

1991

## Crippling United States Airlines: Archaic Interpretations of the Federal Aviation Act's Restriction on Foreign Capital Investments

James E. Gjerset

Follow this and additional works at: <http://digitalcommons.wcl.american.edu/auilr>



Part of the [International Law Commons](#)

---

### Recommended Citation

Gjerset, James E. "Crippling United States Airlines: Archaic Interpretations of the Federal Aviation Act's Restriction on Foreign Capital Investments." *American University International Law Review* 7, no. 1 (1991): 173-196.

This Article is brought to you for free and open access by the Washington College of Law Journals & Law Reviews at Digital Commons @ American University Washington College of Law. It has been accepted for inclusion in *American University International Law Review* by an authorized administrator of Digital Commons @ American University Washington College of Law. For more information, please contact [fbrown@wcl.american.edu](mailto:fbrown@wcl.american.edu).

# CRIPPLING UNITED STATES AIRLINES: ARCHAIC INTERPRETATIONS OF THE FEDERAL AVIATION ACT'S RESTRICTION ON FOREIGN CAPITAL INVESTMENTS

James E. Gjerset\*

## INTRODUCTION

The Federal Aviation Act's<sup>1</sup> (FAA) requirement that a United States citizen own or control seventy-five percent of the voting interest of a domestic airline<sup>2</sup> provides an excellent example of a regulatory policy which stifles the economic development of an industry currently

---

\* J.D. Candidate, 1992, Washington College of Law, The American University. The author wishes to thank Administrative Law Judge Ronnie A. Yoder of the United States Department of Transportation for his support and the entire Office of Hearings for providing the author with the opportunity to gain valuable insight as a law clerk. All views expressed herein are the author's and are in no way attributable to any Department of Transportation personnel.

1. Federal Aviation Act of 1958, Pub. L. No. 85-726, 72 Stat. 737 (codified at 49 U.S.C. §§ 1301 *et. seq.* (1988)).

2. *Id.* at § 1301 The FAA, for purposes of ownership and control of a domestic airline, defines a citizen of the United States as:

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

49 U.S.C. § 1301(16) (1988).

This analysis focuses on regulatory agency interpretations of § 1301 which require a United States air-carrier to demonstrate not only that it meets the voting stock requirement but also that it actually is owned and controlled by citizens of the United States within the meaning of section 1301(16) of the Act. Pan Aviation, Inc., D.O.T. Order No. 86-8-65 at 10 (1986); Denham Aircraft Services Corp. II Fitness Investigation, C.A.B. Order No. 83-8-54 at n.1 (1983).

In addition to the citizenship requirement, an applicant air-carrier must establish that: (1) it will have the necessary management skills and technical ability, before beginning service, to safely conduct the proposed operations; (2) if not internally financed, it has a plan for financing that, if carried out, will generate sufficient resources to commence the proposed operation without undue risk to consumers; and (3) it will comply with the Act and regulations imposed by federal and state agencies. *In re* Discovery Airways, Inc., D.O.T. Order No. 89-12-41 at 4-5 (1989); Pan Aviation, Inc. Fitness Investigation, D.O.T. Order No. 86-8-65 at 9-10 (1986); Sun Pacific Airlines Fitness Investigation, C.A.B. Order No. 81-6-126 at 4-6 (1981); New York Air Fitness Investigation, C.A.B. Order No. 80-12-57 at 4 (1980).

facing severe financial difficulties<sup>3</sup> while ostensibly fostering growth and fulfilling national objectives.<sup>4</sup> During the 1990 fiscal year, many domestic airlines operated at a loss.<sup>5</sup> Stringent restrictions on foreign capital investment,<sup>6</sup> coupled with a weakened economy<sup>7</sup> and volatile oil prices,<sup>8</sup> crippled an already faltering airline industry.<sup>9</sup> The economic ramifications of an impaired airline industry affect the entire United

---

3. See *U.S. Airlines Expect 4th-Quarter Losses Exceeding \$1 Billion*, Wall St. J., Oct. 19, 1990, at A7A (noting that airline industry analysts predict record losses exceeding one billion dollars for United States airlines in the fourth quarter of 1990); *Northwest Air Plans to Cut Some Flights as of Nov. 1*, Wall St. J., Oct. 17, 1990, at B8 (speculating that to remain functional, struggling airlines must impose employee cutbacks and reduce flight schedules); Nomani, *Northwest Air Union Rejects Wage-Cut Plan*, Wall St. J., Oct. 15, 1990, at B10 (suggesting the entire airline industry must accept fare increases, asset sales, and mergers to remain solvent); Nomani & O'Brian, *AMR Seeks Pan Am's London Routes, Moves to Top United Airlines Agreement*, Wall St. J., Oct. 26, 1990, at A3 (detailing the collapse of Pan Am, as well as the airline's effort to sell its most lucrative London routes to United Airlines, in exchange for cash and a marketing agreement in order to avoid total collapse); Valente, *Midway's Deal Signals Airline's Fare Shakeout*, Wall St. J., Oct. 22, 1990, at A3 (concluding that Midway Airlines' attempted sale of its unprofitable hub operation at Philadelphia to USAir for cash mirrors the decline of Braniff, which filed for bankruptcy protection under Chapter 11 in 1989, People's Express, and New York Air); O'Brian, *Continental Hopes to Sell Planes, Not International Routes, to Raise Cash*, Wall St. J., Oct. 25, 1990, at A4 (noting that Continental Airlines' board of directors considered a Chapter 11 bankruptcy filing and offered to sell a number of its assets in an attempt to raise cash).

4. See *infra* notes 51-97 and accompanying text (noting the legislative history of United States aviation law clearly demonstrates that Congress enacted the citizenship requirement both to ensure United States national security and to protect the United States aviation industry from foreign competition).

5. See *In re Ionosphere Clubs, Inc.*, 113 Bankr. 164, 168-69 (Bankr. S.D.N.Y. 1990) (noting Eastern Airlines' operating losses from March 9, 1989 through April 1990 exceeded \$1.2 billion); Medina & Nomani, *Delta Air Posts Loss of \$51.6 Million; UAL Net Income Slips to \$106.1 Million*, Wall St. J., Oct. 26, 1990, at A5 (indicating that in the first quarter of 1990, Delta Airlines suffered almost a fifty-two million dollar loss while in the third quarter USAir's net income loss increased from approximately seventy-eight million dollars in 1989 to one-hundred twenty million dollars in 1990); Hamilton, *Pan Am to Sell Routes*, Wash. Post, Oct. 24, 1990, at G1 (detailing Pan Am's sale of a major portion of its transatlantic service in order to raise enough cash to survive).

6. See *infra* notes 103-39 and accompanying text (detailing the restrictive interpretation of the citizenship requirement).

7. See Berry, *U.S. Economy Moves Deeper Into Recession, Figures Show*, Wash. Post, Feb. 16, 1991, at G11 (stating that both Allen Sinai, chief economist of the Boston Co., and Michael Darby, undersecretary of commerce, predict the United States economy will continue to move deeper into a recession).

8. See Tanner, *War Beginning to Sop Up Glut of World's Oil*, Wall St. J., Feb. 14, 1991, at A3 (attributing increased oil prices to the Persian Gulf War).

9. See Kilman, Nomani & Taylor, *It May Be Irrational, But Terrorism Anxiety Spurs Plunge in Travel*, Wall St. J., Feb. 13, 1991, at A1 (observing that travel bookings dropped by up to twenty-five percent since the beginning of the Persian Gulf crisis); Carroll & Kim, *Pan Am Sells Key Routes to United*, USA Today, Oct. 24, 1990, at B1 (noting that Pan Am lost over one billion dollars during the past five years).

States economy.<sup>10</sup> If the industry continues its downward spiral, it could ultimately push the entire United States economy into an even deeper economic recession.<sup>11</sup> The Department of Transportation's (DOT) stringent interpretation of FAA § 1301(16) mandating seventy-five percent United States citizen ownership and control of all United States air-carriers represents a major cause of the airline industry's current problems. By forcing airlines to adhere to this interpretation, the DOT thwarts the free market system by reducing the available capital pool from which airlines can draw funds for development and stability in difficult times. Ultimately, this requirement leaves failing airlines with two options: either distribute assets according to a judge's ruling<sup>12</sup> or raise capital according to agency directives.<sup>13</sup>

This comment addresses the inherent problems of interpreting the statutory requirement mandating United States citizen ownership and control of seventy-five percent of the voting interest in a United States air-carrier as pertaining to all forms of equity ownership as well as indirect personal control. Part I describes the economic and political realities currently influencing contemporary citizenship requirement interpretations. Part II addresses the citizenship requirement's statutory history and congressional modifications. Part III examines the evolution of administrative interpretations of the citizenship requirement, and

---

10. See Kilman, Nomani & Taylor, *supra* note 9, at A13 (noting that travelers spent approximately three hundred and fifty billion dollars in the United States in 1990). This figure represents almost seven percent of the United States gross national product. *Id.* See also Crenshaw and Hamilton, *USAir Cost-Cutting Action May Prove to Be Expensive*, Wash. Post, Feb. 14, 1991, at D1 (discussing USAir's decrease in its insurance coverage from thirty-three million dollars to sixteen million dollars); *300 Northwest Flight Attendants Face Layoffs; Others Take Leaves*, Wash. Post, Feb. 17, 1991, at A13 (noting that Northwest Airlines laid off three hundred employees and asked another six hundred to take a voluntary leave of absence).

