ESTABLISHMENT OF AIR TRANSPORT UNDERTAKINGS –

TOWARDS A MORE HOLISTIC APPROACH

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Synopsis

This contribution to the Airneth Conference is designed to introduce a more holistic approach to the question pertaining to the establishment of air transport undertakings by the formulation of new criteria for the link between an airline and "its" state. Traditionally that link is determined by ownership and control standards. However, a new condition is emerging, namely, that of *principal place of business*. Attention will be paid to the meaning of the term "principal place of business" by referring to legal instruments in which it is used. It is found that the term can be interpreted in various manners as not only international air law determines its contents. As a corollary, the term "establishment' will be analysed. Since the *Open Skies* decisions of the European Court of Justice of 2002, this term is used but has yet to be reconciled with the existing aviation law regime.

The interpretation of these terms is not only an academic exercise. Airlines may be able to choose their hubs in relation to the meaning of their principal place of business, and exercise traffic rights from there. The same is true for the interpretation of the term establishment.

Since airlines generate about 80% of their revenues from the operation of traffic rights and the choice for the criteria for the determination of the term 'principal place of business' affects the position of airports as hubs under a modernised air law regime, this examination appears to have practical relevance for the conduct of a future air transport policy.

This article subsequently addresses:

(1) Principal place of business of undertakings generally
(2) The meaning of the term 'principal place of business' under international air law
(3) Establishment of air carriers
(4) Case studies on establishment
(5) Conclusions

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(1) Principal place of business generally

The theme addressed in this brief survey is a topical one. World wide undertakings such as Procter & Gamble, Colgate Palmolive, Gillette, Google, Ralph Lauren and L'Oreal are moving their 'principal places of business' to cantons in Switzerland, namely, Obwalden and Schwyz offering very attractive company tax regimes ranging from 13.1 % to 15.6 % respectively. The same tax in Germany amounts to 38.3 %.

Apart from the 'tax factor', the nationality of undertakings outside the air transport sector is not so relevant. Undertakings choose their establishments in relation to the availability of infrastructure and work force. From this point of view, the air transport sector is different.

For reasons which will be explained below, similar moves are not, at least not yet, feasible in the air transport sector. True, American Airlines considers itself for tax reasons a 'Delaware company' but its principal place of business – defined as the place where the main hub and the headquarters are located – is Dallas Forth Worth. From a management structure point of view, the principal place of business of the holding Air France/KLM can be said to be located in both Paris and Amsterdam, as the management of the holding gets together in these two places. There can be no doubt that the principal place of business of the *operating* company, KLM NV, is Amstelveen, The Netherlands – as to which see below.

The legal relevance of the choice of the principal place of business in international civil aviation is not dictated by tax motives. Under Community law, the state of the principal place of business licenses the airline, that is the Community air carrier, is responsible for issuing a license – but not necessarily designates the air carrier in question for the operation of international air services under bilateral air services agreements.[1] Will Lufthansa in years yet to come be tempted to move its principal place of business to Vaduz, Lichtenstein while keeping Frankfurt as its main hub? The following sections will examine to what extent such a decision is, or is not yet, possible under current aviation regimes.

[1] As to which see the following section

(2) The term 'principal place of business' under current international air law

The Chicago Convention of 1944

There is sometimes confusion about the origin of the traditional criteria which international air law imposes upon the nationality of an airline. Those criteria are designed to establish a link between the airline and a state so that the state in question can designate the airline under bilateral air services agreements for the purpose of exercising traffic rights. That state is then responsible for the operation of the designated airline.

Those traditional criteria encompass "substantial ownership and effective control" as laid down in bilateral air services agreements[2] rather than in the Chicago Convention – a much debated subject in air law publications. It does not make sense to even summarise the myriad of publications which have been made on the subject.[3] Suffice it to say that those criteria still play an important role in international aviation relations as to which see the choice for the corporate structure of the Air France/KLM merger as discussed below under (4).

