ORDER 91-8-15

ISSUED AUG. 8, 1991
(VOTING TRUST)

UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C

Issued by the Department of Transportation
on the 8th day of August, 1991

SERVED AUG 9 1991

Petition of **HUTCHINSON AUTO AND AIR TRANSPORT CO., INC.** for rulemaking to allow increased foreign investment in small aircraft all-cargo carriers	Docket 47535
Petition of **HUTCHINSON AUTO AND AIR TRANSPORT CO., INC.** for an exemption from the citizenship requirement of section 101(16) of the Federal Aviation Act	Docket 47534
In the matter of the cancellation of the operating authority issued to **HUTCHINSON AUTO AND AIR TRANSPORT CO., INC.** for failure to meet the citizenship requirement of section 101(16) of the Federal Aviation Act	Docket 47690

ORDER DENYING PETITIONS FOR RULEMAKING AND EXEMPTION AND TO SHOW CAUSE

I. SUMMARY

By this order, we are (1) denying the petition of Hutchinson Auto and Air Transport Co., Inc. (HAA) to institute a rulemaking proceeding to relieve, under certain circumstances, all-cargo carriers which operate small aircraft exclusively from the citizenship requirement of section 101(16) of the Federal Aviation Act; (2) denying HAA's application for an individual exemption from section 101(16); and (3) proposing cancellation of HAA's air taxi authority unless it is able to restructure itself to meet the U.S. citizenship requirement of the Act.

II. FACTUAL BACKGROUND

HAA, a Part 298 all-cargo air taxi operator based in Honolulu, provides scheduled and on-demand air freight service to all of the islands of Hawaii with a fleet of three 208B Caravan and one 206 Stationaire aircraft.

Prior to November 1989, Mr. Stephen Uslan and Ms. Georgia Runyan, both U.S. citizens, were equal partners in HAA and Great Bend Air, Inc., an affiliated Honolulu fixed base operator and flight school which operates out of the same "north ramp" area of Honolulu International Airport as does HAA. By January 1990, Ms. Runyan had acquired 100 percent of the ownership of the two companies.

On February 7, 1990, Ms. Runyan agreed to sell 51 percent of the stock of HAA and Great Bend, now known as Pacific Air Academy, to International R&D, Inc. d/b/a International R&D-USA, Inc. (IRD), a California corporation, for $2.9 million. Since Ms. Runyan's common stock was the only class of stock then outstanding, IRD's purchase of the stock in the two companies provided it with an absolute majority of the voting and total stock in each corporation.

The Chairman and Chief Executive Officer of IRD is Mr. Koji S. Shimazu, a Japanese citizen. The President of IRD is Mr. Chisato Okada, also a Japanese national. The Board of Directors of IRD is comprised of Mr. Shimazu, Mr. Okada, and Mr. Eiji Miyakawa, a Japanese citizen. IRD is a subsidiary of two Japanese companies, International R&D Co., Ltd. (IRD Ltd.), which owns 55 percent, and Sanei Land and Building Company, Ltd., which owns 45 percent. 1/

The sales agreement between Ms. Runyan and IRD required the resignation of all existing officers and directors of HAA and Great Bend, and provided that the new Boards of Directors of the two companies would consist of Mr. Shimazu, Ms. Runyan, and Mr. Grant Kidani, and that Mr. Shuichi Hashimoto would serve as "executive advisor" to the Boards of Directors. Mr. Hashimoto, also a Japanese citizen, is a senior executive of IRD Ltd. Mr. Kidani, a U.S. citizen, is IRD's lawyer.

In addition, the sales agreement provided that, in the event of a future sale of HAA or Great Bend, IRD Consulting, Ltd., would be the exclusive representative for the negotiations of the sale.

1/ IRD Ltd. is owned principally by Mr. Takashi Miyakawa, a Japanese national. The remainder of the stock is owned by Sanei Land and Building Company, Ltd. IRD Ltd.'s "principal activity is to invest in foreign territories and to foster international trade between Japan and various countries." Petition for Temporary Exemption, at 10.

The sale was completed on February 23, 1990. After the purchase, IRD retained the stock of Great Bend. IRD's stock in HAA, however, was placed in a voting trust that was created for that purpose with Mr. Robert J. Crudele, a U.S. citizen who is Mr. Kidani's law partner, appointed as voting trustee. Also on February 23, a special combined meeting of the stockholders of HAA and Great Bend was held, and Ms. Runyan, Mr. Kidani, Mr. Shimazu, and Mr. Hashimoto were elected to the two companies' Boards of Directors. Ms. Runyan remained as President of both HAA and Great Bend.

