

LIBERALIZE OPEN SKIES: FOREIGN INVESTMENT AND CABOTAGE RESTRICTIONS KEEP NONCITIZENS IN SECOND CLASS

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TABLE OF CONTENTS

Introduction	278
I. The Legal Framework of International Aviation Regulation	282
A. Multilateral Agreements	282
1. The Paris Convention	282
2. The Chicago Convention	283
B. Bilateral Agreements	285
1. Bermuda I	285
2. Bermuda II	286
C. Unilateral Regulation: U.S. Domestic Policy	287
II. Liberalization	289
A. United States Deregulation and Liberalization Policy	289
B. International Liberalization Efforts	293
1. The United Kingdom	293
2. The European Community	294
III. Open Skies	299
A. The U.S. Open Skies Policy	299
B. The United States-Netherlands Open Skies Agreement	300
C. United States-United Kingdom Open Skies Efforts .	301
IV. United States Protectionist Policy	303
A. Restrictions on Foreign Investment	304
1. United States foreign investment policy	305
a. The Air Commerce Act of 1926 and the original justifications for the citizenship requirement	305

b. The Civil Aeronautics Act of 1938	306
c. The Federal Aviation Act of 1958	307
d. The DOT's current foreign investment policy	309
2. Foreign ownership and control restrictions are unnecessary	310
3. Modern justifications for the citizenship requirement	312
B. Cabotage Restrictions	314
1. The history of cabotage restrictions	314
2. Cabotage restrictions are unnecessary	317
V. Recommendations	318
A. The Globalization of Air Transportation	318
B. Proposed Amendments to the Federal Aviation Act and the U.S. Open Skies Policy	320
Conclusion	323

INTRODUCTION

Advances in transportation and communications technology have changed the nature of international trade and contributed to the creation of a unified, global, and free market economy. In accordance with the reduction of government-imposed barriers to the free trade of goods,¹ nations are preparing for the free trade of services, particularly international air service.² Free trade in the air transport industry increases competition,³ which yields lower fares⁴ and creates

1. See Daniel M. Kasper, BA-USAir: Network Effects and Other Public Policy Considerations, Address Before the American Enterprise Institute, Trade Policy Forum 1 (Sept. 1992) (on file with *The American University Law Review*) [hereinafter Kasper, BA-USAir] (noting that since end of World War II, United States has tried to eliminate barriers to free trade of goods, services, and capital in world economy); see also HELEN HUTCHESON, VOCABULARY OF FREE TRADE 103 (1991) (defining free trade as "trade which is unfettered by government-imposed trade restrictions or distortion").

2. See James Ott, *Analysts Call Consolidation a Threat to Weak Carriers*, AVIATION WK. & SPACE TECH., Feb. 26, 1990, at 64, 64-65 (paraphrasing former Transportation Secretary Skinner's statement suggesting that United States consider new ways to promote free trade in international air service).

3. See THE NAT'L COMM'N TO ENSURE A STRONG COMPETITIVE AIRLINE INDUS., CHANGE, CHALLENGE, AND COMPETITION: A REPORT TO THE PRESIDENT AND CONGRESS 1 (1993) [hereinafter NATIONAL COMMISSION REPORT] (concluding from its study that airline industry is more competitive today than before 1978 due to deregulation).

4. U.S. GEN. ACCOUNTING OFFICE, AIRLINE COMPETITION: STRATEGIES FOR ADDRESSING FINANCIAL AND COMPETITIVE PROBLEMS IN THE AIRLINE INDUSTRY 1, 3-4 (1993) [hereinafter GAO REPORT ON AIRLINE COMPETITION] (statement of Kenneth M. Mead, Director, Transportation Issues, Resources, Community, and Economic Development Division) (concluding from study that lack of competition leads to higher air fares for consumers); see also NATIONAL COMMISSION REPORT, *supra* note 3, at 1 (concluding that airlines charge passengers and shippers lower fares in real dollars than they did before deregulation in 1978). The Commission determined that

better service for airline passengers.⁵

The 1919 Paris Convention and the 1944 Chicago Convention established the principle that every nation has "complete and exclusive sovereignty over the airspace above its territory."⁶ Many countries own, subsidize, or control their national airlines⁷ and are reluctant to open their domestic commercial air routes to foreign competition.⁸ Some nations, however, have begun to privatize their national airlines⁹ and liberalize¹⁰ their air transport markets.¹¹ Similarly, the United States deregulated its domestic aviation market in the late 1970s to promote competition¹² and, ultimately, to

"there is more head-to-head, city-pair competition" in the airline industry today than before deregulation. NATIONAL COMMISSION REPORT, *supra* note 3, at 1.

5. See United States-Benelux Low-Fare Proceeding, C.A.B. Order No. 78-6-97, at 5 (1978) (stating that Civil Aeronautics Board's policy was to develop domestic and international air transportation system based on competition to improve quality and price of air service). Alfred Kahn, former Chairman of the Civil Aeronautics Board, opined that the "[e]ssential components of this policy [to develop an air transportation system] are greater competitive opportunities for airlines and the promotion of low-fare transportation options for travelers and shippers." *Id.*; see also NATIONAL COMMISSION REPORT, *supra* note 3, at 18 (suggesting that DOT continue to grant certificates to new air carrier applicants because entry of new air carriers creates downward pressure on fares, lowers traveling expenses, and leads to overall increase in airline traffic). See generally Paul S. Dempsey, *The International Rate and Route Revolution in North Atlantic Passenger Transportation*, 17 COLUM. J. TRANSNAT'L L. 393, 441 (1978) (positing that increased competition among air carriers leads to proliferation of services for airline passengers at competitive prices, and that price elasticity of passenger market increases air carrier's capacity, resulting in increased revenues); Robert M. Hardaway, *Transportation Deregulation (1976-1984): Turning the Tide*, 14 TRANSP. L.J. 101, 105 (1985) (noting that after deregulation, air safety records improved, air fares decreased, and more carriers entered air transport market).

6. Convention on International Civil Aviation, Dec. 7, 1944, art. 1, 61 Stat. 1180, 1180, 15 U.N.T.S. 295, 296 [hereinafter Chicago Convention]; Convention for the Regulation of Aerial Navigation, Oct. 13, 1919, art. 1, 11 L.N.T.S. 173, 190 [hereinafter Paris Convention]; see *infra* part I.A. (discussing Paris and Chicago Conventions).

7. Paul S. Dempsey, *Turbulence in the "Open Skies": The Deregulation of International Air Transport*, 15 TRANSP. L.J. 305, 362 (1987) [hereinafter Dempsey, *Turbulence*].

8. *Id.* Many nations control foreign air carriers not to maximize profits, but to enhance national prestige, national security, tourism, or earn foreign exchange. *Id.* at 362-63.

9. See PAUL S. DEMPSEY, LAW AND FOREIGN POLICY IN INTERNATIONAL AVIATION 83 (1987) [hereinafter DEMPSEY, INTERNATIONAL AVIATION] (noting that many European states have partially or wholly privatized their national airlines). For example, British Airways has been completely privatized and the Dutch government holds only a small percentage (38.2%) of KLM Royal Dutch Airlines. *Id.*

10. Liberalization is defined as "the reduction of constraints imposed upon the existing actors in the marketplace, the incumbent national airlines." *Reports of Conferences*, 12 AIR L. 303, 306 (1987). Deregulation, by comparison, is defined as "the abolition of all restrictions dominating the air traffic marketplace, thus providing free access to international air transport." *Id.*

11. See, e.g., *infra* part II.B.2. (discussing liberalization of air transport policies among EC member states).

12. See *infra* notes 82-86 and accompanying text (describing congressional intent and purpose of Airline Deregulation Act of 1978); see also Kasper, BA-USAir, *supra* note 1, at 1 (claiming that deregulation of U.S. domestic air services industry created new market opportunities rather than new restrictions).

provide better air service and lower air fares for American consumers.¹³

Through its recently defined Open Skies initiative,¹⁴ the United States is seeking to export its deregulation policy to the rest of the world.¹⁵ The Open Skies policy, however, does not include provisions on liberalizing foreign investment¹⁶ or cabotage¹⁷ restrictions.¹⁸ The United States Department of Transportation (DOT) correctly determined that it did not have authority to amend the foreign ownership and cabotage statutes through its Open Skies policy and that only Congress has the power to legislate on these issues.¹⁹ Open Skies is a model set of provisions that the United States currently uses in negotiating liberal bilateral aviation agreements with sovereign nations. An Open Skies agreement with the United States may provide foreign airlines with virtually unlimited access to the U.S. market and the freedom to set fares.²⁰ The United States recently incorporated the elements of the Open Skies initiative into a bilateral agreement with the Netherlands.²¹ Because the Netherlands had signed an Open Skies agreement, the DOT subsequently authorized the integration of services between the Netherlands-based KLM Royal Dutch Airlines (KLM) and the U.S.-based Northwest Airlines, effectively creating a global air carrier.²²

Since the fall of 1992, however, the United States and the United Kingdom have been unable to reach an Open Skies agreement.²³

13. See Airline Deregulation Act of 1978, Pub. L. No. 95-504, § 3, 92 Stat. 1705, 1705-07 (1978) (codified at 49 U.S.C.A. § 1302(a) (1993)) (stating purpose of Deregulation Act). See generally Alfred E. Kahn, *The Changing Environment of International Air Commerce*, 3 AIR L. 163 (1978) (discussing U.S. deregulation policy).

14. See *infra* text accompanying note 165 (listing elements of DOT's Open Skies policy).

15. See *infra* part III.A. (explaining U.S. Open Skies initiative).

16. See *infra* notes 222-35 and accompanying text (discussing U.S. foreign investment laws).

17. United States cabotage laws prohibit foreign air carriers from carrying local traffic on U.S. domestic air routes. See W.M. Sheehan, Comment, *Air Cabotage and the Chicago Convention*, 63 HARV. L. REV. 1157, 1157 (1950) (defining cabotage as carriage of passengers or goods between two points within territory of same nation for compensation or hire); see also Jan Ernst C. de Groot, *Cabotage Liberalization in the European Economic Community and Article 7 of the Chicago Convention*, 14 ANNALS AIR & SPACE L. 139, 140 (1989) (noting that cabotage rights, also referred to as eighth freedom of air, have been denied or restricted to protect national airlines from foreign competition on domestic routes).

18. See *infra* notes 267-69 and accompanying text (discussing denial of cabotage rights to foreign air carriers).

19. Defining "Open Skies," D.O.T. Order No. 92-8-13, at 6 (1992).

20. See *infra* text accompanying note 165 (listing elements of Open Skies initiative).

21. See *infra* notes 171-74 and accompanying text (discussing Open Skies agreement between United States and the Netherlands).

22. See *infra* notes 175-78 and accompanying text (describing KLM Royal Dutch Airlines-Northwest Airlines transaction).

23. See *infra* notes 179-84 and accompanying text (discussing Open Skies negotiations between United States and United Kingdom).

These negotiations for a bilateral Open Skies agreement failed because the United Kingdom would not grant U.S. air carriers greater access to slots²⁴ in its airports,²⁵ and because the United States would not guarantee the approval of the British Airways-USAir transaction²⁶ and the revision of U.S. foreign investment²⁷ and cabotage²⁸ laws. In July 1992, British Airways filed an application with the DOT for the authority to make a substantial investment in USAir and to enter into a code sharing agreement²⁹ with USAir that would have effectively integrated the operations of the two airlines.³⁰ Anticipating that the DOT would reject its application because U.S.-U.K. efforts to reach an Open Skies agreement were unsuccessful, British Airways withdrew its application from the DOT in December 1992.³¹

Unless Congress amends U.S. protectionist and nationalistic foreign investment and cabotage laws,³² the United States will be unable to persuade many nations to liberalize their air transport regulations. For U.S. air carriers to obtain greater access to foreign markets, Congress must create a statutory framework that eliminates restrictions on foreign investment and cabotage rights for foreign air carriers whose governments enter into Open Skies agreements with the United States. Part I of this Comment traces the evolution of the

24. See DANIEL M. KASPER, DEREGULATION AND GLOBALIZATION: LIBERALIZING INTERNATIONAL TRADE IN AIR SERVICES 68 (1988) [hereinafter KASPER, DEREGULATION] (predicting accurately that "allocating access to take-off and landing slots" is barrier to expansion of international air transportation).

25. See *infra* note 183 and accompanying text (noting that British refused to grant U.S. air carriers greater access to Heathrow Airport).

26. See *infra* note 184 and accompanying text (presenting U.S. reasons for refusing support of British Airways-USAir transaction).

27. See *infra* notes 222-35 and accompanying text (discussing U.S. foreign investment laws).

28. See *infra* notes 267-69 and accompanying text (discussing denial of cabotage rights to foreign air carriers).

29. Code sharing is the practice by which airlines connect flight legs into a longer route under one computer designator code and charge a single fare for the combined flights. See Stanley Ziemba, *British Airways-USAir Link Cleared for Takeoff*, CHI. TRIB., Mar. 16, 1993, at N1 (describing code sharing agreements). A code sharing agreement is a joint marketing agreement, typically between a large airline and a commuter airline, that enables the commuter airline to link passengers to longer routes. GAO REPORT ON AIRLINE COMPETITION, *supra* note 4, at 11 n.20. Code sharing provides an advantage in computer reservations by linking flights from separate airlines, creating greater customer convenience, and allowing them to book passage on multiple airlines through a single reservation. *Id.* at 11 n.21.

30. USAir Group Inc., the parent corporation of USAir Inc., and British Airways entered into an Investment Agreement that required the Department of Transportation's approval. See *infra* notes 181-93 and accompanying text (discussing British Airways-USAir transactions). The parent and subsidiary companies will be referred to interchangeably as USAir in this Comment.

31. See *infra* notes 180-84 and accompanying text (discussing first attempted British Airways-USAir transaction).

32. See *infra* notes 284-98 and accompanying text (recommending measures to relax foreign investment and cabotage restrictions).

international aviation system and explains multilateral, bilateral, and unilateral models of regulation. Part II describes domestic and international efforts to deregulate and liberalize civil aviation markets and thereby promote competition. Part III evaluates the Open Skies initiative. Part IV analyzes attempts by the United States to restrict foreign investment and limit cabotage rights to domestic air carriers. Part V recommends that both the Federal Aviation Act of 1958 (Federal Aviation Act)³³ and the Open Skies initiative be amended to eliminate restrictions on foreign ownership, foreign control, and cabotage rights through bilateral or multilateral agreements with other countries that provide reciprocal rights. Finally, this Comment concludes that the United States must provide foreign air carriers with greater access to its domestic market to encourage other nations to liberalize their air transport policies.

I. THE LEGAL FRAMEWORK OF INTERNATIONAL AVIATION REGULATION

A. *Multilateral Agreements*

1. *The Paris Convention*

The Paris Peace Conference of 1919 produced the Convention for the Regulation of Aerial Navigation (Paris Convention), which established and defined the legal framework for international aviation.³⁴ The Paris Convention recognized that every nation has sovereignty over the airspace above its territory³⁵ and set the foundation for governments to regulate air carriers operating in their national airspace.³⁶

33. Pub. L. No. 85-726, 72 Stat. 731 (codified at 49 U.S.C. app. §§ 1301-1542 (1988 & Supp. I 1989 & Supp. II 1990)).

34. Paris Convention, *supra* note 6, 11 L.N.T.S. at 173.

35. Paris Convention, *supra* note 6, art. 1, 11 L.N.T.S. at 190. The delegates to the Paris Conference did not adopt the maritime "freedom of the seas" principle for international aviation. See E. Tazewell Ellett, *International and U.S. Legal and Policy Impediments to the Growth of the Airline Industry: Time for a Change in the World Order?*, AIR & SPACE L., Winter 1991, at 3, 3 (explaining that "freedom of the seas" concept permits ships to travel oceans freely and call at port of any country without limitations). The delegates to the Paris Conference probably declined to adopt the "freedom of the seas" concept for international aviation because of the airplane's effective use as a weapon in World War I and the concern that this freedom would be abused. *Id.*

36. See Ellett, *supra* note 35, at 4 (asserting that Paris Convention recognized that role of national governments in international aviation regulation would be more active than in other international industries).

2. *The Chicago Convention*

In 1944, the United States sponsored the Chicago International Civil Aviation Conference (Chicago Conference),³⁷ which produced the Chicago Convention.³⁸ The United States endorsed a laissez-faire, free-market philosophy through which all airlines would have relatively unrestricted operating rights on international routes.³⁹ To effectuate this free-market policy, the U.S. delegation to the Chicago Conference proposed the multilateral recognition of the five "freedoms of the air."⁴⁰ The United States further contended that market forces, rather than an international regulatory body, should determine capacity,⁴¹ frequency,⁴² and fares for transcontinental

37. Dempsey, *Turbulence*, *supra* note 7, at 310; see U.S. DEP'T OF STATE, PUB. L. NO. 2820, PROCEEDINGS OF THE INTERNATIONAL CIVIL AVIATION CONFERENCE, CHICAGO, ILL., NOV. 1 - DEC. 7, 1944, at 14-15 (1948) [hereinafter U.S. DEP'T OF STATE, CHICAGO CONFERENCE] (indicating that purpose of conference was to establish permanent international aeronautical body and multilateral aviation agreement to address fields of air transport, air navigation, and other technical aspects of aviation); see also ANTHONY SAMPSON, EMPIRES OF THE SKY: THE POLITICS, CONTESTS AND CARTELS OF WORLD AIRLINES 66 (1984) (noting that United States invited all members of newly formed United Nations to Conference and that Soviet Union accepted invitation to attend but withdrew just before Conference opened in September 1944); Michael Milde, *The Chicago Convention—After Forty Years*, 9 ANNALS AIR & SPACE L. 119, 119-20 (1984) (stating that 52 states participated in Chicago Conference and 35 states signed Convention on International Civil Aviation).

38. Chicago Convention, *supra* note 6, 61 Stat. at 1180, 15 U.N.T.S. at 295; see U.S. DEP'T OF STATE, CHICAGO CONFERENCE, *supra* note 37, at 132-372 (noting that Chicago Conference also resulted in Interim Agreement on International Civil Aviation, International Air Services Transit Agreement, International Air Transport Agreement, model bilateral agreement form, and draft of 12 technical annexes).

