U.S./EC WORKING GROUP
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BEYOND OPEN SKIES:
THE SECOND STAGE OF U.S./EC AIRLINE LIBERALIZATION

Briefing Paper (November 2 Version)

1.0 Preliminary Reflections

1.1 What, ideally, do we want the outcome of the Second Stage (see below) to be? Imagine the airlines as the object of the talks and not the drivers. What sort of framework would politicians wish to impose on the industry and why? From this "top-down" perspective, if airlines are seen to be key strategic instruments, as U.S. legislation has always implied and lately even attempted to encode, then they play a quasi-public function and must have public protection. In that view, we can never escape the bilateral system. If ownership and control restrictions must be maintained as part of this public function/public utility analysis, then we cannot move "beyond" open skies. Indeed, both management and labor, especially in downturns, often also see airlines as a public service—leading to too much union leverage and to risk-averse management.

1.2 The "bottom-up" perspective, exalts the airlines and asks what *they* need in terms of an ideal framework. A list has been created for the Second Stage and is discussed at length in this paper, but some observers ask if the elements of the list are really what the airlines need to create value in this industry. In this argument, the structural inefficiencies of the global airline "system," rather than foreign investment rights and other specific elements as now envisaged, are what the airlines should press negotiators to deliver in the Second Stage. These inefficiencies would include divergent security standards, divergent competition law interpretation, divergent objectives and strategies for environmental policy, failure to implement the ICAO principles on the airline/airport relationship (transparency, consultation, cost efficiency, etc.), and lack of interoperability of ATM systems. These are all obstacles to creating airline value, compounded by the oligopolistic and monopolistic structures of airline service providers (ATM, airports, GDS, caterers, fuel suppliers, etc.) which drive costs up even as ticket prices are driven down in a liberalized ticket market.

1.3 The argument runs, therefore, that private equity investors (in place of or in addition to the current activities of airline strategic investors) would be interested in an industry where all of these obstacles to creating value would be removed. If private investors become interested, ownership and control provisions fall, and bilateralism falls.

2.0 The U.S./EC Air Transport Agreement:[1] Second Stage

2.1 A new aeropolitical regime is being negotiated between the United States and the European Union. The U.S./EC Air Transport Agreement, signed in April 2007,[2] is scheduled to come into provisional effect in March 2008.[3] The Preliminary Joint Committee has already been convened, and the Agreement holds the potential to be the reference point for continuing liberalization efforts. Reports of a Canada/EC joint initiative, for example, have appeared over the summer.

2.2 The agenda for the second stage of negotiations[4] will include certain "priority" issues including further liberalization of traffic rights, additional foreign investment opportunities, the effect of environmental measures and infrastructure constraints on the exercise of traffic rights, further access to Government-financed air transportation, and wet-leasing.[5] John Byerly, the lead U.S. negotiator, has promised that the 2007 Agreement should not be seen as "a clever foxtrot" to the side, and that in the second stage the United States will "fairly assess decades-old policies to determine whether they serve our long term interests."[6] According to a recent business briefing by the UK-based *Guardian* newspaper, "with Congress now controlled by protectionist Democrats . . . it would be a surprise if restrictions on internal flights and ownership rights were lifted."[7] Moreover, it has been observed that the Second Stage negotiations will take place against the backdrop of a U.S. presidential election, never an ideal time for bold international initiatives that have domestic resonance.

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[1] Although in a strict legal and constitutional sense the European Union (EU) is the overarching constitutional fusion of three separate "Communities," the engine of the Member States' *economic* integration is the European Community (EC, formerly the European Economic Community). Constant alternation of the terms "EU" and "EC" seems to inspire confusion and annoyance rather than clarity. The European Community, *not* the European Union, is a signatory to the 2007 air transport agreement with the United States.

[2] Air Transport Agreement between the United States of America and the Parties to the Treaty Establishing the European Community and the European Community, April 2007, *available at* http://eur-lex.europa.eu/LexUriServ/site/en/oj/2007/l_134/l_13420070525en00040041.pdf [hereinafter U.S./EC Air Transport Agreement].

[3] This provisional effect is to allow national procedures to take place in the 27 EC Member States. *See id.*, art. 26.

[4] *See id.*, art. 21.

[5] *See id.*, art. 21(2).

[6] John R. Byerly, Deputy Assistant Secretary of State for Transportation Affairs, Speech to the International Aviation Club, Washington, D.C., Apr. 24, 2007.

[7] Dan Milmo, *Open Skies Q & A*, GUARDIAN UNLIMITED BUSINESS, March 22, 2007.

2.3 A specific timetable will govern the second stage of the U.S./EC open skies process. Negotiations must begin not later than 60 days after March 30, 2008, when the Agreement goes into effect provisionally. Then the parties will review progress no later than 18 months after the start of negotiations, and if no Second Stage agreement can be reached within 12 months after the review of progress, either party can suspend any or all of the rights specified in the Agreement, but suspension will not come into effect until the IATA traffic season that begins no less than 12 months from the date of providing the notice of suspension.[8] Here is a chart of the timetable that focuses on actual dates:

March 30, 2008—*Agreement goes into provisional effect*

May 30, 2008—*Parties start negotiations*

November 30, 2009—*Review of progress begins*

November 30, 2010—*If no second stage agreement, notice of suspension*

March 2012—*Next IATA season begins, suspension takes effect*

2.4 It appears, therefore, that up to four years may elapse from the time the Agreement goes into effect before any rights will actually be suspended. Presumably this lengthy timetable is intended to accustom States and their carriers to a new status quo and to deter any unscrambling of vested and useful rights. Note, also, that the minutes of the Council of the European Union meeting that approved the Agreement reflect what may be a significant variation from the suspension protocol in the main Agreement. According to the Agreement, either "party" may suspend any rights specified in the Agreement.[9] The Agreement defines "party" as either the United States or "the European Community and its Member States."[10] It is not immediately clear, therefore, whether the Community as a whole, or individual Member States acting unilaterally in addition to or in lieu of the Community, would have the right to suspend. Nevertheless, suspension must be in accord with the terms of the Agreement.

2.5 Irrespective of how a formal right of suspension would be invoked, however, the Council minutes indicate that any Member State could ultimately withdraw rights with respect to its own territory. This language was (reportedly) insisted upon by the United Kingdom as the price for its support for the Agreement, and in the view of some reflects UK uneasiness with the introduction of open skies at Heathrow. Thus, the United Kingdom could withdraw Continental's rights through Heathrow, but could not unilaterally affect United's code-share to Spain nor indeed United's own

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8 *See* U.S./EC Air Transport Agreement, art. 21(3).

9 *See id*.

10 *See id*., art. 1 (6).

rights to Heathrow (which are vested under Bermuda II, and are therefore arguably not new rights granted under the 2007 Agreement). The UK position is that traffic rights could be withdrawn after the Second Stage (whether unilaterally by an individual Member State or through suspension of the Agreement as a whole) if U.S. domestic market access through cabotage or reform of ownership and control laws has not been achieved.

3.0 Beyond Open Skies: The Political Challenge of Authentic Liberalization

3.1 The phrase "authentic liberalization," it has been argued, carries a redundancy: liberalization is neither authentic nor inauthentic, it is a continuum or a process that leads ultimately to a new paradigm of competitive behavior where a balance of benefits is replaced by a balance of opportunities.

