



**U.S. Department of  
Transportation**

Office of the Secretary  
of Transportation

The Inspector General

Office of Inspector General  
Washington, D.C. 20590

March 4, 2003

The Honorable Don Young  
United States House of Representatives  
Chairman, House Transportation and  
Infrastructure Committee  
Washington, DC 20510

Dear Mr. Chairman:

In response to your request, we examined how the Department of Transportation (“Department” or “DOT”) makes determinations of an air carrier’s citizenship following a substantial change in ownership, management, or operations. We specifically evaluated the informal process the Department used in reviewing DHL Airways’ citizenship after the recent change in its ownership, as well as the rationale the Department employed in finding that DHL Airways is a United States citizen.

This document includes confidential business information as defined in 18 U.S.C. § 1905 and is for your official use only. We are also providing you with a redacted version that contains no confidential business information and may be used for general release.

When reviewing changes in air carrier ownership, the Department typically uses an informal proceeding based on 14 C.F.R. § 204.5. Under this regulation, an air carrier must disclose information concerning a substantial change in ownership, management, or operations to the Assistant Secretary for Aviation and International Affairs (“Assistant Secretary”). DHL Airways provided the Department such notice in the fall of 2000. After conducting its informal review, the Department concluded that DHL Airways met the requirements for U.S. citizenship. Following the Department’s decision and after we had begun our review, the Department opened a consolidated formal docket based on petitions filed by Federal Express (“FedEx”) and United Parcel Service (“UPS”) contesting DHL Airways’ U.S. citizenship. This docket is currently pending.

After an extensive examination of the Department's informal review, we identified a number of issues the Department should address within the formal docket proceeding. We provided our observations to the Department in advance of this response to you so that it could have the benefit of our views before disposition of the consolidated docket. We understand that the Department is considering several options to address the issues we have raised.

I want to make clear that our views on the informal and formal processes used by the Department and the issues we have identified should not be interpreted to presuppose a particular outcome. It is the Department's role to decide these matters and we defer entirely to the Department in that regard.

### **BACKGROUND**

The Department's review was initiated in the fall of 2000 when DHL Airways disclosed a substantial change in ownership, management, and operations to the Assistant Secretary as required by law.<sup>1</sup> While the Department's informal review of this reorganization was in progress, the Department denied requests for formal proceedings from FedEx and UPS that contested DHL Airways' U.S. citizenship. In May 2002, based on that review, the Assistant General Counsel ("AGC") for International Law informed DHL Airways that it met U.S. citizenship requirements.<sup>2</sup> Subsequently, the Secretary and the Assistant Secretary advised members of Congress of the results of the Department's informal review.<sup>3</sup> Following the Department's decision and after your request, the Department opened the consolidated formal docket that is currently pending based on petitions filed by FedEx and UPS.

Under U.S. law no entity may provide air transportation between points within the United States without possessing a certificate of public convenience and necessity ("certificate") issued by DOT. A prerequisite for a certificate is U.S. citizenship. There are three statutory requirements governing corporation citizenship. The company must:

- Be incorporated in the United States

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<sup>1</sup> 14 C.F.R. § 204.5(c).

<sup>2</sup> Letter from Assistant General Counsel for International Law Donald Horn to DHL Airways, dated May 7, 2002.

<sup>3</sup> Letter from Secretary Norman Mineta to Senator Ernest Hollings, dated September 25, 2002; Letter from Assistant Secretary Read Van de Water to Senator John D. Rockefeller IV, dated May 7, 2002.

- Have a president and two-thirds of the board of directors who are U.S. citizens and
- Ensure that no less than 75% of its voting stock is owned by U.S. citizens.

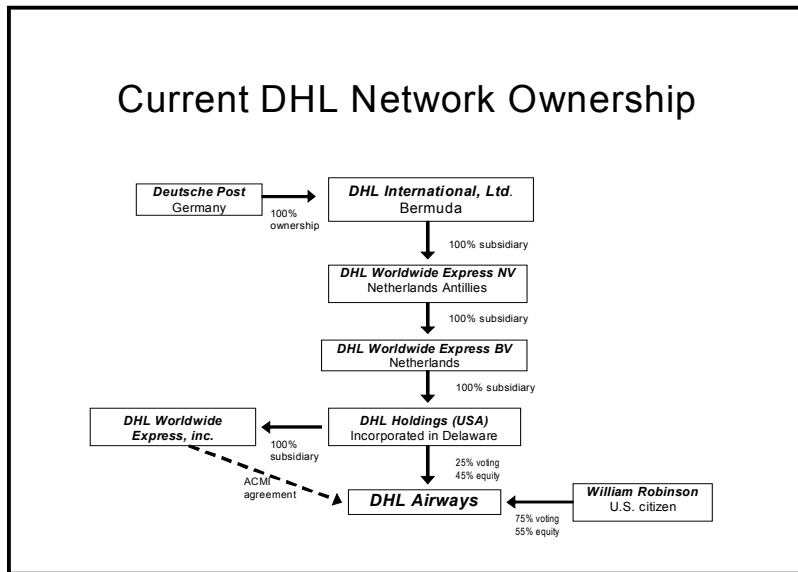
There is little or no dispute that DHL Airways currently meets these three prerequisites. However, the Department, and the Civil Aeronautics Board (“CAB”) before it, quite correctly, have interpreted these requirements to mean that U.S. citizens be in control of a carrier, both in form and in fact. To this end, the Department looks at the totality of the circumstances to determine whether the carrier is, in fact, under the “actual control” of U.S. citizens.<sup>4</sup> There are seven factors that have recurred frequently in past orders of the Department addressing the issue of actual control. These factors, while known to Department and aviation attorneys, have not been delineated in any one public document. Good public policy would suggest that the Department address these and other factors in a document that is widely available.

