

## **Ownership and control in airlines**

(Presented by European Civil Aviation Conference - ECAC)

Replying to the call for a position paper on the Ownership & Control (O&C) of airlines by Hermes Air Transport Organisation, the ECAC Economic Working Group decided to contribute to the discussion with a position paper to share the outcome of the discussions held on this interesting issue within the Economic Working Group and the European ad hoc Coordination Group.

Ownership and control of the airlines is one of the key aviation challenges that needs to be addressed under the economic regulation perspective.

As mentioned in the background information provided by Hermes, air transport promotes freedom of movement and brings people closer together. According to the IATA Director General, aviation is the business of freedom. Still, this freedom for airlines finds a constraint in the ownership & control clause included in the bilateral and multilateral air services agreements. Airlines are the only stakeholders of the aviation industry that are subject to such regulatory restriction.

### **Liberalisation**

Air transport liberalisation started with the US deregulation in 1978. Almost ten years later, Europe launched a gradual removal of bilateral restrictions. In 1987, ECAC developed two international agreements to promote a partial liberalisation of capacity and tariffs. In December 1987, the process towards the full liberalisation began within the European Union (then the European Community) with a First Package of measures. In 1992, the third and last package of measures was adopted. Based on this regulation, starting from 1 April 1997 EU carriers were authorised to operate between any two points, including domestic destinations (cabotage), within the EU. The European Union's internal aviation market was completely liberalised in terms of traffic rights, tariffs, capacity and commercial opportunities. In 2017 the European Union celebrated 25 years of the EU internal aviation market which has revolutionised air travel within the EU and generated very significant economic benefits for EU citizens and new opportunities for the aviation industry.

The liberalisation led to more air services, new airline business models and enhanced competition with lower fares as a result. Air travel changed drastically for passengers, operators and regulators.

The former flag carriers, fully or largely state controlled, have started a transformation process.

However, the liberalisation and the privatisation were, and still are, facing the limit of the ownership and control provisions in case of third country investment.

## Ownership & Control

European regulation on internal aviation market introduced the concept of community air carrier replacing the national ownership and control clause with the concept of European Community air carrier<sup>1</sup>.

Notwithstanding the replacement of the national majority ownership requirements with the EU majority ownership clause, the O&C majority system was and is still applied at European level which has been a big step forward.

In 2008, the European Commission recast and consolidated the previous three EU internal aviation market regulations into one single regulation - the Regulation (EC) No 1008/2008 on common rules for the operation of air services in the Community. This regulation, that currently regulates the internal EU aviation market, refers to Community air carrier<sup>2</sup>, providing for EU ownership and control. The EU majority ownership requirement can be waived through EU comprehensive agreements with partner countries which would allow for foreign majority ownership and control of EU airlines and vice-versa.

The European Commission challenged the nationality clause for designation applied by EU Member States in their bilateral air service agreements with third countries and in 2002, the European Court of Justice ruled that bilateral aviation agreements of Member States with third countries were in breach of fundamental provisions of the EU Treaty ("freedom of establishment").

Based on the Court's judgement, the European Union started developing an external aviation policy and in order to restore legal certainty to the bilateral agreements negotiating the so-called Horizontal Agreements with partner countries which aimed at replacing the national designation clause with the European one. At the same time, EU Member States had to start negotiations with third countries in order to replace the national designation clause with the EU designation clause which was developed on EU level

Since 2003, European Union started negotiations for a Common Aviation Area with neighbouring countries and negotiated comprehensive agreements with key international trading partners. In some of these agreements there are clauses allowing for fully liberalised investments in the carriers of the other Party.

However, some of the major international partners continue to apply more restrictive provisions for O&C of national air carriers.

For instance, Canada and the US limit foreign investments in national airlines to 25% (voting rights) of ownership and effective control, with strict requirements on the effective control. Mexico have recently raised the cap for foreign investments to 49%. China limits it at 35% and Brazil at 49% - a recently proposed increase to the full liberalisation has been rejected by the Congress. India is at 49%, with restrictions on Air India. These restrictions have been recently lifted in order to promote the privatisation of the national carrier. Japan imposes the limit of 33% and Australia

restricts to 49% the foreign investments in international Australian air carrier. Chile has no limit on foreign investments and applies the “*principal place of business*” concept.

The ECAC Economic Working Group regularly monitors the developments of market access among ECAC Member States and conducts surveys. The results of a 2017 survey showed that among ECAC Member States barriers to market access still exist and that the national ownership and control clause is one of the limitations to the liberalisation. In December 2017, the Directors General of ECAC Member States considered these results and recognised the need for an evolution of the ownership and control concept, preferably at ICAO level.

The limits of the model clearly emerged during the economic crisis. Bankruptcies and takeovers were rare in the air transport sector during the era of national flag-carriers. In recent years, such developments are more common and are reshaping the market and the competition landscape. The consolidation, as it already happened in the US, is gaining momentum in Europe as well as in other regions.

Mergers and takeovers are the main response from airlines facing financial difficulties that has affected the aviation sector in recent years. Airlines are participating in the capital of other carriers, in some cases creating international and cross-border groups of carriers.

