Skies Half Open:
Foreign Investment In India’s Airline Industry

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ABSTRACT

The foreign investment regime governing the airline industry has been the subject matter of considerable debate. Our goal in this paper is to supplement the literature by embarking on an analysis of the foreign investment regime in India and to cautiously suggest that India’s new regulatory reforms could be a harbinger for other states. A study of the foreign investment regime in the airline industry in India is both interesting and timely, for at least two reasons. First, India has nearly everything that bodes well for the growth of an aviation market, and it is one of the fastest growing aviation markets in the world. Second, the Indian Government has introduced substantial reforms to liberalize the aviation sector.

Although India has transitioned from a highly restrictive regime to one that is among the most liberal in the world, and that too within a relatively short span of time, we argue in this paper that the liberalized norms give rise to tension on several counts that is not easy to resolve. For instance, the policy creates a dichotomy between foreign airline investors (who face a restrictive regime) and non-airline investors (who enjoy a liberal regime). Moreover, the restrictions on “substantial ownership and effective control” that apply to the airline investors give rise to several issues in implementation. This is complicated further by the influence of several interest groups that seek to influence government policy in this area. These are generally incumbent airline companies and their controllers who seek to raise the bar for new entrants.

Even if Indian domestic law on foreign investments can be addressed, the ownership and control requirements under various bilateral agreements between India and other countries (which cater for the operation of flights between those countries) tend to pose a stumbling block towards full liberalization. Unlike domestic laws which can be reformed unilaterally, India’s ability to unlock the investment restrictions under the bilateral agreements is much more circumscribed given that such negotiations occur within the realm of reciprocity.

Despite various shortcomings in India’s foreign investment policy in the airline sector, the industry has witnessed massive growth. It remains to be seen whether resolving the regulatory problems will unleash its further potential. It will also be illuminating to see how and to what extent India’s new way will influence other states as to their policy.

Key words: Foreign investment, aviation industry, airline, substantial ownership, control, India

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I. INTRODUCTION

Spurred by the growth in travel and tourism, the airline industry has acquired a prominent place in the global economy.¹ Despite gradual liberalization over the last few decades, the industry continues to face significant regulatory barriers, which have arguably failed to keep pace with the times. One such constraint relates to the stringent rules pertaining to foreign ownership of airline companies. This is attributable to the way the regulatory mechanism governing the airline industry had been established more than half a century ago, which continues to the present day. There is limited visibility regarding any possible overhaul of the regulatory approaches towards ownership of the airline industry.

The global regulation of the aviation industry has been premised on the concept of a “flag carrier”, which is subject to national laws as well as bilateral agreements between nations.² The “nationality rule” ensures that an airline is necessarily owned and controlled by a state or citizens of such a state.³ Such a requirement by which the “substantial ownership and effective control” (SOEC) of an airline must vest in a state or its citizens substantially limits

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the flow of foreign investment into the airline industry. This not only hampers capital raising activities by airlines to fund their business, but it also stanches cross-border mergers and acquisitions activity in the industry, thereby impeding the benefits of size and efficiencies that would ultimately augur to customers in the form of enhanced options, services and reduced cost.\(^4\) While there have been calls for the abolition of the nationality requirements in the airline industry to permit a free flow of capital investment,\(^5\) equally there has been significant resistance given the vulnerability of the airline industry to safety and security concerns.\(^6\)

The foreign investment regime governing the airline industry has been the subject matter of considerable debate, both in the legal academy as well as in the field of air transport management.\(^7\) Given that some of the earliest restrictions emanated from the United States (U.S.), it is not surprising that a substantial part of the literature deals with the U.S. regulation on foreign investment in the airline sector.\(^8\) In the last few decades, there has been an increasing focus on the European Union.\(^9\) More recently, the spotlight has shifted to Asia.\(^10\) Our goal in this paper is to fill a perceptible gap in the literature by embarking on an analysis of the foreign investment regime in India, a country that has not only attained the status as a leading player in the aviation industry, but one that has also been the subject matter of significant legal reforms pertaining to foreign investment in the aviation sector. We also cautiously suggest that India’s new regulatory reforms could be a harbinger for other states.

A study of the foreign investment regime in the airline industry in India is both interesting and timely, for at least two reasons. First, India has nearly everything that bodes well for the

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\(^5\) LELIEUR, *supra* note 2, at 151-152.


growth of an aviation market. It is a country with an ideal geographical location between the eastern and western hemispheres, a growing middle class population of about 300 million and a rapidly developing economy. In 2017, it acquired the status of being the third largest aviation market in terms of domestic traffic (after the U.S. and China) and the fourth largest in terms of overall air passenger traffic (that includes both domestic and international). As one of the fastest growing aviation markets in the world, it is unsurprising that India achieved this status much faster than had been previously predicted.

Second, the Indian Government has introduced substantial reforms to liberalize the aviation sector. Historically, and from the time foreign investment was allowed in the sector, significant limits were imposed on the extent of such investment. Initially, a limit of 40% was placed on foreign investment, which was subsequently enhanced to 49%. In 2012, the Government removed a barrier that kept foreign airlines from investing in Indian airlines, and permitted them to invest up to 49%, subject of course to the condition that the SOEC remained in Indian hands. More recently, in 2016, limits have been lifted on non-airline foreign investments that can now been made up to 100% of an Indian airline, while airline investments are still subject to the 49% limit with the SOEC requirements. In the same year, the Government also revamped the policy surrounding the civil aviation sector in general. Although this has indeed made India one of the more liberalized markets for foreign investment in airline companies, certain barriers such as the SOEC requirements for foreign airline investments will likely continue to place constraints on significant foreign investment.

Although India has transitioned from a highly restrictive regime to one that is among the most liberal in the world, and that too within a span of two decades, we argue in this paper that the liberalized norms give rise to tension on several counts that is not easy to resolve. For instance, the policy creates a dichotomy between foreign airline investors (who face a restrictive regime) and non-airline investors (who enjoy a liberal regime). Moreover, the SOEC restrictions that apply to the airline investors give rise to several issues in implementation. This is complicated further by the influence of several interest groups that

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12 India now 3rd largest aviation market in domestic air passenger traffic: Capa, THE MINT (Mar. 26, 2017); India becomes 3rd largest aviation market in domestic traffic, TIMES OF INDIA (Mar. 26, 2017).
13 It earlier was anticipated that India will occupy the third position only by 2022. India’s Cabinet approves Civil Aviation Policy, CENTRE FOR AVIATION (Jun. 15, 2016), available at http://centreforaviation.com/news/cabinet-approves-civil-aviation-policy-565639; Ramesh Vaidyanathan, India’s New Aviation Policy: Will it be a Game Changer?, 29 AIR & SPACE LAW. 1 (2016).
18 Ministry of Civil Aviation, supra note 11.
seek to influence government policy in this area. These are generally incumbent airline companies and their controllers who seek to raise the bar for new entrants.

Even if Indian domestic law on foreign investments can be addressed, the SOEC requirements under various bilateral agreements between India and other countries (which cater for the operation of flights between those countries) tend to pose a stumbling block towards full liberalization. Unlike domestic laws which can be reformed unilaterally, India’s ability to unlock the investment restrictions under the bilateral agreements is much more circumscribed given that such negotiations occur within the realm of reciprocity. Despite various shortcomings in India’s foreign investment policy in the airline sector, the industry has witnessed massive growth. It remains to be seen whether resolving the regulatory problems will unleash further potential. It will also be illuminating to see how and to what extent India’s new way will influence other states as to their policy.

Part II of this paper begins with an introduction to the specific issues that arise in the regulation of foreign investment in the airline industry, with emphasis on the SOEC restrictions. Part III traces the evolution of the regulatory regime in India governing foreign investment in its airline sector. We find that a wholly restrictive sector transformed rapidly into a liberal one. Part IV delves into detailed evaluation of India’s foreign investment norms, and analyzes various issues and problems emanating therefrom. These include the disparate treatment of foreign airline investors and others, and the role of various incumbent players (such as non-resident Indian investors, the state-owned carrier Air India and an industry lobby) that have influenced the nature of the foreign investment regulation. Part V deals with issues that India faces in bringing the treatment of its airlines under bilateral agreements with that conferred under domestic law. Part VI concludes with anticipation that India’s new approach could have an impact on other states relating to foreign investment regime in the airline industry.

II. FOREIGN INVESTMENT RESTRICTIONS IN THE AIRLINE INDUSTRY

We begin with a discussion of foreign investment in the airline industry from a global perspective. Apart from analyzing the regime in various countries, both from the purview of national regulations as well as bilateral arrangements entered into by nations, we also highlight the background and rationale for tight restrictions on foreign investment in the industry. Such a comparative setting will provide the framework on which the regulation of the Indian aviation sector can be analyzed in detail.

A. Substantial Ownership and Effective Control

Foreign ownership restrictions have been the mainstay of the airline industry since the first half of the 20th century. Their origin can be attributed to a fundamental principle of
international law by which a state’s sovereignty extends to the airspace above its territory.\textsuperscript{19} Such a principle is translated into nationality restrictions through the “double-bolted locking mechanism”.\textsuperscript{20} The internal bolt is represented by ownership restrictions set out in the national laws and regulations of various countries that set out limitations on foreign investment.\textsuperscript{21} For example, most countries prescribe the SOEC requirements by which their airlines must not only be owned substantially by its own nationals, but they must also be under effective local control. Substantial ownership requirements are quantitative in nature.\textsuperscript{22} For instance, the national rules of country A may state that foreign nationals or foreign companies cannot own more than 49\% of the shares in its airlines. Effective control requirements are, however, trickier, as they are qualitative in nature.\textsuperscript{23} Illustratively, an investor X who is a national of country B may be said to be in effective control of an airline in country A even though X only holds less than 49\% of the shares of an airline. Effective control may be conferred by means other than substantial ownership of airlines, including through contractual rights and protections that may be conferred upon the foreign investor that may enable it to exercise \textit{de facto} control over the airline in country A.

The external bolt is represented by various bilateral air service agreements (ASAs) entered into by countries to regulate the flow of air traffic between them.\textsuperscript{24} The ASAs prescribe SOEC requirements so that only airlines from the country that is a party to the ASA is entitled to take advantage of the benefits of the agreement. This is achieved by ensuring that each of the states that is a party to the ASA “reserves the right to revoke, limit or suspend the traffic rights of any foreign airline designated to operate service under the ASA if that airline is not substantially owned and effectively controlled by the other state party (or by citizens of that other state party).”\textsuperscript{25} To illustrate this point, take the case of countries A and B that have entered into an ASA to regulate air traffic rights between the two. The SOEC requirements embedded into the ASA will ensure that an airline from country C does not acquire SOEC in an airline in country B to take advantage of the bilateral arrangements between countries A and B in the ASA. This would be particularly important if country B has been able to negotiate a more favorable bilateral arrangement with country A than has country C been able to negotiate with country A. Effectively, the external bolt will ensure that airlines do not engage in treaty-shopping.\textsuperscript{26}

\textsuperscript{19} \textsc{LELIEUR, supra note 2, at 7; Havel & Sanchez, supra note 3, at 644.} Linked to these are restrictions on “cabotage” which prohibit an airline from one country from offering flights on wholly domestic routes in another country. \textsc{See, Havel, supra note 4, at 13203; Brown, supra note 8, at 1273; Bohmann, supra note 4, at 690; Lykotrafiti, supra note 4, at 666; Havel & Sanchez, supra note 3, at 646; Alexandrakis, supra note 8, at 85.}

\textsuperscript{20} \textsc{World Economic Forum, supra note 1, at 6; Havel & Sanchez, supra note 3, at 651; Havel, supra note 4, at 13202.}

\textsuperscript{21} \textit{Id.}

\textsuperscript{22} Havel & Sanchez, supra note 3, at 650.

\textsuperscript{23} \textit{Id.}, at 650-651.

\textsuperscript{24} \textit{Supra} note 20.

