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CHAPTER XII

MAJOR PROVISIONS IN AIR TRANSPORT AGREEMENTS*

SYNOPSIS

I. INTRODUCTION

The Chicago Convention of 1944 addresses airspace sovereignty and traffic rights. Article 1 of the Convention affirms the "complete and exclusive sovereignty" of every State over "the airspace above its territory." Article 3 prohibits State aircraft from flying over the territory of another State without its permission. Article 5 provides certain traffic rights for non-scheduled flights, though potentially restricted by "such regulations, conditions or limitations" as the underlying State may deem desirable. Article 6 prohibits scheduled international flights over the territory of a State, "except with the special permission or other authorization of that State, and in accordance with the terms of such permission or authorization." Article 7 allows a State to restrict foreign airlines from engaging in for-hire domestic (cabotage) air transport, and prohibits the discriminatory authorization of cabotage rights to a foreign airline. Hence, international flights to, from, through or within foreign airspace are prohibited unless the State whose territorial airspace is penetrated has authorized such operations. State State

The Chicago Conference produced two multilateral documents to exchange such rights – the Transit Agreement (exchanging First, Second and Third Freedom rights), and the Transport Agreement (exchanging the first Five Freedoms). The former has been widely adopted, while the latter has received

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few ratifications. Thus, bilateral air transport agreements have become the principal vehicle for implementing the rights conferred to States under Articles 1 and 6 of the Chicago Convention to authorize foreign scheduled air services over their territory.[1]

II. ENTRY (CARRIER AND ROUTE DESIGNATION)

As noted in the preceding Chapter, U.S. and British negotiators met in Bermuda in 1946 in an attempt to reconcile their respective aviation policies, producing the so-called *Bermuda I* bilateral air transport agreement. In addition to provisions relating to pricing and capacity/frequency controls, *Bermuda I* also contained important provisions relating to the identification of international routes and the designation of carriers which are authorized to operate on such routes. In contrast with the Standard Chicago Agreement, which itself did not provide for the identification of specific routes, the *Bermuda I* agreement contains a detailed description of routes and airports.[2]

Article 2 of the bilateral makes it clear that the designation of international carriers is reserved to governmental authorities of each State.[3] Each government is authorized to designate "a carrier or carriers"[4] to operate on those routes identified in the Annex to the agreement, subject to the requirement that the designated carrier(s) of each State satisfy certain standards imposed by the aeronautical authorities of the other.[5] Pre-existing routes were "grandfathered", or Stated differently, were affirmed by the *Bermuda I* agreement.[6]

Although the *Bermuda I* agreement would influence most bilaterals concluded during the postwar era, many post-*Bermuda I* agreements contained a single designation system. This system allowed each State to choose one carrier to perform air services pursuant to the bilateral in question, and was prevalent in agreements between States, each having but a single international carrier.[7]

Nations which have more than one international carrier, however, such as the United States, have traditionally insisted upon a system of multiple designation.[8] Under the United States standard form bilateral provision, as under *Bermuda I*, the United States was free to designate an unlimited number of carriers;[9] it was also free to designate an unlimited number of gateway city pairs by virtue of language which read "from the United States . . . ."[10]

The provisions of *Bermuda I* and the U.S. standard form bilateral relating to the designation of air carriers were subsequently incorporated into the vast majority of bilaterals concluded by the United States in the postwar era. Most States which entered into *Bermuda I*-type agreements, including the United States, implemented the "air carrier or carriers" terminology simply by designating an equal number of carriers *vis-à-vis* the other party to the bilateral. Most States with which the United States

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[1] Critics of this regime include Professor Brian Havel, who argues that the *Chicago Convention* and the bilateral system which emerged reserved, "to governments the power to parcel out (and to deny) access to national airspace by foreign airlines, to exclude foreign airlines from domestic point-to-point service, and to prohibit foreign citizens (and their airlines) from owning or controlling national air carriers." BRIAN HAVEL, IN SEARCH OF OPEN SKIES 1 (KLUWER 1997).

[2] *Bermuda I*, *supra*, Annex III.

[3] *Id.*, art. 2.

[4] *Id.*

[5] Article 2 of *Bermuda I* states that "[t]he designated air carrier or carriers may be required to [prove that it is]. . . qualified to fulfill the conditions prescribed by or under the laws and regulations normally applied by those authorities to the operations of commercial air carriers." Clauses like this are included in nearly all bilateral air transport agreements.

[6] *Bermuda I*, Art. 10.

[7] Peter Haanappel, *Bilateral Air Transport Agreements – 1913-1980*, 5 INT'L TRADE L.J. 241, 252 (1980).

[8] *Id.*

[9] *United States Standard form of Bilateral Air Transport Agreement*, Art. 3 (1953). *See* Peter Haanappel, *Bilateral Air Transport Agreements – 1913-1980*, 5 INT'L TRADE L.J. 241, 252 (1980).

[10] *Id.*

maintained air services had but a single carrier to serve a particular market, except in more heavily traveled markets. Despite the existence of the "air carrier or carriers" language contained in nearly all U.S. bilaterals concluded during the thirty-year period from *Bermuda I* until the beginning of the Carter administration—language which did not explicitly limit the number of carriers which could be designated—the CAB continued to designate only that number of carriers necessary to maintain a rough parity or *quid pro quo* with the number of foreign carriers operating in a particular market pursuant to the bilateral in force.[11]

Just as they had in the area of pricing, however, the deregulatory initiatives of the Carter administration were to have a profound impact on the issue of carrier designation. The 1978 Statement of U.S. aviation policy declared that, in negotiating new bilaterals, American negotiators were to seek "[f]lexibility to designate multiple U.S. airlines in international transportation."[12] Article 3 of the U.S. model agreement provides that each State "shall have the right to designate as many airlines as it wishes and to withdraw or alter such designations."[13]

In accordance with these policy objectives, in the late 1970s, the CAB began to designate numerous U.S.-flag carriers to provide service between a number of U.S. interior points and London—markets which had theretofore lain dormant under *Bermuda I*.[14] Between 1978 and 1980, for example, five new U.S.-flag carriers were authorized to serve the transatlantic market.[15]

The U.S. and U.K. signed *Bermuda II* in 1977.[16] In principle, the *Bermuda II* agreement contains a system of multiple designation.[17] On North Atlantic routes, however, a single designation system existed, with the exception of two routes where multiple designation was permitted.[18] One noted commentator has argued that these carrier designation provisions represent the major British triumph at the *Bermuda II* negotiations.[19]

Despite the restrictive nature of the *Bermuda II* carrier designation provisions, the Carter administration remained determined to substitute its negotiating strategy aimed at enhancing consumer benefits for the traditional U.S. objective of obtaining equal operating opportunities and a fair exchange of traffic rights.[20] In an effort to circumvent opposition by the British and others to U.S. regulatory

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[11] In the early 1970s, for example, only two major U.S. carriers operated in the U.S.-Pacific market (*i.e.*, Pan Am and Northwest Orient), the U.S.-Latin America market (*i.e.*, Pan Am and Braniff), and the U.S.-Europe market (*i.e.*, Pan Am and TWA). In 1985, financially troubled Pan Am sold virtually all of its Pacific routes to United Airlines for $750 million.

[12] *Statement Concerning United States Policy on the Conduct of International Air Transport Negotiations*, 14 WEEKLY COMP. OF PRES. DOC., 1462 (AUG. 28, 1978) [hereinafter cited as U.S. Policy Statement].

[13] Bogosian, *Aviation Negotiation and the U.S. Model Agreement*, 46 J. AIR L. & COM. 1007, 1024 (1981) [hereinafter cited as *Bogosian*].

[14] Paul Dempsey, *The International Rate and Route Revolution in North Atlantic Passenger Transportation*, 17 COLUM. J. TRANSNAT'L L. 393, 415-34 (1978).

[15] These carriers were Air Florida, Braniff, Delta, Northwest and Western.

[16] *Bermuda II*, *supra*.

[17] The relevant provision states that eachState "shall have the right to designate an airline or airlines . . . ." *Id.*, Art. 3 ¶ 1.

[18] *Id.*, Art. 3 ¶ 2.

[19] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 37 (1984).

[20] Policymakers and commentators alike have disagreed with respect to what constitutes a "fair" exchange of routes in international air transport. Frank E. Loy, a former U.S. bilateral air transport agreement negotiator, described the traditional U.S. view of what constitutes such an exchange:

> [I]t is our belief that bilateral air transport route exchanges must be viewed within the general framework of over-all commercial policy, and that we should follow similar commercial trading concepts in making route exchanges. Under these principles the appropriate test for route exchanges, we are convinced, is an equitable exchange of economic benefits.

LOY, BILATERAL AIR TRANSPORT AGREEMENTS: SOME PROBLEMS OF FINDING A FAIR ROUTE EXCHANGE, *reprinted in* A. LOWENFELD, AVIATION LAW II-96 (1972). In order to effectuate such an exchange, Loy argues, a four-step analysis is required:

- Determining the kinds of traffic properly included in evaluating the market potential of the route.
- Determining the proportion of the potential market that can properly be attributed to the carriers of the two countries.
- Calculating the projected numbers of passengers or tons of cargo that are attributable to the carriers of the two countries.
- Converting the resulting volume of traffic into potential revenues.

initiatives, including those relating to multiple designation, the CAB adopted a "divide and conquer" strategy; smaller European States would be offered access to lucrative interior U.S. points in exchange for cooperation with the United States in eliminating restrictions on numbers of carriers, capacities and rates.[21]

In 1978, the first generation "liberal" bilaterals were concluded by the United States with the Netherlands,[22] Belgium,[23] and Israel.[24] These bilaterals explicitly provided for the unlimited designation of carriers by aviation authorities of both States. For example, the 1978 U.S.-Belgium bilateral authorizes each State to "designate as many airlines as it wishes for any market covered" by the agreement.[25] In return, carriers of these States were given an opportunity to commence service between their own territories and numerous interior U.S. points.[26] In the U.S.-Belgium bilateral, for example, U.S.-flag carriers were given unlimited Third, Fourth and Fifth Freedom rights to Belgium and beyond. But Belgium-flag carriers received less; they were given the right to serve five U.S. points (i.e., Atlanta, New York and three to be subsequently designated), and Fifth Freedom rights to serve only Canada and Mexico.[27] Charter and cargo services could be flown to or from "any point or points" in either State.[28] However, Seventh Freedom rights were prohibited.[29] The Netherlands received authority for its carriers to serve Los Angeles and one additional point.[30]

Between 1978 and 1980, the United States concluded eleven additional liberal *Benelux*-type bilaterals or amendments to existing bilaterals, each explicitly providing for unlimited designation of carriers.[31] Unlimited multiple designation has often been cited as one of the main characteristics of the new "open skies" bilaterals.[32]

Despite perceived successes in the *Benelux* negotiations, the U.S. multiple designation policy generated considerable criticism both at home and abroad.[33] Domestic opposition focused on the CAB decision to grant foreign carriers access to numerous interior U.S. cities.[34] In the international sphere, the CAB's attempts to implement its liberal multiple designation policy led to serious confrontations with a

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Id., II-90. Thus, according to Loy, "a fair route exchange requires an equitable exchange of economic benefits, expressed in terms of route rights having approximately equal market value." *Id.,* II-89. Other commentators, however, have criticized the economic benefits approach traditionally espoused by the United States. *See generally*, Henri Wassenbergh, *Aspect of the Exchange of International Air Transportation Rights*, VI ANNALS AIR & SPACE L. 235 (1981).

[21] Professor Wassenbergh has set forth the conditions which promptStates to enter into liberal bilaterals. *See* Wassenbergh, *Towards a New Model Bilateral Air Transport Services Agreement?,* 3 AIR L. 197 (1978) [hereinafter cited as *Wassenbergh*].

[22] *U.S.-Netherlands Air Transport Agreement*, *supra*.

[23] *Agreement on Air Transport Services, United States-Belgium*, October 23, 1978, 30 U.S.T. 217; T.I.A.S. NO. 9903.

[24] *U.S.-Israel Air Transport Agreement*, *supra*.

[25] *Agreement on Air Transport Services, United States-Belgium*, October 23, 1978, 30 U.S.T. 217; T.I.A.S. NO. 9903, Art. 2(1).

[26] KLM, for example, began new service to Miami, Boston, Houston, Atlanta and Los Angeles.

[27] *Agreement on Air Transport Services, United States-Belgium*, October 23, 1978, 30 U.S.T. 217; T.I.A.S. NO. 9903, Art. 3. Mexico City could be served by a Belgium carrier only from one U.S. city.

[28] *Agreement on Air Transport Services, United States-Belgium*, October 23, 1978, 30 U.S.T. 217; T.I.A.S. NO. 9903, Art. 3(2)(b), 4.

[29] *Agreement on Air Transport Services, United States-Belgium*, October 23, 1978, 30 U.S.T. 217; T.I.A.S. NO. 9903, Art. 3(3). Flights on routes authorized under the agreement were required to begin or end in the territory of the designatingState.

[30] Pablo Mendes de Leon, *Before and After the Tenth Anniversary of the Open Skies Agreement Netherlands-US of 1992*, 18 AIR & SPACE L. 280, 283 (2002).

[31] *See, e.g., Agreement on Air Transport Services, United States-Belgium*, October 23, 1978, 30 U.S.T. 217; T.I.A.S. NO. 9903, Art. 3.

[32] Henri Wassenbergh, *Towards a New Model Bilateral Air Transport Services Agreement?* 3 AIR L. 197, 198 (1978).

[33] In late 1980, the Air Transport Association [ATA], which represents the vast majority of U.S. domestic and international carriers, criticized the Carter policy *See* Henri Wassenbergh, *Aspect of the Exchange of International Air Transportation Rights*, VI ANNALS AIR & SPACE L. 235 n. 1 (1981).

[34] U.S. carriers have complained that the value accruing to foreign air carriers, as a result of their entry into the large U.S. market, far exceeds the value accruing to U.S. carriers by way of access to more modest foreign markets. *Id.,* 235. U.S. carriers also claim that foreign carriers, particularly European carriers, have an additional advantage once they receive access to U.S. gateways, namely, the European "feeder" network which allows them to carry sixth-freedom traffic; U.S. carriers, on the one hand, must rely upon the end-to-end traffic between their "own" U.S. markets and each individual foreign market.

number of States, including Japan,[35] the United Kingdom,[36] France,[37] and Peru.[38] Thus, despite the proliferation of liberal U.S. bilaterals providing for unlimited multiple designation, it must be noted that many States, including several important aviation powers, opposed U.S. initiatives in this area.

An examination of the carrier designation provisions of sixty-six U.S. bilaterals in force in the mid-1980s revealed a wide variety of textual variations:

- forty-eight allowed each State to designate "an airline or airlines,"
- three allowed each State to designate "one or more airlines,"
- one allowed each State to designate "airlines,"
- nine allowed each State to designate "as many airlines as it wishes,"
- two allowed each State to designate "an airline,"
- one allowed each State to designate "two airlines,"
- one allowed each State to designate "up to five airlines," and
- one (Greece) identified the specific airlines authorized to operate air services pursuant to the bilateral (*i.e.*, TWA and Olympic Airways).[39]

Conflicts were precipitated by the Bermuda I-type "airline or airlines" provision contained in U.S. bilaterals with States such as Japan and France. Of the nine bilaterals containing what is arguably the unambiguous language denoting unlimited multiple designation (i.e., "Each party shall have the right to designate as many airlines as it wishes . . ."), all but one were concluded after 1977. Not all post-1977 U.S. bilaterals adopted such language; however, several such bilaterals, some of the liberal Benelux-type, contain the Bermuda I-type "airline or airlines" language.

The modern "open skies" U.S. approach is to insist on a provision allowing each State "to designate as many airlines as it wishes." It is also unrestricted as to potential city-pair markets and Fifth Freedom rights. For example, the U.S.-Netherlands agreement of 1992 provides for multiple carrier designation, and allows each State's airlines to serve "a point or points" in the other State and beyond, without limitation.[40] Seventh Freedom rights have been conferred to cargo, but not for passenger, service.[41] Cabotage rights, also, have not been included in U.S. "open skies" bilaterals.

Similar to the air transport agreements concluded by the U.S., the bilaterals concluded by Canada between 1955 and 2000 are not uniform in their provisions regarding the designation of carriers. A review of thirteen air agreements to which Canada is a party[42] showed the following variety of requirements:

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[35] In the early 1970s, Japan refused to allow services by Continental Air Micronesia, which had been designated by the CAB. In 1977, the Japanese government finally authorized the service.

[36] British opposition to the designation of additional U.S. carriers in the late 1970s led to restrictions on multiple designation in the *Bermuda II* bilateral.

[37] In the late 1970s, the CAB invited all interested parties to be certificated to serve France, despite the French government's strong opposition to multiple entry.

[38] Conflict over multiple designation was merely one of many such conflicts between the United States and Peru in the late 1970s and early 1980s. These conflicts led Peru to renounce the bilateral in 1984.

[39] *See* AIR TRANSPORT ASSOCIATION, PROVISIONS IN U.S. INTERNATIONAL TRANSPORT AGREEMENTS (1985).

[40] Pablo Mendes de Leon, *Before and After the Tenth Anniversary of the Open Skies Agreement Netherlands-US of 1992*, 18 AIR & SPACE L. 280, 289 (2002).

[41] Pablo Mendes de Leon, *Before and After the Tenth Anniversary of the Open Skies Agreement Netherlands-US of 1992,* 18 AIR & SPACE L. 280, 291 (2002).

[42] For the purpose of this Chapter, the following air transport agreements were reviewed: *Air Agreement between the Government of Canada and the Government of the Federative Republic of Brazil on Air Transport* (with Annex), May 15, 1986, CANADA TREATY SERIES 1990 NO. 5 (entered into force on July 26, 1990) [hereinafter *Canada-Brazil Bilateral*], *Air Agreement between Canada and the People's Republic of China (with Protocol)*, June 11, 1973, CANADA TREATY SERIES 1973, NO. 21 (entered into force on June 11, 1973) [hereinafter *Canada-China Bilateral*], *Air Transport Agreement between the Government of Canada and the Government of the Republic of Cuba* (with Annex), February 12, 1998, CANADA TREATY SERIES 2000/31 (entered into force on November 27, 2000) [hereinafter *Canada-Cuba Bilateral*], *Air Agreement between Canada and France*, June 15, 1976, CANADA TREATY SERIES 1977, NO. 15 (entered into force on January

- One bilateral contains a clause for designation of a specific airline for one Party and allows for the other Party to designate one airline (i.e., Canada-China Bilateral)
- Two bilaterals contain a clause for the designation of one airline by each Contracting Parties (i.e., Canada-Korea Bilateral "*an airline*" and Canada-Mexico Bilateral "*one airline*")
- One bilateral contains a clause for the designation of two airlines by each Contracting Parties (i.e., Canada-Cuba Bilateral)
- One bilateral contains a clause for the designation of "*an airline or airlines*" but not more than two at any one time (Canada-Brazil Bilateral)
- Three bilaterals contain clauses of designation referring to "*one or more airlines*" (Canada-UK Bilateral, Canada-France Bilateral; Canada-Italy Bilateral)
- Four bilaterals contain clauses of designation referring to "*an airline or airlines*" (Canada-Spain Bilateral, Canada-Russian Federation Bilateral; Canada-Germany Bilateral; Canada-Japan Bilateral)
- One bilateral contains a clause of designation that refers to "*as many airlines as it wishes*" (Canada-US Bilateral).

One should note that all of the carrier designation provision provide for the possibility of a subsequent withdrawal or alteration of the initial designation.

In terms of route designation, 12 out of the 13 agreements reviewed refer to access only to routes specified in the agreement. Only the US-Canada agreement provides for open entry to all routes (to and from any point in Canada to and from any point in the United States), with some limitations on some routes provided in the Annex to the agreement.

With regard to traffic rights granted to the Contracting parties, the bilaterals signed by Canada and its partners are almost unanimous in expressly prohibiting cabotage (among the 13 Canadian bilaterals reviewed, only the Canada-Germany Bilateral appears not to explicitly prohibit cabotage). Fifth Freedom rights are usually granted to points specified in the annexes to these agreements or to be determined subsequently by the Contracting Parties. Under "open skies" bilaterals, however, unlimited Third, Fourth and Fifth Freedom rights are conferred in both directions.

III. NATIONALITY REQUIREMENTS

A. NATIONALITY OF AIRCRAFT

Professor John Cobb Cooper described aircraft nationality as "in some respects, the most important

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8, 1977) [hereinafter *Canada-France Bilateral*], *Air Agreement between Canada and the Federal Republic of Germany* (with supplementary Notes), March 26, 1973, CANADA TREATY SERIES 1975, NO. 4 (entered into force on February 18, 1975) [hereinafter *Canada-Germany Bilateral*], *Air Agreement between Canada and Italy*, February 2, 1960, CANADA TREATY SERIES 1962 NO. 4 (entered into force on April 13, 1962) [hereinafter *Canada-Italy Bilateral*], *Agreement between Canada and Japan for Air Services*, January 12, 1955, CANADA TREATY SERIES 1955 NO. 14 (entered into force on July 20, 1955) [hereinafter *Canada-Japan Bilateral*], *Air Agreement between the Government of Canada and the Government of the Republic of Korea for Air Services between and beyond their Respective Territories* (with Annex and Memorandum of Understanding on Capacity), September 20, 1989, CANADA TREATY SERIES 1989 No. 50 (entered into force on September 20, 1989) [hereinafter *Canada-Korea Bilateral*], *Air Agreement between Canada and the United Mexican States*, December 21, 1961, CANADA TREATY SERIES 1964, NO. 4 (entered into force on February 21, 1964) [hereinafter *Canada-Mexico Bilateral*], *Air Services Agreement between the Government of Canada and the Government of the Russian Federation,* December 18, 2000, CANADA TREATY SERIES 2001/15 (entered into force on March 9, 2001) [hereinafter *Canada-Russia Bilateral*], *Agreement between the Government of Canada and the Government of Spain on Air Transport* (with Annex), September 16, 1988 [hereinafter *Canada-Spain Bilateral*], *Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Canada concerning Air Services*, June 22, 1988, CANADA TREATY SERIES 1989 NO. 37 (entered into force on June 22, 1988) [hereinafter *Canada-UK Bilateral*], *Air Transport Agreement between the Government of the United States of America and the Government of Canada*, February 24, 1995, CCH, AVIATION LAW REPORTS (1999) CANADA ¶ 26, 246a (entered into force on February 24, 1995) [hereinafter *Canada-US Bilateral*].

principle in aeronautical law . . . ."[43] Article 17 of the Chicago Convention provides that, "Aircraft shall have the nationality of the State in which they are registered."[44] They may not be registered in more than a single State, though registration may be transferred from one State to another.[45] Registration and transfers shall be subject to the domestic laws of the registering State.[46]

Registering States must report to ICAO data revealing the ownership and control of aircraft they register. They must make available to other contracting States, or ICAO, information concerning the registration and ownership of aircraft registered in it, on demand.[47] They must provide such aircraft with a certificate of airworthiness,[48] and issue certificates of competency and licenses for pilots and flight crews.[49]

Other States, in turn, have a duty to recognize certificates of airworthiness and personnel certificates of competency and licenses as valid, but only so long as the requirements under which they are issued "are equal to or above the minimum standards which may be established" by ICAO.[50]

B. NATIONALITY OF AIRLINES

Airline nationality is not addressed in the Chicago Convention, though it has become an important part of most bilateral air transport agreements, whose "substantial ownership and effective control" requirements have effectively precluded adoption of the Maritime Law notion of "flags of convenience" into international aviation. In both the Paris Convention of 1919 and the Chicago Convention of 1944, aviation negotiators deliberately rejected expansion of Grotius' freedom of the seas into the skies, in favor of complete and exclusive territorial sovereignty. Almost all bilateral air transport agreements, as well as the multilateral Transit and Transport Agreements, require that carriers designated thereunder be substantially owned and effectively controlled by citizens of the State from which they originate. For example, Section 5 of the Transit Agreement, and Section 6 of the Transport Agreement, both provide, inter alia: "Each contracting State reserves the right to withhold or revoke a certificate or permit to an air transport enterprise of another State in any case where it is not satisfied that substantial ownership and effective control are vested in nationals of a contracting State . . . ." Hence, there is no concept of "flags of convenience" in aviation as there is in maritime law.[51]

Ownership and control requirements originated over the post-war concern about the potential use of civil aviation for military purposes, for the same reasons European States had different gauge rail tracks at their borders. A year after the Mongolfier brothers took a balloon up in 1783, the French began using balloons for military surveillance. States like the U.S. restrict foreign ownership in several strategic infrastructure industries -- communications, broadcasting, nuclear power production, inland and intercoastal shipping, and aviation. The restrictions are also designed to prohibit Seventh Freedom operations, limiting competition to Third, Fourth and Fifth freedom rights.

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[43] John Cobb Cooper, *Backgrounds of International Public Air Law*, 1 YEARBOOK OF AIR AND SPACE LAW 3, 31 (1967).

[44] *Chicago Convention*, Art. 17.

[45] *Chicago Convention*, Art. 18. Some aircraft are leased to carriers who do not fly to the state of registration, making it difficult for the registering state to monitor the aircraft's airworthiness. Article 83*bis* allows the registration functions to be transferred to another state better able to fulfill such regulatory requirements.

[46] *Chicago Convention*, Art. 19.

[47] *Chicago Convention*, Art. 21.

[48] *Chicago Convention*, Art. 31.

[49] *Chicago Convention*, Art. 32.

[50] *Chicago Convention*, Art. 33.

[51] Flags of convenience have created enormous problems in the maritime trade. *See e.g.*, Paul Dempsey, *Compliance and Enforcement in International Law - Oil Pollution of the Marine Environment by Ocean Vessels*, 6 N.W. J. INT'L L. & BUS. 459 (1984); and Paul Dempsey & Lisa Helling, *Oil Pollution by Ocean Vessels - An Environmental Tragedy: The Legal Regime of Flags of Convenience, Multilateral Conventions and Coastal States*, 10 DEN. J. INT'L L. & POL'Y 37 (1980).