In the spring of 1990, disputes arose between Ms. Runyan and IRD over the financial condition and management of HAA and Great Bend. IRD attempted to reorganize the day-to-day operations of the two companies by replacing Ms. Runyan with its own management team at an emergency meeting of the Boards of Directors of the two companies held on May 26. Ms. Runyan refused to recognize the resultant organizational and personnel changes and obtained a temporary restraining order enjoining the newly appointed officers from entering the premises of the two companies and interfering with their operations. 2/

On June 5, 1990, IRD and Mr. Crudele, as trustee of IRD's stock in HAA, called, respectively, for special stockholders' meetings of Great Bend and HAA to be held on June 12. On June 11, Mr. Shimazu, acting as representative of IRD, appointed Mr. Richard Fast to replace Mr. Crudele as voting trustee. 3/

At the June 12 special stockholders' meetings, Mr. Fast voted the 51 percent of the shares he represented on behalf of IRD to replace the original Boards of Directors of the two companies, which consisted of Ms. Runyan, Mr. Kidani, Mr. Shimazu, and Mr. Hashimoto, with new Boards that consisted of Mr. Fast, Ms. Runyan, and Mr. Shimazu.

Following these meetings, the newly elected Boards of Directors voted to remove Ms. Runyan as an officer of HAA and Great Bend, approved Mr. Fast as President and Secretary of both companies,

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2/ *Hutchinson, et. al. v. Stephen D. Uslan, et. al.*, Civ. No. 90-1768-06 (First Cir. Ct. Hawaii). The temporary restraining order was vacated on June 21, 1990.

3/ Mr. Fast, a retired U.S. Navy captain, was originally hired by Ms. Runyan as the manager of Great Bend.

and appointed Mr. Anton Thoma as Vice President and Treasurer of both HAA and Great Bend. 4/

Subsequently, the Boards of Directors of HAA and Great Bend were changed to include three U.S. citizens--Mr. Fast, Mr. Thoma, and Ms. Carol Read HAA's Vice President of Flight Operations--and one Japanese citizen--Mr. Shimazu. On June 28, 1990, Mr. Fast, acting in his capacity as President of HAA and Great Bend obtained a temporary restraining order against Ms. Runyan (and others) enjoining her from active participation in the management and operations of the two companies. 5/

In October 1990, Ms. Runyan and IRD reached a settlement of various lawsuits that they had filed against each other. As a result, IRD acquired and now owns 100 percent of the stock of HAA and Great Bend. 6/

After reviewing these facts, the Department's staff informally advised HAA that it could not conclude that HAA, as presently structured, met the citizenship requirement of section 101(16) of the Act, and, thus, that the carrier was no longer qualified to hold authority as a U.S. air taxi operator.

4/ Because of Ms. Runyan's objection to the right of Mr. Crudele as voting trustee to call the June 12 stockholders' meeting of HAA (in apparent contravention of HAA's by-laws which require the President or any two directors to call such meetings), Mr. Kidani and Mr. Shimazu called another meeting of the original Board of Directors of HAA (*i.e.*, those elected on February 23, 1990). The meeting was held on June 16, and the result was the same as at the June 12 meeting--Messrs. Shimazu, Hashimoto, and Kidani voted to replace Ms. Runyan with Mr. Fast and to appoint Mr. Thoma to his position.

5/ *Hutchinson, et. al. v. Georgia Runyan, et. al.*, Civ. No. 90-1936-06 (First Cir. Ct. Hawaii). Prior to this action, in a complaint filed on June 20 against IRD, Mr. Fast, Ms. Read and others, Ms. Runyan sought an order from the court declaring that the various shareholders and directors meetings held in June were not lawful and that the actions taken at those meetings were null and void. *Georgia S. H. Runyan v. International R & D, Co., Inc., et. al.*, Civ. No. 90-1881-06 (First Cir. Ct. Hawaii).

6/ Under the settlement agreement, Ms. Runyan would be removed as a part owner of HAA and Great Bend upon the surrender of her stock to each company. The stock then would be retired by each company to its respective corporate treasuries as unissued but authorized stock. Ms. Runyan surrendered her stock certificates on October 15, 1990, and received a cash settlement payment from IRD.

III. PETITIONS FOR EXEMPTION AND RULEMAKING

On May 9, 1991, HAA filed an application (Docket 47634) for a temporary exemption so that it could continue to operate as an air taxi pending Department action on a concurrently filed petition for rulemaking (Docket 47535) which would allow increased foreign ownership (up to and including 100 percent) of small aircraft cargo carriers, and possibly other operators of small aircraft, through a properly structured voting trust.

In support of its requests, HAA states that it operates 24 hours per day, seven days per week, and is currently the only all-cargo carrier operating regular flights to certain small communities and isolated areas in Hawaii; that its presence as a competitive force in the Hawaiian air cargo market provides a needed and genuine service alternative; 7/ and that, since increased competition in the Hawaiian market is beneficial to both shippers and consumers, there is a clear policy reason for allowing carriers such as HAA to operate with an exemption.

1. Petition for Temporary Exemption

In its exemption application, HAA states its belief that an exemption from section 101(16) is not necessary in the first place and that the Department merely needs to reaffirm its policy of allowing the temporary use of a voting trust to insulate an air carrier from foreign control during the pendency of further proceedings. 8/ In the alternative, HAA requests that the Department (1) grant HAA a temporary exemption from section 298.2(b) of our rules, or (2) temporarily amend (as underlined) the definition of "air taxi operator" set forth in section 298.2(b) on an expedited basis as follows:

> "Air taxi operator" means an air carrier coming within the classification of "air taxi operators" established by section 298.3 <u>including a U.S. corporation conducting all cargo operations wholly within the State of Hawaii with aircraft having a maximum payload capacity of less than eighteen thousand pounds and in which at least 75 percent of the voting interest of said corporation, although beneficially owned by non-U.S. citizens, is held in a voting trust with an independent U.S. citizen</u>

7/ HAA states that, in Hawaii, 70 to 80 percent of the air cargo market is held by Aloha Airlines; 10 percent is held by Hawaiian Airlines; and HAA and Inter-Island Air, Inc., each have approximately 5 percent of the market.