\textsuperscript{25} \textsc{World Economic Forum, supra note 1, at 8.}

\textsuperscript{26} \textsc{See Havel & Sanchez, supra note 3, at 649 (noting that “the concessions exchanged between two states cannot be captured by a third state not party to the deal.”)}
Given the bilateral nature of the external bolt, it is more cumbersome to unfasten it to allow foreign investment in airlines. As Havel observes: “Countries are caught in a kind of prisoner’s dilemma under this system. If a country unilaterally allows foreign ownership and control of its airlines, it risks compromising the access of its airlines to international routes to other countries.” Hence, even if countries allow a relaxation of their domestic rules relating to foreign investment (i.e., the internal lock), they may be constrained in liberalizing the restrictions under the ASAs (i.e., the external lock) unless there is consensus on both sides under bilateral arrangements, which may be harder to achieve.

With this background regarding the genesis of the SOEC requirements, it would be useful to explore the evolution of the rules, both nationally and bilaterally, keeping in mind the rationale and benefits (as well as impediments) of foreign ownership restrictions in the airline industry.

B. The Origins of Foreign Ownership Restrictions

Foreign investment restrictions in the airline industry have their origins in U.S. domestic law, not least because the U.S. was a pioneer in the development of the aviation industry. The U.S. Air Commerce Act of 1926 was the first law that required U.S. air carriers to maintain 51% of their voting stock under U.S. citizenship and to ensure that 66% of the members on the board of directors were U.S. citizens.

The U.S. government has proffered four main reasons why it has limited the ownership of its airlines to U.S. citizens: the need to protect the fledgling U.S. airline industry; the desire to regulate international air services through bilateral agreements; safety concerns about foreign aircraft gaining access to U.S. airspace; and military reliance on civilian airlines to supplement airlift capacity. Clearly, the U.S. Congress initiated the citizenship requirement to ensure the availability of aircraft for national defense purposes in 1925. At the time, the U.S. Congress and the head of the U.S. military believed that it was necessary to have “government intervention in commercial air carrier development for the dual purpose of training a reserve corps of pilots and maintaining an auxiliary air force.” Given that it was in the immediate aftermath of the First World War, the country’s political and military leaders naturally attributed a close association between the commercial and military roles of aviation. Essentially, commercial pilots were potential military pilots, and commercial aircraft constituted a reserve air fleet in the event of war.

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27 Havel, supra note 4, at 13203.
28 See Alexandrakis, supra note 8, at 73-74; Edwards, supra note 6, at 603; Gjerset, supra note 8, at 181-182; Nanda, supra note 8, at 363.
30 See Alexandrakis, supra note 8, at 73.
31 Gjerset, supra note 8, at 180-181.
32 Nanda, supra note 8, at 379; Chang, et. al., supra note 2, at 169; Brown, supra note 8, at 1272; Bohmann, supra note 4, at 696; Lykotrafiti, supra note 4, at 664; Alexandrakis, supra note 8, at 73.
In the 1930s, the justification for the citizenship requirement expanded from strict national security goals to those within the domain of economics, namely protecting developing industries from foreign competition. Accordingly, the Civil Aeronautics Act of 1938 increased the ownership requirement of voting stocks by U.S. nationals from 51% to 75% for a carrier to qualify as a U.S. operator. The Federal Aviation Act of 1958 further narrowed the ownership restriction by specifically defining what a “citizen of the United States” meant. This legislation was first amended by the Airline Deregulation Act of 1978, and these amendments were later codified in separate sections of U.S. Code (USC): Title 49 – Transportation, which is still in effect.

More fundamentally, when a state determines the desired ownership profile of particular (or all) sectors of its economy, the state naturally gives preferences to its own nationals. As Brian Havel and Gabriel Sanchez have argued, the right to exclude foreign investment has always been as much a principle of sovereignty as the right to permit it. Accordingly, aviation has been one of the sectors for which foreign investment is tightly regulated. Also, as we discuss later, the U.S. has not only continued on a restrictive path on foreign investment in the airline sector, but its rules in the area are among the most constraining even from a comparative perspective.

If the U.S. has been the forerunner in domestic restrictions on foreign investment in its airline industry (i.e., internal lock), it also forged the first the bilateral treatment in the field (i.e.,

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33 Gjerset, supra note 8, at 182.
34 49 U.S. Code, 40102(a), para 15 provides:
[C]itizen of the United States” means—
(A) an individual who is a citizen of the United States;
(B) a partnership each of whose partners is an individual who is a citizen of the United States; or
(C) a corporation or association organized under the laws of the United States or a State, the District of Columbia, or a territory or possession of the United States, of which the president and at least two-thirds of the board of directors and other managing officers are citizens of the United States, which is under the actual control of citizens of the United States, and in which at least 75 percent of the voting interest is owned or controlled by persons that are citizens of the United States.
36 Id.
37 Although the foreign investment restriction started in the U.S., it is important to note that the U.S. airline industry has never been nationalized. From the iconic airlines of the 20th century, viz., Pan American Airways (commonly known as Pan Am) and Trans World Airlines (commonly known as TWA) to the current “Big 3” airlines, viz., Delta, United Airlines, and American Airlines, the U.S. airlines were never owned substantially by the U.S. Government. Paul Stephen Dempsey, The Rise and Fall of the Civil Aeronautics Board - Opening Wide the Floodgates of Entry, 11 TRANSP. L.J. 91, 179 (1979); White Paper, Restoring Open Skies: The Need to Address Subsidized Competition from State-Owned Airlines in Qatar and the UAE (Jan. 28, 2015) at 2, available at https://skift.com/wp-content/uploads/2015/03/White.Paper-2.pdf.
38 For detailed analyses of how the foreign ownership restrictions have been interpreted by the U.S. regulatory authorities in specific cases, see, LELIEUR, supra note 2, at 31-40; Alexandrakis, supra note 8, at 76-91; Nanda, supra note 8, at 365-372; Bohmann, supra note 4, at 695-711; Gjerset, supra note 8, at 186-192; HAVEL, supra note 7, at 138-162. A detailed discussion of such interpretation by the U.S. authorities is beyond our scope in this paper.
external lock). In 1946, the U.S. entered into the first bilateral ASA with the United Kingdom (U.K.) (referred to commonly as Bermuda I) under which traffic rights could be denied by either state if a carrier did not satisfy the SOEC requirements as stipulated in the ASA. Although Bermuda I provided a model form for other bilateral ASAs, the agreement came under considerable strain. The U.K. withdrew from Bermuda I in 1976, which led to another agreement between the two countries, known as Bermuda II. Subsequently, since the early 1990s, the U.S. began pursuing the Open Skies policy with a view to a liberalized aviation sector through the creation of an open environment for international air travel. Despite following an open policy in terms of granting liberalized air traffic rights, the SOEC requirements in bilateral arrangements continued unabated. In other words, while considerable relaxations have occurred on the business front, tight restrictions have endured on the ownership front (that continue to inhibit foreign investments in the airline sector).

C. The Expansion of Foreign Ownership Restrictions around the World

The “double-bolted locking mechanism” has expanded to other countries around the world as well, albeit with subtle variations. For example, in the European Union (“EU”), the SOEC requirements initially operate on a national basis, i.e. with reference to each individual country. However, subsequent reforms have “marked the transition from nationally owned and controlled airlines to community owned and controlled airlines.” This has resulted in a fully liberalized aviation market within the EU, as it does away with nationality requirements across various EU nations. However, the SOEC requirements apply in relation to bilateral ASAs with other non-EU countries. At the same time, it is necessary to note that the evolution of the SOEC requirements in Europe has been riddled with legal battles, which have not been easy to resolve.

Elsewhere in the Asia-Pacific region, most, if not all, states have domestic laws that impose ownership restrictions in the airline industry. Table 1 shows the foreign ownership restrictions of selected Asia-Pacific countries.

**Table 1: Foreign Ownership Limits in Selected Asia-Pacific Countries**

<table>
<thead>
<tr>
<th>Country</th>
<th>Maximum percent of foreign ownership in selected countries</th>
</tr>
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<tbody>
<tr>
<td>Australia</td>
<td>• 49% for international airlines</td>
</tr>
</tbody>
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40 Edwards, *supra* note 6, at 601; Alexandrakis, *supra* note 8, at 75; Nanda, *supra* note 8, at 373.
41 *Id.*
42 Edwards, *supra* note 6, at 607; Nanda, *supra* note 8, at 374; Lykotrafiti, *supra* note 4, at 675-676.
43 Lykotrafiti, *supra* note 4, at 676.
44 *Id.*, at 683.
45 *Id.*, at 685.
46 Bohmann, *supra* note 4, at 718.
47 Chang, et. al., *supra* note 2, at 165.
49 Adapted from Lee & Dy, *A Commentary on Jetstar Hong Kong Airways*, *supra* note 10, at 181.
Most states use the 51/49 model (that is, majority ownership by local interest). Hong Kong and Singapore are unique in that they use “principal place of business” (PPB) as a replacement for the traditional nationality rule that is based on ownership and control. In other words, the home state is allowed to designate a carrier whose PPB is within its territory despite the said carrier being wholly or partially owned by non-nationals of that State. However, despite the seemingly liberalized tenor of the PPB formula, there continues to be a great deal of uncertainty as matters relating to management and control of the airline cannot be eschewed altogether in this analysis.

Here, we find it apposite to explain the boom of joint venture airlines in Asia. Due to the ownership and control restrictions, foreign airlines cannot obtain majority ownership and

<table>
<thead>
<tr>
<th>Country</th>
<th>Ownership Percentage</th>
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<tbody>
<tr>
<td>China</td>
<td>100% for domestic airlines</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>49%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>49%</td>
</tr>
<tr>
<td>Japan</td>
<td>49%</td>
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<tr>
<td>Korea</td>
<td>49%</td>
</tr>
<tr>
<td>Malaysia</td>
<td>45% for Malaysia Airlines, but the maximum holding by any single foreign entity is 20%</td>
</tr>
<tr>
<td></td>
<td>49% for other airlines</td>
</tr>
<tr>
<td>New Zealand</td>
<td>49% for international airlines</td>
</tr>
<tr>
<td></td>
<td>100% for domestic airlines</td>
</tr>
<tr>
<td>Philippines</td>
<td>40%</td>
</tr>
<tr>
<td>Singapore</td>
<td>The only requirement for designation as a Singapore carrier is its principal place of business</td>
</tr>
<tr>
<td>Taiwan</td>
<td>One third</td>
</tr>
<tr>
<td>Thailand</td>
<td>49%</td>
</tr>
</tbody>
</table>

50 This has spawned the growth of joint ventures, particularly in the low-cost carrier sector in Southeast Asia. See e.g., infra note 52.

51 This issue came to the fore in Hong Kong. See, ATLA Public Inquiry with Regard to the Application for Licence by Jetstar Hong Kong Airways Limited (Jun. 25, 2015), available at http://www.thb.gov.hk/eng/boards/transport/air/Full%20written%20decision%20(Eng)%2025062015.pdf (hereinafter the “ATLA Public Inquiry”), which has been analyzed in Lee & Dy, A Commentary on Jetstar Hong Kong Airways, supra note 10. See also, text accompanying infra notes 59-62.

52 For example, AirAsia owns a 49% stake in carriers in India, Thailand, Indonesia and the Philippines, although the question of whether control of management remains with local hands is more contestable. See, World Economic Forum, supra note 1, at 11; Lee & Dy, Mitigating ‘Effective Control’ Restriction, supra note 10.
control of domestic carriers or set up new airlines (or subsidiaries) in a domestic market.\textsuperscript{53} Since the wholly-owned subsidiary strategy is not legally permissible, airlines developed commercial approaches for circumventing ownership and control restrictions. Establishing joint ventures (JVs) with local interests is a classic example.\textsuperscript{54}

In Asia, we can find the business model in the likes of AirAsia, Lion Air, Jetstar, Spring Airlines, Tigerair, and Vietjet, all of which have managed to establish a business presence in jurisdictions outside their own through JV arrangements with local investors.\textsuperscript{55} In such cases, the JV airlines’ domestic equity tends to be owned by individuals or companies with or without prior business experience in the airline industry.\textsuperscript{56} In other instances, Asian airlines have invested in companies where the local partner is itself an airline.\textsuperscript{57}

If we consider JV airlines whose local shareholders are not airline companies, an important question comes to mind – who would really control the airline? Although each foreign airline’s shareholding is a minority, it is doubtful that the local majority shareholders really possess the knowledge and capability to manage and control the airline, which is a highly sophisticated business. Rather, it is likely that the foreign carriers have \textit{de facto} control of the airline in question.\textsuperscript{58} Nonetheless, many local governments in Asia have obviously relaxed effective control inquiries when they permit JV airlines with local shareholders that are not airline companies.

