Reconsidering Limits on Foreign Investment in United States Airlines

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In recent years, the United States airline industry has been facing financial difficulties. Among the major domestic carriers, these financial difficulties have resulted in the closing of Eastern Airlines, and Pan American World Airways (Pan Am), and bankruptcy filings by Continental Airlines, America West, and Trans World Airlines (TWA). To face the challenges ahead, the other major carriers have had to restructure by scaling down, merging, or consolidating. Moreover, "more than 20,000 U.S. employees have lost their jobs since January [1991] and another 18,000... have been displaced."

Carriers throughout the industry face a common problem — the lack of capital. The capital intensive nature of the airline industry, coupled with other factors including the sudden rise in oil prices associated with the Gulf War, aggressive competition resulting from domestic deregulation, and questionable corporate strategies resulting in large corporate debt, have led to this capital crunch. Although some carriers with sufficient capital have survived these hard times, most have suffered severe financial difficulties.

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4 Free Market, supra note 2, at 74.

5 Bruce Noble, formerly of Pan Am and the Trump Shuttle, has said that the biggest problems facing the U.S. airline industry are "the availability of capital and access to limited facilities at major business airports." Bill Poling, Experts and DOT Officials Give Deregulation a Passing Grade, TRAVEL WKLY., Sept. 23, 1991, at 133 [hereinafter Poling, Experts and DOT Officials].


8 See Free Market, supra note 2, at 74.

After deregulation, the U.S. market could not sufficiently meet the capital needs of the airlines. Nevertheless, statutory limits on foreign investment in domestic airlines hampered attempts by willing foreign investors to supply the airlines' capital needs. These legally-imposed limits forced many foreign investors to limit their involvement or avoid investment altogether.¹⁰

This article will examine foreign investment as a possible source of capital for U.S. airlines. Title IV of the Federal Aviation Act of 1958 ("FAVA") provides the pertinent law governing foreign investment in domestic air carriers.¹¹ Two overriding concerns relating to foreign investment in the airline industry are national security and competition concerns. Ironically, because national security concerns favor more limits on investment¹² and competition concerns favor fewer limits,¹³ an inherent tension exists when attempting to further both goals by regulating foreign investment. This article asserts that attempts to increase foreign investment in U.S. airlines beyond the current levels will sacrifice neither national security nor competition and, on the contrary, may even further both policy goals.

This paper will demonstrate that a liberalized foreign investment policy could benefit U.S. airlines while enhancing competition and safeguarding national security. The current limits on foreign investment create artificial barriers to the inflow of much needed capital for U.S. airlines. Additionally, they do not necessarily further the policy goals of national security and enhanced competition. The new proposed limits, however, fall short of their stated purpose of increasing the amount of foreign investment beyond the current limits. To increase foreign investment in U.S. airlines while balancing the goals of national security and competition, Congress should place statutory limits


on foreign ownership to 49% of voting interest while allowing unlimited ownership of nonvoting equity. Furthermore, the Department of Transportation (DOT) should continue to use its control test.

Part I provides a background of the U.S. airline industry and the problems it faces as a result of its lack of capital. Part II lists the concerns raised by foreign investment in domestic airlines. Part III outlines the current law on foreign investment under the FAVA and DOT's interpretation of the FAVA. Part IV details the current Congressional proposals on limiting foreign investment and explains why these provisions are inadequate. Part V argues that although the current law is preferable to the Congressional proposals, it needs to be further liberalized to allow for more foreign investment in U.S. airlines. Increased foreign investment would result in greater competition and a healthy airline industry without sacrificing national security which it may, in fact, strengthen.

I. THE U.S. AIRLINE INDUSTRY

Ten participants in the U.S. airline industry are characterized as major airlines because they earn over $1 billion in annual revenues. U.S. airlines suffered a net loss of approximately $1.8 billion in 1991 with the ten major airlines losing $3.8 billion in 1990. Five major airlines have filed for Chapter 11 bankruptcy since 1990, and two have ceased operations altogether.

Many reasons account for the financial difficulties facing the U.S. airline industry. The airline industry's most fundamental problem lies in the cyclical nature of its earnings. Airline

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14 The ten major airlines are America West, American, Continental, Delta, Northwest, Pan Am, Southwest, TWA, United, and USAir. Canning, supra note 1, at A1.


16 Canning, supra note 1, at A1.

17 Reguly, supra note 2, at 13. The five major airlines that have filed for bankruptcy are Pan Am, Continental, TWA, Eastern, and America West. Id.; Free Market, supra note 2, at 74.

18 The two major airlines no longer operating are Eastern and Pan Am. Reguly, supra note 2, at 3.

traffic increases in the summer months and slows down during the winter months. Airline must earn enough in the peak summer months to survive through the slow winter months. In addition, the "industry is among the most capital intensive of all U.S. industries." Aside from the airline's need for terminal buildings, gate slots, and air routes, the clearest and most visible example of an airline's capital need is the actual airplane. In 1989, one Boeing 747-400 cost in excess of $125 million. For these reasons, airlines must earn enough during the upside of the cycle to weather the downside.

In recent years, many U.S. airlines could not survive because their debt levels increased, causing a capital crunch. Some of this increase directly resulted from voluntary leveraging in the form of leveraged buyouts. Other causes contributing significantly to the increased debt included the unexpectedly high oil prices during the Persian Gulf War, the general economic recession, the effects of deregulation and increased

20 See id. at 73 (table).
22 Id.
23 For example, Carl Icahn took TWA private in 1988 in a leveraged buyout that gave him 90% ownership and too much debt to weather the recession. Reguly, supra note 2, at 13. Robert Crandall, Chairman of American Airlines, said that "the airline industry in the United States is literally going broke." Yinong, supra note 6.
24 House Hearings, supra note 13, at 20 (submission of Representative William F. Clinger, Jr.). A leveraged buyout (LBO) is an acquisition method in which the target firm's debt level is increased significantly to finance the acquisition. See also DALE A. OESTERLE, THE LAW OF MERGERS, ACQUISITIONS, AND REORGANIZATIONS 12-28 (1991) (quoting Michael C. Jensen, Eclipse of the Public Corporation, HARV. BUS. REV., Sept./Oct. 1989, at 61).
25 Yinong, supra note 6. Oil prices jumped significantly on the world market in the period immediately preceding the Gulf War. Jet fuel prices skyrocketed to $1.39 per gallon in October 1990 from $0.63 per gallon in August 1990. Id. "[A]nalysts say an increase of one cent per gallon for aviation fuel costs [U.S.] airlines an extra 160 million dollars annually." Id. The rise in jet fuel price is significant considering it represents the second largest expense for airlines. Jeff Pelline, Some Upbeat Signs for Airlines, S.F. CHRON., Jan. 22, 1991, at C1.
26 Canning, supra note 1, at A1.
competition, and simply poor management. A partial solution to these problems is more capital, which some airlines have raised by selling assets. Others not so fortunate have declared bankruptcy, ceased operations, or merged.