Several reasons have been advanced in favor of nationality requirements and cabotage restrictions: (1) to protect national security; (2) to ensure the exchange of traffic and other rights would go to airlines only of the State with which they were negotiated; (3) to protect national airlines from market dilution and excessive competition; (4) to protect labor wages and working conditions; and (5) to avoid the problem that exists in the maritime trade of "flag of convenience" vessels with lax safety, labor, and environmental restrictions.[52]

Under Bermuda I, carriers designated by each State had to be substantially owned and effectively controlled by its citizens. They were also required to abide by the laws and regulations applied by regulatory authorities to the operations of commercial airlines,[53] such as, for example, safety and security requirements. Laws relating to entry and departure (e.g., clearance, immigration, passport, quarantine or customs laws) were also made explicitly applicable to the passengers, crew, cargo and carriers of the other party to the bilateral.[54] However, licenses and certificates of airworthiness and competency granted by a State to its flag carriers were to be recognized as valid by the other party to the bilateral.[55] Failure to satisfy the "substantial ownership and effective control" requirement, or failure to abide by these national laws and regulations, could result in the withholding or revocation of rights conferred under the bilateral.[56]

The liberal bilaterals concluded beginning in the late 1970s typically provided that the State in whose territory the traffic originated had exclusive jurisdiction to enforce its rules and regulations, and required each government to "minimize the administrative burdens of filing requirements".[57]

Like their predecessors, modern "Open Skies" bilaterals require that "substantial ownership and effective control" be vested in the nationals of the State designating the airline, and that failure to meet this requirement (or to abide by laws governing operation and navigation of aircraft, safety, or security) would entitle either State to revoke, suspend or limit the operations of the offending airline.[58]

However, the exercise of these nationality requirements was discretionary, and often waived. Thus, on several occasions, the U.S. waived the nationality requirements for airlines registered in States that met FAA Category I safety and security requirements, and that had concluded an "open skies" bilateral with the United States.[59] Thus, when Iberia gained control of Aerolinas Argentinas, the U.S. did not object to the fact that Spanish citizens owned and control the Argentinian carrier once Argentina opened the bilateral to expand traffic rights for U.S. carriers. Conversely, the 1992 proposal of British Airways to gain effective control of USAir hit a shallow reef as bilateral negotiations between the U.S. and U.K. stalled over opening London Heathrow Airport to more than the two U.S.-flag carriers authorized under Bermuda II.[60] Hence, the presence of an ownership and control restriction can be an

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[52] *See* Stephen Rynerson, *Everybody Wants to Go to Heaven, But Nobody Wants to Die: The Story of the Transatlantic Common Aviation Area*, 30 DEN. J. INT'L L. & POL'Y 421, 423 (2002); Howard Kass, *Cabotage and Control: Bringing 1938 U.S. Aviation Policy into the Jet Age*, 26 CASE W. RES. J. INT'L L. 143 (1994); and BRIAN HAVEL, IN SEARCH OF OPEN SKIES 62 (KLUWER 1997). For a review of the safety and environmental problems created by "flags of convenience" in the maritime trade, *see* Paul Stephen Dempsey, *Compliance and Enforcement in International Law - Oil Pollution of the Marine Environment by Ocean Vessels*, 6 NW J. INT'L L. & BUS. 459 (1984).

[53] *Bermuda I*, art. 2(2).

[54] *Bermuda I*, art. 5.

[55] *Bermuda I*, art. 4.

[56] *Bermuda I*, art. 6.

[57] *Agreement on Air Transport Services, United States-Belgium*, October 23, 1978, 30 U.S.T. 217; T.I.A.S. NO. 9903, Art 8(1), 9.

[58] *See e.g., Air Transport Agreement between the Government of the United States and Singapore*, 1997, CCH AVIATION ¶ 26,495A, Art. 3(2), 4, 5, 6, 7.

[59] Pablo Mendes de Leon, *A New Phase in Alliance Building; The Air France/KLM Venture as a Case Study*, ZEITSCHRIFT FÜR LUFT- UND WELTRAUMRECHT 359 (2004); Allan Mendelsohn, *Myths of International Aviation*, 68 J. AIR L. & COM. 519, 524-26 (2003).

[60] Pablo Mendes de Leon, *A New Phase in Alliance Building; The Air France/KLM Venture as a Case Study*, ZEITSCHRIFT FÜR LUFT- UND WELTRAUMRECHT 359, 369 (2004); ISABELLE LELIEUR, LAW AND POLICY OF SUBSTANTIAL OWNERSHIP AND EFFECTIVE CONTROL OF AIRLINES 38 (ASHGATE 2003).

effective lever to pry loose concessions that would be unattainable absent formal renunciation of the bilateral.

The same requirement of "substantial ownership and effective control" of the designated airlines by the nationals of the Contracting Parties is found in each of the 13 air agreements signed by Canada[61] and reviewed for the purpose of this study. In case one Party is not satisfy that substantial ownership and effective control of such airline is vested in the other Contracting Party or its nationals, these agreements provide that the dissatisfied Party has the right to withhold, revoke or impose conditions on, the authorization granted to the other Party's designated airline. This right is discretionary, and may be waived by either party. In fact, the United States has waived this requirement on numerous occasions.[62]

Of late, ownership and control requirements have been criticized by advocates of liberalization of governmental restrictions, who argue that the "open skies" approach does not go far enough. Professor Brian Havel, for example, calls for elimination of what he describes as "the central legal pillars of the prevailing Chicago system of protective bilaterals – the principles of cabotage. . . and the nationality principle . . . . Until these pillars crumble, in the US and among its aviation trading partners, no authentic globalization of the international aviation system will be possible."[63]

Several multilateral approaches to the issue of effective ownership and control emerged early in the 21st Century. First, in 2001, the United States concluded a Multilateral Agreement on the Liberalization of Air Transportation [MALIAT] (also referred to as the "APEC Agreement", or the "Kona Accord"), which included optional provisions waiving ownership requirements, but preserved effective control, incorporation, and principal place of business requirements, seemingly to avoid "flags of convenience" issues.

The second approach emerged in 2002 from the Organization for Economic Co-operation and Development's [OECD] effort to draft a model all-cargo bilateral or multilateral template.[64] Irrespective of the nationality of the airline's majority owner, the carrier would incorporate itself in a certain country, and operate under its regulatory control. The OECD draft also contemplated that a "group of States" could form the nationality of a carrier (thus contemplating EU designation, for example), while assuming some national form of oversight and regulation. According to Allan Mendelsohn:

> This assumption, while totally ignoring ownership, rests on a fairly healthy amount of "national" input or regulation by the State (or multinational entity) of incorporation. But how else could the air operator's certificate (AOC), safety oversight, minimum insurance mandates and all those other requirements that had made aviation so internationally accepted, while so safe and reliable, be assured as they had been when the airline was both regulated by, and substantially owned and controlled by nationals of, that country?[65]

The third approach emerged from the European Union. Council Regulation 2407/92 provides that a "Community carrier" may receive an air carrier license from a member State if it is majority-owned and effectively controlled by an EU State or its citizens, and has its principal place of business in that member State.[66] Such carriers enjoy the right of establishment anywhere in the EU, and cabotage rights within any member State.[67] In 2002, the EU Court of Justice's issued a decision requiring that, under the "Right of

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[61] See *supra,* note 41.

[62] Pablo Mendes de Leon, *A New Phase in Alliance Building; The Air France/KLM Venture as a Case Study*, ZEITSCHRIFT FÜR LUFT- UND WELTRAUMRECHT 359 (2004); and Allan Mendelsohn, *Myths of International Aviation*, 68 J. AIR L. & COM. 519, 525-26 (2003).

[63] BRIAN HAVEL, IN SEARCH OF OPEN SKIES 5-6 (KLUWER 1997).

[64] ISABELLE LELIEUR, LAW AND POLICY OF SUBSTANTIAL OWNERSHIP AND EFFECTIVE CONTROL OF AIRLINES 132-35 (ASHGATE 2003).

[65] Allan Mendelsohn, *Myths of International Aviation*, 68 J. AIR L. & COM. 519, 528 (2003).

[66] PAUL DEMPSEY, EUROPEAN AVIATION LAW 64-68 (KLUWER 2004).

[67] ISABELLE LELIEUR, LAW AND POLICY OF SUBSTANTIAL OWNERSHIP AND EFFECTIVE CONTROL OF AIRLINES 41 (ASHGATE 2003).

Establishment" provisions of Community Law, no member State may conclude a bilateral air transport agreement that excludes any "Community carrier" from operating on the traffic rights provided under the bilateral. Traditionally, States have negotiated traffic rights on behalf of their national (flag) carrier. EU member States have been directed to renegotiate their bilaterals to include unrestricted designation of all carriers having "Community nationality."[68] Europe appears to recognize that each of its 25 member States cannot maintain a separate national carrier, and industry consolidation is required. The EU approved the acquisition of Sabena by Swissair, and of KLM by Air France. This may be well and good under Community law, but it creates some level of uncertainty as to how other States will respond under the bilateral "substantial ownership and effective control" clauses. Thus, the EU has pressed its member States to renegotiate their bilaterals to authorize service by Community carriers. This would, for example, enable Lufthansa to operate to New York from Paris, and British Airways to fly to Chicago from Munich.

The fourth approach emerged from ICAO's Fifth Worldwide Air Transport Conference in 2003. A model clause for insertion into bilaterals was drafted that focused on an airline's "principal place of business" and "effective regulatory control." "Permanent residence" was an optional requirement.

C. FOREIGN OWNERSHIP RESTRICTIONS IN U.S. LAW

For aviation, citizenship requirements were first imposed by the Air Commerce Act of 1926.[69] Aviation had demonstrated its military potential in World War I, and the U.S. was determined not to have its skies dominated by foreign airlines. Originally, the 1926 Act required that U.S. citizens held 51% of an airline for it to be deemed a U.S.-flag carrier; as World War II was heating up in Europe (Germany invaded Austria in early 1938), the Civil Aeronautics Act of 1938 increased that requirement to 75%.[70] (Canadian law also requires that 75% of the voting rights in Canadian airlines be owned and controlled by Canadian citizens).[71] Today, to be considered a U.S.-flag carrier (subject to designation to fly on routes specified in U.S. bilaterals, and to provide domestic cabotage), U.S. citizens must: (1) hold at least 75% of the voting stock of the airline; (2) hold not less than 51% of the airlines non-voting equity; and (3) in all important respects, effectively "control" the airline.

But foreign ownership restrictions are not unique to aviation. They have long been imposed in a number of infrastructure industries in the United States, including industrial defense production, telecommunications, broadcasting,[72] electric power production,[73] nuclear power production,[74] inland, intercoastal, and international maritime shipping,[75] banking, mining and fuel extraction on federal

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[68] Pablo Mendes de Leon, *A New Phase in Alliance Building; The Air France/KLM Venture as a Case Study*, ZEITSCHRIFT FÜR LUFT- UND WELTRAUMRECHT 359, 363-65 (2004);

[69] PUB.L. NO. 69-254, 44 STAT. 568 (1926).

[70] Seth Warner, *Liberalize Open Skies: Foreign Investment and Cabotage Restrictions Keep Noncitizens in Second Class*, 43 AM. U. L. REV. 277, 306 (1993); Angela Edwards, *Foreign Investment in the U.S. Airline Industry: Friend or Foe?*, 9 EMORY INT'L L. REV. 595, 604 (1995); ISABELLE LELIEUR, LAW AND POLICY OF SUBSTANTIAL OWNERSHIP AND EFFECTIVE CONTROL OF AIRLINES 32-33 (ASHGATE 2003).

[71] *Canada Transportation Act*, Art. 55. For a discussion of Canadian law on the subject, see ISABELLE LELIEUR, LAW AND POLICY OF SUBSTANTIAL OWNERSHIP AND EFFECTIVE CONTROL OF AIRLINES 46-50 (ASHGATE 2003).

[72] Foreign owned or controlled corporations are prohibited from receiving licenses to operate as instruments for the transmission of communications. A corporation is defined as foreign-owned if any director or officer is an alien, or if more than one-fifth of its capital stock is owned by aliens, a foreign government, or a corporation organized under the laws of a foreign country. Additionally, a corporation is generally considered as foreign-controlled if it is directly or indirectly controlled by any other corporation, at least one-fourth of whose capital stock is owned by foreign interests. 47 U.S.C. § 310(b).

[73] Hydroelectric power sites on navigable streams located within the United States may be developed only by U.S. citizens or domestically organized corporations. 16 U.S.C. § 797(e).

[74] No licenses for the operation of atomic energy utilization or production facilities may be issued to aliens or to foreign-owned or foreign-controlled corporations. 42 U.S.C. § 2133.

[75] The *Jones Act of 1920* requires that any shipping of passengers or property between points in the United States or its territories must be accomplished in vessels constructed and registered in the United States and owned by U.S. citizens. A ship may not be registered in the United States unless the corporation's principal officers are U.S. citizens and 75% of the stock is owned by U.S. citizens. Any vessel that is

lands,[76] and aviation.[77] By and large, these requirements reflect the importance these infrastructure industries have in supporting national defense.

In addition to these specific requirements, since 1975, foreign investment in all U.S. industries has been subject to discretionary national security review by the Committee on Foreign Investment in the United States [CFIUS], chaired by the U.S. Secretary of the Treasury.[78] If a CFIUS investigation concludes that a proposed transaction could impair national security, it may be blocked and divestiture may be required.

Essentially, eligibility to register an airline in the United States is limited to: (a) United States citizens; (b) partnerships in which all partners are United States citizens; or (c) U.S. corporations in which at least two-thirds of the board of directors are U.S. citizens and at least 75% of the voting stock is owned by U.S. citizens. Moreover, the right to enter into cabotage (transport between two points within the United States) is limited to domestically registered aircraft.[79]

The Federal Aviation Act makes it unlawful "for any foreign air carrier or person controlling a foreign air carrier to acquire control in any manner whatsoever of any citizen of the United States substantially engaged in the business of aeronautics."[80] Historically, a presumption of control existed where ownership exceeded 10% of the airline.[81] Securities and Exchange Commission reporting requirements are triggered by the acquisition of 5%. In reality, ownership of substantially lesser percentages of widely held corporations can result in effective "control" (although, as we shall see, the current view of the DOT is that foreign control of U.S. airlines almost never exists). Moreover, it is unlikely that a foreign investor would be interested in investing substantial capital in an airline he could not effectively control.[82] But in the unlikely event a foreign citizen should be deemed by DOT to have "control" of a U.S. airline, it would no longer be deemed a U.S.-flag carrier, and hence prohibited under the cabotage restrictions from plying the domestic trade.

Another statutory provision provides that in order to qualify as a U.S. citizen (i.e., a U.S.-flag carrier), the airline must have as its ". . . president and two-thirds or more of the board of directors and other managing officers thereof . . . [U.S. citizens and] at least 75 per centum of the voting interest is owned or controlled by persons who are citizens of the United States . . . ."[83]

These are, then, separate requirements -- that no foreign citizen or airline "control" a U.S.-flag carrier, and that no foreign citizens serve as president, hold more than two-thirds of the seats on the board of directors, or more than 25% of the voting stock of a U.S. airline.

DOT has also employed its fitness requirements under of the Act to monitor foreign control

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at any time registered in a foreign country permanently loses these United States shipping rights. Moreover, any eligible vessel weighing more than 500 gross tons that is later rebuilt outside the United States also forfeits these privileges. However, vessels registered in foreignStates granting reciprocal privileges to U.S.-flag vessels may perform intercoastal transportation of empty items, such as cargo vans, barges, shipping tanks, and equipment utilized therewith. 46 U.S.C § 883.

[76] 30 U.S.C. §§ 22, 24, 71, 181, 352.

[77] For a comprehensive review of these statutes, see Christopher Corr, *A Survey of United States Controls on Foreign Investment and Operations: How Much Is Enough?*, 9 AM. U.J. INT'L L. & POL'Y 417 (1994).

[78] U.S. GENERAL ACCOUNTING OFFICE, AIRLINE COMPETITION: IMPACT OF CHANGING FOREIGN INVESTMENT AND CONTROL LIMITS ON U.S. AIRLINES 19 (1992). CFIUS must complete its review and submit its recommendation to the President within 45 days, who must render a decision within 15 days thereafter, approving, suspending or prohibiting all or part of a foreign investment.

[79] 49 U.S.C. §§ 1378, 1401, 1508.

[80] 49 U.S.C. § 1378(a)(4). The authority of the Department of Transportation under this provision was terminated as of January 1, 1989. 49 U.S.C. § 1551(a)(7).

[81] 49 U.S.C. § 1378(f).

[82] Feldman, *What Are the Chances of Foreign Ownership of U.S. Airlines?*, AIR TRANSPORT WORLD (NOV. 1987).

[83] 49 U.S.C. § 1301(16).

issues.[84] As to control generally, DOT said this:

> [F]oreign influence may be concentrated or diffuse. It need not be identified with any particular nationality. It need not be shown to have sinister intent. It need not be continually exercisable on a day-to-day basis. If persons other than U.S. citizens, individually or collectively, can significantly influence the affairs of [the U.S. carrier], it is not a U.S. citizen.[85]

The most important case addressing the issue of foreign control of a U.S. airline involved KLM's acquisition of a significant interest in the holding company of Northwest Airlines.[86] In a transaction which increased Northwest's debt-to-equity ratio from 0.42/1 to 5.85/1, in August 1989, Wings Holdings, Inc., acquired control of Northwest with 81.5% debt and 18.5% equity.[87] Wings' debt was $3.1 billion, almost two-thirds of which was provided by Japanese banks. Equity was $705 million, of which Alfred Checchi, Gary Wilson and Frederic Malek put up only $40 million (for which they received about half the voting and nonvoting common stock), KLM (the Netherlands' airline) put up $400 million (or 57% of the equity, for which KLM received 70% of Wings' nonvoting preferred stock, 31% of its nonvoting common stock, and 4.9% of its voting common stock, as well as a warrant allowing it to convert up to $50 million of its preferred stock into common stock, some of which could be voting), and Elders IXL (an Australian company) put up $80 million (or 11% of the equity, for which it received 10% of Wings' nonvoting preferred stock, 16% of its nonvoting common stock, and 15.4% of its voting stock).[88]

Both KLM and Elders had the right to name one representative to the 12-member Wings' Board of Directors. KLM had the right to name a 3-person committee to advise Wings on financial matters, and to enter into a variety of cooperative arrangements with Northwest, and preclude such arrangements with other airlines.[89]

In its first order, issued September 29, 1989, the DOT concluded that unless KLM reduced its equity interest to 25%, KLM could be in a position to exert actual control over Wings.[90] DOT acknowledged that determining whether foreign "control" exists is a complex matter:

> Analysis in this area 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.[91]

DOT expressed concern about the size of KLM's equity interest, both in absolute and proportional terms, its ability to exert influence on Wings, and the fact that it was an actual competitor with Northwest

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[84] 49 U.S.C. § 1372(r). Carriers undertaking significant changes in their operations must provide DOT with information relevant to their citizenship and fitness. 14 C.F.R. § 204.4.

[85] IN THE MATTER OF INTERA ARCTIC SERVICES, INC., DOT ORDER 87-8-43 (1987), at 5.

[86] Denver oil king Marvin Davis began a hostile takeover bid for Northwest Airlines in 1989, offering $2.7 billion. He was out-bid by Alfred Checchi and associates, offering $3.7 billion. PAUL DEMPSEY & ANDREW GOETZ, AIRLINE DEREGULATION & LAISSEZ-FAIRE MYTHOLOGY 14 (1992).

[87] Wings, which became the parent company of Northwest, encumbered Northwest's balance sheet with several billion dollars of debt as a result of the LBO. That is more than the purchase price of Pan Am's trans-Pacific division (purchased by United for $715 million), Western Airlines (bought by Delta for $860 million), Ozark Airlines (bought by TWA for $250 million), Eastern Airlines and People Express (purchased by Texas Air for $676 million and $112 million, respectively), and Air Cal (bought by American for $225 million), *combined*. For these investments, those airlines acquired significant operating assets and market share. As a result of the LBO, Northwest acquired nothing more than burdensome debt. PAUL DEMPSEY, AIRLINE MANAGEMENT: STRATEGIES FOR THE 21ST CENTURY 127-29 (COAST AIRE 1997).

[88] IN THE MATTER OF THE ACQUISITION OF NORTHWEST AIRLINES BY WINGS HOLDINGS, INC., DOT ORDER 91-1-41 (1991), at 2.

[89] *Id.*

[90] IN THE MATTER OF THE ACQUISITION OF NORTHWEST AIRLINES BY WINGS HOLDINGS, INC., DOT ORDER 89-9-51, at 3.

[91] *Id.*, 4-5.

in a number of markets. DOT Secretary of Transportation Samuel Skinner expressed legitimate concern over the Checchi group acquisition of Northwest Airlines, not only because the LBO would increase Northwest's debt fourfold, but also because the $400 million equity participation by KLM Royal Dutch Airlines would give it about 57% of total equity.[92] Secretary Skinner appeared to interpret the Federal Aviation Act to limit total foreign equity (voting or not) to 25%. As Skinner said:

> While KLM's voting share technically fell within the statute's numerical limits [which requires that the airline's President and two-thirds of its Board and other managing officers be U.S. citizens, and that not less than 75% of voting interest be owned and controlled by U.S. citizens], we concluded that KLM's ownership of 57 percent of NWA Inc.'s total equity, together with the existence of other links between the carriers and KLM's position as a competitor, could create the potential for the exercise of influence and control over the carrier's decisions. This would be inconsistent with the law.[93]

DOT observed that "it is clear from our precedent that a large share in a carrier's equity poses citizenship problems, even where the interest does not take the form of voting stock, particularly if there are other ties to the foreign entity."[94] DOT noted that the incentive for the foreign airline to exert control was much enhanced where it is also an actual or potential competitor. The interest of Elders in Wings appeared to be no more than a pecuniary interest, not rising to the level of concern about control.[95] However, KLM's large equity interest, its right to sit on Wings' Board and name a financial committee, and the working arrangements between the two airlines caused the DOT to conclude that KLM could be in a position to exert control over Northwest, thereby jeopardizing its status as a U.S. citizen. DOT and Northwest entered into a consent order whereby KLM's equity interest in Wings would be reduced to 25%, its power to establish a financial advisory committee would be revoked, and Northwest would fulfill certain reporting requirements.[96]

Remarkably, that which Secretary Skinner then declared would be, in his words, "inconsistent with the law", he subsequently proclaimed to be well within the law. The disintegration of the economic position of a number of U.S. airlines in late 1990, precipitated by the War with Iraq, escalating fuel prices, fear of terrorism by the traveling public, and a global recession which diminished passenger demand (and perhaps, a key campaign contribution), subsequently led the DOT to reevaluate its position on foreign ownership, and take another look at Wings and Northwest. On its second review, DOT concluded that Messrs. Checchi, Wilson and Malek were firmly in control of Wings, holding two-thirds of its voting stock and having the power to appoint most of its directors.[97] The DOT announced that it was adopting a new policy:

> [W]e have reexamined our application of the control test in order to reflect more accurately today's complex, global corporate and financial environment, consistent with the requirement for U.S. citizen control. Specifically, we have reviewed the relationship between voting equity, on the one hand, and nonvoting equity and debt, on the other.[98]

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[92] *Statement of Samuel Skinner before the Aviation Subcomm. of the House Comm. on Public Works and Transportation* (Oct. 4, 1989), at 4. Had the management/pilot deal for United not fallen through, British Airways was prepared to supply $570 million, or 78% of the total $965 million equity for the proposed leveraged buy-out of United Airlines. Valente & McGinley, *UAL Machinists Refuse to Back Buy-Out Plan*, WALL ST. J., OCT. 5, 1989, at A6.

[93] Statement of Skinner, *supra,* at 4-5. In September 1989, Skinner jawboned Checchi and Northwest into agreeing, *inter alia,* to limit KLM's voting stock to 25%, and to limit KLM's representation on Northwest's Board of Directors to "matters relevant to KLM's pecuniary interest, recusing himself or herself when the board is dealing with certain matters, such as bilateral negotiations and competitive issues." *Id.,* 6.

[94] *Id.,* 6.

[95] *Id.,* 5.

[96] *Id.,* 8.

[97] DOT ORDER 91-1-41 (1991), at 8.

[98] *Id.,* 9.

The DOT concluded that non-voting foreign equity ownership of up to 49% would be allowed, although foreign voting equity would be limited, as the statute required, to 25%. Foreign debt would not be treated as a control issue.[99] The DOT also indicated that it would not ordinarily allow a foreigner to serve as Chairman of the Board.[100] It had earlier approved the placement of three representatives of SAS on the Continental Airline Holdings' board.[101] KLM could have three seats on the 15 member Wings' board.[102] DOT warned, "the naming of a disproportionate number of foreign director representatives to important committees, such as the executive committee, nominating committee, or finance committee, may be taken as an indication of control and would be cause for us to review the citizenship of the affected air carrier."[103]

The truth is, with ownership, code sharing and marketing alliances, a foreign airline can effectively control a U.S. carrier, reducing competition in the international market while creating domestic U.S. feed for its international operations. Foreign ownership is the back door to cabotage. Actually, foreign airlines do not need cabotage rights if they can buy access to the U.S. market.[104]

In a sharp departure from precedent, DOT announced that it will allow foreign equity ownership of up to 49%. Secretary Skinner also proposed that Congress raise the statutory limits on voting ownership to 49%.[105] Moreover, in the closing days of the Bush Administration, antitrust immunity was conferred to the alliance between Northwest Airlines and KLM,[106] authorizing pricing coordination and pooling of revenue.[107] Some speculated the decision was predicated on the $100,000 contribution Northwest co-chairman Gary Wilson had made to Bush's committee to re-elect the President in August 1992. In contrast, four years earlier he had contributed to Democrat Michael Dukakis' Presidential

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[99] *Id.*

[100] *Id.*, 11.

