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Aviation and Tourism: The Traveling Public

CHUCK Y. GEE, DEAN*

As one who deals with tourism planning at various levels, I am pleased to be here today to speak about the vital relationship between aviation and tourism and its implications for the traveling public. Over the past thirty years, the development of tourism worldwide has paralleled the evolution and growth of the airline industry. Recently, we saw dramatic evidence of the linkage between aviation and tourism during the Persian Gulf crisis when adverse conditions affected both industries drastically. The historical message is clear: The health and vitality of tourism is dependent upon affordable, speedy, convenient, and safe air transportation; and the growth of the airline industry revolves on more accessible tourist destinations worldwide.

In addressing this topic, I will touch upon the historical relationship between the two and the key issues which are important to the future of tourism and aviation. First is the strategic importance of tourism to our national economy and in international trade, second is the contribution of aviation technology to long-haul travel, and third is the impact of civil aviation policies on travel and public concerns about air service.

THE GROWTH OF TRAVEL AND TOURISM

Tourism is said to be the largest and fastest growing industry in the world today with current revenues estimated in excess of two trillion dol-

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lars — more than twice the amount the world spends to support its military establishments. On an average day worldwide, an estimated 3.4 million passengers take off from 16,000 airports on over 600 domestic and international airlines that serve thousands of destinations.

Since 1985, the volume of international tourism to the United States has increased by fifty-five percent. Current projections suggest that scheduled international passenger traffic will double by the year 2000, growing at an average annual rate of six to seven percent in this decade. In 1990 the travel industry became our nation’s leading export, generating $52.8 billion in expenditures from nearly 40 million international visitors and creating a $4.7 billion surplus in our international trade account.

1990 also marked the fifth consecutive year that travel to, from, and within the United States expanded. In over two-thirds of our states, travel and tourism is considered either the first, second, or third largest industry. In my state of Hawaii, for example, tourism is the number one industry, accounting for over 11 billion dollars in expenditures, or forty-five percent of our gross state product, generated by nearly 7 million visitors, virtually all of whom arrive by air. Here in Colorado, the travel industry is just second to agriculture, attracting more than 26 million visitors annually and generating over $6 billion in revenues.

This growth of travel and tourism has generally reflected economic, social, and political trends favoring travel consumption but clearly would not have been possible without a parallel growth in reliable air service, aircraft technology, airline regulatory changes, and travel incentives.

Let me turn now to several key areas where aviation has impacted travel trends, beginning with aviation technology.

AVIATION TECHNOLOGY

Jet Service. It is fair to say that the most influential factor in the development of modern tourism was the introduction of commercial jet service in 1958, offering increased carrier speed, range, and capacity. During the 1960s, passenger traffic grew at an annual rate of fifteen percent as travelers were able, for the first time, to cross continents and span oceans within the course of a day. At the beginning of the jet age, only about one-third of all Americans had ever flown. By 1970, this number had increased to nearly fifty percent, with leisure trips accounting for about half of all air passenger arrivals.

Wide-Body Aircraft. In the 1970s, the Boeing B747, the McDonnell-Douglas DC-10, and the Lockheed L1011 introduced a new era of airline travel. These wide-body jumbo jets were capable of carrying about twice as many passengers as the Boeing 707 and the DC-8 and provided economies of scale which reduced airfares. By the end of the 1970s, world-
wide figures show that over 130 million more passengers had boarded commercial airplanes, a ninety one percent increase over counts at the beginning of the decade.

**Long-Haul Aircraft.** Within the past year, we have been introduced to yet another generation of jet service: the B747-400 and the McDonnell-Douglas MD11 — aircrafts capable of flying over 8,000 miles at a time. These long-haul jumbo jets open more options for travelers who will be able to fly halfway around the world nonstop; for example, from New York to the Far East or from Europe to the Pacific Islands.

**Faster Aircraft.** As we move into the new century, we can expect even more innovative technology. Long-haul aircraft will increase passenger capacity by twenty percent; and by the year 2100, the U.S. National Aerospace Program will introduce commercial supersonic aircraft that will fly from California to New York in about one hour (3,400 miles per hour); or from California to Hawaii in forty-five minutes. For some of us this is faster than our morning rush-hour commute. The compression of travel distances and time will affect the marketing of tourism on a global scale that will dwarf today’s already impressive accomplishments.

There are other key policy issues that continue to have an enormous impact on travel.

**AIRLINE DEREGULATION**

Of these, perhaps no topic has been more controversial or as inconclusive with respect to long-term public impact as the issue of airline deregulation. Congress passed the Airline Deregulation Act in 1978 to allow airlines to compete on the basis of fares and routes.

In the early years of deregulation, the number of scheduled air carriers almost tripled. The new entrants fueled a price war by generally offering lower fares in markets that previously were profitable, had the fewest incumbent carriers, and represented transfer markets. Some of these carriers justified lower fares by offering no frills service. By the mid-eighties, consumers were enjoying up to half the full-fare discounts and more choices of airlines in expanded markets as routes served by two or more carriers grew by more than fifty percent over 1978 figures.

The net effect, as estimated by the Brookings Institute, is that deregulation has generated some $6 billion in cumulative savings to travelers, after subtracting $500 million a year from consumer savings as the cost of increased flight delays. The largest part of the savings has accrued to vacation travelers in the form of increased discounting with various restrictions. It should be noted, however, that general agreement on the costs and benefits of deregulation remains elusive in spite of numerous major studies on this matter.
Airline Concentration. As I pointed out earlier, deregulation spawned a number of new entrants into the domestic airline industry. By 1985 more than twenty new airlines had begun interstate service. These newcomers increased their market share by offering fewer amenities and lower fares than their more established competitors.

However, this advantage was short lived as the major airlines countered with competitive marketing strategies and by selectively matching the fares of their new rivals. The resulting bankruptcies and consolidations have left the airline industry more concentrated today than before deregulation, when the eight largest airlines held eighty-one percent of the market. Their share now is ninety-five percent, creating a virtual unregulated monopoly or oligopoly in some markets. Given the sad current financial climate of the carriers, it is all too possible that we will be down to four or five major carriers by the end of this century.

The lack of competition, for example, at such airports as Atlanta, Denver, and Pittsburgh, according to some studies, has produced significantly higher prices. A 1988 Department of Transportation study found that fares were eighteen point seven percent higher at concentrated airports served by a few dominant carriers. Given this state of affairs, it is interesting to note that the Reagan administration did not challenge a single merger or acquisition in the airline industry under existing antitrust laws even as reduced competition became evident.

PUBLIC CONCERNS

Air transportation policy and airline operational changes have also spawned questions of growing public concern in air travel. The most recent issues deal with air congestion, air safety, the quality of air service, and finally, one with which the public has not yet come to grips—that of taxation in air travel.

Congestion. In tourism, the first and last impression of the travel experience and a destination takes place at the air terminal. Airport congestion, security, customs inspection, immigration, and other support services are important to travelers and are of high priority to destinations seriously interested in developing tourism. It is, therefore, a concern to the industry that despite the increase of more than 150 million air passengers in the 1980s, not a single new airport was built. Instead, $6 billion in the Airport Trust Fund was left unspent to reduce the federal budget deficit.

The shortage of facilities, gates, landing rights, and airspace is not expected to subside in the near future as airport expansion and construction are often stalled by environmental impact problems, scarcity of land, cost, market issues, and politics. The new airport under construction in
northeast Denver is a good case in point as new political opposition to its ongoing development makes the headlines.

Airport congestion is due also to an air traffic control (ATC) system that has not fully recovered from the air traffic controllers' strike in 1981 and its aftermath. A shortage of qualified controllers, a lack of up-to-date equipment, and a concomitant increase in air traffic have contributed to more airline delays; and new ATC equipment which could alleviate these problems will not be available for some time.

Congestion creates frustrating experiences for the traveling public. It is also costly to airports and airlines, inevitably leading to increased ticket prices and additional passenger facility charges, which have serious implications for tourism during recessionary times.

Unless governments, airlines, and the travel industry work together on the congestion problem, delays at major airports will increase. The construction of additional terminals and runways will be expensive, and we must also examine other measures to improve the system’s capacity to cope. For example, many governments are allowing private sector participation and investment capital to provide new and upgraded facilities while public agencies meet other urgent demands for more basic services. The lifting of air curfews, especially in Asian countries, is another solution proposed by industry experts.

**Airline Safety.** Safety is one of four key concerns affecting travel motivation and behavior. An incident on one carrier affects not only the particular airline in question, but also casts a shadow on the travel industry in general. To bear out the thesis of public interest in safety, a recent survey by Becker Associates travel consultants reports that forty-seven percent of the respondents want more detailed records of airline safety infractions; forty-two percent want maintenance and performance information; thirty-nine percent want aircraft age data and twenty-two percent even want to know about the experience of the flight crews.

The hub and spoke system, which is widely used today by the major air carriers, has increased the number of aircraft takeoffs and landings in a given time period, causing premature metal fatigue and stress on those planes serving high demand markets. An examination of Hawaii’s Aloha Airlines jet that lost part of its fuselage in midair three years ago—perhaps the most notorious instance of this problem—showed corrosion and cracks, having flown an average of twelve or more cycles per day over Pacific waters for the previous nineteen years.

The Aloha tragedy had the useful consequence of raising the issue of the viable economic life of an aircraft. It is expected that by 1994, forty percent of the world’s aircraft will be over twenty years old, which is a problem from both marketing and operating perspectives. The primary
impact of over-utilized and aging aircraft fleet on the travel industry is a reduced level of public confidence in flying.

Airline Service. Along with concerns over safety are issues about airline service in general. The hub and spoke system, which improved operational efficiency through route changes and realignments increased flight frequency and single-carrier service, consequently adding to the convenience of air travel. But the obverse side of this is the longer travel time, transfers, and in some instances, added cost, for those who must now fly five to thirty percent farther to reach a final destination.

Information on discount fares are often confusing. Announcements of special fares sometimes seem to reach the public before the retail travel sector or the airline’s own sales offices can even find the information on their computer screens. While discounted, low cost fares are appreciated particularly by the vacation segment of the travel market, the applicable restrictions are formidable and the rules do not always appear rational, except to the airlines.

Other airline consumer-oriented services such as frequent flyer programs, computerized reservations systems, and yield management do provide convenience and savings for travelers, but these incentives also discourage potential competitors since incumbent airlines have the advantage of an established base which can respond to consumer demands more quickly.

At the same time that incentive programs were promoted, complaints about the quality of airline passenger service have increased, largely as a result of airline cost-cutting practices such as overbooked flights, delayed flights, tighter airplane configurations, lower foodservice quality, and reduced ground services, adding up to what many see as reduced value. The contrast between service of U.S. carriers and such foreign carriers as SAS, Swissair, SIA, Cathay Pacific and others is startling to those who have flown on them.

Air Travel Taxation. Finally, a word about air travel taxes. In recent years, as local and federal governments face budgetary woes, air passengers have increasingly become the source of additional tax revenues. Travelers make ideal targets; they do not vote locally and they seldom notice airline and user taxes, which are well hidden under a "UX" code. An international airline traveler may now pay as many as five different taxes per trip. These charges include a departure tax, an immigration fee, customs fee, plus the new animal and plant inspection fee and a passenger facility charge. By summer, a domestic passenger may see an even greater increase with the ten percent ticket tax plus a passenger facility tax of up to twelve dollars. The airline and other segments of the travel industry are, of course, vehemently opposed to these taxes and fees, which add to the cost of travel and thus hamper tourism growth. More-
The Traveling Public

over, destinations themselves do not necessarily benefit from travel and tourism taxes, as travelers compensate for added cost through lower daily expenditures or shortened stays. We have found in Hawaii, as elsewhere, that it is hard to outsmart a seasoned traveler.

CONCLUSION

To summarize, aviation technology and airline policies generally have been beneficial to the travel industry up to this point in time. As a result of faster and larger long-range aircraft and unregulated competition among the airlines, the traveling public enjoys increased access to more destinations, travel conveniences, relative safety, and expanded services at affordable rates. The long-term effects, however, have yet to be realized and warrant attention. I have not attempted, for instance, to comment on the current nonprofitability of carriers, the financial implications of consolidation, the interest of foreign airlines in linking with U.S. carriers, recent developments in more liberal bilateral agreements, or the airlines' evolving relationships with other sectors of the travel industry. These strategic issues hold significant consequences for the financial health of the U.S. airline industry.

Despite a cloudy crystal ball, the prognostications and projections for tourism by leading authorities appear to be both promising and bright as we move toward the twenty-first century. Tourism, in its broadest definition, is the ultimate communications force that unites people, community, business, and political interests and hastens the arrival of Marshall McLuhan's "global village". To paraphrase Professor McLuhan, if tourism is the message, then the airline industry is the medium enabling its delivery.

Whatever affects the health of the airline industry will also affect the health of the travel industry. The last chapters on airline regulatory policy and other issues have yet to be written. The decade of the nineties will be one to watch as new policies and developments are forged to respond to new challenges and new mandates from the traveling public.
I. The Disintegration of the U.S. Airline Industry

Paul Stephen Dempsey*

The airline industry is in an unprecedented crisis, one that was not entirely unforeseen, but one which was nonetheless, unfortunate and avoidable. As 1991 dawned, five major airlines, accounting for nearly one-fourth of the nation’s aviation passenger capacity, found themselves in some stage of liquidation, desperately selling off operating assets to raise enough cash to stay aloft. Five have also stumbled into bankruptcy, and one of those died. The U.S. fleet of aircraft is now the oldest in the developed world. The entire U.S. publicly-traded passenger airline industry could be purchased today for about $14 billion,1 less than the value of either Japan Air Lines or All Nippon Airways individually — despite the fact that the U.S. market is the largest in the world. These are the proud legacies of airline deregulation.

Before deregulation, many industry analysts warned that after a binge of destructive competition, only a handful of airlines would survive.2 These warnings were dismissed by deregulation proponents who saw nearly textbook levels of competition everywhere they looked.3 Alfred

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Kahn, the architect of airline deregulation, recently confessed, "We thought an airplane was nothing but a marginal cost with wings."  

Deregulation was supposed to produce lots of new airlines. Congress was told that barriers to entry and economies of scale were insignificant; new entrants would emerge to prevent the industry from becoming concentrated; even if new entrants didn’t materialize, the threat of new entry would discipline the market, for aviation markets were, in theory, "contestable."  

In deregulation’s inaugural years, new airlines appeared; but most couldn’t survive. Many, like People Express, were consumed in mergers and acquisitions or, like Air Florida and nearly 200 other airlines, fell into the abyss of bankruptcy. Although they sent ticket prices spiraling downward, new entrants never accounted for more than about 5% of the passenger market. New entry is highly unlikely today.

The magnitude of the crisis with which the airlines are now confronted is unparalleled in the history of commercial aviation. In January 1991, after a prolonged illness, Eastern Air Lines was laid to rest. The tragedy that was Eastern’s could be dismissed as an aberration were it not for the fact that four other major U.S. airlines — Continental, Pan Am, TWA and Midway — are liquidating major operating assets to stay aloft. Pan Am, Continental, Midway and America West have also stumbled into bankruptcy, Continental for the second time (some call it Chapter 22 bankruptcy). TWA has announced its intention to enter bankruptcy. More will likely follow. Take a closer look at the disintegrating airlines:

A year after closing its Kansas City hub, Eastern entered bankruptcy and sold its Washington-New York-Boston shuttle (to Donald Trump for $365 million) as well as the Latin American routes it picked up a few years earlier at Braniff’s fire sale (to American Airlines for $310 million). After running out of cash, it ceased operations in January, 1991. Delta and United were the highest bidders in the Eastern liquidation of gates, landing slots and routes.

Pan Am sold its trans-Atlantic routes to London and beyond to United for $400 million. Pan Am has also agreed to sell its Washington-New

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York-Boston shuttle and remaining transatlantic routes to Delta for $621 million cash and $668 million in assumed liabilities.\textsuperscript{9} The 1980s was a decade of dismemberment for anemic Pan Am, during which it sold off its trans-Pacific routes (again to United, for $750 million), its Intercontinental Hotel chain, and the Manhattan skyscraper which still bears its name. The 1990s look even worse for this once proud pioneer of international aviation, now in bankruptcy. Deregulation brought us Market Darwinism, a product of the Jeffrey Dahmer school of economics, pursuant to which the stronger airlines tear off the arms and legs of the weaker carriers and consumed them. With Pan Am, only the heart (its Latin American operations, which is where it began in the 1920s) remains. The larger airlines are saving that, to eat later.

TWA is selling off international routes, gates and landing slots at Chicago and Washington, D.C. American is spending $445 million for TWA’s Heathrow authority as well as other domestic airport and landing slot assets.\textsuperscript{10}

Midway sold the Philadelphia gates it picked up at Eastern’s fire sale, to USAir, at a $32 million loss, then entered bankruptcy.\textsuperscript{11} The airline lost $139 million in 1990, a tremendous loss for a carrier that size.\textsuperscript{12}

In bankruptcy for the second time in a decade, Continental sold its lucrative Seattle-Tokyo route to American Airlines, for $150 million.\textsuperscript{13} Continental lost more than $400 million in the first six months of 1991. Recently, it has explored buy-outs with Marvin Davis, H. Ross Perot, Jr., Northwest Airlines and USAir.

Other U.S. airlines are having serious problems. USAir lost nearly half a billion dollars in 1990.\textsuperscript{14} It has tightened its belt significantly by reducing flights, withdrawing from markets (including the California routes it acquired in its acquisition of PSA only five years ago), and furloughing thousands of workers.\textsuperscript{15}

Of course, a few gargantuan airlines will survive. The healthiest three, United, American and Delta, already control more than half the mar-
ket. All three are on a buying binge, gobbling up the dismembered parts of the disintegrating airlines.

The airline industry suffered recessions and sharply increased fuel costs before deregulation. Fuel prices shot up 300% in the 1970s, after the Arab oil embargo of 1973, and there was recession in the early 1970s as well. But never before have major airlines collapsed.

All the world's airlines are paying the sharply higher fuel prices inspired by the Persian Gulf crisis, and all are suffering from the early pangs of global recession. But only America's are in bankruptcy, only America's have died, and only America's are selling off operating assets — despite the fact that international aviation fuel costs more than domestic fuel. Why are America's airlines having such difficulty in today's marketplace?

II. DOT SECRETARY SKINNER'S OBSERVATIONS ON THE CONTEMPORARY CRISIS IN THE AIRLINE INDUSTRY

In early 1991, the Secretary of Transportation, Samuel Skinner, delivered a speech before the National Press Club and testified before two Congressional committees in which he addressed the contemporary crisis in the airline industry. Distilled to its essence, Secretary Skinner made the following points:

1. The contemporary shakeout will leave air passenger transportation dominated by "more than three and less than seven" airlines over the next few years and, as a consequence, "some of the lowest fares will disappear."  

2. The deregulation experiment is not the cause of the industry's problems. It is instead a profound success, and the deregulation debate is proclaimed over.

3. While deregulation is not the cause of the industry's problems, labor costs are.

4. Foreign ownership is the cure for the industry's ills.

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Only Skinner’s first conclusion is probably correct. The industry will achieve even higher levels of concentration than the unprecedented levels it has already reached. Before deregulation, the eight largest airlines controlled eighty percent of the domestic passenger market. They now control ninety-four percent. The five disintegrating airlines accounted for about twenty-five percent of the domestic market, which if Secretary Skinner is right, will likely be distributed among four to six surviving airlines. The three largest airlines (American, United and Delta) already account for more than half the domestic market.

A growing number of industry experts and concerned citizens dispute Secretary Skinner’s second point. Eastern Airlines trustee Marty Shugrue observed, “Deregulation is simply not working out as anticipated. There are far fewer airlines than when deregulation began. Of the remaining carriers, more than half are struggling and several may well go the way of Eastern.”

Aviation fuel costs soared 300% during the 1970s, and the industry was plagued by recession then as well; but not a single airline folded, entered bankruptcy, or liquidated operating assets. Then of course, the industry was regulated; today it is not.

Today, aviation fuel is cheaper than before Saddam Hussein invaded Kuwait. While fuel costs rose significantly during the crisis, they were nonetheless lower in actual and real terms than they were a decade ago. Between 1981 and 1984, the actual cost per gallon of aviation fuel ranged between $0.79 and $1.04 per gallon, while in real terms (adjusted for inflation) it ranged between $1.04 and $1.47. In 1990, aviation fuel sold for only $0.80 per gallon. Despite the fact that fuel is cheaper, today five airlines are liquidating operating assets.

The first decade of deregulation produced a blood bath of ruinous competition. The industry as a whole enjoyed a average profit margin on less than one percent during the 1980s (compared with an average of between three percent and six percent for manufacturers). Excessive losses produced nearly 200 bankruptcies and fifty mergers during deregulation’s first decade. The DOT never met a merger it didn’t like, approve-
ing all twenty-one submitted to it.\textsuperscript{25} Deregulation also freed corporate raiders like Carl Icahn and Frank Lorenzo to strip airlines of assets. Debt service is now crushing the operating profits of the disintegrating airlines. DOT could have stopped it, but chose not to intervene.

The economic anemia unleashed by deregulation forced airlines to defer new equipment purchases. Sadly, U.S. airlines today fly the oldest fleet of aircraft in the developed world. The geriatric jets burn more fuel.\textsuperscript{26} They are also less safe.

Deregulation created the fuel-guzzling hub-and-spoke phenomenon, which requires flying passengers more miles, with more takeoffs and landings, and creating more airway congestion than before. Flying older jets more miles necessarily consumes more fuel. So when fuel costs rise even modestly, as they did during the Persian Gulf crisis, the profit margin disappears.

Secretary Skinner is therefore wrong. Deregulation must shoulder at least part of the blame for the industry’s disintegration and unprecedented concentration. The same is true in the savings and loan industry, and the trucking and bus industries.

We will address Secretary Skinner’s other conclusions in greater detail below. First, let us examine the principal survival characteristics of airlines in these unfriendly skies.

III. SURVIVAL CHARACTERISTICS OF U.S. AIRLINES

After more than a decade of deregulation, several survival characteristics appear essential for survival of airlines. Listed below are nine:\textsuperscript{27}

1. MULTIPLE HUBS, STRATEGICALLY LOCATED
2. FREQUENT FLYER PROGRAMS
3. COMPUTER RESERVATIONS SYSTEMS
4. SOPHISTICATED YIELD MANAGEMENT
5. FUEL EFFICIENT FLEET OF STANDARDIZED AIRCRAFT
6. LOW DEBT (CONSERVATIVE GROWTH)
7. LOW WAGES/FLEXIBLE WORK RULES
8. SUPERIOR SERVICE
9. INTERNATIONAL ROUTES

These survival criteria are neither listed in order of importance, nor are they of equal value. But generally speaking, the more of them an

\textsuperscript{26} “[T]he decline in fuel prices [of 31% between 1985 and 1986] encouraged airlines to continue to operate fuel-inefficient aircraft beyond the point at which they would have been retired ....” Flint, Don’t Blame It All On Fuel, AIR TRANSPORT WORLD (Feb. 1991), at 32.
\textsuperscript{27} Not to take all the credit, several of these characteristics, or derivations of them, have been identified by other sources, including work done on the subject by Airline Economics, Inc.
airline possesses, the better its chances for survival. Let us examine each:

1. MULTIPLE HUBS, STRATEGICALLY LOCATED — Before deregulation, while Atlanta (for Delta) and Pittsburgh (for Allegheny, now USAir), were moderately concentrated, no airline dominated more than fifty percent of the market (measured by gates, passengers, or takeoffs and landings) at any major airport in the nation. Today, dominant airlines control more than sixty percent of the market (sometimes more than ninety percent) at about eighteen major airports; none were so dominated before deregulation. The infrastructure of gates and landing slots at the major airports has been consumed by the megacarriers, leaving little room for new entry.28 Charts I through III reveal the growth in concentration at several of the nation’s largest airports.

Chart I — Single Carrier Market Share at Concentrated Airports

<table>
<thead>
<tr>
<th>Airport</th>
<th>1977</th>
<th>1991</th>
</tr>
</thead>
<tbody>
<tr>
<td>Baltimore</td>
<td>24.5</td>
<td>69.2</td>
</tr>
<tr>
<td>Detroit</td>
<td>21.2</td>
<td>71.1</td>
</tr>
<tr>
<td>Houston</td>
<td>20.4</td>
<td>77.9</td>
</tr>
</tbody>
</table>

Strategically located hubs are designated to allow the carriers to blanket the nation with service. For example, United has hubs at Chicago, Denver, San Francisco, and Washington, D.C. (Dulles). American Airlines has expanded its traditional hubs at Chicago and Dallas/Ft. Worth, and established new ones at San Jose, Nashville, Raleigh/Durham, and

28. Intelligence, AVIATION DAILY, Aug. 20, 1990, at 323 (88% of the gates at the nation’s 66 largest airports are leased to airlines, and 85% of the leases are for exclusive use.)
San Juan. Delta has hubs at Atlanta, Dallas/Ft. Worth, Salt Lake City, and Cincinnati.

In contrast, TWA has a domestic hub only at St. Louis (and an international hub at New York-Kennedy). Pan Am dominates no domestic airport. America West is hubbed at Phoenix. Midway has a hub at Chicago's Midway Airport. Among the troubled airlines, only Continental has multiple strategically located hubs — at Houston, Denver, Cleveland and Newark (the latter it acquired from People Express on its death bed).

Moreover, consumption of airport infrastructure can translate into higher yields. Yields at concentrated airports are twenty-seven percent higher per mile for passengers who begin or end their trips there than at unconcentrated airports.\(^{29}\) Airlines with more gates, takeoff and landing slots (at capacity constrained airports), and/or code sharing agreements charge significantly higher prices than those without, according to the U.S. General Accounting Office [GAO].

For example, as of 1988, the eight largest airlines owned ninety-six percent of the landing and takeoff slots at the four slot-constrained airports (i.e., Chicago O'Hare, Washington National, and New York's Kennedy and LaGuardia). In 1985, before the Department of Transportation decreed they could be bought and sold in the market, the eight largest

\(^{29}\) GENERAL ACCOUNTING OFFICE, AIRLINE COMPETITION: HIGHER FARES AND REDUCED COMPETITION AT CONCENTRATED AIRPORTS (1990).
airlines controlled only seventy percent of the slots.\textsuperscript{30} Fares are seven percent higher, on average, at slot constrained airports.\textsuperscript{31} Moreover, an airline which doubles the number of its gates enjoys a 3.5% increase in fares.\textsuperscript{32}

2. FREQUENT FLYER PROGRAMS — The widespread service permitted by multiple hubs allows airlines to enjoy economies of density, and better market their product to the most lucrative customer, the business traveler. For example, United Airlines serves all fifty states, not because each is profitable, but because it can offer to fill all the geographic needs of business travelers.

Airlines offer to fill business persons' needs, while luring them with rewards of free travel to exotic destinations. In essence, airlines encourage business fraud. Suppose, for example, a distributor of copying paper offered to sell paper to a business executive at a price twenty-five percent higher than his competitors, but promised him two free first class airline tickets to Hawaii if he bought the paper all year long. Wouldn't the business executive be defrauding his company if he purchased the higher-priced paper? Yet that is precisely the type of inducement that


\textsuperscript{32} Id. at 6.
airlines offer business travelers addicted to their frequent flyer programs. Once addicted, many business travelers select, and bill their companies for, the higher-priced flight on the airline, satiating their desire for free travel. Indeed, seventy-five percent of travel agents report that their business customers chose to fly a particular airline more than half the time because of their membership in a frequent flyer program.\(^3^3\)

3. COMPUTER RESERVATIONS SYSTEMS — Eighty percent of flights are booked through travel agents, and ninety-five percent of agents use one of the airline-owned computer reservations systems.\(^3^4\) According to the GAO, an airline which owns its own computer reservations system stands between a thirteen-eighteen percent better chance of selling its product through its system than does a competitor.\(^3^5\) American Airlines pioneered them, with SABRE. United owns APOLLO. Continental owns SYSTEM ONE, which it took from Eastern for a good deal less than its fair market value. TWA, Northwest and Delta share the combination of PARS and DATAS II (now named WORLDSPAN).

Computer reservations systems have created a sophisticated and expedient means of exchanging pricing proposals, and have facilitated implicit price fixing.\(^3^6\) They also produce extraordinary profits for their owners, far beyond the rents which could be exacted in a fully competitive market.

4. SOPHISTICATED YIELD MANAGEMENT — Airlines have learned that by watching passenger demand carefully, they can shrewdly manipulate the number of seats for which restricted discounts are offered on an hourly basis, and fill seats with passengers paying the maximum price. That explains the phenomenon of thousands (40,000 to 80,000) of rate changes each day.\(^3^7\)

Consumer groups complain that by offering cut-rate fares for only a relatively small number of seats, airlines are engaging in "bait-and-switch" advertising.\(^3^8\) The bewildering array of fares has also increased transactions costs for consumers.

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34. GENERAL ACCOUNTING OFFICE, AIRLINE COMPETITION: HIGHER FARES AND REDUCED COMPETITION AT CONCENTRATED AIRPORTS 27 (1990). Airlines attempt to induce travel agents to book flights with them by offering commission overrides, which offer economic inducements for exceeding quotas. A poll of travel agents reveals that more than half of them “usually” or “sometimes” select a carrier in order to obtain override commissions. Id. at 29.
35. GENERAL ACCOUNTING OFFICE, AIRLINE COMPETITION: IMPACT OF COMPUTERIZED RESERVATION SYSTEMS (1986).
37. Uchitelle, Off Course, N.Y. TIMES MAGAZINE (Sept. 1, 1991), at 12, 16.
Yield management is actually a euphemism for pricing discrimination and market segmentation. Pricing discrimination can be divided in two categories, based upon the demand characteristics of the passenger and the supply characteristics of the market. On the demand side, passengers fall into three categories: (1) discretionary travelers; (2) large business travelers; and (3) small and medium business travelers. Airlines have learned that by offering discounts, they can tap the elasticities of demand and encourage individuals to fly who might not otherwise and, thereby, fill seats which otherwise would go empty. However, the airlines don't want to sell these discounted seats to passengers who otherwise would fly, particularly business travelers, who often need to fly on short notice and would prefer to be home with their families on weekends. Thus, the discounted fares are loaded with restrictions. They require advance purchase (up to three weeks before travel), are wholly or partially nonrefundable, and require that the passenger stay over a Saturday night. Business travelers are divided into two broad categories: those who work for large corporations; and those who work for small and medium size businesses. A Fortune 500 corporation (or indeed, any corporation which does more than half a million dollars in travel annually) can negotiate a contract rate with the airlines allowing its employees to travel at a rate nearly as low as the discretionary price, but without the onerous restrictions. However, small and medium size businesses and professionals do not have the oligopsony power to negotiate a fair price for service, and are forced to pay the full Y fare, or something close to it.

During the first decade of deregulation, the full unrestricted coach fare shot up 156%, a level double the inflation rate. While most passengers (in fact, some ninety percent) travel on some sort of a discount, the range of discounts are taken off a reference rate which is much higher than it was before deregulation. Thus, many passengers, particularly professionals and those who work for small and medium size businesses, pay a rate well above pre-deregulation levels. This should be of some public policy concern in light of the fact that small businesses create ninety percent of America's jobs. If a small firm cannot get its sales force out to market its product at a fair price, it cannot compete as effectively with large firms selling similar products.

Transportation is an infrastructure industry essential for commerce, communications and national defense. It is the veins and arteries through which commerce flows. Distortions here will result in distortions in the

broader market for the purchase and sale of products in the national distribution market.

The second plane along which airlines have segmented the market is geographic in nature. Trips of more than a thousand miles usually have multiple hub competition to drive down prices to competitive levels. But prices for passengers who begin or end their trips at a concentrated hub airport are some twenty-seven percent higher than in competitive markets. Also, passengers who live in small communities served by only a single airline pay higher prices for airline service.

Of course, widespread pricing discrimination is driven by the chronic propensity of airlines to engage in below-cost pricing when they compete head-to-head. They do so for two reasons. First, airlines sell what is, in effect, an instantly perishable commodity. Once a scheduled flight pulls away from the jetway, any empty seats are lost forever. They cannot be warehoused and sold another day. Second, the short term marginal costs of production are nil. Adding another bottom to fill an empty seat costs the airline only a bag of peanuts, a cup of Coca-Cola, and a few drops of fuel. These two characteristics tend to result in a pricing structure which, in competitive markets, fails to cover the full costs of production. Before regulation in 1938, this phenomenon was labeled “destructive competition.”

Today, it might be called the “death spiral,” the consequences of which meant bankruptcy for about 200 airlines. These economic characteristics encourage airlines to compete to the death in competitive markets, hoping to establish market dominance if they are lucky enough to survive, and to look to those markets in which they already enjoy dominance to cross-subsidize losses in competitive markets. This has, of course, produced an unprecedented number of mergers, consolidations, bankruptcies, and widespread pricing discrimination (a/k/a “yield management”).

5. FUEL EFFICIENT FLEET OF STANDARDIZED AIRCRAFT — The economic anemia created by the destructive competition unleashed by deregulation left airlines with inadequate resources to buy new planes, causing the U.S. fleet to degenerate into the oldest in the developed world. Thirty-one percent of the U.S. fleet now exceeds the economic design goals originally set by the manufacturers. Older generation aircraft gulp more fuel. TWA and Pan Am fly the oldest jets in our geriatric U.S. fleet.


Merged airlines have been forced to deal with the problems of consolidating huge fleets of aircraft of inconsistent types from several manufacturers, which increase the cost of maintenance and require multiple inventories of spare parts. As Chart IV reveals, deregulation led to an unprecedented number of mergers and acquisitions during its first decade.

As a consequence, Continental, which flies the fleets of former carriers like Texas International, New York Air, People Express and Frontier, experiences this problem. Northwest flies the fleets of North Central, Southern and Hughes Airwest, which merged to form Republic, which Northwest acquired. In contrast, airlines which grow from within (such as, for the most part, American and United) save maintenance cost and aircraft downtime by growing incrementally with relatively standardized fleets. United has placed orders for new aircraft which will expand its fleet by between forty percent and ninety percent, all with a single manufacturer, Boeing, "promoting commonality within the fleet which assures significant long-term operational efficiencies." Moreover, because of the oligopsony power wielded by the larger airlines, they buy aircraft at a unit price significantly lower than that paid by smaller airlines.

Incidentally, the largest airlines now control the order books at the major aircraft manufacturers. Both American and United are taking delivery of new jets every week (and will through the middle of this decade), while the collapsing airlines are not. As noted above, newer generation aircraft are relatively fuel efficient. This will matter more as the decade proceeds toward the statutory retirement of Stage 2 aircraft on December 31, 1999. As of May 1990, the airlines with the highest percentage of aging Stage 2 aircraft were: Eastern (seventy percent), Northwest (sixty-five percent), Pan Am (fifty-eight percent), USAir (fifty-five percent), TWA (fifty-five percent), Continental (fifty-two percent), and Midway (eighty-five percent). In contrast, only thirty-one percent of American’s fleet consists of Stage 2 aircraft.

As noted above, deregulation also produced the fuel guzzling hub-and-spoke phenomenon — the dominant megatrend on the deregulation landscape. Hubbing requires that airlines fly passengers more miles in smaller aircraft with more takeoffs and landings. Indeed, hubbing led many airlines to cancel orders for wide-body aircraft in the early 1980s, and either fly their existing jets or place orders for narrow-bodied planes. The average seat mile costs for a wide-bodied aircraft like a Boeing 747 are about half that of a narrow-bodied plane like a Boeing 737 or 727.

42. UAL CORPORATION, ANNUAL REPORT 7 (1990).
44. AMR CORPORATION, ANNUAL REPORT 27 (1990).
Chart IV — Major Air Carrier Mergers, Acquisitions, Purchases and Consolidations Since Progulgation of the Airlines Deregulation Act of 1978

<table>
<thead>
<tr>
<th>Air Carrier</th>
<th>Market Share</th>
</tr>
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<tbody>
<tr>
<td>American</td>
<td>13.8</td>
</tr>
<tr>
<td>Air Cal.</td>
<td></td>
</tr>
<tr>
<td>TWA (London routes)</td>
<td>16.9</td>
</tr>
<tr>
<td>Eastern (Latin American routes)</td>
<td>12.2</td>
</tr>
<tr>
<td>United</td>
<td></td>
</tr>
<tr>
<td>Pan Am (Transpacific, Latin American, &amp; London Routes)</td>
<td>10.3</td>
</tr>
<tr>
<td>Air Wisconsin</td>
<td></td>
</tr>
<tr>
<td>Delta</td>
<td></td>
</tr>
<tr>
<td>Western</td>
<td></td>
</tr>
<tr>
<td>Pan Am</td>
<td></td>
</tr>
<tr>
<td>(European routes and N.Y. shuttle)</td>
<td></td>
</tr>
<tr>
<td>North Central Republic</td>
<td>19.0</td>
</tr>
<tr>
<td>Southern</td>
<td></td>
</tr>
<tr>
<td>Hughes Airwest</td>
<td></td>
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<tr>
<td>Texas International</td>
<td></td>
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<tr>
<td>Continental</td>
<td></td>
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<tr>
<td>New York Air</td>
<td></td>
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<tr>
<td>Frontier</td>
<td></td>
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<tr>
<td>People Express</td>
<td></td>
</tr>
<tr>
<td>Britt</td>
<td></td>
</tr>
<tr>
<td>PSA</td>
<td></td>
</tr>
<tr>
<td>Braniff (Latin America)</td>
<td></td>
</tr>
<tr>
<td>Eastern</td>
<td></td>
</tr>
<tr>
<td>Rocky Mountain</td>
<td></td>
</tr>
<tr>
<td>USAIR</td>
<td>7.1</td>
</tr>
<tr>
<td>PSA</td>
<td></td>
</tr>
<tr>
<td>Empire</td>
<td></td>
</tr>
<tr>
<td>Piedmont</td>
<td></td>
</tr>
<tr>
<td>Honeon</td>
<td></td>
</tr>
<tr>
<td>Midway (Philadelphia gates and Canadian routes)</td>
<td>8.2</td>
</tr>
<tr>
<td>TWA</td>
<td></td>
</tr>
<tr>
<td>Ozark</td>
<td></td>
</tr>
<tr>
<td>Pan Am</td>
<td>6.3</td>
</tr>
<tr>
<td>National</td>
<td></td>
</tr>
<tr>
<td>Renamed Continental Airline Holdings</td>
<td></td>
</tr>
</tbody>
</table>

Sources:
Chart V reveals the pre-deregulation trend toward larger capacity (and lower seat mile cost) aircraft, compared with its reversal in the post-deregulation period.

Chart V — Average Seats Per Aircraft Fiscal Years 1969-1989

Funnelling passengers through constipated hub-and-choke bottlenecks not only squanders billions of dollars of business traveler time and productivity, it burns fuel wastefully. Smaller, older jets flying more miles with more takeoffs and landings necessarily cause their airlines to suffer increased costs during a period of ascending fuel prices.

6. LOW DEBT (CONSERVATIVE GROWTH) — The operating losses engendered by deregulation created enormous debt. Despite reduced wages, airline operating expenses increased ninety-four percent during deregulation’s first six years. During deregulation’s first decade, the industry suffered a seventy-four percent decline in its profit margin to a mere point six percent — until now, the worst financial period in the industry’s history. The industry became an economic basket case, prompting the rash of mergers in the mid-1980s, and bankruptcies, which continue to the present.

Deregulation also freed corporate raiders, like Frank Lorenzo (at Continental and Eastern) and Carl Icahn (at TWA), to loot airlines, leaving

them with suffocating debt. Frank Lorenzo is the only man in history to have bankrupted two airlines (one of them twice).

TWA owes $3.2 billion in long term debt, lease obligations and unfunded pension liability. Continental suffers from about $2.2 billion in debt. Eastern’s collapse could expose parent Continental to an additional billion dollars of liability for Eastern’s unfunded pension obligations and the transfer of assets into the Texas Air empire at less than fair market value. Interest payments recently exceeded 8% of operating expenses at both TWA and Eastern — the highest in the industry.

As a percentage of total capitalization, Pan Am’s debt soared from sixty-two percent in 1980 to 273% in 1989. Pan Am has $3 billion in long-term debt, lease obligations, and unfunded pension liability. Eastern’s debt climbed from seventy-nine percent of total capitalization in 1980 to 473% in 1988, its last year before bankruptcy. TWA’s debt soared from sixty-two percent in 1980 to 115% in 1989. Continental’s rose from sixty-two percent in 1980 to ninety-six percent in 1989. It is no wonder the anemic airlines are cannibalizing assets to stave off extinction. Chart VI reveals this distressing trend.

Representative Byron Dorgan aptly noted, “I’m not so alarmed if they load up a lipstick company with debt and it fails. But if you do that to an airline, it’s a real blow to the public interest.” Indeed it is. A collapsing infrastructure industry sends shock waves throughout the economy.

The Department of Transportation has long held jurisdiction to investigate the “fitness” of airlines plagued with debt. Here, like with respect to so many of its other statutory responsibilities, DOT has shown no enthusiasm for protecting the public interest.