These financial difficulties and forced restructurings have caused the airline industry to consolidate with fewer carriers acquiring increasing capacity and traffic. This dramatic change in the structure of the airline industry raises serious competition concerns. For example, the domestic market share of the five largest carriers accounted for 72% of the total market in 1991 compared with only 54% in 1986.

(See table next page.)

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28 Poling, supra note 5, at 133. A typical case of poor management is USAir's underutilization of its Indianapolis hub. Murphy & Lim, supra note 3, at 12.

29 Recent asset sales include the sale of Midway's assets to Northwest, the sale of TWA's routes to American, the sale of Pan Am's routes to Delta and United, and the sale of the Pan Am Shuttle to Delta. Canning, supra note 1, at A3.

30 Id. at A1-A3.

31 See Poling, supra note 5, at 133. Senator Wendell Ford, Chairman of the Subcommittee on Aviation of the Senate Committee on Commerce, Science, and Transportation said, "being left in this country with only three or four carriers . . . isn't what we intended when we passed deregulation." Id.

32 Id.

33 Murphy & Lim, supra note 3, at 1.
II. COMMON CONCERNS RAISED ABOUT FOREIGN INVESTMENT

The major policy concerns regarding limits on foreign investment in the domestic airline industry are national security, competition, reciprocal treatment between nations, and even distribution among airlines.

A. NATIONAL SECURITY

Foreign ownership of U.S. airlines makes national security a major concern. The significant role played by U.S. civilian aircraft in the recent Gulf War makes this fact particularly relevant. U.S. airlines carried nearly two-thirds of all personnel

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34 Canning, supra note 1, at A3 (table).
35 Ott, supra note 12, at 96.
and more than one-quarter of all air cargo for the U.S. Armed Forces and returned 87% of the troops and 43% of the air cargo to their home bases as part of the Civil Reserve Air Fleet ("CRAF") during Operations Desert Shield and Storm. When CRAF is activated, the Military Airlift Command ("MAC") may call civil aircraft into military service with only twenty-four hours notice. Although airlines participate in CRAF voluntarily, airlines that do join the program are contractually obligated to respond with the number of aircraft requested once called by MAC. In return, the military gives these airlines preferential treatment in awarding routine military charter contracts during peacetime. Supporters of strong limits on foreign investment argue that with greater foreign investment, this voluntary program will not have enough participants. Moreover, they argue, CRAF would not have enough planes at its disposal to serve the purpose for which it was established.

B. COMPETITION

Proponents of stringent limits on foreign investment are further concerned that without these limits, the resulting consolidation of airlines will inhibit competition. They fear that more foreign investment will result in a handful of global airlines that could manipulate the market. In this scenario, entry into the airline industry would become increasingly difficult, resulting in a global market made up of only a small number of airlines. Additionally, whether U.S. antitrust

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37 Id. CRAF is a military transport program developed during the Korean War, but not implemented until the Gulf War. Id. at 24.
38 Id.
39 Id. at 24-25.
40 Id. at 25. Peacetime military charters create a $500 million per year industry. Id. at 24.
41 Free Market, supra note 2, at 75. As long as CRAF participants can benefit economically from the program, the number of its participants should not decrease.
42 Ott, supra note 7, at 30.
43 Id. Entry into the industry is difficult because of the limited availability of facilities, capital, and air routes. "Only a limited number of carriers will be able to achieve market presence in a sufficient number of large cities to build
enforcement could effectively counter the global anticompetitive effects is questionable.\(^4\)

Competing foreign airlines have provided a significant source of recent foreign investment in U.S. airlines.\(^4\) Proponents of strong limits worry that by taking an equity stake in domestic airlines, these foreign airlines, together with the U.S. airline in which they invested, could be in a position to gain competitive advantages over other U.S. airlines.\(^4\) Alternatively, they argue that foreign and domestic airlines could share sensitive information in order to create monopolies in certain areas.\(^4\) Finally, they argue that equity stakes in U.S. airlines could enable foreign airlines to influence bilateral aviation agreements between the U.S. and their countries of origin to their advantage.\(^4\) The concern is that this influence will negatively affect the position of U.S. airlines vis a vis their foreign competitors by allowing the foreign competitors access to air routes that were previously accessible only to U.S. airlines.

C. RECIPROCAL TREATMENT

Supporters of strong limits also raise a reciprocal treatment argument. Reciprocal treatment advocates argue that U.S. investors should have the same opportunities to invest in foreign airlines as foreign investors have in U.S. airlines.

a national network." Id. Further concentration is inevitable because few airports will serve as a hub for more than one airline, according to a report by the Transportation Research Board released in the Fall of 1991. Id. (referring to TRANSPORTATION RESEARCH BOARD, WINDS OF CHANGE: DOMESTIC AIR TRANSPORT SINCE DEREGULATION (1991)).


\(^4\) See Senate Hearings, supra note 21, at 23 (statement of Timothy Pettee, First Vice President, Airline Industry Analyst, Merrill Lynch Capital Markets).

\(^4\) House Hearings, supra note 13, at 17-18 (submission of Representative James L. Oberstar).

\(^4\) Foreign and domestic airlines could share sensitive scheduling, passenger, or reservation system information. They also could make exclusive arrangements (gates, slots, terminal buildings) to tie the operations of the airlines together. The proposed amendments to the FAVA limit arrangements between airlines for airline reservation systems, gates, and slots. H.R. 2074, 102d Cong., 1st Sess. § 2(a) (1991); S. 1628, 102d Cong., 1st Sess. § 2 (1991).

\(^4\) Free Market, supra note 2, at 75.
Therefore, they support limiting foreign investment to those investors from countries that allow U.S. investment in their own airlines. Otherwise, they assert, this lack of reciprocity creates a "one way street" for capital to flow out of the U.S.\textsuperscript{49} the U.S. markets would be relatively open to foreign investors, while foreign markets would be closed to U.S. investors. Exclusion from foreign airline markets, however, often results not so much from strict foreign investment rules as from the fact that the ownership structure of most foreign carriers precludes U.S. investment. Many foreign airlines are either owned largely by national governments or are closely held by private interests.\textsuperscript{50} U.S. investors are, thus, excluded from investing in most foreign airline stock on the open market.

