GAO
Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

October 30, 2003

The Honorable Trent Lott
Chairman
The Honorable John D. Rockefeller
Ranking Minority Member
Subcommittee on Aviation
Committee on Commerce,
Science, and Transportation
United States Senate

Subject: *Issues Relating to Foreign Investment and Control of U.S. Airlines*

In May 2003, the Bush Administration proposed amending the legislation that currently restricts foreign ownership of U.S. airlines, raising the allowable percentage of total foreign ownership of voting stock in U.S. airlines from 25 to 49 percent. The Department of Transportation (DOT) suggested that implementing this amendment could provide significant benefits to U.S. consumers and airlines, particularly by providing access to additional capital, which would help the financial health of the industry. DOT and the Department of State also maintain that these new limitations would bring the United States in line with current foreign ownership laws of the European Union (EU).

Concerned about the effect that changes in foreign ownership and control requirements might have on the aviation industry, national interests, and consumers—and recognizing that we examined this issue in 1992 when DOT earlier proposed increasing the level of foreign ownership—you asked us to discuss two related topics: (1) current proposals to revise U.S. limits on foreign ownership and control, including information on current shareholders and past examples of efforts by foreign interests to purchase significant equity in U.S. air carriers and (2) whether key analytic issues raised in our 1992 report on foreign ownership and control remain relevant.[1] This report summarizes the information we provided to Committee staff during our June 25, 2003, briefing pursuant to your request. The briefing slides, which provide more details about our analysis, are attached as enclosure I.

[1]U.S. General Accounting Office, *Airline Competition: Impact of Change Foreign Investment and Control Limits on U.S. Airlines*, GAO/RCED-93-7 (Washington, D.C.: December, 1992).

In summary:

- Foreign airlines have attempted to invest in and influence the operations of U.S. airlines several times since the late 1980s. These foreign airlines have on occasion invested significant amounts of capital into U.S. airlines, only to later disinvest due in part to U.S. policies concerning airline control. The Administration's proposal does not seek to change U.S. law regarding control of air carriers.
- Our 1992 report identified five key issues relating to raising the limit on foreign investment in U.S. airlines. In general, those issues covered the potential impact of foreign investment on domestic competition, national security, employment, safety, and international competition. Because the current economic environment and the state of the aviation industry are similar to that in existence at the time of the prior report, we believe that most of these issues remain relevant today.

Background

Congress first enacted citizenship requirements for U.S. airlines with the Air Commerce Act of 1926. That act required that U.S. citizens own at least 51 percent of any individual aircraft in order for it to be registered in the United States. Under the Civil Aeronautics Act of 1938, Congress required that U.S. citizens own or control at least 75 percent of the voting interests of U.S. airlines. This standard has remained the same since then.[2]

Under current U.S. law, in order to operate as a U.S. airline, an entity must obtain a certificate of public convenience and necessity or an exemption from the certification requirement from DOT. A prerequisite for obtaining such authority is U.S. "citizenship." Current U.S. law defines a "citizen of the United States" as an individual U.S. citizen, a partnership whose members are U.S. citizens, or a corporation or association organized under U.S. law where at least 75 percent of the voting interest is owned and controlled by U.S. citizens.[3] The law also specifies that the President, as well as at least two-thirds of the Board of Directors of the corporation, must be U.S. citizens. In practice, DOT has interpreted control to mean that day-to-day management decisions must be made by U.S. citizens, even if there is substantial foreign investment in the airlines. That is, the law has been construed as requiring actual control of the enterprise to rest with U.S. citizens.

In addition to DOT's initial citizenship evaluation of an airline when it first applies for certification, DOT again reviews the airline's citizenship status following any

[2]The United States has restricted ownership and control of U.S. airlines for four primary reasons: (1) protection of the then-fledgling U.S. airline industry, (2) regulation of international air service through bilateral agreements, (3) concern about allowing foreign aircraft access to U.S. airspace, and (4) military reliance on civilian airlines to supplement airlift capacity. See U.S. General Accounting Office, *Airline Competition: Impact of Changing Foreign Investment and Control Limits on U.S. Airlines*, GAO/RCED-93-7 (Washington, D.C.: Dec. 9, 1992).

[3]49 U.S.C. 40102.

substantial change in an airline's ownership, management or operations.[4] This is done on a case-by-case basis. In a March 2003 review of DOT's citizenship evaluation process, the DOT Inspector General found that no single document defines the process or criteria to be applied for the review and that DOT examines several factors when determining the issue of control.[5] These factors include any significant contracts between the airline seeking citizenship and its business partners, voting rights held by U.S. and non-U.S. citizens, and the terms of any debt instruments or bankruptcy agreements. During its analysis, DOT determines whether a foreign entity's influence over any of these factors shifts the actual, day-to-day control of the airline from U.S. citizens to foreign citizens.

DOT has previously proposed easing the restrictions on foreign investment in U.S. airlines. In 1991, the Secretary of Transportation proposed allowing foreign investors to own up to 49 percent of a U.S. airline's voting stock, although no legislative proposal was submitted to the Congress. According to DOT officials, the proposal was made in response to heavy losses suffered by U.S. airlines in 1990 and 1991, and experience gained in structuring foreign investments to maintain U.S. citizen control by working with two major U.S. airlines (Northwest Airlines (NW) and Continental Airlines) and their foreign investors. Congress did not adopt these proposals.

Proposed Legislation Would Affect Ownership and Control of U.S. Airlines

The latest efforts to change U.S. foreign investment and control restrictions were submitted as two separate amendments to the Federal Aviation Administration (FAA) reauthorization bill (H.R. 2115 and S. 824).

