

**WORLDWIDE AIR TRANSPORT CONFERENCE: CHALLENGES AND
OPPORTUNITIES OF LIBERALIZATION**

Montreal, 24 to 29 March 2003

DRAFT REPORT ON AGENDA ITEMS 2 AND 2.1

Agenda Item 2: Examination of key regulatory issues in liberalization

2.1 Documentation

Secretariat (WP/22-information paper) provided a draft revision of the *Manual on the Regulation of International Air Transport* (Doc 9626) as a reference for the items to be considered under this agenda item.

Agenda Item 2: Examination of key regulatory issues in liberalization**2.1: Air carrier ownership and control****2.1.1 Documentation**

Secretariat (WP/7) reviewed the efforts to use alternative criterion to traditional national ownership and control of air carriers for market access and examined issues and policy options in liberalizing ownership and control. The Secretariat proposed a new optional criterion for airline use of market access (in addition to existing ICAO-endorsed options for “community of interest” and predefined group ownership), based on principal place of business and effective regulatory control by the designating State. Proposed conclusions and a recommendation for action by States and ICAO were designed to facilitate application of more flexible arrangements by States wishing to liberalize while protecting the position of all States and ensuring that safety and security are not only maintained but enhanced.

Barbados (WP/48) described the difficult financial situation facing airlines of developing countries and their need for foreign investment. Barbados suggested, as an advancement of the liberalization already taken under the “community of interest” principle for developing States, that “substantial” ownership rules should be relaxed to permit authorization of airlines which have at least 25 per cent of share ownership vested in the nationals of the designating State.

Cuba (WP/52), noting the changes in the international air transport regulations of States as well as the experience in the sector, believed the Secretariat’s new proposals would assist the evolution of international air transport in a safe, orderly, gradual and efficient manner.

Pakistan (WP/57) believed that national ownership and control criteria could be applied more flexibly in existing bilateral air services agreements, on a case-by-case basis, without excessive change which could lead to “flags of convenience”.

Republic of Korea (WP/101) believed that national ownership and control criteria are more appropriate for the bilateral air transport framework, while the principal place of business criterion could be applied more appropriately in regional frameworks. Although the principal place of business criterion includes safeguards to prevent concerns about third party “free riders” as well as safety and security, there were still concerns with a third party “free rider” situation if a member State in a region concluded a bilateral containing this criterion with a State outside of the region.

Singapore (WP/39) emphasized the importance of an open and consultative approach by States to understand and identify solutions to their unique concerns. Such an approach would pave the way for States to find common middle ground for adapting existing frameworks for liberalization without compromising their interests.

United States (WP/96) noted that, under new regimes that change the traditional rules involving airline ownership and control, the responsibility and lines of authority for safety and security oversight must remain clear. There must be a clear point of contact for safety and security which in almost all cases will be the State of the operator, regardless of the extent to which it has delegated execution of its responsibilities to others.

Members of the Arab Civil Aviation Commission (ACAC) (WP/65) explained their rationale for favoring the gradual liberalization of the traditional ownership and control criteria for non-scheduled transport of passengers and cargo and for adopting the principle of liberalizing ownership and control for scheduled air transport at the level of regional groupings while using the traditional regime with other parties.

EU, ECAC and their Member States (WP/84) considered that the economic situation of many airlines, the need to make international financial resources more accessible for aviation, and the wish of the air transport industry to have the same commercial freedom enjoyed by other sectors of the economy could be met by three key principles: 1) States should accommodate any other State that wishes to liberalize its ownership and control restrictions unilaterally or as part of a group of like-minded States; 2) with appropriate assurances on safety, consideration should be given to designation of airlines based in a third country; and 3) ICAO Member States should develop a common approach to liberalizing ownership and control requirements while ensuring high standards in aviation safety.

Members of LACAC (WP/99) noted that although liberalization of ownership and control has been extensively debated, no solution acceptable to the majority of States has yet been found. Special attention should be paid to concerns such as the potential emergence of “flags of convenience”, deterioration of safety and security standards, possible flight of capital; impacts on labour, national emergency requirements and assurance of service; and, in the long run, anti-competitive effects from industry concentration.

53 African States (WP/80) examined issues and policy options in liberalizing air carrier ownership and control as presented by the Secretariat and supported the adoption of the proposed model clause on airline designation and authorization provided States spell out in their laws and regulations the conditions of both “evidence of principal place of business” and “evidence of effective regulatory control”.

International Air Transport Association (IATA) (WP/26) advocated four steps to liberalize airline ownership and control: 1) distinguish between commercial control conferred by ownership and regulatory control exercised by the licensing authority; 2) remove restrictions on ownership; 3) make regulatory control the responsibility of the designating State(s); and 4) provide control of safety and security through adoption and implementation of the relevant ICAO/ECAC Model Clauses. The **International Air Carrier Association (IACA)** (WP/33) supported this IATA position on ownership and control.

International Transport Workers’ Federation (ITF) (WP/75) doubted the beneficial effects claimed by proponents of liberalizing the national ownership and effective control criteria and believed such action would lead to the “flags of convenience” situation prevalent in the maritime industry. ITF recommended that the national ownership and control criteria be retained in the interest of stability, reliability and economic security of air transport, that States retain effective regulatory tools to meet the public interest dimension of air transport and that ICAO identify measures to prevent safety and security “dumping”.

