A Conversation with Jeffrey N. Shane  
April 12, 2012  
Professor Brian F. Havel, Interlocutor

Introduction

PROFESSOR BRIAN F. HAVEL: Hello. Our format today, as it has been in the past, will be three one-hour sessions. And we’ll be paying special attention in this program to the emergence and implementation of an ambitious U.S. effort to extend at least some of the features of domestic airline deregulation to the international sphere through the policy known as “Open Skies.”

But today’s guest I hope will also travel back with us to the period before the arrival of the formal Open Skies policy in the early 1990s, and help us to understand the first stirrings of international air transport liberalization during the preceding decade.

My guest today to talk about all these things is Jeffrey N. Shane, who was described by one of our previous interviewees, Bob Crandall, as one of the principal movers of U.S. transportation and aviation policy for many years.

And by another of our interviewees, former chief U.S. aviation negotiator John Byerly, in his conversation with us in October 2010, as “one of the great thinkers at the forefront of aviation policy.” A person who can “step back from the trees and see the whole forest, able to articulate tough ideas in understandable terms, and in many ways the originator of the Open Skies concept and the person who drove it forward.” We’ll see, Jeff, if that turns out to be a valid claim as we chat this morning!

Jeffrey Shane has a distinguished career in both public service and private legal practice. He served in a number of policy-making capacities at the Department of Transportation, and he was also chief aviation negotiator for a period of time at the Department of State.

All of that happened between 1979 and 1993. And he returned to government service in 2002, serving until 2008 and culminating in his appointment as DOT Under Secretary of Transportation for Policy between 2003 and 2008, which gave him a critical role in the emergence of the historic 2007 U.S.-EU Air Transport Agreement.

Jeff holds an undergraduate degree from Princeton University and a law degree from Columbia Law School, where he was Articles Editor of the Columbia Journal of Law and Social Problems.

He is currently a partner with the Hogan Lovells law firm in Washington, D.C., where his practice is principally devoted to domestic and international transportation issues with particular focus on strategic regulatory, legislative, and transactional advice and representation.

He’s the recipient of many professional recognitions, including Aviation Week’s L. Welch Pogue Award for Lifetime Achievement in Aviation, which I think is the top award in this field for those who have served the international
aviation industry. And I was myself in the visitor’s gallery at the International Civil Aviation Organization in Montreal in 2007 when Jeff Shane took the gavel as the first American to serve as President of the ICAO Triennial Assembly since 1959. That was quite an achievement.

There’s a great deal more to say about you, Jeff, including your service as a Professor of International Transportation Law for a period at Georgetown University. But that would simply prolong my words of introduction and we need to hear from you.

And I hope to have given, in these introductory remarks, a flavor to our audience of your commanding professional involvement in the evolution of U.S. aviation law and policy. And again, welcome to the International Aviation Law Institute and welcome back to Chicago. I know you haven’t been here for some time.

In this first hour, we’ll be looking at some of the background to deregulation and some of the early liberalization efforts that preceded Open Skies in the 1990s.

The Conversation

PROFESSOR HAVEL: Now, as I said in my introduction, you had a number of positions which you held over the years and let me quickly recite that in 1979 you were DOT Assistant General Counsel for International Law, up to ’83. From ’83 to ’85, DOT Deputy Assistant Secretary for Policy and International Affairs. Eighty-five to ’89, Deputy Assistant Secretary of State for Transportation Affairs. You moved over to the Department of State. And then from ’89 to ’93, back to the DOT as Assistant Secretary for Policy and International Affairs. About 15 years of holding those appointments, then into private practice, and then you returned to government in 2002 and you served as DOT Under Secretary of Transportation for Policy.

So let me ask you, Jeff, perhaps to take us back through your career in public service, the evolving nature of your responsibilities, and to what extent some of those responsibilities turned from being career appointments in the public service and became political appointments, which I think is the subject of some interest.

Again, this is not a deposition. But I’m interested in hearing your CV.

JEFFREY N. SHANE: Well thank you, Brian. First, before I get to the question, I just wanted to express my heartfelt thanks to you and to the Institute, not just for having me here as one of your subjects, but for really understanding the importance of the transformations that took place in international aviation policy – highlighting them as sort of iconic examples of what happens when government is working.

I think there are some very important lessons in the transformations that we’re going to be looking at today, and that you’ve looked at in previous interviews, for some of the problems facing the country today. And it’s really interesting to look back, even for those of us who participated in them, to try to understand why these important sea changes in government policy were possible. And why, at a time when we desperately need similar sea changes today,
they don’t seem to be taking place. So this is a very interesting enterprise, and I'm very excited to be part of it.

**PROFESSOR HAVEL:** So we’re going to see sea changes in the aviation industry . . .

**MR. SHANE:** It’s an intermodal metaphor, yes.

**PROFESSOR HAVEL:** Yes. Okay.

**MR. SHANE:** Because intermodalism is, of course, an important theme at the Department of Transportation.

**PROFESSOR HAVEL:** Yes.

**MR. SHANE:** And I’m particularly privileged to be interviewed by none less than the Director of the International Aviation Law Institute. So thank you so much for the time that you’ve put into this.

**PROFESSOR HAVEL:** Thank you.

**MR. SHANE:** Anyway, going back to the question about this checkered career that you’ve just outlined. I think it’s probably not unfair to look back even further just briefly, because my first tour of duty with the Department of Transportation actually began in 1968. The Department had only been created a year before.

I had been working at an independent regulatory agency called the Federal Power Commission for two years as a trial lawyer, meaning an administrative litigator. I had been in a lot of natural gas pipeline rate cases . . .

It’s fascinating to think about why I was there and why I was doing that. And the answer is simply that while I didn’t like law school very much, the subject that I disliked the least, believe it or not, was economic regulation. There was a craft to it that appealed to my anal-compulsive nature and administrative law was sort of a nice, hermetically-sealed system within with which I thought I could work quite effectively.

And I actually became a research assistant to a law professor at Columbia who was writing a book about state regulation of utilities.

**PROFESSOR HAVEL:** Who was that?

**MR. SHANE:** Ken Jones. William Kenneth Jones.

**PROFESSOR HAVEL:** Right.

**MR. SHANE:** He was a fixture on the New York Public Utilities Commission for many years, and a great man, one of the seminal thinkers, I think, about utilities regulation.

So I grew up in this culture of utilities regulation and so that’s why, when I came to Washington, I wanted to work for a regulatory agency and the Federal Power Commission at that time, regulating both electricity and natural gas, was a classic regulatory agency.

And when I moved from the FPC to the Department of Transportation after DOT was created, it was very much for the same sort of job. DOT understood that an enormous amount of transportation policy was still being made in independent regulatory agencies: the CAB, of course, but also the Interstate Commerce Commission and the Federal Maritime Commission.
DOT was an executive branch agency. Nothing in the law that created the Department of Transportation enabled it to pronounce on transportation policy issues that were still the purview of these independent agencies. If we were going to have any effect on transportation policy, we had to basically put on a case. We had to litigate before these agencies and try to make our case for a different approach.

And that, in many ways, was my first introduction to an effort to liberalize some regulatory structures that had been in place for a long, long time. I apologize for this aside, because it's probably going back a little too far -- but I'm still in touch with a great man named Alan Boyd. Alan Boyd was the very first Secretary of Transportation. He had been a Chairman of the CAB.

PROFESSOR HAVEL: We're back in 1965?

MR. SHANE: He was Chairman, I think, in '64 or '65. He then became an Under Secretary of Commerce for Transportation, which was the highest transportation policy position in the government prior to the creation of the Department of Transportation. And President Lyndon Johnson went to him, he knew him personally, and said, "I want you to draft the law that will create this new cabinet agency." Lyndon Johnson created the Department of Transportation. He also created HUD. He was very much about trying to make government more efficient by pulling a lot of disparate threads under one roof and make them work better.

Alan Boyd told me, not too long ago, that in the first draft of the law that became the Department of Transportation Act, he included a whole chapter on deregulation. He wanted to deregulate modes of transportation that were being overregulated, he felt, based on his own regulatory experience.

PROFESSOR HAVEL: Did he use the term "deregulation" or was he using a term like "regulatory reform," which sort of preceded deregulation in the formation of public policy?

MR. SHANE: He used the term "deregulation." Now whether he would have used it in 1965, I don't know.

PROFESSOR HAVEL: Yeah.

MR. SHANE: It has become, after all, a pretty important term. But he felt that if they were really going to get their arms around some of the issues in transportation policy, a huge step forward in that regard -- an important piece of the puzzle -- would be some measure of deregulation. Lyndon Johnson, by his telling, said, "Young man, let's do one thing at a time. I'd like to create this department. If you throw deregulation in," whatever he called it, "we'll never get this done." Because he anticipated that there'd be plenty of opposition.

So the Department of Transportation, because it was being led by Alan Boyd, he became the first Secretary of Transportation, went to these independent regulatory agencies in the context of actual, on-the-record proceedings with a very deregulatory or liberalizing approach.

---

1 Alan S. Boyd was appointed as a Member of the Civil Aeronautics Board by President Eisenhower in 1959. He was appointed Chairman by President Kennedy in 1961 and remained in that position until 1965.
And some of the cases are funny. You know Brian that I’m incorrigible pack rat, and I have all the files. And so I actually have the briefs that I wrote before these agencies at that time. Just to give you one particularly silly example, there was a case called the Substituted Service Investigation\(^2\) at the CAB. It had been the rule that if you tendered a package to an airline because you wanted it to travel by air, you wanted it to be “air cargo,” the airline had no alternative but to make sure that it was transported by air. If the airplane broke down, if they knew it was going to be on the ground for an entire day and they might be able to get it to the destination by truck, too bad! You had paid for air transportation and, by God, you were going to get air transportation because that’s what the CAB rule said.

The CAB began to question whether or not that was a sensible rule, particularly because you could probably get the package to its destination the next morning on a truck, but it wasn’t allowed. And so I represented the Department of Transportation in the Substituted Service Investigation to make the very profound point that if it’s possible to get the package to its destination by the time the consignor wants it there, even if not by air, perhaps it should be allowed. And the CAB, in its wisdom, said, “Yes, we will allow it.” So henceforth, if the airplane broke down, the transportation could still take place.

PROFESSOR HAVEL: So that was the sense of liberalization at the time.

MR. SHANE: That was the quality of liberalization we were talking about at the time. We also did a lot of rate cases. It was a very interesting introduction.

So I was at the Department of Transportation in that role for about four years. I left government for quite a long time, became more of an environmental lawyer, I should say, because environmental controversies were very much the biggest issue at the time, particularly in the context of public works. Highways being put through towns without much democratic participation in the planning process. Runways being extended and so forth. Progress being made, but not being made in a way that really enhanced the franchise that citizens had. So there was a lot of litigation about that.

And I came away thinking that I was really an environmental lawyer. And I did spend the next several years doing environmental law, both overseas in Southeast Asia and back in Washington. I worked for the U.N. Development Program for a while, based in Bangkok.

PROFESSOR HAVEL: When did you leave government service the first time then?


PROFESSOR HAVEL: So between ’72 and ’79 you’re talking about.

MR. SHANE: I was out. I was –

PROFESSOR HAVEL: Out . . .

MR. SHANE: Yes. And then . . . when I was invited to an interview to talk about the first of the jobs you mentioned in 1979, the Assistant General Counsel job, I did it very reluctantly.

PROFESSOR HAVEL: Carter was President at the time, is that right?

MR. SHANE: Carter was President at the time.

PROFESSOR HAVEL: So this was not a political appointment?

MR. SHANE: It was not. No. This was just a career civil service appointment. I was quite reluctant, actually, to even show up at that interview because I had worked at the Department of Transportation for four years. And I thought the idea of going back and treading the same corridors and probably seeing the same memos on the same desks seven years later, didn't seem like a very smart move.

PROFESSOR HAVEL: Right.

MR. SHANE: But I did the interview as a favor to a former boss who asked me to. And when the General Counsel at the time, a woman named Linda Kamm, described the job, I began to have second thoughts; it sounded quite interesting. This was Assistant General Counsel for International Law. We hadn't done much international law at the department when I had been there before.

And she said something about, "You have to pay attention to these negotiations that we have with other countries." I had no idea what she was talking about. That sounded good. The most important reason I wanted to take the job had nothing to do with that; it had to do with the fact that it would give me an opportunity to supervise somebody. You know, supervisory jobs are like credit cards, Brian. If you've never had one, you're not eligible to get one.

And I had found that not having supervised anybody had become a real obstacle to landing the kinds of positions that I had been applying for. So the fact that I was going to be a supervisor meant that I would finally check that box, and who knew where my career would go from there?

PROFESSOR HAVEL: Okay.

MR. SHANE: So that's why I took that job. It did, in fact, introduce me –

PROFESSOR HAVEL: There were no kerosene fumes involved in this. You weren't –

MR. SHANE: I was not –

PROFESSOR HAVEL: Aviation was not flowing through your veins and arteries at this point.

MR. SHANE: No. Like Mike Levine, whom you interviewed in 2006, I think –

PROFESSOR HAVEL: Yes. That's correct.

MR. SHANE: I lived just a few miles from what was then called Idlewild Airport. My favorite cheap date was to drive to the observation deck and watch airplanes taking off. But it was really because it was cheaper than taking my date to dinner. It was not because I was so dramatically in love with airplanes.
No. I can’t qualify myself as a lifelong aviation buff. I sleepwalked into this business.

PROFESSOR HAVEL: Okay.

MR. SHANE: But the bilateral negotiations that were taking place – and I had to participate in those as a member of the delegation once I became the Assistant General Counsel – did seem pretty interesting. My staff, who had been working on these things for quite a long time, of course, had to give me an education into the intricacies of third freedom, fourth freedom, fifth freedom. I didn’t understand any of that. I could see, however, that none of it had anything to do with freedom.

But eventually I figured it out. And it became more and more fascinating. Particularly because, number one, you could travel everywhere to meet your counterparts in their capitals. And because the issues seemed to be important, particularly to the airline industry.

This, remember, was now during the Carter administration. The Carter administration had begun the process of taking domestic deregulation, which was already a fact, it had happened in 1978, into the negotiating process – not with the idea that we could, even through an agreement, completely deregulate the air transportation between the U.S. and a trading partner – but that we could at least liberalize those agreements to the point where governments would stop regulating the price of air transportation, or the capacity, or even the number of airlines serving a market, the destinations. We were trying to make real progress in that way. We were successful, as the record will show. A lot of so-called “liberal” bilateral agreements were being forged at that time.

PROFESSOR HAVEL: From the very first time you went into the Department of Transportation in 1979, then you were working on these –

MR. SHANE: That’s right.

PROFESSOR HAVEL: – liberal bilaterals. That designation, of “International Law,” in your title was aimed at these negotiations. That was the context and substance.

MR. SHANE: That was a part of the job. I also had a maritime component and even a cross-border surface transportation responsibility. We had trucking with Mexico and Canada and I had to think about some of the issues there. But it was mostly about aviation.

PROFESSOR HAVEL: I want to come back to bilaterals and how you proceeded with those.

MR. SHANE: Okay.

PROFESSOR HAVEL: But before we do that, you had an interesting vantage point in 1979, coming back after the passage of the Airline Deregulation Act. And domestic deregulation had occurred, it was beginning to unfold. What was your perception of how things were at the Department of Transportation and the CAB at that time, looking at deregulation? You didn’t have the same investment in its success that some of your predecessors may have had.

MR. SHANE: That’s right.
PROFESSOR HAVEL: You were coming in to look at this process. Recollect for us what you found when you arrived and what the situation was with deregulation at that time, from a perspective of the DOT.

MR. SHANE: Right. Well the President had essentially embraced deregulation, of course. The Congress enacted it through the efforts of Senator Kennedy, all of that has been well-documented, even in your interviews.

And so there was really no questioning the domestic deregulation achievement. That was a part of our culture at this point. And in fact, in the early '80s, there was a pretty serious recession and traffic was drying up pretty quickly and the airlines were doing very poorly. And there was some effort by the industry, as I recall, to blame deregulation on what had become a pretty negative performance. And I recall attending a number of hearings, even as a witness or accompanying the General Counsel of the Department of Transportation at hearings which were designed to examine that question. Was deregulation a mistake? Are we now –

PROFESSOR HAVEL: Oh really?

MR. SHANE: Yes. This was 1980... There was a genuine effort to explore whether or not deregulation made sense given the economic performance of the airlines just a couple of years into the deregulation process. And the Department of Transportation was steadfastly in favor of defending it and maintaining it. And in fairness, Congress never touched a hair on the head of deregulation. We went through that process and by the time the '80s had ended, the airlines were making record profits again.

So the downturn in the airlines' fortunes clearly had nothing to do with deregulation. In fact, deregulation may have rescued them, in many ways, at the end. But DOT was very much in favor of that.

If you look at the international side, however – the extension of deregulatory principles to these bilateral relationships – there were real tensions within the administration. The CAB was, of course, the most aggressive. The State Department was, I think, in favor of liberalizing as a tropism, as an economic policy instinct. The Department of Transportation was in favor of liberalizing but in a much more, I guess putting quotes around it, “realistic” way, in a practical way.

Remember that we had chosen instruments at that time. The majority of international air services were being provided by Pan Am, by TWA, by Northwest Orient to the Pacific.

PROFESSOR HAVEL: What do you mean by “chosen instruments?”

MR. SHANE: Well they had been identified as the airlines that would, in effect, be given the international route rights that our negotiators were able to develop through this bilateral negotiating process. We had another group of domestic carriers that were just beginning to dip their toe into some of these international markets. But for the most part, they were feeders to the international carriers. And the international carriers, well-known, would be the ones that our trading partners expected to see.

As a result of deregulation, given the fact that now our domestic airlines were producing huge hub-and-spoke systems in the U.S. that would be able to
feed international routes in a very efficient way, they—you know, the Americans and the Deltas and Continentals and Uniteds—all became very interested in international routes. And they insisted that there be an opening up of these markets.