The Administration proposed an amendment that would relax the restrictions on foreign-owned voting stock of U.S. airlines from 25 to 49 percent, while not changing the policy that U.S. citizens control U.S. airlines. DOT suggested that increasing allowable foreign ownership limits would provide access to additional capital, which would provide several benefits that would help the financial health of the industry. This includes encouraging more efficient market-driven networks, creating opportunities for new airlines to enter the market, and bringing U.S. ownership limitations in line with European laws. DOT also sought to find additional tools for the airline industry to respond to unforeseen economic conditions, such as the recent effects of the Iraqi War or the Sudden Acute Respiratory Syndrome outbreak in Asia.

A separate but related amendment addressed the issue of control of U.S. airlines. The House and Senate conference agreement on the FAA reauthorization bill includes a section that would revise the definition of "control."[6] The bill would amend Section 40102(a)(15)(C) of title 49 to include in the criteria for meeting the citizenship

[4]14 C.F.R. 204.5.

[5]Department of Transportation, Office of Inspector General, Letter to the Honorable Don Young, Chairman, Committee on Transportation and Infrastructure, U.S. House of Representatives, March 4, 2003.

[6]Section 807 of the conference report on H.R. 2115.

requirement as "(airlines) which (are) under the actual control of citizens of the United States." In effect, this language would codify DOT's existing practice.

There are differing levels of support by various aviation stakeholders for altering current foreign ownership and control statutes. Several key aviation stakeholders generally support the proposal of raising the allowable level of foreign ownership in U.S. airlines. Most major U.S. airlines favor increasing their access to foreign capital, and some have called for removing all restrictions regarding foreign ownership. The Air Transport Association issued its support in June 2003, citing the potential to create greater access to global capital for U.S. airlines, while also bringing U.S. foreign ownership laws into line with those of other countries.[7] Certain international aviation organizations also support removing barriers to international investment and open markets. Both the International Civil Aviation Association and the International Air Transport Association support the liberalization of ownership and control. Other stakeholders, especially various labor groups, oppose increasing foreign ownership levels. For example, the Association of Flight Attendants has a preference that foreign ownership be handled on a case-by-case basis and not just as a blanket lifting of the limitations. They also support control of U.S. airlines by U.S. citizens. The AFL-CIO's Transport Trade Department also strongly opposes any relaxation of the rules on foreign control of domestic airlines, citing both national security and the economic welfare of U.S. workers among their concerns.

Current Status of Foreign Investment in U.S. Airlines

As of July 2003, the amount of foreign investment in U.S. airlines remained limited. According to a major international investment bank, as of May 2003 no major stockholders—U.S. or foreign—owned more than 20 percent of any major U.S. network carrier.[8] American Airlines and Delta Air Lines both had significant blocks of stock owned by single shareholders, but these were U.S. financial service firms. Both NW (18 percent), and Continental (13 percent) have shares held by Axa Financial, a U.S. subsidiary of the French-based Axa Group.[9]

Past Examples Show Control Has Been the Central Issue

Foreign airlines have attempted to invest in and influence the operations of U.S. airlines several times since the late 1980s. These foreign airlines have on occasion invested significant amounts of capital into U.S. airlines, only to later disinvest due in part to U.S. policies concerning airline control.

---

[7]The Air Transport Association is the principal trade organization for large U.S. airlines.

[8]Section 13(d) of the Securities Exchange Act of 1934, as amended, requires that any person who obtains beneficial ownership of 5 percent or more of any equity security must provide notice to the issuer of the security, to each exchange where the security is traded, and to the Securities and Exchange Commission (SEC). The notice must include detailed information on citizenship, the number of shares purchased, and other related business arrangements.

[9]We omitted information on ownership for United Airlines and US Airways due to their respective ongoing and recent emergence from bankruptcy.

In 1989, NW announced that it would be acquired in a leveraged buyout by Wings Acquisition, Inc. (Wings). KLM Royal Dutch Airlines (KLM) provided about 57 percent of the total equity in Wings and owned 5 percent of the voting shares of Wings. KLM also proposed to gain the right to appoint one member of Wings' 12-member Board of Directors and to form a financial advisory committee to advise Wings on the management of NW.[10] In its review of the proposed transaction, DOT objected to the proposed deal's structure and issued a consent order, with NW and Wings agreeing to (1) place KLM's interest above 25 percent of the total equity in a voting trust, (2) terminate KLM's right to appoint a financial advisory committee, and (3) disqualify KLM's board member from participating in all decisions on competitive and international aviation matters. NW petitioned for reconsideration in 1991. DOT then permitted KLM to own 49 percent of the total equity investment in Wings and allowed increased representation on Wings' board, since the United States and the Netherlands had an open skies bilateral aviation agreement.[11] DOT ordered modifications to the original investments and attached conditions to its approval to ensure that NW retained its decision-making independence from its foreign airline investor. In 1997, KLM decided to disinvest from NW and instead focused on building up an alliance without direct financial investment. KLM and NW formed the first international code-sharing alliance granted antitrust immunity in 1993.[12]

In 1992, British Airways (BA) proposed investing $750 million in USAir in an arrangement that would have created the world's largest airline alliance.[13] In the original proposal, BA's investment would include about 44 percent of USAir's total equity, 21 percent of USAir's voting stock and representation on USAir's Board of Directors.[14] BA included some important conditions to its investment, including one that it would have significant influence over major investment and financing decisions by USAir. DOT initiated a review of the proposal. BA withdrew its proposal before DOT issued a formal decision, in part because of changes being

---

[10]In addition, other foreign investors held about 15 percent of Wings' voting common stock, bringing the total voting stock held by foreign investors to about 20 percent of Wings' voting stock.

[11]DOT allowed expansion of KLM's representation on Wings' board when the number of directors was increased and continued the disqualification provision regards decision on competitive and international issues. However, the order stated that appointment of foreign representatives to key positions on Wings' board, especially the position of chairman, would be "cause for us to review the citizenship of the affected air carrier."