In order to better understand the concerns raised over DHL Airways, it is important to understand the DHL reorganization. This reorganization occurred as the result of the acquisition of the global DHL network by Deutsche Post, the German postal monopoly owned, in part, by the German government.

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<sup>4</sup> See, e.g., Acquisition of Northwest Airlines by Wings Holdings, Docket 46371, Orders 89-9-51, 91-1-41; Wrangler Aviation, Inc., Dockets 47291 and 47389, Order 91-15-51.

The chart below depicts the current structure of the DHL network and the relationship between DHL Airways and Deutsche Post's subsidiaries which comprise the DHL organization:



Prior to September 2000, the DHL network was divided into two groups of companies. One was controlled by DHL International Ltd., a Bermuda corporation, which was responsible for operations outside the United States. The other was controlled by DHL Worldwide Express, Inc., which conducted operations in the U.S. DHL Worldwide Express, Inc. owned DHL Airways, which, as a DOT-certificated air carrier, was considered a U.S. citizen.

In 2000, Deutsche Post increased its equity holdings in DHL International to 51% and acquired all remaining equity in December 2002. Concurrently, a foreign DHL International subsidiary bought out all the other shareholders in DHL Worldwide Express, Inc. Among these shareholders was William Robinson ("Mr. Robinson"), a U.S. citizen who owned 25% of the equity [43% of voting stock] in DHL Worldwide Express, Inc. and served as a director. He also owned approximately 4.7% of DHL International stock before Deutsche Post acquired 100% of its stock.

Because foreign DHL companies purchased DHL Worldwide Express, Inc. (renamed “DHL Holdings (USA)”), DHL Airways needed to be sold to U.S. citizens in order to maintain its certificate requirements. Accordingly, DHL Holdings (USA), a foreign-owned subsidiary in the global DHL network, sold 55% of the equity and 75% of the voting stock in DHL Airways to Mr. Robinson.

#### **FORMAL AND INFORMAL PROCESSES FOR CITIZENSHIP DETERMINATIONS**

The Department uses a formal process to determine the citizenship of carriers applying for an initial certificate, which includes opportunities for third-party comments, open dockets, and review of the carrier’s application and supporting documentation. Once a carrier has been granted a certificate, the Department may periodically conduct a “fitness review” to ensure that it is in compliance with DOT certificate requirements, such as citizenship. Typically, a carrier undergoing a substantial change in ownership, management, or operation undergoes a fitness review. In these circumstances, the Department and the CAB have used an informal process to determine continued U.S. citizenship. It is this type of process that the Department utilized between 2000 and 2002 with respect to DHL Airways.

The informal process used for citizenship reviews can be beneficial when the issues are not complex or contentious by providing for open dialogue between the Department and carriers to resolve matters expeditiously. However, the informal process is not as transparent as the Department’s formal process and, therefore, it is not well-suited for matters that are complex or that have become contentious and controversial. One reason is that interested parties are not provided with notice, opportunity to comment, or access to confidential documents, and there is no process for verifying the carriers’ representations, either in the form of sworn or certified statements.

The informal process was not well-suited to this case. As it evolved, it became clear that it was complex, contentious, and controversial. After we initiated our review, the Department shifted to a more formal process by accepting FedEx and UPS petitions and opening a formal docket. While the current proceeding provides notice, comment, and responsive pleadings, it does not have certain other attributes customarily associated with a formal process, namely, access to confidential documents, similar to that provided in the Delta, Northwest, Continental code-share and frequent-flyer program reciprocity proceeding (“*Alliance Carriers*”), and verification, either in the form of certification or sworn statements.

