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Cabotage and Control: Bringing 1938 U.S. Aviation Policy into the Jet Age

Howard E. Kass*

I. INTRODUCTION

Uncertainty and change have harmed the United States airline industry in recent years. Eastern and Pan Am airlines are no longer flying and other carriers such as Continental, Northwest, TWA, and USAir have experienced financial difficulties.¹ American, Delta, and United, industry leaders, have all suffered record losses, and most post-deregulation carriers have shut down completely.² Over-expansion, bad management, labor unrest, and a poor economy all contributed to the industry's difficulties, and were exacerbated by the competitive forces unleashed by the 1978 Airline Deregulation Act.³ Despite the problems afflicting the airline industry, the federal government does not appear to favor wide-spread re-regulation of the industry, particularly with respect to routes, fares, and capacity.⁴ In response, American carriers are in-

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¹ See THE NATIONAL COMMISSION TO ENSURE A STRONG COMPETITIVE AIRLINE INDUSTRY, CHANGE, CHALLENGE, AND COMPETITION 1 (1993) [hereinafter COMMISSION REPORT] (report delivered to the President and Congress).

² *Id.* On the other hand, Southwest Airlines has made a profit each of the last 21 years. Terry Maxon, *Southwest's '93 Profits Sky-high*, THE DALLAS MORNING NEWS, Feb. 3, 1994, at 1D.

³ Airline Deregulation Act of 1978, Pub. L. No. 95-504 (codified as amended in scattered sections of 49 U.S.C.). Among the many provisions of the Act, the government withdrew from regulating those U.S. destinations airlines could serve, and the government is no longer required to approve domestic fares. *Id.*

⁴ Senate Aviation Subcommittee Chairman Wendell Ford noted that because airlines are in trouble, the government should not be obliged to provide all of the solutions. Bruce Ingersoll & Brett Pauley, *With U.S. Carriers Mired in a Cutthroat War, Government Assistance Remains Up in the Air*, WALL ST. J., Feb. 11, 1993, at A16. The Clinton Administration and Congress created the National Commission to Ensure A Strong and Competitive Airline Industry in an attempt to search for the answers. See Section 204 of the Airport and Airway Safety, Capacity, Noise Improvement and Intermodal Transportation Act of 1992, 49 U.S.C. app. § 1371 (1988 & Supp. IV 1992).

creasingly looking abroad for solutions.⁵

Statutory provisions presently limit foreign air carrier access to the U.S. market. Changing this statutory regime could benefit both consumers and the U.S. airline industry. In the short term, U.S. carriers would gain increased foreign expertise, capital, and traffic. In the long term, they could secure rights to domestic routes in foreign countries or at least acquire enhanced inter-regional rights. These steps are needed for true globalization of the airline industry; otherwise, the current situation will persist in which governments talk about liberalization while shielding their national carriers behind protectionist barriers.

The agency charged with economic oversight of the airline industry in the U.S. is the Department of Transportation (DOT).⁶ DOT's varied duties often conflict with one another. For example, DOT must enforce statutory limitations on the rights of non-U.S. carriers to compete in the U.S.⁷ At the same time, however, DOT is expected to increase:

[t]he availability of a variety of adequate, economic, efficient, and low-price services by air carriers and foreign air carriers without unjust discriminations, undue preferences or advantages, or unfair or deceptive practices, the need to improve relations among, and coordinate transportation by, air carriers, and the need to encourage fair wages and equitable working conditions for air carriers.⁸

Further complicating matters is DOT's commitment to achieving globalization of the aviation industry by reducing non-statutory restrictions on

⁵ This is evident from the large number of agreements and alliances that U.S. carriers have made with foreign airlines. For example, Northwest and the Dutch carrier KLM have entered into a broad based strategic agreement. Continental has similar agreements with both Air Canada and Scandinavian Airline Systems (SAS). Other agreements include Delta with Swissair and Singapore Airlines, USAir with All Nippon Airways, Alitalia, and British Airways. The lure of such arrangements for U.S. carriers is that these strategic alliances often mean increased passengers on their domestic systems, expansion of international service, and most importantly in some cases, an infusion of equity (cash). See, e.g., *Northwest, KLM Continue Expanding Joint Service Operations*, AVIATION DAILY, July 19, 1993, at 88 (discussing Northwest's cooperative service agreement with KLM, the positive effect it has had on Northwest's U.S. market share, and Northwest's increase in transatlantic operations to nearly ninety percent of capacity).

⁶ Prior to 1985, economic regulation of the airline industry was overseen by the Civil Aeronautics Board (CAB), however, as part of the Airline Deregulation Act of 1978, the CAB was dissolved on January 1, 1984. See 49 U.S.C. app. §§ 1551-1555 (1992).

⁷ See 49 U.S.C. app. § 1372 (1992) (requiring foreign carriers to obtain permits for foreign air transportation); 49 U.S.C. app. § 1508(b) (1992) (requiring foreign aircraft to be operated by persons holding certificates or licenses issued by the United States or the nation in which the aircraft is registered).

⁸ 49 U.S.C. app. § 1302(a)(3) (1992).

foreign air carriers' ability to serve the U.S. market.⁹ These conflicting goals have recently forced DOT to make difficult choices in determining whether to allow foreign carriers to help weaker U.S. carriers with equity infusions (cash) and enter into strategic alliances (marketing arrangements). Accordingly, U.S. policy has appeared reactionary, controlled less by principle than politics.¹⁰ The lack of a comprehensive policy that is wholly consistent with U.S. law will only serve to undermine U.S. officials as future aviation treaties are negotiated.¹¹ As the world's largest aviation market, the U.S. must develop a policy, consistent with U.S. law, that will enhance the prospects for a liberal international aviation regime.

This note examines the prospects of international aviation liberalization by reviewing the impact of U.S. restrictions on access to its market and how these restrictions inhibit free trade in aviation services (globalization). It examines both the historical and contemporary consequences of two of the largest restrictions¹² on non-U.S. airlines seeking access to the U.S. market. They are the prohibition against cabotage by foreign carriers¹³ and the statutory limits on foreign investment in U.S. carriers.¹⁴ The note then evaluates recent DOT decisions which discuss the above restrictions and analyzes how DOT handles its often inconsistent

⁹ In the Matter of Defining "Open Skies," DOT Order 92-8-13 (Aug. 5, 1992).

¹⁰ Recent U.S. aviation policy has been described as "Pollyanna" in its belief that if the U.S. changes its laws, "other countries, out of the goodness of their hearts will" change theirs. *Airlines Want Tougher Bilateral Negotiations Under Clinton*, AVIATION DAILY, Jan. 15, 1993, at 80.

¹¹ Acting Assistant Secretary of Transportation Patrick V. Murphy has stated that it is, at times, unclear who we are negotiating for. Adam Bryant, *U.S. Tries to Restore the Once-Friendly Skies*, N.Y. TIMES, Aug. 30, 1993, at C1.

¹² While there are numerous restrictions on foreign carriers operating within the U.S. (freedom to price, frequency of service, choice of markets, etc.), many of them can be circumvented through bilateral agreements. Restrictions on cabotage and foreign ownership are statutory, however, and cannot be avoided through negotiations.

¹³ "The origin of the term is in dispute, but cabotage is generally understood as the carriage of passengers, cargo, and mail between two points within the territory of the same nation for compensation or hire. Such traffic has traditionally been reserved for the state's own carriers." Douglas R. Lewis, Note, *Air Cabotage: Historical and Modern-Day Perspectives*, 45 J. AIR L. & COM. 1059 (1980). Cabotage has also been defined as "[a] nautical term from the Spanish, denoting strictly navigation from cape to cape along the coast without going out into the open sea. In International Law, cabotage is identified with *coasting-trade* so that it means navigating and trading along the coast between the ports thereof." BLACK'S LAW DICTIONARY 202 (6th ed. 1990). Bruce Stockfish notes that cabotage is "'air transport between any two points in the same political unit, that is to say, in the territory of a State as that term is used in air law.'" Bruce Stockfish, *Opening Closed Skies: The Prospects for Further Liberalization of Trade In International Air Transport Services*, 57 J. AIR L. & COMM. 599, 612 n.47 (1992).

¹⁴ 49 U.S.C. app. § 1378(a)(4) (1992).

mandates. The analysis will also explore recent efforts by non-U.S. carriers to gain increased access to the U.S. market, and examine the effects of recent U.S. policies on liberalizing the international aviation regime. Finally, the note offers some proposals on how to achieve a liberal aviation regime.

II. THE CHICAGO CONVENTION AND BILATERAL DEVELOPMENT

A. *Chicago Convention*

Developments in aviation technology during World War II established that aviation would play an important role after the war.¹⁵ The first opportunity to develop an international aviation regime for the post-war world¹⁶ was at the 1944 Chicago Convention.¹⁷ Delegates to the Convention had two major objectives:

1. To draw up a new set of uniform safety and technical standards on an international scale to replace the outmoded ones which had been promulgated years before at the Paris and Habana [sic] Conventions.
2. To determine if and to what extent international air transport could be regulated by international economic control.¹⁸

Several different proposals designed to satisfy the second objective were discussed.¹⁹ The permissive U.S. plan envisioned no "regulatory controls of an economic nature."²⁰ Fearing U.S. aviation power and wishing to develop their own airlines, other nations rejected the U.S. propos-

¹⁵ A.J. THOMAS, JR., *ECONOMIC REGULATION OF SCHEDULED AIR TRANSPORT* 178 (1951) (explaining that the technological development achieved during World War II ensured that aviation would play a pivotal role in post-war development).

¹⁶ Prior to this, international aviation had been governed by the Paris Convention of 1919. *Convention Relating to the Regulation of Aerial Navigation*, Oct. 13, 1919, 11 L.N.T.S. 173. It was the first treaty to codify the notion of cabotage as it related to air transport. Lewis, *supra* note 13, at 1060.

¹⁷ *Convention on International Civil Aviation*, *opened for signature*, Dec. 7, 1944, 61 Stat. 1180, T.I.A.S. No. 1591 [hereinafter *Chicago Convention*].

¹⁸ THOMAS, *supra* note 15, at 191.

¹⁹ Among the plans discussed, the U.S. plan was by far the most permissive with respect to the freedom of airlines to carry traffic in international markets. Other countries sought much more restrictive regimes. The British wanted to create an "International Air Authority to . . . avoid wasteful competition" by regulating all international air routes. Stockfish, *supra* note 13, at 603-04. Canada, Australia, and New Zealand wanted an even more restrictive regime, through the cartelization of international airlines under a single authority. *Id.*; Barry E. Hawk, *Airline Deregulation After Ten Years: The Need for Vigorous Antitrust Enforcement and Intergovernmental Agreements*, 34 THE ANTITRUST BULL. 267, 290 (1989); *see also*, THOMAS, *supra* note 15, at 192-94.

²⁰ THOMAS, *supra* note 15, at 192 (noting the surprisingly liberal U.S. position at the Convention considering the highly restricted U.S. domestic market).

als.²¹ Alternative ideas for the establishment of an international authority to oversee international aviation were also rejected.²²

The Chicago Convention reaffirmed a basic principal of international law, "that every State has complete and exclusive sovereignty over the air space above its territory."²³ This affirmation proved false because the preamble to the Convention stated that air service should be developed "on the basis of equality of opportunity and operated soundly and economically."²⁴ Affirmation of each nation's sovereignty over its own airspace, therefore, caused a conflict with the Convention's underlying goals and objectives.²⁵ Participation in international aviation was not premised on an airline's ability to acquire aircraft and advertise service; rather, it was based on the degree to which an airline's national government could secure foreign market access.²⁶ Viewing the Chicago Convention as a starting point for the development of a liberal international aviation regime is dissatisfying, because progress toward an open, global aviation regime has generally progressed slowly.²⁷ The creation of a new world order in aviation would have required states to concede at least some of their sovereignty. However, the restrictive regime that was implemented made the Chicago Convention a missed opportunity.²⁸ The recognition of individual state sovereignty was the genesis of the present international aviation regime, and the first failure to liberalize air transport.²⁹

The Convention did not adopt an extreme absolute sovereignty

²¹ See Stockfish, *supra* note 13, at 603-04.

²² *Id.*

²³ Chicago Convention, *supra* note 17, at art. 1. Article 1 states that "[t]he contracting States recognize that every State has complete and exclusive sovereignty over the airspace above its territory." *Id.*

²⁴ Chicago Convention, *supra* note 17, at pmb1. According to the Chicago Convention, "the future development of international civil aviation can greatly help to preserve friendship and understanding among the nations . . . yet its abuse can become a threat to the general security." *Id.*

²⁵ Stockfish notes that the first article of the Convention "effectively amounts to a contradiction of the right of states to participate equally in the provision of air transport services." Stockfish, *supra* note 13, at 603.