[12]"Code sharing" refers to the practice of airlines applying their names—and selling tickets via reservation systems—to flights operated by other carriers.

[13]USAir officially changed its name to the current US Airways on February 27, 1997.

[14]In 1992, we reported that the proposed investment included a number of potential benefits for the two airlines planning to integrate their services. It would have provided BA a secure partnership that could feed U.S. passengers to its international flights and allow USAir to better compete with U.S. airlines that have expanded their international routes systems by purchasing international route authority from struggling U.S. airlines. See U.S. General Accounting Office, *Airline Competition: Impact of Changing Foreign Investment and Control Limits on U.S. Airlines*, GAO/RCED-93-7 (Washington, D.C.: Dec. 9, 1992).

sought in the bilateral aviation agreement between the United States and the United Kingdom. BA later revised its proposal and invested $300 million, with an option to invest an additional $450 million in the future, and eliminated the governance condition. The alliance never functioned as the two airlines had hoped, according to court motions filed by USAir in 1996, and the BA-USAir alliance ended in 1997.

Changes in the ownership, management, and operations of DHL Airways illustrate that it is sometimes difficult to determine the control of an airline. DHL Airways (now ASTAR Air Cargo) holds a certificate of public convenience and necessity from DOT, and thus was found to meet U.S. citizenship requirements. In the fall of 2000, DHL Airways reported to DOT that it had undergone a substantial change in ownership, involving Deutsche Post, the German postal monopoly. DOT conducted an informal review of its citizenship, as is standard practice, and in May 2002, informed DHL Airways that it met U.S. citizenship requirements. However, Federal Express and United Parcel Service petitioned for a public review, alleging that DHL no longer met the citizenship requirement. DOT initiated a public proceeding to examine the issue.

In April 2003, P.L. 108-11 directed that DOT use an Administrative Law Judge to assist in resolving this issue. The Administrative Law Judge is to issue a recommended decision by December 1, 2003. DOT will then review that decision.

Prior GAO Report Identified Five Key Issues Relating to Changes in Foreign Investment Laws

In 1992, we reported on the potential impact of changing U.S. airline foreign investment and control laws and evaluated DOT's 1991 proposal to allow for increased foreign investment in U.S. airlines.[15] We found that the five key issues identified in the prior report are still relevant today. This proposal, according to DOT officials, was in response to the heavy losses suffered by U.S. airlines in 1990 and 1991, who were hurt by the generally weak economy. The report noted that six large U.S. airlines had declared bankruptcy and three of them had ceased operations. The report concluded that fewer airlines could mean less competition and higher fares. The report addressed five key areas that may be affected by changing ownership and control laws:

[15]U.S. General Accounting Office, *Airline Competition: Impact of Changing Foreign Investment and Control Limits on U.S. Airlines*, GAO/RCED-93-7 (Washington, D.C: December, 1992).

- Domestic competition – Allowing greater potential access to foreign capital could give U.S airlines, particularly those in financial difficulty, additional capital which would allow them to enhance their domestic competitive position.[16]
- National security – U.S airlines, through their voluntary participation in the Civil Reserve Air Fleet (CRAF) program, provide the Department of Defense (DOD) with supplemental airlift capacity in emergencies.[17] DOD was concerned that foreign investors might discourage continued participation in CRAF.
- Employment – Increased foreign investment could put jobs at risk—for example, those of U.S. pilots and crew on international routes; but it could also help stabilize U.S. airline employment by strengthening financially weak airlines.
- Safety - Increased foreign investment could place additional burdens on the Federal Aviation Administration's safety oversight responsibilities if foreign aircraft are transferred to U.S. registry.
- International competition – The impact of increased foreign investment on international competition depends, in part, on existing bilateral aviation agreements. These agreements set the conditions under which U.S. and foreign airlines operate and compete, and can restrict competition by limiting the service that can be offered. There may be opportunities for relaxing operating restrictions in some bilateral agreements in exchange for relaxing restrictions on foreign investment in U.S. airlines. Eligibility to invest in U.S. airlines could be restricted to airlines from nations that allow greater access to their aviation markets or do not subsidize their airlines.

Issues Identified in Prior GAO Report Still Relevant Because Current Aviation Environment Is Similar to 1992

Although 11 years have passed since we reported on the potential effect of changing foreign investment and control limits on U.S. airlines, most of the issues that we identified still appear to be relevant. As in the early 1990s, the U.S. commercial airline industry in 2003 faces a weak economy, relatively high fuel prices, and military action in the Middle East. These conditions, as in the past, have contributed to weak passenger demand, decreased airlines revenues, and some airline bankruptcies. The airlines have likewise used some of the same basic strategies to control operating costs. For example, major airlines responded to the 1992 economic downturn by

[16]The 1992 GAO report (GAO/RCED-93-7) noted that while foreign investment had potential benefits for U.S. airlines, it was not a panacea for preserving domestic competition, because other factors—such as airline control over gates and other facilities at major U.S. airports—also affect airline competition.

[17]Under the CRAF program, U.S. airlines commit and put under contract aircraft and crew for DOD's use during emergencies. The commercial airlines receive no compensation for their participation in the program unless they are activated, but they are given an incentive to participate by being made eligible to bid for DOD's peacetime airlift business and General Services Administration's city pair program. Airlines are paid for missions they fly at predetermined rates based on a weighted average of their costs plus a return on investment.

implementing cost-cutting programs, laying off employees, canceling or delaying aircraft deliveries and refocusing service. These same strategies have been implemented again since 2001 by major airlines. For example, United and American have made huge employee cutbacks, and Continental Airlines announced in July, 2003 that it plans to defer prior orders for additional Boeing planes until the domestic economy recovers. Some airlines also are again expressing interest in acquiring capital through foreign investment. Therefore, general issues identified in our prior report appear to be still relevant to U.S. interests.