Despite the general trend towards gradually relaxing effective control restrictions, some governments have applied the effective control requirement more strictly, including those that have migrated to the PPB approach. The most prominent case is the Hong Kong Air Transport Licensing Authority (ATLA)’s decision to reject Jetstar Hong Kong’s license application. When Jetstar Hong Kong Airways (Proposed: Shun Tak Holdings – 51%, Qantas Airways – 24.5% and China Eastern Airlines – 24.5%) applied for a license to operate scheduled air services, an objection was raised by Hong Kong’s incumbent airlines, including Cathay Pacific Airways Limited. Although the actual concept that the ATLA applied was PPB based on Hong Kong’s Basic Law,\textsuperscript{59} the ruling had a lot to do with interpreting “effective control”.\textsuperscript{60}

Because Hong Kong’s Basic Law does not set out any definition of PPB, ATLA cited relevant case law from other jurisdictions. The cases cited by ATLA provided them with an opening to link the concept of PPB with control. This then gave them the ability to address their concern that airlines licensed in Hong Kong should be actually controlled in Hong Kong

\textsuperscript{53} Havel & Sanchez, supra note 3, at 651.
\textsuperscript{54} Lee & Dy, Mitigating ‘Effective Control’ Restriction, supra note 10, at 238.
\textsuperscript{55} For a table listing out such JVs, see id., at 239-240.
\textsuperscript{56} Id.
\textsuperscript{57} For a table listing out such JVs, see id., at 243-244.
\textsuperscript{58} JAE WOON LEE, REGIONAL LIBERALIZATION IN INTERNATIONAL AIR TRANSPORT: TOWARDS NORTHEAST ASIAN OPEN SKIES (2016) 187.
\textsuperscript{59} ATLA Public Inquiry, supra note 51. See also, Lee & Dy, A Commentary on Jetstar Hong Kong Airways, supra note 10.
\textsuperscript{60} Lee & Dy, A Commentary on Jetstar Hong Kong Airways, supra note 10.
as well. In the decision, ATLA set out the applicable test in deciding whether an airline is able to satisfy the requirement. Highlights of the requirement that ATLA pronounced are as follows:

(i) The airline has to have independent control and management in Hong Kong, free from directions or decisions made elsewhere.

(ii) The nerve centre has to be in Hong Kong. By nerve centre, ATLA looks at where and by whom the decisions regarding the key operations of an airline are made. Decisions are not those of the day-to-day operations only but also those which are relevant and crucial to the business of the airline.

(iii) The core business of an airline is the carriage of passengers and goods for reward and the decisions as to where the airline can fly (i.e. route and networking) and how much it can charge for the services rendered (i.e. pricing) are two important factors, among others, under ATLA’s consideration. Decisions pertaining to these matters have to be independently controlled and managed in Hong Kong.

Judging by ATLA’s approach in the Jetstar case, there remains some doubt about whether the PPB approach constitutes much of a departure at all from the typical SOEC requirements.

Moving on, Australia and New Zealand have adopted a somewhat exceptional approach. Both these states have completely liberalized foreign ownership of domestic airlines. As the first country to do so, New Zealand removed the foreign ownership restriction in 1988; Australia relaxed the ownership rules in 1999. This means that “any foreign person including a foreign airline can acquire up to 100% of the equity of an Australian domestic airline.” The lifting of the foreign ownership cap was particularly significant in the creation of low-cost carriers. Virgin Blue (now Virgin Australia), a subsidiary of the Virgin Group, was established in 2000 with 100% U.K. capital, and Tiger Airways Australia has been a wholly-owned subsidiary of Singapore’s Tiger Airways Holdings Limited since its creation in 2007.

In all, while there are countries like Australia and New Zealand, which have fully liberalized their domestic air segment, and those like Hong Kong and Singapore that have adopted the PPB model, most others continue to apply stringent regulations that set forth nationality

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61 Lee & Dy, A Commentary on Jetstar Hong Kong Airways, supra note 10, at 188.
62 ATLA Public Inquiry, supra note 51.
64 Havel & Sanchez, supra note 3, at 652; Bohmann, supra note 4, at 698; Lee & Dy, A Commentary on Jetstar Hong Kong Airways, supra note 10, at 182-183.
66 Hsu & Chang, supra note 63, at 566.
67 See, Lee & Dy, A Commentary on Jetstar Hong Kong Airways, supra note 10, at 182.
requirements for foreign investment in the airline industry. Strict SOEC requirements are the
norm rather than the exception. With a maximum limit of 25% foreign investment, the U.S.
continues to reflect one of the most onerous regimes for foreign ownership of the airline
industry.

D. Proposals for Reform

As we have seen, restrictive foreign ownership conditions around the world have left the
airline industry far behind in the path of liberalization. Often, the SOEC requirements are
ambiguous, leading to substantial uncertainty for industry players. The regime grants
considerable discretion to national government authorities to interpret SOEC on a case-by-
case basis. Moreover, although nearly a century has elapsed since the origin of the SOEC
requirements and the airline industry has come a long way, the regulatory developments have
failed to keep pace with reality. In these circumstances, there have been considerable calls for
reform of the SOEC regime, both within national legislation as well as under bilateral
arrangements.

One set of proposals argues that the time has come for a complete overhaul of the foreign
investment regime in the airline industry by obliterating ownership restrictions altogether. This
strain of thought finds that safety and security considerations can be addressed through
other mechanisms rather than through ownership restraints. The proposal that is gathering a
lot of momentum is one that calls for a transition from the nationality rule to a norm that
considers “an ‘establishment,’ ‘strong link,’ or ‘corporate affinity’” of an airline towards a
state. According to this approach, the focus must be on the country that regulates various
aspects of an airline, including safety, security, environmental, taxation and labor issues.
The focus is on regulatory connections to a country as opposed to ownership linkages. As the
CAPA Centre for Aviation notes:

Regulatory nationality would refer to the state that oversees the airline’s compliance with safety, labour and environmental regulations; where the majority of its aircraft are registered, and where it pays taxes. This would separate the nationality of an airline as determined from a regulatory point of view from the nationality of those owning its shares or making operational decisions.

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68 LEHUR, supra note 2, at 6.
69 Id.
70 Id., at 151.
71 Id. At the same time, there have been strong protestations against such an approach, and in favor of the status quo. Edwards, supra note 6.
72 HAVEL, supra note 7, at 167.
73 World Economic Forum, supra note 1, at 15.
Although this is similar to the PPB approach followed by Hong Kong and Singapore, the regulatory nationality proposal is somewhat narrower, and seeks to avoid the issues that arose in the case of Jetstar Hong Kong.\footnote{Id. For a discussion on Jetstar Hong Kong, see text accompanying supra notes 59-62.}

The aforesaid proposal has its limitations. While some states may be willing to relax or remove their nationality restrictions under domestic law, the ability to lift restraints under bilateral arrangements is more difficult due to the external lock. Due to the prisoner’s dilemma, states will be hesitant to make any concessions, and the only way a major reform can be accomplished is if some of the leading countries take the step to lift the foreign ownership restrictions.\footnote{Havel, supra note 7, at 165; Havel, supra note 4, at 13215. Both Australia and New Zealand have already demonstrated a commitment in this regard. See text accompanying supra notes 63-67.} However, proposals have been made for stopgap arrangements through appropriate waivers of nationality requirements under bilateral treaties.\footnote{Havel & Sanchez, supra note 3, at 662 (noting that a ‘novel ‘short path’ approach … contemplates that a state’s authorized government officials would declare publicly that they would no longer enforce the nationality clauses in bilaterals with those states which agree reciprocally to do the same.’)\footnote{John F. O’Connell & George Williams, Transformation of India’s Domestic Airlines: A Case Study of Indian Airlines, Jet Airways, Air Sahara and Air Deccan, 12 J. AIR TRANSP. MGT. 358 (2006).\footnote{V.S. Mani & V. Balakista Reddy, The History and Development of Air Law in India: A Survey, in S. Bhatt, V. S. Mani & V. Balakista Reddy (Eds.), Air Law and Policy in India 23 (1994). See also, Alan Khee-Jin Tan, India’s Evolving Policy on International Civil Aviation, 38 AIR & SPACE LAW 439, 440 (2013).\footnote{This followed India’s economic liberalization in 1991. See, Montek S. Ahluwalia, Economic Reforms in India Since 1991: Has Gradualism Worked? In RAHUL MUKHERJI (ED.), INDIA’S ECONOMIC TRANSITION: THE}}}

In the light of the origin, evolution and diffusion of the ownership restrictions in the airline industry both through domestic regulation (internal lock) and bilateral arrangements (external lock) as discussed in this Part, we now embark upon a detailed examination of the legal regime in India.

\section*{III. INDIA’S FOREIGN INVESTMENT REGIME IN THE AIRLINE INDUSTRY}

The foreign investment regime in India’s airline industry has witnessed a checkered history. After shutting out any kind of foreign investment altogether for several decades, it is only about a quarter of a century ago that Indian airlines were permitted to take on foreign ownership, but with stringent limits. Since then, the foreign investment rules have been considerably liberalized, with the process picking up substantial momentum in recent years.

\subsection*{A. A Restrictive Regime Historically}

Although private airlines were operating in India in the years following independence in 1947, the Government took the step of nationalizing eight private airlines by enacting the Air Corporation Act, 1953.\footnote{This followed India’s economic liberalization in 1991. See, Montek S. Ahluwalia, Economic Reforms in India Since 1991: Has Gradualism Worked? In RAHUL MUKHERJI (ED.), INDIA’S ECONOMIC TRANSITION: THE} Since then, the Indian airline industry constituted a state monopoly, with Air India operating on international routes and Indian Airlines in the domestic sector.\footnote{John F. O’Connell & George Williams, Transformation of India’s Domestic Airlines: A Case Study of Indian Airlines, Jet Airways, Air Sahara and Air Deccan, 12 J. AIR TRANSP. MGT. 358 (2006).\footnote{V.S. Mani & V. Balakista Reddy, The History and Development of Air Law in India: A Survey, in S. Bhatt, V. S. Mani & V. Balakista Reddy (Eds.), Air Law and Policy in India 23 (1994). See also, Alan Khee-Jin Tan, India’s Evolving Policy on International Civil Aviation, 38 AIR & SPACE LAW 439, 440 (2013).\footnote{This followed India’s economic liberalization in 1991. See, Montek S. Ahluwalia, Economic Reforms in India Since 1991: Has Gradualism Worked? In RAHUL MUKHERJI (ED.), INDIA’S ECONOMIC TRANSITION: THE}} It was only in 1994 that the state monopoly in the airline industry was ended through the
repeal of the Air Corporation Act, which paved the way for the reentry of private players.\textsuperscript{81} This development also coincided with the opening up, for the very first time, of the Indian skies to foreign investment.\textsuperscript{82} Under the 1994 policy, foreign direct investment (“FDI”) was permitted up to 40% in Indian airline companies, although the participation (direct or indirect) of foreign airlines was prohibited altogether.\textsuperscript{83} Moreover, the SOEC was to be vested with Indian nationals, and the airline’s chairman as well as two-thirds of the directors were to be citizens of India. At the same time, an important concession was made for non-resident Indians (“NRIs”), who could invest up to 100% in an Indian airline company.\textsuperscript{84}

Several private operators took advantage of the liberalization of the airline industries by obtaining scheduled airline status and commencing operations.\textsuperscript{85} Of these, only Jet Airways continues to operate services to the present day; it has also been one of the leading players on the Indian aviation scene. In 1993, when it was granted the license to operate, Jet Airways was established as an Indian company, which was owned Tail Winds, a company based in the Isle of Man.\textsuperscript{86} In turn, Naresh Goyal (the founder of the company, who was an NRI) held 60% of the shares of Tail Winds, with two foreign airlines, Gulf Air and Kuwait Airways, holding 20% each.\textsuperscript{87} The precarious nature of India’s then foreign investment policy in the airline industry is symptomatic in a material revision the Government made soon thereafter in 1997 by which it decided to enforce the ban against any investments by foreign airlines in Indian operators.\textsuperscript{88} Consequently, Gulf Air and Kuwait Airways divested their shares in Tail Winds to Naresh Goyal who became the sole owner of the company and indirectly of Jet Airways. The ability of NRIs to fully own Indian airline companies is a peculiar feature of foreign investment in the aviation industry (that continues to date), and one that has been successfully utilized by companies such as Jet Airways.