39. Dempsey, *Turbulence*, *supra* note 7, at 311-12 (describing U.S. position as favoring airline market driven by consumer demand rather than governmental economic regulation).

40. The "five freedoms" are terms of art commonly used in bilateral air transportation treaties. The "five freedoms" are:

1) A civil aircraft has the right to fly over the territory of another country without landing, provided the overflown country is notified in advance and approval is given [first freedom].

2) A civil aircraft of one country has the right to land in another country for technical reasons, such as refueling or maintenance, without offering any commercial service to or from that point [second freedom].

3) An airline has the right to carry traffic from its country of registry to another country [third freedom].

4) An airline has the right to carry traffic from another country to its own country of registry [fourth freedom].

5) An airline has the right to carry traffic between two countries outside its own country of registry as long as the flight originates or terminates in its own country of registry [fifth freedom].

Dempsey, *Turbulence*, *supra* note 7, at 311 n.12.

41. See Dempsey, *Turbulence*, *supra* note 7, at 312 n.14 (defining capacity as total number of available commercial seats on specific type of aircraft multiplied by flight frequency of that aircraft during specific time period over specific route).

42. See Dempsey, *Turbulence*, *supra* note 7, at 312 n.15 (defining frequency as "number of flights during a specific time period (usually one week) over a specific route").

routes.⁴³ The British delegation, however, endorsed the establishment of an international regulatory body, the "International Air Authority," to coordinate air transport, apportion the world's air routes, and establish frequencies and tariffs to avoid wasteful competition.⁴⁴ Neither the U.S. nor the British proposal received significant support, and the participants at the Chicago Conference rejected both theories.⁴⁵

Although the Chicago Conference failed to create an international economic regulatory body or arrange a multilateral exchange of traffic rights,⁴⁶ it did produce several notable accomplishments. First, the Chicago Conference established the International Civil Aviation Organization (ICAO),⁴⁷ which was formally organized in 1947 to regulate safety, communications, and technological aspects of international civil aviation.⁴⁸ Second, the Chicago Convention reaffirmed the principle originally articulated at the Paris Conven-

43. Dempsey, *Turbulence*, *supra* note 7, at 311-12 (describing U.S. promotion of free-market principles that would allow relatively unrestricted operation rights on international flights).

44. Dempsey, *Turbulence*, *supra* note 7, at 312 n.18.

45. Dempsey, *Turbulence*, *supra* note 7, at 312 n.19. Participants of the Chicago Conference generally opposed the multilateral granting of the "five freedoms" with no capacity or frequency restrictions because they believed that such a system would confer upon the United States a near-monopoly on international routes. *Id.*; see also Bruce Stockfish, *Opening Closed Skies: The Prospects for Further Liberalization of Trade in International Air Transport Services*, 57 J. AIR L. & COM. 599, 604 (1992) (noting that delegates to Chicago Conference thought that creation of international authority to regulate international air transport was impractical).

46. Dempsey, *Turbulence*, *supra* note 7, at 311.

47. See Chicago Convention, *supra* note 6, art. 44, 61 Stat. at 1192-93, 15 U.N.T.S. at 326 (setting forth objectives of ICAO). Article 44 of the Chicago Convention provides:

The aims and objectives of the Organisation are to develop the principles and techniques of air navigation and to foster the planning and development of international air transport so as to:

- (a) Insure the safe and orderly growth of international civil aviation throughout the world;
- (b) Encourage the arts of aircraft design and operation for peaceful purposes;
- (c) Encourage the development of airways, airports, and air navigation facilities for international civil aviation;
- (d) Meet the needs of the peoples of the world for safe, regular, efficient and economical air transport;
- (e) Prevent economic waste caused by unreasonable competition;
- (f) Insure that the rights of contracting States are fully respected and that every contracting State has a fair opportunity to operate international airlines;
- (g) Avoid discrimination between contracting States;
- (h) Promote safety of flight in international air navigation;
- (i) Promote generally the development of all aspects of international civil aeronautics.

Chicago Convention, *supra* note 6, art. 44, 61 Stat. at 1192-93, 15 U.N.T.S. at 326.

48. Chicago Convention, *supra* note 6, art. 44, 61 Stat. at 1192-93, 15 U.N.T.S. at 326; see Milde, *supra* note 37, at 119, 122 (noting that Chicago Convention established ICAO as "international organization with wide quasi-legislative and executive powers in the technical regulatory field and with only consultative and advisory functions in the economic sphere").

tion⁴⁹ that nations have sovereignty over the airspace above their territory.⁵⁰ This concept of sovereignty over national airspace precipitated the development of a bilateral system in which airlines rely on bilateral air transport agreements to determine international airline routes, frequency, and capacity.⁵¹

B. Bilateral Agreements

1. Bermuda I

Governments of sovereign nations⁵² negotiate bilateral air transport agreements to regulate air transport services between⁵³ and sometimes beyond their territories.⁵⁴ Bilateral agreements also serve

49. See *supra* text accompanying note 35 (indicating Paris Convention's position on airspace sovereignty).

50. See Chicago Convention, *supra* note 6, art. 1, 61 Stat. at 1180, 15 U.N.T.S. at 296 (providing that "[t]he contracting States recognize that every State has complete and exclusive sovereignty over the airspace above its territory"). Article 6 of the Convention provides that "[n]o scheduled international air service may be operated over or into the territory of a contracting State, except with the special permission or other authorization of that State, and in accordance with the terms of such permission or authorization." *Id.* art. 6, 61 Stat. at 1182, 15 U.N.T.S. at 300.

51. See PETER HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 17-18 (1984) (noting that model bilateral agreement called "Form of Standard Agreement for Provisional Air Routes" was drafted at Chicago Conference); Henri A. Wassenbergh, *Parallels and Differences in the Development of Air, Sea, and Space Law in the Light of Grotius' Heritage*, 9 ANNALS AIR & SPACE L. 163, 171 n.16 (1984) (stating that "Article 6 of the Chicago Convention has become the starting point for the present restrictive bilateralism in the exchange of operational and traffic rights for international scheduled air services"); see also NATIONAL COMMISSION REPORT, *supra* note 3, at 20 (noting that Chicago Conference created bilateral agreement system that resulted in more than 1200 bilateral agreements in last 50 years). The United States used the model developed at the Chicago Conference as a guide to negotiate bilateral agreements with Canada, Denmark, Iceland, Ireland, Norway, Portugal, Spain, Sweden and Switzerland. HAANAPPEL, *supra*.

52. See P.P.C. Haanappel, *Bilateral Air Transport Agreements-1913-1980*, 5 INT'L TRADE L.J. 241, 241 (1980) (observing that bilateral air transport agreements become effective after both nations ratify agreement). Bilateral agreements are made by executive agreements, treaties, or an exchange of diplomatic notes. *Id.* at 263-64. In the United States, bilateral air transport agreements are executive agreements signed by the President and do not require ratification by the Senate. *Id.*; see also Joseph Z. Gertler, *Self-Enforcement of Bilateral Air Transport Agreements*, 14 ANNALS AIR & SPACE L. 113, 116 (1989) (noting that bilateral air transport agreements are essentially reciprocal exchanges of "permissions" or "authorizations" to promote international air services between two contracting parties).

53. Haanappel, *supra* note 52, at 241 (noting that bilateral agreements typically do not include provisions regarding non-scheduled or chartered flights, but that some recent bilateral agreements include regulations for chartered air transport services).

54. The description of air transport services "beyond their territories" refers to fifth-freedom rights that governments often exchange in bilateral agreements. Haanappel, *supra* note 52, at 241. For example, country A may allow an airline registered in country B to pick up passengers, mail, and cargo in country A and to continue the flight to country C, provided that the flight originated in country B. In return, country B would grant the same privilege, or fifth-freedom right, to airlines registered in country A. *Id.* at 305; see Ralph Azzie, *Specific Problems Solved by the Negotiation of Bilateral Air Agreements*, 13 MCGILL L.J. 303, 305 (1967) (describing agreement between Canada and France giving Canada air traffic rights between Paris and other European

as vehicles for harmonizing the domestic aviation rules of the participating countries and for establishing guidelines for government regulation of international air services.⁵⁵ In 1946, the United States and the United Kingdom signed a bilateral air transport agreement, which is commonly known as Bermuda I.⁵⁶ For the next thirty years, Bermuda I served as a model for the United States and other nations negotiating bilateral air transport agreements.⁵⁷

Bermuda I represented a compromise between the liberal American and the restrictive British ideologies that had conflicted at the Chicago Conference.⁵⁸ The United States agreed that the International Air Transport Association (IATA), founded in 1945,⁵⁹ would have primary responsibility for establishing fares on international routes, subject to the approval of the governments affected by IATA fare decisions.⁶⁰ In return, the United Kingdom allowed airlines the freedom to determine capacity and frequency of service.⁶¹

2. *Bermuda II*

In 1976, the United Kingdom terminated Bermuda I and negotiated a more restrictive agreement with the United States, commonly

cities); see also *supra* note 40 (defining fifth-freedom rights).

55. Gertler, *supra* note 52, at 116 (describing bilateral agreements as reciprocal authorizations that govern aviation operations between two countries).

56. Agreement on Air Services, Feb. 11, 1946, U.S.-U.K., 60 Stat. 1499, 1499 [hereinafter Bermuda I].

57. See Dempsey, *Turbulence*, *supra* note 7, at 316 (noting that United States signed bilateral agreements similar to Bermuda I with almost seventy-five countries); see also Haanappel, *supra* note 51, at 243 (stating that Bermuda I remained in effect until 1977 when it was replaced by Bermuda II).

58. Dempsey, *Turbulence*, *supra* note 7, at 315 (attributing compromise to bargaining power of both countries). At the time of these negotiations, Britain had a vast empire with landing areas around the globe, and the United States led the world in aviation technology and production. *Id.*; see also Haanappel, *supra* note 52, at 243 (stating that United Kingdom advocated highly regulated civil aviation structure at Chicago Conference). The United Kingdom wanted to ensure its "fair share" of the international market because the majority of its air fleet had been destroyed in World War II. Haanappel, *supra* note 52, at 243. Conversely, the U.S. air fleet was still large after the war, and the United States thus supported a system of free competition. *Id.*

59. Dempsey, *Turbulence*, *supra* note 7, at 315.

60. Bermuda I, *supra* note 56, annex II, 60 Stat. at 1505 (providing that if government opposed fare set by IATA, it could bargain to achieve acceptable fare); see Dempsey, *Turbulence*, *supra* note 7, at 347 n.146 (explaining that IATA organizes conferences for airlines to coordinate international tariffs).

61. Bermuda I, *supra* note 56, annex IV, 60 Stat. at 1510-11. The decisions on capacity and frequency were subject to ex post review by the governments according to the general principle that air services should be closely related to traffic demand. *Id.* at 1515. Bermuda I also contained several important provisions relating to fifth-freedom traffic rights. *Id.* For example, a designated national carrier had discretion to adopt designated fifth-freedom limitations subject to the general principle that air services should be closely related to demand. Haanappel, *supra* note 52, at 250.

referred to as Bermuda II, that became effective in 1977.⁶² Bermuda II restricted capacity, significantly reduced U.S. air carriers' fifth-freedom rights,⁶³ and added provisions concerning international charter air services.⁶⁴ The United States and the United Kingdom expected Bermuda II to replace Bermuda I as the world model for bilateral air transport agreements.⁶⁵ Bermuda II, however, was not very influential in the international arena. First, Bermuda II dealt with issues specifically related to the United States-United Kingdom relationship.⁶⁶ Second, in the late 1970s and early 1980s, the United States liberalized its international aviation policy and moved away from the restrictive policies set forth in Bermuda II.⁶⁷ A modified, highly restrictive version of Bermuda II, however, currently regulates the civil aviation relationship between the United States and the United Kingdom.⁶⁸

C. *Unilateral Regulation: U.S. Domestic Policy*

The United States first created a definite civil aviation policy in 1926 when Congress passed the Air Commerce Act.⁶⁹ Congress then passed the Civil Aeronautics Act of 1938 (Civil Aeronautics Act),⁷⁰ which reaffirmed the Air Commerce Act⁷¹ and expanded civil aviation policy.⁷² The Civil Aeronautics Act created the Civil Aeronautics Authority,⁷³ which was reorganized and redesignated as

62. Agreement on Air Services, July 23, 1977, U.S.-U.K., 28 U.S.T. 5367, 5367 [hereinafter Bermuda II].

63. L. Gilles Sion, *Multilateral Air Transport Agreements Reconsidered: The Possibility of a Regional Agreement Among North Atlantic States*, 22 VA. J. INT'L L. 155, 164 (1981).

64. Bermuda II, *supra* note 62, art. 14, 28 U.S.T. at 5381.

65. Haanappel, *supra* note 52, at 261.

66. Haanappel, *supra* note 52, at 261 (stating that Bermuda II was very detailed and therefore was not good model for other countries to follow).

67. See Haanappel, *supra* note 52, at 261 (attributing change in policy to Carter administration's belief that government participation in economic regulation should be minimal, leaving economic decisions and policies to discretion of individual airlines).

68. See Kasper, BA-USAir, *supra* note 1, at 1 (noting history of British protectionism and claiming that Bermuda II agreement limits competition, leads to increased air fares, restricts capacity, and prevents airlines from providing nonstop flights between more U.S. and U.K. points); see also GAO REPORT ON AIRLINE COMPETITION, *supra* note 4, at 7 (noting that United States currently has 72 bilateral air transport agreements with 95 countries world wide).

69. Air Commerce Act of 1926, Pub. L. No. 69-254, 44 Stat. 568; JOHN C. COOPER, *THE RIGHT TO FLY* 138 (1947).

70. Pub. L. No. 75-706, 52 Stat. 973 (1938) (codified as amended at 49 U.S.C. app. §§ 1301-1542 (1988 & Supp. I 1989 & Supp. II 1990)). In 1958, Congress amended the Civil Aeronautics Act of 1938 with the Federal Aviation Act. Federal Aviation Act of 1958, Pub. L. No. 85-726, 72 Stat. 731 (codified as amended at 49 U.S.C. app. §§ 1301-1542 (1988 & Supp. III 1991)).

71. COOPER, *supra* note 69, at 145.

72. Civil Aeronautics Act of 1938, Pub. L. No. 75-706, § 2, 52 Stat. 973, 980; see *infra* note 79 and accompanying text (relating congressional civil aviation policy).

73. Civil Aeronautics Act of 1938, § 2, 52 Stat. at 980.

the Civil Aeronautics Board (CAB) in 1939,⁷⁴ to regulate the economic growth of the U.S. airline industry.⁷⁵ The Civil Aeronautics Act provided a framework for regulating three aspects of the aviation industry: (1) market entry and exit, including the CAB's power to grant operating permits and to approve, allocate, and assign routes and service to certain communities;⁷⁶ (2) rates and air fares;⁷⁷ and (3) anticompetitive practices.⁷⁸ To implement the Civil Aeronautics Act, Congress authorized the CAB to publish and interpret regulations consistent with the statutory mandate and congressional intent.⁷⁹

74. Reorganization Plan No. IV, § 7, 54 Stat. 1234, 1235 (1940) (merging Civil Aeronautics Authority and Air Safety Board into new body, Civil Aeronautics Board); see Paul S. Dempsey, *The Rise and Fall of the Civil Aeronautics Board: Opening Wide the Floodgates of Entry*, 11 TRANSP. L.J. 91, 93 (1979) (stating that President Roosevelt signed Civil Aeronautics Act to establish CAB "as an independent regulatory agency designed to provide classic public utility type regulation over the air transportation industry, then deemed to be in its infancy"). Congress abolished the CAB on December 31, 1984 and transferred some of its duties to the DOT. See 49 U.S.C. app. § 1551(b) (1988) (transferring to DOT CAB's authority to provide compensation for air transportation to small communities and all of CAB's powers regarding foreign air transportation).

75. See Civil Aeronautics Act of 1938, § 2, 52 Stat. at 980 (assigning to CAB role of restricting issuance of new airline routes and controlling market entry through airline licensing system according to "public convenience and necessity"); Dempsey, *Turbulence*, *supra* note 7, at 319 (noting that legislative history of Civil Aeronautics Act indicates congressional belief that air transport industry, which was in its "infancy," needed regulation for its sound development as if it were public utility); see also Jeffrey S. Heuer & Musette H. Vogel, *Airlines in the Wake of Deregulation: Bankruptcy as an Alternative to Economic Deregulation*, 19 TRANSP. L.J. 247, 249 (1991) (stating that Congress feared that without regulation, air transportation industry would end up like railroads and motor carriers of late 19th and early 20th centuries when competitors in those industries priced each other out of markets, leaving monopolies to charge unreasonably high prices).

76. Civil Aeronautics Act of 1938, § 401, 52 Stat. at 987.

77. *Id.* § 1002(d), 52 Stat. at 1018-19.

78. *Id.* § 408(a), 52 Stat. at 1000-02.

79. The congressional policy statement provides:

In the exercise and performance of its power and duties under this Act, the Authority shall consider the following, among other things, as being in the public interest, and in accordance with the public convenience and necessity -

(a) The encouragement and development of an air-transportation system properly adapted to the present and future needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense;

(b) The regulation of air transportation in such manner as to recognize and preserve the inherent advantages of, assure the highest degree of safety in, and foster sound economic conditions in, such transportation, and to improve the relations between, and coordinate transportation by, air carriers;

(c) The promotion of adequate, economical, and efficient service by air carriers at reasonable charges, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices;

(d) Competition to the extent necessary to assure the sound development of an air-transportation system properly adapted to the needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense;

(e) The regulation of air commerce in such manner as to best promote its development and safety; and

(f) The encouragement and development of civil aeronautics.

Between 1938 and 1976, the CAB rigidly regulated the airline industry by restricting market entry and constraining the innovation of service alternatives.⁸⁰ These policies contributed to the lack of competitive pricing in the industry and ultimately caused U.S. airlines to become less profitable.⁸¹ In 1975, the CAB responded to these problems by reexamining its policies and recommending that Congress deregulate the air transport industry.⁸²

II. LIBERALIZATION

A. *United States Deregulation and Liberalization Policy*

In response to the CAB's recommendation to deregulate the air transport industry, and following extensive congressional hearings on aviation regulatory reform,⁸³ Congress passed the Airline Deregulation Act of 1978 (Airline Deregulation Act).⁸⁴ The Airline Deregulation Act eased restrictions on pricing, market entry, and routes to promote competition.⁸⁵ The goal of this policy was to ensure that airline service was reasonably priced and available to a greater

Civil Aeronautics Act of 1938, § 2, 52 Stat. at 980.

