Mixed Signals on Foreign Ownership: An Assessment

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by Brian F. Havel
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Introduction

Three significant developments have taken place concerning restrictions on foreign ownership of U.S. airlines since my article, A New Approach to Foreign Ownership of National Airlines, appeared in Issues in Aviation Law and Policy in October 2003. First, Congress tightened the U.S. law to insert an explicit requirement of U.S. citizen control. As the 2003 article explained, the prior law was sufficiently ambiguous to make the existence of a control requirement open to a more flexible interpretation. Second, the U.S. Department of Transportation (DOT) declined to review the recommendation of its administrative law judge who found that the DHL corporation's U.S.-based air carrier operator qualified as a citizen of the United States. That set of opinions became the latest opportunity to evaluate the DOT's approach to citizenship review. And third, the U.S./EU open skies negotiations collapsed in June 2004 despite a U.S. offer to seek legislative revision of the foreign stock ownership cap from 25 percent to 49 percent. The talks have resumed in 2005 in a spirit of tentative optimism that has been boosted by United Airlines' call for elimination of all limits on foreign ownership. Each of these three developments—and the mixed signals they send about emerging U.S. policy on foreign ownership—will be assessed in this update.
I. Congress Tightens the U.S. Foreign Ownership Law

The 2003 article noted that 49 U.S.C. § 40102(a)(15) includes a requirement that "ownership or control" of the voting interest must be held by U.S. citizens. The statute included no separate test of U.S. management control. The disjunctive language suggests that Congress assumed, although did not make explicit, that control would simply follow ownership. The DOT, however, routinely applied the statutory language conjunctively, insisting on a distinct test of actual control of the management of the air carrier (in addition to its stock ownership) by U.S. citizens. As the 2003 article discussed, this test is much more fact-dependent and pliable than a simple mathematical measurement of the degree of foreign stock ownership.

Congress memorialized the de facto control test in Section 807 of Vision 100—Century of Aviation Reauthorization Act signed by the President on December 12, 2003. This legislation amends 49 U.S.C. § 40102(a)(15) by adding the words "which is under the actual control of citizens of the United States" to the definition of U.S. air carrier citizenship. The test of managerial control is now conceptually separated from the requirement that 75 percent of the voting interest in a U.S. carrier must be "owned or controlled" by U.S. citizens. The loophole discussed in the 2003 article—which might have allowed the DOT to negotiate away the separate control requirement in discussions with third countries—has therefore been closed.

There is virtually no statutory history to explain why Congress made this change. The revision reflects not only a more cautious security environment after 9/11, but it may also be assumed that the legislation intended to influence events in the DHL citizenship proceeding (considered next). Thus, in addition to modifying 49 U.S.C. § 40102(a)(15), the legislators adopted a lex specialis imposing a citizenship test for Department of Defense airlift contracts. The nature of that test tracked DHL's particular circumstances.2

II. Testing the New "Actual Control" Requirement: the DHL Controversy

The facts of the DHL case are probably the most complex of any DOT citizenship review proceeding. The outcome, favoring DHL's domestic airlift supplier, ASTAR, supports the assertion in the 2003 article that the citizenship review process is not only a lawyer's evidentiary playground but is also clouded by the unpredictability of the ad hoc, impressionistic analysis which DOT regulators continue to apply.
DHL is one of the world's Big Three express package delivery services. FedEx and UPS own 80 percent of the parcel and express delivery market in the United States, while DHL is their major competitor in foreign markets. The facts as stated here are a liberal summarization of the very detailed evidence presented in the hearing. The ultimate owner of DHL is the German mail monopolist Deutsche Post. Until April 2003, DHL was conducting express delivery operations in United States domestic (cabotage) markets using its wholly-owned air carrier called DHL Airways. At that time, DHL sold a 75 percent interest in DHL Airways to a U.S. citizen, triggering a reorganization notification to DOT under its Air Carrier Fitness Division regulations. As the informal DOT citizenship review process unfolded, in July 2003 a venture capital firm owned by former Northwest Airlines chief executive John Dasburg acquired 85 percent of DHL Airways. Dasburg had previously become CEO of DHL Airways. He renamed the company ASTAR Air Cargo, Inc. ("ASTAR") and became its president. The issue in the proceeding, therefore, was whether ASTAR, which receives 90 percent of its U.S. express delivery package business under a non-exclusive wet lease agreement with DHL (a similar arrangement to the one which DHL previously had with DHL Airways), was (and is) a citizen of the United States under 49 U.S.C. § 40102(a)(15). Only an air carrier with U.S. citizenship can provide domestic (cabotage) services inside the United States.