[101] DOT ORDER 90-9-15 (1990), at 6-7. The equity investment of Scandinavian Airline System [SAS] in Continental Airline Holdings was inspired by the U.S. carrier's need for a substantial infusion of new capital, and SAS's perspective feed of U.S. traffic into its trans-Atlantic routes; SAS moved its international hub from New York Kennedy Airport to Newark, where Texas Air's Continental and Eastern could provide domestic feed. *Repeating Mistakes*, J. OF COM, AUG. 30, 1989, at 8A. In October 1988, SAS purchased 10% of the parent company of Continental Airlines, raising its ownership to 18% in August 1990. DOT approved the enhanced ownership on the condition that SAS appointed only three of the 15 Board members of Continental Airline Holdings, and only one member of its Executive Committee; none of SAS's representatives would serve as chairman of the board, and they would disqualify themselves on decisions involving competition, aviation negotiations, or other transactions potentially effecting SAS. DOT ORDER 90-9-15 (1990); U.S. GENERAL ACCOUNTING OFFICE, AIRLINE COMPETITION: IMPACT OF CHANGING FOREIGN INVESTMENT AND CONTROL LIMITS ON U.S. AIRLINES 24 (1992).
As a practical matter, however, much of the foreign investment in U.S. airlines has been an economic failure. SAS eventually wrote its investment in Continental down to zero.

[102] DOT ORDER 91-1-41 (1991), AT 11.

[103] *Id.*

[104] Paul Dempsey, *The State of the Airline, Airport & Aviation Industries*, 21 TRANSP. L.J. 129, 205 (1992).

[105] McGinley, *Transport Aide Backs Raising Limit On Foreign Holdings in U.S. Airlines*, WALL ST. J., FEB. 20, 1991, at A8.

[106] In September 1992, the Bush Administration concluded a somewhat more liberal bilateral agreement with the Netherlands (a very liberal bilateral had been concluded with the Dutch during the Carter Administration), allowing Dutch carriers to fly anywhere they chose in the United States, while allowing U.S. carriers to fly anywhere they chose in the Netherlands (a country about the size of West Virginia). In November 1992, DOT gave Northwest/KLM preliminary antitrust immunity. *Airline Official Gave $100,000 to GOP*, WASHINGTON POST, DEC. 6, 1992, at A8; *Northwest Co-Chair Gave to GOP Prior to Airline Rules*, DENVER POST, DEC. 6, 1992, at 15A. Final approval was given only days before the inauguration of Bill Clinton as President in January 1993. JOINT APPLICATION OF NORTHWEST AIRLINES & KLM, DOT ORDER 91-1-11 (1993).

The benefits appeared to be unbalanced. KLM realized $150 million profit annually from the alliance; Northwest realized about $50 million. Susan Carey, Northwest to Buy Back Preferred from KLM, WALL ST. J., JULY 1, 1996, at A3. Further, consumer prices in the U.S.-Netherlands market appeared to increase under the alliance. Asra Nomani, *Airlines Hope To Get Around Antitrust Laws*, WALL ST. J., MAY 8, 1996, at B1

[107] One of the most remarkable practices which emerged between the two carriers was pooling of revenue and profits -- a practice widespread in international aviation, but steadfastly objected to by the United States in each and every bilateral air transport agreement it signed since the Bermuda I prototype bilateral in 1946. In 2000, United and Lufthansa announced they intended to begin sharing the costs and revenue on six routes across the Atlantic. Kevin Knapp, *UAL Launches Lufthansa Partnership*, CRAIN'S BUSINESS CHICAGO (MAY 22, 2000), at 3.

campaign.

Beginning with Northwest/KLM several global networks (most prominently, the Star Alliance, OneWorld, and Sky Team) have been formed, skirting around foreign ownership and route restrictions.[108] Most of the major agreements have been accorded antitrust immunity, enabling a degree of pricing and service cooperation and coordination unprecedented in the history of commercial aviation.[109] Some have viewed alliances as a "second best" solution to the need to create multinational global airlines.

Arguments in favor of liberalization of foreign ownership restrictions include:

- It will enable airlines to tap foreign capital markets, thereby strengthening weaker airlines;[110]
- It will enable carriers to greater economies of scale, reduce costs, offer lower prices and improve service to consumers;
- As in most other economic sectors, it will enable the creation of integrated multinational companies, unrestrained by national barriers to entry and investment, and consonant with contemporary notions of free trade.[111]

Arguments against liberalization of foreign ownership rules include:

- As in the maritime trade, it would enable the creation of "flags of convenience" in international aviation, with ownership foreign-shopping for the least burdensome labor, safety and environmental requirements;
- It would compromise national security, given that the U.S. relies on the civilian commercial airline fleet for needed lift capacity in time of international conflict under the Civil Reserve Air Fleet [CRAF] program;[112]

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[108] For a description of these restrictions see PAUL DEMPSEY, LAW & FOREIGN POLICY IN INTERNATIONAL AVIATION (TRANSNATIONAL 1987), and PAUL DEMPSEY, ROBERT HARDAWAY & WILLIAM THOMS, AVIATION LAW & REGULATION (BUTTERWORTH 1993).

[109] See Paul Dempsey, *Carving the World into Fiefdoms: The Anticompetitive Future of Commercial Aviation*, XXVII ANNALS OF AIR & SPACE LAW 247 (2002).

[110] "[T]he need of foreign capital is certainly the most relevant issue and therefore represents the main reason in favor of the liberalization of foreign investment." ISABELLE LELIEUR, LAW AND POLICY OF SUBSTANTIAL OWNERSHIP AND EFFECTIVE CONTROL OF AIRLINES 89 (KLUWER 2003).

[111] Thomas Grant, *Foreign Takeovers of United States Airlines: Free Trade Process, Problems and Progress*, 31 HARV. J. LEGIS. 63 (1993); ISABELLE LELIEUR, LAW AND POLICY OF SUBSTANTIAL OWNERSHIP AND EFFECTIVE CONTROL OF AIRLINES 64-65, 73 (KLUWER 2003).

[112] As operations Desert Shield/Storm confirm, the United States depends on the aircraft of our domestic airlines committed to the Civil Reserve Aviation Fleet [CRAF] as the essential logistical means to ferry troops and supplies to distant battlefields. On August 2, 1990, Iraq invaded Kuwait. Two weeks later, the CRAF fleet was activated -- the first time since its creation in 1951. Calling up the CRAF fleet was essential in order to meet the demands of the most massive airlift since the Berlin Airlift in 1948. During the first two months of activation, CRAF planes flew more than 500 missions, carried 66,000 passengers (mostly soldiers) and 22,000 tons of cargo. In the recent Persian Gulf crisis, the U.S. relied upon CRAF to ferry 60% of the soldiers and 23% of the supplies to the battlefield. Foreign ownership restrictions have long existed for many of our essential infrastructure industries -- airlines, intercoastal and inland shipping, telecommunications, broadcasting, electric power production, and nuclear energy. These restrictions were enacted not because of blind xenophobia, but because of legitimate national security considerations. National security concerns have intensified in the United States since the tragic events of September 11, 2001.

Isabelle Lelieur concedes that, "National security is the most specific feature that makes the aviation industry so unique, compared to any other industry, and so important for States. Indeed, States need to maintain a strong domestic airline industry capable of serving loyally the nation in terms of crisis, and the security can be better ensured if the industry is owned by nationals." ISABELLE LELIEUR, LAW AND POLICY OF SUBSTANTIAL OWNERSHIP AND EFFECTIVE CONTROL OF AIRLINES 86 (KLUWER 2003). However, she argues that the government could ensure the availability of sufficient aviation lift capacity in three ways: (1) by making participation in CRAF a condition for registering aircraft in the U.S.; (2) by commandeering aircraft during emergency periods; or (3) by having the Defense Department purchase and maintain sufficient military cargo capacity. *Id.*, 86-87.

Assume Air France owned United Airlines. One wonders whether the French government would have a responded to the use of United's capacity during the war launched by the United States against Iraq to deprive Saddam Hussein of his "weapons of mass destruction." Moreover, since a large percentage of the wide-bodied commercial fleet is flying in international airspace or parked at a foreign tarmac at any given time, the ability to requisition that fleet on short notice would be difficult if its owners resisted its requisition. The cost to the taxpayer of maintaining a military cargo fleet to be used during emergencies would be burdensome.

- It would eliminate competition in the city-pair markets dominated by the acquired and acquiring airline;
- Because a foreign airline effectively sits as an advisor on both sides of the negotiating table, it would undermine the integrity of bilateral air transport negotiations;[113]
- It would enable a carrier from a State with less desirable bilateral relationships to take advantage of a third State's more liberal bilateral relationships;[114] and
- It would reduce bargaining leverage against a carrier whose government had not conceded comparable bilateral opportunities to those being exercised under the bilateral whose rights the foreign carrier was operating.[115]

IV. CABOTAGE

A. THE CHICAGO CONVENTION

The legal concept of cabotage has its origin in Maritime Law. It is thought to have originated from either the French word "cabot," meaning a small vessel, or the Spanish word "cabo," or "cape," which described navigation from cape to cape along the coast without entering the high seas.[116]

In Air Law, cabotage is essentially defined as the transportation of passengers, cargo or mail between two points in the same State -- the carriage of domestic traffic.[117] It was first articulated in aviation law in 1910, as the French objected to German balloons flying entering French air space.[118] The Paris Convention of 1919 recognized cabotage formally, providing in Article 16 that States could favor its airlines "in connection with the carriage of persons and goods for hire between two points in its territory."

Article 7 of the Chicago Convention of 1944 addressed the issue in two sentences.[119] The first provides: "Each contracting State shall have the right to refuse permission to the aircraft of other contracting States to take on in its territory passengers, mail and cargo carried for remuneration or hire and destined for another point within its territory."[120] Thus, each State has exclusive sovereignty over its airspace, and may reserve its domestic traffic to its domestic carriers.

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[113] Foreign ownership potentially jeopardizes the integrity of bilateral air transport negotiations betweenf governments. International routes are traded byStates on a bilateral basis, usually with candid input from their carriers. *See generally*, PAUL STEPHEN DEMPSEY, LAW & FOREIGN POLICY IN INTERNATIONAL AVIATION (1987). Multiple allegiances may well jeopardize the integrity of that process. Paul Dempsey, *The Disintegration of the U.S. Airline Industry*, 20 TRANSP. L.J. 9, 42 (1991).

[114] Paul Dempsey, *The Disintegration of the U.S. Airline Industry*, 20 TRANSP. L.J. 9, 36-42 (1991); Paul Dempsey, *The Sky Ought to Be the Limit*, N.Y. TIMES, JAN. 26, 1991, at 19. "An amendment to current foreign investment laws poses numerous risks to U.S. carriers, U.S. jobs, and the economy as a whole." Angela Edwards, *Foreign Investment in the U.S. Airline Industry: Friend or Foe?*, 9 EMORY INT'L. REV. 595, 641 (1995).

[115] "In a bilateral struggle, a State can effectively expect 'extra' benefits from its partners in exchange for concessions that may be extracted from the other party whose carrier's nationality is in doubt of from a party that owns such a carrier." ISABELLE LELIEUR, LAW AND POLICY OF SUBSTANTIAL OWNERSHIP AND EFFECTIVE CONTROL OF AIRLINES 80 (KLUWER 2003).

[116] Schraft & Rosen, *Cabotage Or Sabotage?*, AIRLINE PILOT (OCT. 1987), at 27 [hereinafter *Schraft & Rosen*].

[117] Cabotage is defined as the carriage of traffic between two points which are both located within the territory of one state. See PABLO MENDES DE LEON, CABOTAGE IN AIR TRANSPORT REGULATION, DORDRECHT, MARTINUS NIJHOFF PUBLISHERS (1992) at xi.

[118] *Subcomm. on Aviation, Sen. Comm. on Commerce, Science and Transportation, Hearings on S.1300, International Air Transportation Competition Act of 1979*, 96th CONG., 1ST SESS. 244-45 (1979) (statement of ABA Section on International Law).

[119] *Convention on International Civil Aviation*, Opened for signature, Dec. 7, 1944, 61 STAT. 1180, T.I.A.S. NO. 1591, Art. 7 [hereinafter cited as *Chicago Convention*].

[120] Though not intended as an instrument for the economic regulation of international air transport, Article 7 of the *Chicago Convention* specifically addresses the issue of cabotage. It provides:

> Each contracting State shall have the right to refuse permission to the aircraft of other contracting States to take on its territory passengers, mail and cargo carried for remuneration or hire and destined for another point within its territory. Each contracting State undertakes not to enter into any arrangements which specifically grant any such privilege on an exclusive basis to any other State or an airline of any other State, and not to obtain any such exclusive privilege from any other State.

Chicago Convention, article 7 [emphasis supplied].

The second sentence of Article 7 provides: "Each contracting State undertakes not to enter into any arrangements which specifically grant any such privilege on an exclusive basis to any other State or an airline of any other State, and not to obtain any such exclusive privilege from any other State." The literal language suggests that if a State gives away cabotage rights to another State's airline(s), it must give them to all States on a nondiscriminatory basis.[121]

The first sentence of Article 7 reinforces the notion of sovereignty by each State over its air space as codified in article 1 of the Chicago Convention, and reaffirms a State's right to prohibit aircraft from other S States from engaging in commercial air transportation within its territory.[122] In the second sentence, States parties to the Convention undertake not to enter into any arrangements or agreements which specifically grant cabotage rights to another State or the airlines thereof on an exclusive basis. There has been some debate in the literature as to the meaning of article 7.

In the opinion of Professor Michael Milde, "[t]he common perception that Article 7 'prohibits' cabotage is patently erroneous. The text only stresses that each State has 'the right to refuse permission to the aircraft of other contracting States' to carry cabotage traffic."[123] In his view, the first sentence of article 7 "adds nothing to the general concept of sovereignty declared in Article 1 and would appear superfluous."[124] However, the undertaking by States not to grant or obtain cabotage privileges "specifically" and "on an exclusive basis" contained in the second part of article 7 opens it up to varying interpretations and controversy.[125]

Professor Pablo Mendes de Leon identifies two such possible interpretations. In his view, Article 7 could be interpreted as creating a multilateral regime for all contracting States that have not reserved cabotage to their national aircraft. Under this view, these States must allow aircraft registered in other contracting States access to their national territories in order to avoid the ban on exclusiveness. The far-reaching consequence of this interpretation would be the grant, to aircraft of all contracting States, of automatic access to the territory of the grantor State, once permission has been given to another contracting State or its airlines to engage in cabotage.[126] Admittedly, a literal interpretation of Article 7 does not support this position since no mention is made of the rights of third party States in respect of a previous agreement between the grantor and receiving State.[127]

An alternative interpretation of Article 7 relates to scheduled international air services. This interpretation, according to Pablo Mendes de Leon, takes into account the bilateral relationships that result from Article 6 of the Chicago Convention. These bilateral relationships are affected by a multilateral clause embodied in the second sentence of Article 7, the effect of which is that, "[c]ontracting States which enter into a bilateral agreement are obliged to either expressly reserve cabotage or take into account the rights of other contracting States with respect to access to the carriage of domestic traffic of the first two States."[128]

Professor Milde identifies yet a third scenario. He questions whether cabotage privileges may be granted on an exclusive basis if it is not done 'specifically'.[129] For instance, can cabotage privileges be

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[121] Angela Edwards, *Foreign Investment in the U.S. Airline Industry: Friend or Foe?*, 9 EMORY INT'L L. REV. 595, 625-26 (1995).
[122] Howard Kass, *Cabotage and Control: Bringing 1938 U.S. Aviation Policy into the Jet Age*, 26 CASE W. RES. J. INT'L L. 143 (1994) AT 152.
[123] Michael Milde, *The Chicago Convention – Are Major Amendments Necessary or Desirable 50 Years Later?*, XIX:I ANNALS OF AIR & SP. L. 401 (1994) AT 421.
[124] *Id.*
[125] *Id.*
[126] PABLO MENDES DE LEON, CABOTAGE IN AIR TRANSPORT REGULATION, DORDRECHT, MARTINUS NIJHOFF PUBLISHERS (1992) at 42.
[127] *Id.*
[128] *Id.*
[129] Michael Milde, *The Chicago Convention – Are Major Amendments Necessary or Desirable 50 Years Later?*, XIX:I ANNALS OF AIR & SP. L.

granted on a non-exclusive basis to one State for a valuable consideration not necessarily of an aeronautical nature, and then made also available to other S States willing to offer a similar acceptable quid pro quo?[130] Taking into consideration the situation in Europe since the Third Package of liberalization, whereby community carriers have unlimited cabotage rights across the territories of all member States of the European Union,[131] the question arises as to whether this is in breach of the provisions of Article 7 of the Convention. If this practice is in breach of the Chicago Convention, a further question arises as to what remedies are available to other contracting States, apart from lodging complaints with the ICAO Council under Article 84 of the Convention.[132] One possibility is that, having conferred unlimited cabotage rights to Community airlines, EU members are obliged to afford airlines of all other States the right to fly domestic routes, else the privilege would have been conferred in violation of Article 7's prohibition of conferring cabotage rights "on an exclusive basis". Yet, Article 7 is silent as to the remedy for its violation.

Over the years, attempts have been made to amend Article 7 of the Convention at the instance of the Swedish delegation to the ICAO Assembly.[133] In 1966, the Swedish delegation submitted a proposal for the deletion of the second sentence of Article 7. The basis for this proposal was that the second sentence was extraordinarily restrictive, gave rise to a certain ambiguity, and was open to various interpretations.[134] Confronted with a variety of interpretations of Article 7, and desirous of protecting existing intra-Scandinavian traffic arrangements with Norway and Denmark,[135] the Swedish delegation held the opinion that, "… the drafters of the Chicago Convention did not intend Article 7 to prevent contracting States from establishing arrangements which promote sound and economical use of civil aviation resources."[136] In their view, deleting the second sentence would not only remove the ambiguity surrounding it, but would also enhance the system of the Chicago Convention.[137]

The matter was considered at the 16th session of the ICAO Assembly in 1968 in Buenos Aires and also at the 18th session in Vienna. In both instances the proposed amendment failed to marshal the required majority of votes in the Assembly.[138] Although the Swedish action drew attention to the problem of interpretation of article 7, its failure has been attributed to the fact that internationally, the role of cabotage in the exchange of traffic rights is very modest. As such, "contracting States were not eager to

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401 (1994) at 421.

[130] Michael Milde, *The Chicago Convention – Are Major Amendments Necessary or Desirable 50 Years Later?*, XIX:I ANNALS OF AIR & SP. L. 401 (1994) at 421.

[131] *See* PAUL STEPHEN DEMPSEY, EUROPEAN AVIATION LAW (KLUWER INTERNATIONAL 2004).

[132] Article 84 of the *Chicago Convention* provides, in relevant part:

If any disagreement between two or more contracting States relating to the interpretation or application of this Convention and its Annexes cannot be settled by negotiation, it shall, on the application of any State concerned in the disagreement, be decided by the Council.

See Paul Stephen Dempsey, *Flights of Fancy and Fights of Fury: Arbitration and Adjudication of Commercial and Political Disputes in International Aviation*, 32 GEORGIA JOURNAL OF INTERNATIONAL & COMPARATIVE LAW 231 (2004).

[133] Michael Milde, *The Chicago Convention – Are Major Amendments Necessary or Desirable 50 Years Later?*, XIX:I ANNALS OF AIR & SP. L. 401 (1994) at 414-15.

[134] *Id. See also* PABLO MENDES DE LEON, CABOTAGE IN AIR TRANSPORT REGULATION, DORDRECHT, MARTINUS NIJHOFF PUBLISHERS (1992) at 63.

[135] The Scandinavian Airline System (SAS) was formed on August 1 1946 through a merger of the national airlines of Sweden, Norway and Denmark. See SAS, online: <http://www.scandinavian.net/EC/Appl/Home/FrontDoor/0,3479,LNG%253Dsv%2526SO%253DC7B8B3F45B1C464E_B5D98DAA0A8EE1B8%2526MKT%253DUS,00.html>. As a result of this merger, domestic air traffic operations between the three Scandinavian countries have been conducted without cabotage restrictions. It was therefore not surprising that Sweden would voice concerns over the confusion resulting from the second part of article 7.

[136] PABLO MENDES DE LEON, CABOTAGE IN AIR TRANSPORT REGULATION, DORDRECHT, MARTINUS NIJHOFF PUBLISHERS (1992) at 64.

[137] *Id.*

[138] Although the Swedish Proposal for amendment failed to obtain the required majority in the plenary session of the ICAO Assembly, it received approval in the Executive Committee of the Assembly in 1971, with 67 votes in support, 3 against and 15 abstentions. *See* Michael Milde, *The Chicago Convention – Are Major Amendments Necessary or Desirable 50 Years Later?*, XIX:I ANNALS OF AIR & SP. L. 401 (1994) at 422.

burn their fingers by supporting the far-reaching step of an amendment, that is, deletion of Article 7(2)"[139] [sic]. States were sufficiently protected by the first sentence of article 7 so that the disputed provision did not even come into play.[140]

A survey of the varying interpretations point to the emergence of two trends, a restrictive approach and a liberal one. "The restrictive view focuses on the language 'an exclusive basis' and holds that if cabotage is granted to one State, the same rights and privileges must be made available to others. The liberal interpretation [on the other hand] focuses on the word 'specifically' and holds that exclusive grants of cabotage are allowed, provided that no agreement between parties contains any clause which would prohibit the granting of cabotage rights to third parties."[141]

B. CABOTAGE RESTRICTIONS IN U.S. LAW

The United States had laws prohibiting cabotage by foreign carriers as early as 1926.[142] Section 6(c) of the Air Commerce Act of 1926[143] provided that no foreign carrier shall engage in inter State or intra State air commerce.[144] This prohibition against cabotage by foreign air carriers was repeated in the Federal Aviation Act of 1958,[145] albeit with some minor modifications. Under the Act, foreign civil aircraft could be authorized to engage in commercial air service in the United States except that they shall not take on at any point within the United States, persons, property or mail carried for compensation or hire and destined for another point within the United States, unless specifically authorized. Under the Federal Aviation Act, only air carriers (defined as U.S. citizens) may ply the domestic trade.[146] Noncitizens may operate as "foreign air carriers",[147] but they must acquire a foreign air carrier permit, and their transport rights are limited to international air transportation.[148]

However, an exemption from the cabotage restrictions is available under certain emergency conditions.[149] In 1979, Congress promulgated the International Air Transportation Competition Act,[150] which

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[139] PABLO MENDES DE LEON, CABOTAGE IN AIR TRANSPORT REGULATION, DORDRECHT, MARTINUS NIJHOFF PUBLISHERS (1992) at 65.

[140] *Id.*

[141] Howard Kass, *Cabotage and Control: Bringing 1938 U.S. Aviation Policy into the Jet Age*, 26 CASE W. RES. J. INT'L L. 143 (1994) at 152. *See also* F. Allen Bliss, *Rethinking Restrictions on Cabotage: Moving to Free Trade in Passenger Aviation*, 17 SUFFOLK TRANSNAT'L L. REV. 382 (1994) at 383-84.

[142] Howard Kass, *Cabotage and Control: Bringing 1938 U.S. Aviation Policy into the Jet Age*, 26 CASE W. RES. J. INT'L L. 143 (1994) at 153.

[143] *U.S. Air Commerce Act*, PUB. L. NO. 69-254, 44 STAT. 568 (1926).

[144] In the United States, cabotage prohibitions originated in the *Air Commerce Act* of 1926. 67 Stat. 489.

[145] U.S. *Federal Aviation Act*, PUB. L. NO. 95-904, 92 STAT. 1705 (1958) § 1508

[146] See 49 U.S.C. § 1301(3), 1371.

[147] Under what was commonly referred to as section 402 of the Federal Aviation Act, in order to serve the U.S., a foreign carrier is required to secure a permit. In order to receive a permit, an applicant must demonstrate that it is "fit, willing, and able" to perform the proposed service, that it has been designated by the government of its registry to serve the route in question under an applicable bilateral air transport agreement (or in the absence of bilateral rights, on the basis of comity and reciprocity), and that issuance of the permit would be in the "public interest." 49 U.S.C. § 41302. The DOT may impose any reasonable conditions, amendments or modifications to such permit once issued, or suspend or revoke it. 49 U.S.C. § 41304.

[148] PAUL DEMPSEY, LAW & FOREIGN POLICY IN INTERNATIONAL AVIATION 78 (1987).

[149] The Department of Transportation has found that these requirements were satisfied in several emergency situations. For example, DOT granted an emergency cabotage exemption to allow Heavylift (a U.K.-flag carrier) to provide one -way cargo charter flights between Houston, Texas, and St. Thomas, U.S. Virgin Islands, to support recovery operations in the Virgin Islands in the aftermath of Hurricane Hugo. APPLICATION OF HEAVYLIFT CARGO AIRLINES LTD., DOT ORDER 89-10-7 (1989), at 2. In order to support oil spill clean-up operations at Valdez, Alaska, the DOT granted North West Territorial Airways Ltd. (a Canadian-flag carrier) an emergency cabotage exemption to provide one-way cargo charter operations between Los Angeles and Anchorage. APPLICATION OF NORTH WEST TERRITORIAL AIRWAYS LTD., DOT ORDER 89-4-1 (1989), at 2.