The protection of confidential business information is one of the reasons cited by the Department for conducting citizenship reviews informally. However, the Department does have alternative tools that protect confidential information while permitting meaningful third-party access. For instance, in the *Alliance Carriers* review, the Department made confidential documents available to interested parties under “Rule 12,”<sup>5</sup> which allows third-party representatives to view such documents, provided that they sign affidavits promising to keep the contents confidential. Use of such a mechanism could help make the citizenship review process more transparent and serve to narrow factual disputes.

For the future, we believe the Department should give consideration to a more transparent and formal process in complex or contentious cases. To that end, the Department’s procedures would have to be modified to provide public notice of the initiation and completion of citizenship reviews; create dockets for third-party comments; provide third-party access to confidential documents, similar to those used in the *Alliance Carriers* review; and obtain sworn or certified statements.

It is in the best interests of the Department that its ultimate decision be perceived as impartial and objective. In this regard, options available to the Department include formal interrogatories under oath, public proceedings where confidential documents are available to third parties under Rule 12, or use of an administrative law judge (“ALJ”) to conduct fact-finding on significant matters in dispute. Under the Administrative Procedure Act and Departmental regulations,<sup>6</sup> utilization of an ALJ does not impinge on the ultimate decision-making authority of the Assistant Secretary.

#### **FACTORS FOR DETERMINING ACTUAL CONTROL OF AN AIR CARRIER**

Our review focused on the issues implicated by the documents examined by the Department during the informal process as well as the parties’ pleadings in the formal process.

As stated above, under U.S. law no entity may provide air transportation between points within the United States without possessing a certificate, a prerequisite to which is U.S. citizenship. There is little or no dispute that DHL Airways currently meets these three prerequisites. The issue is whether DHL Airways is under the “actual control” of U.S. citizens consistent with factors traditionally applied by the Department.

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<sup>5</sup> 14 C.F.R. § 302.12.

<sup>6</sup> 5 U.S.C. 551 *et seq.*; 14 C.F.R. Part 302.

In this context, we see two fundamental questions: 1) whether the contractual agreements Deutsche Post has with DHL Airways, either standing alone or in their cumulative effect, are so pervasive that they give Deutsche Post “actual control” over DHL Airways; and 2) whether Mr. Robinson’s stock transactions, as detailed below, were accompanied by other agreements, oral or written, express or implied, between Mr. Robinson and Deutsche Post or its DHL subsidiaries that bear on the matter of “actual control.”

As we understand it, various agreements have defined the relationship between DHL Airways and Deutsche Post and its subsidiaries in the DHL network since the change in ownership. These included the Aircraft, Crew, Maintenance, and Insurance (“ACMI”) agreement as well as the provision of credit. Based on the pleadings filed by the parties, we believe it would be responsive to all concerned for the Department’s fact-finding and ultimate order to explicitly address these agreements in terms of: 1) what they require of DHL Airways; 2) what they require of Deutsche Post and its wholly-owned DHL subsidiaries; and 3) the control or influence the agreements effectively give Deutsche Post over the governance and operations of DHL Airways. The Department will then be in a position to exercise its judgment as to how these factors bear on the issue of whether or not DHL Airways is under the “actual control” of U.S. citizens.

In addition to examining these written agreements involving DHL Airways and the DHL network, there is also a related matter involving Mr. Robinson that is integral to the Department’s review of this case. That is, whether Mr. Robinson, who holds 55% of the equity and 75% of the voting stock in DHL Airways, has entered into agreements or understandings, in addition to those enumerated above, express or implied, orally or in writing, that bear on the matter of “actual control.” Mr. Robinson is a U.S. citizen who owned 43% of the voting stock in DHL Worldwide Express, Inc. and 25% of its equity before it was bought out by Deutsche Post. He also had owned about 4.7% of DHL International stock before being bought out by Deutsche Post.

### **OBSERVATIONS ON THE INDICIA OF ACTUAL CONTROL**

Based on our review of the Department's precedent, seven of the most commonly cited factors used to determine actual control of an air carrier are listed below. In our examination of the documents submitted in the course of the informal and formal proceedings, three factors bearing on actual control have not been specifically cited by the parties. They are:

- *Control via Super-Majority or Disproportionate Voting Rights* – minority foreign owners may not have disproportionate influence with their voting rights.
- *Negative Control/Power to Veto* – minority foreign owners cannot possess veto rights over major corporate decisions.
- *Buy-Out Clauses* – a foreign entity may not be entitled to exercise buy-out clauses that, if exercised, would jeopardize the air carrier's financial or operational ability to continue in business.

We have also identified four factors bearing on actual control that do appear to be in dispute. These are:

- *Equity Ownership* – the maximum total foreign-equity ownership of an air carrier typically permitted by the Department may be up to 49%.

There are allegations in the formal proceedings that a subsidiary of Deutsche Post owned 52% of DHL Airways at some point before the reorganization, albeit it currently holds 45%. We recommend that the Department address whether this allegation is true and, if so, whether it has any legal significance in light of the current holding of 45%.