PROFESSOR HAVEL: What time frame are we talking about?

MR. SHANE: The time frame in which I came back to the Department of Transportation in 1979, '80, '81, '82, '83. And so the DOT was nervous about opening the floodgates to competition in a way that damaged the incumbent carriers. The feeling seemed to be not to resist liberalization per se, but to do it in a measured, in an incremental way such that the Pan Ams and the TWAs would not be wiped from the face of the earth by this aggressive new competition coming from this jungle of a deregulated market that we had created.

PROFESSOR HAVEL: What was the inciting event that caused international liberalization to become part of the deregulation thinking?

MR. SHANE: Well, you—

PROFESSOR HAVEL: You mentioned in your Kotaite Lecture that there was a letter from Carter in 1977 which—

MR. SHANE: Yes.

PROFESSOR HAVEL: to the Department of Transportation, which may have been at least one of the—

MR. SHANE: Well that was. If you're looking for a single event it was—

PROFESSOR HAVEL: Touch paper events.

MR. SHANE: It was a decision by the President. And I wasn't... I was eating lotus, I was working for the UN in Bangkok during this time. So I have no insight into precisely who produced that very important change in policy. But Carter wrote this memorandum, or signed it, that went to the agencies involved in international aviation and it said, "Let's stop trading restrictions," which is, of course, what the process had been. "Let's begin trading opportunities. Let's demonstrate that we're prepared to open our market if, in fact, our trading partners are prepared to open their markets." And it was a very different take, a very different take on the negotiating process.

PROFESSOR HAVEL: Well that was a remarkable change in thinking.

MR. SHANE: Only a year before, 1976, the Department of Transportation put out an international aviation policy statement, which I still have a copy of. And it said, "Of course we believe in competition. And we believe in competition in international markets as well as domestic markets. But believing in competition doesn't mean that there has to be any number of airlines on an international route."

PROFESSOR HAVEL: Right.

MR. SHANE: It was very much a traditionalist policy. It essentially... it validated years of conventional thinking about how we needed to calibrate the

---

amount of capacity that airlines could put on international routes. And that was very much in the interest of making sure that the Pan Ams and the TWAs, the traditional international carriers, were not challenged too much.

And that continued to be, in some form, notwithstanding the fact that we had this Carter policy, in some respects, a continuing view of the Department of Transportation. “Let’s not move this ball too quickly down the field, we have to do it in a measured way.”

PROFESSOR HAVEL: Did this whole change in thinking also have something to do with the Civil Aeronautics Board’s Order to Show Cause,\(^4\) which I think had occurred in 1978, the year before you arrived, showing cause why the United States should not terminate IATA’s antitrust immunity. Maybe if you would speak to that, what that was that the Department of Transportation was focusing on: what IATA was doing. And how that shifted thinking in its own way.

MR. SHANE: The CAB was an independent regulatory agency and it really was independent. It wasn’t just a formal designation. They didn’t have to check with anybody before doing anything. That was the nature of the structure. And as far as I know, they didn’t check with anybody before deciding to put out this Order to Show Cause.

PROFESSOR HAVEL: Who was Chairman at the time? Do you remember?

MR. SHANE: Fred Kahn would have been Chairman.

PROFESSOR HAVEL: At the time of the Order to Show Cause.

MR. SHANE: I believe so. I don’t think I overlapped with Kahn as Chairman. I think Marvin Cohen had become Chairman by the time I arrived. But I believe the Order to Show Cause was put out while Kahn was still there.

PROFESSOR HAVEL: Okay.

MR. SHANE: That can be checked.

PROFESSOR HAVEL: Yeah.

MR. SHANE: In any event, the Board didn’t change at all when Kahn left. Marvin Cohen basically kept the torch burning and, of course, Mike Levine was still there pushing the envelope as hard as he possibly could.

My recollection of the Order to Show Cause . . . by the time I arrived in government was that it had been a huge source of internecine trouble within the agencies. It was an Order to Show Cause. Remember that the U.S. government, in its initial legal structure, did not have – even the CAB – did not regulate rates for international air services in the traditional way, because they didn’t have to, because there was this cartel called IATA, and because IATA would serve up rate agreements that would essentially define what airlines would charge for taking a passenger between one point and another. These were elaborate agreements and airlines violated them at their peril, because they were actually enforceable in some ways by IATA.

---

IATA saw itself as almost a quasi-governmental agency. And the CAB would – to the extent it had power over rates – it had that power only through its ability to approve or disapprove those agreements. Those agreements needed antitrust immunity under aviation law. And that was the control which the CAB exercised over rate making.

Once we began doing more liberal bilateral agreements – and one of the big objectives was to get governments to stop insisting on these rate agreements, allow airlines to price the services in keeping with what the market actually would want – the CAB became very skeptical of these IATA agreements. And it simply thought as a matter of logic, a logical next step in our effort to liberalize pricing regulation would be to put this long-standing system of inter-carrier agreements over price, put that system to sleep entirely.

And that made sense. If you really were serious about trying to get away from this way of regulating rates or allowing rates to be set by the carriers themselves, that's what you would do.

PROFESSOR HAVEL: They would put it to sleep over a period of time. They obviously didn't do it immediately. A proceeding was begun –

MR. SHANE: I'm just saying what the intention was in the Order to Show Cause. One big reason the Order to Show Cause was so problematic was that it was an Order to Show Cause. It basically said, “We've already decided to put this system to sleep. Give us a few reasons why we shouldn't and see if you can persuade us not to.” It was a fait accompli. And this, of course, went around the world. The Order to Show Cause was addressed at IATA rate making, or rate-fixing I should say, globally. And not surprisingly, it created a firestorm among our trading partners.

And from my perspective, even coming in as late as I did, in 1979, it clearly had represented a huge setback at that time in our effort to carve out more liberal agreements generally because it had created such tension between us and even like-minded trading partners. People abroad were offended that the CAB, just because of the power of the U.S., because of the size of its aviation market, would arrogate to itself the power to pronounce life or death over a system that the entire world had embraced from time immemorial.

So it really . . . I think the CAB Order to Show Cause was a highly controversial and perceived as a highly offensive step forward.

Now, looking from the vantage point of hindsight, what happened was that eventually we had a multilateral discussion with, particularly our European friends, all of whom were represented through the auspices of ECAC, the European Civil Aviation Conference.

PROFESSOR HAVEL: Right.

MR. SHANE: And what we did, in a very clever way, without doing a treaty, without doing a government-to-government agreement of any kind, was establish through some sort of a joint memorandum of understanding among civil aviation authorities, that the CAAs in Europe and the U.S. would in fact create zones of reasonableness – that carriers would not be prohibited from setting price according to their commercial instincts, as long as they were
within these zones. And that was designed specifically to persuade the CAB to terminate its Show Cause proceeding.

**PROFESSOR HAVEL:** When was this?

**MR. SHANE:** 1982 was when that was done. The Show Cause proceeding wasn’t formally terminated until sometime, I believe, in 1985. And in fact, it was terminated by the Department of Transportation because the CAB had already disappeared from the scene by that time.

But the CAB, the Show Cause proceeding was no longer perceived as a threat, once we did the so-called U.S.-ECAC Tariffs Agreement. Because that was the most important first step toward the real deregulation of pricing in international markets.

**PROFESSOR HAVEL:** Well I’m still trying to track back through the mentality or the thinking at the DOT around this time, and there’s one other element that I wonder if you could comment on that must have been influencing thinking. And that’s the Bermuda I\textsuperscript{6} denunciation by the United Kingdom in 1977, and the substitution of Bermuda II.\textsuperscript{7} And that must have had an effect . . . the Bermuda II being the “illiberal” agreement.

**MR. SHANE:** Yes.

**PROFESSOR HAVEL:** Did that influence the thought that there should now be an effort toward liberalization?

**MR. SHANE:** I recall our thinking about Bermuda II being very much compartmentalized. I don’t recall the U.S./U.K. relationship which is sort of *sui generis* in many ways, as really being part and parcel of the more general policy approach that we were taking toward bilateral negotiations and international aviation generally.

You’re right, Brian. Bermuda I had been a fairly liberal agreement, particularly for 1946 when it was crafted. It was very clear that the U.K. began to think that the lion’s share of benefits under that agreement were flowing to the U.S. And it had become a political problem for the Callahan government. And they threatened to simply terminate all flying between the U.S. and the U.K. unless there was a renegotiation.

Carter, for whatever reason, took that threat seriously. Alan Boyd, our first Secretary of Transportation, whom I mentioned, was given the role of Special Ambassador and he led the U.S. delegation in those talks, but was being pushed very hard by the Carter White House to come into an accommodation with our friends in the U.K., such that we would not have a cessation of services.

The net result was an agreement which, from the U.K. perspective, balanced the opportunities to a much greater extent. But from the perspective of U.S. airlines, gave away a lot of things that had been in our pocket from 1946 on.

\footnote{Memorandum of Understanding, U.S.-ECAC, Dec. 17, 1982.}

\footnote{Agreement Between the Government of the United Kingdom and the Government of the United States Relating to Air Services Between Their Respective Territories [Bermuda I], Feb. 11, 1946, 60 Stat. 1499, 3 U.N.T.S. 253 (no longer in force).}

\footnote{Agreement Concerning Air Services [Bermuda II], U.S.-U.K., June 22–July 23, 1977, 28 U.S.T. 5367 (no longer in force).}
Most importantly, as it turned out, giving up one of the two U.S. airlines that was allowed to fly from Boston to London. That became a problem because the Speaker of the House of Representatives was one Tip O’Neill from Boston. And Senator Kennedy, no small figure in the Democratic party at that time, and no small influence on the Democratic President at the time, Jimmy Carter, was also from Boston.

And they basically came to the Carter White House and they said, “Oh, that agreement you just did that gave up one of the two airlines that was serving Boston-London, uh-uh, do that one over again.” Which led to another negotiation, which I was present for in 1980, which we call variously Bermuda II-A, Bermuda II-and-a-half. I was still new to the process. But even I could see that we were basically being taken to the cleaners at that point. You never go into a negotiation with the other side understanding how hungry you are for a particular concession.

So they basically said, “Oh, you want to put that airline back at Boston, that second airline, happy to do it. Let’s talk price.” And the price was a very big price. And we can talk about it later. The most important part of the price, as history will show, was an insistence by the U.K., and an agreement by the U.S., that the two airlines that were allowed to fly from the U.S. to London, to London Heathrow, would be forever named Pan American World Airways and TWA, Trans World Airlines.⁸

The carriers were not just designations, as we say, for the U.S. to figure out how to fill. They were going to be those two airlines. And that was done quite intentionally by the U.K. because they were, even then, basket cases. And British Airways, or its predecessors, were quite happy to compete with Pan Am and TWA. Very unhappy about the prospect of competing with any of the new breed of deregulated . . . these creatures of deregulation that were now hungry —

**PROFESSOR HAVEL:** So TWA and Pan Am were separately negotiated after Bermuda II. That notion of the permanent designation —

**MR. SHANE:** Yes.

**PROFESSOR HAVEL:** came in the Bermuda II-and-a-half or 2.5, whatever it might be.

**MR. SHANE:** In order to get that —

**PROFESSOR HAVEL:** In order to —

**MR. SHANE:** — second carrier back at Boston.

**PROFESSOR HAVEL:** to create the second carrier at Boston.

**MR. SHANE:** Yeah. We got some other concessions too. I think there was a second carrier at Miami and a few other things. But that was a very important concession.

**PROFESSOR HAVEL:** And what was the reaction back home to that?

**MR. SHANE:** Well, I guess the people that were complaining most about the things that had been given up in Bermuda II could stop complaining. Be-

---

CAUSE after all, that problem had been solved. I think the real consequences of Bermuda II-and-a-half really weren't felt until years later. Particularly when Pan Am and TWA wanted to monetize their route opportunities at Heathrow. They needed cash. And in a normal environment, they would have simply been able to sell those routes to any taker. Under the circumstances, we had to beg the U.K. for permission for them to do that. Because whoever now flew to London would not be Pan Am and would not be TWA. As it turned out, it was United and American.

PROFESSOR HAVEL: But I take your point that this was compartmentalized.

MR. SHANE: Yes.

PROFESSOR HAVEL: It didn't necessarily influence the whole process of negotiation that went on in the 1980s. So let's come back now to the discussion we had earlier about the nature of the discussion, the negotiations that you conducted in the 1980s, with respect to bilateral treaties.

I've put one more piece of the puzzle together by asking you about the 1979 International Air Transportation Competition Act. Why it was passed, for starters—and how that affected what you were doing during your period at DOT in the 1980s.

MR. SHANE: A lot of airlines who had been incumbent carriers in international markets under the old system, had nothing good to say about this effort by the Carter administration to liberalize these international markets. They were quite comfortable with the regulated competition that existed. It's not that there wasn't competition, but it was very constrained, as you know. And the idea of just sort of blowing away all these restrictions and opening up the floodgates to whomever wanted to serve, was not their favorite idea. Probably the most important result of that unhappiness was the passage in late 1979 of the International Air Transportation Competition Act, or IATCA, which placed greater emphasis on the importance of addressing restrictions and discriminatory practices encountered by U.S. airlines overseas, as opposed to seeking further liberalization.

But IATCA was only part of the story at that time. As the Carter administration wound down and the Reagan administration was coming in, a group of those incumbents, five airlines, wrote a white paper and handed it, even before the inauguration of Ronald Reagan, to the incoming administration, basically denouncing the Carter administration's policy as having produced the worst results for U.S. airlines in history, having decimated the U.S. airline industry, and insisting that we go back to the status quo ante, or something pretty close to it.

The Reagan administration coming in didn't know quite what to make of this, as you would expect. But the new political appointees who came in saw this as a serious enough political problem that a moratorium was placed on all negotiations that lasted, as I recall, several months.

At the same time, Congress was still hearing from these same folks about how awful the Carter administration’s policy had been and what the consequences for the U.S. carriers had been. And there was a whole series of hearings, six hearings I think, before the Elliott Levitas committee, Elliott Levitas having presided over the Public Works Committee’s Investigations and Oversight Subcommittee. He was basically looking at the negotiating process as a process that needed to be examined closely because of the consequences which were being alleged, and measuring the process against the objectives established in IATCA.

The Act didn’t overturn the approach to liberal negotiations completely; it was rather more nuanced. It said, “Number one, U.S. negotiators have got to focus on the doing-business problems which U.S. airlines have all over the world. Your first objective is to make sure that it’s a level playing field.” And that was because the airlines had said that the Carter administration was liberalizing markets in which there was inherent discrimination, in which people were doing all sorts of untoward things. In many cases it was true. The airlines were not being allowed to repatriate their monies, they weren’t allowed to set up offices, they weren’t allowed to even have counters in the airports where the competition had plenty of counters.

So there were lots of issues. This new act focused the government’s negotiating process on those problems, on solving those problems. And it then said, “And by the way, as to the exchange of opportunities, make sure that henceforth you get as good as you give.”

PROFESSOR HAVEL: What is the language, do you recall, that was used?

MR. SHANE: Yes. It said, in effect, that henceforth U.S. negotiators should ensure that in any agreement that’s crafted with a trading partner, that the rights accorded our foreign trading partner are matched by rights of comparable magnitude for U.S. carriers. And then there were a few additional words that were –

PROFESSOR HAVEL: “A permanent linkage between rights granted and rights given away.”

PROFESSOR HAVEL: Permanent – thank you – yes. And I think it’s probably worth finding that language and reprinting it.

---

11 IATCA, supra note 9, § 17 (current version at 49 U.S.C. § 40101(e)(8)).
12 Id.
13 49 U.S.C. § 40101(e) provides in part:
(e) International Air Transportation. – In formulating United States international air transportation policy, the Secretaries of State and Transportation shall develop a negotiating policy emphasizing the greatest degree of competition compatible with a well-functioning international air transportation system, including the following:
   (1) strengthening the competitive position of air carriers to ensure at least equality with foreign air carriers, including the attainment of the opportunity for air carriers to maintain and increase their profitability in foreign air transportation.
   (8) opportunities for carriers of foreign countries to increase their access to places in the United States if exchanged for benefits of similar magnitude for air carriers.
Professor Havel: Yeah.

Mr. Shane: Because you really need to see it to understand how daunting it was. It basically said that an agreement that simply gets the foreign government to liberalize pricing, liberalize capacity, liberalize the amount of entry that was possible in the market, and in return gives a foreign airline landing rights at six new gateways in the United States — that was not a good agreement. That was not perceived by Congress, according to the legislation, as getting rights of comparable value for U.S. carriers. They weren’t getting incremental route rights, they were only getting liberalization, which they didn’t even want.

There were a few additional words in the statute, however. And it said . . . it referred to the communities who would actually be beneficiaries of this air service. Those few words right at the tail end of that provision, which I wish we had in front of us so we could read them, became vitally important as time went on, as we continued to liberalize. Basically the statute said we’re going to measure the equality of benefits, not just in terms of airline opportunities, but in terms of the overall economic performance of the U.S. under these agreements. The flow of economic value to U.S. interests more generally than just —

Professor Havel: — the traveling public.

Mr. Shane: The one burning question that has been in my mind for years about this is who put those words in? Because whoever put those words in made Open Skies possible; it’s as simple as that.

Professor Havel: Which words specifically?

Mr. Shane: The ones that said, “When we measure the equality of benefits that is now a requirement of our law, we measure those benefits not just in terms of the airline beneficiaries, but in terms of benefits that would flow to U.S. communities, and even to travelers.” I can just imagine the eleventh-hour scrambling within some committee staff as a lobbyist for this or that airport, or this or that travel agency, or somebody, rushing up and saying, “We can’t just measure benefits in terms of how the airlines are doing. There’s a bigger issue here.” And managing, at the very last second, to squeeze these additional words in which became, as I say, vitally important to everything that happened after that.

Professor Havel: So there’s another piece of context, the IATCA, the International Air Transport Competition Act.