The DOT has granted such exemptions by telephone. For Example, on April 28, 1987, Qantas Airways (an Australian-flag carrier) requested an emergency cabotage exemption by telephone to transport a single passenger from Honolulu to San Francisco. The passenger was the father of an injured boy being transported from Nadi, Fiji, to the United States on a scheduled Qantas Australia-Nadi-Honolulu-San Francisco flight. DOT concluded that the waiver was clearly required on humanitarian grounds, constituted unusual circumstances, and could not have been accommodated by U.S. carriers since the son was already aboard a Qantas flight and his physical transfer to a U.S. carrier was not practical. APPLICATION OF QANTAS AIRWAYS LTD., DOT ORDER 87-6-63 (1987), at 2.

amended the Act to allow the U.S. Department of Transportation to confer a 30-day exemption from the cabotage prohibition if it finds the "public interest" so requires, and ". . . because of an emergency created by unusual circumstances not arising in the normal course of business, traffic in such markets cannot be accommodated by . . ." U.S.-flag carriers, all efforts have been made to accommodate such traffic needs using U.S. airlines (including their lease of foreign aircraft), and the exemption is necessary to avoid undue hardship for the traffic in the market.[151]

The motivation behind cabotage restrictions was the protection of domestic U.S. carriers, workers and markets from the rigors of foreign competition. This in turn was based on fears that carriers would use predatory tactics against each other and harm service levels, thus rendering unsafe a transportation service considered appropriate to the needs of commerce and required in the public interest, in the interests of the postal service and national defense.[152] However, cabotage restrictions may be avoided in various ways, including "sharing codes, making 'blocked space' arrangements for both passengers and cargo, obtaining an ownership interest in a U.S. carrier, making arrangements between U.S. and foreign carriers covering computer reservations systems, and setting up joint frequent flier and marketing programs."[153]

Views on cabotage in the U.S. are changing although prohibitions on foreign carriers engaging in cabotage still remain in bilateral air transport agreements and in the law. The U.S. may not change its laws on purely domestic cabotage in the near future, but in reality, limited or tag-end cabotage has become the practice of the day for some foreign carriers that have code-sharing and blocked-space agreements with U.S. carriers.[154] Limited or tag-end cabotage describes a situation where a foreign carrier flies between two points in a country as a continuation of an international flight.[155] Depending upon receiving reciprocal rights from foreign governments, the USDOT has generally approved this practice.[156]

In accordance with the provisions of Article 7 of the Chicago Convention, no bilateral air transport agreements entered into by the U.S., from Bermuda I to the "Open Skies" agreements, ever conferred cabotage rights and privileges upon the other S States involved. The optional Protocol to the APEC Multilateral Agreement (discussed in the preceding Chapter) provides a framework for the exchange of full cabotage and 7th freedom rights between parties that are willing to do so.[157] However, the U.S. is not yet a signatory to the optional Protocol probably because, as noted, domestic legislation does not allow the U.S. to open up its domestic market to foreign carriers.

But, when U.S. airlines have been available to provide the service, the DOT has declined to grant the exemption. For example, the DOT denied the application of Lineas Aereas Del Caribe (a Columbian-flag carrier) to transport cattle from Miami to San Juan, Puerto Rico, when it was advised that two U.S. carriers were available to provide the proposed service. APPLICATION OF LINEAS AEREAS DEL CARIBE, S.A., DOT ORDER 86-8-37 (1986), at 1.

[150] The enactment of the International Air Transport Competition Act of 1979 marked a change in U.S. policy on cabotage, at least in theory. U.S. *International Air Transport Competition Act,* PUB. L. NO. 96-192, 94 STAT. 35 (1979). Section 13 of the Act permits foreign carriers to fly within the U.S. in situations where an emergency occurs and U.S. carriers cannot handle the traffic. In that event, a foreign carrier may apply for an exemption to engage in cabotage. This exemption can only be granted for a period not exceeding 30 days, and it must be shown that unsuccessful efforts have been made to accommodate the traffic on U.S. carriers. F. Allen Bliss, *Rethinking Restrictions on Cabotage: Moving to Free Trade in Passenger Aviation*, 17 SUFFOLK TRANSNAT'L L. REV. 382 (1994) at 383-84; *see also* Howard Kass, *Cabotage and Control: Bringing 1938 U.S. Aviation Policy into the Jet Age*, 26 CASE W. RES. J. INT'L L. 143 (1994) at 154. The change in policy notwithstanding, the provisions of section 13 of the Act are "so inherently restrictive that the exception provides little benefit and does not represent a modification of the United States' protectionist attitude towards its domestic market." Howard Kass, *Cabotage and Control: Bringing 1938 U.S. Aviation Policy into the Jet Age*, 26 CASE W. RES. J. INT'L L. 143 (1994) at 155.

[151] 49 U.S.C. § 1386(b)(7). DOT may renew the exemption for periods of up to 30 days. However, the exemption terminates not more than five days after the unusual circumstances that created its need end. *Id*. Where the traffic inconvenience results from a labor dispute, such exemption must not result in an undue advantage to any party thereto.

[152] Howard Kass, *Cabotage and Control: Bringing 1938 U.S. Aviation Policy into the Jet Age*, 26 CASE W. RES. J. INT'L L. 143 (1994) at 154.

[153] *Schraft & Rosen*, *supra,* at 29.

[154] Howard Kass, *Cabotage and Control: Bringing 1938 U.S. Aviation Policy into the Jet Age*, 26 CASE W. RES. J. INT'L L. 143 (1994) at 161.

[155] *Id.*

[156] *Id.*

157 See article 2 of the Protocol to the APEC Agreement.

The principal arguments in favor of liberalizing cabotage are: (1) it would provide additional domestic competition to enable consumers to enjoy more price and service options; and (2) it would enable creation of global megacarriers. The arguments against liberalization of cabotage rights are: (1) it would send jobs and revenue overseas; and (2) it would compromise national security.[158]

V. PRICING

At the outset, the term "tariff" warrants definition. Although the terms "air rates," "air fares" and "air tariffs" often are used interchangeably, the term "fares" is ordinarily understood to relate to prices to be paid for the air transportation of passengers and their baggage, whereas the term "rates" usually refers to the prices to be paid for the air transportation of cargo. The wider term "tariffs" means the prices to be paid for the air transportation of passengers, baggage and cargo, and the conditions under which those prices apply.[159] Such conditions sometimes include various surcharges that carriers might impose.

Despite their differences at Chicago, the world's two then-dominant aviation powers succeeded in reaching a compromise at Bermuda, concluding a bilateral since known as *Bermuda I*. With respect to tariffs, the United States retreated from its earlier opposition to any form of international regulation of fares. Tariffs were to be set initially by the airlines themselves, subject to approval upon 30-day's notice by each of the governments involved. Rates would have to be "fair and economic", and under U.S. domestic regulatory law, nondiscriminatory, and just and reasonable.[160] It was also agreed that the International Air Transport Association [IATA] would bear primary responsibility for determining collective fares,[161] subject to the approval of those governments affected by the IATA decision.[162] Most *Bermuda I*-type agreements contained an explicit endorsement of the IATA rate-making machinery, identifying procedures to be followed upon a failure of IATA to reach a consensus.[163] In return for American agreement to IATA's ratemaking machinery, the British retreated from their earlier insistence upon some governmental regulation of capacity, particularly on fifth-freedom flights. Together, these concessions comprised the so-called "Bermuda Compromise."

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Paragraph (a) of Annex II to the *Bermuda I* bilateral sets forth the important principle that rates for air services between the two States shall be subject to the approval of both governments (*i.e.,* "double

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158 Angela Edwards, *Foreign Investment in the U.S. Airline Industry: Friend or Foe?*, 9 EMORY INT'L L. REV. 595, 639-41 (1995).

159 Peter Haanappel, *Bilateral Air Transport Agreements – 1913-1980*, 5 INT'L TRADE L.J. 241 (1980); BIN CHENG, THE LAW OF INTERNATIONAL AIR TRANSPORT 17 (1962). For example, Article 8(1) of the Indonesia-Hong Kong bilateral air transport agreement defines a tariff as follows:

> The term "tariff" means one or more of the following:
> (a) the fare charged by an airline for the carriage of passengers and their baggage on scheduled air services and the charges and conditions for services ancillary to such carriage;
> (b) the rate charged by an airline for the carriage of cargo (excluding mail) on scheduled air services;
> (c) the conditions governing the availability or applicability of any such fare or rate including any benefits attaching to it; and
> (d) the rate of commission paid by an airline to an agent in respect of tickets sold or air waybills completed by that agent for carriage on scheduled air services.

Agreement between the Government of Hong Kong and the Government of the Republic of Indonesia Concerning Air Services of June 6, 1997.

160 *Bermuda I*, Annex II. Paul Dempsey, Law & Foreign Policy in International Aviation 422-24 (1987).

161 In the ensuing decades, IATA, whose membership consists of airline companies certificated for scheduled operations by governments eligible to participate in ICAO, long played an integral role as a forum in which carriers set for international routes.

162 Anthony Sampson, Empires of the Sky: The Politics, Contests and Cartels of World Airlines 73-75 (1984).

163 *United States Standard Form of Bilateral Air Transport Agreement*, Art. 11 (1953). *See* Joseph Gertler, *Bermuda Air Transport Agreements: Non Bermuda Reflections*, 42 J. Air L. & Com. 779, 800 (1976); Peter Haanappel, *Bilateral Air Transport Agreements – 1913-1980*, 5 Int'l Trade L.J. 241, 255-57 (1980); Comment, *Bermuda 2: New Model for International Air Services Agreements*, 9 L. & Pol'y Int'l Bus. 1259 (1979) at 1262. In 1960, the United States revised its standard-rate article to eliminate specific endorsement of IATA. For a comprehensive discussion of the Bermuda I provisions, *see* Peter Haanappel, *Bilateral Air Transport Agreements – 1913-1980*, 5 Int'l Trade L.J. 241, 246-50 (1980).

approval" pricing).[164] Paragraph (b) of Annex II contains the most significant ratemaking provision of the bilateral—the delegation of primary ratemaking responsibility to the International Air Transport Association.[165] With respect to the United States, this recognition of IATA's ratemaking machinery required an agreement on the part of the Civil Aeronautics Board to exempt IATA's rate-fixing activities from the operation of U.S. antitrust laws. The recognition of IATA's ratemaking machinery, however, did not constitute an unqualified approval of individual fares established by IATA; paragraph (b) of Annex II expressly provides, for example, that all IATA-established fares would be filed with the regulatory authorities of each State and subject to their approval.[166]

Paragraph (c) Annex II requires that any new rate proposed by a designated carrier be filed with the aeronautical authorities of both States at least 30 days prior to its effective date.[167] This provision was designed to give authorities of both States reasonable time to review established fares and an opportunity to disapprove a specific fare in the event they wished to do so.[168]

Paragraphs (3), (f) and (g) identify procedures to be utilized in the event that: 1) any specific rate agreement is not approved within a reasonable time by either State, or a conference of IATA is unable to agree on a rate, 2) no IATA ratemaking machinery is applicable, or 3) either State at any time withdraws or fails to renew its approval of the relevant IATA rate conference.[169]

The procedures identified in paragraphs (e) and (f) differ in two important aspects. In the event that the States fail to agree on specific rates to be charged by designated carriers on the routes identified in the bilateral, the type (e) procedure allows the disputed fares to become effective on a provisional basis pending the settlement of the dispute in accordance with procedures set forth in the bilateral's arbitration clause. The type (f) procedures, on the other hand, allow the party raising the objection to the proposed fare to block or suspend implementation of the fare in question pending settlement of the dispute.

The type (e) and type (f) provisions also differ in that, while the type (e) procedure is to be followed "in the event that power is conferred by law upon the aeronautical authorities of the United States to fix fares and economic rates for . . . international services and to suspend proposed rates. . . ,"[170] the type (f) procedure is to be followed "prior to the time when such power may be conferred by law upon the aeronautical authorities of the U.S."[171]

At the *Bermuda I* negotiations, the United States, which sought lower fares, favored the type (e) procedure, while the United Kingdom, which supported higher fares, favored the type (f) approach.[172] Throughout the subsequent life of the *Bermuda I* bilateral, however, the type (f) procedure never became operative simply because the language of paragraph (f) was interpreted in the United States as not, in and of itself, conferring upon the CAB the power to intervene in international rate disputes.[173] That power, it was reasoned, could be conferred only by U.S. domestic legislation; although the CAB was given authority in 1972 to suspend and reject international fares, it was not given the power to fix such fares.[174] Thus, as one commentator has noted, the apparently forceful language of paragraph (f) is

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[164] *Air Transport Agreement Between the Government of the United States and Singapore*, 1997, CCH AVIATION ¶ 26,495A, ANNEX II ¶ (A).
[165] *Id.* ¶ (b).
[166] *Id.*
[167] *Bermuda I, supra*, Annex II ¶ (c).
[168] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 29 (1984).
[169] *Bermuda I, supra*, Annex II ¶ (d).
[170] *Id.,* Annex II ¶ (e).
[171] *Id.,* Annex II ¶ (f).
[172] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 31 (1984).
[173] *Id.,* 31.
[174] *Id.*

nothing more than a "paper tiger."[175] Finally, paragraph (h) of Annex II States that rates established pursuant to the pricing provisions of the bilateral "shall be fixed at reasonable levels, due regard being paid to all relevant factors, such as cost of operation, reasonable profit and the rates charged by any other air carriers."[176]

The major pricing provisions set forth in the *Bermuda I* agreement were subsequently incorporated into many bilaterals in the postwar era, not only in agreements consummated by the United States and Great Britain, but in numerous bilaterals concluded by other States as well. Professor Haanappel has observed that the pricing provisions of *Bermuda I* have been more influential in aviation bilaterals than those relating to capacity and frequency.[177]

Like *Bermuda I*, many bilaterals provide that rates are to be determined initially by the carriers involved and that any such fares are subject to the prior approval of both governments (*i.e.,* "double approval" pricing).[178] Most of these bilaterals further provide that the carriers, in determining rates to be submitted for governmental approval, may use or shall use the ratemaking machinery of IATA "where possible" or "wherever possible."[179] Rarely, however, do the pricing provisions of an existing bilateral make use of the IATA mechanism mandatory.[180]

The United States incorporated the basic *Bermuda I* IATA pricing provisions into most of the bilaterals it concluded prior to 1960; each agreement specified procedures which were to be followed in the event IATA failed to reach agreement on a specific fare.[181] In 1960, however, the United States revised its position and refused explicitly to endorse fares set by IATA. *Bermuda I*-type bilaterals consummated by the United States subsequent to 1960, however, continued to provide for double approval pricing, allowing the aviation authorities of either State to suspend rates filed by the carriers

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[175] *Id.*, 32.

[176] *Bermuda I*, *supra*, Annex II ¶ (h). Professor Bin Cheng has noted that the "all relevant factors" language found in most such provisions are generally the following: (a) economic operation; (b) reasonable profit; (c) characteristics of service, for instance, standards of speed and accommodation; and (d) tariffs charged by any other operators on the route. BIN CHENG, THE LAW OF INTERNATIONAL AIR TRANSPORT 13, 17 (1962).

[177] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 37 (1984).

[178] *See, e.g., Agreement on Air Transport Services, United States-Spain,* February 20, 1973, 24 U.S.T. 2102; T.I.A.S. No. 7725. *See* Joseph Gertler, *Bermuda Air Transport Agreements: Non Bermuda Reflections*, 42 J. AIR L. & COM. 779, 802-03 (1976). Bilateral pricing provisions fall into five general categories.

Most bilateral air transport agreements concluded by the United States after 1978 include *mutual disapproval* pricing provisions. States with which the U.S. initially signed such bilaterals include Belgium, TIAS NO. 9903; Costa Rica TIAS NO. 12854; El Salvador, TIAS NO. 9613; Jordan, TIAS NO. 9868; South Korea, TIAS NO. 9427; Malaysia TIAS NO. 12871; Singapore, TIAS NO. 9001; Taiwan, TIAS NO. ___; and Thailand, TIAS NO. 9704. Article 12 of U.S.–Belgium bilateral concluded in 1980 is fairly typical of these.

Several of the post-1977 bilaterals include *zone arrangements* which establish different pricing zones and mutual approval or disapproval. These include bilaterals with Barbados, TIAS NO. 10370; the Peoples Republic of China, TIAS NO. 10326; and the Philippines, TIAS NO. 10443.

Country-of-Origin pricing provisions were included in U.S. bilaterals with Australia, TIAS NO. 1574 & 1980 MOU; Fiji, TIAS NO. 9917; the Federal Republic of Germany, TIAS NO. 9591 & 3556; the Netherlands, TIAS NO. 4782 & 8998; New Zealand, TIAS NO. 9956; Poland, TIAS NO. ___; and Syria, TIAS NO. 9176. Rather typical are Articles 6 and 11 added by 1978 protocol to the 1955 bilateral between the U.S. and the Federal Republic of Germany.

Many pricing provisions are of the *Bermuda I* variety. These include bilaterals the United States concluded with Canada, TIAS NO. 5972; Chile, TIAS NO. 1905; Colombia, TIAS NO. 5338; Cuba, TIAS NO. 2892 (suspended); Czechoslovakia, TIAS NO. 6644; Denmark, TIAS NO. 3104; Egypt, TIAS NO. 5706; France, TIAS NO. 1679; Hungary, TIAS NO. 7577; India, TIAS NO. 3504; Indonesia, TIAS NO. 6441; Iran, TIAS NO. 8149 (suspended); Italy, TIAS NO. 6957; Ivory Coast, TIAS NO. 9766; Japan, TIAS, NO. 2854; Liberia, TIAS NO. 8997; Mexico, TIAS NO. 4675 AND 7167; Morocco, TIAS NO. 6877; Nigeria, TIAS NO. 8999; Norway, TIAS NO. 3015; Pakistan, TIAS NO. 1586; Panama, TIAS NO. 6270; Paraguay, TIAS NO. 8966; Romania, TIAS NO. 7901; Senegal, TIAS NO. __; South Africa, TIAS NO. 1639 (suspended); Spain, TIAS NO. 7735; Sweden, TIAS NO. 3013; Switzerland, TIAS NO. 1929; the U.S.S.R., TIAS NO. 6135; Uruguay, TIAS NO. 5692; Venezuela, TIAS NO. 2831; Yugoslavia, TIAS NO. 9364; and Zaire, TIAS NO. 6935. Typical is that embraced in Article 10 of the U.S.-Italy bilateral, concluded in 1970.

Finally, the U.S.-U.K. has a unique pricing provision in *Bermuda II*, TIAS NO. 8641, concluded in 1977.

[179] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 37 (1984).

[180] *Id.*

[181] *See, e.g., Agreement on Air Transport Services, United States-Switzerland, 1945, as amended 1949*; T.I.A.S. NO. 1929.

involved.[182]

The stability of the *Bermuda I* IATA ratemaking system was first challenged in the 1960s, as non-IATA charter services provided increased competition for scheduled carriers.[183] In the early and mid-1970s, additional pressure on the IATA ratemaking machinery came in the form of price increases and shortages of aviation fuel, short-term overcapacity stemming from the introduction of wide-bodied aircraft, and U.S. attempts to introduce greater competition in international ratemaking.[184] As a result of these external factors, IATA became increasingly unable to agree upon fares internally and to gain support among governmental aviation authorities for those fares it did adopt.[185]

In 1967, the International Agreement on the Procedure for the Establishment of Tariffs for Scheduled International Air Services was concluded in Paris.[186] For signatory States, the tariff provisions set forth in the Agreement supersede pricing provisions contained in existing bilaterals.[187] The Agreement essentially incorporates the basic *Bermuda I* ratemaking provisions and strongly endorses the IATA ratemaking machinery.[188] The Agreement, however, also provides for governmental approval of tariffs.[189] Unlike the 1953 U.S. standard pricing clause, which allows proposed fares to take effect pending resolution of governmental fare disputes, the Agreement provides that existing tariffs shall remain in force until new ones have been established or until twelve months after the date they would have normally expired, whichever occurs first.[190] Tariff dispute clauses similar to that contained in the Agreement are found in many existing bilaterals.[191]

The pricing regime established in *Bermuda I* and its subsequent modifications underwent profound changes in the late 1970s. President Carter and CAB Chairman Alfred E. Kahn, convinced that enhanced pricing competition was to a large extent responsible for record domestic aviation profits in the United States, were determined to introduce similar pricing competition into international markets.

In 1977, a new bilateral was concluded between the United States and the United Kingdom;[192] unlike those of *Bermuda I*, however, the pricing provisions of the *Bermuda II* bilateral would not serve as a model for future U.S. air transport agreements. On the contrary, the Carter administration became obsessed with the objective of introducing greater flexibility and freedom into international ratemaking, despite the restrictive nature of the new U.K. bilateral.[193]

In 1978, Washington announced its objectives in negotiating new bilaterals. Henceforth, in the area of pricing, the U.S. objective would be the "[c]reation of new and greater opportunities for innovation and competitive pricing that will encourage and permit the use of new price and service options to meet the needs of different travelers and shippers."[194] The U.S. Model Agreement provided that neither party to

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[182] *See e.g., Agreement on Air Transport Service, United States-Egypt, 1964*; T.I.A.S. NO. 5706.
[183] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 256 (1984).
[184] *Id.*
[185] *Id.*
[186] *Id.*
[187] *Id.*
[188] *Id.*
[189] *Id.*, 256-57.
[190] *Id.*, 257.
[191] *Id.*
[192] *Agreement on Air Transport Services, United States-United Kingdom*, July 23, 1977, 28 U.S.T. 5367; T.I.A.S. NO. 8641 [hereinafter cited as *Bermuda II*]. *See generally*, Gardiner, *United Kingdom Air Services Agreements, 1970-1980*, 7 AIR LAW 2 (1982). *See generally*, *Bermuda II Model*, *supra*.
[193] Article 12, of *Bermuda II* provides for "double-approval" of tariffs and endorses the use of IATA ratemaking machinery. Should consultations fail to settle governmental disputes over tariffs, eachState has the right to continue in force existing tariffs beyond the date they otherwise would have expired.
[194] *Statement Concerning United States Policy on the Conduct of International Air Transport Negotiations*, 14 WEEKLY COMP. OF PRES. DOC.,

the bilateral could take unilateral action to prevent the inauguration or continuation of a proposed or existing fare (*i.e.*, "mutual disapproval" pricing).[195] The Model Agreement provides that fares are "to be established by each designated airline based upon commercial considerations in the marketplace";[196] governmental intervention in ratemaking is to be limited to "prevention of predatory or discriminatory prices or practices, protection of consumers from prices that are unduly high or restrictive because of the abuse of a dominant position, and protection of airlines from prices that are artificially low because of direct or indirect governmental subsidy or support."[197]

In 1978, ICAO adopted a Standard Bilateral Tariff Clause,[198] designed to provide guidance to member States in the negotiation of their bilateral air transport agreements. It contrasts sharply with the U.S. Model Agreement. The ICAO Standard Clause is similar to the 1967 International Agreement in several important respects; tariffs are determined by carriers, subject to governmental approval, and such tariffs, once approved and in force, remain in force until new tariffs are established, or until twelve months after the date on which they otherwise would have expired.[199] Unlike the 1967 International Agreement, however, the ICAO Standard Clause only implicitly endorses IATA rates, providing for use "whenever possible" of the "appropriate international rate fixing mechanism."[200]

In 1978, the United States signed the first of its "liberal" bilaterals. Pricing provisions in these new bilaterals place an emphasis on the encouragement of low rates, set by individual carriers on the basis of forces in the marketplace, without reference to the IATA ratemaking machinery.[201] The liberal bilaterals typically provide for either "mutual disapproval" pricing or "country-of-origin" pricing.

Under mutual disapproval pricing provisions, discussed above in connection with the U.S. Model Agreement, neither State may disapprove and suspend a proposed rate unless the other also disapproves the rate in question. In the event that the two States fail to agree, the carrier's proposed rate becomes effective. Mutual disapproval pricing provisions, which are considered more liberal than country-of-origin provisions, were initially incorporated into U.S. bilaterals with Israel,[202] Belgium,[203] and Korea.[204]

Under country-of-origin pricing provisions, governmental authorities can unilaterally disapprove a fare proposed by a carrier only if the route in question originates within its own territory. Country-of-origin provisions were initially incorporated into U.S. bilaterals and protocols with the Federal Republic of Germany[205] and the Netherlands.[206] In the U.S.-Netherlands Agreement of 1978, for example, government intervention in the realm of pricing was limited only to prevention of predatory or discriminatory practices, protection of consumers from the abuse of abuse of a dominant position (market power), and from artificially low prices resulting from governmental subsidies.[207]

The International Air Transportation Competition Act of 1979 endorsed several of the liberal policy

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1462 (AUG. 28, 1978) [hereinafter cited as U.S. Policy Statement]. M. Brenner, *supra,* at 15.

[195] Bogosian, *Aviation Negotiation and the U.S. Model Agreement*, 46 J. AIR L. & COM. 1007. 1030-31 (1981).

[196] *Id.*, 1030.

[197] *Id.*, 1030-31.

[198] ICAO DOC. 9928-C/1036 (1978).

[199] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 23 (1984).

[200] *Id. See* Joseph Gertler, *Bermuda Air Transport Agreements: Non Bermuda Reflections*, 42 J. AIR L. & COM. 779, 800 (1976).

[201] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 42 (1984).

[202] *Protocol Relating to Air Transport Services, United States-Israel, August 16, 1978*, 29 U.S.T. 3144; T.I.A.S. NO. 9002.

[203] *Agreement on Air Transport Services, United States-Belgium, October 23, 1978*, 30 U.S.T. 217; T.I.A.S. NO. 9903.

[204] *Agreement on Air Transport Services, United States-Korea, March 22, 1979*, 30 U.S.T. 3823; T.I.A.S. NO. 9427.

[205] *Protocol Relating to Air Transport Services, United States-Federal Republic of Germany, November 1, 1978*, 30 U.S.T. 7323; T.I.A.S. NO. 9591.

[206] *Protocol Relating to Air Transport Services, United States-Netherlands, March 31, 1978*, 29 U.S.T. 3088; T.I.A.S. 8998.

[207] Pablo Mendes de Leon, *Before and After the Tenth Anniversary of the Open Skies Agreement Netherlands-US of 1992*, 18 AIR & SPACE L. 280, 284 (2002).

objectives inaugurated by the Carter administration.[208] The relevant provision of the Act States that U.S. negotiators will seek the "freedom of air carriers and foreign air carriers to offer fares and rates which correspond with consumer demand."[209] More importantly, the Act significantly increased the power of the CAB [now DOT] to suspend and reject international air tariffs.[210]

In 1984, the U.S.-ECAC Memoranda of Understanding was signed. It established a price band (*i.e.*, "zone of reasonableness") around a reference fare level within which carriers are free to set fares without governmental interference. Outside the band, the zone pricing provisions of the relevant bilaterals are in force.

