

Capital and Market Access in International Aviation: Nationality Requirements and Cabotage Restrictions

by Prof. Dr. Paul Stephen Dempsey

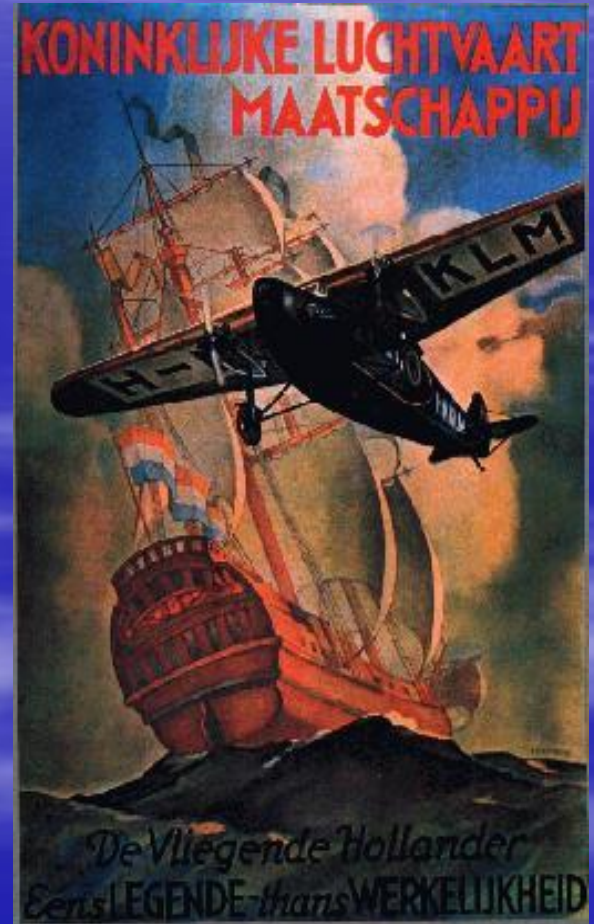
McGill University Institute of Air & Space Law

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“Flags of Convenience” Rejected in Air Law

- In 1633, Hugo Grotius, wrote “Freedom of the Seas: The Right Which Belongs to the Dutch to Take Part in the East India Trade.” To this day, freedom of the seas and “flags of convenience” dominate maritime transport.
- The Paris Convention of 1919 reaffirmed the customary international law principle that each State possesses exclusive national sovereignty over the air space above its territory.
- The United States promulgated a nationality requirement in its airline certification requirements, and reserved cabotage to U.S. airlines in the Air Commerce Act of 1926.
- The U.S. increased the domestic control requirement to 75% in the Civil Aeronautics Act of 1938.



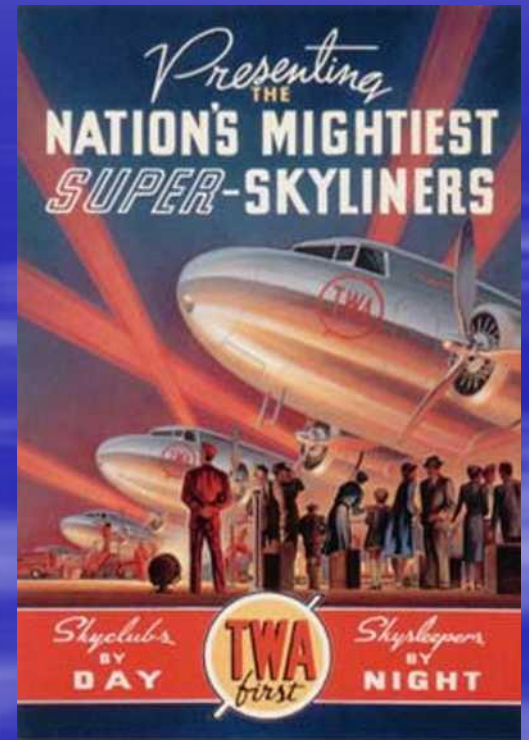
The Chicago Convention of 1944



- *Article 1 affirms the “complete and exclusive sovereignty” of every State over “the airspace above its territory.”*
- *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.”*
- *Hence, scheduled international flights through or into foreign airspace is prohibited unless the State whose territory is penetrated has authorized such operations, normally in bilateral air transport agreements.*

Aircraft Nationality

- Article 17 of the Chicago Convention provides that, “Aircraft shall have the nationality of the State in which they are registered.”
- Article 18 provides that aircraft may not be registered in more than one State.
- Article 31-32 require registering States to provide such aircraft with a certificate of airworthiness, and issue certificates of competency and licenses for pilots and flight crew.
- However, **airline nationality** is nowhere addressed in the Chicago Convention.