The above mentioned confusion stems from the idea that the Chicago Convention of 1944 on international civil aviation forms the source of the traditional nationality criteria pertaining to substantial ownership and effective control. That is not true. The Chicago Convention merely proceeds from the fact that there is or should be a link between an airline and a state as its provisions refer to the notion 'airline of a state'[4] – however that link between airline

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[2] A typical clause reads as follows: "Each contracting party reserves the right to withhold, revoke or suspend, or impose conditions as it may deem necessary with respect to the operating permission of the designated airline, *in any case where it is not satisfied that substantial ownership and effective control of that airline are vested in nationals of the other contracting party*." (italics added)

[3] See for instance, See, Allan I. Mendelsohn, *Myths of International Aviation*, 68(3) Journal of Air Law and Commerce 519-535 (2003); Peter P.C. Haanappel, *Airline Ownership and Control, and Some Related Matters*, XXVI AIR and Space Law 90-104 (2001); Bin Cheng, *The Law of International Air Transport* 375-379 (1962); Martin Staniland, *The vanishing national airline*? European Business Journal 71-77 (1998); David T. Arlington, *Liberalization of restrictions on foreign ownership in U.S. carriers*: *the United States must take the first step in aviation globalization*, 59 Journal of Air Law and Commerce 133-181 (1993); H.A. Wassenbergh, *Principles and Practices in Air Transport Regulation* 158 (1992)

[4] See, for instance, Article 81 *Registration of existing agreements*

"All aeronautical agreements which are in existence on the coming into force of this Convention, and which are between a contracting State and any other State or between *an airline of a contracting State* and any other State or the *airline of any other State*, shall be forthwith registered with the Council."(*italics added*); but see also Article 7(2) on cabotage.

and state is made. Criteria such as ownership, control, and principal place of business are the most prominent candidates for establishing the link between an airline and "its" state.

However, the word "of" indicates that an airline must somehow belong to a state. In the period following the establishment of the Chicago Convention, there could be hardly any doubt as to the link between a state and "its" airline: Air France belonged to France, Air India to India, and British Airways to the UK and KLM to Holland.

If the Chicago Convention stipulates a criterion for the link between airline and state, the 'principal place of business' is the most obvious candidate as it is the only one which is mentioned in this convention.[5] Several other air law conventions are doing the same, and so are certain bilateral air agreements.

Bilateral air services agreements

Generally speaking, bilateral air services agreements contain the 'traditional' "substantial ownership and effective control" clause. The relevance of international policy considerations regarding nationality of airlines stems from the existence of nationality clauses embodied in bilateral air agreements. In short, governments designate flag carriers under bilateral air services agreements, stipulating that those carriers *may* have to be substantially owned and effectively controlled by the designating states and/or its nationals.[6] The verb "may" in the previous sentence means that states are entitled to waive these nationality requirements on an *ad hoc*, policy basis. And they have done so in a number of cases.[7]

A historical example of the deviation from the 'substantial ownership and control' clause forms the "Hong Kong Clause" pursuant to which formerly the British and now the Chinese authorities are entitled to designate Cathay Pacific not by virtue of its ownership and control standards but its principal place of business being located in Hong Kong. In the course of the

[5] See Article 83 bis: "….when an aircraft is registered in a contracting State pursuant to an agreement for the lease, charter or interchange of the aircraft or any other similar arrangement by an operator who has his *principal place of business or*, if he has no such *place of business*, his *permanent residence* in another contracting State, the State of registry may, by agreement with such other State, transfer all or part of its functions and duties as a State of registry in respect of that aircraft under Articles 12, 30, 31 and 32a." (*italics added*)
[6] For a typical clause, see footnote 2
[7] See for instance a number of rather old cases decided by the predecessor of the current Department of Transportation (DoT), the *Civil Aeronautics Board* (CAB): *Scandinavian Airlines System*, Foreign Air Carrier Permit, Docket No. 2560, 8 CAB Reports 679-681 (1947), *Air Afrique*, Foreign Permit, Docket No. 17369, 46 CAB Reports 31-36 (1967) and *East African Airways*, Foreign Permit, Docket No. 22381, 55(19) CAB Reports 641-645

1990s, governmental authorities appear to follow this development in the context of concluding Open Skies agreements.[8]

In 2007, Switzerland which is not taking part in the external EU aviation relations and is not obliged to include the Community air carrier clause in its bilateral air services agreements is also attempting to include a reference to the principal place of business of "its" carrier Swiss because of the corporate structure of Swiss in relation to Lufthansa. Similar but not identical arguments play a role in the corporate structure of Air France-KLM.[9]

The *Air Transport Agreement* concluded in April 2007 between the United States,[10] the 27 EC Member States and the European Community,[11] also refers to the 'principal place of business' as an *alternative* condition for designation instead of 'substantial ownership and effective control'. Airlines which have their principal place of business in either an EC state or the US are entitled to enjoy the rights exchanged under this agreement. However, under current Community and US law, the link between principal place of business, substantial ownership and effective control and licensing state,[12] is still firmly embedded in 'local' – that is, US and Community – law respectively so that – as long as this link continues to stay in place – the last mentioned agreement does not contribute to the liberalisation of air services beyond the boundaries of the parties involved, and does not enhance the idea of opening markets for third country carriers such as, for instance, Emirates or Singapore Airlines.