The modern U.S. approach has been to include a clause requiring that prices are to be established by each airline based on commercial considerations in the marketplace, with government intervention limited to the "prevention of predatory or discriminatory prices or practices, protection of consumers from prices that are unduly high or restrictive because of the abuse of a dominant position, and protection of airlines form prices that are artificially low because of direct or indirect subsidy or support."

A review of the thirteen of the bilaterals agreements concluded by Canada reveal a variety of approaches to pricing determination. Such pricing provisions usually list the factors to be taken into account in determining prices, the procedure for developing the prices and their justification, filing requirements, the role of government in the process of determining prices and the process of approval or acceptance of prices.

In terms of relevant factors that are to be given due regard, most of the bilaterals mention cost of operations, reasonable profit, characteristics of service and the tariffs of other airlines for any part of the specified route.[211] One may note that the Canada-US and Canada-Cuba bilaterals (nations at both ends of the capitalist/communist spectrum) mention that market forces should be the primary consideration in price determination.[212] Most of these bilaterals stress that prices should be at "reasonable levels". It is interesting to note that the Canada-UK Bilateral lists in its Annex "reference levels" for prices.[213] In terms of references to IATA rate-making machinery, only seven of the thirteen Canadian bilaterals mention it, five of which making its rates applicable "whenever possible"[214] and two making its application mandatory.[215]

For the development of prices, some of the bilaterals reviewed for this study provide that prices should be agreed upon by the designated airlines[216] while others leave at the option of the designated airlines whether to determine the prices on their own or though consultation with the other airlines.[217]

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[208] PUB. L. 96-192, FEB. 15, 1980, 94 STAT. 35.

[209] *Id.*, Section 17.

[210] *See generally,* PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 54-56 (1984).

[211] *See* Canada-Russia Bilateral, *supra,* Art. 12, Canada-Cuba Bilateral, *supra,* Art. XIV, Canada-France Bilateral, *supra,* Art. 12, Canada-UK Bilateral, *supra,* Art. 13, Canada-Germany Bilateral, *supra,* Art. 12, Canada-Korea Bilateral, *supra,* Art. 10, Canada-China Bilateral, *supra,* Art. 8, Canada-Spain Bilateral, *supra,* Art. XIII, Canada-Brazil Bilateral, *supra,* Art. XIV, Canada-Mexico Bilateral, *supra,* Art. 11, Canada-Italy Bilateral, *supra,* Art. VI, Canada-Japan Bilateral, *supra,* Art. X.

[212] Canada-US Bilateral, *supra,* Art. 5 and Canada-Cuba Bilateral, *supra,* Art. XIV.

[213] Canada-UK Bilateral, *supra,* Annex II, Appendix A.

[214] Canada-Brazil Bilateral, *supra,* Art. XIV, Canada-France Bilateral, *supra,* Art. 12, Canada-Germany Bilateral, *supra,* Art. 12, Canada-Japan Bilateral, *supra,* Art. X, Canada-Korea Bilateral, *supra,* Art. 10.

[215] Canada-Italy Bilateral, *supra,* Art. VI and Canada-Mexico Bilateral, *supra,* Art. 11.

[216] Canada-Brazil Bilateral, *supra,* Art. XIV, Canada-China Bilateral, *supra,* Art. 8, Canada-France Bilateral, *supra,* Art. 12, Canada-Germany Bilateral, *supra,* Art. 12, Canada-Italy Bilateral, *supra,* Art. VI, Canada-Japan Bilateral, *supra,* Art. X, Canada-Korea Bilateral, *supra,* Art. 10.

[217] Canada-US Bilateral, *supra,* Art. 5, Canada-UK Bilateral, *supra,* Art. 13, Canada-Spain Bilateral, *supra,* Art. XIII, Canada-Russia Bilateral, *supra,* Art. 12, Canada-Cuba Bilateral, *supra,* Art. XIV.

Only one Canadian bilateral establishes that airlines will develop prices individually.[218]

Once the prices are determined, most of the bilaterals require that these prices be submitted for approval to the aeronautical authorities of the Contracting Parties.[219] Such filing is mandatory in most cases.[220] In terms of the government's role in the approval of prices, most of the bilaterals analyzed provide that both aeronautical authorities of the Contracting Parties must approve the tariffs ("double approval") or in case of disagreement between the airlines or disapproval by one of the authorities of the prices proposed by the airlines, the authorities should endeavor to determine the prices by agreement between themselves.[221] One may note that several bilaterals adopted different approaches. For example, the Canada-Cuba and Canada-UK Bilaterals impose the "mutual disapproval" requirement for blocking a proposed price for services between the Contracting Parties and "country of origin" requirement for services between a CP and a third country.[222] Also, the Canada-Spain Bilateral imposes a "mutual disapproval" requirement for rejection of a price.[223] One may also note that only two bilaterals (i.e., Canada-US and Canada-Spain), contain liberal provisions regarding pricing by limiting government intervention only to prevention of predatory or discriminatory prices or practices and protection of consumers from prices that are unduly high or restrictive and the protection of airlines from prices to the extent that they are artificially low due to direct or indirect subsidy or support.[224] These bilaterals provide expressly that unilateral governmental action of preventing or continuing an existing or proposed price is prohibited. Thus, in order to prevent or discontinue an existing price, there is a need for "mutual disapproval" of the price by both aeronautical authorities.[225]

Finally, it should be mentioned that in terms of the prices applicable pending determination, most of the Canadian bilaterals reviewed provide that, where a price was determined following the procedure established in the respective air agreement, it remains in force until replaced by a new price adopted following the same procedure. Several bilaterals limit this period of transition to 12 months from the date on which the tariff would have expired.[226] The Canada-Mexico bilateral provides that the Contracting Party raising the objection to a tariff may take any steps as it may consider necessary to prevent the inauguration or the continuation of the service in question at the objectional tariff.

VI. CAPACITY/FREQUENCY

The capacity determination provisions of *Bermuda I* are contained in the Final Act of the agreement. These provisions, although highly controversial, are considered by many commentators to be the hallmark of the *Bermuda I* bilateral. The major capacity provisions enunciated at Bermuda would subsequently be incorporated, often verbatim, into many of the post-*Bermuda I* bilaterals.[227]

At Chicago, the British delegation had insisted upon some governmental regulation of capacity. In exchange for the U.S. recognition of IATA's ratemaking machinery, however, the British acquiesced to a

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[218] Canada-Mexico Bilateral, *supra,* Art. 11.

[219] One may note that, since it requires only individual determination of prices, Canada-Mexico Bilateral provides that the filing should be made only with the authority of the other Contracting Party.

[220] Note that only Canada-Spain Bilateral, *supra,* Art. XIII and Canada-Cuba Bilateral, *supra,* Art. XIV, provide that filing *may* be required. The U.S. – Canada Bilateral, *supra,* Art. 5, provides that there is no filing requirement for the prices.

[221] See Canada-Russia Bilateral, *supra,* Art. 12, Canada-Mexico Bilateral, *supra,* Art. 11, Canada-Korea Bilateral, *supra,* Art. 10, Canada-Japan Bilateral, *supra,* Art. X, Canada-Italy Bilateral, *supra,* Art. VI, Canada-Germany Bilateral, *supra,* Art. 12, Canada-France Bilateral, *supra,* Art. 12, Canada-China Bilateral, *supra,* Art. 8, Canada-Brazil Bilateral, *supra,* Art. XIV.

[222] Canada-Cuba Bilateral, *supra,* Art. XIV, Canada-UK Bilateral, *supra,* Art. 13.

[223] Canada-Spain Bilateral, *supra,* Art. XIII.

[224] See Canada-US Bilateral, *supra,* Art. 5, Canada-Spain Bilateral, *supra,* Art. XIII.

[225] *Id*.

[226] Canada-Cuba Bilateral, *supra,* Art. XIV, Canada-UK Bilateral, *supra,* Art. 13.

[227] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 32 (1984).

capacity determination system under which carriers themselves would have the authority to institute at their discretion capacity and fifth-freedom traffic arrangements, subject to a number of general considerations, and *ex post facto* governmental review.

These general considerations, set forth in paragraphs 3 through 6 of the Final Act, have been criticized by numerous commentators as being extremely vague and difficult to implement.[228] Paragraph 3 States that air transport facilities available to the traveling public must "bear a close relationship to the requirements of the public for air transport."[229] Paragraph 4 provides that there must be a "fair and equal opportunity for the carriers of the two States to operate over the designated routes."[230] Paragraph 5 States that "the interest of the air carriers of the other government shall be taken into consideration so as not to affect unduly the services which the latter provides on all or part of the same route."[231] Paragraph 6 of the Final Act contains perhaps the most important and influential of these general capacity considerations; it States that the "primary objective" of the provision of capacity is to meet traffic demands between the country of nationality of the air carrier and the country of destination of the traffic, with fifth-freedom traffic capacity bearing a relationship to the carrier's combined third- and fourth-freedom traffic on the route in question.[232]

Thus, the capacity determination principles set forth in *Bermuda I* allow carriers of the two States considerable flexibility in determining appropriate levels of capacity and frequency of flights. In the event that either State becomes dissatisfied with capacity offered by carriers on a particular route, Article 9 of the Final Act provides for a system of regular and frequent consultations between governmental authorities of the two States.[233] In conjunction with the consultation, dispute, and renunciation provisions set forth in articles 8, 9, and 10 of the Agreement, Article 9 of the Final Act establishes the so-called *ex post facto* review procedure of capacity which is considered by many commentators to be one of the essential elements of *Bermuda I*.[234] If either State invoked the *ex post facto* review mechanism, governmental authorities of both States might enter negotiations or, if necessary, submit the dispute to arbitration.

In retrospect, the *Bermuda I* capacity principles appear quite liberal. Professor Peter Haanappel observed that the majority of States have not remained as faithful to the *Bermuda I* provisions relating to capacity and frequency as they have to those relating to pricing or ratemaking.[235] Another commentator has maintained that capacity restrictions which have been imposed in the post-*Bermuda I* era, although ostensibly introduced within the framework of the *Bermuda I* capacity principles, have in fact gone beyond what the parties to *Bermuda I* could possibly have intended.[236]

Bermuda I granted to carriers of each State the right to institute at their discretion capacity and fifth-freedom traffic arrangements, subject to an *ex post facto* review by governmental authorities of both States in the event that either State became dissatisfied with capacity levels instituted by those carriers operating on the route(s) in question. In the forty years since *Bermuda I* was concluded, however, many States have

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[228] *See generally*, Andreas Lowenfeld, *The Future Determines the Past: Bermuda I in the Light of Bermuda II*, 3 AIR L. 39 (1978).

[229] *Bermuda I, supra*, Final Act ¶ 3.

[230] *Id.* ¶ 4.

[231] *Id.* ¶ 5.

[232] *Id.* ¶ 6. Bilaterals modeled on *Bermuda I* ,such as the US-Australia bilateral, provide that the "primary objective" of the provision of capacity is to meet traffic demands between the country of nationality of the air carrier and the country of destination of the traffic, with fifth-freedom traffic capacity bearing a relationship to the carrier's combined third- and fourth-freedom traffic on the route in question. Air Services Agreement with the United Kingdom, Feb. 11, 1946, 60 STAT. 1499, T.I.A.S. NO. 1507 ¶ 6. Annex B(ii) the US-Australia bilateral provided "the primary purposes of such service is the carriage of traffic originating in or destined for the designated airline's territory." 3 CCH AV. L. REP. ¶ 26,207C.

[233] *Id.* ¶ 9.

[234] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 33 (1984).

[235] *Id* at 35.

[236] Diamond, *The Bermuda Agreement Revisited: A Look at the Past, Present and Future of Bilateral Air Transport Agreements*, 41 J. AIR L. & COM. 419, 459, 462 (1975) [hereinafter cited as Diamond].

rejected the *Bermuda I* capacity principles in favor of a system providing for the predetermination of capacity. As one commentator noted:

> The freedom of the air the United States has long advocated under the Bermuda principles is a special kind of freedom; the freedom of the stronger (in terms of traffic generating capability and bargaining power) to freely compete with the weaker. This Darwinian notion of freedom has understandably not set well with that large body of politic of countries which together compromise the category of "the weaker." Like weaker species in nature, these countries have fought back with whatever weapons they happened to have at hand. This arsenal of weapons (*i.e.*, restrictions) has been more than a match for the single big weapon in the U.S. arsenal—traffic generating capacity. The reasons noted for this . . . stem from the fact that, to paraphrase John Donne, no State is an island unto itself in international air transportation.[237]

As the term suggests, a system providing for predetermination of capacity requires prior governmental approval of capacity before air services on specified routes may commence.[238] The scope of this prior governmental approval requirement varies from bilateral to bilateral. In some existing bilaterals, the determination or approval is limited to total capacity only, but more often it relates not only to total capacity but also to frequency or scheduling of flights, and/or specific types and sizes of aircraft to be used.[239]

Professor Peter Haanappel has identified two basic forms of predetermination clauses. The first repeats the Bermuda I capacity principles but makes them subject to prior rather than *ex post facto* government review.[240] The second contains some other type of capacity principle, such as those providing for reciprocity or equal sharing of capacity between carriers of the two States, subject to prior governmental determination or approval.[241]

Haanappel has also identified two systems of governmental approval prevalent among bilaterals requiring predetermination of capacity. Under one system, individual carriers must seek prior governmental approval of capacity and frequencies.[242] Under the other, the designated carriers must reach an inter-carrier agreement on capacity and capacity-related matters, subject to prior governmental approval.[243]

Bilaterals which include an inter-carrier agreement on capacity and capacity-related issues often require, encourage or permit an anticompetitive practice known as "pooling."[244] Under a pooling agreement, in its simplest form, revenues derived from the joint operation of an air route or air routes by two or more carriers are shared; these revenues are placed into a single fund and divided between the carriers on the basis of a predetermined formula.[245] Not all pooling agreements are identical. Some place

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[237] *Id.*, 462.

[238] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 35 (1984).

[239] *Id.*

[240] *Id.*

[241] *Id.*, 35-36.

[242] *Id.*, 36.

[243] *Id.*

[244] *See generally*, BIN CHENG, THE LAW OF INTERNATIONAL AIR TRANSPORT 278-86 (1962). Pooling is expressly permitted by the *Chicago Convention*. *Id.*, 279. Professor Cheng noted that:

> To a large extent, pooling reintroduces capacity predetermination, where the bilateral agreement provides more, through a back-door on a non-governmental but interline level. Since, however, such interline pooling agreements cannot be concluded without the blessing, or at least the acquiescence, of the governments concerned, the difference between these two types of capacity predetermination becomes relatively insignificant.

Id., 281.

[245] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 36 (1984).

a "ceiling" above which no pooling of revenues is permitted.[246] Other particularly restrictive agreements require the pooling of both revenues and costs, thereby eliminating much of the incentive for competition on the routes in question.[247]

Pooling agreements, whether required, permitted, or encouraged by the bilateral, are common in all parts of the world with one major exception; namely, on air routes within, to, from, or via the United States. On the contrary, the United States generally remained faithful to the Bermuda I capacity principles in the period from 1946 to 1977.

In many post-Bermuda I U.S. bilaterals, however, it has become necessary to clarify and elaborate upon the *ex post facto* review mechanism first established at Bermuda. Some U.S. bilaterals explicitly provide that neither State may unilaterally impose any restriction on capacity, frequency, scheduling or type of aircraft to be used on the routes in question.[248]

By the mid-1970s, British aviation authorities had become dissatisfied with capacity on North Atlantic routes, claiming that the traffic share of the major U.S. carriers (i.e., Pan Am and TWA) far exceeded that of British Airways. The United Kingdom entered the Bermuda II negotiations seeking an equal division of U.S.-U.K. traffic between carriers of the two States; on this point, the British were unsuccessful. British negotiators did succeed, however, in incorporating into the new bilateral an obligation on both parties to avoid overcapacity and undercapacity, as well as a consultative device designed to deal with overcapacity on North Atlantic routes.[249] The Bermuda II agreement also limited U.S. carrier access to certain Fifth Freedom routes, and limited access to London Heathrow Airport to two specified U.S.-flag airlines – Pan Am and TWA.

As in the areas of pricing and designation, however, the restrictive nature of the Bermuda II capacity provisions did not thwart Carter administration attempts to liberalize international aviation markets. U.S. bilateral negotiating objectives announced in 1978 included the "[e]xpansion of scheduled service through elimination of restrictions on capacity, frequency, and route and operating rights."[250] Article II of the U.S. Model Agreement provides that "[n]either Party shall unilaterally limit the volume of traffic, frequency or regularity of service, or the aircraft type or types operated by the designated airlines of the other Party . . ."[251] and that "[n]either Party shall impose on the other Party's designated airlines a first refusal requirement, uplift ratio, no-objection fee, or any other requirement with respect to the capacity, frequency or traffic which would be inconsistent with the purposes of this Agreement."[252] This liberal U.S. approach was designed to allow the airlines "to determine the frequency and capacity of the international air transportation it offers based upon commercial considerations in the marketplace", and to insist that neither State "shall unilaterally limit the volume of traffic, frequency or regularity of service, or the aircraft . . . types operated."

U.S. negotiators succeeded in incorporating these policy objectives into most of the liberal U.S.

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[246] BIN CHENG, THE LAW OF INTERNATIONAL AIR TRANSPORT 281 (1962).

[247] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 37 (1984).

[248] *See e.g.*, *Agreement on Air Transport Services, United States-Malaysia, 1970, as amended 1985* Art. 10,—U.S.T.—T.I.A.S. NO. 6822; *Agreement on Air Transport Services, United States-Belgium, October 23, 1978*, 30 U.S.T. 217; T.I.A.S. NO. 9903, Art. 5(2). The traditional *Bermuda I* language on capacity has been described as "deliberately vague." Joseph Gertler, *Bermuda Air Transport Agreements: Non Bermuda Reflections*, 42 J. AIR L. & COM. 779, 803 (1976).

[249] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 40 (1984).

[250] *Statement Concerning United States Policy on the Conduct of International Air Transport Negotiations*. 14 WEEKLY COMP. OF PRES. DOC. 1462 (AUG. 28, 1978).

[251] Bogosian, *Aviation Negotiation and the U.S. Model Agreement*, 46 J. AIR L. & COM. 1007, 1030 (1981).

[252] *Id.* A "first refusal agreement" is a rule that requires that the national airline be given the first opportunity to operate certain services, before a foreign carrier will be permitted to do so. An "uplift ratio" is used to define the traffic of one air carrier in terms of the traffic of another air carrier. A "no objection fee" is a fixed fee or commission that is paid to a national airline (or the party to the agreement) before a foreign carrier is permitted to commence operations.

bilaterals concluded since the late 1970s. The 1978 U.S.-Netherlands agreement, for example, removed ex post facto restrictions on capacity offered in Fifth and Sixth Freedom markets, limiting capacity only with a Statement that it should be closely related to traffic demand.[253] Professor Haanappel noted that the general characteristics of these liberal bilaterals include "[f]ree determination by the designated airlines of capacity, frequencies and types of aircraft to be used, unhindered by the Bermuda I capacity clauses."[254]

The 1992 U.S.-Netherlands agreement provides that "neither Contracting Party shall unilaterally limit the volume of traffic, frequency or regularity of service, or the aircraft type", and that capacity may only be restricted for customs, technical operational, security or environmental reasons.[255] Despite U.S. successes in removing restrictive capacity practices from a number of important international markets, many States still insist upon and practice some form of predetermination of capacity.

The thirteen Canadian bilaterals reviewed for the purpose of this study reveal a variety of approaches to the issue of capacity and frequency of flights on the designated routes. Most of them include in connection with capacity provisions a call for a fair and equal opportunity to operate the agreed services and point out the requirement to not unduly affect the interests of other airlines operating on the same routes.[256] Most of these bilaterals contain the standard Bermuda I requirements, i.e., that capacity should bear a "close" or "reasonable" relationship to the requirements of the public for air transport on the specified routes,[257] and that the "primary objective" is to meet traffic demands between the country of nationality of the air carrier and the country of destination of the traffic.[258]

In terms of governmental intervention in regulating the capacity and frequency of service on the specified routes, one should note that the only bilateral which does not provide for governmental approval of capacity and frequency is the Canada-US Bilateral, according to which neither Party is allowed to unilaterally impose any restrictions on capacity, frequency, scheduling or type of aircraft to be used on the routes in question. In addition, there should be no first refusal requirement, uplift ration, no-objection fee, or any other requirement with respect to capacity, frequency or traffic which would be inconsistent with the purposes of the Bilateral.[259]

All other twelve bilaterals reviewed provide for some type of governmental intervention in regard to the capacity and frequency allowed on the specified routes. Four bilateral provide for *ex post facto* review by the aeronautical authorities of the Contracting Parties[260] and eight require prior governmental approval of either applications from individual carriers[261] or inter-carrier agreements on capacity.[262]

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[253] Pablo Mendes de Leon, *Before and After the Tenth Anniversary of the Open Skies Agreement Netherlands-US of 1992,* 18 AIR & SPACE L. 280, 283 (2002).

[254] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 42 (1984).

[255] Pablo Mendes de Leon, *Before and After the Tenth Anniversary of the Open Skies Agreement Netherlands-US of 1992,* 18 AIR & SPACE L. 280, 289 (2002).

[256] See for example, Canada-Cuba Bilateral, *supra,*Art. X, Canada-Korea Bilateral, *supra,* Art. 9, Canada-Russia Bilateral, *supra,* Art. 9, Canada-UK Bilateral, *supra,* Art. 7, Canada-France Bilateral, *supra,* Art. 8, Canada-China Bilateral, *supra,* Art. 7, Canada-Brazil Bilateral, *supra,* Art. XI, Canada-Spain Bilateral, *supra,* Art. X, Canada-Italy Bilateral, *supra,* Art. V.

[257] *See* Canada-Cuba Bilateral, *supra,* Art. X, Canada-Korea Bilateral, *supra,* Art. 9, Canada-Russia Bilateral, *supra,* Art. 9, Canada-UK Bilateral, *supra,* Art. 7, Canada-Germany Bilateral, *supra,* Art. 9, Canada-China Bilateral, *supra,* Art. 7, Canada-Mexico Bilateral, *supra,* Art. 10, Canada-Italy Bilateral, *supra,* Art. V, and Canada-Japan Bilateral, *supra,* Art. IX.

[258] "Primary Objective" provisions are included in Canada-Cuba Bilateral, *supra,* Art. X, Canada-Korea Bilateral, *supra,* Art. 9, Canada-Russia Bilateral, *supra,* Art. 9, Canada-UK Bilateral, *supra,* Art. 7, Canada-France Bilateral, *supra,* Art. 8, Canada-Germany Bilateral, *supra,* Art. 9, Canada-Mexico Bilateral, *supra,* Art. 10, Canada-Brazil Bilateral, *supra,* Art. XI, Canada-Spain Bilateral, *supra,* Art. X, Canada-Italy Bilateral, *supra,* Art. V, Canada-Japan Bilateral, *supra,* Art. IX.

[259] Canada-US Bilateral, *supra,* Art. 4.

[260] *See* Canada-Cuba Bilateral, *supra,* Art. X, Canada-Mexico Bilateral, *supra,* Art. 10, Canada-Spain Bilateral, *supra,* Art. X (note that both Governments must disagree with a certain capacity provision in order to have it replaced), and Canada-Japan Bilateral, *supra,* implied from Arts. IX and XI.

[261] This is the case with the Canada-Brazil Bilateral, *supra,* Art. XI, Canada-France Bilateral, *supra,* Art. 9, and Canada-UK Bilateral, *supra,* Art. 7.

In relation to capacity, it should be noted that some bilaterals contain special provisions regarding change of gauge, defined as the operation of one of the agreed services by a designated airline in such a way that one section of the route is flown by aircraft different in capacity from those used on another section. Most of the Canadian agreements reviewed that allow change of gauge by the designated airline of one Contracting Party in the territory of the other Contracting Party impose several conditions on such changes, such as:

- the change of aircraft is justified by reason of economy of operations;[263]
- the capacity used on the section of the route more distant from the territory of the Contracting Party designating the airline is not larger in capacity than that used on the nearer section;[264]
- the aircraft of smaller capacity should operate only in connection with the aircraft of larger capacity;[265]
- there is an adequate volume of through traffic;[266]
- the airline should not hold itself out to the public by advertisement or otherwise as providing a service which originates at the point where the change of gauge is made,[267] or, in a different wording, the airline does not hold itself out, directly or indirectly, as providing any other service other than the agreed service on the relevant specified route;[268]
- the fact that an agreed service includes a change of aircraft is shown in all timetables, computer reservation systems, fare quote systems and other means of holding out the service;[269]
- in connection with any one aircraft flight into territory of the other Contracting Party only one flight may be made out of that territory, unless otherwise specified,[270] or, the number of outgoing flights should not exceed the number of incoming flights.[271]

If such conditions are fulfilled, the change of gauge is allowed at any stop on the specified routes.

The only bilateral that does not impose such conditions for changing of aircraft is the Canada-US Bilateral, under which each designated airline may transfer traffic from any of its aircraft to any of its other aircraft, at any point on the routes, without limitation as to change in type or numbers of aircraft operated, without geographic or directional limitation and without loss of any right to carry traffic otherwise permissible under the Bilateral, with the only condition that the service begins or terminates in the territory of the Party designating that airline.[272] (See attached Excel files on capacity provisions and change of gauge provisions.)

VII. DISCRIMINATION AND FAIR COMPETITION

The *Bermuda I* agreement, like most early bilaterals, contains relatively few provisions relating to "soft rights", such as discrimination and unfair methods of competition. Article 3 of the bilateral,

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[262] This is the case with Canada-China Bilateral, *supra,* Art. 7, Canada-Germany Bilateral, *supra,* Art. IX, Canada-Italy Bilateral, *supra,* Art. V, Canada-Korea Bilateral, *supra,* Art. 9, and Canada-Russia Bilateral, *supra,* Art. 9.

[263] See Canada-Cuba Bilateral, *supra,* Art. XI, Canada-Korea Bilateral, *supra,* Art. 5, Canada-UK Bilateral, *supra,* Art. 4, Canada-Spain Bilateral, *supra,* Annex 1, Section 1, Canada-Brazil Bilateral, *supra,* Art. III, Canada-Mexico Bilateral, *supra,* Art. 10.