Multilateral and Bilateral Air Transport Agreements

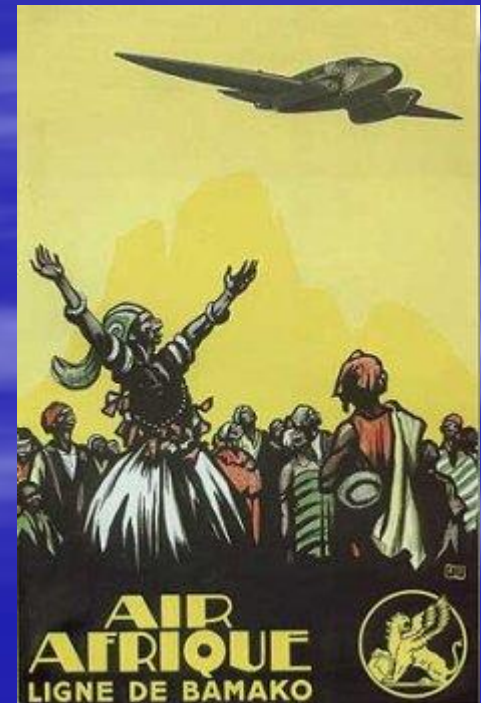


Section 5 of the Transit Agreement, and Section 6 of the Transport Agreement, provide: “Each contracting State reserves the right to withhold or revoke a certificate or permit to an air transport enterprise of another State in any case where it is not satisfied that **substantial ownership and effective control** are vested in nationals of a contracting State”

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 would entitle either nation to revoke, suspend or limit the operations of the offending airline.

Nationality Rules Are Discretionary and May Be Waived

- To qualify as a U.S. flag carrier, U.S. citizens must: (1) hold at least 75% of the voting equity; (2) hold at least 51% of non-voting equity; and (3) effectively “control” the airline.
- Foreign ownership restrictions are not unique to aviation, and exist in broadcasting, telecommunications, electric and nuclear power production, shipping and banking.
- The U.S. has waived the nationality requirements for airlines registered in states that met FAA Category I safety/security requirements, and that have concluded an “Open Skies” bilateral with the U.S..
- When Iberia gained control of Aerolinas Argentinas, the U.S. did not object to the fact that Spanish citizens owned and control the Argentine carrier after Argentina opened the bilateral to expand traffic rights for U.S. carriers.
- Conversely, when British Airways sought to gain effective control of USAir, the U.S. stalled on grounds that Bermuda II limited US access to Heathrow.
- The US denied Virgin Nigeria operations between Lagos-New York on grounds that the carrier was substantially owned and effectively controlled by British citizens (e.g., Richard Branson).
- The US initially denied Virgin America an operating certificate on grounds it was not controlled by US citizens.
- Hence, the presence of an ownership and control restriction can be an effective lever to pry loose concessions that would be unattainable absent formal renunciation of the bilateral.



Rationales for Nationality Requirements



- to ensure the exchange of traffic and other rights would go to airlines only of the nation with which they were negotiated;
- to protect national airlines from market dilution and excessive competition;
- to avoid the problem that exists in the maritime trade of “flags of convenience” vessels with lax safety, labor, and environmental restrictions; and
- to protect national security.



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REASON—All over the world are America's military outposts. It is equally vital to our nation's defense. How do we reach them? They probably know that within our nation, they already have an air-aid network that can bridge oceans, sea and sky.

When circumstances call for it, a Navy or Marine Corps ship of the United States Navy is the "first line of defense" of our nation's defense. It is the "first line of defense" of our nation's defense. It is the "first line of defense" of our nation's defense.

...and planes, modern equipment, crews of bold and daring men, and a network of land, sea, and air, that can reach them.

How does this work? It means that the U.S. Navy is the "first line of defense" of our nation's defense. It is the "first line of defense" of our nation's defense. It is the "first line of defense" of our nation's defense.



Travel **PAN AMERICAN AIRWAYS** *System*

Multilateral Efforts Toward Liberalization

- 2001 - “APEC Agreement” (“Kona Accord”) included optional provisions waiving ownership requirements, and substituted effective control, incorporation, and principal place of business requirements .
- 2002 - *OECD model all-cargo template*: 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.
- 2002 - *EU Court of Justice decision*: under the “Right of 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.
- 2003 - *ICAO’s Fifth Worldwide Air Transport Conference* drafted a model clause for insertion into bilaterals that focused on an airline’s “principal place of business” and “effective regulatory control.” “Permanent residence” was an optional requirement.
- Australia and New Zealand have created a common aviation area.