3.2 In any event, liberalization, like the period of restrictive bilaterals that preceded it, is effectively a political process. That process has been supported by successive U.S. Administrations but it has not been completed. The struggles faced by the Department of Transportation in its Notice of Proposed Rulemaking initiative on foreign ownership[11] demonstrated that the political process, for the moment, is stalled. But true liberalization, to those who support it, does not mean only a better allocation of traffic rights for U.S. carriers into Europe and other jurisdictions. Arguably, U.S. carriers have already obtained most of the access rights they seek. (With over 90 open skies agreements in place, the significant hold-outs are China, Japan, Mexico, Russia, and Australia.)

3.3 If liberalization continues to be a political goal, the United States will need to be in the vanguard, persisting with the removal of limitations on foreign ownership and control, and abolition of vestiges of protectionism such as the Fly America program. In this view, liberalization will not mean more open skies bilaterals within the framework of the "Chicago system," it will require a

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[11] This rulemaking process was a gallant effort by the U.S. Department of Transportation intended to motivate EC Member State approval of the 2007 U.S./EC Air Transport Agreement by introducing a more expansive interpretive approach to the control test component of the "nationality" rule (which also caps foreign investment in U.S. airlines). The new interpretation, shadows of which flicker in the final text of the Agreement (see, for instance, Virgin America's "franchise" relationship to the UK-based Virgin Group), would have cracked the nationality "pillar" of U.S. airline ownership law but would not have caused it to crumble. Although this DOT effort failed (in part because of labor-inspired Congressional opposition), it signaled that U.S. aviation officials continue to show fidelity to the liberalizing instincts of the open skies era. One of those officials, DOT Under Secretary for Policy Jeffrey N. Shane, comprehensively stated the implications of the agency's interpretive "rulemaking" in Congressional testimony delivered at the peak of the controversy. *See* U.S. Department of Transportation, Office of Public Affairs, Statement of Jeffrey N. Shane, Under Secretary for Policy, Department of Transportation, Before the Aviation Subcommittee of the House Transportation and Infrastructure Committee, Feb. 8, 2006, available at http://www.dot.gov/affairs/jeffshane020806.htm (criticizing the unpredictable and subjective tests applied for U.S. citizen "control" of U.S. airlines and suggesting that only a narrower set of objective ownership criteria, focused on shareholding, safety, and security rather than freedom of commercial decision-making, would not disturb the capital flows of a global economy and would allow the citizenship oversight process to "add value").

much more fundamental restructuring of the international airline system. By lifting restrictions on capital inflow and the right of establishment, this restructuring would deliver important benefits that are unavailable under today's open skies regime, including the ability to consolidate across national lines and, relatedly, to more efficiently allocate capacity. It would also give the industry the opportunity to move beyond the inefficient and unstable business model of the alliance.

3.4 Although U.S. airlines emerged from bankruptcy with capital raised in the U.S. marketplace (in some cases obtained at lower rates than expected), this does not mean that the capital argument for liberalization has been defeated. These investments took place at the peak of the liquidity flood, and there is no guarantee that they will be repeated. Meanwhile, private transborder equity deals are now being focused on the aviation industry (as investments in Iberia and Qantas have shown), and there is no good reason why U.S. airlines should be shut out of that trend. In a global finance market, it is inefficient and costly to structure this industry solely through domestic capital allocation.[12]

3.5 The supporters of liberalization are not troubled by what carriers might actually do to take advantage of new marketplace opportunities. For example, until the recent dramatic Air France/Delta joint venture announcement,[13] preliminary reports of the next IATA traffic season had suggested that few new routes would be introduced in the transatlantic marketplace despite the additional opportunities in the U.S./EC Agreement. Bmi, for example, long a proponent of U.S/EC open skies, has decided to concentrate its future growth plans in its Middle Eastern markets.[14] But a similar situation accompanied the introduction of EC liberalization, and eventually the low-cost industry developed without the traditional ownership restraints and some legacy carriers even transformed themselves into low-cost operators. The same process has affected a number of U.S. legacy carriers under the discipline of bankruptcy.

3.6 Airline capital cycles are much longer than airline business cycles, and the fact that there is a tepid response to a liberalization initiative does not mean that the political reality of liberalization is thereby compromised. The quest for liberalization, in this view, always has the same purpose—allow market forces to determine the shape of a marketplace where cost structures are so

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[12] The "globality" of these rules, incidentally, also prohibits Texas Pacific Group buying more of Ryanair.

[13] *See* Tim Hepher & Benoit van Overstraeten, *Air France, Delta Lead Charge on Heathrow*, washingtonpost.com, Oct. 17, 2007 (describing new Air France/Delta joint venture plans with respect to Heathrow and other EC hubs). The joint venture is the first use of the "Community carrier" concept to which the United States agreed early on in U.S./EC negotiations. The response of Heathrow incumbents British Airways and Virgin Atlantic to this incursion will be interesting, not least in terms of possible future consolidation.. Plans have also reportedly been made by BA and Virgin with respect to continental gateways to New York's JFK.

[14] *See* Victoria Moores, *Bmi puts off transatlantic Push*, AIRLINE BUSINESS, Oct 2007, at 26 (noting that bmi management believes that "everybody was caught off-guard by how quickly Open Skies came through, following many false dawns").

marginal that there will always be potential players who, if they have the freedom to enter the market with a perceived advantage, will exercise it.

4.0 A Recap of the First Stage Achievements

4.1 It can be agreed that the 2007 U.S./EC agreement is only a staging-post on the journey to (true) liberalization. Despite its apparent multilateral provenance (at least on the European side), some commentators claim that it is effectively a further iteration of an existing, well-understood *bilateral* model—the open skies agreements that the United States has been pursuing both before and since the Clinton Administration's statement of U.S. international air transport policy in 1995.[15]

4.2 Nonetheless, whether one agrees or not with Andrew Charlton's caustic "calling a spade a spade" assessment of the agreement,[16] or Allan Mendelsohn's suggestion that the new agreement does not "accomplish very much that is new,"[17] it is important to take stock of certain features of the 2007 agreement that go "beyond" the conventional open skies template. (It will also be useful, in the next section, to make some comparisons between the incremental advancements of the U.S./EC agreement and those agreed in the startling new bilateral agreement between the United Kingdom and Singapore.) Here, in summary, are the "new" features of the U.S./EC agreement:

1. Creation of a "Joint Committee"[18]

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15 U.S. Department of Transportation, *International Air Transportation Policy Statement* (1995).

16 *See* Andrew Charlton (Principal, Aviation Advocacy), Speech to ABA Air and Space Law Forum, Memphis, Tennessee, Oct. 4, 2007. Actually, Charlton used the more forceful variant (calling a spade a "shovel").

17 Allan I. Mendelsohn, *Major Controversial Issues Outstanding Between the United States and the European Union in International Aviation*, Lecture at the University of Genoa Law School, Oct. 17, 2007.

18 Article 18 of the U.S./EC Air Transport Agreement speaks to areas of U.S./EC cooperation that will include expert-level exchanges on new legislative or regulatory initiatives, as well as cooperation on potential areas for further development of the agreement. One year from March 30, 2008, the Committee is charged to develop "approaches to regulatory determinations with regard to regard to airline fitness and citizenship, with the goal of achieving reciprocal recognition of such determinations." *Id*., art. 18(4)(f). The charge also includes developing a "common understanding" of the criteria used by each party for airline control. *Id*., art. 18(4)(g). The Joint Committee will operate by consensus. The European Commission has some experience in the establishment and operation of such bodies as an institutional tool to implement various forms of cooperation and international economic cooperation.