\textbf{D. \textsc{Even Distribution}}

Lastly, proponents of stringent limits are concerned that foreign investment will be disproportionately distributed to healthier U.S. airlines instead of to those that truly need the capital.\textsuperscript{51} Proponents argue that this uneven distribution will not help the U.S. airline industry as a whole to grow and to become more competitive because the capital-poor airlines will continue to be starved for adequate capital.\textsuperscript{52}

\section*{III. CURRENT LAW}

\textbf{A. \textsc{The Underlying Policies of the Federal Aviation Act of 1958}}

The Civil Aeronautics Act of 1938 ("CAA") regulated the airline industry at the time when Congress proposed the FAVA.\textsuperscript{53} Legislators thought the FAVA was necessary because

\begin{itemize}
\item \textsuperscript{49} \textit{Weigh Foreign Ownership Carefully}, AVIATION WK. \& SPACE TECH., June 3, 1991, at 7.
\item \textsuperscript{50} \textit{Id.}
\item \textsuperscript{52} \textit{Id.}
the CAA had been ineffectively implemented and did not adequately address the "ever-growing importance and complexity of [the] aviation [industry]." Legislators used examples of airline accidents and near misses to illustrate the necessity of new legislation. A midair collision of two airliners over the Grand Canyon in 1956 that resulted in the loss of 128 lives raised public awareness of the need for regulation. Following this disaster, civilian and military aircraft, operating under separate flight rules, collided on two separate occasions. These accidents served as an impetus to improve air safety and to consolidate civilian and military flight rules.

Recognizing the need for new aviation legislation, Congress passed the FAVA with the dual purposes of improving safety in aviation and creating a unified system for both civilian and military aircraft. To accomplish this, the FAVA created a single aviation body, the Federal Aviation Administration ('FAA') which included significant military participation. This illustrates Congress' recognition of the military's stake in the proper management of national airspace and national security interests. In a further attempt to preserve national security, Congress kept in place the CAA requirement of U.S. citizenship.


54 For example, the Senate criticized the implementation of the CAA as follows:

The present Civil Aeronautics Act, at the time of its passage in 1983, provided a reasonably adequate, unified basis for aviation safety regulation . . . vested in an independent Civil Aeronautics Authority . . . But the idea of a centralized authority for civil aviation was never given a real try. Less than 2 years after its establishment, the Civil Aeronautics Authority was "split down the middle" into entirely separate rulemaking and operational bodies . . . .


55 Id. at 6.

56 Id. at 7; see also, H.R. REP. NO. 2360, 85th Cong., 2d Sess. 2 (1958).

57 S. REP. NO. 1811, 85th Cong., 2d Sess. 7-8 (1958). In addition, the Civil Aeronautics Board reported a total of 971 near misses aloft during 1957. Id. at 8.

58 Id. at 6.


61 Id. at 15.
The FAVA, however, did not significantly amend economic regulations related to foreign investment in U.S. airlines.\textsuperscript{62} Congress pursued safety and national security as policy goals, but neglected other policy concerns, such as competition. The Legislature's silence on competition concerns was probably due to the relatively small size and highly regulated state of the industry at the time of enactment.

B. THE FEDERAL AVIATION ACT OF 1958

The FAVA regulates operators of air carriers in the United States by requiring that carriers wishing to engage in air transportation obtain a certificate of public convenience and necessity issued by the Civil Aeronautics Board.\textsuperscript{63} The Board will only grant this certificate if the applicant's request is, among other things, consistent with public convenience and necessity.\textsuperscript{64} Under the FAVA, an "air carrier" must be a U.S. citizen engaged in air transportation.\textsuperscript{65} A U.S. citizen is defined under the statute as:

(a) an individual who is a citizen of the United States or of 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 person who are citizens of the United States or of one of its possessions.\textsuperscript{66}

Congress, therefore, limited foreign ownership to a maximum of 25% of the voting interest in a U.S. airline.


\textsuperscript{64} Id. § 1371(d)(1).


C. RECENT DEPARTMENT OF TRANSPORTATION DECISIONS ON THE FAVA

In two recent cases, the Department of Transportation (DOT)\textsuperscript{67} discussed the citizenship issue in instances where foreign investors attempted to invest in U.S. airlines. In both cases, the DOT allowed the foreign investment with slight modifications. In \textit{The Acquisition of Stock in Continental Airlines Holdings, Inc., by Scandinavian Airlines System ("SAS/Continental")},\textsuperscript{68} the DOT ruled that the equity position acquired by Scandinavian Airlines System (SAS) in Continental Airline's (Continental) parent company, Continental Airlines Holdings, Inc. ("Holdings") did not affect Continental's status as a U.S. citizen under the FAVA.\textsuperscript{69} The DOT reviewed a transaction wherein SAS increased its equity in Holdings while concurrently increasing its representation on the Holdings Board.\textsuperscript{70} Before the transaction, SAS held 9.9\% of Holdings stock.\textsuperscript{71} After the transaction, the SAS stake increased to 16.8\% of the total outstanding common stock and 18.4\% of the total voting stock of Holdings.\textsuperscript{72} The transaction also increased the number of directors nominated by SAS from one to three, as the board grew from fourteen to fifteen members, representing an increase from 7\% to 20\%.\textsuperscript{73} SAS, however, proposed limitations on the activities of its nominees to the board, requiring


\textsuperscript{69} \textit{Id.} at *12. "Holdings owns all the outstanding common stock of Continental." \textit{Id.} at *5.

\textsuperscript{70} \textit{Id.} at *1.

\textsuperscript{71} \textit{Id.}

\textsuperscript{72} \textit{Id.}, supra note 68, at *4. Additionally, SAS agreed to limit its holdings of voting stock to a maximum of 22\% for three years. \textit{Id.} at *5.

\textsuperscript{73} \textit{Id.} Since one of the other members of the board was an Australian citizen, the total number of directors who were foreign nationals or nominees of foreign entities would have been about 27\% of the board. \textit{Id.} at *7.
that nominees recuse themselves from situations of potential conflict between SAS and Continental.\textsuperscript{74}

The DOT interpreted the statute by developing a two-part citizenship test to determine whether Continental would remain a U.S. citizen after the transaction because the FAVA allows only citizens of the U.S. to hold certificates of public convenience and necessity.\textsuperscript{75} First, the airline must satisfy statutory requirements that "the president and two-thirds of the board of directors and other managing officers be U.S. citizens and that at least 75\% of the outstanding voting stock be owned by U.S. citizens."\textsuperscript{76} Second, U.S. citizens must actually control the carrier ("control test").\textsuperscript{77}

Under this two-part citizenship test, the DOT decided that Continental remained a U.S. citizen.\textsuperscript{78} First, the President of Holdings and Continental was a U.S. citizen and more than two-thirds of the directors and other managing officers of both companies were U.S. citizens.\textsuperscript{79} In addition, U.S. citizens continued to hold more than 75\% of the voting shares thereby meeting the express statutory requirements.\textsuperscript{80} Second, the DOT determined that SAS's 18.4\% share of voting rights did not reflect any real threat to Continental's ability to direct the affairs of the company.\textsuperscript{81} Similarly, the actual dollar value of the SAS acquisition was not large enough to raise concerns that the size of the investment would enable SAS to exercise control.\textsuperscript{82} The DOT also found that SAS's presence on the Board did not place SAS in a position of control. The DOT noted specifically SAS's self-imposed limitations to prevent potential conflicts of interest.\textsuperscript{83} The DOT did, however, require Conti-

\begin{footnotesize}
\begin{enumerate}
\item Id. at *8.
\item Id. at *11.
\item Id. at *11-12.
\item Id. at *12. This control test is the DOT's interpretation of the "owned or controlled" language of the FAVA. 49 U.S.C.A. § 1301(16) (West Supp. 1991).
\item SAS/Continental, supra note 68, at *12.
\item Id.
\item Id. at *12.
\item Id. at *12-13.
\item Id. at *13.
\item Id. at *13-14. For example, SAS's designated directors would recuse themselves from participating in any matter which might affect actual or potential competition with Continental and bilateral or multilateral aviation negotiations to which SAS or Denmark, Norway, or Sweden would be a party.
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nental and Holdings to report any significant future changes in their relationship with SAS.\textsuperscript{84}