The enormous debt assumed by Pan Am and Eastern (to shore up declining revenues) and Continental and TWA (to pay off exorbitant debt put on by corporate raiders) appears to be dragging these airlines down a black hole.

Unfortunately, low debt has subjected some airlines to leveraged

buy-outs. Low debt suggests there are a lot of assets owned which can be sold to re-pay the debt assumed during the acquisition. For example, Northwest had one of the lowest percentage of aircraft leased (four percent) in the industry prior to its leveraged buy-out. In order to thwart potential LBOs, some airlines have sold aircraft and leased them back, a strategy which reduces the inventory of aircraft which could finance an LBO, but nonetheless increases the long-term costs of doing business, whether the debt shows up on the books of the airline or not. In fact, during the last decade, rental fees (primarily aircraft lease expenses) grew 781%, more than any other operating expense.

Some claim that wealth transfers (from owners and labor) to consumers have totalled billions of dollars per year, and that this savings is overwhelming proof of the success of deregulation as a masterpiece of public policy. Even if it were true that consumers were savings billions (and for reasons expressed below, this is dubious), the cannibalization of assets, the deferment in equipment investment, and the crushing debt is in the long run resulting in an anemic and highly concentrated industry incapable of preserving the competition of which deregulation proponents have been so proud. Moreover, no less an economic scholar than W. Edwards Deming, the single individual most responsible for post-War Japanese

56. AVIATION DAILY, Nov. 6, 1986.
prosperity, has observed, "The policy of forever trying to drive down the price of anything purchased with no regard to quality and service, can drive good vendors and good service out of business."58 Hence, raping an essential infrastructure industry in order to provide alleged short-term consumer benefits is inimical to longer term public policy and national economic interests.

7. LOW WAGES/FLEXIBLE WORK RULES — Some airlines have broken unions and thereby reduced costs. Continental and TWA are prime examples. Although Continental has lower labor costs than any other major airline, not even that has kept it out of bankruptcy. Labor acrimony, perhaps enhanced by the tactics of its former chairman, Frank Lorenzo, cost it dearly in the 1980s.

The airline industry is a service industry. Happy employees can give passengers a lovely trip, and lure them back for another, and another. Angry, embittered employees can do the opposite. For example, the tremendous acrimony between TWA's workers and owner Carl Icahn, has resulted in that airline repeatedly being ranked among the worst among the major airlines in terms of consumer complaints.59

Other airlines have convinced unions to settle for two-tier wage rates, with the "B" scale at entry grade. American, United, and Delta are examples. More than half of the present pilots and flight attendants at American, for example, are on the "B" scale. Some of the flight attendants at the two-tier airlines, earning between $950 and $1,220 a month,60 qualify for food stamps.

In most service industries, salaries account for a disproportionate share of operating costs. But low wages do not guarantee survival. People Express collapsed despite its rock bottom wages. Continental, America West and Midway, also with relatively low wages, are struggling in the contemporary environment.61

As a percentage of operating expenses, Delta has among the highest labor costs of any major airline, and Continental the lowest.62 Yet Delta has thrived under deregulation, and most analysts predict it to be one of the few surviving airlines. There seems to be a rather poor correlation between low wages and survival, despite Secretary Skinner's allegations to the contrary. In fact, as a percentage of operating expenses, employee

61. Continental has the lowest labor costs, as a percentage of operating expenses, of any major U.S. airline. AVIATION DAILY, Feb. 11, 1991, at 276.
salaries and benefits declined significantly during the 1980s.63

8. SUPERIOR SERVICE — Airline service has degenerated universally under deregulation, so consumers have been taught not to expect much. Consumer polls reveal they rate foreign airlines higher than our domestic ones (one showed the highest-ranking U.S. airline as an embarrassing 17th among the world’s major airlines).64 It is no wonder. When USAir consumed Piedmont, its loyal customers were most concerned with whether USAir would continue Piedmont’s practice of giving passengers the full can of Coke, rather than just a cup. That one example reflects how far consumer expectations have fallen.

To pose an analogy, before deregulation, we enjoyed chicken fried steak. Now we are relegated to a diet of ground horse meat. Consumers save billions of dollars eating horse meat, but it just doesn’t taste the same.

The point is, today, it doesn’t take a lot of service to stand out as being better. Consumers can be, and too often are, turned off by late arrivals and departures, dirty planes, inedible food, and embittered employees. The three largest airlines — Delta, United and American — typically are rated higher than other domestic airlines in terms of service.

9. INTERNATIONAL ROUTES — The global air transport market is growing, and many international markets are quite lucrative. Although traffic is temporarily down on the North Atlantic, airlines which serve the North Pacific market enjoy the most attractive yields. Both Northwest and United earn a disproportionate share of their total income from international markets. Between 1987 and 1989, Northwest earned between sixty-eight percent and ninety-one percent of its total operating profit from international markets, while United earned between twenty-four percent and thirty-four percent.65 Many industry analysts predict international markets will grow faster than domestic markets during this decade.

IV. CONCENTRATION IN THE TRANSPORTATION INDUSTRY

Collapsing airlines means more concentration. Already, the eight largest airlines account for more than ninety percent of the domestic market (up from eighty percent prior to deregulation). Sadly, additional concentration will send ticket prices soaring into the ionosphere.

The Brookings Institution alleges that consumers save $6 billion a

63. In 1980, labor costs accounted for 37.3% of operating expenses; a decade later, they accounted for only 33.8%. Salaries Have Doubled Since 1980; Other Expenses Grew Faster, AVIATION DAILY, July 29, 1991, at 173.

64. CONDE NAST TRAVELER, Nov. 1988, at 26.

year because of airline deregulation. Not so. Fuel adjusted real air fares fell at a significantly faster rate during the decade before deregulation than in the decade after it. Except for a brief spate of sharply lower fares in the 1977-79 period, post-deregulation fuel and inflation adjusted fares fell at a thirty percent slower rate per mile than in the pre-deregulation period.66

The Brookings studies wholly ignore the pre-deregulation trend of falling ticket prices (which for four decades, was driven by technological improvements) and attribute all price savings since promulgation of the Airline Deregulation Act of 1978 to its favorite ideology, deregulation. Brookings also ignores the post-deregulation increased unit costs of operation created by the smaller aircraft mandated by hubbing, the increased labor and fuel costs attributable to circuitous hub connections, the billions of dollars of opportunity costs wasted by business travelers resulting therefrom, as well as the decline the pre-deregulation trend in productivity improvements attainable by new technology (which the U.S. industry has largely been unable to acquire because of inadequate profits and crushing debt). Yet the Brookings studies have been relied on heavily by the U.S. Department of Transportation and other deregulation proponents as proving the splendid success of this masterpiece of public policy.

Paradoxically, while deregulation was supposed to produce more competition, lower prices and better service, it has instead produced more concentration, higher prices and miserable service. Every major prediction made by the textbook economists has proven wrong.

The airline story could itself be considered a curious aberration if the concentration epidemic was not also plaguing every other mode of transport. But under deregulation, the number of major railroads dwindled from twelve to seven, with no significant new entry. Two thirds of the general freight trucking companies collapsed, with no significant new entry. And with the merger of Greyhound and Trailways, the bus duopoly became a monopoly, and is now in bankruptcy; here too, there has been no significant new entry.67

V. CABOTAGE, FOREIGN OWNERSHIP AND INTERNATIONAL AVIATION

A. CABOTAGE

The legal concept of cabotage has its origin in maritime law. It is thought to have originated from either the French word "cabot," meaning a small vessel, or the Spanish word "cabo," or "cape," which described

navigation from cape to cape along the coast without entering the high seas.\textsuperscript{68}

In aviation law, cabotage is essentially defined as the transportation of passengers, cargo or mail by a foreign airline between two points in the same nation — the foreign carriage of domestic traffic. It was first articulated in aviation law in 1910, as the French objected to German balloons flying entering French air space.\textsuperscript{69} The Paris Convention of 1919 recognized cabotage formally, providing in Article 16 that nations could favor its airlines "in connection with the carriage of persons and goods for hire between two points in its territory."

Article 7 of the Chicago Convention of 1944 addressed the issue in two sentences.\textsuperscript{70} The first provides: "Each contracting State shall have the right to refuse permission to the aircraft of other contracting States to take on in its territory passengers, mail and cargo carried for remuneration or hire and destined for another point within its territory." Thus, each nation has exclusive sovereignty over its airspace, and may reserve its domestic traffic to its domestic carriers.

The second sentence of Article 7 provides: "Each contracting State undertakes not to enter into any arrangements which specifically grant any such privilege on an exclusive basis to any other State or an airline of any other State, and not to obtain any such exclusive privilege from any other State." The literal language strongly suggests that if a nation gives away cabotage rights to another state's airline(s), it must give them to all nations on a nondiscriminatory basis.

In the United States, cabotage prohibitions originated in the Air Commerce Act of 1926.\textsuperscript{71} Cabotage is generally prohibited under section 1108(b) of the Federal Aviation Act. Under section 401 of the Act, only air carriers (defined as U.S. citizens) may ply the domestic trade.\textsuperscript{72} Noncitizens may operate as "foreign air carriers" under section 402, but they must acquire a section 402 permit and their transport rights are limited to foreign air transportation.\textsuperscript{73}

In 1991, negotiations between Canada and the United States on a new bilateral air transport agreement included discussions of a partial ex-

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{68} Schraft & Rosen, \textit{Cabotage Or Sabotage?}, AIRLINE PILOT (Oct. 1987), at 27 [hereinafter Schraft & Rosen].
\item \textsuperscript{69} International Air Transportation Competition Act of 1979: Hearings on S. 2400 Before the Subcomm on Aviation of the Sen. Comm. on Commerce, Science and Transportation, 96th Cong. 1st Sess. 244-45 (1980) (Statement of ABA Section in Intl. Law).
\item \textsuperscript{71} 67 Stat. 489.
\end{itemize}
\end{footnotesize}
change of cabotage rights. In defining negotiating objectives, Congress in 1979 amended the Federal Aviation Act to include a provision requiring "opportunities for carriers of foreign countries to increase their access to United States points if exchanged for benefits of similar magnitude of United States carriers or the traveling public with permanent linkage between rights granted and rights given away." Canada has a larger land mass than the United States, and therefore potentially offers more destinations than would most other nations. But the United States has twenty-four city-pairs that generate more than one million passengers annually, while Canada has but one. The domestic passenger and cargo market in the United States is so many times larger and richer than any other domestic market (even that of a combined European Community) that an exchange of equal rights of "similar magnitude" would be a practical impossibility. As Duane Woerth, vice president of the Air Line Pilots Association, noted, "It's like exchanging gold for tin. Only a zealot who believed in trade for trade's sake could support such an imbalance as fair or astute." Exchanging cabotage rights would require a statutory change, and therefore could not be negotiated without Congressional approval. Moreover, as noted above, Article 7 of the Chicago Convention insists that giving cabotage rights to one nation requires that it be given to all under a kind of most favored nation basis.

However, an exemption from the cabotage restrictions is available under certain emergency conditions. In 1979, Congress promulgated the International Air Transportation Competition Act, which amended the Federal Aviation Act to allow the U.S. Department of Transportation to confer a thirty-day exemption from the cabotage prohibition if it finds the "public interest" so requires, and "... because of an emergency created by unusual circumstances not arising in the normal course of business, traffic in such markets cannot be accommodated by ..." U.S.-flag carriers, all efforts have been made to accommodate such traffic needs using U.S. airlines (including their lease of foreign aircraft), and the exemption is necessary to avoid undue hardship for the traffic in the market. Where the traffic inconvenience results from a labor dispute, such exemption must not result in an undue advantage to any party thereto.

The Department of Transportation (DOT) has found that these requirements were satisfied in several emergency situations. For example, DOT granted an emergency cabotage exemption to allow Heavylift (a

75. Letter from Captain Duane E. Woerth to Paul Stephen Dempsey (July 24, 1991).
76. 49 U.S.C. sec. 1386(b)(7) (1991). DOT may renew the exemption for periods of up to 30 days. However, the exemption terminates not more than five days after the unusual circumstances that created its need end. Id.
U.K.-flag carrier) to provide one-way cargo charter flights between Houston, Texas, and St. Thomas, U.S. Virgin Islands, to support recovery operations in the Virgin Islands in the aftermath of Hurricane Hugo.\footnote{77} In order to support oil spill clean-up operations at Valdez, Alaska, the DOT granted North West Territorial Airways Ltd. (a Canadian-flag carrier) an emergency cabotage exemption to provide one-way cargo charter operations between Los Angeles and Anchorage.\footnote{78}

The DOT has granted such exemptions by telephone. For example, on April 28, 1987, Qantas Airways (an Australian-flag carrier) requested an emergency cabotage exemption by telephone to transport a single passenger from Honolulu to San Francisco. The passenger was the father of an injured boy being transported from Hadi, Fiji, to the United States on a scheduled Qantas Australia-Nadi-Honolulu-San Francisco flight. DOT concluded that the waiver was clearly required on humanitarian grounds, constituted unusual circumstances, and could not have been accommodated by U.S. carriers since the son was already aboard a Qantas flight and his physical transfer to a U.S. carrier was not practical.\footnote{79}

But, when U.S. airlines have been available to provide the service, the DOT has declined to grant the exemption. For example, the DOT denied the application of Lineas Aereas Del Caribe (a Columbian-flag carrier) to transport cattle from Miami to San Juan, Puerto Rico, when it was advised that two U.S. carriers were available to provide the proposed service.\footnote{80}

Cabotage restrictions may be avoided in various ways, including “sharing codes, making ‘blocked space’ arrangements for both passengers and cargo, obtaining an ownership interest in a U.S. carrier, making arrangements between U.S. and foreign carriers covering computer reservations systems, and setting up joint frequent flier and marketing programs.”\footnote{81}

“Blocked space” arrangements involve the leasing or reservation of a specific number of seats by one passenger airline for its passengers to be flown in aircraft operated by another airline. For example, Northwest might enter into a blocked space agreement with KLM whereby Northwest would sell up to a specified number of seats on the KLM Minneapolis-Amsterdam flight to Northwest’s customers. “Code share” arrangements involve the listing in the computer reservation systems of the connecting flights of two airlines as a single through flight number.
For example, Continental might show a through Continental flight number from Houston to Stockholm via Newark, although the passengers would fly via Continental from Houston to Newark, and via SAS from Newark to Stockholm.

In considering whether blocked space or code sharing arrangements are in the public interest, the DOT considers such issues as the extent to which the authority involved is consistent with applicable bilateral air transport agreements, whether reciprocity exists on the part of the nation whose flag the foreign carrier flies, and what benefits would accrue to U.S. carriers, passengers and shippers under the proposed arrangements.\(^8\)

### B. FOREIGN OWNERSHIP

Almost all bilateral air transport agreements require that carriers designated thereunder be owned and controlled by citizens of the nation from which they originate. Hence, there is no concept of “flags of convenience” in aviation as there is in maritime law.

Foreign ownership restrictions have long been imposed in a number of infrastructure industries in the United States, including telecommunication, broadcasting,\(^8\) electric power production,\(^8\) nuclear power productions,\(^8\) inland and intercoastal shipping,\(^8\) mining on federal lands,\(^8\) and

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83. Foreign owned or controlled corporations are prohibited from receiving licenses to operate as instruments for the transmission of communications. A corporation is defined as foreign-owned if any director or officer is an alien, or if more than one-fifth of its capital stock is owned by aliens, a foreign government, or a corporation organized under the laws of a foreign country. Additionally, a corporation is generally considered as foreign-controlled if it is directly or indirectly controlled by any other corporation, at least one-fourth of whose capital stock is owned by foreign interests. 47 U.S.C. sec. 310(b). (1991)
84. Hydroelectric power sites on navigable streams located within the United States may be developed only by U.S. citizens or domestically organized corporations. 16 U.S.C. sec. 797(e) (1991).
85. No licenses for the operation of atomic energy utilization or production facilities may be issued to aliens or to foreign-owned or foreign-controlled corporations. 42 U.S.C. sec. 2133 (1991).
86. The Jones Act of 1920 requires that any shipping of passengers or property between points in the United States or its territories must be accomplished in vessels constructed and registered in the United States and owned by U.S. citizens. A ship may not be registered in the United States unless the corporation’s principal officers are U.S. citizens and 75% of the stock is owned by U.S. citizens. Any vessel that is at any time registered in a foreign country permanently loses these United States shipping rights. Moreover, any eligible vessel weighing more than 500 gross tons that is later rebuilt outside the United States also forfeits these privileges. However, vessels registered in foreign nations granting reciprocal privileges to U.S.-flag vessels may perform intercoastal transportation of empty items, such as cargo vans, barges, shipping tanks, and equipment utilized therewith. 46 U.S.C sec 893 (1991).
aviation. These requirements reflect the importance these infrastructure industries have in supporting national defense.

Essentially, eligibility to register an airline in the United States is limited to: (a) United States citizens; (b) partnerships in which all partners are United States citizens; or (c) U.S. corporations in which at least two-thirds of the board of directors are U.S. citizens and at least seventy-five percent of the voting stock is owned by U.S. citizens. Moreover, the right to enter into cabotage (trade or transport between two points within the United States) is limited to domestically registered aircraft.\(^8\)

Section 408(a)(4) of the Federal Aviation Act makes it unlawful "for any foreign air carrier or person controlling a foreign air carrier to acquire control in any manner whatsoever of any citizen of the United States substantially engaged in the business of aeronautics."\(^9\) Historically, a presumption of control existed where ownership exceeded 10% of the airline.\(^9\) Securities and Exchange Commission reporting requirements are triggered by the acquisition of five percent. In reality, ownership of substantially lesser percentages of widely held corporations can result in effective "control" (although, as we shall see, the current view of the DOT is that foreign control of U.S. airlines almost never exists). Moreover, it is unlikely that a foreign investor would be interested in investing substantial capital in an airline he could not effectively control.\(^9\) But in the unlikely event a foreign citizen should be deemed by DOT to have "control" of a U.S. airline, it would no longer be deemed a U.S.-flag carrier, and hence prohibited under the cabotage restrictions (described above) from plying the domestic trade.

Another statutory provision provides that in order to qualify as a U.S. citizen (i.e., a U.S.-flag carrier), the airline must have as its "... president and two-thirds or more of the board of directors and other managing officers thereof ... [U.S. citizens and] at least seventy-five per centum of the voting interest is owned or controlled by persons who are citizens of the United States ... ."\(^9\)

These are, then, separate requirements — that no foreign citizen or airline "control" a U.S.-flag carrier, and that no foreign citizens serve as president, hold more than two-thirds of the seats on the board of directors, or more than twenty-five percent of the voting stock of a U.S. airline.

DOT has also employed its fitness requirements under section 401(r)

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of the Act to monitor foreign control issues.\textsuperscript{93}

As to control generally, DOT said this:

[F]oreign influence may be concentrated or diffuse. It need not be identified
with any particular nationality. It need not be shown to have sinister intent. It
need not be continually exercisable on a day-to-day basis. If persons other
than U.S. citizens, individually or collectively, can significantly influence the
affairs of [the U.S. carrier], it is not a U.S. citizen.\textsuperscript{94}

The most important case addressing the issue of foreign control of a
U.S. airline involved KLM's acquisition of a significant interest in the holding
company of Northwest Airlines. In a transaction which increased
Northwest's debt-to-equity ratio from $0.42/1 to $5.85/1, in August 1989,
Wings Holdings, Inc., acquired control of Northwest with eighty-one and
five tenths percent debt and eighteen and five tenths percent equity.

Wings' debt was $3.1 billion, almost two-thirds of which was put up
by Japanese banks. Equity was $705 million, of which Alfred Checchi,
Gary Wilson and Frederic Malek put up only $40 million (for which they
received about half the voting and nonvoting common stock), KLM (a
Netherlands airline) put up $400 million (or fifty-seven percent of the equ­
ity, for which KLM received seventy percent of Wings' nonvoting preferred
stock, thirty-one percent of its nonvoting common stock, and four
and nine tenths percent of its voting common stock, as well as a warrant
allowing it to convert up to $50 million of its preferred stock into common
stock, some of which could be voting), and Elders IXL (an Australian com­
pany) put up $80 million (or eleven and three tenths percent of the equity,
for which it received ten percent of Wings' nonvoting preferred stock, six­
ten percent of its nonvoting common stock, and fifteen and four tenths
percent of its voting stock).\textsuperscript{95}

Both KLM and Elders had the right to name one representative to the
defense of the Act, \textsuperscript{93}
dollar to buy the Wingers Board of Directors. KLM had the right to name a
three-person committee to advise Wings on financial matters, and to enter
into a variety of cooperative agreements with Northwest and preclude
such agreements with other airlines.\textsuperscript{96}

In its first order, issued September 29, 1989, the DOT concluded that
unless KLM reduced its equity interest to twenty-five percent, KLM could
be in a position to exert actual control over Wings.\textsuperscript{97} DOT expressed con­
cern about the size of KLM’s equity interest, both in absolute and proportional terms, its ability to exert influence on Wings, and the fact that it was an actual competitor with Northwest in a number of markets.

DOT acknowledged that determining whether foreign “control” exists is a complex matter:

Analysis in this area has always necessarily been on a case-by-case basis, as there are myriad potential avenues of control. The control standard is a \textit{de facto} one — we seek to discover whether a foreign interest may be in a position to exercise actual control over the airline, \textit{i.e.}, whether it will have a substantial ability to influence the carrier’s activities.\textsuperscript{98}

DOT observed that “it is clear from our precedent that a large share in a carrier’s equity poses citizenship problems, even where the interest does not take the form of voting stock, particularly if there are other ties to the foreign entity.”\textsuperscript{99} DOT noted that the incentive for the foreign airline to exert control was much enhanced where it is also an actual or potential competitor. The interest of Elders in Wings appeared to be no more than a pecuniary interest, not rising to the level of concern about control.\textsuperscript{100} However, KLM’s large equity interest, its right to sit on Wings’ Board and name a financial committee, and the working arrangements between the two airlines caused the DOT to conclude that KLM could be in a position to exert control over Northwest, thereby jeopardizing its status as a U.S. citizen. DOT and Northwest entered into a consent order whereby KLM’s equity interest in Wings would be reduced to twenty-five percent, its power to establish a financial advisory committee would be revoked, and Northwest would fulfill certain reporting requirements.\textsuperscript{101}

The disintegration of the economic position of a number of U.S. airlines in late 1990, precipitated by the War with Iraq, escalating fuel prices, fear of terrorism by the traveling public, and a global recession which diminished passenger demand, led the DOT to reverse its position on foreign ownership. The DOT was now willing to take another look at Wings and Northwest. It concluded that Messrs. Checchi, Wilson and Malek were firmly in control of Wings, holding two-thirds of its voting stock and having the power to appoint most of its directors.\textsuperscript{102} The DOT announced that it was adopting a new policy:

\begin{quote}
[W]e have reexamined our application of the control test in order to reflect more accurately today’s complex, global corporate and financial environment, consistent with the requirement for U.S. citizen control. Specifically, we have reviewed the relationship between voting equity, on the one hand,
\end{quote}

\textsuperscript{98} Id. at 4-5.
\textsuperscript{99} Id. at 6.
\textsuperscript{100} Id. at 5.
\textsuperscript{101} Id. at 8.
\textsuperscript{102} DOT Order 91-1-41 (1991), at 8.
and nonvoting equity and debt, on the other.\(^{103}\)

The DOT concluded that foreign equity ownership of up to forty-nine percent would be allowed, although foreign voting equity would be limited, as the statute required, to twenty-five percent. Foreign debt would not be treated as a control issue.\(^{104}\) The DOT also indicated that it would not ordinarily allow a foreigner to serve as Chairman of the Board.\(^{105}\) It had earlier approved the placement of three representatives of SAS on the Continental Airline Holdings’ board.\(^ {106}\) KLM could have three seats on the fifteen member Wings’ board.\(^ {107}\) DOT warned, “the naming of a disproportionate number of foreign director representatives to important committees, such as the executive committee, nominating committee, or finance committee, may be taken as an indication of control and would be cause for us to review the citizenship of the affected air carrier.”\(^ {108}\)

The truth is, with ownership, code sharing and marketing alliances, a foreign airline can effectively control a U.S. carrier, reducing competition in the international market while creating domestic U.S. feed for its international operations. Foreign ownership is the back door to cabotage. With ownership, foreign airlines do not need cabotage rights.

VI. THE PUBLIC POLICY IMPLICATIONS OF FOREIGN CONTROL OF THE U.S. AIRLINE INDUSTRY

Now that deregulation has failed to produce the near perfect model of textbook competition the laisser faire economists predicted, the deregulationists are proposing to sell our domestic industry off to foreign airlines. Already Northwest, Delta, Continental, America West and Hawaiian Airlines have significant foreign equity. DOT has suggested that, insofar as foreign ownership is concerned, the sky is the limit.

In 1989, Secretary of Transportation Samuel Skinner expressed legitimate concern over the Checchi group acquisition of Northwest Airlines, not only because the LBO would increase Northwest’s debt fourfold, but also because the $400 million equity participation by KLM Royal Dutch Airlines would give it about fifty-seven percent of total equity.\(^{109}\) Secretary Skinner appeared to interpret section 101(16) of the

103. Id. at 9.
104. Id.
105. Id. at 11.
108. Id.
Federal Aviation Act to limit foreign equity to twenty-five percent. As Skinner said,

While KLM’s voting share technically fell within the statute’s numerical limits [which requires that the airline’s President and two-thirds of its Board and other managing officers be U.S. citizens, and that not less than 75% of voting interest be owned and controlled by U.S. citizens], we concluded that KLM’s ownership of 57 percent of NWA Inc.’s total equity, together with the existence of other links between the carriers and KLM’s position as a competitor, could create the potential for the exercise of influence and control over the carrier’s decisions. This would be inconsistent with the law.110

Remarkably, that which Secretary Skinner then declared would be, in his words, “inconsistent with the law”, he now proclaims to be well within the law.

The statute has not been amended since Secretary Skinner found that KLM’s gargantuan ownership was inconsistent with the law. The U.S. Department of Transportation continues to hold jurisdiction under section 401 of the Federal Aviation Act to scrutinize the fitness of airlines (which includes safety and compliance fitness), and under section 101(16) to review foreign ownership. Under present law, foreign ownership is limited to twenty-five percent of the voting stock of U.S. airlines, and no foreign airline can ply the domestic trade.

In a radical departure from precedent and a tortuous interpretation of law, DOT announced recently that it will allow foreign equity ownership of up to fifty percent.111 DOT has even proposed to put the exchange of cabotage rights (the opportunity for foreign airlines to serve domestic routes) on the table in negotiations with the government of Canada, despite the legislative prohibition. Actually, foreign airlines don’t need cabotage rights if they can buy access to the U.S. market.

Foreign alliances with U.S. airlines began in the 1980s with shared frequent flyer programs, then entered computer reservations systems, and now have turned to outright equity ownership. Chart VII reveals the alliances of the two dominant European computer reservations systems.

International airline alliances have been stimulated by the prospect for liberalizing European transport in 1992.112 Having witnessed the in-

110. Statement of Skinner, supra at 4-5. In September 1 989, Skinner jawboned Checchi and Northwest into agreeing, inter alia, to limit KLM’s voting stock to 25%, and to limit KLM’s representation on Northwest’s Board of Directors to “matters relevant to KLM’s pecuniary interest, recusing himself or herself when the board is dealing with certain matters, such as bilateral negotiations and competitive issues.” Id. at 6.
112. Dempsey, Aerial Dogfights Over Europe: The Liberalization of EEC Air Transport, 53 J.
tense shakeout deregulation produced in America, foreign management believes that the liberalization of competition rules will result in extreme concentration. The conventional wisdom is that, when the dust settles from U.S. deregulation and international aviation liberalization, only a handful of global megacarriers will dominate air transport. Several industry experts predict that the world’s air transport system will eventually be dominated by just eight to ten global megacarriers.

Wanting to be among the survivors motivated the contemporary surge in international combinations and alliances. Moreover, with Europe’s aviation infrastructure even more saturated than America’s, opportunities for growth are largely limited to acquiring or affiliating with existing airlines.

Foreign airlines are deeply interested in penetrating the U.S. passenger market — a market larger than that of the rest of the world combined. In the last few years, KLM bought a huge piece of Northwest, SAS purchased a chunk of Continental, Singapore Airlines and Swissair each acquired a slice of Delta, and British Airways (which gobbled up British Caledonian) sought a share of United Airlines. Chart VIII depicts the substantial foreign airline interests in U.S. flag carriers:

<table>
<thead>
<tr>
<th>Foreign Airline</th>
<th>Percentage Ownership</th>
<th>U.S. Airline</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAS</td>
<td>18.4%</td>
<td>Continental</td>
</tr>
<tr>
<td>Swissair</td>
<td>5%</td>
<td>Delta</td>
</tr>
<tr>
<td>Singapore Airlines</td>
<td>5%</td>
<td>Delta</td>
</tr>
<tr>
<td>Ansett Airlines</td>
<td>17%</td>
<td>America West</td>
</tr>
<tr>
<td>Japan Air Lines</td>
<td>20%</td>
<td>Hawaiian Airlines</td>
</tr>
<tr>
<td>KLM</td>
<td>49%</td>
<td>Northwest</td>
</tr>
<tr>
<td>British Air</td>
<td>15%*</td>
<td>United</td>
</tr>
</tbody>
</table>

The equity interests by Scandinavian Airline System [SAS] in

Continental Airline Holdings was inspired by the American carriers’ need for a substantial infusion of new capital. From SAS’s perspective, the Texas Air alliance gave it new feed into its transatlantic routes; SAS moved its international hub from New York Kennedy Airport to Newark, where Texas Air’s Continental and Eastern could provide domestic feed.\(^\text{113}\) (However, SAS may have over-extended itself, and is now retrenching). Swissair’s and Singapore Airlines’ interest in Delta appears to have been inspired by different reasons — the desire of Delta to have a friendly partners poised to fend off LBOs.

But most are motivated by foreign airlines’ interests in creating operating and market alliances. Thus, they invest “dumb equity”, accepting sub-optimal returns because they anticipate synergistic revenue on the passenger feed U.S. airlines promise them, and the diminution of competition thereby created.

Not only are foreign airlines affiliating with U.S. carriers. Other international aviation alliances are emerging, including British Airway’s acquisition of British Caledonian, and Air France’s purchase of UTA. Chart IX reveals the major ownership interests of foreign airlines.

<table>
<thead>
<tr>
<th>Purchaser</th>
<th>Percentage Ownership</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Air France</td>
<td>1.5%</td>
<td>Austrian Airlines</td>
</tr>
<tr>
<td>Air France</td>
<td>71%</td>
<td>UTA</td>
</tr>
<tr>
<td>Air France</td>
<td>37%</td>
<td>Air Inter</td>
</tr>
<tr>
<td>Air France</td>
<td>2%</td>
<td>Austrian Airlines</td>
</tr>
<tr>
<td>American</td>
<td>8%</td>
<td>Air New Zealand</td>
</tr>
<tr>
<td>ANA</td>
<td>10%</td>
<td>Austrian Airlines</td>
</tr>
<tr>
<td>Cathay Pacific</td>
<td>35%</td>
<td>Dragonair</td>
</tr>
<tr>
<td>Delta</td>
<td>3%</td>
<td>Singapore Airlines</td>
</tr>
<tr>
<td>Delta</td>
<td>5%</td>
<td>Swissair</td>
</tr>
<tr>
<td>Iberia</td>
<td>85%</td>
<td>Aerolíneas Argentinas</td>
</tr>
<tr>
<td>Japan Air Lines</td>
<td>8%</td>
<td>Air New Zealand</td>
</tr>
<tr>
<td>KLM</td>
<td>15%</td>
<td>Air UK</td>
</tr>
<tr>
<td>Qantas</td>
<td>20%</td>
<td>Air New Zealand</td>
</tr>
<tr>
<td>SAS</td>
<td>5%</td>
<td>Swissair</td>
</tr>
<tr>
<td>SAS</td>
<td>35%</td>
<td>Lan Chile</td>
</tr>
<tr>
<td>SAS</td>
<td>25%</td>
<td>Airlines of Britain</td>
</tr>
<tr>
<td>SAS</td>
<td>16%</td>
<td>CTA</td>
</tr>
<tr>
<td>Singapore</td>
<td>3%</td>
<td>Swissair</td>
</tr>
<tr>
<td>Swissair</td>
<td>10%</td>
<td>Austrian Airlines</td>
</tr>
<tr>
<td>Swissair</td>
<td>5%</td>
<td>SAS</td>
</tr>
</tbody>
</table>

\(^{113}\) Repeating Mistakes, JOURNAL OF COMMERCE, Aug. 30, 1989, at 8A.

\(^{114}\) Testimony of Helane Becker (vice president, Lehman Brothers) Before the Subcomm. on Aviation of the House Comm. on Public Works and Transportation (Feb. 6, 1991), at 5. Going
Here's a college board exam question: if Delta owns five percent of Swissair, and Swissair owns five percent of SAS, and SAS owns eighteen and four tenths percent of Continental, how much of Continental does Delta control?

Foreign ownership raises serious anti-competitive concerns. Many international markets are already among the highest priced, fastest growing, most lucrative and least competitive. As noted above, United and Northwest both earn a disproportionate share of their profits from the trans-Pacific market. How vigorous a competitor would they be if Japan Air Lines (or for that matter, Korean Air Lines, or Cathay Pacific) owned a significant chunk of either?

KLM now owns forty-nine percent of Northwest. Both airlines serve Amsterdam and Minneapolis (their respective hubs), as well as interior European and U.S. cities. How can we expect vigorous competition between an airline (Northwest) and its owner (KLM)? We didn't see it between Continental and Eastern once Frank Lorenzo's Texas Air subdued both.

Further, most foreign airlines are owned, in whole or part, by their governments. Monopoly is not the antithesis of competition; socialism is. A government owned or subsidized airline need not make a profit to stay alive, and therefore lacks a proper competitive discipline. Their presence in a "free market" creates an unlevel playing field. Government treasuries have financial resources beyond the wildest dreams of privately owned companies. Foreign governments can subsidize losses or underwrite the capital requirements necessary to develop monopoly positions.

At the outset of deregulation, some predicted that ultimately only a handful of airlines would survive, and that they would be nationalized as wards of the state. Never could they have imagined that the few surviving airlines would be wards of foreign governments.

Today, about eight percent of Northwest is owned by the government of the Netherlands. About eight percent of Continental and Eastern are owned by the Scandinavian governments. We have now embarked upon a regime of partial nationalization, not by our government, but by foreign governments.

Foreign ownership restrictions have long existed for many of our essential infrastructure industries — airlines, intercoastal and inland shipping, telecommunications, broadcasting, electric power production, and nuclear energy. These restrictions were added to our law not

because of blind xenophobia, but because of legitimate national security considerations.

Aviation is essential to national security. As operation Desert Shield confirms, the nation depends on the aircraft of our domestic airlines committed to the Civil Reserve Aviation Fleet [CRAF] as the essential logistical means to ferry troops and supplies to distant battlefields. We need the CRAF fleet for airlift capacity in time of war. Foreign ownership may jeopardize access to it. The Air Force simply doesn’t have enough C-5As to do the job.

On August 2, 1990, Iraq invaded Kuwait. Two weeks later, the CRAF fleet was activated — the first time since its creation in 1951. Calling up the CRAF fleet was essential in order to meet the demands of the most massive airlift since the Berlin Airlift in 1948. During the first two months of activation, CRAF planes flew more than 500 missions, carried 66,000 passengers (mostly soldiers) and 22,000 tons of cargo. In the recent Persian Gulf crisis, we relied upon our domestic civil reserve aviation fleet [CRAF] to ferry sixty percent of the soldiers and twenty-three percent of the supplies to the battlefield. Yet Secretary Skinner would have foreign governments sit on the boards of directors of U.S. airlines.

Similarly, we maintain a federally subsidized U.S.-flag fleet of ocean carriers because of the lesson we learned in World War I — when we looked around for essential ships to ferry troops and supplies across the Atlantic, there were nearly none. Not that long ago, the federal government bailed out a collapsing Conrail and Lockheed, in part, because of their importance to national security. Transportation is essential to our national defense.

Of course, we could commandeer the aircraft of foreign airlines if we needed them — seize the property of foreign companies as other nations have done to American firms. But acquisition of capacity is not the only problem.

Those who argue for foreign ownership of domestic airlines forget that most of the technological breakthroughs of aviation were inspired by its military applications — its proficiency in delivering troops and bombs. Imagine a world where we had never prohibited foreign ownership or foreign airline competition. How many Pearl Harbors would we have suffered if the dominant domestic airlines in 1940 had been Lufthansa and Japan Air Lines?

Although we fought wars with Britain in two centuries, British Airways doesn’t look like much of a national security threat these days. But our alliances are constantly shifting, so that an Aeroflot looks more or less threatening depending upon the point in history at which you ask the question. We embraced Stalin to fight Hitler, and Syria’s Assad to
destroy Saddam Hussein. Today, would we want Donald Trump to sell the Trump shuttle to Iraqi Airways?

In 1974, the Shah of Iran proposed to buy Pan American World Airways. Had Secretary of Transportation Skinner been calling the shots then, he might well have allowed it. After all, Iran was then our closest ally in that part of the world.

We all know the tragic events which transpired in Iran after the fall of the Shah. If the foreign ownership rules adopted by DOT in 1991 had been in effect in 1974, would Iranian President Rafsanjani today be Chairman of Pan Am’s Board, and would Pan Am’s CRAFT 747s be parked on Iranian military airfields next to Iraqi jet fighters?

We need to keep our essential infrastructure industries out of foreign hands so that we don’t wake up one day in the midst of a global crisis wondering why we were so short sighted as to allow them to be crippled by our adversaries. We don’t want foreign owners sabotaging, disrupting or delaying the free movement of commerce, or communications, or electric power, or indeed, putting their grubby hands on nuclear fuel rods. We need a healthy domestic infrastructure capable of serving the nation loyally in times of crisis.

Moreover, foreign ownership jeopardizes the integrity of bilateral air transport negotiations between the United States and foreign governments. International routes are traded by nations on a bilateral basis, usually with candid input from their carriers.115 Multiple allegiances may well jeopardize the integrity of that process.

VII. CONCLUSION AND RECOMMENDATIONS

Foreign ownership restrictions didn’t cause the disintegration of our domestic airline industry. Neither did the fuel crisis of 1991-92.

Look around the world. No foreign airline is in as sorry shape as ours — none are liquidating operating assets, none are in bankruptcy, and none have died — despite the fact that international aviation fuel costs more than domestic fuel, and the entire world is feeling the pangs of recession.

Surely, we need to alleviate the economic crisis plaguing the airline industry and threatening healthy competition. To do that, we best get on tackling its true cause rather than hastily grasping for radical alternatives which might endanger our national security.

There are more than two temperatures at which to cook a pot of stew. In the 1970s, the competitive dial was set on LOW. The stew wasn’t warm enough, so Congress turned the dial up to HIGH by promul-

gating the Airline Deregulation Act of 1978. The competitive bubbles began to boil, causing stew to splatter over the side of the pot. The aroma was sweet for a short while, until it turned foul with smoke. Before the stew burns a charcoal black, Congress should turn the dial down to MEDIUM, so that we can have stew the public can eat.

The public owns the trillion dollar airport and airway infrastructure. Common sense suggests that it ought to have some say in how the airlines use that public system. Consider that all the stock of all the airlines could be purchased on Wall Street for less than $15 billion, or a mere one and five tenths percent the value of the public investment.

Unlike the highways, where people have direct access in their privately owned automobiles, the only access for the great majority of citizens to the airport and airway system they own is via the commercial airlines. Yet the destinations, the terms, conditions and prices of services are all dictated by private monopolists and oligopolists, with no input from the public which owns ninety-eight and five tenths percent of the system.

Deregulation gave away the public system to private monopolists. It replaced the U.S. Civil Aeronautics Board, which protected the public interest, with the chief executive officers of a handful of airlines, who treat the public system as their private Monopoly board, buying and selling properties while charging the public exorbitant rents. They are allowed to turn a profit by selling assets owned by the nation — landing slots and international routes. Deregulation transformed the air transport system from a public utility into segmented and shared regional and city-pair monopolies, and a national oligopoly.

It would be the equivalent of deregulating the trucking industry, and giving the Interstate Highways to the trucking companies — letting them set the rates and service conditions of public access, and allowing the trucking companies to sell these monopoly rights to the Dutch government.

The tyranny of monopoly gave birth to economic and antitrust regulation in the nineteenth Century. (Congress regulated the monopoly railroads in 1887, and passed the Sherman Antitrust Act just three years later). A nation which fails to learn from its history is doomed to repeat it.

The Wall Street Journal asked Americans to identify the industries in which they have most, or least, confidence. The largest number by far, forty-three percent, said they had no confidence in the airline industry. The disapproval rating for the industries which followed — insurance (twenty-seven percent), banking (twenty-three percent), oil and gas (twenty-two percent), and stockbrokers (twenty-two percent) — was not
nearly as high as that for airlines.\textsuperscript{116}

Note the common denominator of each of these five industries. Insurance has never been regulated by the federal government, and airlines, banks, oil and gas companies and securities have all experienced significant deregulation during the last decade.