The early 1990s also witnessed an attempt by Singapore Airlines to establish an airline in India as a joint venture with the renowned Tata group. Despite tireless efforts, the companies failed to obtain the requisite license from the Ministry of Civil Aviation due to too much capacity.\textsuperscript{89} The aversion of Indian regulators to the entry of foreign airlines through equity investment in Indian companies dealt a fatal blow to the Singapore Airlines-Tata venture,

\begin{itemize}
\item \textsuperscript{81} Hooper, supra note 14, at 116; Tan, supra note 79, at 440; \textit{Aviation Sector: Policy Changes and Their Impact}, THE HINDU BUSINESS LINE (Aug. 27, 2013).
\item \textsuperscript{82} SHARAD KUMAR CHATURVEDI, FOREIGN INVESTMENT LAW AND ITS IMPACT ON LABOUR (2007) 75.
\item \textsuperscript{83} Id., at 75-76.
\item \textsuperscript{84} Id.
\item \textsuperscript{85} These are Archana, Damania, East-West, Jet Airways, Modiluft and NEPC Airlines. O’Connell & Williams, supra note 78, at 360.
\item \textsuperscript{86} Id. See also, Jet Airways (India) Limited, \textit{Prospectus} (Feb. 28, 2005) 61, available at http://www.cmllinks.com/pub/dp/dp5586.pdf (hereinafter the “Jet Airways Prospectus”).
\item \textsuperscript{87} Jet Airways Prospectus, supra note 86, at 61. It is a matter of some curiosity that the two foreign airlines were permitted to invest in Jet Airways despite a policy pronouncement that clearly barred foreign airlines from investing in the equity of Indian company.
\item \textsuperscript{88} Id. O’Connell & Williams, supra note 78, at 360.
\item \textsuperscript{89} Hooper, supra note 14, at 117.
\end{itemize}
which failed to take off.90 Some have argued that this was a result of “malignant lobbying”91 by the existing private operators as well as the state-owned Indian Airlines that led to the rejection of the Singapore Airlines-Tata proposal.92 There is some evidence of the influence of domestic interest groups in determining the shape of India’s foreign investment policy in the airline sector.

In the ensuing period, a restrictive legal regime began adversely affecting the airline industry, which had a consequential negative impact on the economy.93 The Government appointed a committee under the chairmanship of Naresh Chandra, which recognized that due to the “highly capital intensive nature of the airlines business, liberal norms for foreign investment is a critical pre-requisite for enhancing India’s airlines’ access to international capital flows.”94 Interestingly, the committee’s report sought to assuage concerns pertaining to national security concerns in the airline industry and acknowledged the steps taken by other countries to liberalize foreign participation in their airlines.95 Accordingly, it recommended not only that the foreign investment limit be raised from 40% to 49% in India’s airlines (both domestic and international), but also that foreign airlines be allowed to invest within the raised limit.96 The committee’s recommendations were accepted in part in 2008 when the foreign investment limit was raised to 49%,97 but the doors continued to be shut for foreign airlines.98

B. The Entry of Foreign Airlines

The year 2012 witnessed a momentous change. The Government permitted foreign airlines to invest in Indian airline companies to the extent of the prescribed limit of 49%.99 However, it stipulated stringent conditions for investment by foreign airlines. Such investment could be made only with the prior approval of the Government, while non-airline foreign investors could invest under the automatic route (without prior governmental approval).100 An Indian airline receiving investment from a foreign airline would be granted a permit to operate only

90 Id.
91 S.K. Saraswati, Operating Environment for a Civil Aviation Industry in India, 7 J. AIR TRANSP. MGMT. 127, 133 (2001).
92 Id. See also, O’Connell & Williams, supra note 78, at 362-363.
93 O’Connell & Williams, supra note 78, at 364.
95 Id., at 26-27.
96 Id., at 27.
98 However, foreign airlines were permitted to invest in cargo airlines. See, text accompanying infra notes 103-106. This period also saw mergers and acquisitions activity in the airline industry. For example, in the private sector, Air Sahara merged with Jet Airways and Air Deccan with Kingfisher Airlines; in the public (state) sector, Indian Airlines merged with Air India. See, Tan, supra note 79, at 440-441.
100 Id, paragraph 2.2(i).
if: (i) its principal place of business is in India; (ii) the chairman and at least two-thirds of the directors are Indian citizens; and (iii) the SOEC is vested with Indian nationals.\(^{101}\) Safety and security concerns were also addressed in that foreign nationals to be involved in the Indian airline’s business must be cleared from a security point of view before deployment, and that technical equipment to be imported into India would also require appropriate clearances.\(^{102}\)

Two additional features of the 2012 policy merit discussion. The first is that foreign airlines were allowed to participate in the equity of Indian cargo airlines, and a higher limit of 74% was prescribed on the extent of such investments.\(^{103}\) For instance, Singapore Airlines could potentially set up a freighter airline in India, subject to the limit prescribed above. Generally, it has been easier to liberalize cargo service than passenger service at a global level.\(^{104}\) States have traditionally shown far more willingness to provide market access for foreign carriers carrying cargo than passengers. For instance, the ASEAN Single Aviation Market approach has shown that the cargo market is more flexible than the passenger market.\(^{105}\) The reason why cargo liberalization tends to be less controversial for states and their carriers is that the participation of foreign carriers in freight transport can help increase the exports of a particular state.\(^{106}\)

The second is that the state-owned airline, Air India, was immunized against participation by foreign airlines because the policy was inapplicable to it.\(^{107}\) Presumably, this was intended to shield the flag carrier. But, the reality is that the aviation community criticized this measure by calling it the “Air India Syndrome,” through which the carrier was protected almost to death, as it allowed other carriers to become more efficient.\(^{108}\)

The 2012 policy had an immediate impact on the airline industry, as three foreign airlines capitalized on the opportunity invest in India. The first to get off the block was Abu Dhabi-based Etihad Airways, which took a 24% stake in Jet Airways.\(^{109}\) This was followed by the establishment of two new joint venture airlines. One involves a 49% stake by Singapore

\(^{101}\) Id, paragraph 2.2(iv).

\(^{102}\) Id, paragraph 2.2(v), (vi).

\(^{103}\) Id, paragraph 3.

\(^{104}\) International Civil Aviation Organization (ICAO), Liberalization of Air Cargo Services, ICAO ATCONF/6-WP/14 (Dec. 13, 2012) (Presented by ICAO Secretariat), available at http://www.icao.int/Meetings/atconf6/Documents/WorkingPapers/ATConf6-wp014_en.pdf [1.2] (noting that “[A]s at the end of October 2012, of the 400 plus open skies agreements concluded by States, more than 100 granted Seventh freedom for air cargo or all cargo services, thus providing greater opportunity for the growth of such services.”).

\(^{105}\) Ian Thomas, David Stone, Alan Khee-Jin Tan, Andrew Drysdale, & Phil McDermott, Developing ASEAN’s Single Aviation Market and Regional Air Services Arrangements with Dialogue Partners, (Final Report, June 2008, REPSEF II Project No. 07/003) 72.

\(^{106}\) Id.

\(^{107}\) Press Note 6 of 2012, supra note 16, at paragraph 2.3.

\(^{108}\) Centre For Aviation, North Asian LCC, Round 1: Inertia prevails over innovation in 2013, AIRLINE LEADER 18 (Aug-Sep 2013) 36, 38.

Airlines in Vistara, in which the Indian partner, Tata Sons, holds 51%. The other is a 49% stake obtained by AirAsia in AirAsia India, with the remaining stake currently held 49% by Tata Sons and 2% by two Tata Sons executives. We subsequently discuss these airline investments in greater detail with a view to analyzing the impact of the policy.

C. Recent Further Liberalization

The most recent round of liberalization occurred in 2016 in two parts. In June of that year, the Government of India further opened up foreign investments in various sectors, including the civil aviation sector. The most drastic change is that foreign investment in Indian airlines is permitted up to 100%. Of this, 49% can be brought in under the automatic route, while the investment beyond that requires prior Government permission. While this may seem like complete liberalization of the Indian airline sector to foreign investment, the increased limit has been made unavailable to foreign airlines. In other words, foreign airlines continue to be subject to the 49% cap on investment coupled with the SOEC and security restrictions discussed earlier. At the same time, foreign investment in cargo airlines was fully opened up to foreign investment thereby allowing 100% participation by foreign investors (including foreign airlines), thereby once again establishing the intent of the Government to put the cargo sector on a different pedestal from that of the passenger sector.

Also in June 2016, the Government of India, through the Ministry of Civil Aviation, issued the National Civil Aviation Policy 2016 (“NCAP 2016”) with a view not only to prescribing a comprehensive regulatory policy governing the sector, but also to liberalizing the administrative and regulatory setup. While the NCAP 2016 covers a wide range of issues relevant to the aviation sector in general, here we confine our discussion to one important aspect that has direct relevance to the question of foreign investment. Since 2004, the Government required that, for Indian private carriers to fly on international routes, they must have been flying on domestic routes for five years and must also have a fleet of at least 20 aircraft. However, such a scheme which was unique to India, was considered an impediment to new carriers, especially those such as Vistara and AirAsia, which had only
It recently begun their operations. At the same time, the existing carriers who had already been subject to this rule only believed this to be fair as they all had to carry out domestic operations for five years before being allowed to operate internationally.\footnote{Vaidyanathan, supra note 13, at 22; Neelam Mathews, India Adopts Long-Awaited National Aviation Policy, AIN ONLINE (Jun. 29, 2016), available at http://www.ainonline.com/aviation-news/air-transport/2016-06-29/indiaadopts-long-awaited-national-aviation-policy.} After taking into account various factors, the NCAP 2016 decided to do away with the five-year requirement and provided that “all airlines can commence international operations provided that they deploy 20 aircraft or 20% of total capacity (in terms of average number of seats on all departures put together), whichever is higher for domestic operations.”\footnote{Id., at paragraph 8(b).} This will potentially allow the newly-minted Indian carriers with foreign investment as well as those to be set up in the future to not only fly domestic routes, but to also accelerate their international foray (as long as they satisfy the requirements regarding the minimum number of aircraft). This policy arguably works to incentivize foreign investment in Indian carriers as they can spread their business and risks through both domestic as well as international operations.

In concluding our discussion of the evolution of the Indian legal regime governing foreign investments in the airline industry, we find that there has been a sea-change in regulation over the last quarter of a century. From 1993 when only the two state-owned airlines (Air India and Indian Airlines) were in operation, we have witnessed the rapid expansion of the airline industry that has grown to 14 scheduled operators\footnote{Director General of Civil Aviation, Government of India, List of Air Operator Certificate/Permit (Scheduled) as on 20.07.2017, available at http://www.dgca.nic.in/operator/sch-ind.htm.} with the national carrier, Air India, having only 13% of the market share of the industry.\footnote{As of March 2017. Pravin Krishna & Vivek Dehejia, Privatize Air India, Now, THE MINT (May 29, 2017).} Several private carriers have demonstrated strong performance,\footnote{As the dominant player in the Indian domestic market, Indigo had a market share of 41.4% in March 2017. FE Bureau, Air traffic soars 15% in April; Indigo stays on top; Air India marketshare flat at 12.9%, FINANCIAL EXPRESS (May 19, 2017).} while some have fallen by the wayside.\footnote{The most prominent airline among those who have suspended their operations is Kingfisher Airlines. See, Tan, supra note 79, at 441.} Ultimately, the regulatory progression in India is a story of a transition from a highly restrictive legal regime to one that is now liberal compared to most other jurisdictions around the world.

With this background, we now examine the prevalent foreign investment policy in the Indian airline industry with a view to determining whether the benefits of foreign investment are as strong as they have been portrayed to be.