[264] *Id*.

[265] *Id*.

[266] *Id*.

[267] Canada-Korea Bilateral, *supra,* Art. 5, Canada-Spain Bilateral, *supra,* Annex 1, Section 1, Canada-Brazil Bilateral, *supra,* Art. III.

[268] Canada-Cuba Bilateral, *supra,* Art. XI, Canada-UK Bilateral, *supra,* Art. 4.

[269] Canada-UK Bilateral, *supra,* Art. 4, Canada-Cuba Bilateral, *supra,* Art. XI.

[270] Canada-Korea Bilateral, *supra,* Art. 5, Canada-UK Bilateral, *supra,* Art. 4, Canada-Brazil Bilateral, *supra,* Art. III, Canada-Spain Bilateral, *supra,* Annex 1, Section 1.

[271] Canada-Cuba Bilateral, *supra,* Art. XI.

[272] Canada-US Bilateral, *supra,* Annex I Section I.

however, provided that neither signatory State could impose or permit to be imposed upon designated carriers of the other user charges which are discriminatory in nature.[273] Foreign carriers were not to be accorded treatment less favorable with respect to customs duties, inspection fees and other charges than domestic carriers.[274] Fuel, lubricating oil and spare parts were to be wholly exempt from such fees and charges.[275]

But issues relating to discrimination and unfair methods of competition in international civil aviation became an integral component of bilateral air transport negotiations in the post-*Bermuda I* era. The United States had played the dominant role in bringing these issues to the forefront in such negotiations, particularly since the first liberal bilaterals were concluded in 1978.[276]

Although concerns about unfair competitive practices of foreign air carriers were voiced in the United States as early as 1961, the first U.S. economic regulatory mechanism designed to combat foreign anticompetitive practices was promulgated in 1970 as Part 213 of the CAB's Economic Regulations.[277] Part 213 empowered the CAB, upon finding that the "public interest" so required, to insist that a foreign carrier file its schedules with the Board.[278]

In 1972, Congress enacted a series of ratemaking amendments to the Federal Aviation Act of 1958 designed to combat discriminatory and anticompetitive ratemaking activities of foreign governments.[279] Although the *Bermuda I* bilateral gave each State the opportunity, in the event bilateral negotiations were unsuccessful, "to take such steps as it may consider necessary to prevent the inauguration or continuation of the service in question at the rate complained of . . . ,"[280] prior to 1972, the CAB held no such jurisdiction over tariffs and rate practices in foreign transportation.[281] The 1972 amendments, however, gave the CAB specific statutory authority to respond to foreign anticompetitive behavior. Under the amendments, the CAB could suspend proposed or existing international tariffs for a period of up to one year. If, after a hearing, the Board made a finding that foreign-carrier rates or practices were "unjust or unreasonable, or unjustly discriminatory, or unduly preferential, or unduly prejudicial," the Board could cancel the fare in question.[282]

The International Air Transportation Fair Competitive Practices Act of 1974 [FCPA][283] was enacted by the U.S. Congress in response to perceived unfair competitive practices by foreign governments and carriers. Section 3 of the Act provides for the imposition of "compensating charges" against selected foreign-flag carriers upon a finding by the U.S. Secretary of Transportation that a foreign aviation authority is imposing discriminatory fees against U.S.-flag carriers, or that charges against U.S.-flag carriers unreasonably exceed comparable charges in the United States.

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[273] Article 3 of *Bermuda I* provides that "[t]he charges which either of the Contracting Parties may impose . . . for the use of airports and others facilities shall not be higher than would be paid for the use of such airports and facilities by its national aircraft engaged in similar international air services."

[274] *Bermuda I*, art. 3(2).

[275] *Bermuda I*, art. 3(3).

[276] *See* BETSY GIDWITZ, THE POLITICS OF INTERNATIONAL AIR TRANSPORT 23-32 (1980).

[277] 14 C.F.R. PART 213 (1985).

[278] Where the foreign carrier was operating pursuant to an existing bilateral, the CAB could require the foreign carrier to file its schedules only upon a CAB determination that the foreign carrier's government had limited, terminated, or denied the operating rights of a U.S. carrier under the bilateral or had otherwise denied it a fair and equal opportunity to exercise such rights. Upon such a finding, the CAB could issue an order (subject to presidential veto) blocking the inauguration or continuation of those operations set forth in the schedule.

[279] PUB. L. NO. 92-259, 86 STAT. 95 (1972), adding subsection (j) to Section 1002 of the *Federal Aviation Act*.

[280] *Bermuda I*, *supra*, Art. II (f).

[281] PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 31 (1984).

[282] *Federal Aviation Act* § 1002(j)(1)(2); 49 U.S.C. § 1482(j)(1)(2). In the event a foreign government rejected fares filed by a U.S. carrier, the Board could suspend them, and insist that it charge the rates of the U.S. carrier. *Id*. § 1002(j)(3); 49 U.S.C. § 1482(j)(3).

[283] PUB. L. 93-623, JANUARY 3, 1975, 88 STAT. 2102.

The International Air Transportation Competition Act of 1979[284] [IATCA] was the most comprehensive U.S. legislation in the area of discrimination and fair competition. Enacted by the U.S. Congress to combat "unjust discrimination, undue preferences or advantages, or unfair or deceptive practices" in international aviation, IATCA amends, *inter alia*, the ratemaking provisions of the Federal Aviation Act of 1958. Under the legislation, the CAB [now DOT] may suspend or cancel a foreign carrier's fares without a hearing upon a finding that such action is in "the public interest."[285]

In addition to expanding significantly the CAB's [now DOT's] power to suspend or cancel fares of foreign carriers, IATCA also gives the CAB [DOT] authority to suspend a foreign carrier's operating permit, subject to presidential approval, upon a finding that a foreign government has jeopardized the operating rights of U.S.-flag carriers or has engaged in "unfair, discriminatory, or restrictive practices with a substantial adverse impact upon United States carriers . . . ."[286]

Moreover, Section 23 of IATCA amends the FCPA by giving the CAB [now DOT] authority to respond to anticompetitive practices of foreign governments and carriers "by such action as it deems to be in the public interest," including foreign permit or tariff suspension or revocation.[287] And Section 17 of IATCA also sets forth a series of objectives designed to provide guidance for U.S. aviation authorities in negotiating future bilaterals; these objectives include an obligation to eliminate "discrimination and unfair practices faced by United States airlines in foreign air transportation, including excessive landing and user fees, unreasonable ground handling requirements, undue restrictions on operations, prohibitions against change of gauge, and similar restrictive practices . . . ."

In addition to these regulatory and statutory relief mechanisms, the United States in the late 1970s took a number of important steps designed to counteract foreign discriminatory practices. The Carter administration's 1978 policy Statement provides that, in negotiating new bilaterals, the United States would seek the "[e]limination of discrimination and unfair competitive practices faced by U.S. airlines in international transportation."[288] The Model U.S. Agreement echoes this general objective by calling upon each State to "allow a fair and equal opportunity for the designated airlines of both Parties to compete . . ."[289] and requiring each State to eliminate "all forms of discrimination or unfair competitive practices adversely affecting the competitive position of the airlines of the other Party."[290] The Model Agreement also contains specific provisions relating to, among other things, ground handling,[291] user charges,[292] and currency problems.[293]

Provisions in existing U.S. bilaterals relating to fair competition and discrimination can generally be characterized as being either of the pre-1978 *Bermuda I*-type or post-1977 type. Nearly all U.S. *Bermuda I*-type bilaterals still in force contain a provision stating that carriers of both States shall have a "fair and equal opportunity" to operate on the routes identified in the agreement.[294] This "fair and equal

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[284] PUB. L. 96-192, FEBRUARY 16, 1979, 94 STAT. 35.

[285] *Federal Aviation Act* § 1002(j)(1)(2), 49 U.S.C. § 1402(j)(1).

[286] *Federal Aviation Act* § 402(f)(2), 49 U.S.C. § 1372(f)(2).

[287] 49 U.S.C. §1159(b)(1).

[288] *Statement Concerning United States Policy on the Conduct of International Air Transport Negotiations*, 14 WEEKLY COMP. OF PRES. DOC., 1462 (AUG. 28, 1978). Bogosian, *Aviation Negotiation and the U.S. Model Agreement*, 46 J. AIR L. & COM. 1007, 1029 (1981).

[289] Bogosian, *Aviation Negotiation and the U.S. Model Agreement*, 46 J. AIR L. & COM. 1007, 1029 (1981).

[290] *Id.*

[291] *Id.*, 1027.

[292] *Id.*, 1029.

[293] *Id.*, 1027-28.

[294] *See, e.g., Agreement on Air Transport Services, United States-Japan, August 11, 1952*, 4 U.S.T. 1948. Article 10 states, *inter alia*, that "[t]here shall be fair and equal opportunity for the airlines of both Contracting Parties to operate the agreed services on the specified routes between their respective territories." *See generally*, Joseph Gertler, *Nationality of Airlines: A Hidden Force in the International Air Regulation Equation*, 48 J. AIR L. & COM. 51, 85 (1982).

opportunity" clause is typically located in the capacity provisions of the agreement and is intended to be read in conjunction with the "primary objective" *Bermuda I*-type capacity provision, discussed previously. In addition, nearly all *Bermuda I*-type U.S. bilaterals include provisions relating to user charges which are identical or substantially identical to those contained in *Bermuda I*.[295]

By comparison, later U.S. bilaterals, particularly those liberal agreements concluded after 1977, incorporate an array of anti-discrimination and fair competition provisions. These later bilaterals typically contain "fair and equal opportunity" *Bermuda I*-type clauses;[296] unlike earlier agreements, however, the post-1977 agreements typically do not contain the "primary objective" *Bermuda I*-type capacity clause. Rather, the "fair and equal opportunity" clause found in the later bilaterals is usually located in the article of the agreement entitled "Fair Competition." This article in post-1977 bilaterals typically provides for an elimination of all discrimination and unfair competition practices; in particular, each State is prohibited from placing unilateral limitations on capacity, frequency or aircraft sizes or types to be used on the routes in question.[297]

Unlike *Bermuda I*-type U.S. bilaterals, many post-1977 U.S. agreements, both liberal and non-liberal, include articles entitled "Commercial Opportunities." Typical are provisions relating, to, among other things, ground handling ("Self-handling"); airline office facilities, ticket sales, and personnel; and currency conversion/remittance.[298] Provisions concerning currency conversion/remittance and "self-handling" were not incorporated into U.S. bilaterals until the mid-1970s, and then only with those States in which problems had been experienced or a potential for such difficulties had been perceived.[299] By specifically addressing such problem areas, U.S. negotiators sought to avoid reliance upon overly broad and potentially vague types of fair competition clauses such as those contained in *Bermuda I*-type bilaterals.

For example, the 1978 U.S.-Belgium bilateral requires that each State "allow a fair opportunity for the designated airline of both Parties to compete"[300] and "eliminate all forms of discrimination or unfair competitive practices" affecting the other State's airline.[301] Airlines have the right to establish offices in the territory of the other party, to have their own managerial, technical, operational and other staff, to perform their own ground handling and surface transportation incidental-to-air, to sell transportation directly or through their agents, and to convert and remit currency.[302] User charges must be "just, reasonable and non-discriminatory."[303]

Many of these provisions were repeated in the "open skies" bilaterals concluded beginning in the early 1990s. For example, the 1997 U.S.-Singapore bilateral gives the airline of each State the right to establish offices in the other, to bring in managerial, sales, technical, operational and other specialized staff, perform its own ground-handling, passenger check-in, maintenance, and cargo, sell air transportation directly or through its agents, and convert and remit local currency without restriction or taxation.[304] Broad national tax and customs exemptions are provided, other than those based on the cost

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[295] *See, e.g., Agreement on Air Transport Services, United States-France, March 27, 1946*, 61 STAT. 3445; T.I.A.S. 1679; 139 U.N.T.S. 114.

[296] While some liberal bilaterals incorporate the identical language of *Bermuda I* in this area, a number of liberal bilaterals provide that carriers shall have the right to "compete," rather than "operate," on the routes in question. *See Agreement on Air Transport Services, United States-Singapore, March 31, 1978*, 29 U.S.T. 3119; T.I.A.S. 9001; Art. 9 ("operate"). *See e.g., Agreement on Air Transport Services, United States-Jordan, June 8, 1980*, T.I.A.S. 9868, Art. 11 ("compete").

[297] *See e.g., Agreement on Air Transport Services, United States-Jamaica, April 4, 1979*, 31 U.S.T. 308; T.I.A.S. 9613.

[298] Typical is Article 10 of the U.S.-Israel Air Transport Agreement, *supra*.

[299] ATA U.S. Provisions, *supra,* at 122.

[300] *Agreement on Air Transport Services, United States-Belgium, October 23, 1978*, 30 U.S.T. 217; T.I.A.S. NO. 9903, Art. 5(1).

[301] *Agreement on Air Transport Services, United States-Belgium, October 23, 1978*, 30 U.S.T. 217; T.I.A.S. NO. 9903, Art 5(4).

[302] *Agreement on Air Transport Services, United States-Belgium, October 23, 1978*, 30 U.S.T. 217; T.I.A.S. NO. 9903, Art. 10, 13.

[303] *Agreement on Air Transport Services, United States-Belgium, October 23, 1978*, 30 U.S.T. 217; T.I.A.S. NO. 9903, Art. 11(1).

[304] *Air Transport Agreement Between the Government of the United States and Singapore*, 1997, CCH AVIATION ¶ 26,495A, Art. 8.

of services provided.[305] User charges must be "just, reasonable, not unjustly discriminatory, and reasonably apportioned among categories of users . . . on terms not less favorable than the most favorable terms available to any other airline at the time the charges are assessed."[306] They may not exceed the full cost of providing the service.[307] Moreover, the agreement also allows entry into "cooperative marketing arrangements such as blocked-space, code-sharing or leasing arrangements".[308]

A review of thirteen bilaterals concluded by Canada shows that all of them require a "fair and equal opportunity" for the designated airlines of the Contracting Parties to operate the agreed services on the specified routes. Most of these requirements are included in the provisions dealing with capacity.[309] Also, complimentary to the condition of fair and equal opportunity, some of these agreements mention that, in operating the agreed services, the designated airlines of each Contracting Party must take into account the interests of the designated airline of the other Contracting Party so as not to unduly affect the services which the latter provides on all or part of the same routes.[310] One should also mention that several of these bilaterals add specific provisions regarding discrimination and fair competition. For example, the Canada-UK bilateral imposes on the Contracting Parties the obligation to take "all measures to eliminate any form of discrimination or unfair competition."[311] Also, the Canada-US bilateral, which devotes a separate article to "Fair Competition", requires that the designated airlines of both Contracting Parties should have a "fair and equal opportunity to compete" in providing the agreed air transportation services.[312]

A significant set of provisions aimed at preventing discrimination between airlines regards the charges for the use of airports and other aviation facilities (user charges), as well as the access to airports and other facilities. Eleven of the thirteen Canada bilaterals analyzed for the purpose of this study contain such provisions.[313] Although the wording is somewhat different from bilateral to bilateral, the overall purpose of such provisions is to ensure that the charges imposed on the airlines of one Contracting Party by other Contracting Party for the use of airport and airport-related services is not unjustly discriminatory. While several Canada bilaterals require, in general terms, that the user charges are "just and reasonable"[314] or "just, reasonable and not unjustly discriminatory,"[315] most of these agreement establish a level of reasonableness by using slightly different standards.

For example, some agreements require that the user charges imposed in the territory of one Contracting Party on a designated airline of the other Contracting Party for the use of airports and other aviation facilities should "not be higher than those imposed on a national airline" of the first Contracting Party engaged in similar international services.[316] Other agreements demand that such charges should not be higher than the ones that would be paid for the use of such airports and facilities by "the airlines of the most favoured nation or by any national airline" of the first Contracting Party engaged on similar

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[305] *Air Transport Agreement Between the Government of the United States and Singapore*, 1997, CCH AVIATION ¶ 26,495A, Art. 9.
[306] *Air Transport Agreement Between the Government of the United States and Singapore*, 1997, CCH AVIATION ¶ 26,495A, Art. 10(1).
[307] *Air Transport Agreement Between the Government of the United States and Singapore*, 1997, CCH AVIATION ¶ 26,495A, Art. 10(2). However, full cost can include a reasonable return of assets, after depreciation. *Id*.
[308] *Air Transport Agreement Between the Government of the United States and Singapore*, 1997, CCH AVIATION ¶ 26,495A, Art. 8(7).
[309] Note that only the Bilaterals with Japan, Mexico, and the U.S., respectively, do not expressly link the "equal and fair opportunity" condition with the capacity requirements.
[310] Only the bilaterals with the U.S. and Spain do not contain such a provision regarding taking into account the interest of other designated airlines on the same routes.
[311] *Canada-UK Bilateral*, *supra,* Art. 7.
[312] *Canada-US Bilateral*, *supra,* Art. 4.
[313] Only the Bilaterals with Mexico and Italy, respectively, do not address expressly the issue of user charges or airport use.
[314] *See* the Canada-China Bilateral, *supra,* Art. 10, the Canada-Japan Bilateral, *supra,* Art. 5, and the Canada-US Bilateral, *supra,* Art. 8.
[315] *See* Canada-Cuba Bilateral, *supra,* Art. IX, and Canada-US Bilateral, *supra,* note, Art. 8.
[316] *See* Canada-Spain Bilateral, *supra,* Art. IX, Canada-Germany, *supr,* Art. 8, Canada-France Bilateral, *supra,* Art. 7, Canada-UK Bilateral, *supra,* Art. 18, Canada-Brazil Bilateral, *supra,* Art. X.

international air service.[317] Several other bilaterals go even farther and require that such user charges should be not higher than the charges imposed upon "all other airlines engaged in similar international services"[318] or that the charges are assessed on "terms not less favourable than the most favourable terms available to any airline engaged in similar international air services" at the time the charges are imposed.[319] One should note that Canada-Russia Bilateral adopts a slightly different approach by requiring that the user charges be levied in accordance with the rates established in the territory of each Contracting Party as applied to their own or to foreign carriers operating international air service. However, as a non-discriminatory safeguard, this bilateral States that no preference should be given to any airline over an airline of the other Contracting Party.[320] Also, one may note that the Canada-US Bilateral provides that user charges may reflect, but should not exceed, the full cost of the competent charging authorities of providing the appropriate airport, aviation security, and related facilities and services.

With respect to the access to airport, airways, air navigation services, air traffic control, the majority of the Canada bilaterals analyzed require that the Contracting Parties give "no preference" to their own or any other airline engaged in similar international services in the use of airports and other aviation facilities.[321]

In connection to airport access and use of aviation facilities, several bilaterals concluded by Canada contain specific provisions regarding *ground handling services*.[322] According to such provisions, the designated airlines of any Contracting Party have the option to chose between performing their own ground handling services in the territory of the other Contracting Party or selecting among competing agents for such services in whole or in part. The Canada-US Bilateral mention that the right to self-handling is subject only to physical constraints resulting from considerations of airport safety and operational constraints arising from such physical limitations.[323] In addition, this bilateral provides that where such considerations preclude self-handling, ground services must be available on an equal basis to all airlines; charges should be based on the costs of services provided and such services should be comparable to the kind and quality of services as if self-handling were possible. Similar provisions are included in the Canada-Cuba Bilateral which added that the charges for ground handling imposed on the airlines of the other Contracting Party should be not less favourable than the charges imposed on any airline engaged in similar international air services.[324]

The majority of the bilaterals signed by Canada reviewed for the purpose of this study contain also provisions regarding the right of designated airlines to maintain and employ their representatives, including administrative, commercial and technical personnel as required in connection with the operation of agreed services in the airports and cities in the territory of the other Contracting Party.[325]

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[317] *See* Canada-Korea Bilateral, *supra,* Art. 18, and Canada-Japan Bilateral, *supra,* Art. 5.

[318] *See* Canada-China Bilateral, *supra,* Art. 10.

[319] *See* Canada-US Bilateral, *supra,* Art. 8, Canada-Cuba Bilateral, *supra*, Art. IX.

[320] Canada-Russia Bilateral, *supra,* Art. 8.

[321] See Canada-Brazil Bilateral, *supra,* Art. X, Canada-UK Bilateral, *supra,* Art. 18, Canada-Japan Bilateral, *supra,* Art. 5, Canada-Germany Bilateral, *supra,* Art. 8, Canada-France Bilateral, *supra,* Art. 7, Canada-China Bilateral, *supra,* Art. 10, Canada-Russia Bilateral, *supra,* Art. 8, Canada-Korea Bilateral, *supra,* 18, Canada-Spain Bilateral, *supra,* Art. IX. Note that Canada-Cuba Bilateral requires that the use of airports and other aviation facilities shall be provided "without preference" to any airline over an airline of the other Contracting Party engaged in similar international air service. *Supra,* Art. IX.

[322] See Canada-Spain Bilateral, *supra,*Art. XVI, Canada-Cuba Bilateral, *supra,*Art. XVIII, Canada-US Bilateral, *supra,* Art. 7, Canada-Russia Bilateral, *supra,* Annex II.

[323] Canada-US Bilateral, *supra,* Art. 7.

[324] Canada-Cuba Bilateral, *supra,* Art. XVIII.

[325] See Canada-China Bilateral, *supra,* Art. 13, Canada-Germany Bilateral, *supra,* Art. 14, Canada-France Bilateral, *supra,* Art. 14, Canada Spain Bilateral, *supra,* Art. XVI, Canada-Russia Bilateral, *supra,* Art. 15, Canada-Cuba Bilateral, *supra,* Art. XVII, Canada-Korea Bilateral, *supra,* Art. 7, Canada-UK Bilateral, *supra,* Art. 16, Canada-US Bilateral, *supra,* Art. 10, Canada-Brazil Bilateral, *supra,* Art. XVI.

However, the designated airlines may decide to not establish its own offices at airports in the territory of the other Party and, in such conditions, work is to be provided, as far as possible, by the personnel of such airports or of an another airline.[326] Some bilaterals provide that the number of the representatives of one Contracting Party allowed on the territory of the other Contracting Party is subject to the approval of the aeronautical authority of either both Contracting Parties[327] or only of the Party on which territory the representatives are maintained.[328] The conditions of employment of representatives of designated airlines of one Contracting Party in the territory of the other Contracting Party differ from bilateral to bilateral. For example, most of the agreements State that the laws and regulations of the other Contracting Party relating to entry, residence and employment apply but that, on the basis of reciprocity, employment authorizations must be issued with the minimum delay.[329] One should note that Canada-Germany Bilateral provides that work permits are not required between the two Contracting Parties.[330] Also, other bilaterals exempt temporary workers from the employment authorization requirement.[331]

Another important set of provisions in most of the bilaterals analyzed regard the sales *of air transportation services and the transfer of funds*.[332] Thus, these bilaterals allow the designated airlines to engage in the sale of air transport in the territory of the other Contracting Party, directly or, at their discretion, through agents, in the currency of that territory or in freely convertible currencies.[333] Also, these agreements recognize the right of transferring, on demand, the funds obtained by each designated airline in the normal course of its operation. Such transfers should be freely made, without restrictions, at the market rate of exchange.[334]

Another provision that is aimed at ensuring fair competition and elimination of discrimination concerns access to *computer reservation systems.* Among the thirteen air service agreements signed by Canada which were reviewed for the purpose of this study, only the Canada-US Bilateral contains a mention of the obligation of both Contracting Parties to ensure that all designated airlines of the other Contracting Party have non-discriminatory access to computer reservation systems in their own territory. Each designated airline is entitled to inform its customers about its services, in a fair and impartial manner through the computer reservation system in each territory.[335]

Several bilaterals concluded by Canada contain provisions regarding *cooperative agreements,* such as code-sharing, blocked-space or pooling between airlines. In terms of categories of potential partners for code-sharing and blocked space arrangements, these bilaterals differ in a sense that some allow only for airlines from either Contracting Party as partners, while others allow for partners from other countries as well, under certain conditions. For example, in the first category of bilaterals, one may include the Canada-US Bilateral which allows any designated airline of the Contracting Parties to enter cooperative

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[326] See Canada-Germany Bilateral, Canada-Spain Bilateral, Canada-Cuba Bilateral, Canada-Korea Bilateral, Canada-Brazil Bilateral, *supra,* note .

[327] As required by Canada-China Bilateral, *supra,* Art. 13.

[328] As required by Canada-Russia Bilateral, *supra,* Art. 15.

[329] See Canada-Brazil Bilateral, *supra,* Art. XVI, Canada-Korea Bilateral, *supra,* Art. 7, Canada-Russia Bilateral, *supra,* Art. 15, Canada-Spain Bilateral, *supra,* note, Art. XVI.

[330] Canada-Germany, *supra,* Art. 14.

[331] For example, Canada-Spain Bilateral, Canada-Russia Bilateral (for temporary duties not exceeding 90 days), Canada-Cuba Bilateral, Canada-Korea Bilateral, Canada-Brazil Bilateral.

[332] The only bilaterals which do not contain specific provisions regarding sales and transfer of funds are Canada-Italy, Canada-Japan, and Canada-Mexico Bilaterals, *supra.*

[333] Canada-France Bilateral, *supra,* Art. 13, Canada-Russia Bilateral, *supra,* Art. 13, Canada-Brazil Bilateral, *supra,* Art. XV, Canada-US Bilateral, *supra,* Art. 10, Canada-UK Bilateral, *supra,* Art. 14, Canada-Korea Bilateral, *supra,* Art. 11, Canada-Cuba, *supra,* Art. XV, and Canada-Spain, *supra,* Art. XIV.

[334] *See* Canada-France, *supra,* Art. 13, Canada-Germany Bilateral, *supra,* Art. 13, Canada-China Bilateral, *supra,* Art. 11, Canada-Russia Bilateral, *supra,* Art. 14, Canada-Brazil, *supra,* Art. XV, Canada-US Bilateral, *supra,* Art. 10, Canada-Spain Bilateral, *supra,* Art. XIV, Canada-UK Bilateral, *supra,* Art. 15, Canada-Korea Bilateral, *supra,* Art. 11, Canada-Cuba Bilateral, *supra,* Art. XV.

