



COMMENTS ON SNPRM

These comments are intended to build upon the Institute's previous "Commentary" that was submitted to this docket (Docket No. OST-2003-15759-28) in December 2005.

I. Introduction

After reviewing the supplemental notice of proposed rulemaking (SNPRM) recently published by the United States (U.S.) Department of Transportation (DOT), it is apparent that, while useful clarifications and modifications have been inserted, one of the contemplated interpretive changes in particular is unlikely to "strengthen" the original proposed rule as the DOT suggests.¹ The proposal to require that "any...delegation of [decision-making] authority [regarding commercial issues] to foreign interests by the U.S. citizen majority owners be revocable" (the "revocability proposal") is problematic.² This interpretation, if followed, could potentially deter strategic investments in U.S. airlines by foreign investors and sidetrack European Union (EU) approval of the draft U.S./EU air transport agreement. However, the Institute fully supports the DOT's broadening of the scope of decision-making authority that must remain under the "actual control" of U.S. citizens in the areas of safety, security, and national defense airlift commitments.

II. The EU's Evaluative Criteria for the NPRM

As noted in our previous commentary, the "adoption of the [NPRM] has now become a virtual pre-condition to EU acceptance of the draft treaty."³ In a May 11, 2006 press briefing, Daniel Calleja, Director of Air Transport in the European Commission's Directorate General for Energy and Transport, distilled the EU's position into a succinct series of evaluative criteria:

"Once the rule is adopted, what the Ministers of Transport will do...is to verify three things – is the rule clear? Is the rule meaningful? Does it allow for an investment from Europeans in the

¹ It should be noted that the SNPRM changes little of the actual wording of the proposed final rule. Our comments, accordingly, are directed to the interpretive commentary in the SNPRM which, if the final rule is adopted, may become part of the Department's official interpretive approach to the rule.

² See Actual Control of U.S. Air Carriers, 71 Fed. Reg. 26,425 (2006).

³ See OST-2003-15759-28 at 4.

United States? Does it give greater opportunities than the present situation? And, is the rule legally safe?⁴ Are the investments protected? If the reply to these questions is positive, then the European Ministers of Transport will give their green light to the agreement.”⁵

If the significant liberalization promised by the draft U.S./EU air transport agreement is to be brought to fruition, it is imperative to consider the effect of the revocability proposal using these same verification criteria (which can be reduced even more succinctly into three questions—if the revocability proposal survives, will the rule still be clear? will it still be meaningful? will it still be legally safe?).

A. Will the rule still be clear?

In the Institute’s view, the revocability proposal is not likely to enhance the clarity of the rule. A foreign investor may likely ask whether or not there are any limitations at all on this revocability. According to the SNPRM, the “board [two-thirds of whom must be U.S. citizens] or voting shareholders [75 percent of the voting interest must be owned or controlled by U.S. citizens] would retain the *ultimate power* to revoke delegations of managerial responsibilities to foreign investors.”⁶ (Emphasis added.) While this majority power of revocation is potentially an unremarkable incident of corporate structure, in the precise context of encouraging foreign investment in U.S. airlines it is regrettable that the DOT’s interpretation offers no guidance to the foreign investor as to the circumstances in which the power of revocation could be exercised to curtail its control of the commercial aspects of a U.S. carrier’s business. If the intent of the rule is indeed to encourage rather than chill investment, the circumstances of revocability must be explained more fully. This is further addressed below.

B. Will the rule still be meaningful?

To understand better the criterion of meaningfulness, it is worth quoting the following remarks by the chief U.S. negotiator in the U.S./EU treaty conclaves, John Byerly, Deputy Assistant Secretary of State for Transportation Affairs, in response to a question at a May 11, 2006 press briefing:

“[T]he investment that airlines outside the United States would be interested in pursuing is what we call ‘strategic investment,’ that is not trying to put some money in and hope the stock rises and pull it out and make some money. That is not the nature of the investment – a short term, for capital gains approach. But rather investing in an enterprise in which you have expertise, aviation, airlines, having some say in the business so your own views are represented in the commercial decisions of the American airline in which you have invested, and then making a

⁴ The Council of Ministers has also used the word “robust” in this context. See Draft Minutes of the 2695th Meeting of the Council of the European Union (Transport/Telecommunications/Energy), held in Brussels on December 1 and 5, 2005, at 13.

⁵ See “U.S.’s Byerly, EU’s Calleja Hope Air Services Accord Could Be Applied by March 2007,” available at http://useu.usmission.gov/Dossiers/Open_Skies/May1106_Byerly_Calleja.asp.