Mr. Shane: Yes. And make no mistake, IATCA was meant to ensure that we protected our airlines against all forms of harm overseas. It was really meant to slow things down, to put a damper on this quest to liberalize international markets.

or the traveling public with permanent linkage between rights granted and rights given away.


15 IATCA, supra note 9.
PROFESSOR HAVEL: Where were you at this point? What . . . have you moved into a –

MR. SHANE: I was still an Assistant General Counsel [at DOT].

PROFESSOR HAVEL: Part of the political appointment at this point, or are you still –

MR. SHANE: No. I was a career bureaucrat. I was a civil servant and still doing my job as an Assistant General Counsel.

PROFESSOR HAVEL: Okay. And tell me about these liberal bilaterals that caused such complaint among the industry participants.

MR. SHANE: Well, the liberal bilaterals were, in their own way, pretty revolutionary because we had had these Bermuda I format agreements forever where everybody kind of knew what the provisions said. There was never any questioning of that. And the notion that we would actually call some of those traditional provisions into question was quite revolutionary at the time. Now this started, again, before I got there. It began in '77; by the time I arrived we already have liberal agreements with people like Belgium, and Israel, and Jordan, and Singapore, I think, had signed one, and –

PROFESSOR HAVEL: When you say liberal agreements, do you mean Open Skies agreements?

MR. SHANE: No. No Open Skies, Brian. This was simply the deregulation of capacity and pricing and entry. That was the main thing, to the extent that we could get an agreement to allow a multiplicity of ground handlers at a foreign airport to compete with each other and not insist that our carriers use a monopoly ground handler, so much the better. But for the most part it was just the liberalization of these regulatory constructs.

We didn’t need . . . U.S. carriers really didn’t need new route rights. They pretty much could fly to the destinations that were commercially viable under the Bermuda I agreement. And that became the problem, because we always paid for . . . they say the U.S. government always paid for this liberalization that we were trying to extract from our trading partners with new route opportunities for the national carriers or the countries we’re negotiating with.

So with the Dutch . . . they would give us everything they had to give and liberalize pricing, capacity, and entry and everything else and give us Fifth Freedom rights beyond Holland to anywhere in the world. And we would give them six new gateways in the U.S. U.S. carriers got no new gateways. U.S. carriers weren’t particularly enthusiastic about having more competition, so that wasn’t a win for them. And they didn’t get any new traffic rights. And so they said, “Why are we doing this? Why are U.S. government negotiators going out and just making sure that KLM can take a bigger bite out of our market than they can before the agreement is done?”

So that was really kind of the genesis of that white paper I told you that went to the Reagan administration. And that was the genesis of the Levitas hearings which produced IATCA. There was a huge amount of questioning about whether this was a very sensible policy. Again, looked at from the very narrow perspective of the U.S. airlines who had been quite happy with the arrangements that had been in place before.
PROFESSOR HAVEL: Were you concerned at all that some of the potential negotiating partners might stampede toward a Bermuda II themselves? Was that a fear inside the department at the time?

MR. SHANE: No. Because the markets just didn’t really, I think . . . the markets we were talking about after the U.K. were not amenable to that sort of a city pair approach. They just weren’t robust enough to justify that sort of a route-by-route schedule that we had. Pages and pages of routes that were at the end of Bermuda II. It was . . . that’s why I say, the U.K. was sui generis.

PROFESSOR HAVEL: So what happens next in the process, going through the 1980s. You’ve got the hearings. You’ve got protests from the carriers. Is it a quiescent period or do you continue to negotiate your more liberal bilaterals?

MR. SHANE: I remember it being . . . well we did more of liberal bilaterals after a time. The Reagan administration had that moratorium for a few months, but then really came back to the table. The Reagan administration, of course, was a market-based administration. It believed in market economics, as you know.

And so the government negotiating process sort of returned to the status quo ante and continued to try to push the envelope. Not so hard as would have been done under Carter, as I recall. And we had this mandate under IATCA to stamp out discrimination, doing-business issues, and other things wherever we found them. So that, as much an anything, became a very important part of the negotiating mandate.

And I remember it being quite a quiet time in terms of really pushing the ball for liberalization. It became quite different. I moved from the legal office over to the policy office and I became the Deputy Assistant Secretary for Policy. Interestingly, I was there when the CAB was finally put to sleep under the Deregulation Act and the CAB Sunset Act. It was at the end of 1984.

Under our regulations we decided that when there was a limited entry market created by a new bilateral agreement – when one new airline would be allowed to serve some city pair market between the city and the U.S. and a foreign capital – that decision would have to be made by the senior career official in the Office of Policy at the Department of Transportation. And just by happenstance, that was yours truly. So I ended up being, as a career civil servant, the first person at the Department of Transportation that actually made the kinds of route decisions that heretofore had been made by the five-member Civil Aeronautics Board.

And it was a very interesting little episode because the question before the industry was, “Could this political department of government – after all, not an independent regulatory agency, with none of the fences that are supposed to protect the process – could this political department make a decision about the allocation of a valuable international route opportunity in a way that was actually, and perceived as, being objective, on the record, and on the merits?

And I hope, I like to think, that we actually did satisfy the industry that we could do that. But I presided over the very first route proceedings that DOT managed.

PROFESSOR HAVEL: After the sunset –
MR. SHANE: After the sunset of the CAB.

PROFESSOR HAVEL: Of the CAB. One has a perception... that we talked about... I threw in the term Open Skies and meant in a sense, to suggest what’s coming in our next hour. We often have the perception that Open Skies, 1992, is Year Zero in all of this liberalization internationally. And I think we’re getting a different perspective from you in this first hour.

But is it fair to say that after the initial push toward liberal bilaterals that you talked about, the instigation of the Carter administration, that things became, shall we say, a question of smaller goals with respect to the implementation of IATCA. That they were no dramatic agreements that occurred between... the time that Carter left office and the arrival of Year Zero in 1992?

MR. SHANE: I think small goals might be fair as one part of the phenomenon. But the other thing that I think it’s important to recall is that our trading partners were getting increasingly cross with the U.S. First of all, we had the IATA Show Cause Proceeding, which continued on the books until 1985, which was seen as fundamentally offensive. A gross example of U.S. unilateralism. And there was a huge diplomatic effort to try to tamp that concern down, but it was never terribly successful.

Even the U.S. effort to buy liberalization by offering route rights to certain U.S. cities was resented, I think, in a way. Because, of course, our foreign airline friends wanted more access to this candy store of a market, as I’ve always called it. It was the most important market on the planet. And they needed it. And we were using it, using that thirst for more access to the U.S., as a way to crowbar our trading partners away from traditional forms of regulation.

Eventually, of course, we could do it because they desperately needed the route rights, but they didn’t like it. They thought it was offensive and we were just throwing our weight around. And eventually they began to see that—and this is one of the great ironies—notwithstanding all of the complaints that we had from U.S. carriers that led to the moratorium, led to IATCA, led to all those difficult hearings, notwithstanding all of their complaining, they were doing marvelously with the new bilateral agreements! They had taken the opportunities that had been served up to them, even over their own dead bodies, and they were actually exploiting them. And the net result was because they had these wonderful hub-and-spoke systems now, under deregulation, they were essentially cleaning the clocks of foreign carrier competitors. And the foreign carrier competitors didn’t like it and understood it.

And so in addition to kind of winnowing down the goals of negotiating on the U.S. side, we actually had some partners overseas that were getting increasingly difficult, who were really tired of this effort by the U.S. that just muscled its way in, forced governments to deregulate international access to their capitals, and so forth.

And so you really had a lot of forces sort of working against any real further progress, in terms of liberalization.
PROFESSOR HAVEL: But some major progress did occur in the early 1990s or late 1980s—the Cities Program.\footnote{In the Matter of Expanding International Air Service Opportunities to More U.S. Cities, Dep't of Transp. Order No. 90-1-62, 55 Fed. Reg. 4039 (Feb. 6, 1990) [hereinafter Underserved Cities Program].}

MR. SHANE: The Cities Program was in 1990, I believe. And that was the first Bush administration. So we are now—

PROFESSOR HAVEL: And where is Jeff Shane at this point?

MR. SHANE: Now Jeff Shane had been the chief negotiator at the State Department from 1985 to 1989, again, in a civil service capacity. In other words, presiding over a pretty desultory period in our negotiating history, chasing those doing-business problems to the extent possible, every now and then achieving a meaningful agreement. But for the most part making sure that the world was safe for the Sabre system, making sure that the world was not discriminating too much against U.S. carriers' ability to do this and that, but not really making enormous progress.

I was somewhat miraculously given a political appointment in the Bush administration and I became Assistant Secretary for Policy at the Department of Transportation. So I segued back, having spent four years at the Department of State. Much to my astonishment, I was sent back to the Department of Transportation, but in a political position, that was a presidential appointment.

I had been thinking a lot about everything that was wrong with the negotiating process for a long time, particularly during the four years when I was supposed to be in charge of it. And it just seemed to me increasingly obvious that this effort to obtain benefits for U.S. carriers, only when they needed some benefit from the other side, was a losing proposition for us. It was getting us nowhere.

The fact is, U.S. carriers had just about all the route rights that they wanted, just by virtue of the way the rest of the world is Balkanized. The ingredients for making progress simply weren't there. And I had made a lot of speeches to Chambers of Commerce during my time at the State Department which I have, by the way, because I never throw anything away! I'm happy about that, my wife is very distraught about that. But I still have them. It's very interesting to see where our heads were. I found, as I went out and spoke to Chambers of Commerce in various important cities, that they were completely oblivious to this whole bilateral negotiating process, had no idea what was going on, and had no idea the extent to which the airlines had basically dominated the policymaking that was going on in Washington.

And so I started sort of making these speeches saying, "You're not paying attention, and the net result is you're not getting the international connections that you really deserve, that you should have, that would advance your economic growth dramatically. One route to a foreign capital could increase economic activity in your community by a hundred million dollars a year. Why are you not paying attention to that?"

PROFESSOR HAVEL: And you are now a political official going around to Chambers of Commerce.
MR. SHANE: I was not. I was a reckless bureaucrat, civil servant. And I don’t know exactly how this happened.

PROFESSOR HAVEL: It’s an interesting idea that it might have happened, but it did happen!

MR. SHANE: Well I had this bad habit of . . . first of all, I had figured out some time earlier that when you have these positions, whether it’s a career position or a political position . . . but if it has the word “Secretary” in it . . . I had been a Deputy Assistant Secretary at DOT and I had been a Deputy Assistant Secretary of State. When you have the word “Secretary” in it, people actually pay attention to what you say.

And so when you said something, it became U.S. policy, if you could get coverage for it. And this is actually a serious point, for anybody thinking about government service.

PROFESSOR HAVEL: Right.

MR. SHANE: They need to pay attention to this. So I decided that if there was any point to having these jobs, it was to actually make something happen. And one way available to me as somebody with the word “Secretary” in his title, to make something happen, was to make a speech.

[break]

PROFESSOR HAVEL: Jeff, before the break we were talking about, perhaps we might say your quixotic adventures around the country promoting the idea that cities might be interested in a Cities Program. Can you talk a little bit more about that?

MR. SHANE: Well, yeah, I guess the first thing I have to say about all of that was that for whatever reason I always decided to make these speeches without clearing them with anybody. I didn’t know whether that was a good idea or a bad idea, but my history in government had always been . . . I could see that, as I was saying before, if you have the word “Secretary” in your title, people paid attention to what you said when you made a speech. And then I noticed that when people paid attention and when reporters actually wrote it down – whether in a real newspaper or the trade press – people began to think that that was U.S. government policy. And so, sort of accidentally, I found out that I could make a lot of U.S. government policy just by saying that was what it was.

And I didn’t start out quite that robustly. I was going around to a lot of communities where my perception was that they were not paying very much attention to the bilateral negotiating process. That we were doing agreements with a lot of trading partners where an airline from another country wanted to fly to Phoenix or Atlanta or Houston and our airlines would say, “Well we don’t really need anything from them right now. So let’s just wait. Let’s wait until we want something and then we can give them some new route rights.” And so the net result was, our negotiating policy was, “You cities can’t have new economic opportunities of this magnitude until such time as we have [been] given permission by U.S. airlines to grant you those connections.

I made a speech in Atlanta where we were having a problem. SwissAir wanted very much to fly to Atlanta. Atlanta very much wanted SwissAir to fly
to Atlanta. But we were having a problem with Zurich. Zurich was treating our airlines badly. They were concerned about security. They were putting their counters behind some big wall. And we had to solve that problem. And until we solved that problem, Atlanta would not have that non-stop service between Atlanta and Switzerland. No U.S. carrier was offering that service. U.S. carriers didn’t want SwissAir to have any of that service. And the net result was, because of the nature of the bilateral negotiating process, Atlanta was basically being held high and dry. That was the story I was telling. And I told it in Atlanta. I told it in Houston. I told it in Phoenix.

And eventually what you began to see – lobbyists don’t take long to figure out where there might be an opportunity – a bunch of lobbyists decided to organize the cities, create a political force in favor of actually looking at the larger economic benefit of international air service. And that began to change the drill a little bit. And once that happened – the speeches I’m talking about I was making when I was a career Deputy Assistant Secretary of State, conducting these negotiations – I finally moved back to the Department of Transportation under Secretary Sam Skinner. That as I said was my first political appointment. I knew Sam Skinner was a courageous leader. He was interested in doing interesting things with his time at the Department of Transportation. And I suggested to him that it doesn’t make the slightest bit of policy sense for us not to allow a foreign carrier, who’s given us all that they have to give, to fly to a U.S. city that they want to fly to, where no U.S. carrier is offering service to that city, between that city and that country. It didn’t make the slightest bit of sense for us to say no to that.

What were we trying to achieve? We were not seeking anything. We were in effect waiting until we had something that we were seeking, and then we’d give it to them when we had something that we could get in return, partly driven by that crazy language that was in IATCA that we talked about earlier. So I said, why don’t we craft a policy whereby if a foreign carrier has basically given us everything that there is to give, a foreign government has nothing more, there’s no discrimination, they’re a liberal partner of ours, they’ve answered all of our questions with a “yes,” they want to fly to a U.S. city that no U.S. carrier is serving. Why do we need to have a negotiation about that? Why don’t we just say “Sure”? Sam thought that was an intriguing idea, much to my astonishment.

PROFESSOR HAVEL: Did you have the statutory authority to do that?

MR. SHANE: I thought we did. I thought we did because in that provision of IATCA that said we had to get as good as we were giving in our negotiations. Remember I said that there were those little words at the end that said or for the benefit of travelers or –

PROFESSOR HAVEL: The traveling public.

MR. SHANE: The traveling public. Thank you. And that “traveling public” language was the hook that we were able to hang this innovation on. He was intrigued with it. We put out a notice proposing it. There were lots of comments pro and con. And we decided that we had the legal authority, thanks to those words. There was enough to be said about doing it. The community seemed to be pretty enthusiastic about it. So we actually issued an
order saying there would be this new program called the Underserved Cities Program, which later –

PROFESSOR HAVEL: Great title.

MR. SHANE: Yeah. And later it was called the Cities Program.

PROFESSOR HAVEL: So you’re giving hard rights free of charge, is that a fair characterization?

MR. SHANE: It's a very fair characterization. That's precisely how it was characterized by our airline friends.

PROFESSOR HAVEL: And what was your response to the airlines?

MR. SHANE: My response to the airlines was, “It’s not all about you.”

PROFESSOR HAVEL: Which had been a theme I think since the time you arrived.

MR. SHANE: Right. Yeah. Just one little quick anecdote about all of that. We issued that final order in establishing the Cities Program. One of the first airlines to come through the door, much to my dismay at the time, of course, was KLM from the Netherlands. KLM was problematic in the sense that they didn’t actually carry people from Holland to the U.S. They carried people from everywhere else in the world to the U.S. They were treated by the rest of the industry as essentially pirates. In the lingo of the day we called them a “sixth freedom” carrier.

PROFESSOR HAVEL: The Emirates of their day.

MR. SHANE: Right. Anyway, they qualified under the rules that we had written. And so we really had no alternative but to say yes. “If you want to serve a city in the U.S. that’s not getting service, you may.” And they did. And they chose BWI, Baltimore Washington International Airport, as their first destination under the Cities Program. The people running BWI asked me if I would come and represent the U.S. Department of Transportation at the ribbon cutting when the first flight arrived. And I said, “Sure, that’d be a lot of fun.” And so on the fated day I got into one of the DOT cars and was being driven to the airport about 45 minutes from DOT headquarters.

And I was working on my remarks, not paying attention to where we were. And suddenly the car stopped. The driver said, “We’re here,” and I came out of my reverie. And I looked out of the window and we were right in front of the terminal. And I could see behind the terminal this sky-blue 747 with KLM painted on the side. It was a very large airplane that was sitting there because of a memorandum which I had written to Sam Skinner at one point. And I thought this doesn’t happen very often in public service, when you actually see palpable results from a memo you write. Normally the result is that somebody says, “Hey, nice memo.” A 747 was sitting there because we had changed policy.

PROFESSOR HAVEL: It was remarkable.

MR. SHANE: It was stunning. And needless to say, Brian, I was very full of myself that day!
**PROFESSOR HAVEL:** As you deserved to be! But Jeff, could an official in a comparable position today perform this campaign that you did in the late 1980s?

**MR. SHANE:** Absolutely. And I think that's one of the reasons that I think this whole story is so interesting – because we have some huge challenges in our transportation system today, particularly on the infrastructure side. The highway trust fund is bankrupt, something we've relied on for decades as the fundamental circulatory system of our economy. And nobody... there are a lot of reports, lots of studies have been done, lots of solutions have been offered. But you don't see any of the ferment taking place in Washington today that's going to actually produce a comparable change. We need – as I was saying earlier – we need that fundamental change in approach. And I'm not sure at this point where it's coming from. So it's interesting to look back and see what the ingredients were that facilitated the kind of change we're talking about in international air transport. Because I think there are lessons there for what's going on today.