International Federation of Air Line Pilots’ Associations (IFALPA) (WP/34-information paper) considered that the proposed changes to the ownership and control criteria did not address the labour and social implications and that the general rule that a designated airline must be substantially owned and effectively controlled by the national of the

designating country should be preserved as an essential safeguard against the use of “flags of convenience” which would undermine labour and social standards.

Latin American Association of Air and Space Law (ALADA) (WP/71-information paper) recognized that relaxing the traditional notion of substantial ownership and effective control of airlines to allow foreign investment has to be subject to the legislative criteria of each country, and that the responsibility of the State where the airline operates has to be maintained.

2.1.2 Discussion

2.1.2.1 Air carrier ownership and control was regarded as a key issue facing the Conference. Broadening the criteria for the use of market access could bring benefits such as wider access for airlines to capital markets, reducing their dependence on government financial support, allowing airlines to build more extensive networks through mergers and acquisitions; and improving the health of the industry, efficiency and competition in international air transport. However, it was pointed out that broadening the criteria also had some potential risks including “free riders” (where an airline of a third party uses bilateral traffic rights which its government does not have), industry concentration that could result in anti-competitive actions against smaller airlines, the emergence of “flags of convenience”, degradation of safety and security, the reduction of labour standards and protection for airline workers. There was therefore a need to provide adequate safeguards in the liberalization process. As with liberalization generally, there was widespread support for gradual, progressive, and orderly change with respect to air carrier ownership and control.

2.1.2.2 At the same time support was expressed by a number of States for retaining the use of the traditional national ownership and control criteria, particularly in bilateral air services agreements, to take into account the disparities in economies, markets and competitiveness of airlines of the partners to the agreement as well as to ensure reciprocity. It was noted that there were also instances over the years of mutual agreement between bilateral partners for the use of alternate, or even no specific ownership and control criteria, on a case-by-case basis.

2.1.2.3 At the regional level, there was support for gradually liberalizing air carrier ownership and control, for example applying liberalized criteria such as “community of interest” within the region while using the traditional criteria for bilateral agreements with third parties. At the same time, States from several regions favoured the proposed principal place of business/effective regulatory control criteria as an improvement over the “community of interest” concept as fostering access to additional capital not available within the region. One plurilateral agreement used principal place of business and effective control without an ownership criterion. Small island States without airlines favoured broadened criteria as a means of attracting service by foreign airlines or for attracting capital if they should decide to establish an airline in the future.

2.1.2.4 Given the wide divergence in practices and the number of different mechanisms being employed at the bilateral and regional levels, detailed prescribed criteria were unlikely to be effective. For example, the proposed criteria of principal place of business and effective regulatory control by the designating State did not take account of airline mergers. What was required was a flexible and voluntary approach which allows each State to choose the type of air carrier ownership and control that meets its needs, while accepting that a partner in an air services agreement may make a different choice. The key point was authorizing services by a designated air carrier which uses different, or alternative, criteria as long as safety and security are safeguarded. This would allow States which wish to liberalize airline ownership and control to do so while States which prefer the traditional ownership and control criteria may retain them.

2.1.2.5 In view of the range of options now available through State practice over the years or as adopted previously by ICAO, the model clause proposed in the Secretariat paper should be for discretionary use and as one among a number of available options.

2.1.2.6 Recognizing that liberalization of air carrier ownership and control might be given further impetus among like minded States, the proposal by the Secretariat for a practical mechanism to facilitate liberalization was considered useful, subject to some modifications.

2.1.2.7 To give effect to its consideration of this item the Conference reached the following conclusions, and proposed the adoption of a draft model clause and a Recommendation.

2.1.3 Conclusions

2.1.3.1 From the documentation and the ensuing discussion on Agenda item 2.1 - Air carrier ownership and control, the Conference concluded that:

- a) Growing and widespread liberalization, privatization and globalization call for regulatory modernization in respect of conditions for air carrier designation and authorization in order to enable carriers to adapt to the dynamic environment. While there are concerns to be addressed, there would also be benefits in liberalizing air carrier ownership and control provisions. Past experience of liberalization in ownership and control has demonstrated that it can take place without conflicting with the obligations of the parties under the Chicago Convention and without undermining the nature of international air transport.
- b) There is widespread support by States for liberalization, in some form, of provisions governing air carrier designation and authorization. Particular approaches vary widely from substantial broadening of provisions beyond national ownership and control in the near term, through gradual reduction of specified proportions of national ownership, to limited change for the time being regarding certain types of operations (for example non-scheduled or cargo), application within certain geographic regions, or simply case-by-case consideration.
- c) There is a consequential need for flexibility in associated regulatory arrangements to enable all States to follow the approach of their own choice at their own pace while accommodating the approaches chosen by others.
- d) Whatever the form and pace of liberalization, conditions for air carrier designation and authorization should ensure that safety and security remain paramount, and that clear lines of responsibility and accountability for safety and security are established for the parties involved in liberalized arrangements.
- e) In liberalizing the conditions for air carrier designation and authorization, States should ensure that the economic and social impact, including the concerns of labour, are properly addressed, and that other potential risks associated with foreign investments (such as flight of capital, uncertainty for assurance of service) are fully taken into account.
- f) The proposed regulatory arrangement presented by the Secretariat and appearing as amended in paragraph 2.1.3.2 below provides a practical option for States wishing to