2. Self-identification as a "plurilateral" agreement[19]

3. Second-Stage negotiations explicitly contemplated[20]

4. Unrestricted reciprocal third, fourth, and fifth freedom rights contained in the body of the Agreement and not in a traditional bilateral "Annex"

5. Unrestricted reciprocal seventh freedom all-cargo rights, except that U.S. rights will be limited to the Czech Republic, France, Germany, Luxembourg, Malta, Poland, Portugal, and the Slovak Republic

6. "Community carrier" designation accepted by the United States for seventh freedom passenger/cargo combination services by EC airlines from both EC and European Common Aviation Area States[21]

7. Clarification of current ownership and control rules, allowing up to 49.9% foreign ownership of total equity in U.S. airlines without deeming that level to be "control," but allowing European Community to impose stricter 25% cap on U.S. investment in EC airlines; also allowing each party's nationals to own majority stake

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[19] *See* Article18(5) of the U.S./EC Air Transport Agreement, which speaks to extending the agreement to third parties (following development of conditions and procedures and necessary amendments).

[20] *See* Article 21 of the U.S./EC Air Transport Agreement, considered below.

[21] This statement merits some further explanation, for which I am grateful to John Byerly. Under the 2007 Agreement, EC airlines can fly combination (passenger and cargo) service to the United States from any point in the European Community as well as any point in the States of the ECAA as of the date of the Agreement. Thus, Lufthansa could fly a freestanding (seventh freedom) service from Trondheim (Norway) to New York, with no connection to Germany or anywhere else in the Community. But ECAA airlines, in contrast, have only the rights that the relevant bilaterals grant them (typically cargo seventh freedom but not combination seventh freedom). Thus, for example, Icelandair does not have the right to operate combination seventh freedom services from Madrid to the United States. Under Annex 4 of the Agreement, ownership and control of an EC airline by an ECAA national does not put in jeopardy the EC airline's right to fly under the U.S./EC Agreement. An Icelander could own and control Lufthansa, and Lufthansa could still fly to the United States under the Agreement. Moreover, the United States waived its right under its bilateral agreements with ECAA States (as well as Switzerland, Liechtenstein, and a number of African countries) to object to their airlines' operations to the United States on the ground that effective control is vested in non-nationals of such countries. Thus, a UK citizen could buy and control Icelandair and the United States would not object to Icelandair's continuing to fly to the United States under the U.S./Iceland open skies agreement. (The Annex 2 waiver with respect to ownership by itself––without control––is much broader and covers all third country airlines in which EC carriers invest; this provision is modeled on the existing Multilateral Agreement on the Liberalization of International Air Transportation, signed on November 15, 2000, by the United States, Brunei Darussalam, New Zealand, and Singapore (*see* http://www.maliat.govt.nz.)).

in third country airlines without suspension of relevant bilateral agreements[22]

8. Open pricing protocol without approval or filing requirements or any emergency measures, except that U.S airlines cannot be price leaders on intra-EC routes

9. No unilateral capacity or "change of gauge" restrictions

10. Franchising provisions that will allow closer business relationships and cooperative arrangements between the airlines of each party and foreign businesses

11. Reciprocal wet-leasing arrangements, except in domestic transportation

12. Recognition of the importance of minimizing regulatory divergence and "working towards" compatible practices and standards in security, as well as affirmation that each party will "evaluate" and "take into account" possible adverse effects on international air transportation when considering security measures

13. Novel provisions on Government Subsidies and Support (allowing "observations" to be submitted to the Joint Committee on adverse effects of grants and other supports on "fair and equal opportunity to compete")

14. Novel provisions on Competition Law (replacing classical "market share" provisions by U.S. doctrinal formula on protecting competition rather than competitors, advocating a minimization of differences in application of competition laws to inter-carrier agreements, and promoting generalized "cooperation" between competition authorities—to discuss developments, to reach mutual understanding, to consult, and to notify—as outlined in Annex 2 and the MOU)

15. Novel provisions on Environmental Matters (conditioning adoption of proposed environmental measures on evaluation of "possible adverse effects on the exercise of rights" contained in the agreement)

16. Novel provisions on Consumer Protection

17. Novel provisions on traffic uplift preferences, in particular access by EC airlines to U.S. Government Procured Transportation, except that "city-pair contract fares" and transportation obtained or funded by the Secretary of Defense or the Secretary of a military department are excluded

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[22] But this concession does not extend to control; *see supra* note 21 for further explanation.

5.0 The Open Aviation Area

5.1 At present, the "beyond open skies" paradigm contemplated by the European Commission is the so-called "Open Aviation Area" (OAA) which would come into effect between the United States and the European Community.[23] The OAA, regarded by some as "the next big idea" in global aviation, would comprise the following:

1. *Full freedoms of the air (including cabotage) extended to both parties*
2. *Removal of investment restrictions by both parties*
3. *Unrestricted wet leasing (to include domestic routes)*
4. *Commitment to regulatory convergence and harmonization standards at a high common level in safety, security, operations, competition, state subsidies, and the environment*

5.2 Thus, the OAA is intended to provide a *holistic* framework to deliver full market access. It shares with the U.S. open skies policy a consumer orientation, as well as the goal of transcending the traditional Chicago market constraints that lead to an under-supply of the "travel commodity," non-optimal pricing, and the discouragement of new operators and increased capacities. Given the legislative changes necessary for an OAA regime, it is thought that this capstone agreement would be adopted as a Senate treaty rather than in the form of an executive agreement, the procedure used for the 2007 first stage.

6.0 The Second Stage Agenda

6.1 A suggested agenda for the Second Stage (bearing in mind the comments made in § 1 above) could comprise two categories: those items which feature in either the OAA or the UK/Singapore agreement but not in the new U.S./EC Agreement, and a further set of items which are explicitly mentioned in Article 21 of the U.S./EC Agreement. (*Note*: Some of the items in the first category are also addressed, explicitly or implicitly, in Article 21.)

6.2 Here, in summary, are OAA and/or UK/Singapore features that are not in the new U.S./EC Agreement:

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[23] *See* THE BRATTLE GROUP, THE ECONOMIC IMPACT OF AN EU-U.S. OPEN AVIATION AREA (Dec. 2002). The OAA is derived conceptually from the "Transatlantic Common Aviation Area" proposed by the Association of European Airlines in its groundbreaking 1999 policy paper. *See* ASSOCIATION OF EUROPEAN AIRLINES, TOWARDS A TRANSATLANTIC COMMON AVIATION AREA: AEA POLICY STATEMENT (Sept. 1999).

1. Cabotage rights (although not excluded on an ex-bilateral basis subject to local laws)

Certain U.S. airlines have concluded collective bargaining agreements that prevent them from supporting cabotage. The prevailing U.S. view (among both government and industry officials) is that cabotage is a "red herring" floated by those who publicly endorse liberalization but who seek in reality to maintain the status quo (or to return to the current system using the renunciation option enshrined in the agreement). In U.S. eyes, it makes more commercial sense for airlines to gain access to the U.S. domestic market through relaxation of foreign investment and right of establishment restrictions.