**PROFESSOR HAVEL:** Is it also fair to say that the Cities Program sprang from your mind as a reaction to your experience with the bilateral negotiating process? You saw this lacuna, you saw this gap, and you thought it could be filled almost by administrative fiat without going back to Congress and having new legislation and so forth. It was an opportunity for some creative activity by the DOT.

**MR. SHANE:** That's a very positive and laudable way to put it, and I'd be very proud if that were the instinct that actually led to the Cities Program. But actually it was fear of having to make another speech to another city and being hugely embarrassed by having to say to the city fathers of another great state capital that we have an airline out there that actually wants to provide you this huge economic benefit by flying every day from another country, but we're not going to let that happen because we have a doing-business problem that we have to solve first. I was really tired of having to explain that.

**PROFESSOR HAVEL:** So municipal leaders were not just mobilized after the event; they were already lobbying the DOT with respect to service.

**MR. SHANE:** Well, they weren't very effective lobbyists, I would say. But they were able to give us support. There was at least a source of support in the docket when we proposed the Cities Program. It wasn't all lopsided in favor of airlines that were opposed to the deal. We at least had some comments that we could point to. Because you go through the comments and you say, here are the pros and here are the cons. And on balance we find that we like the ones that are in favor of the program better. And that becomes the rationale. If we didn't have that support in the docket, it would have been much more difficult to simply blow off all of the opposition, to have no particular support for the change and nevertheless go ahead and do it.

**PROFESSOR HAVEL:** Now the foreign carriers at this point, Jeff, were not code-sharing with any American carriers, is that correct?

**MR. SHANE:** I said earlier that the foreign carriers were increasingly cross with the U.S., and foreign governments were, because they felt that U.S. carriers were really having their way with them and doing so much better in the
competition. And a very important reason for that was precisely that, that international code-sharing was not allowed. Domestic code-sharing had begun. We were seeing interline connections being turned into fictional online connections by virtue of people sharing codes. But a Lufthansa coming to Chicago and wanting, for example, to put its code on a United Airlines flight between Chicago and Orlando, that would not have been allowed.

PROFESSOR HAVEL: How do you mean it wasn’t allowed? Was there a statutory bar or was it something you just didn’t negotiate at the time?

MR. SHANE: First of all it was prohibited as a matter of domestic regulation. It wasn’t something that was covered in the statute. Domestic U.S. aviation regulation had finally opened up to the point where it – over a lot of dead bodies, this was highly controversial – it allowed the domestic carriers, in the context of domestic flying, to code-share. You remember that Bob Crandall, whom you’ve interviewed, made a huge campaign of saying this was deceptive. This was deceiving consumers. And of course he was right until such time as DOT then required absolute disclosure of code-sharing opportunities. But even when the DOT finally allowed code-sharing on domestic routes, it didn’t go so far as to allow international code-sharing. And so that was yet another obstacle to foreign carriers being able to operate in real competition with their U.S. domestic competitors who had the feed coming off of these hub-and-spoke systems, who could basically serve any point in the interior United States with an online connection. Foreign carriers could only serve the gateways they’d been allowed to serve.

PROFESSOR HAVEL: Bob Crandall’s exact words were, “Organized lying.” That’s what he said in his conversation with us.

MR. SHANE: Yeah. And I think in the beginning it’s not unfair to say that it was. He had a strong point because disclosure wasn’t required in the first instance. But once it was required, there was no more lying. There was simply much more convenient services available to the public.

PROFESSOR HAVEL: As we move to talk about Open Skies after 1992, would you say that the Underserved Cities Program was an essential prerequisite, precondition, necessary to Open Skies? Could have Open Skies happened without the Underserved Cities Program?

MR. SHANE: I’m not really sure. I think that the Underserved Cities Program helped us break the back of an assumption that would have been treated as antithetical to Open Skies up until that time. And that was the notion that you could give hard rights, real route opportunities, to a foreign carrier in return for nothing, which was precisely what the Cities Program was doing. Until we were able to get away with it, to articulate a rationale and an interpretation of that provision of IATCA that was consistent with the idea of giving hard rights away and not getting any hard rights for the U.S. carriers – by definition we were only allowed to do it when the U.S. carriers had all the hard rights the other side had to give, so of course we couldn’t get any more for them – until we were able to articulate that rationale and that interpretation, I think Open Skies would have been impossible to do.
PROFESSOR HAVEL: So what’s going on in your mind around this time? You’ve got your signature of the Secretary on the Underserved Cities Program. What are you going to do next?

MR. SHANE: What I’m going to do next is try to figure out how to jump-start the negotiating process. Because the Underserved Cities Program was not about negotiations, it was about creating opportunities for communities without the negotiating process. The negotiating process had all but dried up, for all the reasons I’ve explained. The foreign carriers saw coming to the U.S. as just an opportunity to get their clocks cleaned by these creatures of the deregulated market that we had here. They couldn’t compete. They didn’t have hub-and-spoke systems in the United States because of the cabotage rule. We wouldn’t let them code-share. Even after we let them code-share to some extent, they still couldn’t compete very effectively because we didn’t really have these integrated alliances that made those code-sharing opportunities really work.

PROFESSOR HAVEL: Was the Heathrow Succession Agreement initialed around this time? I think it was 1991. Were you involved in that?

MR. SHANE: Very much involved in that. Yeah. I think it . . . I can’t remember exactly which year, but it would have been around the same time. But again, I still see the U.K.-U.S. relationship as in a separate compartment. The U.K. was always different. And it wasn’t necessarily part of this. The U.K. had indicated no interest whatsoever in doing an Open Skies agreement with the United States. So we ended up having to do another agreement we didn’t like in order to get the right to put United in place of Pan Am, to put American in place of TWA, because of that Bermuda II-and-a-half agreement that said it had to be Pan Am or TWA or nobody. But that was kind of a sport on the–

PROFESSOR HAVEL: True, compartmentalized. But it must have frustrated you at the time.

MR. SHANE: Right. That was a hugely frustrating thing. It was frustrating, of course, for the carriers involved. But the U.K. was within its rights to say you can’t substitute stronger airlines for weaker ones at Heathrow without our permission because of the agreement that we had signed.

PROFESSOR HAVEL: Why do you think the Thatcher administration, being so free market oriented, took this protectionist approach?

MR. SHANE: You would have to psychoanalyze a lot of people in the U.K. to understand that. I think notwithstanding the Thatcher government’s approach, they wanted to privatize British Airways. They had privatized–

PROFESSOR HAVEL: They had done so.

MR. SHANE: – the airports authority. And it was very important in the interest of continuing the privatization route which Margaret Thatcher put the U.K. government on, that these be treated as success stories. And my interpretation is that if they had opened the floodgates to real competition for BA in the immediate aftermath of privatization, when of course it was going through a huge internal upheaval by virtue of this privatization, they would have put the privatization of BA, that particular entity, at risk to an extent that they
couldn’t measure. And to that extent, if BA were to fail by virtue of its inability to actually operate in a competitive market for the first time – and who knew whether it could – they may have thought it would put the entire Thatcher program at risk.

PROFESSOR HAVEL: Right.

MR. SHANE: So I sort of understood that real competition to and from the U.K. was going to be beyond reach for a while. We didn’t spend a lot of time thinking about it.

PROFESSOR HAVEL: Did you ever consider denouncing Bermuda II, as Bob Crandall proposed, for example, at the time?

MR. SHANE: Never did, because again, first of all it was the special relationship. I didn’t think there’d be any interest in doing that. You know Crandall talked about denouncing Bermuda II during the Clinton years. I wasn’t in government at that time. But if you look back at the Clinton years, you know what was going on between the U.S. and the U.K. I think Bill Clinton invited Gerry Adams to the White House for a while. John Major wouldn’t return Clinton’s phone call for several days because he was so furious that we were talking to Sinn Fein at this really dramatic moment in U.K. history, all that was going on in Northern Ireland. To denounce the bilateral agreement pursuant to which air transportation took place between the two countries was . . . that wasn’t a point that I would have raised had I been in government at that particular moment; it wouldn’t have been taken seriously.

PROFESSOR HAVEL: Well all these things were in your mind as you thought to yourself how do we change this process, this negotiating process. So how did Open Skies emerge from the ferment?

MR. SHANE: I asked the staff to do a quantitative study of what was really going on. How are U.S. carriers doing in the liberal agreements that we had? How are foreign governments doing? How are foreign carriers doing? How are our cities doing? We put on essentially what would be today a PowerPoint presentation. I think we used Harvard Graphics. Whatever happened to Harvard Graphics? Anyway, it was a pretty powerful demonstration. Number one, the airlines through the ’80s had – as I think I said earlier – had profited enormously. They had made record profits through the ’80s. And largely that was just talking about the international markets.

PROFESSOR HAVEL: U.S. airlines.

MR. SHANE: U.S. airlines had done very, very well thanks to the liberal agreements that we had put in place over their dead bodies. It was an interesting little revelation. They had hated the whole idea of liberalizing these markets. We did it anyway. And then they just rode roughshod over the competition once they had the opportunities that those agreements created. Foreign carriers were increasingly upset. Their market shares were diminishing, and they knew it. And they were getting very cross with their own governments for not negotiating more effectively on their behalf. And we had begun to see some real renunciations.

You remember there was a big economic downturn in the early ’90s. And everybody pulled back in terms of transatlantic capacity because the traffic
wasn’t there. And then the economy came back, I think, in 1992. And we had an agreement with France, just to take one example, which enabled us – it was a liberal agreement as we defined liberal agreements in those days – it enabled the carriers to put in whatever capacity they wanted. The U.S. carriers felt that there was a lot of pent up demand for travel to and from France. And so they announced new schedule increases for, I think, the summer season in 1992. The French went crazy because Air France went crazy. They thought they were going to be wiped from the face of the earth by this darkening of the skies over Paris by U.S. airlines. And so they threatened to renounce the agreement. This became a diplomatic issue and in fact Secretary of State James Baker ended up having to take this up in conversations with the Foreign Minister of France at the time. He was supposed to tell them that we would cut back on our capacity if the French would stay in the agreement. He came back saying that that was the agreement. I had to go to all the U.S. airlines and plead with them to cut back on capacity, which they had every right to introduce into France under the bilateral agreement at the time. They did reduce their capacity, however, but then the French renounced anyway.

And there were a lot of other threats to renounce because, just as had been the case with Bermuda II, our trading partners felt that they weren’t getting a fair shake, that they couldn’t compete with U.S. carriers that were coming out of these hub-and-spoke systems for a whole variety of reasons. So what we were facing therefore was a real diminution in the quality of air service that was designed to benefit U.S. communities and the U.S. national economy at large.

That was the case we ended up making, first to Sam Skinner and then ultimately to Andrew Card, who was Sam’s successor as of Secretary of Transportation, and which was bought. I said the only way to really jumpstart this process is to say we don’t have any interest in limiting the access of foreign airlines to anyplace in the U.S. market. We don’t have to calibrate their access to the U.S. market as long as they have given us all there is to give. As long as they have opened their markets to the extent that they can open those markets, there’s nothing for us to negotiate for. Why would we not begin to take advantage, at long last, of the larger economic significance of international air services for the benefit of communities, for the benefit of the U.S. economy, for the benefit of travelers everywhere?

And I sent a memorandum to Secretary Skinner, I remember. I can’t remember exactly what month or what year, but it was after discussing this concept internally and with the Department of State for a while, saying that we really should be mature enough to actually begin to look askance at this way of calibrating international aviation markets. There seemed to be, certainly at the working level, at my level, there was a lot of interest in moving forward. I described this little concept in a three-paragraph memorandum to Secretary Skinner, sent it to him. After sending a memorandum like that, you would not have been wrong to expect that a six-month process of meetings and analysis would have been launched. The typical response would be to insist that we really calibrate as carefully as we can what the costs and benefits of a change like that would be.
In the case of Secretary Skinner, the memorandum came back from his secretary the next morning. And scribbled in the margin was, "Go for it! S." I still have a copy of it. That was a miraculous moment in my government career because I had never seen that sort of decisiveness, that sort of vision come from any Cabinet member before. Not to draw invidious comparisons. We've had great members of the Cabinet and some great Secretaries of Transportation. But that gave us the confidence to move this thing forward. Of course, we had to do it deliberately. You had to have a notice of proposed policy, and you had to put it out for notice and comment.

PROFESSOR HAVEL: You defined Open Skies.

MR. SHANE: Defining Open Skies, finding out what people thought about it. We had pros and cons again in the comments, but by and large nobody really laid a glove on it. At this point in our history it just seemed like it was time to do it. And –

PROFESSOR HAVEL: You must have had the credibility to put this memo before Skinner and to have him adopt it so rapidly.

MR. SHANE: Well, he must have felt I had the credibility because he bought it. And in fact the very idea of transitioning from a career position like the one I had had at the Department of State where I was a civil servant in effect, to a presidential appointment under Sam Skinner as an Assistant Secretary of Transportation, that was pretty unusual. And I attribute that to his clarity. As he came to the job, he had a whole variety of things that he was interested in achieving. And he knew that he didn't have a lot of personal strength in understanding how internationally the aviation markets had worked. And he had been hearing a lot about international aviation.

So he wanted somebody who had that on his resume, if you will. And thanks to my friend Ellen Craig – who is here today and I'm delighted to see her – she was Chairman of the Illinois Commerce Commission at the time, I believe – she somehow found out that Sam Skinner, a son of Chicago, a member of this Institute's Board of Advisors, was going to be the next Secretary of Transportation. I was – thanks to Ellen – the first person in Washington to know that, other than George H.W. Bush – at least I think I was.

And so I vectored my resume towards Sam Skinner in 16 different ways, trying to make sure that at least he knew that I had this in my background. I didn't really know what he was looking for, of course, but then I finally got an interview with him. And it turned out that it went well. I didn't know for the next three months whether I was going to get the job. I was just reading Aviation Daily every day about who was going to get the job. It was everybody but me. But then he called me one day and said, "I think I got it done." And I said, "You got what done?" He said he had talked the White House into allowing him to hire me.

That was an achievement – no question – because I had been a career civil servant. I could not have helped get George H.W. Bush elected President without having committed a felony. And so I didn't help George Bush get

---

elected President. But nevertheless that wasn’t being held against me. And in fact the White House personnel operation – I don’t think this question ever went to President Bush, the elder George Bush – the White House personnel operation finally blessed it. But only because Sam Skinner pushed it as hard as he did.

So he clearly felt that I knew something about the subject matter and by virtue of all the years that I’d been putting into it. And I guess it was because I was at that point “his guy” that he was willing to take my recommendation seriously.

PROFESSOR HAVEL: Let me clarify the timeline. Was he the Secretary of Transportation . . . were you rather a political appointee for both of the historic memos that we’re talking about? Were you in that same political capacity?

MR. SHANE: Both historic memos?

PROFESSOR HAVEL: The Underserved Cities and the Open Skies, the memos that you put on his desk.

MR. SHANE: Yes. Those were both done at DOT under Secretary Skinner.

PROFESSOR HAVEL: How far apart did they occur? Can you remember?

MR. SHANE: About a year apart.

PROFESSOR HAVEL: A year apart.

MR. SHANE: Yes. I think we saw that the Underserved Cities Program would throw off some benefits, but limited benefits. What we really saw again was that the system was really drying up in terms of throwing off new opportunities for communities, even for our own airlines. And therefore once we knew that we could get away – notwithstanding IATCA’s language – with giving away hard rights for nothing, it was possible to propose the Open Skies program.

PROFESSOR HAVEL: So the same broad interpretation was used?

MR. SHANE: Yes. It was validated by the Cities Program and we were able to take it forward by articulating it very deliberately and putting it out again for notice and comment. We were able to get validation of that and make it part of our policy. Again, let me just say that in the first instance Open Skies was being limited just to our European partners, not to the world at large because we wanted to get our arms around the consequences of this and measure the results before it went any further. And we had a lot of liberal agreements already in Europe. We weren’t able to negotiate with our European friends for any new rights for U.S. carriers. They had them all. They even had the ability to fly between European cities.

By the way, that was another thing that we were concerned about. Europe was, of course, talking at that point about pulling itself together into a single market. Remember, we thought 1992 was to be the big year. And so we began worrying about what the consequences of that would be. If they were a single market – and if you’re going to get into this later we can postpone this – but it was an important part of the calculus that led to Open Skies. A lot of people in Europe were talking about pulling a single market together as a defensive
mechanism, not just to satisfy the Treaty of Rome’s requirements and to facilitate intercarrier competition in a single market in Europe, but because by pulling the single market together in Europe they would be able to establish that as a cabotage space. And these offensive U.S. fifth freedom opportunities, the ability of U.S. carriers to carry Europeans between London and Paris or Paris and Rome – however much they were doing that I don’t know, but theoretically they could do it – those could be taken away was the theory. I made a lot of speeches about that at the time as well. And I said, look, these are rights that are enshrined in bilateral agreements that have been signed by sovereign governments. And any effort to take those rights away from the United States, from the U.S. carriers that are enjoying them, will be met with a comparable reduction in your rights. At a time when Europe’s approach to international aviation policy and the U.S. approach were finally converging, it would be a very strange result to see us now reducing opportunities on either side, tit for tat. What we should be trying to do is how do we take these converging policies and manufacture many more opportunities out of them. So worrying about what the single market would portend for U.S. carriers was another reason why we needed to get ahead of the curve a little bit and try to really change the drill, begin to open up our market, take a lot of the resentment and the arguments that foreign governments were making against us away, and really create a much more contemporary approach to civil aviation than had been the case before.

PROFESSOR HAVEL: How did you decide what to include in the template and why did you decide on a one-size-fits-all approach? Because that appears to be what you did.

MR. SHANE: We insisted that any partner that would be eligible under our policy for an Open Skies approach, by definition, would have already given us just about everything they had to give. So they had liberalized or would be prepared to give us everything they had to give. Again, the route rights were pretty much established. The partners that we knew that would be interested in this, that would negotiate an Open Skies agreement with us, were already our most liberal partners.