The DOT decided another case on this issue, \textit{The Acquisition of Northwest Airlines, Inc. by Wings Holdings, Inc.} ("Wings II").\textsuperscript{85} In Wings II, the DOT modified a previous consent decree, \textit{The Acquisition of Northwest Airlines by Wings Holding, Inc.} ("Wings I").\textsuperscript{86} In Wings I, the DOT ruled that a buyout of Northwest Airlines jeopardized the airline’s status as a U.S. citizen.\textsuperscript{87} The DOT was concerned with this buyout because foreign investors contributed a significant portion of the equity for the transactions. KLM\textsuperscript{88} contributed 56.74\% of the equity\textsuperscript{89} and Elders\textsuperscript{90} provided another 11.3\% of the total equity.\textsuperscript{91} Five U.S. citizens contributed the remaining equity.\textsuperscript{92}

Although KLM contributed the majority of the total equity, it held less than 5\% of the Wings voting stock,\textsuperscript{93} while Elders held 15.4\% of Wings voting stock.\textsuperscript{94} The DOT found that these voting interests did not violate the statutory prong of the \textit{SAS/Continental} two-part citizenship test.\textsuperscript{95} The DOT did,

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This recusal system would prevent these directors from even receiving documents which would otherwise be unavailable to SAS. \textit{Id.} at *8.
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\textsuperscript{84} \textit{Id.} at *15.
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\textsuperscript{85} \textit{The Acquisition of Northwest Airlines, Inc. by Wings Holdings, Inc., No. 91-1-41, 1991 DOT Av. LEXIS 55 (Jan. 23, 1991) [hereinafter Wings II].}
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\textsuperscript{86} \textit{The Acquisition of Northwest Airlines by Wings Holding, Inc., Order No. 89-9-51, 1989 DOT Av. LEXIS 643 (Sept. 29, 1989) [hereinafter Wings I].}
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\textsuperscript{87} \textit{Id.} at *13. The buyout in question actually consisted of the purchase of Northwest’s parent company, NWA, Inc., by a holding company established for this purpose, Wings Holdings, Inc. ("Wings"). \textit{Id.} at *1.
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\textsuperscript{88} KLM stands for Koninklijke Luchtvaart Maasschappij, a Dutch airline. \textit{Id.} at *4.
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\textsuperscript{89} KLM provided $350 million in preferred stock and $50 million in common stock of the $705 million in total equity invested in Wings. \textit{Id.} at *3-4, 11.
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\textsuperscript{90} Elders, IXL Ltd., is an Australian investment company. \textit{Id.}
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\textsuperscript{91} Elders provided $80 million of the $705 million. \textit{Id.} at *10.
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\textsuperscript{92} Mr. Alfred Checchi, Mr. Gary Wilson, Mr. Frederick Malek, Wings Associates, L.P., and Bankers Trust New York Corporation. \textit{Id.} at *3.
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\textsuperscript{93} \textit{Id.} at *11.
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\textsuperscript{94} \textit{Id.} at *10.
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\textsuperscript{95} \textit{Id.} at *7. The DOT specifically stated:
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this case does not present a problem with the requirement in the Federal Aviation Act that the President and two-thirds of the board
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however, find a problem with the control prong of the citizenship test — that Northwest be "under the actual control of U.S. citizens." The DOT held that KLM was in a position to exercise control over Northwest because of the "multiplicity and importance of links between KLM and Wings." These links included: the substantial portion of equity contributed by KLM, the right to have one KLM representative sit on the Board, the right to name a three-person committee to advise Wings on Northwest's financial affairs, and various cooperative working arrangements between Northwest and KLM.

The DOT decided not to pursue a citizenship proceeding when Wings and Northwest agreed to take several steps to ensure Northwest would remain a U.S. citizen under the FAVA. However, on January 15, 1991, Northwest filed a petition with the DOT requesting a modification of the Wings I order. The DOT changed its position in Wings II and held

of directors and other managing officers be U.S. citizens and that 75 percent of the voting stock in the company be owned or controlled by U.S. citizens.

Id. at *7-8.

96 Id.

97 Id.

98 Id. at *12-13.

99 Id.

100 Id. at *13.

101 Id. at *14.

102 Id. at *16-17. These steps included: reducing KLM's share of Wings equity investment from 56.74% to a maximum of 25% without debt interest, with any excess beyond the 25% going immediately to a voting trust free from KLM's control; terminating KLM's rights to appoint a financial advisory committee and requiring the KLM Board member to recuse himself from any matters in which a conflict of interest could arise; and filing reports of any ownership changes and agreements between Wings and Northwest with the DOT. Id. at *16-24.

103 Wings II, supra note 85, at *8. This petition asked the DOT to: (1) terminate the requirement that KLM's total equity investment in Wings be reduced to 25 percent; (2) permit KLM to hold 49 percent of the equity in Wings including 10.544 percent of the voting interest free of the voting trust ... with any equity in excess of 49 percent to continue to be held in the trust; (3) permit KLM to designate three members of the Wings board of directors after that board has been increased from 12 to 15 members; and (4) remove the financial reporting conditions contained in the order. Id. at *8-9 (footnote omitted).
that control resided firmly with the U.S. equity holders in Wings rather than with KLM as found in Wings I.\textsuperscript{104} The DOT based its new decision on its reassessment of "the complexities of today’s corporate and financial environment."\textsuperscript{105} Based on this new control test, the DOT modified the existing order.\textsuperscript{106} The DOT allowed foreign investors to hold up to 49% of the total equity investment, including both voting and non-voting stock, provided that the investors did not hold more than the statutorily prescribed 25% of voting equity.\textsuperscript{107} Also central to the Wings II decision was the DOT’s changed position allowing the conversion of the excess equity interest into debt.\textsuperscript{108}

In Wings II, the DOT indicated that debt held by a foreign airline would not constitute foreign control unless the debt instrument provided the lender with special rights that would imply control.\textsuperscript{109}

In addition to allowing increased foreign equity investment, the DOT also permitted KLM other rights which it had previously held would lead to excessive control. For example, the DOT allowed KLM to increase its representatives on the Board as long as a foreign citizen was not Chairperson of the Board and a disproportionate number of KLM representatives did not sit on important committees.\textsuperscript{110}