80. See Heuer & Vogel, *supra* note 75, at 252 (observing that CAB's de jure policy of denying certification requests to new carriers led to shortage of new carriers entering market, lack of price competition, higher rates and fares, inefficiency, and over time stagnation).

81. See Herbert D. Kelleher, *Deregulation and the Troglodytes—How the Airlines Met Adam Smith*, 50 J. AIR L. & COM. 299, 301 n.11 (1985) (stating that regulation led to high costs and prices, weakened carriers' ability to respond to market demands, and narrowed range of prices and quality of services available to consumers); see also Heuer & Vogel, *supra* note 75, at 252 (stating that CAB's regulatory policy was effective when first instituted because economy was strong and growing but was not appropriate in 1970s when economy was weak).

82. See Kelleher, *supra* note 81, at 301 n.11 (concluding that airline industry was "naturally competitive, not monopolistic") (quoting CIVIL AERONAUTICS BOARD, REPORT OF THE CAB SPECIAL STAFF ON REGULATORY REFORM 1 (1975)).

83. See, e.g., *Aviation Regulatory Reform: Hearings Before the Subcomm. on Aviation of the House Comm. on Public Works and Transportation*, 95th Cong., 1st Sess. 60 (1977) [hereinafter *Hearings on Aviation Regulatory Reform*] (testimony of John E. Robson, Chairman, Civil Aeronautics Board) (weighing costs and benefits of, and supporting, airline deregulation); *Oversight of Civil Aeronautics Board Practices and Procedures: Senate Subcomm. on Administrative Practice and Procedure of the Senate Comm. on the Judiciary*, 94th Cong., 1st Sess. 56, 56-66 (1975) (testimony of James C. Miller, Senior Staff Economist, Council of Economic Advisors) (examining deregulation of airline industry).

84. Pub. L. No. 95-504, 92 Stat. 1705 (1978) (codified as amended at 49 U.S.C. app. §§ 1301-1542 (1988 & Supp. III 1991)).

85. Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1704, 1705 (1978) (codified as amended at 49 U.S.C. app. §§ 1301-1542 (1988 & Supp. III 1991)). In addition, the Airline Deregulation Act guaranteed essential air service to small communities through federal subsidies of unprofitable operations and restrictions against market exit. *Id.* § 419, 92 Stat. at 1733-34 (codified as amended at 49 U.S.C. § 1389 (1988 & Supp. III 1991)). The Airline Deregulation Act prevented the CAB and any successor to its authority from regulating reasonable fares. *Id.* § 37, 92 Stat. at 1741-42 (codified as amended at 49 U.S.C. § 1492 (1988)). It also prevented unlawful consolidations and mergers in the industry. *Id.* § 408, 92 Stat. at 1726 (codified as amended at 49 U.S.C. § 1378 (1988)).

percentage of the American public.⁸⁶

Following passage of the Airline Deregulation Act, the United States negotiated liberal bilateral air transport agreements⁸⁷ and attempted to persuade other nations to open their air transport markets.⁸⁸ To deregulate international routes, the United States entered into eleven liberal bilateral air transport agreements, or amendments to existing agreements, between 1978 and 1980.⁸⁹ The U.S. policy of promoting liberalization was moderately successful in northern Europe, but did not have significant effects on air transport agreements in southern Europe, Asia, or Latin America.⁹⁰

The Bush administration also promoted competition by pursuing the international Open Skies concept originally proposed by the

86. See *Hearings on Aviation Regulatory Reform*, *supra* note 83, at 62 (testimony of John E. Robson, Chairman, Civil Aeronautics Board) (indicating that goal of deregulation was to create system that would maximize efficiency, create fares reflecting those efficiencies, allow air carrier management to pursue pricing, service and marketing innovations, allow for air carrier profitability, and maintain adequate air service to meet America's needs).

87. See *infra* note 89 and accompanying text (listing newly negotiated liberal bilateral agreements and characteristics each agreement has shared).

88. The rationale behind the U.S. policy of liberalizing international air transportation was described by the CAB:

The policy of our government is to trade liberalizations rather than restrictions The underlying premise is that expansion of competitive opportunities for all carriers—foreign as well as U.S.—benefits everyone, particularly the consumer. This has been the domestic experience, and it is equally applicable internationally, if governments will allow.

World Airways, Inc., C.A.B. Order No. 78-9-2, at 6 (1978).

89. Haanappel, *supra* note 52, at 261-62 (noting that liberal bilateral air transport agreements were reached with Australia, Belgium, Fiji, Finland, West Germany, Iceland, Israel, Jamaica, the Netherlands, Papua New Guinea, and Singapore). These new bilateral agreements generally contained the following characteristics: "pricing flexibility, unrestricted capacity, multiple designations [of airlines], access to interior U.S. markets for foreign flag carriers, some new fifth-freedom rights for U.S.-flag carriers, country of origin charter rules, and elimination of discrimination and unfair methods of competition." DEMPSEY, INTERNATIONAL AVIATION, *supra* note 9, at 35.

90. See MELVIN A. BRENNER ET AL., AIRLINE DEREGULATION 13, 106-07 (1985) (discussing results of U.S. efforts to promote international liberalization of air transportation). Northern European nations accepted liberal bilateral agreements because the region already had widespread competition in air service and fares. *Id.* at 106. Several European governments believed that the cost of increased competition with U.S. airlines would be outweighed by the gains from increased access to the U.S. market. *Id.* at 383-84. United States airlines also criticized Carter's policy because they objected to the U.S. Government's trading of "hard" rights (landing rights at major U.S. interior markets) for "soft" rights (liberalized pricing policies and prohibitions against discrimination and unfair competitive prices). *Id.* at 383-84.

United States at the 1944 Chicago Conference.⁹¹ In 1990, the DOT implemented the Cities Program to further the Bush administration's policy of striving to increase the number of U.S. airports providing air service to foreign destinations.⁹² Under the Cities Program, the DOT granted eligible foreign air carriers access to additional U.S. communities.⁹³ In its final order approving the Cities Program, the DOT stated that this program would supplement rather than replace the bilateral negotiation procedures that enable U.S. air carriers and communities to obtain new international routes.⁹⁴

In furtherance of its international Open Skies policy, the United States proposed plans to France, Germany, and the United Kingdom to establish aviation regimes and routes of operation unrestricted by

91. Ellett, *supra* note 35, at 8.

92. Expanding International Air Service Opportunities to More U.S. Cities, 55 Fed. Reg. 4039 (Dep't Transp. 1990), *as amended by* Expanding Int'l Air Serv. Opportunities to More U.S. Cities, D.O.T. Order No. 91-11-26, at 1 (1991) (establishing framework for Cities Program).

93. Expanding Int'l Air Serv. Opportunities to More U.S. Cities, D.O.T. Order No. 91-11-26, at 1-2 (1991). The DOT originally set forth the requirements of this program as follows:

[T]he Department will approve a foreign carrier's application for a one-year, renewable exemption authority to provide scheduled combination nonstop international air service, or one-stop single-plane international air service via another U.S. point, between its homeland and a U.S. community provided that:

- (1) a U.S. or foreign carrier does not provide nonstop or one-stop single-plane international air service to that community from the same foreign country;
- (2) there is a procompetitive agreement in place with the [applicant's] homeland country and thus a basis does not exist for a traditional aviation trade to obtain benefits for U.S. airlines;
- (3) the foreign carrier's proposal does not involve service to and from third countries;
- (4) interested U.S. parties have not raised overriding public interest reasons for denying requested authority;
- (5) the foreign carrier has firm plans to operate the proposed service; and
- (6) the foreign carrier meets all other applicable licensing standards.

If the foreign carrier has not inaugurated such service within 90 days or suspends such service for more than nine months, the authority would expire by its terms without prejudice to any subsequent application for the same authority.

Expanding International Air Service Opportunities to More U.S. Cities, 55 Fed. Reg. 4039; *see* Expanding Int'l Air Serv. Opportunities to More U.S. Cities, D.O.T. Order No. 91-11-26, at 4 (1991) (reviewing original requirements of Cities Program).

The DOT amended the Cities Program to reflect: (1) that existing U.S. carrier one-stop service would not bar a foreign carrier's request to provide nonstop service under the program; and (2) that to be able to block approval of a foreign carrier's application, a U.S. carrier's nonstop service must be in "same city-pair, not to/from another point in same foreign country." Expanding Int'l Air Serv. Opportunities to More U.S. Cities, D.O.T. Order No. 91-11-26, at 1-2 (1991).

94. Expanding Int'l Air Serv. Opportunities to More U.S. Cities, D.O.T. Order No. 91-11-26, at 2 (observing that unmodified program had not met public and private sector expectations for better international service). Under the Cities Program, the DOT granted the application of the Netherlands-based KLM Royal Dutch Airlines to engage in scheduled, combination foreign air transportation of persons, property, and mail between Amsterdam and Detroit. Application of KLM Royal Dutch Airlines for an Exemption under §416(b) of the Federal Aviation Act of 1958, as amended, D.O.T. Order No. 91-9-22, at 1 (1991).

government regulation.⁹⁵ In exchange for granting American carriers increased access to foreign markets, the United States proposed to allow foreign airlines access to any and all cities in the United States.⁹⁶ The United States also offered to grant foreign and domestic airlines permission to determine fares and schedules without governmental approval.⁹⁷ The United States hoped that by opening these dominant markets, other nations would liberalize their air transport policies toward the United States.⁹⁸

The U.S. initiative, however, met substantial international opposition.⁹⁹ The United States had difficulty securing new, full-scale, liberal bilateral agreements.¹⁰⁰ France and Germany, for example, rejected the U.S. liberalization proposals,¹⁰¹ and the United Kingdom and many other countries are currently struggling to conclude new bilateral agreements with the United States.¹⁰² Despite these setbacks, the United States has succeeded in negotiating new bilateral

95. Ellett, *supra* note 35, at 8-9 (discussing several attempts by Bush administration to attain international Open Skies objective); see also *Convene Another Chicago Convention*, AVIATION WK. & SPACE TECH., Oct. 14, 1991, at 7, 7 (noting that U.S. rejected Open Skies proposals proffered by Switzerland and the Netherlands in 1990, after futile attempts to secure agreements with France, Germany, and United Kingdom).

96. Ellett, *supra* note 35, at 8.

97. Ellett, *supra* note 35, at 8 (explaining that fares and schedules could also be set to comply with general market principles).

98. Ellett, *supra* note 35, at 8 (noting strategic importance of markets targeted by United States); see also BRENNER ET AL., *supra* note 90 (explaining that under "encirclement theory," United States hoped that securing liberal pro-competition agreements with nations such as Belgium and the Netherlands would motivate United Kingdom to modify restrictive terms of Bermuda II agreement with United States).

99. See NATIONAL COMMISSION REPORT, *supra* note 3, at 21 (noting that important U.S. bilateral partners such as Canada, France, Germany, Japan, and United Kingdom have rejected "less restrictive more competitive bilateral agreements"); James Ott, *USAir/BA Pact to Spur Alliances*, AVIATION WK. & SPACE TECH., Mar. 22, 1993, at 32, 32 (noting that France and Germany oppose U.S. liberalization efforts and seek to replace current bilateral agreements with capacity-restricting agreements).

100. See Stockfish, *supra* note 45, at 618 (attributing failure to conclude new agreements to lack of compatible partners and international resistance to U.S. liberalization policy); Ron Katz, *U.S. Bilateral Agreements Hit Worldwide Turbulence*, INT'L HERALD TRIB., June 11, 1993, (Special Report), at II (indicating that United States is disputing bilateral agreements with France, Germany, Canada, Japan, and Australia, and noting that France renounced its bilateral agreement with United States in 1992). But see *infra* notes 171-74 and accompanying text (explaining Open Skies agreement between United States and the Netherlands that eliminated restrictions on routes and frequencies that U.S. airlines and KLM Royal Dutch Airlines may serve).

101. See Joan M. Feldman, *On Having It Both Ways; International Civil Aviation Organization's Colloquium on Air-Transport Regulations*, 29 AIR TRANSP. WORLD 210, 213 (1992) (reporting that Germany, France, and United Kingdom rejected U.S. terms for new bilateral agreements).

102. See Katz, *supra* note 100, at II (explaining tension between United States and its bilateral partners); *infra* notes 179-84 and accompanying text (explaining failure of United States and United Kingdom to negotiate new bilateral aviation agreement).

agreements that provide incremental liberalization.¹⁰³

B. International Liberalization Efforts

1. The United Kingdom

Although the United States has been the primary advocate of international air transport liberalization, the United Kingdom also attempted to liberalize air transport in the 1980s.¹⁰⁴ In 1984, for example, the United Kingdom and the Netherlands signed an exceptionally liberal bilateral agreement that allowed their airlines to offer discount fares.¹⁰⁵ In 1985, the United Kingdom and Luxembourg concluded the first bilateral agreement to liberalize "route access, capacity control and tariff approvals."¹⁰⁶ Following the lead of the United Kingdom-Luxembourg agreement, other nations began to enter into bilateral agreements in the late 1980s that typically included double disapproval pricing,¹⁰⁷ open market entry, and capacity provisions.¹⁰⁸

103. See Stockfish, *supra* note 45, at 618 (noting that since 1990, United States has concluded new bilateral agreements with Brazil, Greece, Hungary, Italy, Poland, Soviet Union, Singapore, Spain, Trinidad and Tobago, and Venezuela).

104. See *New Agreements Spur European Liberalization*, AVIATION WK. & SPACE TECH., Nov. 12, 1984, at 71, 71-73 (stating that United Kingdom was involved in most new liberal fare agreements and was main proponent of lower fares). See generally Paul S. Dempsey, *European Aviation Regulation: Flying Through the Liberalization Labyrinth*, 15 B.C. INT'L & COMP. L. REV. 311, 311-33 (1992) [hereinafter Dempsey, *European Aviation Regulation*] (discussing liberalization efforts in European Community).

105. See Michael Feazel, *British, Dutch Aim at Deregulation*, AVIATION WK. & SPACE TECH., June 25, 1984, at 29, 29-30 (reporting that United Kingdom-Netherlands agreement gave British and Dutch airlines authority to determine fares, capacity, schedules, and frequencies for routes between two signatory countries).

106. STEPHEN WHEATCROFT & GEOFFREY LIPMAN, AIR TRANSPORT IN A COMPETITIVE EUROPEAN MARKET: PROBLEMS, PROSPECTS AND STRATEGIES 65, 66 (1986) (indicating that "liberal phraseology" of route access, capacity control, and tariff provisions of United Kingdom-Luxembourg agreement became model for United Kingdom's later bilateral agreements with France, Belgium, and Switzerland); see Dempsey, *European Aviation Regulation*, *supra* note 104, at 321 (explaining that United Kingdom-Luxembourg agreement granted unrestricted market entry and capacity); see also WHEATCROFT & LIPMAN, *supra*, at 213 (stating that under United Kingdom-Luxembourg agreement, one government may unilaterally reject tariff of its own airline if it determines that fare is "predatory or excessive" in relation to costs).

107. See Dempsey, *European Aviation Regulation*, *supra* note 104, at 321 (defining double disapproval pricing as provision in bilateral treaty that allows set fares to be rejected only with approval of both governments, and noting that United Kingdom-Luxembourg agreement became model for later bilateral agreements).

108. Werner F. Ebke & George W. Wenglorz, *Liberalizing Scheduled Air Transport Within the European Community: From the First Phase to the Second and Beyond*, 19 TRANSP. L.J. 417, 425 (1991) (stating that since 1980s, United Kingdom concluded procompetitive bilateral air transport agreements with the Netherlands, Belgium, and Federal Republic of Germany that provided for dismantling of market access and capacity restrictions); see also *New Agreements Spur European Liberalization*, *supra* note 104, at 73 (noting that after British signed 1984 agreement with the Netherlands, other countries such as West Germany, Switzerland, France, Finland, Greece, Spain, Italy, and Portugal signed new liberal bilateral agreements allowing discount fares).

2. *The European Community*

In addition to U.S. initiatives and the British bilateral agreements, the European Community made significant efforts to liberalize air transportation. The European Community promulgated the Treaty of Rome¹⁰⁹ in 1957 to increase competition in various sectors of the economy, including transportation.¹¹⁰ In 1979, the European Commission produced its first air transport memorandum,¹¹¹ which identified the overall problems of the industry and recommended a framework for establishing a new policy.¹¹² In 1984, the European Commission issued a second memorandum¹¹³ that focused on maintaining the bilateral agreement system and imposing gradual reductions in capacity and tariff controls.¹¹⁴ The European Council, however, has not passed either memorandum proposed by the European Commission.¹¹⁵

The Court of Justice of the European Communities has also become involved in the air transport liberalization effort. In 1986, the court held in the *Nouvelles Frontières*¹¹⁶ case that the European Economic Community's antitrust laws¹¹⁷ applied to civil aviation matters.¹¹⁸ This decision was significant because it enabled the European Economic Community to intervene in the civil aviation policies of individual member states.¹¹⁹ One year after the *Nouvelles*

109. TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY [hereinafter EEC TREATY].

110. See *id.* art. 3(e) (directing European Community to adopt common transport policy). See generally DENNIS SWANN, *THE ECONOMICS OF THE COMMON MARKET* 232 (1990) (explaining that common transport policy is necessary to enhance interstate trade).

111. Air Transport: A Community Approach (Memorandum of the Commission), BULL. OF THE EUR. ECON. COMMUNITIES 11 (Supp. 5/1979).

112. See Emily E. Tegelberg-Aberson, *Freedom in European Air Transport: The Best of Both Worlds?*, 12 AIR L. 282, 284 (1987) (reporting that EC Commission recommended gradual increase of air transport competition to improve flexibility and innovation in industry); see also SWANN, *supra* note 110, at 238-39 (stating that problems in European Community included high fares, consumer dissatisfaction with availability of flights, and collusive tendencies and restriction of free trade in services).