²⁶ *Id.* at 602-03.

²⁷ *Id.*

²⁸ "The Chicago Conference provided a multilateral opportunity for states to respond accordingly through a broad exchange of airline operating rights, but it was not to be." Stockfish, *supra* note 13, at 603.

²⁹ The affirmation of state sovereignty over airspace went beyond the borders of an individual state. International air routes could not be easily developed if there were no limitations on a state's ability to extract economic gain through the exercise of sovereignty. See THOMAS, *supra* note 15, at 174.

position. If this was the case, an airline flying between Bombay and London would be required to seek overflight rights from every country the aircraft would fly over—or otherwise, fly only over international waterways.³⁰ At the conference, the U.S. sought to minimize state control over international aviation by seeking to establish “five freedoms of the air:”

1. The right to fly over the territory of another country without landing.
2. The right to land in another country for technical reasons.
3. The right to discharge traffic from the home country in a foreign country.
4. The right to pick up traffic in a foreign country bound for the home country.
5. The right to pick up traffic in a foreign country and convey them to yet another country, provided that the flight originates or terminates in the home country.³¹

Had the U.S. delegation not pressed for unlimited rights for airlines to exercise all five freedoms, the Convention might have succeeded in achieving a multilateral regime without restrictions on airlines flying between two countries.³²

The delegates to the Chicago Convention did agree on universal application of the first two freedoms.³³ Article Six of the Convention,

³⁰ See Chicago Convention, *supra* note 16, at art. 2.

³¹ Stockfish, *supra* note 13, at 603-04 n.12.

³² *Id.* (noting that the five freedoms were rejected out of fear that the U.S. would dominate international aviation); see also, THOMAS, *supra* note 15, at 185 (arguing that the U.S. position was justified by the fact that without the ability to pick-up traffic on long distance flights, after discharging passengers along the way, aircraft would arrive at a final destination nearly empty).

³³ International Air Services Transit Agreement, 59 Stat. 1693, E.A.S. No. 487 (Dec. 7, 1944) (this was an ancillary agreement to the Chicago Convention). The failure of the Chicago Convention to develop economic policies for international aviation was ameliorated by the formation of the International Civil Aviation Organization (ICAO) and the Convention's general agreement on other technical regulations which made it “one of the most successful international agreements ever negotiated.” Stockfish, *supra* note 13, at 606; Despite the failure of the Convention to create a liberal international aviation regime, the Convention did lead to the creation of standardized rules concerning the international operation of non-scheduled air service, the nationality of aircraft, and the facilitation of air navigation. Chicago Convention, *supra* note 17. The Convention also created the International Civil Aviation Organization whose aims are 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 for international civil aviation;
- (d) Meet the needs of the peoples of the world for safe, regular, efficient

which requires permission from individual nations to begin scheduled air service in that country, has been viewed as the beginning of the modern day bilateral agreement.³⁴ Although the governing convention outlining the process is multilateral, it requires that signatories negotiate specific commitments and undertakings with each other on a bilateral basis.³⁵ In short, the Chicago Convention granted rights to overfly and make emergency landings, but did not grant a right to establish regularly scheduled commercial landings in another country—an issue that still requires negotiation between individual nations.³⁶

B. Foreign Ownership

In 1946, the United States and Great Britain signed a bilateral agreement known as Bermuda I.³⁷ The agreement represented a sharp departure from the policies of both nations at the Chicago Convention.³⁸ It became the model upon which other bilateral agreements would be based.³⁹ Bermuda I established many new routes and privileg-

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.

Id. at arts. 43-44.

³⁴ Article 6 states 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.” Chicago Convention, *supra* note 17, at art. 6.

³⁵ *Id.*

³⁶ These negotiations generally address third and fourth freedom rights and other ancillary issues.

³⁷ Air Services Agreement, Feb. 11, 1946, U.S.-Gr. Brit.-N. Ir., 15 U.N.T.S. 295 [hereinafter Bermuda I] (the agreement codified the levels of air service that were to be provided by carriers of each nation).

³⁸ THOMAS, *supra* note 15, at 218. The Chairman of the U.S. delegation to the conference suggested that the ability to reach an agreement with the British was based primarily on political sentiment in both countries that there should be cooperation in the post war period, which led to a softening of both nations positions. George P. Baker, *The Bermuda Plan as the Basis for a Multilateral Agreement*, lecture delivered at McGill University (April 14, 1947), *reprinted in* ANDREAS F. LOWENFIELD, *AVIATION LAW* §1.13, at 2-9-11 (2nd ed. 1981).

³⁹ See Stockfish, *supra* note 13, at 609-10 (explaining that the Bermuda I agreement caused states to think about traffic rights as a good which could only be sold for the best available price); see also Jose A. Gomez-Ibanez, *Deregulating International Markets: The Examples of Aviation and Ocean Shipping*, 2 YALE J. ON REG. 107, 110 (1984). The basic framework that

es for both nations' air carriers.⁴⁰

Not surprisingly, Bermuda I prohibited the granting of traffic rights to U.S. or British airlines that were not controlled by U.S. or British nationals.⁴¹ The fact that this clause was in Bermuda I, despite its apparent inconsistency with the U.S. position at the Chicago Convention, seems to indicate a negotiating victory for the British. The reality is that despite pressing for unlimited traffic rights at the Chicago Convention, the U.S. did try to prevent foreign ownership or control of U.S. carriers.⁴² While several drafts of the Convention included outright prohibitions on foreign ownership, a number of smaller countries, led by El Salvador, opposed these restrictions because of the need for outside capital and expertise in order to start their own civil aviation programs.⁴³ Ironically, the U.S. position of the 1940s advocating a free market with ownership restrictions, mirrors recent U.S. aviation policy.

The reasons that support the imposition of ownership restrictions have been subject to some debate. One view holds that the test for substantial national ownership arose in order to prevent airlines from taking on "flags of convenience" in countries with less stringent safety regulations.⁴⁴ While governmental concern for ensuring safety is laud-

Bermuda I developed includes 1) international air service must start and terminate in a carrier's home country; 2) fifth freedom traffic must be an ancillary goal; 3) cabotage traffic must be reserved for a nation's flag carriers; and 4) international air service can only be operated by a carrier which is owned and controlled by nationals of the state granting the rights. H.A. Wassenbergh, *International Air Transport: Regulatory Approaches in the Nineties*, 17 AIR AND SPACE L. 69, 74-75 (1992) [hereinafter *Int'l Air Transport*].

⁴⁰ The agreement contains provisions relating to routes, capacity, and fares. THOMAS, *supra* note 15, at 218-24.

⁴¹ See Bermuda I, *supra* note 37, at art. 6.

⁴² This was one of the few areas which the U.S. and the U.K. agreed on without debate at the Chicago Convention. Both parties shared the view that until a state was "satisfied that 'substantial ownership and effective control are vested in the nationals of that state,'" no state would be obligated to grant rights to airlines of another state. Z. Joseph Gertler, *Nationality of Airlines: A Hidden Force In the International Air Regulation Equation*, 48 J. AIR L. & COM. 51, 58 (1982).

⁴³ *Id.* See also Marc L.J. Dierikx, *Bermuda Bias: Substantial Ownership and Effective Control 45 Years On*, 16 AIR L. 118, 120 (1991).

⁴⁴ Gertler, *supra* note 42, at 60. A flag of convenience is used

to describe the flags of such countries . . . whose laws allow — and indeed make it easy — for ships owned by foreign nationals or companies to fly the flags. This is in contrast to the practice in the maritime countries (and in many others) where the right to fly the national flag is subject to stringent conditions and involves far reaching obligations.

L.F.E. Goldie, *Environmental Catastrophes and Flags of Convenience — Does the Present Law Pose Special Liability Issues?*, 3 PACE Y.B. INT'L L. 63, 64 n.5 (1991). It has also been described as the "[p]ractice of registering a merchant vessel with a country that has favorable (ie.

able, it is not an objective that is necessarily related to foreign ownership. Article 11 of the Chicago Convention provides that an aircraft operating in a foreign nation must comply with all of the applicable air regulations of the host nation.⁴⁵ More persuasive is the view that the U.S. was concerned with security considerations.⁴⁶ These concerns stemmed from the German and Italian influence in Latin America before and during World War II.⁴⁷ After World War II, these fears continued because of the new threat from the Soviet Union.⁴⁸

Despite nationalist and mercantilist pressures to ensure that airlines were controlled by nationals of the flag country, potential for industry liberalization arose from Britain's initial understanding of Bermuda I.⁴⁹ The British believed that if a U.S. national was to control a British airline that had been granted rights under Bermuda I, the British were not "obliged" to rescind the rights of this carrier since both countries were parties to the agreement.⁵⁰ The British agreement with Brazil included this liberal interpretation because Brazil explained that it was unable to operate a wholly national airline.⁵¹ The U.S. initially supported this permissive interpretation; however, the political realities of the Cold War forced it to reconsider its view.⁵²

less restrictive) safety requirements, registration fees, etc." BLACK'S LAW DICTIONARY 638 (6th Ed. 1990).

⁴⁵

Subject to the provisions of this Convention, the laws and regulations of a contracting State relating to the admission to or departure from its territory of aircraft engaged in international air navigation, or to the operation and navigation of such aircraft while within its territory, shall be applied to the aircraft of all contracting States without distinction as to nationality, and shall be complied with by such aircraft upon entering or departing from or while within the territory of that State.

Chicago Convention, *supra* note 17, at art. 11.

⁴⁶ Dierikx, *supra* note 43, at 119.

⁴⁷ *Id.* at 119-20.

⁴⁸ *Id.* at 123.

⁴⁹ *Id.* at 122.

⁵⁰ The text of a letter between the British Ministry of Civil Aviation and Foreign Office explains the British position:

The Article is, of course, permissive and not mandatory. What it says is that if . . . the US designated a company to operate from the US to the UK under the terms of the Bermuda Agreement, and the company were not substantially owned and effectively controlled by US or UK citizens, we could reserve the right to withhold or revoke the exercise of rights by that carrier. We should not, however, be obliged to do so unless we wished.

Id.

⁵¹ *Id.*

⁵² *Id.* at 122-24.

C. Cabotage Restrictions

1. International

Article 7 of the Chicago Convention specifically addressed the issue of cabotage. Reinforcing notions of sovereignty codified by Article 1, Article 7 reaffirms a country's right to prohibit aircrafts from other states from carrying passengers or cargo within its territory.⁵³ The language explicitly prohibits the granting of cabotage rights to another state "on an exclusive basis."⁵⁴ Debate over whether the restriction is "qualified or absolute"⁵⁵ has arisen because of Article 7's ambiguity.

The restrictive view focuses on the language "an exclusive basis" and holds that if cabotage is granted to one state, the same rights and privileges must be made available to other states.⁵⁶ The liberal interpretation focuses on the word "specifically" and holds that exclusive grants of cabotage are allowed, provided that no agreement between parties contains any clause which would prohibit the granting of cabotage rights to third parties.⁵⁷ The International Civil Aviation Organization (ICAO) has made several failed efforts to clarify Article 7.⁵⁸ The consistently held U.S. position is that the Convention does not require cabotage rights to be granted to all countries in cases where they have been granted to only one. Underlying this position is the view that the granting of cabotage rights is a "sovereign, unilateral judgement" which is

⁵³ Article VII of the Convention reads:

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 17, at art. 7.

⁵⁴ *Id.*

⁵⁵ Lewis, *supra* note 13, at 1063.

⁵⁶ *Id.* at 1063-64; Z. Joseph Gertler, *Towards a New, Rational and Fair Exchange of Opportunities for Airlines*, in EEC AIR TRANSPORT POLICY AND REGULATION AND THEIR IMPLICATIONS FOR NORTH AMERICA 199, 202-03 (Peter P.C. Haanappel et al. eds., 1990) (explaining that if one state was to grant cabotage rights to another country, any third state would be entitled to the same rights).

⁵⁷ See, e.g., Lewis, *supra* note 13, at 1065; Gertler, *supra* note 56, at 202.