IV. NATIONALITY REQUIREMENTS UNDER INDIA’S DOMESTIC LAW

We begin with a discussion of the “internal bolt”\footnote{For a discussion of this concept, see text accompanying supra notes 20-23.} that sets out foreign investment restrictions under Indian domestic law.\footnote{For a discussion on the “external bolt”, see infra Part V.} At the outset, India’s current policy on foreign
investment in the airline sector appears from a comparative perspective to be rather open. While most countries have strict limits on the level of foreign investment, India has adopted a broad-minded approach by allowing foreign investors to acquire total ownership and control of an Indian airline. In doing so, it joins a select group of countries such as Australia and New Zealand that allow 100% foreign investment in the industry. In some ways, India’s approach is even more liberal than Australia and New Zealand. While those two countries allow 100% foreign investment only in domestic airlines (and no more than 49% in international airlines), India makes no such distinction. In that sense, foreign investors can invest up to 100% in an Indian airline that operates internationally, thereby making it perhaps the most liberal regime in the world.127

India’s attitude is also comparable to the PPB approach adopted by countries such as Hong Kong and Singapore. In allowing 100% foreign investment (without any control constraints for non-airline investors), it has in some ways demonstrated a bolder outlook, thereby avoiding some of the control- and management-related issues that cropped up in the Jetstar case in Hong Kong.128

The apparent liberalism of the Indian Government ends there. As we argue in this Part, there are several factors that impose constraints on foreign investments in the airline industry in practice. First, to our knowledge, India is the only country in recent history that makes a distinction in its foreign investment policy on ownership and control by foreign airline investors and non-airline investors.129 While it displays a flexible and receptive sentiment towards non-airline investors, it has continued to impose shackles on airline investors. To our minds, this is a significant impediment to foreign investment in India’s airline industry. Second, and in the case of non-airline investors, India’s policy signals an open invitation for foreign ownership up to 49% (by permitting such investments under the automatic route), but it subjects investments beyond that limit to the requirement of obtaining prior Government approval. As of this writing, there is less clarity (if at all) on the circumstances in which such approval might be granted, and the conditions which the Government is likely to impose. This leaves us with a perplexing question: can the Government, exercising its discretion in granting approvals beyond 49% investment by non-airline investors, reintroduce the SOEC requirements through the back door? If so, the benefits of liberalization in India’s policy may not be as extensive as it appears.

127 See, Tim Worstall, *India’s Civil Aviation Industry Now To Be More Free Than That In The United States*, Forbes (Jun. 20, 2016) (observing that “the Indian civil aviation industry should now be more economically free than that in the United States”). As we will further discuss in the next section, however, such international flights require a waiver from the partner states to which the airlines operate based on the air services agreements.

128 See, text accompanying *supra* notes 59-62.

To enunciate our aforesaid arguments, we explore the implementation of India’s foreign investment policy, first to foreign airline investors, and thereafter to non-airline investors. In doing so, we analyze, by way of illustration, some recent efforts by foreign investors to obtain shareholdings in Indian airlines, the issues that cropped up during the process, and the way they were resolved, either satisfactorily or otherwise. We then consider some of the idiosyncrasies of the Indian regime (such as a liberalized approach towards NRI investments, as well the treatment of Air India with kid gloves) and the role of lobbying in shaping foreign investment regulation in India’s airline industry.

A. Investments by Foreign Airlines

The SOEC requirements for investments by foreign airlines are now encapsulated in India’s Consolidated FDI Policy. Apart from stating that such investment is limited to a maximum of 49% of the paid-up capital in the Indian operator, the material wording runs as follows:

A Scheduled Operator’s Permit can be granted only to a company:

a) that is registered and has its principal place of business within India;

b) the Chairman and at least two-thirds of the Directors of which are citizens of India; and

c) the substantial ownership and effective control of which is vested in Indian nationals.

Of these, it is the third condition that has caused a considerable level of consternation. Although the concepts of substantial ownership and effective control in aviation are inter-related, they have distinct characteristics. Substantial ownership is a quantitative restriction that sets a limit on the amount of a national carriers’ shares held by foreigners. The limit of 49% is placed on the “paid-up capital” of the company. Hence, it does not matter whether the investment is in voting shares or non-voting shares, the foreign airline’s overall shareholding in the aggregate in the Indian company cannot exceed 49%. This may affect the capital raising ability of the Indian company even if it wishes to do so by issuing non-voting shares to foreign airline investor.

The effective control restriction, on the other hand, is a qualitative criterion that focuses on “who controls” national air carriers. By its very nature, evaluating effective control is

130 Supra note 113.
131 Even though substantial ownership is seemingly a quantitative question, reasonable minds can differ. Some argue that the concept involves holding a majority of shares (say 51%), but other believe that in case of a company with a fragmented shareholding, even a 30% shareholding could tantamount to substantial ownership. See, Behind the invisible hand, BUSINESS STANDARD (Apr. 24, 2016).
132 Contrast this with the 25% limit available to foreign investments into US airlines, where it is based on the amount of “voting stock”. However, this too has been subject to varying interpretations by the US regulatory authorities. See, Alexandrakis, supra note 8, at 80-91; Nanda, supra note 8, at 365-372; Gjerset, supra note 8, at 190-192.
133 Lee & Dy, Mitigating ‘Effective Control’ Restriction, supra note 10, at 234.
trickier than assessing substantial ownership because it is not a mathematical question. The Consolidated FDI Policy defines “control” to “include the right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements.”

Based on the definition, control can be classified into two types. The first is board control, which is more straightforward. The contractual documentation between the parties must not give the foreign airline investor the right to appoint a majority of the directors of the Indian company. The second is management (or operational) control, which is thornier. This moves matters to a subjective domain that confers considerable discretion to the regulatory authority to determine whether the foreign airline has management control. It ultimately depends on the terms of the contractual arrangements between the parties, and has given rise to ambiguities in the Indian context. These are best understood through a brief discussion of the three foreign airline investments that have been made in India since the policy was liberalized in 2012.

1. Existing Airline: Jet Airways

Etihad Airways’ 2013 investment in a 24% stake in Jet Airways represents a key milestone in the Indian aviation sector, as it was the first significant investment by a foreign airline into an Indian one. In spite of being a relative newcomer to the industry, the Abu Dhabi based Etihad Airways has grown at a scorching pace. In a sector dominated by strong regional rivals such as Emirates and Qatar Airways, it was imperative for Etihad to adopt a unique model, which was to focus on an inorganic strategy through partnerships and equity investments in other airlines. Within a short span of time, Etihad entered into numerous “equity alliance” arrangements with airlines across several continents.

A 24% investment in Jet Airways fit elegantly into Etihad’s strategy. Etihad, Jet Airways and the controlling shareholders of Jet Airways entered into an appropriate shareholders’ agreement (to deal with shareholding and control matters) and a commercial co-operation agreement (covering matters such as “administrative costs, sharing of joint resources, better customer service and efficient administration of their respective businesses”). However, Etihad faced considerable difficulties as it navigated through the Indian regulatory maze to obtain the various government approvals required for the investment.

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134 Consolidated FDI Circular, supra note 113, at paragraph 2.1.8.
139 Etihad decided to take a 24% stake (rather than utilize the full headroom of 49%) in order to avoid making a mandatory offer to buy the shares of all the shareholders of Jet Airways (a listed company), which would be triggered by an acquisition of 25% or more. See, Varottil, supra note 135, at 226.
140 Nishith Desai Associates, supra note 109, at 2.
Under the relevant policy, Etihad was required to obtain the permission of the Government of India, for which applications were then considered by an inter-ministerial body referred to as the Foreign Investment Promotion Board (“FIPB”). Even though Etihad was taking up only a 24% stake in Jet Airways, the FIPB raised concerns on matters pertaining to SOEC, particularly in respect of board representation and management rights of Etihad. Issues arose as to whether Etihad was obtaining de facto control of Jet Airways. Such concerns were also echoed by other regulators that needed to clear the transaction, such as India’s securities regulator, the Securities and Exchange Board of India (“SEBI”), and the competition regulator, the Competition Commission of India (“CCI”).

To clear the hurdles imposed by the various regulators, Etihad agreed to amend the provisions of (and thereby “sanitize”) the contractual agreements it had with Jet Airways (and its controlling shareholders) to considerably dilute the protective provisions. Etihad was therefore compelled to forsake some of its contractual and commercial protection in exchange for ensuring that the transaction sails through smoothly with the Indian regulators. In the end, Etihad had to agree for watered down rights: it settled for only two board nominees out of a total of 12 directors with no majority board control, and it had to give up any veto rights or affirmative votes on key decisions involving the company.

Even though Etihad acquired only 24% shares in Jet Airways, it endured an elongated process with the Indian authorities that lasted more than a year before its investment could be cleared. In the process, not only did it have to forsake the customary rights available to minority shareholders in companies that are required to protect their own interests (rather than exercise any control), but it was subjected to investigations by multiple regulators (sometime on repeated occasions) before its investment was cleared. Etihad was not even the largest shareholder to be able to exercise any influence on its own, since the controlling shareholders of Jet Airways hold more than a double of Etihad’s stake at 51% thereby exercising legal control.

Etihad had to tread a fine line by devising the contractual arrangements and protections clinically to withstand the Indian regulators’ eagle eye. Although it succeeded in obtaining the regulatory clearances in the end, the price it had to pay was diminished protection and lost time and effort in convincing multiple regulators. But, the presence of zealous regulators with considerable discretion to interpret “control” would mean that parties must be willing to alter their carefully negotiated contractual arrangements to meet with the regulators’ concerns. In that sense, regulatory discretion conferred through the SEOC requirements penetrates the realm of contractual negotiation when a foreign airline invests in an Indian one.

2. Newly-Established Airlines: AirAsia India and Vistara

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141 Press Note 6 of 2012, supra note 16.
142 For a brief background regarding the FIPB, see, Umakanth Varottil, Abolition of the Foreign Investment Promotion Board, INDIACORPLAW (Feb. 25, 2017).
143 Nishith Desai Associates, supra note 109, at 2-4.
144 Id., at 3-4.
The liberalization of 2012 also paved the way for two JV airlines in India: AirAsia India and Vistara. Tata Sons, India’s leading conglomerate holding company has a stake in both airlines. While AirAsia India is a low-cost carrier, Vistara is a full-service carrier primarily targeting high-end business travelers.

From the SOEC perspective, the change in the ownership structure of AirAsia India is noteworthy. When AirAsia India secured the Indian air operator certificate in 2013, the company was a three-way joint venture with Tata Sons, Arun Bhatia’s Telestra Tradeplace Pvt Ltd (an Indian company), and AirAsia, with the partners holding 30%, 21%, and 49%, respectively. Interestingly, Arun Bhatia had a close relationship with AirAsia’s founder and group CEO, Tony Fernandes. In June 2014, when AirAsia India commenced domestic services, ownership was changed to 41.06% (Tata Sons), 9.94% (Arun Bhatia), and 49% (AirAsia). In March 2016, the media reported that Arun Bhatia was set to exit AirAsia India after igniting a controversy through his remark that AirAsia India was being controlled by its Malaysian partner. Consequently, Tata Sons bought a 7.94% stake from Bhatia. Two Tata Sons executives—AirAsia India chairman S. Ramadorai and director R. Venkataramanan—acquired 0.5% and 1.5%, respectively, from Bhatia in their personal capacity. Ultimately, AirAsia and Tata Sons each hold an equal stake of 49%, with Ramadorai and Venkataramanan holding the remaining 2% shares in the aggregate.

Vistara’s background is less eventful than AirAsia India. From the beginning, the ownership structure has been 51% by Tata Sons and 49% by Singapore Airlines. In fact, this joint venture was long awaited by Tata Sons, given the Indian conglomerate’s unsuccessful attempts in the 1990s to launch an airline in partnership with Singapore Airlines. Unlike AirAsia India, in which Tata Sons started off with a 30% stake and minimal involvement in operations, Vistara was seen as Tatas’ official reentry into the airline business after over six decades.