2. Expanding safety cooperation to include "ramp" inspections (UK/Singapore only)

3. Full embrace of the ECAA States (OAA)

4. Unlimited seventh freedom rights for cargo and passenger airlines of both parties

5. Special labor provisions including social protections for airline workers and amendment of immigration laws to allow exercise of cabotage, wet leasing, and other operations (see Appendix A)

An OAA, however, could—but need not—require any general liberalization of the labor market, liberalization of outsourcing beyond wet-leasing, modification of current employee social and protections, or changes in the rights of labor organizations to represent employees. It is argued that the evidence suggests that neither American nor European employees enjoy a more favorable position under law and regulation, and that it will be the performance of individual companies rather than differences in levels of social protection that will more decisively shape the prospects and welfare of employees of U.S. and Community airlines.

5. Reciprocal investment rights (OAA only)

It seems clear that U.S. government negotiators and many U.S. industry leaders in principle favor full relaxation of the foreign investment restrictions on a reciprocal basis. A main focus (if not *the* main focus) of the Second Stage discussion will be how to overcome strong congressional opposition typified by the recent Oberstar amendment to the FAA Reauthorization Bill, which would prohibit

foreign citizens from having any degree of business control over a U.S. airline (see below).

The right of investment would, in the view of most commentators, be structured as a "right of establishment" that would require the foreign-owned enterprise (whether an acquired U.S. corporation or a newly-created subsidiary of a foreign airline) to have its principal place of business in the inward jurisdiction as well as to operate in accordance with that jurisdiction's laws and policies on incorporation, taxation, labor, immigration, environment, national security, and other matters. All of this compliance, however, would require a nondiscriminatory national treatment regime that would give foreign investors equal standing with their domestic counterparts (for example, with respect to tax rates and access to the national judicial system).

For a briefing on the revised U.S. national security procedures for strategic inward investments, see Appendix B. These procedures could form part of a more liberal regime for foreign investment in U.S. airlines. Appendix B also includes a brief description of the national treatment provisions commonly found in U.S. bilateral investment treaties (BITs).

It remains unclear, however, whether the OAA intends ultimately to create a truly "open"investment regime that would allow inward investment in OAA airlines by non-OAA nationals, or whether it would continue to insist that ownership and regulatory control must be vested in OAA nationals (whether U.S. or EC). The UK/Singapore agreement, incidentally, breaks no new ground on reciprocal investment: the traditional caps remain, leaving Chicago system notions of cabotage and seventh freedom rights as the agreement's most impressive innovation.

6. Deeper agreements on convergence and harmonization (OAA only)

There is strong interest among stakeholders that governments should work together efficiently and constructively in areas like aviation security, facilitation of international travel, and harmonization of technical standards in safety-related areas as well as in creating clarity and business certainty with respect to regulation of the competitive framework.

Of course, a great deal more could be done on competition harmonization and convergence, but considerations of confidentiality because of separate regimes set limits that Annex 2 of the U.S./EC Air Transport Agreement and the MOU explain and respect. Some commentators, such as Rutger Jan toe Laer, propose that the Second Stage could embed a more integrated mechanism that would take advantage of the consumer-driven philosophy of U.S. and EC antitrust laws and their respective application.[24] Replacement of the present "double approval" system by a "one-stop approval" system would assign approval of new airline alliances to the jurisdiction which (to borrow U.S. jurisprudential parlance) has the greatest "center of gravity" relationship with the transaction under review. This would be, for example, the jurisdiction where the alliance partner with the largest city-pair network or the largest contribution to alliance revenues is established. It is unclear whether this kind of "substantive positive comity" would require legislative action (in the United States) or whether indeed the ouster of U.S. appellate procedures (in situations where the European Community becomes the "one-stop" jurisdiction) would even be constitutionally valid. One of the assumptions of these proposals is that the alliance system will survive for the moment (and, consequently, that full freedom of transnational investment will not be a part of the Second Stage).

Moreover, some believe it to be illogical, not just from a safety perspective, that there should be divergent rules under an OAA governing persons operating the same types of aircraft over the same routes and under the same operating conditions.

6.3 But there are several other unsettled issues that are explicitly made part of the U.S./EC Second Stage that should be indicated here. Some of these issues, especially access to infrastructure, have been spoken of disparagingly in the past as "soft" rights (in contrast to "hard" rights such as traffic rights and the right of investment). Yet these "soft" rights will be, in the view of many, of "hard" importance in the years to come. Article 21 of the agreement adds to the agenda the following "items of priority interest to one or both parties":

1. Effect of Environmental Measures and Infrastructure Constraints on the Exercise of Traffic Rights

Single European Sky: The Single European Sky (SES) would enhance Air Traffic Management ("ATM") in the EU by rationalizing

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[24] *See* H.S. Rutger Jan toe Laer, *Kick-Starting Cross-Border Alliances: Approval and Clearance; the Past, the Present and the Future*, XXXII AIR AND SPACE LAW 287 (2007).

the fragmented system that exists today. It would also have a positive environmental impact: IATA calculates that 12 percent of fuel burn in Europe is directly attributable to ATM and infrastructure inefficiencies (the same percentage attributed to the same problems in the United States). Some argue that unions and national pride are slowing progress towards SES implementation.

Runways: Of principal concern is the construction of a third runway at Heathrow. As the price for the runway, however, the UK government has imposed a number of environmental taxes and charges, including the increased Air Passenger Duty ("APD") that it claims are necessary to ensure that Heathrow will comply with EC environmental laws when the third runway is constructed.

The so-called "mixed mode" at Heathrow would increase capacity by 10-15 percent. The UK government is seriously considering its introduction.

Slots: With Heathrow slots allegedly commanding up to $40 million a pair, the future allocation of EC airport slots is of major concern to U.S. operators. Air France-KLM is contemplating lease-based slot trading with its U.S. SkyTeam partners, but may also enter the ex-Heathrow transatlantic market itself rather than through code-sharing. It has been suggested that U.S. negotiators may ask for slots to be freed up for its carriers at Europe's big business hubs as part of the Second Stage talks, "an unpleasant prospect for those already holding them."[25] The prospects for slot confiscation of this kind are unclear in a system historically based on the sanctity of grandfather rights. Nonetheless, change seems inevitable. The Commission's own expert study recognizes that price-based slot trading may be needed to cope with saturation capacity and the constraints on expansion imposed by environmental concerns.

Environmental Taxes and Charges: The growing number of environmental taxes and charges obviously increases the cost of doing business. Currently, the British government's APD raises ₤2 billion annually for the Treasury. There are also NOx charges in the UK and Switzerland. Germany has proposed the introduction of NOx charges (albeit on an allegedly revenue neutral basis). And the Dutch government has proposed a ticket tax for passengers departing Dutch airports. If approved by the Dutch Parliament, the tax will come into

[25] Mark Pilling, *Slot Machines*, *in* AIRLINE BUSINESS, Oct. 2007, at 74.

effect in July 2008 and increase the existing passenger service charge by€45 for transatlantic passengers.

It is extremely difficult to combat these taxes. The governments attract political support by attaching an "environmental" label even though the monies collected are not earmarked for environmental purposes (the UK APD, for example, flows to the general treasury.) It also appears, in the view of some, that governments frame the taxes in a manner calculated to benefit the home carrier. In recent proposals to revise the current APD that will be subject to a consultation process, the UK government hints that special treatment should be accorded to transit passengers, with obvious benefits for carriers with hubs in the UK. It has also been noted that the Dutch ticket tax proposal does not appear to apply to connecting passengers at all even though their environmental footprint is arguably larger (because they both are taking off and landing) than passengers originating in the Netherlands who will be subject to the tax.