⁵⁸ The main arguments against the need to clarify the ambiguity of Article 7 are that there are no problems with the system and that developing nations fear that they could be taken advantage of by stronger carriers from developed nations. Gertler, *supra* note 56, at 201-02.

not affected by Article 7.⁵⁹ The U.S. position is consistent with the Swedish proposal, put forth at the 1967 ICAO conference, which called for clarification of Article 7.⁶⁰ The Swedish delegation believed that the Convention's delegates did not intend to prohibit agreements which would ultimately produce more efficient air service.⁶¹

2. U.S. Domestic Cabotage Restrictions

The United States has had laws prohibiting cabotage by foreign carriers since 1926.⁶² U.S. cabotage laws between 1926 and 1979, reserved "cabotage traffic for domestic carriers, thus protecting domestic airlines, workers and markets from the rigors of foreign competition."⁶³ Congressional motivation behind protecting the domestic market was based on fear that carriers would use predatory tactics against each other and harm service levels.⁶⁴ Congress felt that the airline industry was

⁵⁹ PABLO MENDES DE LEON, CABOTAGE IN AIR TRANSPORT REGULATION 54-55 (1992).

⁶⁰ Sweden proposed deleting the second sentence of Article 7 which deals with the exclusivity issue. *Id.* at 63.

⁶¹ *Id.* at 64.

⁶² See Air Commerce Act, 44 Stat. § 568 (1926) [hereinafter ACA]; Civil Aeronautics Act, 52 Stat. § 973 (1938) [hereinafter CAA]; Act of August 8, 1953, 67 Stat. § 489 (1953); Federal Aviation Act 72 Stat. § 731 [hereinafter FAA]. 49 U.S.C. states, in relevant part:

§ 1372 (a) Necessity

No foreign air carrier shall engage in foreign air transportation unless there is in force a permit issued by the board authorizing such a carrier so to engage.

§ 1372 (b) Issuance

The Board is empowered to issue such a permit if it finds (1) that the applicant is fit, willing, and able properly to perform such foreign air transportation and to conform to the provisions of this Act and the rules, regulations, and requirements of the Board hereunder and (2) either the applicant is qualified, and has been designated by its government, to perform such foreign air transportation under the terms of an agreement with the United States, or that such transportation will be in the public interest.

§ 1508(a)

The United States of America is hereby declared to possess and exercise complete and exclusive national sovereignty in the airspace of the United States

§ 1508(b)

Foreign aircraft . . . may be navigated in the United States [A]ircraft permitted to navigate in the United States . . . 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

See also, 49 U.S.C. app. § 1301 (1992).

⁶³ Lewis, *supra* note 13, at 1070.

⁶⁴ These prohibitions are consistent with the way Congress viewed the airline industry. Con-

too competitive and that this would adversely affect the "financial status of . . . air carriers and . . . render unsafe a transportation service appropriate to the needs of commerce and required in the public interest, in the interests of the Postal Service, and national defense."⁶⁵ In other words, the purpose behind the Civil Aeronautics Act "was to promote air transportation through regulated competition."⁶⁶

In 1980, Congress passed the International Air Transportation Act of 1979 which allows for cabotage in limited circumstances.⁶⁷ Section 13 of the Act permits an exception for foreign carriers to fly within the U.S. in situations where an 'emergency' occurs and U.S. carriers cannot handle the traffic.⁶⁸ The exemption can only be granted if efforts to accommodate the traffic on other U.S. carriers have been made.⁶⁹ This exemption cannot extend longer than thirty days and is only available in situations where it is necessary to avoid undue hardship on airline traffic.⁷⁰ While Congress may have thought it was protecting the travelling public, Section 13's provisions are so inherently restrictive that the ex-

gressional legislation has continually reflected the view that the airline industry is a unique industry and should be protected by the state from destructive competition. Jonathan B. Wilson, Note, *The Lessons of Airline Deregulation and The Challenge of Foreign Ownership of U.S. Air Carriers*, 24 GEO. WASH. J. INT'L. L. & ECON. 103, 111-12 (1990). Domestic carriers were regulated by the Civil Aeronautics Board (CAB) as to the routes they could serve, and the markets they could enter. See CAA, *supra* note 62.

⁶⁵ S. REP. NO. 1661, 75th Cong., 3rd Sess. 2 (1938).

⁶⁶ SAMUEL B. RICHMOND, REGULATION AND COMPETITION IN AIR TRANSPORTATION 29 (1961). See also *A Bill to Create a Civil Aeronautics Authority to Provide for the Regulation of Civil Aeronautics for Other Purposes: Hearings on S. 3760 Before the Senate Comm. on Commerce*, 75th Cong., 3rd Sess. 23-29 (1938) (statement of Senator Gorrell) [hereinafter *Gorrell Statement*]. Senator Gorrell noted that the problems facing the industry are ones of management and government politics which could only be solved by enacting economic legislation that would provide stability for the airlines. *Id.* From a national security standpoint, the Senator noted that air transport contributes to national defense in a way that very few other industries contribute in time of crisis. *Id.*

⁶⁷ International Air Transportation Competition Act of 1979, 49 U.S.C. app. § 1386 (1992).

⁶⁸

The Board may . . . to the extent it finds that such action is required in the public interest, exempt any foreign air carrier for a period not to exceed 30 days . . . to the extent necessary to authorize the foreign air carrier to carry passengers, cargo, or mail in interstate or overseas air transportation in certain markets if the Board . . . finds that because of an emergency created by unusual circumstances not arising in the normal course of business, traffic in such markets cannot be accommodated by air carriers [and] all possible efforts have been made to accommodate such traffic by utilizing the resources of such air carriers

Id.

⁶⁹ *Id.*

⁷⁰ *Id.*

ception provides little benefit and does not represent a modification of the United States' protectionist attitude towards its domestic market.⁷¹

III. PROHIBITIONS ON FOREIGN OWNERSHIP

A. U.S. Foreign Ownership Laws

U.S. law requires a certificate of public convenience, analogous to a license, in order to operate a commercial aircraft.⁷² To obtain such a certificate, DOT must find the airline to be in compliance with § 1301 which outlines the requirements of U.S. citizenship.⁷³ The statutory language 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 of 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.⁷⁴

Most conflicts arising through DOT's examination of a carrier's conformity with U.S. citizenship requirements involve the "control" component. In essence, the "control" test is an evaluation by DOT of who is actually controlling the airline. Therefore, satisfaction of the statutory percentages is often not sufficient; the airline must actually be controlled by U.S. citizens.⁷⁵ One of the reasons for these ownership restrictions is related to national security concerns.⁷⁶ In addition, economic concerns surround the fact that outside of the United States, a majority of the world's airlines are either government-owned or subsidized.⁷⁷ The prohibition on foreign ownership was designed to prevent

⁷¹ Lewis, *supra* note 13, at 1084 (noting that the provisions are "only a minimal concession to the public's interest" and give "unduly excessive weight [to] domestic carrier and labor interests").

⁷² See FAA, *supra* note 62.

⁷³ 49 U.S.C. app. § 1371(d)(1) (establishing requirement for certification), § 1302 (matters to consider in the public interest) (1992).

⁷⁴ 49 U.S.C. app. § 1301 (1992).

⁷⁵ Jeffery D. Brown, Note, *Foreign Investments in U.S. Airlines: What Limits Should Be Placed on Foreign Ownership of U.S. Carriers?* 41 SYRACUSE L. REV. 1269, 1275-76 (1990).

⁷⁶ Wilson, *supra* note 64, at 146. Congress originally viewed the airline industry as analogous to the merchant marine and believed that the air transportation system must be maintained and ready for war. See *Gorrell Statement*, *supra* note 64, at 31-32.

⁷⁷ For example, of the eight largest European airlines, only British Airways is entirely

a state-owned foreign carrier from buying a U.S. carrier and competing unfairly in the domestic U.S. market to the detriment of private U.S. carriers.⁷⁸

The present international regime including foreign ownership restrictions, state control of routes through bilateral processes, and domestic airlines' freedom from international competition on domestic routes, dates to at least the mid-1940s. Liberalization of world trade over the last twenty-five years has affected international aviation and should make maintenance of the status-quo a tenuous proposition.⁷⁹ Changes in international aviation have upset the stability of the old regime and have forced states to rethink the validity of the reasons that they proffer as justification for protecting their national airlines.⁸⁰

IV. CONTEMPORARY INTERPRETATION OF CABOTAGE

A. *Statutory Interpretation*

Congress' overt action to protect the domestic U.S. airline industry has made cabotage violations very rare. However, in 1992, Aerovias, a Guatemalan carrier, was found to have violated 49 U.S.C. app. § 1372⁸¹ by engaging in illegal cargo flights.⁸² DOT ruled that Aerovias had operated flights between the U.S. and foreign countries without proper authorization.⁸³ Additionally, the carrier had conducted eleven flights between Palau (U.S. Trust Territory) and Saipain (U.S. Trust Territory).⁸⁴ DOT noted that "[c]abotage and other unauthorized operations

privately owned. Of the remaining seven airlines, two are almost completely state owned (Air France and Iberia), and three are at least half owned by governments (Alitalia, Lufthansa, and SAS). Only KLM and Swissair are less than fifty percent government-owned. Kenneth Labich, *Europe's Sky Wars*, FORTUNE, Nov. 2, 1992, at 88, 90.

⁷⁸ This could have a dramatic impact on U.S. aviation policy because it would certainly color the nature and tone of future U.S. aviation negotiations with a foreign county, as well as have a drastic effect on domestic carriers' ability to remain profitable.

⁷⁹ British Airways Deputy Chairman Colin Marshall stated that the "root of the airline industry's problem is the 'obstacle of nationalism' . . . created by state-ownership and nurtured by the bilateral process." *Marshall Warns Against Turning Down BA/USAir Deal*, AVIATION DAILY, Oct. 15, 1992, at 80.

⁸⁰ See generally James P. Woolsey, *Governments Must Surrender Control; Interview With Colin Marshall Deputy Chairman of British Airways*, AIR TRANSPORT WORLD, Dec. 1991, at 29 (indicating that airlines should make decisions on a commercial basis, not as protected companies).

⁸¹ 49 U.S.C. app. § 1372(a) states that "[n]o foreign carrier shall engage in foreign air transportation unless there is in force a permit issued by the Board authorizing such carrier so to engage." *Id.*

⁸² See DOT Consent Order 92-4-21 (Apr. 8, 1992).

⁸³ *Id.*

⁸⁴ United States Trust Territories are part of the U.S. for purposes of the F.A.A. See 49

into the U.S. by foreign air carriers purloin the economic opportunities available to U.S. carriers. As such, these unlawful operations are serious matters warranting significant enforcement action."⁸⁵ Aerovias countered that it had been misinformed about the fact that it was providing service to U.S. destinations.⁸⁶

DOT is very hesitant to use its authority under the International Air Transportation Competition Act to grant exceptions for cabotage flights, except in extremely compelling circumstances. The threshold test for DOT authorization is:

- 1) that the authority is required in the public interest;
- 2) that because of an emergency created by unusual circumstances not arising in the normal course of business the traffic cannot be accommodated by U.S. carriers holding certificates under section 401 of the Act;
- 3) that all possible efforts have been made to place the traffic on U.S. carriers; and
- 4) that the transportation is necessary to avoid undue hardship to the passengers (or cargo) involved.⁸⁷

DOT requires that any carrier requesting a cabotage exemption must serve notice on all U.S. carriers who may be able to accommodate the traffic.⁸⁸ For example, when a U.S. carrier suspended operations, live camels en route to Los Angeles were stranded in Honolulu.⁸⁹ Qantas, an Australian carrier, operated between Honolulu and Los Angeles with an aircraft configuration capable of transporting the camels. In order to get the business, Qantas was required to serve notice on all U.S. carriers that had an appropriate cargo configuration and scheduled service to Hawaii from the U.S. mainland.⁹⁰ After no U.S. carrier expressed interest in providing an aircraft, DOT granted the exemption because the situation "clearly constitute[d] an emergency created by unusual circumstances not arising in the normal course of business."⁹¹

U.S.C. app. § 1301(41) (1992).

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ The Application for Emergency Exemption is made pursuant to FAA § 416(b)(7), DOT Order 86-8-37 (Aug. 15, 1986) (denying Lineas Aereas Del Caribe, S.A., the right to carry 90 cattle between Miami, Florida, and San Juan, Puerto Rico, on behalf of Arrow Air). *See also* 49 U.S.C. app. § 1386(b)(3) (1992).

⁸⁸ *See* Application of Qantas Airways Limited for Emergency Exemption made pursuant to FAA § 416(b)(7), DOT Order 91-10-10 (Oct. 4, 1991).