There was only one thing that was missing from those agreements. And that one thing was the source of all of the resentment that I was increasingly worried about, that I thought would begin to result in the real diminution in the rights of U.S. carriers in international markets and a real diminution in the benefits of international air transport to U.S. communities. And that was the ability of foreign airlines to serve the U.S. market in any way they chose. That was what was calibrated. That was what was limited by even the liberal agreements that had come out of the Carter administration.

We would never say to a foreign airline, if you will deregulate the regulation of pricing, deregulate your regulation of capacity, allow us any number of airlines, and allow us to serve any city in your country – we would never say that in response to those concessions we would provide access to the whole U.S. We’d say, “We’ll give you two more gateways.”

PROFESSOR HAVEL: It was always a gateway policy.
MR. SHANE: Always a gateway policy. All the negotiation was about during those Carter years, when we were beginning the process of liberalizing these agreements, was how many gateways would we be required to give them? And the Department of Transportation – this is harkening back to a discussion we had earlier – was often there, again, looking at the incumbents, looking at the Pan Ams, TWAs, the NorthWests, and so forth, people that were enjoying these markets... recognizing that they had a big stake in those markets, not wanting to see the floodgates open too suddenly because they would possibly be driven off these markets by foreign competition.

So there was an effort to really calibrate the access which we would give foreign carriers, even in the context of an agreement where the foreign government in question had agreed to liberalize everything for the benefit of U.S. carriers.

So the difference between those liberal agreements and the Open Skies agreements in my mind was a single difference. And it was the international opportunities that foreign carriers were given to serve the U.S., the new gateways that foreign carriers would be able to serve in the U.S. And that’s why communities around the U.S. were in favor of Open Skies. That’s why we had the broad support for Open Skies that we did. It was coming out of this cluster of communities that saw, at long last, that the federal government would finally be getting out of the way of foreign carriers that wanted to serve them provided that the foreign carriers came from countries who were sufficiently liberal to justify an Open Skies approach.

PROFESSOR HAVEL: What about the U.S. airlines, they were going through a period of prosperity, that was about to change. So were you fortunate that you were able to push this policy through before another period of turbulence occurred?

MR. SHANE: You never know when their fortunes are about to change.

PROFESSOR HAVEL: Right.

MR. SHANE: And yes, it’s a good thing we didn’t know. U.S. carriers were, I would say, a mixed bag. Mr. Crandall responded to our Open Skies agreement with the Dutch, the first one that we were able to do. Mr. Crandall told me that as a result of that “ridiculous policy”... and I think I’m paraphrasing... he would have to fire 5,000 people. I didn’t think he would have to fire 5,000 people. I thought if he took advantage of these opportunities, he’d probably be hiring 5,000 people. But that was the reaction that I got from him and from a number of other U.S. airlines. It wasn’t anything like the reaction to the liberalization that the Carter administration tried to do. It was a more muted reaction. But it was pretty negative.

Still, I think even carriers, even executives in the industry who would have been happier not to have seen Open Skies take place understood that this was where policy was heading. This was the logical conclusion of all the liberalizing we had been doing. At the end of the day why should governments be trying to figure out where airplanes should fly? What did these bureaucrats, after all, that were doing the negotiations know about any of that? I think they saw the writing on the wall and to the extent they did that they in effect accepted it. There was no blowback that was anything like the blowback
which the Carter administration got from its early efforts to liberalize, or like the paper that went to the Reagan administration that I talked about, the moratorium, the quiescence that we presided over for a number of years as a result of all that.

PROFESSOR HAVEL: For a number of years. Did it occur to you at the time that perhaps the whole bilateral system needed to be shaken up and that it might be a good approach to try multilateral negotiations with larger markets: Canada, the EU, clearly EU came later, the MALIAT came later, the Multilateral Agreement on Air Transportation with some small countries. How free was your thinking at the time in terms of really pushing the paradigm in a different direction?

MR. SHANE: Well you could easily envision that multilateral approach. And you could see that perhaps eventually becoming the logical conclusion of all of this ferment. But it was tough enough to just establish an Open Skies approach to bilateral negotiations. So we wanted to do this in stages. Bilateral liberalization had always been pretty hard. Open Skies was a pretty revolutionary approach to what had been a very mercantilistic approach to these negotiations. And just achieving that, which is pretty much toward the end of the first Bush administration, was, we thought, achievement enough for the time being. We knew that Europe was pulling itself together. We didn’t know that it would take five more years, until 1997, for Europe to pull itself together into that Third Package, which finally created the single aviation market.

But talking about these speeches, I went back and I found one that I delivered to the Wings Club in New York in 1988. Now this is four years before Open Skies became a reality; I was at the State Department at the time. It was another one of these speeches that I didn’t clear with anybody. I said, number one, we are as a matter of government policy putting in place systematically, through a process of bilateral negotiations and executive agreements with other governments, we’re putting in place restrictions on the operations of international carriers that would be treated as non-tariff barriers and ipso facto unacceptable in any other walk of economic activity. That’s number one. And number two, if we’re ever going to get over this, if we’re going to be able to really figure out how to liberalize in a meaningful way, in a multilateral way if you will, we need a partner on the other side of the table that has a market comparable to ours, that has negotiating strength comparable to ours, that has an airline industry comparable to ours. And the only one I can think of right now would be the European Community."

And so in that speech in 1988, I sort of hypothesized a negotiation between the U.S. and Europe for the purpose of trying to articulate a different vision. I was very interested, by the way, in what reaction I would get to that speech again, which nobody had seen until I gave it. And there was a moment, I will

---

18 Multilateral Agreement on the Liberalization of International Air Transportation (MALIAT), May 1, 2001, 2215 U.N.T.S. 33.
20 Jeffrey N. Shane, Deputy Assistant Sec’y of State for Transp. Affairs, Address before the Wings Club, New York: Challenges in International Civil Aviation Negotiations (Feb. 26, 1988).
just tell you, that I was walking down the hall in the State Department and around the corner came my boss, the Assistant Secretary for Economic and Business Affairs of the Department of State, Jules Katz. I knew he had read the speech because I had to send it to him. We always sent our speeches to the boss. And I thought, it’s show time. Now I’m going to find out whether this was a good idea or bad idea to make this speech. As Jules approached, he looked at me and my heart stopped for a moment and he said, “Good speech.” And he walked on. I walked on, too. And when I got around the corner I went [SIGH]. And it was a great moment! I had gotten away with it.

And that sort of became a theme that I then felt comfortable to insert into a lot of other speeches, again knowing that every time I made a speech, a lot of people thought that that was actually U.S. policy.

PROFESSOR HA VEL: But there must have been some people who were trying to get the ear of the Secretary to say, “What is Jeff Shane talking about? Why is he making these speeches?”

MR. SHANE: I knew, going in, that I was part of an administration that would be sympathetic to these views. The issue was not, was this sensible? The issue was, was there enough of a political reaction to upset the White House, to upset George Shultz, the Secretary of State, who was an economist, by the way, by training. And I don’t think at that stage in our history — remember we had matured, this is 1988, not 1978 — I think the industry was beginning to get used to the idea that liberalization was part and parcel of what we were doing. And as important as it was, these were nevertheless simply pushing policy in a direction which had already been established.

We were talking about credit . . . I give much more credit to the guys in the Carter administration, to the Mike Levines and the Fred Kahns, than to people in my generation who came along later pushing the envelope, because they were the ones fighting the real resistance. That was hard fought resistance. You could see the reactions, we’ve talked about them, how hard fought those battles were. And the quality of the resistance which the airlines were capable of mustering as a political matter, I mean really swarming over the Congress, swarming over the White House saying, “What are these negotiators doing?” We weren’t facing anything quite like that.

I was much more concerned, again, about this quiescence, this shriveling up, of what had been a pretty robust system of opening markets because our foreign carrier friends and foreign governments, our trading partners, were so convinced that we were enjoying too many benefits in the system that we had created.

PROFESSOR HA VEL: Were you ever concerned that by taking the text of IATCA, the benefits of similar magnitude, the language we talked about earlier, traveling public, and by pushing the Open Skies policy, that you might in fact be thought of as having violated the text in some way and the courts would end ruling on Open Skies?

MR. SHANE: We had to take it on, and we took it on explicitly in the definitions that we put together, even of the Cities Program. We essentially pointed to that language. We didn’t leave it to chance. And we articulated a particular interpretation that, we felt, clearly justified the approach we were
taking, again, because of those famous words at the end I talked about, the benefits to the traveling public, that were the essential target here. And so I knew enough about administrative law – I was an administrative lawyer, again that’s how I cut my teeth in Washington – to know that if we were able to write that clearly enough with enough granularity, no court of appeals would ever overturn it as long as there was substantial evidence, as long as it was not possible to say this was arbitrary and capricious. . . . No court was going to substitute its judgment and say Open Skies violated the law. But we had to be careful about it. We had to make sure that we covered that very important statutory point because without that it would have been a remand. We would have had to do it again.

PROFESSOR HAVEL: We’ll come back to this in the context of a later notice of proposed rule-making that you were involved in when you came back to government a decade later. But just before we leave this particular part of the discussion, the Netherlands became the first Open Skies partner per se. Was that done while you were still in office?


PROFESSOR HAVEL: So that was paving the way. Was it a unique case or was it your anticipation that this would be the first of many?

MR. SHANE: Well I told you about how difficult it was when KLM became our first Cities Program partner for this issue, the first Cities Program beneficiary, because again they weren’t perceived as having an indigenous market of their own, which is a bit of an overstatement. But nevertheless they did rely heavily on other markets for their prosperity. But in negotiating with friends from the Netherlands over so many years, I had learned a lot from them. I had learned a lot about what international aviation should be, that the models that we had created were clearly becoming a problem in terms of growing the market. And I knew that having the Dutch be our first Open Skies partner would present exactly the sort of awkwardness that having them as our first Cities Program beneficiary presented.

But nevertheless they were courageous enough, knowing that they would be very unpopular within Europe, to do this agreement. It was very important to have an agreement that we could actually point to and say this Open Skies thing works. Look what happens as a result. Look at KLM. I think they were limited to 12 gateways before Open Skies. As a result of Open Skies they had any city in the United States they wanted to serve, and could fly beyond the U.S. to any point in the world. And that began to look very good to a lot of our other trading partner airlines.

So notwithstanding the fact that in some ways the Dutch were a problematic trading partner for purposes of the first Open Skies agreement, it was so important that we have one that we didn’t spend a lot of time worrying about that.

PROFESSOR HAVEL: Did you get pushback from U.S. airlines who I know at the time were saying, “We get to fly anywhere in the Netherlands and the Dutch carriers get to fly anywhere in the United States.” It was an interesting first choice for you.
MR. SHANE: Well, in terms of the rhetoric surrounding all of this, you couldn't have had a worse first choice. Because the airlines could say, and without exaggeration, “We got nothing out of this agreement. We could already fly to Amsterdam or Maastricht.” Don’t forget about Maastricht, a big cargo point. “And that’s all we want. And, by the way, we can also fly beyond...” In other words, they were allowed to use the Netherlands as a hub, even before Open Skies. The Dutch had given us everything that they had to give. They didn’t regulate the price of air transportation. They didn’t have any limits on entry. They didn’t care what we did beyond the Netherlands. It was a completely open agreement. And the U.S. carriers felt we should stop right there. “We don’t have to do this. What is KLM giving us?”

A very important part of the criticism, which I felt was a huge problem and which we really had to respond to dramatically and effectively – and I think we did – was the notion that we would measure the benefits of bilateral negotiations in terms of how many airports we got versus how many airports they got. If that was your test for a balanced bilateral agreement, we needed to fold up our tent and go home because there was nobody to negotiate with, right? Nobody out there had the number of gateways that we had. So, by definition, we couldn’t do an agreement that satisfied IATCA, certainly not in the Open Skies context. We had to get people to understand this fundamental point. It’s Economics 101 but believe it or not we had to keep saying it over and over again. “This negotiation is not about counting airports in their territory and airports in our territory. This is negotiation about a basket of passengers who want to fly between the two countries.” It may be that that country has only one airport. We might have 30 airports. But without that destination, without that one destination, there wouldn’t be a basket of passengers. So it’s balanced if we have an equal opportunity to serve those passengers, however hundreds of thousands of passengers a year wanted to fly between our country and theirs, regardless of how many airports they had and how many airports we had. It would be a balanced agreement as long as we had equal opportunity to serve those passengers.

And I think that point, which seemed so obvious to those of us that were in the business, but was not obvious to members of Congress who kept hearing the rhetoric about, “Well how many airports did you get us? How many more destinations did we get?” After a while it finally sank in. And it had to sink in or we wouldn’t have been able to get away with Open Skies.

PROFESSOR HAVEL: Why did the Netherlands become the first Open Skies state? Who made the approach to them? Did they come to you? Did you –

MR. SHANE: They would always come to us. They were always interested in pushing the envelope. They had always been very creative about how to take air transportation forward. Remember, all the rhetoric about pulling the European market together in a single market was in effect defensive rhetoric. It was about finally getting the U.S. to back off and finally cutting back on those fifth freedom rights and making sure that they got as much as they were giving.
They felt that the U.S. was taking much too much advantage. We were being accused of having picked them off, one by one, in individual bilateral agreements when they thought of themselves increasingly as a single market. We weren’t picking them off. The European Commission had no authority to negotiate with us. The only way you could advance the ball was by talking to nation-states, member states of the European Union, because nobody else had the authority to negotiate. Only after 1997 was there a mandate given to Brussels to actually conduct a negotiation with us. Again, I had been talking about having that negotiation, encouraging that negotiation, since 1988, since that Wings Club speech.

PROFESSOR HAVEL: You’re talking about the strategy of encirclement, I think, aren’t you?

MR. SHANE: I’m not sure I finished answering the question that you asked because I think it’s important. So most of the European partners with whom we might have conducted a negotiation, Germany would have been a much more attractive partner in terms of really demonstrating the importance of Open Skies than the Netherlands would have been. But they were very much in this camp of wanting to make sure that there was a unified European front, that they were not allowing us to pick off one after the other. The Dutch were willing to abandon that notion, become the leader of the pack, in effect. And as a result of the agreement – and I knew this would happen – they were more seen as pariahs in Europe for having done the Open Skies agreement than the U.S. was. They had broken the line and broken the back of what had been intended, I think, to be a united front. And so there was no question that the Dutch would end up becoming our first trading partner for Open Skies purposes because nobody else would have stepped up to the plate.

PROFESSOR HAVEL: Well I don’t know if you were part of the strategy of encirclement or that even occurred to you at the time. Did that not take place after you left office?

MR. SHANE: Well there was a strategy – I think there was –

PROFESSOR HAVEL: Maybe you could explain what that is and then comment on it.

MR. SHANE: Right. I think of it most conspicuously in the context of some of the late 1970s and early 1980s negotiations. Think of Japan. Japan was the essential destination in Asia at that time. China wasn’t really on the map for aviation purposes quite yet. And so Tokyo was, if you will, Narita was the Heathrow of Asia, the essential destination. The Japanese, very much like the U.K., knew that they were the essential destination and had no interest in any liberalization.

But we weren’t talking about Open Skies. We were just talking about deregulating some aspects of the flights between the U.S. and Japan and then using our rights beyond Japan to other places in Asia and Australasia. The Japanese were extremely tough on all of that. And so there was a concerted effort, I think, back in the ’70s and early ’80s to try to establish as many liberal agreements around Japan as possible, in effect threatening them with the loss of a lot of traffic. The theory was that people would start doing end-runs around Japan. I think it was folly.
At the end of the day, I don’t think it really achieved anything. Japan stuck to its guns right up until it was possible for them to get antitrust immunity for Japan Airlines and All Nippon, which as we know, was just a year and a half ago\(^2\); they never liberalized. So the encirclement that we talked about back then I think was ineffective as a strategy. It was quite effective, however, in establishing liberal agreements with a lot of other trading partners in Asia.

I don’t recall that we ever thought there could be encirclement within Europe. Again, doing an Open Skies agreement with Netherlands didn’t encircle anybody. We still had real resistance coming from the U.K. In 1992, right around the time we were doing an Open Skies agreement with the Dutch, British Airways came and offered to invest $700 million in USAir, as it was called at the time – $700 million at a time when USAir was really on its knees.

We had a huge interest in seeing whether we could facilitate that very important investment in USAir, saving a tremendous number of jobs and keeping an important competitor alive in the U.S. market. But investing $700 million in USAir meant that British Airways was in effect buying access to the U.S. domestic market. So when I met with BA for that first conversation I said, “You’re buying access to the U.S. market. I’m intrigued with this, and I’d love to find a way to break through some of the restrictions on foreign ownership – which I’m sure we’ll talk about at greater length in a few moments – but what exactly are you proposing to do for the benefit of U.S. carriers in your market in return for this opportunity that you’ve asked for in ours?”

The result, the answer to the question was, “Well we’ve calibrated this transaction very carefully. We’re prepared to pay $700 million and not one penny more,” meaning not one penny more in terms of any additional competition for them at Heathrow, thank you very much. That was the predicate upon which they were prepared to make that investment.

Notwithstanding that answer from BA, we nevertheless talked to the U.K. government about an Open Skies agreement. We said we’d like to figure out a way to make this happen. We’re intrigued with this. We think you should rescue US Airways and this could be a new model for the cross-border flows of capital in this industry. But we really need an Open Skies agreement. We can’t let this happen and still have you say only two U.S. airlines can fly to Heathrow. That doesn’t work.

The U.K., notwithstanding a number of rounds that took place, even at the ministerial level, Secretary Andy Card negotiated with his counterpart, U.K. Secretary of State for Transport John McDermott. We never got anywhere.

So there was really no interest in Open Skies among our European trading partners beyond the Dutch at that particular time.