EC Emissions Trading Scheme (ETS): The IATA/ICAO position supports a global ETS (although the European Community Member States have filed a reservation to the ICAO proposal), provided it is properly designed and in lock-step with infrastructure enhancements, technological improvements, and research and development into alternative fuels. The EC proposal, controversially, is both regional and unilateral in scope and does not prioritize technological and infrastructure improvements and R&D. Through promotion of ETS, the Community appears to acknowledge that its antiquated ATM causes some percentage of GHG emissions. Yet, in the U.S. perspective, the EC proposal to include aviation in the existing ETS does not give the airlines credit for emissions caused by ATM inefficiencies that are beyond the industry's control. There is also a difference of interpretation between US and EC officials as to the compatibility of the ETS with the Chicago Convention.

Night Noise Restrictions: These restrictions, subject in the main to local Member State regulations, are an important issue for U.S. cargo carriers.

2. Further access to Government-financed air transportation

A liberalization philosophy would justify further EC carrier access to the so-called Fly America program. To address U.S. Department of Defense concerns about the abolition of the Fly America policy, it has

been suggested on the U.S. side that all U.S. and EC carriers that seek U.S. government business should be required to subscribe to the Civil Reserve Air Fleet (CRAF) program. Such a contractual agreement, backed by appropriate penalties including loss of operating certificates, would ensure that U.S. military requirements would not suffer as a result of the policy's full or partial elimination.

No comparable program formally exists in the Community. To ensure, however, that U.S. carriers suffer no discrimination under an informal government policy favoring EC airlines, it has been proposed that language should be included in the next US-EC agreement to guarantee equality of treatment in the procurement of government financed international traffic. The WTO Plurilateral Agreement on Government Procurement provides a useful starting point for guaranteeing non-discrimination. In respect of the procurement covered by the Agreement, parties to the agreement are required to give the products, services and suppliers of any other party to the Agreement treatment "no less favorable" than what they give to their domestic products, services and suppliers and not to discriminate among goods, services and suppliers of other parties.

3. Provision of Aircraft with Crew (Wet Leasing)

The agreement presently permits U.S. and EC carriers to wet-lease aircraft of the other party or a third-country for international transportation. An extension of this right to transportation in the U.S. domestic market would arguably be deemed to constitute cabotage.

7.0 Strategies For Future Multilateral Cooperation: "Broadening" As Well As "Deepening" Liberalization

7.1 With respect to other initiatives that may flow from the U.S./EC process, as mentioned above there is some interest in pursuing a Canada/EC agreement[26] and no doubt other proposals will emerge. The value of further initiatives that focus primarily on traffic rights has, however, been questioned. For example, it has been argued that the question—"what are the impediments to a NAFTA open skies agreement?—is really the wrong way to look at the issues for future negotiation. Thus, the liberalizing agenda of "open skies," as noted earlier, has reached its culmination in the

[26] It was reported in mid-2007 that Canada, pursuing its new "Blue Sky" international aviation policy, had opened preliminary discussions toward its own open skies agreement with the 27-member Community. See Madhu Unnikrishnan, *Canada Eyes EU Open Skies As Part of Blue Sky Program*, AV. DAILY, June 5,2007, at 4 (mentioning prior Canadian agreements with the United States, Serbia, Croatia, Ireland, Portugal, and Kuwait).

U.S./EC model, and it is not clear what incremental gains can or should be achieved by pursuing that model in other directions.

7.2 In this argument, the bilateral negotiation process was for a number of reasons the best way to open markets internationally for the benefit of U.S. carriers. As noted above, that process is largely complete. With a few (albeit significant) exceptions, international markets are open to U.S. carrier service. Increasingly, the challenges that confront international service relates less to opening markets and more to a new set of challenges that are not necessarily appropriate for bilateral arrangements. For these newer and growing challenges (e.g., emissions, security, foreign ownership and control, and airport and airspace congestion), multilateral (and maybe even unilateral) approaches should be pursued. (Some of these challenges, and their effect on "value" in the industry, were also addressed in the preliminary comments in §1.)

7.3 According to this approach, security and environment issues have emerged as global challenges that require ever-closer collaboration among governments in order to address the threats efficiently and effectively and to ensure that businesses and their customers are not harmed by duplicative, conflicting, or unnecessarily burdensome and costly rules and regulations. Other pressing issues, such as congested airports and oversubscribed air traffic systems, may be tackled optimally through unilateral government intervention, but unilateralism always carries the risk of discriminatory treatment and it is clear that some international standards to protect non-national carriers will be implicated.

7.4 With respect to foreign ownership and control, the internal and external dimensions of the applicable laws (combining bilateral restrictions with domestic legislation) mean that States must focus on both multilateral and unilateral action. The search for appropriate multilateral fora continues. Regionalism has been the preferred model (U.S./EC and the MALIAT, for example), but other options could include the multipolar framework of the WTO General Agreement on Trade in Services and its Air Transport Annex. The International Civil Aviation Organization offers a forum for global solutions on environmental issues, and the North American Free Trade Agreement remains a potential vehicle for cooperation in air transport, a sector that NAFTA has never embraced despite the "continental thinking" that it is supposed to represent.

APPENDIX A: LABOR BRIEFING

A.1 *Introduction*. Liberalization has its opponents, and these stakeholders (including U.S. and EC unions) are a powerful and concentrated group. In the United States, labor's position is sometimes conceptually associated with the quite separate issue of objections to foreign investment in critical infrastructure (considered in Appendix B in the context of the CFIUS gatekeeper legislation). Rep. James Oberstar, Chairman of the House Committee on Transportation and Infrastructure, has been especially vocal in defense of nationally owned and controlled airlines. Chairman Oberstar has recently proposed language amending the ownership and control statute that, in the view of some, could be interpreted by a future Administration as requiring that all middle and upper management

positions in U.S. airlines be occupied by U.S. citizens.[27] The language provides, in pertinent part, that U.S. citizens must control "all matters pertaining to the business and structure of the air carrier, including operational matters such as marketing, branding, fleet composition, route selection, pricing, and labor relations."[28] It has been observed that this proposed language is not in the spirit of the Second Stage, and may well contradict the First Stage provisions for branding and franchising opportunities.

A.2 Other opponents, especially U.S. airline unions, fear that the proposed multilateral regulatory framework does not take adequate account of labor protection and representation needs. The unions identify an "ambiguity" at the heart of liberalization which will deprive labor of any means to negotiate with "holding companies" (a single Lufthansa/United corporation, for example, owning airlines in both the United States and Europe) on a transnational basis. It remains a potential shortcoming of the applicable labor laws in both jurisdictions that they are fundamentally territorial, and operate without any protective transnational effect. The unions are concerned that, as liberalization takes hold, they would be seeking an effective right to negotiate with a collective transnational entity (rather than just with a foreign investor in a U.S. airline). The same is not true domestically. In the United States, when there are several airlines in one corporate "family," a mechanism exists to secure single representation.

A.3 Labor notes that the Europeans, despite deregulating in 27 Member States, left territorial labor laws in place. That is one of the reasons, labor contends, why the Air France/KLM quasi-merger remains unconsummated.[29] The variances in EC labor laws will make it tempting for carriers to flag in countries such as Romania where protection is weaker, and already that has happened with Ryanair (which flags in Ireland where it is harder for unions to organize, but is primarily a UK operator). Labor believes that these tendencies will not be resisted and that the only way to avoid forum-shopping for weak labor protection is to take out the variables and level the field. This would be an extraordinarily complex public policy challenge.