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.*

While DOT, and its predecessor CAB, grant exemptions in emergencies, it adheres to the statutory language very closely. In two different cases, DOT has denied requests for exemptions when surface transportation was an option,⁹² and has allowed passengers to become stranded when American carriers have needed a weekend to service a passenger backlog.⁹³ In the latter instance, 240 passengers were in danger of being stranded over the weekend in San Juan because of Prinair's unscheduled maintenance problems.⁹⁴ Air BVI filed an emergency exemption and requested the right to provide transport for the stranded passengers.⁹⁵ CAB denied the request and stated that there were a sufficient number of non-certified air carriers (air taxis) on Puerto Rico which could provide extra flights.⁹⁶

B. Shifts in Policy Interpretation

While the Airline Deregulation Act of 1978 eliminated much of the economic regulation of the airline industry, Congress has been unwilling to repeal laws relating to cabotage. Congressional legislation forced the CAB, and now DOT, to tell foreign carriers that they cannot regularly compete in domestic U.S. markets.⁹⁷ As a result, U.S. consumers and shippers probably pay higher fares than necessary for air service because the maximum number of potential competitors in any given market is never realized. Most troubling though, is that U.S. restrictions on competition can seriously jeopardize DOT efforts to obtain better opportunities for U.S. carriers in other countries because DOT cannot offer cabotage rights as an inducement for more meaningful concessions from foreign states.

However, views on cabotage are beginning to change. Both DOT and the U.S. airline industry were opposed to cabotage as recently as the mid-1980s.⁹⁸ As recently as 1986, DOT officials said that cabotage

⁹² See Application of Heavylift Cargo Airlines Limited for Emergency Exemption denied pursuant to FAA § 416(b)(7), DOT Order 85-12-78 (Dec. 27, 1985).

⁹³ See Application of Qantas Airways Limited for Emergency Exemption made pursuant to FAA § 416(b)(7), DOT Order 85-6-20; Application of Air BVI for Cabotage Exemption, DOT Order 84-2-108 and Cabotage Exemption Denial, § CAB ¶ 388 (Feb. 24, 1984).

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ See *supra* notes 62-71 and accompanying text.

⁹⁸ James K. Gordon, *Canadian-U.S. Bilateral Talks Hinge on Cabotage Agreement*, AVIATION WK. & SPACE TECHNOLOGY, Dec. 2, 1985, at 45; cf. Jane Levere, *Cohen Urges Cabotage Liberalization to Bargain for Overseas Rights*, TRAVEL WKLY., Nov. 4, 1985, at 68 (discussing former CAB chief Marvin Cohen's call for a repeal of cabotage rights).

was an idea which would one day be accepted, but which could not yet be realized.⁹⁹ Industry leaders have also called for change. Former Texas Air and Eastern Airlines chairman Frank Lorenzo stated in 1991, that "cabotage in the U.S. would strengthen competition."¹⁰⁰ Delta Airlines also supports limited cabotage.¹⁰¹ A year earlier, former DOT Assistant Deputy Secretary of State for Transportation and Telecommunications stated that "[t]he time is ripe for discussions . . . in the area of cabotage rights."¹⁰² The softening of views on cabotage by some American carriers is motivated by U.S. carriers' desire to secure additional rights overseas in return for a relaxation of cabotage in this country. This is particularly true with respect to the largest carriers which have little opportunity for domestic growth given that they already serve nearly every significant U.S. market.¹⁰³

The Air Line Pilots Association (ALPA) is the most significant and consistent opponent of any liberalization of existing cabotage restrictions.¹⁰⁴ ALPA President, Captain J. Randolph Babbitt, believes that if cabotage is granted, foreign carriers would only compete in the most attractive routes that are already extensively served by U.S. carriers.

⁹⁹ See Joan Feldman, *Will the U.S. Ever Grant Cabotage Rights; International Air Space Law*, AIR TRANSPORT WORLD, Sept. 1986, at 26; Fran Durbin, *Official Urges Look at Canadian Service on U.S. Intercity Routes*, TRAVEL WKLY., Nov. 27, 1986, at 13; Jeffery Shane, *Deputy Assistant Secretary of State for Transportation Discusses Cabotage Rights*, TRAVEL WKLY., Nov. 27, 1986, at 13, (discussing how U.S. law and policy are opposed to "cabotage in any form" and, therefore, should not be a subject of U.S.-Canadian bilateral negotiations).

¹⁰⁰ Lorenzo *Calls on Government to Review Bilateral Objectives*, AVIATION DAILY, Dec. 19, 1991, at 495.

¹⁰¹ *Delta Supports Limited Cabotage, Increased Foreign Ownership*, AVIATION DAILY, Nov. 25, 1991, at 345. Under Delta's proposal, a foreign air carrier could fly from a foreign country to a U.S. destination A and collect additional domestic passengers for the on-going flight to U.S. destination B (this is known as limited or tag-end cabotage). Delta does not support full-scale cabotage rights (full scale cabotage would not require the flight to originate in a foreign country) in the United States, unless U.S. carriers would be granted the same routes within Europe as a whole. *Id. Carriers Push Increasing Foreign Ownership As Mainstay of Opening Skies*, AVIATION DAILY, June 5, 1992, at 409. Other smaller U.S. and foreign carriers, while not opposed to cabotage, do not believe it will have any impact on the existing market power of larger U.S. carriers. *Id.*

¹⁰² Matthew V. Scocozza, *EEC-US Aviation Relations and Cabotage*, in *EEC AIR TRANSPORT POLICY AND REGULATION AND THEIR IMPLICATIONS FOR NORTH AMERICA*, 211, 216 (Peter P.C. Haanappel et al. eds., 1990); compare with Gordon, *supra* note 98, at 45 (at a meeting between U.S. and Canadian negotiators the U.S. informed Canada that cabotage rights would be impossible to grant because of wide-spread industry opposition).

¹⁰³ James S. Hirsch, *Code Sharing Leaves Fliers Up in the Air*, WALL ST. J., Mar. 11, 1993, at B1.

¹⁰⁴ President Clinton has also expressed opposition to loosening cabotage restrictions, although he has not explained why. *Clinton Opposes Cabotage, Changing Foreign Ownership Rules*, AVIATION DAILY, Sep. 23, 1992, at 511.

This would cut directly into U.S. carrier revenue while offering a limited benefit to U.S. consumers.¹⁰⁵ Babbitt has envisioned an exchange of cabotage rights with Singapore.¹⁰⁶ Singapore Airlines would fly between Minneapolis and Seattle; in return, Northwest would be able to fly anywhere in Singapore.¹⁰⁷ But according to the ALPA, there can be "no *quid pro quo* concerning the domestic routes of the United States."¹⁰⁸

ALPA claims that cabotage would devastate an industry that has realized only a two percent return on equity investment over the last decade.¹⁰⁹ Its opposition to cabotage rights even extends to Canadian carriers,¹¹⁰ fearing that the Chicago Convention would entitle other nations to similar rights.¹¹¹ According to ALPA, the experience of other industries such as "shipping, textiles, and electronics," is evidence of the results of too much free market competition and why the airline industry needs continued protection.¹¹² While ALPA clearly has an interest in maintaining union jobs and wage rates, its assertion that there is more to a successful U.S. aviation policy than lowering fares has merit. Policy choices must also consider the interests of investors and airlines and the commercial health of the nation.¹¹³

The ultimate goal of foreign carriers is to increase access to the world's single largest air transport market, thereby competing more effectively for international traffic to and from the United States.¹¹⁴ This competitive desire has refocused the cabotage debate. The prohibi-

¹⁰⁵ *Hearings Before Subcomm. on Aviation of the House Comm. of Public Works and Transportation*, 102 Cong., 1st Sess. (1991) (statement of Captain J. Randolph Babbitt) [hereinafter *Aviation Policy Statement*].

¹⁰⁶ Captain J. Randolph Babbitt, Speech at Solomon Brothers, Inc. Sixth Annual Transportation Conference (Nov. 14, 1991) [hereinafter Babbitt on Cabotage].

¹⁰⁷ Mr. Babbitt's remarks seem exaggerated — it is unlikely the U.S. would grant cabotage rights to a country with virtually no domestic market. Additionally, the route between Minneapolis and Seattle could probably withstand additional competition, as Northwest is the only carrier offering non-stop service on the route, and alternative routings are circuitous and involve hubs in Salt Lake City, Denver, or points South and East of Minneapolis.

¹⁰⁸ See Babbitt on Cabotage, *supra* note 106.

¹⁰⁹ *Id.*

¹¹⁰ *The Financial Condition of the Airline Industry and The Adequacy of Competition: Hearings Before the Subcomm. on Aviation of the House Comm. on Public Works and Transportation*, 102 Cong., 1st Sess. (1991) (statement of Captain J. Randolph Babbitt).

¹¹¹ ALPA's view is not consistent with U.S. policy and such a scenario is not likely to occur. See *supra* text accompanying notes 53-61.

¹¹² *Id.*

¹¹³ NAWAL K. TANEJA, U.S. INTERNATIONAL AVIATION POLICY 73 (1980).

¹¹⁴ The U.S. market accounts for approximately forty percent of total world air travel. *Aviation Policy Statement*, *supra* note 105.

tion of cabotage expressly prevents foreign carriers from carrying domestic traffic.¹¹⁵ The U.S. may not change its laws with respect to purely domestic cabotage; however, "limited" or "tag-end" cabotage could become a reality.¹¹⁶ "Limited" or "tag-end" cabotage describes a situation where a foreign carrier flies between two points in a country as a continuation of an international flight.¹¹⁷ Although the evidence is imperfect, it can be argued that foreign carriers have essentially legally duplicated this type of cabotage by entering into code-sharing¹¹⁸ or blocked space agreements¹¹⁹ with U.S. carriers. Dependent upon receiving reciprocal rights from foreign governments, the U.S. has generally approved this practice.¹²⁰ In order to receive this right, a foreign carrier and its domestic U.S. counterpart must apply for a statement of authorization under 14 C.F.R. 207.10, which prohibits carriers from performing flights for one another without DOT authorization.¹²¹ DOT

¹¹⁵ 49 U.S.C. app. § 1508(b) (1992).

¹¹⁶ See, *Canadian Study Urges Limited Cabotage for its Carriers Without Reciprocity*, AVIATION DAILY, Feb. 13, 1992, at 267.

¹¹⁷ DE LEON, *supra* note 59, at 103. This type of cabotage has recently begun within the European Community—although there are limitations on the number of seats that a carrier may sell. See, *Air France to Use Cabotage Rights*, TRAVEL WKLY., Dec. 24, 1992.

¹¹⁸ Code-sharing is based on a contract between air carriers, enabling one of them . . . to extend

its scheduled international air services as published under its own code and line-numbers and operated by itself, to a point or points not served by it and situated beyond a point (most often the terminal point) which it serves with its own service(s) by including in the publication of its network, a connecting service of another carrier(s) . . . as a service of its own to such beyond points.

Int'l Air Transport, *supra* note 39, at 73. A less technical definition of code-sharing "refers to the computer reservations system (CRS) code, [which] allows the airlines to display each other's flights in computer reservations systems." James Ott, *Market Pressures to Spur U.S., Canadian Alliances*, AVIATION WK. & SPACE TECHNOLOGY, May 25, 1992, at 24.

¹¹⁹ A blocked space agreement is when carrier A is given a specific amount of guaranteed capacity on a particular flight by carrier B. This ensures that there is always capacity available for carrier A. *Int'l Air Transport*, *supra* note 39, at 74. "Blocked space agreements are leases of a determined portion of an aircraft, such as the seats and/or cargo space. An agreed sum is paid by the lessee to the lessor regardless of the utilization made by the lessee of the leased space." Burton A. Landy, *Cooperative Agreements Involving Foreign Airlines: A Review of the Policy of the United States Civil Aeronautics Board*, 35 J. AIR L. & COMM. 575, 576 (1969).

¹²⁰ Nearly all of the major U.S. carriers have reached code-share agreements with foreign carriers. Some of the larger agreements included Continental-SAS, Northwest-KLM, USAir-British Airways. See Application of United Airlines, DOT Order 88-3-38, (Mar. 21, 1988) [hereinafter DOT Order 88-3-38] (stating that all code-share arrangements will require a statement of authorization under either 14 C.F.R. 207 or 212).

¹²¹ "A direct air carrier shall not perform any flights for a direct foreign air carrier under a long-term wet lease unless it has obtained a statement of authorization under this section." 14 C.F.R. § 207.10(a) (1992). "A wet-lease normally involves the lease of an aircraft with the fuel

must approve these types of agreements by verifying that the arrangement is consistent with public interest and that the non-U.S. carrier has the necessary underlying economic authority to serve a particular destination.¹²² Determination of whether code-sharing is in the public interest requires evaluation of many factors. These include:

[t]he extent to which the authority involved is covered by and consistent with a bilateral aviation agreement, and, in the absence of an agreement covering the proposed services, whether reciprocity exists on the part of the homeland of the foreign carrier or carriers involved. Where circumstances warrant, we will also look at other factors, such as the benefits which would accrue to U.S. carriers, passengers, and shippers under the proposed arrangement.¹²³

When a code-sharing exemption is granted, DOT requires that the ticket and other media for transmitting information about the flights reflects the name of the carrier actually providing the transportation, and that carrier accept responsibility for the passengers, consistent with its contractual obligations.¹²⁴ In addition, DOT requires the airlines involved "to give reasonable and timely notice of the existence of such code-sharing arrangements."¹²⁵

For example, Scandinavian Airlines System (SAS) and Continental Airlines have a code-sharing agreement.¹²⁶ In renewing the agreement in 1990, DOT found that the arrangement "increase[d] the service options available to the public and result[ed] in substantial economic bene-

and crew to carry out the specific operation. A significant factor in this arrangement is whether the lessor or the lessee exercises operational control of the aircraft." Landy, *supra* note 119, at 576.