**PROFESSOR HAVEL:** Well you mentioned antitrust immunity. And we have to talk about that in the context of the Dutch agreement and its consequences later for the creation of the alliances. Where did that idea come from at the time of the negotiation? Was it brought up by the airlines or was it suggested by –

MR. SHANE: It came from the airlines. We were not thinking that there would be a link in any way between Open Skies agreements and immunizing alliances. Alliances were pretty desultory affairs back then. They were very loose partnerships of airlines. They didn't have antitrust immunity. They couldn't really integrate their services very much.

PROFESSOR HAVEL: But you did have KLM/Northwest.

MR. SHANE: We had KLM/Northwest. Yes, I agree.

PROFESSOR HAVEL: That was the commercial predicate for this whole thing.

MR. SHANE: We had reviewed very carefully the KLM/Northwest arrangement that was presented to Secretary Skinner and me. It included an investment of $400 million. But we worked very carefully with the U.S. promoters of that alliance and had to be assured that there could be no semblance of any control by KLM in Northwest Airlines because that would violate the long-standing regulations and long-standing policy of the United States. So notwithstanding this pretty substantial investment KLM made in Northwest at that time, there was only a very loose alliance. The alliance was a very arm's-length sort of thing - not integrated in any way. They had no immunity. And they really couldn't operate as one airline, as they wanted to do.

And so that had become a problem for them, and once we were seriously on the path toward Open Skies – I'm sure they presented it to us before we actually concluded the agreement – they came to us and said, one good thing that could come out of this would be, once you've got a clearly open market, once there's demonstrated contestability in the market, you don't have to worry about anybody monopolizing it permanently because you've always got open entry – anybody who wants to come in can, and we've got capacity at Schiphol to accommodate it – why can't we begin to really integrate this alliance in ways that would create a different model for alliances generally? To do that, we really need to be immunized from spurious antitrust litigation, whether Justice Department enforcement or private litigation. We need antitrust immunity, they said. And we said we'd think about it.

PROFESSOR HAVEL: Weren't you surprised by that? Didn't you find that a very dramatic request?

MR. SHANE: I thought it was a logical request.

PROFESSOR HAVEL: Did you?

MR. SHANE: Yeah. It seemed to me that they were making a lot of sense. I had felt that the restrictions on cross-border capital flows in the industry were a terrible anachronism. They were unseemly. They were strange. We didn't see any of that in virtually any other economic activity. There was some of that, of course, in publishing and telecommunications. Rupert Murdoch, remember, became a U.S. citizen so he could acquire the Wall Street Journal and all of that. So it wasn't completely unique to aviation, but it was pretty unique. And so I saw this effort to integrate services and the need for antitrust immunity in order to facilitate that as being a sort of a logical next step. If we couldn't get rid of the restrictions on ownership, than this was –
PROFESSOR HAVEL: That’s what was on your mind when this request was made. It was a way through the ownership issue.

MR. SHANE: Yes.

PROFESSOR HAVEL: Because you’d never exercised this power before, had you in international aviation?

MR. SHANE: There had been no occasion to.

PROFESSOR HAVEL: No occasion to.

MR. SHANE: Right, we didn’t have a completely open market.

PROFESSOR HAVEL: Did you know about this part when you defined Open Skies? Did you even think about it as an issue?

MR. SHANE: Well, we were thinking about it, not as part of Open Skies. No, we didn’t have that in our –

PROFESSOR HAVEL: It wasn’t part of your template?

MR. SHANE: No, no.

PROFESSOR HAVEL: Why?

MR. SHANE: It had not been presented because we thought there was benefit enough in simply getting out of the business of calibrating access to gateways in the U.S. We should just let airlines look at the map and decide as a commercial matter where they wanted to fly. That seemed to be to us an achievement worthy of the change.

PROFESSOR HAVEL: Which it was.

MR. SHANE: Yeah. And I think quite honestly if KLM/Northwest had not thought about antitrust immunity, had not come to us with the idea, if there had not been a decision to grant antitrust immunity, I think at the end of the day we still would have had a long list of Open Skies partners. Because, quite apart from the integration of the alliance, KLM had access to the U.S. market that exceeded anything any other non-U.S. airline enjoyed at that time. Maybe this is what you meant by encirclement. That became a threat, if you will. Encirclement seems like the wrong metaphor, but it certainly became a threat to the others. And I think quite apart from antitrust immunity, eventually others would have had to step up to the plate –

PROFESSOR HAVEL: A threat and an enticement, the idea of an antitrust immunity. Because Lufthansa and United followed in short order.

MR. SHANE: Yes. But what I’m saying is even if we hadn’t gone that further step, if it had not been presented, if we’d never had to think about antitrust immunity, I think there would have been enough incentive to other trading partners to do Open Skies. So we would have had eventually all the same Open Skies agreements that we have.

PROFESSOR HAVEL: Even without antitrust immunity?

MR. SHANE: I think so.

PROFESSOR HAVEL: You do?

MR. SHANE: Yes.

[break]
PROFESSOR HAVEL: Jeff, just before the break you were talking about antitrust immunity with respect to Open Skies agreements, and you made the point that you think the whole Open Skies series would have occurred irrespective of the existence or otherwise of antitrust immunity. Could you elaborate on that comment?

MR. SHANE: Well, we were talking about, of course, in the Open Skies negotiations, giving our trading partners meaningful access to this U.S. market of ours which is, of course, still the largest and most robust aviation market on the planet.

And it seemed to me that if KLM had open access to the U.S. market, and then you would imagine Lufthansa might get it and then have open access to the U.S. market, and then perhaps somebody else would get it. Those who didn’t have it would soon find themselves very much second-class players in the global industry.

So it would, I thought, engender a rush to the top. You would just, basically, get everybody eventually signing on. The only reason for not doing it would be somehow to continue to regulate aviation. That was what you had the right to do if you didn’t want an Open Skies agreement . . . you could regulate the capacity of the air transportation that was available to your citizens, you could regulate the price of air transportation to your citizens. Which meant keeping airfares higher than the industry itself would have pegged them at. Not a politically popular thing for any government to do.

So I don’t see what rationale governments would have had in the longer term for trying to maintain the traditional approach. Too many examples would have been out there. It’s very much like what happened driving the single market phenomenon. People saw the benefits of deregulation in the U.S. They noticed airfares in Europe were a lot higher per nautical mile than they were in the United States. There’s the famous story about the little boy in Berlin who was asked if he knew where New York was on the map. He said, “No. I don’t really know where it is. But judging by the airfare to New York, it must be somewhere between Hamburg and London.” And that became the story in Europe. They really had to continue to think about liberalizing because there was too much evidence of the good that flowed to consumers and to economies from liberalization to continue to resist it.

PROFESSOR HAVEL: But the airlines clearly, as a commercial matter, saw the value of antitrust immunity and the value of code-sharing. And somehow they put it all together in the form of the alliance. Would you give them credit for creating the alliance, or was that something that you think the government . . . there’s been so much government initiative in our discussion today. Where did the initiative come from to build alliances out of code-sharing opportunities?

MR. SHANE: It came from industry. We presented them with, at long last, a genuine open market. The question then became, “Well, how do we actually create global entities in a world that’s still governed by anachronistic ownership restrictions, that is governed by anachronistic cabotage laws?” We liberalized the bilateral negotiations through Open Skies, but we didn’t change any of these national restrictions. These are all a function of national law. And not
just in the U.S., where they’re famous. But usually those are the laws of just about every country.

And so in order to take advantage of this brave new world of global international air transport services, airlines had to be creative about using Open Skies agreements, using the ability to forge these alliances, in a much more robust way. And to really do that, to in effect manufacture something like a surrogate merger between the two or more airline partners, you had to be free of worry about whether or not you were about to be prosecuted for an antitrust violation. Because you weren’t allowed to sit down with your alliance partner and talk about the price for air transportation that you should both be charging between a city pair that you were both serving. You shouldn’t talk about price at all.

If you’re forced to be an arm’s-length competitor of your alliance partner, the alliance really is not going to become a very efficient one. It won’t be throwing off the kinds of consumer benefits that antitrust regulators like to see in these alliances.

PROFESSOR HAVEL: But would you agree that Open Skies is better for the existence of antitrust immunity? That the policy was even more successful because that immunity was made available?

MR. SHANE: Well, you couldn’t have had antitrust immunity without Open Skies. You needed an open market in order to justify immunizing two competitors in the market. You needed contestability, which would only be available through an open entry policy and that was what Open Skies was all about.

I do think Open Skies has actually delivered greater benefits by virtue of the antitrust immunity that has been granted to certain alliances and certain players in certain alliances because, at long last, we are beginning to see the kind of global competition which otherwise would be impossible. You would continue to have national carriers based in particular countries, governed by the rules of particular countries, flying pursuant to . . . maybe they’re Open Skies agreements, but they’re purely bilateral arrangements.

It’s a very, very restrictive – at the end of the day – a restrictive, hide-bound structure for a business that ought to be as free flowing and creative as the air transport business should be. So the antitrust immunity that the industry itself decided it needed, and which government saw value to granting – although the jurisprudence around that morphed over the years in ways we can talk about – I think did deliver much bigger benefits at the end of the day than pure Open Skies would have delivered.

PROFESSOR HAVEL: Well just to close this topic as we move now to the U.S.-EU and your return to government in 2002, do you think it’s ironic, or would you find it ironic, that the liberalization process that we began to talk about this morning began with the revocation of antitrust immunity for the IATA cartel, and the global competition of which you now speak has been made possible by antitrust immunity?

MR. SHANE: That’s an interesting question. Yeah. What the CAB was proposing to revoke was an immunity for price-fixing on a global basis. Open Skies and the antitrust immunity that’s been granted to alliances has been a
pro-competitive development, in my view. It has facilitated meaningful price
competition between alliances and has given the participants in these alliances
much more strength, if you will, to be robust competitors. The antitrust im-

PROFESSOR HAVEL: So the irony isn’t as deep as I was going to suggest.
Okay.

MR. SHANE: He hastens to say!

PROFESSOR HAVEL: Let’s move to your return to government. Why did
you come back into the government? How did it happen; 2002, is that correct?

MR. SHANE: Yes. I was happily practicing law and not really thinking
about going back into government. I thought I had done quite enough of it,
thank you very much! I’d had 20 years or more. And then Norm Mineta
became the Secretary of Transportation under President George W. Bush. I
had known him very well for many years. He had been the Chairman of the
House Transportation and Infrastructure Committee and Chairman of the
Aviation Subcommittee. He’d been doing transportation policy, and aviation
policy in particular, for 25 years in the Congress. So I thought he was an
amazing choice.

He chose Michael Jackson as his Deputy Secretary. Michael had been the
Chief of Staff to Andrew Card, who had been my boss at the very end of the
first Bush administration. One day I received a call from Michael Jackson
who said, “We’re thinking about reconfiguring the policy office at the Depart-
ment of Transportation and we would like you to come and run it.” And I
said, “Thanks very much. I think it’s something that ought to be done, but
‘been there, done that.’ And that was the end of the conversation. He called
me one more time. He actually plied me with drinks for a while. It was all
very flattering but I really felt as though I had done this government thing for
long enough.

And I knew that my wife was not going to be happy about my going back
into government. It had nothing to do with income or salary or anything like
that. It just had to do with her knowledge of what government means in terms
of the time available to the family and at home, which is exactly right.

So I said “No” again. And then, to my chagrin, he took no for an answer.
And that’s when my brain started churning and I began to think: “Well, let me
think now. That guy Andrew Card, who had been the Secretary of Transpor-
tation, he became the Chief of Staff to President Bush. A former Secretary of
Transportation is Chief of Staff to the President. Norman Mineta has been
doing transportation policy for 25 years and now he’s the Secretary of Trans-
portation. Michael Jackson was a colleague of mine in the first Bush adminis-
tration. And they want me to help them run the policy shop. This could be the
golden age of transportation policy and I am walking away from that.” I
didn’t feel good about that.

And I had a feeling I was going to regret missing the opportunity. And so I
had a long, heartfelt conversation with my wife and I said, “I really think I
want to do this.” And she said, “Well, if you really want to do it, you know I
won’t stand in your way. As long as it’s not for more than two years.” And I
said, "Okay." And I called him back and I said – this is like four or five weeks after the last conversation – I said, "Have you given that job to anybody?"

And at this point I was really nervous that he would have found another candidate. He said, "No. But, look," he said, "You got to be serious about this because I'm not going to go back to the White House and talk about you if you're still dithering." I said, "If you can manufacture an appointment, I will be there." And so that's what happened.

PROFESSOR HAVEL: A Presidential appointment?

MR. SHANE: Yes. They wanted it to be Under Secretary for Policy, but that position didn't exist in the DOT statute; it had to be created. And it took a while to create it because 9/11 happened and Congress was not thinking about moving boxes around on the DOT organizational chart; they were thinking about other things. And so I had a place-holder job for about a year. But then they did create the job.

PROFESSOR HAVEL: What sorts of policy and innovations were spinning around in your head? You said in the first hour, I think, that you'd made a speech to the [Wings Club in New York] a long time ago proposing the U.S.-EU kind of arrangement. In the meantime, you had the Transatlantic Common Aviation Area Proposal from the Europeans in 1999 or 2000.

MR. SHANE: Yeah. Well, I was thinking about that.

PROFESSOR HAVEL: Some of that was still current.

MR. SHANE: Yes. But understand this was not an aviation-only job.

PROFESSOR HAVEL: Right.

MR. SHANE: This was a job that involved policy about transportation of all kinds. And I was very concerned about where I knew that the highway program was going and transit and rail. And I knew that we were really on the cusp of needing some very big innovations in all of that. And as to aviation, I knew that there was a lot of unfinished business. And I knew that there would be pent up demand for a U.S.-EU agreement. And I thought this would be a way of continuing all of that, and maybe taking it to the logical conclusion, and maybe even finding the wherewithal to change the ownership restrictions such that we could actually, at long last, normalize the legal structure, globally, for this industry.

PROFESSOR HAVEL: Right.

MR. SHANE: So those were all in the back of my mind. Ironically, we have to remember that no sooner had I signed up for this job, and long before I got confirmed for it by the Senate, we had 9/11. And for all intents and purposes the Department of Transportation turned into a security agency for the better part of two years.

All of these vaunted ideas I had about transformations in transportation policy of all kinds, were essentially put on the back burner, put on a shelf for two years while we created the Transportation Security Administration. It was created at DOT before the Department of Homeland Security came into being. And DOT just worried about transportation security in every conceivable way. It was a huge distraction from our core job. So we didn't jump right into all these big issues for a while.
PROFESSOR HAVEL: Well as I understand it, the U.S.-EU negotiations got underway in 2004, is that correct, with the "early harvest" approach.

MR. SHANE: I think that’s right.

PROFESSOR HAVEL: Where were you at that time? What was your involvement?

MR. SHANE: Well I was Under Secretary for Policy. I had two Assistant Secretaries reporting to me. One was an Assistant Secretary for Transportation Policy, which meant all the surface programs. And then I had the Assistant Secretary for Aviation and International Affairs. And it was in that office that all of the international policymaking was done. And so I oversaw that, I supervised that.

PROFESSOR HAVEL: Who held that position at the time?

MR. SHANE: Initially it was Read Van de Water.

PROFESSOR HAVEL: Right.

MR. SHANE: And then, after two years, she decided to leave. She eventually became a member of the National Mediation Board. And I found a former colleague of mine from one of the law firms I had worked in, Karan Bhatia. I introduced him to Secretary Mineta. And in fairly short order – he was then working at the Department of Commerce – he became Read’s successor. He was the Assistant Secretary for the next couple of years.

PROFESSOR HAVEL: And what was going on in DOT and DOS? Was there collaboration, was there –

MR. SHANE: Yes.

PROFESSOR HAVEL: Tell us about the way this agreement began to take shape.

MR. SHANE: Well, being a notch above the working level, I wasn’t watching it on a day-to-day basis. I had absolute confidence that both Read, and Karan after her, would basically figure this out. They knew that I was very interested. For all these years, again, I had been talking about having a robust conversation with the EU.

Along about that time we had the European Court of Justice deciding that all the Open Skies bilaterals that we had signed with our European Open Skies partners were illegal because they all had this so-called “nationality clause” – in other words, because they all limited competition in the bilateral markets in question to the national carrier of that European country. And that was, of course, a violation of the very pro-competitive elements of the Treaty of Rome which envision that all European carriers would be able to fly out of Europe from anywhere.

Europe had a problem as a result of that decision and, as I recall, they made it abundantly clear very quickly that we had to solve that problem. They had to make these agreements right. They had to conform them, if you will, to the decision of the court.

So we took that seriously. It seemed like the perfect opportunity to go to the place I was hoping we would go to, in terms of a relationship across the Atlantic. And I think the only cardinal mistake that we made was in saying on day
one, "Well, if we can work out an Open Skies agreement, we'll give you that so-called seventh freedom opportunity," as we would call it. The ability of Lufthansa to fly out of Paris and BA to fly out of Rome, and all around.

PROFESSOR HAVEL: You came on day one and offered it?

MR. SHANE: Right. We said . . . I don't know that I did, I think it might have been John Byerly, who as Deputy Assistant Secretary of State at the time was our chief negotiator. But this was all discussed. We basically wanted them to know – I may have said it in one of my speeches – that we understood the value of this to Europe and the importance of living up to the Treaty of Rome, that this had been our vision as well, that we had longed for a more robust and open and open-textured relationship with Europe in aviation. This may be just the ticket, we said, just the opportunity that we've been looking for. And so you can be sure, if we finally get to an agreement that makes sense in all of its dimensions, that this so-called seventh freedom opportunity that's lacking in the Open Skies agreements, the thing that the European Court of Justice focused on, we would solve that problem.

PROFESSOR HAVEL: Did you think this was going to be an impossible task, 27 countries negotiating with the United States at the same time?

MR. SHANE: No. I thought they had every reason to negotiate with us. It was going to be the U.S. that was, after all, taking the big hit.