The decision in Wings II represents the latest DOT interpretation of the citizenship requirement in the FAVA.\textsuperscript{111} Wings II is significant because it liberalized the citizenship standard for an airline from that set forth only one year earlier in SAS/Continental. As indicated above, the DOT modified its

\textsuperscript{104} Id. at *17.
\textsuperscript{105} Id. at *16.
\textsuperscript{106} Id. at *20. Elders and KLM could eliminate their interests in excess of the 49% by (1) divesting it to U.S. citizens, (2) converting it to debt in which the debt instruments confer no special control rights to the debt holder, or (3) allowing the excess amount to remain indefinitely in a voting trust. Id. at *22-23.
\textsuperscript{107} Id. at *9. Together, KLM and Elders controlled 24.999% of the voting interests in Wings.
\textsuperscript{108} Id. at *19-20.
\textsuperscript{109} Id. at *21.
\textsuperscript{110} Id. at *13-14.
\textsuperscript{111} The DOT specifically stated in a footnote that "the decision in this order will constitute a part of the body of our precedent to be considered in the disposition of future cases as appropriate." Id. at *20, n. 22.
own control test criteria established in *Wings I*. These modifications suggest that the DOT is headed toward further liberalization of limits on foreign investment in U.S. airlines.

The *SAS/Continental* citizenship test was composed of a statutory requirement and a control test. In applying the control test in *SAS/Continental*, the criteria considered included: the percentage of voting shares held by the foreign investor; the absolute dollar value of the investment; the number of directors appointed to the board by the foreign investor; the limits, if any, on the activity of those directors; and the requirement of disclosure to the DOT of future changes.¹¹²

In *Wings II*, the first prong of the test remained unaltered. The DOT broadened the second prong, however, to include additional criteria, including the citizenship of key management appointments; the liberalized aviation relationship between the U.S. and the Netherlands; and, most importantly, the relationship between voting equity, on the one hand, and nonvoting equity and debt, on the other.¹¹³ The DOT stated that the additional criteria were necessary for the control test to reflect changes in the airline industry.¹¹⁴

The DOT's recognition of the new environment in which airlines operate is important in that it demonstrates that the FAVA's general purposes of safety and national security are no longer the only goals involved in legislating limits on foreign investment in U.S. airlines. The DOT has recognized that foreign investment rules affect the competitiveness of U.S. airlines. While the dual aims of safety and national security need to be safeguarded, the realities of competing in the airline industry today require more capital investment.

The DOT's new approach permits more foreign investment to flow into airlines than previously allowed. The current law on foreign investment in U.S. airlines allows foreigners to own or control 25% of voting stock and up to 49% of total equity which was previously limited to 25%.¹¹⁵ These limits continue to adequately guard the policy goals of air safety and national security. This increased foreign investment in U.S. airlines has not resulted in any significant increase in airline collisions or

¹¹⁴ *Id.* at *19.
¹¹⁵ See *id.*
accidents. Moreover, national security has not been sacrificed because U.S. citizens continue to "control" all domestic airlines. Actually, Northwest Airlines, the U.S. airline with the most foreign investment, actively participated in the Civil Reserve Air Fleet ("CRAF").

Proponents of increased limits on foreign investment favor an investment environment that adequately addresses the concerns of reciprocal treatment and even distribution. At first glance, the calls for reciprocal treatment of U.S. investors are appealing. The public perception of unfair trade practices abroad and the U.S. balance of payments deficit is at a near fever pitch. That the public would demand policy makers to hold reciprocal treatment abroad as a policy goal is understandable. However, a closer examination of the implications of reciprocal treatment exposes the frailty of this argument. Reciprocal treatment would require other nations to give U.S. investors the same investment opportunities in their nations' airlines as the U.S. allows foreign investors in its airlines. Initially, whether U.S. investors would want to invest in foreign airlines is questionable considering return on investment is often superior in the U.S.. Foreign airlines invest in the U.S. because the U.S. airline industry is the world leader and has significant growth possibilities. Furthermore, if U.S. investors did choose to invest abroad, they would face invest-


117 Ott, Foreign Ownership Feared, supra note 12, at 96. Twenty-six airlines volunteered approximately 70 aircraft as part of CRAF during the Gulf War. Id. "Northwest, a key CRAF member because of its high number of wide-body aircraft, provided five passenger aircraft and three of its eight dedicated freighters for the airlift." Id. Statistically, Northwest, which represented only 3% of all airline participants in CRAF, supplied over 11% of the planes. Furthermore, Northwest put 42% of its total number of dedicated freighters at CRAF's disposal. Id.

118 See Senate Hearings, supra note 21 at 23 (statement of Timothy Pettee, First Vice President, Airline Industry Analyst, Merrill Lynch Capital Markets).

ment rules which generally resemble those in the U.S. In many nations, however, the demand for a commercial airline is so anemic that governments operate money-losing national air carriers for reasons of national pride, not profit.

Even if U.S. investors wanted to invest abroad and were limited by foreign laws, liberalizing foreign investment in U.S. airlines would promote U.S. interests in four ways, despite the lack of reciprocity. First, it would secure jobs in the U.S. and keep airline assets at home. Second, it would strengthen national security by ensuring a large fleet of commercial carriers based in the U.S. to call into service if the need arose. Third, it would further competition by slowing concentration among U.S. airlines, thus enabling capital-starved airlines to survive without merging or consolidating with the healthier airlines. Finally, liberalizing foreign investment would provide necessary inflows of capital to U.S. airlines, improving the domestic airline industry’s capital balance.

Even distribution is also a vulnerable policy consideration for three principal reasons. First, in a free market there will always be those who enter as well as those who leave the market. Unhealthy airlines who cannot compete will be forced to leave the market instead of being artificially propped up, only to depart later. Second, foreign investors presumably invest in the U.S. airline industry only if they can receive adequate returns. If policy makers leave investors no choice but to invest in the weakest of U.S. airlines, they would effectively bar investment in the U.S. airline industry entirely. Third, domestic airlines receiving foreign capital in exchange for equity take the benefit of the foreign investment because they need it. No U.S. airline would take capital from foreign sources unless it needed to. Thus, even those supposedly healthy airlines which

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120 House Hearings, supra note 13, at 123 (statement of Daniel M. Kasper, Harbridge House, Inc.).

121 Foreign investment rules are not the obstacle to investing in foreign airlines as much as the fact that few opportunities to invest exist because most foreign airlines are government owned or closely held. Senate Hearings, supra note 21, at 15 (testimony of Hon. Samuel K. Skinner, Secretary, Department of Transportation).

122 House Hearings, supra note 13, at 156 (statement of Secretary Samuel K. Skinner).

123 CRAF requires a large fleet as evidenced by Operation Desert Storm. See Reingold, supra note 36.
receive foreign capital are financially unhealthy enough in the eyes of their managers to require a capital infusion.