A.4 While cabotage remains the ultimate sacred cow for labor, rejected out of hand because of the absence of any domestic regulatory control, it is possible that the right of establishment could win labor's support depending on how its representation concerns are respected.

A.5 For those who favor liberalization, labor's preoccupation with protectionism seems misplaced. Some see labor as having been captured by an antimarket bias and a suspicion of foreigners, focused more on tying success to employment rather than production. Labor's agenda, in this view, protects

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27 *See* Letter of Rep. John L. Mica, Ranking Republican Member, House Committee on Transportation and Infrastructure, to Chairman Oberstar, August 2, 2007.

28 *See* H.R. 2881: FAA Reauthorization Act of 2007, Sec. 801.

29 Pursuant to one of the few pieces of Community labor legislation, a transnational "Works Council" represents Air France/KLM workers. It appears to have a primarily information-giving purpose and has not displaced the country-based staff representative bodies in each company.

existing jobs at the expense of future jobs and in defiance of a discernible global trend in comparable industries such as automobiles, steel, and oil. Labor responds that it is protecting existing highly-paid jobs, and that it is unclear how many jobs of similar status will result from liberalization (the Booz Allen study projects a five-year net gain of over 70,000 direct and indirect jobs, not only in the airline industry itself but also through the effects of liberalization on general employment, from the 2007 Agreement). Labor's position may be an historical misjudgment, some argue, because U.S. labor has generally been satisfied to deal with private employers and to focus its energies on the collective bargaining process. Special interest pleading fails to recognize that a balance must be struck that will have benefits for both labor and liberalization.

A.6 *Comparison of U.S. and EC Labor Laws*. The Booz Allen Hamilton Report in 2007[30] did a comparative study of U.S. and EC labor laws implicated by a possible Open Aviation Area. Its principal focus was the status of so-called "mobile workers" (flight and cabin crew) and the likelihood that foreign airlines would use their investment powers to favor work allocation to their own staffs even if U.S. crews were equally or more competitive. In the United States, the laws are primarily federal (the Railway Labor Act of 1926), whereas in the European Community only a limited number of labor-related areas are harmonized at Community level. National rules, especially with respect to settlement of labor disputes, remain fundamental. The Report emphasizes, however, that different regulatory contexts can produce like results in an industry where technical standards and commercial service priorities have always been strongly influenced by international standards and criteria as well as national thinking.

A.7 One interesting example of this continued importance of transnational thinking springs from the labor unions themselves, which have joined forces in the Wings Pilots Coalition, the Star Solidarity Alliance, and the oneworld Cockpit Crew Alliance. It is conceivable that strikes of Northwest pilots could result in strikes of KLM pilots in order to maintain a balance between wages so as to avoid a shift of production from KLM to Northwest (or vice versa). More significantly, the stage is being set for dialogue across national and continental borders.

A.8 It is also important to recognize that the special features of the U.S. Railway Labor Act, including permanent institutional machinery and procedures, make clear that the U.S. Government viewed (and views) its national transportation system as a matter of public interest whose operations should experience minimized levels of disruption. The first purpose of the Act is not to protect employees but to protect the U.S. national interest by providing a mechanism to defer if not prevent disruptions of the interstate and international transportation system. One of these features is that the National Mediation Board is to impose indefinite mediation. These general public/economy-at-large concerns are part of the balance of interests (also including management and labor) struck in the Act. Ultimately, if a dispute threatens deprivation of essential transportation services, the President can exercise emergency powers to arrest work stoppages.

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[30] *See* BOOZ ALLEN HAMILTON, THE ECONOMIC IMPACTS OF AN OPEN AVIATION AREA BETWEEN THE EU AND THE US: FINAL REPORT (Jan. 2007).

A.9 The RLA and its ceaseless bargaining procedures created a regime of rigid contracts and deliberate inflexibilities with respect to amendment of contracts. In part this has led to recourse to Chapter 11 bankruptcy proceedings as a method not only to shed debt and equity obligations but also, it would appear, to walk away from such contracts. "Scope clauses" developed in collective bargaining negotiations define which categories of person have preference or access to which jobs in the airline system. It is understood that contracts now include subjects affecting the division of labor among international partners. Matters such as code-sharing policies (and larger and essentially capital decisions such as policy toward potential foreign investors) have repeatedly been addressed in recent scope clause discussions as part of job protection strategy. These arrangements appear to have aspects of what is known in Europe as management /labor "co-determination."

A.10 U.S. bilateral air services agreements allow foreign airlines to bring in managerial, sales, technical, operational, and other staff provided they comply with U.S. immigration laws. In sharp contrast to EC practice, flight and cabin crews require "alien crewman" visas. Theoretically (unless constrained by collective bargaining agreements) a U.S. airline could employ aliens on its services between the United States and other countries. The immigration laws do, however, constrain the use of foreign crews by U.S. carriers during labor disputes. Many regard the meticulous U.S. travel control rules for temporary air transport workers as inconsistent with a policy of deregulation and open skies. Also, U.S. law expressly forbids issuance of crew visas for the purpose of providing domestic transportation.

A.11 Europe, with 27 separate labor law regimes, has few common labor laws but does share the terms of the Rome Convention on the Law Applicable to Contractual Obligations. Article 6 of the Convention provides that an employment contract is governed by the law of the State where the employee "habitually" carries out his work in performance of the contract (for a ground staff employee, for example, even if he is temporarily employed in another country, and if no such State exists, by the law of the State in which the place of business through which he is employed is located (for example, mobile airline crews operating internationally)). On its face, these provisions support the practices of Ryanair and others in applying the law of their incorporation (in Ryanair's case, Ireland grants its operating license and AOC, even though its principal place of doing business is arguably the United Kingdom) to mobile crew who work in other EC States. This question of the relationship between the corporate choice of establishment and the application of labor laws is topical in the Community.[31] The Railway Labor Act takes a similar approach to the Rome Convention, since it foresees protection of all employees of airlines, foreign as well as American, working regularly in the United States.

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[31] Charleroi-based Ryanair pilots brought suit in Belgium claiming that social rights (including payment of irregular and supplemental working hours) must be governed by Belgian law. Ryanair asserted that Irish fiscal and labor law must govern the employment relationship. The local court found for the pilots. The Rome Convention question of "habitual presence," and the applicability of labor laws other than those of the licensing State (or even the State of principal business) can be considered unsettled in the Community.

A.12 The European Community does have some protective law with respect to the rights of workers upon the sale or insolvency of undertakings (notably with respect to preservation of accrued social payments), and the trend appears to be toward giving employees the benefit of mandatory rules of law in the State of habitual employment.

A.13 In terms of the power to terminate, however, national policy is dominant and there are other discernible trends toward giving employers greater flexibility to react to business cycle demand. According to the Booz Allen Report, "any general assumption that laying off professional staff in 'Europe' is much more costly or less costly and difficult than in the United States . . . is superficial if not outright wrong."[32] Having said that, some countries (the United Kingdom, Denmark, Spain) are manifestly more flexible to employers than others (France, Germany).[33] Denmark leads the way, giving employers great flexibility but matching that flexibility with a commitment to social justice in the form of generous redundancy benefits and job retraining.