If you just take the U.S.-German agreement, for example, a lot of U.S. carriers can fly to Germany under the agreement, but for all intents and purposes it was only Lufthansa coming out of Germany. Now if we were going to sign this Open Skies agreement with the EU, as opposed to just Germany, all of the European carriers could fly out of Frankfurt, or Munich, or –

PROFESSOR HAVEL: Right.

MR. SHANE: So it seemed as though we were the ones that were going to have to make the decision. The Europeans basically already faced this multiplicity of U.S. carriers. I didn't see that they were going to have to face very big decision making of any kind. It was we that would have to do it and I knew that we were prepared to do it in the interest of having this agreement.

PROFESSOR HAVEL: And you felt you had the authority to make this open gesture at the very beginning: that you would recognize a seventh freedom.

MR. SHANE: Sure.

PROFESSOR HAVEL: Where did that authority come from?

MR. SHANE: Where did the authority come from?

PROFESSOR HAVEL: Uh-huh.

MR. SHANE: Well these agreements are executive agreements. The statutes aren't so granular as to prescribe the limits on our negotiators and what they can do. So yes, we –

PROFESSOR HAVEL: So once again, IATCA was not going to be a handicap.

MR. SHANE: We had broken the back of IATCA in the Open Skies agreements.
PROFESSOR HAVEL: Okay.

MR. SHANE: That was no longer an issue. The issue really was politics. Would there be any real likelihood that we would see a proliferation of European carriers coming out of Paris or London or anywhere else. And we thought, probably not, they probably aren’t going to challenge each other too much.

PROFESSOR HAVEL: Yeah.

MR. SHANE: So it seemed, I thought in my naïve way, it would be pretty easy.

PROFESSOR HAVEL: Why was that naïve?

MR. SHANE: I forgot about the U.K.! British Airways perceived itself, with some justification, as the single airline that was going to pay the price for this big new agreement. Again, the U.S. had Open Skies agreements with everybody else. U.S. carriers had their way with everybody else. They could fly anywhere they wanted and through, except Heathrow. Heathrow, being part of the EU, last time we checked, would be opened up as part of any Open Skies agreement that we did with Europe. That meant that BA would suddenly face a whole different quality of competition at its hub.

And it was difficult because the U.K., as you pointed out, is a market-based economy. It’s a market-based government. They believe in competition. They’re very consumer-oriented in their own domestic regulation. The U.K. couldn’t just say, “We don’t want Open Skies.” That would have been anathema.

So they decided to say, “We want true Open Skies.” And by true Open Skies they meant, it’s not enough to simply open up our gateways and have more people flying, we really need to have a free flow of capital between countries. We need to have the wherewithal, if we choose, to buy a U.S. carrier and operate within the United States. Any European carrier that wants to play in that market should have the ability to do so. And if a U.S. carrier wants to come and do the same thing in Europe, it should have the ability to do so as well. I mean it was a beautiful concept. It made every bit of economic sense. That is exactly what the industry should look like. And it was, as BA well understood, politically impossible to accomplish.

PROFESSOR HAVEL: Did they wrap cabotage rights into that demand?

MR. SHANE: I can’t recall. They didn’t need to.

PROFESSOR HAVEL: Didn’t need to.

MR. SHANE: I think they probably thought that that would be a natural part of it because they would have said – and the Europeans generally said – that the U.S. was enjoying cabotage rights in Europe, as we were, albeit through fifth freedom rights. They were doing it through code-sharing at this point, not actually flying their own aircraft between European cities. But the fact is that that was another lopsided element of the trans-Atlantic marketplace.
PROFESSOR HAVEL: So how did you respond to the British? The negotiations terminated on that point and then resumed again. But some point you had your notice of proposed rulemaking.22

MR. SHANE: Yeah. It was during the first effort to try to forge the agreement. Again, I was not unsympathetic to what the U.K. was asking for. I thought, maybe this is precisely the interest that we need, finally get these restrictions cleaned off the books. But I knew that if Congress had to vote on it, it would never happen.

There was just too much deep-seated opposition, particularly within the labor unions, but even within the airlines. If the airlines weren’t going to be campaigning for it in a robust way, Congress was never going to make the change. And the airlines wouldn’t campaign for it because they had enough problems with labor. They were fighting enough battles with the unions on enough different fronts that adding this one, having a battle with the unions over whether or not we should liberalize the foreign investment restrictions – who needed that? It really wasn’t going to make much of a difference, they felt. So I thought the politics just weren’t… the stars were not lined up to make any statutory change.

As I recall, Karan Bhatia came to me after thinking deeply about this for a long time, a very creative guy. And he said he thought there was a way we could do it administratively, without reference to Congress. Remember, the serious restriction on foreign investment is not the statutory 25-percent limit. That… you know, people can live with that. We had occasionally allowed preferred shares, non-voting shares, in excess of the 25-percent limit. We’ve had circumstances where foreign investors have had more than half the equity of a U.S. carrier, but only 25 percent of the voting shares.

PROFESSOR HAVEL: Right.

MR. SHANE: The more serious restriction was that there couldn’t be any semblance of control. Whatever ownership [stake] you had in the carrier, you couldn’t exercise control. That was a construct of the CAB. That was purely a common law rule, if you will, that came out of CAB cases over many, many years. It wasn’t written down anywhere.

So Karan suggested that we could, very deliberately, through a notice of proposed rulemaking or through a decision that people could comment on, decide to redefine control.

PROFESSOR HAVEL: But it was in the statute at this point, isn’t it? The 2002 amendment put the words “actual control” into the statute.

MR. SHANE: “Control” was in the statute.

PROFESSOR HAVEL: “Control” was in the statute.


MR. SHANE: No, no. “Control” was in the statute previously.

PROFESSOR HAVEL: Was it? Okay.

MR. SHANE: Yeah. It wasn’t “actual control.”

PROFESSOR HAVEL: Okay.

22 See Actual Control of U.S. Air Carriers, infra note 23.
MR. SHANE: But we knew that was the predicate for the CAB’s decision that no semblance of control could be exercised by a foreign carrier. They had taken the notion that foreigners couldn’t control an airline, which was just a fairly wooden, brief statement in the definition of a U.S. citizen, I think, in the statute, and over the years said “no semblance of control.” They just made it as strict as possible. Any suggestion that you are touching a hair on the head of a U.S. carrier, and you are . . . if you have a foreign passport, that’s illegal. Karan suggested—and I was intrigued with this notion—that we could redefine that. It had been done by the CAB administratively. It was manufactured out of whole cloth back in the ’40s or ’50s or whenever. We could redo that. We could say what we mean by “control” is control of those elements of an airline operation in which the government has some equity. Decisions about safety, decisions about participation in national defense programs, those are the kinds of decisions. National security, what kind of security program is it . . . things that the government cares about. Why should the government care if some foreign entity is controlling a decision about flight attendant uniforms, routes to be flown, frequencies to be flown, whether to raise fares or lower them—why would we care? Those are wholly commercial aspects of an airline operation and the government has no stake in any of that. And we’ve said that over and over again in all of the stuff that we’ve been putting out in terms of deregulation, Open Skies, and what have you.

So the idea was to put out a notice of proposed rulemaking basically saying all of that and asking for comment on it. Henceforth, we proposed to evaluate the “control” that is prohibited by the statute as control over those equities that are of interest to government: Safety, security, national defense.23

We put that out, and got a raft of comments back. Many of them were intrigued and positive. And, of course, the Europeans were watching it very closely. At one point they felt that it might be a pig in a poke, that there really wasn’t very much there, this was just a bit of fluff that we were trying to show them to demonstrate that we could deliver this.

PROFESSOR HAVEL: Why did you find that idea appealing when Karan brought it to you?

MR. SHANE: Well, I may have forgotten the first step of the story, which is Europeans, of course, had put this on the table as a result of the U.K.’s insistence.

PROFESSOR HAVEL: Right.

MR. SHANE: So it became part of that negotiation. And that was the reason why we decided to try to be creative about it. Again, I was intrigued that we actually had an opportunity to do something about this rule which I had felt was an anachronism for a long, long time. We didn’t want it to be . . . it was going to be politically difficult to be seen as doing it solely to satisfy the European Commission in these negotiations.

---

We had genuine reasons for wanting to do it ourselves. And, in fact, I said many times that if the negotiations [with Europe] dried up and went away tomorrow, we would continue to follow this rule through because there was a genuine interest in our government in seeing whether we could liberalize the foreign ownership restrictions to that extent.

In any event, we put the rule out, we got comments on it. When the Congress really began thinking that this actually was going to be done, that the Department of Transportation was serious about this, I think it was the Chairman of the Aviation Subcommittee, Jim Oberstar – who had such a long and respected reputation in Congress for all of his work in transportation, that they sort of treated him as “Mr. Transportation,” and specifically, “Mr. Aviation” – he was adamantly opposed to this.

PROFESSOR HAVEL: You testified before him.

MR. SHANE: Yes, I testified before him.

PROFESSOR HAVEL: According to John Byerly, you took the larger arrows and slings and spears. Do you remember that?

MR. SHANE: Would you like to see my scars?

PROFESSOR HAVEL: Well –

MR. SHANE: Yeah.

PROFESSOR HAVEL: Is that an accurate statement?

MR. SHANE: Oh, absolutely. Yes. I did and I basically put it all on the table and got a real shellacking from members of Congress for having said it. But again, we weren’t proposing to do anything that the Congress was going to have any say over. So I was essentially there to describe it for them, being polite, but I thought this was something well within our power to do.

What Chairman Oberstar managed to do, however, was collect pledges from about three-quarters of the House of Representatives that the moment we did it, they would enact . . . they would pass a bill that would repeal, legislatively repeal, what we had done and in effect, make the anachronisms even worse. And that was a pretty serious threat. And we took our measure of that. The White House then got involved. The White House was obviously enthusiastic about trying to take this step forward. We had a lot of support from the Domestic Policy Council for doing it. This was now the George W. Bush administration. But when they realized that the likelihood was we were going to get a great big pie in the face from Congress, that they would actually repeal it on day one through an act of Congress, we began to think that this might just be beyond reach.

PROFESSOR HAVEL: Was there a threat of withholding appropriations to support the interpretation of the rule?

MR. SHANE: I don’t think it ever got to that, honestly.

PROFESSOR HAVEL: Never got to that. Why didn’t you bypass the NPRM proceeding and just adopt the rule?

MR. SHANE: Couldn’t. You couldn’t under U.S. law. If you’ve got a policy that’s been in place, enshrined in so many cases, that has been acknowledged, and that the industry has relied upon in all of its own decision making,
you have to morph out of that, you have to segue out of that in a very deliberate way. It’s a matter of administrative law in the U.S. You can’t just change your mind.

PROFESSOR HAVEL: Even with the Chevron Doctrine Protection and –

MR. SHANE: My view is that you really have to do it deliberately.

PROFESSOR HAVEL: Because you got some pushback from the private bar, for example, there were suggestions that it could have been done by fiat and there was no need for the NPR.

MR. SHANE: It’s possible. I think it would have been even more offensive [to Congress]. Even doing it as deliberately and as I thought, politely and respectfully as we did, giving everybody who had a view on it an opportunity to tell us what they thought before we did it – we still got that threat of repeal that was absolutely . . . it was going to be carried out. We would have lost, there was no question about that. If we had done it in the way you’re suggesting, which is by fiat, it would have happened even faster and probably the consequences would have been worse.

PROFESSOR HAVEL: But after all your prior experience in your previous time in government, where you never had these kinds of issues, the Congress and you never clashed on any particular innovation that you were creating, this must have been quite a difficult experience for you.

MR. SHANE: No. Well, it wasn’t. I was used to clashing with Congress on any number of things. Remember again, during those famous Levitas hearings that I talked about in the late ’70s and early ’80s, there was a huge amount of pushback. Now I wasn’t central to it at that point, I was a lawyer who was on the delegation. But I was watching very closely as the administration took a huge hit from Congress for being audacious enough to go out and give away hard rights for soft rights. I had seen that. The Cities Program was controversial. I had been taken to task any number of times for any number of specific negotiations or specific agreements that we had done where a concession was made and perceived to be too rich for the agreement.

PROFESSOR HAVEL: But were those kind of high profile? This was unusually high profile.

MR. SHANE: Nothing . . . yeah.

PROFESSOR HAVEL: Dubai Ports was in the background, wasn’t it, as well?

MR. SHANE: Dubai Ports came along in the middle of all of this, yes.

PROFESSOR HAVEL: Explain what that is.

MR. SHANE: Well, Dubai Ports was an episode in which Dubai Ports World, a Dubai-based operator of ports globally wanted to buy six or eight port operations in the United States. This wasn’t subject, of course, to the aviation restrictions, there was no ab initio, a priori restriction on foreign ownership of ports or port operations in the United States. In fact, the ports, which Dubai Ports wanted to buy were already owned by a British firm. So that wasn’t the problem. But they had to go through what we call the CFIUS

---

24 See supra text accompanying note 10.
process, the Committee on Foreign Investment in the United States.\textsuperscript{25} And that's just to review the security dimensions of the investment, and we do that with every major foreign investment that's deemed to have any strategic significance.

That [proposed purchase] came across my desk. I signed it. I don't think it stayed on my desk for more than a minute. The recommendation was that there was no security issue. Every other Cabinet department had exactly the same presentation, and every other Cabinet department in the Bush administration had no problem with it. It went through the CFIUS process like a knife through butter, as they say. And we approved it.

And then politics happened. There was an opportunity to embarrass the Bush administration by virtue of the fact that it was actually going to allow this Arab company to buy all of these port operations, what did that say? I frankly thought it was ... I thought the United States had lost its collective mind.

Dubai Ports World was so large a company that they were already loading overseas many of the vessels that they were now proposing to unload in the U.S. If we're really worried about the security of Dubai Ports World, we don't need to worry about their buying U.S. ports; they're already out there loading these vessels that are coming to our country! Why have we not been concerned about that? We weren't concerned about it, of course, because they were a world-class port operator.

It became an iconic, very embarrassing episode for the United States, and it came, exactly as you suggest, at the worst possible time in terms of our deliberations over foreign investment in U.S. airlines.\textsuperscript{26}

\textbf{PROFESSOR HAVEL:} Was it explicitly connected to your implementing?

\textbf{MR. SHANE:} The connection was certainly made by the opponents. If we hadn't had Dubai Ports World, I think we would have still ended up the same way. I don't think we could have done the NPRM. I don't think we could have finalized it and succeeded in the way we were hoping to, just by virtue of the fact that it had become so controversial.

\textsuperscript{25} Under the U.S. Foreign Investment and National Security Act of 2007, 50 U.S.C.A. § 2170(d)(4)(A)-(B) (West 2008) (FINSA), the President of the United States is granted broad powers to block or suspend investments in and/or acquisitions of U.S. companies and assets by foreign entities if the transaction presents a "credible" threat to national security. Under FINSA, the duty to investigate proposed foreign investments is delegated to the Committee on Foreign Investment in the United States (CFIUS), a cross-departmental consortium of U.S. federal agencies. Arguably, the President has had the power to block transactions on national security grounds for a number of years prior to the enactment of FINSA. \textit{See} Exec. Order No. 11,858, 40 Fed. Reg. 20,263 (May 7, 1975).

There was really a lot of demagoguing going on about what would happen to U.S. airlines, what would happen to labor, who would be doing all the flying— a real vilification, I think, of the foreign owners that were—

PROFESSOR HAVEL: Of foreign owners.

MR. SHANE: Yeah. Just none of it made any sense to me. I should have been a little bit smarter in anticipating it. The Europeans were skeptical there would be anything there, and I briefed them and I explained how much would be there. And then, because they were reading the transcript of hearings before Congress, when Congress asked me what this all meant, I had to say, yes, a foreign manager would be able to do anything with the U.S. airline that it wanted, as long as it was wholly confined to commercial considerations. Not national security, national defense, or safety.

I actually saw a clip of some of that testimony on Lou Dobbs. Do you remember Lou Dobbs when he was out there being as jingoistic as possible?

PROFESSOR HAVEL: Yes. He took the Dubai Ports issue for himself.

MR. SHANE: Well yeah, and immigration and everything else.

PROFESSOR HAVEL: Yeah.

MR. SHANE: And so this thing was really hyped to the max, as we say. And it just became impossible, became impossible to do. I was deeply disappointed. Again, not because of what it implied for the U.S.-EU negotiations. My conviction was the EU really needed these negotiations. It really needed this Open Skies agreement for reasons having to do with the European Court of Justice, and that decision.

So we were going to get that, one way or another. But I was really, really hoping we could leverage that negotiation in a way that enabled us to get rid of some of these anachronisms in our own law and really devastated that we . . .

PROFESSOR HAVEL: Do you really think, counterfactually, do you think if that had been adopted, the NPRM, that that kind of structure would have worked in an American airline. Where you had the separation between what government’s interested in and the daily commercial activities. Did you ever sort—

MR. SHANE: I think it would have—

PROFESSOR HAVEL: Expand with it.

MR. SHANE: First of all, what was the rationale for suggesting that U.S. citizens had to be in charge of safety, and not foreign citizens? Are foreign citizens cavalier about safety in the air transport business. My view was, this was our foot in the door. This was how to define it and justify it and defend it. And that eventually somebody would snap out of it and ask why are we making this distinction. Let’s just normalize this industry once and for all. So it seemed to me a temporary exigency.

PROFESSOR HAVEL: What happened? Did you decide to pull the NPRM?

MR. SHANE: No. It was. . . . I can remember exactly. We had a meeting at the White House. Not with the President, but with the President’s advisors,
and it was robust conversation. There were, again, advisors to the President who were adamant that we not pull the plug.