Even if these non-EC airlines would be entitled to have 'an establishment' in an EC Member State, they would not be able to operate air services from there, unless there is a "Community agreement" in place between for instance Singapore, the EC and its member States providing for such an opening of the air transport market to non-EC carriers.[13] The

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[8] See also, the Open Skies Agreement of 1997 between Aruba and the US, which has a Memorandum of Consultations containing the following text:
"The Aruban delegation inquired under what circumstances the U.S. government waives its policy of requiring that foreign carriers be substantially owned and effectively controlled by citizens of their claimed homeland. The U.S. delegation responded that the U.S. government has granted waivers of this policy to the extent that a question may exists as to the ownership and control of a carrier where it has found that there is nothing inimical to U.S. aviation policies or interests."
[9] See section 4
[10] Published in OJ L 134/4-41 (2007)
[11] As to which see further below
[12] As further defined and explained in Annex 4 of the mentioned *Air Transport Agreement* of 2007; as to Community law, see footnote 13
[13] Pursuant to Article 4 of Regulation 2407/92, referring to Community agreements with third states:
"1. …

EC-US Agreement on Air Transport of 2007 as to which see further below, does not grant such a right of establishment to carriers of the two sides.

In recent cases, which are coming closer to the realities of the 21st century in terms of corporate structure, governmental authorities appear to give more weight to the question whether the international merger or take over is accompanied by support for liberalisation of international air services by the states designating the merging airlines. In addition, the grant of air policy advantages to third country airlines may be important for approval of the merged airline by the third country.[14] In such cases, room may be made for the adoption of other criteria than the 'substantial ownership and control' standards – which alternative policy approach may be useful for the Hungarian carrier Malev being under scrutiny of the European Commission in the light of Russian interests in regard to this carrier.[15]

ICAO policy

ICAO recognises the growing importance of the principal place of business confirming the nexus between an airline and a state. During the *Worldwide Air Transport Conference*: *Challenges and Opportunities of Liberalization*, which was held in March 2004 in Montreal, the conference concluded that the introduction of the term 'principal place of business' could help to move forward the liberalisation process. For the sake of maintaining the necessary safety supervision, ICAO found that this term should be related to the fundamental principle of "effective regulatory control" meaning that the state in which the airline has its principal place of business must exercise safety oversight over the airline in question.[16]

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

[14] See also, the *Open Skies* Agreement of 1997 between Aruba and the US, as quoted in footnote 8,.

[15] See section 4

[16] See the final conclusions on:
http://www.icao.int/icao/en/atb/atconf5/docs/ATConf5_wp113_en.pdf:
"2.1.3.2 The Conference agreed that States should give due consideration to the following draft model clause as an option for use at their discretion in air services agreements.
"Article X: Designation and Authorization
1. Each Party shall have the right to designate in writing to the other Party [an airline] [one or more airlines] [as many airlines as it wishes] to operate the agreed services [in accordance with this Agreement] and to withdraw or alter such designation.
2. On receipt of such a designation, and of application from the designated airline, in the form and manner prescribed for operating authorization [and technical permission,] each Party shall grant the appropriate operating authorization with minimum procedural delay, provided that:
a) the designated airline has its principal place of business* [and permanent residence] in the

Whether the imposition of this extra condition – subjecting the principal place of business to the condition safety supervision – is in accordance corporate law, especially the corporate law of the state in which the airline is established, is another question. Similar questions may be asked in relation to the imposition of yet other conditions for the choice of a 'principal place of business' of an airline such as the presence of a substantial amount of the operations and capital investment in physical facilities in the state in question, the employment of a significant number of employees there, and the registration of its aircraft in that state.

