STATEMENT OF
JEFFREY N. SHANE
UNDER SECRETARY FOR POLICY
DEPARTMENT OF TRANSPORTATION
BEFORE THE
AVIATION SUBCOMMITTEE
OF THE
HOUSE TRANSPORTATION AND INFRASTRUCTURE COMMITTEE
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Thank you, Mr. Chairman, Members of the Subcommittee. I am pleased to appear before you today in response to your invitation to review the status of a comprehensive first-step U.S.-EU aviation agreement, with a focus on the Department of Transportation's Notice of Proposed Rulemaking regarding "actual control" of U.S. air carriers. Since the Department of State's Deputy Assistant Secretary, John Byerly, who led the multi-agency team that negotiated the agreement, is sitting beside me, I will let him review the negotiating dynamics that resulted in an agreement that has the potential to fundamentally transform the framework within which transatlantic air services operate, increasing dramatically the quality of competition in the market and benefiting consumers and communities on both sides of the Atlantic in ways that transcend anything achieved through our existing open-skies accords. I will focus my testimony on the Department of Transportation's Notice of Proposed Rulemaking.

As you know, it is unusual for DOT to appear at a hearing concerning an ongoing rulemaking. Since we are in the middle of the rulemaking process I cannot tell you what the Department is going to do. However, I recognize the importance of this initiative and this Committee's interest in it. Therefore, I wanted to share, to the extent possible, the Department's thinking in proposing to refine the administrative policies that guide our citizenship reviews. I hope that you will also understand that, since the comment period in the rulemaking has closed, I cannot address the substantive issues raised in those comments, other than to say that we will give them careful consideration, and I must be relatively circumspect in my own comments. I will do my best to be responsive to you within those parameters.

As a preliminary matter, let me clarify, from the Department's perspective, the relationship between the U.S.-EU agreement and the NPRM. It is no secret that, in reaching a decision on whether to proceed with an EU-U.S. Air Transport Agreement, the European Community and its 25 Member States will consider the results of the NPRM process as expressed in a final rule. The European side included those very words in the Record of Negotiations that was adopted upon the conclusion of our negotiations and that has been widely circulated. Nor will I pretend that we don't care whether the proposal, if finalized, will have a positive impact on the U.S.-EU talks. Of course we do. We want to conclude the agreement -- not only for the market access that U.S. carriers will achieve, but because it can be expected to enhance the quality of competition across the Atlantic in a dramatic way and provide impetus for further aviation liberalization around the world. However, I also want to be clear that, although European acceptance of the

Air Transport Agreement may be a consequence of adopting a final rule, the decision to initiate this proceeding was based on our assessment that the proposed change in the DOT approach was long overdue and is in the best interests of the United States, its air transportation industry, and those that rely on that industry, not only for transport services, but also directly and indirectly for jobs. Even if the U.S.-EU talks had collapsed, we would not have abandoned the proposal, but would have seen it through to its conclusion. However, thanks to the fine work of John and his team, we have a successful negotiating result.

Next let me address what DOT did not propose. DOT did propose to change the specific tests in the statute for determining that a U.S. airline meets the U.S. citizenship requirement. Under DOT's proposal the company would need to be organized under the laws of the United States or a state; 75% of the voting stock would need to be owned or controlled by U.S. citizens; the president and two-thirds of the board of directors and other managing officials would need to be U.S. citizens; and the company would need to be under the actual control of U.S. citizens. In addition, we have not proposed any change in how DOT would assess the citizenship of the managers or members of the board of directors -- U.S. citizens appointed by, or otherwise beholden to, a foreigner would still be considered foreign. Therefore, the company would be a U.S. airline by any measure.

Turning to the affirmative, I will summarize what DOT proposed to do. The NPRM proposed that DOT move away from the subjective test of "no semblance of foreign control" in making decisions about the control of U.S. airlines. Many years ago, the Civil Aeronautics Board (CAB) added that test to the statutory requirements, at its administrative discretion. And the "no semblance test" is now buttressed by a long list of subjective criteria that have appeared over the years in CAB and DOT case law, which does not make it easy to predict how DOT might rule on any given foreign control case. In place of this approach, the NPRM proposed to make our criteria for validating the U.S. control of an airline both simple and explicit. Under DOT's proposal we would seek only four objectively verifiable answers:

- Will U.S. citizens be in a position to control decisions having to do with the Department of Defense?
- Will U.S. citizens be in a position to control decisions and activities relating to aviation security?
- Will U.S. citizens be in a position to control carrier policies and implementation with respect to safety?
- Is the corporate documentation - the charter, the certificate of incorporation, bylaws, etc. - under the control of U.S. citizens?