The administrative law judge, Burton S. Kolko, who characterized the proceeding as a disguised private lawsuit (ASTAR v. FedEx/UPS), found that ASTAR is, and continues to be, a U.S. citizen. In his Recommended Decision served on December 19, 2003, he found that not only does ASTAR meet the stock ownership requirements of the statute (100 percent of its voting rights are now owned by U.S. citizens), but that the preponderance of reliable, credible and probative evidence indicated that ASTAR is "actually controlled" by U.S. citizens. On May, 13, 2004, the DOT issued an order declining review of the administrative law judge's Recommended Decision.

FedEx and UPS had argued that ASTAR was so beholden to its wet lease agreement with DHL, its dominant supplier, that DHL would be in a position to exercise "actual control" over ASTAR. At both levels of review, a stacking of the huge quantities of evidence advanced by each side led to the classic impressionistic or "gestalt" approach that the 2003 article exposed in prior DOT decisions on citizenship. On the one hand, ASTAR's business profile—90 percent of its express delivery business (by revenue) supplied by DHL under a wet lease agreement—was virtually identical to that of
Arguably, ASTAR is still, like DHL Airways, merely a "creature of the DHL network," a so-called "cost center," as FedEx and UPS maintained. Alternatively, as Judge Kolko ultimately found, it could be said that in a dynamic marketplace (for express delivery services) the non-exclusivity of the wet lease agreement would allow enough flexibility to ASTAR to cultivate discretionary business relationships other than with DHL. In either of these outcomes, however, what precisely is the determinative factor that suggests either the presence or absence of a substantial risk of actual foreign control? How could the DOT regulators intuit what they have previously called "the shadow of substantial foreign influence"? Merely stacking the evidence would not necessarily point one way or the other. The resolving factor, as it has been in the past, was gestalt.

Judge Kolko, for example, seemed dazzled by the aggressiveness of the alleged servants of DHL (Dasburg and his ASTAR comrades): "They are not as numerous as 'The Magnificent Seven,' but I suspect that one messes with this trio at his peril." Accordingly, he characterized Dasburg and his associates as a "client" of DHL, not a dominated subordinate. And, in adopting the judge's Recommended Decision, the DOT made two critical policy observations that transcended the evidentiary details of what the wet lease agreement actually provided. First, the Department noted that American consumers benefit from the competition (with FedEx and UPS) provided by ASTAR's presence in the U.S. market as part of the DHL network. Second, as a matter of international aviation policy, the DOT rejected the FedEx/UPS contention that accepting ASTAR's citizenship would undermine a significant U.S. bargaining chip in international aviation negotiations. On the contrary, the Department found, denying citizenship to ASTAR could lead to retaliation against U.S. express delivery companies which use similar dominant-customer arrangements with local air carriers in foreign markets.

Reading the psychological state of the challenged company's officers (or potential foreign masters), and assessing the challenge within the context of international aviation policy, represent separate gestalt approaches the 2003 article detected in the leading DOT precedents, Daetwyler and KLM/Northwest, respectively. The ASTAR case articulates an additional gestalt factor, that of consumer welfare. ASTAR, therefore, represents yet another shift in the mood of DOT investment control interpretation. As the 2003 article noted, it is unwise, as a matter of law and policy, to allow unpredictable impressionistic criteria—in ASTAR, the perceived moxie of a domestic or foreign citizen, the likely impact of the
determination on doing-business issues in foreign markets, or the projected competitive effects of allowing or disallowing citizenship—to trump simple examination of any restrictions on the voting powers of the voting equity held by the majority owner (or any other collateral restraint on the voting powers of the voting equity held by the majority owner).