8/ HAA cites the voting trust arrangements that the Department approved in connection with *The Acquisition of Northwest Airlines, Inc., by Wings Holdings, Inc.*, Orders 89-9-51 and 91-1-41, and *Application of Discovery Airways, Inc.*, Order 89-12-41.

trustee approved by the U.S. Department of Transportation. 9/

2. Petition for Rulemaking

In its petition for rulemaking, AA relies on three arguments in presenting its case for increased foreign investment: (1) the language and legislative history of section 416(b)(4) provide the Department with the authority to exempt small passenger and small cargo carriers from any requirement of the Act, including the citizenship requirement set forth in section 101(16); (2) the pre-existing extensive foreign participation in the U.S. aviation industry suggests that granting such relief will not bring about a major change in the status quo; and (3) public interest and policy considerations strongly support granting this exemption.

a. Language and Legislative History of Section 416(b)(4)

According to HAA, the language of section 416(b)(4) that was added to section 416 by the 1978 Airline Deregulation Act grants the Department the authority to exempt small carriers from any of the Act's requirements, including the requirement in section 101(16) for 75-percent U.S. citizen ownership and from Department policy interpretations. HAA states that section 416(b)(4) permits the Department to exempt, by regulation, operators of small aircraft from any "sections of this chapter," and that the term "this chapter" is a reference to chapter 20 of Title 49, 49 U.S.C. app. section 1301-1557. Section 101, including the definition of "U.S. citizen," is in subchapter 1 of chapter 20, and thus within the scope of section 416(b)(4). 10/ Furthermore, the legislative history reflects that Congress specifically intended to broaden the Department's (and, before it, the Civil Aeronautics Board's) exemption authority and believed that a flexible exemption power would allow the Department to better serve the public interest.

b. Pre-existing Foreign Participation in the U.S. Aviation Industry

HAA argues that foreign civil aircraft are already allowed to engage in extensive air commerce within the United States pursuant to section 1108(b) of the Act. This section allows foreign civil aircraft to engage in a broad range of commercial operations, including the limited carriage of cargo. Because small air carriers, such as HAA, conduct operations similar to these commercial operations, adopting the proposed rule would not significantly change the extent of foreign participation in the U.S. aviation industry.

9/ Petition for Temporary Exemption, at 15.

10/ Petition for Rulemaking, at 5-6.

Moreover, pursuant to section 416(b)(3), the Department "may by order relieve foreign air carriers who are not directly engaged in the operation of aircraft in foreign air transportation from the provisions of this chapter to the extent and for such periods as such relief may be in the public interest" (emphasis added). 11/ Thus, the Department allows foreign indirect air carriers to consolidate freight in interstate and overseas air transportation, in effect, relieving such carriers from the citizenship requirement of the Act. Since many of HAA's largest customers are air freight forwarders, it is "a small step from allowing foreign air freight forwarders to engage indirectly in air transportation to allowing small air cargo carriers such as HAA to engage in direct air transportation with an exemption..." 12/

HAA also argues that, under section 501(b)(1)(A)(ii) of the Act, an aircraft "owned by a corporation (other than a corporation which is a citizen of the United States) lawfully organized and doing business under the laws of the United States or any state thereof [is eligible for U.S. registration] so long as such aircraft is based and primarily used in the United States." 13/ Thus, a foreign corporation doing business in the U.S. can lawfully operate and register the aircraft it owns and uses here.

c. Public Interest and Policy Considerations

HAA's public policy arguments span several fronts. According to HAA, increased foreign investment in small aircraft operators will increase the levels of service and competition in markets served by those carriers, thus improving the overall air transportation system. HAA also argues that adopting the rule will allow the Department to test the concept of foreign investment as a stimulant to competition and new entry with a minimum of risk. In HAA's view, the fact that small aircraft operators are already the least regulated class of air carrier justifies limiting the proposed exception to this group. HAA suggests that the proposed rule could be further limited to small cargo carriers operating in Hawaii, Alaska, or "various sparsely populated states" where there is a need for new entry. 14/

HAA proposes that the use of a properly structured voting trust should be permitted to qualify a carrier as a U.S. citizen because it is consistent with the statutory requirement set forth in section 101(16), U.S. national security concerns, and trade reciprocity. HAA points to other federal agencies responsible for national security, such as the Department of Defense, which have

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11/ *Id.*, at 26.

12/ *Id.*, at 27-28.

13/ *Id.*, at 28.

14/ *Id.*, at 2-3.

used voting trusts to meet their ownership and control requirements. Furthermore, the operations of small aircraft cargo carriers are of no significance to U.S. national security, in HAA's view. In any case, HAA suggests that Department of Defense contractors could be excluded from the proposed exemption if there are any national security concerns. A voting trust is also consistent with the reciprocal treatment given U.S. corporations investing in Japan's air cargo industry according to HAA. Under Japan's Civil Aeronautics law, as amended in 1987, foreign persons can own up to a third of the voting shares and can own an unlimited proportion of the non-voting shares of Japanese air carriers.