Before deregulation, our transportation system was universally acclaimed to be the world’s finest. But since then, the deterioration in our transportation infrastructure, public and private, would embarrass a third world nation. The potholes we dodge on the highways and the aging jets in which we fly are symptoms of a malignant illness.

The failure of deregulation disproves the implicit thesis of the theology of laissez faire — that unconstrained human greed will produce a better society. It is time for a spoonful of regulatory medicine, while there is still some modicum of competition to preserve. It is time to roll back deregulation, not to the strict regime of the early 1970s, but to an enlightened regime of responsible government oversight. It is time for regulatory reform.

Several bills have been introduced by Congressmen genuinely concerned about the disintegration of the airline industry. Unfortunately, these proposals do not go far enough. They are designed to give the patient a few aspirin and band-aids, while the doctor fails to recognize that the patient has a chronic disease and needs major surgery. The disease is deregulation, and it is time to take the airline industry to the operating room.

What, specifically, should reform legislation include? The DOT has proffered foreign investment as a panacea for the deteriorating economic condition of U.S. airlines, and the elimination of cabotage restriction as a panacea for the demise of competition. These proposals are dangerous. For the reasons expressed above, if adopted, they would jeopardize national security.

If Congress does nothing, we will likely see an airline industry more highly concentrated than it now is. Because airline managers are rational wealth maximizers, prices will rise and grow even more discriminatory. Transportation, like many public utilities, is a necessity. Distortions in its service and the extraction of monopoly rents cannot long be tolerated. Eventually, Congress may be faced with the prospect of introducing public utility regulation to the few surviving firms.

Neither of the extremes of public utility regulation nor the contemporary environment of economic anarchy and Market Darwinism are desirable. Public policy in this essential infrastructure industry would best be

enhanced by preserving the level of competition which now exists and imposing light-handed regulation upon it, while there is still competition to preserve.\textsuperscript{117} How might that be accomplished?

1. \textit{Indirect Subsidies}. Recognizing the importance of transportation to commerce, communications and national defense, in earlier periods of American history direct federal subsidies were given to bail out transportation firms such as Conrail, Chrysler, Lockheed, and Amtrak. But the contemporary realities of a $3 trillion federal debt preclude direct subsidies to ameliorate the contemporary crisis in the transportation industry. Nonetheless, weaker carriers, new entrants, and carriers which can best enhance the competitive environment ought to be favored in distributing postal subsidies, international routes and landing slots. However, these franchises ought not be allowed to be sold for profit, for they generally end up in the hands of the megacarriers when sold. They should be issued on a limited term basis, and issued to whatever carrier fulfills public needs best at their expiration or upon their surrender. The sale of carriers piecemeal (as is being done at TWA and Pan Am, for example) only makes these carriers less attractive for acquisition as a whole property, and makes them less viable long-term.

2. \textit{Nonstop Route Certificates}. Hubbing-and-spoking, the dominant megatrend on the deregulation landscape, is choking the air transport system, causing flight schedules to regress back to the DC-3 era and burning fuel unmercifully. New nonstop service overflying hubs might be inaugurated if airlines could receive a protected franchise for a term of years. A franchise to serve any city-pair not now receiving nonstop service ought to be available to an airline promising to provide at least one round-trip a day. It would receive an exclusive franchise to serve the market for say, three to five years. If necessary, designated carriers would receive access to congested airport gates and slots, perhaps through use of federal eminent domain power, to condemn the necessary property at fair market value and sell it to the franchisee. Preference would again be given to weak airlines, new entrants, and carriers best able to enhance competition. To protect consumers, average yields in the market could be no higher than industry average yields for similar stage lengths.

3. \textit{Price Ceilings and Floors}. Carriers should be prohibited from extracting monopoly or oligopoly rents by raising prices, or driving smaller carriers out by lowering them. Average fares per mile in any market should not exceed, say fifteen percent of industry average fares, unless the airline can show good cause why they should, usually in the form of extraordinary costs attributable to serving the market in question. As to

\footnotesize{\textsuperscript{117} See P. DEMPSEY, FLYING BLIND: THE FAILURE OF AIRLINE Deregulation 46-59 (1990).}
predatory conduct, a smaller aggrieved airline should be able to object to a larger competitor's price or service war poised to drive it out.

4. Consumer Protection. Something must be done about the myriad of abusive practices such as "bait and switch" advertising, unrealistic scheduling, deliberate overbooking, nonrefundable tickets, misleading code-sharing and change-of-gauge, and demand based flight cancellations. Perhaps Congress should pass a law requiring DOT to promulgate regulations addressing such problems within, say 120 days. If the rules aren't tough enough, Congress can fine tune with legislation. Alternatively, Congress could eliminate federal preemption over such questions, letting the state Attorney Generals lose.

5. Financial Fitness. The DOT had ample jurisdiction to prevent the airlines from being loaded with onerous debt or stripped of assets in leveraged buy-outs. It chose to do nothing while our airline industry was crippled. Congress should pass legislation prohibiting any future LBO of an airline, force existing owners to wean them of debt over a period of time, and prohibit public assets (such as international routes, landing slots and gates) to be sold off to enhance the personal wealth of the corporate raiders.

6. U.S. Transportation Commission. During the past decade, the DOT has shown absolutely no enthusiasm for protecting the public interest or performing its statutory obligations in a responsible way. That is because the DOT is an executive branch agency, with policy dictated by the White House. Yet Article I section 8 of the U.S. Constitution vests in Congress the power to regulate interstate and foreign commerce. Hence, regulatory power over transportation should be extricated from the executive branch and vested in an independent agency.

Two alternatives come to mind. One is that of splitting off the Federal Aviation Administration from DOT, making it an independent agency and enhancing its jurisdiction over economic matters. Another is to strip the economic regulation function from DOT and consolidate them with the jurisdiction now held by the Interstate Commerce Commission and the Federal Maritime Commission into a new "U.S. Transportation Commission" with broad jurisdiction over all modes of transport (after all, transportation is increasingly multimodal). Under either alternative, the agency should be headed by a collegial body of, say seven or nine commissioners having terms of office and appointed in a manner similar to the governing members of the Federal Reserve Board, an agency which performs major economic policy functions without much of the political degeneration of most other federal agencies.
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The modern airport provides the modern laboratory for the application of both legal and economic principles. The airport is a basic economic unit though which is funneled a myriad of economic activities affecting not only interstate and international trade, but also the local economy in which the airport is very often the center. But the airport’s very status as an economic hub requires a legal superstructure not required of more ordinary economic activities. As a “natural monopoly” its resources can not be permitted to be controlled by those representing narrowly defined economic interests. In short, regulation of its activities can not be left solely to market forces, but must rely, at least in part, on allocative decisions made through the political and legal processes.

Maintenance of free market competition in the airline industry depends upon an allocative process which insures broad access to airport resources. That private control of a vital economic artery can cause the destruction of competition was recognized as early as 1912 when the United States Supreme Court in United States v. Terminal Railroad Asso-
cation of St. Louis\(^1\) invalidated a scheme by which a few powerful railroads took control of a central railroad terminal and excluded competitors from its use. This decision was based on the Sherman Act, which provides that "(e)very person who shall monopolize . . . any part of the trade or commerce . . . shall be punished.\(^2\)

Nowhere is the need for the cross-fertilization of legal and economic principles more apparent than in the area of airport regulation. And yet it is in this very area that such cross-fertilization has failed to materialize. Judges rarely give full consideration to economic principles, as illustrated by such cases as In Re Braniff Airways\(^3\) (in which the Court declined to analyze airline slots in terms of their economic value) and Northwest Airlines v. Goldschmidt\(^4\) (in which the Court failed to fully consider the economic impact of an administrative regulation which allocated specific slots to individual airlines.)

Legal scholars writing in the area of transportation regulation rarely incorporate or discuss the application of economic principles in reaching their conclusions.\(^5\) Economists are often equally insular, as revealed by their published articles which make few references to legal factors or decisions.\(^6\) It is not surprising, therefore, that lawyers and economists come out at opposite ends of the spectrum in the deregulation debate.\(^7\) Some critics have suggested that lawyers tend to favor regulation because its administration requires the services of lawyers.\(^8\) Economists, on the other hand are criticized for putting undue emphasis on such considera-

\(^1\) 224 U.S. 383 (1912).
\(^3\) 700 F.2d 935 (5th Cir. 1983).
\(^4\) 645 F.2d 1309 (8th Cir. 1982).
\(^5\) See e.g., Transportation Deregulation - On a Collision Course, 13 TRANSP. L. J. 329 (1984); Brewer, Regulation-The Balance Point, 1 PEPP. L. REV. 355 (1974); Note, Staggers Rail Act of 1980; Authority to Compete with Ability to Compete, 12 TRANSP. L. J. 301 (1981).
\(^7\) See notes 5 and 6, supra.
\(^8\) See e.g., Hirshleifer, Comment, 19 J.L. & ECON. 241 (1976)( "[T]he regulators themselves constitute an interest group."). Id.
tions as economic "efficiency" at the expense of broader considerations of social policy. But whatever the explanation, it is clear that a full understanding of airport regulation requires a cross-fertilization of legal and economic principles, and the application of both.

Airline Deregulation

The economics of airport regulation has been directly affected by the manner in which airlines have been regulated. The Civil Aeronautics Act of 1938 \(^9\) virtually created an airline cartel. Under that Act, the Civil Aeronautics Board (CAB) was empowered to control entry by the issuance of "certificates of convenience." As a result, not a single major trunk carrier was permitted to enter the industry between 1938 and 1978 despite seventy-nine applications during that period. Nor were inefficient carriers permitted to go out of business. Rather they were kept afloat by enforcement of rates based on the average costs of the industry. \(^10\) With no incentive to gain a competitive advantage by cutting costs or reducing fares, airlines engaged in extravagant service competition. \(^11\) Airlines also competed by offering more flights than were dictated by demand, thus resulting in costly and wasteful over capacity. (One economist has calculated that the fare-service combination during regulation was suitable only for passengers whose time was worth $60,000 per year in 1969). \(^12\)

With no incentive to reduce costs, airlines showed little resistance to wage demands. The result was that airline employees received wages far in excess of that received by their counterparts in deregulated industries. When such technological advances as the stratoliner appeared in the 1950's (and jets in the 1960's), more of the productivity gains were translated into higher pilot wages and reduced flying time than reduced fares. Average flying hours per month declined by eight hours during the period 1955-1975. \(^13\)

By regulating entry, routes, and fares, the CAB created economic effects similar to those achieved where there is but one producer in the industry; that is, it created economic conditions in which airline profits were maximized not at the most efficient level of price at marginal cost, but rather of price at marginal revenue. \(^14\) It was therefore not surprising that the effects of monopoly predicted by economic theory (i.e., too high a

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12. Id. at 205.
price and wastage of resources)\textsuperscript{15} were the same as those actually observed in the regulated air industry. In 1975, U.S. Senate Judiciary Subcommittee\textsuperscript{16} hearings revealed that fares were forty to one hundred percent higher than would have been the case under deregulation. Non-regulated air fares on intrastate routes were found to be fifty to seventy percent of the CAB regulated fares for the same distances.\textsuperscript{17} It therefore came as no surprise when load factors on aircraft jumped five points in the first year of deregulation.\textsuperscript{18}

Thus, deregulation was in large measure a vindication of the theories of such economists as George Stigler, who in his landmark article \textit{The Theory of Economic Regulation} proposed his general hypothesis: "(E)very industry or occupation that has enough political power to utilize the state will seek to control entry."\textsuperscript{19} Under Stigler's theory, any industry with sufficient political power will seek to fix prices above the level which would be determined by supply and demand. In 1976 Roger Noll described public interest theories as "no larger widely shared";\textsuperscript{20} in 1977 Jean Luc Mique' observed: "it seems fair to say that among economists the most widely accepted theory of government regulation is that, as a rule, regulation is acquired by the industry regulated and is designed and operated primarily for its benefit."\textsuperscript{21} As early as 1957 A. Downs observed "a government run by individuals trying to maximize a private, rather than public utility function."\textsuperscript{22}

In the case of airline regulation, CAB policy was ambivalent. The CAB had difficulty in deciding whether its purpose was to keep prices up in order to protect the industry, or down to protect the consumer. Ultimately, it did neither: On the one hand, as the 1975 Senate Hearings revealed, prices were far too high; on the other, as a CAB chairman observed in 1977, "(o)only three times in the past twenty-six years, and never in the past decade, has the industry earned the . . . allowable return on the investment."\textsuperscript{23}

\textsuperscript{15} Id. at 93.
\textsuperscript{17} STAFF OF SENATE SUBCOMM. ON ADMINISTRATIVE PRACTICE AND PROCEDURE OF THE SENATE COMM. ON THE JUDICIARY, 84TH Cong., 1st Sess., REPORT ON CAB PRACTICES AND PROCEDURES 41 (COMM. PRINT. 1975).
\textsuperscript{18} CAB Report, supra note 13 at 19-24.
\textsuperscript{19} Stigler, \textit{The Theory of Economic Regulation}, 2 BELL J. ECON MGMT. SCI. 3, at 6 (1971).
\textsuperscript{20} R. NOLL, GOVERNMENT ADMINISTRATIVE BEHAVIOR AND PRIVATE SECTOR RESPONSE: A MULTIDISCIPLINARY SURVEY 12 (1976).
\textsuperscript{22} See Downs, \textit{An Economic Theory of Democracy} (1975).
\textsuperscript{23} TRAFFIC WORLD, July 18, 1977, at 14.
By 1984, airline deregulation had achieved most of the results predicted by economists: average fares in real terms decreased dramatically despite staggering increases in the cost of fuel; concentration in the industry eased as the market share of the major trunks decreased from ninety-seven and three-tenths percent in 1978 to ninety two percent in 1983, while eleven newly formed airlines entered the industry; industry employment increased to 294,930 from 265,777 during the period 1977 to 1979 alone; subsidies to small communities were reduced, while service to such communities improved. One important study concluded: "(a)s a group, small communities (both small hubs and non-hubs) were receiving more scheduled airline service after deregulation than before." Contrary to popular perception, even safety improved as the number of fatal crashes per 100,000 take-offs declined from .10 in 1978 to .08 in 1982.

Nevertheless, some critics of deregulation pointed out that certain small communities had lost service or had access only to smaller commuter type aircraft rather than large passenger jet service. Concern was also expressed over the trend toward increased industry reliance on the system of hubs and spokes, which tended to increase economies of scale that might encourage industry concentration.

Such concerns appeared justified when, beginning in 1985 a rash of airline merger applications was approved by the Department of Transportation (DOT). Increased reliance on hubs and spokes created economies of scale that favored the larger carriers and gave them the economic incentive to concentrate. Consequently, during the period 1986-1987, the percentage of traffic enjoyed by the five largest airlines increased from fifty-four percent to seventy-two percent, while most of the nation's major airports became effective monopolies serving as hubs for one, or at

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25. STAFF OF THE CIVIL AERONAUTICS BOARD, CAB PROFIT REPORT 13, at 20 (Table 1.2) (1984).
27. Id.
29. Id. at 35 (Table 1.4).
30. Supra note 27 at 50.
31. Supra note 28 at 156.
32. WALL ST. JOURNAL, Oct. 18, 1983 at 7, Col. 1.
33. Supra Note 5.
34. Supra Note 5.
most two airlines. Biased computer systems and frequent flier programs which favored the largest carriers also raised concerns.  

These concerns were eased somewhat by the most comprehensive study of airline competition ever undertaken by the Department of Transportation. This 1990 study cited a few "pockets of problems" resulting from the increased concentration of market power, but nevertheless concluded that airlines were competing vigorously, and that the public was enjoying lower fares and broader service than had been the case several years before when there were more airlines. These findings, which the report itself described as "seemingly counter-intuitive", led to its conclusion that the changes in the industry had resulted in "more service at a lower cost". (A 1990 Report of the Economic Policy Institute has criticized such conclusions, however, arguing that estimates of fare reductions resulting from deregulation fail to take into account fuel prices and the fact that fares were falling downward even before deregulation.)  

The DOT conclusions, however, do not appear to have altered the perception of the flying public that the quality of air service has declined, as reflected by increased incidents of passenger complaints, lost baggage, and delayed and canceled flights. Advocates of a return to regulation point to such problems in support of their conclusion that deregulation has been a failure. In fact such problems highlight an entirely different kind of failure. The direct result of deregulation has been a dramatic increase in air travel. However, there has been no corresponding expansion of the airport infrastructure to accommodate this increase in air travel. The inevitable result has been an increase in flight delays and cancellations.  

Expansion of the airport infrastructure by building new airports has become increasingly problematic due to lack of available land near major population centers, environmental requirements and concerns (particularly noise), and the reluctance of Congress to release funds from the Airport Trust Fund which now exceeds 7 billion dollars. Only one major airport is presently planned in the United States for the rest of this century.

36. Id.  
40. Id.  
the regional airport in Denver, Colorado. Expansion of facilities at existing airports is only a partial solution and by itself can not accommodate the expected increases in air traffic.

Airport expansion faces many of the same obstacles as the building of new airports. The means by which existing airport resources are allocated therefore takes on increased importance. Although laws and regulations have been promulgated by both federal and state authorities to deal with the problem of allocation, any solution cannot fail to take account of economic factors. Within the bounds of existing law (including the anti-trust laws) the following questions will therefore be considered: 1) how should existing airport resources (including ground facilities, terminal space, gates and slots) be allocated to individual airlines in order to insure the most efficient use of those resources? and 2) once airport resources have been allocated to individual airlines, how should the use of those resources be restricted or regulated?

Ground Resource Allocation

Although terminal space may be owned by either an airport, airline or third party, actual control over terminal use is determined by an elaborate web of interlocking agreements, leases, and industry custom. Access to terminal space is as critical to airline operations as was the issuance of an "operating certificate" during the period of airline regulation. Denial of access serves as an absolute barrier to entry. Many of the agreements now in force which determine the rights of airlines to use airport facilities were entered into many years ago at a time when airlines were still regulated by the CAB. With this fact in mind, it is apparent that the Airline Deregulation Act of 1978 brought about only a partial end to regulation. Airline activities previously regulated by CAB administrative action continue to be restricted by a complex labyrinth of long-term agreements sanctioned by the CAB administrators of the regulation period. In a very real sense, therefore, airline regulation continues to do its work from the grave, or as the Shakespearian character in Julius Caesar observed, "the evil that men do lives after them."

Airport ground resources may be divided into two elements: 1) "Gate Elements A" which includes passenger loading and unloading facilities, passenger hold room facilities, and aircraft parking facilities, and 2) "gate elements B", which include passenger check in facilities and baggage claim facilities. A 1989 Airport Operators Council International (AOCI) Report on Airport gate availability revealed that nineteen of the nation's

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42. 1990 DOT Report, supra note 38 at 3-2.
43. Id. at 3-9.
thirty largest airports have no available terminal gates with both A and B elements. The remaining airports had only very limited availability.

Airport leases of ground facilities to airlines are typically exclusive, and are usually for extended periods up to thirty years. Airports are financed by use of one of two methods: 1) the residual cost method under which the airline assumes the greater financial risk by guaranteeing payment of airport costs, and 2) the compensatory method under which the airport authority assumes the financial risk for its operations, and charges airlines on a cost-recovery basis. A study of thirty major airports in 1983 revealed that fifteen used the compensatory method, and fifteen used the residual method.44

Leases often contain “majority in interest” clauses which give the lessee airline the right to approve decisions affecting such airport costs as capital improvements or expansion. Other clauses prevent the airport from charging airlines additional rates, fees, or charges. A small number of such leases permit airport authorities to reclaim such facilities for redistribution to new entrants. In most cases, however, a new entrant must approach an incumbent for a sub-lease since most leases have no such provision. Not surprisingly, the 1990 DOT study revealed that rents changed by incumbent airlines were very high when the gates could be obtained at all. For example, Southwest Airlines has been reported as paying Northwest $150 per flight for a sub-lease of two gates or “about nineteen times what Northwest pays the airport authority to lease the space.”45

The present system of ground resource allocation completely frustrates the policies set forth in the Airport and Airway Improvement Act of 1982 which states that an airport “will be available for public use on fair and reasonable terms.”46 The reality is that once a long-term lease is entered into with an airline, there are few restraints on how the property rights of the leasing airline may be exercised.

There is a significant economic incentive for an incumbent airline to charge an exorbitant rent or refuse to sub-lease to a competitor. By keeping out a competitor, an incumbent can take maximum advantage of the scarcity of gates and allow the incumbent to face a steeper demand curve than would be the case were the competitor permitted to obtain the gate.47 A declining demand curve means that the incumbent will maximize its profit at a price higher than marginal cost. The result is a misallocation of resources, and the earning by the incumbent of an “oligop-

45. DOT Report, supra, note 38.
Oligopolist profits far above that which it would earn were there free entry into the market. As economist Paul Samuelson has observed, the net effect is that society does not get "as much (service from the incumbent) as it really wants in terms of what (the air service) really costs society (to) produce." For the oligopolist, profits are maximized "by equating marginal revenue to marginal cost, thus leading to a price that is above marginal cost. The canny seller contrives an artificial scarcity of his product so as not to spoil the price he can get on earlier pre-marginal units." The price obtained above marginal cost represents the oligopolist's "excess profit."

When an incumbent sub-leases a terminal facility it is, from an economic standpoint, also "selling" an operating certificate. Such a certificate enables its holder to reap an excess profit, which is why such certificates always command a premium. For example, a New York city taxicab medallion is a kind of operating certificate. Its value is based on the scarcity it represents. In the case of the taxicab medallion, this value can exceed hundreds of thousands of dollars. Were unlimited entry permitted, the value of such a medallion would, of course, fall to virtually zero. The value of operating certificates of truckers during the period of motor carrier regulation has been conservatively estimated at over four billion dollars.

The value of an airport terminal lease therefore includes the "premium" value of the oligopoly profits it enables its holder to reap. From an economic standpoint, however, it does not matter whether the oligopoly profits are earned by the lessor or the lessee. The misallocative effects exist regardless of who earns the profits. The amount of rent paid by a sub-lessee which is in excess of what the market rent would be were it sold by a disinterested seller approximates the value of the oligopolist's "premium."

It may be concluded, therefore, that the allocation of terminal resources under the existing system of leases and sub-leases results in a misallocation of terminal resources. The obvious solution, of course is to expand total airport resources in order to minimize their scarcity value. This option is severely restricted, however, by such political factors as community resistance to increased noise, and such legal factors as clauses in existing leases which give airlines effective veto power over such expansion. The 1990 DOT Study of Airports and Air Traffic Control concluded:

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48. Id.
49. Id. at 476.
50. Id.
Gate facilities are a potential barrier to entry into the aviation industry. At best, contractual barriers make it difficult for a new entrant to obtain cost-competitive access to airports. At worst, contractual clauses such as MII (majority in interest clauses) deter efficient development of new gate capacity, with a negative effect on new entry.\footnote{52}

Seeking another solution, the Department of Justice has taken the view that, as leases eventually expire, they should be auctioned to the highest bidder.\footnote{53} Such a change would be an improvement in the existing system of allocation, and would have the advantage of giving potential new entrants a practical opportunity to obtain access to terminal resources. Presumably, such auctions would award such resources to the airline which could put them to the best economic use. However, it would not eliminate the misallocative effects of oligopoly pricing any more than the auctioning off of taxi-cab medallions. It would simply award oligopoly profits to the highest bidder. The net effect would be to put the oligopoly profits into the hands of the airport rather than the airline, thus constituting a kind of indirect tax paid ultimately by the airline passenger. While such a result might be more desirable from a social welfare standpoint and provide a convenient means of financing airport operations, it does not solve the problem of misallocation of airport resources.

Since most regional airports meet the economist's definition of a "natural monopoly," there may be no better solution than to channel oligopoly profits to where they provide maximum social utility. The misallocative effects of oligopoly pricing may be reduced, however, by vigorous enforcement of the antitrust laws where it appears that market power is being used to deny entry for anti-competitive purposes.

\textit{Airport Slots}

Regardless of who owns an airport's ground resources, the airport's capacity to accommodate air traffic is restricted by such factors as runway space, weather, and air traffic control capabilities. In short, only a limited number of aircraft can safely be permitted to land or take-off during any particular time period. The specific authorization for particular aircraft to land or take-off is known as a "slot." Since the demand for such slots exceeds the supply at most airports, the slots must be rationed in some way. Any evaluation of an allocative method depends upon a determination of the "value" of a slot. This in turn depends upon whether the law recognizes a slot as property.

\footnote{52} DOT Report, \textit{supra}, note 38.  
SLOT VALUES

The Courts have had difficulty in determining whether a slot is property capable of having economic value. As early as 1969, airport congestion made it necessary for the FAA to limit administratively the total number of slots at five high density airports: Washington National, O'Hare International, LaGuardia, Kennedy International, and Newark International.\(^{54}\) This High Density Rule (HDR)\(^ {55}\) was originally intended to be a temporary regulation to cope with delays caused by excessive congestion at these five airports. Each "slot" permitted one operation each day during the same time period, usually for seven days a week. In 1973 the HDR was made permanent for all of the original five HDR airports except Newark International,\(^ {56}\) and was later superseded by the Interim Operations Plan\(^ {57}\) and the Interim Final Rule in 1984.\(^ {58}\) Limits at the remaining HDR airports have not changed since 1984.

In 1983 the Fifth Circuit Court of Appeals ruled in \textit{In Re Braniff} that a Bankruptcy Court could not prevent the FAA from recovering a slot from a bankrupt carrier on grounds of non-use since "slots are actually restrictions on the use of property airplanes, not property in themselves."\(^ {59}\) The hesitancy of the Courts to recognize the economic value of slots was also reflected in \textit{Northwest Airlines v. Goldschmidt}, which characterized an allocation of slots to individual carriers as having only "incidental economic impact."\(^ {60}\)

Bankruptcy decisions subsequent to \textit{In Re Braniff} have split on the question of whether slots are "property". \textit{In Re Air Illinois} followed \textit{In Re Braniff} in holding that slots did not constitute property.\(^ {61}\) \textit{American Central Airlines}\(^ {62}\) and \textit{In Re McClain Airlines},\(^ {63}\) however, took a contrary view, the former holding that "(s)uch a possessory interest constitutes property of the estate."\(^ {64}\)

On April, 1986, an FAA regulation provided that "slots may be bought, sold or leased for any consideration and any time period."\(^ {65}\) In

\(^{54}\) Newark is not currently subject to HDR.
\(^{55}\) 14 C.F.R. Part 93, Subpart K.
\(^{57}\) SFAR No. 44.
\(^{59}\) 700 F.2d 935, 942 (5th Cir. 1983).
\(^{60}\) 645 F.2d 1309 (8th Cir. 1982).
\(^{61}\) 53 B.R. 1, 2-3 (Bankr. S.D. Ill. 1985).
\(^{64}\) 52 B.R. 567 at 571.
\(^{65}\) 14 C.F.R. sec. 93.221(A) (1989).
adopting this regulation (popularly referred to as the "buy-sell" rule)\textsuperscript{66} the Secretary of Transportation made it clear that the purpose of it was to permit "maximum reliance on market forces to determine slot distribution."\textsuperscript{67}

In the 1989 case of \textit{FAA v. Gull Air},\textsuperscript{68} however, the FAA nevertheless took the view that slots were not property, but rather "operating privileges subject to absolute FAA control." As in \textit{Braniff}, the FAA attempted to recover slots from a carrier in bankruptcy. Unlike the petitioners in \textit{Braniff}, however, Gull Air could rely on the FAA "Buy-Sell" Rule to support its contention that slots had value on the very open market created by the FAA regulation. With some uncertainty the Bankruptcy Judge agreed in substance with Gull's contention, stating that "pressed to the wall, (Gulls' slot) would be a property right. But I don't know that I have to find that it is a property right in its total sense. It's a license in which the debtor has a proprietary interest since the regulation gives the debtor the privilege to sell it."\textsuperscript{69} The First Circuit Court of Appeals reversed, holding that, whatever interest Gull held, it was subject to a provision of the "Buy-Sell" Regulation which provided that the FAA had the power to reclaim any slot which was not utilized at least sixty-five percent of the time over a two month period.\textsuperscript{70} In so doing, however, the Court used the terminology of property law in characterizing Gull's interest as similar to a "determinable fee interest . . . which reverts to the FAA upon failure to use the slots as mandated in the regulations."\textsuperscript{71}

Despite the law's ambivalence on the subject of slots as property, economists and analysts have been able to make precise estimates of the economic value of slots. The actual market price of slots provides only limited data in making such estimates. Since slots are not publicly traded on a slot exchange or clearinghouse, all slot sales are privately traded. However, a 1990 DOT study\textsuperscript{72} did obtain some information about slot sales. During a 1982 forty-two day experiment in slot sales, 248 slots were traded at prices ranging from $12,000 to $500,000, depending on the time period and airport. In 1984 Air Florida sold slots to Eastern at prices estimated at $218,000 per slot. Several years later, Texas Air/Eastern sold Pan Am three gates and thirty-two slots for $65 million. Shortly thereafter, American West reportedly offered to buy ten gates and

\begin{itemize}
\item \textsuperscript{67} 50 Fed. Reg. 52,180 at 52,184 (1985).
\item \textsuperscript{68} No. 88-1780 (1st Cir. Dec. 7, 1989).
\item \textsuperscript{69} Id. at 5.
\item \textsuperscript{70} 14 C.F.R. sec. 93.227(a) 1989.
\item \textsuperscript{71} Id. at 16 (footnote 6), 602 F.2d 998, 1001 (1st Cir.), \textit{cert den.}, 444 U.S. 992 (1979).
\item \textsuperscript{72} 1990 DOT Report, \textit{Airports, supra} note 42 at App. B-3.
\end{itemize}
ninety slots from Eastern for $375 million or 4 million dollars for each
gate/slot combination.\textsuperscript{73} There are, however, few slots being sold on the
open market today. Since an airline can never be sure of being able to
get a slot in the future, airlines prefer to lease them out only for very lim-
ited periods if they are inclined to relinquish them at all.

Any estimate of slot values must take into account the following
factors:

1. The amount of increase in revenue for each flight which uses the slot
   relative to an available alternative slot.
2. Costs at slot-constrained airports which exceed those at other available
   airports.
3. The risk of the FAA reclaiming the slot under applicable regulations.
4. Capacity of the air traffic control system.

Several of these factors have been studied. One study which con-
sidered such variables as the distance of a flight and the number of com-
petitors has estimated that the revenue “premium” per slot at the four
HDR airports ranges from $226,000 to $261,000.\textsuperscript{74}

Costs at HDR airports which exceed costs at other airports are attrib-
utable to such factors as congestion delays. The DOT reports that the
costs of delay for each operation ranges from a low of thirteen dollars at
National Airport to eighty-three dollars at Chicago O’Hare.\textsuperscript{75} Based on
such costs, DOT has estimated that slot values at HDR airports range
from $800,000 to over $1 million, depending upon time of day, size of
aircraft, carrier’s load factors, actual delay at the HDR airport compared
to other airports, and access to gates. Estimates made by such in-
dependent investment companies as Morgan-Keegan and Prudential-
Bache range from a low of $100,000 at JFK in 1987, to a high of 1.1
million at National Airport in 1989.\textsuperscript{76} A comparison of these studies is
difficult since the investment company estimates were made without an
explanation of the factors taken into consideration.

Estimates of slot values, whether measured by anecdotal reports of
actual exchanges, or analysis of variable factors, reflect the scarcity value
of each slot. As in the case of ground resources, a slot serves as an
“operating certificate” without which a carrier can not operate. The
holder of a rationed slot earns a premium based on the oligopolist car-
rier’s market power to set prices above marginal cost, since the oligo-
polist maximizes revenue at the point at which price equals marginal
revenue.

\textsuperscript{73} Id.
\textsuperscript{74} Id., using data from Morrison and Winston, \textit{Empirical Implications and Tests of The Con-
\textsuperscript{75} Id. at B-9.
\textsuperscript{76} Id. at B-10.
A 1983 FTC Report summed up the value of a slot as follows:

The maximum price an airline would pay for a slot is the amount that, when added to the other costs of the flight that will use the slot, equals the flight’s expected revenues. This amount is directly related to the value that passengers place on the flight which, in turn, is a function of such variables as passengers’ income, purpose of trip, etc.\textsuperscript{77}

Since it is not possible, given present resources, to increase the number of slots to the point where price equals marginal cost, the more realistic goal is to determine a least anti-competitive method of allocating scarce slots. A variety of methods have been used to allocate scarce slots:

1. “first come-first serve”
2. scheduling committees
3. administrative regulation
4. open market sales, exchanges, auctions
5. variable landing fees
6. lotteries

Each will be discussed and evaluated separately.

\textit{FIRST COME—FIRST SERVED}

All but a handful of American airports use a “first come-first serve” system as the primary method of allocating scarce slots. Such a system takes advantage of the fact that the real rationing has already taken place through restrictions on access to ground resources. The number of aircraft eligible to use slots is drastically reduced by the limited availability of gates and terminal space. The aircraft of airlines who have the rights to gates simply queue up on the taxi-ways and await their turn to take-off. Incoming aircraft are either stacked up overhead or delayed at their origination points.

There is virtually no support among economists for this system, which allocates scarce slots based on who is willing to waste the most time in line or the most fuel on the taxi-way. A 1985 Report revealed that the cost to airlines of such delays at one major airport exceeded 100 million dollars per year.\textsuperscript{78}

While such methods of allocation are common in the centralized economies of socialist countries (witness the long lines on Moscow streets for scarce price-controlled goods), they are relatively rare in the United States. Such a system at airports reflects a \textit{de facto} policy of refusing to recognize slots as having economic value; that is, slots are given

\textsuperscript{77} \textit{STAFF REPORT, BUREAUR OF ECONOMICS, FTC, AIRPORT ACCESS PROBLEMS: LESSONS LEARNED FROM SLOT REGULATION BY THE FAA (1983) [hereinafter referred to as FTC Report].}

\textsuperscript{78} \textit{ROCKY MOUNTAIN NEWS, Report on Stapleton Airport, Denver Colorado, Mar. 6, 1986, at 7.}
free of charge to any airline willing to wait in line long enough or waste enough fuel to get one. Slots are awarded to an airline based not on which airline will most efficiently use them but rather on the basis of which airline has the most time to waste. Just as the unemployed Moscow consumer may get his eighteenth bar of soap by waiting in line for six hours because he has nothing better to do while his employed brethren whose time is more valuable cannot get even one bar of soap, so "first-come first serve" at American airports results in an inefficient allocation of resources. But while efficient allocation of soap bars to Moscow consumers who most value them might eventually take place by the selling of them on the black market, slots may be legally sold at market prices only at the four HDR airports.

SCHEDULING COMMITTEES

The 1969 High Density Rule restricted the total number of slots at high density airports. It did not, however, allocate slots to individual carriers. Prior to 1985, such allocation was done by scheduling committees made up of representatives of airlines using the airport. Prior to its sunset, the CAB approved a number of agreements, including schedule adjustment agreements, and granted anti-trust immunity under section 414 of the Federal Aviation Act. This enabled airlines to collude in allocating slots without violating the anti-trust laws.

During the period of airline regulation, scheduling committees provided a convenient way of allocating slots. Since all participants were CAB-protected incumbents, there was ample incentive to reach agreement since the alternative was to suffer the uncertainty of administrative allocation. After deregulation, however, the demand for slots by new entrants complicated matters considerably. Incumbents were naturally reluctant to part with their slots, particularly if it meant giving them to potential competitors who threatened to undercut their fares. It soon became apparent to the CAB that incumbent members of scheduling committees were deliberately trying to keep out the competition. A 1983 FTC Report observed the results of a scheduling committee at National Airport:

At the last meeting the dispute was so intense that nine airlines voted against a proposal that would have given each of them exactly the number of flights they wanted. They did so, they said, to keep New York Air and US Air from increasing the number of their flights.

In approving a 1984 request for antitrust immunity for proposed scheduling agreements at six air side congested cities, the CAB observed: "For the past six months (Air Atlanta) has unsuccessfully . . . attempted to obtain slots from the airline scheduling committee. Despite the existence of twenty-five unused slots, the committee has been unable
to agree; thus Air Atlanta's request for ten slots has not been granted.\textsuperscript{79}

In another order, the CAB acknowledged that scheduling discussion "could reduce competition substantially."\textsuperscript{80} Nevertheless the CAB was reluctant to withdraw anti-trust immunity for scheduling agreements on grounds that "(t)he alternative could be a frustrated public that eventually could demand a return to some form of regulation or another government agency forcefully regulating airline actions without concern for the benefits of competition."\textsuperscript{81} It therefore continued to approve the agreements for lack of a "reasonably available less anti-competitive alternative."\textsuperscript{82}

Numerous studies have revealed that the allocation of slots by scheduling committees is anti-competitive.\textsuperscript{83} One recent study by Grether\textsuperscript{84} conducted simulations of the scheduling committee allocative process in order to assess their impact on economic efficiency. The study concluded that any economic efficiency obtained is purely coincidental. It did note, however, that the degree of inefficiency depended to a large extent on the default provisions triggered by failure to reach a consensus. In this regard, it found that lotteries provided a better default provision than grandfathering in easing barriers of entry to new carriers.

In summary, allocation of slots by scheduling committee results in allocation of slots to low-valued flights. Decisions on such committees are the result of the political power structure of each committee and are not based on market factors. It is to the advantage of an incumbent to use a slot on a low-valued flight rather than relinquish it to an aggressive competitor for a higher valued flight, since such relinquishment would result in a flatter demand curve for that incumbent and a reduction of the oligopoly premiums that it can obtain from use of its other slots.

As a result of the difficulties in reaching agreement on scheduling committees after deregulation, many committees ceased to function and allocations were frozen.

\textit{Administrative Regulation}

It has been settled law since the passage of the Air Commerce Act in 1926 that the federal government may exercise exclusive control over the

\begin{footnotesize}
\textsuperscript{79} CAB Order No. 84-10-120 at 9 (Oct. 25, 1984).
\textsuperscript{80} CAB Order No. 84-8-129 at 9 (Aug. 31, 1984).
\textsuperscript{81} CAB Order No. 84-10-120 at 8 (Oct. 25, 1984).
\textsuperscript{82} CAB Order No. 84-8-129 at 9 (Aug. 31, 1984).
\end{footnotesize}
use of airspace pursuant to its Commerce and Supremacy Powers under the U.S. Constitution (See Chapter Two). The FAA/DOT therefore has ultimate authority to allocate slots to individual carriers. This power was reaffirmed in *Northwest Airlines v. Goldschmidt.* In that case the DOT had issued SFAR/43 which allocated specific slots to particular carriers. It had done so, however, only as a last resort where a scheduling committee had deadlocked on an air allocation plan. Despite the Deregulation Act of 1979 which withdrew direct DOT power of economic regulation of the airlines, the Court upheld SFAR/43 under the Federal Aviation Act which gave the DOT power not only to regulate safety, but also to regulate for the purpose of achieving "the efficient utilization of ... airspace." 85

Some analysts have suggested that administrative regulation can improve the efficiency of allocation by considering such factors as a previous period's allocation, the average number of locations served, airline preferences, and the number of passengers enplaned. 86 These analysts have noted that administrative allocation has the added advantage of enabling the FAA to ensure slot availability to new entrants and to airlines serving essential service to small communities. 87 Others, however, have opined that administrative allocation is based on political rather than economic considerations. 88 A 1990 DOT study cited this author for his conclusion that administrative allocation is "cumbersome and the least viable, and certainly least palatable method of allocation." 89

In order to avoid administrative allocation, the CAB as early as 1984 began approving scheduling agreements which it conceded to be anti-competitive, believing that the alternative of administrative allocation could lead to demands for economic re-regulation. 90 In order to avoid the need for administrative allocation at HDR airports, the DOT promulgated the "buy-sell" regulation which permitted sale of slots on the open market. 91

SLOT SALES AND EXCHANGES

The 1986 DOT "buy-sell" rule permitted an after market in slot sales.

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90. *See text accompanying note 80-93, supra.*
91. FAR Part 93, Subpart 5: 50 FR 52160, (Dec. 20, 1985); amended 51 FR 21708 (June 13, 1986).
Its most controversial provision, however, was one that "grandfathered" existing slots to those already holding them. Other provisions provided that slots not used at least sixty-five percent of the time were subject to reclamation by the FAA for distribution by lottery.\(^92\) The rule also made it clear that it did not authorize airport proprietors to sell slots, and that the FAA retained sole jurisdiction over the nation's airspace.

At a series of public hearings, opponents to the Rule voiced four major objections to the rule: 1) it would give an undeserved windfall to incumbents, 2) increase air fares, 3) result in carriers to some small communities being out-bid by carriers intending to use slots for longer and more lucrative routes, and 4) create anti-competitive incentives for large carriers to outbid smaller ones for slots.