- Domestic competition – U.S. airlines have made significant reductions in service, but continue to have more capacity than passenger demand. Airlines are seeking additional capital to provide operating funds to survive the reduced passenger traffic and revenues and avoid bankruptcy. The effect that airline bankruptcies might have on domestic competition is uncertain. Since most U.S. "legacy" airlines' balance sheets are considerably weaker than in 1992, DOT believes that the ability to access international capital markets is even more valuable to the airlines in the current economic environment.[18]

- National security – While DOD has traditionally been concerned about increasing foreign ownership due to the belief that any foreign control of U.S. airlines would negatively affect CRAF, it presently has no official comment on the administration's latest proposal. Questions already exist regarding the effectiveness of DOD's program incentives, and it is unclear if these incentives will be affected by changes in foreign ownership restrictions.

- Employment – The impact of increased foreign investment on employment remains unclear. There are differing views on how changes in foreign investment restrictions could affect employment—would additional investment stimulate domestic aviation, thus domestic aviation employment, or would foreign investment lead to jobs being transferred to foreign workforces? DOT indicated that there is no evidence to suggest that increased foreign investment in U.S. airlines would have any effect on labor. DOT commented that, due to existing collective bargaining agreements and other regulatory requirements governing U.S. airlines and their employees, the administration's proposal would not affect the rights of labor or the obligation of airlines with respect to labor.

- International competition – While bilateral "open skies" agreements between the United State and many EU member states have improved the access, level of integration, and volume of travel across the Atlantic, other aviation agreements, such as the Bermuda II Accord, continue to limit airline integration and efficiencies.[19] As the United States and EU start negotiations

[18]"Legacy" airlines generally refer to major U.S. airlines that operate network service, including both domestic and international operations, such as United, American, and Delta.

[19]The "Bermuda II Accord" is the 1977 agreement between the United Kingdom and the United States that restricts UK and U.S. flights serving London Heathrow Airport to two airlines from each countries.

for a new aviation agreement, one of the primary negotiations points for EU officials will be the relaxing of current U.S. foreign investment and control restrictions.[20] The effect that recent legislative proposals codifying control standards could have is unclear. DOT has stated that since 1992, many U.S. airlines have formed international alliances. These alliances may find mutual investments more desirable, either to sustain a valuable alliance partner experiencing financial difficulties or to solidify commercial relationships.

At this time, we do not believe that the FAA safety workload issue raised in the 1992 report continues to be a significant relevant concern in the current environment. In addition to any legal obstacles to transferring foreign aircraft to U.S. registry, it is not clear what incentives exist that would encourage a foreign investor to do so. U.S. carriers have grounded a significant number of aircraft and have been operating less frequency with existing fleets over the past 2 years as a result of the downturn in demand. Also, even if such a change were to occur, it is unlikely that aircraft would be added in such numbers so as to materially increase FAA's safety oversight responsibilities over and above its current workload.

Scope and Methodology

To address the administration's current proposal and discuss the potential affect on domestic competition, national security, airline employment, airline safety, and international competition, we conducted interviews with key stakeholders and industry experts. This included representatives from DOT, the European Union, various member states, and U.S. airlines. In addition, we reviewed the literature regarding foreign ownership regulations and implications, studied transcripts of speeches by key U.S. government personnel, and reviewed financial regulations and materials. Finally, we examined documents filed with DOT regarding citizenship of airlines.

- - - -

Agency Comments

We provided a draft report with briefing slides to DOT for review and formal comment. DOT provided technical comments, which we have incorporated into this report as appropriate.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from its date. At that time we will send copies to the Secretary of Transportation and other interested parties. We will also send copies to others upon request. In addition, this report will be available at no charge on our Web site at http://www.gao.gov.

---

[20]DOT has noted that any U.S.-EU agreement, which includes provisions on foreign investment would require implementing legislation.

For further information on this report, please contract JayEtta Hecker at (202) 512-2834. Individuals making key contributions to this report included Steve Martin, Emily Pickrell, Tim Schindler, and Matt Zisman.