IV. RESPONSES TO THE PETITIONS

1. Answers

Answers to the Petition for Temporary Exemption were filed by the Air Line Pilots Association, International (ALPA), Aloha Airlines, Inc., and Hawaiian Airlines, Inc.

In general, these answers request that the Department deny the relief requested and order HAA to cease operations immediately because it is 100 percent foreign owned, is not eligible for the license under which it operates, and is engaging in unlawful cabotage. The objectors further argue that there is no justification under the statute for creating a different definition of citizenship for an air carrier because it is an air taxi operator or small cargo carrier, and that the Department may not even have the statutory power to grant the requested exemption because, although section 416 of the Act authorizes the Department to grant an exemption from Title IV, the definition of "air carrier" and "U.S. citizen" are in Title I and are not the subject of the section 416 exemption power.

The objectors further assert that a voting trust cannot be used to satisfy the 75 percent ownership requirement of section 101(16). They argue that at least 75 percent of the voting interest must be owned by U.S. citizens before there is an issue of whether a voting trust will resolve control issues created by the 25 percent or less of the stock owned by foreign interests. In any event, the proposed voting trust would not be effective, since IRD is the sole stockholder and would, therefore, be solely responsible for the administration of the trust. Aloha and ALPA also distinguish the facts in the *Northwest* case from those here by noting that, in *Northwest*, U.S. citizens owned 75 percent of the voting interest and the voting trust arrangement concerned equity other than voting stock, and the Department determined that the U.S. interests were actively involved in the operations and management of the carrier.

Aloha also states that unchecked foreign ownership would have a negative effect on the bilateral negotiation process, since the U.S.-Japan market remains heavily restricted in terms of new

carrier entry and foreign investment. According to Aloha, it is unlikely that a U.S. carrier would be permitted to own all of the voting stock of a Japanese carrier engaging in a domestic Japanese service; and that Japanese law prohibits a foreign citizen from exercising its voting rights in excess of 33.3 percent of a Japanese carrier's total outstanding voting rights.

Finally, Aloha claims that it would be inappropriate for the Department to increase the permissible limit of foreign investment and control when the House of Representatives is currently considering two bills regarding the same issue. IRD's investment in HAA would not qualify under either of these proposed bills. Therefore, Aloha claims that the Department would be effectively rewriting the law by sanctioning the use of a voting trust to circumvent the statutory ownership requirement.

2. Reply

On June 5, 1991, HAA filed a Consolidated Reply to the Answers filed by ALPA, Aloha, and Hawaiian. In its Reply, HAA reiterates its arguments that the Department has the statutory authority to grant the requested exemption from the citizenship requirement of the Act; and that use of a proper voting trust with an independent U.S. citizen trustee is an appropriate and effective method of insulating small carriers, including HAA, from foreign ownership and control. HAA also recognizes that the Department and the Civil Aeronautics Board have not allowed use of a voting trust to meet the statutory voting stock ownership requirement, but argues that this policy can and should be changed for operators of small aircraft.

HAA asserts that the public interest arguments in favor of granting its temporary exemption were not rebutted in any of the answers; 15/ and that, contrary to Aloha's arguments that HAA is seeking foreign investement rights which the Japanese would not permit in its carriers, under the proposed HAA voting trust, the beneficial owner of the stock, IRD, could exercise no voting rights in the stock.

HAA further states that it has recently entered into a new voting trust agreement, which has been modeled upon FAA and DOD trust agreements; that it has recently appointed a new trustee, who is obligated to make decisions independent of IRD and to ensure that IRD is not represented on HAA's Board of Directors; and that HAA's

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15/ HAA included with its Reply a number of letters from its customers and supporters in favor of granting HAA's petitions.

Board has been reconstituted with Mr. Fast, Ms. Read, and Mr. Michael Nakaji, all U.S. citizens, as its members. 16/

3. Subsequent Pleadings

On June 12, Aloha filed a Motion and Surreply to HAA's Reply. Aloha states that it requests leave, pursuant to Rule 4(f) of the Department's Rules of Practice, to file its Surreply in order to clarify and correct certain statements made by HAA in its consolidated reply.

On June 21, HAA filed a Motion for Leave to File and filed a Response to Aloha's Surreply. Accompanying the Response were additional letters from HAA's customers in support of its petitions.

On July 1, Aloha filed another Motion and Reply to HAA's June 21 Response.

Although we have decided to accept the motions and accompanying responses of Aloha and HAA, we do so reluctantly and only because we had not yet completed our review of the matters raised in the original petitions at the time the unauthorized pleadings were filed. Surreplies are not permitted in exemption cases, and none of the unauthorized documents submitted by either Aloha or HAA raise any new issues or provide information not already included in the authorized pleadings or which was not otherwise available to the Department. We expect parties in our proceedings to act with restraint, filing unauthorized pleadings only when the need is clear or the information is new, and not merely argumentative.