Community air law

Community air law dictates that the licensing state of a Community air carrier should not be the state whose nationals own the majority of the shares of the airline and control the decision making processes of the airline, but the state hosting its *principal place of business*.[17]

The EU is currently attempting to "export" its achievements under Community law, whether under the highly topical term 'regulatory convergence' or otherwise. One of those achievements is the acceptance of the Community clause on the internal market, under which internal market access is allowed to all carriers having a "Community nationality".

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territory of the designating Party;
b) the Party designating the airline has and maintains effective regulatory control** of the airline;
c) the Party designating the airline is in compliance with the provisions set forth in Article X
(Safety) and Article Y (Aviation Security); and
d) the designated airline is qualified to meet other conditions prescribed under the laws and regulations normally applied to the operation of international air transport services by the Party receiving the designation.
ATConf/5-WP/105
2.1-6 Report on Agenda Item 2.1
3. On receipt of the operating authorization of paragraph 2, a designated airline may at any time begin to operate the agreed services for which it is so designated, provided that the airline complies with the applicable provisions of this Agreement.
Integral Notes:
(i) *evidence of principal place of business is predicated upon: the airline is established and incorporated in the territory of the designating Party in accordance with relevant national laws and regulations, has a substantial amount of its operations and capital investment in physical facilities in the territory of the designating Party, pays income tax, registers and bases its aircraft there, and employs a significant number of nationals in managerial, technical and operational positions. ...."

[17] There is not yet a standardised formulation of such a Community clause, but the elements of the Community clause are contained in Article 4 of Regulation 2407/92:
See Article 4 of Regulation 2407/92, explaining "substantial ownership" as "majority ownership".
Article 4: *Operating licence*
"1. No undertaking shall be granted an operating licence by a Member State unless:
(a) its principal place of business and, if any, its registered office are located in that Member State; and
(b) its main occupation is air transport in isolation or combined with any other commercial operation of aircraft or repair and maintenance of aircraft.

As a consequence of the landmark decision of the European Court of Justice in the so called *Open Skies* cases,[18] EC Member States are required to enforce this Community clause in their relations with third countries. In practice this means that Community air carriers having an establishment in another EU state should be entitled to exercise traffic rights from that establishment – however defined.[19]

The EC legislator also made suggestions for the formulation of a clause re-defining the link between state and airline. A state is entitled to designate an airline for the purpose of operating the agreed services if it has, amongst others, its principal place of business in that EC state. The UK has implemented this suggestion along the following lines:

The UK may refuse the designation made by a third – non-EC state if the airline designated by that third state of the UK is not satisfied that it "Is incorporated and has its principal place of business" in the territory of that third state, whereas the third state may refuse a designation from the UK side if, amongst others, the third state is not satisfied that the airline so designated by the UK "is incorporated and has its principal place of business" in an EC member State, or in a state belonging to the European Economic Area.[20]

The element regarding "incorporation" in the above quote touches upon a delicate point as corporate law among EC Member States has not been harmonised. Certain EC states adhere to the '*incorporation*' doctrine according to which the state in which the undertaking – such as an airline – was established grants the nationality to the undertaking. Under the '*real seat*' doctrine, the state in which the undertaking carriers out its central activities lends its nationality to the undertaking. The Netherlands – with its open market economy – has adopted the incorporation concept whereas for instance France uses the '*siège réel*' concept.[21]

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[18] See, for instance, the case of the *Commission* versus the *Federal Republic of Germany*, in the matter of Germany's Open Skies agreement with the US, Case C-476/98, par. 144-162, available at http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=61998J0476 - see on this, and other matters coming up in this article, an excellent article written by Mr Rainer Münz of the Federal Ministry of Transport, Building and Housing: *The Future of Ownership and Control Clauses - The German point of view*, published in Stephan Hobe and others (editors), *Consequences of Air Transport Globalization* (2003).

[19] See section 4, below

[20] See, UK House of Lords, Select Committee on the European Union, Session 2002-03, 17th Report, "*Open Skies or Open Markets? The Effect of the European Court of Justice* (*ECJ*) *Judgements on Aviation Relations between the European Union and the United States of America* (*USA*)" at 20 – Source: Department of Transport

[21] See, Prof. Jan Wouters of Leuven University, *Private International Law and Companies*' *Freedom of Establishment*, 2 European Business Organization Law Review 101-139 (2001)

A further discussion of this subject, however relevant for the promotion of the theme of this brief essay, falls outside its context.

The next section discusses changing perceptions with regard to the relationship between an airline and a state, or 'its' state. It is geared to illustrate how the airline of a state is becoming an aviation company operating in a market.