JayEtta Z. Hecker
Director, Physical Infrastructure Issues

Enclosure

Enclosure I

Commercial Aviation

Issues Relating to Foreign Investment and Control of U.S. Airlines

Briefing for the Subcommittee on Aviation

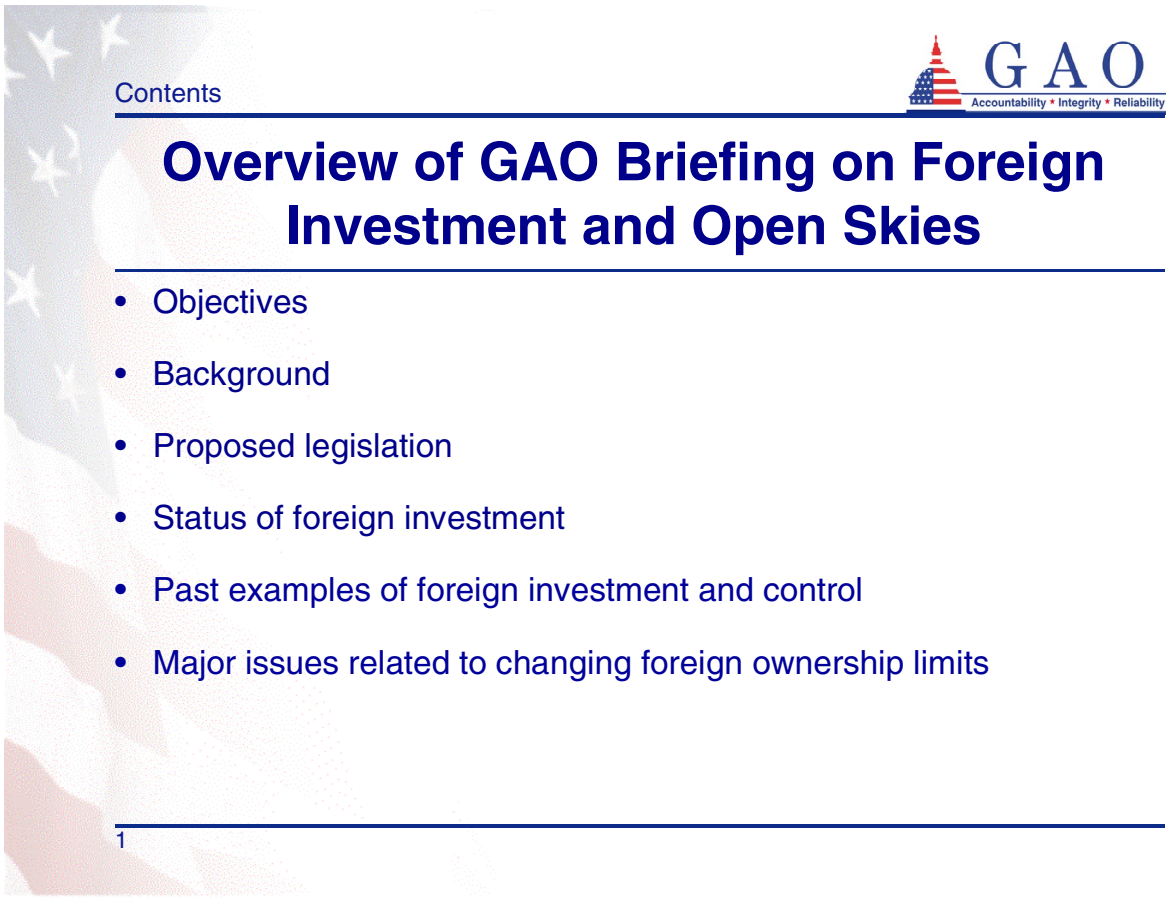
Committee on Commerce, Science and Transportation

U.S. Senate

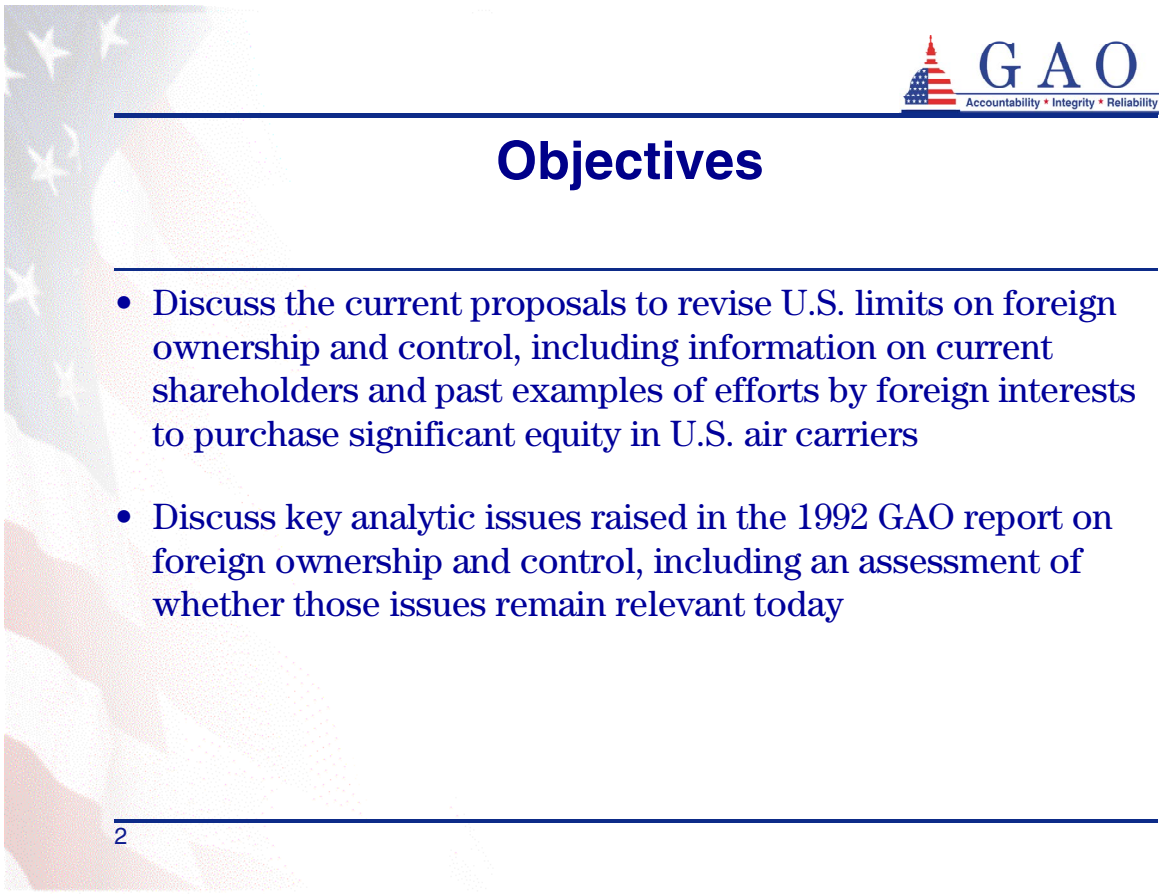
U.S. General Accounting Office

June 25, 2003

Enclosure I


Contents
GAO
Accountability * Integrity * Reliability
Overview of GAO Briefing on Foreign Investment and Open Skies
• Objectives
• Background
• Proposed legislation
• Status of foreign investment
• Past examples of foreign investment and control
• Major issues related to changing foreign ownership limits
1