The International Airlines Group’s as well as Lufthansa’s acquisitions are major examples of this. The exchange of shares completed between Air France/KLM, Delta Airlines and China Eastern is another example of a consolidation taking place among members of an alliance (i.e SkyTeam).

This consolidation is underway in Europe, but also at the international level. However, the limits imposed by Ownership and Control rules included in domestic legislation and in the international Air Services Agreements still restrict the possibility of majority ownership and control of foreign investments in air carriers.

## **Challenges**

As it emerged from the ECAC/EU Dialogue on aviation financing held in June 2017 in Rome, there is capital available to be invested in the sector. However, the legal framework should facilitate and support these developments.

There is a clear trend in lifting existing limitations to the ownership rule in order to attract investment in airlines. Some countries have replaced the O&C clause with the concept of “*principal place of business*”. However, there are no common and agreed criteria to define the “*principle place of business*” at international level.

A new O&C concept could entail the full liberalisation of ownership and effective control, and keep the “regulatory” control with the designating State to ensure safety and security.

It must be noted that a liberalisation of Ownership and Control, if linked to a principal place of business requirement in the country concerned, represents no threat to employment and fiscal revenues in that country.

However, liberalisation of the O&C may be effective only if recognised at international level (e.g. ICAO).

Any liberalisation on bilateral and/or multilateral basis may prevent the air carriers from operating to/from third countries. Even the EU designation clause is not fully recognised and applied by all third countries – yet by a large number of them. Consequently, European Member States can designate to operate air services under bilateral air service agreements with third countries, only the air carriers whose majority ownership is by nationals of the Member States, unless the third country have accepted the EU designation clause or modified the ASA to allow for principle place of business. It must be noted however that most air service agreements do accept such designation.

The same will happen in case of a full liberalisation of the ownership with another country on a reciprocal basis (e.g. a European carrier owned by US nationals to operate services to/from India) unless the third country accepts to waive the national ownership and control clause for designation.

Dealing with ownership and effective control rule at international level is the only real solution.

ECAC member States supported a liberalisation in O&C already in 2013 at ATconf/6 presenting two working Papers on the subjects.

Consistently, ECAC Member States are supporting and promoting the development of a stand-alone convention for the liberalisation of foreign investments in air carriers within the ICAO Air Transport Regulation Panel (ATRP), as the first and essential step towards liberalisation of market access.

At the last meeting in July 2017, ATRP discussed and agreed on the possibility to develop a stand-alone convention on foreign investment in air carriers, while continuing the discussions on a multilateral agreement on liberalisation of market access. A draft convention on foreign investment has been developed by the European members of the panel and presented at the Panel Working Group meeting held at the beginning of April 2018.

Some states still have concerns about effective control and would prefer to retain the possibility to deny the authorisation of carriers owned by an investor from certain countries. European members of the panel drafted proposals for clauses addressing this and other concerns, aiming to develop a text to be agreed upon by as many states as possible.

In order to be effective, the convention on foreign investment should be signed by as many states as possible.

Some key aspects of the convention need to be further developed and clarified, however the discussions have started and will engage the states at the next meeting of the Air Transport Regulation Panel.

Liberalisation of O&C of airlines remains therefore one of the main challenges to be tackled by regulators at international level in the coming years.

The European Commission has started an evaluation of Regulation (EC) No 1008/2008 which contains the provisions of ownership and control to assess whether the current rules are fit for purpose. Therefore, the discussion on the relevance of the existing rules is very timely.

<sup>1</sup> *Council Regulation (EEC) No 2408/92 of 23 July 1992 on access for Community air carriers to intra- Community air routes*, in the Article 2 b provided that:

“b) 'Community air carrier' means an air carrier with a valid operating licence granted by a Member State in accordance with Council Regulation (EEC) No 2407/92 of 23 July 1992 of licensing of air carriers”.

*Council Regulation (EEC) No 2407/92 of 23 July 1992 of licensing of air carriers*, in article, paragraph 1 and 2 provided that:

“1. No undertaking shall be granted an operating licence by a Member State unless:

(a) its principal place of business and, if any, its registered office are located in that Member State; and

(b) its main occupation is air transport in isolation or combined with any other commercial operation of aircraft or repair and maintenance of aircraft.

2. Without prejudice to agreements and conventions to which the Community is a contracting party, the undertaking shall be owned and continue to be owned directly or through majority ownership by Member States and/or nationals of Member States. It shall at all times be effectively controlled by such States or such nationals”.

<sup>2</sup> “Community air carrier’ means an air carrier with a valid operating licence granted by a competent licensing authority in accordance with Chapter II”.

*Chapter II Article 4 - Conditions for granting an operating licence -paragraphs a and f:*

“An undertaking shall be granted an operating licence by the competent licensing authority of a Member State provided that:

(a) its principal place of business is located in that Member State;

(f) Member States and/or nationals of Member States own more than 50 % of the undertaking and effectively control it, whether directly or indirectly through one or more intermediate undertakings, except as provided for in an agreement with a third country to which the Community is a party.