V. DISPOSITION OF THE PETITIONS

After careful review of the arguments that HAA has presented in its petitions and those contained in the responses, we have reluctantly decided to deny both its request for rulemaking and its application for an exemption.

In order to engage in air transportation operations, an air carrier must qualify as a U.S. citizen under section 101(16) of the Act and must hold operating authority from the Department. Section 101(16) requires that the president and two-thirds of the Board of Directors and other managing officers be U.S. citizens, and that at least 75 percent of the outstanding voting stock of corporations be owned or controlled by U.S. citizens. Historically, the Department, and the Civil Aeronautics Board

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16/ According to the Corporate Minutes of a Special Meeting of the Shareholder, Mr. Fast, acting in his capacity as voting trustee for IRD's stock, stated that he wished to stay on as a member of the Board and nominated and elected Ms. Read and Mr. Nakaji, "the Company's accountant," for their positions on the Board. Exhibit F to HAA's Reply at 2-3.

before it, have construed section 101(16) to require that a carrier, in fact, must be controlled by U.S. citizens. 17/

Recently, we have undertaken a re-examination of our position and policies on capital investment in U.S. air carriers from foreign sources in order to reflect more accurately today's complex, global corporate and financial environment. As a result, in January, we adopted general guidelines that would allow a greater level of foreign debt and equity investment under certain circumstances than had been permitted previously. In doing so, however, we indicated that total foreign voting equity could not exceed the 25-percent statutory limit and that actual control must be in the hands of U.S. citizens. 18/ In June, we announced that the Administration would support a further liberalization of the law to allow foreign investment in the voting stock of U.S. air carriers up to 49 percent. 19/ Pending any such statutory change, however, we are adhering to the provisions of the current law as Congress has written it and as we have interpreted it.

1. Petition for Rulemaking

In its petition for rulemaking, HAA argues that certain air carriers, specifically those operating small aircraft in cargo-only service, should be given an opportunity not available to other carriers. HAA asks that these small carriers be permitted to be owned up to 100 percent by foreign investors, as long as any voting interest above 25 percent is placed in a voting trust.

While it is our intention to continue to take steps to increase the opportunities for foreign capital investment in U.S. air carriers, we believe such opportunities should be afforded to all air carriers. We find no basis now in HAA's arguments in this record, either economically or operationally, to distinguish all-cargo carriers operating small aircraft from passenger carriers operating similar-sized equipment or from carriers operating larger aircraft with respect to the applicability of section 101(16).

17/ *See, e.g., In the Matter of the Acquisition of Northwest Airlines By Wings Holdings, Inc.*, Order 89-9-51, issued September 29, 1989.

18/ Specifically, we stated that, as a general rule, up to 49 percent of the total equity of a carrier could be held by non-U.S. citizens without automatically constituting control, and that debt would not be considered a control factor, unless the debt agreement provided special rights that implied control. *See In the Matter of the Acquisition of Northwest Airlines, Inc.*, Order 91-1-41, issued January 23, 1991.

19/ This announcement was made in a speech delivered by the Secretary of Transportation before the British-American Chamber of Commerce on June 21, 1991.

HAA justifies its proposal on the grounds that it will allow the Department to test the concept of foreign investment as a stimulant to competition and new entry with a minimum of risk. One of HAA's primary arguments as to why small aircraft cargo carriers should be given special consideration is that such operators are already the least regulated class of air taxis and that this difference provides a reasonable basis for limiting the proposed citizenship exception to this group of carriers.

The fact that certain air taxis already enjoy a greater degree of relief from operational regulation does not, by itself, justify the additional requested relief from the citizenship requirement. HAA presents no evidence of unique circumstances at this time facing the small aircraft cargo industry that other air carriers do not face and that justify disparate treatment for purposes of the Act's basic citizenship qualification. Indeed, the need for new entry and competitive operations is not limited to small aircraft all-cargo operations. Nor can we readily distinguish these small aircraft cargo operations from those performed by other carriers based on aircraft size or even scope of operations.

Air taxi operators engaging in cargo service are not limited under Part 298 as to the geographic area in which they do business, the number of aircraft they may operate, the number of markets they may serve, or the size of their business in any financial terms such as net worth or annual revenues. The only limit is on the size of each aircraft in the fleet--such aircraft cannot exceed a maximum payload capacity of 18,000 pounds, which is comparable to the 60-seat limit for passenger carriers. Of the 135 air carriers that currently hold section 401 certificates issued by the Department, 61 of them, or 45 percent, operate only small aircraft (under 60 seats or 18,000 pounds payload). These carriers are in addition to the 108 carriers that hold authority to engage in small aircraft scheduled passenger operations as commuters. The operations of some of these section 401 and commuter carriers, particularly those in Alaska, are smaller in scope than those of many air taxi operators, including HAA.

HAA argues that the applicability of the proposed rule could be further limited to small cargo carriers operating in Hawaii, Alaska, or "various sparsely populated states" where there is a need for new entry. It also notes that if we or the Department of Defense are concerned about the national security implications of foreign ownership, DOD contractors could be excluded from the proposed exemption. Thus, even within the class of small aircraft cargo carriers, HAA proposes that there would be a further fragmentation of the applicability of the citizenship requirement. In essence, HAA would have us carve out a rule specifically to cover its own situation.