113. Proposal for a Council Decision on Bilateral Agreements, Arrangements, and Memorandum of Understanding Between Member States Relating to Air Transport, 1984 O.J. (C 182) 1.

114. Tegelberg-Aberson, *supra* note 112, at 285.

115. Dempsey, *European Aviation Regulation*, *supra* note 104, at 350 (noting that European Council endorsed guidelines for further action and study on each memorandum).

116. Joined Cases 209 & 1384, *Ministère Pub. v. Lucas Asjes*, 4 E.C.R. 1457, 3 C.M.L.R. 173 (1986) (Lux.) [hereinafter *Nouvelles Frontières*] (analyzing whether French travel agency had right to sell airline tickets below levels agreed to in airline tariff agreement approved by member states).

117. See EEC TREATY, *supra* note 109, arts. 85-86 (prohibiting monopolies and collusive practices that prevent, restrict, or distort competition within common market).

118. *Nouvelles Frontières*, 4 E.C.R. at 1465-66, 3 C.M.L.R. at 215.

119. See Daniel Vincent & Dinos Stasinopoulos, *The Aviation Policy of the European Community*, 24 J. TRANSP. ECON. & POL'Y 95, 96 (1990) (stating that *Nouvelles Frontières* decision and EC

Frontières decision, the European Council passed the Single European Act.¹²⁰ Through this Act, which is one of the most important agreements for the liberalization of air transportation in the European Community,¹²¹ the European Council sought to unite the European Community by the end of 1992.¹²² To prepare for a single EC air transport market, the European Council passed, in three phases, measures to liberalize the air transportation industry.¹²³ In December 1987, the European Council approved the first phase, called the First Liberalization Package,¹²⁴ which included two Council Regulations,¹²⁵ one Council Directive,¹²⁶ and one Council Decision.¹²⁷ These provisions, which pertain only to flights between EC member states,¹²⁸ became effective on January 1, 1988.¹²⁹ The two Council Regulations, 3975/87¹³⁰ and 3976/87,¹³¹ set forth procedures for applying the European Community's antitrust rules to the air transport industry, and provide exemptions from these rules for certain agreements and practices.¹³² The single Council Directive,

legislation regarding "tariffs, capacity, market access and rules of competition" provided strong impetus for continuing liberalization of air transport in European Community).

120. Single European Act, 1987 O.J. (L 169) 1-29 (stating that Single European Act would go into effect July 1, 1987 and that signatories to Act were committed to establishing European internal market by Dec. 31, 1992).

121. See Vincent & Stasinopoulos, *supra* note 119, at 95 (observing that Single European Act enabled EC Transport Council to create legislation that was major step toward achieving common European transport aviation policy).

122. Vincent & Stasinopoulos, *supra* note 119, at 95 (noting that end of 1992 was target date for completion of internal market).

123. Ebke & Wenglorz, *supra* note 108, at 434-37, 441-51 (discussing provisions and significance of tripartite liberalization package).

124. Ebke & Wenglorz, *supra* note 108, at 434.

125. Council Regulation 3975/87 of 14 December 1987 Laying Down the Procedure for the Application of the Rules on Competition to Undertakings in the Air Transport Sector, 1987 O.J. (L 374) 1 [hereinafter Council Regulation 3975/87]; Council Regulation 3976/87 of 14 December 1987 on the Application of Article 85(3) of the Treaty to Certain Categories of Agreements and Concerted Practices in the Air Transport Sector, 1987 O.J. (L 374) 9 [hereinafter Council Regulation 3976/87].

126. Council Directive 87/601 of 14 December 1987 on Fares for Scheduled Air Services Between Member States, 1987 O.J. (L 374) 12 [hereinafter Council Directive 87/601].

127. Council Decision 87/602 of 14 December 1987 on the Sharing of Passenger Capacity Between Air Carriers on Scheduled Air Services Between Member States and on Access for Air Carriers to Scheduled Air-Service Routes Between Member States, 1987 O.J. (L 374) 19 [hereinafter Council Decision 87/602].

128. See Ebke & Wenglorz, *supra* note 108, at 434 (discussing scope of first phase of liberalization).

129. Dempsey, *European Aviation Regulation*, *supra* note 104, at 539.

130. Council Regulation 3975/87, *supra* note 125, 1987 O.J. (L 374) at 1.

131. Council Regulation 3976/87, *supra* note 125, 1987 O.J. (L 374) at 9.

132. See Council Regulation 3975/87, *supra* note 125, art. 1, 1987 O.J. (L 374) at 2 (creating detailed rules for applying EEC Treaty articles 85 and 86, which prohibit monopolies and collusive practice, to air transport services); *id.* art. 2, 1987 O.J. (L 374) at 9-10 (noting that list of exemptions is not exhaustive); see also Ebke & Wenglorz, *supra* note 108, at 434-35 (discussing antitrust regulations under first package of liberalization).

tive, 87/601,¹³³ provides that governments must approve air fares proposed by airlines if the fares are reasonably related to the air carrier's costs.¹³⁴

Finally, Council Decision 87/602¹³⁵ addresses capacity sharing between air carriers on scheduled routes, and market access for air carriers on scheduled routes between EC member states.¹³⁶ Council Decision 87/602 also enables a member state to assign multiple airlines to a single interstate route if certain criteria are met.¹³⁷ In addition, the Council Decision eliminates the requirement that air carriers share capacity equally on routes between member states.¹³⁸ The First Liberalization Package, however, caused negligible effects on competition in the European Community and resulted in only slight reductions in air fares.¹³⁹

In September 1989, the European Council approved the second phase of liberalization, consisting of three Council Regulations.¹⁴⁰

133. Council Directive 87/601, *supra* note 126, 1987 O.J. (L 374) at 12.

134. Council Directive 87/601, *supra* note 126, art. 3, 1987 O.J. (L 374) at 13-14 (providing that member states are obligated to approve fares that "are reasonably related to the long-term fully allocated costs of the applicant air carrier, while taking into account other relevant factors"). The fact that a fare proposed by one airline is less than a fare charged by another airline for the same route is not grounds for the government to deny approval. *Id.* Council Directive 87/601 also establishes two zones of flexibility for airlines to set discount and deep-discount fares, subject to certain limitations. *Id.* art. 5, 1987 O.J. (L 374) at 14; *see also* Ebke & Wenglorz, *supra* note 108, at 435-36 (explaining measures to liberalize tariffs).

135. Council Decision 87/602, *supra* note 127, art. 1, 1987 O.J. (L 374) at 20.

136. Council Decision 87/602, *supra* note 127, art. 1, 1987 O.J. (L 374) at 20.

137. *See* Council Decision 87/602, *supra* note 127, art. 5, 1987 O.J. (L 374) at 22 (permitting more than one carrier of member state to operate on routes that carry more than 250,000 annual passengers). The threshold for number of passengers would be decreased to 200,000 in the second year, and 180,000 in the third year. *Id.*; *see also* Ebke & Wenglorz, *supra* note 108, at 437 (explaining market access liberalization measures).

138. *See* Council Decision 87/602, *supra* note 127, art. 3, 1987 O.J. (L 374) at 21 (replacing traditional 50%-50% capacity-sharing rule between air carriers on intra-European routes with graduated 55%-45%, and then 60%-40% rule). This decision also allows EC air carriers to introduce and operate third- and fourth-freedom traffic rights for scheduled carriers on routes between main and regional airports. *Id.* art. 6, 1987 O.J. (L 374) at 21. Furthermore, it permits EC air carriers to operate certain fifth-freedom routes where third- or fourth-freedom rights exist under certain conditions. *Id.* art. 8, 1987 O.J. (L 374) at 22-23. Moreover, a third- or fourth-freedom carrier can combine scheduled air services by an air carrier that operates a scheduled air service to or from two or more points in another member state or states. *Id.* arts. 6-8, 1987 O.J. (L 374) at 22-23; *see also* Ebke & Wenglorz, *supra* note 108, at 436-37 (explaining capacity-sharing liberalization measures).

139. *See* Ebke & Wenglorz, *supra* note 108, at 437-38 (concluding that First Package of Liberalization did not have noticeable effects on tariff reductions or on development of air fares, and that competition reforms were minor because of general exemptions for EC carriers from antitrust laws).

140. Council Regulation 2342/90 of 24 July 1990 on Fares for Scheduled Air Services, 1990 O.J. (L 217) 1 [hereinafter Council Regulation 2342/90]; Council Regulation 2343/90 of 24 July 1990 on Access for Air Carriers to Scheduled Intra-Community Air Service Routes and on the Sharing of Passenger Capacity Between Air Carriers on Scheduled Air Services Between Member States, 1990 O.J. (L 217) 8 [hereinafter Council Regulation 2343/90]; Council Regulation 2344/90 of 24 July 1990 Amending Regulation 3976/87 on the Application of Article 85(3) of

Phase two sought to relax tariffs, capacity sharing, and market access in preparation for phase three, which would create a unified market for air transportation in the European Community by January 1, 1993.¹⁴¹ Council Regulation 2342/90¹⁴² replaced Council Directive 87/601 (implemented in the first phase of liberalization)¹⁴³ and gave airlines greater flexibility to set fares.¹⁴⁴ Council Regulation 2343/90¹⁴⁵ replaced Council Decision 87/602 (also implemented in the first phase)¹⁴⁶ and further relaxed market access¹⁴⁷ and capacity sharing regulations.¹⁴⁸ Finally, Council Regulation 2344/90¹⁴⁹ amended the effective dates of Council Regulation 3976/87 pertaining to the application of the European Community's antitrust rules to the air transport industry.¹⁵⁰ The second liberalization phase further prepared the European Community for the creation of a unified market for air transport.¹⁵¹

In June 1992, the European Council adopted the third phase of airline liberalization, which effectively created a single EC airline

the Treaty to Certain Categories of Agreements and Concerted Practices in the Air Transport Sector, 1990 O.J. (L 217) 15 [hereinafter Council Regulation 2344/90].

141. See Ebke & Wenglorz, *supra* note 108, at 441-51 (discussing "Second Phase" of liberalization of air transport in European Community). Issues such as cabotage rights, technological improvements, and reverse discrimination of domestic carriers remained unresolved, thus necessitating a third phase of air transport liberalization. *Id.* at 441-51.

142. Council Regulation 2342/90, *supra* note 140, 1990 O.J. (L 217) at 1.

143. Council Regulation 2342/90, *supra* note 140, 1990 O.J. (L 217) at 1.

144. Council Regulation 2342/90, *supra* note 140, art. 4(3)(b), 1990 O.J. (L 217) at 3 (permitting carriers to charge 95% to 100% of reference fare for normal one-way or return economy air fare ordinarily charged by third- or fourth-freedom air carrier on rate in question). This regulation also narrows the discount zone from 94% to 80% of the reference fare, and expands the deep-discount zone from 79% to 30%. *Id.*; see also Dempsey, *European Aviation Regulation*, *supra* note 104, at 364 (explaining that narrowing and expanding ranges in Phase Two allows much more pricing flexibility than Phase One).

145. Council Regulation 2343/90, *supra* note 140, 1990 O.J. (L 217) at 8.

146. Council Regulation 2343/90, *supra* note 140, 1990 O.J. (L 217) at 9.

147. See Council Regulation 2343/90, *supra* note 140, art. 4, 1990 O.J. (L 217) at 10 (permitting EC air carriers to freely operate third- and fourth-freedom air services on any route between any EC airport, whether hub or regional).

148. See Council Regulation 2343/90, *supra* note 140, arts. 8(1)(b) & 11, 1990 O.J. (L 217) at 12-13 (expanding use of fifth-freedom service from 30% to 50% of carrier's seasonal seat capacity, permitting member states to increase capacity share for any season by 7.5% above previous corresponding season, and eliminating capacity limitations to services between regional airports).

149. Council Regulation 2344/90, *supra* note 140, 1990 O.J. (L 217) at 15.

150. Council Regulation 2344/90, *supra* note 140, art. 1, 1990 O.J. (L 217) at 15 (amending expiration date of any regulation adopted by Commission pursuant to Council Regulation 3976/87 from January 31, 1991 to December 31, 1992, changing date for revision of 3976/87 from June 30, 1990 to December 31, 1992, and revising date for Commission proposal on 3976/87 from November 1, 1989 to July 1, 1992).

151. See Ebke & Wenglorz, *supra* note 108, at 419 (noting that second phase of liberalization represents significant step toward single European market for air transport).

market.¹⁵² This initiative enables an air carrier of one EC member state that meets certain financial and safety standards to establish airlines in other European Community countries.¹⁵³ The third phase also permits air carriers to set fares and rates subject to review and disapproval by the government of a member state or the European Commission if fares are determined to be excessively high or low.¹⁵⁴ Cabotage is permitted, but airlines of member states have only limited access to each other's internal air markets until April 1, 1997, when full cabotage will be permitted.¹⁵⁵ Before full cabotage is allowed, air carriers are subject to two major temporary limitations: (1) member states can only grant "consecutive" cabotage rights,¹⁵⁶ and (2) cabotage is limited to fifty percent of the total seasonal capacity of any given international route.¹⁵⁷ In addition, EC air carriers now have full fifth-freedom rights.¹⁵⁸ Bilateral agreements, capacity limitations, and national ownership rules for air carriers have also been abrogated by the adoption of the third phase of liberalization.¹⁵⁹ In sum, the European Council's three phases of regulations have effectively created a liberalized and single air transport market in the European Community.

152. See Pierre Sparaco, *Liberalization Creates EC Single Airline Market*, AVIATION WK. & SPACE TECH., Jan. 18, 1993, at 39, 39 (discussing creation of unified air transport market and noting that air carriers of EC member states can serve all routes within 12-country market).

153. Carole A. Shifrin, *EC Ministers Approve Liberalization, But 'Safeguards' May Slow Competition*, AVIATION WK. & SPACE TECH., June 29, 1992, at 21, 22. To receive an operating license in a member country, a majority of an air carrier's shares must be held and controlled by European nationals. *Id.* An air carrier must also locate its headquarters in the country issuing the license, have insurance, and meet European safety regulations. *Id.*

154. See *id.* at 21 (explaining that government of EC member state may suspend fare of airline from another member state, and that parties can appeal decision to European Commission).

155. *Id.* at 21-22 (reporting that flight origination and capacity restrictions will be lifted on April 1, 1997).

156. *Id.* at 21. "Consecutive" cabotage refers to continuing flights. For example, if an air carrier from France wants to fly between two points in Spain, the flight must originate in France. *Id.*

157. *Id.* at 21. For example, if Iberia offers 20,000 seats on a route from Madrid to Paris during the season, it may provide a maximum of 10,000 seats between Paris and Nice. *Id.*

158. *Id.* at 22. These fifth-freedom rights enable air carriers to operate flights in other countries without beginning or terminating the flight in the air carrier's country of registration. *Id.* at 22.

159. Sparaco, *supra* note 152, at 39.

III. OPEN SKIES

A. *The U.S. Open Skies Policy*

The most recent attempt to liberalize international air transport was the Open Skies initiative,¹⁶⁰ announced in March 1992 by Andrew H. Card, Jr., then Secretary of Transportation.¹⁶¹ Card announced that the United States would negotiate Open Skies agreements initially with European countries, and then with other regions of the world¹⁶² willing to grant U.S. air carriers essentially free access to their markets.¹⁶³ After evaluating comments from various parties,¹⁶⁴ the DOT defined Open Skies as follows:

- 1) Open entry on all routes;
- 2) Unrestricted capacity and frequency on all routes;
- 3) The right to operate between any point in the U.S. and any point in the European country without restriction, including service to intermediate and beyond points, and the right to transfer passengers to an unlimited number of smaller aircraft at the international gateway;
- 4) Flexibility in setting fares;
- 5) Liberal charter arrangements;
- 6) Liberal cargo arrangements;
- 7) The ability of carriers to convert earnings into hard currency and return those earnings to their homelands promptly and without restriction;
- 8) Open code-sharing opportunities;

160. Defining "Open Skies," D.O.T. Order No. 92-8-13, at 1 (1992).

161. See Defining "Open Skies"; Order Requesting Comments, 57 Fed. Reg. 19,323 (1992) [hereinafter *Open Skies*] (stating that Secretary Card's Open Skies initiative is "designed to stimulate interest in creating an even more market-oriented international aviation environment").

162. See *id.* (statement of Andrew H. Card, Jr., Secretary of Transportation) ("[W]hile these discussions were at present being confined to Europe—since Europe is moving toward the free flow of passengers . . . we hope that other regions will soon be ready to join us in similar talks."); James Ott, *More Skies To Open as U.S. Signs Pacts*, AVIATION WK. & SPACE TECH., Sept. 14, 1992, at 32, 32 (stating that Singapore, Switzerland, and Belgium are candidates for Open Skies agreements with United States); see also *How To Make the Skies a Little Friendlier: Unsuccessful British Effort Underscores Larger Problem*, L.A. TIMES, Dec. 31, 1992, at B4 [hereinafter *Friendly Skies*] (reporting that United States currently seeks Open Skies agreements with Japan, France, and Germany).

163. *Open Skies*, 57 Fed. Reg. 19,323 (statement of Andrew H. Card, Jr.) ("[W]e will now offer to negotiate open skies agreements with all European countries willing to permit U.S. carriers essentially free access to their markets.").

164. See Defining "Open Skies," D.O.T. Order No. 92-8-13, at 1-22 (summarizing comments filed by 45 parties). Some parties supported the proposal in its entirety, some parties questioned whether certain elements were essential, and other parties completely rejected the plan. *Id.* Parties questioning the validity of the program suggested that the Open Skies initiative will produce greater economic benefits for other nations than it will for the United States. *Id.* at 2.