¹²² DOT Order 88-3-38, *supra* note 120. Under 49 U.S.C. app. § 1508(b):

[t]he Board (DOT) shall issue permits, orders, or regulations to such extent only as it shall find such action to be in the interest of the public: *Provided, however*, That in exercising its powers hereunder, the Board shall do so consistently with any treaty, convention, or agreement which may be in force between the United States and any foreign country or countries

49 U.S.C. app. § 1508(b) (1992).

¹²³ Application of Transavia Holland, B.V., DOT Order 88-3-51 (Mar. 24, 1988).

¹²⁴ Application of Gulf Air, DOT Order 88-6-3 n.10 (March 1988) (forcing carriers to accept responsibility so that passengers know with which carrier they have recourse against in the event of an irregularity).

¹²⁵ 14 C.F.R. § 399.88 (1992) (requiring notice of code sharing in any published schedules, advertisements, and at the point of ticket purchase).

¹²⁶ Applications of Continental Airlines and Scandinavian Airlines, DOT Order 88-12-46 (Dec. 23, 1988); In the Matter of the Acquisition of Stock in Continental Airlines Holdings by Scandinavian Airlines, DOT Order 90-9-15 (Sept. 12, 1990); Application of Continental Airlines and Scandinavian Airlines, DOT Order 92-1-35 (Jan. 22, 1992).

fits [being] accru[ed] [by] Continental.”¹²⁷ In practice, this agreement allows passengers to travel between any point in SAS’s system and specific points in the United States.¹²⁸ For example, a passenger who wishes to fly from Stockholm to Los Angeles could fly on SAS non-stop to Los Angeles, or fly SAS nonstop to Newark and transfer to a Continental Airlines flight, which also has a SAS code for the domestic U.S. segment.¹²⁹ Continental is authorized to sell tickets from any of its U.S. points of origin to Scandinavia and beyond, while advertising these flights as if the passenger were flying Continental for the entire journey.¹³⁰ Code-sharing also enhances the airlines’ ability to attract passengers because code-shared connections are given priority ranking over interline connections¹³¹ in computer reservation systems. Travel agents, often working under severe time restraints, are more likely to select the first flight appearing on their computer screens for their customers. Thus, improving a flight’s computer ranking should generate additional passengers.¹³²

While these agreements do produce more competition, they raise several legal questions.¹³³ As a result of its DOT approved marketing agreement with Continental, SAS is gaining access to a larger portion of the U.S. aviation market. This increased access appears contrary to the spirit of U.S. cabotage laws.

Air transport is subject to much more international competitive pressure than sea travel which has no access to internal markets.¹³⁴ Therefore, by allowing a foreign carrier to fly to a destination specified in a bilateral agreement and code-share with a domestic carrier for traffic from other internal markets, one can affect the competitive position of other U.S. carriers.¹³⁵ For example, assume that only three carriers serve Stockholm non-stop from the U.S.: Delta through Atlanta, American through Chicago, and SAS from Newark. A Stockholm-bound traveller, travelling from St. Louis, prior to the code-sharing arrangement,

¹²⁷ See DOT Order 88-12-46, *supra* note 126.

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ For a discussion of the limitations, see 14 C.F.R. § 399.88, *supra* note 125.

¹³¹ Competition in the Airline Industry, Hearings Before the Subcomm. on Aviation of the House Comm. on Public Works and Transportation, (Sept. 21, 1989) (statement of Kenneth M. Mead) (transcript available in the United States General Accounting Office).

¹³² See generally 14 C.F.R. § 255 (1992) (regulating carrier-owned reservation systems).

¹³³ See DE LEON, *supra* note 59, at 116 (questioning whether code sharing violates either national cabotage laws or Article 7 of the Chicago Convention).

¹³⁴ Lewis, *supra* note 13, at 1063.

¹³⁵ DE LEON, *supra* note 59, at 116 (noting that code-sharing agreements increase the value of bilateral agreements without any *quid pro quo*).

would likely fly through Atlanta or Chicago in order to remain on the same U.S. carrier. Travelling on SAS would have meant flying to Newark, changing terminals, and perhaps re-checking tickets and luggage. However, after the implementation of the code-sharing agreement, this same passenger could fly Continental to Newark and transfer within the same terminal to an SAS flight, as if the passenger were transferring to another Continental flight. Under a code-sharing arrangement, there is no advantage to flying on an American carrier for the entire journey.

While the above model is somewhat simplified, it highlights how a code-sharing arrangement can dramatically increase a foreign carrier's ability to gather passengers beyond traditional gateway cities. Since cabotage restrictions were designed to provide a domestic monopoly for national carriers, code-sharing undermines the purpose of cabotage prohibitions—particularly on routes non-U.S. carriers would not otherwise operate.¹³⁶ Through code-sharing, SAS has tapped into Continental's established hub-and-spoke network, gained a better position in airline computer reservation systems, and benefitted from Continental's marketing efforts—including its frequent flier program. Thus, SAS and Continental have achieved the air carrier goal of "seamless" service, which allows a passenger to check-in at her local airport and claim her baggage at her final destination, as if she was on a single airline for the entire trip.¹³⁷

C. Code-Sharing and U.S. Cabotage Law

Code-sharing ultimately provides additional opportunities for foreign carriers to gain traffic they would not have otherwise captured, resulting in additional U.S. passengers on foreign carriers.¹³⁸ This raises the legal question of whether code-sharing violates the prohibition on cabotage. DOT's position is that since the foreign carrier is only exercising a contractual right to sell air service to cities in which it already has traffic rights, it is not cabotage.¹³⁹ Additionally "[c]ode-sharing is a

¹³⁶ *Id.* at 116-17.

¹³⁷ Hirsch, *supra* note 103.

¹³⁸ See *infra* text accompanying note 145.

¹³⁹ H.A. Wassenbergh, *New Aspects of National Aviation Policies and the Future of International Air Transport Regulations*, 13 AIR L. 18, 26 (1988). While many believe that code-share agreements are not cabotage, airline executives might disagree. In 1987, British Airways' Marketing Director, Jim Harris, noted that the proposed joint marketing plan between United Airlines and British Airways, which included code-sharing, would allow British Airways "vastly increased penetration of the vital U.S. market." Nadine Godwin, *United, British Airways Team Up With Global Joint Marketing Plan; Would Become Essentially One Airline*, TRAVEL WKLY., Dec. 17, 1987, at 1. See also *United's Union Buyout Would Limit Management Action*, AVIATION DAILY,

private law arrangement. It is not the 're-flagging' of the aircraft of the carrier operating the connecting service. A code is not a flag."¹⁴⁰

Code-sharing does not violate the letter of U.S. law because the airplane actually carrying passengers within the United States is owned and operated by U.S. nationals.¹⁴¹ It does, however, raise questions as to whether the spirit and intent of U.S. law is violated. In 1987, KLM attempted to receive operating authority between Amsterdam and Orlando. As part of its proposal, KLM envisioned using small U.S. carriers, Air Atlanta and Florida Express, as well as KLM's code to provide additional connecting service to smaller U.S. cities.¹⁴² Opposition to the proposed plan was fierce. The Air Transport Association called the idea "a 'disturbing proposal that is similar in concept to cabotage.'"¹⁴³ ALPA claimed that the proposal would result in cabotage and stated that they did not want the "prohibition against cabotage eroded, compromised or undermined in any way."¹⁴⁴ Congress was also concerned about the proposed agreement. In both the House and Senate reports on DOT appropriations, Congress warned the DOT that "code-sharing agreements should not be permitted if the results would be to undermine well established restrictions on cabotage or to give foreign carriers an unfair trade advantage and transfer American jobs to our competitors abroad."¹⁴⁵ The Senate report further noted that if foreign carriers were granted expanded code-sharing rights without reciprocal gains for U.S. carriers in other nations, then such agreements should be prohibited.¹⁴⁶ While the Senate report did not call for a total ban on code-sharing arrangements, it reminded DOT of its statutory obligation to disapprove of agreements that could be detrimental to the U.S. airline industry.¹⁴⁷

Foreign carriers covet code-sharing arrangements with U.S. carriers because they increase the value of their bilateral rights.¹⁴⁸ However,

Dec. 28, 1993, at 475 (noting that the proposed union buy-out of United would place limitations on management's ability to execute international code-share agreements if they would affect the airline's level of international service).

¹⁴⁰ Wassenbergh, *supra* note 139, at 25 n.9.

¹⁴¹ DE LEON, *supra* note 59, at 116.

¹⁴² Bill Poling, *KLM Code-Sharing Meets Opposition*, TRAVEL WKLY., June 11, 1987, at 129.

¹⁴³ *Id.*

¹⁴⁴ *Id.* at 130; see generally James Ott, *Foreign Airlines Switching Tactics In Seeking Rights to U.S. Market*, AVIATION WK. & SPACE TECHNOLOGY, June 15, 1987.

¹⁴⁵ S. REP. NO. 198, 100th Cong., 1st Sess. 11 (1988). See also H.R. REP. NO. 202, 100th Cong., 1st Sess. 10, 11 (1988).

¹⁴⁶ S. REP. NO. 198, *supra* note 145, at 11.

¹⁴⁷ *Id.* at 12.

¹⁴⁸ "Code sharing arrangements on cabotage segments increase the economic value of the preceding or following long haul services to more than one foreign gateway." DE LEON, *supra* note

despite these early objections, code-sharing has become an integral part of most U.S. carriers' efforts to gain new passengers, perhaps in recognition of the fact that the fastest growing market segment is international traffic. Despite its similarity to cabotage, U.S. carriers probably view code-sharing today as nothing more than a contractual agreement between carriers.¹⁴⁹

The importance of code-sharing to U.S. carriers should not be underestimated. For example, Northwest Airlines recently filed a DOT complaint detailing the German government's refusal to allow code-sharing to Germany on Northwest-KLM flights from Amsterdam. The German government viewed the arrangement as a violation of Northwest's frequency allocation as specified in the U.S.-German bilateral agreement.¹⁵⁰ The German (Lufthansa) response notes that code-sharing provides Northwest with the ability to sell services between the United States and Germany, as if Northwest was operating the service solely by itself.¹⁵¹ Lufthansa also argued that code-sharing might be more beneficial than actually operating a route because of the reduced economic risk.¹⁵² In fact, the thrust of the dispute between Northwest and Germany is whether, for bilateral purposes, a flight operated under a code-sharing agreement should be counted towards the flight frequency limits under the bilateral agreement.¹⁵³

While code-sharing provides many benefits to U.S. carriers, notably increased traffic from foreign carriers' home markets and increased presence in overseas markets,¹⁵⁴ these agreements have become a

59, at 116.

¹⁴⁹ *Id.* at 2 n.11. KLM once viewed code sharing as an interline practice, not a traffic right. However, it has stated that code sharing's only advantage to foreign carriers is to provide a better ranking in U.S. computer reservation systems. *Five U.S. Airlines Battle United-BA Code-Sharing*, TRAVEL WKLY., Feb. 15, 1988, at 3. KLM also stated that "it is doubtful that [a] foreign government would trade actual route rights or other economic benefits in return for code-share opportunities that might diminish in value." *Id.* But see, *Dutch Gain From U.S. Open Skies*, FLIGHT INT'L, Sept. 16, 1992, available in LEXIS, Trans Library, Air File (noting that among other things the U.S. and Dutch agreement calls for unlimited code-share rights).

¹⁵⁰ See Complaint of Northwest Airlines, Inc. Against Lufthansa German Airlines and the Government of the Federal Republic of Germany, DOT Order 93-8-5 (Aug. 4, 1993).

¹⁵¹ Answer of Lufthansa German Airlines, DOT Docket No. 49063, at 19 (Aug. 12, 1993).

¹⁵² *Id.* at 18.

¹⁵³ One of the key issues facing government aviation officials is what the value of a code-share arrangement is. For example, what rights should a government demand for its carriers in return for allowing code sharing? See *As International Markets Change, Old Access Issues Remain*, AVIATION DAILY, Dec. 28, 1993, at 475.