(3) Establishment of air carriers

*Freedom of establish*ment *in air transport following the Open Skies decisions of the ECJ*

Taking the ECJ decisions in the above Open Skies decisions as the point of departure,[22] it seems to us that the Court had in mind a distinction between principal place of business and establishment, or perhaps more precisely: "secondary establishment."

As stated above, EC Member States licence carriers as Community air carriers when they are owned and controlled by Community interests, and have their principal place of business within the territory of the licensing state.[23] The ECJ decided that such Community air carriers must be able to operate traffic rights from an EC Member State other than the one in whose territory they have a principal place of business, and in which they are licensed. By meeting the conditions applied to and enjoying the same opportunities of a national operator, they must be able to obtain "national treatment" and thereby exercise the principle of Freedom of establishment of the EC treaty.[24] Hence, it is necessary to establish and clarify the meaning of an "establishment" which is not obvious under international air law.

Definition of establishment

The EC Treaty does not define "establishment" other than by stating that:

> *"Freedom of establishment shall include the right…to set up and manage undertakings" including:*

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[22] See, footnote 16

[23] In accordance with Article 4 of Regulation 2407/92 on licensing of air carriers

[24] Pursuant to Article 43 of the EC Treaty: "Freedom of establishment shall include the right to take up and pursue activities as self employed persons and to set up and manage undertakings, in particular companies and undertakings or firms … *under the conditions laid down for its own nationals by the law of the country where such establishment is effected* …" (*italics added*)

> *"the setting up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State."*[25]

In the *Factortame* case,[26] the ECJ has further defined the concept of establishment as the place where an operator (in this case of a vessel):

- *pursues an economic activity* in another Member State (other than the Member State where the operator has his principal place of business);
- has a "*fixed establishment*" in that other Member State;
- pursues that economic activity "*for an indefinite period of time*" in that other Member State.

Once an airline has a "permanent establishment" through a branch or an agency in another Member State (other than the Member State in which it has its principal place of business), that company is entitled to national treatment in that other Member State by virtue of the Freedom of establishment.[27] National treatment means that an airline must be able to enjoy the grant, or allocation of *international* traffic rights, that is, the operation of extra-Community routes rights,[28] in the other Member State.

Community air carriers can be said to comply with the above conditions imposed by general Community law,[29] where the following circumstances apply in an EC Member State of "secondary establishment"; a Community air carrier has an establishment in another Member State if it:

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[25] See Article 43 of the EC Treaty, quoted in footnote 24

[26] Case C-221/89, see in particular paragraphs 21 and 22:
"21 Consequently, the registration of a vessel does not necessarily involve establishment within the meaning of the Treaty, in particular where the vessel is not used to pursue an economic activity or where the application for registration is made by or on behalf of a person who is not established, and has no intention of becoming established, in the State concerned.
22 However, where the vessel constitutes an instrument for pursuing an economic activity which involves a fixed establishment in the Member State concerned, the registration of that vessel cannot be dissociated from the exercise of the freedom of establishment.

[27] See for instance: *Elide Gottardo*, case C-55/00, para. 32; *Centros*, Case C-212/97, par. 17; *Saint Gobain*, Case C-307/97, par. 34, 35.

[28] By which we mean a route linking the "secondary" establishment of the Community air carrier to a point outside the Community.

[29] Consideration No (10) of the Preamble of the Regulation 847/2004! Common Position (EC) No 7/2004 defines an establishment as "the effective and real exercise of air transport activity through stable arrangement" whereby "the legal form of such an establishment, whether a branch or subsidiary with legal personality, should not be the determining factor in this respect."

- has sales offices there; and
- has a manager at the airport, and
- has set up an agency or branch office, and:
- carries out air transport activities for an indefinite period of time.

Consequently, it seems that the major carriers of the Community can be said to have a "secondary establishment" in the airports of other Member States into and from which they operate. Hence, the aviation authorities of the Member State in which the Community air carrier has a secondary establishment must permit such a carrier to apply for available route licences and compete on equal terms for scarce capacity pursuant to the 'national treatment' principle referred to above and laid down in Article 43(2) of the EC Treaty.

For instance, if Finnair has an establishment at Amsterdam Airport Schiphol in the form of offices, employees and long term contracts there, it could be argued that this airline is established there. Consequently, Finnair should be able to provide and operate air services from that airport, not only to intra-Community destinations but also beyond.