11. See Auerbach, *Aircraft Makers Hit by Airline Recession*, Wash. Post, Feb. 13, 1991, at C10 (noting the problems in the air-carrier industry negatively affect aircraft manufacturers who accounted for almost eighty percent of the overall United States economic growth in 1990); see also Kilman, Nomani & Taylor, *supra* note 9, at A1 (noting United States travel agencies recently laid off hundreds of employees); Nomani, *Climbing Fares Are Scaring Off Air Travellers*, Wall St. J., Oct. 17, 1990, at B1 (stating that airline fares increased at a rate of eleven and one-half percent between January and August of 1990, which represents an increase of almost two times the rise in overall consumer prices during the same period).

12. See McCartney, *Northwest Gets Rights at National*, Wash. Post, Feb. 16, 1991, at G11 (noting a United States bankruptcy judge's ruling prohibiting Eastern Airlines from selling specific assets to the highest bidder, United Airlines).

13. See *id.* (noting the Justice Department's objection, based on competition grounds, to Eastern Airlines' sale of designated assets to United Airlines); McGinley & Nomani, *U.S. Says Refusal of British Airways Bid to Cut Fares Applies to Domestic Carriers*, Wall St. J., Feb. 14, 1991, at A4 (discussing the Department of Transportation's refusal to allow Pan Am, TWA, Northwest Airlines, Continental, USAir, and American Airlines to cut fares by as much as fifty percent).

demonstrates how these interpretations hinder the development of the aviation industry by making it more difficult for airlines to acquire operating capital. Finally, part IV recommends alternative approaches to the DOT's stringent interpretation of § 1301(16) and the inherent problems of restricting foreign capital investment in the airline industry.

## I. CONTEMPORARY ECONOMIC THEORIES

Before analyzing the economic and political consequences of citizenship requirements, one must first recognize the economic theories governing international trade. Current international trade policy divides along two distinct lines of reasoning.<sup>14</sup> The first adheres to the classical concept of free trade.<sup>15</sup> This concept concludes that liberalization of trade barriers by minimizing government interference in trade crossing international borders enhances a country's economic potential,<sup>16</sup> regardless of whether all countries participate.<sup>17</sup> The law of comparative advantage,<sup>18</sup> which asserts that free trade enhances the potential economic growth of all nations by promoting a competitive market atmosphere for worldwide trade and investments, constitutes an essential part of the free trade theory.<sup>19</sup> The second line of reasoning historically centers around domestic efforts to sustain national growth<sup>20</sup> and fulfill

---

14. See Caplan, *Out of Bondage: Loosening the Grip of U.S. Export Controls*, *Export Today*, Nov.-Dec. 1988, at 34, 35 (explaining that advocates of a liberal free trade policy encourage open investment markets to allow industrial growth and continued United States leadership, while advocates of government regulation of foreign investment demand economic protection for United States industries in an effort to advance domestic policy goals and to ensure that citizens of the United States reap the benefits of foreign trade).

15. See generally J. JACKSON, *THE WORLD TRADING SYSTEM: LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS* (1990) (analyzing the classical free trade model and its application to present day international trade).

16. *Id.* at 1-2.

17. See J. JACKSON & W. DAVEY, *LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS* 18 (2d ed. 1986) [hereinafter *PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS*] (asserting that trade barriers negatively affect the economy of the country invoking those barriers because they force domestic consumers to pay more for each unit of the restricted product and consequently consumers have less disposable income to spend on other products).

18. See C.P. KINDLEBERGER, *INTERNATIONAL ECONOMICS* 17-20 (5th ed. 1973) (explaining the assumptions behind the theory of comparative advantage).

19. See *id.* (explaining that a comparative advantage results when a country exports the commodity in which it has a production advantage and imports those in which it has a disadvantage).

20. See *PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS*, *supra* note 17, at 18-20 (describing various arguments for government intervention in international trade).

national objectives<sup>21</sup> through government intervention in international trade.<sup>22</sup> As the complexity of multinational economic interdependence<sup>23</sup> escalated,<sup>24</sup> nations initially employed trade barriers as a tool to promote national objectives in foreign policy<sup>25</sup> and to protect specific domestic industries from foreign competition.<sup>26</sup> Economists label this the neomercantilist economic theory.<sup>27</sup>

After World War II, economists and policy-makers realized the importance of implementing a global economic policy to maximize the

---

Jackson and Davey first argue that government intervention gives domestic producers a larger market share, and thus creates more domestic jobs, protects workers in a high-wage industry from "pauper labor" in developing countries, and equalizes costs in the importing and exporting nations. *Id.* at 18-19. Jackson and Davey also assert that some national interests, such as the need to protect an industry necessary for national defense or some other national goal and the need to enable a new industry having a potential comparative advantage to develop to the size necessary to achieve that comparative advantage, are so imperative as to require trade restrictions. *Id.*

21. *See id.* at 28 (noting that although most economists concur with the theory that unrestricted international trade maximizes global production, policy concerns of individual nations often mandate certain protectionist policies motivated by political goals, such as protecting particular groups from foreign competition and the need to develop specific industries, rather than maximizing output); *see also* Fisher, *The Multinationals and the Crisis In United States Trade and Investment Policy*, 53 B.U.L. REV. 308, 309-16 (1973) (discussing the first instance of United States infant industry protection and the evolution of trade barriers).

22. For other sources examining the history of United States international trade policy, *see generally* S. METZGER, *TRADE AGREEMENTS AND THE KENNEDY ROUND* (1964); J. CONDLITTLE, *THE COMMERCE OF NATIONS* (1950); I. TARBELL, *THE TARIFF IN OUR TIMES* (1911); E. STANWOOD, *AMERICAN TARIFF CONTROVERSIES IN THE NINETEENTH CENTURY* (1903).

23. *See* Cooper, *Economic Interdependence and Foreign Policy in the Seventies*, 24 WORLD POL. No. 2, 159-81 (Jan. 1972) (describing the magnitude of international economic interdependence which characterizes the contemporary global policy of states).

24. *See* D. BLAKE & R. WALTERS, *THE POLITICS OF GLOBAL ECONOMIC RELATIONS* (3d ed. 1987) [hereinafter *GLOBAL ECONOMIC RELATIONS*] (providing an excellent in-depth analysis of the proliferation of economic interdependency among developed as well as undeveloped nations).

25. *See id.* at 11-18 (analyzing inherent problems as well as the political and economic ramifications when nations use trade policy as leverage for international political relations); *see also* Export Administration Act of 1969, Pub. L. No. 91-184, § 2, 83 Stat. 841 (codified as amended at 50 U.S.C. app. §§ 2401-2420 (1988)) (finding that the complexity of, and interrelation between, trade balances, capital accounts, service accounts, foreign exchange rates, and international monetary reserves allowed nations to impose trade barriers as policy vehicles).

26. *See* Malmgren, *Coming Trade Wars?*, FOREIGN POL'Y, No. 1 (Winter 1970-71) at 120 (explaining the neomercantilist trade orientation as one in which states stimulate home production, reduce imports, and promote exports to maintain a balance-of-trade surplus and encourage domestic production and employment).

27. *See* *GLOBAL ECONOMIC RELATIONS*, *supra* note 24, at 9 (noting that the neomercantilist economic theory elevates national priorities to the same level as the efficient use of resources and economic growth).

economic potential of all countries.<sup>28</sup> Most importantly, nations involved in World War II aspired to prevent the reoccurrence of the economic policies that helped foster World War II.<sup>29</sup> Major western states ultimately forged an economic alliance<sup>30</sup> based on the premise of promoting international trade as a growth stimulant.<sup>31</sup> This alliance resulted in unprecedented global economic interdependence.<sup>32</sup>

Beginning in 1971, the United States faced an extraordinary economic crisis<sup>33</sup> as a result of a critically high balance of payments deficit<sup>34</sup> coupled with an aggressive expansion policy by foreign investors<sup>35</sup> during which the influx of foreign capital investment into the United States rose almost nine hundred percent.<sup>36</sup> United States public sentiment eventually shifted towards a policy which advocated government intervention in international trade.<sup>37</sup> This shift in public sentiment per-

28. See *id.*, at 11-12 (describing international economic policy evolution in the period following World War II).

29. See *id.* (citing C. WILCOX, A CHARTER FOR WORLD TRADE 8-9 (1949)) (condemning the global economic policies of export subsidies, high tariffs, and discriminatory trade agreements for causing the deterioration of world trade and a global economic depression).