¹⁵⁴ SAS "contributes 150,000 passengers" annually into the Continental route network through Newark. *SAS To Stay Out of Continental Bidding But Forge Closer Ties to Carrier*, AVIATION DAILY, Nov. 5, 1992, at 213.

means by which foreign carriers have solved their access problems into the U.S. market. This has hurt the larger U.S. carriers who have developed international routes through internal growth or asset purchase.¹⁵⁵ Code-sharing's results have caused many carriers to no longer desire cabotage rights, specifically because access into the U.S. market can be achieved through other means.¹⁵⁶

The reason the U.S. sought to prohibit cabotage was to preserve the airline industry's financial health and protect the industry from the rigors of foreign competition.¹⁵⁷ Code-sharing appears to contravene many of these objectives. While the U.S. carriers that have made agreements with foreign carriers have benefitted, other carriers who have instead invested corporate resources into developing their own international routes have been disadvantaged by these agreements.¹⁵⁸ A U.S. carrier that receives enough revenue from code-sharing could, conceivably, cross-subsidize by underpricing seats on domestic flights. It would appear that because foreign carriers view code-sharing as an acceptable alternative to the elimination of cabotage provisions, it indicates that they must be realizing the economic advantages that cabotage laws seek to prohibit.¹⁵⁹

Assuming that code-sharing does not violate the letter of U.S. law, the next inquiry is whether a code-sharing agreement, combined with an equity investment by a foreign carrier, violates U.S. law with respect to either cabotage or foreign control of U.S. carriers?

¹⁵⁵ As the United States Airports for Better International Air Service organization noted in a recent letter to Secretary Pena, code sharing "rights are of a limited benefit to our cities and the travelling public [since c]ode sharing does not . . . add new nonstop service" on international routes. *USABIAS Wants DOT to Press for More International Routes*, *Aviation Daily*, Dec. 29, 1993, at 479. The group also asked that code sharing negotiations be secondary to securing actual increases in the number of international flights authorized between the U.S. and other nations. *Id.*

¹⁵⁶ See *Cathay Pacific, Cautious About North America, Sees Expansion in Europe*, *AVIATION DAILY*, Mar. 4, 1992, at 385. See also *Terminating Bilateral with U.S. Not Ruled Out By Lufthansa*, *AVIATION DAILY*, Feb. 24 1992, at 321. A Lufthansa official stated that "cabotage in the U.S. does not interest Lufthansa [and] that access to passenger feed from smaller U.S. markets is important, and . . . two possible means to achieve this feed [including] marketing agreements with one or more U.S. carriers [or] if U.S. ownership rules were changed, Lufthansa could acquire its own small, feeder line." *Id.*

¹⁵⁷ See *supra* notes 62-66.

¹⁵⁸ See *Hearings Before the Subcomm. on Aviation of the House Comm. on Public Works and Transportation*, 103d Cong., 1st Sess. (1993) (statement of Stephen M. Wolf). Mr. Wolf notes that by purchasing shares in U.S. carriers, foreign carriers are able to purchase access to the U.S. market without liberalization of their own markets. *Id.*

¹⁵⁹ Getting unlimited code-share rights within the U.S. has become very important for KLM because of the recently signed U.S.-Dutch bilateral agreement. Airlines now must "insure that they have route-network distributions in regions where they can't get bilateral rights to fly." Agis Salpukas, *A Survival Move For KLM Airlines*, *N.Y. TIMES*, Sept. 25, 1992, at C4.

V. MODERN VIEWS ON FOREIGN OWNERSHIP

A. *Statutory Analysis*

When a U.S. carrier receives equity from foreign sources, DOT reviews the carriers' fitness.¹⁶⁰ DOT's determination is based in part on whether a carrier is considered a U.S. citizen.¹⁶¹ In early 1991, DOT pronounced a standard which would determine the outcome of future foreign investments in U.S. carriers.¹⁶² The case involved the 1989 purchase of Northwest Airlines by Wings Holding.¹⁶³ Shortly after announcing its intentions, Wings issued a tender offer for Northwest stock.¹⁶⁴ Investment partners KLM and Elders IXL Ltd. (Elders) purchased almost \$500 million in stock. The total available investment was \$705 million.¹⁶⁵ Two-thirds of the \$3 billion in loans used to finance the acquisition came from foreign banks.¹⁶⁶ KLM and Elders were each given one position on the Northwest board, and KLM was allowed

¹⁶⁰ The statutory mandate for DOT review is found at 49 U.S.C. app. § 1371(r) which states that:

[t]he requirement that each applicant for a certificate . . . must be found to be fit, willing, and able to perform properly the transportation covered . . . and the rules, regulations, and requirements of the Board under this chapter shall be a continuing requirement applicable to each such air carrier.

49 U.S.C. app. § 1371(r) (1992). Additionally, 14 C.F.R. § 204.4 (1992) states that a "certified carrier proposing a substantial change in operations shall file the data set forth in this section." *Id.*

¹⁶¹ Citizenship and control is determined by a two-part test which is generally satisfied by the limitation of foreign equity investment to 25% and by the requirement that at least two-thirds of the airline's board be comprised of U.S. citizens. *See* 49 U.S.C. app. § 1301 (1992). The most significant issue is control of the airline. The statute explicitly requires that at least three-quarters of the voting interests be in U.S. hands. *Id.* While the statute is silent on other means of exercising control, many legal experts believe that factors such as the ability to select board members, veto rights over decisions, dispersion of voting stock, and other factors may be more salient tests than the percentage of total voting shares. *See also* Martin Tolchin, *Will British Airways Control USAir?*, N.Y. TIMES, Mar. 17, 1993, at C16. DOT seems to be aware of these other factors, and precedent suggests that Congressional intent is clear: U.S. carriers may not be controlled by foreigners, and DOT should withdraw the operating certificate if it has any doubts that a carrier is controlled by non-U.S. nationals. *See* 49 U.S.C. app. § 1301 (1992).

¹⁶² In the Matter of the Acquisition of Northwest Airlines, Inc. by Wings Holding, Inc., DOT Order 91-1-41 (Jan. 23, 1991) [hereinafter DOT Order 91-1-41] (Wings Holding was a private holding company created by the investors who purchased Northwest Airlines).

¹⁶³ In the matter of The Acquisition of Northwest Airlines By Wings Holding, Inc., DOT Order 89-9-51, (Sept. 29, 1989) [hereinafter DOT Order 89-9-51].

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

to create a committee to advise Northwest on financial affairs.¹⁶⁷

DOT was concerned about whether KLM would be able to exert control over Northwest, through Wings, and that the size of the debt would unduly burden Northwest.¹⁶⁸ Although DOT ruled that Northwest remained a U.S. citizen, it was concerned that the airline would be controlled by KLM.¹⁶⁹ DOT noted that the control test

has traditionally been a complex matter in past cases. Analysis in this area has always necessarily been on a case-by-case basis, as there are a myriad of 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.*¹⁷⁰

DOT went on to note that “influence may be concentrated or diffuse. It need not be identified with any particular nationality . . . be shown to have sinister intent [or] be continually exercisable on a day-to-day basis.”¹⁷¹

DOT first determined that neither the banks providing loans nor Elders were in a position, either individually or jointly, to exercise control.¹⁷² Notwithstanding the magnitude of KLM's investment, and its stated intention to become involved in Northwest's decisionmaking,¹⁷³ the proposed agreement did not violate the citizenship test because KLM's voting stock, together with all other foreign shareholders, was less than twenty-five percent.¹⁷⁴ The agreement did, however, indicate that KLM would control Northwest through the equity investment which, despite not having voting rights, did include a number of ancillary rights which would allow a check on management in certain situations.¹⁷⁵ DOT was concerned with KLM's ability to appoint a financial advisory committee and by the unrestricted nature of the KLM board members' voting power.¹⁷⁶ After applying a strict level of scrutiny,¹⁷⁷ DOT con-

¹⁶⁷ *Id.*

¹⁶⁸ *Id.*

¹⁶⁹ *Id.*

¹⁷⁰ *Id.* at 8 (emphasis added).

¹⁷¹ In the Matter of Inter Arctic Services, Inc., DOT Order 87-8-43, at 5 (Aug. 18, 1987) [hereinafter DOT Order 87-8-43].

¹⁷² DOT Order 89-9-51, *supra* note 163, at 9.

¹⁷³ *Id.*

¹⁷⁴ *Id.* at 11.

¹⁷⁵ Examples of when KLM could check management arise with regard to the issuance of securities and other amendments to the Certificate of Incorporation. *Id.* at 12-13.

¹⁷⁶ *Id.* at 13-14.

¹⁷⁷ *Id.* at 15 (noting that DOT applies stricter scrutiny when the investor is an airline, par-

cluded that "KLM would be in a position to exercise . . . control over Northwest, and . . . the latter could thereby cease to be a U.S. citizen for purposes of the Federal Aviation Act."¹⁷⁸ DOT was most concerned that KLM's investment was too large in a relative sense, that KLM could apply influence in ways that compensated for their inability to vote their shares, and that KLM was (and remains) a Northwest competitor on certain routes.¹⁷⁹

Northwest (Wings) and KLM agreed to a number of changes in the original ownership structure in order to avoid judicial involvement in determining whether citizenship requirements had been violated.¹⁸⁰ The major revisions included a reduction in KLM's investment to only twenty-five percent of total equity, dissolution of the financial advisory board, and recusal of KLM's representative to the Northwest board in certain circumstances.¹⁸¹ Additionally, Northwest and Wings agreed to file regular reports concerning their ownership structure.¹⁸² DOT based its ultimate decision on the theory that KLM's investment, having been reduced, would result in "KLM's ability to influence Northwest [being] significantly reduced."¹⁸³

In 1991, Wings Holdings requested a modification of the original consent decree. In its petition for modification, Wings requested that KLM's non-voting equity investment be allowed to rise to 49 percent with just over 10 percent to be held as voting shares, that Northwest be permitted to increase the total number of board members to fifteen with three appointed by KLM, and that a termination of the financial disclosure requirements be accomplished.¹⁸⁴

DOT permitted the modification, noting that the decision was reached "in the context of the liberalized aviation relationship that prevails between the United States" and the Netherlands.¹⁸⁵ Although the statute does not mention the issue of U.S. aviation relations, DOT apparently believes that it is a legitimate criterion when considering investment by foreign carriers.¹⁸⁶ DOT again declined to set forth specific

ticularly a competitor, because of ownership and control questions).

¹⁷⁸ *Id.* at 16.

¹⁷⁹ *Id.* at 10-11.

¹⁸⁰ *Id.* at 17-18.

¹⁸¹ *Id.*

¹⁸² *Id.* at 19.

¹⁸³ *Id.* at 18.

¹⁸⁴ See DOT Order 91-1-41, *supra* note 162.

¹⁸⁵ *Id.* at 16.

¹⁸⁶ In approving the second USAir-British Airways agreement, U.S. Transportation Secretary Frederico Pena noted "that the future of the agreement will depend on a renegotiation of the air

standards for determining when a U.S. carrier is controlled by foreign owners. DOT instead stated that

[W]e have reviewed the relationship between voting equity, on the one hand, and nonvoting equity and debt, on the other [and] we continue to believe that 'check-list' standards are not advisable due to the uniqueness and complexity of each transaction¹⁸⁷

By making this modification to its original order, DOT expanded the availability of foreign capital for U.S. airlines. While Secretary Skinner's decision in this case has proven to be precedent setting, the decision itself should not be viewed as surprising. In 1989, North American Airlines (NAA), a U.S. carrier, was granted a certificate to provide transportation with significant backing from El Al, the state airline of Israel.¹⁸⁸ El Al had agreed to the following terms with NAA:

El Al will (1) provide \$400,000 (\$75,000 as equity) to assist with start-up funding, (2) secure the availability of a B-757 aircraft and serve, for five years, as the garniture of one month's aircraft lease payment (approximately \$400,000), (3) have the option to receive 24.9 percent of the outstanding common stock of NAA and a seat on the carrier's board of directors, and receive a guarantee that, until it has exercised its ownership option and as long as it is guaranteeing the aircraft lease, Mr. McKinnon (the founder of NAA and former head of the CAB) will not sell or distribute NAA stock to any parties without El Al's consent, which would not be unreasonably withheld.¹⁸⁹

NAA was to supply passengers from Los Angeles to El Al flights leaving New York.¹⁹⁰ DOT stated that because the financing for NAA was a simple capital structure (as opposed to the original Northwest deal), there was no large influx of cash which might suggest a hidden agenda of control.¹⁹¹ In addition, because much of NAA's U.S. debt and equity were vested in a single individual, there would be a much lower likelihood of minority control.¹⁹² DOT was also unconcerned that ap-

travel treaty between the United States and Britain." Richard M. Weintraub, *USAir Deal Approved By Clinton*, WASH. POST, Mar. 16, 1993, at A1.

