



WORLDWIDE AIR TRANSPORT CONFERENCE (ATCONF)

SIXTH MEETING

Montréal, 18 to 22 March 2013

Agenda Item 2: Examination of key issues and related regulatory framework

Agenda Item 2.2: Air carrier ownership and control

**DIFFERENCES BETWEEN CARRIER OWNERSHIP AND CONTROL PRINCIPLES IN
DESIGNATION CLAUSES IN AIR SERVICES AGREEMENTS AND NATIONAL LAWS
REGULATING THE SUBJECT**

(Presented by Brazil)

EXECUTIVE SUMMARY

The objective of this Working Paper is to raise discussions on the difference between the Ownership and Control principles in the designation clause of bilateral Air Services Agreements (ASAs) and the actual national restrictions on foreign investments. This Paper will argue that most countries are keen on keeping their respective national restrictions on foreign investments to safeguard domestic markets to national airlines, be it in response to safety, strategic or other nationally defined public interests. However, the insistence on Ownership and Control clauses on ASAs simply inhibits the evolution of the aviation sector of other countries, adding an unnecessary double safeguard measure to national regulations on ownership and control. As a consequence, removing Ownership and Control clauses from ASAs solely removes a burden for those countries that have more flexible foreign investment regimes, while rightfully maintaining the limits on foreign capital by means of national regulations.

Action: The Conference is invited to:

- a) review the information presented in this paper;
- b) endorse the conclusions presented in paragraph 3; and
- c) adopt the recommendations presented in paragraph 4.

References:

1. INTRODUCTION

1.1 Despite the progress made worldwide towards a more liberal regulatory regime for international air transport, national ownership and control (O&C) rules for air carriers are often restrictive. As a direct consequence, many countries still maintain rules in ASAs stipulating that air carriers of a Contracting Party must be majority owned and effectively controlled by the nationals of the

Contracting Party designating the air carrier. However, this is mainly because their national laws regulating the issue are restrictive, paying no respect to the other countries' own national laws.

1.2 Undoubtedly, both cross-border consolidation and general access to capital markets are seen by many as a pre-requisite for the air carrier industry's economic sustainability, and the liberalization of foreign investment in airlines seems to be a major concern nowadays, which is clearly endorsed by the various working papers presented for this 6th Worldwide Conference with different approaches and recommendations.

1.3 Many States indicate that they are revising their laws and regulations on foreign investment in airlines. Some have recommended the adoption of a multilateral agreement towards its full liberalization. It is recognized that achieving broad consensus on that matter will be difficult, since countries rightfully prefer to maintain limits on foreign capital for safety or other national interests.

1.4 As a stepping stone, countries should recognize the difference between national restrictions on foreign capital and the Ownership and Control principles in the designation clause of bilateral (ASAs). The removal of the last from ASAs damage not the national limits on capital, while removing restrictions on countries that were able to liberalize their own investment limits.

2. DISCUSSION

2.1 The international air transport system is essentially governed by bilateral agreements. In accordance with high state participation in the construction and financing of airlines, such agreements traditionally allowed only services of airlines whose substantial ownership and effective control were vested in the Party designating them and nationals of that Party. This was an exclusivist model designed to maintain international markets under strict nationality rules.

2.2 Needless to say that this model poses difficulties for airlines to fulfil their needs for capital. Worldwide experience on the last decades has demonstrated that foreign investments are increasingly necessary to help the industry to cope with its challenges.

2.3 This scenario is gradually changing the approach of many countries towards the liberalization of foreign investments in airlines. Many ICAO Member States have already upgraded their national limits on foreign capital to 49%, while others have managed to remove such restrictions completely. In either case, evidence shows positive results in terms of cross-border investments, improved financial stability of airlines and on the growth of air traffic in countries/regions affected (i.e. Latin America).

2.4 Other countries have rightfully decided to maintain their national restrictions on foreign investments to safeguard domestic markets to national airlines, in response to safety, strategic or other nationally defined public interests.