30. See GLOBAL ECONOMIC RELATIONS, *supra* note 24, at 12-14 (describing the General Agreement on Tariffs and Trade (GATT) as the principle organization utilized by market economy countries to establish, through multilateral negotiations and international standards, principles, and procedures which promote international trade through trade barrier reductions). For discussions of the GATT negotiation and dispute settlement procedures, see generally R. HUDEC, THE GATT LEGAL SYSTEM AND WORLD TRADE DIPLOMACY (1975); J. JACKSON, WORLD TRADE AND THE LAW OF GATT ch. 8 (1969).

31. See GLOBAL ECONOMIC RELATIONS, *supra* note 24, at 12 (describing the goals of GATT as maximizing global trade and economic growth by reducing trade barriers in a nondiscriminatory fashion).

32. J. BARTON & B. FISHER, INTERNATIONAL TRADE AND INVESTMENT, REGULATING INTERNATIONAL BUSINESS 25 (1986) [hereinafter REGULATING INTERNATIONAL BUSINESS] (noting that in 1983 United States profits from foreign operations accounted for approximately one-fifth of all corporate profits while international investment accounted for approximately one-sixth of all manufacturing investment) (data derived from United States Department of Commerce, 61 *Surv. Current Bus.* 33 (June, 1986)).

33. See United States Department of Commerce, Overseas Business Reports OBR 71-009 and United States Department of Commerce Bureau of the Census, news release FT 900-71-6, July 28, 1971 (finding United States balance of exports and imports changed from a positive average annual balance of \$5.4 billion during the 1960's to a negative balance of \$3.2 billion, annual rate, for the second quarter of 1970).

34. See United States Department of Commerce, Office of Business Economics, news release OBE 71-43, July 6, 1971 (concluding that during the first quarter of 1971 the United States deficit reached an annual rate of \$22 billion).

35. See United States Department of Commerce, 61 *Surv. Current Bus.* 33 (June 1986) (revealing that between 1973 and 1985, foreign direct investment in the United States increased from \$20.5 billion to \$183 billion).

36. *Id.*

37. See R. VERNON, EXPLORING THE GLOBAL ECONOMY 8-9 (1985) [hereinafter EXPLORING THE GLOBAL ECONOMY] (noting public outrage in the United States over

meated congressional deliberations and executive branch determinations.<sup>38</sup> Consequently, government leaders and administrators deviated from the classical free trade model<sup>39</sup> of open markets and imposed restrictive measures on foreign imports and capital to appease their constituents.<sup>40</sup> At the same time, the percentage of the United States gross national product (GNP) involved in international trade rose almost eighteen percent.<sup>41</sup> Experts speculate this percentage will more than double in the next ten years.<sup>42</sup>

Statutory restrictions on foreign capital investment represent an important hidden barrier to the free flow of international trade. These restrictions generally take the form of citizenship requirements<sup>43</sup> in which the United States imposes capital restrictions on non-United States citizens investing in a United States industry. In reality, this policy mirrors neomercantilist economic theory<sup>44</sup> which places national economic priorities on the same level as efficient resource allocation and growth.<sup>45</sup> Thus, before attempting to modify the citizenship requirements, one must determine Congress'<sup>46</sup> economic motive<sup>47</sup> in lim-

---

the perception of inequitable treatment by other nations imposing non-tariff barriers on United States products).

38. *Id.*

39. See GLOBAL ECONOMIC RELATIONS, *supra* note 24, at 6 (explaining the reasoning put forth by proponents of the classical liberal economic model for asserting that efficient allocation of resources among all the world's economies produces the maximum economic growth for each individual state).

40. EXPLORING THE GLOBAL ECONOMY, *supra* note 37, at 8-9.

41. See REGULATING INTERNATIONAL BUSINESS, *supra* note 32, at 23 (noting the magnitude of United States involvement in international trade rose from two percent of the United States GNP in 1950 to approximately twenty percent in 1986).

42. See *id.* (concluding that forty percent of the United States GNP could be tied to international trade by the end of the twentieth century).

43. See, e.g., Federal Aviation Act of 1958, Pub. L. No. 85-726, 72 Stat. 737 (codified at 49 U.S.C. § 1301(16) (1988)) (defining "Citizen of the United States"); Communications Act of 1934, ch. 652, 48 Stat. 1064 (codified at 47 U.S.C. § 310 (b) (1988)) (restricting common carrier licenses to United States citizens); Shipping Act of 1916, Pub. L. No. 64-2460, § 2, 39 Stat. 728 (codified at 46 U.S.C. § 802 (1988)) (mandating seventy-five percent United States citizen control for licensed maritime vessels employed in coastal trade); Federal Banking Act, (codified at 12 U.S.C. § 72 (1988)) (requiring United States citizen officers for United States banks).

44. See GLOBAL ECONOMIC RELATIONS, *supra* note 24, at 9 (noting that neomercantilists view economic relations as a means to distribute wealth and power rather than as a way to maximize global welfare).

45. *Id.*

46. U.S. CONST. art. I, § 8, cl. 1-3. The legislative branch's authority over foreign commerce and trade derives from article I, section 8 of the Constitution, which specifically empowers Congress to "lay and collect Taxes, Duties, Imports and Excises" and to "regulate Commerce with foreign Nations." *Id.*

47. See Fisher, *The Multinationals and the Crisis in United States Trade and Investment Policy*, 53 B.U.L. REV. 308, 308-11 (1973) (arguing that congressional obsession with United States trade policy wandered over the years between the need to pro-



iting the percentage of voting stock a foreign entity can hold in a United States air-carrier.<sup>48</sup>

## II. ORIGINAL CONGRESSIONAL INTENT

### A. NATIONAL SECURITY

Fundamental principles of statutory construction require interpreting statutory language according to its use at the time Congress passed the legislation.<sup>49</sup> This principle is difficult to apply to the FAA's citizenship requirement because statutory history reflects a congressional economic policy which evolved over time in conjunction with economic situations and political realities which no longer exist.<sup>50</sup>

During the early stages of commercial aviation development, Congress initiated the citizenship requirement to assure aircraft availability for national defense purposes.<sup>51</sup> At the time, congressional leaders and

duce revenue, protection against "unfair" foreign competition, concern over national independence, and protection of United States infant industries and established United States industries).

48. For purposes of this analysis, the citizenship requirement of the Federal Aviation Act of 1958, 49 U.S.C. § 1301(16) (1988), serves as the illustrative example.

Note, however, the similarities in other federal statutes that limit foreign investment by mandating citizenship requirements. *See, e.g.*, Shipping Act of 1916, 46 U.S.C. § 802 (1988) (mandating seventy-five percent control by United States citizens for licensed maritime vessels employed in coastal trade and 51 percent United States citizen control for those engaged in international trade); Communications Act of 1934, 47 U.S.C. § 310(b) (1988) (prohibiting foreign individuals and foreign corporations from holding a United States common carrier license). The Communications Act defines a foreign corporation as:

[A]ny corporation of which any officer or director is an alien or of which more than one-fifth of the capital stock is owned of record or voted by aliens or their representatives or by a foreign government or representative thereof or by any corporation organized under the laws of a foreign country; [or] any corporation directly or indirectly controlled by any other corporation of which any officer or more than one-fourth [25%] of the capital stock is owned [by aliens].

*Id.* at § 310(b)(3)-(4).

The act most similar in rationale to the FAA, however, is the Merchant Marine Act in which Congress' stated intent was to protect the United States in wartime, to ensure that control of shipping vessels remained in American hands, and to prevent foreign interests from acquiring control of American shipping by any device. Merchant Marine Act, Pub. L. No. 66-261, § 38, 41 Stat. 988, 1008 (1920).

49. *See Securities Industry Ass'n v. Board of Governors*, 468 U.S. 137, 150 (1984) (analyzing the "ordinary meaning" of a term as used by Congress); *see also Livermore v. Heckler*, 743 F.2d 1396, 1401-03 (9th Cir. 1984) (analyzing a term according to common usage during the period in which the legislation passed).

50. *See infra* notes 51-65 and accompanying text (describing congressional rationale for initially invoking citizenship requirements and the subsequent debates over the percentage of foreign ownership allowed for a United States air-carrier).