The words "but also beyond" have serious international air law and policy implications. Since the ECJ decision, the Commission has published two documents pertaining to the consequences of this decision on the air transport relations between the Community and its Member States on the one hand and third states on the other hand.[30] The right of Community air carriers to operate air services from a secondary establishment in another EC Member States to points outside the EC has yielded a heavy effect on intra Community relations – that is, between Community institutions and EC Member States – and between EC Member States and third states, as evidenced by negotiations between EC Member States, the Commission and third states pursuant to 'horizontal' and 'vertical' mandates.

The recognition of the application of the freedom of establishment, and the creation of a link between that freedom with the freedom for airlines to provide *international* air services under

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[30] See: COM(2002) 649 final of 19 November 2002 at 36, in which the Commission states that national treatment applies when an airline has "an establishment" in another Member State, "regardless of the principal place of business", and COM(2003) 94 final of 26 February 2003, at 11, under which a Community air carrier should enjoy national treatment (as regards the allocation of traffic rights) when he "can show that he has a place of business (subsidiary, branch or agency) in the territory of a Member State."

Community law amounts to the grant of seventh Freedom rights under traditional air law and policy. Seventh Freedom rights were and still are negotiated and exchanged in a bilateral context in very exceptional cases only. Hence, the mentioned recognition was designed to break yet another wall in the strongly protected aviation law framework.

However, a unilateral recognition by Community institutions like the ECJ and the European Commission does not suffice. Pursuant to Article 6 of the Chicago Convention,[31] the third state must agree with the operation of these new unilaterally recognised, Freedom rights by *international agreement* as to which see the following paragraph.

In practical terms, this piece of liberalisation implies that, for instance, Air France, KLM and Lufthansa should be allowed to operate from London Heathrow airport to points in the US – subject to the availability of slots but that is another matter. The Air Transport Agreement concluded in April 2007 between the United States,[32] the 27 EC Member States and the European Community provides the legal basis – that is, the 'international agreement' referred to in the previous paragraph – for the operation of such – seventh Freedom – rights.

While accepting the need for a broad interpretation of the term "(secondary) establishment", it may be important legally to define this term more rigorously in the context of drawing up criteria for the application of carriers qualifying for Community designation outside the territory where such carriers have their principal place of business. Arguably, the prime concern for safety oversight (not mentioned in this consideration) as well as the international law based principle that the designating state assumes international responsibility for the designated carrier vis a vis third states, dictate such precise criteria. Such criteria could not act as quantitative bars to entry, i.e. any carrier would in principle be able to meet them.

The ECJ has pronounced on the permissibility of such formal requirements, which are liable to affect the freedom of establishment and the freedom to provide services. Reference is made to the jurisprudence of the Court in such cases.[33] National courts may, case by case, take account – on the basis of objective evidence – of abuse or fraudulent conduct on the part

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[31] Article 6 *Scheduled air services*
"No scheduled international air service may be operated over or into the territory of a contracting State, except with the special permission or other authorization of that State, and in accordance with the terms of such permission or authorization."

[32] Published in OJ L 134/4-41 (2007)

[33] See case 33/74, *Van Binsbergen*; Case 279/80, *Webb*; Cases 110 and 111/78, *Van Wesemael*; 204/84, *Commission* versus *Germany*; Case C-61/89 *Bouchoucha*.

of the persons concerned in order, where appropriate, to deny them the benefit of the provisions of Community law on which they seek to rely. However, they must nevertheless assess such conduct in the light of the objectives pursued by those provisions.[34]

(4) Case studies

This section looks at a number of airlines having a trans-national or multilateral dimension in terms of corporate structure. The trend to de-nationalise the corporate structure of airlines, moving away from the traditional ownership and control criteria, is not an exclusive development in Europe. Other parts of the world are following suit if not setting a trend.

The emergence of such airlines as LAN Argentina, LAN Ecuador LAN Peru and LAN Express all belonging to the Chilean LAN Airlines Group, forms an example of the very strong liberalisation trends taking place in Latin America. In 2007, Chile's dominant airline LAN Airlines has boosted its stake in LAN Argentina to 70 percent from 49 percent. When LAN Airlines first began operating in Argentina, it created a new company, and Argentinean regulations barred it from owning more than 50 percent of that company's capital. A subsequent change to the aeronautical code, however, cleared the way for LAN Airlines to increase its participation in LAN Argentina.[35]

Walls around national ownership and control also appear to be breaking in Europe. In 2007, the European Commission has started an investigation into the ownership and control structure of the Hungarian airline Malev as Russian Air Bridge consortium tries to create a base in the European internal market through its stake in the Hungarian airline. It is said that a similar interest from the Russian side exists for the Yugoslav carrier JAT.