- 9) The right of a carrier to perform its own ground handling in the other country;
- 10) The ability of carriers to freely enter into commercial transactions related to their flight operations; [and]
- 11) A commitment for nondiscriminatory operation of and access to computer reservation systems.¹⁶⁵

The DOT incorporated many traditional elements of a bilateral air transport agreement into its Open Skies definition,¹⁶⁶ but declined to include provisions regarding cabotage or foreign investment.¹⁶⁷ The DOT noted that changes in the cabotage and foreign investment statutes required legislative action¹⁶⁸ and, therefore, were outside the scope of the Open Skies proceeding.¹⁶⁹ Furthermore, the DOT determined that these issues were best addressed on a case-by-case basis in the context of individual bilateral agreements.¹⁷⁰

B. The United States-Netherlands Open Skies Agreement

In September 1992, the United States concluded an Open Skies agreement with the Netherlands,¹⁷¹ the only air transport agreement thus far secured under the Open Skies initiative. The goal of this agreement is to stimulate competition in the international air transport market with minimal government involvement.¹⁷² Because both parties believed that many elements of the Open Skies definition already existed in their prior bilateral aviation agreement,¹⁷³ they simply amended their existing bilateral agreement to incorporate the remaining elements of the DOT's Open Skies definition.¹⁷⁴

The United States-Netherlands Open Skies agreement set the foundation for KLM Royal Dutch Airlines to integrate its operations with Northwest Airlines¹⁷⁵ and will eventually enable these two air

165. *Id.* at app. 1. The DOT also stated that it would include provisions on safety and security in an Open Skies agreement. *Id.* at app. 1 n.1.

166. *See id.* (incorporating standard elements of liberal bilateral air transport agreements such as open entry, unrestricted capacity, and flexible fares).

167. *See id.* at 6 (noting absence of cabotage or foreign ownership and control provisions).

168. *Id.*

169. *Id.*

170. *Id.*

171. Memorandum of Consultations and Amendments, Sept. 4, 1992, U.S.-Neth. 1 (on file with *The American University Law Review*) [hereinafter 1992 U.S.-Netherlands Open Skies Agreement] (amending Air Transport Agreement, Apr. 3, 1957, U.S.-Neth., 12 U.S.T. 837, 837).

172. *Id.*

173. *Id.*

174. *Id.*

175. *See id.* (discussing commercial airline integration agreements). The United States and the Netherlands agreed:

(a) to give sympathetic consideration, in the context of the Open Skies agreement, to the concept of commercial cooperation and integration of commercial operations

carriers to operate, in effect, as a single airline.¹⁷⁶ In January 1993, the DOT facilitated this integration process by granting antitrust immunity for KLM and Northwest Airlines.¹⁷⁷ The airlines plan to combine advertising and marketing efforts, coordinate the scheduling of flights, and consult and cooperate on pricing.¹⁷⁸

C. United States-United Kingdom Open Skies Efforts

The United States has been unsuccessful in negotiating an Open Skies agreement with the United Kingdom.¹⁷⁹ Until December 1992, the course of United States-United Kingdom negotiations¹⁸⁰ turned, in part, on the DOT's approval of British Airways' July 1992 application to invest \$750 million in USAir.¹⁸¹ The parties failed to

between airlines of the United States and the Netherlands through commercial agreements or arrangements, provided that such agreements or arrangements are in conformity with the applicable antitrust and competition laws; and

(b) to provide fair and expeditious consideration to any such agreements or arrangements filed for approval and antitrust immunity.

Id. The United States-Netherlands Open Skies Agreement does not guarantee that U.S. airlines would be able to perform their own ground handling at Schiphol Airport in Amsterdam and does not provide a solution for the potential dilemma of limited access to certain U.S. airports. Ott, *supra* note 162, at 32; see also *infra* text accompanying note 178 (explaining how KLM and Northwest intend to integrate).

176. See Martha M. Hamilton, *Northwest-KLM Deal Tentatively Approved*, WASH. POST, Nov. 17, 1992, at B1 (noting that KLM owns 20% of common stock of NWA, Inc., Northwest's parent company, and 10% of its voting shares); see also James T. McKenna, *Northwest/KLM Package Challenges Competition*, AVIATION WK. & SPACE TECH., Feb. 15, 1993, at 31, 31 (reporting that in 1989, KLM invested \$400 million in Northwest to expand international service).

177. See Acquisition of Northwest Airlines by Wings Holdings, Inc., D.O.T. Order No. 93-1-11, at 1 (1993) (approving and granting antitrust immunity for commercial cooperation and integration agreement between Northwest and KLM); Acquisition of Northwest Airlines by Wings Holdings, Inc., D.O.T. Order No. 92-11-27, at 1 (1992) (determining tentatively to grant approval and antitrust immunity for Northwest and KLM to integrate services); see also McKenna, *supra* note 176, at 31 (noting that Northwest and KLM are moving quickly to coordinate business activities after DOT's final approval in January 1993).

178. McKenna, *supra* note 176, at 31 (commenting that Northwest and KLM face obstacles in melding marketing and financing activities). As a result of this agreement, American and Dutch consumers will be able to fly between the United States and the Netherlands from a greater number of cities. *Id.*

179. At the time of publication of this Comment, the United States and the United Kingdom still had not concluded a new bilateral agreement.

180. See *Friendlier Skies*, *supra* note 162, at B4 (stating that DOT approval of British Airways-USAir transaction was contingent upon United Kingdom participation in Open Skies agreement); see also United States Department of Transportation Press Conference, FED. NEWS SERVICE, Dec. 22, 1992, available in LEXIS, Nexis Library, Fednew File, at 4 [hereinafter Card Press Conference] (statement by Andrew H. Card, Jr., Secretary of Transportation) (implying that DOT would not approve British Airways-USAir transaction unless United Kingdom gave U.S. air carriers greater access to British airports).

181. Bill Poling, *Delta Protests BA Plan To Buy USAir Shares*, TRAVEL WKLY., Aug. 6, 1992, at 3, 3 (stating that under proposed transaction, British Airways would acquire 21% of voting shares and 44% of total equity of USAir). The proposed transaction would not violate the U.S. foreign investment statutes, which permit foreign entities to own up to 25% of voting equity and up to 49% of total equity in U.S. airlines. See *Towards Open Skies*, ECONOMIST, Sept. 5, 1992, at 14, 15 ("Under the deal, BA would own just 44% of the equity and 21% of voting rights, less than the

reach an agreement because the United Kingdom demanded approval of the British Airways-USAir transaction and requested changes in U.S. foreign investment and cabotage laws.¹⁸² The U.S. demand for greater U.S. air carrier access to British airports also contributed to the failure of the negotiations.¹⁸³ Anticipating that the DOT would reject the British Airways-USAir transaction because the United States and the United Kingdom had not signed an Open Skies agreement, British Airways withdrew its application to integrate its operations with USAir.¹⁸⁴

In January 1993, British Airways announced another attempt to invest in USAir.¹⁸⁵ In March 1993, however, the DOT approved British Airways' application to invest \$300 million and acquire nearly a twenty-percent interest in USAir.¹⁸⁶ The DOT also granted a one-year approval of leasing¹⁸⁷ and code sharing¹⁸⁸ arrangements on

legal limits of 49% and 25%, respectively . . ."); see also *infra* notes 222-35 and accompanying text (discussing statutes limiting foreign investment and foreign control of U.S. air carriers). In addition, British Airways would obtain four seats on USAir's 16-member board of directors and a guarantee that no major decisions would be made without the approval of at least 80% of the board of directors. See *Towards Open Skies*, *supra*, at 15. According to USAir's rival airlines (Delta, United, and American), British Airways would have negative veto power and de facto control of USAir. *Id.*

182. See Card Press Conference, *supra* note 180, at 4 (discussing major obstacles to concluding Open Skies agreement with United Kingdom); *infra* notes 201-26 and accompanying text (discussing U.S. statutes that restrict foreign investment in U.S. airlines and prohibit foreign air carriers from engaging in cabotage).

183. Card Press Conference, *supra* note 180, at 4. Former Secretary Card advocated an Open Skies relationship with the United Kingdom that would give U.S. air carriers unrestricted access to all airports in the United Kingdom, and the right to pick up passengers in the United Kingdom and carry them to other countries. *Id.* at 5. Card indicated that the United Kingdom's refusal to expand U.S. access to Heathrow Airport in London was a major stumbling block for the U.S. delegation to the negotiations. *Id.*

184. Letter from Richard D. Matthias & Frank J. Costello, Counsel for USAir Inc., to Jeffrey N. Shane, Assistant Secretary for Policy & International Affairs, U.S. Department of Transportation (Dec. 22, 1992) (on file with *The American University Law Review*) (advising DOT that British Airways had terminated plan to invest in USAir); see Card Press Conference, *supra* note 180, at 7 (announcing termination of USAir citizenship proceeding). Card stated that he probably would not have approved the transaction as it had been submitted because it would have violated the current United States-United Kingdom bilateral aviation agreement. *Id.*

185. USAir and British Airways; Application of British Airways PLC for an Exemption; Application of USAir for a Statement of Authorization to Code-share; Application of USAir for a Statement of Authorization for a Wet Lease, D.O.T. Order No. 93-3-17, at 1, 1 (1993) [hereinafter BA-USAir II].

186. See BA-USAir II, *supra* note 185, at 1 (announcing first stage of three-step investment schedule to invest total of \$750 million in USAir).

187. BA-USAir II, *supra* note 185, at 17-18. Transportation Secretary Federico Peña approved the British Airways-USAir request to permit USAir to provide aircraft and crews for British Airways flights between London and Baltimore and London and Pittsburgh. Ziemba, *supra* note 29, at N1. Secretary Peña refused to extend this approval to flights between London and Charlotte, North Carolina because British Airways lacks authority to serve the Charlotte market. *Id.*

188. BA-USAir II, *supra* note 185, at 17-18.

flights between thirty-eight U.S. cities and London.¹⁸⁹ British Airways intends to invest an additional \$200 million in USAir within the next three years and another \$250 million within five years.¹⁹⁰ Thus, British Airways ultimately plans to integrate its operations with USAir by investing a total of \$750 million to acquire a forty-four percent interest in USAir.¹⁹¹ Although the DOT approved the first stage of the investment, it retained the right to reconsider the transaction after one year.¹⁹² The DOT indicated that it probably will not approve the last two stages of the British Airways-USAir transaction unless the United Kingdom enters into an Open Skies agreement with the United States in which U.S. air carriers gain greater access to British airports.¹⁹³

In sum, the United States seeks to liberalize European, and eventually global, air transport services to achieve international free-market competition.¹⁹⁴ The DOT's Open Skies initiative will not encourage significant liberalization of the international air transport market, however, unless the United States is willing to further liberalize its domestic market for foreign carriers.

IV. UNITED STATES PROTECTIONIST POLICY

Despite its liberalization rhetoric, the United States continues to protect its domestic air carriers from meaningful foreign investment and foreign control,¹⁹⁵ and precludes foreign air carriers from

189. BA-USAir II, *supra* note 185, at 17-18; see Ziemba, *supra* note 29, at N1 (reporting that code-sharing agreement will permit British Airways and USAir to offer "one-time baggage check in, one-stop shopping for reservations and fares and coordinated flight schedules" for passengers flying between 38 U.S. cities and London). Initially, British Airways announced its intention to begin code-sharing on May 1, 1993 for flights from Cleveland, Syracuse, and Rochester through Philadelphia to London and beyond. Ziemba, *supra* note 29, at N2.

190. BA-USAir II, *supra* note 185, at 1.

191. BA-USAir II, *supra* note 185, at 1.

192. BA-USAir II, *supra* note 185, at 17 (granting permission for code-sharing and leasing operations for one year).

193. Ziemba, *supra* note 29, at N1. The United States seeks greater access to British take-off and landing slots. See *id.*

194. See *supra* notes 162-63 and accompanying text (explaining that United States hopes to initiate Open Skies negotiations with other nations).

195. See 49 U.S.C. app. § 1301(16) (1988) (defining "[c]itizen of the United States" as "a corporation or association created or organized under the laws of the United States . . . in which at least 75 per centum of the voting interest is owned or controlled by persons who are citizens of the United States"); 49 U.S.C. app. § 1301(3) (1988) (explaining that "air carrier" refers to any citizen of United States that engages in air transportation); 49 U.S.C. app. § 1372 (1988) (requiring every foreign air carrier to obtain permit from DOT before engaging in foreign air transportation); 49 U.S.C. app. § 1401(b) (1988) (stating that only aircraft "owned by a corporation . . . lawfully organized and doing business under the laws of the United States" is eligible for registration); 49 U.S.C. app. § 1508(a) (1988) (declaring that United States possesses "complete and exclusive national sovereignty" over U.S. airspace, including airspace above all inland waters, adjacent seas, or lakes over which United States has national jurisdiction); see also

obtaining cabotage rights.¹⁹⁶ These measures prohibit foreign influence and exclude foreign air carriers from the U.S. air transport market. Although the National Commission to Ensure a Strong Competitive Airline Industry¹⁹⁷ has recommended that Congress amend the Federal Aviation Act to permit foreign investors to hold up to forty-nine percent voting equity in U.S. airlines,¹⁹⁸ this measure is not enough to achieve global open skies for air transport.¹⁹⁹

A. *Restrictions on Foreign Investment*

The United States has traditionally imposed foreign investment restrictions on infrastructure industries²⁰⁰ such as broadcasting,²⁰¹ electric power,²⁰² nuclear power,²⁰³ and shipping.²⁰⁴ Congress first enacted citizenship requirements for U.S. air carriers in the Air Commerce Act of 1926 (Air Commerce Act).²⁰⁵ The Air Commerce Act provided that aircraft could be registered in the United States only if owned by U.S. citizens.²⁰⁶ The Air Commerce Act also

infra notes 223-26 and accompanying text (explaining that only U.S. citizens can control U.S. airlines).

196. See 49 U.S.C. app. § 1508(b) (1988) (precluding foreign air carriers from taking on passengers at point in United States and transporting them to other points in United States).

197. See generally NATIONAL COMMISSION REPORT, *supra* note 3 (recommending measures to President Clinton and Congress to improve U.S. air transport industry).

198. See *infra* note 289 (discussing National Commission's proposal to amend U.S. foreign investment laws).

199. See *infra* notes 278-98 and accompanying text (recommending measures to liberalize U.S. air transport laws).

200. Paul S. Dempsey, *The Disintegration of the U.S. Airline Industry*, 20 TRANSP. L.J. 9, 32-33 (1991) [hereinafter Dempsey, *Disintegration*] (explaining that foreign investment restrictions reflect important role of infrastructure industries in supporting national defense).

201. See 47 U.S.C. § 310(b) (1988) (requiring that Federal Communications Commission issue broadcasting, common carrier, aeronautical en route, or aeronautical fixed radio station licenses only to U.S. citizens and that officers and directors of such corporations be U.S. citizens).

202. See 16 U.S.C. § 797(e) (1988) (limiting operation of hydroelectric power plants on navigable streams within U.S. territories to U.S. citizens or domestic corporations).

203. See 42 U.S.C. § 2133(d) (1988) (mandating that atomic energy production licenses not be issued to aliens or foreign-owned or foreign-controlled corporations).

204. See 46 U.S.C. app. § 883 (1988) (providing that only vessels constructed and registered in United States and owned by U.S. citizens may engage in shipping of merchandise between points within United States or its territories). In order to register a ship in the United States, a corporation's principal officers must be U.S. citizens and 75% of its stock must be owned by U.S. citizens. *Id.*

205. Ch. 344, 44 Stat. 568.

206. Air Commerce Act of 1926, ch. 344, § 3(a), 44 Stat. 568, 569. The Act defined a U.S. citizen as:

(1) an individual who is a citizen of the United States or its possessions, or (2) a partnership of which each member is an individual who is a citizen of the United States or its possessions, or (3) a corporation or association . . . of any State, Territory, or possession thereof, of which the president and two-thirds or more of the board of directors or other managing officers thereof, as the case may be, are individuals who are citizens of the United States or its possessions and in which at least 51 per centum

required that U.S. citizens control at least fifty-one percent of the voting interest of any U.S. air carrier, and that the carrier's president and at least two-thirds of its board of directors be U.S. citizens.²⁰⁷

1. *United States foreign investment policy*

a. *The Air Commerce Act of 1926 and the original justifications for the citizenship requirement*

Initially, Congress limited foreign investment in U.S. air carriers²⁰⁸ primarily for national defense purposes.²⁰⁹ After World War I, the U.S. Air Force was weak and needed support from the commercial aviation industry.²¹⁰ Congress included a citizenship requirement in the Air Commerce Act so that the military would have access to commercial aircraft to supplement its military fleet in the event of a national emergency.²¹¹ Congress was concerned that foreign investment in U.S. airlines, particularly by Germany, would pose a threat to U.S. national defense.²¹² Congress feared that Germany or other enemies would gain control of U.S. airlines and use them against the United States as an instrument of war.²¹³ In addition, because the Federal Government subsidized all U.S. airlines through contracts to provide air mail service,²¹⁴ Congress wanted to ensure

of the voting interest is controlled by persons who are citizens of the United States or its possessions.

Id. § 9(a), 44 Stat. at 573.

207. *Id.* § 9(a), 44 Stat. at 573.

208. *Cf. Dempsey, Turbulence, supra* note 7, at 306 (stating that governments of many nations have controlled or protected their national air carriers because of their "important role in facilitating communications, trade, tourism, and national pride and prestige, as they 'show the flag' around the world").

209. Dempsey, *Disintegration, supra* note 200, at 40-41 (explaining that national security considerations were primary purpose behind restrictions on many "essential infrastructure industries," including air transportation).

210. *See infra* note 212 and accompanying text (explaining U.S. reliance on commercial airlines).

211. *See CIVIL AIR NAVIGATION BILL, H.R. CONF. REP. NO. 1262, 68th Cong., 2d Sess. 1, 26 (1925)* (concluding that requirement that 75% of each U.S. air carrier be owned by U.S. citizens ensures that aircraft will be available and in good condition for use as auxiliary U.S. air force in times of war or other national emergencies).

212. *See Inquiry into Operations of the United States Air Services: Hearing Before the House Select Comm. of Inquiry into Operations of the United States Air Services, 68th Cong., 1st Sess. 519, 525-27 (1925)* (statement of Major General Mason M. Patrick, Chief of the Army Air Service) (expressing concern over strength of U.S. Air Force and recognizing need to depend on commercial airlines for additional support during war emergencies).

213. *See Ellett, supra* note 35, at 3-4 (explaining that fear of airplane's proven capability as instrument of war was probable basis for restrictive national sovereignty notions of airspace).