51. *See Inquiry into Operations of the United States Air Services: Hearing Before the House Select Committee of Inquiry into Operations of the United States Air Services*, 68th Cong., 1st Sess. 527 (1925) (statement of Major General M. Patrick, Chief

military planners advocated government intervention in commercial air carrier development for the dual purpose of training a reserve corp of pilots<sup>52</sup> and maintaining an auxiliary air force<sup>53</sup> for United States military service during national emergencies.<sup>54</sup> Congressional leaders and military advisors ultimately concluded that national security necessitated a citizenship requirement for ownership of United States air-carriers.<sup>55</sup> They premised this conclusion on the assumption that, without a citizenship requirement, non-United States citizens might control some components of the theoretical auxiliary military air-fleet.<sup>56</sup> Proponents of this policy maintained that citizens of the United States should hold at least seventy-five percent of the interest in a United States air carrier<sup>57</sup> to counter possible foreign control problems.<sup>58</sup>

When finally enacted, the Air Commerce Act of 1926 (1926 Act)<sup>59</sup> required a corporation to maintain fifty-one percent United States citizen ownership of voting stock,<sup>60</sup> as opposed to non-voting equity or debt interest, sixty-six and two-thirds percent United States citizen membership on the corporation's board of directors,<sup>61</sup> and a president<sup>62</sup> who

---

of the Army Air Service) [hereinafter *Air Services Hearing*] (encouraging interdependence between the military and the commercial aviation industry).

52. *See id.* (noting the United States military Air Service's inability to maintain an adequate air fleet in preparation for a national emergency and the need to depend on domestic air-carriers to augment United States military requirements during crisis situations). Major General Patrick stressed that the United States government should maintain a reserve corps of pilots and surplus parts, planes, mechanics, etc. to press into service during an emergency. *Id.*

53. *See* H.R. REP. NO. 1262, 68th Cong., 2d Sess. 26 (1925) (providing that United States aircraft will function as a reserve air-fleet during times of war).

54. *See Air Services Hearing, supra* note 51, at 527 (concluding that the commercial aviation industry can provide the military with aircraft as well as a pool of trained pilots, mechanics, air-traffic controllers and other individuals who the government can draft in war time).

55. H.R. REP. NO. 1262, 68th Cong., 2d Sess. 26 (1925).

56. *See id.* (noting that since the United States auxiliary air force consists of commercial aircraft registered in the United States, the individuals who own or control the airline companies supplying the planes should be United States citizens to ensure the aircraft's condition and availability).

57. *See id.* (stating that the Secretary of Commerce and representatives of the Secretary of War and Secretary of the Navy proposed that United States citizens should hold a minimum of seventy-five percent interest in a corporation applying for a United States air-carrier certificate).

58. *See id.* (ensuring exclusion of foreign controlled aircraft from the United States auxiliary air-fleet).

59. Air Commerce Act of 1926, Pub. L. No. 69-254, §§ 1-14, 44 Stat. 568 (1926) (previously 49 U.S.C.A. §§ 171-84 (West 1951) (repealed 1958)).

60. *Id.* § 9(a), 44 Stat. at 573.

61. *Id.*

62. *Id.*

qualified as a United States citizen.<sup>63</sup> Consequently, the 1926 Act embodies the least restrictive<sup>64</sup> alternative for fulfilling congress' stated national security goals. With the advent of the Great Depression and New Deal Legislation, however, the justification for the citizenship requirement changed from strict national security goals to protecting developing industries from foreign competition.<sup>65</sup>

## B. NEW DEAL LEGISLATION

One of the most serious ramifications of the Great Depression of the 1930's was the devastating transformation of international trade policy.<sup>66</sup> Policy-makers shifted their economic position from advocating the classical theory of free trade<sup>67</sup> to heavy reliance on governmental intervention through tariffs<sup>68</sup> and quotas<sup>69</sup> to stimulate domestic growth.<sup>70</sup> Adhering to this changing domestic philosophy, government policy makers recommended government control over United States airline development in both domestic and foreign commerce to advance United States political and economic interests.<sup>71</sup>

---

63. *Id.* The Air Commerce Act of 1926 defines a citizen of the United States for purposes of ownership and control of a domestic airline as:

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

*Id.*

64. *Id.* Congress adopted a fifty-one percent ownership requirement rather than the proposed seventy-five percent, and a two-thirds United States citizen requirement for members of the board of directors rather than the proposed three-fourths. *Id.*

65. See *infra* notes 66-92 and accompanying text (describing Congress' new rationale for a United States citizenship requirement for air-carriers).

66. See GLOBAL ECONOMIC RELATIONS, *supra* note 24, at 11-12 (noting efforts to avoid the popular "beggar-thy-neighbor" policy of international trade relations during the 1930's).

67. See *supra* notes 15-19 and accompanying text (describing what economists term the classical liberal or free trade model of economic thought).

68. See PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS, *supra* note 17, at 17 (defining tariff as a tax assessed on imports upon importation, frequently resulting in increased consumer prices).

69. See *id.* (defining quota as a ceiling on the volume or value of a foreign import admitted during a specified term).

70. REGULATING INTERNATIONAL BUSINESS, *supra* note 32, at 146.

71. See *infra* notes 78-98 (observing that nationalism and protectionism in the development of air commerce prevents international free trade in the airline industry).

Following the lead of the Federal Aviation Commission, the House introduced H.R. 5234<sup>72</sup> which combined with other proposals to become the Civil Aeronautics Act of 1938<sup>73</sup> (1938 Act). The 1938 Act contained substantially the same definition of "citizen of the United States"<sup>74</sup> as the 1926 Act<sup>75</sup> with one important difference. The 1938 Act required seventy-five percent United States citizen ownership of the voting interest in an airline for that airline to qualify as a United States citizen while the 1926 Act required only fifty-one percent United States citizen voting interest.<sup>76</sup> In hearings prior to the implementation of the 1938 Act regarding increased United States governmental intervention in the airline industry, proponents of a protectionist policy argued that development of the industry necessitated making airlines "a part of the commercial arm of the nation"<sup>77</sup> because of the expense of commercial aviation. In addition, these proponents argued that the United States government should assist United States air-carriers that operate in foreign commerce as much as possible.<sup>78</sup>

In accordance with these concerns, the Department of Commerce declared it inappropriate for a corporation with the minimum fifty-one percent United States citizen ownership to receive economic support from the United States government.<sup>79</sup> The Senate concurred with this

72. 75th Cong., 1st Sess. (1937).

73. Pub. L. No. 76-706, 52 Stat. 977 (codified at 49 U.S.C. app. §§ 1301 *et. seq.*, (1988)).

74. *Id.* § 179(a).

75. Air Commerce Act of 1926, Pub. L. No. 69-254, §§ 1-14, 44 Stat. 568 (1926) (previously 49 U.S.C.A. §§ 171-84 (West 1951) (repealed 1958)).

76. *Id.* § 6, 44 Stat. at 572.

77. *Aviation: Hearing on H.R. 5234 and H.R. 4652 Before the Comm. on Interstate and Foreign Commerce, 75th Cong., 1st Sess. 72 (1937) (statement of Edgar G. Gorrell, Air Transport Association of America).*

78. *Id.* at 73 (asserting that only American air-carriers should receive economic support for purposes of national commerce and national defense, particularly in competition with foreign air-carriers in foreign commerce).

79. *Id.* at 261 (statement of Dennis Mulligan, Office of the Solicitor, Department of Commerce); see *Hearings on S.2 and S. 1760 Before a Subcomm. of the Comm. on Interstate Commerce, 75th Cong. 1st Sess. 101 (1937) [hereinafter Interstate Commerce Hearings]* (statement of Dennis Mulligan, Office of the Solicitor, Department of Commerce). Mr. Mulligan stated:

Paragraph (d) of section 303 requires only a holding of 51 percent of the voting interest for air-carrier operations. While such a percentage is required under the provisions of the Air Commerce Act for the purpose of determining the nationality of owners of aircraft, it is at least open to question whether such a percentage should suffice for air-carrier operations receiving economic protection from a Federal Agency.

It is believed that serious consideration should be given to the air-carrier precedent of requiring at least a 75 percent ownership on the part of our nationals before engaging in certain kinds of commercial enterprise. The differentiations between stock ownership and stock control have been so clearly pointed out by

philosophy and suggested that Congress increase the required percentage of American ownership and control of corporate stock<sup>80</sup> before granting an airline United States citizen status.<sup>81</sup> Finally, in a statement to the House Interstate Commerce Committee,<sup>82</sup> the Assistant Secretary of Commerce urged the Committee to study every aspect of possible foreign control<sup>83</sup> and suggested that the Civil Aeronautics Act adopt the Shipping Act<sup>84</sup> precedent of seventy-five percent United States citizen ownership.<sup>85</sup>

In the mid-1930's, policy makers expressed the sentiment that American prestige and economic welfare required Americans to retain control of domestic airlines.<sup>86</sup> In an attempt to further protect the aviation industry from foreign incursion, Congress increased the mandatory percentage of United States citizen voting equity in a United States air-carrier from fifty-one to seventy-five percent.<sup>87</sup> Congress based this action on a carefully constructed theory, which hypothesized that allowing a foreign citizen to hold forty-nine percent of the voting interest in a corporation might, in fact, give control of operations to that for-

---

the Securities and Exchange Commission and leading writers on corporation finance that this matter should be given careful thought . . . . Fifty-one percent of stock ownership is a rather nebulous term at best, and, as a matter of historical record, even with respect to the present rule in the original Air Commerce Act there was provided something quite different from what was actually approved in the law.