Enclosure I


GAO
Accountability • Integrity • Reliability
Objectives
• Discuss the current proposals to revise U.S. limits on foreign ownership and control, including information on current shareholders and past examples of efforts by foreign interests to purchase significant equity in U.S. air carriers
• Discuss key analytic issues raised in the 1992 GAO report on foreign ownership and control, including an assessment of whether those issues remain relevant today
2

GAO
Accountability * Integrity * Reliability

Background

- Air Commerce Act of 1926 required U.S. citizens own at least 51 percent of any individual aircraft in order for it to be registered in the United States.
- The Civil Aeronautics Act of 1938 provided that U.S. citizens own or control 75 percent of the voting stock of U.S. airlines.
  - This requirement remains in place today.

3

Background

GAO
Accountability * Integrity * Reliability

Definition of U.S. Aviation Citizenship

- To fly in the United States as a U.S. airline, an airline must meet aviation "citizenship" criteria.
- "Citizen of the United States" is defined as,
  - an individual who is a citizen of the United States,
  - a partnership whose members are U.S. citizens, or
  - a corporation or association in which at least 75 percent of the voting interest is owned or **controlled** by persons that are citizens of the United States (49 U.S.C. 40102(a)(15)(C)).

4

Background

GAO
Accountability * Integrity * Reliability

U.S. Airline Citizenship Requirements

- Department of Transportation (DOT) has interpreted control to mean day-to-day management decisions made by U.S. citizens, even with substantial foreign investment in the airline.
- DOT evaluates actual control on a case-by-case basis.
- Factors used include,
  - the quality and design of any significant contracts;
  - voting rights (whether there are disproportionate voting rights, power to veto and buy-out clauses); and
  - any debt-instrument clauses or agreements.

5

Background

GAO
Accountability * Integrity * Reliability

Prior Attempts to Change Ownership Laws

- In 1991, the Secretary of Transportation proposed changing foreign investment limitations to 49 percent.
  - The proposal responded to heavy financial losses by the airlines in 1990 and 1991.
  - DOT believed that its past experiences with U.S. airlines and their foreign investors would allow it to structure foreign investment to retain U.S. control.
- Congress did not adopt the proposal.

6

Enclosure I

GAO
Accountability * Integrity * Reliability

Administration's Proposal

- The administration has proposed legislation that would relax restrictions on foreign-owned voting stock of U.S airlines.
  - Maximum percentage of voting stock that could be foreign-owned would increase from 25 to 49 percent.
  - No change to policy that U.S. airline be controlled by U.S. citizens.
- This legislation mirrors DOT's 1991 proposal.

Enclosure I

GAO
Accountability * Integrity * Reliability

DOT Rationale for Proposal

- According to DOT, significant benefits arise from increasing limit to 49 percent, including,
  - allowing U.S. airlines greater access to global capital;
  - encouraging U.S. airlines to develop more efficient, market-driven networks;
  - creating opportunities for airlines to enter into new markets; and
  - consistency with the European Union (EU) and other bilateral partner's foreign investment restrictions.

8

Enclosure I

Proposed Legislation

GAO
Accountability * Integrity * Reliability

Congressional Action on Foreign Control Restrictions

- House and Senate conference agreement on Federal Aviation Administration (FAA) reauthorization bill addresses the issue of "control."
  - H.R. 2115, Section 807, would change 49 U.S.C. 40102(a)(15)(C) to define carrier citizenship as: "… *which is under the actual control of citizens of the United States."*
- This language codifies the existing practice that airlines be under the control of U.S. citizens.

9

Enclosure I


Proposed Legislation
GAO
Accountability * Integrity * Reliability
Stakeholder Positions on Foreign Investment and Control Restrictions
• Several key stakeholders in the aviation industry support increases in foreign investment limits:
• major U.S. network carriers,
• The International Civil Aviation Organization, and
• The International Air Transport Association.
• Some labor groups do not support relaxing current foreign investment restrictions.
10