With the support of an FTC Economic Staff Report\(^93\) and a Department of Justice economic analysis,\(^94\) the FAA responded to these objections as follows: 1) the economic scarcity of a slot existed before the promulgation of the "buy-sell" rule, and the rule therefore did not create a windfall, but simply recognized existing economic values, 2) airfares would not increase, since fares already reflected the scarcity value of the slots. Rather, airfares would decrease due to a decrease in delays and more efficient use of slots, 3) service to small communities is protected by the Essential Air Service Program; under the hub and spoke system many short hauls are now highly valued, and in any case would be available for lease or purchase, 4) small carriers would not necessarily be out-bid by larger carriers since slot sales could be financed. Lenders are more likely to lend money to carriers using a slot profitably. Thus, smaller, efficient carriers might actually be favored over larger, debt-laden, or inefficient carriers.

The FAA maintained that "buy-sell" would improve efficiency by providing the incentive for an airline to "liquidate a slot at a price higher than the value to the using carrier"\(^95\) and "to acquire a slot at a price which will permit a return on investment higher than the next preferable investment alternative."\(^96\)

An FTC Report supported the DOT conclusions:

The likelihood of successful monopolization by buying slots ... appears to be small. While a slot market would facilitate the obtaining of slots by the airline attempting to monopolize, it would be necessary for the airline to obtain most of the slots available at an airport to monopolize any route into that

\(^{92}\) 50 Fed. Reg. 52,193.

\(^{93}\) REPORT, OFFICE OF ECONOMIC ANALYSIS, CIVIL AERONAUTICS BOARD, COMPETITION AND THE AIRLINES: AN EVALUATION OF Deregulation (1982).


\(^{95}\) 50 Fed. Reg. 52,194.

\(^{96}\) Id.
airport. And, the existence of the slot market would also facilitate entry by rivals, if the would-be monopolizer attempted to raise his price.\footnote{FTC Report, supra note 77 at 16.}

This analysis overlooks several critical factors. The alternative is not between total contestability or total monopolization. Each slot held by an incumbent represents exactly one slot not held by a competitor whose operations could flatten the incumbent's demand curve. The degree of this flattening would, of course, depend on the extent of the competitor's operations. The Report states with confidence that "an airline would not buy a slot in order to operate a flight that is expected to have a relatively low value simply because it has the cash to do so," since "(c)apital markets exist precisely to evaluate such investment and to provide funds for those that appear sufficiently attractive."\footnote{Id. at 28.} This analysis fails to take into account the premium oligopoly value of a slot for an airline facing a relatively non-horizontal demand curve. For a large firm facing a steeply declining demand curve, the oligopoly premium of the slot is in inverse proportion to the percentage of that firm's market share. For the smaller firm, the only premium for a slot is represented by the value of the slot as the equivalent of an "operating certificate," and will vary with that firm's potential to charge prices above marginal cost. Thus, "to the extent that the large firm's total premiums exceed the smaller firm's total premiums, the large firm will have the economic incentive to outbid the smaller firm for a slot."\footnote{Hardaway, supra note 65 at 29.}

If a larger firm outbids a smaller firm for a slot or refuses to sell at marginal cost, the following results occur: 1) a barrier to entry is created, and the incumbent firm will face a more steeply declining demand curve, thus enabling it to set prices at a profit-maximizing and misallocative level above marginal cost (but equal to marginal revenue), and 2) large firms will, in order to avoid losing a slot under the "use it or lose it" clause of the "buy-sell" rule, use that slot for a lower valued flight even if it does not cover variable costs; it will do so in order to preserve the oligopoly premium for its other flights. The result is a misallocation of slot resources.

Empirical data collected since "buy-sell" suggests that the result predicted by the above analysis has in fact occurred. The 1990 DOT Report on Airports concludes from its data that "the slot aftermarket has few sellers,"\footnote{1990 DOT Report, Airports, supra note 42 at 2-16.} and that only a relative handful of actual slot transactions has been reported.\footnote{Id.}

The efficiency of open market slot sales cannot be properly evaluated without considering gates and ground resources. A new entrant
needs both a gate and a slot to begin operations. Without a gate a slot has no value to an airline. Slots and gates are rarely sold in pairs, and slots do not usually become available at the same time as a gate. Since one has no value without the other, the oligopoly premium for a gate/slot combination may exceed the sum of each when valued separately. This in return serves to increase the anti-competitive and misallocative effects of slot sales.

Analysts differ in their evaluation of slot sales. Some argue that a market system puts slots to their highest valued use.\textsuperscript{102} Others have argued that slot sales do not necessarily achieve this result; rather the results of slot sales depend upon such factors as elasticity of demand, the extent to which an airline is able to exercise price discrimination, and the degree to which an airline's ability to capture increases in surplus is correlated with expected profits.\textsuperscript{103}

An auction of all slots has been proposed as a means of avoiding the "windfall" to incumbent carriers.\textsuperscript{104} Under this proposal all slots would be reclaimed and then sold to the highest bidder.\textsuperscript{105} This would have the added benefit of raising money for airport operations and expansion.

Proponents of auctions argue that the government should not give valuable slots away for nothing, as is presently being done. The problem with this view, however, is that slots have already been given away, and to reclaim them now without compensation would result in a forfeiture to those who now possess them. It should also be noted that most major airlines have made considerable financial contributions to the airport infrastructure, and these contributions have heretofore entitled them to the use of airport facilities and slots.\textsuperscript{106} Nor would auctions cure any of the anti-competitive or misallocative effects experienced under "buy-sell".

\textbf{LOTTERIES}

Under the 1986 FAA "Buy-Sell Rule, five percent of total slots were to be allocated by lottery."\textsuperscript{107} The Rule also provided that if any slots became available under the "use it or lose it" provision they would be

\begin{footnotesize}
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\item\textsuperscript{103} BORENSTEIN, S., \textit{TESTIMONY BEFORE THE UNITED STATES CONGRESS, HOUSE OF REPRESENTATIVES, COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION, SUBCOMMITTEE ON AVIATION, HEARINGS ON GOVERNMENT POLICIES ON THE TRANSFER OF OPERATING RIGHTS GRANTED BY THE FEDERAL GOVERNMENT, PARTICULARLY CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY AND AIRPORT SLOTS}, 99th Congress, 1st session. (Washington: 1986).
\item\textsuperscript{104} 1990 DO\textit{T} Report, supra note 38 at E-12.
\item\textsuperscript{105} \textit{id}.
\item\textsuperscript{106} See text accompanying note 47-48, Chapter One, supra.
\item\textsuperscript{107} 50 Fed. Reg. 52,193 (1985).
\end{itemize}
\end{footnotesize}
redistributed by lottery. The primary rationale for slot distribution by lottery is that it gives new entrants an opportunity to obtain slots. Since financially healthy sellers rarely give up slots which can be distributed by lottery, however, lotteries have not achieved this purpose.

The 1990 DOT Airport Study reveals that of the 145 slots made available to new entrants under HDR, only fifteen remain in the hands of the new entrants who obtained them.\textsuperscript{108} The rest were simply sold in the minimum time permitted. Such a result is predictable under a system which allocates slots based on chance rather than on considerations of efficiency. Certainly there is no expectation under such a system that slots will initially be distributed to those who can use the slots most efficiently. However, as long as an after-market exists, lottery-allocated slots can ultimately be sold to those to whom they have the greatest marginal utility. The ultimate benefactors are the lottery recipients who reap a windfall when they sell the slots.

Even if lotteries resulted in allocation of slots to new entrants who could most efficiently use them, those slots would still be useless to any new entrant who did not also have a gate. In addition, the obtaining of a slot at an HDR airport would be useless without control of a matching gate/slot at another airport.

\textit{VARIABLE LANDING FEES}

Congestion at high density airports is due not so much to lack of total available capacity as to lack of capacity at peak hours. If flights could be spread out evenly over twenty-four hour periods, existing congestion could be significantly reduced or even eliminated. Unfortunately, however, hours of flight operations at most airports are severely restricted, particularly in late evening and early morning hours. Such restrictions take the form of curfew, noise, and other environmental regulations. Passengers, moreover, prefer to travel during convenient day-time hours. In response, competitive airlines schedule flights at peak times to accommodate passenger demand. As a result, there is excessive congestion at peak travel times, which causes expensive and time-consuming delays.

User fees imposed at most airports exacerbate the congestion problem by failing to extract the full economic rental from airport resources, particularly slots. Typical fees include a passenger embarkation fee,\textsuperscript{109} a fee based on aircraft weight,\textsuperscript{110} a fee based on distance\textsuperscript{111} and a flat fee

\textsuperscript{111} \textit{id}.
based on aircraft movements. All such fees are based on the premise that the primary purpose of airport user fees is to cover the cost of airport operations. Indeed, such a purpose appears justified in light of the Airport and Airway Improvement Act\textsuperscript{112} which states that as a precondition to approval of an airport development project, airport fees must not be "excessive in relation to costs incurred by the taxing authorities." Thus, most airports simply impose the most convenient fee which will allow it to recover its costs.

Michael Levine, in his landmark article \textit{Landing Fees and the Airport Congestion Problem},\textsuperscript{113} analyzes the economic effects of the most common types of airport user fees: His study concludes that fees based on weight encourage airlines to schedule flights at peak hours. Since fees cause airlines to experience "the average, rather than marginal, delay, measuring the cost to the airline of adding the schedule against the incremental revenue will yield a more favorable result than would be the case if the cost to all users were taken into account."\textsuperscript{114}

Fees based on a flat rate do not allow airlines which are capable of efficient aircraft unitization to obtain savings from such efficient use: "(i)t delays equally long-haul passengers who have few substitutes for air travel and short-haul passengers who have many."\textsuperscript{115} Fuel flowage fees encourage the most frivolous airport uses: "The recreational flight for lunch or a cup of coffee, the short trip to pick up or drop-off a passenger who could make the trip by surface, the instructional approach landing to give the student a taste of operating at a busy airport."\textsuperscript{116}

Embarkation fees do not accurately reflect the actual cost of airport use, with the result that "smaller aggregate charges (are) assessed against unpopular flights than against popular ones - precisely the opposite of the effect desired at peak hours when capacity is of prime value."\textsuperscript{117} This in turn causes distortions in demand which results in investment mistakes.\textsuperscript{118}

Such fees therefore fail to take advantage of a second important function of pricing: efficient rationing. It is through a market-oriented pricing system that the value of uses is tested and resources are ultimately allocated to highly valued uses. Congestion at peak hours could be elimi-

\textsuperscript{112} 49 U.S.C.A. sec. 2202(a)(5).
\textsuperscript{114}  \textit{Id.} at 91.
\textsuperscript{115}  \textit{Id.}
\textsuperscript{116}  \textit{Id.} at 94.
\textsuperscript{117}  \textit{Id.} at 101.
\textsuperscript{118}  \textit{Id.}
nated by setting landing fees at a price at which the supply of an airport resource equalled its demand.

For example, assume that an airport is experiencing extreme congestion during the hours of eight to eleven a.m. and three to six p.m. Business travelers prefer to get an early start so that they can arrive at their destination with sufficient time to conduct their business on that same day. Recreational travelers also prefer to get an early (but not too early) start. The value of the business traveler might be higher than that of the recreational traveler, since a business traveler’s time is expensive and business negotiations or conferences may involve higher economic stakes. The business traveler must compete with the recreational traveler for use of this desirable time slot. An aircraft using this time slot, however, is not charged any more for it than for another unpopular, low demand time slot. Although an airline attempting to use this time slot sustains costs due to delay, this cost will be no more than the average cost for all other aircraft attempting to use this time slot.

Thus, no incentive exists for an airline to use a less congested time period, since it will suffer no competitive disadvantage by using the congested time period; its competitors will experience the same costs and delays by using that same congested time period. The result is that a time slot will not be used in a way which provides the highest marginal utility to its user. A seat on an aircraft using the desirable time slot may not be available to a business traveler who highly values it, because it is being used by a recreational traveler to whom it is only marginally more valuable than a less congested time period.

By charging a landing fee which results in the supply of an airport resource equalling the demand for it at that price, the resource will be allocated to its most highly valued use. A business traveler who values the resource highly, or a passenger who needs to use that time period to get to a daughter’s wedding or visit a dying parent, can obtain a seat on an aircraft using the desired time period, albeit at a higher price reflecting its higher valued use. The recreational traveler going on a two week vacation, however, to whom the use of another less desirable time slot involves only marginal inconvenience, reaps the advantage of a sharply reduced fee. In such a manner, the airport resource is put to its highest valued use. The business traveler or passenger who values a slot highly will not experience the costly delays experienced under the present system of landing fees since the desired time slot will no longer be congested. The recreational passenger will be able to enjoy his vacation at a lower price. The decision as to what value to put on the use of a time period is up to the individual consumer. An efficient pricing system merely permits him to make that decision. If that decision is instead made by a committee or a bureaucrat, the result is misallocation since it is im-
possible to fully take into account the multitude of individual choices and preferences of each consumer.

Although variable landing fees should, in theory, equalize the demand for airport use at high and low peak periods, the question arises as to whether such fees will be passed on to the consumer who ultimately determines the value of the use at that time period. If the landing fee is charged directly to the airline, that airline might, for a variety of reasons, elect not to charge fares which reflect that fee. It might, for example, wish to maintain its visibility during a popular time period. A large airline might wish to use its market power to saturate a time slot, electing to subsidize ticket fares on those flights at the expense of its flights at low-peak periods. This would in turn prevent smaller competitors from using its aircraft in the most efficient manner. Since a smaller carrier might be less able to sustain the economic losses caused by such inefficient use, it might be forced to exit the market entirely, thus benefitting its larger competitor. The purpose of a system of variable landing fees could therefore be frustrated.

To prevent this result, landing fees should be imposed as a direct tax on the price of a passenger’s ticket. Proceeds from the fee would go directly to the airport authority. Thus, regardless of a particular airline’s ticket price, a passenger electing to take a flight at a high-peak period would have to pay a higher fee. Passengers electing to take a flight at a low-peak period might pay no fee at all, or even receive a rebate on their ticket. In such a way, high and low peak periods would be evened out and congestion relieved.

Although the economic rationale for variable landing fees seems clear, these may be legal obstacles to its implementation. It has been noted that the Airport and Runway Improvement Act requires that airports prevent "unjust and discriminatory practices." The Interstate Commerce Clause also acts as a restraint on the amount of fees which can be charged. In *Evansville-Vanderburg Airport Authority District v. Delta Airlines*, the Supreme Court held that airport fees must reflect "a fair, if imperfect approximation of the use of facilities for whose benefit they are imposed," and must not be "excessive in relation to costs incurred." It has been argued and indeed held by some Courts, that if fees are raised to a level sufficient to reduce demand to the level of supply, such fees would not reflect actual costs and would therefore be prohibited. Such an argument is based on a very narrow definition of the cost to an airport of an airline’s use of it. Costs can not be determined

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121. Id.
simply by calculating the total expense of building and operating an airport and dividing this sum by the number of minutes an airline wishes to use it. An airport is paying fixed costs on its assets twenty-four hours a day, 365 days a year. Any definition of cost must take into account the scarcity value of an airport resource.

A short illustration makes the point: if the government (or any economic entity) were to open a diamond mine, a considerable amount of time, effort and expense would be expended in searching for diamonds. Assume that an expenditure of a thousand man-hours results in the finding of ten diamonds. Nine of the diamonds are of little value on the open market. The tenth however, is ten carats and worth a million dollars. Assume also that a statute requires that the government sell its diamonds based on the “cost” of producing them. One way to calculate the “cost” of the ten carat diamond would be calculate the average number of hours spent on finding each diamond (i.e., 100 hours) and multiply that by the hourly wage (say ten dollars an hour). Under such a calculation, the government would be required to sell its ten carat diamond for $1,000, i.e., a price equal to that of the other nine less valuable diamonds. (Such a method is analogous to the way “costs” of airport resources are now calculated at most airports).

It is submitted that a more accurate way of calculating the “cost” of producing the ten carat diamond would be to use a weighted formula which takes into account the greater demand for and scarcity value of the ten carat diamond. Even this is not a truly satisfactory solution since, even though the ten carat diamond will now be priced higher than the less valuable diamonds, it will still be sold at a price which is far lower than the price it would command on the open market. There is no way to get around the latter problem, however, if a statute requires that the diamonds be priced only at a level which “recovers the cost” of production. Were the government to sell the ten carat diamond at its true market value of one million dollars, such a sale would be in violation of the statute which prohibits the government from selling it at a price which is “excessive” in relation to the “costs of producing it.” The hapless taxpayer is thus deprived of a potential “profit” on the ten carat diamond; the profit will instead go to the lucky buyer who purchases it at its below market price on a first come, first serve basis.

In summary: since the Airport and Runway Improvement Act requires that airport resources be rented at prices “not excessive in relation to costs,” valuable slots are now priced at the average cost of providing it, and allocated at most airports on a first come, first serve basis. The term “cost” should not be limited to a definition based on a calculation of average costs, but rather should be based on a definition which takes into account the scarcity value. This would permit the imposition of landing
fees which vary according to demand. It would not, however, necessarily permit fees based on the function of a flight (i.e., general aviation vs. commercial). Rather the value of a flight should be determined by each individual user. The Airport and Runway Act would, however, restrict pricing based purely on supply and demand. Until this law is changed, the value of an airport resource above its market value will continue to be enjoyed by those lucky enough to obtain that resource on a first-come, first-serve basis.

Unfortunately, there has been fierce opposition to demand determined pricing of landing fees. The DOT has upheld complaints by general aviation and small regional carriers directed against landing fees which take into account the opportunity costs of landing slots. In the 1989 case of New England Legal Foundation v. Massachusetts Port Authority the First Circuit Court of Appeals upheld such a DOT determination.

Noise Regulation

The nature and extent of local and proprietary noise abatement regulations and restrictions is described in Chapter Two. While the federal government has the exclusive power to regulate use of navigable airspace,\(^\text{122}\) local governments have the power to regulate activities which are of purely local concern. Thus, local governments may regulate ground operations and impose height and zoning restrictions.\(^\text{123}\) Although local and state governments do not have the direct police power to regulate aircraft noise, such governments may, in their capacity as airport proprietors, fill the vacuum left by Congress’ failure to exercise its powers of preemption; that is, they may promulgate noise abatement regulations as long as they do not violate the Interstate Commerce Clause.\(^\text{124}\) The result is what an FAA General Counsel has described as “(a) patchwork quilt of local airport use restrictions which threatens to ‘Balkanize’ the national system and strangle its vitality.”\(^\text{125}\) By refusing to exercise its preemptive powers to regulate noise at the local airport level, however, the federal government has been able to avoid liability for noise pollution. Under the case of Griggs v. Allegheny County,\(^\text{126}\) the airport is responsible for any “taking” of an avigation easement.

A 1983 Airport Access Task Force has concluded that the existing “patchwork quilt” of local noise restrictions has “significantly impaired airport capacity and access.” This study also concluded that while single

\(^\text{122}\) See text accompanying notes 21-23, Chapter Two, supra.
\(^\text{123}\) Id.
\(^\text{124}\) Id.
\(^\text{126}\) 369 U.S. 84 (1961).
restrictions at individual airports do not substantially burden interstate commerce, the haphazard application of non-uniform restrictions would have that effect. Such non-uniform restrictions at airports now vary considerably. Such restrictions now include bans, capacity limits, perimeter rules, single-event noise limits, noise abatement profiles and tracks, displaced landing thresholds, training restrictions, ground run-up restrictions, and aircraft towing requirements. The Task Force concludes by suggesting a more active federal role in establishing uniform noise standards. The DOT, however, disagrees with this suggestion, noting that while national standards would benefit the airlines, they might also subject individual communities to more or less noise than they would otherwise tolerate. Instead, the DOT has suggested a plan for placing direct charges on airlines for noise pollution based on such factors as time of day operation and individual aircraft noise levels. The Department of Justice has also taken an approach based on economic factors, suggesting that "noise charges" be imposed on airlines, and that these charges be based on the amount of noise damage actually caused by flight operations.

Statistical studies have determined the effect of airport noise on the value of property surrounding airports. It has been found that an increase in noise exposure by one NEF (Noise Exposure Forecast) reduces the value of property surrounding an airport by about one percent. (NEF is a sound measurement based on a twenty four hour exposure which takes into account the extra sensitivity of the human ear to nighttime noise). For example, a property valued at $100,000 would decrease in value by $5,000 if the NEF increased by five percentage points. Nierenberg has suggested that noise charges be assessed based on a fee using average noise levels. The technology for measuring such noise levels presently exists. The Manchester International Airport in England and Washington National Airport have had such monitoring systems in place for a number of years.

The money obtained from such noise fees could then be placed in a fund to compensate property owners who sue for inverse condemnation. Such a system would be preferable to direct administrative regulation by either federal or local authorities. Considerations of public policy would dictate the total amount of noise to be permitted at any individual airport. Once this political decision is made the question of what percentage of the total noise is to be allotted to a particular airline would be determined by the economic decisions of each airline. Noise pollution "rights" at each airport could be sold or allocated to airlines in the same manner that slots are now sold and allocated at HDR airports. Airlines which have invested substantial sums in quiet, third generation engines for their aircraft would be permitted a greater number of flight operations within their
noise allotments, while airlines with older and noisier aircraft would have fewer. Economic incentives for airlines to invest in quieter aircraft would thereby be created. Economic considerations would also affect an airlines decision to operate aircraft at less noise sensitive times of the day and to develop procedures for the quieter operation of aircraft.

Only by making the producer of noise pollution pay for the actual cost of it can noise be restricted in a manner which permits maximum efficiency of aircraft operations within the total noise perimeters set by public policy. If an airport were to condemn private property for the purpose of building a runway, there would be no question as to its obligation to pay fair compensation to the property owner. Griggs applied this same principle to condemnation of avigational easements, and allocated liability for such avigational takings to the airport proprietor.

Since the technology now exists for precise determination of the damage caused by noise as measured by NEF, there is no reason for an airport not to charge its users a fee which is based on a formula which reflects the degree of liability which that use creates for the airport. It is submitted that a such fee would meet the definition of reasonableness as set forth in the Airport Acceleration Act which provides that states which own or operate an airport may collect “reasonable rental charges, landing fees, and other service charges from aircraft operations for the use of airport facilities.”

It does not follow from the above analysis, that a separate noise fee system should be imposed at each individual airport. If each airport is free to set its own total noise parameters, a potential threat to interstate commerce would persist if some airports set unreasonably low parameters in order to satisfy purely provincial considerations. Lack of uniformity in noise fee schedules would also create unnecessary burdens on interstate carriers, and increase the costs of administration. Rather, the FAA should use its preemptory powers to set a range of total noise parameters within which each local administrator could set local parameters which take into account local factors and considerations. In addition, the FAA should establish, on a nation-wide basis, an administrative procedure for the funding of a national noise “fund” and the processing of claims for noise damage to property owners. National NEF standards and property appraisal formula should be adopted and standardized. Criteria for the submission of inverse condemnation claims based on noise damage and the taking of avigational easements should also be established. The institution of such uniform administrative procedures should replace existing local procedures for the processing of claims sounding in inverse condemnation, nuisance, and trespass. These procedures now vary considerably from state to state. However, while local property owners should retain the option of pursuing state or local remedies, a national system
would doubtless provide an attractive alternative and set de facto national standards.

The establishment of a national administrative structure would and should bring with it federal liability for noise pollution. However, if noise fees are set at levels which adequately compensate for actual damages sustained, there would be no net drain on the federal treasury.

Finally, the setting of federally established noise fees should be combined with fees for use of slots. Slot fees should also be federally administered, and imposed at all airports serving aircraft conducting interstate operations. Ground resources and gates should be retrieved as leases expire at airports owned and operated by the federal government (such as National and Dulles). Gates and slots should be then paired and redistributed in the same manner as slots are allocated under the present “buy-sell” rule at HDR airports.

Only through a uniform and federally administered system of noise, slot, and use fees can the highest and most efficient use of airport resources be assured, and the threat to interstate commerce effectively neutralized.
The Impact Of Disaster Litigation On Airline And Aircraft Technology

BY CHARLES F. KRAUSE 1

A firm conclusion that disaster litigation has had an impact on airline and aircraft technology seems unlikely. The data necessary to make such a conclusion seems non-existent. However, we trial lawyers specializing in disaster litigation like to think that, in addition to making a recovery for a specific client or group of clients, a greater social purpose is being served in attacking a product defect or an unsafe procedure.

In the auto industry, it seems easier to reach a conclusion that consumer unrest and litigation has made an impact. Ralph Nader's *Unsafe At Any Speed* (1965) initiated the current national interest in product safety. There, Mr. Nader claimed that the 1960 - 1963 Chevrolet Corvair (the sporty rear-engine compact that was one of General Motors' best sellers) was a menace to life and limb because GM had ignored one of its own leading engineers, Maurice Olley, whose written report had warned of the inherent hazards of this type of rear-engine auto. As a result of this revelation and countless private lawsuits, the Corvair automobile was taken off the market. The New York Times, in an August 17, 1970 editorial, concluded:

Today, Mr. Nader's book, *Unsafe At Any Speed*, is recognized as one of the most important investigatory studies of the last decade. But only five years

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ago its revelations caused GM to look into the personal life of the author instead of looking under its own hood.

Perhaps the most widely publicized product safety case is *Grimshaw v. Ford Motors* (1981) in which a woman was killed and her child was severely burned when their Ford Pinto exploded into flames after being struck from behind by another car. Testimony revealed that high-ranking Ford officials knew of the serious problems associated with the location and design of the gas tank and of the low cost required to redesign the vehicle. Because the company decided to continue production of the car after it caused at least twenty-seven deaths and twenty-four serious burn injuries, a substantial jury verdict was returned against Ford. Thereafter, Ford Motor Company took the lead in redesigning its gas tanks as well as other components of its automobiles, so that Ford has been an advertising leader in "safety first" for American automobiles.

Auto manufacturers now advertise the crashworthiness of their vehicles. Cadillac states that "crush zones in the front and rear of every Cadillac absorb energy in the event of a collision. The engine is also designed to rotate downward in a frontal collision to help protect you and your family." Do you believe that was a voluntary decision by the Board of Directors, or that the Federal Government mandated such safety changes? In 1968, in *Larson v. General Motors*, the Eighth Circuit Court of Appeals held that in a head-on collision where the steering column of a Chevy Corvair was shoved into the driver, General Motors had breached its duty to protect accident victims. The following year, where the roof of a Buick collapsed, crushing the passenger, *Dyson v. General Motors*, in response to a jury verdict, held that "it is the obligation of automobile manufacturers to provide more than a moveable platform capable of transporting passengers from one point to another." That case encouraged our auto industry to provide safety cages to protect us in our motor vehicles. Door impact beams were found by a jury to be required to protect passengers from lateral impacts in *Dawson v. Chrysler Corp* (1980). Therefore, front, back, top and side protection all has resulted from product safety lawsuits by private parties represented by private trial lawyers.

With regard to aviation litigation, however, one must wonder whether or not it is the litigation that brings about changes or the magnitude of the disaster in and of itself. A defective toaster causing a fire, or a car crash, does not get the same headlines of a DC-10 crashing at Sioux City, Iowa. However, one must conclude that air transportation has become safer because of private lawsuits. New fabric for aircraft seat covers was developed so that if they burn, toxic fumes will not asphyxiate the passengers causing death. The Varig Boeing 707 crash in 1973 near Orly Airport at Paris was an important case from the standpoint of air safety.
The investigation of this accident and, we believe, the resulting litigation in the United States, resulted in a very intensive study of materials used in passenger cabins. The FAA adopted stricter standards so that there is now less danger of turning the passenger cabin into a gas chamber. The "no smoking" signs you now see in the lavatories of all airliners and the announcement which is given to the passengers before takeoff, were put into place because of what was learned from the 1973 Varig accident. There are still some improvements to be made in passenger oxygen equipment and cabin venting systems, but it is unlikely that we will see a repetition of the Varig gas chamber. In that particular case, a fire started in the lavatory's paper receptable and burned the plastic wall coverings and other materials resulting in acrylic hydro-carbon material being circulated throughout the airplane. The smoke contained a poison gas — carbon monoxide and cyanide. The crew put their oxygen masks on and successfully landed the aircraft in a farm field short of the airport; but, when they opened the cabin door to give their passengers the good news and start the evacuation, they found, to their horror, that all the passengers were slumped lifeless in their seats, fatally overcome by poisonous fumes. The pilots had not lowered the passengers' oxygen masks because this would have caused an immediate flow of oxygen in the cabin area and might have fed the combustion. The pilot's own masks were of the demand type, which does not feed oxygen until the wearer inhales. Thus, the pilots were able to use their masks but they had to deny their passengers the life-saving flow of oxygen. But, one must wonder what litigation has done to remove the hazard of flying in a DC-10. On March 3, 1974, the first crash of a fully loaded jumbo jet, a Turkish Airlines DC-10 carrying 346 people, occurred near Ermenonville, just outside of Paris. The aircraft climbed through 11,000 feet when the rear cargo door, which was not properly latched, blew out. The air pressure in the cabin, pushed through the flooring of the passenger cabin severing and jamming vital control cables and ejecting some passengers through the hole. The aircraft subsequently went into a nose-dive, crashing into the ground killing everyone aboard.

The odd part of this is that a cargo door blew out of an American Airlines DC-10 in June 1972 near Windsor, Ontario. And, although the aircraft suffered control problems, the pilot's skill and the fact that he only had 56 passengers on board, saved the aircraft. As a result of this incident, McDonnell Douglas designed a fix for the latching mechanism for the rear cargo door. It was expected that the FAA would issue an Airworthiness Directive (AD), ordering all operators to make the modification immediately. However, McDonnell-Douglas was in competition with other manufacturers and did not want a frightening AD on its record at that point. McDonnell-Douglas convinced the FAA they would take care of the
problem and, according to their "gentlemen's agreement", McDonnell-Douglas would issue a service bulletin to its customers and would supply them with modification kits. This agreement was entered into just four days after the Windsor, Ontario incident. The strange thing was that with regard to the Paris DC-10 crash, McDonnell-Douglas evidently had not even implemented its own three-step modification in its factory. More mystifying was the fact that the company announced that the records showed that the modification had been made to the Turkish Airlines DC-10, but investigation of the aircraft wreckage showed that the modification had not been made.

Massive litigation was started on behalf of many of the survivors centered in California before Judge Peirson Hall. An excellent account of this litigation can be found in the book entitled Lawsuit, by Stu Speiser, where he chronicles the events of this litigation from the time of the accident to the time of settlement. In this case, the final amount paid by the manufacturer in settlement of the claims was approximately $62,000,000. Strangely, this was approximately the same figure that was given by the FAA as the cost of modifying every jumbo jet to prevent catastrophic floor failure and damage to an aircraft by reason of an opening of a cargo door in flight. The $60,000,000 cost of making all jumbo jets' floors safe would be shared by the entire industry. It was known and publicized after the Windsor blow-out that the floors needed strengthening and, indeed, the National Transportation Safety Board (NTSB) had recommended such modifications in 1972. The question is why didn't the FAA order the floor modifications in 1972? I don't have an answer. Yet, even the accident didn't prevent the United Air Lines Flight 811 cargo door blow out in 1989 on a Boeing 747 soon after take off from Hawaii. The plane landed with the loss of fewer than ten lives, but near heart attacks for scores of others.

We must remember that in the aviation industry we are dealing with executives who are highly motivated to produce a safe airplane. Their marketplace will react quickly to known dangers, as happened later on in 1979 when the engine pylon on a DC-10 cracked and ripped the engine off the aircraft shortly after take-off in Chicago. Their own training and ideals should rule out laxity when it comes to safety. Yet, unfortunately, if a fault is found in an initial design there is a strong impetus to sweep it under the rug and hope, like many other human errors, that it will never be discovered. As was stated in the Sunday London Times, written in the book, DESTINATION DISASTER, the story of the Turkish DC-10:

"Corporations, especially the large and complex ones with which we have to live, now appear to possess some of the qualities of nation states, including, perhaps an alarming capacity to insulate their members from the moral consequences of their actions.

The Turkish DC-10 disaster is a clear case for the deterrent of civil
litigation to break through that corporate insulation to establish personal responsibility for aviation safety. It seems quite certain that if the Windsor incident had ended in a crash, the Turkish DC-10 crash would never have occurred since litigation would have forced attention on this matter far beyond any industry self-examination that existed and that permitted the Turkish DC-10 to get airborne over a year later without the necessary fix to the cargo door latching mechanism. The courtroom makes public that information which otherwise is shared only by the regulated and regulator, notoriously a closed, somewhat incestuous group.

Probably one of the strongest arguments in favor of the conclusion that litigation has an impact on aircraft and airline technology is the insistence by most defense firms representing the aviation industry, upon the issuance of protective orders and confidentiality agreements to prevent disclosure of information in aircraft product litigation. Many disaster cases usually have an allegation of a product defect affecting numerous plaintiffs. The issues are generally technical and complex and most all of the important documents are in the exclusive possession of the manufacturer. Thus, the technique which many defendants resort to is an attempt to limit the access to the documentation and to limit the use of the information to the specific case in question. Obviously, in a disaster case, the multidistrict litigation procedures will usually sweep in almost all of the cases and, therefore, at least to those affected by the specific accident, that information is accessible. However, quite frequently in private airplane accidents and certainly in other accidents, where there are relatively few victims, the request for confidentiality is used as a way to limit the exposure of the manufacturer. The U.S. Senate held hearings on the subject of Confidentiality Orders in May, 1990. Before that, a bill had been introduced in the House of Representatives by the Honorable Cardis Collins, of Illinois, stating, "One of the most questionable, if not unethical practices in product liability suits today is the use of court orders to bar public disclosure of manufacturer’s information concerning product safety." Certain cases were referred to in those comments, one of them being that "A serious design defect in the heating system of the Chevy Corvair, first discovered in the mid-1960s, was not disclosed until 1971 because of a protective order."

Similar orders were also entered in the Dalkon Shield cases. Hence, it would appear that litigation does force, in many cases, information to be divulged that, without the court involvement, would never see the light of day.

In 1988, the Office of Technology Assessment (OTA) of the U.S. Congress prepared a report regarding aviation safety in a competitive environment. The statistical data presented showed clearly that over the years the risk of injury or death has steadily declined for airline passen-
These statistics also showed that the fatality rate per million passengers enplaned for Federal Aviation Regulation (FAR) Part 121 (14 CFR 121) scheduled airlines was one-eighth of the fatality rate per million passengers enplaned as for FAR Part 135 scheduled airlines. For Part 135 non-scheduled carriers, the fatality rate was thirty-six times that of the Part 121 scheduled carriers. These statistics were for the years 1975 through 1987.

The primary purpose of accident investigation is to determine the probable cause of the accident and to recommend preventative measures. Data show that most accidents involve a complex congruence of multiple events and causes. The OTA reports one finding that only twenty-eight percent of large jet transport accidents could be attributed to a single probable cause. The report also classified the causal data as follows: pilot, personnel, aircraft, weather and miscellaneous. The findings also showed that sixty percent of the fatal accidents of scheduled passenger carriers are initiated by human error and human error is a causal factor in over seventy percent of these accidents. The data also showed that where aircraft component failure was involved, it initiated thirty-five percent of the total accidents of Part 121 scheduled passenger carriers, but just eighteen percent of the fatal accidents. In short, many of the component failures, because of redundancy, did not cause a crash involving fatal injuries. The Sioux City United Air Lines DC-10 number 232 two engine failure, however, clearly is an initiating failure of an aircraft component, as well as the cause of the fatalities and injuries resulting from that engine disintegration. The other obvious one is the DC-10 accident in Chicago in 1979 when the engine came off the left wing and the aircraft rolled over on take-off, killing everyone on board. The other one that we have already discussed is the Turkish Airlines crash where the failure of the latch on the aft cargo door caused major destruction of the control capabilities of the aircraft, resulting in a fatal accident.

Of course, we are also all aware of the fact that the introduction of the jet engine resulted in a major decline in engine failures on commercial aircraft and improvements have continued to reduce the percentage of in-flight shut downs of jet engines.

An accepted maxim through the aviation industry is that safety begins at the top. It is generally accepted that senior corporate officials set the safety framework within their organization by the policies they set. The OTA reports that, although airline and government officials alike profess a willingness to pay any price for safety, in reality this is not a practical approach. While safety is an important passenger concern, convenience and cost dictate much of the air transport industry policy. Again, it is frequently very difficult to determine what corporate actions and cost savings have a clear cause and effect relationship to an accident.
In short, it is truly impossible to make an educated estimate of the impact that litigation has on air carrier safety. We can only hope that it plays an important role in being a watch dog on the industry itself, as well as the Federal Aviation Administration, in improving safety. In the four major causal factors in commercial aviation accidents, litigation can be important. The four main factors are human performance, weather, aircraft component failure and the air traffic environment. Certainly, litigation can highlight where human performance has failed and where improved training procedures could make a difference in improving human performance generally. Also, with regard to weather, litigation has paid an important part in stressing the methods of dealing with wind shear. The Delta-Dallas 1986 accident involved a courtroom shoot-out between Delta Airlines pilot training and operational techniques and the United States air traffic control policies and performance relating to wind shear and information leading to the conclusion that wind shear exists. I can point to no statistics, but I am sure that the microscopic examination given to the causal factors in the Delta-Dallas accident have improved procedures both of the air traffic control system, as well as the airlines' training of their crew members and the performance of their crew members.

One of the biggest problems that we have at this time, and where the system is bound to break down, is in the air traffic control area. The recent USAir-Skywest collision on the runway in Los Angeles and the Detroit runway collision support that conclusion. Air traffic control safety, in my judgement, is the weak link. The OTA report that I referred to indicates that the rate of pilot error caused accidents has remained constant for quite a few years. It is questionable whether gains in aircraft mechanical reliability and understanding and coping with severe weather will outweigh the decline in air traffic control safety, as the system becomes choked with a large number of movements of aircraft. Unfortunately, litigation can do little to force the U.S. government to change its air traffic control or to improve it. However, public outcry generates support for tax dollars which can be spent to increase air traffic control safety. The OTA report also concluded that civilian aviation in the United States lacks a long-term human performance research and development program, but that enhancing human performance is a top priority.

If nothing else, disaster litigation has kept a focus on placing the cost of deaths and injuries as a result of air transportation placed upon the parties best able to afford that cost, namely the air carrier and the manufacturer of the aircraft, as well as the air traffic control system or the U.S. Treasury. Having kept this cost placed squarely on the shoulders of these parties has obviously been a motivation to continually improve the procedures to avoid fatalities and injuries. Therefore, even though there are no hard data upon which we can rely to prove that litigation has brought
about a product improvement, procedural improvement or training improvement, it seems clear that our legal system has placed a premium on fault. That premium is to subsidize the impact of the fault.

The future of commercial aircraft technology and airline operations will include the development and use of new electronic systems, new aircraft engines, new composite materials, and even new types of aircraft, such as the tilt rotor and hypersonic aircraft. Although safety will always be in mind, the primary force will be the desire to improve travel for the greater numbers that will demand same, and to increase the speed of travel. These advanced technologies will present significant challenges to the government in terms of certification and flight safety. However, it is clear that our legal system will continue to demand that the burden of any injuries or deaths resulting from the failures in this new technology will be borne by those who are providing same. We are hopeful that our judiciary, as well as our juries, will be able to cope with this information and continue to resolve these disputes in a manner which is fair to all parties. Strict liability, of course, has played an important part in the product responsibility cases. This will be especially true in the future where advanced materials are used and where new engine designs are incorporated in high speed aircraft. Also, those who are reaping the benefit of using the new technology in vertical take-off and landing aircraft and short take-off and landing aircraft will pay the price for any failures of this new technology.

I believe our legal system can cope with this and, in fact, probably will incorporate a greater reliance on expertise to educate the jury, as well as the greater use of computer enhanced video depictions of aircraft crashes, as well as greater video displays of testimony and other information relating to such things as air traffic control, crashworthiness, and weather phenomena.

In short, I don't believe it is necessary to justify our legal system on the ground that litigation in some way enhances airline performance or aircraft technology. That is not the purpose of our litigation system. Although our litigation system of adversarial representation and jury determination has defects and problems, it has been written that Winston Churchill's appraisal of democracy fits: "It's the worst system, except for all the others that have been tried from time to time."

Some people confuse the weaknesses of human nature with those of the legal system. Dishonesty, stupidity, infidelity, recklessness, and greed are human failings. Lawyers must deal with providing relief from these. Because of that, I believe society likes to lay the blame for much of the human failings on lawyers. Legal rights are not self executing, and people do not always tell the truth when money is at stake. Centuries of experience have shown that the best way to achieve justice is to have both
sides present the strongest possible case represented by their attorney and let an impartial group decide who should prevail.

It is true that Americans have become more litigious as the years have gone by. The lawyer population has more than tripled in the almost thirty years that I have been practicing law. Contrary to popular opinion, statistics show that personal injury law suits are not the culprit for the clogged civil docket of our courts, but rather business law suits have increased many fold. Personal injury law suits have increased at the same rate as our population has increased. Lawyers don’t invent disputes, they can only be called upon to assist in enforcement of legal rights. The United States places a high value on attempting to achieve perfect justice and, consequently, we have a high lawyer population. Currently, we have one lawyer for approximately 250 people.