*Id.*

80. *Id.* at 423 (statement of Senator Pat McCarran).

81. *Id.*

82. *Id.* at 79, 101, 423; *Hearing on H.R. 5234 and H.R. 4652 Before the Comm. on Interstate and Foreign Commerce, 75th Cong., 1st Sess. 252, 254-55, 261-62, 267 (1937) [hereinafter Interstate and Foreign Commerce Hearing].*

83. *Interstate Commerce Hearings, supra* note 79, at 101.

84. Shipping Act of 1916, Pub. L. No. 64-2460, § 2, 39 Stat. 728, 729 (codified at 46 U.S.C. § 802(a) (1988)). The current version of the Shipping Act requires seventy-five percent United States citizen ownership for registration of ships engaged in coastwise trade and fifty-one percent United States citizen ownership for registration of ships engaged in international trade. 46 U.S.C. § 802(a) (1988).

85. *Id.* See *Interstate and Foreign Commerce Hearing, supra* note 82, at 252, 254-55, 261 (concluding that Congress should emulate the water-carrier precedent and require United States air-carriers to restrict foreign holdings of voting equity to a maximum of twenty-five percent).

86. See Rivers and Greenwald, *The Negotiation of a Code on Subsidies and Countervailing Measures: Bridging Fundamental Policy Differences*, 11 LAW & POL'Y INT'L BUS. 1447, 1470 (1979) (explaining that in cases in which governments promote domestic growth through development of social and economic programs, government decision-makers are unlikely to be affected by the impact of such programs on international trade).

87. Civil Aeronautics Act of 1938, ch. 601, Pub. L. No. 76-706, 52 Stat. 977, 978 (codified at 49 U.S.C. § 1301(16) (1988)).

foreign citizen.<sup>88</sup> During its deliberations, Congress completely disregarded the original intent of the citizenship requirement.<sup>89</sup> Congress abandoned the original intent in an effort to ensure the airline industry's economic growth and security.<sup>90</sup> Consequently, Congress defined "citizen of the United States" more strictly because of a policy to give economic support to United States air-carriers in competition with foreign air-carriers,<sup>91</sup> while it ostensibly limited foreign ownership for the purpose of national defense.<sup>92</sup>

By limiting the amount of voting equity a non-United States citizen can hold in a United States air-carrier, the 1938 Act, in reality, imposed a quota on the amount of capital a foreign entity can invest in a United States air-carrier. This situation thus presents a classic example of the "infant industry argument" for protection of developing domestic industries.<sup>93</sup> In applying this policy, the government invokes either quotas or tariffs in order to protect the development of a new industry while that industry learns to function efficiently.<sup>94</sup> The assumption behind the infant industry argument, as it relates to the aviation industry, is that the initial start-up cost, coupled with the fierce competition from subsidized foreign entities,<sup>95</sup> prohibits United States firms from developing and competing in the industry.<sup>96</sup> Consequently, in order to preserve the industry seeking protection, the government imposes a temporary import restriction to ensure short-run profitability while the industry develops.<sup>97</sup> The inherent problem in infant industry protection,

---

88. See *Interstate Commerce Hearings*, *supra* note 79, at 101 (1937) (questioning whether fifty-one percent stock ownership actually provides the holder with control of the corporation).

89. See *supra* notes 51-56 and accompanying text (noting Congress' intent to use commercial transportation vehicles as an auxiliary military force in wartime).

90. See *supra* notes 66-70 and accompanying text (explaining Congress' justification for its abandonment of the original intent of the citizenship requirement during the Great Depression).

91. *Interstate Commerce Hearings*, *supra* note 79, at 439-40, 504 (statement of Edgar S. Gorrell, President, Air Transport Association of America).

92. *Hearings on H.R. 9738, Before the Comm. on Interstate and Foreign Commerce*, 75th Cong., 3d Sess. 147, 339 (1938) (statements of Clinton M. Hester, Assistant General Counsel, Treasury Department and Col. Edgar S. Gorrell, President of the Air Transport Association of America).

93. See R. Stern, *Tariffs and Other Measures of Trade Control: A Survey of Recent Developments*, 11 J. ECON. LITERATURE 857 (1973) (explaining that the infant industry theory calls for temporary protection of certain industries during the early stage of their development).

94. *Id.*

95. *Interstate and Foreign Commerce Hearing*, *supra* note 82, at 72 (statement of Edgar S. Gorrell, President, Air Transport Association of America).

96. *Id.*

97. PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS, *supra* note 16.

however, as demonstrated by the airline industry's recent problems, is that the industry being protected never matures because the quotas create vested interests within the industry which help ensure that Congress never repeals the beneficial protectionist legislation. As a result, inefficient domestic industries continue to survive and operate, benefiting United States capitalists with the resources to invest in the protected industry, while at the same time injuring consumers through price increases.<sup>98</sup>

### III. CONTEMPORARY ADMINISTRATIVE INTERPRETATION

While Congress determines the course of United States trade policy,<sup>99</sup> it has neither the resources nor the desire to respond to the volatile nature of international commerce.<sup>100</sup> The complex interrelationships between the domestic pressures for trade barriers and the overall desire for free international trade, as well as the lack of interest among local constituents, make it hazardous for elected officials to involve themselves in the intricacies of trade negotiations.<sup>101</sup> Consequently, the executive branch, through a variety of specialized agencies, executes United States international economic policy on a daily basis.<sup>102</sup> The problem with current citizenship and control determinations, however, is that they are made in an economic vacuum, without consideration of the overall impact on long-term productivity and competitiveness in the United States.

The deregulation of the airline industry in 1978<sup>103</sup> constituted the United States government's first attempt to encourage more competition among airlines. The stated objectives of the Deregulation Act were "the avoidance of unreasonable industry concentration, excessive market domination, and monopoly power" and "the encouragement of entry into air transportation markets by new carriers."<sup>104</sup> In passing the Deregulation Act Congress intended to force airlines to compete with one another for consumers as well as for capital investments.<sup>105</sup> Con-

98. *Id.* at 18.

99. *See supra* note 46 (explaining how Congress derives its power over foreign trade policy).

100. S. COHEN, *THE MAKING OF UNITED STATES INTERNATIONAL ECONOMIC POLICY: PRINCIPLES, PROBLEMS, AND PROPOSALS FOR REFORM* 105-06 (1977).

101. *Id.* at 58.

102. *Id.* at 60.

103. Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705 (codified as amended at 49 U.S.C. §§ 1301-1522 (1988)) (Deregulation Act).

104. *Id.* at § 102(7), (10), 92 Stat. 1705, 1706-07.

105. S. REP. No. 631, 95th Cong., 2d Sess. 52 (1978).

gress concluded that, by relaxing investment criteria, established airlines could acquire additional financing while new companies could acquire start-up capital and eventually compete with the industry giants.<sup>106</sup> Agency interpretations of the statute, however, remained unaffected.

The Department of Transportation (DOT) currently interprets FAA requirements. The Civil Aeronautics Board (CAB), the predecessor to the DOT, initially determined that all foreign control evaluations should focus on whether the foreign interests have the power, either directly or indirectly, to influence the directors,<sup>107</sup> officers<sup>108</sup> or stockholders<sup>109</sup> of the applicant air carrier.<sup>110</sup> In applying these stringent guidelines, the DOT essentially recognized two distinct types of foreign control: control through personal relationships and financial control through equity and debt ownership.

As a result of this restrictive interpretation of the congressional mandate that foreign citizens may not hold more than twenty-five percent of the voting stock of a United States air-carrier, the DOT examines every aspect of interlocking corporate relationships to determine whether a foreign entity has the power to exercise influence over a United States air-carrier.<sup>111</sup> Therefore, when one or more corporations own or control an interest in an air-carrier which attempts to establish citizenship, the DOT requires each and every corporate stockholder within the corporate chain to establish that it is a citizen of the United States within the meaning of the Act.<sup>112</sup> Consequently, the DOT inter-

---

106. H.R. REP. NO. 1211, 95th Cong., 2d Sess. 17, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 3737, 3753.

107. *In re* Page Avjet Corp., C.A.B. Order No. 83-7-5 at 2-3 (1983).

