



# **GUIDANCE ON CRITERIA FOR JUDGING NATIONALITY OF OWNERSHIP AND CONTROL**

**Extract from Official Record Series 1 (Annex 1)**

# **OPERATOR LICENSING: CIVIL AVIATION AUTHORITY GUIDANCE ON CRITERIA FOR JUDGING NATIONALITY OF OWNERSHIP AND CONTROL**

## **Introduction**

1. The EC 1008/2008 (the Council Regulation<sup>1</sup>) sets nationality requirements for the undertakings that may hold Operating Licences. The granting of Operating Licences in the United Kingdom is delegated to the Civil Aviation Authority, which has to make a first assessment in relation to nationality matters, though any decision to refuse or revoke a licence on such grounds may be taken only by the Secretary of State.

2. This statement gives guidance on the approaches and criteria that the CAA adopts in ensuring compliance. It draws on cases that have been decided since the Council Regulation became effective, though the detail of those cases is protected by confidentiality provisions, and on views given by the European Commission, informally as well as in its published decision 95/404/EC<sup>1</sup>. It must be emphasised that most aspects of the CAA's interpretation set out in the statement have not been judged by any UK court or in the European Court, nor have they been the subject of any formal opinion by the Commission.

## **Aspects of Judgement on Compliance with Nationality Criteria**

### ***General***

3. The factors involved in individual instances vary widely from case to case. However, the following sections highlight some of the issues that frequently arise in the application of Article 8.

4. The tests of ownership and control are separate and both have to be met to achieve compliance. Experience has shown that it is possible for ownership to be considered satisfactory while control is not, and also for the reverse to be possible.

5. One issue that affects both ownership and control is how nationality is defined. The CAA's view is that the term "nationals of Member States" means persons who hold citizenship of a Member State, irrespective of their place of residence or of whether those persons also hold citizenship of a non-EU state. For individuals, it will regard the possession of an appropriate passport as evidence of

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<sup>1</sup> Commission Decision of 19 July 1995 on a procedure relating to the application of Council Regulation (EEC) No 2407/92 (Swissair/Sabena)

citizenship. In the event that it faces intermediate companies in the corporate chain, it will look at the nationality of the individuals owning and controlling the entity on the same basis.

6. The CAA will look with particular care at complex structures which appear to have been devised for no purpose other than compliance with Article 4. A structure which has been devised for that purpose may in reality achieve compliance, but the CAA will be concerned to ensure that it complies in substance as well as form.

7. There may be different implications for ownership and for control where an airline is part of a wider group and there are minority interests at one or more levels. If, for example, EU nationals own 60% of a company which in turn owns 70% of an airline, it may be concluded, subject to all other factors which may influence control, that the EU nationals are in a position to control the airline. However, in examining ownership the CAA will look at the diluted shareholding of the EU investor through the intermediate company having a controlling shareholding in the airline.

### **Ownership Issues**

8. The CAA's interpretation of the "majority" ownership criterion is that 50% of the relevant shares in an airline, plus one share, must be in EU hands at all times. The number of shareholders which make up the majority is not a relevant issue, though this may have implications for control. The issue may therefore be relatively straightforward where only one class of share exists. However, particular issues arise where different classes of shares with different values and characteristics exist, and the CAA has to consider which shares are relevant for the purposes of assessing ownership.

9. Essentially, the CAA will expect shares which qualify for ownership purposes to be subject to the risks and rewards that are normally associated with ordinary shares in English law. The European Commission has an interpretative role in relation to Article 8, and the CAA is guided in this context by the criteria of "equity capital" set out in the Commission's decision already noted at footnote 1. In considering ownership, the decision commented:

*"The Commission further considers that ... refers to a concept of ownership of an undertaking which is essentially based on the notion of equity capital. Holders of such capital normally have the right to participate in decisions affecting the management of the undertaking as well as to share in the residual profits or, in the event of liquidation, in the residual assets of the undertaking after all other obligations have been met. ....If capital does not confer upon its holders any of the two above mentioned rights to an appreciable extent, it must generally be disregarded in determining the ownership situation of an undertaking."*

10. The CAA considers it reasonable to extrapolate from this view and to conclude that, if two classes of share are to be considered *pari passu* for the purposes of calculating shares of ownership, they should both have broadly comparable attributes. It does not however follow that they need have (for example) precisely the same voting entitlement to qualify as equity capital, though in assessing

control the CAA will normally attribute different weightings to shares with different voting rights.