Foreign investment, even if only in the healthier airlines, helps strengthen national security because domestic airlines can use the capital to remain healthy and expand. This leaves fleets of carriers in the U.S. larger than those that would have existed without foreign capital inflows. Competition also intensifies because U.S. airline concentration will slow as weaker airlines, receiving a capital infusion from foreign investors, remain independent and survive instead of merging or consolidating with other U.S. airlines.

IV. THE PROPOSED LAW

In response to a perceived threat of foreign takeovers of U.S. airlines, both the House of Representatives and the Senate brought proposals in 1989 to further limit foreign acquisition of equity in U.S. airlines. Both bills, however, failed to be enacted. Since then, the mood in both the House and Senate seems to have changed, with new proposals initiated in 1991 to liberalize the limits on foreign investment in U.S. airlines in certain circumstances.

Congress also seems to have recognized that limits on foreign investment are linked to competition problems, as reflected by the short titles of the House and Senate proposals to amend the FAVA: "Airline Competition Enhancement Act of 1991" and "Airline Competition Equity Act of 1991," respectively. One of the stated purposes of Congress, in proposing these amendments, was to increase competition. In addi-

124 See generally House Hearings, supra note 13; Senate Hearings supra note 21.
126 For a general discussion of these proposals, see Brown, supra note 67, at 1282-1284.
tion, Congress focused on the effects on safety and national security of limiting foreign investment.

A. THE HOUSE PROPOSAL

On April 24, 1991, the House introduced the Airline Competition Enhancement Act of 1991 ("House proposal"), which Representatives Oberstar, Roe, Hammerschmidt, and Clinger sponsored, and which Congress referred to the Committee on Public Works and Transportation. Section three of the proposed bill, entitled "Reduction of U.S. Citizenship Voting Interest Ownership Requirement," would allow non-U.S. citizens to acquire up to 49% of a U.S. airline's stock under specific circumstances. It would give the Secretary of Transportation the authority to permit foreign investors to acquire up to 49% of the stock if eight conditions are met. These eight conditions


132 Id. at § 3(a). The proposed bill would no longer consider the percentage of voting interest, but would consider the percentage of stock by vote or value in determining the statutory requirement. Additionally, if the conditions were not met, the current law would still apply.

133 Id. at § 3(a). The eight conditions are:
(1) the air service agreement between the United States and the foreign country of which the purchaser is a citizen is a procompetitive agreement which, at a minimum, allows those air carriers designated by the United States to provide air service from any point in the United States to any significant air service point in the foreign country;
(2) after the purchase, the president, chairman of the board of directors, chief operating officer, and two-thirds or more of the board of directors of the corporation or association which is, or owns or controls, the air carrier would be citizens of the United States;
(3) the laws and regulations of the foreign country would permit a citizen of the United States to acquire, under similar terms and conditions, the same percentage of stock (by vote or value) of a person who provides in the foreign country transportation by aircraft of persons property as a common carrier for compensation or hire as the percentage of ownership which the person making the purchase would have in the air carrier after the purchase;
(4) the purchaser is not a corporation or association of which 50 percent or more of its stock (by vote or value) is owned or controlled by a government of a foreign country;
(5) the air carrier (or the person applying for a certificate under section 401 of this Act to engage in foreign air transportation) is
address many of the concerns voiced by supporters of limits on foreign investment. This conditional liberalization is an effort to balance the competing concerns of enhancing competition and protecting national security.

These conditions also address public fears of an onslaught of foreign investment. Several conditions limit foreign investment to purchasers from countries which exercise reciprocity. For example, the first condition requires that the foreign country of which the purchaser is a citizen have a procompetitive agreement with the U.S.. The third condition mandates that the foreign country also allow comparable investments by U.S. investors in its own airlines. The fifth condition further limits foreign investment by addressing uneven distribution concerns. The House proposal accomplishes this by allowing foreign investment in only those U.S. airlines that cannot find capital from U.S. investors on comparable terms.

The remaining conditions address a more appropriate policy goal, national security. The second and fourth conditions ensure that a U.S. citizen will remain in control of a U.S. airline by specifying the minimum number of U.S. citizens who must be directors, officers, and owners of the U.S. airline. The sixth condition explicitly requires that a U.S. citizen control the airline after the purchase. Finally, the seventh and eighth conditions require the purchase to be consistent with national security and the public interest. This general statement on public interest presumably will give the Secretary of Transportation the discretion to decide that transactions not furthering the stated goals of protecting national security, maintaining

unlikely to be able to provide, or to continue to provide, air transportation without the revenues which would be derived from the sale of the stock and no citizen of the United States is willing to purchase the stock under comparable terms and conditions; (6) after the purchase, a citizen of the United States would have the power to exercise control over the air carrier; (7) the purchase is consistent with the national security interests of the United States; and (8) the purchase is otherwise in the public interest.

Id.

135 Id.
135 Id.
137 Id.
Foreigh Investment in U.S. Airlines

safety, and enhancing competition will not benefit from the liberalized limits. 138

B. THE SENATE PROPOSAL

On August 2, 1991, Senators McCain, Danforth, and Kassebaum introduced the Airline Competition Equity Act of 1991 ("Senate proposal") which Congress then referred to the Committee on Commerce, Science, and Transportation. 139

Section 4 of the proposed bill, entitled "Foreign Investment in Air Carriers", would allow non-U.S. citizens to own or control up to 25% of equity and up to 25% of voting interest. 140 Alternatively, it would allow non-U.S. citizens to own or control up to 49% of the equity or voting interest if the Secretary of Transportation authorized the transaction. 141 Like the House proposal, the transaction must meet certain conditions before gaining authorization from the Secretary of Transportation. 142

While the Senate stated its proposed conditions more generally than did the House proposal, the two sets of conditions are similar in most respects. For example, the first and second conditions address the reciprocity concern by requiring the

138 Note that while the purpose of the proposed bill is to enhance competition, none of the conditions specifically states that the Secretary may permit the purchase of up to 49% of a U.S. airline's stock when competition requires it.


140 Id. § 4(a).

141 Id.

142 Id. § 4(b). The conditions are:

(1) the investment laws of the country of nationality of each foreign person involved in the transaction provide reciprocal rights for air carriers and other citizens of the United States to invest in a foreign air carrier of that country's flag;

(2) the United States has a procompetitive aviation agreement with the country of nationality of each foreign person involved in the transaction;

(3) no foreign person involved in the transaction is substantially owned or controlled by a foreign government;

(4) competition in the domestic airline industry will be enhanced by the transaction; and

(5) the increased percentage of foreign ownership or control will not adversely affect the national security interest of the United States or unfairly disadvantage United States aircraft manufacturers.