We have seen no indication that entry and competition in sparsely populated areas or in the two states that HAA mentions are any more dependent on foreign capital than in other regions. Because

of the mobility of aircraft, air carriers often serve a wide geographic area, including some densely populated areas as well as those with more limited populations. Under HAA's proposal, such carriers, even though they might be engaging only in small aircraft cargo service, could be precluded from receiving increased foreign investment because of the areas they served, or could be precluded from changing operations by the investment they receive. A carrier's access to capital markets should not be based on the type of service it performs, the size of aircraft it uses, or where it flies.

HAA's arguments that we already allow foreign companies to operate service in the U.S. and thus should extend this "right" to U.S. carriers that are owned or controlled by foreign interests is not persuasive. The types of operations HAA cites either do not involve common carriage air transportation operations (*e.g.*, operations performed under section 1108(b) of the Act or by companies with foreign registered aircraft) or do not involve the direct operation of aircraft in air transportation (*e.g.*, operations by foreign indirect air carriers, including foreign air freight forwarders). Thus, the cited operations are neither of the same nature, nor provide a precedent for waiving the citizenship requirements for U.S. air carriers.

HAA proposes that voting stock in excess of 25 percent which is held by a foreign investor be allowed as long as that stock is placed in a voting trust approved by the Department and administered by an independent U.S. citizen trustee. We are unable to accept this proposal. In only a small number of limited cases in the past have we allowed persons, who, for compliance reasons or special citizenship considerations might not otherwise have been allowed to retain their ownership interest in an air carrier, to maintain that interest through a voting trust administered by an independent U.S. trustee. 20/ In general, we considered these trusts to be temporary, interim measures which were instituted pending resolution of specific issues or problems, rather than as permanent solutions as HAA proposes.

Further, the Department and the Civil Aeronautics Board have always maintained a policy that a voting trust cannot be used to circumvent the 75 percent statutory ownership test; at least 75 percent of the voting interest must be owned by U.S. citizens before the issue even arises as to whether a voting trust will resolve possible control issues created by the 25 percent or less

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20/ *See, e.g., Fitness Determination of L'Express, Inc.*, Order 90-7-4 issued July 5, 1990; *Application of Ryan Air Service, Inc.*, Order 88-7-25 issued July 18, 1988; and *Application of Discovery Airways, Inc.*, Order 90-7-17, issued July 6, 1990.

of the stock owned by foreign interests. 21/ After reviewing HAA's arguments, we find no reason to change that policy now.

As a final matter, there are several bills pending in the House of Representatives which propose to amend the citizenship definition of the Act to allow for additional foreign investment up to 49 percent under specified circumstances. We note that none of these bills proposes a system which would differentiate investment limits in air carriers based on the size of aircraft operated, the scope of operations, or the type of authority held, nor would they permit the level of foreign investment (100 percent) proposed by HAA.

While supportive of the general policy goal of liberalizing foreign investment opportunities in aviation, we are reluctant to make major policy revisions in this area at the same time that Congress is reviewing what it feels are the appropriate levels of foreign involvement.

For all of these reasons, we have decided to deny the petition for rulemaking filed by HAA.

2. Petition for Temporary Exemption

While the Department may have the authority under section 416(b)(4) to exempt small aircraft operators, by regulation, from the requirements of section 101(16), it is not clear that such authority would allow us to grant a *pendente lite* exemption by order. We need not resolve that issue, however, since we find that it is not in the public interest to grant HAA an individual exemption from the citizenship requirement of the Act.

As we have already discussed, HAA cannot satisfy the 75 percent statutory U.S. ownership test of section 101(16) by putting its voting common shares owned by IRD in the voting trust which was established for that purpose. 22/ In the *Northwest* case, which

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21/ *See, e.g., Premiere Airlines, Inc., Fitness Investigation*, 95 C.A.B. 101 (1982), and *AirPass Airlines, Inc.*, Order 84-5-90, issued May 30, 1984.

22/ Apparently because of her ouster, Ms. Runyan turned in HAA's Part 135 certificate to the Federal Aviation Administration (FAA), citing the fact that HAA was under foreign control. Subsequently, however, the FAA Western-Pacific Region's Counsel concluded that, since IRD's stock had been put in a voting trust administered by a U.S. citizen trustee, the citizenship requirement of FAR 135.13(a)(1) had been met, and HAA's Part 135 certificate was returned. The FAA's determination on this issue under Titles V and VI of the Act is not dispositive of our citizenship tests under Titles IV and XI. In fact, it has long been recognized that the voting trust arrangements authorized by 14 CFR 47.8 to establish U.S. citizenship under Title V do not necessarily

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HAA cited as a precedent, we did allow total foreign equity investment in Northwest Airlines of up to a total of 49 percent and permitted a limited amount of excess non-voting foreign equity investment to remain indefinitely in a trust approved by the Department and administered by an independent U.S. citizen trustee. However, we emphasized that the 25 percent voting stock restriction set forth in section 101(16) still applied. Moreover, our willingness to allow the retention of more than 49 percent total equity was based, in large part, on other factors not present here. First, we noted the existence of U.S. holders of a controlling block of voting stock who were active in the management and direction of the company. Second, we noted that the Netherlands, the country of the primary foreign investor, has a liberal aviation agreement with the U.S., and our decision was consistent with our policy of reciprocity.