Finally, the only other requirements would be that, for a non-U.S. investor to enjoy the benefits of the flexibility newly available through this proposed policy, there would have to be reciprocity for U.S. investment and an open-skies agreement governing the aviation relations between the United States and the home country of the foreign investor, or other relevant international legal obligations.

By targeting the analysis of actual control to these four areas, the proposal would allow more meaningful participation of foreign interests in a U.S. airline's commercial decision-making if that is what the U.S. citizens who own at least 75% of the voting stock and the foreigners agree upon. At the same time, it would continue to protect those features of a U.S. airline's operations in safety, security, and national defense. These are areas in which, despite economic deregulation, there continues to be significant Federal government regulation and involvement.

Finally, I want to move beyond WHAT the Department has proposed to the central issue of WHY the Department proposed this change. The Department has a statutory mandate to foster a safe, healthy, and competitive airline industry that will remain capable of supporting U.S. economic growth by meeting the public's transportation needs. Our regulatory efforts are informed by a simple principle: that our oversight needs to be limited to those areas in which it adds value. For that reason, we have been reviewing carefully the entire corpus of DOT regulations in order to ensure that they pass this test. Where the added-value test is not met, or worse yet, when a regulatory approach actually impedes the ability to secure industry health, we need to make changes.

U.S. aviation policy since deregulation has been to continue to reduce government intrusion in commercial decision-making by airlines, and to recognize and accommodate changes in the marketplace. In other words, deregulation is a work in progress. This policy has been successful in areas such as pricing, route selection, fleet acquisition, and marketing, with positive consequences in many aspects of U.S. airline economic activity. Airlines now provide seamless, end-to-end service through global systems that depend upon webs of contractual networks among airlines, distribution companies, and service providers. These changes have enabled U.S. airlines to compete more effectively in domestic and international markets. However, as set out in the Notice of Proposed Rulemaking, substantial structural changes have taken place in global financial markets and we tentatively concluded that our current interpretation of the actual control test has failed to keep pace with changes in the global economy and evolving financial and operational realities in the airline industry itself, to the detriment of U.S. airlines.

Why did we consider it important to catch up? Because to continue to be effective players, U.S. airlines require significant capital investments in facilities, technology, and a variety of commercial arrangements. In their efforts to meet these challenges, U.S. airlines should have the broadest access to global capital markets permitted by law. Furthermore, new U.S. airlines seeking to enter the market should similarly be able to obtain the financial capital necessary to launch their businesses. Our tentative conclusion was that actual control should not be interpreted in a way that needlessly restricts the commercial opportunities of U.S. airlines, their ability to compete, and their potential to create jobs.

Today, in major industries, capital is allowed to flow freely across national borders so that competitors can establish a global market presence, exploit economies of scope and scale, respond effectively to customer demand and tap market opportunities wherever

they arise. It's a well-established policy, and one that applies even to industries long thought essential to our national and economic security, such as financial services, automobile manufacturing, information technology, steel and pharmaceuticals. And our proposal, consistent with our statutory mandate of "placing maximum reliance on competitive market forces ... to encourage efficient and well-managed air carriers to earn adequate profits and attract capital," was to open up global investment options to the very industry that facilitated the globalization of all the others. Today although many U.S. airlines participate in international alliances, we believed that the "semblance test" has chilled cooperation with, and investment by, foreign entities, since it has made it difficult for actual or potential foreign investors to protect their interests -- a situation that caused KLM to withdraw its investment in Northwest Airlines in 1997. The goal of our proposal is to eliminate that uncertainty with respect to economic decision-making.

Finally, I want to make this as clear as I can. Under DOT's proposal, U.S. citizens would still have to be in "actual control" of a U.S. airline for it to be eligible to keep its certificate. They would own 75 percent of the voting stock in the airline; they would occupy two-thirds of the directorships; the president and two-thirds of the officers would be U.S. citizens. It would be a U.S. airline by any measure. What we are saying is that the greater scope we have proposed to allow non-U.S. citizens for participation in the governance of a U.S. airline would no longer be deemed inconsistent with the finding of actual control by U.S. citizens, as it is today, provided that the short list of objective requirements in the proposed new rule are met.

The potential benefits of the proposal go well beyond our interest in enhancing the availability of capital to U.S. airlines. The international alliances among U.S. and foreign airlines represent a surrogate for the kind of globalization that occurs in other network industries. Our thinking was that our proposal, if adopted, would create an environment far more conducive to productive cooperation among airline alliance partners, providing new opportunities for U.S., as well as foreign, airlines. It could facilitate the further evolution of the world's airline industry into an even more robust and competitive global services sector, by changing the administrative policies that today are significant impediments to that evolution.

Thank you for the opportunity to share the Department of Transportation's perspectives with you. I would be pleased to respond to your questions.