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145 Unlike Jet Airways, the stocks of these companies are not publicly listed.
146 Vistara, AirAsia India look to expand fleet size to 20 planes as rules eased, THE HINDUSTAN TIMES (Jun. 16, 2016).
147 AirAsia in expansion drive, THE HERALD (Jul. 1, 2013). A public interest challenge was mounted in the Delhi High Court against AirAsia’s investment in AirAsia India on the ground that the 2012 FDI policy in the civil aviation sector applied only to investments in existing airlines (i.e., brownfield projects) and not to investments in newly established airlines (i.e., greenfield projects). At the interim stage, the Delhi High Court refused to interfere as this was a policy question to be left to the executive branch of the government to determine. However, the matter is pending final adjudication. See Dr. Subramanian Swamy v. Union of India, [2014] 125 SCL 133 (Del.).
149 P.R. Sanjai, Tata Sons to buy out Arun Bhatia, supra note 111.
150 Id. For the details of an interview by Arun Bhatia, see Binoy Prabhakar, AirAsia India controlled by Malaysian partner claims cofounder Arun Bhatia, THE ECONOMIC TIMES (Dec. 11, 2015).
151 Sanjai, Tata Sons to buy out Arun Bhatia, supra note 111.
152 Aneesh Phadnis, With Vistara, a Tata airline is reborn, BUSINESS STANDARD (Jan. 9, 2015). See also, text accompanying supra notes 89-92.
153 Phadnis, supra note 152.
However, India’s incumbent airlines have accused AirAsia India and Vistara of being controlled by foreigners and have asked for their operating licenses to be suspended. In response to their allegation, the Tata group argued:

Majority ownership and effective control of both airlines are with the Indian parties … Further, all the important decisions concerning the day-to-day operations of the airlines are taken by the management teams of these airlines under the overall supervision, control and direction of the respective boards of directors (which include a majority of Indian nationals).

Although the controversy is unabated and a lawsuit is in progress whose outcome is difficult to predict, the Jetstar Hong Kong decision can be an important lesson for India. The fact that conduct of day-to-day management is taking place in India would not be sufficient to meet the control criteria. What is more, the terms and tenor of contractual arrangements such as the shareholders’ agreement and any business service agreement could be important considerations. To be clear, the shareholders’ agreement must establish that the Indian airlines (AirAsia India and Vistara) can make its decisions independently from the foreign airline shareholders. Similarly, the business service agreement or commercial co-operation agreement, if any, must show that AirAsia India and Vistara have the right to determine their own network, fare structure, and other flight-related matters.

In all, the experience borne out by the investments by the foreign airlines is far from satisfactory. The SOEC restrictions have been designed and applied in an ambiguous manner, and uncertainties have not been put to rest till date. While the opening of the Indian civil aviation sector in 2012 to foreign airlines is a momentous occasion in the industry’s evolution, the regulatory regime still leaves much to be desired.

B. Non-Airline Investors

India has fully liberalized foreign investments by non-airline investors into its civil aviation industry by opening it up to 100% foreign ownership. This is beneficial to the Indian airline industry, as it allows Indian carriers to raise capital to meet their business needs in a highly competitive environment. It also enables Indian airline companies to undertake initial public offerings on domestic or international stock exchanges, with a view to accommodating foreign investment without quantitative limitations. While at one level this approach looks

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154 Tarun Shukla, *India’s Airlines Team to Try to Block AirAsia Low Cost Carrier*, SKIFT: CORPORATE TRAVEL INFORMATION REPORT (Feb. 22, 2014).
156 See supra note 147.
157 P.R. Sanjai, *What does 100% FDI in aviation mean?*, THE MINT (Jun. 21, 2016).
158 *Id.* On a related note, several Indian airline companies have approached the capital markets in the past, including Jet Airways India Limited, SpiceJet Limited and, most recently, InterGlobe Aviation Limited (which operates Indigo). See, Ravindra N. Sonavane, *Aviation stocks rally on robust passenger growth*, THE MINT (Jan. 19, 2017).
beneficial in attracting foreign investment, there appear to be several hurdles in its implementation.

At the outset, the liberalization seems to have been undertaken in a piecemeal manner. The Consolidated FDI Policy\(^\text{159}\) that deals with foreign investments allows 100% foreign ownership in the sector without any apparent SOEC restrictions on non-airlines investors.\(^\text{160}\) However, the requirements stipulated by the Director General of Civil Aviation (“DGCA”) have failed to keep pace with the liberalization in foreign investment. The requirements imposed by the DGCA for grant of a permit to operate scheduled air transport services continue to carry the condition that in case of an Indian airline seeking the permit, “substantial ownership and effective control is vested in Indian nationals”.\(^\text{161}\) These are mutually contradictory. The interaction of the legal regimes governing foreign investment and the aviation sector results in an inconceivable situation where an airline may have 100% foreign investment, but nevertheless the substantial ownership and effective control need to be vested in Indian hands! Unless the regulations imposed by the DGCA are reformed, investments by non-airline investors that exceed 49% or confer SOEC on such foreign shareholders will remain a fanciful hope.

Moreover, foreign investments beyond 49% require the approval of the Government of India, which will be granted on a case-by-case basis. Yet, there are no signs of how the Government will exercise its discretion in considering the applications for majority foreign investment in Indian airlines.\(^\text{162}\) More importantly, it is always open to the Government to introduce the SOEC requirements by way of conditions while granting the approvals for foreign ownership beyond 49%, although such SOEC requirements are not evident from the text of the FDI Policy Circular itself as it applies to non-airline investors. In other words, there is a risk that the Government might not provide a freehand to non-airline investors, and might use its discretion to curb the ownership and control rights that they might exercise.\(^\text{163}\) While the policy pronouncement at a broad level undoubtedly makes India’s foreign investment regime

\[^{159}\text{Supra note 113, at paragraph 5.2.9.2.}\]

\[^{160}\text{The conditions relating to SOEC apply only to foreign airline investors. See id. under the head “Other Conditions”; sub-paragraph (c). See also, Sindh Bhattacharya, Reasons why 100% FDI in India’s civil aviation could fail to take off, FIRSTPOST (Jun. 23, 2016); PTI, Government working on ‘appropriate policies’ for 100% FDI in airline, THE ECONOMIC TIMES (Mar. 15, 2017).}\]

\[^{161}\text{Director General of Civil Aviation, Minimum Requirements for Grant of Permit to Operate Scheduled Passenger Air Transport Services (Mar. 1, 1994), available at http://www.dgca.nic.in/operator/aop-ind.htm, at paragraph 3.1(b)(iii).}\]

\[^{162}\text{Hitherto, Government approvals for foreign investment were considered and granted by the FIPB, an inter-ministerial body. See supra note 142. However, in 2017, the Government abolished the FIPB, and announced standard operating procedures by which foreign investment applications will be considered by the relevant ministries or sectoral regulators. Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India, Standard Operating Procedures (SOP) for Processing FDI Proposals (Jun. 29, 2017), available at http://dipp.nic.in/whats-new/standard-operating-procedure-sop-processing-fdi-proposals. However, until considerable experience and proper practices have developed under these newly-minted reforms, there are likely to be difficulties in their implementation. See, Prem Rajani & Poorvi Sanjanawala, Will abolishing FIPB make India a more investor-friendly destination?, VCCIRCLE (Jun. 8, 2017).}\]

\[^{163}\text{Bhattacharya, supra note 160 (noting that “any non-airline foreign investor may have to undergo minute scrutiny from government agencies for permission to bring in funds into an Indian carrier”).}\]
in the airline sector fully open, matters are not likely to be as straightforward when the policy is operationalized, especially to the extent that non-airline investors seek to obtain more than a 49% shareholding in Indian companies. Moreover, this issue remains untested as, to our knowledge, no foreign investor has made an application to the Government for foreign investment beyond 49% in an Indian airline, and some believe that we are unlikely to witness a foreign investor taking a substantial stake in an Indian company soon.

Even as the dust settles on the new policy reforms allowing foreign investments up to 100% in Indian airlines, an announcement by Qatar Airways to set up an airline in India has stirred up a hornet’s nest. Since Qatar Airways itself cannot acquire more than 49% shares in an Indian airline (and that it will be subject to the SOEC requirements), it has been reported to consider partnering with Qatar Investment Authority, the country’s sovereign wealth fund. To begin with, Qatar’s proposal sounds rather attractive. The airline’s investment will be confined to the 49% allowed under the law, with the sovereign wealth fund taking the remaining stake (with, of course, the Indian Government’s approval), such that the Indian airline can be owned entirely by the two Qatari entities. However, there is more to it than meets the eye. First, the Consolidated FDI Policy is unclear about whether the 100% limit for foreign investment applies only when there is no participation by a foreign airline, or whether it is possible for a foreign airline to partner with a non-airline investor (as in the Qatar case) to fully exploit the rules. Some might argue that the 100% limit applies only when there is no involvement by a foreign airline in the proposed transaction. Second, even if the policy were to be interpreted expansively to allow such a partnership, it would be imprudent to expect that the Government of India would approve such an investment, given that it might be viewed as circumventing the SOEC requirements applicable to foreign airlines.

For the reasons we discuss above, foreign non-airline investors too face numerous hurdles in obtaining a significant majority stake in Indian airline companies. After separately analyzing investments by foreign airlines on the one hand, and those by non-airline investors on the other, we now aim to account for the unique distinction that the Indian foreign investment policy makes regarding ownership by these two types of investors, and consider whether such a differentiation is worthy of merit.

C. Reviewing the Dichotomy between Airline and Non-Airline Investors

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164 PTI, supra note 160.
165 Sanjai, What does 100% FDI in aviation mean?, supra note 157.
166 FC Bureau, Qatar Airways confident of clearing FDI hurdles in India, FINANCIAL CHRONICLE (Mar. 28, 2017).
168 FC Bureau, supra note 166 (quoting the Aviation Secretary as saying: “We would like to see there is no connection, direct or indirect between a foreign airline and its co-partner investing beyond the 49 per cent stake in an Indian carrier. …”).
The regulatory regime in India is distinctive in that the foreign investment norms draw a line embodied by the SOEC requirements to dissect foreign airlines and non-airline investors. A detailed rationale for such a distinction has eluded the public domain. On the surface, it appears to be a neat distinction. The exercise of control by foreign airlines might arguably affect the safety and security concerns, and increase any economic threat to the Indian airline sector. However, as we have already highlighted earlier in this Part, this distinction gives rise to several problems in its practical implementation.

While foreign airlines are likely to be strategic investors, non-airline owners are largely likely to be financial investors. To that extent, foreign airlines can seek to benefit substantially from their investments only if they have other forms of partnership with the Indian airline and possess the capability to participate in at least some of the key strategic decisions of the company. In case of investments by foreign airlines, much would depend upon the identity of the Indian controllers, who possess SOEC. If the local partner is an established company or group in the airline industry, the investor that is a foreign airline may be more willing to cede full control over the operations of the Indian airline to the local partner. However, when the Indian partner does not have prior experience in the airline sector, matters become somewhat murkier. In such cases, it is likely that the foreign airline investor would seek to exercise a greater say, at least on key decisions, in order to protect its investment in the company, and also to utilize to the maximum extent the business advantages it receives through such a partnership. One of us has argued (with a co-author) that foreign airline investors may in fact prefer such a scenario where there is only one specialist partner, as differences over managerial or operational matters may be difficult to reconcile between two airline partners. However, a partnership between a foreign airline and a non-airline Indian controlling shareholder might result in a situation where the foreign airline may be deemed to possess de facto control. This is arguably not an appropriate scenario when the only partner in the arrangement that has airline expertise is restrained from contributing the same to the full extent due to regulatory compulsions, thereby conferring all powers of control in the hands of a non-specialist Indian partner. Surely, this cannot be desirable from the perspective of full utilization of management skills and in enhancing business efficiency.

Moving to foreign ownership by non-airline investors, there are thorny issues within that realm as well. Such investors are principally expected to invest with a view to obtaining financial returns rather than to exercise control over the management and policy of the Indian airline. Such investors may take a stake through a public offering or private placement of shares by the company that may have capital needs. While such investors are potentially

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169 For a discussion of such rationale in the U.S. context, see text accompanying supra notes 29-32.
170 See, Lee & Dy, Mitigating ‘Effective Control’ Restriction, supra note 10, at 241-244. However, even in such a scenario, foreign airline investors would like to retain as much control as is legally permissible so long as to fully exploit the commercial benefits of the investment in the Indian airline from a business perspective. This explains the detailed rights initially sought by Etihad in its investment in Jet Airways, although it had to subsequently water them down to pass muster under the Indian foreign investment regulations. See text accompanying supra notes 143-144.
172 Id.
entitled to exercise control (since the Consolidated FDI Policy does not stipulate SOEC requirements on them), it might very well be that they are uninterested. There is a greater likelihood of a financial investor partnering with a foreign airline, which tips the scale towards the other side of the divide, with the entire transaction being colored by the presence of the foreign airline, which would invoke the SOEC requirements.173

For these reasons, it remains to be seen whether the two-part legal regime, i.e., one governing foreign airlines as investors, and the other concerning non-airline investors will be beneficial for the Indian aviation sector, or whether such a classification is likely to attract peculiar consequences.