In the instant case, all of the equity investment in HAA is in the form of voting stock and all of that investment is owned by foreign interests and is currently in a voting trust. Thus, the HAA voting trust situation does not meet the criteria present in other cases that permitted such arrangements.

HAA argues that it provides useful and valuable services to shippers in the Hawaiian Islands which would be eliminated if we were not to grant it the relief requested. We do not dispute that HAA's operation under its current ownership will have to cease. That does not mean, however, that HAA's corporate ownership should not or cannot be corrected by a satisfactory restructuring which complies with the citizenship requirment of the Act.

We are unable to find any public interest basis to single out HAA for special treatment. Therefore, we will deny its request for exemption.

VI. PROPOSED CANCELLATION OF HAA'S OPERATING AUTHORITY

We believe that the evidence before us clearly shows that, as a matter of law and fact, HAA does not meet the U.S. citizenship requirement of section 101(16). 23/ Under these circumstances, we propose to cancel HAA's Part 298 air taxi authority on the basis that it no longer qualifies to hold such authority as a U.S. citizen air carrier, unless, within 90 days after issuance of a final order in this proceeding, it presents acceptable evidence that it has been restructured to meet the citizenship requirement

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qualify an operator as a U.S. citizen under CAB and Department precedents established in administering Titles IV and XI of the Act. *In the matter of Intera Arctic Services, Inc., supra*, at 2.

23/ HAA, itself, recognizes its failure to meet the citizenship requirement through the filing of its exemption request in Docket 47534.

of the Act. We will, however, give HAA and other interested parties an opportunity to show cause why we should not adopt as final the tentative findings and conclusions leading to this proposed action.

There is no question that IRD is the *de jure* owner of HAA and Great Bend. At the time of its purchase, IRD obtained 51 percent of the stock of both companies. By itself, this is a clear and absolute controlling interest. Now, as a result of the tender by Ms. Runyan of her 49 percent of the stock to the companies and the subsequent retirement of Ms. Runyan's stock, IRD in effect owns 100 percent of the stock of the two companies.

Since IRD is the owner of HAA, if IRD or any other corporations in the chain of ownership of HAA are not U.S. citizens, then none of the corporations, including HAA, are U.S. citizens. IRD is not a U.S. citizen for purposes of Title IV of the Act since more than 25 percent of its stock is held by non-U.S. citizens. Although IRD is a California corporation, 100 percent of its stock is held by two Japanese corporations, IRD Ltd. and Sanei. Therefore, we tentatively find that HAA, being wholly owned by a non-U.S. citizen parent, is not a U.S. citizen within the meaning of the Act.

Further, we tentatively find that, in addition to *de jure* control of HAA, IRD exercised and continues to exercise *de facto* control of the carrier. This *de facto* control is clearly shown by the actions of IRD and its representatives in the special stockholders' meeting of HAA which was held on June 12, 1990, and the two Board of Directors' meetings which were held on June 12 and 16, 1990, which culminated in Ms. Runyan and the other officers of HAA being replaced by IRD's nominees, Mr. Fast and Mr. Thoma.

We also tentatively find that, after IRD's purchase of HAA, the carrier failed to meet the statutory requirement of section 101(16) that the President and two-thirds of its Board of Directors and managing officers be U.S. citizens. As noted above, Mr. Fast was installed as HAA's President (and Secretary) by IRD and its representatives. He serves in a similar capacity at Great Bend, which is also wholly owned by IRD and which shares the same key personnel and has adjoining facilities with HAA. It is clear that Mr. Fast is beholden to IRD for his position and is directly and/or indirectly subject to IRD's influence and control. As IRD's nominee, we tentatively find that Mr. Fast is not a U.S. citizen under the Act for purposes of his role as President of HAA.

Similarly, the current Board of Directors of HAA consists of Mr. Fast and Ms. Read, both of whom served on the previous Board at the behest of IRD or its representatives, and Mr. Nakaji. Ms. Read and Mr. Nakaji were nominated by Mr. Fast at the May 21, 1991, Special Stockholder's Meeting to serve on the current Board, where he also nominated himself to continue serving on HAA's

Board. Since we have already tentatively found that Mr. Fast is IRD's nominee, and in this capacity cannot be considered a U.S. citizen for purposes of his role at the carrier, any persons that he nominates would similarly be considered as under the indirect influence of IRD. In this connection, while Ms. Read was employed by HAA prior to the IRD acquisition, her promotion to her current management position and her election to the Board of Directors occurred after IRD acquired control of the carrier. Therefore, we tentatively find that the current Board of Directors does not meet the statutory requirement that at least two-thirds of its members be U.S. citizens. 24/ Since all three of these persons, along with another IRD nominee, Mr. Anton Thoma, also serve in key management positions with HAA, it appears that the two-thirds managing officer requirement of section 101(16) has also not been met.