2.5 Even though countries recognize those movements as a legitimate response to the dynamics of modern air transport, most Air Services Agreements still retain intact the principle of majority or substantial ownership in their designation clause. This stringent position pays no respect to other countries' own national laws and increasingly create conflicts between the Agreements and partners' national laws. In fact, this double check system resembles the out-dated system of double-approval of tariffs that countries used to impose, irrespective of the partners own legitimate national regulations.

2.6 Additionally, if Country A has a standard policy of negotiating traditional ownership and control clauses on ASAs, and its national laws regarding foreign investments on airlines are updated to permit higher thresholds of foreign capital, all its ASAs will immediately need to be renegotiated by its authorities. That would unnecessarily overburden ASA negotiators and most national congresses with new bills to approve.

2.7 Finally, it seems plausible to assert that Ownership and Control clauses are in its nature not practical. For instance, if Country B decides to liberalize investments in its domestic airlines and, as a consequence, a main carrier is now controlled by a third Party national, it seems improbable that other countries would, in fact, deny airlines from Country B to utilize its traffic rights, since this would most certainly ensue a prolonged dispute settlement that could jeopardize traffic between otherwise air transport partners.

2.8 In order to avoid such circumstances, Brazil has adopted the "establishment and/or principal place of business" principle, already included in ICAO's template, instead of majority/substantial ownership, as a standard policy on international negotiations. Maintaining "effective regulatory control" provisions are mandatory for obvious reasons.

2.9 In this case, each Party accepts the operation of airlines of the other Party, provided that they are legally established in the territory of that Party and under its effective regulatory control. Therefore, it is no longer observed the capital structure and nationality of the airlines, an exclusive matter of internal legislation of the designating State, which remains responsible for ensuring aviation safety and liability of airlines. The focus becomes, therefore, to ensure the provision of adequate instruments for the airlines' sustainability allowing them to continue offering adequate services to the users.

2.10 The International Civil Aviation Organization – ICAO, during the 37th Session of its Assembly in October 2010, has already expressed a formal position on the matter, encouraging its Member States to amend the ASA designation provisions, withdrawing foreign capital restrictions to airlines.

2.11 Brazil has gone in that direction over the last years. Since 2007, approximately 60% of the ASAs that were either negotiated or re-negotiated included "Establishment and Effective Regulatory Control" principle on its Designation clause.

2.12 Brazil's experience in negotiating the liberalization of O&C in their ASAs was generally welcomed by other Parties. Other States are invited to adjust their Agreements in anticipation of eventual new developments in their national laws towards the liberalization of ownership of airlines, granting them greater opportunities and more sustainability in the future.

3. CONCLUSIONS

3.1 This Paper argued that most countries are keen on keeping their respective national restrictions on foreign investments to safeguard domestic markets to national airlines, be it in response to safety, strategic or other nationally defined public interests.

3.2 The insistence on Ownership and Control clauses on ASAs, however, simply inhibits the evolution of the aviation sector of other countries, adding an unnecessary double safeguard measure to national regulations on ownership and control.

3.3 Additionally, Ownership and Control clauses are in its nature not practical and have rarely been used by countries. Therefore, States should seek to remove those provisions from ASAs, adopting more modern “principal place of business” and “effective regulatory control” provisions.

4. **RECOMMENDATIONS**

4.1 The following recommendations are proposed for consideration by the Conference:

- a) ICAO Member States should recognize the difference between the Ownership and Control principles in the designation clause of bilateral Air Services Agreements (ASAs) and the actual national restrictions on foreign investments;
- b) Member States are invited to recognize Ownership and Control clauses as intrusive and not applicable to functioning markets, even though national restrictions of foreign capital might be justified in terms of national interests;
- c) Member States are invited to recognize that the removal of Ownership and Control clauses from ASAs harm not legitimate interests on retaining limits to foreign investments; and
- d) ICAO is invited to promote and extend existing guidance material and to encourage its Member States to take a more flexible approach towards O&C requirements in bilateral ASAs.

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