108. *Id.*

109. *Id.*

110. *Id.* See *Uraba, Medellin, Cent. Airways-Canal Zone-Columbia Op.*, 2 C.A.B. 334, 337 (1940) (establishing basic citizenship criteria by holding that Congress intended that the CAB investigate whether the applicant is a citizen of the United States in fact, in purpose, and in management rather than merely applying a strict mathematical formula to calculate voting equity percentages).

111. See *Cathay Pacific Airways Case*, C.A.B. Order No. 77-3-91 at 2 (1977) (discussing interrelationships between companies and the question of control). *But see* BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS, (J. Downes & J. Goodman eds. 1985) (stating that an entity controls a corporation if that entity can cause the corporation to do its bidding).

112. See *Cathay Pacific*, C.A.B. Order No. 77-3-91 at 2 (defining affiliate in terms of the relationship between companies).

[W]e shall define 'affiliate' to mean a person who directly or indirectly through a representative, nominee, trustee, subsidiary, attorney, or other agent owns, controls, or holds the power to vote 10 percent or more of the debt obligations [including voting securities or total securities] of another person. The term includes both parents and subsidiaries and affiliates of parents and subsidiaries.



pretation effectively makes the citizenship of the applicant corporation dependent upon the citizenship of each and every shareholder and corporation in a corporate chain as well as the citizenship of affiliated persons and corporations.

#### A. CONTROL THROUGH PERSONAL RELATIONSHIPS

Applicants often orchestrate their organizational configuration merely to meet the minimum foreign control requirements. The issue before the DOT in these instances is who actually controls the air-carrier.<sup>113</sup> The DOT approaches this issue by determining whether the organizational configuration allows a foreign interest to exercise a degree of control sufficient to nullify the United States controlling interests,<sup>114</sup> or to restrict the United States carrier's operations to suit the needs of the particular foreign interest.<sup>115</sup>

In one of the earliest decisions regarding the possibility of a foreign interest exercising control through personal relationships,<sup>116</sup> the CAB concluded that Interamerican Air Freight Company failed to meet the citizenship standards set forth in the 1958 Act<sup>117</sup> because several of the applicant's officers and employees enjoyed long-standing personal and professional relationships with Daetwyler, a Swiss national.<sup>118</sup> The CAB determined that Daetwyler could influence decisions of the appli-

---

*Id.* (citing Pre-hearing Conference Report dated August 5, 1975, in Application of Tourist Enterprises Corp., at 30-31 Docket 27914).

113. See Willye Peter Daetwyler, D.B.A. Interamerican Airfreight Co., Foreign Permit, 58 C.A.B. 118, 119 (1971) (questioning whether a non-United States citizen can exercise control over the United States citizen owners).

114. See *id.* (noting that the CAB looks beyond intricate corporate structures and United States "citizen front men" to ascertain whose financial interests are at stake and who will actually run the corporation).

115. See Application of Premiere Airlines, Inc., 95 C.A.B. 101, 103-05 (1982) (concluding highly favorable loans from foreign citizens gave those foreign citizens substantial influence over the airline by allowing the foreign citizens the ability to exercise control over the United States citizen borrower).

116. Willye Peter Daetwyler, D.B.A. Interamerican Airfreight Co., Foreign Permit, 58 C.A.B. 118 (1971).

117. *Id.* at 120-22.

118. *Id.* Daetwyler formed a United States company to take over its international airfreight operations, which Daetwyler previously operated as a foreign air-carrier. *Id.* at 127. Daetwyler, a non-United States citizen, owned twenty-five percent of the company's voting stock and represented one-third of the board of directors. *Id.* at 129. The remaining shareholders, directors, and officers were all United States citizens, but they were also employees of other Daetwyler companies. *Id.* at 128-29. The CAB concluded that Daetwyler would be able to influence decisions by the officers and directors to such an extent as to constitute control. *Id.* at 131-33. The Board based its conclusion on three findings: that Daetwyler controlled the other corporations in which the stockholders, officers, and directors of the applicant air-carrier were employees; that a relationship existed among Daetwyler and the applicant's United States stockholders, officers,

cant's board of directors and officers to an extent that violated the CAB's interpretation of the foreign control limitation.<sup>119</sup> In conclusion, the CAB held that the definition of United States citizen does not include corporations barely meeting the minimum voting interest requirement if foreign citizens in fact control the air-carrier.<sup>120</sup> By employing a personal relationship evaluation, the DOT unnecessarily restricts the number of qualified individuals who can make significant investments in an air-carrier under the guise that any United States carrier might be susceptible to control by foreign interests,<sup>121</sup> regardless of whether the foreign entity's interest remains below the congressionally mandated twenty-five percent voting equity or whether that foreign entity affirmatively exercises control.<sup>122</sup>

---

and directors; and that the applicant would continue to do business as part of the system of Daetwyler-controlled companies. *Id.*

*Compare* *Bernardine Inc. v. Midland Oil Corp.*, 520 F.2d 771, 775 (7th Cir. 1975) (establishing factors considered in determining whether a parent corporation actually controls a subsidiary). The factors established in *Bernardine* include 1) the amount of the subsidiary's capital stock owned by the parent, 2) the number of common directors, 3) financing of the subsidiary by the parent, 4) whether the parent caused the subsidiary's incorporation, 5) whether the subsidiary has adequate capital, 6) who pays the subsidiary employees' salaries, 7) who pays other miscellaneous expenses of the subsidiary and who pays the losses, 8) whether the parent corporation exercises control over the property of the subsidiary, and 9) independence of the directors and executives of the subsidiary. *Id.* *But see* *United States v. Jon-T Chemicals, Inc.*, 768 F.2d 686, 691 (5th Cir. 1985) (concluding that a person who is either an officer or director of both a parent corporation and its subsidiary can represent the interests of both separately and independently).

119. *Willye Peter Daetwyler, D.B.A. Interamerican Airfreight Co., Foreign Permit*, 58 C.A.B. at 120.

120. *Id.*

121. *See* *The Acquisition of Northwest Airlines by Wings Holdings, Inc.*, D.O.T. Order No. 89-9-51 at 6 (1989) (reasoning that heightened equity interest, and the ability to exert influence and status, as both an actual and potential competitor, are important elements tending to support the conclusion that the foreign investor's relationship with Northwest puts the air-carrier in a position violative of the control limitations); *Application of Pan Aviation*, D.O.T. Order No. 85-3-85 at 3 (1985) (suggesting that questions surrounding forgiveness of an investor's debt obligations and the likelihood of foreign control have a direct bearing on an investor's fitness).

122. *See* 49 U.S.C. § 1378(f) (1988) (defining control as ownership of ten percent or more of the carrier's capital or voting stock). The provision provides:

[A]ny person owning beneficially 10 per centum or more of the voting securities or capital, as the case may be, of an air carrier shall be presumed to be in control of such air carrier unless the Board finds otherwise. As used herein, beneficial ownership of 10 per centum of the voting securities of a carrier means ownership of such amount of its outstanding voting securities as entitles the holder thereof to cast 10 per centum of the aggregate votes which the holders of all the outstanding voting securities of such carrier are entitled to cast.

*Id.*

*Compare* *The Acquisition of Northwest Airlines by Wings Holdings, Inc.*, D.O.T. Order No. 89-9-51 at 5 (1989) (concluding that guidelines used for determining citizenship consistently distinguish between de facto control and mere investment). The

## B. CONTROL THROUGH CAPITAL INVESTMENTS

In a case decided shortly after the passing of the 1978 Act,<sup>123</sup> the CAB further limited the ability of United States air-carriers to obtain capital infusions by holding that satisfaction of the technical criteria mandating that United States citizens hold seventy-five percent of an airlines voting equity is merely a threshold issue for purposes of identity of control.<sup>124</sup> The CAB concluded that the real question with respect to citizenship is whether the applicant does or can assert control in any way.<sup>125</sup> In response to this extraordinarily restrictive interpretation of FAA section 1301(16) and growing concerns over the future of the airline industry, the CAB approved a capital transfer of securities options, the exercise of which would result in a foreign corporation owning twenty-five percent of the voting stock of a United States airline.<sup>126</sup> The approved transaction, however, gave the foreign corporation the right to elect a proportional number of directors to the air-carrier's board,<sup>127</sup> even though the foreign corporation was already the carriers' principle creditor.<sup>128</sup> In so doing, the CAB temporarily abandoned its restrictive citizenship interpretation,<sup>129</sup> and momentarily acknowledged that Congress intended the citizenship requirement to limit

---

DOT's principal concern is to examine cases in which foreign air-carriers are motivated by a direct, vested interest in controlling the marketing of the United States carriers' service, as opposed to disinterested investors whose only purpose is to maximize their return. *Id.*

123. Application of Silvas Air Lines, Inc., C.A.B. Order No. 80-10-103 (1980).

124. *See id.* at 3-4 (concluding that a foreign investor's principle control came through his loan arrangement with Silvas because the proceeds of the loan were deposited into a special bank account and withdrawals could only be made with the foreign investor's explicit approval). The CAB subsequently held that since the foreign investor had complete control over the carrier's use of the loan proceeds, he had control over the airline itself, even though he only owned twenty-five percent of the voting stock. *Id.*

125. *See id.* at 3 (concluding that Congress did not intend to liberalize citizenship requirements when it enacted the Airline Deregulation Act of 1978).