Id. § 4(b).
foreign investor's country to give reciprocal investment and operating opportunities to U.S. citizens.\textsuperscript{143} The Senate proposal adds a restriction that a foreign government may not control the foreign investor.\textsuperscript{144} The Senate proposal adds two general provisions: one regarding competition\textsuperscript{145} and the other, national security.\textsuperscript{146}

C. PROBLEMS WITH THE CONGRESSIONAL PROPOSALS

Both the House and Senate proposals inadequately attempt to liberalize foreign investment policy because the conditions they impose are both too general and too specific. First, very specific and narrow conditions act as a hindrance to liberalization because they may not allow enough flexibility. The House proposal, for example, has specific citizenship requirements for directors and managers. These requirements may not prove to be in the best interest of the airline industry. In light of the rapidly changing financial world and the changing needs of U.S. national security, the DOT is better suited than Congress to evaluate transactions. The DOT can react more quickly to the changing business environment, as demonstrated in the Wings II order. An example of a condition that leaves enough flexibility is one in the Senate proposal that simply calls for the protection of national security and the nonparticipation by foreign governments in transactions. This would enable the law to better reflect and respond to the realities of today's financial world.

Second, when the conditions are too general, the unfettered discretion available to the Secretary of Transportation may prohibit even transactions that meet all the other requirements. For example, the House proposal requires that the transaction be in the public interest, but it contains no explanation of what constitutes a valid policy concern, effectively giving the Secretary unfettered discretion. The Secretary might potentially misuse this discretion to limit investment more than Congress intended. More cynically, the public interest condition does not limit the influence of personal views regarding foreign investment or political considerations on the Secretary's decisions.

\textsuperscript{143} Id.
\textsuperscript{144} Id.
\textsuperscript{145} Id.
\textsuperscript{146} Id.
Given the inevitable changes in the Secretary's office, such unlimited discretion would lead to an absence of uniformity and predictability. This potential misuse of discretion would lead to uncertainty in the market. Consequently, foreign investors, not knowing how to properly structure their transactions, would shy away from investment opportunities in U.S. airlines.

Additionally, one condition of the Senate proposal requires transactions to enhance competition. The usefulness of a condition addressing the competition concern would depend largely on the interpretation of the statute by the Secretary. The inherent difficulty of quantifying the "enhancement of competition" requirement would once again allow the Secretary to use his discretion.

D. THE BUSH ADMINISTRATION RESPONSE

The Bush Administration currently supports a "substantially higher percentage" of foreign ownership in the voting interests of U.S. airlines than allowed by current law.\textsuperscript{147} Not surprisingly, DOT Secretary Samuel Skinner has come out in favor of the House proposal that would allow foreign investors to own 49% of the stock.\textsuperscript{148} The Secretary's view is "that a genuine globalization of airline companies is on the horizon."\textsuperscript{149} The Secretary further stated that the U.S. must "create an environment more receptive to foreign investment in the U.S. airline industry."\textsuperscript{150} The Administration's new policy tries to help U.S. carriers to compete more effectively in world markets, and to persuade foreign governments to eliminate subsidies to carriers and manufacturers.\textsuperscript{151} This policy is premised on the belief that these industries can accommodate increased foreign investment without sacrificing national security concerns.\textsuperscript{152} Finally, the administration currently views the issue of reciprocal investment opportunities as one best taken up in multilateral and bilateral negotiations to deregulate international aviation

\textsuperscript{147} Bush Administration Moves Toward Liberalized Foreign Ownership, 304 AVIATION DAILY at 563 (1991).
\textsuperscript{148} Id., (referring to H.R. 2074, 102d Cong., 1st Sess. (1991)).
\textsuperscript{149} Id.
\textsuperscript{150} Id.
\textsuperscript{151} Id.
\textsuperscript{152} Id.
markets and to encourage free global competition for air transportation.\footnote{153}{Id. Secretary Skinner specifically mentioned the Administration attempts to bring the issue of reciprocal investment opportunities before GATT (General Agreement on Tariffs and Trade). \textit{Id.} The GATT is a multilateral agreement with the purpose of reducing tariffs and other barriers to trade. It is the prevailing law on international trade among member states. \textsc{Louis Henkin et al., International Law: Cases and Materials} 1164-66 (2d ed. 1989).}

V. ANALYSIS

A. ARE THE PROPOSALS AN IMPROVEMENT OVER THE CURRENT LAW?

The current law must change because the FAVA unnecessarily hampers foreign investment in U.S. airlines and fails to respond to the needs of the modern airline industry. Congressional recognition of this problem has brought about the proposed amendments to the FAVA.\footnote{154}{S. 1628, 102d Cong., 1st Sess. (1991); H.R. 2074, 102d Cong., 1st Sess. (1991).} The question remains, however, as to the extent to which these proposals improve the current law regulating foreign investment in U.S. airlines.

The proposed law may in fact represent a step backwards from the current law toward a regime of more limits on foreign investment in U.S. airlines. Under the proposed law, if the conditions are not met, foreign investment would be limited to 25% of total equity and 25% of voting interest.\footnote{155}{Note that these limits are the same as those imposed by the \textit{Wings I} order. \textit{Wings I, supra} note 86, at *21-29.} Under current law,\footnote{156}{Current law refers to the FAVA as interpreted by the DOT in \textit{Wings II}. \textit{Wings II, supra} note 85.} however, investors who do not meet the proposed conditions would be able to purchase up to 49% of total equity.
and 25% of voting interest. The proposed law would, thus, require those investors who do not meet the numerous conditions to operate under more restrictive regulations than currently in force.

Under the proposals, the maximum ownership allowed rises to 49% of total equity if the conditions are met. The conditions, however, are so onerous that few transactions involving foreign investment would satisfy all the requirements. Additionally, the proposed reciprocity conditions would needlessly prohibit many transactions that might otherwise enhance competition without sacrificing safety or national security. Finally, the Secretary would have wide discretionary power under the broad language of some of the conditions. Whether either proposal would significantly improve upon the current law and gener-

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<th>Foreign Ownership Allowed (%)</th>
<th>voting interest</th>
<th>total equity</th>
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<tr>
<td>Current Law</td>
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<td>49</td>
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<tr>
<td>House Proposal -requirements not met</td>
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<td>Senate Proposal -requirements not met</td>
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<td>Senate Proposal -requirements met</td>
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The general terms of some of the conditions in the House proposal would make it difficult to determine when the standards are met. For example, what determination would be necessary to find that "comparable terms" or "similar terms and conditions" had been met. H.R. 2074, 102d Cong. 1st Sess. § 3(a) (1991). Similarly, it is unclear what exactly would constitute a transaction "in the public interest." Id. The Senate proposal poses similar difficulties when it requires that competition be enhanced. S. 1628, 102d Cong., 1st Sess., § 4(b) (1991).