Many people attack our jury system as a ponderous method of obtaining justice. However, I feel that juries are particularly adept at handling intangible concepts such as good faith, reasonable care, dangerous design and assessment of damages suffered by an individual. Although the use of a jury probably slows down a trial, it is the last opportunity for our citizens to participate directly and personally in self government. Most of our government is turned over to bureaucrats; however, the real power of democracy rests in the jury system.

People complain of multi-million dollar awards. However, most of the multi-million dollar awards today are in commercial litigation, corporation suing corporation. Notwithstanding that, our court system does provide for the review of verdicts that are the result of passion and prejudice, and if our appellate courts are doing the proper job, then that infrequent anomaly where a jury does get caught up in the passion of a case, can be cured.

In conclusion, it is my firm belief that our civil justice system, which is designed simply to determine the relative rights of a victim vis-a-vis, an alleged tort feasor, does that job better than any other system. In addition, there is a beneficial side effect, both naturally and intentionally, when a specific accident results in litigation that uncovers data which leads to the enhancement of safety, not only in the aviation industry, but virtually all other walks of life.
The Disaster of Deregulation

THEODORE P. HARRIS1

If, as its proponents proclaim, deregulation is such a success, then why is the travelling public so unhappy? Why are airlines screaming about imminent financial ruin? Why is air travel seemingly choking itself to death? For the last few years, air travel has received the most complaints at the FTC, as public opinion polls have seen the airline industry plummet from the most admired to the least trusted.

The airplane is arguably among man’s greatest inventions, certainly in the twentieth century. That its full benefits and capabilities would be denied to the travelling public seems unthinkable, but our national stewardship of this remarkable invention during the past decade has, in my opinion, been abysmal. By the late 1970’s, the airline system was providing approximately ninety percent of our public, intercity transportation. It was our national mass transportation system.

More than one hundred large and small airlines have failed in the last few years. This past year began with eleven large airlines and has seen the bankruptcy or liquidation of five of them. Three others are on the “endangered species” list.

The industry is insolvent, with only three airlines considered viable, and those three do not really compete with one another. What little com-

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petition is left is generally that authorized by bankruptcy judges who, incidentally, have also supplanted the DOT and the White House as major decision makers on international routes.

Airlines have become unregulated, monolithic companies providing inferior air transportation service at arbitrary prices. Their objective is to segment the market, not to serve it. They force feed passengers through a patchwork of hub-and-spoke routes without regard to transport efficiency or public convenience, not to mention national interest objectives such as the efficient utilization of public resources and the national defense.

It is time to get back to some basics about air transportation so that we can understand where we are and where we need to go. In the middle-1960's, I was fortunate to have had the opportunity to develop and teach probably the first undergraduate course devoted to commercial airline management. This required the identification for the inherent and competitive advantages of the commercial airliner. Simplistic as they may sound, they are relevant today—perhaps more than ever:

1. The commercial jet airliner is ten times faster than any other mode of transportation.
2. It can travel nonstop in a straight line—the shortest distance from origin to destination.
3. It is unencumbered by geographical obstacles like mountains and rivers (nothing was said of politicians and cowboy economists).

On the downside, air travel is inherently dangerous and very expensive (in large part to overcome the danger) and it requires considerable public investment for airports and airways.

The goal of air transportation, as a branch of transportation science, is the increasingly efficient movement of people, products, and ideas—through the air—over time and space. Efficiency is measured not just in terms of cost, but also in terms of time—man's most perishable commodity.

This incredible time component of air transportation has proven to be an important catalyst in the rapid social and economic development of the United States. And yet we are throwing it away with high fares and circuitous routings through choking hubs operated by what is now the oldest fleet of inefficient geriatric jets in the developed world.

Air travel speed, the correlative of time, has effectively been cut in half—compromised by hub-and-spoke operations that can double travel time on almost all but nonstop routings. Travel in a straight line from origin to destination? Not through a hub. Circuity—the extra miles flown—can run fifty percent or more of actual nonstop mileage in today's fuel guzzling hub operations. The added landings and takeoffs in hub rotations are not only expensive, they create severe peaking congestion of
airways, runways, and gates — and cries for more airports. They add greatly to travel time and stress, discouraging travel on the one hand, while turning one day business trips into expensive overnight excursions on the other; or worse — as airlines today are finding out — no trips at all.

Today's air travel is rife with all types of oppressive discrimination in terms of price, service, and place (regions of the country). It would require volumes to document. This discrimination ultimately affects most, those who can least afford it. Fares often bear no relationship to the cost of the service provided. Sure there were low, predatory fares for a period in the mid 1980's. Among other things, they helped to destroy our intercity bus system — transportation for the common man. They also created the imperative for consolidation and hub fortress development to eliminate competition.

For many, even the speed of air transport is no longer a factor: many people simply cannot afford the higher fares or meet the complicated restrictions attached to so-called "discount" fares. And fares were further increased by as much as twenty percent earlier this week (Editors Note: Statements made in April 1991). Americans are, in effect, being denied access to what is left of our national, public air transportation system. There is nothing subtle about the discrimination that materializes in the form of a 300% increase in adjusted, unrestricted coach fares in the last ten years — the only truly comparable pre- and post-deregulation fare categories. Is there really "common carriage" available to all when an airline ticket requires round-trip travel between Tuesday and Thursday with a Saturday night stay over; fourteen (and now extend to 21-30) day advance purchase; nonrefundability; no itinerary changes, and; "capacity controls" (which means that a fare may not be available even though there are plenty of empty seats)? And, in all probability, that ticket provides a circuitous routing through a hub. The 1978 air travel dollar bought steak. Today, it buys hamburger.

Consider this: The replacement value of our nation's 560 taxpayer-owned commercial airports and the airways system is estimated at more than $1 trillion. According to the Aviation Daily, the Wall Street market value of the stock of all of the major airlines is currently less than $15 billion, or one point five percent of the value of our airport system. Yet that one point five percent dictates whether airline service is provided, under what schedules, and at what price — all with no input from the same public that owns the airports. The tail is wagging the dog — and a very small tail at that. This is the functional equivalent of turning over the interstate highway system for the sole use of the trucking industry.

The quality of leadership and innovative management to which the public has entrusted the air transportation service is of no surprise. Regu-
latory fitness standards have succumbed to political expediency. An asset-rich, national air transportation system has literally been carved up and devoured, much of it at the expense of tens of thousands of once-dedicated and professional airline employees who are the real martyrs of deregulation. The pride and spirit that made airlines one of our most outstanding and socially responsible industries has been bludgeoned to death in the ruthless pursuit of greed. The industry has been the deregulated victim of insidious moral and ethical decay at all levels. Greed is the real Icon.

And where was leadership at the DOT? The "industry-lap dog" mentality of that agency is best evidenced by automatic merger approval that sent fares skyrocketing and service levels plummeting across the country. That the forces of ruinous competition were driving the industry into mass bankruptcy should have been more than enough reason to reverse deregulation in 1984-1985. But the DOT, at the behest of major airlines, even joined lawsuits to prevent the states from requiring airlines to behave ethically. Remember the DOT Burnley regime’s "clean bill of health" for Eastern Air Lines following the "exhaustive" inspection in mid 1988? Couple the bankruptcy examiner’s findings of nearly $750 million in probably fraudulent Eastern asset transfers by Lorenzo’s Texas Air Corporation, and the criminal indictments in New York of Eastern managers for alleged crimes involving maintenance records falsification in the same time frame, and you have a good idea of a cynical quality of the DOT’s leadership and industry ethics in the 1980’s — worse than vacuous. An ironic postscript to the Eastern tragedy was the recent guilty plea for maintenance violations entered by the Trustee because Eastern was "no longer concerned about its public image." The travelling public is in bad shape when it has to depend on the U.S. Attorney in Brooklyn to enforce the Federal airline safety regulations. Eastern’s employees objected to a policy that said it was cheaper to fix the books than it was to fix the airplanes. It cost them their careers.

Deregulation failed because key assumptions of its cowboy proponents were plain wrong and they were too arrogant to heed the chorus of warnings. They saw the very positive results of the sound Ford Administration policy, known as "Regulatory Reform," developed in the middle-1970’s and concluded that if a little "reform" was good, then complete deregulation would make celebrities (and millionaires) of them all. Events have demonstrated, again and again, that there are very significant economies of scale in the airline industry — something that every airline executive knows. Yet the deregulationists claimed that because economies of scale did not exist, the industry was "perfectly competitive." And then there was the "contestability theory," which assured monopoly market
disipline through the threat of “potential” competition that would have had even a monopolist trembling in his boots.

Deregulation and our airline system were ultimately doomed because deregulation’s cultist proponents focused their attention only on the air carrier part of the travel equation. If they had the breadth of vision to look at the system as a whole, they might have recognized the system for the public utility that it is. Individual airlines are not public utilities — but the air transportation system is and it needs to be treated as such by the federal government. Unrestrained competition in public utility type services is notoriously counterproductive and ultimately leads to the kind of concentration we have seen in air transportation.

Deregulationists continue to claim that fares are lower and that traffic experienced “explosive growth” in response to deregulation. The truth is that traffic grew at about the same rate in the ten years before deregulation as it did in the ten years after. Fares, according to recent studies, are much higher—not lower—for highly restrictive and circuitous air travel. Even the government admits that fares are much higher at hub cities, such as Denver. At many smaller cities, average fares are two or three times what they were in the 1970’s, with full allowance for inflation—that is, if they still have airline service.

Airlines continue to quote their own “yield” figures as evidence that fares are lower. Yield is based on actual miles flown, not on straight line (great circle) distance. Thus, they include very significant levels of circuitry that lower average yields and leave the intended false impression that fares must be lower.

Technology was once the lifeblood of the airline industry. Advanced jumbo jets, new propulsion systems, and dramatic fuel saving innovations all fell victims—and the global leadership of our aircraft manufacturing industry is being held hostage—to the dramatically changed circumstances of deregulation. The airlines retrogressed to old, first generation jet equipment in order to feed hub-and-spoke operations, with some carriers (such as United) buying back the very airplanes they had earlier disposed of as obsolete. Two months ago, United retired its first 727—a twenty-eight year old airplane. Boeing refurbished its 737 jigs and the DC-9 became the MD-80—the airplanes that deregulation built.

The Civil Reserve Air Fleet (CRAF) is the civilian airline component of the Military Airlift Command. In times of national emergency it can be activated by the President impressing civil aircraft for military use—something of a flying volunteer fire department. In its forty year history, CRAF had never been activated because there was plenty of available civil airlift. Not so anymore. The real long haul “lift” capability of the CRAF fleet has fallen by more than fifty percent since the start of deregulation. CRAF was activated for the very first time by the President for use in Operation
Desert Shield. There are many in the industry who doubt our country’s ability to support an all-out airlift in the event of a prolonged war in the Persian Gulf, in part because of CRAF. It is not surprising that the shift to older, short haul equipment needed for hub operations resulted in a sharp reduction in the number of long haul, civil aircraft capable of carrying heavy loads. This caused the National Defense Transportation Association to warn the President in 1987: “The nation’s shortfall in long-range cargo airlift capacity is substantial, and as such, constitutes a dangerous threat to national security.”

I believe our nation’s airport and airway system is operating at only a fraction of its designed capacity. The congestion problems are caused by hub-and-spoke operations spawned by deregulation. A B-747 or DC-10 occupies the same amount of runway and airway space as a DC-9, B-737 or B-727, but carries more than three times as many passengers (at lower seat mile costs). Yet the larger widebodies (which were a blessing on regulated routes where traffic could be consolidated for nonstop flights) did not lend themselves to hub-and-spoke operations. Contrary to airline assertions, hub-and-spoke systems are defensive mechanisms. They are hardly innovative — merely reincarnations of sixteenth century freight transportation systems. The initial objective of hub systems was survival in the early turbulence of deregulation. Today they provide market control and domination by blocking out competition, tying up gates and slots, and controlling feed through code-sharing.

The U.S. mail has taken a terrible beating under deregulation, particularly since CAB sunset in 1985. Unlike linear route systems, hubs do not operate during the late night/early morning hours favored by the Postal Service and the major combination carriers discontinued night freighter services. Increased transit time and missed hub connections have seriously eroded the reliability and quality of air service provided to the Postal Service. Add to that the fact that airline mail rates shot up by almost fifty percent following CAB sunset and the difficult problems faced in moving the mail by scheduled airlines can be appreciated.

Up until the structural changes brought about in 1985 by CAB sunset, CAB-approved business rules required travel agents to work first and foremost in the best interests of passengers, booking the most convenient flight at the lowest fare. Airline rules prohibited travel agents from discriminating either for or against individual airlines. The name is the same and the office may look the same but the travel agency business has undergone a metamorphosis. Incentive and override commissions, “preferred” and exclusive airline supplier relationship are the norm as powerful airline Computer Reservation Systems monitor closely travel agent sales activities. Most travel agents now work for airlines first with the passenger a distant second. Consortiums, franchise schemes, and
large chains have been created from once independent travel agent ranks driving up commissions almost sixty percent—and thus the cost of air travel. Caveat emptor.

Regional and commuter airlines have come under the domination of megacarriers through “code-sharing” programs, which represent a nadir in industry ethics, already at an all time low. Schedules are no longer made for the convenience of the local market, but for the convenience of the hub operator. In the words of one commuter official: “The only thing worse than a code-sharing agreement for passengers is no code-sharing agreement for the commuter airline.”

The airlines of today are vastly different from those promised by the deregulationists. I have touched briefly on only a few of the pratfalls of deregulation.

In 1966, the Department of Transportation was created. Its “Declaration of Purpose,” applicable today, stated in part:

“The Congress therefore finds that the establishment of a Department of Transportation is necessary in the public interest and to assure coordinated, effective administration of the transportation programs of the Federal Government; to facilitate the development and improvement of coordinated transportation service, to be provided by private enterprise to the maximum extent feasible; to encourage cooperation of Federal, State, and local governments, carriers, labor, and other interested parties toward the achievement of national transportation; to provide general leadership in the identification and solution of transportation problems; and to develop and recommend to the President and the Congress for approval national transportation policies and programs to accomplish these objectives with full and appropriate consideration of the needs of the public, users, carriers, industry, labor, and the national defense.”

It seems to me that on almost all counts we are not measuring up. Much damage has been done to our airline system and, consequently, to the nation and to the public it was built to serve.

Last year’s DOT Report on Airline Competition was no more than just another pro-deregulation puff piece by the Flat Earth Club at the Department of Transportation. Is it possible that one of the latest bromides from the cult of deregulationists and the DOT will prevail? Let the foreign airlines operate in the U.S. domestic market? Let them buy U.S. carriers and control our airport and airway system? The Secretary says so. Our air transport industry, once the envy of the world, has become a mere shadow of what it should be. Consider this: Aviation Daily reported on March 6th that a twenty-five percent share in Japan Air Lines would cost $3.6 Billion. On that basis, Japan Air Lines alone is worth more than what’s left of all major U.S. airlines combined.

DOT has thoroughly discredited itself and forfeited any right to leadership. It is time we acknowledged the truth: Deregulation is really a ma-
failure from almost every vantage point. It has nearly destroyed what had been the finest airline system in the world. Congress must take back leadership in commercial aviation if we are ever to restore vitality to this once vibrant industry and rebuild our intercity public transportation system.

Sam Skinner proclaimed recently that the deregulation debate is over. For once he is right, and the results are obvious.
Good morning. I am very happy to be here this morning to discuss my perspective of the airline industry in the nineties. Just looking at the program brochure for this seminar is an indication of how rapidly changing the airline industry may be in the nineties. Two of the so-called "mega carriers" listed in the brochure are now in bankruptcy, another is entirely out of business, and one of the so-called "Second Tier" carriers is also in bankruptcy. And since I have been out of the country the last few weeks, there may have been even further casualties to these lists given the challenging financial environment that airlines are currently facing.

I believe this rapid change also will be seen in the computer reservation system (CRS) business in the nineties. This rapid change in CRS will be brought about primarily by three forces, two of which are natural and one of which is unnatural. These three forces are globalization, technology and, the unnatural one - regulation. I will talk briefly this morning about each of these forces and the potential effects they may have on CRS in the nineties.

I. GLOBALIZATION

Before discussing globalization, it's useful to look at how CRS has evolved over time. The CRS systems of today originated as internal airlines systems. After this initial phase, these systems were modified and marketed as national CRS systems to travel agents. The next phase in the CRS evolution was the transition from national CRS systems to regional CRS systems. For example, Covia markets Apollo today outside the United States in such countries as Japan and other parts of the Far East. We are just at the beginning of the next step in the CRS evolutionary process, global systems.

A commonly expressed opinion is that the push towards CRS global-
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II. TECHNOLOGY

Technology is the second force which will rapidly change the CRS business in the nineties. It is often overlooked that CRS systems consist of some of the largest computer networks in the world, coupled with some of the largest computing facilities in the world. In order to implement global CRS, advanced flexible technology tools are an absolute requirement. United States CRS systems - particularly Covia - are the undisputed world leaders in CRS technology. Unfortunately, the United States cannot make such a claim about very many other businesses today. It is this technology leadership that is bringing about CRS globalization by Covia at a rapid pace.

So what are the effects of technology on the CRS business in the nineties. First, technical advancements will give carriers, travel agents, and travelers more choices than they have ever had before. For example, carriers will have more choices about how their product is distributed; travel agents will have a wider range of possible services to offer travelers; and travelers will have the ability to make all their travel arrangements themselves directly from their homes. Second, technology will make CRS systems more flexible and easier to use.

III. REGULATION

That brings me to the third force that will shape the CRS business in the nineties - the unnatural one - regulation. As many of you may know, the CRS business became regulated in 1984. Those regulations were set
to expire at the end of 1990, and the United States Department of Trans­portation (DOT) commenced a rulemaking proceeding in 1989 to review the existing rules and determine if continued regulation was necessary, and if so, what changes in regulation were required. The DOT extended the current Rules until November of this year (1991) and recently published its proposed new CRS rules for comment. These proposals are far reaching and have the potential to alter CRS in a number of reasonably foreseeable ways, and in perhaps many more unforeseeable ways.

Before briefly discussing the proposed rules and their possible effects, I feel compelled to say that in my opinion, these proposals are founded upon a totally incorrect view of the CRS business. The two basic premises that the DOT has founded its proposed Rules upon — that the CRS business is a monopoly market and that CRS companies are outrageously profitable, are totally incorrect. To prove that these premises are incorrect, only a brief examination of a few basic facts is required.

Let's look at the monopolized market premise. Here are the facts: First, agents change CRS's frequently in spite of the rhetoric that contracts between CRS companies and travel agents severely impede such changes. Second, travel agents are paying dramatically less for CRS services each year. Third, the basic booking fee to airlines did not increase - even to account for inflation - for five years. And fourth, CRS features and enhancements continue at a rapid rate.

These are not the characteristics of a monopolized market. In a monopolized market, at a minimum you would expect to see agents paying increasingly higher above market rates for CRS services each year, frequent large increases in above market rate booking fees to airlines, and very little or no investment for new features or enhancements. The facts demonstrate that contrary to the rhetoric, the CRS business is driven by vigorous competition.

Insofar as the premise of outrageous CRS profitability goes, the combination of substantially lower revenue from travel agents, the decrease - in real terms - of over ten percent in the last five years for the basic booking fee, and the increase in expense driven by the reality of fifty percent more work per booking transaction today than five years ago (this is what I refer as the fifty percent more work for ten percent less money phenomenon) has caused CRS profits to decline to very modest levels. In fact, since I believe Covia is the most efficient provider of CRS services, Covia may be the only profitable CRS on a truly stand-alone basis.

So now that I have that off my chest, let's look at some of the basic changes proposed by the DOT. I should say initially that the DOT took more than a hundred single spaced pages to explain its proposed rules, so given the time constraints of this morning, I can only touch on a few of the many proposed changes. Two of the basic categories of proposed
changes that I would like to briefly discuss are changes which govern the basic contract between the travel agent and the CRS company, and the changes which affect the provision of CRS services.

Insofar as the proposed contract changes are concerned, the DOT proposes to eliminate minimum-use provisions (i.e., the basic agreement between the CRS company and the travel agent that the travel agent will actually use the system), reduce the maximum term of the contract from five years to three years (given a prohibition on minimum use provisions and the result that an agent would have no obligation to use the system at all - the term of the contract may become essentially irrelevant), and prohibit productivity pricing (i.e., a CRS company could not charge a travel agent a lower rate if it used the CRS system more).

Insofar as the changes affecting CRS services are concerned, the proposed DOT rules call for multi-access through a single terminal and, at least in DOT's view, a greater ability for agents to use third-party hardware and software.

So what are some of the possible effects of the proposed rules? Again, given the press of time I will only be able to touch on a few possible effects. But since the effect on travel agents may have been overlooked, I would like to focus principally on those possible effects. It is worth noting, however, that some agents and agency associations opposed additional DOT regulation.

The first possible effect of the proposed rules is that they will result in financial uncertainty. This financial uncertainty stems from the fact that the basic economic pricing model in the CRS business will have to radically change because the basis of this model is the "minimum use provision" and "productivity pricing." The so-called "free automation" reported in the press is founded upon the basic agreement between the CRS company and the travel agent that the agent will use the system which in turn produces booking fees for the CRS company. The proposed CRS rules would prohibit this basic agreement between CRS companies and travel agents. This change in the pricing model may result, particularly for smaller agencies, in higher prices for CRS services. In addition, this financial uncertainty may discourage investment in United States CRS systems by their owners. This could jeopardize the technical leadership position enjoyed by United States CRS companies and undermine their ability to continue in a leadership position as CRS pushes towards globalization.

The proposed changes regarding CRS services may also have several effects. First, multi-access from a single terminal and increased use of third-party hardware and software may create a much more complicated and inefficient environment for travel agents. Multiple hardware, software and service providers could make the support and maintenance
environments much more difficult and complicated - the day of one stop problem resolution with the CRS company could be in jeopardy.

This could mean, for example, that when a travel agent experiences a problem with the system, unlike today when the agent simply calls the CRS company, the agent will have to deal with multiple service providers. In an environment of multiple hardware, software and maintenance providers the diagnosis and repair of the problems could be more complicated and more difficult. In addition, travel agents will need to train their agents to use multiple systems in a multi-access environment, and agents will also have to develop a mechanism to track what CRS system in which each particular traveler's reservation was made.

This is important because when a traveler calls at midnight to change her reservation and speaks with a different travel agent, that travel agent needs to know which of the systems accessible through the multi-access terminal contains the passenger name record for that traveler. Travel agents may indeed seek to maintain the simplicity and efficiency of their current operations even in a multi-access environment. This may evidence itself through agents settling on one or two systems which could lead to a substantial reduction in booking revenue for CRS systems which are not favored by agents. This in turn could lead to the reluctance of a number of carriers to continue to participate in CRS systems which are little used.

IV. CONCLUSION

Because of the negative rhetoric that you see regarding the CRS industry, it is often forgotten that CRS represents one of the most beneficial developments in the airline industry in its history. CRS is the reason that new airline entrants can get their products to market immediately without any up front costs. CRS promotes and facilitates a carrier's ability to immediately provide a competitive response to the fare and schedule changes of its competitors. CRS insures travelers of the lowest fare and the most convenient flights available, and much, much more.

CRS today is vigorously competitive and United States CRS companies, particularly Covia, are world leaders in CRS technology. In the nineties, absent overreaching and ill-founded regulation, CRS will provide even more benefits to carriers, agents and travelers on a global scale. I am optimistic and I am looking forward to helping shape the advanced global CRS systems of the nineties. Thank you very much.
T. Allan McArtor\textsuperscript{2}

Those of you who know me know that I have opinions on just about all the aviation issues of one type or another, but I'm going to try to focus my remarks today on the cargo side of our industry. Cargo is a legitimate player in the air transportation system. Most of the high-value, time-sensitive goods in our country and around the world rely on air transportation for their delivery. So cargo, freight and express are all very essential logistics links and not just some fly-by-night airlines as some would think we are.

The traditional transportation markets can be divided into three sectors: mail, parcel post and freight. In these traditional markets, there's little emphasis on service levels. While people relying on these services are interested in dependability, their sensitivity to time, certainly is relatively low. Additionally, there is little need to take any custodial control of the item in transit. And often these shippers and recipients don't require an invoice with complete accurate records of the transaction, much less proof of delivery of each shipment.

Over the years, however, a separate express market has evolved, also with three distinct segments: express documents, express packages and express freight. Freight is defined in this context as items which must be handled with equipment assistance. Unlike the traditional transport markets, all three express segments are highly time-sensitive. Because of their high value, strict custodial control is required.

Currently, there are two air transport markets. One, traditional mail, parcel and freight which is much larger in terms of unit volume. The other, the express market which is characterized by high revenue per shipment.

If present international trends continue, both of these sectors should have a strong economic future. Federal Express, of course, is a great believer in the long-term profit potential of the express market. Our rationale is based on three factors. First, expanding international trade. Second, the impact of economic downsizing. Third, the effects of fast-cycle production trends. It's hard to avoid the realization that the U.S. economy is becoming much more like the European and Asian economies, which are entirely tied to global trade.

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In 1960, less than ten percent of the U.S. economy was involved in global trade, and the vast majority of that was agricultural products and petroleum. By last year, that figure had grown to about twenty five percent of our GNP. But, that is already changing.

According to the U.S. Department of Commerce, as reported in the March twenty first USA Today, exports rose three point six percent in January to thirty-four point five billion. Imports rose four point eight one to forty-one point five percent and I predict you’ll see much more equal balance in the next two to three years, as soon as the recession dissipates.

Robert Ruska, an economist at Nico Securities, adds another bright note. Given restored U.S. competitiveness, he believes U.S. firms will find it easier to compete with overseas imports. Reports from our company’s North Pacific Region are of an international trend. One of the most dramatic changes they’ve witnessed is the current near equilibrium between westbound and eastbound traffic. Only two years ago, it was sixty five percent to thirty five percent. To show you how far this trend will probably go, let me point out that almost sixty percent of the German economy is devoted to international trade of one sort or another. Of course, a large part of that is intra-European which is why Federal Express has been developing its intra-Europe infrastructure.

In the United Kingdom and France, international trade figures account for about forty-five percent of the total and Japan is not far from that. In certain Asian economies, Singapore and Hong Kong for example, the figure is seventy-five percent to eighty percent. In short, the United States is the exception rather than the rule.

The international market is compelling because of market size alone. U.S. export goods and services have grown strongly in the past few years.

More importantly for the express market, this growth is coming from high-value products: computers, microprocessors, the ethical drugs, the enzymes, avionics, aircraft parts and high-priority documents required to close multi-national deals. More and more trade is becoming high-value in nature.

As Alan Greenspan, Chairman of the Federal Reserve Board, explained last October in the WALL STREET JOURNAL, while many factors are encouraging the expansion of world trade, one little known element has had a significant impact on trade across borders in recent decades. It is the marked downsizing of economic output. The creation of economic value in recent decades has shifted toward conceptual values, those created by new scientific insights and knowledge with far less reliance on physical volume. We can see evidence of Greenspan’s observation everywhere. One of the most obvious examples is the radio. When we were kids, you recall, radios had their requisite vacuum tubes and
were very bulky. Today, they fit in our pockets. Fiber optics replace thick bundles of telephone wire and financial transactions that once consumed reams of paper are reduced to electronic impulses.

Even our own industry has been affected. Our new aircraft, notably the MD11’s, are more fuel-efficient and have greater lift capacity. As Greenspan notes, the number of air travelers, with a notable exception of the Gulf Crisis period, has expanded greatly relative to the materials required to build and fuel large modern aircraft.

The downsizing trend has had a significant impact on trade across borders. High-value, easily transportable electronic computer parts and medicines, the items I cited earlier, are more attractive cross-border products than, for example, cumbersome building materials. And these products easily spill over borders that global telecommunications are already rendering nearly invisible.

In today’s “Global Village” protectionist countries now have to choose between becoming a market driven economy or building higher walls of protectionism, walls that will be much more difficult to sustain. Just as CNN found its way through the Berlin Wall, to Albania and Lithuania, over the Great Wall of China and into Saddam Hussein’s bunker, so too will technological innovation continue to stimulate the downsizing trend, making global trade nearly impossible to suppress.

All signs point to more open trade, lowered barriers and integrated economies. Europe 1992 is the paradigm. Europe 1992 offers a microcosm of the global distribution revolution. One in which product parts are culled from various countries, assembled in another, and distributed worldwide.

Implicit in the move toward downsizing and greater economic integration is the need for a highly reliable, rapid transportation system. A system from anywhere in the world to anywhere. That is what is driving Federal Express global expansion.

My guess is that all of us in the air cargo industry are experiencing the increasing momentum of this trend. Greenspan predicts that coordination of international economies is bound to expand and become ever more pervasive as the cross-border trade in goods and services grows as a proportion of world output.

With global integration comes international competition. Customers and suppliers half-way around the world expect the same high quality products and services as do their domestic counterparts.

What is more, high quality products and services are becoming the norm. More and more companies are recognizing that one aspect of quality, time, is the key differentiation point between them and their competitors. Toyota’s reduced production times are becoming legendary with
their ability to knock the competitors into the corner of their market. Other automobile manufacturers are responding with their own time-based strategies. Witness Cadillac’s Malcolm Baldrige winning “Simultaneous Engineering” process. These fast-cycle production trends bode well for the air express industry. Along with sophisticated information systems, air express enables any company to engage in Just-In-Time (JIT) methodologies on a global basis.

As Robert Hall suggests, in the 1990s, anyone who isn’t getting on board with sophisticated inventory management simply won’t be in business. If you’re competing in a world market and not doing this, you won’t be able to compete. We’re betting that there won’t be many companies deciding not to compete. A Council of Logistics Management survey findings support this notion:

- Inventory turnover at plant warehouses is expected to increase by almost two-thirds by 1995.
- The proportion of orders transmitted by electronic data interchange will increase from thirty nine percent in 1990 to fifty five percent in 1995.
- Out bound bar-coded shipments will increase from forty nine percent to sixty seven percent in 1995.
- Volume shipped just-in-time has increased from nineteen percent of shipments in 1987 to twenty seven percent in 1990 and will increase to thirty two percent by 1995.

The results are already impressive:

- Today, forty percent of US manufacturers use some form of JIT to enhance competitiveness.
- Today’s inventory to sales ratio in the United States is twenty five percent lower than the early eighties.
- Inventory carrying costs are down from thirteen point seven percent of GNP in the seventies to ten point eight percent by the end of the eighties.

With this kind of impact on the bottom line, we believe more companies will increase their use of JIT methodologies turn to global inter-modal transportation systems to add value to the process. That is why Federal Express is extending its real-time information system, COSMOS, internationally at nearly the same pace it is expanding its air-ground network. Our ability to track packages every step of the way, from pick up to delivery, concurrent with providing inventory management information on a global basis is value-added to our customers. We intend to be more than an international air express company. We intend to be the logistics arm of choice for any company wishing to compete globally.

I couldn’t help but plug FedEx just now. The point is the direction we’re going quite clearly is the direction global trends are pointing: Expanding international markets, the downsizing of products and services and the increasing reliance on fast cycle methodologies. These factors also indicate there will be strong international markets for both express
and traditional transport segments. This rationale was behind our acquisition of Flying Tiger Lines and its global network, route authorities, landing slots and airport facilities.

We realize the risk with the international freight markets, therefore, we will continue to focus on the express business even though there are a few short-term concerns. First, we can’t ignore the current volatility of the intercontinental freight market.

Pacific markets that were up in 1989 were down sharply in 1990. While the same is generally true in the trans-Atlantic markets, the U.S.-to-Europe market is reflecting the integration of global economies trend. Europe is buying an increased share of U.S. goods. Secondly, it’s apparent that over the next several years there will be a tremendous increase in marginal cost, wide-body lift capacity. The reason, of course, is the introduction of the new, ultra long-range aircraft I mentioned earlier, the MD-11, A340 and B747-400.

This means that sectors previously unable to accommodate any under-belly freight, now can. On their U.S.-Australian route, United Airlines, for example, replaced their 747-200 with a 747-400. This increased their under-belly lift capacity from zero to 34,000 lbs. A United hub in Taipei has created more under-belly lift in the Pacific Rim.

Just compare the cost structure of an all-cargo aircraft, combination aircraft and under-belly freight movement on a JFK/Brussels run. Then extend that to a Frankfurt/Tokyo run and compare the relative cost differences when talking about longer distances. There’s about 1200 more miles in the Frankfurt/Tokyo route. The costs assigned to under-belly are about forty percent to fifty percent lower than a fully dedicated all-cargo aircraft. When we look at the Belgium market, we see that costs are twenty-seven cents per pound for the under-belly aircraft, forty-five cents per pound for the combi-aircraft and sixty-nine cents per pound for an all-cargo freighter.

Notice, too, on the horizontal axis a comparison of supply and demand. 92 million lbs. of demand versus the current supply of about 153 million lbs.. On the face of it, not a pretty picture for the all-cargo carrier.

Needless to say, we are asked constantly, “Aren’t you worried about all that lift capacity coming into the marketplace?...” and “Aren’t you concerned that both combi-aircraft and under-belly space has a price advantage over your all-cargo aircraft?” One hundred and fifty-three million pounds of freight lift with only 92 million pounds of demand in just that one market?! Sure we’re worried, but only in the short run.

We believe there is a growing global air express freight market. We plan to do our job right and fill the express niche. Clearly, there’s room enough for everybody. Freight forwarders and passenger carriers can
more profitably serve the traditional air freight business. They can perform a role for the price sensitive freight market that we cannot. On the other hand, in the traditional market, the customer will find the marginally priced product is simply not responsive to their time-certain, custodial-control, service sensitive, information-intensive shipments.

The short-term hurdles are a challenge. We expect they will be for the next couple of years, but as the trends I discussed make an even greater impact on the global marketplace, we expect the air cargo business, in general, will profit enormously from it in the coming century.
JOHN W. TIMMONS

I would like to begin my remarks by borrowing from Robert Cutner a phrase which I believe is relevant to this discussion. That is the tyranny of the economically correct. This applies to the airline industry and I think it applies to other industries as well. But since we’re here to talk about the airline industry, that’s what we’ll focus on. I think an objective study of history will show that over time it has been recognized that the simple interplay of supply and demand through unregulated private transactions does not always lead to the best possible outcomes either for citizens or for nations. I think that is very applicable to the state of the U.S. domestic airline industry. I think we should be seriously concerned about the great impact and great potential for damage that exists under the tyranny of the economically correct. This is an attempt by some to state that deregulation has succeeded. End of discussion, let’s move on.

This panel is supposed to address the idea of where the industry is headed and that is, of course, very intertwined with deregulation and how it will proceed in its second decade. I think there is no doubt that the industry is and will continue to globalize. I think there is no doubt that national boundaries will eventually come down, and with all due respect to my friends from labor, I think that the term cabotage will become as outmoded a term here in the U.S. as the term State Collective is becoming in Eastern Europe. I think the question turns on how we get to this globalized state and when we get there. The answers have deep ramifications for our country and for the industry. I think in large measure this depends on how we as a nation respond to what has happened in deregulation for the first decade and what we do about it in ensuring its success in future decades.

The U.S. market comprises over fifty percent of all the world’s aviation traffic. As such, it’s an incredible lever and influence, or should be, on all other markets. We should be using this lever to achieve our goals as an industry and, of course, as a nation. But with this opportunity comes risk. With any opportunity comes risk and with that comes the potential that we could blow it. We could wind up giving away our market and not getting back commensurate returns. I believe that we are at the proverbial fork in the road. In one direction is industry concentration, in the other direction is a competitive environment. And I believe these are mutually exclusive.

3. John W. Timmons, is graduate of Albion College and earned his law degree from Washington and Lee University. In the past decade, he has had extensive experience holding key staff positions in both Houses of Congress. He served as Deputy Assistant Secretary of the United States Department of Transportation before becoming Minority Counsel to the Subcommittee on Aviation of the Senate Commerce Committee. Recently, he was named Vice President of Government Affairs for America West Airlines.
All the empirical evidence I have seen shows that fares increase in the face of concentration, and they decrease when healthy competition is present. I'm sure most of you, if not all of you, are familiar with the General Accounting Office (GAO) and the Department of Transportation (DOT) studies over the past couple of years and with the DOT study that they put out last year. I think these clearly show the truth of the trends I mentioned above.

I might also add that we at America West are working on a market power study. It's a regressive fare analysis. Don't ask me to explain that. I'm not an economist. That's just what it says at the top. But we have analyzed the 999 top domestic U.S. markets, and while I am not in a position to present the entire study, I think some of the evidence is interesting, given what has happened on the national scene and some of the statements that our national leaders have made about competition.

Our study indicates the most competitive market in the U.S. on a non-stop basis is Cincinnati-Chicago. There are seventeen non-stops between Cincinnati and Chicago. That includes the three hubs of Delta, American, and United. Our study indicates the average fare in that market as opposed to the average industry fare, weighted for all the appropriate variables, is double. So you have up to three supposed competitors beating each other's brains out by charging twice the average fare that exists in most U.S. markets.

Our study also indicates that American and United fares in markets where Midway is not present are close to twenty percent higher than markets where Midway is present. Our study indicates that American and Delta fares out of Dallas-Fort Worth are twice that in markets where Southwest is not present. In other words, Southwest's presence reduces the fares by half. I think that clearly shows the impact of competition and diversity on the industry. Particularly on fares.

Given the state of the industry, given the returns the industry has produced over the last few years, maybe fares are too low, and they should go up. What sort of significance does that line of reasoning have if you take it to the level of competition that exists in the Cincinnati-Chicago market? I think the significance is all around us.

If any of you read USA Today, there was a big article in the Money section on how attendance at conventions was down...the article cited the experience of the editor of the Charlotte Observer who found it more in his interest to drive 850 miles to a convention than fly because of the price. He was going from Charlotte to Philadelphia, which is a hub-to-hub case. These rising fares will dramatically slow growth in the domestic market. There is a Boeing study where they showed that the growth of the industry domestically depends on expansion of the industry into the middle and lower-middle classes. If fares keep going up I don't think...
there is much reality that expansion is going to occur. If that expansion does not occur, what will happen is a stagnating industry, and a stagnating industry reduces opportunity for everybody.

In contrast, a growing, highly competitive industry provides opportunities for everybody and produces a more vibrant industry which is much more competitive. I would give as an example the state of the automobile industry here and in Japan. Japan has a market that's approximately our size yet they have nine automobile companies and we have three. I would ask you this question: Do we want our aviation industry over the next two decades to experience, vis-a-vis the rest of the world, what we've experienced in our automobile industry, vis-a-vis the Japanese.

I think that when we saw a concentration in the auto industry, we lost quality. We were forced to invite or allow, and I'm not saying we should not have, foreign competitors into our markets to restore that quality. As a result of that, we've lost jobs, lost market share, and I don't think we really gained much in terms of penetration of the Japanese market. So we essentially gave away a good section of our market and got little in return. I think international aviation will be similar. We cannot give away our market without getting commensurate benefits. Earlier I said a study of history will indicate that you just can't rely on economic factors pricing decisions. I think aviation, clearly, is a good example of that. Aviation is a very nationalistic industry. All nations want an airline with their flag on its tail. To think that countries will surrender their industries in some sort of globalization wave is not realistic. I think that's something we have to plan for. If we're going to get more access, other countries are going to exact a price from us. A good example of that is the recent U.S.-U.K. bilateral. I don't think it's in our country's best interest to have a series of bilateral similar to that one. It's my view that we gave a lot more than we got.

I think the answer to all this is the maintenance of a highly competitive domestic industry. We are on the opposite road now to a very concentrated industry. I think the competitive problems are clear. The recent DOT study, along with the GAO, are in virtual agreement on things like frequent flyer programs, travel agent commission override slots and majority-in-interest clauses which deny people, especially a new entrant such as ourselves, access to the aviation system, and the ground system, and the air traffic control system. I think also that the U.S.-U.K. bilateral demonstrates that foreign countries recognize the power, the market power certainly, of such things as CRS and frequent flyers. In fact, in Europe, they have decided not to compete on that basis. I really question whether we are going to gain any more penetration and any more benefits vis-a-vis Europe until we deal with those competitive tools. I don't think they'll let us come riding into town with CRS in one holster and frequent
flyer in the other and start blazing away. They are going to make sure that they disarm those particular weapons before they allow us in.

In addition to that, a new domestic competitive problem has arisen: The sale of international routes. It was always my understanding that when a company was in trouble, a company would shuck off the parts that weren’t making much money for it, and concentrate on the stuff it did best and was the most profitable. What government policy has done by allowing the buying and selling of international routes is give incentive for companies to shuck off those parts that are the best and keep those parts that are not working. That is, of course, a recipe for disaster.