[335] Canada-US Bilateral, *supra,* Art. 11.

marketing or operational arrangements, such as code-sharing, blocked-space or leasing arrangements, with an airline of either Party under the condition that all airlines involved in such arrangements hold the specified route rights and meet the requirements applied to such arrangements, including necessary authorizations.[336] In a very similar fashion, the Canada-Cuba Bilateral provides that, subject to the regulatory requirements normally applied by the aeronautical authorities of the two Contracting Parties, any designated airline of the Contracting Parties may enter into cooperative marketing or operational arrangements such as blocked-space or code sharing with a designated airline of the other Contracting Party, provided that all airlines in such arrangements hold the specified route rights.[337]

In the second category of bilaterals, Canada-Spain Bilateral provides that the designated airlines of the two Contracting Parties may enter into cooperative agreements for the purpose of (a) holding out the agreed services on the specified routes by code-sharing (i.e., selling transportation under its own code) on flights operated by an airline of any of the Contracting Parties and/or *of any third country*; and/or (b) carrying traffic under the code of any other airline(s) where such other airline(s) has been authorized by the aeronautical authorities of the other Contracting Party to sell transportation under its own code on flights operated by that designated airline.[338] Similarly, the Canada-Russia Bilateral recognizes the right of each designated airline to operate the agreed services on transatlantic routings by selling transportation under its own code on flights of the designated airlines of the two Contracting Parties or on flights of up *to two airlines of its choice* operating scheduled air services between up to two Intermediate Points of its choice and Points in the other Contracting Party. Change of gauge is allowed for the purpose of code sharing arrangements.[339]

Another type of arrangement between airlines is *pooling* and the Canada-Mexico Bilateral makes special reference it. This type of arrangement can be made by a designated airline with any other airline or airlines of the same or different nationalities for the purpose of operating jointly any of the agreed services and to share amongst themselves the revenue and expenses thereof. The Canada-Mexico Bilateral expressly allows a designated airline of either Contracting Party to enter into a pooling arrangement for the operation of any of the specified routes, under certain conditions regarding the potential partners.[340] Thus, pooling arrangements can be made between the designated airlines of the Contracting Parties, between a designated airline and other airline or airlines of the same Contracting Parties, and between a designated airline of one Contracting Party and an airline or airlines of a third country which is or are authorized by the other Contracting Party to exercise third and fourth or third, fourth, and Fifth Freedom rights at the point in the territory of the other Contracting Party through which the pooled service is to be operated.[341]

Another type of provision present in the bilaterals signed by Canada regards the *taxation of income or profits* resulting from the operation of aircraft in international traffic. Six out of the thirteen bilaterals reviewed for the purpose of this study deal expressly with this issue and provide that such income is to be *exempted* from taxation in the territory of the other Contracting Party in accordance with conventions for the avoidance of double taxation and prevention of fiscal evasion in force between the Contracting Parties.[342]

Also, it may be pointed out that 11 of the 13 agreements analyzed for the purpose of this study

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[336] Canada-US Bilateral, *supra,* Art. 10.

[337] Canada-Cuba Bilateral, *supra,* Art. Annex.

[338] Canada-Spain Bilateral, *supra,*Annex, Section I.

[339] Canada-Russia Bilateral, *supra,* Annex.

[340] Canada-Mexico Bilateral, *supra,* Art. 12.

[341] *Id*.

[342] *See* Canada-Germany Bilateral, *supra,* Agreed Minute of 22 Dec. 1972, Canada-China Bilateral, *supra,* Art. 11, Canada-UK Bilateral, *supra,* Art. 17, Canada-Korea Bilateral, *supra,* Art. 20, Canada-Cuba Bilateral, *supra,* Art. XVI, Canada-Spain Bilateral, *supra,* Art. XV.

contained provisions that fuels, lubricants oils, space parts and normal aircraft equipment introduce into the territory of a contracting Party or taken on board aircraft of the airlines designated by the other Contracting Party which are for the exclusive use of aircraft of the same airlines operating the agreed services, are exempt , on the basis of reciprocity, from customs duties, inspection fees and other charges while entering, departing from or flying across the territory of the other Contracting Party.[343] Two bilaterals (i.e., the ones with Japan and with Mexico) provide that with regard to customs duties and similar charges on fuel, lubricating oils, space parts, regular aircraft equipment and aircraft stores introduce into the territory of one Contracting Party or taken on board aircraft in that territory by the designated airlines of the other Contracting Party, and intended solely for use by or in the aircraft of those airlines shall be accorded treatment not less favorable than that granted by the first Contracting Party to the airlines of the most favored nation or to its national airlines engaged in international air services.[344] Note that the bilateral with Japan provides that exemption from customs duties should be granted only on the basis of reciprocity.[345]

VIII. DISPUTE RESOLUTION

The *Bermuda I* bilateral contains several provisions relating to the settlement of disputes. Article 8 of the agreement provides that either State may request consultation between the aeronautical authorities of both States in the event that it considers it desirable to modify the terms of the Annex of the agreement (*i.e.*, routes to be operated on by carriers designated by each State and rates to be charged by such carriers). Article 13 of the agreement provides that either State may request consultations with the other for the purpose of initiating amendments either to the agreement itself or to the Annex "which may be desirable in the light of experience;"[346] pending the outcome of such consultation, either party is free to give notice to the other of its desire to terminate the agreement.[347] If notice to renounce is given by either party, the bilateral will terminate one year after such notice is received by the other party, unless such notice is subsequently withdrawn.[348] After such notice expires and the bilateral is renounced, air operations may continue under principles of *comity* and *reciprocity*.[349]

Article 9 of the agreement contains perhaps the most important dispute settlement provision. In the event that any dispute between the parties relating to the interpretation or application of the agreement cannot be settled through consultation, Article 9 requires that such a dispute be referred to the [P]ICAO.[350] The [P]ICAO, in turn, would consider the dispute and issue an "advisory report";[351] such a report, however, due to its "advisory" nature, would not be binding on either party to the agreement.

Professor Bin Cheng has identified three possible approaches to the settlement of specific types of conflicts arising under bilateral air transport agreements.[352] Under the first, all disputes arising under the

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[343] *See* Canada - U.S. Bilateral, *supra,* Art. 9, Canada-UK, *supra,* Art. 11, Canada-Russia Bilateral, *supra,* Art. 11, Canada-Brazil Bilateral, *supra,* Art. XIII, Canada-Korea Bilateral, *supra,* Art. 4, Canada-Cuba Bilateral, *supra,* Art. XII, Canada-Spain Bilateral, *supra,* Art. XII, Canada- China Bilateral, *supra,* Art. 9, Canada-Italy Bilateral, *supra,* Art. IV, Canada-France Bilateral, *supra,* Art. 11, Canada-Germany Bilateral, *supra,* Art. 11.

[344] *See* Canada - Japan Bilateral, *supra,* Art. VI and Canada- Mexico Bilateral, *supra,* Art. 7.

[345] Canada-Mexico Bilateral, *supra,* Art. V.

[346] *Air Services Agreement with the United Kingdom, Feb. 11, 1946*, 60 STAT. 1499, T.I.A.S. NO. 1507, art. 3.

[347] *Id.*

[348] *Id.*

[349] Today, a matrix of more than 2,500 bilateral air transport agreements govern the practices of airlines in international aviation. Only rarely have they been renounced.

[350] *Id.*, art. 9. [P]ICAO refers to the "Provisional" International Civil Aviation Organization, which came into existence in 1945 on an interim basis with the signing of an Interim Agreement at the *Chicago Convention*, to be replaced by ICAO upon its formulation in 1947.

[351] *Id.*

[352] Professor Bin Cheng has discussed in detail the need for timely and effective dispute settlement mechanisms in international air transportation. *See generally*, BIN CHENG, DISPUTE SETTLEMENT IN BILATERAL AIR TRANSPORT AGREEMENTS, IN SETTLEMENT OF SPACE

agreement are to be settled by negotiation (*i.e.*, consultation); such an approach is typically found in the bilaterals of those States which have traditionally refused to submit to third-party settlement of disputes.[353] Under the second, the bilateral provides for a general method for the settlement of disputes in addition to negotiation, but no specific procedure for specific disputes.[354] Under the third approach, special procedures for the settlement of certain types of disputes are provided either in the absence of, or in addition to, a general method of settling all disputes arising under the bilateral.[355] An examination of existing bilaterals concluded by the United States reveals that most such bilaterals can be classified as containing procedures consistent with either the second or third approach identified by Professor Cheng.[356]

In the event that consultation between the parties is unable to produce a satisfactory settlement, U.S. bilaterals typically provide resolution via some form of arbitral or adjudicatory forum. Many early bilaterals, including a number of U.S. bilaterals currently in force, require that the dispute be referred to the Council of ICAO for an advisory (*i.e.*, non-binding) report.[357]

The *Bermuda I* model ceased to be the template for U.S. aviation negotiations with its "open skies" initiative of the late 1970s. But well before that policy shift, the strong trend in the post-*Bermuda I* era reveals a shift away from designation of the ICAO as a dispute settlement forum; most existing U.S. bilaterals provide for compulsory arbitration by an *ad hoc* tribunal.[358] In recent years, efforts have been

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LAW DISPUTES 97 (K. BOCKSTEIGER ED. 1979) [hereinafter cited as Cheng]. Dr. Gertler has acknowledged the potential danger that "the relief mechanism of bilateral air agreements may be inflexible and too cumbersome to invoke in situations requiring an urgent corrective measure." Joseph Gertler, *Nationality of Airlines: A Hidden Force in the International Air Regulation Equation*, 48 J. AIR L. & COM. 51 (1982). Most bilaterals do provide for dispute settlement, and most by arbitration. Joseph Gertler, *Bermuda Air Transport Agreements: Non Bermuda Reflections*, 42 J. AIR L. & COM. 779, 819-20 (1976). Involuntary disruption of air services due to a breakdown in the interpretation and/or application of a bilateral air transport agreement may lead to disastrous economic losses, both direct and indirect, as well as substantial social inconvenience. Bin Cheng, DISPUTE SETTLEMENT IN BILATERAL AIR TRANSPORT AGREEMENTS, IN SETTLEMENT OF SPACE LAW DISPUTES 97, 98 (K. BOCKSTEIGER ED. 1979). As a result, bilateral agreements must contain mechanisms for both dispute prevention and dispute resolution. *Id.* Due to the potentially disastrous economic and social consequences which might stem from a breakdown in aviation relations, it is clearly preferable to implement a system which recognizes potential problem areas before they assume the status of full-blown disputes. Essential to any such system, according to Cheng, is effective communication between parties to the agreement; regular consultations between the twoStates might identify potential difficulties at an early stage and facilitate an early resolution of the issue. *Id.*

Professor Cheng has stated that consultation can facilitate at least six different purposes. First, it can serve as a means for the joint supervision and control by the contracting states of the "two-tier" operation of the bilateral; consultation enables the states to control and supervise both the operation of the agreement and the observance of its terms by the designated airlines. Second, consultation can serve as an appellate jurisdiction in the "two-tier" structure when changes proposed by the carrier of one state have been disapproved by the other. Third, consultation can serve as a means of elevating an issue to the international level; it can enable a contracting state to gather information about a given situation and, if necessary, to make its own views known to the other state, or to keep the other state informed of a given situation so that, in the event it decides to do so, it can make its views known. Fourth, it can be used for the purpose of reviewing changed circumstances as a matter of good will. Fifth, consultation can be used for the purpose of changing the bilateral itself. Finally, it can serve as a means for settling disputes and as a precondition to submitting a dispute to a third party. *Id.*, 98-104. This is also an area in which preventive law can play an important role in diminishing the likelihood of conflict and confrontation between governments and their commercial enterprises.

[353] *Id.*, 105.

[354] *Id.*

[355] *Id.*

[356] Aside from those types of disputes for which some bilaterals specify a certain type of settlement mechanism, virtually all existing U.S. bilaterals, whether they be of the general pre-1978 *Bermuda I*-type or the post-1977 type, require that the parties to the dispute first attempt to settle their differences through some form of consultation. The specific language employed in the bilateral with respect to consultation varies from agreement to agreement; some U.S. bilaterals provide merely for "consultations," (*See*, *e.g.*, *Protocol Relating to Air Transport Services, United States-Israel, August 16, 1978*, 29 U.S.T. 3144; T.I.A.S. NO. 9002., Art. 12) others provide for "formal consultations," (*See*, *e.g.*, *Agreement on Air Transport Services, United States-Belgium, October 23, 1978*, 30 U.S.T. 217; T.I.A.S. NO. 9903, Art. 17) while at least one agreement provides for "direct negotiations through diplomatic channels" (*See, e.g.*, *Agreement on Air Transport Services, United States-Romania, 1973, as extended and amended, 1979*, T.I.A.S. 7901, Art. 16). Although the language of these provisions varies, an identical intent is clearly evident in virtually all existing U.S. bilaterals, namely, that disputes must first be addressed through consultations between the contracting parties to the agreement.

[357] *See e.g.*, *Agreement on Air Transport Services, United States-Syria, 1947*, — U.S.T. —, T.I.A.S. 3285, Art. 10.

[358] Some do not require arbitration, however. For example, Article 16 of the *Agreement Between the United States and the People's*

made in drafting such provisions to make them truly compulsory by ensuring that neither party can block arbitration by refusing to cooperate in the establishment of the arbitral tribunal.[359] In addition, efforts have been made to accelerate the arbitral process.[360]

The typical post-*Bermuda I* arbitral clause permits each State to designate one of three arbitrators who will comprise the arbitral tribunal. The third arbitrator, who typically may not be a national of either contracting party, is to be selected by the two arbitrators already chosen.[361]

With respect to the decision or award of the arbitral tribunal, most pre-1978 U.S. bilaterals incorporate language which is non-binding in nature; these bilaterals typically provide that each State "shall use its best efforts consistent with its national law to put into effect" any such decision or award.[362] Attempts have been made in numerous post-1977 liberal bilaterals, however, to make such decisions or awards truly binding upon both parties. Instead of merely requiring the "best efforts" of the parties, these newer bilaterals typically provide that each State "shall, consistent with its national law, give full effect to any decision or award of the arbitral tribunal."[363] In the event that a State fails to give full effect to any such decision or award, some liberal bilaterals provide that the other State "may take such proportionate steps as may be appropriate."[364] At this writing, only six *ad hoc* arbitrations that have been sought to resolve issues of commercial aviation under bilateral air transport agreements:

- *United States v. France* (1963) – involving Fifth Freedom[365] rights beyond Paris;
- *United States v. Italy* (1965) – involving all-cargo service to Rome;
- *United States v. France* (1978) – involving "change of gauge"[366] operations between London and Paris;
- *Belgium v. Ireland* (1981) – involving airline capacity between Dublin and Brussels;
- *United States v. United Kingdom* (1992) – involving airline user charges at London Heathrow Airport;
- *Australia v. United States* (1993) – involving Fifth Freedom operations between Osaka and

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Republic of China provides, *inter alia,* "the Parties shall, in a spirit of friendly cooperation and mutual understanding, settle [any dispute arising hereunder] by negotiation or, if the parties so agree, by mediation, conciliation, or arbitration." 33 UST 4559, TIAS 10326 (SEPT. 17, 1980), 3 CCH AV. L. REP. ¶ 26,255A.

[359] BIN CHENG, DISPUTE SETTLEMENT IN BILATERAL AIR TRANSPORT AGREEMENTS, IN SETTLEMENT OF SPACE LAW DISPUTES 97, 107 (K. BOCKSTEIGER ED. 1979).

[360] *Id.*

[361] While some U.S. bilaterals do not identify procedures to be utilized in the event that eitherState fails to designate an arbitrator or that a third arbitrator cannot be agreed upon, a number of arbitral clauses provide that either party may request that the President of ICAO Council or the President of the ICJ appoint an arbitrator or arbitrators as the case requires. Typically, if the two designated arbitrators are unable to agree on a third arbitrator, the bilaterals provide that the third arbitrator shall be appointed by the President of the International Court of Justice (*see e.g., Air Services Agreement Between the United States and Austria*, art. 14(2)(b), TIAS 11,265 (MAR. 16, 1989), 3 CCH AV. L. REP. ¶ 26,210A; *Air Transport Agreement Between the United States and Germany*, art. 13(2), 7 UST 527, TIAS 3536, 3 CCH AV. L. REP. ¶ 26,315A), or the President of the ICAO (*see e.g., Air Transport Agreement Between the United States and Canada*, art. 17(7)(b) (Feb. 24, 1995), 3 CCH AV. L. REP. ¶26,246A; *Air Transport Agreement Between the United States and Costa Rica*, art. 14(2)(b), (May 8, 1997), 3 CCH AV. L. REP. ¶ 26,264A). However, some bilaterals are silent on the issue of a deadlock in selecting a third arbitrator, saying only that that individual "shall not be a national of either contracting party." (*See e.g., Air Transport Agreement Between the United States and Colombia*, art. 12, 14 UST 429, TIAS 5338, (OCT. 24, 1956), 3 CCH AV. L. REP. ¶ 26,258A.

[362] *See e.g., Agreement on Air Transport Services, United States-Japan, August 11, 1952*, 4 U.S.T. 1948, TIAS 2854 ART. 15, 3 CCH AV. L. REP. ¶ 26,366A.

[363] *See e.g., Agreement on Air Transport Services, United States-Belgium, October 23, 1978*, 30 U.S.T. 217; T.I.A.S. NO. 9903 (Oct. 23, 1980), art. 17, 3 CCH AV. L. REP. ¶ 26,222A. Similarly, Article 14(8) of the *Air Transport Agreement Between the United States and the Russian Federation (Jan. 14, 1994)*, provides, "Each Party shall, consistent with its national law, give full effect to any decision or award of the arbitral tribunal." 3 CCH AV. L. REP. ¶ 22,474A.

[364] *See e.g., Agreement on Air Transport Services, United States-Fiji*, (Oct. 1, 1979), 32 U.S.T. 3747, T.I.A.S. 9917, ART. 15, 3 CCH AV. L. REP. ¶ 236,303A.

[365] Under "Fifth Freedom" rights, an airline has the right to carry traffic between two countries outside its own country of registry so long as the flight originates or terminates in its own country of registry.

[366] "Change of gauge" operations involves the transfer of passengers between aircraft at a foreign point for a through journey.

Sydney.[367]

IX. SECURITY

ICAO has developed a model clause addressing aviation security for insertion into bilateral air transport agreements between governments. Annex 17 of the Chicago Convention includes as a Recommended Practice that Contracting States should include an aviation security clause in their bilateral air transport agreements.[368] Many States have, in fact. For example, Article 9 of the U.S.-Netherlands "Open Skies" bilateral air transport agreement provides that the two States "agree to provide maximum aid to each other with a view to preventing hijackings and sabotage to aircraft, airports and air navigation facilities and threats to aviation security." The bilateral reaffirms commitment to their obligations under the Tokyo, Hague and Montreal Conventions, and "applicable aviation security provisions established by [ICAO]." They also agreed to "take adequate measures to screen passengers and their carry-on items." When incidents or threats materialize, the States agree to "assist each other by facilitating communications intended to terminate such incidents rapidly and safely." They also agree to "give sympathetic consideration to any request from the other for special security measures for its aircraft or passengers to meet a particular threat."[369] Many modern bilaterals include provisions on safety and security (requiring acting in conformance with the Tokyo, Hague and Montreal Conventions).[370]

A review of thirteen bilaterals[371] concluded by Canada shows that only seven of those agreements contain provisions dealing specifically with aviation security issues (i.e., the agreements signed by Canada and the U.S., the U.K., Cuba, Russian Federation, Brazil, Spain, and Republic of Korea, respectively). Such provisions refer to the obligation of the Contracting Parties to each other to protect the security of civil aviation against acts of unlawful interference.[372] Some of these bilaterals list the conventions and other multilateral agreements governing aviation security which bind the Contracting Parties.[373] Most of these bilaterals require that the Contracting Parties provide all necessary assistance to each other to prevent acts of unlawful seizure of aircraft and other unlawful acts against the safety of such aircraft, their passengers and crew, airports and air navigation facilities, and any other threat to the security of civil aviation.[374] In addition, some of these bilaterals require the Contracting Parties to act in conformity with the aviation security provisions and technical requirements set by ICAO.[375] Another important provision present in all of these agreements imposes on the Contracting States the obligation to observe the aviation security requirements for entry into, departure from, or while within the territory of the other Party, if so required by the other Contracting Party. Also, according to all of these bilaterals, the Contracting Parties are required to ensure that adequate measures are effectively applied within their territories to protect the aircraft and to inspect passengers, crew, carry-on items, bagage, cargo and aircraft stores prior to and during boarding or loading. In addition, each Contracting Party is required to give "sympathetic consideration" to any request from the other Contracting Party for reasonable special

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[367] Paul Dempsey, *Flights of Fancy and Fights of Fury: Arbitration and Adjudication of Commercial and Political Disputes in International Aviation*, 32 GA. J. INT'L & COMP. L. 231 (2004).

[368] *Chicago Convention*, Annex 17, § 2.3.7.

[369] CCH AV. LAW REP. ¶ 26,423B (1999).

[370] Paul Dempsey, *Flights of Fancy and Fights of Fury: Arbitration and Adjudication of Commercial and Political Disputes in International Aviation*, 32 GA. J. INT'L & COMP. L. 231 (2004).

[371] *See supra,* note 41.

[372] *See* for example, Canada-Russia Bilateral, *supra,* Art. 7, Canada-US Bilateral, *supra,* Art. 14, Canada-Korea Bilatera, *supra,* Art. 17, Canada-Russia Bilateral, *supra,* Art. 7, Canada-Spain Bilateral, *supra,* Art. VIII, Canada-Cuba Bilateral, *supra,* Art. VIII, Canada-UK Bilateral, *supra,* Art. 10.

[373] This is the case with the bilaterals between Canada and Spain, Cuba,UK, Korea, Brazil and the U.S., respectively.

[374] *See* bilaterals between Canada and the UK, Cuba, Spain, Russia, Korea, the U.S. respectively. The bilateral between Canada and Brazil contains similar wording requiring the Parties to provide aid to each other as necessary with a view to preventing acts against or threats to aviation security.

[375] This type of provision is included in the bilaterals between Canada and Spain, Cuba, the UK, Korea, the U.S., and Russia, respectively.

security measures to meet a particular threat.[376] All of these bilaterals provide that when a Contracting Party has reasonable grounds to believe that the other Contracting Party is not fulfilling its security obligations under the respective bilateral, the first Contracting Party may request immediate consultations.[377]

X. CARGO

In most bilaterals, provisions relating to cargo are often addressed as part of the general exchange of rights between the parties, and are essentially based on the provisions of the International Air Services Transit Agreement (the Five Freedoms Agreement).[378] Thus, a standard Bermuda I type clause on the grant of rights would provide that each contracting party grants to the other, rights necessary for the conduct of air services (the Agreed Services) by the designated airline(s) as follows: the rights of transit, of stops for non-traffic purposes and of commercial entry and departure for international traffic in passengers, cargo, and mail, separately or in combination, … on the routes specified in an Annex to the Agreement.[379] Seventh freedom and cabotage rights in respect of cargo were, however, prohibited by most Bermuda I type bilaterals.

In addition, some Bermuda I type agreements contained special provisions relating to cargo services. For instance, the agreement between the United States and France,[380] signed in 1946 and amended in 1969, contained special "cargo flexibility" provisions relating to all-cargo air services.[381] Under the cargo flexibility provisions, carriers designated by the United States were allowed to operate all-cargo air services in both directions from the United States via intermediate points in the United Kingdom and the then Federal Republic of Germany to Paris, Marseille and Nice, and beyond to points in the United Kingdom and the Federal Republic of Germany without traffic rights between Paris, Marseille and Nice and the said intermediate or beyond points in the United Kingdom and the Federal Republic of Germany.[382] Aircraft engaged in the above services could, under the special provisions, be routed with complete flexibility in the order of points served among the points in France mentioned above as well as the intermediate and beyond points in the UK and Germany.[383] However, since these operations were required to begin or end in the territory of the United States, they did not amount to the grant of seventh freedom rights.

Although the U.S. and UK Bermuda II agreement restricted U.S. access to London Heathrow Airport only to two US-flag carriers, it contained special provisions in relation to cargo services. Annex 5 to the Bermuda II agreement, as subsequently amended in 1980,[384] established a regime of liberalized air cargo services between the parties under which the U.S. was allowed to designate any number of carriers to operate scheduled air cargo services between any points in the U.S. and any points in the UK.[385] However, this somewhat liberalized regime, which was already applicable to cargo charter operations,[386]

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[376] This provision is present in the bilatreals between Canada and Cuba, Spain, Korea, Brazil, U.S., and Russia, respectively. The Canada-UK Bilateral contains a similar wording: "Each Contracting Party shall act favourably on any request from the other Contracting Party for reasonable special security measures to meet a particular threat." *Supra,* Art. 10.

[377] This provision, in various wording, is present in the bilaterals between Canada and the U.S., the UK, Russia, Brazil, Korea, Cuba, and Spain, respectively.

[378] *See* ATA U.S. Provisions, *supra,* note 4 at 414.

[379] *See* for example, *Agreement on Air Transport Services, United States-Australia, 1946*, T.I.A.S. NO. 3880, art. II; *Agreement on Air Transport Services, United States-Czechoslovakia*, 1969, T.I.A.S. NO. 6644, art. 1 [emphasis supplied].

[380] *Agreement on Air Transport Services, United States-France, 1946*, T.I.A.S. NO. 6727.

[381] *Id.* ¶ 3B.

[382] *Id.* ¶ 3.

[383] *Id.* ¶ 3A.

[384] *Agreement amending the Air Transport Services Agreement of July 23, 1977 (Bermuda II) United States-United Kingdom, 1980*, T.I.A.S. NO. 10059.

[385] *Id.* Annex 5 part III.