A leading case may be Swissair's investment into Sabena in 1997. In *Swissair-Sabena* (1995),[36] the Commission noted, as a matter of fact, that: "Sabena is to remain a separate legal entity having its registered office and corporate headquarters in Belgium."[37] Obviously, this determination is relevant for the licensing of Sabena under Community licensing rules: if the

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[34] See Case C-206/94 *Paletta II*, Par. 24
[35] See, http://www.reuters.com/article/companyNewsAndPR/idUSN2248340320070222
[36] Decision 95/404/EC: Commission decision of 19 July 1995 on a procedure relating to the application of Council Regulation (EEC) No 2407/92 (*Swissair/Sabena*), OJ L 239/19-28 (1995) - henceforth also referred to as: Swissair/Sabena Decision (1995)
[37] At VIII of the Swissair/Sabena Decision (1995)

Commission had found that the principal place of business of the two merged airlines would have moved to Switzerland as a consequence of this transaction, Sabena would not have been entitled to receive a license from the Belgium authorities.

The investigation of the ownership and control issue was even more complicated as Swissair acquired no less than 49.5 per cent of the voting shares of Sabena. The Commission was of the opinion that the ownership standard (at least 50 per cent in the hands of Community nationals) is met, if 50 per cent plus one share are owned by such Community nationals. That being the case, Swissair's investment in relation to ownership can be approved.[38]

Even lengthier was the analysis of the "effective control" test. Effective control is defined in the applicable Regulation on licensing of air carriers,[39] implying that there is less room for interpretation based on policy criteria. However, the final question is to determine who has the ultimate decision-making power in the management of the carrier concerned.[40] In sum, the Commission found that Belgian nationals held "effective control" of Sabena.

So far, the Commission decision was based on application of legal criteria. That is why the above arguments are more adaptable to other ventures than those used in the US decisions. However, the Commission did take into account a wider policy objective: Switzerland was in the process of adopting the "*acquis communautaire*" in the field of air transport, which materialised in an agreement made in 2002. In so far, the above decisions only reflected a transitionally stage of affairs.[41]

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[38] Subject to the following conditions:

- the scale of the third country investment;
- the distribution of the shares within each group of shareholders;
- the effect of ownership upon control of the Community company;

see section X of the Swissair/Sabena Decision (1995)

[39] In that respect, it does not matter whether appointments have been made directly or indirectly, but it is relevant to find out who has "the final say" on such key questions as the carrier's business plan, its annual budget or any major investment or co-operation project.

[40] The Board of Directors of Sabena was composed of twelve persons, including the chairman. Five are appointed by Swissair, and six by the Belgian shareholders. The chairman was to be nominated on joint proposal of Swissair and Belgian shareholders. If they could not agree, Swissair's proposal won.
The Commission took into consideration that the shareholders' influence on the day to day management of Sabena was relatively limited, their role being restricted to investment decisions. Finally, the Belgian state had the possibility of reversing the above transaction by exercising its call option to purchase all the shares to be held by Swissair; see section XI of the Swissair/Sabena Decision (1995)

[41] See section XI of the Swissair/Sabena Decision (1995)

If the Commission would have decided otherwise in the case brought under the licensing Regulation (2407/92), so that Sabena could not be qualified anymore as a "Community air carrier", such decision would have had the effect of barring the "Swiss Sabena" combination from having access to intra-Community routes. The "Swiss Sabena" combination would not be allowed to fly from Brussels to Athens or from Munich to Madrid.

The next case involving two European 'flag' carriers involved Air France and KLM. Air France and KLM set up a holding company, called Air France-KLM S.A. (*société anonyme*).

This holding company Air France-KLM holds two operating companies, namely, Air France and KLM. Ownership and control on the Air France side will be French. On the KLM side, the operating company - KLM - is in the hands of Dutch nationals, that is, 51 percent. The principal place of business of KLM remains in Amstelveen.