126. *See In re* Citizenship of Golden West Airlines, Co., C.A.B. Order No. 82-7-23 at 2 (1982) (finding that Golden West would continue to meet the United States citizenship requirement, even though a Canadian corporation owned twenty-five percent of Golden West's voting stock, could elect a member of the Board of Directors, and held more than one-half of Golden West's long-term debt).

127. *See id.* (finding that the ability of a foreign entity to elect a member to the board of directors did not harm the citizenship of the airline).

128. *See id.* (finding that the citizenship requirements of the Federal Aviation Act were met despite the fact that a foreign entity held more than half of Golden West's long-term debt); *accord* Application of Charlotte Aircraft Corp., Intercontinental Airways, Inc., C.A.B. Order No. 81-9-64 at 6 (1981) (holding that a carrier was a United States citizen even though a Netherlands corporation acquired twenty percent of the United States carrier's common stock and was the carrier's principle creditor).

129. *See* Institutional Control of Air-Carriers Investigation, C.A.B. Order No. 82-9-84 at 4 (1984) (formulating a policy that allowed a foreign interest to acquire a large block of a carrier's debt without undermining the carrier's citizenship status).

control in voting equity rather than control of non-voting equity or debt investments.<sup>130</sup> In the following years, the CAB subtly revised the citizenship standard to allow innovative investment structures,<sup>131</sup> and to create a less stringent standard of foreign control analysis,<sup>132</sup> while it permitted the influx of greater amounts of foreign capital.<sup>133</sup>

In 1987, however, the citizenship standard returned to its previously restrictive form.<sup>134</sup> The DOT maintained that the precedent established in *In re Page Avjet Corp.*<sup>135</sup> reflected the outer limits of permissible foreign control under the Act.<sup>136</sup> The DOT subsequently found Intera Arctic services, Inc. susceptible to foreign control<sup>137</sup> because foreign investors could use the threat of forcing the carrier to repurchase stock to influence the carrier's activities.<sup>138</sup> This holding, coupled with more re-

---

130. *See id.* (recognizing that air-carriers must compete with other industries for financing and even though creditors possess some incidental means of control through their position as creditors, increasing the regulatory burden places them at a disadvantage when competing with unregulated industries).

131. *See* Application of Premiere Airlines, Inc., 95 C.A.B. 101, 101-02 (1982) (granting Premiere's certificate once it restructured its stock plan to remove all foreign influence over the voting interests through the establishment of a voting trust).

132. *Id.*

133. Application of Premiere Airlines, Inc., Fitness Investigation, C.A.B. Order No. 82-5-11 (1982). In *Premiere*, a foreign citizen provided a significant portion of the applicant carrier's intended start-up capital in what was purported to be a "no strings" attached gift to a United States citizen. *Id.* at 2. The terms of the loan agreement were highly favorable to the borrower. *Id.* The principle concern in *Premiere* was not that a foreign citizen owned twenty-five percent of the voting stock, *id.* at 2-3; rather, the CAB focused on the fact that Premiere's principle United States citizen shareholder, Cicippio, financed his purchase of shares through a loan from a Saudi Arabian citizen. *Id.* Thus, the CAB's concern was that the Saudi Arabian creditor may be able to influence Cicippio. *Id.* The CAB resolved the problem of possible foreign control by requiring the United States citizen with ties to the Saudi Arabian citizen to place his stock in a voting trust which would be voted in proportion to the remaining shares. *Id.* at 3-4.

*See also In re Page Avjet Corp.*, C.A.B. Order No. 83-7-5 at 1 (1983) (noting how a foreign investor acquired one-hundred percent of the non-voting shares of an airline). In *Page*, the holder of the non-voting shares had the power to initiate and approve a company liquidation on dissolution, and to vote and approve company actions in extraordinary circumstances, such as a merger or consolidation. *Id.* Initially, the CAB ruled that because the non-voting share could block a merger, dissolution, or liquidation, the foreign non-voting shareholder controlled the company. *Id.* at 3. The CAB resolved the issue when Page Avjet Corporation established a buy-out provision where the voting shareholders could buy back the non-voting shares if they blocked corporate action. *In re Page Avjet Corp.*, C.A.B. Order No. 84-8-12 at 1 (1984).

134. *In re Intera Arctic Services, Inc.*, D.O.T. Order No. 87-8-43 (1987) (holding that a corporation must, as a factual matter, be controlled by a United States citizen in order to meet the citizenship requirements of the 1978 Act).

135. C.A.B. Order No. 83-7-5 (1983). *See also supra* note 133 and accompanying text (discussing the rationale and pertinent facts of the *Page* decision).

136. *In re Intera Arctic Services, Inc.*, D.O.T. Order No. 87-8-43 at 11 (1987).

137. *Id.* at 14.

138. *See id.* at 11-14 (distinguishing this case from *Page Avjet*, in which a buy-out option was far less onerous). The Department also held two of the carrier's key person-

cent DOT decisions,<sup>139</sup> returned the citizenship requirement to its primitive roots of stringent regulation.

#### IV. RECOMMENDATIONS

On January 23, 1991, the DOT issued Order 91-1-41,<sup>140</sup> which significantly liberalized the DOT's stringent foreign investment policy by allowing Wings Holdings to increase its interest in Northwest Airlines to forty-nine percent equity ownership.<sup>141</sup> The only limitations placed on the amount of equity Wings could hold were that the total equity held by foreign citizens could not exceed forty-nine percent<sup>142</sup> and foreign held voting equity could not exceed the twenty-five percent statutory limitation.<sup>143</sup> This decision effectively rejects the longstanding CAB and DOT policy that any indication of potential control by non-United States citizens mandates a finding of foreign ownership.<sup>144</sup>

Now that the DOT has finally acknowledged the difference between voting equity, non-voting equity and debt equity, as well as the inherent problems of restricting capital investment, Congress should follow suit and clarify its intentions for restricting foreign investment. Congress should go even further than the DOT and allow foreign concerns to hold up to forty-nine percent voting equity and one hundred percent non-voting equity in a United States air-carrier.<sup>145</sup> Requiring United

---

nel were employees of the foreign investors, and would be "ready conduits" for Intera to use in attempting to exercise control. *Id.* at 12.

139. See Joint Application of Blue Bell, Inc., Wrangler Aviation, Inc. and W.A. Services, Inc., D.O.T. Order No. 88-2-43 at 1-3 (1988) (Blue Bell I) (concluding that in instances where persons with longstanding financial and business ties to a foreign citizen attempt to sever those ties, the DOT looks beyond mere formalistic relationships and considers the prior business relationships of a United States carrier's principle officers with a foreign citizen corporation). In *Blue Bell*, the DOT refused to approve the transfer because of the possibility that the transaction might subject the carrier to foreign control. *Id.* at 3.

140. *In re* The Acquisition of Northwest Airlines, Inc. by Wings Holdings, Inc., D.O.T. Order No. 91-1-41 (1991).

141. *Id.* at 20. The DOT concluded that forty-nine percent foreign equity ownership remained within the permissible statutory limit, "based on our reassessment of the complexities of today's corporate and financial environment [and] a reexamination of the relationship between nonvoting equity/debt and control in light of our recent experience . . . ." *Id.* at 16.

142. *Id.* at 20.

143. *Id.*

144. See *id.* at 17 (rationalizing the conflict with previous decisions by noting that United States citizens hold approximately two-thirds of the non-voting equity in Wings and also hold the power to appoint the majority of the Wings directors). In dicta, the DOT also noted that debt would no longer be considered for purposes of ascertaining potential or actual foreign control. *Id.* at 20.

145. It is important to remember that the DOT is prohibited from exceeding the authority Congress granted to it to correct flaws in the congressional scheme. Ulti-

States citizens to own seventy-five percent of an air-carrier's voting interest is, in reality, a statutory outcropping of neomercantilist philosophy, which asserts an infant industry argument as a guise for protectionist actions. This policy completely ignores the theory that trade liberalization and expansion increases competition within the domestic market and forces lethargic companies to terminate inefficient activities and to revamp management strategies.