A.14 With respect to temporary hiring, in particular short-term stays of airline crews in EC Member States, European laws are much more flexible than the U.S. immigration regime and, for example, allow stays in the so-called "Schengen" (visa-free travel) area for up to three months within a period of six months. In most cases, a single authority can arrange work permits if needed, whereas U.S. laws require the involvement of at least three major federal agencies. Overall, it is procedurally much easier to use U.S. crews in the Community than Community crews in the United States.

A.15 Finally, with respect to labor fears of reallocation on lucrative transatlantic markets (including shifting of work within a networked firm to crews and aircraft working under the most flexible rules and at the most competitive wage rates), the Booz Allen study makes a number of macroeconomic findings that rely on the persistence of a dynamic marketplace and of a highly specialized labor force that can extract high rents. But, more significantly, the study seems to place more emphasis on transborder dialogue among industry professionals than on regulatory convergence. In other words, a regime of *de facto* convergence may emerge (as it has in the alliances).

A.16 What then of the concerns raised by (U.S.) labor with respect to the right of establishment? One important working assumption is that neither the United States nor the European Community Member States provide an absolute protection of employment, although arbitrary selective dismissal is generally difficult if not impossible. In individual Member States, legal restrictions on laying off staff may even be less than in the United States. But granting rights of investment, the Booz Allen report concludes, would not remove a single existing employee legal protection.

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32 BOOZ ALLEN HAMILTON REPORT, at 133.

33 According to an index established by the World Bank, measuring the difficulty under general law (*i.e.*, outside collective bargaining frameworks) of dismissing an employee, on an ease-difficulty scale of 0-100, Denmark scored 10, as did the United States, the United Kingdom, and Switzerland.

APPENDIX B: U.S. FOREIGN INVESTMENT PROCESS

B.1 The Foreign Investment and National Security Act of 2007 (FINSA) took effect on October 24, 2007. FINSA substantially modifies the 1988 Exon-Florio amendment which established the Committee on Foreign Investment in the United States (CFIUS) by expanding the scope of its subject matter, altering its composition, extending the duration of its reviews, and mandating more detailed reports by CFIUS of its activities to Congress.

B.2 The reconstituted CFIUS is charged with formally investigating and reviewing foreign investments and/or acquisitions of U.S. companies or assets that may impact national security. Under the Exon-Florio amendment, the President is afforded broad powers to block or suspend investments and/or acquisitions of U.S. companies and assets by foreign entities if there is "credible evidence that leads the President to believe that the foreign interest exercising control might take action that threatens to impair the national security" and that there are no "provisions of law . . . [which], in the judgment of the President, provide adequate and appropriate authority for the President to protect the national security in the matter before the President." The amendment further endows the President with broad enforcement powers, including full divestment by the foreign entity. It also insulates all findings and actions taken by the President under the amendment from judicial review.[34]

B.3 A party or parties to an investment or acquisition subject to the amendment's scope may attempt to immunize themselves from presidential action by voluntarily filing notice with CFIUS. Within 30 days of such notice, CFIUS may review the transaction in order to determine if there are any national security interests at stake.[35] If there is such a finding, CFIUS has 45 days to carry out a more detailed investigation. During that period, CFIUS assesses the transaction and determines whether or not to clear it. If such clearance is granted, the transaction is safe from any presidential intervention. An exception to this would be in instances where it is found that a party has made a material misrepresentation concerning itself or the transaction in question. It is also worth mentioning that CFIUS has the power to compel party notices to be withdrawn and re-submitted and that such a requirement can, in practice, extend the time period in which a transaction must wait for clearance.[36]

B.4 *The Expanded Scope of National Security Under FINSA*. With the enactment of FINSA, the definition of "national security" is greatly expanded: "The term 'national security' shall be construed so as to include those issues relating to 'homeland security', including its application to critical infrastructure.[37]" "Critical infrastructure" is defined as "systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security."[38] FINSA also applies to "critical technologies"

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34 50 App. U.S.C.A. § 2170(d)(4)(A)–(B), § 2170(d)(3); § 2170(e).

35 31 C.F.R. § 800.503.

36 *Id*. § 800.504.

37 *Id*. § 800.505.

38 Foreign Investment and National Security Act of 2007, Pub. L. No. 110-49, § 2.

which are defined as "critical technology, critical components, or critical technology items essential to national defense . . . ."[39] Notably missing from this legislation is any reference to "economic security."[40] As Larson and Marchick recall, "economic security [language] . . . has been proposed close to a half-dozen times since 1988, including when Exon-Florio became law."[41] They further point out that "[i]t would be difficult for CFIUS to implement a statutory requirement to protect 'economic security,' since the term is extraordinarily vague" and, more importantly, "an 'economic security' test would simply be a vehicle for domestic industries seeking to block foreign competition."[42]

B.5 In addition to the expanded definition of "national security," FINSA also places a heightened emphasis on foreign government-controlled transactions, *i.e.*, "transaction[s] that could result in the control of any person engaged in interstate commerce in the United States by a foreign government or an entity controlled by or acting on behalf of a foreign government."[43] In instances where this is found to be the case, FINSA requires an assessment of the following:

> (A) the adherence of the subject country to nonproliferation control regimes, including treaties and multilateral supply guidelines, which shall draw on, but not be limited to, the annual report on 'Adherence to and Compliance with Arms Control, Nonproliferation and Disarmament Agreements and Commitments' required by section 403 of the Arms Control and Disarmament Act;
> (B) the relationship of such country with the United States, specifically on its record on cooperating in counter-terrorism efforts, which shall draw on, but not be limited to, the report of the President to Congress under section 7120 of the Intelligence Reform and Terrorism Prevention Act of 2004; and
> (C) the potential for transshipment or diversion of technologies with military applications, including an analysis of national export control laws and regulations[.][44]

Larson and Marchick have noted that such provisions are animated, "[r]ightly or wrongly, [by] a perception in some part of the U.S. government that American-owned and –controlled companies are more likely to abide by the spirit of U.S. government laws, regulations, and policies."[45] In addition, they have noted additional concerns over acquisitions linked to hostile foreign governments and the potential need for companies to work closely with U.S. agencies on matters of security and intelligence.[46]

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39 *Id.*

40 *Id.*

41 ALAN P. LARSON & DAVID M. MARCHICK, FOREIGN INVESTMENT AND NATIONAL SECURITY: GETTING THE BALANCE RIGHT 28 (2006).

42 *Id.*

43 Pub. L. No. 110-49, § 2.

44 *Id.* § 4.

45 LARSON & MARCHICK, *supra* note 41, at 9.

46 *Id.*

B.6 On the flip side, Larson and Marchick have pointed out that

> [f]oreign investment can be part of the answer to the new security challenges. For example, foreign investments can contribute to infrastructure modernization and development of technologies in the United States. Alternatively, a foreign acquisition may make it possible for a defense supplier to remain in the United States or may lead to enhanced investments in a particular division of a major defense company that has not been a strategic priority for that company.[47]

B.7 In addition to the aforementioned factors which CFIUS must take into consideration during its investigations, FINSA also adds that the Committee must look at "the long-term projection of United States requirements for sources of energy and other critical resources and material" and "such other factors as the President or the Committee may determine to be appropriate, generally or in connection with a specific review or investigation".[48]

B.8 *Changes in the Organization of CFIUS*. While the internal organization of CFIUS may not appear immediately relevant to concerns about the future of foreign investment, a few changes are worth identifying. First, FINSA establishes a new position—the Assistant Secretary of the Treasury—which oversees CFIUS activities and, more importantly, designates the lead agencies or agencies charged with carrying out the CFIUS investigation for a particular transaction.[49] Second, the Secretary of the Treasury is confirmed as the chairperson of CFIUS and shall, under the new provisions, "consult with the heads of such other Federal departments, agencies, and independent establishments in any review or investigation . . . as the chairperson deems appropriate . . . ."[50] Last, FINSA also sets out the list of CFIUS members or designees, adding that it may be expanded to include "[t]he heads of any other executive department, agency, or office, as the President determines appropriate, generally or on a case-by case basis."[51]

B.9 A recent commentary by Rubinoff and Terhune has lamented this expansion of CFIUS membership and the involvement of additional agencies in the investigatory process. Such an increase, when coupled with expansion of transactions susceptible to investigation and congressional oversight (discussed below), "create[s] new and additional opportunities and avenues for competitors of the parties and/or opponents of a proposed transaction to have an impact on the CFIUS process in order to block or heavily condition a transaction, or dissuade a potential buyer."[52]

B.10 *Increased Review Period*. One of the most potent weapons CFIUS has in its arsenal is the ability to negotiate so-called mitigation agreements with parties whose transaction is under review.