liberalize provisions regarding air carrier designation and authorization in their air services agreements. Complementing other options already developed by ICAO (including that of “community of interest”), it would facilitate and contribute to the pursuit by States of the general goal of progressive regulatory liberalization. While it is up to each State to choose its liberalization approach and direction based on national interest, the use of the proposed arrangement could be a catalyst for broader liberalization. However, use of the proposed arrangement by a State would not necessitate that State changing its existing laws or regulations pertaining to national ownership and control for its own carriers.

- g) Given the flexibility already existing in the framework of air services agreements, States may, in the short term and at their discretion, take more positive approaches (including coordinated action) to facilitating liberalization by accepting designated foreign air carriers that might not meet the traditional national ownership and control criteria.
- h) States may choose to liberalize air carrier ownership and control on a unilateral, bilateral, regional or plurilateral basis.
- i) ICAO has played, and should continue to play, a leading role in facilitating liberalization in this area, should promote the Organization’s guidance, keep developments under review and study further, as necessary, the underlying issues in the broader context of progressive liberalization.

2.1.3.2 The Conference agreed that States should give due consideration to the following draft model clause as an option for use at their discretion in air services agreements.

“Article X: Designation and Authorization

1. *Each Party shall have the right to designate in writing to the other Party [an airline] [one or more airlines] [as many airlines as it wishes] to operate the agreed services [in accordance with this Agreement] and to withdraw or alter such designation.*
2. *On receipt of such a designation, and of application from the designated airline, in the form and manner prescribed for operating authorization [and technical permission,] each Party shall grant the appropriate operating authorization with minimum procedural delay, provided that:*
 - a) *the designated airline has its principal place of business* [and permanent residence] in the territory of the designating Party;*
 - b) *the Party designating the airline has and maintains effective regulatory control** of the airline;*
 - c) *the Party designating the airline is in compliance with the provisions set forth in Article X (Safety) and Article Y (Aviation Security); and*
 - d) *the designated airline is qualified to meet other conditions prescribed under the laws and regulations normally applied to the operation of international air transport services by the Party receiving the designation.*

3. *On receipt of the operating authorization of paragraph 2, a designated airline may at any time begin to operate the agreed services for which it is so designated, provided that the airline complies with the applicable provisions of this Agreement.*

Integral Notes:

- (i) **evidence of principal place of business is predicated upon: the airline is established and incorporated in the territory of the designating Party in accordance with relevant national laws and regulations, has a substantial amount of its operations and capital investment in physical facilities in the territory of the designating Party, pays income tax, registers and bases its aircraft there, and employs a significant number of nationals in managerial, technical and operational positions.*

***evidence of effective regulatory control is predicated upon but is not limited to: the airline holds a valid operating licence or permit issued by the licensing authority such as an Air Operator Certificate (AOC), meets the criteria of the designating Party for the operation of international air services, such as proof of financial health, ability to meet public interest requirement, obligations for assurance of service; and the designating Party has and maintains safety and security oversight programmes in compliance with ICAO standards.”*

- (ii) *The conditions set forth in paragraph 2 of this Article should also be used in the article on revocation of authorization.”*

2.1.4 Recommendation

RECOMMENDATION 2.1/1

THE CONFERENCE RECOMMENDS THAT:

- a) Air carrier designation and authorization for market access should be liberalized progressively, flexibly and with effective regulatory control of safety and security;
- b) States, when dealing with air carrier designation and authorization in their international air transport relationships, use as an option at their discretion and in a flexible manner, the alternative criterion set out in paragraph 2.1.3.2 above.
- c) States that wish to liberalize the conditions under which they accept designation of a foreign air carrier in cases where that air carrier does not meet the ownership and control provisions of the relevant air services agreements, do so by:
 - 1) issuing individual statements of their policies for accepting designations of foreign air carriers;
 - 2) issuing joint statements of common policy; and/or
 - 3) developing a binding legal instrument;

while assuring whenever possible that these policies are developed in accordance with the principles of non-discrimination and non-exclusive participation.

- d) the State designating the air carrier provides or ensures the provision of adequate oversight of safety and security for the designated air carrier, in accordance with standards established by ICAO.
- e) States that wish to retain the national ownership and control provision for their own air carriers make known their positions and practices regarding the conditions under which they accept foreign designated air carriers.
- f) States notify ICAO of their policies, including individual or joint statements of common policy, on the conditions under which they accept the designation of an air carrier pursuant to an air services agreement.
- g) ICAO maintain and make public information on States' policies, positions or practices on air carrier ownership and control.
- h) ICAO assist States or groups of States requesting development and further refinement of the option in paragraph c).
- i) ICAO continue to monitor developments in the liberalization of air carrier ownership and control, and address related issues as required.

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