214. *See Air Mail (McNary-Watres) Act of 1930, ch. 223, § 1, 46 Stat. 259 (1930) (repealed 1934)* (establishing formula to determine compensation based on amount of mail transported); *see also Air Mail Act of 1934, ch. 466, §§ 3, 4, 5, 48 Stat. 933* (codified as amended in scattered sections of 39 U.S.C. (1988)) (authorizing Postmaster General to conduct competitive bidding procedures to award contracts to transport mail); *Air Mail Act of 1925, ch. 128, § 4, 43 Stat. 805*

that only U.S. citizens received such economic support.²¹⁵

b. The Civil Aeronautics Act of 1938

The Civil Aeronautics Act of 1938²¹⁶ modified the Air Commerce Act by increasing the minimum percentage of U.S. citizen-held voting equity in U.S. air carriers from fifty-one to seventy-five percent.²¹⁷ Although it ostensibly raised the minimum U.S. citizen ownership standard for national security purposes,²¹⁸ Congress further limited foreign investment in U.S. air carriers for protectionist reasons.²¹⁹ In 1944, the Chicago Convention reaffirmed a nation's right to establish citizenship requirements for its airlines²²⁰ and thus left the U.S. citizenship requirements intact.²²¹

(authorizing Postmaster General to award airmail carriage contracts to commercial carriers).

215. *Uraba, Medellin & Cent. Airways*, 2 C.A.B. 334, 337 (1940) (stating that general intent of Civil Aeronautics Act was to ensure that air carriers receiving U.S. economic support are "citizens of the United States in fact, in purpose and in management").

216. Ch. 601, 52 Stat. 973.

217. Civil Aeronautics Act of 1938, ch. 601, § 1(13), 52 Stat. at 978. The Civil Aeronautics Act also amended the Air Commerce Act by requiring that two-thirds of the managing officers of the corporation, in addition to two-thirds of the board of directors, be U.S. citizens. *Id.*

218. *Id.*; see also *Key Airlines, Inc. Fitness Investigation*, C.A.B. Order No. 84-4-83, at 31 n.31 (1984) (explaining that citizenship requirement was raised to 51% "because of the difficulty in assuring control rather than mere ownership").

219. See GAO REPORT ON AIRLINE COMPETITION, *supra* note 4, at 6 (noting that original intent of investment restrictions was to support heavily subsidized fledgling U.S. airline industry); see also *Hearings on S.2 and S.1760 Before a Subcomm. of the Comm. of Interstate Commerce*, 75th Cong., 1st Sess. 426, 439-40, 504 (1937) (statement of Edgar S. Gorrell, President, Air Transport Association of America) (discussing desire to keep America "out in front" of aviation industry).

220. Chicago Convention, *supra* note 6, arts. 17, 18, 61 Stat. at 1180, 1185, 15 U.N.T.S. at 295, 308. Article 17 provides that "[a]ircraft have the nationality of the State in which they are registered." *Id.* art. 17, 61 Stat. at 1185, 15 U.N.T.S. at 308. Article 18 provides that "[a]n aircraft cannot be validly registered in more than one State, but its registration may be changed from one State to another." *Id.* art. 18, 61 Stat. at 1185, 15 U.N.T.S. at 308. The Chicago Convention also provided in Article 19 that "[t]he registration or transfer of registration of aircraft in any contracting State shall be made in accordance with its laws and regulations." *Id.* art. 19, 61 Stat. at 1185, 15 U.N.T.S. at 308.

Two agreements resulting from the Chicago Convention addressed airline nationality. See *International Air Services Transit Agreement*, Dec. 7, 1944, art. 1, § 5, 59 Stat. 1693, 1694, 184 U.N.T.S. 389, 389 (reserving right of contracting states to withhold or revoke certificate or permit to foreign air transport enterprise in any case where contracting state "is not satisfied that substantial ownership and effective control are vested in nationals of a contracting State . . ."); *International Air Transport Agreement*, Dec. 7, 1944, art. 1, § 6, 59 Stat. 1701, 1702-03, 171 U.N.T.S. 387, 394 (providing same right of revocation upon evidence of substantial foreign ownership as provided in *International Air Services Transit Agreement*).

221. See *supra* notes 216-19 and accompanying text (explaining citizenship requirements for U.S. air carriers under Civil Aeronautics Act).

c. *The Federal Aviation Act of 1958*

The Federal Aviation Act of 1958²²² further modified the citizenship provisions by requiring that a U.S. air carrier be a "citizen of the United States."²²³ Air carriers must satisfy two important criteria to meet the U.S. citizenship requirement. First, U.S. citizens must own seventy-five percent of the voting interest in U.S. air carriers.²²⁴ Second, in addition to enforcing compliance with the objective numerical requirements, the CAB and the DOT have consistently interpreted the law to require that U.S. citizens actually control²²⁵ U.S. air carriers.²²⁶ The Federal Aviation Act did not elaborate on

222. Pub. L. No. 85-726, 72 Stat. 731 (codified at 49 U.S.C. app. §§ 1301-1542 (1988 & Supp. I 1989 & Supp. II 1990)).

223. 49 U.S.C. § 1301(16). Section 1301(16) defines a U.S. citizen as:

(a) an individual who is a citizen of the United States or one of its possessions, or (b) a partnership of which each member is such an individual, or (c) a corporation or association created or organized under the laws of the United States or any State, Territory, or possession of the United States, of which the president and two-thirds or more of the board of directors and other managing officers thereof are such individuals and in which at least 75 per centum of the voting interest is owned or controlled by persons who are citizens of the United States or of one of its possessions.

Id. The Federal Aviation Act also governs who may operate commercial aircraft in the United States. *See id.* § 1371 (requiring that "certificate of public convenience" be obtained from DOT in order to operate aircraft within United States); *id.* § 1301(3) (requiring by definition that "air carrier" eligible for certification under § 1371 be U.S. citizen).

224. 49 U.S.C. app. § 1301(16) (1988); *see id.* app. § 1371(r) (monitoring foreign control by requiring air carriers that undertake significant changes in their operations to provide DOT with information relevant to their citizenship and fitness).

225. *See id.* app. § 1383 (providing that control may be direct or indirect for purposes of title 49).

226. *Intera Arctic Servs., Inc.*, D.O.T. Order No. 87-8-43, at 5 (1987). In this order, DOT stated:

[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. air carrier], it is not a U.S. citizen

Id.

In *Page Avjet Corp.*, 102 C.A.B. 488, 489-90 (1983), the CAB summarized its position on this matter:

In examining the control aspect for purposes of determining citizenship, we look beyond the bare technical requirements to see if the foreign interest has the power—either directly or indirectly—to influence the directors, officers or stockholders. We have found control to embrace every form of control and to include negative as well as positive influence; we have recognized that a dominating influence may be exercised in ways other than through a vote.

Id.; *see, e.g., Hutchinson Auto & Air Transp. Co.*, D.O.T. Order No. 91-8-15, at 10-11 (1991) (stating that CAB and DOT historically have construed § 101(16) as requiring that U.S. citizens control air carriers); *Third-Party Enforcement Complaint of Alas de Transporte Internacional, S.A. Against Challenge Air Cargo, Inc.*, D.O.T. Order No. 91-4-32, at 2 n.2 (1991) (noting DOT's policy requiring air carriers to be under actual control of U.S. citizens); *Allegis Investors Group*, D.O.T. Order No. 87-7-42, at 4 (1987) (noting that meaning of control is factual matter and not merely limited to ability to manage carrier's daily operations); *Suspension of the Air Carrier*

the meaning of "control," and neither the CAB nor the DOT has established a definition of the term. In *Acquisition of Northwest Airlines by Wings Holdings, Inc. (KLM-Northwest I)*,²²⁷ the DOT explained the analysis of control as follows:

[It] has always necessarily been on a case-by-case basis, as there are myriad potential avenues of control. The control standard is a de facto one—we seek to discover whether a foreign interest may be in a position to exercise actual control over the airline, i.e., whether it will have a substantial ability to influence the carrier's activities.²²⁸

Certificate Issued to Pride Air, Inc. Under Section 401 of the Federal Aviation Act, D.O.T. Order No. 87-5-59, at 2 (1987) (finding that 49 U.S.C. § 1301(16) requires that U.S. citizens control air carrier in order for carrier to receive certificate to engage in air transportation); Key Airlines, Inc., Fitness Investigation, C.A.B. Order No. 84-4-83, at 11 (1984) (indicating that foreign control test under § 101(16) encompasses potential as well as actual control); Charlotte Aircraft Corp., 91 C.A.B. 1004, 1009 (1981) (stating that corporation is not U.S. citizen if controlled by foreign national); Daetwyler d/b/a Interamerican Airfreight Co., 58 C.A.B. 118, 120-21 (1971) (asserting that interpreting 49 U.S.C. § 1301(16) as requiring either U.S. citizen ownership or control would defeat congressional intent, which was to prevent foreign influence over U.S. air carriers); Uraba, Medellin & Cent. Airways, Inc., 2 C.A.B. 334, 337 (1940). In *Uraba*, the CAB reached the following determination:

The apparent general intent of the statute is to insure that air carriers receiving economic support from the United States and seeking certificates of public convenience and necessity . . . shall be citizens of the United States in fact, in purpose, and in management. The shadow of substantial foreign influence may not exist. While it may be permissible to look behind the form to the substance of the management of an air carrier to determine whether in fact, as well as in law, it is under the control of citizens of the United States, it is also clear that the letter of the statute must be considered and its requirement met in order to qualify as a citizen.

Uraba, 2 C.A.B. at 337.

227. D.O.T. Order No. 89-9-51, at 4-5 (1989).

228. *Acquisition of Northwest Airlines by Wings Holdings, Inc.*, D.O.T. Order No. 89-9-51, at 8 (1989); see *Executive Air Fleet*, D.O.T. Order No. 92-9-46, at 2 (1992) (emphasizing consistency of DOT's interpretation of § 101(16) as requiring actual control by U.S. citizen); *Discovery Airways*, D.O.T. Order No. 90-2-23, at 2 (1990) ("Each decision reflects underlying common principles and provides guidance as to what elements may be relevant and what corrections may be appropriate in analogous future cases."); *Charlotte Aircraft*, 91 C.A.B. at 1009 (stating that foreign nationals that control corporation may be ineligible for U.S. citizen status despite satisfaction of technical 75% standard); *Silvas Air Lines*, 87 C.A.B. 160, 162 (1980) (indicating that questions of control will be determined based on substance of transaction "beyond the technical requirements"); *Pan American Airways*, 4 C.A.B. 403, 405 (1943) (noting that where word "control" is used in public utility statute without restrictions, existence of control should be factual matter determined in accordance with statute's intent).

In *Eastern-Colonial Control Case*, 20 C.A.B. 629 (1955), the CAB provided a clear statement of its position on the matter of control:

In ascertaining the existence of control of one company by another, it is clear that control is an issue of fact which must be determined from a broad consideration of the special circumstances of each case; that control may be exercised in other ways than through a vote of the stock of the corporation sought to be controlled; that control does not depend upon the ownership of any specific quantum of stock or other ownership rights but rather represents the amount of power and influence necessary to give one company actual domination or substantial influence over another; that power over another company's stock through affiliates, through close business associates with the same interests, or power over stockholdings exercised in combina-

This case-by-case factual analysis ensures that the congressional purposes of the citizenship requirement will not be defeated or circumvented if a foreign entity undertakes a transaction that adheres to the numerical statutory requirements but nevertheless dominates the daily operations of a U.S. air carrier.²²⁹

d. *The DOT's current foreign investment policy*

In its 1991 decision, *Acquisition of Northwest Airlines by Wings Holdings, Inc. (KLM-Northwest II)*,²³⁰ the DOT liberalized its foreign investment policy by distinguishing voting equity from nonvoting equity and debt.²³¹ The DOT decided to permit total foreign equity ownership of a U.S. air carrier of up to forty-nine percent, provided that U.S. citizens actually control the air carrier.²³² Foreign voting equity, however, is still limited to twenty-five percent.²³³ In dicta, the DOT indicated that, absent loan default, it would not consider debt to be a factor in evaluating foreign control, and suggested that a loan agreement does not give a debt holder certain controlling rights.²³⁴ The DOT based its change in policy partly on its "reassessment of the complexities of today's corporate and financial environment, [and]

tion with other factors bearing pressure upon the company sought to be dominated may spell corporate control; and that, while there is no technical meaning of control apart from that accorded the term in ordinary usage, the term "control" embraces every form of control and may cover a wide variety of situations of fact. In short, it has been consistently held that the term "control" is not an absolute or unqualified concept, but rather one which involves the act or the power of direction or domination under many and varied circumstances.

Id. at 634-35.

229. See *Daetwyler d/b/a Interamerican Airfreight Co.*, 58 C.A.B. at 120-21 (noting that CAB must analyze substance over form in ownership determination, and finding that interpretation of 49 U.S.C. § 1301(16) requiring either U.S. citizen ownership or control would defeat congressional intent behind statute).

230. D.O.T. Order No. 91-1-41, at 1 (1991).

231. *Acquisition of Northwest Airlines, Inc. by Wings Holdings, Inc.*, D.O.T. Order No. 91-1-41, at 1 (1991) (permitting Wings Holdings to increase its interest in Northwest Airlines to 49% equity ownership).

232. *Id.* The DOT ruled that it would not construe total foreign equity investment up to 49%, taken alone, as indicative of foreign control. *Id.* In addition, the DOT determined that it would not consider debt as a factor in evaluating foreign control absent default, and provided that the specific loan agreement at issue did not give a debt holder certain controlling rights. *Id.* at 7. The DOT relaxed the 25% foreign equity limitation but Congress did not amend the Federal Aviation Act to reflect this change in policy. *Id.* at 1.

233. 49 U.S.C. app. § 1301(16) (1988) (requiring that U.S. citizens hold 75% of voting interest in U.S. airlines).

234. *Acquisition of Northwest Airlines by Wings Holdings, Inc.*, D.O.T. Order No. 91-1-41, at 7. The order declared that unless "special rights . . . that imply foreign control are provided to a debt holder by loan agreement, DOT do[es] not anticipate treating debt as a foreign control issue." *Id.*

a re-examination of the relationship between non-voting equity/debt and control in light of recent experience in this area."²³⁵

2. *Foreign ownership and control restrictions are unnecessary*

Congress' original justifications for limiting foreign ownership and control of U.S. air carriers are no longer valid.²³⁶ Because Congress has virtually eliminated all subsidies to U.S. air carriers,²³⁷ there is no basis for concern that U.S. tax dollars will support foreign investors that own or control domestic air carriers. Second, there are no *compelling* national security reasons for limiting foreign investment in U.S. air carriers.²³⁸

235. *Id.*

236. See GAO REPORT ON AIRLINE COMPETITION, *supra* note 4, at 6 (stating that original justifications for foreign investment restriction such as protecting "heavily subsidized [and] fledgling industry" are no longer relevant).

237. See Airline Deregulation Act of 1978, Pub. L. No. 95-504, § 24, 92 Stat. 1705, 1725 (1978) (codified at 49 U.S.C.S. app. § 1376(c) (1993)) (eliminating airline subsidies for carriage of mail).

238. See KASPER, DEREGULATION, *supra* note 24, at 71 (suggesting that national security considerations are overblown as justification for regulatory policies limiting foreign investment).

Even if a foreign airline or other foreign entity were to obtain control over a United States air carrier, the effects of this transaction on U.S. national security, if necessary, should be reviewed by the President of the United States rather than by the DOT under section 101(16) of the Federal Aviation Act. The Exon-Florio Amendment to the Defense Production Act of 1950, Pub. L. No. 81-774, 64 Stat. 798, 798-822 (codified in scattered sections of 50 U.S.C.), which was adopted as § 5021 of the Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, § 5021, 102 Stat. 1107, 1425-26 (codified at 50 U.S.C.A. app. § 2170) (West Supp. 1993), provides that the President:

may take such action for such time as the President considers appropriate to suspend or prohibit any acquisition, merger, or takeover, of a person engaged in interstate commerce in the United States . . . by or with foreign persons so that such control will not threaten to impair the national security. . . . The President may direct the Attorney General to seek appropriate relief, including divestment relief, in the district courts of the United States in order to implement and enforce this section.

50 U.S.C.A. app. § 2170(d) (West Supp. 1993). Section 2170(f) further provides:

For purposes of this section, the President or the President's designee may, taking into account the requirements of national security, consider among other factors—

- (1) domestic production needed for projected national defense requirements,
- (2) the capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services,
- (3) the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security,
- (4) the potential effects of the proposed or pending transaction on sales of military goods, equipment, or technology to any country . . . [and]
- (5) the potential effects of the proposed or pending transaction on United States international technological leadership in areas affecting United States national security.

Id. § 2170(f). The United States already has adequate procedures to protect against transactions that threaten to impair national security and, therefore, does not need to impose a general ban on foreign control of U.S. airlines.

Although the U.S. Government has utilized commercial aircraft on a limited basis through the Civil Reserve Air Fleet Program (CRAF),²³⁹ national registration requirements, rather than foreign investment limitations, could ensure that aircraft would be available for national defense purposes.²⁴⁰ As a condition for registration in the United States, the DOT could require that aircraft owned or controlled by both foreign and domestic parties be pledged under CRAF for emergency use. If a foreign-owned or foreign-controlled air carrier violates its CRAF agreement and refuses to provide its aircraft and related services to the United States in a national emergency, the Government could commandeer the nonparticipating foreign aircraft.²⁴¹

239. Congress enacted the Defense Production Act of 1950, Pub. L. No. 81-774, 64 Stat. 798 (codified as amended at 50 U.S.C. app. § 2071 (1988)), which created CRAF and authorized the President to enlist aircraft registered in the United States for national defense purposes. KASPER, DEREGULATION, *supra* note 24, at 71 (noting that U.S. air carriers may pledge aircraft to Department of Defense through CRAF). This program uses "preferential allocation of military cargo and passenger transport business to induce voluntary commitment of aircraft and crews for meeting emergency national security airlift requirements." *Id.* In return for participating in CRAF, commercial air carriers receive military contracts for peacetime passenger and cargo services at uniform negotiated rates based on weighted average costs plus a return on their investment. U.S. GEN. ACCOUNTING OFFICE, MILITARY AIRCRAFT: CHANGES UNDERWAY TO ENSURE CONTINUED SUCCESS OF CIVIL RESERVE AIR FLEET 1, 2 (1992) [hereinafter MILITARY AIRCRAFT].