11. The CAA will also examine the value of shares in different classes, and will normally take into account the nominal or par values of shares as well as the number held; in a simple example, the possession of 1,000 shares with a nominal value of 10 pence may confer the same proportion of ownership as 100 shares with a nominal value of £1. The approach may however need to vary where shares have been issued at different times and the nominal values reflect differences. In other cases, it may be appropriate to take into account conversion ratios for convertible shares.

12. The CAA takes the view that fluctuations in prices cannot normally affect the proportion of ownership pertaining to a class of share, but it will be concerned to ensure that shares which are counted with others for the purposes of ownership have a substantial value. If shares have only a trivial value, as indicated either by the price paid for them or the price that might be obtained for them on the open market, it may be right to disregard them even if they appear to conform with the criteria for equity capital set out above. In other cases where values may be clearly attributed, the value of one class of shares may be clearly greater than the value of others, and in such a case it may be right to apply weighting to the share of ownership thereby conferred.

13. As a general rule, the existence of options or warrants that may alter the balance of shareholdings at some point in the future will not be relevant to the issue of ownership in the present. However, there may be certain complex structures where the existence of options will risk rendering ineffective the “equity capital” attributes of a class of share, and these will merit close examination. In any event, options may be an immediate issue in relation to control if their existence confers on a minority shareholder an ability to impose its demands on the airline.

#### *Ownership Issues in Publicly Quoted Companies and Institutional Investments*

14. Particular issues arise in relation to licence holders which are (directly or indirectly) publicly quoted or owned by investment institutions, where shareholdings may vary from day to day and the true beneficial owners are likely to be several stages removed from the investment in the airline, being beneficiaries of pension funds or unit trust holders. In the absence of particular mechanisms there may be no clear information as to the nationality of the beneficial shareholders, or any ability on the part of the company to control the level of non-EU shareholdings.

15. The CAA’s approach to such companies incorporates the following approaches and presumptions:-

- where shares are held by a nominee or trust, it bases its judgement as to ownership on the nationality of the beneficial shareholder or beneficiary; if a trust is involved, it will however look at practical constraints to determine whether control lies with the trustees or with the beneficiaries.

- where shares are held by an investment fund, the CAA adopts a broad presumption that the beneficial shareholders will be citizens of the country where the fund manager is domiciled. This presumption will not be true in absolute terms, and it would expect to maintain a reasonable margin in favour of total EU shareholdings in order to allow for the fact that it cannot rely absolutely on the presumption. In cases where a fund manager domiciled in an EU Member State is in a larger group owned in a non-EU state, it may also be appropriate to question further how funds are used within the group.
- where an investment fund is based in the Channel Islands or the Isle of Man, the presumption in the absence of evidence to the contrary will be that it represents non-EU investors.
- it will monitor regularly the shareholdings of companies which are publicly quoted or have a publicly quoted parent if there is a significant identified non-EU holding. This may be on a monthly or quarterly basis – or even more frequently – depending on the proportion of non-EU ownership.
- it may in some cases require provisions in a company's Articles which permit the directors to control nationality of shareholdings, and to require both nationality declarations by shareholders and divestment in certain cases. It may in any event be prudent for directors to have such powers where the company's shares are traded.

16. The monitoring requirements for publicly quoted companies may in some cases be considerable. However, the CAA regards this as inevitable in the light of the obligation in Article 4.5 for carriers to be able at all times to demonstrate that they meet the requirements of Article 4.