After discussion of the principal issues governing foreign investment in the Indian airline industry, we now touch upon certain other quirks of the regulatory regime as well as the markets in the Indian financial sector that have a role to play in the shaping and implementation of foreign investment norms.

D. Some Twists in India’s Aviation Tale

Law and economics theorists have sought to analyze the role of the industry in shaping government regulation. Theories such as “interest group politics” and the “regulatory capture theory” have focused on the influence of the industry in molding the regulation that governs it.174 These theories have been attributed to the way in which the regulation of the aviation industry too has evolved, particularly in the U.S.175 Often, the interest groups interact in rather complex ways with the government authorities, due to which discernible trends may not always emerge.

Applying this theory, we find that Indian regulation in the civil aviation sector has also been subject to the influences of various interest groups, either overtly or with a dose of subtlety.176 Three groups, all of which are incumbents in the Indian airline sector, are worth exploring. They are (i) the NRI community, which has received a preferential treatment all along with respect to foreign investment;177 (ii) the state-owned Air India, which enjoyed monopoly for nearly half a century; and (iii) the Federation of Indian Airlines, a lobby group

173 The discussion surrounding the potential entry of Qatar Airways into the Indian aviation scene epitomizes this point. See text accompanying supra notes 166-168.
177 See, text accompanying supra note 84.
comprising incumbents that has sought to keep the barriers high to restrict new entrants into the Indian airline industry.

1. Investments by NRIs

Ever since private airlines became operational in India in the 1990s, NRIs have received a preferential treatment in that they have been allowed invest up to 100% shares of an Indian airline. This puts them at a significant advantage over other foreign investors. Although the definition of who constitutes an NRI as well as some of the rules surrounding that have changed over time, an NRI is currently defined to mean either an Indian citizen who is resident outside India or is an “Overseas Citizen of India” (OCI).178

Historically, some leading Indian private airlines had been established through the NRI route. The most significant example is that of Jet Airways, which was 100% owned by Tail Winds, a company in turn wholly owned by Naresh Goyal, an NRI.179 Subsequently, Tail Winds transferred its shareholding to Goyal180 who, following the company’s initial public offering and investment by Etihad Airways,181 now holds 51% shares,182 and thereby has SOEC. Similarly, there is evidence of NRI investments in InterGlobe Aviation Limited, the company that runs Indigo Airlines. One of its founders, Rakesh Gangwal, is an NRI based in the U.S.,183 and continues to own a significant number of shares in the company.184

The NRI investment structure has come under some attack as not only being incumbent friendly, but also as being non-transparent. Some have argued that the NRI structure can be used to mask the real shareholding of the company.185 The newer entrants to the Indian aviation sector have argued that the NRI route discriminates against foreign airline investors. While NRIs can enjoy massive benefits under India’s regulatory regime even though they are resident outside India, other types of foreign investors (especially foreign airlines) are subject to strict SOEC restrictions. Such an incumbent-friendly policy has come under significant attack from Tony Fernandes, the AirAsia boss, who has ridiculed the situation whereby leading Indian airlines have been controlled by NRIs.186 Fernandes has not only responded

178 Consolidated FDI Policy, supra note 113, at paragraph 2.1.32. An OCI is defined under section 7A of the Citizenship Act, 1955 to include persons who are of Indian origin and who have been issued an OCI card by the Government of India. An OCI includes a person whose parent or grandparent was (or is) a citizen of India. 179 See also, text accompanying supra notes 85-88.
180 This transfer was accomplished in tranches during 2013. See, Nishith Desai Associates, supra note 109, at 5-6; Aneesh Phadnis, Change in Jet Airways ownership as Tail Winds transfers shares to Naresh Goyal, BUSINESS STANDARD (May 23, 2013).
181 For a detailed discussion of Etihad’s investment in Jet Airways, see supra Part IVA.1.
183 Air Asia boss tweet adds to aviation row, Business Standard (Feb. 27, 2016).
184 Shareholding Pattern of Interglobe Aviation as of Jun. 30, 2017, available at https://www.nseindia.com/corporates/corporateHome.html?id=spatterns. Gangwal’s shareholding is shown under the category “Individuals (Non-Resident Individuals/ Foreign Individuals)”.
185 Subramanian Swamy says first find out real owners of Jet Airways, MONEYLIFE (Jul. 29, 2013).
186 Air Asia boss tweet adds to aviation row, supra note 183; P.R. Sanjai, Are owners of airlines living in India, asks AirAsia’s Tony Fernandes, THE MINT (Feb. 28, 2016).
through words, but also through his actions. He himself applied for and obtained NRI status relying upon the fact that his father was of Indian (Goan) origin.\footnote{Anirban Chowdhury, \textit{AirAsia Berhad CEO Tony Fernandes applies for `overseas citizen of India’ status}, \textit{The Economic Times} (Mar. 17, 2016); Shahkar Abidi, \textit{AirAsia chief gets Overseas Citizenship of India card ahead of new civil aviation policy}, \textit{DNA India} (Jun. 13, 2016).} The tenor of his press statements indicate that such a move is to offer retaliation against the accusations of incumbent Indian airlines that have alleged that the SOEC relating to AirAsia vests with its foreign owners rather than the Indian partners.\footnote{See, \textit{id}.} However, it is not entirely clear whether this confers any legal advantage on Fernandez. He may encounter legal hurdles if he seeks to obtain shares in AirAsia India in addition to the 49% shareholding already held by the AirAsia parent company.\footnote{The issues would be akin to the type of proposal announced by Qatar Airways to start an airline in India along with the Qatar Investment Authority. See text accompanying \textit{supra} notes 166-168.} Whether the NRI route can be exploited when the NRI invests along with a foreign airline is not a question that the Indian authorities have been called upon to deal with under the current regime.\footnote{While Naresh Goyal’s investment in Jet Airways and Rakesh Gangwal’s in Indigo were made on a standalone basis, any prospective investment by Tony Fernandez in AirAsia India will be colored by the pre-existing investment by the AirAsia parent. In that sense, while the Jet Airways and Indigo situations merely involved NRI investments and were treated as such, one cannot rule out the possibility that the AirAsia case could be categorized under the foreign airline category for purpose of determining the SOEC requirements under Indian law.}

The NRI route remains an oddity in the Indian legal regime governing foreign investments in the airline sector, and has continued to create a few ripples in the industry.

2. Incumbency of the State-Owned Behemoth

Historically, the privatization of state-owned carriers has been a “politically sensitive topic”, due to which it is understandable that countries established ownership and control restrictions for foreign investors as part of the process.\footnote{World Economic Forum, \textit{supra} note 1, at 9 (discussing the examples of Canada, France, Great Britain and Australia).} In India, the dichotomy between foreign investors that are airlines and those that are non-airline investors has been taken to another level altogether in the context of its state-owned carrier, Air India. Since the 2012 policy that opened the Indian skies to foreign airline investors\footnote{Press Note 6 of 2012, \textit{supra} note 16, at paragraph 3.0.} until the present,\footnote{Consolidated FDI Circular, \textit{supra} note 113, at paragraph 5.9.2.3, Notes, sub-paragraph (iii).} a clear and categorical exception has been carved out by which foreign airlines cannot invest in any shares whatsoever in Air India. In other words, the national carrier has been out of bounds for foreign airline investments.

The debate surrounding the prohibition of foreign airline investments in Air India has grown louder more recently as the Government of India explores methods for privatization of the
Such privatization has become necessary given the need for a rejuvenation of its business, as it has not only ceded market share to leading private carriers, but it also carries a heavy debt burden.

However, the Government’s resistance against allowing foreign airlines from investing in Air India has met with criticism. While the need to shield the national carrier against a takeover by a foreign airline (giving rise to concerns regarding safety, security and consumer protection) is understandable, the solution of not allowing any foreign airline investment at all might be an extreme one. For instance, foreign airlines would be in a position to use their managerial and financial capabilities to bring about a successful turnaround of the national carrier. However, by eliminating the possibility of a foreign airline participating, the options for resuscitating Air India are confined to a domestic carrier or to a group of foreign non-airline investors. While Indigo has expressed some interest in Air India’s international business as a means of supplementing its own dominion over the domestic sector, it is not clear if any substantial interest has yet been evinced by any significant non-airline investors.

The paternalistic treatment provided to Air India represents another peculiarity of the foreign investment regime governing India’s aviation sector. While the need to impose curbs on investments by foreign airlines is explicable, a total ban against foreign airline investments in Air India is not. The question of whether Air India needs to continue to be treated differently from other Indian airlines from a foreign investment perspective continues to remain. One solution would have been to make the usual restrictions on foreign airline investments (i.e. a cap of 49% with SOEC restrictions) applicable to Air India as well, but it is evident that there is insufficient political will to proceed in that direction.

3. Lobbying by the Incumbent Airlines

A more visible manifestation of interest group activity lies in the Federation of Indian Aviation (“FIA”) that was formed in 2006. It consists of the leading incumbent airlines, currently Jet Airways, Indigo, SpiceJet and Go Air. Although Air India was one of the founding members of the FIA, it subsequently stepped down from the organization.

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194 See, Arindam Majumder, *Air India disinvestment: Govt likely to rule out foreign buyer*, BUSINESS STANDARD (Sep. 6, 2017); Mihir Mishra, *Air India not to be sold to foreign carriers: FDI policy*, THE ECONOMIC TIMES (Aug. 28, 2017); *FDI policy rules out sale of stake in Air India to foreign airlines*, HINDUSTAN TIMES (Aug. 28, 2017).


196 Id.

197 Tarun Shukla, *Air India exit leaves lobby FIA in jeopardy*, The Mint (Nov. 3, 2014). See also, Federation of Indian Airlines, *About Us*, available at http://www.fiaindia.in/member/index.htm (defining its role: “as the voice of India’s airline industry, works to identify and take up issues on behalf of the industry, with various regulatory authorities, government departments and other key stake-holders. The Federation provides a platform for consensus building amongst the member carriers.”).


199 See, Shukla, *Air India exit*, *supra* note 197 (noting Air India’s realization that it is preferable for it to convey its views directly to the Government rather than to route it through the FIA).
The FIA has been vocal with respect to reforms or policy initiatives of the Government that have an impact on foreign investment in India’s airline sector. For example, the FIA vehemently opposed the entry of AirAsia and Vistara into the Indian markets on the ground that not only would it result in overcrowding of the Indian skies, but also that de facto control over these airlines was likely to be exercised by their foreign airline owners. The FIA has also registered its protest with the Government against allowing Qatar Airways to establish an airline in India. This it has done so due to alleged security concerns.

The FIA also lobbied to put up a stiff (but ultimately unsuccessful) resistance against liberalizing the 5/20 rule. The FIA’s argument was that while the incumbent airlines had to wait five years before flying international routes, any relaxation of that rule will adversely affect them if the newly established airlines can skirt the requirement of the time-period and begin flying immediately. However, this argument did not cut ice with the Government which relaxed the rule anyway.

The composition of the FIA is also somewhat unique in that it creates a schism between various Indian airlines. Its membership currently comprises only the well-established Indian private carriers, and this is so following the departure of Air India from the group. The newly established airlines such as AirAsia and Vistara have not been brought within the fold of the FIA for obvious reasons, given that the FIA has been vehemently opposing the entry of those airlines into India and the benefits conferred upon them by the regulatory policy. Some have argued that the composition of the FIA smacks of “crony capitalism” as it is a proclaimed defender of the interests of the well-established players at the cost of other entrants.