Moreover, until recently, the voting trustee could not be considered "independent" of IRD's control or influence. 25/ While it appears that HAA has now taken steps to rectify this problem by installing a trustee who does not appear to be an employee or representative of HAA or IRD, it has not been able to resolve our basic premise that voting trusts should only be used to shield a carrier from possible foreign control when at least 75

24/ It also appears that during the period February 23 - June 12, 1990, three of the four members of HAA's Board were non-U.S. citizens or representatives of non-U.S. citizens in violation of the provision that no more than one-third of the directors can be non-U.S. citizens. Included on the Board at that time were Messrs. Shimazu and Hashimoto, both Japanese citizens; Mr. Kidani, a U.S. citizen who served as IRD's attorney; and Ms. Runyan. In light of their attorney-client relationship, IRD clearly had the ability to exert influence over Mr. Kidani. Similarly, from June 12, 1990, to May 21, 1991, the HAA Board consisted of Mr. Shimazu, a Japanese citizen, Mr. Fast, and Mr. Thoma; Ms. Read was added to the Board sometime later. The latter three were IRD's nominees for the Board. Thus, it appears that all four members of the Board did not meet the U.S. citizenship criterion.

25/ Mr. Crudele's replacement, Mr. Fast, was installed not only as voting trustee of HAA, but as President and Secretary of both HAA and its sister company, Great Bend, by IRD and its representatives. Thus, Mr. Fast could not be considered as an independent trustee and the voting trust could not be relied upon as an effective mechanism to shield HAA from the influence of IRD. Recently, HAA appointed a new trustee, Mr. A. Duane Black, who most recently was Administrator of the Lanai Community Hospital in Hawaii.

percent of the voting stock is already in the hands of U.S. citizen investors. 26/

In summary, based on all of the above evidence, we tentatively conclude that HAA is under the ownership and control of a foreign corporation and does not qualify as a U.S. citizen. Moreover, we tentatively conclude that, because HAA is not a U.S. citizen, it may not be an air carrier within the meaning of the Act, and cannot register as an air taxi under Part 298 of our regulations.

While the Department is committed to a policy of fostering competition and new entry in the airline industry, and we welcome lawful foreign investment as part of that process, we cannot allow such considerations of policy to undermine the basic requirements of the law, which includes the mandate to ensure an air carrier's U.S. citizenship. Consequently, unless HAA can demonstrate that it is indeed owned and controlled by U.S. citizens and otherwise comes within the definition of a U.S. citizen as set forth in section 101(16) of the Act, it must cease air carrier operations.

We direct HAA and any other interested parties to show cause, within 15 days of the date of this order, why we should not make final the tentative findings and conclusions stated above; answers to objections will be due within 10 days thereafter. In view of the seriousness of the remedy proposed here--loss of operating authority--and the potential difficulties this carrier's sudden withdrawal from the market may have on some of its shippers, we propose to allow HAA to continue to operate for 90 days from the issuance of a final order to restructure its ownership, management and board of directors to achieve compliance with the Act. If, during this period, HAA is able to present acceptable evidence that it has been so restructured, we will take such evidence under consideration before cancelling HAA's Part 298 operating authority.

ACCORDINGLY,

1. We deny the petition for rulemaking filed by Hutchinson Auto and Air Transport Co., Inc., in Docket 47535;

2. We deny the petition for temporary exemption filed by HAA in Docket 47534;

3. We tentatively find (a) that HAA is not a U.S. citizen within the meaning of section 101(16) of the Act; (b) that it is not qualified to register or otherwise hold authority as an air taxi operator under Part 298 of our regulations; and (c) that its Part 298 registration should be cancelled at which time it must cease all air transportation operations, unless, within 90 days of the

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26/ Because of our decision not to accept a voting trust in this case, we do not reach the merits of whether the voting trust presented by HAA in its Reply would be acceptable.

issuance of a final order in this proceeding, HAA has presented evidence that it has been restructured to meet the citizenship requirement of section 101(16) of the Act;

4. We direct any interested persons having objections to the issuance of an order making final any of the proposed findings and conclusions set out in paragraph 3 above to file such objections in Docket 47690 with the Documentary Services Division, C-55, Department of Transportation, 400 7th Street, SW, Washington, DC 20590, and serve them on all persons listed in Attachment A no later than 15 days after the service date of this order; answers to objections will be due within 10 days thereafter; 27/

5. We will accord full consideration to the matters and issues raised in any timely and properly filed responses before we take further action;

6. In the event no one files objections, we will deem all further procedural steps waived, and we will enter an order making final the tentative findings and conclusions set out here; 28/

7. We grant the motions filed by Aloha on June 12, and July 1, 1991, and the motion filed by HAA on June 21, 1991, to file otherwise unauthorized documents;

8. We will serve a copy of this order on the persons listed in Attachment A; and

9. We will publish a summary of the show cause portion of this order in the Federal Register.

By:

JEFFREY N. SHANE
Assistant Secretary for Policy
and International Affairs

(SEAL)

27/ We again caution the parties that we will not look favorably upon the acceptance of successive or otherwise unauthorized filings beyond the objections and replies specifically provided for in this order.

28/ Since we have provided for the filing of objections to this order, we will not entertain petitions for reconsideration.

Attachment A

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