Finally, it is worth emphasizing once again that this decision related to players in the air cargo sector (and, in particular, the highly profitable just-in-time segment of that sector). A different—or at least differently-nuanced—set of impressionistic criteria might have emerged if the proceeding had concerned the more contentious and politicized air passenger and combination sectors.

### III. The Collapse (and Revival) of U.S./EU Aviation Talks

As the 2003 article noted, the momentum for a comprehensive liberalized aviation agreement between the United States and the European Union was considerably magnified when the European Court of Justice ruled in 2002 that the nationality clauses in U.S. bilateral open skies agreements with individual EU Member States violated EU law. A tentative U.S./EU agreement, which did not eliminate foreign ownership restrictions or allow intra-U.S. cabotage, collapsed in June 2004 following rejection by the EU Council of Transport Ministers. The proposal did commit the United States, after the necessary congressional lobbying, to raise the limit on foreign investment to 49 percent from 25 percent. While this change would still not allow EU airlines to establish subsidiaries in the United States (or to acquire U.S. airlines), the negotiations apparently foundered on a specific EU insistence that full cabotage rights in the U.S. domestic market must also be conceded immediately.

In an important speech to the International Aviation Club just after the Council’s vote, John Byerly, U.S. Deputy Assistant Secretary for Transportation Affairs, offered a candid Realpolitik assessment of how things went wrong, arguing that the primary fault lay with internal EU political motives. The speech indicts the European Union negotiators for failing to appreciate the improbability of a first-stage agreement that would revoke U.S. foreign ownership and cabotage laws. But it also concludes that the opposition of some EU Member States and airlines to a more limited first-stage agreement “had little to do with the sufficiency of the U.S. offer and much more to do with relationships within the EU itself.” The speech ends by offering with “four lessons” for future negotiations. The common theme of Byerly’s lessons is the importance of a more realistic and nuanced understanding of what can be achieved.
Byerly’s EU counterpart in the negotiations, Michel Ayral, Director of the Air Transport Directorate of the European Commission, has stepped down, and a speech to the International Aviation Club by his successor, Daniel Calleja, is interesting as much for its positive tone as for its content. Calleja identifies the U.S./EU aviation talks as part of a larger process of transatlantic economic integration. The Hegelian theme of the Director’s remarks (if I may emulate John Byerly’s reference to Hegel in his speech) is that aviation, a global industry, will inevitably achieve the kind of globalized open regulatory environment that other industries already enjoy. Calleja believes that EU aviation liberalization, despite its great strides, remains incomplete without a so-called “external dimension.” The U.S. and EU aviation markets, he notes, together account for 60 percent of global civil aviation output, so that the negotiations have “the potential to set the benchmark for the future regulation of the international air transport industry.”

Calleja does not moderate EU demands for unrestricted access to the U.S. domestic market, including abolition of all foreign ownership restrictions. Nor, departing from Byerly’s pragmatic approach, does he frame his analysis in terms of a “staged” agreement. Rather, he argues that these EU demands must be part of a necessary rethinking of the regulatory model for an industry in crisis. More idealistically, therefore, he thinks of the negotiations as leading to a completely new model for global aviation. Since “the status quo is not an option,” Calleja predicts that a U.S./EU aviation agreement is “achievable” in 2005, although he does not speculate about its content or degree of liberalization.

Calleja’s demands on foreign ownership may find a more appreciative audience in the coming revived talks. The increasing desire of troubled U.S. airlines to access global capital markets—and to merge with or be acquired by more capital-rich foreign airlines—may be the driver for a fundamental recasting of the U.S. foreign ownership rules. The Bush Administration, moreover, has signaled that it will closely examine liberalization of the foreign ownership issue in its second term.