- *Significant Contracts* – contracts with foreign entities may not be used to control the U.S. air carrier.

As stated above, DHL Airways and DHL Holdings (USA), a foreign-owned subsidiary in the global DHL network which owns 45% of the equity in DHL Airways, are parties to an ACMI agreement. Under the ACMI, DHL Airways performs air transportation services for the DHL network in the United States. The agreement provides that "the primary use" of DHL Airways



aircraft leased to DHL Holdings (USA) is to serve DHL Holdings (USA). Moreover, third-party business by DHL Airways using aircraft leased to DHL Holdings (USA) may not interfere with its obligations to the DHL network, and some profits resulting from third-party business on those aircraft are split equally between DHL Airways and DHL Holdings (USA). In turn, DHL Holdings (USA) reimburses DHL Airways for many of its operational costs for those aircraft which it leases, such as those associated with: leasing and financing of aircraft; cockpit crews and compensation for officers and employees; maintenance and repairs; taxes on property, gross receipts, and gross income; insurance; fuel; regulatory compliance; airport fees; over-fly permits; and fines.

Over 90% of DHL Airways' business derives from the DHL foreign network under the ACMI. During its review, DOT was concerned over DHL Airways' reliance on this contract and recommended that DHL Airways hire a marketing executive to increase third-party revenue. DHL Airways did subsequently hire a marketing executive, but, to the best of our knowledge, it has not materially increased third-party revenues.

The parties to this dispute have alleged that the ACMI bears directly on the actual control of DHL Airways. Conversely, DHL Airways contends the ACMI is standard practice in the industry and has no bearing on actual control. It seems to us that the only way to resolve this issue is for the Department to determine the facts of the ACMI, apply them to the decisional criteria, and then determine what, if any, legal significance they have to the question of actual control of DHL Airways.

- *Credit Agreement/Debt* – debt-instrument clauses or bankruptcy agreements cannot allow a foreign entity to control the air carrier.

DHL International guaranteed to banks that DHL Holdings (USA) would make payments to DHL Airways under the ACMI so that DHL Airways could obtain loans and a \$60-million line of credit. DHL Airways portrayed these guarantees as “no more than additional contractual support by one non-citizen entity of the contractual obligation of another non-citizen entity by a parent corporate entity to the financial institution funding the credit facility.” The Department should determine the facts and circumstances surrounding these guarantees and whether, as applied to the indicia of control factors, they carry any legal significance.

- *Family Relationships/Business Relationships* – a foreign citizen may not exert control over an air carrier through a U.S. citizen family member or business associate.

Mr. Robinson is the pivotal American figure in DHL Airways. As the majority shareholder, Mr. Robinson appoints three of the four members of its board of directors. The Chairman of the Board is his personal attorney, another Member of the Board is the Chairman's brother and Mr. Robinson's personal financial advisor, and the third Robinson-appointed Board Member is the Chief Executive Officer of DHL Airways.

It is important to keep in mind that DHL Airways had to remain a U.S. citizen in order to maintain its certificate entitling it to provide point-to-point service within the United States. To that end, DHL Worldwide Express, Inc. sold 55% of the equity and 75% of the voting stock in DHL Airways to Mr. Robinson, who was then a DHL Worldwide Express, Inc. director and major shareholder. Between the time of Deutsche Post's acquisition of 51% of DHL International and its acquisition of the remaining 49%, Mr. Robinson sold his interests in DHL Worldwide Express, Inc. to a Deutsche Post-controlled subsidiary. As a result of these transactions, he made a net profit of \$26 million.

Mr. Robinson also owned 4.753% of the equity in DHL International, which Deutsche Post may have acquired either directly or indirectly. However, the documents submitted to the Department do not disclose the circumstances surrounding this sale, and, to the best of our knowledge, this issue has not been explored by the Department.

In this context, the key issue is whether or not the facts and circumstances surrounding Mr. Robinson's stock transactions and subsequent ownership of DHL Airways involve oral or written obligations, express or implied, that govern the relationship between DHL Airways and Deutsche Post. Mr. Robinson's independence from the DHL network has been raised by the parties as a central issue in this proceeding. The stock purchase agreements were reduced to writing and reviewed by the Department during the course of its informal review. In our view, it is important to verify whether these agreements carried with them other implicit or explicit, oral or written, obligations on either party that bear on the question of actual control and, if so, that they undergo the same scrutiny as have the other agreements in this case.

We were pleased to be of assistance in this matter. If you have any questions or are in need of further assistance, please do not hesitate to contact me at (202) 366-1959, or my Deputy, Todd Zinser, at (202) 366-6767.

Sincerely,

A handwritten signature in black ink, appearing to read "Kenneth M. Mead". The signature is written in a cursive style with a large initial "K".

Kenneth M. Mead  
Inspector General

Enclosure