As long as international aviation is regulated, what you have are exclusive economic franchises that must be allotted on an equitable basis if you are going to have true competition. If you allow those with the deepest pockets to hoard the exclusive economic franchise, you will distort and eliminate competition. I think the sooner we deal with these problems, the sooner we get on the path to a healthy industry with vibrant competitors, the sooner we’re going to be able to realize the benefits of a more liberalized international aviation regime.
The Legal and Regulatory Environment: Safety and Labor

DONALD W. MADOLE

I think the first thing I should do is authorize all of you to have the same authority that a Circuit Judge has and that is if I say something that you don’t understand, because I am here to share what little knowledge I have with you, you can, just like the Circuit Judge, stop me and say well now, what about that.

So now for all of you judges. I think the important thing now is the safety environment. You know that we live in a society that can send people back and forth to the moon safely. We sure ought to be able to get them from Denver to Chicago. We have the capability of doing that and let’s go back historically to see what has been done and what has not been done.

When I first joined the brand new FAA in 1960, I thought I’d spend a couple of years in Washington and then go back to Colorado, but I’m still in Washington. During that time period there was a mid-air collision over Staten Island where a United Airlines DC8 went through its clearance and collided with a Super Constellation. This brought up the issues of air traffic control and the use of radar for the first time.

At that time, our government and the Department of Justice said that they wanted to find at least a couple of lawyers that had experience in jet aircraft. Well, I was one of them. John Baker, who later became President of the ALPA and was an Air Force pilot, was the other man. Both of us were less than one year out of law school. We had passed the bar and they sent us to New York to defend the U.S. government. But I can tell you that on both sides of the aviation bar, those who do this continuously, that I have not met any of those lawyers who have ever once, in my knowledge, have ever made an untruthful statement to the court or to their opposition. And I am very honored to work with people like George Tomkins who’s sitting there. My colleagues here, Aaron Potters. There are some very fine lawyers and they do, in fact, try to make this system safer.

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1. Donald Madole is currently a Partner with the law firm of Speiser, Krause & Madole. He is a graduate of The University of Denver College of Law. Prior to becoming a lawyer he was a naval aviator for 38 years. He has also served with the Civil Aeronautics Board, the FAA, and American Airlines. He was a U.S. Delegate to ICAO.
Now, how are we going to make it safer? For one thing, I am sorry to say that I believe that General Cosada was the best administrator the FAA ever had. He made the rules and he made sure that everyone that worked for the FAA had one job and they better do it. I’m sorry to say that political appointees are not always the same. We have a problem. We have a problem with our FAA and the manner in which they are looking into Airline Safety.

First, we’ll talk about the maintenance of the aircraft. Can you imagine with a major airline that corporate officials direct their lowest level management to write off inspections that were never made? They call it pencil perfect. I am amazed that our FAA inspectors did not ever go behind those so called inspections because everyone was talking about them. So what do we do about this? I think we have to continually let our friends in the press know when something like this happens. I have participated in about sixty three major airline crashes. And I would be absolutely delighted if I never had another one. Do you know how many years it has been since I have seen an airplane crash from a new cause? About fifteen years. You don’t see airplane crashes from new causes. Now I’m suggesting to you that there are certain things that we need to look at.

One is why don’t we have ground radar? We have the capability. Many of the runway collisions we have had in the past two or three years occurred right here at Stapleton Airport. And what about Los Angeles and the December third Northwest crash in Detroit? Can there be any excuse? I’m suggesting to all of us: the economists, the people that run the travel agencies, the people who are part of this great and wonderful industry, that we had better be putting a lot of attention into the safety issue. If we do that, then we will be able to lead the rest of the world in this area. When I talk about what can we do, obviously I don’t want to talk about any cases I am handling right now. But, let’s take the Chicago American Airline DC10 crash. Here is one where American Airlines found a system where they could take the engine off and do an inspection without following the procedures of McDonnell Douglas.

What happened was they had a forklift, and the forklift came up and they undid the engine and inspected the pillion supports, (metal devices that hang down under the wing). The crew went to lunch and the forklift lost some hydraulic power and when it tilted it broke the aft pillion bulkhead. Now, when that airplane took off, all three engines were working perfectly. As the engines rotated, the pillion fracture continued on across, and the engine flew up and over the wing just like it was supposed to. It was designed to do that. Remember on a jet aircraft if you look at the side of a wing of a jet aircraft, it looks almost like an arrow when it’s in flight. When it’s on the ground getting ready for takeoff, to create the lift to get off easily, it looks like half a grapefruit. What happened was, on the
left side of the airplane when it went up and over, it tore off the hydraulic lines and therefore the leading edge slats came back so you had one wing that stalled and the other one turned over, went upside down, the plane crashed, and as a result, 280 plus people were killed.

Now, where were the inspectors in Tulsa? Where were the FAA inspectors when this new, unauthorized procedure was being used in Chicago? By the way, the reason there was finally some admission that they know it had some crack in it, and the reason that they did not pull that airplane out of service was because United was on strike and they were flying the airplanes full. Now, that information came out in court. But what did our government do about it? Well, for one thing, the Secretary of Transportation asked that a special committee be appointed by the National Academy of Science. We discussed what we should do to make a step forward in safety. We have fail safe parts in aircraft and they have to be tested to be fail safe and we test them, but the issue has never been resolved as to what you do with a part that isn’t fail safe? If it isn’t fail safe because it isn’t required for flight, if it breaks, could it break a part that is required for flight?

That was a regulation that we proposed back in 1981. It was in the FAA’s development, if you will, as opposed to rule making for some years, and the FAA didn’t do it. In fact, they withdrew the notice of proposed rule making ten days before the Japan Airlines 747 came apart at Sakura, Japan. So let me suggest that those of us who know a little something about how our government operates, and how our legal system operates... Let’s put some time and thought into making sure that we have the safest airplanes in the world because we have the capability to do it. I know and you know that if we have safe flights, we’re all going to have jobs.
MICHAEL S. OLIN

When Don Madole called me about three months ago and graciously asked me to speak, I said, I'd love to come out to Denver, what do you want me to talk about? He said I want you to talk about aviation litigation and the litigation environment during this two day conference. And I said which day do you want me to take? He then said you have fifteen to twenty minutes, so I already knew I was in trouble before I got on the plane to come out here because there are so many issues and so much is going on in the tort litigation field that to talk about them in twenty minutes is well nigh impossible. What I have decided to do is take an issue that is real hot right now. The most important issue is the Warsaw Convention because it is very hot both in the courts and Congress.

The Warsaw Convention was passed in 1929 as a treaty. It was ad- hered to by the United States in 1934. It's a treaty among nations that governs international air transportation. As originally passed, it was based on the notion that because aviation was in its infancy and there was a risk of destroying the carrier if there was a major crash. It, therefore, limited liability for carriers. If there was an international air crash under the original Warsaw Convention, the limitation of liability for damages was about $8,300 per person. That was the law from 1934 until 1965 in the United States. There are other countries that still adhere to it as it was. But in the United States in 1965, it became apparent that $8,300 wasn't enough and that the aviation and insurance industries were advanced enough that damages could be addressed on a more realistic scale. As a result, the United States renounced its participation in the treaty in 1965, effective six months later. To avoid renunciation becoming effective, the international aviation community, with the agreement of the United States, entered into the Montreal Agreement, which was a special contract authorized by the Convention, that says that the parties can agree to do something else if everybody has agreed to do it. The Montreal Agreement did a couple of things. It said: (1) the limitation of liability is raised to $75,000, (2) there is what I call absolute liability up to that amount for any "accident," and (3) if you want to get more than $75,000, you have to prove that the carrier was guilty of willful misconduct.

Now, what does this apply to? The Montreal Agreement is not the law everywhere, but it is the law for every flight that starts, stops, or ends or has connection with an itinerary that starts, stops, or ends in the United

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2. Michael Olin is a partner in the Miami Law firm of Podhurst, Orseck, Josephberg, Eaton, Meadow, Olin & Perwin. He received his law degree from the University of Michigan, Magna Cum Laude. He is currently Vice Chair of the Civil Procedure Committee and also has chaired the Standard Jury Instruction Committee. He currently serves on the Board of Directors of the Florida Academy of Trial Lawyers and also on the Board of Governors of the Trial Lawyers of America.
States. That means that if I am going to London and I buy a ticket that goes Miami on to Atlanta, British Air from Atlanta to London and Pan Am from London back to Miami direct, the Warsaw Convention applies to the Miami-Atlanta leg. Most people don’t realize that the Convention governs the Miami-Atlanta leg as well. Which means that if Mr. Madole and I are sitting next to each other on the Miami-Atlanta leg of the flight and he is going home to Washington, but I’m getting on a plane to go to London and God forbid the plane goes down, his claim is subject to a completely different set of rules than my claim. My claim is limited to $75,000 absent willfull misconduct, whether the carrier was at fault or not. Fault is irrelevant. If the plane is hijacked by third parties and I’m injured and he’s injured, whether the airline is at fault or not, they are responsible to me up to $75,000. Mr. Madole has to prove some level of fault to recover, but he’s not subject to the $75,000 limit; he’s subject to whatever the law is of the appropriate state in the United States that governs his particular claim - a completely different set of rules. This causes all sorts of problems because it happens all the time.

The reason that the Warsaw cause of action is hot these days is because of Lockerbie. Everybody is reading about Lockerbie and the $75,000 cap for all those people. I’m not going to talk about the litigation in detail. I think generally, throughout the United States, people are of the notion that $75,000 is an inappropriately low limit on liability for the death of people who were killed in an international air disaster. The question of fault is a different issue. But the limit is inappropriately low and so there has been a move afoot to change that and I’ll talk a little bit more about that as well.

The other thing that’s coming up in the Warsaw context now, and this is real, is the type of stuff that’s taught by law professors who wear tweed jackets with patches and smoke pipes and look at the ceiling as they talk - very theoretical stuff. We have a convention that up until the mid seventies, it was held, did not create a cause of action. If you were injured in an international air accident the law of whatever local forum governed and was applied, Florida law, Georgia law, etc.. If that law provided a remedy, that’s the remedy you sued upon. Warsaw simply provided limitations on the remedy. Up until the mid seventies, it was almost universally held that Warsaw did not provide an independent federal remedy. In the late seventies, in a case called Benjamin, the Second Circuit Court of Appeals in New York did a backflip. That was the jurisdiction that first said “no remedy” and now changed its mind and said yes, Warsaw creates its own remedy independent of state law. You can now bring an action under the Warsaw Convention itself if you are injured in an international air case. Finally, we have now come almost full circle because two weeks ago the Second Circuit said that not only can you bring an action
under the Warsaw Convention, it’s the only action you can bring and you have no state law remedies anymore. The Eleventh Circuit has been divided on the issue. Is Warsaw exclusive? Can you still sue on the state law remedy? If you can only sue on Warsaw, can you bring it in state court and stay there? Or does it have to go to federal court? Lots of undecided, difficult legal issues that effect the substantive rights of the people who are on these airplanes because it effects where and when and under what circumstances they can bring a claim. Can they bring a claim, like in Lockerbie in the Florida state court? Do they have to be in federal court before Judge Platt in New York? All these are issues that are being litigated right now and are going to go up and are going to be resolved some day at the Supreme Court level.

Now, under the Warsaw Convention, in the same case out of the Second Circuit, the Second Circuit ruled, agreeing with the Eleventh Circuit, that you cannot get punitive damages under the Warsaw convention. This raises an entirely new issue of substantive, public policy. Are punitive damages beneficial? Do they do what they are supposed to do? Do they act as a deterrent for bad conduct? Will the inability to assess them mean that Ford’s Pinto case will never happen again, or that we just won’t find out about it? We can argue that one issue for an entire day. That’s not in the Supreme Court right now. There is a Warsaw case in the Supreme Court on another issue. If you claim a Warsaw cause of action (say I don’t like the state remedies and I want to recover under the Warsaw cause of action) what are the damages? What kind of damage law do you have? Warsaw refers to state law damage laws. But, does it create its’ own?

This is the Eastern Airlines case from Miami to the Bahamas. An L1011, all three o-rings were left out of the three engines and one by one the engines shut down. The airplane’s at 30,000 feet traveling to the Bahamas with no engines. The plane is prepared for ditching. Everybody on the plane thinks they are going to die. The crew, fortunately, was able after about ten minutes, to restart one engine, turn the plane around and land at Miami International Airport. Now maybe I was foolish, but I thought that was kind of an interesting case to bring for emotional distress. If there was ever an understandable claim where people would have emotional distress, that might be it. Now, standard common law says well, if they didn’t get hit, they didn’t bang their head, or something didn’t happen to them, you have no claim for emotional distress. Sometimes we have to try to change the law. So, we brought a claim for emotional distress for about thirty of the passengers on this aircraft and we worked our way through the District Court. That Court said we had no claim. We worked our way up to the Eleventh Circuit and lo and behold, we won. The Eleventh Circuit says no, you don’t have to look at state law.
The Warsaw Convention creates a cause of action and it will allow you to recover for emotional distress because the term lesion corporelle, which is what the Warsaw Convention is written in French, encompasses that.

Now we’re at the Supreme Court and that was argued in October. I have to tell you that was a great experience being in the Supreme Court. The slippery slope that you’re on in that case is very, very interesting because Justice Marshall asks my partner, “you mean to tell me, Mr. Plaintiff’s Lawyer, that if I’m on a plane with three engines and one of the engines goes out and I get scared, under the Warsaw Convention, because we’re not talking about a domestic trip, we’re talking only international, under the Warsaw Convention that’s an accident? And I left some money on the table somewhere back in the past?” And the answer to that under our position was yes. It may not be very much because you weren’t really in danger from one engine loss, but that is an incident as defined in Air France v. Saks. So as that question is asked, I say we’re dead, we can’t possibly win this case. But then, I think it was Justice O’Connor, and this case makes strange bedfellows folks, Justice O’Connor asks Eastern’s lawyer, John Murray (another friend of ours from Miami) “you mean to tell me that if Mr. Madole and Mr. Olin are sitting next to each other on that plane and Olin bangs his head on the seat and Madole doesn’t, that Olin gets to recover but Madole doesn’t?” The answer to that was also “yes” because traditional notions of common law say that an impact, any kind of an impact, is enough to sustain a claim for emotional distress. So that was ridiculous and Eastern sat down and said how are we going to win this case? Nobody knows what they are going to do. They are going to rule any instant and we have another issue on the Warsaw Convention.³

Now, there is also pending legislation to change how the Convention works. I have to tell you that the reason that this has come about is because the Warsaw Convention is so bad. If we didn’t have the $75,000 limit, with stupid rules like we’ve now got, we wouldn’t have to come up with bad legislation to try to fix it, and the legislation that we have in Congress at the moment, it’s been there the past couple of years, I think it’s chances are improving of passage much to my chagrin, are basically that passengers on international air flights will buy first party insurance mandatorily. There will be a surcharge of two or three dollars a passenger and they will buy first party insurance that will be administered like third party insurance. What that means is it’s like you bought life insurance from the Mutual of Omaha before you got on the plane. You’ll pay your two or three dollars to the carrier who will collect it, pass it along to a

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³ The Supreme Court has since ruled in the case that the Warsaw Convention will not support a claim for emotional distress under the circumstances there presented.
contractor, which is another insurance company, which will insure you above the $75,000 limit, but you still have to fight with them about how much. It's not like you are buying $100,000 or $200,000; you're buying the right to collect more than $75,000 in an amount to be determined, whatever the local if local law allows it. I'm not sure that it's a good idea, in fact, I am sure that it is not as good, in my opinion, to have first party insurance insuring you against the negligence of third parties. Wrongdoers ought to be accountable for their own wrongs.

And I don't like this absolute liability stuff either, personally. I think you ought to be accountable when you do wrong and you ought not to be accountable when you don't. The truth is, planes don't go down in this day and age unless somebody made a big mistake.
Many unions still successfully use traditional methods to exert economic pressure on employers during bargaining. Others, including the unions that dominate the airline industry, increasingly complain that such techniques are no longer effective because in the current economic and political climate, the balance of power is overwhelmingly in the hands of management. Organized labor's principal argument is that employers' increasing willingness to operate with permanent replacements during strikes has rendered what has always been labor's ultimate weapon — the strike — ineffective as a bargaining tool. Consequently, organized labor has dedicated substantial resources to the development of new tactics — short of the strike but equally devastating — to exert pressure on recalcitrant managements.

One increasingly common tactic used by airline unions is to publicly question the safety of a target carrier's operations. In the airline industry, public confidence in the safety of air travel is of paramount importance. No air carrier can long survive if it is perceived as operating with less than the highest degree of safety. In the last several years, airline unions have increasingly and effectively used the safety issue to bring economic pressure on carriers with which they have disputes. One tactic has been to disguise work slowdowns as safety campaigns — which serves the twofold purpose of enabling the union to claim moral high ground while subjecting the carrier to unnecessary delays based on supposed safety concerns. Unions have also found that expressions of concern over safety provide an effective substitute for a call to boycott the carrier, a call which the public might not support if the underlying dispute is perceived as economic in nature. Allegations of safety violations may also trigger governmental investigations and penalties which bring additional pressure on management — all at no cost to the union.

Although the public interest is undoubtedly served by the raising of legitimate questions concerning the safety of a carrier's operations, the raising of such questions as a mere tactic in a labor dispute unnecessarily undermines public confidence in air travel and arguably is undeserving of protection. In the present statutory environment, however, carriers have little recourse against unfounded and highly damaging safety allegations made by unions in the course of disputes with management. Set forth below is a brief description of the way in which safety issues may be raised, followed by a proposal for a possible legislative approach to dealing with the problem.

4. Richard L. Wyatt, Jr. is Partner of Akin, Gump, Hauer and Feld in Washington, D.C.
A. THE SLOWDOWN

Because of the pervasive nature of governmental involvement in all aspects of airline operations, airlines have proven particularly vulnerable to employee slowdowns masked as safety campaigns. The International Association of Machinists ("IAM") used such a campaign against Northwest Airlines in 1987-88. In 1991 the public was treated to the cancellation of twenty percent of American Airlines' scheduled flights after the Allied Pilots Association, the labor organization representing the American pilots, launched its own version of a slowdown. The Air Line Pilots Association's ("ALPA") "MaxSafety" campaign against Eastern in 1987-1988 remains, however, the most conspicuous example of a slowdown masquerading as a safety campaign. As part of the ALPA-sponsored program at Eastern, ALPA members repeatedly delayed or grounded flights with last minute write-ups of items that in many cases were not in fact broken. As a result, Eastern incurred unprecedented levels of late departures and canceled flights.

The IAM also engaged in a slowdown against Eastern, steadfastly refusing to complete maintenance repairs in a timely fashion. The slowdown intensified during the thirty day cooling off period prior to the IAM strike of March fourth, 1989, and, as a result, a substantial percentage of Eastern's fleet was grounded for maintenance checks and repairs which IAM members simply refused to complete. In Eastern Air Lines, Inc. v. IAM, No. 89-0249 (S.D. Fla. February seventeenth, 1989), Eastern alleged that IAM members were taking three times as long as normal to complete the FAA-required heavy maintenance checks. The court enjoined IAM's slowdown activity. On the eve of the strike the slowdown escalated to violence and property damage and the court interpreted its injunction to permit Eastern to "lock out" the IAM mechanics and escort them off the property before the strike actually began. As the Northwest, American and Eastern experiences demonstrate, a concerted, cynical "work-to-the-book" program can effectively cause the delay or grounding of aircraft, resulting in large, unrecoverable losses of revenue and goodwill for the carrier.

To be sure, a slowdown in the form of a safety campaign is enjoinable in many circumstances, just as an outright strike would be. In any such injunction proceeding, the difficulty is in proving that a slowdown

rather than a true concern for safety, is the motivation for the concerted actions of the employees.

Beyond that difficulty is the strategic question of whether to seek an injunction. Injunctions are hard to obtain, particularly where the union cloaks itself as the champion of public safety. And, as was seen at Eastern, injunctions are hard to police. Even if successful, a court proceeding will likely have the effect of publicizing the union’s allegations, and the employer risks the appearance that it is exhorting its employees to work at less than the highest level of safety.

B. CONSUMER BOYCOTTS

Safety campaigns can also effectively mask a call for a consumer boycott of a target carrier. Again, Eastern provides a timely example. In 1988, Eastern’s unions began a concerted campaign of publicizing what it alleged to be unsafe maintenance practices at Eastern, coupled with pleas to support the unions and not travel on Eastern flights. As part of their public relations strategy of making Frank Lorenzo “the issue,” the unions’ leadership characterized him as a “cost cutter” unconcerned with safety and, as a result, Eastern itself was “unsafe.” During a brief period in 1988, union members systematically produced over 1300 postcards to the Secretary of Transportation alleging specific safety violations at Eastern. The unions then lobbied Congress to force the Secretary to launch a special investigation of the high number of safety complaints at Eastern and at its sister carrier, Continental Airlines.

The result was an unprecedented Department of Transportation (“DOT”) investigation which included over 1600 ramp inspections and the grounding of Eastern and Continental planes, wherever they landed, for unscheduled FAA inspections. While this was taking place, teams of government lawyers and investigators conducted interviews, depositions and meetings with more than 200 employees and corporate officials, and examined tens of thousands of pages of documents at five airports and the corporate offices. The investigation significantly eroded managerial resources, and had a significant negative impact upon the public’s perception of Eastern’s safety.

The DOT ultimately recognized the unions’ safety allegations for what they were — merely another weapon in the unions’ war against Eastern. (1) Even though the DOT exonerated Eastern of the unions’ charges, Eastern never recovered from the adverse publicity created by the investigation. Although the unions point to the later indictments of Eastern maintenance personnel as confirmation of their safety claims, proof that a few violations may have occurred falls far short of validating their entire campaign. The degree of governmental and regulatory scrutiny that the un-
ions were able to bring upon Eastern through their unprecedented safety-based campaign demonstrates the brutal effectiveness that such a tactic can have, even when the underlying allegations are almost entirely without merit.

C. A LEGISLATIVE PROPOSAL

That the public interest is served by the raising of legitimate questions of airline safety does not justify continued toleration of the use of unfounded safety allegations to gain financial advantage in labor disputes. As our nation’s labor laws are currently interpreted, however, unions are free to make such allegations without fear of liability, and carriers have little recourse other than to mount their own public relations campaign — which will almost certainly have the effect of further publicizing the union’s charges and thus do more harm than good. A legislative solution to the problem may therefore be necessary, and could be formulated along the following lines.

First, in order to ensure that legitimate safety concerns are not discouraged, Congress could provide statutory protection for the “whistleblower,” an individual employee who in good faith reports what he believes to be a violation by his employer of safety related statutes or regulations. At present, the Federal Aviation Act contains no protection of whistleblowers, but Congress has previously seriously considered the issue. The House passed whistleblower legislation in 1988, and the Senate Labor Committee approved similar legislation, S. 436, on April 25, 1990.

Second, in order to ensure that even legitimate safety related claims are not misused to gain an advantage in a labor dispute, Congress should require that reports by “whistleblowers” be made in good faith and in a timely fashion. Persons making allegations of unsafe practices should not be allowed to hide behind statutory protections to hoard evidence of possible violations for later disclosure at an advantageous moment in an economic dispute with their employer. For example, during the DOT investigation of Eastern, neither ALPA nor IAM presented evidence to the DOT of any management practice that raised safety concerns until the DOT was almost ready to issue its report, despite the fact that much of the evidence concerned activity that had occurred much earlier and had apparently been known to the unions but was withheld for strategic reasons.

Third, the public interest requires that the carrier as well as the government be alerted to any alleged violation as soon as evidence of that violation becomes available or substantial allegations of unsafe practices are made to the government. Such notification could be required of the individual, but certainly should be required of the governmental authority to whom the individual makes the allegation. For either the unions or the
government to fail to promptly alert the carrier to alleged violations so that it may take steps to remedy any legitimate problem that exists would serve to place parochial economic or prosecutorial goals over the public interest.

Finally, the labor laws should be amended so that allegations of unsafe practices made in the context of a labor dispute are subject to the same standards of libel and slander as they would be outside of that context. Under current law, statements made by unions or their members during labor disputes must be shown to have been made maliciously in order for a victimized employer to recover the libel or slander. False or unfounded claims of safety violations in the airline industry are deserving of no such heightened protection.

D. CONCLUSION

The increasingly common use by unions of spurious safety concerns in labor disputes in the airline industry raises significant difficulties for the target carriers, as well as additional questions regarding whether such charges serve any legitimate public interest. An airline faced with such allegations has few attractive choices, since the publicity that is likely to accompany even a successful attempt to enjoin the union’s conduct may be as damaging as the union’s own efforts to publicize the dispute. The battle likely will be fought in the public relations arena, and counter-publicity may be the carrier’s only really effective weapon. The volatility of the issue and the absence of any truly effective defense to such charges suggests that new legislation, designed to protect legitimate safety claims, but to discourage the kind of abuses that have recently occurred, may be necessary.⁶

6. In a letter to ALPA President Duffy, dated April 22, 1988, Transportation Secretary Burnley stated:

I object strongly to efforts to make safety a pawn in a labor-management dispute. There are well established mechanisms for addressing labor-management issues, and a campaign focusing on allegations of safety mismanagement for the sole purpose of pressuring the people on the other side of the table is not one of those mechanisms. The FAA tells me that only six out of more than 1,300 allegations could be substantiated...I appreciate knowing that ALPA’s postcard campaign is essentially over...After ALPA and the IAM petitioned the DOT to reopen the investigation, Secretary of Transportation Burnley harshly criticized the union’s “safety” campaign, calling ALPA’s petition “a transparent attempt to put pressure on Eastern by raising new safety concerns.” DOT News Release, December 14, 1988.
Sometimes it's good to be a procrastinator. I must admit that I have that tendency, particularly when it comes to preparing presentations such as this one, where my objective is to provide timely information. And, especially, when the industry I'm dealing with is the airline industry where everything seems to change about once a day.

Had I begun my preparation when this program was announced, Eastern would have still been flying, Midway would still have been solvent, Pan Am still would have been solvent and independent of United, and TWA wouldn't have been on the verge of liquidation or being taken over by Kirk Kerkorian.

Had I prepared my remarks just two weeks ago, on the airport access issue I would have discussed in detail the fourth Circuit's *Omni Outdoor Advertising v. Columbia Outdoor Adverting*, 891 F.2d 1127 (4th Cir. 1991), which might have placed Denver's decisions concerning access to its planned new airport in considerable antitrust jeopardy.

On computer reservation systems (CRS), I would have speculated on what Department of Transportation (DOT) might do, and I would have given no consideration to the rumors that System One might merge with WORLDSPAN. Since then, though, the United States Supreme Court has reversed the Fourth Circuit's *Omni* decision and DOT has proposed CRS rules that go much further than anyone expected. Their importance now has to be considered in the context of CRS and airline industries that may consolidate even further.

On this panel, I'll stick with the airport access issues. But, as I discuss airport access, keep in mind that from an antitrust lawyer's perspective, airport access and CRS are not entirely separate. CRS is one of the barriers to entry into airline markets that is most often cited by those who take an interest in those issues. Particularly when a CRS is controlled by an airline that is also the primary carrier serving one of the hub cities in the market being examined. And, when an airline complains that its access to a market is blocked, or that a market has been monopolized, it usually has CRS factors as well as airport access in mind.

Turning now to airport access, it is indeed helpful to be addressing these issues in Denver. Not that there are necessarily problems here, but the new airport does serve to focus the discussion.

Stapleton Airport is one of the few airports that is a hub for two airlines: United and Continental. The city is in the process of building the first new airport in about twenty years. Their intention is to improve the

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7. James Weiss is currently with the firm Preston, Gates, Ellis & Rouvelas, Meeds, in Washington, D.C.. Prior to this he was the transportation section chief for the Antitrust Division, U.S. Department of Justice.
service facilities, not only for the two hub carriers, but also to increase airline service by making it more attractive for other airlines to begin or increase their service to the airport. The result will be that Denver passengers will become less dependent on the hub carriers for service and competition.

How can the city accomplish those goals? Certainly it can’t rely on how others developed their airports in the past. If you think the airline industry has changed a lot in the past few months, think how much it has changed in the last twenty years. Today a big concern is hub concentration. There is even a well-publicized Justice Department (DOJ) investigation into whether certain hubs have been illegally monopolized. Twenty years ago, when the last major airport was built (DFW), hubbing was a distant concept. Only Atlanta had anything approaching a hub operation. Some of the airports that today are absolutely full, were leasing large blocks of long-term space to carriers on very favorable terms solely to get them to come into the airport. The last thing that concerned most cities was the available space for other airlines. The big change then, has been the need to accommodate the hub carriers, that are so important to the city’s service, while not foreclosing other airlines’ ability to offer competitive service.

If this sounds like a balancing, or “rule of reason” process, it is intended to. For even though hub concentration has been fingered by the General Accounting Office (GAO), Justice and others as one of the culprits in higher air fares, hubs do not per se create competitive problems. Indeed, many cities have actively sought to become hubs for carriers because of the increased traffic through a city. Improved air service can lead to increased economic activity at a city. Hubs are also highly efficient ways to move people and cargo that results in increased competition and better service nationally. Keep in mind that, without United’s and Continental’s cooperation, the new Denver airport probably would never be built.

The flipside, of course, is that such cooperation does not come cheap. United wants forty-five gates at the new airport and a subsidy to take them; Continental wants over thirty, (which it has agreed to pay for, but it is in bankruptcy). Assuming those financial problems are resolved and they get the gates they want, together they will take up most of the new space. In addition, both airlines sought assurances that Stapleton would not be used again for scheduled service as a condition for supporting the new facility. That is undoubtedly why the city is now trying to figure out what to do with Stapleton. Suggestions have ranged from developing it as a park or shopping mall to using it as a branch of the Smithsonian Air and Space Museum.

That’s not all. United and Continental not only want most of the
space, they want the best space, possibly even locating it in ways that will preclude any other carrier from obtaining large blocks of contiguous gates. They are already in a dispute with one another; United has complained that Continental is getting the best of the new facility.

You might look at the situation in Denver and predict that it is an antitrust suit waiting to happen. An aggrieved airline might claim that it tried but failed to obtain good space at the Denver airport because it was blocked by the incumbents’ airport leases and that entry is essential to its competitive survival in particular markets. An added feature of such a case would be the dominant market position of United’s CRS that Continental claims has been responsible for its relatively poor performance in obtaining bookings of Denver originating passengers. However, Denver would be an unlikely forum for a successful case because it has two hub carriers. Even if an airline failed to obtain favorable gates, its failure to thrive would probably be due more to the economics of airline hubs rather than the availability of good space at those airports. It seems that three hubs at one airport is at least one too many. In the three instances where there have been three hub carriers: Denver (UA,CO,FR); DFW (AA,DL,BN) and Dulles (UA,CO,Presidential), no more than two carriers have survived.

Why? Every hub needs some local traffic to support it and there are few local markets large enough to support three hub carriers. Certainly Denver is not likely to be one of them. In addition, air traffic at Denver has actually declined over the past several years. So, for the time being, at least, there will be plenty of good space at the new facility. Denver is one of the few airports with either a decline in traffic or two hub carriers. Most airports that have a hub carrier, have only one and, except for recently, traffic growth at most of them has been robust.

It should also be recognized that airlines are not the only ones who could bring an antitrust suit on the basis of lack of access to an airport. Airport vendors would have standing to the extent that they can show they have been illegally excluded from a facility that is essential to their business. The potential antitrust violations that arise from foreclosing airport access include monopolization or attempted monopolization, refusals to deal and conspiracies to eliminate competition.

Monopolization or attempted monopolization would be proven very differently by an airline plaintiff than by a vendor plaintiff. A claim by an airline would likely be that the incumbent obtained a dominant position at the airport and as a result is using that position to exclude competition and dictate service and fares in air passenger markets served via that airport. This, I assume, is the gist of the Justice Department’s current investigation into hub dominance. The potential to exclude competition is what the Department of Justice has claimed it was trying to prevent by
blocking last years sale of Eastern’s Philadelphia gates to US Air (A year later the same sale by Midway to USAir, was allowed since Midway failed at PHL and there was no other buyer) and by opposing the sale of National Airport slots to United, preferring instead Northwest.

At first blush, a hub dominance case may appear to be straightforward, since many major airports are dominated by one, or at most two, hub carriers. In most cities, like Denver, there is only one airport that serves scheduled airline traffic so reasonable access to that airport is essential to providing competitive airline service to that city. In fact, however, other than in a few slot-constrained airports, access is never blocked entirely. The case will most likely come down to how much and what kind of space is essential and whether that space is essential to provide competitive service in markets that have been monopolized.

The last question that distinguishing a case against an airline from a case against an airport food concession monopoly is “what is essential to be competitive”. The difference is that an airline, unlike a food vendor, does not sell service in a city. An airline sells service between cities; i.e., in city-pair markets like, for example, Denver-New York. The monopolization question that would have to be answered concerning an airline, would be whether given the airline’s position at Denver, is it foreclosing competition in the Denver-New York market?

Does the would-be competitor have to have a hub at Denver in order to compete, and is the defendant airline controlling a non-duplicable essential facility? These are, of course, much harder questions to answer than simply what is happening at Denver. You also have to examine the market significance of everyone who serves or could serve Denver-New York nonstop and, possibly, everyone who offers connecting service over a hub in between. I am not going to get into the details of what you have to prove to win a case like this, but, if you are interested, I invite your attention to the Aspen Highlands case. The plaintiffs won it on a refusal to deal theory. If you read the case, you will know how hard it is to make out a monopolization case and you will also see why the Justice Department investigation is taking so long, and why so few of these cases have been brought.

Before last week, the more likely antitrust cause of action would have been under a conspiracy theory. Such cases were usually much easier to prove than monopolization cases, particularly under circumstances like the leasing or building of an airport, where the city is involved and everything is “of record”. This is because the city can be a co-conspirator.

There is a law, called the Local Government Antitrust Act, which protects the city from being sued for damages for antitrust violations. But, a city can still be found to conspire with a private entity so that damages can be found against the private entity. Moreover, injunctive relief can be
sought against the city which could disrupt its lease and terminal planning. This is significant because the city enters into contracts with the airlines or vendors to use the airport, and each contract, by definition, excludes someone from use of the space. If the purpose or effect of the contract is unreasonably exclusionary, the private party can be found liable for conspiring with the city in entering into the contract.

Sounds crazy? It is, as the Supreme Court just recognized in overturning the *Omni* case. There has long been an important defense to this type of case which is known as the State Action Doctrine. Under that doctrine, if the state has authorized the airport authority to allocate airport space, its actions in doing so are exempt from antitrust prosecution, even if it conspired with private parties in carrying out its functions. Moreover, private parties petitioning the airport authority to allocate the most favorable space to them, or to exclude others, are also exempted under what is known as the *Noerr-Pennington* doctrine.

In short, while you shouldn’t expect an antitrust case involving Denver any time soon, airport access issues are on prosecutors’ front burners. They will at least become a rationale for blocking some mergers and acquisitions. So the antitrust principles we are discussing today should be relevant for some time.
Deregulation: The Political Environment

MARVIN COHEN

I have to credit my good friend Harvey Wexler that his paper doesn't say that airline travel is less safe because of deregulation. We used to deal with that ten to twelve years ago. I would call to your attention a study that was done by Morrison & Winston published in Science Magazine in which they compared the causes of accidents. All of you know, if you are interested in the subject, that fatal accidents are down by about a half while airline traffic has almost doubled. Yet the question of safety persists.

Winston & Clifford compared the causes of accidents in the ten years before deregulation to the causes of accidents in the ten years after deregulation. They were looking to see the degree to which maintenance caused accidents, and the degree to which younger and less experienced pilots were involved in accidents, because one might logically connect poor maintenance and younger pilots with deregulation. What they found was that maintenance was actually less of a cause of accidents after deregulation than it had been in the ten years before deregulation. They found that pilots were older and more experienced in the accidents that occurred after deregulation than in the accidents before deregulation. It's impossible to say with exactitude that there has been no effect, but whatever effect there has been, there seems to be no evidence at all that flying is less safe because of deregulation.

As all of you know, between 1938 and 1978, the U.S. government closely regulated fares and routes of domestic airlines. For the past twelve years, airlines have been free to structure their own route systems and set their own prices, disciplined by competition in the marketplace rather than by the government. All of the factual studies and results of this change show that to date the benefits have far outweighed the costs. Deregulation has succeeded in allowing this nation's air transport resource to be used efficiently to deliver convenient service at low cost to the great majority of American passengers.

1. Mr. Cohen is a partner of Sacks, Tierney in Phoenix, Arizona. He is also Chairman of the Arizona Commission on the Arts and of the Governor's Regional Airport Advisory Committee. He is well known as Chairman of the CAB between 1978 and 1981. His educational background came from the University of Arizona. He got his BA in 1953, an LLB in 1957. He was Phi Beta Kappa and Phi Kappa Phi. He's authored numerous papers.
Prior to deregulation, entry was closely regulated. No new major carrier was allowed to enter the industry during the entire forty years. And in most cities, air service was limited to one or two airlines. In 1979, just before the airlines were allowed to rationalize their route structures, nearly seventy percent of the nation’s passengers traveled in city pair markets served by fewer than three airlines. It was believed that allowing more than two airlines to offer service in most city pair markets would be duplicative and wasteful. Sort of like in Europe where they thought it would be more efficient to allow European airlines to pool. If you examine it, you’ll find that load factors in this country under deregulation, every year have been higher than load factors in intra-European air travel where they were pooling. High load factors mean greater efficiency.

Air transportation is an important national resource - utilizing high technology aircraft, precious fuel and well trained, highly skilled personnel. Planes should not fly around half empty. And that is exactly what happened under regulation. Despite the limitation to under two carriers on most routes, the airline load factors in the years prior to 1978 were generally under fifty five percent. Since 1978, load factors have run generally an amazing ten points higher in the range between sixty and sixty five percent.

Why this difference? When the CAB regulated fares, it generally established them on a basis which allowed the least efficient carrier to recover its costs. With high fares, efficient carriers would have earned high profits, but they didn’t. Since airlines could not compete on prices, they competed on service. Efficient carriers competed away their high profit opportunities by offering more service than the markets could sustain. Businessmen and the wealthier portion of the American public that could afford to fly at the high, CAB regulated fare levels, became accustomed to traveling on half empty airplanes with a vacant seat next to them and lots of attention from flight attendants.

Since 1980, airlines have been permitted to establish their own route networks. As a result, the city pair markets in which a majority of passengers travel are now served by three or more airlines. The majority of markets have three or more carriers for the majority of travelers. This increase in competition has not led to wasteful duplication. Since airlines are now allowed to compete on price as well as on service, the increased competition has led to lower fares and increased travel. This has meant greater efficiency in the utilization of our valuable transportation resource.

The recent comprehensive multi-volume DOT study on competition in the U.S. domestic airline industry established that airfares have declined significantly under deregulation. There was an increase from 1979 to 1981 because the price of jet fuel skyrocketed from about thirty five cents to seventy cents a gallon. As you can see, fares went up during that early
period because of fuel but then the fares declined in real terms considering inflation, twenty six percent after 1981. Between 1977 and 1987, according to Bailey’s recent article, average fares from 1977 to 1987 dropped in real terms over twenty five percent from about four point six cents to three point three cents.

Morrison & Winston have done a careful and updated study of the cost and benefits of deregulation. They concluded, in their most recent publication, that fare changes have saved the American public about $6 billion a year in 1988 dollars. Another key dimension of benefits is service. While many passengers complain because airplanes are crowded and they often must connect to a hub, air travel is actually more convenient today than it was when CAB regulated routes and fares.

The key to this increased convenience is the significant increase in departure frequencies throughout the country. According to the DOT study, the number of flights available from the twenty eight largest cities has increased more than sixty percent since 1978, with twenty nine medium cities offering nearly seventy percent more flights, small cities thirty three point two percent and rural small communities forty three point nine percent. This increase in flight frequency has meant an increase in non-stop service. In March 1979, the average hub city offered non-stop service to fifty eight destinations. By 1989, service was available to seventy destinations. In other words, non-stop frequency has not decreased, it has increased. Frequency is particularly important to time sensitive travelers such as businessmen.

While hub and spoke systems have proliferated, the number of passengers who change planes on their trip is around forty percent compared to thirty five percent in 1978, a small increase. The big difference is that in 1978, nearly half of those who changed planes also changed airlines. In 1988, only five percent of those passengers had to change airlines. Morrison & Winston estimate the net benefits from this are $7 billion a year. That’s taking into account about a half a million dollars in cost.

There is a great concern notwithstanding all this about fortress hubs. And the fact that rates are higher in monopoly hubs than in competitive markets. These single carrier markets represent only ten percent or so of the total domestic RPM’s travelled. For businessmen traveling to or from a fortress hub, the higher fares are in some degree compensated for by frequency. Charlotte is a good example of this, going from thirty two cities non-stop service in 1979 to seventy three non-stop cities ten years later.

The thing that I think hasn’t been taken into account by the opponents in evaluating deregulation is the dynamics of the system. Southwest in the past few months has been entering new markets. Its new service from St. Louis to Detroit had a dramatic effect. Average fares dropped by
two-thirds, traffic trebled and Southwest captured a forty percent market share. Southwest has moved to Detroit, Nashville, Birmingham, New Orleans and is offering low fares capturing significant portions of market share. In this dynamic marketplace, even fortress hubs are vulnerable from other hubs on the spokes that go back and forth. Winston and Morrison have pointed that airlines with strength at one hub can attack another carrier in another hub.