Meanwhile, attention must also be focused on EU overtures to the potentially huge China market. EU negotiators are planning an aviation summit in Beijing in June 2005 to consider possibilities for an EU/China open aviation area. The possible multi-merger of Cathay Pacific, Air China, and Dragonair, if it were to pass the foreign ownership test under third country bilaterals, would spawn the first of a generation of global “supercarriers” and intensify the pressure on the ailing U.S. industry to attract overseas capital investment. As United Airlines CEO Glenn Tilton has recently
argued in several fora, and as Daniel Calleja apparently agrees, the anachronistic foreign ownership laws are ripe for reform.

Conclusion

The current U.S. attitude to foreign ownership of U.S. airlines, to the extent it can be divined from the developments discussed in this article, is characterized by a number of mixed signals. The flexibility suggested in the U.S./EU talks, including raising the cap on foreign ownership of voting stock to 49 percent from 25 percent, was certainly not reflected in the tightening of the control requirement by Congress. On the other hand, Congress may simply have been reacting (among other things) to the need for clarity in the application of the current law and to the unusual circumstances of the DHL proceeding. Moreover, the outcome of that proceeding suggested a more tolerant DOT view of the issue of foreign control and influence, at least in the air cargo sector. Ultimately, however, these mixed signals will need to reconciled, and that will require a political decision. The future of the foreign ownership rule depends very much on the political support that the airline industry can muster in its efforts to reform the current ownership regime. The developments discussed in this article suggest that the U.S. aviation authorities are now open to some changes—but not yet to a complete abolition of all restrictions.

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Endnotes


2 Section 2710 of the Emergency Wartime Supplemental Appropriations Act 2003, P.L. 108-11, directed the DOT to use an administrative judge in the DHL proceeding and established a foreign revenue test with respect to qualification as a U.S. citizen (barring from defense airlift contracts any carrier receiving more than 50 percent of its operating revenue over the most recent three-year period from a non-U.S. citizen which has a direct or indirect voting interest in the carrier or which is a foreign state agency or instrumentality). The "bill of attainder" nature of these provisions seems not to have raised jurisprudential eyebrows. In any event, neither the administrative law judge nor the DOT found that this special foreign revenue test could have any application in the DHL proceeding.

3 DOT has not yet decided whether that was an unlawful operation, and whether civil penalties will eventually be assessed for that operation.


6 With the important qualification that, under the new agreement, DHL guaranteed a payment to ASTAR of $15 million annually whether or not DHL uses ASTAR's airlift capacity. In Judge Kolko's view, this guarantee would act as a disincentive to DHL to cut off ASTAR's supply of business. Even if DHL terminated the contract or moved its business elsewhere, DHL would remain obligated to pay the guarantee and ASTAR would be free to develop alternative business sources. Any threat of termination would also be illusory, the judge found, because DHL needs the coherence of ASTAR's U.S. network. Balanced against these facts, which the judge thought diminished the threat of foreign control, were provisions requiring DHL to be consulted on a change of control of ASTAR and allowing DHL to terminate the contract (and be released from the guarantee) if UPS or FedEx acquired stock in ASTAR or appointed a director.

7 Here is how Judge Kolko put it: "ASTAR arguendo was formed at the instance of a foreign entity, a foreign entity is backing the loan financing over 80 percent of its purchase price; its dominant customer is a foreign entity; and without that customer, ASTAR probably would not exist—certainly not in a form resembling its form today." Recommended Decision, supra note 4, at 32.


9 Recommended Decision, supra note 4, at 21.
10 Willye Peter Daetwyler, d/b/a InterAmerican Freight Co., Foreign Permit, 58 C.A.B. 118 (1971).
14 Most recently at the Chicago Council on Foreign Relations leadership summit, Moving the World: Global Aviation and the Global Economy," Apr. 21, 2005, where Tilton called upon U.S. aviation regulators to eliminate the limits on foreign ownership of U.S. airlines to help struggling U.S. carriers to compete. "This prohibition not only blocks the capital investment this industry so desperately needs, it excludes U.S. airlines from participating in the supercarrier evolution," Tilton argued. See http://www.aerospacemedia.com/AFP/pre-
view.asp?xml=050421192218.008bfhxi.xml (last visited April 25, 2005).

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