In 1990, for the first time in CRAF's history, President Bush enlisted commercial aircraft to transport supplies and troops to Saudia Arabia in Operation Desert Storm. See Dempsey, *Disintegration*, *supra* note 200, at 41 (discussing use of CRAF for military airlift in Persian Gulf Crisis). The requirement that U.S. citizens control or own U.S. air carriers has been maintained, in part, to ensure that air carriers that pledge aircraft to CRAF will be more amenable to support CRAF for U.S. military or emergency situations. See James Ott, *Foreign Ownership of U.S. Carriers Feared as Limit to Future Military Airlifts*, AVIATION WK. & SPACE TECH., Apr. 22, 1991, at 96 (noting concern of U.S. Department of Defense that relaxation of foreign ownership limitations on air carriers will have negative effect on future CRAF participation). See generally MILITARY AIRCRAFT, *supra*, at 1-28 (evaluating CRAF program).

240. KASPER, DEREGULATION, *supra* note 24, at 71. Relatively few nations have national defense commitments that require extensive airlift provisions. *Id.* The United States would have substantial airlift capacity without these provisions for commercial aircraft availability. *Id.* The United States can turn to the United Nations and its allies for commercial aircraft if necessary. As the United Nations becomes more involved in global disputes, it may increasingly coordinate the transportation of troops and supplies to various areas of the world to resolve conflicts. In the future, it may be more important for the United Nations, rather than the United States, to have commercial aircraft available for emergencies. Until then, however, the United States can preserve its airlift capacity through registration requirements.

241. See Transportation Dept. Considers Standards for Regulating LBOs, AVIATION WK. & SPACE TECH., Sept. 11, 1989, at 128, 128 (expressing belief of some U.S. officials that any aircraft U.S. Government needs can be taken under powers of eminent domain); see also Andrea Rothman & Seth Payne, *Sooner or Later, Airlines Must Learn to Fly Solo*, BUS. WK., Apr. 5, 1993, at 27, 27 (stating that laws permitting seizure of assets in wartime would help to allay national security concerns about foreign ownership of airline carriers).

3. *Modern justifications for the citizenship requirement*

While national security reasons no longer necessitate limiting foreign investment in U.S. air carriers, there may be more modern justifications for maintaining the citizenship requirement. First, if foreign parties own or control U.S. air carriers, the United States may lose bargaining strength in bilateral agreement negotiations.²⁴² For example, if a foreign airline gains control over a U.S. airline, this foreign airline could essentially obtain complete access to the U.S. aviation market. In these circumstances, the foreign airline's government would have little incentive to grant other U.S. airlines greater access to its own market.²⁴³ Thus, the United States would lose leverage in negotiating bilateral aviation agreements that are advantageous to U.S. air carriers. Consequently, U.S. air carriers may lose access to vital foreign markets. Second, if foreign airlines subsidized by their governments are permitted to own or control U.S. airlines, these foreign airlines could create unfair competition and eventually force other U.S. airlines into bankruptcy.²⁴⁴ Third, foreign investors that own or control U.S. air carriers may choose to replace U.S. workers with foreign workers.²⁴⁵

The modern justifications for foreign investment restrictions, much like the national security rationalizations, are unwarranted in today's economic environment. If the United States liberalizes its foreign investment restrictions for investors from countries that relax their foreign investment regulations for U.S. investors, bilateral treaties may become less important to airlines. If U.S. airlines control, are controlled by, or are integrated with foreign airlines, such alliances would enable these airlines to move passengers between the United States and other nations so that access to foreign points would no longer be a major issue in bilateral negotiations.²⁴⁶ Indeed,

242. See Dempsey, *Disintegration*, *supra* note 200, at 42 (indicating that foreign ownership may jeopardize U.S. ability to negotiate bilateral agreements).

243. See GAO REPORT ON AIRLINE COMPETITION, *supra* note 4, at 6 (noting that U.S. airlines with extensive international routes may lose competitive advantage to foreign airline that gains control of another U.S. airline if foreign airline's government maintains restrictive bilateral treaty with United States).

244. See Robert Kuttner, *Flying in the Face of Reason: Why the Skies Need Reregulating*, BUS. WK., May 3, 1993, at 18, 18 (opining that most foreign carriers seeking access to U.S. markets are subsidized, and that resulting proliferation of domestic flights in United States would add to "the ruinous cycle of price-cutting, gouging, and bankruptcy").

245. See GAO REPORT ON AIRLINE COMPETITION, *supra* note 4, at 7 (noting labor union concerns about potential loss of American jobs, especially high-paying crew positions on international flights, if foreign airlines control U.S. airlines).

246. See GAO REPORT ON AIRLINE COMPETITION, *supra* note 4, at 6 (suggesting that alliance between airlines from two different countries would enable those carriers to link domestic and

increased access to foreign markets would diminish the significance of bilateral treaties negotiated by the U.S. Government. Eventually, as the number of alliances between foreign and domestic airlines increases, the bilateral treaty system will be recast or abandoned.²⁴⁷

An increase in foreign capital could help U.S. airlines remain competitive in the U.S. market and could lead to increased domestic competition. Foreign investment could provide U.S. air carriers with an important source of capital that they need to avoid bankruptcy.²⁴⁸ As long as foreign airlines are not "substantially influenced" by their governments, foreign airlines that invest in U.S. airlines will not create unfair competition and force other U.S. airlines into bankruptcy.²⁴⁹ Rather, foreign capital would strengthen U.S. airlines,²⁵⁰ promote airline expansion,²⁵¹ and secure American jobs in the airline industry.²⁵² In fact, capital from foreign airlines would help U.S. airlines expand by creating international alliances which, in turn, would lead to the creation of U.S. jobs. Healthier U.S. airlines could expand their operations to more foreign destinations, which would require more U.S. workers. Furthermore, a greater foreign presence in the United States by a foreign carrier, linked with a U.S. airline through the investment of capital, would create a larger flow

international routes). For example, if a U.S. airline wanted to fly to Paris from Philadelphia, it could fly passengers to New York, switch the passengers to its affiliated French airline that would continue to Paris and points beyond, and then split the revenues with the French airline.

247. See GAO REPORT ON AIRLINE COMPETITION, *supra* note 4, at 8 (noting that "some industry analysts believe that the system of bilaterals will be replaced by a more open, competition-oriented system").

248. See Ellett, *supra* note 35, at 8 (citing remarks of Timothy Pettee, vice president for transportation research, Alliance Capital Management, at Aero Club of Washington (Jan. 29, 1991)) (explaining that current DOT foreign ownership policy does not encourage adequate capital investment and that removing ownership restrictions would enable foreign investors to make meaningful contribution to U.S. airline industry's capital needs); see also GAO REPORT ON AIRLINE COMPETITION, *supra* note 4, at 6 (explaining that another way for airlines to raise capital is through sale of equity stock and that most likely investors are foreign airlines that can "capitalize on operating and marketing synergies" without fear of antitrust scrutiny). Weak American airlines are unlikely to raise significant amounts of capital through U.S. equity investors because of the low rate of returns on this stock. Unlike nonairline investors, foreign airlines are more likely to invest in weak U.S. airlines to take advantage of an operating and marketing alliance. *Id.*

249. See *infra* text accompanying notes 295-96 (discussing proposed "substantially influenced" test).

250. Cf. GAO REPORT ON AIRLINE COMPETITION, *supra* note 4, at 1 n.4 (attributing U.S. airlines' losses in part to limited access to capital and claiming that foreign investment and control restrictions are among primary reasons for limited capital).

251. See NATIONAL COMMISSION REPORT, *supra* note 3, at 2 (reporting \$10 billion loss in U.S. airline industry over last 3 years and indicating that industry needs capital to enable airlines to expand by purchasing new aircraft and extending service in international markets).

252. See J.A. Donoghue, *Controlling Interests: Investing in Other Nations' Airlines*, AIR TRANSP. WORLD, Mar. 1991, at 2, 2 (stating that unions have concluded that protecting members' jobs is more important than objecting to increases in foreign ownership).

of passengers into the United States and lead to an increased demand for U.S. ground services positions, which are generally held by U.S. citizens. Greater foreign investment in U.S. airlines may also increase competition in the U.S. air transport market by enabling U.S. air carriers to reduce their heavy debt burdens,²⁵³ purchase new aircraft and equipment,²⁵⁴ and avoid bankruptcy.²⁵⁵ To encourage foreign parties to invest capital in U.S. air carriers²⁵⁶ and to convince nations to grant U.S. air carriers greater access to their airports, Congress must provide the DOT with the flexibility to eliminate restrictions on foreign investment and control.²⁵⁷

B. Cabotage Restrictions

1. The history of cabotage restrictions

A state's right to restrict cabotage to domestic air carriers was first recognized in the Paris Convention²⁵⁸ and later reaffirmed by Article 7 of the Chicago Convention.²⁵⁹ The first sentence of Article 7 recognizes a nation's right to reserve for its national aircraft the carriage of passengers, mail, or cargo transported for compensation between two points within its "territory."²⁶⁰ The second sentence of

253. See NATIONAL COMMISSION REPORT, *supra* note 3, at 2 (stating that U.S. airlines have accumulated over \$35 billion of debt and predicting that this debt will keep U.S. airlines financially weak for years).

254. See NATIONAL COMMISSION REPORT, *supra* note 3, at 2 (noting that U.S. laws require that airlines purchase quieter aircraft and replace older aircraft).

255. See GAO REPORT ON AIRLINE COMPETITION, *supra* note 4, at 13 (assessing potential impact on international markets of policies that promote domestic competition).

256. See GAO REPORT ON AIRLINE COMPETITION, *supra* note 4, at 6 (indicating that foreign airlines are not likely to invest capital in U.S. airlines unless they can exercise control over and integrate operations with U.S. airlines); Joan M. Feldman, *What Are the Chances of Foreign Ownership of U.S. Airlines?*, AIR TRANSP. WORLD, Nov. 1987, at 47, 48 (noting that few investors willingly invest significant amounts of capital in businesses that they cannot control).

257. Cf. GAO REPORT ON AIRLINE COMPETITION, *supra* note 4, at 5 (suggesting that Congress liberalize foreign investment and control restrictions in exchange for open access to foreign airports for U.S. air carriers).

258. See Paris Convention, *supra* note 6, art. 16, 11 L.T.N.S. at 192 (providing that signatory nation could establish restrictions in favor of its national aircraft "in connection with the carriage of person and goods for hire between two points in its territory").

259. Article 7 of the Chicago Convention 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. 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, *supra* note 6, art. 7, 61 Stat. at 1182, 15 U.N.T.S. at 300.

260. Chicago Convention, *supra* note 6, art. 7, 61 Stat. at 1182, 15 U.N.T.S. at 300. Article 2 of the Chicago Convention defines a state's territory as "the land areas and territorial waters adjacent thereto under the sovereignty, suzerainty, protection or mandate of such State." *Id.* art. 2, 61 Stat. at 1181, 15 U.N.T.S. at 298; see INSTITUT DU TRANSPORT AERIEN, CABOTAGE IN

Article 7 prohibits the exclusive grant or receipt of cabotage rights to a single nation or airline.²⁶¹ The interpretation of the second sentence of Article 7 has created great controversy among legal scholars.²⁶² A restrictive interpretation of Article 7 would only allow the granting of cabotage rights on a nonexclusive basis, thus prohibiting discriminatory grants.²⁶³ According to this interpretation, a nation that grants cabotage rights to one country would be obligated to grant cabotage rights to other nations demanding similar rights.²⁶⁴ A more liberal interpretation of Article 7, however, permits the exclusive grant of cabotage rights if the grant does not "specifically" indicate that the cabotage rights are exclusive.²⁶⁵ Thus, two nations may agree to grant cabotage rights to each other, provided that the agreement allows for the possibility that other nations may receive similar cabotage rights.²⁶⁶

In the Air Commerce Act, the United States first used what later became known as the restrictive interpretation of Article 7 of the Chicago Convention, which denied cabotage rights to all foreign air carriers.²⁶⁷ Congress expanded the Civil Aeronautics Act by passing

INTERNATIONAL AIR TRANSPORT: HISTORICAL AND PRESENT DAY ASPECTS 9 (7-E/1969) [hereinafter ITA STUDY] (reiterating absolute sovereignty principle regarding cabotage).

261. Chicago Convention, *supra* note 6, art. 7, 61 Stat. at 1182, 15 U.N.T.S. at 300.

262. Douglas R. Lewis, *Air Cabotage: Historical and Modern-Day Perspectives*, 45 J. AIR L. & COM. 1059, 1063-65 (1980) (explaining that legal scholars have postulated two interpretations of ambiguous language).

263. *Id.*

264. See ITA STUDY, *supra* note 260, at 9 (explaining that under "rigid and restrictive" interpretation of article 7, if country A "grants cabotage to B, not only should it be conceded to C, D, E, etc., if they ask for it, but each of these third states has the right to demand it"); Lewis, *supra* note 262, at 1063 (stating that confusion is caused by proper interpretation of words "specifically" and "on an exclusive basis"). Lewis suggests that a restrictive interpretation of this sentence deemphasizes the possibility that what is forbidden is only exclusive rights that are specifically granted, and emphasizes the phrase "on an exclusive basis" so that only nonexclusive grants of cabotage rights are allowed. Lewis, *supra* note 262, at 1063-64.

265. See ITA STUDY, *supra* note 260, at 9 (explaining "flexible or liberal" interpretation of second sentence of article 7 and noting that this interpretation allows "State A to grant cabotage privileges to B provided it is not stipulated that they are exclusive . . . without third States having the right to demand the same privileges"); see also BIN CHENG, *THE LAW OF INTERNATIONAL AIR TRANSPORT* 314, 315 (1962) (opining that granting and receiving cabotage rights on nonexclusive basis are clearly permitted according to Article 7 of Chicago Convention). Cheng also suggests that granting and receiving cabotage rights on an exclusive basis seems permissible provided that the agreement does not specify that the rights are exclusive. CHENG, *supra*.

266. See Lewis, *supra* note 262, at 1065 (noting that less restrictive interpretation of Article 7 emphasizes word "specifically" and deemphasizes phrase "on an exclusive basis").

267. See Air Commerce Act of 1926, ch. 344, § 6, 44 Stat. 568, 572 (mandating, prior to Chicago Convention, that navigation of foreign-registered aircraft in United States was prohibited except as permitted by § 6 of Air Commerce Act). Section 6(c) of the Air Commerce Act allowed the Secretary of Commerce to authorize foreign-registered aircraft to be navigated in the United States. Air Commerce Act of 1926, § 6(c), 44 Stat. at 572. This section, however, generally prohibited cabotage: "[n]o foreign aircraft shall engage in interstate or intrastate air commerce." *Id.*; see also ITA STUDY, *supra* note 260, at 9 (discussing restrictive interpretation of second sentence of article 7).

the Federal Aviation Act in 1958, which retained the prohibition of cabotage.²⁶⁸ The DOT, however, can grant exceptions to the cabotage rule for periods not exceeding thirty days in emergency situations if the exception would serve the public interest.²⁶⁹ In sum, because this exception is not used very often, the United States essentially reserves cabotage rights for U.S. air carriers.

United States airlines often advocate denying cabotage rights to foreign air carriers²⁷⁰ for the same reasons that they oppose increasing the ceiling on foreign investment in U.S. air carriers.²⁷¹ Granting cabotage rights to foreign air carriers may impair national security, cause U.S. airlines to lose their competitive advantage in the

The Civil Aeronautics Act amended § 6(c) of the Air Commerce Act, which failed to define "intrastate commerce," to read that "[n]o foreign aircraft shall engage in air commerce otherwise than between any State, Territory, or possession of the United States . . . and a foreign country." Civil Aeronautics Act of 1938, ch. 601, § 1107(i)(5), 52 Stat. 973, 1028. Section 6(c) of the Air Commerce Act was also amended in 1953 to correspond with the cabotage restrictions set forth in the Chicago Convention. The new language, moved to § (6)(b), stated in pertinent part:

Foreign civil aircraft permitted to navigate in the United States under this subsection may be authorized by the [CAB] to engage in air commerce within 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.

Act of Aug. 8, 1953, Pub. L. No. 83-225, § (6)(b), 67 Stat. 489, 489.

268. See 49 U.S.C. app. § 1508(b) (1988) (prohibiting foreign air carriers from cabotage under § 1108(b) of Federal Aviation Act of 1958, as amended). Section 1108(b) provides in pertinent part:

Foreign civil aircraft permitted to navigate in the United States under this subsection may be authorized by the Board [formerly the Civil Aeronautics Board and now the Department of Transportation] to engage in air commerce within 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 section 416(b)(7) of this act [codified as amended at 49 U.S.C. § 1386(b)(7) (1988)] or under regulations prescribed by the secretary authorizing United States air carriers to engage in otherwise authorized common carriage and carriage of mail with foreign registered-aircraft under lease or charter to them without crew.

Id.; see also 49 U.S.C. app. § 1386(b)(7) (1988) (providing that DOT can authorize foreign air carriers to engage in cabotage in emergency situations where domestic air carriers cannot handle traffic demands).

269. International Air Transportation Competition Act of 1979, Pub. L. No. 96-192, §§ 12, 20, 94 Stat. 35, 39, 43 (1980) (codified at 49 U.S.C. app. § 1386(b)(7) (1988)); see Lewis, *supra* note 262, at 1073-74 (stating that exception, as applied, often serves interests of airlines and labor organizations more than those of public).

270. See Jeffrey M. Lenorovitz, *Airline Heads Suggest Multilateral Agreements*, AVIATION WK. & SPACE TECH., June 14, 1993, at 43, 43 (noting United Airlines position, expressed by United Airlines Chairman and Chief Executive Officer Stephen M. Wolf, that United States should not provide foreign airlines with cabotage rights). But see *American Airlines Favours Mutual Cabotage Rights*, Reuters, July 2, 1991, available in LEXIS, Nexis Library, Omni File (favoring exchange of cabotage rights with other countries).

271. See *supra* text accompanying notes 242-45 (explaining possible justifications for restricting foreign investment in U.S. air carriers). These arguments for maintaining a ceiling on foreign investment also support prohibiting the grant of cabotage rights to foreign airlines.