⁶ See Actual Control of U.S. Air Carriers, 71 Fed. Reg. at 26,430.

wise and prudent economic bet, wager, that is going to yield a positive result for you and maybe a positive result that goes beyond stock market gains.”⁷

As addressed in the original NPRM, the idea of allowing a foreign investor to have operational control over commercial decisions such as route planning, yield management and fleet planning, undeniably would yield investment opportunities beyond the “portfolio” stake tolerated under the current 25% cap on foreign ownership. However, the revocability proposal threatens to stifle (if not to make illusory) the promise of “meaningful” strategic control over a U.S. air carrier’s commercial operations. A potential foreign investor would not be likely to consider the final rule as meaningful without clear contractually-assured protection for its capacity to make decisions regarding the commercial activities of the airline.⁸

C. Will the rule still be legally safe?

As argued in our previous commentary, the final rule (with or without the changes proposed in the SNPRM) is likely to withstand legal challenge in the U.S. courts. The Institute endorses the DOT’s reasoning in the SNPRM to support the legality of its proposed interpretation of “actual control” and agrees that the final rule would be consistent with the statutory language and congressional intent. However, the Institute remains unpersuaded by the DOT’s characterization, reiterated in the SNPRM, that its interpretation of “actual control” is being adopted in the form of an “interpretive rule.”⁹ It should be of some assurance to the EU authorities that, under U.S. administrative law, the form of the Department’s administrative action cannot prevent a judicial finding that the outcome of the rulemaking proceeding is in substance a regulation. “As such, it would carry the force of law (as though it were a statute), would bind the courts, and would not be discretionary in each case where it is applied by the DOT.”¹⁰ Any real threat to the legal vitality of the final rule, as the EU authorities well know, would likely come from congressional intervention and not a court challenge.

III. A (More) Modest Revocability Proposal

If the revocability proposal were intended to deter efforts by some members of Congress to hobble the rule-making, it has not been successful. Only a month after the appearance of the SNPRM, the U.S. House of Representatives voted to deny funding to implement the results of the rule-making.¹¹ The DOT should nonetheless take comfort in the failure of previous attempts

⁷ See “U.S.’s Byerly, EU’s Calleja Hope Air Services Accord Could Be Applied by March 2007,” available at http://useu.usmission.gov/Dossiers/Open_Skies/May1106_Byerly_Calleja.asp.

⁸ See Actual Control of U.S. Air Carriers, 71 Fed. Reg. at 26,430-26,431 (“The board’s or shareholders’ ability to revoke the delegation under this proposal could not be conditioned on terms that would make revocation impracticable.”)

⁹ See Actual Control of U.S. Air Carriers, 71 Fed. Reg. at 26,439.

¹⁰ See OST-2003-15759-28 at 4.

¹¹ See David Rogers, “Politics and Economics: House Deals Blow to ‘Open Skies’ As It Passes Latest Spending Bill,” Wall St. Journal, June 15, 2006 at A4. It remains to be seen whether the U.S. Senate will pass a similar provision in its version of the appropriations bill and if the language will survive the conference committee.

by protectionist factions to block the rule-making in Congress, and return its gaze toward refinement of a clear, meaningful, and legally robust final rule that will strengthen the competitiveness of U.S. air carriers in the global economy.

In the Institute's view, the Council of Ministers will reject the U.S./EU draft treaty unless the final rule offers (at least) a more modest iteration of the revocability proposal. Accordingly, as suggested in our earlier commentary, the final rule should include an explicit statement that the "actual control" factors previously considered by the Department will no longer include any factor (other than with respect to corporate documents, safety, security and national defense airlift commitments) previously considered by the DOT in any citizenship proceeding.¹² If the final rule does include the revocability proposal (whether textually or in the interpretive guidelines), the wording should again reflect typical corporate practice by allowing a foreign investor to insist contractually on the payment of penalties (in an amount not out of proportion to the value—both strategic and financial—of the investment) if its ability to control particular commercial operations is compromised or revoked. The DOT, in light of what is routinely expected in investment agreements, should not consider contractual provisions of this kind to be "impracticable."¹³

IV. Conclusion

Criticisms about "the unworkable nature of bifurcating control of a corporation" are not unfounded in an abstract sense but are certainly premature.¹⁴ Other industry innovations such as code-sharing and alliances have evolved despite a regulatory environment that is several steps behind the collaborations created in the marketplace, and the marketplace should be trusted to use the DOT's proposed rule to invent new modes of co-operation and investment. More relevantly, a final rule that includes the modification proposed above would be a pragmatic solution to allow the U.S./EU air services agreement to be signed (further eroding the restrictive bilateral system of air services regulation) and would enhance the ability of capital markets to determine efficiently where investments in U.S. airlines should occur. As the DOT has noted, a well-crafted final rule should enable U.S. airlines to adapt to a better regulatory climate that allows them to "pursue whatever strategies they believe will enhance their ubiquity, competitiveness and profitability in the global airline industry."¹⁵ The Institute, as argued in our previous submission, believes that only a comprehensive elimination of foreign control limitations will truly liberate the marketplace. But the DOT's approach remains a solid incremental step within the constraints imposed by the current law.

¹² See OST-2003-15759-28 at 7.

¹³ See footnote 8.

¹⁴ See Continental Airlines, Press Release, May 3, 2006.

¹⁵ See Actual Control of U.S. Air Carriers, 71 Fed. Reg. at 26,427.