One of the markets in which the corporation functions is the market for capital. In the 1980's, capital markets influenced corporate management through the fear of hostile takeovers. Management became more aware of the market's appraisal of their performance as reflected in the price of its corporation's shares. One of the major advantages of the corporation is the ease with which it can draw upon the resources of many individuals. Ideally, the capital market should serve to judge the performance of firms and to decide whether or not their past achievements and future prospects warrant channeling more resources into a given field.

The airline industry needs an infusion of capital to expand. By reducing restrictions on foreign investment, United States airlines could attract more capital from foreign investors and foreign carriers eager to expand into the United States market. If Congress is unwilling to rewrite the citizenship requirement, the DOT should comply with the spirit of the 1978 Deregulation Act and liberalize the citizenship interpretation in such a way as to adhere to congressional intent while acknowledging economic realities.

A seemingly obvious solution would be to permit non-United States citizen-owners, who merely wish to passively invest in an airline and have no interest in exercising control, to place their interest in a voting trust. Recently, the DOT stated its approval of such a solution.<sup>146</sup> This solution, however, is contrary to previous agency holdings in which the DOT concluded that voting trusts merely symbolize a temporary remedy until the airline locates a United States citizen investor.<sup>147</sup> The

---

mately, an administrative agency is powerless to correct perceived flaws in the statute it is empowered to administer. *Board of Governors v. Dimension Fin. Corp.*, 474 U.S. 361, 374 (1990). The agency's rulemaking power is limited to adopting regulations to carry into effect the will of Congress as expressed in the statute. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). Consequently, if the Act fails to achieve the intended results, Congress, not the DOT, must change the statutory language.

146. See *Application of Discovery Airways, Inc.*, D.O.T. Order No. 89-12-41 at 14 (1989) (stating that voting trusts are an effective means for a company to remain functional while it reorganizes its capital structure to meet the citizenship criteria).

147. See *Toolco-Northeast Control Case*, 42 C.A.B. 822, 825 (1965) (concluding that a control relationship does not terminate merely because stock is placed in a voting

trustee solution, while seemingly ingenious, also presents the inherent problem that the trustee is bound by a fiduciary duty to act in the best interest of the beneficiary. Therefore, the voting trust fails to adequately solve the control problem.

A more viable approach to the lack of available capital entails a two-step strategy. First, the DOT should adhere to the *Northwest Airlines* rationale and continue to acknowledge the distinction between different types of capital investments. Economists generally divide capital investments into two categories: debt<sup>148</sup> and equity investments.<sup>149</sup> Equity security represents equity participation and, therefore, an ownership interest.<sup>150</sup> The term is used in contradistinction to a "debt security" and represents a shareholder's, rather than a creditor's, interest.<sup>151</sup> Thus, the DOT should, at the very least, allow unlimited debt investments while continuing to liberalize the equity restrictions.

Second, as a solution to the problem of personal relationships, as well as debt versus equity investments, the DOT should follow the rationale used in *Joint Application of Blue Bell, Inc., Wrangler Aviation, Inc. and W.A. Services, Inc.*<sup>152</sup> In *Blue Bell II*, a foreign investor appointed

---

trust). In *Toolco*, the non-United States citizen attempted to alleviate a control problem by placing stock in a voting trust. *Id.* at 823.

*But see* Regent Air Fitness Investigation, 102 C.A.B. 260, 282-83 (1979) (setting forth two circumstances in which a voting trust could be used to alleviate control problems:

[W]e have held repeatedly that, with few exceptions, voting trusts could not insulate the beneficial owner of stock from control. Where we have found voting trusts sufficient to insulate the beneficial owner from control, we have generally relied upon the existence of the following factors.

- 1) Proportional voting of the shares in trust on all issues, which in effect made the vote of the other shareholders controlling; and
- 2) hostility between the carriers management and those whose shares are being put in trust.

*Id.*

*But compare* Seaboard and Western Airlines, Agreements, 32 C.A.B. 1322, 1325 (1960) (delineating certain factors which could insulate a voting trust from the control of a non-United States citizen investor).

148. See BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS (J. Downes & J. Goodman eds. 1985) (defining debt security as an obligation to receive a corporate security indicated as debt on the corporation's books). These debt investments usually take the form of corporate or government bonds. BLACK'S LAW DICTIONARY 365 (5th ed. 1979).

149. See Bankruptcy Act, 11 U.S.C. § 101(15) (1988) (defining equity security as a share in a corporation, a limited partner's interest in a limited partnership, or a right to control an interest in the company).

150. See BLACK'S LAW DICTIONARY 365 (5th ed. 1979) (stating that equity security is any non-debt type of security, such as stock).

151. *Id.*

152. See D.O.T. Order No. 88-4-68 (1988) (*Blue Bell II*) at 15-16 (concluding that an agreement which provides that a foreigner with extensive ties to key management

its former employees as the applicant carrier's key personnel with the DOT's approval.<sup>153</sup> Rather than concluding that a foreign interest controlled *Blue Bell*, the DOT noted that a carrier may still qualify as a United States citizen even though a foreign investor's former employees controlled over forty-nine percent of the voting stock.<sup>154</sup> Applying this rationale, the DOT should continue to acknowledge the fact that a carrier may take effective steps to prevent a foreign investor from controlling a company even where the foreign investor's employees have a substantial interest in the company and the foreign investor himself holds a substantial debt interest in the airline along with the maximum equity interest. If the DOT wants to implement the statute in a way consistent with congressional intent and economic realities, the innovative agreement *Blue Bell II* should represent the rule rather than the exception in cases where there is a question as to whether a foreign entity can exert control over voting-interest holders because of previous personal and professional relationships.

### CONCLUSION

Initially, Congress implemented capital restrictions in the airline industry to reflect its concerns that national security interests necessitated limiting foreign ownership and control of United States air-carriers. As this concern subsided, United States economic troubles became the rallying point for the need to restrict foreign investment. Changing multinational economic relationships have made these initial justifications for a citizenship requirement counter-productive. If, as the free trade theory suggests, a nation's prosperity is based on its economic

---

personnel will not exert any influence over management allowed Wrangler to qualify as a United States citizen).

153. *Id.* In *Blue Bell II*, Profit Freight Systems, Inc. acquired twenty-four percent of the carrier's voting stock and was its principle creditor. *Id.* (referencing the factual allegations set forth in the first *Blue Bell* decision, Joint Application of Blue Bell, Inc., Wrangler Aviation, Inc., and W.A Services, Inc., D.O.T. Order No. 88-2-43 (1988)). More importantly, Profit's former employees owned forty-nine percent of the carrier's voting stock, held three of six directorships, and were the carrier's principal officers. *Id.*

154. Joint Application of Blue Bell, Inc., D.O.T. Order No. 88-4-68 (1988). *Compare* Hawaiian Airlines — Japan Air Lines Control Acquisition Case, D.O.T. Order No. 88-12-42 (1988) (allowing Japan Air, a foreign investor competing directly with Hawaiian Airlines, to purchase 20 percent of Hawaiian Airlines' voting stock). In *Hawaiian Airlines*, the Department concluded that the transaction did not violate the citizenship test because of a non-interference agreement with Hawaiian's management that restricted the exercise of direct or indirect control over the company. *Id.* at 3. *See also* Transpacific Enterprises, Inc. and America West Airlines, Inc., D.O.T. Order No. 87-8-31 (1987) (allowing a foreign investor to purchase twenty percent of America West because America West adopted several restrictions on foreign ownership to limit foreign influence and control of the company).



productivity, then the government should create an environment in which the pressures and challenges from competition force the airline industry to develop innovative approaches to profitability which benefit both the consumer and the producer.

Relaxation of the citizenship requirements is necessary to ensure the continuation of a competitive airline industry. High oil prices, heavy debt, and decreased consumer demand all magnify the problems inherent in an industry crippled by its inability to acquire sufficient capital investment because of an illogically uncompromising restriction on foreign capital investment.<sup>155</sup>

---

155. See Application of Discovery Airways, Inc., D.O.T. Order No. 90-7-17 (1990) (praising the citizenship requirement as essential to United States aviation policy and refusing to relax the requirement even to allow needed foreign investment in the aviation industry).

In *Discovery*, the DOT reasserted its stringent position, stating:

[The DOT is] committed to a policy of fostering new entry in the airline industry, and welcomes lawful foreign investment as a part of that process. We cannot, however, allow such considerations of policy to undermine the basic requirements of the law, which include the mandate to ensure carriers' fitness and U.S. citizenship. These standards are among the most basic to the entire regulatory framework of the aviation industry. We therefore do not take lightly the possibility . . . of foreign control of a U.S. airline.

*Id.* at 1.