Status of Foreign Ownership Restrictions for Airlines in Selected Countries

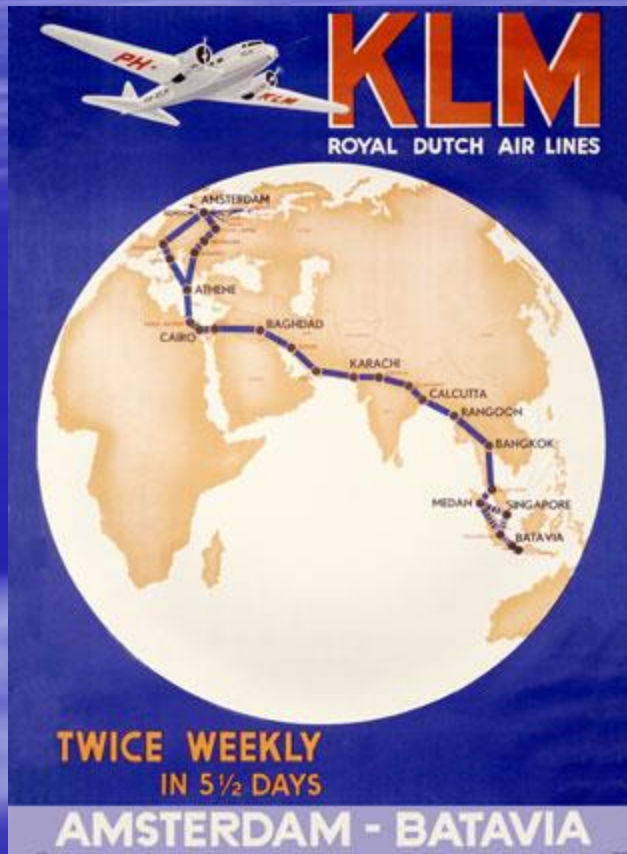
	Status of Foreign Ownership Restrictions for Airlines in Selected Countries
EU	49%
Australia	49% for international (25% single); 100% for domestic ^{a)}
Canada	25% of voting equity (15% single) ^{b)}
Japan	33.33%
New Zealand	49% for international; 100% for domestic
United States	25% of voting equity; 1/3 of board at maximum; cannot be chairman of board
<p>(a) The Australian Government released a policy paper on 1 December 2008 that proposes lifting the foreign ownership limit for single entities to 49%. – (b) In February 2009, the Canadian Government drafted a proposal to increase ownership limits to 49%. The proposal, which is supported by Air Canada, is backed by both the Conservative Party and the Liberal Party.</p>	

Source: Cosmas, A / Belobaba, P / Swelbar, W, Framing the Discussion on Regulatory Liberalisation: A Stakeholder Analysis of Open Skies, Ownership and Control, in: Int. J. Aviation Management, Vol.1, No. 1/2, 2011, p. 21.

Skirting Around Nationality Requirements

- Alliances: Star, Skyteam & oneworld
- Metal Neutral Joint Ventures: e.g. United-Air Canada-Lufthansa
- Multiple Hubs: e.g., Lan hubs in Argentina, Ecuador, Peru and Chile; TACA hubs in El Salvador, Costa Rica and Peru; Lufthansa Italia hubs in Milan; EasyJet hubs in Geneva, Madrid, Milan and the UK
- Mergers and Acquisitions: e.g., Lufthansa acquired Austrian, Swiss, BMI, Brussels
- Minority Ownership: e.g., Delta in Virgin Atlantic; Lufthansa in JetBlue; Etihad in Air Berlin, Alitalia and Jet Airways
- Joint Ventures: e.g., Qantas established Jetstar in Singapore; Singapore Airlines established Tiger in Australia; Air Asia operates affiliates in Thailand, Malaysia and Indonesia

Arguments in Favor of Eliminating Nationality Requirements



- It will enable airlines to tap foreign capital markets, thereby strengthening weaker airlines.
- It will enable carriers to achieve greater economies of scale, reduce costs, and thereby offer lower prices and better 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, consonant with contemporary neo-classical economics notions of free trade.

Arguments in Favor of Preserving the Status Quo

- As in the maritime trade, elimination of the foreign ownership restrictions 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 reliance on the civilian commercial airline fleet for needed lift capacity in time of international conflict, such as the US Civil Reserve Air Fleet [CRAF] program;
- 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;
- It would enable a carrier from a nation with less desirable bilateral relationships to take advantage of a third nation’s more liberal bilateral relationships; 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.



U.S.-EU Air Transport Agreement – “Open Skies Plus”

The Agreement authorizes every U.S. and every EU airline (irrespective of flag) to:

- fly between every city in the European Union and every city in the United States;
- operate without restriction on the number of flights, aircraft, and routes;
- set fares according to market demand; and
- enter into cooperative arrangements, including codesharing, franchising, and leasing.