[386] *See* article 14 of *Bermuda II* Agreement, 1977, T.I.A.S. No. 8964.

did not permit seventh freedom cargo operations.

With the advent of the "open skies" era, the policy of the U.S. has shifted in favour of seventh freedom rights in respect of all-cargo operations but not for passenger service.[387] Although the U.S. refused a Dutch proposal for the exchange of seventh freedom rights with respect to cargo operations during the negotiation of the first such open skies bilateral agreement with the Netherlands in 1992,[388] subsequent agreements provide authority for the designated airline(s) of one country to operate all-cargo services between the other country and a third country, via flights that are in no way connected to its homeland.[389] The provisions on seventh freedom operations are usually contained in the Annexes to the agreements. Whereas all scheduled and charter services between points in the respective territories of each party as well as intermediate and beyond points are allowed so long as they serve a point in the territory of the designating party, an exception is made in most cases with respect to scheduled and charter cargo services; they are not required to serve a point in the territory of the designating party.[390]

Although not clearly specified, the language of section 1 of Annex I to the Current Model Open Skies agreement[391] suggests that co-terminalization is authorized on the routes specified therein. Co-terminalization is the ability of a designated airline to serve more than a single point in the territory of the other party on one flight from the territory of its own country. Constraints on co-terminalization effectively mean that cargo carriers cannot consolidate batches of cargo destined for different cities in one country into one single flight. This severely hampers efficiency as carriers are forced to fly a number of smaller planes to different cities instead of one large aircraft.[392] By simply stating that designated carriers are entitled to operate all-cargo services to any point or points in the territory of the other party, it may well be argued that open skies agreements that employ this formulation do, in fact, authorize co-terminalization.

A review of bilaterals signed by Canada shows that most of them contain a general provision that the "agreed services" between the Contracting Parties include cargo transportation, but only few of them address separately the all cargo services.[393] The most liberal provisions are contained in the Canada-US Bilateral according to which the right to perform cargo services is recognized to and from any point in the territory of Canada to and from any point in the territory of the U.S., "with no restrictions as to aircraft weight group, capacity or frequency".[394] However, the US-Canada Bilateral accords neither Seventh Freedom rights to cargo carriers, nor co-terminalization rights. The other bilaterals addressing specifically the transport of cargo contain less liberal provisions, but the Fifth Freedom rights recognized for all cargo are more extensive than the passenger/combination services.[395]

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[387] Pablo Mendes de Leon, *Before and After the Tenth Anniversary of the Open Skies Agreement Netherlands-US of 1992,* 18 AIR & SPACE L. 280, 290 (2002).

[388] *Id.,* 291

[389] *See* U.S. Department of State, *Open Skies Agreement Highlights*, online: http://www.state.gov/e/eb/rls/fs/208.htm (date accessed: December 20 2004).

[390] *See* for example *Air Transport Agreement Between the United States of America and the Republic of Portugal, May 30 2000*, Annex I section II and Annex II section I, U.S. Department of State website, online: http://www.state.gov/www/issues/economic/tra/opskies_us_portugal.html (date accessed: December 21 2004).

[391] U.S. Department of State, *Current Model Open Skies Agreement*, online: http://www.state.gov/e/eb/rls/othr/19514.htm (date accessed: December 21 2004). Section 1 of Annex I provides that designated airlines of each party shall have be entitled to perform scheduled international air transport between points on the following routes: . . . for all-cargo services, between the United States [Country] and *any point or points* [emphasis supplied].

[392] Chris Mahoney, *Air Cargo Liberalization*, (Speech made on January 28 2004 at the Canada Air Transport Policy Conference held in Ottawa), online: http://www.pressroom.ups.com/execforum/speeches/speech/text/0,1403,501,00.html (date accessed: December 21 2004).

[393] Among the 13 Canadian bilaterals reviewed, only the Canada-Spain Bilateral, the Canada-Korea Bilateral, and the Canada-US Bilateral, *supra,*contain specific provisions dealing with cargo transportation.

[394] Canada-US Bilateral, *supra,* Annex I, Section 2.

[395] *See* for example, Canada-Spain Bilateral, *supra,* Annex, providing that Fifth Freedom rights for all cargo services can be exercised to any point or points in the United States (while for passenger/combination services only few points in the U.S. were allowed) and

XI. SEVENTH FREEDOM

Seventh freedom rights are those granted to a foreign carrier operating entirely outside its designating State, to fly into the territory of the grantor State and there, discharge or take on traffic coming from or destined for a third State or States. These rights enable a foreign carrier to exclusively base its operations in a third country without requiring any of its flights to connect to its home country.[396] Seventh freedom rights have seldom been allowed in international aviation particularly with respect to passenger transport.[397] This, in the opinion of Allan Mendelsohn, "is simply because, passengers originating, for example, in Madrid and flying to New York have traditionally been viewed as the province of – and largely the protected market for – the national carriers" of Spain.[398]

For all-cargo carriers, the ability to operate Seventh Freedom flights makes commercial sense. This is because they would be able to integrate cargo operations over their worldwide networks without having to connect to their home countries. This is probably the reason why the U.S. is exchanging Seventh Freedom traffic rights with its bilateral partners under recent open skies agreements. However, the success of these kinds of arrangements depends entirely upon their acceptance by the other S States from which the cargo originates or is destined.

After the implementation of the Third Package of liberalization in the EU, it is theoretically legitimate for a community carrier to base its operations in any EU State and operate turn around services from there to a country with which it has exchanged seventh freedom rights. However, in practice, no EU member State has allowed such a service in the past,[399] and this trend is not likely to change in the near future. Thus in the foreseeable future, Seventh Freedom operations may only be confined to all cargo services.

XII. THE PROSPECTUS FOR BILATERAL AND MULTILATERAL AIR TRANSPORT AGREEMENTS

An examination of the current environment of international civil aviation suggests that a multilateral agreement on the substantive aspects of the industry may not be forthcoming in the near future. Economic conditions and policies vary greatly from State to State; no State, not even the United States, can unilaterally impose its aviation philosophy on the world community. So long as States pursue their national interests, be they political, economic or military, there will undoubtedly be conflict in international civil aviation.

Multilateral agreements on certain aspects of the international civil aviation industry have played and will continue to play a significant role, particularly within the EEC and ECAC, and those negotiated under ICAO auspices in areas such as liability and security. But since a comprehensive multilateral aviation agreement appears presently beyond the grasp of the community of States, bilateral air transport agreements, despite their shortcomings, will for the foreseeable future remain the principal instruments

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Canada-Korea Bilateral, *supra,* Annex, Section I which allows that points named for all cargo services to be different from those named for passenger/combination services, but should not exceed four at any one time, while for passenger/combination services, points named shall not exceed two at any one time.

[396] Robert C.O. Lim, *Beyond open Skies is True Open Skies*, (paper presented at the Worldwide Conference on Current Challenges in International Aviation held in Montreal from 24-26 September 2004) at 8.

[397] *Id. See also* Allan I. Mendelsohn, *The USA and the EU – Aviation Relations: An Impasse or an Opportunity?*, 19 AIR & SPACE L. 263 at 267 (2004) who cites the limited introduction of seventh freedom all-cargo services under recent U.S. open skies bilaterals as an exception.

[398] *Id.*

[399] *Id.*

for establishing and regulating the basic aspects of international air transportation.

XIII. SUMMARY & CONCLUSIONS

Because the Chicago Conference failed to embrace a comprehensive multilateral solution to the economic regulatory issues, it became apparent that bilateral negotiations between individual pairs of States would designate route assignments, frequencies, capacities, and fares.[400] IATA also addresses the financial, legal and technical aspects of international civil aviation.[401] But while a number of States adopted the *Bermuda* bilateral as a model for their own air transport negotiations, many modified it to include pooling or more restrictive capacity clauses.

Traditionally, the principal provisions of bilateral air transport agreements have been these:

- Entry (designation of routes and carriers) -- In most bilaterals, specific city-pair routes are designated for third, fourth and Fifth Freedom services. Most States limit the number of carriers to one of each flag per route (although this has not been the U.S. model, particularly since the late-1970s). Under the U.S. standard for bilateral provisions, the United States was free to designate an unlimited number of gateway city pairs by virtue of language which read "from the United States . . . ."[402] The United States was also free to designate an unlimited number of carriers, by virtue of provisions which granted each State the right to authorize service on each route by "an airline or airlines."[403] The Bermuda I agreement was unusual in that it specified the names of the carriers to serve the routes, and the airports they could serve, although again, this has not been the norm in bilaterals.
- Capacity -- Most States historically have included a predetermination of capacity offered on the routes (including frequency, seats, or scheduling of flights), or reciprocity, or an sharing of revenue and/or costs (i.e., pooling). The United States has consistently rejected predetermination of capacity, and nearly universally abhorred pooling (the antitrust immunity afforded under the U.S. Netherlands bilateral allows pooling between Northwest and KLM, however). Bermuda I-type agreements also gave carriers the right to determine capacity, although there were vague provisions requiring that: (a) air services should be closely related to traffic demand; (b) there should be a fair and equal opportunity for the air carriers of the two States to operate over the designated routes; and (c) the "interest of the air carriers of the other government shall be taken into consideration so as not to affect unduly the services which the latter provides on all or part of the same route."[404] Similarly, section 6 of the Agreement insists that the provision of fifth-freedom services shall not become the primary objective of capacity placed in the market. Indeed, it requires that capacity shall be related to (a) the traffic requirements between the countries of origin and destination, (b) the requirements of through airline operations, and (c) the traffic requirements of the area through which the airline passes, after taking account of local and regional air services. Moreover, each State enjoys the right of *ex post facto* review of capacity. The Bermuda I agreement called for ex post facto review of capacity, but also insisted that capacity "bear a close relationship to the requirements of the public for air transport," suggesting, for example, that Fifth Freedom capacity be related to the volume of third and fourth freedom traffic carried in the market.[405]
- Rates -- The Bermuda I agreement called for rates to be set individually by carriers, and filed in

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[400] *Id.*, II-7 to II-8.

[401] *But see*, THAI AIRWAYS INTERNATIONAL LTD., DOT ORDER 92-2-37 (1992).

[402] *See generally* Gertler, *Bermuda Air Transport Agreements: Non Bermuda Reflections*, 42 J. AIR L. & COM. 779, 803 (1976). *See* Peter Haanappel, *Bilateral Air Transport Agreements – 1913-1980*, 5 INT'L TRADE L.J. 241, 252 (1980).

[403] *United States Standard Form of Bilateral Air Transport Agreement*, Art. 3 (1953). *See* Peter Haanappel, *Bilateral Air Transport Agreements – 1913-1980*, 5 INT'L TRADE L.J. 241, 252 (1980).

[404] *United States Standard Form of Bilateral Air Transport Agreement*, Art. 8, 9, 10 (1953). *See* Peter Haanappel, *Bilateral Air Transport Agreements – 1913-1980*, 5 INT'L TRADE L.J. 241, 250 (1980).

[405] *Bermuda II Model*, *supra*, at 1262.

tariffs with the aeronautical authorities of each government. Prior to 1960 most Bermuda I-type agreements contained an explicit endorsement of the IATA ratemaking machinery, identifying procedures to be followed upon a failure of IATA to reach a consensus.[406] In 1960, the United States revised its standard-rate article to eliminate specific endorsement of IATA. However, the Bermuda I-type bilaterals ordinarily allowed the aviation authorities of each State to suspend filed tariffs prior to their effective date.[407] Double approval of rates by both governments was the norm until the late 1970s, when the U.S. negotiated a "country of origin" rate provision with the Netherlands, providing that only the State from which the flight departed could reject the rate. A more liberal provision still is the "double disapproval" clause, requiring disapproval by both governments before the rate may be rejected. A Memorandum of Understanding between the U.S. and the European Civil Aviation Conference established a price band around a reference rate within which there would be no governmental interference.

- Discrimination and fair competition -- Though early bilaterals required a "fair and equal opportunity to operate" in the market, more recent bilaterals have specified duties of reasonableness, nondiscrimination and most favored State treatment with respect to a wide variety of so-called "soft rights", including taxes, customs duties, inspection fees and restrictions, fuel, lubricating oil, spare parts, ground handling, ticket sales, CRS, and currency conversion and remittance. The U.S. model "open skies" agreement also provides for "just, reasonable, not unjustly discriminatory, and equitably apportioned" user charges not exceeding the full cost of production, and permits intercarrier agreements on code-sharing, blocked-space and leases. The model annex calls for unlimited change of gauge rights, and nondiscriminatory treatment of CRS.
- Dispute resolution -- Most bilaterals require consultation by governments over disputes before any retaliatory action is taken. Early bilaterals called for an advisory report by ICAO, or adjudication by ICAO. Modern bilaterals have replaced ICAO as a dispute resolution forum with ad hoc arbitration, usually with three arbitrators (each State designates one arbitrator, who then select the third). Bilaterals typically call for termination only on twelve months notice. In the history of international aviation, relatively few disputes have resulted in ICAO adjudication or ad hoc arbitration.[408] In the first half century since the Chicago Convention, only four aviation disputes have been resolved via arbitration, and only three have been submitted to ICAO for adjudication.[409] Most are resolved through negotiation.

XIV. APPENDIX

A. DHL AIRWAYS, INC. (ASTAR)

U.S. Department of Transportation
2003 DOT Av. LEXIS 1086 (2003)

BURTON S. KOLKO, Administrative Law Judge,

1. INTRODUCTION

This month marks the centennial of the flights of Wilbur and Orville Wright. For those reading this decision who do not have a parochial interest in the fullness of its contents, better to commemorate December 17, 1903, by putting this down now . . . and picking up to read "Fate Is The Hunter", by Ernest K. Gann, and "Wings: A History of Aviation from Kites to the Wright Brothers to the Space Age", By Thomas Crouch; or viewing "The Great Waldo

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[406] Peter Haanappel, *Bilateral Air Transport Agreements – 1913-1980*, 5 INT'L TRADE L.J. 241, 255-57 (1980); *Bermuda II Model*, *supra*, at 1262.

[407] *Id.* For a comprehensive discussion of the *Bermuda I* provisions, *see* Peter Haanappel, *Bilateral Air Transport Agreements – 1913-1980*, 5 INT'L TRADE L.J. 241, 246-50 (1980).

[408] For a review of each of these disputes, *see* PAUL DEMPSEY, LAW & FOREIGN POLICY IN INTERNATIONAL AVIATION 293-302, 259-67 (1987); and Paul Dempsey, *Flights of Fancy and Fights of Fury: Arbitration and Adjudication of Commercial and Political Disputes in International Aviation*, 32 GA. J. INT'L & COMP. L. 231 (2004).

[409] *See* PAUL DEMPSEY, LAW & FOREIGN POLICY IN INTERNATIONAL AVIATION 259-67, 295-302 (1987).

Pepper", "Twelve O'Clock High", and "The Right Stuff". On those pages and in those frames, flight is fascinating.

We have come far since the early days of the barnstormers and the intrepid air mail pilots, they reminiscent of the spirit of the Pony Express, and the days when stories were told of struggling airlines rumored to be flying bricks in mail sacks around the Caribbean for the prized airmail subsidies; or of ace Eddie Rickenbacker, whose Eastern Air Lines' aircraft he reputedly ordered be flown high and fast for as long possible, making for steep ascents and descents, to save time and money. We are building a space station, which may become the overnight sorting hub of the future. We are not there yet. But while you are reading this, people in North America are placing on their tables roses that were picked in Ecuador yesterday afternoon. We are in the era of express package delivery and the "just-in-time" inventory that it feeds. The Wright brothers, makers of bicycles, doubtless would have found this useful.

In this country, express package delivery has made Federal Express a household word, not unlike Railway Express of a bygone age. The United Parcel Service developed and honed ground package delivery to a fine art, and has taken that experience to challenge Federal Express in the air. To return the favor, Federal Express has expanded its ground delivery services. Attempting to take on these two giants is DHL, itself a giant of a force outside this country. Its competitive foray has prompted this inquiry, whether the company that operates the aircraft into which DHL pours its express packages, formerly DHL Airways, Inc. and now ASTAR, is a citizen of the United States. . . .

2. CITIZENSHIP STANDARDS

[In 2003, the US Department of Transportation] initiated a *de novo* review of the citizenship of direct air carrier DHL Airways, Inc. (DHLA), which [has] the burden of establishing that it is a U.S. citizen . . . . To be found a U.S. citizen, a carrier must comply with the specific requirements set forth by 49 U.S.C. § 40102(a)(15). That section in pertinent part States:

"citizen of the United States" means--

> (C) a corporation or association organized under the laws of the United States or a State, the District of Columbia, or a territory or possession of the United States, of which the president and at least two-thirds of the board of directors and other managing officers are citizens of the United States, *which is under the actual control of citizens of the United States,* and in which at least 75 percent of the voting interest is owned or controlled by persons that are citizens of the United States.[410]

To fulfill the requirements of U.S. citizenship, an air carrier must not only meet the technical requirements of the statute, but must also, under a preponderance of evidence, satisfy the qualitative evaluation of the "actual control" test. Even where an air carrier meets the "technical minima" of the statute, which is "merely the threshold issue for questions of control," the air carrier does not meet the citizenship requirements if actual or effective control lies with non-U.S. citizens. The substance of any transaction and arrangement must guarantee that control in fact resides in U.S. citizens. . . .

'Control' means "the ability to exert significant influence over a carrier." . . . In determining whether control exists, the Department seeks to discover "whether a foreign interest . . . will have a substantial ability to influence [a] carrier's activities." *Acquisition of Northwest Airlines by Wings Holdings,* Order 89-9-51 (September 29, 1989), p. 8. The control standard evaluates both actual and potential control and influence both positive and negative. It assesses every form of control, whether residing in debt, equity, personal relationships, or other forms of influence. Because "there are myriad potential avenues of control," analysis necessarily must proceed on a case-by-case basis. *Acquisition of Northwest Airlines by Wings Holdings,* p. 8. The Department does not--indeed cannot--use a checklist. Whether control exists in any particular situation depends on its specific facts. . . . As such, circumstances or combinations of circumstances that would demonstrate control cannot be defined with precision.

Nevertheless, past proceedings furnish some overall guidelines for evaluating the question. The Department assesses whether a foreign interest has the power, either directly or indirectly, to influence an entity's directors, officers, or stockholders. Close personal and business relationships between a foreign-citizen part-owner and an applicant's U.S. officers and directors have trumped a non-U.S. citizen's minority shareholder status. The Department's predecessor, the Civil Aeronautics Board, found that when the applicant would "continue to do business as part of the system of [foreign citizen]-controlled companies" it had not met its burden of proving U.S. citizenship. *Willye Peter Daetwyler, d.b.a. Interamerican Airfreight Co., Foreign Permit,* 58 CAB 120 (1971); *see also Wrangler Aviation, Inc.,* Order 93-7-26 (July 15, 1993). Control also may be found from the ability to manage a carrier's day-to-day operations, although it is not necessarily limited to operations. . . .

As *Daetwyler* showed, a dominating influence may be exercised in ways other than through voting power. . . . Shareholders of non-voting stock could possess the requisite control. If, for example, non-U.S. citizens holding only non-voting shares could, individually or collectively, require an entity to repurchase its stock under a variety of

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[410] 49 U.S.C. § 40102(a)(15) as amended by *Vision 100--Century of Aviation Reauthorization Act*, PUB.L. 108-176, § 807, 117 STAT. 2490 (DEC. 12, 2003) [emphasis added].

easily satisfied conditions, the shareholders' ability to withdraw capital could influence company management to the point of finding control. . . . Foreign nonvoting shareholders who could veto any merger or acquisition and could force the carrier to liquidate at any time were found to exercise control of that carrier. . . . Individuals or entities with neither shares nor votes, such as creditors, could exert control. While creditor status--holding even half of a carrier's debt--does not in itself constitute control, . . . a lender's powers under its lending agreement could lead to a control finding. . . . On the other hand, a provision of an agreement that has a legitimate business purpose does not necessarily negate the possibility of control. In the end, the question is whether such a provision, among any other existing indicia of control, suggests as a whole actual control.

The foregoing is not an exhaustive list of situations bearing on the question of control. . . . As the Department has aptly summarized, "we examine the totality of circumstances unique to the particular transaction in the context of the control standard." *Wrangler Aviation, Inc.,* Order 93-7-26 (July 15, 1993), p. 5.

3. DISCUSSION

3.1. Scope of the Proceeding

To paraphrase Marlon Brando in "Guys and Dolls", the entity whose citizenship is here under review is not "the lady we came in with". When the Department instituted this case [in 2003], the then-DHLA was under different ownership and was a party to different agreements than the now-existing carrier, ASTAR. . . .

When this proceeding was instituted in April 2003, . . . the parent of DHLA, DHL Holdings (USA), Inc. (DHLH), had sold 55 percent of DHLA's equity and 75 percent of its voting stock to William A. Robinson for $ 42 million. DHLH retained the remaining 45 percent of DHLA's shares and the remaining 25 percent voting interest . . . .

Robinson . . . is a U.S. citizen. DHLH was not. Although a Delaware corporation, DHLH is a foreign entity because it has been wholly owned (through intermediate companies) by DHL International Ltd. (DHLI), an entity incorporated in Bermuda. DHLI, in turn, has been wholly owned since December 2002 by Deutsche Post, AG, which operates Germany's national postal service, a partially privatized company with a letter-mail monopoly. Deutsche Post is a German company partially owned by the Government of Germany . . . .

Deutsche Post had held a majority interest in DHLI since 2000. While it was buying up the rest, Robinson sold his minority interest in the "old" DHL Worldwide Express, Inc. to a Deutsche Post-controlled subsidiary, DHL Worldwide Express, B.V. (BV). . . . DHLH also held veto power over certain business decisions, including recapitalizations, mergers, and a sale of substantially all assets . . . .

In the fall of 2002, not long after the death of DHLA's CEO Joseph O'Gorman, former airline executive John Dasburg was approached for the position . . . . Dasburg had first-rate credentials. A lawyer and M.B.A. with a tax accounting background, he had held a high executive position at Marriott Corporation before assuming the CEO position at Northwest Airlines, Inc. Dasburg presided over Northwest for eleven years . . . . Although primarily a passenger carrier, Northwest ran an impressively large cargo business . . . .

Dasburg told his recruiters that he would not be interested in DHLA, or any company position, unless he had the opportunity to acquire control . . . . As a result of these discussions, on March 18, 2003, Dasburg entered into an employment agreement with DHLA. The agreement specifically noted that it was Dasburg's intention, alone or with others, to purchase a controlling interest in the carrier . . . . He assumed the position of DHLA chief executive officer on April 1, 2003 . . . .

Negotiations to acquire control of the company began shortly after that Eventually the two sides reached agreement . . . .

On May 20, 2003, the parties executed a plan of merger . . . . Robinson and DHLH agreed to sell their DHLA shares--that is, the 95% of company shares not already owned by Dasburg--for $ 57 million. DHLA's total purchase price was $ 60 million. . . .

On July 14, 2003, the transaction closed (the ASTAR Transaction or the July 14 Transaction). DHLA formally changed hands and was renamed ASTAR Air Cargo, Inc., and BDAP was renamed ASTAR Air Cargo Holdings, LLC. . . . Since then, Dasburg became president of both ASTAR and ASTAR LLC . . . .

ASTAR has shown, and no party disputes, that it complies with the technical requirements for U.S. citizenship under 49 U.S.C. § 40102(a)(15). ASTAR is organized under the laws of the State of Nevada, and its president, directors and other managing officers are U.S. citizens . . . . Further, its voting shares are 100% owned by citizens of the United States . . . .

Based upon the entire record, I find that a preponderance of reliable, credible, and probative evidence exists to support that, under the totality of circumstances, ASTAR is actually controlled by U.S. citizens. . . .

4. FINAL CONSIDERATIONS

ASTAR *arguendo* was formed at the instance of a foreign entity; a foreign entity is backing the loan financing over 80% of its purchase price; its dominant customer is a foreign entity; and without that customer, ASTAR

probably would not exist--certainly not in a form resembling its form today . . . . An examination of this question in fact shows that ASTAR is, so to speak, its own person; it is functionally independent of DHL WE. Neither DHL WE nor the DHL network can be said to be in actual control of ASTAR in any relevant or meaningful sense.

The DHL network hopes to create a seamless, fully integrated system to carry and deliver express packages by air throughout the world . . . . A U.S. presence--that is, the ability to carry cargo between U.S. points--is a major, even invaluable, facet of such a system. And only a U.S. citizen air carrier is permitted to perform such operations. So the network has outsourced this crucial service . . . . ASTAR is one carrier (among others) with which the DHL network has contracted to perform U.S. operations. ASTAR, thus, is a component of an integrated package delivery system in the U.S. whose ground and shipping element is owned by DHL WE . . . . In some sense, then, ASTAR is part of a greater, foreign-operated integrated system. The carrier can be viewed as a unit of a venture larger in conception and scope. But that does not mean that the global DHL network controls its U.S. "unit." It does not suggest in itself that ASTAR is not independent of the larger enterprise.

And in fact the nature of the ASTAR-DHL WE relationship does not implicate control. DHL WE is not a parent or affiliate or even, at bottom, a business partner of ASTAR. It is a client. All clients have needs particular to them. DHL WE's require ASTAR to mesh the entities' services to insure a smooth and reliable delivery system. That is ASTAR's role (*see* JT-404, p. 128). ASTAR simply is selling its services to DHL WE. In Professor Ordover's analogy, the DHL network could have its house painted to its particular specifications without controlling the painting company it hires for the job. Against this background, the notions of actual control and a seamless integrated network for package delivery are not mutually exclusive.

To determine the citizenship question at the core of this proceeding, the salient question is who has the power to direct or dominate ASTAR. And the answer is ASTAR . . . .

In view of the foregoing, I find and conclude that the preponderance of evidence shows that ASTAR Air Cargo, Inc. (formerly DHL Airways, Inc.) is owned and controlled by U.S. citizens within the meaning of the operative statute, 49 U.S.C. § 40102(a)(15). Accordingly, I conclude that ASTAR is a U.S. citizen. . . .