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47 *Id*. at 22.

48 Pub. L. No. 110-49, § 4.

49 *Id*. at 3.

50 *Id*.

51 *Id*.

52 Edward L. Rubinoff & Henry A. Terhune, *New CFIUS Reform Act Presents Challenges to Foreign Investment in the United States*, Metropolitan Corporate Counsel, Sept. 2007, at 29.

While this was an informal process prior to FINSA, CFIUS now has a legal basis to conduct such negotiations. Both CFIUS and the President also have the power to enforce these agreements by being allowed to unilaterally reopen the investigation in instances where a party has either materially breached the mitigation agreement or submitted false information to CFIUS. This new power has been commonly referred to as the "evergreen" provision of FINSA. With respect to the provision and instances of breach, there is a limitation in that the lead agency in the investigation must find that the breach was intentional and that all CFIUS members conclude that there is no other avenue of redress available. A finding of an intentional breach can be particularly detrimental to parties since it may lead to full divestment.[53]

B.11 FINSA also increases the review power of CFIUS by mandating that it establish interim protections to address any security concerns raised during an investigation where a party has withdrawn its notice and resubmission is pending. CFIUS must also establish "a process for tracking any actions that may be taken by any party to the transaction, in connection with the transaction, before the notice . . . is resubmitted."[54]

B.12 *Congressional Oversight*. The last critical change to Exon-Florio by FINSA is the amount of congressional oversight. Under the new law, Congress must now receive a full report from CFIUS at the conclusion of any investigation. The report must include a full account of the actions taken by CFIUS (including any mitigation agreement negotiated), as well as the basis for taking these actions, and must provide assurance that the investigated transaction will not adversely affect national security. The mitigation agreements themselves are subject to further scrutiny by Congress. Any member who has received a CFIUS report because of a designated leadership position in either the House or Senate, a place on a committee with jurisdiction over CFIUS, or is either a Senator or Representative from a jurisdiction where a U.S. company subject to the investigation has its principal place of business, may request an additional briefing on the investigation or compliance with a mitigation agreement. Additionally, FINSA also requires that CFIUS submit annual reports on its activities, including any and all transactions it has investigated.[55]

B.13 Finally, the new statute requires that within 180 days of FINSA's enactment, CFIUS must publish its implementing regulations.[56] Also within that time period, the chairperson of FINSA shall "publish in the Federal Register guidance on the types of transactions that the Committee has reviewed and that have presented national security considerations . . . ."[57]

B.14 *Conclusion*. It is clear that FINSA substantially alters the makeup, operations, and accountability of CFIUS. While it is difficult to gauge effectively what its long-term impact will be, Rubinoff and Terhune have offered this preliminary analysis:

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[53] Pub. L. No. 110-49, § 2.
[54] *Id*. § 5.
[55] *Id*. § 7-8.
[56] *Id*. § 9.
[57] *Id*. § 2.

> CFIUS will be far more proactive and searching in its reviews and investigations, thereby likely resulting in a more formal process covering a greater number of transactions, creating more opportunities for delay, and subjecting more transactions to mitigation agreements. Similarly, the "evergreen" provision for post-clearance re-opening of transactions when and if mitigation agreements are breached results in less certainty regarding the finality of CFIUS determinations and places a premium on parties being accurate, complete and candid in submitting information to CFIUS.[58]

The concerns embedded in this analysis are echoed in the final assessment of Larson and Marchick:

> Our recent travels in Europe, Asia, and the Middle East have shown us the level of concern felt by foreign investors about the current political environment in the United States. Other countries are closely watching the next steps of Congress and the administration. European investors are concerned that the traditional pattern of large investments in both directions across the Atlantic may be broken by protectionist pressures in Washington; Chinese investors fear that Chinese investment in the United States is not welcomed; and cash-rich investors in the Persian Gulf express concerns about the reaction they might provoke by proposing an investment or acquisition in the United States. . . . CFIUS has proved to be—and continues to be—an effective tool for vetting the national security concerns associated with foreign investment. If Congress fails to achieve the right balance, U.S. companies and workers could feel the repercussions for years to come.[59]

The question then remains whether or not that "right balance" has indeed been struck.

B.15 *Notes on Bilateral Investment Treaties*. The U.S. bilateral investment treaty (BIT) program helps protect private investment, develop market-oriented policies in partner countries, and promote U.S. exports.

B.16 The BIT program's basic aims are to:

Protect investment abroad in countries where investor rights are not already protected through existing agreements (such as modern treaties of friendship, commerce, and navigation, or free trade agreements);

Encourage the adoption of market-oriented domestic policies that treat private investment in an open, transparent, and non-discriminatory way; and

Support the development of international law standards consistent with these objectives.

B.17 U.S. BITs provide investments with six core benefits:

58 Rubinoff & Terhune, *supra* note 52, at 29.

59 LARSON & MARCHICK, *supra* note 41, at 33.

1. Require that investors and their "covered investments" (that is, investments of a national or company of one BIT party in the territory of the other party) be treated as favorably as the host party treats its own investors and their investments or investors and investments from any third country. The BIT generally affords the better of national treatment or most-favored-nation treatment for the full life-cycle of investment — from establishment or acquisition, through management, operation, and expansion, to disposition.
2. Establish clear limits on the expropriation of investments and provide for payment of prompt, adequate, and effective compensation when expropriation takes place.
3. Provide for the transferability of investment-related funds into and out of a host country without delay and using a market rate of exchange.
4. Restrict the imposition of performance requirements, such as local content targets or export quotas, as a condition for the establishment, acquisition, expansion, management, conduct, or operation of an investment.
5. Give covered investments the right to engage the top managerial personnel of their choice, regardless of nationality.
6. Give investors from each party the right to submit an investment dispute with the government of the other party to international arbitration. There is no requirement to use that country's domestic courts.

B.18 The United States currently has 39 BITs in force. The BITs include an article making provisions for peace and security. For example, the most recent BIT with Uruguay contains the following language in Article 18:

> Nothing in this Treaty shall be construed:
> 1. to require a Party to furnish or allow access to any information the disclosure of which it determines to be contrary to its essential security interests; or
> 2. to preclude a Party from applying measures that it considers necessary for the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.

B.19 Finally, every BIT allows for a "right of establishment." For example, Article 3 of the U.S./Uruguay Agreement includes the following language:

> 1. Each Party shall accord to investors of the other Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.

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