U.S. market, push some airlines into bankruptcy, and result in the loss of American jobs to foreigners. In today's global economic environment, however, the same policy reasons that provide a basis for the gradual and reciprocal elimination of foreign investment restrictions support the elimination of provisions that prevent foreign air carriers from obtaining cabotage rights.²⁷²

2. *Cabotage restrictions are unnecessary*

There are no longer legitimate reasons for limiting cabotage to U.S. air carriers. National security interests do not require denying cabotage rights to foreign carriers; these rights can be suspended in case of emergency or war.²⁷³ Furthermore, the U.S. domestic air transport market is well-established and highly competitive as a result of deregulation.²⁷⁴ The grant of cabotage rights to foreign air carriers probably would not cause significant economic injury to U.S. air carriers.²⁷⁵ Moreover, cabotage rights for foreign airlines would

272. See *supra* notes 238, 246-57 and accompanying text (discussing policy arguments suggesting that foreign investment statute is outdated); see also *infra* note 297 and accompanying text (comparing effects of foreign investment and cabotage).

273. See *supra* text accompanying notes 236-41 (discussing reasons for eliminating foreign investment restrictions that also support granting cabotage rights to foreign air carriers).

274. See *supra* text accompanying notes 253-55 (discussing potential benefits of competition). United States airlines have become very competitive as a result of "hub and spoke" systems and frequent-flyer programs. Because U.S. airlines are operating in a highly competitive environment, it is unlikely that a foreign air carrier would attempt to establish a new airline to compete with Delta, United, and American, the three dominant U.S. airlines. It is even more unlikely that a foreign airline would survive in the U.S. market, considering the stature of the U.S. air carriers.

275. See NATIONAL COMMISSION REPORT, *supra* note 3, at 3 (noting that U.S. airlines have lower costs and are more efficient than most foreign airlines); Scott Gibson & Saul Goldstein, *The Plane Truth*, WASH. POST, Oct. 10, 1993, at C5 (comparing U.S. and European air carriers and noting that "[t]he U.S. carriers have dramatically lower costs, a larger domestic passenger base, greater experience running hub-and-spoke-networks, and sophisticated management and pricing systems"). "It costs Lufthansa 21.2 cents to carry a passenger one mile, and it costs British Airways about 13.6 cents. For U.S. airlines, the figure is 9.3 cents." Gibson & Goldstein, *supra*; see also Paul Proctor, *Legalizing Cabotage Could Help U.S. Airline Industry, Passengers*, AVIATION WK. & SPACE TECH., Dec. 24, 1990, at 62, 62 (discussing likely negligible effects of granting cabotage rights to foreign air carriers). Proctor notes:

Not all foreign carriers are interested in flying domestic U.S. routes. Those that do primarily want to extend some of their existing U.S. services to major inland cities. A Seoul-to-Los Angeles-to-Dallas route, for instance, would allow Korean Air Lines to offer single-airline convenience for travelers to and from this destination, something only U.S. carriers can provide now.

United Airlines still would enjoy the tremendous marketing advantage of same-airline flights to most U.S. markets—for example, Hong Kong-St. Louis.

Since few foreign carriers mount heavy transpacific or transatlantic schedules, the number of foreign carrier flights actually added to U.S. airways would be minor. Many of these would be at off-peak hours, due to the timing of the intercontinental flights they meet or continue.

Would Singapore Airlines set up a huge hub in San Francisco and offer deep-discount flights throughout the U.S.? I doubt it. Such a foray would be expensive and

benefit American consumers by making available more domestic air transport services.²⁷⁶ Finally, allowing foreign airlines to operate in the domestic market would create American jobs because foreign air carriers would need numerous American services to assist them in their U.S. operations.²⁷⁷ The grant of cabotage rights to foreign air carriers thus would serve the best interests of the United States.

V. RECOMMENDATIONS

A. *The Globalization of Air Transportation*

Airlines around the world are preparing to compete in the global marketplace of the future. United States airlines will be unable to survive in the future international air services market without linking operations with foreign-based airlines. Until an unrestricted and global common market for air services is formed, airlines from different countries must form marketing and operating alliances to circumvent antiquated national foreign investment and cabotage regulations that severely restrict foreign air carriers from domestic markets. By linking operations with a foreign air carrier, a U.S. air carrier may gain access to foreign markets in exchange for allowing its foreign air carrier partner access to U.S. markets.

The future of international aviation lies in regional multilateral agreements among countries that agree to open their skies to one

meet heavy competition. Most of the airline's low-labor cost advantages would disappear operating from a U.S. base.

Proctor, *supra*.

276. The option of choosing a foreign airline for domestic travel would increase domestic competition. Increased competition would force U.S. airlines to upgrade service and lower fares on domestic routes to avoid losing their share of the domestic market to foreign airlines. *See* Bill Poling, *Foreign Aid for U.S. Airline Industry*, TRAVEL WKLY., Feb. 28, 1991, at 31, 32 (predicting effect of granting foreign airlines cabotage rights). Poling states:

Few foreign airlines would volunteer for a bare-knuckled fight with United and American for control of the Chicago hub. Cabotage is more likely to result in niche marketing, and maybe a little dumping. And if foreign carriers dump cheap seats on the deregulated U.S. market while enjoying protected markets at home, the U.S. consumer may benefit

Id.

277. Proctor, *supra* note 275, at 62. Proctor contends:

The extension of fifth freedom flights in Asia and Europe would increase demand at U.S. carriers for high-paying pilots and cabin and operations supervisors. The increased flight time would require more maintenance hours and U.S.-manufactured parts.

Foreign airlines operating in the U.S. would hire American ground crews and reservations agents, buy U.S. fuel and rent U.S. gates.

Id.

another's air carriers.²⁷⁸ When the international aviation market consists of many regional alliances, the United States should convene another Chicago Convention to change the basic nature of air transportation regulation. The United States should strive to eliminate international foreign investment and cabotage restrictions²⁷⁹ and to replace the system of bilateral agreements with a global and unified air transportation market in which countries can no longer restrict access to their airports and domestic routes.²⁸⁰

The DOT currently limits foreign ownership and control of U.S. air carriers, restricting the total of voting and nonvoting equity that a foreign party can hold in a U.S. air carrier to forty-nine percent, provided that U.S. citizens control the air carrier.²⁸¹ Cabotage rights are only available to air carriers that meet these requirements.²⁸² Although the DOT has the authority to reinterpret the foreign investment and cabotage restrictions of the Federal Aviation Act on a case-by-case basis,²⁸³ only Congress has the authority to significantly amend these statutes. Congress must change, or at least clarify, these restrictions to provide a stable environment for foreign

278. See NATIONAL COMMISSION REPORT, *supra* note 3, at 22 (recommending shift in U.S. policy away from bilateral agreement system to model "based on multi-national arrangements that may be regionalized at first, but eventually cover the globe"); see also *supra* notes 123-59 and accompanying text (explaining European Community's liberalization agreement enabling air carriers of one member state to operate in all member states).

279. See NATIONAL COMMISSION REPORT, *supra* note 3, at 22 (recommending that United States create "multi-national operating environment for airlines free of discrimination and restrictions").

280. See NATIONAL COMMISSION REPORT, *supra* note 3, at 3 ("The bilateral system must be replaced with an open and comprehensive multi-national regime that has as broad a geographic base as possible and that allows people and products to move freely and efficiently."). The National Commission reasoned:

The current bilateral system for obtaining rights for U.S. airlines to fly to those regions is anachronistic and badly fraying under the pressures of a global economy. The bilateral system of aviation agreements has become increasingly contentious and often results in agreements or relationships that are little more than exercises in zero sum economics. It is too rigid, too time consuming and too limiting. To put it simply, the bilateral agreement system stymies growth in the global marketplace; it does not encourage it.

Id. The National Commission further criticized bilateral agreements by stating that "[b]ecause of our country's geographic size and population, bilateral agreements can result in the U.S. granting foreign carriers greater access to the immense and diverse U.S. travel market without corresponding competitive opportunities for U.S. carriers." *Id.* at 21.

281. See *supra* notes 222-35 and accompanying text (discussing DOT's current foreign ownership and control policy).

282. See *supra* notes 267-69 and accompanying text (discussing prohibition of cabotage for foreign air carriers).

283. See *Leveraged Buyouts and Foreign Ownership of United States Airlines: Hearings on H.R. 3443 Before the Subcomm. on Aviation of the House Comm. on Public Works and Transportation*, 101st Cong., 1st Sess. 156 (1989) (statement of Samuel K. Skinner, Secretary of Transportation) (stating that current procedure for reviewing continuing citizenship status of air carriers is based on ad hoc, case-by-case analysis).

investors.²⁸⁴ To preserve U.S. bargaining power in the current bilateral agreement system, Congress should not unilaterally confer to noncitizens the right to unlimited investment in U.S. air carriers.²⁸⁵ These rights should be exchanged through bilateral agreements, or ideally through a multilateral agreement, to encourage the liberalization of the international air transport market.²⁸⁶ The United States should only suspend current foreign ownership, foreign control, and cabotage restrictions on a reciprocal basis to ensure that other countries open their markets to U.S. investors.

B. Proposed Amendments to the Federal Aviation Act and the U.S. Open Skies Policy

Congress should amend the Federal Aviation Act and create a new statutory framework under which the DOT could apply the Open Skies program.²⁸⁷ This proposed legislation should eliminate the foreign voting and nonvoting equity limitations,²⁸⁸ the foreign control restrictions, and the provisions that prevent foreign air carriers from obtaining cabotage rights.²⁸⁹ Congress should, howev-

284. See Jeffrey D. Brown, *Foreign Investment in U.S. Airlines: What Limits Should be Placed on Foreign Ownership of U.S. Carriers?*, 41 SYRACUSE L. REV. 1269, 1288-89 (1990) (arguing that Congress must provide legal stability and certainty to encourage foreign investors to invest in U.S. air carriers).

285. Cf. *USAir Chairman Lashes Back at Crandall*, AVIATION DAILY, Sept. 18, 1992, at 485, 485 (opposing as "nonsense" position of "Big Three" that British Airways-USAir transaction should not be approved because U.S. airlines could be injured by "unilateral giveaway" unless they get something in return).

286. Cf. Defining "Open Skies," D.O.T. Order No. 92-8-13, at 2 (1992) (determining to proceed with Open Skies initiative but acknowledging that some bilateral agreements may not "produce benefits for U.S. interests of economic value equal to those accruing to our bilateral partners," and noting that "if we were to embark on negotiation initiatives only where we could anticipate precisely equal economic benefits we would have been deterred from some of the most successful agreements we have achieved in the last decade").

European countries, including France, Germany, Italy, and Spain, would probably reject a multilateral exchange of cabotage rights and reciprocal relaxation of foreign investment restrictions. The United States may be more successful negotiating bilateral Open Skies agreements that include these additional liberalization measures.

287. See Ott, *supra* note 162, at 32 (reiterating comments by Scott Yohe, Vice President of Government Affairs for Delta Air Lines, concerning need for "new statutory framework").

288. To provide U.S. air carriers with badly needed capital, there should not be any limits on the amount of nonvoting equity that a foreign entity can hold in a U.S. air carrier. Cf. Card Press Conference, *supra* note 180, at 3 (supporting legislation to raise statutory ceiling on amount of airline's voting stock that could be held by foreign entities from 25% to 49%).

289. Cf. NATIONAL COMMISSION REPORT, *supra* note 3, at 22 (recommending amendment to Federal Aviation Act that enables United States to negotiate bilateral agreements permitting foreign investors to hold maximum of 49% voting equity in U.S. airlines). The National Commission recommended the increase in foreign voting equity as one element of a liberal bilateral agreement that provides equivalent and reciprocal opportunities for U.S. investors. *Id.* Furthermore, the National Commission stipulated that the foreign investor must not be government owned and that the investment must advance both "the national interest and the development of a liberal global regime for air services." *Id.* at 23.

er, instruct the DOT to enforce its current policy on foreign investment²⁹⁰ and cabotage²⁹¹ restrictions if the following conditions are not met.

First, the United States should only permit unlimited foreign voting and nonvoting equity investment in U.S. air carriers by foreign airlines whose governments do not restrict U.S. ownership of their air carriers. Although this requirement would discriminate against citizens of protectionist countries, it would provide an incentive for individual nations to liberalize their foreign ownership requirements.²⁹² Under this approach, foreign equity and foreign control restrictions would be suspended on a nation-by-nation basis through bilateral or multilateral agreements.²⁹³

Second, the United States should only suspend foreign equity and foreign control restrictions as part of the Open Skies program. To obtain suspension of these restrictions, foreign nations would have to incorporate the key elements of the Open Skies program²⁹⁴ into a bilateral or multilateral agreement with the United States. This

290. See 49 U.S.C. app. § 1301(16) (1988) (defining U.S. citizen for purposes of limiting foreign investment). In *Acquisition of Northwest Airlines Inc.*, the DOT relaxed the limit on total equity that a foreign entity can hold in U.S. air carriers to 49%, provided that a U.S. citizen controls the air carrier. *Acquisition of Northwest Airlines, Inc. by Wings Holdings, Inc., D.O.T. Order No. 91-1-41*, at 1 (1991). The controlling statute, however, still mandates that foreign ownership be limited to 25% of the air carrier's voting equity stock. 49 U.S.C. app. § 1301(16) (1988). Legislative action is required to amend the statute. At a minimum, Congress should amend this statute to reflect current DOT policy.

291. See 49 U.S.C. app. § 1508(b) (1988) (precluding foreign air carriers from cabotage in United States).

292. See *USAir Chairman Lashes Back at Crandall*, *supra* note 285, at 485 (noting Delta's position that transaction that would have given control of USAir to British Airways without liberalization of U.S.-U.K. bilateral agreement would have been giveaway of U.S. air transport market). According to Delta, the approval of this transaction would have made it virtually impossible for the United States to achieve its objective of liberalizing world aviation markets. *Id.*

293. See *American Airlines Chairman Robert L. Crandall Says Open Skies Aviation Agreement with Netherlands Sets a Disastrous Precedent*, BUS. WIRE, Sept. 16, 1992, available in LEXIS, Nexis Library, Business File (relaying statement of American Airlines Chairman Robert L. Crandall). Crandall argues:

The U.S. Government must insist that U.S. carriers be granted equal access to these beyond routes to other countries before it grants such access to the enormous U.S. market. . . . Once the foreign flag carriers have access to the U.S. market, there will be no incentive for them or their governments to provide access to worldwide markets for U.S. carriers.

Id.

294. In response to the question "whether each and every element must be effective immediately and simultaneously for an open-skies relationship to exist," the DOT noted:

We accept that in some contexts the phasing in of certain aspects of our definition might not be inconsistent with the overall notion of an open-skies regime. However, rather than make any specific determination here, we regard this issue as one that we can better assess on a case-by-case basis in the context of the negotiating process.

Defining "Open Skies," D.O.T. Order No. 92-8-13, at 7 (1992).

requirement would create an incentive for individual countries to liberalize their air transport policies so that their nationals could invest in U.S. air carriers.

Third, the United States should not permit airlines, individuals, or other entities to invest in U.S. air carriers if they are "substantially influenced" by foreign governments.²⁹⁵ A "substantial influence" test should apply on a case-by-case basis and should examine entities that are owned, controlled, or subsidized by foreign governments. If there is substantial government influence, the DOT's current policy on foreign investment restrictions should apply. In addition, the DOT should take adequate measures to prevent foreign air carriers, especially air carriers owned, controlled, or subsidized by foreign governments, from engaging in price dumping.²⁹⁶ This policy would prevent foreign, government-influenced air carriers, which could obtain unfair competitive advantages, from operating within the U.S. domestic air transport market.

Finally, the United States should exchange cabotage rights bilaterally or multilaterally as an additional element of the Open Skies program. The United States should only exchange cabotage rights with nations that can satisfy the same conditions required for suspension of foreign equity and foreign control restrictions. The policy considerations and the effects of allowing unlimited foreign investment and control are the same for granting cabotage rights to foreigners.²⁹⁷ If Congress amends the foreign investment statute to permit foreign control of U.S. air carriers, which would amount to de facto cabotage, the approval of cabotage rights for foreign entities would naturally follow.²⁹⁸

295. See Nadine Godwin, *BA's Chief: Allow Foreign Control*, TRAVEL WKLY., Oct. 7, 1991, at 80, 80 (quoting Sir Colin Marshall, Chairman, British Airways, Remarks at the ASTA World Travel Congress Forum (Oct. 6, 1991)) ("Dropping barriers to investment in airlines across national frontiers is a necessary element in such an open market. . . . But it goes both ways. . . . European governments will have to privatize their national carriers and let them take their chances in the market.").

296. See 49 U.S.C. app. § 1373(a) (regulating tariffs of air carriers and providing right to reject tariff if inconsistent with this section).

297. See J.A. Donoghue, *Open The Door: US Domestic Air Travel Market Should Be Opened to Foreign Airlines*, AIR TRANSP. WORLD, Aug. 1992, at 5 (stating that foreign investment is often recognized as "back door" to cabotage). This statement refers to the two ways in which noncitizens can enter the United States domestic air transport market: 1) directly, through direct entry of a foreign air carrier; or 2) indirectly, through foreign ownership and control of a U.S. carrier. *Id.*

298. *Id.*

CONCLUSION

The Paris and Chicago Conventions established the principle that each state has absolute sovereignty over the airspace above its territory.²⁹⁹ This principle led to the development of national air carriers, which have been protected from foreign competition by their governments.³⁰⁰ Initially, governments owned, controlled, or subsidized air carriers and negotiated bilateral agreements with other governments to exchange travel rights. The governments that controlled the largest or most influential air transport markets, primarily the governments of the United States and the United Kingdom, were able to control international air transport policy.

If the United States hopes to liberalize the global air transport market, it must first permit the liberalization of its domestic market. The current Open Skies program should provide a framework for the reciprocal elimination of restrictions on foreign ownership, foreign control, and cabotage rights. The United States, however, must be willing to eliminate these restrictions in exchange for the liberalization of foreign air transport policies. A series of bilateral Open Skies agreements might lead to another Chicago Convention, where nations would exchange rights on a multilateral basis to form a unified, global, and free market for air transport.

299. See *supra* notes 6, 35, 50 and accompanying text (discussing sovereignty over airspace).

300. Ellett, *supra* note 35, at 4.