Another benefit that has not been talked about is the benefit of putting former automobile travelers into airplanes. A study by Richard McKenzie indicates 1,700 lives a year have been saved because air travel is more available to the traveling public and people have moved from their cars to airplanes.

Most importantly, deregulation has allowed air transportation in this country to grow from a conservative focus on businessmen and the wealthy to mass transit serving the great majority of Americans. Air travel is now affordable by families, retired people and students. The nation has shrunk and we’re much closer to each other. Of course, just as the regulated air transport system was flawed, the development of our domestic air transport system after the government stopped regulating fares and routes has been less than perfect. Fares are high in the short haul in concentrated markets where competition is minimal. Airline profitability on average has not improved compared to the pre-deregulation period. Airports are becoming crowded and constrained. Control of CRS systems has threatened competition in many instances.

In 1983, I urged action to deal with all of these issues and I’m pleased to see serious attention is finally being paid. The Persian Gulf War and attendant fuel cost increases are causing major industry losses. Eastern is gone and we’ve heard about the others that are in trouble, but enough healthy air carriers remain to offer continued competition in city pair markets throughout the country. After all, we’re not talking about a national market concentration. The market we deal with is the market for travel from one city to another. That’s the relevant market here. The question is whether there is competition in those markets, and you can see in the DOT study, there are more carriers serving city pair markets for more travelers than there were ten years ago.

International liberalization was a partner in domestic deregulation back in the late seventies. As new international markets have opened, all the major U.S. carriers have developed international service. And in fact, lower international fares and ease of entry into gateways throughout the United States have built international operations to twenty four percent of the total RPM’s recorded by U.S. carriers in 1988, and accounted for twenty nine percent of the profit of the carriers.

I’m pleased that Secretary Skinner is moving to open up globaliza-
tion of air transport by allowing more investment by foreign carriers in U.S. airlines. I am pleased to see the potential open skies with Canada. I would call to your attention to the fact that other countries around the world are starting to emulate the American experience. Canada, Chile, New Zealand, and Australia have already deregulated. Some forty airlines around the world are moving to privatize and, of course, the great movement is in Europe in connection with 1992 economic integration. At this historic watershed, when millions of people in Eastern Europe and Russia have rejected close government control of their economies and are struggling to develop free markets, can there be any credible reason to reject market principles in the air transport system? The American experience over the past twelve years establishes that however imperfect, competition in air transport has provided substantial benefits to the American public. If we constructively address the remaining infrastructure and competition problems, these benefits should continue and with globalization should expand. A free dynamic air transport system able to respond quickly to changes and demands will be a crucial element of the next century’s world economy. Thank you.
Economics is as old as man himself for man’s survival has depended in no small measure upon his material well being. The Babylonians were concerned about interest, the Phoenicians about trade and mediums of exchange, and the Greeks about division of labor, etc. Economic thought found its way into the writings of the early philosophers including Plato and Aristotle. With the emergence of Christianity, consideration was given to a “just price”, a term which is an anathema to proponents of deregulation.

For good or for evil, there have only been five economists that have had an everlasting impact upon the world. One of these five was Alfred Marshall. His mammoth treatise was published just over a century ago, and reflected a synthesis of what he perceived the English economy to be in the mid and late nineteenth century. His work represents both the New and Old Testament to the theology of deregulation. It was, in fact, Professor Marshall who conceived the theory of contestable markets although he termed it the theory of equilibrium. More recent writers have merely relabeled his thought.

Professor Marshall’s perception of the English economy, which may have been reasonably valid at the time of his writing, bears little resemblance to what is now almost twenty first century air transportation. His theory and philosophy were applicable to an economy that was described by one of Britain’s most famous Prime Ministers as a “nation of shopkeepers”. Shopkeeping is neither a capital intensive industry, nor one where the natural barriers of entry are severe. If the economics of contemporary air transportation were even vaguely similar to the mid nineteenth century English economy, deregulation would have proven to be a success, but such is not the case.

It is significant to note that none of the deregulation advocates ever refer to “The Economics of Imperfect Competition” or “The Theory of Monopolistic Competition.” For academic economists to ignore these monumental advances in economic thought and perception is tantamount to a theologian ignoring the Reformation, or an historian ignoring the American and French Revolutions.

Mr. Tipton, the air transport executive who testified more times before Congress than any other, had a standard second paragraph in his
testimony. He stated that the U.S. scheduled airline industry is the most efficient, most technologically advanced, most competitive and most economic in the world. He was absolutely correct when he described the U.S. scheduled air transport system. No one can make that same statement now — at least not under oath without the risk of perjury.

1. Efficiency is a measure of how effectively a given factor of production is utilized, and in this case, it is the airplane. The utility of the plane is speed. Under regulation, the plane's natural advantage was maximized by providing the public with a maximum of non-stop and single plane service. Such service, unlike change of plane service, minimizes the elapsed travel time. Under deregulation, the advantage of the plane is inhibited since change of plane service is regarded as "the norm". Thus, the efficiency of the plane is reduced under deregulation.

For distances of less than 1,000 miles, today's change of plane service (a standard adopted by the DOT) results in elapsed travel time approximating the non-stop travel time in the piston era. For a very substantial portion of air travel, deregulation has resulted in reducing efficiency back to the state of the art of thirty years ago!

It should, of course, be pointed out that there is a considerable amount of efficient non-stop service today to and from hub cities, but such service is now regarded as a premium service and priced accordingly.

The hub and spoke system with its attendant change of plane is substantially less efficient than non-stop and single plane service (the standards under regulation). Why then is change of plane now a norm? Simply because this lower quality service is more economic from the point of view of the producer of air transportation. The greater costs of the hub and spoke system (substituting more frequent flights with smaller aircraft for fewer flights of larger aircraft and incurring the additional costs of circuity or added flying time) is more than offset by the market domination and consequent pricing that the hub and spoke system accords the producer — to the disadvantage of the buyer. In a word, deregulation has reduced the efficiency of the plane, but in so doing, has made for a more economic operation for the airline by enabling it to effectively field monopolistic power and all the advantages which flow therefrom. The most convincing evidence to confirm this is the fact that today, probably no airline would willingly trade its hub and spoke system for an equivalent linear route system because a trade would dissolve its monopolistic advantages.

2. Technology. The U.S. aircraft fleet today is not the most modern in the world. Nothing more needs to be said in this regard. Deregulation has sacrificed American technological leadership insofar as our airline fleet is concerned. The most advanced aircraft are now first purchased and introduced into service by heretofore competitive foreign carriers.
For example, the B747-400 was first ordered by a European and an Oriental carrier.

3. Competition. Here we get to the crux of the debate. Much has been written on this element, and unfortunately there has been considerable misinformation published.

To view this all important element properly, one has to return to elementary economics. Competition exists when no one buyer or seller of a good or service can determine its price. It is as simple as that. Competition exists when price is determined by factors well beyond the unilateral control of individual buyers or sellers. Price is determined by the impersonal forces of the marketplace. That is the classical competitive model, and it is applicable in certain industries — deregulated air transportation is not one of those industries. Much of agriculture is.

The largest wheat farmer in the nation cannot influence the price of wheat on the commodity exchange nor can General Mills, Kellogg, or any other individual buyer of wheat.

When a seller (or buyer) can influence or determine price, such ability represents monopoly power. The Federal Reserve and the Bank of England, working in collusion, cannot fix the price of the dollar or the pound with any precision. However, a director or manager of pricing in a sophisticated airline can and does set prices of fares each day. I submit to the reader’s judgment as to whether or not monopoly power exists under deregulation when the power over pricing is greater by an airline than that of a central banker.

Under regulation, pricing was akin to that of competition; no individual airline or buyer of air transportation could unilaterally determine its price. Price was determined beyond the control of seller or buyer as in the case of competition. It was determined by an agency of the Federal government which was accountable to the duly elected representatives of the people. In a word, under regulation pricing was determined far more like that of competition than currently exists.

Under deregulation the monopoly power of the seller is to a significant extent offset by the monopoly power of the large buyer (monopsony power). No one knows the extent and exact magnitude of the price concessions extracted by monopsony power. Recently, the U.S. Government announced that it was able to obtain a twenty five percent discount for unrestricted travel on one route. Stated otherwise, the taxpayer who funds such travel pays one third more than his or her government for the identical service — even though there is no difference in the cost to the airline for such carriage. This type of monopsony power is being widely exercised by federal and state governments as well as by travel management companies and others. It is quite pervasive. What is ironic is that this type of discounting and rebating, which was illegal under regulation,
is applied to the most inelastic traffic; namely, business and government travel. I cannot prove the following, but likewise no one can disprove it; namely, if the Robinson Patman Act were applicable to passenger air transportation, the airline industry within the U.S. would be profitable today! (The Robinson Patman Act permits price concessions that are cost justified; it curbs the effects of monopsony power.)

The pervasive exercise of monopoly power on the part of the seller and monopsony power on the part of a relatively few large buyers leaves the public at large at a tremendous disadvantage. Whether a system which benefits the few and disadvantages the many, is fair, reasonable and in the overall public interest I leave to the reader to decide. Proponents of deregulation, by definition, believe it is.

4. Economic. Does a system characterized by monopoly power with some offset by virtue of monopsony power produce a more economic price than a system where price is determined in a manner akin to competition? Again, deregulation proponents believe it does.

Every study I have seen that concludes that monopoly power with some offsetting monopsony power produces lower prices than a regulated system based its conclusion not on comparative prices but on yields. This is grossly misleading. Does anyone believe that a comparison of yields in food stores (revenue per square foot of store space) would represent a fair and accurate measure of the food component of the CPI index? The airline studies based upon yields would urge you to accept that as a measure of comparative prices.

I have yet to see a study which supports deregulation that bases its conclusions on specific comparative prices. They cannot as such a comparison contravenes the conclusions reached in these studies.

The reliance on yield data ought to be obvious as to its shortcomings. Have you ever seen an airline ticket expressed in yield? I have nor has anyone else. It is expressed in terms of a specific price, but specific prices are not compared for they would reveal that deregulation has disadvantaged the public at large.

Let me cite two illustrations to reveal how grossly misleading these yield studies are. If all prices and fares throughout the U.S. had been held absolutely static for the past decade and a half, yields would have declined. Some would conclude that this means that consumers have saved vast sums by virtue of deregulation as evidenced by the decline in yields. What, in fact, happened is that the increased circuity (a lower quality of service) caused by deregulation resulted in a decrease in yield even though what the consumer paid remained static.

One trade association sponsored study concluded that even where an airline has a monopolistic position, monopoly prices have not occurred
under deregulation. This is absurd as it means its members are either overly philanthropic or economically irrational.

One should be extremely skeptical of any study based upon yield data which attempts to measure comparative prices. Prices and yields are not interchangeable data. Passengers pay prices. Yields are an important micro management tool, but not a measure of the prices paid by consumers.

The occasional “fire sales” in airline pricing that have occurred under deregulation have been cited as a public benefit derived from deregulation. When fires occur, one or two things happen: either the fire is forcibly extinguished by one means or another or the property burns up and disappears. In air transport, fire sales occur when a carrier is strapped for cash and is in extreme financial ill health. History has indicated that such carriers usually disappear, and the stability of monopolistic pricing restored.

5. Growth. The faithful defenders of deregulation often make the point that “more people are flying today than ever before”, and attribute it to the public benefits of deregulation. The reader should be aware that “more people are flying than ever before” is a statement that could be made for virtually every year since 1937! In fact, the rate of growth of air travel has been slightly less under deregulation than under regulation. The singularly largest percentage increase in air travel took place the year the original Civil Aeronautics Act was legislated.

The reader may properly ask that given the economic advantages that the hub and spoke system produces for the respective carriers, and their ability to yield a measure of monopolistic pricing, why is the airline industry in such a dismal financial state at the present time? Fuel prices have increased, but the 1990 fuel shock was proportionately less severe than in 1973. In 1973 under regulation, there were no bankruptcies, no forced liquidations, and no change in the structure or competitive balance of the industry. Is it recession? Recessions occurred since 1938 under regulation, and again, no bankruptcies, no forced liquidations, etc. Deregulation has in some important aspects, prevented the industry from adjusting to an unpleasant environment.

Under regulation, a carrier would reduce its plane miles flown in order to tailor its output to demand. Reducing plane miles flown under a hub and spoke system becomes extremely difficult, if not impossible, because a reduction in plane miles flown causes a more than proportional decrease in traffic carried. It is ironic that under deregulation the system is less flexible in adjusting to the business cycle than was the case under regulated linear routings.

The dire financial consequences of deregulation are becoming increasingly evident. Individual carrier balance sheets are deteriorating.
with cash outflows so extreme that foreign capital is being invited to pro-
vide operating subsidies for our domestic air transport network. The term
“foreign investment” as used today is a misnomer — such capital is not
intended for the purchase of new equipment or facilities but rather to
cover current losses, and that can more aptly be termed “foreign operat-
ing subsidies”. The financial picture of the airlines is such that the De-
partment of Transportation, which is mandated by law to establish
financial fitness standards, has not even promulgated such standards for
major carriers.

If the current deregulatory trends continue, it will most unfortunately
produce a Marxist result. It was Karl Marx who stated that, “It always
ends in the ruin of many small capitalists, whose capitals partly pass into
the hands of their conquerors (through route sales and acquisitions),
partly vanish (through bankruptcies and liquidations).”\(^3\) Over a sustained
period, the issue facing the nation as CBS-TV might term it, is not regu-
lation versus deregulation but rather regulated private enterprise versus a
form of socialism. The author fervently urges the former; faithful adher-
ence to a century old concept that is not applicable to a public utility will
eventually produce the latter.

As a wise CEO of a major carrier aptly observed, “deregulation was
not premised on economics — it was a political movement.” As a polit-
ical movement, it was a short term feat. As a matter of economic public
policy, it is proving to be a long term disaster.

\(^3\) Parentheses added.
Airport Infrastructure

PETER GROSSHUESCH

Aurora, a suburb of Denver with a population of 230,000, is located immediately to the east of Denver, and is in an ideal location to capitalize on development anticipated to occur around the new Denver airport. Within the past five years, the City has carried out an aggressive annexation program in order to better position itself to capture the lucrative tax and employment base that will inevitably develop adjacent to both the new Denver airport, and along the E-470 circumferential freeway alignment.

MODERN GEOGRAPHIC HISTORY

The City was contained geographically by a self imposed annexation boundary, known as the "Blue Line", for a ten year period between 1975 and 1985. The purpose of the Blue Line policy, was to control "leap-frog" development, by providing urban services only to land contained within a sixty-five square mile area defined by the Blue Line.

In the ten years preceding 1985, vacant land in the City had developed at a very rapid pace. The pace was rapid enough to make Aurora the fastest growing municipality in the United States with a population over 100,000, for three of those ten years. Toward the end of that decade, the City had begun to run out of vacant land for residential development.

By 1985, a number of substantial public infrastructure projects were being planned for the area just beyond the eastern boundary of the City's Blue Line. Those projects included the new Denver Airport, E-470, the Front Range Airport, (which opened in 1982), the Aurora Reservoir, and the Arapahoe Downs Race Track, (which also had opened by that time).

Colorado's metropolitan district legislation contributed in a significant way to the City's decision to rescind the Blue Line Policy. Metropolitan districts are designed, in part, to allow developers to provide their own urban services as an alternative to securing them from existing local governments. The dilemma the City faced was that once a property had secured commitments for urban services, whether through a district or

1. Peter Grosshuesch is a Senior Project Coordinator with the City of Aurora, Colorado.
another means, there was little incentive for the owner to seek annexation to a city.

These factors combined to make it highly likely that development would occur near these facilities whether the City annexed into the area or not. The City chose to annex rather than become an inner-ring suburb, insulated from the lucrative development typically found near the fringe of the urban settlement.

COMPREHENSIVE PLANNING

Prior to annexing beyond the Blue Line, the City conducted a very extensive analysis of the land within the intended annexation area. These studies provided the basis for a subsequent master planning effort. The preparation and adoption of the City's Comprehensive Plan for the area enabled Aurora to entertain large scale annexations in a relatively short period of time, and to do so with the confidence of knowing how it would provide urban services to the area. The following is a brief description of the base studies prepared in conjunction with the Master Plan:

Water and Sewer - The City conducted a $500,000 study that projected the demand for water and sanitary sewer service. The study also identified and located major facilities to provide the services.

Drainage Basin Master Planning - The City shifted its philosophy from on-site storm water detention to a more cost effective, overall regional detention facilities approach. The Study also identified the location of the related major capital facilities. In addition, it inventoried areas of significant wildlife habitat, archeological value, and significant open spaces that would be preserved from development.

Computer Assisted Traffic Modeling - The City conducted its own computerized traffic modeling in order to establish a functional relationship between the carrying capacity of the roadway network and the planned land uses it is intended to serve.

Fiscal Impact Modeling - The City conducted extensive fiscal impact modeling to ensure that the planned, full build-out development scenario would generate sufficient cash flow for the City to support the related new demand for urban services.

ANNEXATION PROGRAM

The City has annexed over seventy square miles of land, more than doubling its land mass since lifting the Blue Line policy. Some of the annexations were of parcels containing more than one thousand acres, the largest one being the Northern Quadrant at more than ten thousand acres.

The Current high priority locations for annexation lie adjacent to the
new Denver Airport, the Front Range Airport, and along the E-470 Corridor. It is anticipated that these locations will be the most likely places for early development in the City’s planning area.

AIRPORT ENVIRONS PLANNING

Shortly after the City repealed the Blue Line policy and began annexing property, the final location of the new Denver Airport was announced. At that time, several of the local governments near the new airport were approached by a prominent property owner in the area to join him in seeking advice from the Urban Land Institute for positioning the land near the new airport for development.

Based, in part, on advice received from the Urban Land Institute, the local governments surrounding the new Denver Airport jointly prepared a land use and transportation plan for the area. The plan prepared by Adams County, Aurora, Commerce City, and Brighton became known as "The Airport Environs Plan."

A primary goal of the planning effort was to maximize the economic development potential of the land surrounding the new airport, while prohibiting residential development from encroaching under its flight tracts. Accomplishing the latter would remove the biggest potential constraint to the Airport’s future growth. The approach taken by the planners was to integrate the goals for economic development within a plan for a high quality environment in which to live, work, and recreate.

Another goal of the plan was to counter the perception identified by the Urban Land Institute panel, that the area would become “Balkanized” by the lack of coordinated planning for the area. Denver’s planning for the Gateway Area along Airport Boulevard was later coordinated with that of the Airport Environs Plan, thereby ensuring that all of the land surrounding the new Denver Airport had been planned in a coordinated manner.

ENVIRONMENTAL IMPACTS

The noise contours generated by the arrival and departure tracts of the new airport define a forty-five square mile area unsuitable for residential development. These contours extend environmental impacts into an area of approximately 250 square miles that had to be accounted for in planning for land uses in the environs of the new Denver airport.

This vast reservation of non-residential land gave rise to a concern that the airport environs might become plagued with a fundamental imbalance in the supply of land by category of use, and would therefore exert forces leading to sub-optimal absorption patterns in the airport environs’ real estate market.
Due to the concern mentioned above, and to the unique nature of planning for the new airport, a real-estate market analysis was conducted and used as a base study in the preparation of the Airport Environs Plan. The jurisdictions wanted to ensure that sufficient land would be set aside in the most advantageous locations, with the appropriate public infrastructure and urban services to accommodate businesses likely to locate in the area surrounding the new Denver Airport.

The market study projected that the 250 square mile area contained within the Airport Environs Plan area would absorb anywhere from 23 to 30 million square feet of commercial development by the year 2010. This level of absorption would create anywhere from 68,800 to 91,500 new jobs in addition to the 33,800 transferred to the new airport from Stapleton International Airport when it closes in 1993.

This absorption would occur within seventeen years of the airport opening in 1993. Of that total: industrial absorption will account for 13.8 to 16.6 million square feet; office development will absorb from 4.8 to 7.7 million square feet; retail development will account for 1.7 to 2.5 million square feet; and lodging development will amount to 2.8 to 3.3 million square feet (or, 5,600 to 6,600 hotel rooms). Additionally, there will be 25,000 to 31,700 new residential dwelling units constructed in the airport environs by the year 2010.

The difference in the range of absorption rates for each of the categories is explained by the two different build-out scenarios developed by the consultant. The low end of the ranges represents a “base case” scenario, where the local governments simply extend infrastructure and urban services on a timely manner, and of sufficient quality to provide only the minimum level of urban services needed to sustain development. The high end of the ranges represents the “enhanced case” scenario, where it is assumed that higher quality public infrastructure elements and urban services are developed then described in the base case, the airport environs successfully establishes for itself an image of high quality. Further, it is assumed that this image is aggressively marketed to developers with an interest in quality office and industrial parks, on both a national and international basis. The reward to the communities in the airport environs for achieving the enhanced case scenario is an additional forty percent increment in the absorption of real estate over the base case.

In elaborating on the ingredients making up the quality image necessary to achieve the enhanced case, the market consultant specified that the cities must develop high quality public infrastructure, a first class parks and recreation system, good schools, high end retail facilities, and
nearby executive housing. In short, a comprehensive community development effort was prescribed. The City responded by developing a strategic plan entitled, "DVX Aurora", that will be discussed later.

In addition to developing projections for real estate absorption, the market consultant described the types of tenants, or end users, that are likely to locate in the Airport Environs. In addition, the consultant predicted where those tenants might prefer to locate in the Airport Environs, the types of services and infrastructure needed to support them, when they would be likely to develop, and what the communities surrounding the airport could do to make the environs more attractive to them.

The market study also provided assurances that if land use planning was properly thought out, there could be an adequate supply of land in the most advantageous locations for the respective end users. This, in spite of the fact that large land areas will be affected by aircraft noise related land use restrictions. With this information in hand, the planning staffs of the airport environs jurisdictions proceeded to distribute land uses on the Airport Environs Land Use Plan.

Incorporated in the land use plan is a transportation system that is anchored by an expressway system looping around the new airport and connecting with an arterial network arrayed on a one mile grid. The east leg of the expressway loop is the planned E-470 circumferential freeway, that will eventually encircle the eastern half of the Denver Metropolitan area. The jurisdictions agreed on the alignments and the functional classifications of the roadway facilities making up the transportation plan, thereby ensuring continuity in the system throughout the airport environs. This combination of roadway facilities provides convenient access for the surrounding properties to both the airport and the nearby regional highway system. The regional highway system serving the airport environs includes: I-70 on the south, I-76 on the northwest, E-470 on the west, and Airport Boulevard connecting the passenger terminal with I-70.

EMERALD STRANDS PARKS, TRAILS, AND OPEN SPACE PLAN

An award winning parks, trails and open space plan entitled "The Emerald Strands," was developed as a part of the Airport Environs Plan. This plan, in addition to assuring continuity in the trail system between jurisdictions, will accommodate the recreational needs for the planned development, and will protect significant open-space and wildlife habitats from development pressures. Implementation of the plan has already begun, and when completed, the planned system will go a long way in contributing to an image of quality for the Airport Environs. The Airport Environs Plan was adopted by all of the Airport Environs jurisdictions in 1990.
The City of Aurora has taken the airport environs planning task to the next level of detail by developing a strategic plan that will position its planning area for the new airport real estate market. In doing so, the City began with the finding of the market study that there would be a half-dozen distinct, and geographically separate real estate sub-markets in the 250 square mile airport environs. Four of those sub-markets are located in whole or in part, in the Planning Area of the City of Aurora.

The City chose to develop strategic plans for each of these areas by refining the market consultant's projections for development types likely to be attracted to each of the sub-markets. A vision statement for each sub-market was prepared, defining the character of development. The individual strategic plans also identified infrastructure elements needed to open each area for development as well as specifying additional infrastructure needed in subsequent phases of build-out. Portions of those infrastructure plans have been translated into the City's five year capital facilities plan, with some of those projects are already under design.

The City has also begun to develop and implement marketing strategies for each of the four sub-markets in its Planning Area. In doing so, the City has worked closely with its economic development agency, the Aurora Economic Development Council.

A brief description of Aurora's Airport real-estate sub-markets follows:

The I-70 Corridor extending from the existing developed industrial areas near I-225, eastward to the Front Range Airport, will likely attract a substantial share of the 13 to 17 million square feet of industrial development predicted for the Airport Environs. The type of development the City will recruit includes light manufacturing, warehousing, and distribution activities, including air-cargo and freight forwarding. This corridor, with the near-by main line of the Union Pacific Railroad and convenient access to the regional highway system via I-70, is an ideal transhipment point that will make it a convenient location for a wide variety of multi-modal activities.

THE INTERNATIONAL CENTER

The International Center is a part of the E-470/Airport Boulevard sub-market identified by the market consultant. The City will strive to establish a major activity center there by integrating class "A" office parks, lodging facilities, high end retail centers, and executive housing in the vicinity of the nearest interchange to the passenger terminal for the new Denver Airport. This is a likely location for a substantial share of the office development that will locate in the airport environs.
THE AURORA GATEWAY CENTER

Located on property surrounding the interchange of I-70 and Airport Boulevard, the Gateway Center will cater to office and lodging activities. The fringe of the Gateway center will transition into office showroom and universal space commercial development. Because urban services are already available at this location, the Gateway Center will likely be one of the first sub-markets to develop in the Airport Environs.

THE FRONT RANGE AIRPORT CENTER

The Front Range general aviation airport anchors this activity center, located several miles southeast of the new Denver airport. This sub-market is served by both I-70 and the Union Pacific Railroad. The City will join with the Front Range Airport Authority in marketing this area to a full range of aviation related industries, including aircraft manufacturing, air cargo, general aviation, and distribution activities requiring multi-modal transportation assets.

CONCLUSION

The City of Aurora has already accomplished a lot in preparing for development around the new Denver airport. The biggest challenges however, lie ahead in the provision of urban services and attracting the mix of development that will establish the Airport Environs as the Denver Metropolitan area’s most exciting new location for business investment.
It's a little daunting that I am in a group of this kind and that I should be identified as an expert. I don't claim to be an expert. I claim to be somebody who has, over a career of different kinds of jobs, attained some perspectives that I would like to share with you. Almost every industry with which I've been associated involves the transportation business. There are cycles that can be identified in the history of those businesses which have an impact on the bottom line of how you make a decision in investing in those businesses.

When you go back to the early days of shipping, the port was identified because of some attractive geographic features and some attractive locations. The railroads were bound in the same way, but to a lesser degree. Obviously, airports are even less bound. They have the advantage of being relatively independent of geographic features and, today, their importance is as much a function of centrality as it is of historic location and market. I want to come back to market because, in many ways, the discussions that we are going to be having this morning have to do with what the nature of the market is and how that relates to services in individual communities. And, in looking at this issue, I want to keep in mind several questions that we will come back to at the end of my remarks, questions about how you make economic decisions and what kind of criteria to use.

First, is this investment an article of faith or is it an issue of image? And, while there are many people who would say "No, no, no, it's not an issue of image," it clearly is. There is no question that a major world class community is going to need a world class facility to be its gateway to the world. That's not as important in making the decision even though it is a very hard element to quantify.

Second, at the other end of the spectrum, what kind of return will it generate? What is the nature of that return? And on whose books will that return appear? These are not unimportant questions because the nature of government in the U.S. is so balkanized that responsibilities for investment are often allocated very differently from those people and entities that will reap the benefits of those investments. And then, indeed, what kind of return are we talking about? Are we talking about rents to an airport operator? Are we talking about taxes to a community? Are we talking about jobs? Are we, again, talking about a business environment that is attractive to the world in some fashion. Who is going to pay the

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2. Mr. Plavin is the Director of Aviation for the Port Authority of Newark, New Jersey. Mr. Plavin prior to coming to the Port Authority, served as its Chief Financial Officer for a period and as the Director of Aviation Redevelopment Program. He spent over eight years prior to that time as the Executive Director of the Metropolitan Transportation Authority.
costs of these investments? Who indeed. I think that is a very important question a lot of us have lost sight of in some of these discussions. How much investment is necessary and how much is enough?

All of these questions need to be addressed. I know that I am not going to have any particularly exciting answers to these questions, but I think that the importance is in addressing all of these elements.

In asking these questions, let's go back to why some of the airline centers, hubs, developed the way they did. Originally, in the aviation business, domestic airline service connected local markets and they were local centers which had been already established as hubs for other reasons, whether for railroads or for shipping purposes. Hub locations were also a function of the distances that planes could fly. We were bound by a technology that was essentially very limited and it was especially true for traditional ports which became transfer locations as the industry progressed from domestic to international operations. Then we developed longer distance capabilities and that intensified, for a while, the advantages of coastal locations because you were able to fly across the Atlantic, and across the continent, and across the Pacific. But, as the longer distances became possible, a lot of intermediate locations became unnecessary and, in fact, we are still seeing that process take place today.

There are some United States and international cities who are on the map precisely because they were stopping off points for international air travel and they are no longer necessary for that purpose. Regulation reinforced that pattern by designating certain carriers as international carriers and other carriers for domestic service only. I would remind all of us sitting here that international travel continues to be regulated by a series of complex bilateral agreements (to which I would also add the adjective "unfathomable") which, in today's environment of world-wide routes and ownership, are probably entirely outmoded and will need to be replaced. They will probably be circumvented anyway as globalization of airline ownership becomes more the rule.

International airlines historically were prohibited from engaging in domestic service. They were actively discouraged from developing domestic route structures and, until recently, the reverse was true for domestic carriers.

Going back to the domestic interior for a moment, there were many centrally located significant economic centers with airports of sizable capacity that were being greatly under-utilized from the aviation point of view. During the years leading up to deregulation, domestic carriers came to these facilities and gave them proposals they could not refuse. Precisely because they were not heavily utilized, they were ideal places
Far-sighted communities who needed the business got the business in a variety of ways in which that term can be interpreted. They got jobs. They got air service which grew in quantum amounts, but they also saw their facilities increasingly controlled by the carriers who came there to set up business. We have heard a great deal about the nature of the control of carriers exercised over the airports so I won’t dwell on that at this point. Suffice it to say that the hubs give the domestic carriers a power in dealing with routes and route structures that they had not previously had. And with deregulation, domestic activity exploded and the political power of the domestic carriers exploded along with it. They now had the power to begin to challenge the monopolies on international routes and to attack the international hubs. They also had a vision of new aircraft that could reach inland gateways and that were small enough and economic enough to be serving sparse routes. You did not need big aircraft; you now had small aircraft that could begin to serve less populous and less active gateways inland. We are now faced with a situation where the two international carriers who had not previously been permitted on the domestic scene simply could not catch up. Where Pan Am’s attempt (by buying National Airlines) was a total failure— they really could not swallow National, it’s different culture and it’s different union structure. In fact, as somebody remarked the other day, all that’s left of Pan Am is what they got from National, a rather remarkable turn of events. Well, why couldn’t they catch up?

First of all, they had neither the necessary management capability nor a geographic base. Pan Am’s lack of a geographic base became quite a disadvantage and at the same time, there was a sense among the domestic carriers that their status would be significantly enhanced by access to international routes. In the highly regulated international market, free of what has been called destructive competition, there are higher yields, revenues, returns, profits, whichever of those nasty words you want to use. But airline demands and aspirations were not enough because international route decisions were made within a very small group including, obviously, the interested carriers at the time. On the transatlantic side there was Pan Am and TWA; on the Pacific side, there was Pan Am, and Northwest; South America on a smaller scale, Braniff and Pan Am. Notice that Pan Am was in each one of those regions.

The U.S. government was very concerned that Pan Am was so powerful that it would overwhelm any of the other carriers if they had a domestic service. The demands and aspirations of the domestic carriers needed assistance. They needed assistance with the political structure and their versions of what used to be called “the Senator from Boeing”
are now “the Senators from American and from TWA” and yes, even “the Senator from America West.” The domestic carriers now created a symbiosis that produced the desire to combine the aspirations of the airlines with those of the communities from which they operated, to launch an assault on these international fortresses. Thus, the economic element rationale was developed as a tool to get there. Communities began to say, “how do we marshal the resources?” Senators are not interested in the fact that one business competes with another, unless there is something in it for their constituents. So the numbers became important. We now have a whole industry of people who produce numbers justifying things from an economic benefit point of view, and we in New York do the same thing. When you look at the metropolitan region of New York and New Jersey, we have a thirty-one county region in three states. It has 20 million people and a half trillion dollar economy, which is about the size of the gross national product of Canada. The region is a vast area which stretches from Trenton on the south to New Haven on the north and obviously, we expect that it will continue to play a dramatic role.

Here are some numbers because everybody has numbers and the bigger the better. So here are some interesting ones:

The aviation industry in the metropolitan region of New York accounts for about three point five percent of the gross regional profit in the New York Metropolitan area. It is obviously a major generator. It accounts for $22 billion annually in economic activity, 244,000 jobs and $7 billion in wages and salaries. The air cargo component of that is extremely large and air cargo is an interesting phenomenon in the sense that it is beginning to follow passenger activity. We are seeing larger and larger aircraft with larger amounts of excess capacity, it is natural for that capacity to be sold cheaply and to be able to be used, in fact, to reinforce a carrier’s passenger hub with similar kinds of patterns for cargo activity. Cargo activity alone in the New York area accounts for some 98,000 jobs and visitors, which are excluded from the numbers I have just given you, and contribute an additional $15 billion a year in economic activity, and over 200,000 jobs.

In that context, I want to come back to the questions that I raised earlier because the previous speaker talked a little about some of the other techniques that have followed as people have begun to ask some of the tough questions about these numbers. I caution you from the beginning that these numbers are suspect. There is an agenda associated with them. But the point is not whether the numbers are particularly precise or accurate. The point is that we are finally recognizing the need to begin to quantify what it is we are getting for our investment. What is it, in fact, that is going to turn around and create business? Because airport investment is useless if the underlying market strength of the local economy isn’t
there. Can an airport survive without it? Well, that’s an interesting ques­
tion. In the New York area, we built three terminals at Newark Airport, one of which laid totally empty and uncompleted for twelve years. But because we had that terminal we were able to attract People’s Express during the heyday of economic deregulation. The terminal’s availability, however, was able to be combined with the strategic location and a strong economy. So you really need all of those in order for that to be able to work. We are beginning to see further evidence of that on the outskirts of the New York metropolitan area with growth in passenger activity in Stewart Airport. A very large underutilized facility which New York State took over from the federal government when they went out of the airforce base business at Stewart.

Let’s come back to the issue of who is really going to pay for these investments. Historically, the airport operator has been the entity to pay. But, it really is not the airport operator who is paying. The airport operator is making the investment and then seeking a return from the carrier who in turn, is seeking a return from his passengers. It is not anyone other than the passenger who ultimately pays the price. This is a classic example of an old comedy routine from the Monty Python show where they costume themselves as a town counsel, trying to decide how to raise revenue; they decided to levy a tax on all foreigners living abroad. That’s who airline customers are. They are nobody’s constituencies. They are foreigners living abroad for tax consequences. And so, it is the passenger who pays the price of your investment. The fundamental question is, “Will there be enough passengers to pay that price?” That is the question the airline will ask.

Additional investment means that the airline has to have a plan and be willing to put enough passengers through your airport at today’s prices and be able to charge high enough fares. That’s the second part of that question: “Can they charge enough to be able to recoup the investment?” It doesn’t really matter what the cost of that investment is, provided that there is enough revenue associated with being able to put enough passengers through the facility. If you negotiate a lease with an airline, his question to you is how do I recoup that? And your job obviously, is to help him figure it out. Additional service means he has additional costs. How will he amortize these costs? It had better be worth it. Of course, an airline and some passengers make it all worthwhile.
The Technological Environment

MIKE FROM

I am assuming that most of you do not have a technical background. Therefore I will try to give you a top level view of the new airplane without boring you with too many details.

This conference has given us a great chance to see each other’s worlds. I know I have learned a lot about the legal environment in the last day and a half. Now it’s my turn to show you a little about the technical environment.

Let’s get started: First, I’d like to start off with a little background as to why Boeing decided to build the airplane. Then proceed with some specifics about the technical advances that will be a part of the 777. And finally the future development and growth potential of the 777.

Boeing Marketing and Sales Department, after conferring with the airlines, divided the world into three major markets. Market A consists of airline routes of 4,000 nautical miles or less. Market B routes are an average of 5,500 nautical miles. Market C routes are about 7,300 nautical miles.

Market A, being across the U.S. continent, the west coast to Hawaii, the European countries to the Middle East. The B market being from Chicago to Europe and across the Asia continent. The C market being the very long range markets of the 7,300 nautical miles which are essentially across Asia and the Pacific. Now let’s take a look at what marketing predicted the number of airplane sales to be between 1991 and 2005; they predict it to be 8,848 units. Of the range that we’re talking about, the medium size range, Boeing initially had only one airplane in that market, the 767. Whereas their direct competitor, Airbus, had essentially four airplanes that they were offering. This was a couple of years ago. They offered these four airplanes that would fit into that size category and the MD-11 was well under development and now we are able to offer the 777 that will enter into that market.

To give you a little idea of where Boeing Marketing perceives the market to be going is that growth is about three-quarters, one-quarter being the replacement of the DC10 and L1011’s. The U.S. Airlines, essen-

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initially the big three, United, American and Delta, taking up about forty percent of the new airplanes, Asian and Pacific taking about twenty-two percent and Europe taking about twenty-five percent.

What Boeing did before they introduced the 777 to the airlines, was to take a hard look at what Boeing already had in their arsenal and that was the 737 family which is about a 110-140 passenger airplane, the 757 which is about 160-180, the 767 which is anywhere from about 210-260 depending on your configuration and your particular airline. And the 747 which is about 410-450, again depending on airplane configuration. So Boeing really didn't have anything between the 250 range and the 400 range in passenger count. So they decided to try different derivatives of the 767 to see what they could come up with.

First they tried to stretch the fuselage of the 767. Then tried putting a new wing on the 767. But those ideas proved uneconomical. They tried other things where they shrank a 747 model and put a 767 wing on it, again the economics just didn't prove out. So what happened next was the airlines said we don't want old technology, the 767 being late seventies technology. The 747 is mid-sixties technology. What we really want is something that is the latest and greatest. And so with that, they went on to help Boeing define what the new airplane would be.

The new airplane would have regional and intercontinental market capabilities. It will have state of the art service, features and technology. It will aid the airlines, as was pointed out, in their economics to be able to get through tight times. It will have industry leading performance and economics again strictly to save the airlines some money and to allow growth and we'll get into the future growth of this airplane.

Anybody here from United? Since we are in United's backyard, I had to bring a picture of the 777 in United's livery.

Let's take a look at how this airplane looks stacked against its competitors. Boeing has decided that going to the customer and finding out what the customer wants is a better philosophy and have gone to key airlines. The eight key airlines consist of the three big airlines in the United States. United, American and Delta, also the two biggies in Japan, which are Japan Airlines and All Nippon Airways, British, Quantas, and Cathay Pacific. All are big, heavy airplane flyers. With that, we polled them as to what they wanted in this next generation of airplanes. They wanted to replace the DC10 and the L1011. They also wanted to replace the larger of the DC1030s and they also wanted to help out their international markets which are currently covered by the 747SP's. There aren't many SP's out there. The SP is a special performance airplane and they were not a big seller and as a result, they do want to hit that market as well. And they also want to be able to replace the early 747-100, which was introduced in the early seventies and is now becoming an
older airplane. So what you have is, if you look at the DC10 and the L1011 we are replacing, those again with a little bit higher passenger count, this is a tri-class seating. First class, business, and coach. The DC10 has a smaller range of passenger seating on its typical tri-class. The 777, in its interior flexibility, has a larger tri-class or world class capability. So even though it's drawn as having 300 passenger capability, you can also drop that down into these ranges and still run it more economically than its competitors.

Again, we are coming out in May 1995, we have a growth airplane of a higher gross weight capability airplane, more fuel, coming out in December, 1996. We'll eventually stretch the airplane and get a higher passenger count, and then in the future offer longer range derivatives. So that one airplane, one flight crew, will be able to fly in any of that range. That's the amount of capability.

One of the things the airlines are very concerned about is the economics of the airplane. One of the things that is paramount in our minds is that if you can get a larger wing span then you're going to produce a more economical airplane. What we have found is that the airplanes we wanted to replace, strictly the DC10 and the L1011, have about a 156 foot wing span. The other airplanes that park in similar gates at airports are the 767 and the A310. The 777 has about 196-197 foot wing span and the problem with that is you can't park that in one of these gates. The 747 has about a 200 foot wing span, i.e., the only gate we can park this airplane in is a 747 gate and there are only a limited number of 747 gates available. Our competitor with their counterpart the A340, which is a four engine airplane, (essentially the same airplane just two engines versus four engines), has a much larger wing span and they are not operating with the folded wing tip option.