The “Plus” bit is Subject to (to be Negotiated) Side Agreements



The Open Skies Plus framework of the Agreement would:

- Allow U.S. investors to invest in a European Community airline, as long as the airline is majority owned and effectively controlled by a member State and/or nationals of member States;
- Make clear that, under U.S. law, EU investors may hold up to 49.9 percent of the total equity in U.S. airlines, and on a case-by-case basis even more;
- Enjoy cabotage rights in the US; and
- Grant new traffic rights to EU carriers that would open the door to cross-border airline mergers and acquisitions within the EU, which is possible today only if airlines are prepared to place their international operating rights in legal jeopardy.

ALPA Weighs In

The Voice of the Professional Air Line Pilot



- “The writing is clearly on the wall! This Administration wants foreign investors, airlines or otherwise, to pay for the costs of our aviation infrastructure, while risking hundreds of thousands of aviation jobs, the Civil Reserve Air Fleet program (CRAF), and the safety and security of our national airspace. Forty percent of all Air Force Reserve and National Guard pilots are also airline pilots.
- “If the White House is successful in changing the foreign ownership rules, within just a few short years our industry will mirror the maritime industry. Our jobs will no longer exist, our country's ability to militarily act abroad will be handicapped, and our families may no longer be safe in our own airspace!
- “Our country already has a dependence upon foreign oil. Are we going to allow the DOT to make air travel dependent on foreign airlines, too?”



Bush administration withdraws plan for more foreign control of U.S. airlines

The Associated Press
Published: December 5, 2006



- WASHINGTON: Already rebuffed by a Republican-controlled Congress, the Bush administration withdrew its plan to give foreign investors more management control of U.S. airlines.
- The decision was announced Tuesday by Transportation Secretary Mary E. Peters after the department reviewed public comments about the proposal, including votes by both the Senate and House this year to prevent the plan from going forward.

Cabotage –

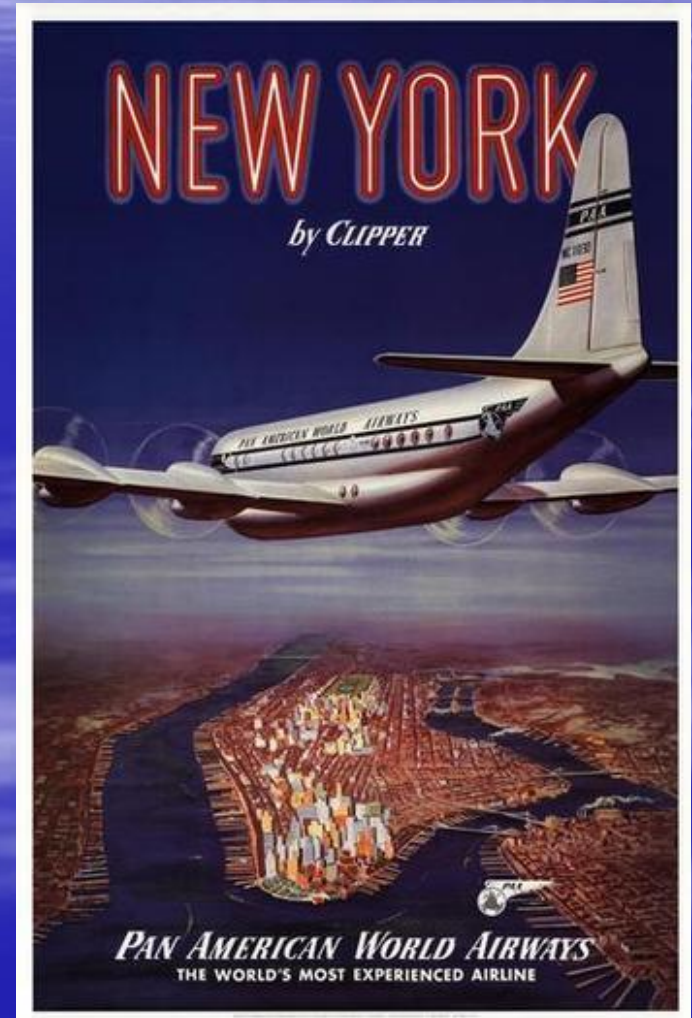
Article 7 of the Chicago Convention



- "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."
- "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."

Arguments Against Cabotage Restrictions

- Eliminating cabotage restrictions would provide additional domestic competition, enabling consumers to enjoy more price and service options; and
- It would enable the creation of global megacarriers.



Arguments for Preserving the Status Quo



- Liberalization of cabotage rights would send jobs and revenue abroad; and
- Liberalization would compromise national security.



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