Paradoxically, the role of the Dutch State has become more prominent than in the "old" KLM structure. The paradox lies in the fact that the Dutch State privatised KLM to a large degree withdrew its representatives from the Board of Governors of KLM, and left the airline operating under free market rules. Under the Air France-KLM transaction, the Dutch state continues, amongst other things, to host the main hub of KLM at Amsterdam Airport Schiphol and the principal place of business of KLM in Amstelveen, and to tax KLM as a Dutch company.

Parties prefer to call the transaction a "combination",[42] avoiding terms like "mergers", let alone "take over" which preference is supported by the use of the name "Air France-KLM". Their choice for the term "combination" is supported by for instance, the group having two principal places of business, which is relevant from a regulatory and taxation point of view; the maintenance of two brands that will be further strengthened;[43] and the choice for a *dual hub strategy* by using of two operational hubs at Paris Charles de Gaulle and Amsterdam Airport Schiphol.

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[42] See, Press Release: *Air France and KLM Royal Dutch Airlines to create Europe's leading airline group* of 30 September 2003 at for instance pages 1 and 7, as well as Mr Dominique Patry, speaking at a conference on the Future of international alliances and mergers organised by the European Aviation Club and the International Institute of Air and Space Law of Leiden University in Brussels on 18 March 2004

[43] See, Press Release: *Air France and KLM Royal Dutch Airlines to create Europe's leading airline group* of 30 September 2003 at page 7

In another case, a Portuguese airline called Aero Condor chartered an aircraft from a Danish company which was linked to an airline established in Lithuania. The Lithuanian company was the actual operator of the aircraft. Aero Condor applied for a concession to fly domestic routes in France on the basis of a *Public Service Obligation*, so that Aero Condor would receive money from France tax resources. As a corollary, the question becomes where Aero Condor has its principal place of business, and consequently which EC Member State should license this airline. Also, it is unclear which EC Member State is in a position to effectively exercise safety oversight.

The sophisticated structures of the above 'transnational' airlines are far away from the traditional and conveniently arranged corporate structures of British Airways, Air India and Japan Airlines. The legal and air policy status of the three last mentioned airlines does not cast any doubt as they are supervised by provisions of bilateral agreements and national law, confirming their nationality and their rights with respect to market access.

(5) Conclusions

There is nothing in the Chicago Convention to prevent its 190 contracting states from moving forward with the liberalisation process in terms of finding alternative conditions for the establishment of an airline. If at all, this convention refers to 'principal place of business as the nexus between state and airline.

This is different for bilateral air service agreements and the *International Air Transport* and *International Air Services Transit Agreements* of 1944 which are attached to the Chicago Convention but have not been discussed here. If liberalisation has to move on, bilateral clauses must be adapted. ICAO has given suggestions for such modifications, and points at the necessary link between designating states, the right of establishment in its territory and the need for safety oversight – perhaps understandably so from an ICAO perspective but regard should be had to the influence of corporate law of the state of establishment. The question is whether such laws allow for the imposition of relatively heavy conditions for incorporation.

The case studies presented above and the recent developments in this area have hopefully demonstrated that a legal analysis serves practical purposes for policymakers. Airlines are

choosing new forms of cooperation and governance which exceed the traditional boundaries imposed by international air law, especially by the restrictive clauses of bilateral air services agreements. Airports come into play when they are able to present themselves as an attractive establishment for airlines – along with criteria which are already relevant for other undertakings such as the presence of a decent infrastructure, labour force and tax regime.[44] Obviously, the geographical position of an airport is essential for being chosen as 'an establishment' and even more so 'principal place of business' of an airline.

The above brief survey has hopefully also articulated the development according to which international aviation law and policy is increasingly influenced by a variety of other disciplines: economics, competition, corporate governance and international trade relations, confirming the need for a more comprehensive and holistic approach towards air transport relations generally and the establishment of air carriers in particular. Airneth should be congratulated for bringing a myriad of aviation interests together in order to contribute to further thinking and advancing solutions in this area.

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[44] As further articulated and explained in Sub sections 2.2.1 and 4.2.4.1 of the draft Final report dated 12 February 2008 made by SEO for the Dutch Ministry of Transport and Public Works on the Development of a sustainable decision making process regarding a policy on selectivity in relation to Amsterdam Airport Schiphol; *De ontwikkeling van een houdbaar afwegingskader voor het luchtvaartpolitieke selectiviteitsbeleid op Schiphol* (not yet published)