¹⁸⁷ In this case, DOT reexamined the control test based on the "global corporate and financial environment." DOT Order 91-1-41, *supra* note 162, at 19 (explaining that at the time of this decision, the U.S. recession had begun and the effects of the Persian Gulf War were combining to drastically cut airline revenues).

¹⁸⁸ Application of North American Airlines, Inc., DOT Final Order 89-11-26 (Nov. 14, 1989).

¹⁸⁹ Application of North American Airlines, Inc., DOT Order 89-11-8 (Nov. 6, 1989).

¹⁹⁰ *Id.*

¹⁹¹ *Id.*

¹⁹² *Id.* This is despite the fact that all of the foreign equity was invested by El Al.

proximately 30 percent of NAA's first year revenues would be generated from traffic associated with El Al flights.¹⁹³ DOT was even sympathetic to the traditional security concerns of El Al. The original agreement had been concluded as a code-sharing agreement, but because of security arrangements, the flights would be operated as a single entity charter agreement where "El Al would lease a NAA's B-757 aircraft with NAA crews and operate nonstop El Al flights between New York City and Los Angeles carrying only passengers arriving from or departing to points in Israel."¹⁹⁴ DOT went to great length to contrast the control issues in this case with those in the original Northwest agreement.

While El Al may hold the remaining interest, its capital contribution reflects that interest proportionately, with no outsize contributions suggesting a hidden quid pro quo and a corollary means of control. Moreover, the concentration of the U.S. debt and equity interest in a single individual suggest a much lesser power of control by the minority interest given similar opportunities, than if the U.S. interest was dissipated among numerous stockholders and lenders.¹⁹⁵

DOT's decisions in the NAA and Northwest case seem difficult to harmonize. The Northwest case represents an equity agreement between two of the world's largest airlines, each with a separate base of operations, and each relying on the other for a small percentage of their total revenues. By contrast, NAA, a new carrier, will be relying on El Al for almost one-third of its first year revenues. Furthermore, KLM does not place limitations on the operation of Northwest's aircraft, as El Al insisted upon in its agreements with NAA. In the end, DOT viewed the NAA-El Al agreement to be a simple commercial transaction.

While DOT may view the NAA-El Al agreement as an arm's length transaction, the details of the investment indicate that it is a more complex arrangement. By investing in a new U.S. carrier, El Al increased the load factor on its New York-Tel Aviv route without having to fly non-stop from Tel Aviv to Los Angeles. It also maintained its security standards through passenger control at its Los Angeles check-in. Several questions are raised by this arrangement. First, would NAA have begun operations without El Al's investment? Second, does a commercial agreement alone offer enough guarantee to El Al, or does El Al need an equity investment in order to ensure control of its access to the U.S. market?

¹⁹³ *Id.*

¹⁹⁴ *Id.*

¹⁹⁵ *Id.*

A review of NAA's finances suggests that contrary to the initial forecasts, El Al's revenues may not be declining as a proportion of total revenues. NAA grosses approximately \$16 million annually from the El Al agreement, Club Med charter operations, and the U.S. military.¹⁹⁶ Yet, the code-sharing arrangement with El Al has expanded, and NAA has added service to Baltimore-Washington, Boston, Chicago, Dallas-Ft. Worth, and Miami.¹⁹⁷ Furthermore, on NAA's aircraft, cabin interiors look like El Al's, with flight crews that speak Hebrew and provide kosher catering.¹⁹⁸ El Al has exercised a purchase option, giving it 24.9 percent of NAA stock.¹⁹⁹

DOT faces many difficulties in determining what constitutes a U.S. carrier. In dealing with them, DOT adheres to the statutory limitations imposed by Congress, but its decisions demonstrate that it has the ability to exercise great latitude.

B. Current Issues in Foreign Ownership

DOT recently examined the proposed USAir-British Airways deal.²⁰⁰ The transaction

calls for British Airways to make an investment of \$750 million in USAir for which British Airways will receive convertible preferred shares, representation on the USAir Board and a joint commitment to integrate the activities of the two airlines.²⁰¹

American, Delta, United, and other U.S. airlines strongly opposed the deal on a number of different grounds.²⁰² These carriers believed that

British Airways would have the right to dictate every important aspect

¹⁹⁶ Robert McNatt, *Small Airline Flies into a Sound Niche*, CRAIN'S N.Y. BUS., May 11-17, 1992, at 19.

¹⁹⁷ Lester Geiss, *El Al Moves to Make Tel Aviv An Efficient Hub and Spoke Network*, WORLD AIRLINE NEWS, Aug. 10, 1992, available in LEXIS, Nexis Library, ZTP1 File; Additional cities being included are Atlanta, Mexico City, and San Francisco. *El Al*, AIRPORTS, Mar. 31, 1992, at 126.

¹⁹⁸ See Geiss, *supra* note 197.

¹⁹⁹ McNatt, *supra* note 196.

²⁰⁰ *British Airways to Invest \$750 Million in USAir, First Step in Creation of World's Largest Airline Alliance*, USAir Press Release, July 21, 1992.

²⁰¹ *Id.*

²⁰² A Delta representative has stated that "[t]he BA-USAir deal without liberalization of the U.S.-U.K. bilateral, is a unilateral giveaway of the U.S. transport market, and would make it virtually impossible for the U.S. to achieve its objective to liberalize world aviation markets." *USAir Chairman Lashes Back at Crandall, Criticism of BA Deal*, AVIATION DAILY, Sept. 18, 1992, at 485.

of USAir's business, including for example, who it can hire to run the company, what markets it can serve, what airplanes it may acquire, and what prices it should charge.²⁰³

The carriers also believed that the "planned integration of marketing and operational functions would produce a single 'airline system' controlled by British Airways and operating under one 'management structure.'"²⁰⁴ At least one writer has concluded that this type of foreign investment is de facto cabotage,²⁰⁵ a conclusion supported by Alaska Airlines.²⁰⁶ Yet, Sir Colin Marshall of British Airways believes that an investor must have some degree of control over an investment.²⁰⁷ The U.S. position, dating back to the Chicago Convention, has been that "no country will wish to have its essential internal air communications under the domination of any save their own nationals."²⁰⁸

After talks between the U.S. and Great Britain failed to allow U.S. carriers additional access to London's Heathrow Airport, British Airways withdrew from the deal.²⁰⁹ Those carriers opposed to the deal were less concerned with control over USAir,²¹⁰ then with the opportunity to

²⁰³ See POWELL TATE, *AMERICAN AIRLINES, UNITED AIRLINES, DELTA AIRLINES & UNITED PARCEL SERVICE, AN ISSUE OF NATIONAL POLICY, COMPETITION AND FAIRNESS* (1992).

²⁰⁴ *Id.* at 3.

²⁰⁵ See generally, J.A. Donoghue, *Open the Door; US Domestic Air Travel Market Should be Opened to Foreign Airlines*, *AIR TRANSPORT WORLD*, Aug. 1992, at 5.

²⁰⁶ See Order 91-1-41, *supra* note 162, at 15 n.16.

²⁰⁷ Marshall has stated that British Airways is interested in creating a truly global airline but that it would not make large risky investments "without having a high degree of control." *Marshall Rails Against U.S. Ownership Law, European Subsidies*, *AVIATION DAILY*, May 22, 1992, at 329. He cites foreign carriers' lost investment in America West and Continental which has been wiped out due to bankruptcy. *Id.* Notwithstanding Marshall's comments, the important question is what is a foreign carrier's real investment motivation? Aside from a return on investment, solidification of marketing agreements and U.S. market access may be the primary answer. See generally, Paul Stephen Dempsey, *U.S. Deregulation's Result May Be Foreign Domination*, *AVIATION WK. & SPACE TECHNOLOGY*, Nov. 2, 1992, at 65.

²⁰⁸ Lewis, *supra* note 13, at 1063.

²⁰⁹ USAir Citizenship Proceeding, DOT Order 92-12-27 (Dec. 22, 1992); Richard M. Weintraub, *British Airways Drops Plan For USAir Links*, *WASH. POST*, Dec. 22, 1992, at A1, A4. A new plan for a strategic alliance between British Airways and USAir was recently unveiled. The plan called for an immediate \$300 million investment in USAir by British Airways, and included a code-share agreement and the right to make future investments in USAir depending on "financial and regulatory conditions." *British Airways, USAir Jump Back Into Fray With \$300 Million Investment*, *AVIATION DAILY*, Jan. 22, 1993, at 123. The plan was approved March 15, 1993 by the U.S. government. Martin Tolchin, *U.S. Approves British Stake in USAir but Issues Warning*, *N.Y. TIMES*, Mar. 16, 1993, at C1.

²¹⁰ American Airlines Chairman, Robert L. Crandall, has stated that the agreement "seems consistent with American's advocacy of greater liberalization of opportunities for international carriers but should be blocked unless U.S. carriers are allowed larger opportunities in Britain."

gain increased access to the British aviation market.²¹¹

Paradoxically, criticism of the Northwest-KLM antitrust immunity waiver²¹² was less controversial, despite being described as a merger by Northwest's Chief Operating Officer.²¹³ The distinction between the two agreements is that the KLM-Northwest deal is based on an arrangement reached between the U.S. and the Netherlands, which allows among other things, unlimited access for U.S. carriers into the Netherlands.²¹⁴ This demonstrates that, contrary to suggestions from USAir,²¹⁵ U.S. airlines are primarily interested in reciprocal opportunities to compete in foreign countries.²¹⁶ Former-Secretary of Transportation Andrew H. Card, Jr. underscored this by stating that he had "flexibility" on the so-called control issue if a country fully opens up its airports to U.S. airlines."²¹⁷

The most recent deal involving investment in a U.S. airline by a

Airlines in Partnership, WASH. POST, Aug. 6, 1992, at A24.

²¹¹ *Id.* While large U.S. carriers are persistent in their arguments that the British should allow U.S. carriers expanded rights, it is also these carriers that are most likely to benefit from the granting of any new rights.

²¹² In their filing, the carriers seek "to establish a legal framework under which the two carriers may operate as if they were a single firm." Joint Application of Northwest Airlines, Inc. and KLM Royal Dutch Airlines for Approval and Antitrust Immunity of an Agreement, DOT Order 92-9-30 (Sep. 16, 1992) (the filing also states that should they be allowed to act like one firm, the ancillary agreements (if any) should be treated as "private agreements . . . [of] a single firm and of no further interest to the government.").

²¹³ The proposed global alliance between the two carriers provides for a full integration "of their commercial operations, allowing them to operate as if they were a single firm." Bill Poling, *Northwest, KLM Seek to Operate as Single Firm Under New Pact*, TRAVEL WKLY., Sept. 14, 1992, at 1. Besides the obvious plans to coordinate schedules and increase customer convenience, the carriers are considering integrating their sales forces and commissions, as well as pricing and the "sharing and/or pooling of revenue." *Id.* (emphasis added). The goal of such a proposal is the creation of "'seamless service' in which passengers would feel they are getting the same quality throughout a flight." Agis Salpukas, *How Northwest and KLM Would Unite*, N.Y. TIMES, Sept. 10, 1992, at C1.

²¹⁴ The new agreement is the most liberal bilateral agreement that the U.S. has ever signed. Some of the provisions include no restrictions on destinations, frequencies, capacity, and the right to fly to other countries (subject to third government approval). See Agis Salpukas, *A Survival Move For KLM Airlines*, N.Y. TIMES, Sept. 25, 1992, at C4. KLM also has the right to code-share in every U.S. city. *Id.* There was little reaction in the industry because observers noted that the agreement is of little benefit to the U.S., and does not provide much incentive for other nations to sign new agreements with the U.S. See James Ott, *More Skies to Open As U.S. Signs Pact*, AVIATION WK. & SPACE TECHNOLOGY, Sept. 14, 1992, at 32.

²¹⁵ See *Statement of USAir Chairman Seth E. Schofield*, USAir Press Release, Sept. 17, 1992 (stating that the objective of airlines such as American is to prevent competition by other carriers).

²¹⁶ See TATE, *supra* note 203.