### **Control Issues**

17. The definition in the Council Regulation is:-

*“effective control” means a relationship constituted by rights, contracts or any other means which, either separately or jointly and having regard to the considerations of fact or law involved, confer the possibility of directly or indirectly exercising a decisive influence on an undertaking, in particular by:*

*the right to use all or part of the assets of an undertaking;*

*rights or contracts which confer a decisive influence on the composition, voting or decisions of the bodies of an undertaking or otherwise confer a decisive influence on the running of the business of the undertaking.”*

18. In determining control, the CAA is concerned to establish the practical reality of who is actually making a company's decisions as well as positions which derive from legal powers and agreements. The relative strength of the parties may be an issue, as may the personalities involved. In borderline cases, it requires statements from both principals and legal representatives that there are no undeclared agreements which confer powers outside the disclosed legal documents.

19. The definition in the Council Regulation appears to the CAA to preclude any concept of control being exercised together with another (non-EU) party. In any circumstance where non-EU nationals have significant influence, the CAA will wish to ensure that the ultimate decision-making power is with the EU investors.

20. The CAA's starting point in determining from a company's circumstances where control lies is ownership rather than management, the premise being that management may be controlled or eventually replaced by a company's Board, and the Board may likewise be replaced by shareholders. In the absence of any other factors, therefore, it might be assumed that control would follow ownership.

21. There are however many variations that can alter this presumption. Some of the factors are:-

- Control may not be in direct proportion to ownership if some shares have more votes attached to them than others. Equally, however, the CAA would examine with care any proposal where it was asserted that control depended solely on a disproportionate share of votes.
- The motives of investors, and consequently their wish or otherwise to exercise control, will vary. As a general presumption, a fund manager may be expected merely to require a return on investment, whereas an individual or a company that is not an investment institution will normally want to influence the company's decisions in return for holding a majority of the shares. The CAA looks particularly carefully at any proposal for an investment in a UK licence holder by a non-EU airline, which might be expected to do so for strategic purposes rather than as a venture capitalist.
- The largest single shareholder may have particular influence, especially if other shareholders are thinly spread, are professional or small investors or if there is no device to ensure that they exercise their voting powers in concert. There may however be particular "stapling" agreements to ensure that minority shareholders vote in unison so as to maintain a majority over the largest single shareholder.
- Conditions may be included in loan or lease agreements that confer on the lender or lessor unusual powers; this would not normally occur in a secured loan or a normal commercial lease, but situations can arise where the lender or lessor has other links with the airline. The CAA also examines with particular care any proposal for a non-EU investor to hold a minority of the shares but to provide a majority of the finance through loan stock.
- Where an airline has a non-EU associated company, particularly an airline or one in a related travel business, the CAA looks carefully at the nature of any services supplied to the airline by the associate. Aspects that merit particular attention might include, for example, key operational areas such as schedule planning and pricing, and strategic financial services such as budgeting and control of treasury.

- The CAA examines with care the key legal documents associated with any non-EU investment, including at least the Memorandum and Articles and the shareholders' agreement. It pays particular attention to powers of approval reserved to a non-EU investor which may effectively give it a right of veto on matters which would normally be within the powers of a company's Board to decide, such as approval of budgets. It is however acceptable for a significant minority investor to have a power of veto in relation to matters which essentially serve to protect the investment, such as the sale of major assets or investments, the disposal of subsidiaries or changes in the company's constitution or capital structure.
- In extreme cases, a power of control may be in the hands of a single customer or supplier if the nature of the relationship is such that the airline could not in practice continue to trade without that company's co-operation.

22. Although the composition of the Board of directors is not in itself regarded as sufficient evidence of control, in the short term strategic decisions will be made by a company's Board. The CAA will normally therefore require there to be a majority of EU citizens on the Board, and will take into account both the nationality of the individuals and the nationality of the investors they represent. It will also take into account any particular requirements for a Board quorum which may restrict the extent to which decisions may be taken in the absence of an EU majority.