the government could pay up to half the construction costs of a vessel built in the United States.\(^{187}\) The “operating differential subsidies” (ODS)\(^{188}\) were intended to enable U.S. vessels to successfully compete with all foreign-flagged vessels that can be crewed and maintained at lower costs.\(^{189}\) The domestic trading restrictions expire when either the ship owner pays back the unamortized subsidy or the subsidy becomes fully amortized at the end of the economic life of the ship.\(^{190}\)

Although these subsidies have offset a number of costs associated with operating a U.S.-flag vessel in international trade, American shipping subsidies were unreliable and, as labor and other maintenance costs continued to rise, not sufficient to en-

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\(^{185}\) 46 U.S.C § 1151 (1994).
\(^{189}\) 46 U.S.C. § 1156 (1994). It granted two exceptions to the obligation to operate the vessel exclusively in the foreign trade: first, a subsidized ship was permitted to operate in a domestic trade incident to a bona fide foreign voyage, meaning that the ship is allowed to travel in the domestic trade on one leg to a foreign voyage; second, the ship may operate in the domestic trade if the Secretary of Transportation has consented to a temporary transfer of the vessel to the domestic trade.
able the U.S. fleet to compete effectively with foreign ship liners. For many shipping companies the only way to remain financially viable was to escape the U.S. regime for less restrictive convenience registries.


In 1995, it appeared that the U.S. fleet would vanish entirely unless decisive steps were taken to support the merchant marine. The ODS subsidies provided for by the 1936 Merchant Marine Act were no longer available, since the last contracts benefiting from them expired in 1998.191 It was the common understanding that the U.S.-flag presence in international trade was likely to disappear unless a maritime bill would be enacted that sufficiently supported the U.S. fleet. Hence, in 1996 the House and Senate passed the Maritime Security Act192 to replace, even though to a smaller degree, the ODS program of the 1936 Act. Major beneficiaries of the new subsidy program are the U.S. maritime workers, as the subsidies principally help to offset the higher costs of U.S. crews.

Under the Maritime Security Act, 47 U.S. ships are subsidized over the next decade. Unlike the Merchant Maritime Act, the Maritime Security Program grants a flat fee per vessel and does not require certain specified trade routes. Ship owners received $2.3 million per vessel in 1996 and $2.1 million per vessel for each following year through fiscal year 2007. In return, carriers must participate in the Maritime Security Fleet. In the event of war or national emergency, carriers must make their participating vessels available for the use of the DOD.193

Currently, the Maritime Security Program provides nearly $100 million in subsidies for U.S.-flagged vessels.194 Remarkably, most of these vessels are ultimately owned by foreign companies—many of the once U.S. companies that participate in the program have since been sold to foreign companies. Just after the enactment of the program, the second-largest U.S.-flag container ship operator, APL Ltd., was sold to the Singapore-

192 Maritime Security Act, Pub. L. No. 104-239, 110 Stat. 3118 (1996); President Clinton signing the bill stated: “[The Act] will ensure that the United States will continue to have American Flag ships crewed by loyal American citizen merchant mariners to meet our Nation’s economic and sealift defense requirements”, available in 1996 WL 576962.
193 Id. at § 2.
194 It’s Pure Clinton, J. OF COM., Feb. 2, 2000, at EP.
based Neptune Orient Lines (NOL). In 1998, Lykes Bros. Steamship Co., another large U.S.-flag carrier, was sold to a Canadian company; and in 1999, CSX Corp. sold the international services of Sea-Land Service Inc., the largest U.S.-flag container ship operator, to the Danish A.P. Moller Group, the parent of the Maersk Line. Despite the change in ownership, the Maritime Administration approved the transfer of the subsidies to the new owners that continue to operate the ships under the U.S. flag.\textsuperscript{195} The method by which this is all accomplished is: the buyers regularly set up U.S.-owned trusts that operate the vessels for the foreign owner and employ and direct captain and crew. Evidently, the Maritime Administration believes that the creation of a straw-man U.S. trust is sufficient to keep ownership and control in U.S. hands, even though the vessel is presumably time chartered exclusively to its foreign owner that directs where, when, and how the vessel operates.

After the transfer of Sea-Land's 15 subsidized ships, only three of the 47 vessels participating in the program are now operated by companies based inside the United States.\textsuperscript{196} It appears possible that U.S.-flagged ships that are held by a U.S. trust and ultimately owned and operated by foreigners can participate in the Maritime Security Fleet program.

Compared with the situation in the aviation sector, it appears that the standards regarding ownership requirements are very different, and much less strict, in the maritime sector. While the DOT closely examines any links of the U.S. owners or trustees of U.S. carriers with foreign interests, the Marad does not seem to be equally interested in the ultimate ownership situation of U.S. shipping companies that receive federal subsidies. Although the connections with the foreign owners of the U.S. trusts that operate the vessels for the foreign owner seemed to be obvious and well known, the Marad approved the transfer of the subsidies to the new companies. One can assume that the Marad, in making its decision to approve the transfer, also takes into account the purpose of the subsidy and, in particular, the effects a revocation of the subsidies would have on U.S.-flagged ships and U.S. crews. Without the subsidies, the foreign buyer of the shipping companies would have no incentive to maintain them under the U.S. flag or to employ U.S. crews. Conse-


\textsuperscript{196} \textit{Id.}
sequently, it appears as if Marad views the ownership status of a shipping company and potential foreign interests in the company as less important than the continuing maintenance of a U.S.-flagged and U.S.-crewed shipping line—with whatever benefits to the U.S. economy and U.S. national security are provided by such “hybrid” owned companies.

4. Conclusion

Despite the positive influence of the Maritime Security Program, the decline in the U.S.-flagged merchant marine fleet has continued. Due to the high costs of U.S. labor, especially in comparison with flag of convenience crews, and the burdensome U.S. tax regime, the U.S.-flagged shipping fleet cannot survive without federal operating subsidies.\(^\text{197}\) The major factors identified as to responsible for the ongoing decline of U.S.-owned and flagged ships is the high cost of operating ships that must comply with U.S. laws.\(^\text{198}\) Ownership requirements, however, do not have the same impact on the U.S. maritime industry as they have on the aviation industry. While ownership and control requirements in the aviation sector, due to the bilateral regime, prevent or at least impede cross-border mergers of air carriers, the sale of U.S. shipping companies to foreign shipping lines itself is not affected by statutory ownership requirements. However, the ownership issue is of importance in the context of the domestic trade—which is, however, irrelevant for shipping lines that operate in the international trade (such as the companies named above) and in the context of the subsidies granted by the 1996 Maritime Security Act.


Comments