**PROFESSOR HAVEL:** Really?

**MR. SHANE:** More strenuously than even the Department of Transportation. But this was also a political issue for the White House. We were just serving up the content, but at the end of the day it had to be a decision the White House made. And it simply their view – and I think that it was an absolutely correct view – that we could not win this. This would just be a legislative defeat for the administration, and who needs it? It was a brand new Congress and it was a brand new legislative cycle and it was a perfectly rational decision, it seemed to me, to pull the plug on the NPRM. Which meant, of course, going back to the U.S.-EU negotiations, and having to recalibrate all of the assumptions about that. And this became extremely difficult. The U.K. had said that it was a *sine qua non* to their signing on, the U.K. being sufficiently important within the EU complex that without a U.K. agreement, it was going to be very difficult for the people in Brussels to deliver that agreement. So it was a huge problem.

**PROFESSOR HAVEL:** And did you stay involved in the negotiations to the end?

**MR. SHANE:** Oh yeah. Sure. Stayed involved as, if you will, a supervisor, an overseer. I got daily reports on those negotiations and contributed a lot of interim decisions along the way as we would try to figure out which turns to take.

**PROFESSOR HAVEL:** We have discussed the course of those negotiations with John Byerly. But I wonder how do you feel overall about the outcome? Do you think the European Union was disappointed? Do you think that the United States was pleased that Heathrow was released into the Open Skies world?

**MR. SHANE:** Well, the United States was certainly pleased with the agreement as far as it went. I may be speaking more personally than on behalf of the U.S. government because I'm not authorized to represent the U.S. government any longer. But I would say, the EU was clearly disappointed that we didn't make that huge leap forward that they had made part and parcel, thanks to the U.K., of their negotiating objectives. But – and this isn't widely understood – I think the United States was disappointed in precisely the same way – that we had hoped that the negotiation would produce breakthroughs even within our domestic law, particularly to normalize this industry at long last such that we could really let the industry seek its own level as an economic proposition. It continues to be highly artificial in its structure. The antitrust immunity granted to the alliances, of course, is a well understood surrogate for the kinds of mixing and matching and ferment that you might have seen in a more normalized industry, one that didn't have these rules.

I'm very disappointed that we just don't know yet what this industry is capable of, in terms of delivering a real service to populations around the world.

**PROFESSOR HAVEL:** But going back, before we close our discussion of U.S.-EU to when you met with your . . . with Karan, I think you said, to
discuss the interpretation of the term "actual control." Once again you were in a position where you were able to take a broad view of a piece of text and you were ready to run with that as a government matter, as a policy matter, because you thought that was good public policy. That seems to have been a theme in the way in which you have approached your career. That you have looked at these texts in a flexible way. And that, indeed, pushed a lot of the evolution of international aviation policy in your first period.

So to what extent do you feel that the NPRM experience, in effect, closed some of your flexibility, or did you feel that at all through this process?

MR. SHANE: No. I wouldn't draw that large a conclusion. That was an issue that had been singled out by the AFL-CIO as the most important issue in transportation for the year. This was not just another issue, this wasn't a challenge to the ability of the administration or any Executive Branch department to interpret statutes. That's unquestioned. It was that we had chosen to interpret a particular policy that had been on the books a long, long time, that huge stakeholders, huge numbers of stakeholders felt very comfortable with, and turn it on its head, and do it through NPRM process. We have to understand as we look at liberalization, that in fairness, deregulation flowed huge economic benefits to consumers and those have been measured in a number of economic studies, and we all know about those.

But it's also fair to say that labor didn't do very well as a result. Suddenly there was downward pressure on [air fares]. That meant there'd be downward pressure on wages. An industry that people would go into because of its glamour, because of the excitement of world travel, because of the comfort people had that it was a regulated industry and that you could be pretty comfortable where you would end up, suddenly was turned inside out. Careers were destroyed.

The unions that organized airline workers saw nothing good in the deregulation process. Here we were proposing to liberalize it yet again in ways that were untested, that suggested now we would have offshore owners, people managing airlines that we didn't even know. And the mythology was out there that they wouldn't even have to comply with U.S. labor laws, which was of course, completely untrue, but that was the word that went out.

I'm not the least bit surprised that labor continues to look with real skepticism at another major change, the dimensions of which they don't fully understand. It seemed to me understandable. And we probably should have appreciated to a greater extent what it meant.

We also had the Department of Defense to worry about. Remember that the Department of Defense was always assumed to be adamantly opposed to any liberalization of these rules. Well, it goes without saying, I couldn't have proposed an NPRM, or anything else that would have affected foreign ownership rules in any way, without knowing that the Department of Defense was comfortable with it.

I had worked for many years, even during my private sector time, with the Air Mobility Command based in Saint Louis. And I had served as Chairman of something called the Military Airlift Committee, it was sort of a pro bono thing. And I knew the Commanders in Chief of the Air Mobility Command
and the U.S. Transportation Command very well. And those relationships
were valuable when I was able to present this NPRM to them and to quantify
for them the extent to which it would not have any negative impact on their
access to the commercial civilian airlift upon which they depend for a lot of
peacetime movements, and even wartime movements. They were completely
comfortable with it.

I thought I had had . . . I won’t go so far as to say that I thought I had
agreement from the unions, but I certainly had spent time with them trying to
talk them through it and trying to get them to understand that they were en-
tirely protected here. There wasn’t going to be any giving up on U.S. labor
law – that whatever protections they had under the current system, they would
have under the new system. What they would also have is a lot more capital in
their companies to make them more successful than they would be, more jobs,
but that didn’t seem to –

PROFESSOR HAVEL: And didn’t Congressman Oberstar respond with
another bill in which he actually made it a condition of employment as an
executive in the U.S. airline, that that person be a citizen of the United States.

MR. SHANE: Yeah. A bill, I’m happy to say, went nowhere.

PROFESSOR HAVEL: A bill that went nowhere, but it was part of that,
the fallout from the NPRM, I suppose.

MR. SHANE: I suppose.

PROFESSOR HAVEL: Yeah. One other question about the U.S.-EU
agreement, did it ever occur to you . . . because you really wanted to remake
the world with this agreement, to some extent anyway.

MR. SHANE: Yeah.

PROFESSOR HAVEL: To use an Article 2 treaty as the methodology for
getting it through Congress, and not an executive agreement?

MR. SHANE: No.

PROFESSOR HAVEL: Was that ever discussed?

MR. SHANE: No. The last thing in the world we needed was a battle over
ratification in the Congress. That’s the nice thing about it, and all of the pro-
gress that we made, I think, in moving from the Bermuda I model to the Open
Skies model, I think, is largely attributable to the fact that we define these
agreements as executive agreements in our system. Which is to say, under the
Case Act, we notify the House of Representatives, we’ve done this agreement,
but we don’t ask anybody’s permission. Better to ask forgiveness than permis-
sion. And to have to go back to Congress with a brand new Open Skies model
and say, “Let’s ratify this new treaty that we have with the Netherlands,” with
people like Bob Crandall screaming about how he was going to fire 5,000 peo-
ple off to the side, I think it would have been impossible.

PROFESSOR HAVEL: Over the years did you ever reflect on the fact that
the executive agreement was an interesting way to create these treaties, that
Congress was never directly involved.

MR. SHANE: Well, Congress should be involved in a lot less, it seems to
me, that they’re involved in. It’s just dumb luck, I think, that they chose this
route. I think it was because for the longest time these agreements were not particularly interesting. They were adding one more gateway. It wasn't the stuff of Congress.

When it suddenly morphed into something far more interesting and intriguing and liberalizing, changing all the assumptions that an industry had been relying upon for a long time, I would argue that probably was something Congress might have focused on, and you could justify having a treaty ratification process. But luckily, we had already established the executive agreement pattern and we were able to stay within it. We still had lots of hearings. The Congress maintained oversight, but chose to leave us to our own devices, I'm happy to say.

Professor Havel: But you maintained an interest in this question of foreign ownership even after you left public service?

Mr. Shane: Yes.

Professor Havel: What about the IATA Agenda for Freedom?

Mr. Shane: Well this was a remarkable episode. I'm not used to seeing associations of airlines actually advocating forms of liberalization that even their members do not necessarily subscribe to.

Under the leadership of Giovanni Bisignani, IATA – still the global association for the airline industry – decided that one of the real impediments to making money in this business continues to be a set of anachronistic restrictions that individual governments put on the industry. He would have also said there's too much taxation, and all the usual arguments. But he was focused quite miraculously, for this purpose at least, on the restrictions that governments put on ownership of airlines, not through their national laws, but through bilateral agreements. And what he was talking about in the first instance was the nationality clause. And just to explain that in words of one syllable for a moment, in a bilateral agreement the agreement says, "Each party has the ability to say no to an airline from the other side if it's not satisfied that that airline who wants to serve its territory is owned and controlled by nationals of that country."

So what that means is that these bilateral aviation agreements give each party the ability to control the legislative process in the other party. You may not liberalize your ownership rules, even for your own purposes, because if you do, I won't let your airlines fly to my country. And I have the right to do that under the bilateral agreement.

Giovanni's view was, "That's nuts." Countries should be allowed to do what they want. As long as an airline is based in the other country and is a creature of the other country, regardless of the nationality of its ownership, it should be allowed to fly.

And so he created the Agenda for Freedom. We found a group of like-minded CAAs that were sympathetic to this notion. We gathered them at a meeting in Istanbul in 2009, I think it was. And we began talking about not a treaty, but a joint understanding, a mutual pact in which they would agree,

---

27 Civil aviation administrations.
just as a matter of trust, that they wouldn't exercise these restrictions, even
though they could.

PROFESSOR HAVEL: On a reciprocal basis, I assume.

MR. SHANE: On a reciprocal basis, of course. But looking at their own
interests the entire time.

We had a second meeting a year later in Montebello, just outside of Mon-
treal. And, in fact, that joint statement was signed by about five or six or
seven governments, not governments but the CAAs. Again, it wasn't at the
governmental level. But it was an understanding among regulators.

PROFESSOR HAVEL: And you presided at that event?

MR. SHANE: I presided at both events. He asked me to chair the Agenda
for Freedom, which I did and which I was privileged to do. I thought it was
innovative, I thought it was forward looking, I thought it spoke very highly
of IATA. This erstwhile cartel that had been the subject of the Show Cause Pro-
ceeding in 1978 had now actually begun getting ahead of where governments
were in term of its vision of what a liberal market could look like. It was
spectacular. I just thought it challenged government thinking in ways that I'd
never seen the industry do before.

A far cry from the reactions to the Cities
Program, reactions to even the Carter administration's liberalization. It really
was a sea change, I think, in the way the industry was looking at this whole
issue. It meant for me, among other things, that the industry had embraced
liberalization at long last, and now was impatient to see the other shoe
drop... "Let's push governments to the point where they get out of our way
completely."

PROFESSOR HAVEL: And what happened to it?

MR. SHANE: It stopped. This is my surmise - I don't know this on a first-
hand basis - but we saw some very powerful airlines emerging from parts of
the Middle East. And they were putting together a very, very attractive ser-
dvice, a level of service unmatched anywhere. And because of their geographic
location, were becoming the new KLMs, to make your [earlier] point.

PROFESSOR HAVEL: Come back to that point, yes.

MR. SHANE: The ultimate sixth freedom carriers, carrying people from the
West to the East, over Dubai, over Abu Dhabi. A huge challenge to the tradi-
tional carriers. And my guess is, because the Agenda for Freedom stopped
dead in its tracks - we never took it any further - that IATA's membership
went to management and said, "If you keep pushing this, we're going to lose
our ability to keep a damper on what these leviathan airlines are beginning to
do to us in our own markets. We don't want this Agenda for Freedom to go
very much further, thank you." And so IATA essentially just stopped it. It is
what it is.

PROFESSOR HAVEL: Yeah. An interesting experiment in quasi interna-
tional law making, I suppose.

MR. SHANE: And I think that it will ultimately prove to have succeeded in
the sense that I really find as people continue to liberalize, and they will, it's
just the natural course of events. As airlines become multinational creatures
over time, it's going to be unseemly for a government to raise an objection to
the ownership of somebody else’s airline, even though the bilateral agreement might technically give you the ability to do so.

PROFESSOR HAVEL: And if Willie Walsh tries to buy American Airlines, maybe we’ll see some from the ground up changes in the way governments perceive these rules.

MR. SHANE: Yeah. It’s going to be interesting to watch that develop and to see if that actually happens. Because that will be a very interesting . . . an interesting problem for the U.S. to have to wrestle with.

PROFESSOR HAVEL: Jeff, I have another several hours of questions for you and I’m down to the last less than ten minutes. I do want to talk about ICAO for a few minutes, since you presided over ICAO, the International Civil Aviation Organization. What’s your impression of that organization? It’s in the crosshairs now with the Emissions Trading [Scheme] controversy.

MR. SHANE: Well, two impressions. One is, it’s a superb organization, I think. I worked for the United Nations for a while and I know something about some of the UN agencies that are out there. ICAO, I think, stands head and shoulders over others. And I know I’ll be criticized for this by the World Health Organization. But I think they deliver enormous value to the member states through their management of the global framework for international air transport. That’s the secretariat that I’m talking about – their ability to deliver what the member states need.

Where ICAO becomes more problematic is where the member states have to vote on things, because they all have one vote each. They’re in the crosshairs at the moment because of the controversy over the European Emissions Trading Scheme. Everybody who’s not a European, and even some people who are European, seem to be against what the EU is doing.

ICAO should be the locus of the activity that delivers the quality of emissions control, reduction over time, that ends up satisfying the European Commission’s requirements. And that would give the European Commission a graceful way out of applying the ETS unilaterally to foreign carriers flying to and from Europe.

The problem that ICAO has is that the only way it can do that is by getting its member states to adopt something. We tried to do this in 2007 when I was President of that assembly. We pulled together a small group, because that’s the only way business gets done, with a small group. It involved all of the major players, including China and India. And what I found was that, as a result of concepts that were first articulated in Kyoto, concepts like “common but differentiated responsibilities,” which is an elaborate way of saying, “If you are a developing economy, you can get a pass on whatever the rest of the world does in the sphere of emissions [reduction].” Because of that concept, they were unwilling to really make any kind of move. They were unwilling to participate in any agreement that would have moved in the direction of satisfying Europe.

I was unable, during the Assembly, the 36th Assembly in 2007, to make any progress on that. We did a resolution which said, “You shouldn’t do things unilaterally” and “market-based measures are a good thing” and indeed what the Europeans are doing might make sense as a global system. But nobody
should impose their own system on foreign airlines without mutual agreement. That’s what the resolution said.

The Europeans have been very clear that if the world comes up with a way of achieving what it is that they are trying to achieve through the ETS, they will back down. That’s what they say out loud all the time at every conference they go to. Can ICAO manufacture that excuse for allowing the Europeans to back down? Thus far the answer has been no. And I saw that close up and personal.

I am not giving up on ICAO, however, because I think the pressures are huge and they’re mounting. It may well be that ICAO will find a way to concoct a formula whereby there will be measured reductions, measured targets that have to be achieved by governments and by their airlines, by the industry over time, and that that can be characterized as precisely what the Europeans were trying to achieve through the ETS. And maybe that can be the way out. And if it’s not that, I have a feeling it’s going to be an Article 84 proceeding before ICAO and –

**PROFESSOR HAVEL:** Which ICAO isn’t particularly well equipped to deal with.

**MR. SHANE:** That’s right. Right. It will be an unhappy development, for sure. And it’s not likely to produce a result that satisfies anybody at the end of the day. So I think we really need to be optimistic that ICAO, having now gone through several rounds of failure, will come together around a scheme, will finally begin to deliver.

**PROFESSOR HAVEL:** Well maybe this ICAO experience will be one of your answers to my final question, or close to my final question. Looking back on your long career in government service and your central role in U.S. national and international aviation policy, what do you think was your greatest achievement and what was your greatest disappointment?

**MR. SHANE:** Well, the answer might surprise you. I think of the greatest achievement, if you will, and that engendered the wherewithal to do the things that we’ve been talking about, was just survival. Just having either chosen or simply decided not to choose what my career would be for enough years that I was eventually empowered to see what John Byerly very kindly called the forest instead of the trees.

There have been so many brilliant people that have come through the process, and I’ve worked with all of them, and most of them come in as political appointments and they stay for two years and they do a marvelous job for two years and then they leave. Two years, unfortunately, is not enough time to achieve anything. You can push the envelope a little bit, you can push things in the right direction, but then you leave.

To really make something important happen, there’s got to be continuity of leadership. And I think if I’ve done anything right in this business, it’s just staying there long enough – or coming back frequently enough – to continue to move things in the direction which I think they would have moved anyway. I want to be very clear about that. In government, if you can move something in a direction that it’s already moving and get it there five minutes ahead of
time, you’ve had a good day. And I think my career could be defined that way.

PROFESSOR HAVEL: I think you’re . . . in that sense, your greatest achievement may have been that you can hand a memo to the Secretary of Transportation, he could write “Go for it!” on the memo. That was pretty impressive.

MR. SHANE: Well, yeah. But I think what was impressive was that he would do that, notwithstanding the fact that I had been around for many years.

PROFESSOR HAVEL: Your greatest disappointment?

MR. SHANE: That we are still stuck in an anachronistic world, and that we haven’t begun to unleash the real power of air transportation for the benefit of national economies everywhere, and for the global economy. I look at this industry and I ask what it might look like if we didn’t have these completely bizarre and unique restrictions on their corporate existence . . .

PROFESSOR HAVEL: Jeff, with those tantalizing remarks, we come to the end of our three hours.

MR. SHANE: We should have come to the end five minutes sooner!

Conclusion

PROFESSOR HAVEL: We close this installment of Conversations with Aviation Leaders. Sincere thanks, of course, to you for generously giving us your time to join us today in Chicago, and for your immense contribution to the advancement of so many aspects of domestic and global aviation policy. You certainly have demonstrated today, not only that you see the forest and can work with the trees as well, but that you have shown how important government can be in forming and fashioning and creating policy. It’s been a fascinating insight into something that we don’t often appreciate. In fact, we rarely get to see.

And we at the Institute are honored that you gave us the opportunity today to archive many of your thoughts and reminiscences about your long and productive career. And we wish you continued success . . .