In all, these examples reflect the operation of the interest group theory in the Indian aviation sector that may explain the shape that foreign investment regulation has taken over the years. While the Indian Government has seemingly taken bold steps to allow 100% foreign investment in this sensitive sector, the problems highlighted in this Part indicate that in practice it is unlikely that foreign investors would be able to enjoy full freedom in entering into and exiting from the Indian market. Several underlying factors continue to inhibit foreign

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200 Tarun Shukla, *India’s Airlines Team to Try to Block*, supra note 154.
201 Tarun Shukla, *Qatar Airways’ India airline plan may face opposition from airlines lobby FIA*, The Mint (Mar. 10, 2017); Amber Dubey, *Why are we scared of foreign airlines?*, BUSINESS STANDARD (Apr. 4, 2017); Suchetana Ray, *Indian airlines continue to oppose 100% FDI: Fear of Qatar Airways’ India plans?*, HINDUSTAN TIMES (Jun. 8, 2017). Qatar’s proposal, and the legal issues surrounding its possible foreign investment structure, have been discussed earlier. See text accompanying notes supra 166-168.
202 Foreign players owning airlines in India may trigger security issues: FIA, BUSINESS STANDARD (May 25, 2017); Sindhu Bhattacharya, *Indian carriers are against Qatar Airways’ India plans and their points are valid; govt should take heed*, FIRSTPOST (May 25, 2017).
203 For a discussion of this rule and its implications, see text accompanying supra notes 118-120.
205 Tarun Shukla, *Air India exit*, supra note 197.
206 Id (quoting a former executive director of Air India).
investments, such that it may be difficult to translate the Government’s overt pronouncements into action.

V. TREATMENT UNDER BILATERAL AIR SERVICES AGREEMENTS

After extensively discussing the nationality requirements under domestic Indian law, we address some issues that will likely arise under the “external bolt” wherein SOEC requirements are stipulated in bilateral ASAs between India and other countries. While the Indian Government can unilaterally disengage the internal bolt, matters become somewhat complicated given the questions of reciprocity that arise under the ASAs.

This issue is somewhat unique to India. The bilateral treatment problem arises only when a country relaxes the SOEC requirements for foreign investment, and that too in respect of its international sector. India is arguably the only country to liberalize foreign investment norms to allow foreign investors without any restrictions on nationalities to take majority ownership (and control) in airlines that operate internationally. To that extent, how India deals with the bilateral issues may be relevant for other countries that might liberalize their foreign investment in the aviation sector in the future.

To be sure, relaxation of the SOEC requirement at a regional level has been observed over the past few decades. The concept of “community carrier” has been developed (such as in the E.U., ASEAN, the League of Arab States). It means that the SOEC of the air carrier in the member states of a given community no longer requires the national SOEC, but instead has been redefined as community SOEC. For instance, a Luxemburg-registered cargo airline, Cargo Lion (now defunct), had no Luxembourg national ownership interest: a German national owned 49%, a Swiss national 41%, and a UK and Canadian national each 5%.

Apart from the aforesaid developments, on routes governed by an ASA between two states, SOEC restrictions in the agreement require that a state party designate only carriers that are substantially owned and effectively controlled by its own nationals. For instance, the Air Services Agreement between India and the U.S. stipulates ownership and control restrictions in Article 4 (Revocation of Authorization):

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207 For a discussion of this concept, see text accompanying supra notes 24-27.
208 See text accompanying supra note 24.
209 While Australia and New Zealand allow 100% foreign investment, they do so only for the domestic sector where bilateral aspects do not come into play. See, text accompanying supra notes 63-67. Moreover, while Hong Kong and Singapore follow the PPB approach, they do not appear to eliminate requirements that might attract de facto control. For a discussion of the issues, see text accompanying supra notes 59-62.
210 See Lee, supra note 58, at 45-82.
212 Havel supra note 4, at 13208-13209.
213 Barring some exceptions, the ASAs that India has entered into with several countries contain such SOEC restrictions. See, Tarun Shukla, Will foreign airlines fly into India?, THE MINT (Aug. 23, 2016).
1. Either Party may revoke, suspend or limit the operating authorizations or technical permissions of an airline designated by the other Party where:

   a. substantial ownership and effective control of that airline are not vested in the other Party, the Party’s nationals, or both; …

Under this dispensation, for instance, Jet Airways’ traffic rights could be revoked or suspended by the U.S. if Jet Airways ceases to be substantially owned or effectively controlled by Indian nationals. This external restriction effectively restrains India’s national air carriers from attracting sizeable foreign investment. Consequently, Indian airlines would ensure that they limit foreign investment to the previous level of 49%. Thus, while the nationality requirements have been liberalized under domestic Indian law (i.e. internal bolt), the restrictions under the ASAs (i.e. external bolt) continue to constrain foreign investment in India’s aviation industry. To that extent, the only practical implication of the recent reforms is that an Indian company can now set up an airline with foreign investors while flying only domestic routes. Among existing airlines, Go Air has not started operations on international routes. Hence, it is free to obtain foreign investment of more than 49% of foreign investment without being constrained by ASA, so long as it is satisfied operating only domestic routes.

If India can amend the ownership and control clause in consultation with the country concerned, the foreign investment opportunity for Indian airlines will increase. Indeed, some states are making an effort to liberalize the ownership and control restrictions in their ASAs. In particular, Brazil, Chile, Columbia, Egypt, Indonesia, Switzerland, and Vietnam reported that they are in the process of replacing traditional substantial ownership and control with “principal place of business and effective regulatory control” in their ASAs. Obviously, their bilateral partners must agree to the change.

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215 For the future, however, Go Air too has been contemplating operations on international routes. Mihir Mishra & Anirban Chowdhury, GoAir says airline will be available to fly international, THE ECONOMIC TIMES (Jun. 2, 2016); GoAir to start international flights by end of 2017, THE ASIAN AGE (Jun. 23, 2017)
As regards bilateral arrangements, one option is that India can consider the U.S.’s position. The U.S. has displayed a willingness to ease the restrictions either based on reciprocity or where U.S. interests are not jeopardized by a higher percentage of foreign ownership.\textsuperscript{217} Indeed, the U.S. has selectively waived the nationality clause in cases where the airlines of partner states have been acquired by non-nationals.\textsuperscript{218}

However, to give effect to India’s liberalization of domestic norms, it must also be able to convince its partners under bilateral ASAs to either amend or waive the nationality restrictions in the form of the SOECs requirements. This would require negotiation on a piecemeal basis with different countries, which would be cumbersome.

In order to overcome such negotiation problems, other methods have been suggested. These include the adoption of model ICAO clauses “to deal with ownership and control requirements with flexibility without the need to change the existing regime.”\textsuperscript{219} This would involve using expansive criteria for the interpretation of the SOEC requirements under the bilateral ASAs. It has also been suggested that states (such as India that have liberalized their foreign investment norms) could make their position public as to the conditions upon which they would accept foreign carriers, so that an appropriate network can be created among states to implement the reforms.\textsuperscript{220}

To conclude this Part, it is clear that the domestic reforms that India has introduced would be problematic to implement internationally, given the bilateral nature of the rights governing international air traffic. While several possible measures have been bandied about in the literature, it remains to be seen whether a practical solution is yet available.

\textbf{VI. CONCLUSION}

India is a leading player in the global aviation market, and hence the legal reforms surrounding foreign investment in the aviation industry would be of wider interest internationally. India has made rapid strides in liberalizing her overly protected airline industry for the last two decades, particularly in order to rescue the troubled domestic airline

\textsuperscript{217} Lykotrafiti, \textit{supra} note 4, at 672.
\textsuperscript{218} Havel & Gabriel Sanchez, \textit{supra} note 3, at 655; \textit{See also}, World Trade Organization (WTO), Council for Trade in Services, \textit{Quantitative Air Services Agreements Review (QUASAR): Part B: PRELIMINARY RESULTS}, S/C/W/270/ADD.1 2006 at 34, para 68, available at http://www.wto.org/english/tratop_e/serv_e/transport_e/quasar_partb_e.pdf (noting that “substantial ownership requirements, but also the effective control prerequisite, are often waived in practice. Aerolineas Argentinas, for instance, was never denied the right to fly although it had two successive Spanish majority owners. The same was true for Sabena when it was owned by Air France and then by Swissair.”). Similarly, the U.S. did not suspend the traffic rights of Cargo Lion., Notice of Action Taken Order--DOT Docket 98-4329.
\textsuperscript{219} Chang, et. al., \textit{supra} note 2, at 170. \textit{See also} \textit{ICAO Template Air Service Agreements} (2009), available at https://www.icao.int/Meetings/AMC/MA/ICAN2009/templateairservicesagreements.pdf.
\textsuperscript{220} \textit{Id.}
sector. From being one of the most restrictive markets for foreign investment in the airline industry, it has metamorphosed into one of the most liberal, and that too within a relatively short span of time. The most important changes emerged when Indian permitted foreign airlines in 2012 to invest up to 49% in the airline industry, and when in 2016 it extended up to 100% the limit up to which non-airline investors can invest.

Although the reforms appear to be expansive and significant at the outset, there are obvious as well as invisible constraints, and it is too early to speculate how and to what extent the airline industry would take advantage of the policy. At the same time, some foreign airlines such as Etihad Airways, AirAsia and Singapore Airlines have capitalized on the reforms, and entered the Indian markets, while those such as Qatar Airways are still waiting in the wings. But, the liberalization of foreign investment in the Indian airline industry also reveals a story that sketches out the interplay between a complex array of factors. The interaction between the governmental authorities on the one hand, and other interest groups such as incumbent players in the industry, the new entrants and the industry body represented by the FIA has not been smooth, to say the least. Allegations of regulatory capture and crony capitalism run galore. In the end, given that the reforms have been brought about through various policy pronouncements issued by the Government from time to time, it is not clear whether (and to what extent) the actions of the Government are justiciable before a court of law. To that extent, it might very well be that courts may have a limited role to play on this count.

If the domestic legal regime governing foreign investment in the airline sector is complicated, the order of magnitude is significantly enhanced in the treatment of SOEC requirements under bilateral ASAs that India has signed with various countries. The ASAs give rise to a patent risk that an Indian airline (with foreign investment in accordance with the fully liberalized policy) may not be able to operate international routes with such an ownership structure. Unless the Indian Government embarks upon the gargantuan exercise of either negotiating alterations or waivers with its counterparts, no satisfactory long-term solution is likely to emerge.

India’s aviation sector has demonstrated strong growth (and will continue to do so) “despite facing numerous policy and regulatory challenges”. The entry of three foreign airlines into the Indian markets over the last five years is evidence that there are takers for India’s regulatory approach. However, the further potential of the industry can be unleashed through continued redesign of the policy as well as its effective implementation.

The primary goal of this paper has been to analyze the new foreign investment regime in the airline industry in India. A bigger question is whether the India’s new approach can make an

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221 Tan, supra note 79, at 462.
222 Some legal challenges are pending before courts, but courts have not been quick to interfere. See, e.g., supra note 147.
impact on other states. It is worth reiterating that India’s status in international aviation community is exceptional.\textsuperscript{224} The fact that such an enormous market made a legislative reform in the SOEC requirement may give an impression that the nationality norm in the airline industry is no longer unbreakable.

Indeed, the orthodox position that the SOEC requirement is an immutable condition in the airline industry has been facing challenges. The concept of “community carrier” certainly diluted the nationality requirement. The ownership and control of airlines in EU member states has been redefined as EU ownership and control rather than national ownership and control requirement. To a lesser extent, ASEAN and the League of Arab States adopted regional agreements that allow community carriers.\textsuperscript{225} In Asia, more states have begun to mitigate the effective control inquiries when granting operation of joint venture airlines.\textsuperscript{226} However, this measure does not come with the legislative reform of SOEC requirements. Thus, it is arbitrary by its nature and lacks the regulatory certainty and predictability that are much sought after by foreign investors.

India’s bold approach is a great step forward. It clearly sets out the changes by the regulatory reform so that foreign investors will derive greater comfort with the cross-border investment in the airline industry in India. India, once one of the most protective states in the foreign investment regime, adopted the most liberalized approach. This fact is significant enough to make other states, particularly in Asia, revisit their SOEC requirements on the airline industry. It will be illuminating to see how and to what extent other states are influenced by India’s new way.

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\textsuperscript{224} See, text accompanying supra notes 11-13.
\textsuperscript{225} The 2009 Multilateral Agreement on Air Services (MAAS); the 2010 Multilateral Agreement for the Full Liberalization of Passenger Air Services (MAFLPAS); the 2004 Agreement for the Liberalization of Air Transport between the Arab States in Damascus.
\textsuperscript{226} See Lee & Dy, Mitigating ‘Effective Control’ Restriction, supra note 10.