Enclosure I

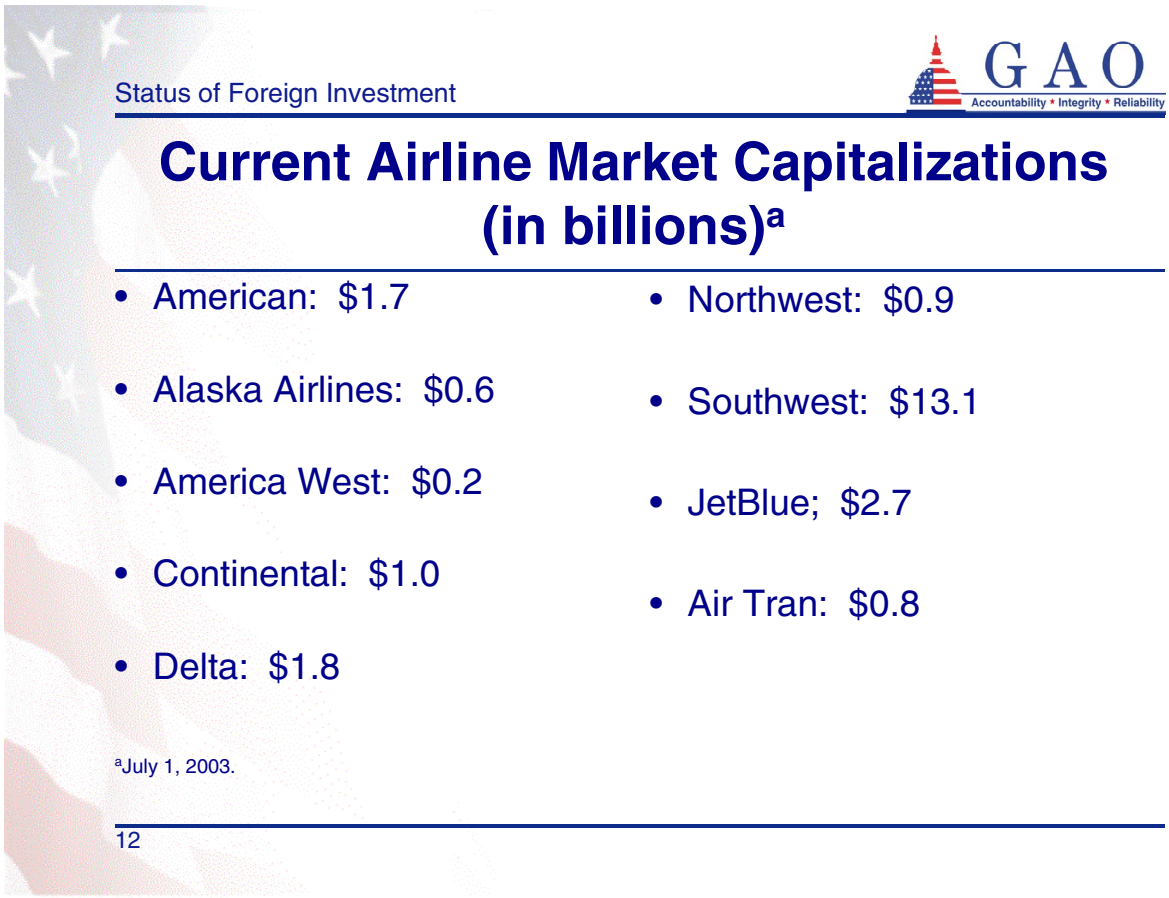
GAO
Accountability * Integrity * Reliability

Current Airline Stock Major Owners

Carrier	Largest holder (%)[a]	Total holders above 5% share	
		U.S.	Foreign
American	Lord Abbett (18.3%)	3	0
Continental	Axa Financial (12.6%)	3	1
Delta	Primecap Management (12.5%)	3	0
Northwest	Axa Financial (17.8%)	5	1

[a] Lord Abbett and Primecap Management are U.S. companies; Axa Financial is the U.S. subsidiary of a French-based conglomerate.

Enclosure I


Status of Foreign Investment
GAO
Accountability * Integrity * Reliability
Current Airline Market Capitalizations (in billions)a
American: $1.7
Alaska Airlines: $0.6
America West: $0.2
Continental: $1.0
Delta: $1.8
Northwest: $0.9
Southwest: $13.1
JetBlue; $2.7
Air Tran: $0.8
aJuly 1, 2003.
12

Past Examples

GAO
Accountability * Integrity * Reliability

Determining Ownership and Control: KLM and NW

- In 1989, KLM Royal Dutch Airlines (KLM) attempted to purchase significant equity in Northwest Airlines (NW) through a KLM-owned company (Wings Acquisition, Inc.).
- Original proposal provided KLM with significant governance over NW.
- DOT reviewed proposal and ordered modifications, and added conditions to ensure NW would remain in control of U.S. citizens.
- In 1997, KLM ultimately disinvested in NW and instead focused on a stronger international code-share alliance.

13

Past Examples

GAO
Accountability * Integrity * Reliability

Determining Ownership and Control: British Airways and USAir

- In 1992, British Airways (BA) proposed investing $750 million (44 percent total equity) in USAir.
- BA investment included purchasing 21 percent of USAir's voting stock and representation on USAir's board.
- DOT initiated a review of the proposal. BA withdrew its proposal before DOT issued a formal decision, in part because of changes being sought in the bilateral aviation agreement between the United States and the United Kingdom.
- BA revised proposal invested $300 million while the governance requests were dropped.
- The alliance never functioned as planned and ended in1997.

14

Enclosure I

Past Examples

GAO
Accountability * Integrity * Reliability

Defining U.S. Citizenship: DHL Airways

- In the fall of 2000, DHL Airways (now ASTAR Air Cargo) reported to DOT a substantial change in ownership.
- These changes involved Deutsche Post, the German postal monopoly.
- DOT conducted an informal review of DHL Airways' citizenship and in May 2002 determined it met U.S. citizenship requirements.
- Federal Express and United Parcel Service petitioned for public review, alleging that DHL no longer met the citizenship requirement.
- In April 2003, Public Law 108-11 directed DOT to use an administrative law judge to resolve this issue.
- An administrative law judge is to issue a decision by December 2003, which DOT will review.

15

GAO
Accountability * Integrity * Reliability

Most Major Issues Identified in 1992 GAO Report Remain Relevant

- The aviation industry suffered heavy financial losses in 1990 and 1991 due to a weak economy.
- In response to these conditions, DOT proposed in 1991 to increased the foreign investment restrictions from 25 to 49 percent.
- In 1992, GAO reported on the implications of changing U.S. airline foreign investment restrictions.
- This report identified five major issue areas,
  - domestic competition,
  - national security,
  - employment,
  - airline safety oversight, and
  - international competition.