²¹⁷ See Weintraub, *supra* note 209.

non-U.S. carrier was the Continental-Air Canada agreement which was finalized in early 1993. At one point, five different suitors had made offers to acquire a financial interest in Continental.²¹⁸ The structure of the deal called for Air Canada to invest \$235 million and receive 27.5% of the total equity and 24% of the voting stock, while Air Canada's U.S. partner (Air Partners) would invest \$215 million and receive 27.5% of total equity and 41% of the total voting stock.²¹⁹ Both Air Canada and Air Partners will select six board members.²²⁰

DOT did not undertake a formal public review of the proposed transaction, and there is very little official DOT documentation explaining the transaction's approval. In a later proceeding, DOT did state that the "great majority of Continental's equity is held by U.S. citizens, not by Air Canada."²²¹ In addition, DOT viewed the relationship between the two carriers as consistent with existing U.S. law, and the marketing alliance was typical of those entered into by other airlines.²²² Secretary Card noted that the deal's approval reaffirmed the Bush Administration's willingness to allow overseas investment in U.S. carriers.²²³

C. Conclusion

A review of cabotage and foreign ownership suggests that if code-sharing agreements are viewed as a basic contractual agreements between airlines, then it is probably impossible to link code-sharing with cabotage. Yet, if the underlying reasons that carriers seek code-sharing agreements are examined, it becomes clear that the purposes of cabotage prohibitions are being negated. Where code-sharing agreements are part of a larger alliance and involve a significant equity investment, then claims that argue that code-sharing is not related to cabotage, particularly when control is at issue, should be viewed with skepticism. If a foreign carrier is able to exercise control, then suggestions that the U.S. aircraft has essentially been re-flagged and is therefore violating U.S.

²¹⁸ The different groups included the parent company of AeroMexico, the largest shareholder of Mexicana Airlines, SAS, and Lufthansa, in addition to Air Canada's successful bid. See David A. Brown, *Court Approves Plan For Continental Bidding*, AVIATION WK. & SPACE TECHNOLOGY, Oct. 12, 1992, at 61.

²¹⁹ Martin Tolchin, *U.S. Approves Financing for Continental Airlines*, N.Y. TIMES, Jan. 8, 1993, at D3.

²²⁰ *Id.* (Continental's Board has 18 members).

²²¹ *Id.*

²²² U.S. Colombia Combination Service Case, DOT Order 93-9-12, at 8 (Aug. 10, 1993).

²²³ See Martin Tolchin, *U.S. Approves Financing for Continental Airlines*, N.Y. TIMES, Jan 8, 1993, at D3.

law, are proper. This is not to suggest that such alliances are inherently bad; rather, U.S. law needs to be modified to reflect the dramatically different environment in which airlines currently operate.

VI. OPEN SKIES

Since the Chicago Convention, international aviation has been governed by bilateral agreements between countries. The DOT has made a concerted effort to remove barriers so as to allow U.S. carriers entry into foreign markets. One approach is to sign less restrictive bilateral agreements with other like-minded countries.²²⁴ It has been demonstrated that in markets governed by liberal agreements, air travel grows at much faster rates than in markets with restrictive agreements.²²⁵

U.S. policymakers have once again focussed efforts on obtaining a U.S.-European Open Skies regime.²²⁶ Success in this area would require the removal of all non-safety related government imposed barriers affecting air travel between the U.S. and Europe. This "deregulation" of U.S.-European air markets could then be used as a model for future agreements with other nations and regions. Key aspects of such a regime include open entry on all routes, unrestricted capacity and frequency on all routes, unlimited rights between the U.S. and any point in Europe, flexibility in fare-setting, less restrictive charter and cargo arrangements, freedom of currency conversion, open code-sharing arrangements, self-handling provisions, freedom of contract related to flight operations, and commitment to non-discriminatory operation of, and access to, computer reservation systems.²²⁷ It is too early to tell if Open Skies will successfully liberalize air travel between the U.S. and Europe.

DOT continues to attempt to satisfy all interests.²²⁸ Those opposed to such a change are satisfied by DOT's failure to articulate a position on foreign ownership and cabotage. Yet, by allowing for open code-sharing arrangements, DOT appears willing to trade unlimited access for foreign carriers in U.S. markets for similar rights overseas. Indeed, early indicators demonstrated that the original USAir-British Airways deal was in jeopardy because of the inability of the U.S. and British governments

²²⁴ See Gomez-Ibanez, *supra* note 39, at 113 (discussing that proponents of an Open Skies policy believe that restrictions on travel harm "air travellers and the economy in general").

²²⁵ *Id.* at 114-16.

²²⁶ See In the Matter of Defining "Open Skies," DOT Order 92-8-13 (Aug. 5, 1992) [hereinafter DOT Order 92-8-13].

²²⁷ *Id.*

²²⁸ The purpose behind the Open Skies initiative was to "liberalize, to the maximum extent, the aviation markets between and beyond the U.S. and Europe." *Id.*

to reach an Open Skies arrangement.²²⁹ Thus, the new policy of Open Skies appears to be nothing more than a formalization of how DOT has been operating in recent years. While this effort is unlikely to yield significant results, it does appear to be an effort by DOT to liberalize air travel while adhering to its statutory constraints.

VII. RECOMMENDATIONS

DOT must follow statutory provisions developed in the 1930s, while trying to encourage liberalization of air travel in the 1990s. In order to address this dilemma, the U.S. must re-examine its justifications for cabotage and foreign ownership restrictions.²³⁰ The U.S. government is no longer responsible for the economic success of airlines; airlines are free to enter virtually any domestic market they wish to serve, with no restrictions on frequency, capacity, or any other operational decision. Fears of destructive competition no longer drive U.S. policy towards the airline industry and, therefore, the market should be allowed to determine the number of competitors.²³¹

The most significant obstacle to the U.S. changing its laws to permit it to lead in the liberalization of air services is the relatively immense size of its own market. The Open Skies Agreement with the Netherlands is indicative. Under the agreement, any Dutch carrier can fly to any point within the U.S. from the Netherlands.²³² In return, U.S. carriers can fly to any point in the Netherlands.²³³ Disparity in relative market size and lack of reciprocity by other governments have proven to be the largest obstacles to changes in international air service.²³⁴

This has led to an inability to directly confront issues such as cabotage and foreign ownership. Instead, DOT has been forced to find ways to inject competition into aviation, while not violating the letter of U.S.

²²⁹ Weintraub, *supra* note 209.

²³⁰ As Robert Crandall has pointed out "[o]wnership is the same thing as cabotage and it's easier and better." Joan Feldman, *On Getting From Here to There; International Aviation Structure is Becoming Obsolete*, AIR TRANSPORT WORLD, July 1990, at 23.

²³¹ The best example of this is the fact that a number of airlines in the country, including Eastern and Pan Am, have gone bankrupt.

²³² A KLM official called the deal a "'dream' agreement," while American Airlines President Robert Crandall said, "Holland is a very small country [and] we get nothing." See CONG. REC. (daily ed. Jan. 6, 1993) (statement of Hon. Leon E. Panetta).

²³³ *Id.*

²³⁴ As early as 1984, some commentators already thought that the relative strengths of U.S. carriers would allow them to compete effectively in a competitive marketplace if the U.S. government could convince other nations to open up their markets. Gomez-Ibanez, *supra* note 39, at 109. See also COMMISSION REPORT, *supra* note 1, at 20.

law. DOT has protected itself by refusing to articulate a test for foreign ownership, and by allowing U.S. and foreign airline contractual agreements to permit increased access to U.S. markets. This results in an ad hoc policy which breeds confusion, and ultimately, reduces consumer choice and provides fewer opportunities for U.S. airlines overseas.

Legislative change also needs to occur. The U.S. should allow U.S. airlines to be purchased by foreign carriers and, under certain conditions, remove U.S. cabotage restrictions.²³⁵ As previously mentioned, one of the reasons for the prohibition on foreign ownership stemmed from national security concerns. While these concerns may have diminished, they still exist. Therefore, any legislative change in foreign ownership provisions should require DOT, perhaps in conjunction with other government agencies, to retain the right to disapprove of foreign investment in U.S. carriers if national security is threatened. Congress may also want to consider lifting the DOT's orders immunity from judicial review since the purpose behind liberalization would be to promote *commercial* arrangements between airlines, and not to maintain airlines as foreign policy tools of government.

Among the problems facing the Clinton Administration, is the fact that the industry has become deeply divided on what type of approach to take.²³⁶ Complaints about the present bilateral system have increased,²³⁷ yet many nations do not seem to favor another multilateral Chicago Convention.²³⁸ Despite nearly fifty years of trade liberaliza-

²³⁵ Former CAB official Michael Levine has said before Congress that the U.S. should do away with ownership restrictions and cabotage with countries that are willing to reciprocate with the U.S. . See Bill Poling, *Kahn, Levine Call for More Foreign Ownership of U.S. Carriers*, TRAVEL WKLY., May 23, 1991, at 10. The Airline Commission recommended allowing up to 49% of voting equity to be held by foreign, non-government investors, provided that U.S. airlines had similar rights in the context of a liberal aviation agreement. See COMMISSION REPORT, *supra* note 1, at 22-23.

²³⁶ The battle has been characterized as the "strong vs. the weak" in which the airline "industry is so at war with itself that the carriers can't agree on what sort of assistance they need from government." Ingersoll and Pulley, *supra* note 4.

²³⁷ Another former DOT official has stated that a system of bilateral agreements is inappropriate for a mature industry because it permits protectionism too readily. See Poling, *supra* note 235; House Aviation Subcommittee Chairman James Oberstar noted that the bilateral system "is too confining and rigid for the evolving liberalized air system [and] is no longer adequately responding to the broader and stronger ties governing trade . . ." See *Rep. Oberstar Says DOT Must Unchain Itself From Bilaterals*, AVIATION DAILY, Sep. 30, 1991, at 599. Factors which help ensure success in negotiating an unrestricted bilateral agreement include a negotiating partner whose government has a free-market ideology, who is strong national carrier, and whose air traffic can easily be diverted to other nations. Gomez-Ibanez, *supra* note 39, at 118.

²³⁸ Joan M. Feldman, *On having it both ways; International Civil Aviation Organization's Colloquium on Air-Transport Regulations*, AIR TRANSPORT WORLD, June 1992, at 210 (noting that at the conference a majority of countries still regard air transport as "special").

tion, many nations still fear that their sovereignty and national interests would be subordinated if they allow a multinational body to negotiate on their behalf.²³⁹ Similarly, foreign airlines are also debating the best approach. Large airlines such as Air France and Japan Airlines, as well as smaller carriers such as Royal Jordanian and Air India, support the bilateral system as a means of preventing U.S. carriers from dominating international markets.²⁴⁰ Other carriers, such as Swissair and Singapore Airlines, suggest that smaller countries may be better off without flag carriers and bilateral restrictions.²⁴¹ These carriers generally have small domestic markets and would like the opportunity to further develop their route systems.²⁴²

One proposed solution that should be further explored is known as a plurilateral agreement.²⁴³ A plurilateral agreement is defined as an agreement between two nations which other nations can agree to follow.²⁴⁴ A plurilateral arrangement will not open all markets immediately, but it will gradually achieve this goal by increasing the number of countries that are committed to a specific set of principles. For example, the U.S. position is that it is unwilling to discuss changes in foreign ownership and cabotage, except on a case-by-case basis. This position is understandable, because if the U.S. negotiated cabotage rights with one nation, other nations would seek similar rights in their bilateral agreement. This could lead to extremely difficult negotiations with nations who generally follow protectionist policies. By signing Open Skies agreements with individual nations, a base of common agreement would be solidified. It would then be much easier to convene a multilateral convention among these countries to consider subjects such as foreign ownership and cabotage. The interim period would also allow a transition in which problems could be resolved more effectively because a smaller number of nations would be involved.

²³⁹ *Id.*

²⁴⁰ The fear of these carriers is that in any multilateral world the only winners will be U.S. carriers. See James Ott, *Free Trade Advocates Foresee End of Bilaterals*, AVIATION WK & SPACE TECHNOLOGY, Apr. 13, 1992, at 10.

²⁴¹ Proponents of multilateral negotiations favor treating airline services similar to other products and services. *Id.* This view was echoed by the Commission which noted that continued reliance on bilateral agreements will be detrimental to American interests. See COMMISSION REPORT, *supra*, note 1, at 21.

²⁴² *Id.*

²⁴³ *Id.*

²⁴⁴ *Id.*

VIII. CONCLUSION

Fifty years ago, a restrictive aviation accord was signed at the Chicago Convention. The restrictions were largely driven by fears of U.S. dominance. Fifty years later, efforts to liberalize aviation are again stalled because of concerns of U.S. dominance. In the interim, the U.S. has developed the largest and most efficient air transportation system in the world, with most of its growth coming after 1978. This success should serve as the impetus for other nations to abandon their protectionist policies. The ultimate goal of these efforts should one day allow a passenger to fly an American airline, owned by an Australian company, between Rome and Naples.