An illustration of the difficulty of satisfying the conditions would be the Northwest/KLM deal. Under the House proposal, the deal would have been stopped because Northwest did not necessarily need the money to continue to operate (or survive). Under the Senate proposal, the deal would have been stopped because competition was not necessarily enhanced.
ally liberalize limits on foreign investment in U.S. airlines beyond existing levels remains unclear.\textsuperscript{159}

The Congressional proposals recognize the difficult balancing necessary both to promote competition and to protect national security. An inherent tension exists between furthering the goals of competition and national security. If Congress encouraged only competition, then limits on foreign investment would be unnecessary.\textsuperscript{160} On the other hand, if Congress encouraged only national security, then severe limits on foreign investment would be preferable.\textsuperscript{161} The current law under \textit{Wings II} both safeguards national security and, to some extent, encourages competitive practices by utilizing the control test and enforcing compliance with statutory limits on ownership of equity and voting interest. Similarly, the Senate proposal would safeguard security and enhance competition to some degree. Unfortunately, the inappropriate policy concerns of reciprocal treatment and uneven distribution hamper the proposals. A better balance of the policy goals can be struck if, in liberalizing foreign investment limits, only the legitimate concerns of safety, competition, and national security are considered.

Given the rapid globalization of the airline industry, one cannot underestimate the importance of liberalizing foreign investment in enhancing competition. Foreign investment is necessary to boost the struggling airline industry.\textsuperscript{162} Foreign investment provides capital for new jobs, spending, and growth in this capital intensive industry.\textsuperscript{163} It allows capital starved airlines to remain independent and operational instead of filing for bankruptcy, consolidating with stronger U.S. airlines, or ceasing to exist.\textsuperscript{164} Foreign investment can prevent a handful of monopolistic carriers from dominating the U.S. market.

\textsuperscript{159} Whether the proposals would be an improvement depends largely on the interpretation and implementation of the amendment by the DOT or Secretary of Transportation if enacted.

\textsuperscript{160} Foreign investments without limits would allow the market to work without any inefficiencies and result in the most competitive market.

\textsuperscript{161} Increasing limits on foreign investment would maximize national security because absolute control would be in the hands of U.S. citizens only.

\textsuperscript{162} \textit{Senate Hearings, supra} note 21, at 11 (statement of Hon. Samuel K. Skinner, Secretary, Department of Transportation).

\textsuperscript{163} \textit{Id}.

\textsuperscript{164} A significant competition problem has developed as the concentration of U.S. airlines continues. \textit{Ott, supra} note 7, at 30.
Foreign investment plays an especially important role when the U.S. market cannot provide enough capital, or when airlines can get funds more efficiently abroad.\textsuperscript{165} Moreover, foreign investment increases the availability of capital for expansion and enhancement of competition in the global marketplace.\textsuperscript{166} Increased foreign investment will, thus, place U.S. airlines in a better position to compete effectively, both domestically and abroad.

In safeguarding national security, policy makers must consider changes in global banking and finance. Foreign banks now play an important role in providing debt capital to U.S. airlines. Foreign leasing companies also provide aircraft lease financing for many U.S. airlines. In light of the large sums of capital that foreign banks and lease companies provide, these institutions could potentially exert considerable influence on U.S. airlines. Upon examining the significant involvement of such foreign financing in the U.S. airline industry, however, the DOT ignored the sources of debt capital in scrutinizing a carrier's citizenship, except where the loan agreement provided special rights to the debt holder which implied control.\textsuperscript{167} Apparently, the DOT did not consider foreign debt holders to be a threat to national security.

Congress should treat capital from nonvoting equity in the same fashion as debt capital. In many ways, some forms of nonvoting equity resemble, more than differ from, debt instruments. Indeed, from the airline's standpoint, the only difference between raising capital through debt or equity instruments is that one may cost more than the other. Debt and nonvoting equity simply represent alternative financing methods for airlines. Nonvoting equity holders do not have more control over an airline's activities than debt holders because both groups can only exercise influence indirectly — debt holders by calling in loans and nonvoting equity holders by selling in the open market. Since debt capital is no longer a factor in the control test, capital from nonvoting equity should not be a factor either.

Accommodation of modern realities will not sacrifice national security. The fear that a foreign investor would attempt to gain

\textsuperscript{165} Senate Hearings, supra note 21, at 32-33 (statement of Timothy Pettee, First Vice President, Airline Industry Analyst, Merrill Lynch Capital Market).

\textsuperscript{166} Id. at 32.

\textsuperscript{167} Wings II, supra note 85, at *20-21.
control by threatening to pull their investment out of the airline is misplaced. Investors who have invested large amounts of nonvoting equity invest with the knowledge that they will not have the right to vote their shares. They assume the role of passive investors from the start. Thus, the possibility of profitable returns, rather than control, motivates their investment.

Additionally, a healthier airline industry may actually enhance national security. The inflows of foreign investment would ensure that real assets such as aircraft and airport terminals would remain in the U.S.. So, in the event of a national emergency like a natural disaster or a war requiring the use of such assets, foreign investment would ensure the availability of these assets. Recent airline bankruptcies coupled with the trend among U.S. airlines to buy fewer wide-body aircraft illustrate the impact of economic weakness on national security.\textsuperscript{168} The military has expressed concern that the civilian airline industry may be insufficient to supply the needed aircraft and personnel the next time the need to activate CRAF arises.\textsuperscript{169} The health of the airline industry is important because CRAF relies upon a strong and viable industry to ensure ready access to the U.S. civilian fleet.\textsuperscript{170} Economic weakness in the airline industry, therefore, may jeopardize national security.

CONCLUSION

The current law, while remaining faithful to the policies underlying the FAVA, unnecessarily encumbers foreign investment in U.S. airlines. At the same time, the U.S. airline industry has suffered financial difficulties. Foreign capital infusion may solve the airlines' problems, but current limits inhibit foreign capital's entry into the industry. Consequently, a weak and struggling U.S. airline industry remains.

The relevant policies of safeguarding national security and promoting competition can be effectively accommodated while addressing the need for more capital in the U.S. airline industry. Congress should raise the current limits, 25% of voting stock and 49% of total equity, to 49% of voting stock and no limit on total equity. The current control prong of the citizen-

\textsuperscript{168} Ott, supra note 12, at 96.

\textsuperscript{169} Id.

\textsuperscript{170} Id.
ship test ensures that domestic airlines will remain under the control of U.S. citizens. In evaluating a transaction under the control test, the DOT considers a multitude of factors, including the relationship between voting equity, on the one hand, and nonvoting equity and debt, on the other. Since the DOT already considers the role of equity and debt as part of the control prong, arbitrary statutory limits on nonvoting equity create needless obstacles to foreign investment. A 49% limit on voting equity, however, is statutorily necessary because voting stock provides holders with direct control.

The current law and the proposed laws create a regulatory scheme which unnecessarily hinders the flow of needed capital to U.S. airlines. As a result, the domestic airline industry suffers. A struggling airline industry cannot advance national security or competition. My proposal would allow U.S. airlines access to the foreign capital they need without giving up control to foreign investors.

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† Candidate for J.D., 1993. I am grateful to Lawrence R. Fullerton for suggesting the topic and providing ideas for this article.