16

GAO
Accountability * Integrity * Reliability

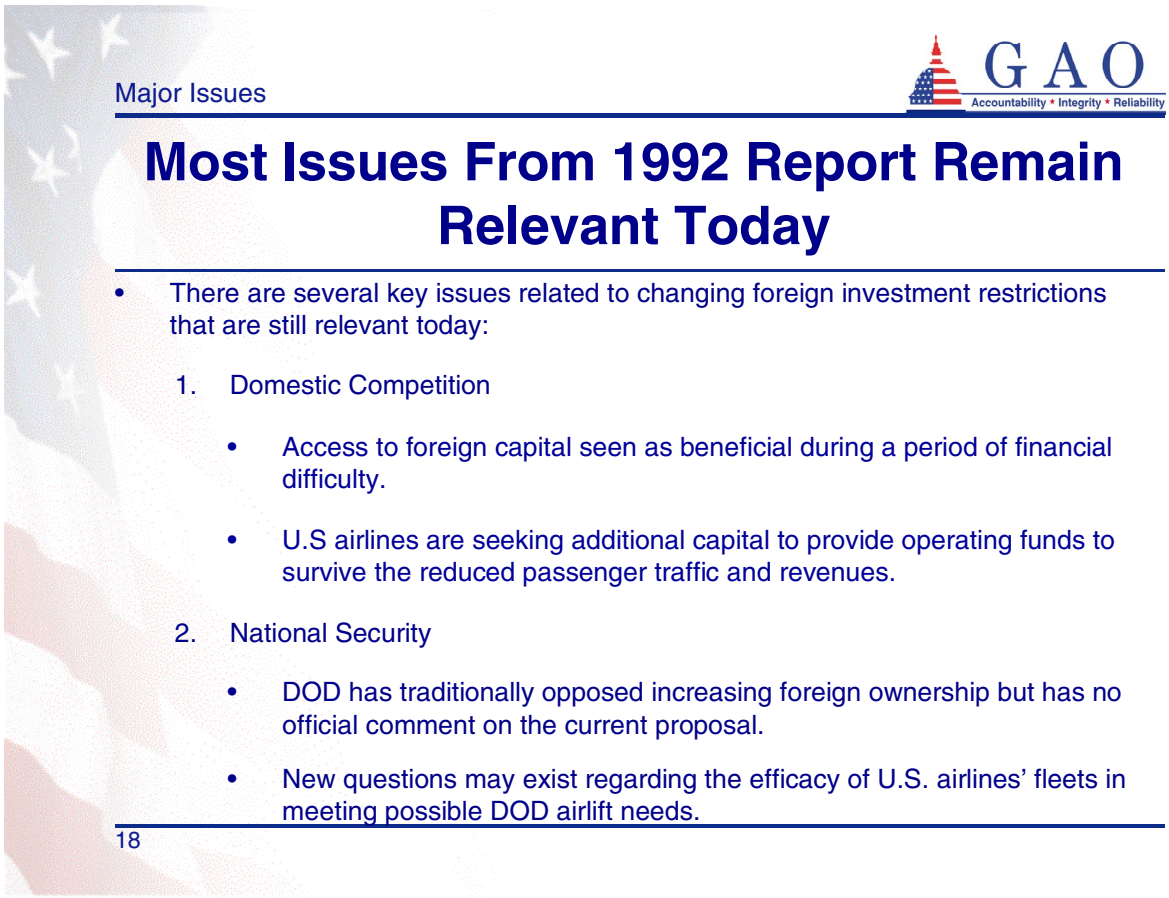
Relevance of Issues Identified in 1992 Report Related to Economic Conditions

- Relevance today of issues identified in 1992 report depends on similarities in economic environment.

	1990-1992	2001-2002
Industry profit(loss) – In 2002 constant dollars	($13.2 billion)	($19.7 billion)
Number of airline bankruptcies	27	6
Jobs losses at majors airlines	19,000 (3.6%)	86,000 (14.7%)

17

Enclosure I


Major Issues
GAO
Accountability * Integrity * Reliability
Most Issues From 1992 Report Remain Relevant Today
• There are several key issues related to changing foreign investment restrictions that are still relevant today:
1. Domestic Competition
• Access to foreign capital seen as beneficial during a period of financial difficulty.
• U.S airlines are seeking additional capital to provide operating funds to survive the reduced passenger traffic and revenues.
2. National Security
• DOD has traditionally opposed increasing foreign ownership but has no official comment on the current proposal.
• New questions may exist regarding the efficacy of U.S. airlines' fleets in meeting possible DOD airlift needs.
18

GAO
Accountability * Integrity * Reliability

Most Issues From 1992 Report Remain Relevant Today (cont'd)

3. Employment
   - There are questions whether changes in foreign investment restrictions would stimulate domestic aviation, thus domestic aviation employment, or lead to jobs being transferred to foreign workforces .
4. International Competition
   - As the United States and European Union (EU) start negotiations for a new aviation agreement, one of the primary negotiations points for EU officials will be the relaxing of current U.S. foreign investment and control restrictions.
   - The effect that recent legislative proposals codifying control standards could have is unclear.

19

GAO's Mission

The General Accounting Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through the Internet. GAO's Web site (www.gao.gov) contains abstracts and full-text files of current reports and testimony and an expanding archive of older products. The Web site features a search engine to help you locate documents using key words and phrases. You can print these documents in their entirety, including charts and other graphics.

Each day, GAO issues a list of newly released reports, testimony, and correspondence. GAO posts this list, known as "Today's Reports," on its Web site daily. The list contains links to the full-text document files. To have GAO e-mail this list to you every afternoon, go to www.gao.gov and select "Subscribe to e-mail alerts" under the "Order GAO Products" heading.

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are $2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. General Accounting Office
441 G Street NW, Room LM
Washington, D.C. 20548

To order by Phone:	Voice:	(202) 512-6000
	TDD:	(202) 512-2537
	Fax:	(202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm
E-mail: fraudnet@gao.gov
Automated answering system: (800) 424-5454 or (202) 512-7470

Public Affairs

Jeff Nelligan, Managing Director, NelliganJ@gao.gov (202) 512-4800
U.S. General Accounting Office, 441 G Street NW, Room 7149
Washington, D.C. 20548