To give you a dramatic view of what this looks like, if you look at Chicago O'Hare, you can take a look at the DC10s parked in their DC10 gates and you can see the 777, as depicted with the folded wing tip fitting into the DC10 gate. Out here on the end, you can see the 747-400 with its wing tips, which are not folded. You can see that it takes up a large amount of space for a 747, in a 747 gate. There are only a limited number of 747 gates at Chicago O'Hare airport, as well as other airports.

Next I would like to cover performance, reliability and economy. Computer aided design is an extremely helpful tool for all of engineering. They have to have a better way of doing things other than just straight mockups. A mockup is essentially that. It is built from scratch. It is extremely expensive and time consuming. There are a whole lot of people out in the factory that have to do these mockups that curse up one side and down the other at the engineer that designed it, because the design and the mockup, in the past, have always been a back and forth issue. It
has never been a one way gate and what we’re trying to do this time is to do digital preassembly.

Digital preassembly is where one part of the airplane is designed, fit in with the rest of the design in the computer and you can’t fool the computer. You can draw a line and say it doesn’t quite meet it, I’ll just erase it. And that’s great on paper, but when you try to go and build something like that, that’s when the boys in the factory get really upset with the design engineer. This one will make the engineers be honest. They can erase their line and draw it so it will fit on the computer and from there, all of the parts are built together and assembled in the computer.

The Class Three mockup is essentially a full buildup of the airplane. This way we’re going to skip Class One and Class Two. Class One is strictly nuts and bolts where they’re just trying to make things fit together. Class Two is in between. Class Three is essentially a full airplane mockup. We’re going to go from digital preassembly to the full mockup right away. Tremendous savings there.

I alluded to aerodynamic efficiency here a moment ago with large wing span, but there’s a little bit more to it than just a large wing span. I hope you’ll allow me to digress here a minute into my aerodynamic engineering background, to give you an idea about technology that will help us to make a better airplane.

One of the things that we’re doing on this airplane is that, through the technological advances in structures, we’re allowed to build a thicker wing, which can cruise at mach point eighty-three. Previous airplanes, the 757 and 767, cruised at eighty. So it will be a little faster airplane, not quite as fast as the 747, but more economical than the 747. As a result, if you can increase your cruise speed and wing thickness, you will have an improvement in technology and improvement in efficiency. If we can increase the wing span, we can increase the range, then there is another improvement in performance. If we can increase the wing area, we can increase the altitude capability. A heavyweight airplane with a big wing can fly at a higher altitude than a heavyweight airplane with a small wing. You’ll find that our counterparts, Airbus and McDonnell Douglas, do not have a big wing. Boeing has typically been a big wing builder because of the potential growth of the airplane.

Initially, right off the factory line, there will be a 515,000 pound maximum takeoff weight Market A airplane. Eventually, we’re going to grow the plane into the B market. And you can see when you get to that size airplane, you’re talking an increase in the amount of fuel capability and you can see the extended range will enable the 777 to go from Chicago to Tokyo and Chicago to Beijing. You open up a tremendous amount of the world straight from Chicago with this airplane.

Let’s talk about the three engine manufacturers. Boeing is an air-
plane assembler. They're not a manufacturer. They have many separate companies that support manufacturing. We’re essentially the assembler. And one of the things that we assemble or we mount on the airplanes are the engines. So, we’ll talk about the three engine manufacturers.

The three big engine manufactures are General Electric, Pratt & Whitney, and Rolls Royce. All three of them are offering engines that will work on this airplane. And the thing to point out here is the relative size of these engines. The size is essentially a ten foot diameter engine and you wrap a nacelle around it and you’re talking about thirteen to fourteen feet. How many of you flew in on a 737 or an MD80 or a 757? The diameter of the fuselage, the interior of it, would be the diameter of this engine. So that’ll give you an idea of the relative size. And we’re not too concerned about it because technology that has advanced over the years has enabled us to build this engine. The engine core, essentially the meat and potatoes of this engine, is essentially the same as that on the present day 747 and 767. And what they’ve done is they’ve made the fan, the bypass ratio, much larger and that improves fuel efficiency.

One of the questions that comes to mind is why build an engine so big? So why not go with a smaller engine and make it a four engine airplane? Well, if you look at the operating costs of four engine or three engine airplanes versus two engine airplanes, you’ll find that about five to nine percent of the operating cost of the airplane is wound up in the difference between a four engine and a two engine airplane depending on the range that you fly that airplane. And you’ll see that the twin engine airplane weighs less and therefore burns less fuel. Two engines cost less to purchase than four engines. Two engines cost less to maintain than four engines. A large percentage of the airlines cost of operation is wound up in their engine maintenance.

One of the things that’s near and dear to a lot of people’s hearts is the issue of noise, airport noise. And if you compare this airplane with previous airplanes and you look at their noise footprint, you’ll see that if you take a DC1030 and you look at its noise footprint for a fifty-five decibel area, you’ll find that the reduction is about fifty-one percent over the DC10 and you’ll see that it is very comparable to the 767 today. So it’s essentially the same as today’s engine and that’s a 1991. By the time this engine services in 1995, they are predicting that it will come down. So we’re talking about a bigger engine that’s as quiet and by the time it goes into service, it will be even quieter.

One of the other issues, that is I’m sure near and dear to a lot of litigators here, is the extended twin operations or ETOC. ETOC is the buzz word that’s been around quite some time. The major concern is that you have three engines on this airplane versus four. Where if you lose one engine, you only have one left and on a four engine airplane or three
engine, obviously, you have two or three left after that one failure. But you'll find that with the advancement in technology, these engines are as reliable if not even more reliable than their predecessors. Again I mention that the engines have the same core as the engines on the day sixty-seven and forty-seven models. They're going to use that information to argue the point that these engines will be as reliable if not more reliable from the lessons they have learned from the previous engines and they'll take advantage of that. So that's what they're trying to do is to utilize all the information that they've gathered since 1985 with respect to twin engine operations.

The next topic is avionics. One of the things the airlines wanted was an advance flight deck. Many airlines classify the 767, which is fairly new technology, as steam driven technology. So we knew we were in trouble when they classified it that way. What you're looking at is the 777 flight deck. It is extremely similar to the 747 flight deck. There have been some advances made and there will be more by the time this airplane goes into production. But currently this is its design. One of the things that they wanted was to optimize the quiet airplane situation and what we've done is we've compacted an awful lot of information into a one-eighth inch square tube. A pilot can look at one instrument and get his attitude, altitude, his speed, his direction. You can just glance down at it.

In previous airplanes, he would have to hunt around for several different dials, several different instruments, to be able to get that kind of information. Now he can get it at a glance. And with a lot of reference tick marks on that instrument, he can figure out exactly where he is and where he should be. So at a glance he can pick this information out. Again, that will minimize the heads down time. He will be able to look down at a glance and figure out the situation especially in the terminal control areas where most of your pilot awareness is keen.

They also wanted to design for future expansion of flight operation. One of the future advances is that they're going to add in another eight inch tube. Although they'll be flat plate displays by that time, which is another new technology we're working on. Over here on the side, you'd want the basic airplane information to be at the pilot's command right away. Other information that is not essential to the operation of the airplane, but you'd like the pilot to be aware of it, will be put off on the side tubes. Any type of communication between the airline and the airplane itself, that you don't want to have go through the control tower, you'll be able to send through these separate tubes. One of the big keys for the airlines.

Again, to tell you a little about the avionics package, the 747 package with an expansion from there. You'll be able to have satellite communications again that gets into separate amounts of information from the pilot.
You’ll have a global communication system which is more accurate than what they have in current airplanes.

One of the things I wanted to mention as well is the microwave landing system.

There has been a lot of talk in this past day and a half where they’re worried about airport congestion, being able to get airplanes in and out. I’ve sat on the Chicago O’Hare tarmac, where one time, it was well over an hour wait for all of the airplanes ahead of me to take off and they have to wait for subsequent airplanes to land in between. With a microwave landing system, currently you can land two airplanes parallel to each other with a 1,500 foot distance between them. With a microwave landing system, because of its accuracy capability, we’re talking about being able to have that. Also you have to land two minutes apart. They’re also talking about stacking them up even tighter than that because of the accuracy of this, as well as, some other advances. Then we also have some imbedded software in our airborne information and maintenance system.

On previous airplanes we have had several black boxes or separate computers to do all sorts of different things on the airplane. On this airplane we are going to combine them all in one. And that’s the airplane information and management system. What we’re going to do is we’re going to reduce the weight of the overall system by twenty percent, not the weight of the airplane. We used to have all these separate boxes and now they’re combined into one, that’s where most of the weight reduction comes from. A thirty percent power reduction requirement again because we don’t have all these separate boxes, we only have one that’s going to require a certain level of power. Again, with the separate number of boxes you have more failure of individual boxes now we’re going to only have one. We’re going to try to increase that reliability factor.

One of the keys that the airlines wanted was that we consider when we design a box, when you design an airplane, that it’s about five years before it actually flies. There’s a lot of design activity. You design a black box or a computer to be able to handle a certain amount of information. Well, as the airplane progresses through its development, you’ll find that the airlines want more and more and more information to be able to be processed through these computers. And what we’re doing is that in its initial design we’re allowing for that thing to double in size as to the amount of information that is processed. Key to the airlines is a lesson learned in the 767 and 747 which are right up against their limit right now as to how much information they can process. The airlines are not very happy about that . . . . As you’re about to backup away from the gate, they unplug the power from shore power and you’re now on ship power or airplane power and you find the lights flicker. Well, for all of you who own digital computers, you know what a power surge does to the digital box.
It makes it go haywire. They are going to make this less susceptible to those power surges. So that it will operate right on through a power surge. Again, all of the flight crew functions that were associated with instrumentation for the pilot will be able to operate on either engine power or standby power which is extremely important. A pilot has the capability of selecting what source of electrical power he requires and he can set it to standby power if he wishes.

The cabin management system is another big key for the airlines. This is all information that has come back to us from the airlines. We're making it modular so that what Boeing will provide to the airlines is dispatch critical and non-dispatch critical items that will be built into the airline. The one thing about buyer furnished equipment is all the video entertainment. With this capability, they'll be able to buy anybody's peripherals, anybody's video tape machine, anybody's audio entertainment, anybody's cameras or whatever, and be able to plug into the system. With the way they've done it in the past, every airline had its own way of doing things. They have their favorite video entertainment supplier, etc. Very rarely will we find two airlines that have the same supplier.

Let's give you a little gee whiz picture here. Imagine a flight attendant here at the cabin management system terminal. She has a keyboard where she can enter all sorts of information that will allow her to understand the health of the system as well as any other information that she may require, telephone, everything is available to her at one easy station. She can then operate all of the video, all of the audio, everything from one terminal. One thing we are going to offer to the airlines is the ability to put the screen on the seat back in front of you. This way you'll be able to watch it right in front of you.

The next thing to get into is the interior flexibility, a real key Boeing has to offer and the other airline manufacturers have to offer. Not that I'm trying to sell this airplane. One of the key features of this airplane is that one day you may want to fly this airplane in an all coach or all tourist setup and within twenty-four hours you might want, because of the way you are routing your airplane, to go with a large business class or a large first class and a smaller tourist class. So you'll want to be able to remove seats and replace it with a lavatory or a galley depending on how long your trip is if you need more galley or any combination thereof. In the past, and on our competitor's airplanes, you're going to find that in order to make those kind of changes, your airplane would be down for a matter of days if not on the order of a week. And for all you economists out there, that costs on an order of $100 million on the ground for seven days, you've lost a lot of revenue. We're not going to allow them free reign on the airplane because as you can imagine if you have a seat and you're going to replace it with a lavatory, one of the things you have to do
is you have wastewater management and you know it's kind of tough to leave a hole in the floor underneath somebody's seat.

So, what we're offering is a footprint where you can put your galleys in a certain area and these areas are key areas. It allows you to have that capability of enlarging your first class or shrinking your business or vice versa to be able to handle the galley. Also, in the lavatory are the capabilities where you can locate your lavatories in regard to how you want to arrange your interior. Certain areas are fixed, there are certain fixed galleys. And that's pretty standard. You're not going to want to stuff somebody, a passenger, way back here in the back. So we feel fairly safe about that. Certain areas are fixed lavatories on the airplane. But again the difference is the middle of the airplane where you make all of your interior changes.

The last thing to talk about, as far as technology is concerned, is the composite structure material that we'll use on board the airplane. This is nothing new. Composite structures have been used on airplanes for quite some time. The one thing that will be new for the 777 airplane is that we will use an extensive amount of composite in the horizontal and vertical tails. We have used, in the past, almost every other area that you see here highlighted by the different types of lightweight composites we have used on the fifty-seven and sixty-seven, and subsequently, on the 747-400. One of the things that has come up, especially in the recent past, is structural durability and one of the things that Boeing is pretty smart at is learning their lessons and we're now going with the thicker skin than we had in the past. We have improved damage drainage to reduce corrosion. One of the things you'll find is that you go through the service of the airplane, through taking off up to altitude and back down, you're stretching and shrinking the airplane over and over again. As a result of that, you're always going to have a certain amount of fuel leak either through your wastewater management or any of the hydraulics or anything. All airplanes have that. One of the things that's key is to be able to get into these areas where this fluid will get caught and be able to remove it. Again, parts and features, better accessibility to trouble prone areas, again that's the same thing that fluid tends to be trapped in certain areas of the airplane and you want to be able to get in there and remove it.

Just a recap. What we're looking at is we're going to twin engines instead of the prior four, again for lower fuel burn and the lower noise. We have improved the avionics and aerodynamics to be able to lessen the cost for the airlines. We're looking at a better design through the digital preassembly and also through the use of components. And we're also offering a tremendous interior flexibility for the airline as well as the spaciousness for the airlines. Just to give you one indication of direct operating costs. Direct operating cost for the airlines that use the fuel are
maintenance, engine maintenance, insurance, and flight crew costs. If you look at the regional markets, the dual class on a 1,000 nautical mission although 1,000 might be a little on the short side. It was just chosen as an example. If you look at the 767-300 which Boeing builds today versus the new airplane, you can see that through our use of technology we were able to lower the operating costs quite a bit. The difference here is just nine abreast or ten abreast seating. Ten abreast is a little bit tight and nine abreast is our standard. So if we look at nine abreast versus our present technology, we're that much improved. And we are improved over the MD11 and MD-8330 which is our counterpart twin. If you look at our international market, the big jump here was fairly bold here and the reason that they've fallen off here is the four engine airplane. That's one of the big increases that there is the extra cost for the extra two engines.

Just to give you one final cap here on the now and in the future we're going to introduce in May 1995, United Airlines is our first customer, All Nippon Airways bought our airplane a couple of months ago. They have not chosen an engine as of yet. United Airlines chose Pratt & Whitney, so there's a bit to do between Rolls Royce and General Electric as far as who gets that second engine. There's big money for that. December of 1996 we're going to go to the higher airplane. That was the one you'll be able to fly to Tokyo and Beijing. We're going to stretch the airplane, we're not sure on a date on that. We're still negotiating with Cathay Pacific out of Hong Kong who is very interested in our stretch version and then the future growth of the airplane as we mentioned earlier which is a bit further off in the distance. And what that amounts to is what Boeing offers is the full family of airplanes now. We go all the way from 110 passengers all the way to about 450 passengers and we've got everything covered. So as our Vice Presidents like to say, we have one stop shopping. Whatever you want, we got. And with that, I'll say thank you.
JOHN M. SWIHART

I'd like to start where Mike left off and talk about growth for a second because that's extremely important. He mentioned the broad analysis of growth. One of them very optimistic, one very conservative. Boeing tends to be in the middle. But all of them predict that in the year 2000, traffic relative to today is going to nearly double. Right now there are 1,200 million revenue passenger miles being flown in the world. There is going to be nearly double that number by the year 2000 and by 2005 it will be more than double. And what that really means is that there's going to be nearly 9,000 new aircraft come into the system by 2005. That combination of replacement aircraft, which is going to be approximately 3,000 of the 9,000 aircraft, and the new aircraft is a market of $617 billion between now and 2005. About $423 billion new and $194 billion for replacement overall. Now the interesting thing about the Boeing study which was just released in February 1990, is that the largest share of those new aircraft are going to be in airplanes of over 350 seats. Now there's a very good reason for that. The biggest problem we have in the world today is between runway capacity and air traffic control. In fact, the lack of runways and the lack of global positioned satellites and combination is really keeping things below what they should be if we could get them done. Mike mentioned MLS. MLS and all of its combinations will only increase runway acceptance by twenty-five percent, but we're going to double. So you need more runways and that's pretty soon.

There are twenty-five countries waiting for landing slots at Narita Airport in Japan right now. The internal Japanese lines are turning six million passengers a year over to the railroads because there are not enough runways, even though they fly 747-SR's at 550 seats and they fly every half hour. There is not enough runway capacity to handle the traffic traveling between Tokyo-Sapporo, Tokyo-Osaka, Tokyo-Fukuoka and Tokyo-Naha. They're turning six million passengers over to Bullet Train (Shinkansen). That's just on the main four trunk routes, that's not the other part of the domestic system.

Airports, as you must well know, in Denver, bring thousands of jobs once they get put in place. So we've got to have more concrete around the world. That's all there is to it and it's a great mistake, and I'll go on record with this, to close Stapleton when you make the new airport. Because if you are going to double capacity within ten years, what are you going to do? You are going to have the same problem you've got today.

2. John M. Swihart is currently President of Swihart Consulting, Inc., President of the National Center for Advanced Technology, and President of the American Institute for Aeronautics and Astronautics. Previously he was a vice President of Boeing.
There are twenty-five airports under constraint in the United States right now. By 2005 that number will be over fifty which is a serious problem.

Let me talk about technology for a moment. I'm fortunate to have retired from Boeing and I'm the President of the National Center for Advanced Technologies, which is a non-profit foundation of the Aerospace Industry Association. We got together a group of senior vice presidents of research and engineering here in 1987 and we looked at all of the technologies which would affect our international competitiveness by the year 2000. We used some very selective criteria, but we picked a bunch of them and I'm only going to mention those that apply to airplanes at this particular moment. We picked air breathing propulsion, advanced composite structure, advanced metallic materials, computational sciences. We got a lot of commonality with what Mike had to say. Ultra reliable electronics and optical information processing.

The process we used is that we appointed one of those senior vice presidents to be the sponsor of each one of these technologies. He, in turn, went to his company, he got a senior person from engineering, and a senior person from manufacturing and said, "you go out and get one third of the number of people you need to build a road map from industry, you get one third from government, you get one third from academia and you start building a road map with that technology for the next ten years." As soon as you get that road map built, go back to the central authority, so to speak, we'll review it, and then we'll start doing a national technology development plan for each one of these things. So we'll lay out ten years worth of very detailed technology development plans that will ensure that several things happen. One, we will double the productivity of our manpower in aerospace. We will cut the time from idea to product in half, and we will leap frog our international competition.

Industry leads the process of making these national technology development plans. The government participates and academia participates. If they want to join the team, if they want to put their money in that technology, that's fine because industry is putting their money in. A large share of their internal research and development is going into these eleven key technologies that we have identified.

I want to talk about each one of those a little bit with reference to some of the things that Mike had to say. For example, air breathing propulsion. The goal is to double the thrust to weight ratio of those big engines that you see that Mike had there in the first part of the twenty first century. Now that roughly means that their thrust weight ratio right now is about five to one. This would mean that they go ten to one. We could do that by using metal matrices for the turbine wheels. We could use ceramic matrices for the combustion chambers. We could use advanced composites for the frames and the blades. Just to put that into context, if
you could double the thrust to weight ratio of the two engines on Mike’s new airplane, you could do several things. I’ll put it in terms of passengers; you could increase the passenger capacity by eighty passengers. You wouldn’t do that. What you’d do is take the savings in weight and put it immediately into range or higher initial cruise altitude. Also, the second goal of air breathing propulsion is to reduce the specific fuel consumption by twenty-five percent. This, in that same frame of reference, would increase the passenger capacity of the 777 by sixty-eight passengers. Between those two, you see there’s almost half of the payload in advanced technology. You could run the gross weight down and increase the range. You could reduce the ticket price because the direct operating cost would go down a very substantial amount.

Advanced composite structure. We’re talking about structures that are designed right from the beginning not as black aluminum, which is a lot of what we do today, but taking advantage of the strengths of the advanced composite structure and making new material, new manufacturing methods, lower cost. If we could do that and actually apply it to the entire airplane, you could probably reduce the operating empty weight by between twenty-five to thirty percent. That’s about 7,500 pounds of the 777 airplane. What a terrific affect that would have when you integrate that back into the total airplane. Engine size goes down, fuel burn goes down, landing fees go down, everything goes down very substantially.

Advanced metallic structure. There are new ways of manufacturing metallics today that are being talked about. For example, you might make the wing in two pieces. You might make the front spar on the lower surface, the rear spar in the upper surface and put it together. A very simple two piece wing in other words. That could result a ten percent reduction in operating empty weight and substantial reduction in cost.

Computational science, computational fuel dynamics are the new thing. Mike showed you a lot of wonderful things. The three dimensional mockups. All of that material. The aerodynamics that he mentioned. All of that. There could be some tremendous advances made in computational science. For example, today we could probably run computers at an average speed of maybe a billion of operations per second. What we’re looking for is a 100 billion operations per second. So when we can do the type of computations it takes to get the complete analysis of the airplane which now takes twenty-four to thirty-six hours and costs hundreds of thousands of dollars, in a couple of minutes, then we could look at the result and say let’s make that change. Let’s try that out. Two minutes later you would know if it was right or wrong. Then you could get to the stage where you make one wind tunnel model and that particular model is the one that you use to guarantee United what their performance should be.
Now, a couple of others things you might get with new computational science. Laminar flow. For example, laminar flow is a very smooth flow of air one-fifth of the drag we get with an airplane today. The 757 has run a test in this past year when they achieved laminar flow over the upper surface of the wing from the leading edge to the seventy percent chord. A very substantial amount of laminar flow. They achieved it 100% of the time on ninety one flights. Properly applied to the wings, the nacelles, the vertical and horizontal tails of the 777, this would result in a thirteen to fifteen percent fuel savings below the numbers that Mike already showed you. This also will do a couple of other things. With laminar flow of that kind you can reduce the engine size. You wouldn't do that probably. You would run the initial cruise altitude up 2,000 or 3,000 feet because that helps promote more laminar flow and the engine likes to fly higher and faster anyway. Therefore, you get reduced maintenance cost on the engine. Overall it would be a very large improvement. You'd get better airframe engine integration by using computational science than we have today without a lot of wind tunnel testing.

Ultra reliable electronics. I just want to mention very quickly that the goal is to design and build an electronic suite that never fails in the lifetime of either a civil or military aircraft. That's the goal of the technology. Never fails. Think of the reduction of life cycle costs if United bought an airplane and expected it to last for 60,000 - 70,000 hours and never have an electronic failure. That's the goal of the ultra reliable electronics, very powerful reduction in life cycle costs.

Let me just summarize quickly and then we'll get to some questions. If you combine all of these technologies into a new series of airplane, you obviously make obsolete our current product. Those things would lead you to do some other things. Remember I said there are not enough runways? One of the ways you take care of not enough runways is to build bigger airplanes. An airplane that should be on the design board, at this particular moment, and with these advance technologies will probably do it before the end of the 1990’s is an 800 passenger, three class airplane that would fly 7,500-8,000 nautical miles. It will solve most of the runway problems to probably the year 2025.

The second one that I'll mention quickly, because George mentioned it, is high speed civil transport. The high speed civil transport has some environmental problems that have to be solved first Arnold Goldberg and I worked on this most of our lives I think. You have to show that you don't wreck the ozone layer. You have to show that you can meet those nice noise requirements that Mike showed and you have to show that you do not make a startling sonic boom. The technology is available right now to very probably accomplish every one of those three things. But even if you couldn't solve the last one, the non startling sonic boom, the use of these
technologies would allow us to build a high speed civil transport and probably cruise between 1,500 and 1,800 miles per hour, seat 300-350-400 passengers and fly from Denver to Japan in four and a half hours and have a ticket price that was within ten percent of the 747-400. Thank you.
I. COMPUTER RESERVATION SYSTEMS

JAMES WEISS

Competitive problems for both airlines and travel agents ostensibly caused by computer reservations systems (CRS) are among the most written about topics in antitrust and trade literature today. CRSs are essential to both travel agents and airlines to market their products, and they are controlled by only a few vendors, two of which, Sabre and Apollo, have long held an advantage in terms of market placement. The recent formation of the WORLDSPAN partnership only partially redresses this problem. Long term contracts, liquidated damages, minimum use clauses and other factors lock in travel agents to use one particular CRS. In addition, the availability of better information on the host airlines as well as commission overrides and other devices, which may or may not be tied explicitly to CRS usage, disadvantage the airlines that do not own the system most travel agents in a given city are using. The combination of these factors, and their advantages to the vendor airlines, has been dubbed the “halo effect”.

It is a fact that travel agents do tend to book disproportionately on the airline or airlines that own the CRS they use. This behavior is the very reason airlines have invested in CRS development and travel agency conversion. This problem is not unique to the United States. This phenomenon has been recognized in Canada and Europe, with respect to their vendors, and in Asia with respect to U.S. vendors. The Canadians have imposed rules concerning the ownership and operation of the systems that go beyond the ones adopted by the Civil Aeronautics Board (CAB) shortly before it went out of business in 1984. And, currently, the Economic Community (EC) is considering whether to impose rules to deal with the proposed joint venture between SABRE and Amadeus.

The Asian governments have taken a different route. In some instances, they have denied access to U.S. CRSs altogether, either directly or by allowing their own carriers to refuse to participate in the U.S. sys-

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1. James Weiss is currently with the firm Preston, Gates, Ellis & Rouvelas, Meeds, in Washington, D.C. Prior to this he was the transportation section chief for the Antitrust Division, U.S. Department of Justice.
tems. The result is that U.S. systems are noncompetitive and U.S. airlines less competitive.

The Department of Transportation (DOT) is proposing to outregulate the other regulators. In addition to maintaining the current rules, the DOT may change the contract terms, further level the playing field between host and non-host airlines, and even require multiple vendor access to travel agency hardware. It is important to keep in mind that these are not final rules but proposed rules and, indeed, most of them are posed as questions; i.e., we would like comments on what might happen if we require that all vendors allow other CRS vendors access to their installed hardware base. It is unclear which of the proposals will be adopted. However, you can be sure that some of them will, and they have the potential to change the industry radically.

First, the proposal retains the current rules precluding biased displays, but it would expand them to require that each vendor carrier participate in other systems to the degree it participates in its own. The result would be that no carrier will be able to display its flights, or offer services concerning the booking of its flights, more favorably in its own system than in the others. While it may appear that this rule would be more directed at one CRS than another, in fact it should affect the CRSs equally since the owners of each CRS are leaders in some markets.

Second, the proposal includes some tightening of specific rules prohibiting display bias. The new proposals are to (1) disallow "direct flight" status for change of gauge flights, (2) require improved connecting flight data, and (3) consider precluding host carriers from offering biased second screens. It would not, however, require the elimination of the systems' preference for online over interline connections.

These proposals would eliminate some of the more obvious ways a host can get an advantage on its system over non-host carriers. Again like the vendor participation proposal, the affect on all the systems would be equal. On the other hand, it is probably safe to assume that if the vendors came up with these ways to defeat the purpose of the earlier bias rules, some will come up with ways to beat the new ones.

Third, the rules seek to address what the Justice Department has referred to as "architectural bias." This refers to the inherent advantage a host has when the data base of its CRS is its own internal reservation system. The proposed rule seeks comment on whether technological advances in the CRS industry now make possible universal "equal functionality" such as WORLDSPAN is currently developing, so that the information a system provides concerning the flights of participating carriers is equivalent in timeliness and accuracy to the information provided about the host carriers' flights.

First, the rules would prohibit host carriers from loading fares into
their own system more quickly than others' fares are loaded. If other carriers have to go through ATPCO, so will the host carrier. Second, the proposal would change the current rules which allow host carriers to reserve enhancements for themselves. Any enhancement for the host carrier will have to be offered to all participating carriers as well. Lastly, the rule seeks information on the feasibility of achieving functional equality by either requiring separation of internal reservation systems from the CRS, or development of enhanced links between each CRS and the internal reservation systems of each participating carrier. WORLDSPAN is currently developing these enhanced links.

These proposals are sure to be controversial. They could involve substantial additional costs or, alternatively, could lead to a reduction in the quality of information available about carriers' services.

The big changes in industry structure would come from the proposed changes in the vendor-agent relationship. Those changes could be significant if adopted because the proposed rules would make an agency’s choice of a system less momentous by eliminating most of the impediments to switching systems. These rules would provide for arbitration of agent-vendor contract disputes, reduced contract length from no more than five to no more than three years, eliminate minimum use provisions, and prohibit rollover clauses. The rules might require inclusion of some of the provisions of the rules in agency contracts so that the rules will be enforceable in court and require the vendors to allow access to third party (non-CRS) products that are compatible with their system and would require all vendors to offer open architecture; i.e., to allow agencies to switch between systems on their terminals. The latter two proposals are likely to be particularly controversial.

Third party products could allow the agents to introduce their own bias, possibly without notice to their clients. Open architecture, aside from possibly being limited by current technology, would limit the amount of computer hardware likely to be sold to an agency. Unlike the airline-vendor rules, the agent-vendor rules are obviously designed to affect certain systems more than others. If the rules are effective, the systems will have to compete for one another’s user bases on the merits. If they win expiring or new contracts from one another approximately equally, the big losers will ultimately be Sabre and Apollo, today’s leaders in the industry, and the most aggressive enforcers of restrictive agency contract terms.

All sorts of questions are raised by the proposed rules, not the least of which is “Are they too little too late,” and “how will this affect the vendors’ ability to market their products overseas?” Certainly some carriers are likely to argue that the damage has already been done. One argument is that CRS bias so weakened them that they have either exited the industry or are in dire financial straits. Whether that is true or not may
never be known, since the issue has been litigated, and the damages the plaintiff airlines were alleging were found to be too remote from their claims concerning limitations on agents switching systems to entitle them to an antitrust recovery.

As for marketing overseas, one lever the U.S. vendors have had to date to achieve access to foreign markets is their right to bias their systems against foreign carriers from countries that impede the vendor’s sales in that country. The new rules would presumably eliminate that leverage since they do not distinguish between foreign and domestic carriers and they allude to the fact that we are required by most of our bilateral agreements to treat all carriers fairly. It may be, however, that leverage will no longer be necessary.

One of the primary weapons used against U.S. systems is the refusal of foreign carriers to participate in the U.S. system in their home country. For example, Iberia does not participate in WORLDSPAN at all, and Lufthansa provides much less information to WORLDSPAN than it provides to Amadeus, the system in which it is a part owner.

Canada has already adopted rules that would preclude such actions. In the context of the merger of its two computer reservations systems, Canada required the Canadian carriers to participate in other systems, chiefly Sabre, which was actively marketing in Canada, to the same degree as they participate in their own system. The EC has the opportunity to do the same now, as a condition of its approval of the proposed Sabre/Amadeus alliance. If it doesn’t, it will be a serious problem for other U.S. systems, in particular WORLDSPAN, which is not allied with one of the two European systems. It will be foreclosed from access to a number of countries and will have no leverage to overcome that handicap.

In short, DOT has been kind enough to give us a lot to talk about and to think about. Given the scope of the changes the agency is proposing, I suspect the question of which rules will be adopted will not be resolved soon. Furthermore, even once the rules are adopted, there will undoubtedly have to be modifications. Regardless of what you think of the rules, however, you have to be surprised by the agency’s initiative. For while the rules may be coming too late for some, it appears that they will go further to address the perceived problems in the CRS industry than anyone anticipated they would.
II. NO TRAIN TO THE PLANE, OR YOU CAN'T GET THERE FROM HERE

WILLIAM E. THOMS

Long distance air travel began as an adjunct to railroad sleeping car service. Transcontinental passengers would board a Pullman train in New York’s Pennsylvania Station, travel in sleepers to Columbus, Ohio, whence they would fly during the following day to Albuquerque. From there, the Santa Fe was ready to take them to their California destinations, thus spending two nights on the rails, rather than three or more.

The advent of navigational aids permitting night travel by plane, and soon the rail-air combination went the way of the dodo and dinosaur. Transcontinental rail travel exists, but the airways have long since preempted the market for coast-to-coast passengers. And surface transportation companies are unwilling to short-haul themselves by interlining with air carriers.

When one flies to a destination city, there is very little concern on how one gets from airside to his urban destination. Presumably the rental car companies fill the gap, but relatively high rental prices plus the special needs of those unable or unwilling to drive themselves leaves the American air traveler with few travel alternatives. Those cities which maintain airport transit links often fail to indicate to the air traveler how to use the system, and the casual tourist finds the transit vehicles hard to find and confusing to use.

Intermodal passenger transportation has not been developed in the United States to the extent that it has in most urbanized and industrial countries. Most airports are operated by local or county authorities, who have little or no responsibility for surface operation. Similarly, bus terminals are often owned by intercity bus companies, and rail facilities by local commuter authorities or Amtrak. There is very little coordination among these bureaucracies and no reason why one should aid the other. Thus, getting to the airport may well be the most traumatic part of the trip.

A quick run-through of the extent of surface-air passenger connections appears as follows:

AMTRAK: The rail passenger carrier is over twenty years old. It has evolved from a fledgling entity using the equipment, track and crews of private railroads to a nationwide system, using its own employees and trains and requiring less in federal subsidy each year. Primarily an intercity carrier, Amtrak is precluded from entering the commuter rail business and has only recently provided some intermodal service with dedicated buses. However, in connection with the State of Maryland, Amtrak has
established an intercity stop at BWI (Baltimore-Washington International Airport) for its Boston-Washington "corridor" trains to interconnect with Maryland commuter trains and (via a bus shuttle) the air terminal itself. The system is not perfect; not all trains stop at BWI, and the shuttle bus adds to the downtown-to-airport time. But it is an attempt to link air and rail travelers in the vicinity of the nation's capital, using a pre-existing rail line. The renovation and restoration of Union Station as a Washington tourist, shopping and transportation center has increased the attractiveness of the BWI connection. Amtrak's other foray into airport connections was not so felicitous. In 1990, Amtrak extended its Atlantic City service, then suffering from disappointing patronage and competition from chartered buses, to the Philadelphia International Airport using a spur line built by Philadelphia's SEPTA commuter rail system. Amtrak engaged in a through-ticketing arrangement with Midway Airlines; the trains were listed in Midway's public timetable, and baggage was checked through to the passenger's final destination. Alas, Midway gave up its Philadelphia hub in 1991, and filed for bankruptcy in March of that year. Amtrak quickly removed its trains from the airport spur by the Spring 1991 timetable. However, Philadelphia commuter trains still serve the airport, much as MARC commuter service between Baltimore and Washington over Amtrak's main line serves BWI.

Early this year, Amtrak entered into a joint ticketing arrangement with United Airlines, by which a passenger could travel one way by air, the other by rail on the same round-trip ticket. Although adding to the flexibility of travel plans, the arrangement did not contemplate any intermodal service to airports. Outside of BWI, Amtrak has not chosen to penetrate that market. In Europe, by contrast, the railways of Britain, Belgium, Netherlands and Germany provide express connecting service to their principal international airports. (For a while, British Railways was selling tickets in Stapleton International Airport.) Lufthansa operates its own trains, in its own livery on Deutsches Bundebahn trackage; these are listed in the timetable as local connecting "flights," very much like the short-lived Midway/Amtrak experiment.

GREYHOUND: When Greyhound Lines (the bus operator) was sold to the current operating company, the intercity carrier made an effort to provide airport connections. A national timetable was published, showing Greyhound connections from regional airports to smaller cities throughout the country. Many of these were routes to small cities near principal airports but not adequately served by commuter airlines. (New Orleans-Baton Rouge, seventy five miles, was an excellent niche for such service.) Most of these bus schedules were intercity runs, originating at downtown terminals, which incidentally stopped at the airport terminal. Designed mostly for the long-haul passenger, rather than the air traveler
wishing to reach a nearby town, the schedules were often inconvenient for air travelers (who tended to arrive and leave at a hub’s “pulse” time).

Greyhound’s role as a feeder for air service did not have long to develop. The year 1990 was not kind to the bus company. Difficulties in absorbing one-time competitor Trailways and a long bitter strike led the “Big Dog” to file for bankruptcy in 1991. Now attempting an income-based reorganization and looking for a new buyer, America’s only nationwide intercity bus company is on the ropes. Concentrating on rebuilding its major routes, its role as an incidental-to-air carrier has apparently fallen by the wayside. A future role for a bus connection to airlines should focus on more luxurious equipment and schedules tailored to the air traveler, rather than incidentally trying to pick up one or two airport passengers on an existing downtown-to-downtown schedule.

**TRANSIT AUTHORITIES**

Most large cities have bus lines which serve the airport, but few make an earnest attempt to draw air travelers to use the service. Denver, with express service to Boulder direct from the airport and a number of lines serving the metro area, probably does as good a job as most. Usually, the signs marking the bus areas are inconspicuous and hard to find and the traveler with baggage is wary of getting involved with city bus systems where the driver stops at every other block.

Cleveland was the first city to build a rail transit line to its airport. Since then, the following cities have added to their transit systems to include an airport rail line:

- Atlanta
- Chicago (O’Hare)
- Miami
- Washington, DC (National)
- Boston (a bus shuttle is required)
- Philadelphia (commuter rail)
- Baltimore (commuter rail)

New initiatives will bring rail transit to airports in San Francisco, Los Angeles, Milwaukee and South Bend within the current decade.

Denver fielded an ambitious proposal in 1990 to build a demonstration light-rail line from downtown to Stapleton Airport. However, community opposition to the route along Martin Luther King Blvd., plus the fact that the city planned to close Stapleton to air traffic at the time the line was to be completed, caused the plan to die aborning.

This year, New York City discontinued its “train-to-the-plane” service to JFK International Airport. The plan suffered from lack of direct connections (a bus transfer from Howard Beach was required) and despite the
extra fare, passengers were often required to wait on the track behind a stopped local subway train. The demise of the "train-to-the-plane" illustrates the difficulty of attempting to adapt an old system to the needs of air travelers in a hurry.

**OPPOSITION**

Taxpayers, for one. The new rail lines cost money — lots of it. In addition, as the Denver example shows, local residents are fearful of the disruption to their communities which construction of new rail lines will bring. Taxi and limousine companies, although in many ways pursuing a discrete market, fear competition from swift rail facilities. The opposition is probably enough to insure that an airport rail line will not be built in New York City.

However, for the rest of the country, as freeways become congested and air travel concentrated in fewer and fewer hubs, we should be looking at some type of improved facility for the traveler who debarks from his plane and starts the really dangerous part of his journey — on a public highway.
III. ORGANIZING GLOBALIZATION

ERWIN VON DEN STEINEN

I shall offer you modest ideas under a mile high title, Organizing Globalization. I choose that because, if I could sell one idea, it is that the globalization we would like will require forms of organization that we have barely begun to think about, far less achieve.

People use words differently. The word organization as I am using it should not suggest imposing control. Germans used to have a terrible term: Gleichschaltung — making everything the same — that's one old form of organization. There are others. Some forms of adversarial belief can also make it harder to create cooperative forms of order. We, for example, still think of capital and labor as fundamentally opposed, even as knowledge-based production processes increasingly put capital inside people. Another albatross is industry and government antagonism, especially the American tendency to view not only strong but even just capable government as a step toward socialism. The reverse can be true.

To cite an aviation example, consider air traffic control. Here adversarial approaches, in this case even more in Europe than here, have not produced effective organization — neither at governmental nor at industry levels. Safety and sovereignty concerns have typically dictated putting ATC inside government. But we also want innovation, ability to invest and service provider motivation in this modern network industry.

We could probably be best served by an integrated network of regional systems with rigorous governmental supervision of technical and performance standards but corporately run under private managements in which airlines, airports and key professional groups such as pilots, controllers and engineers directly participate. If users become part of management, then the monopoly-pricing aspect, for what is an essentially a pipeline service, would also be in far better hands than it is today, and essentially self-regulating.

Unfortunately, the various forums that try to organize international aviation, whether in the setting of technical support services or in the negotiation of air service rights, still tend to be trapped in various "we" and "they" contexts.

Some say it is the role of government just to get out of the way. Others say: "Industry should keep its powder dry." Industry, to quote Sir Colin Marshall, needs to be "proactive" not reactive. A government that tries to be non-competent will often just succeed in being incompetent.

3. Erwin von den Steinen is the current President for International Transport Policy Analysis in Arlington, VA.
Aviation agreements represent choices on how to organize markets. Then the question becomes: How well do the markets work — do players operate under conditions of trust, information, rules and opportunity that establish acceptance; or do we keep coming back to the table year after year, sometimes month and month, because we failed to get it right?

The frameworks we organize for international aviation must relate more to markets — all kinds of markets, including those in information and ideas, as well as transportation. We are no longer in the age of the Conquistadores who showed up somewhere after a long voyage, planted a flag and said "This is Spain." Modern systems have become and will remain dynamic, interactive and diverse. There is a system called Canada and another one called the U.S.; then there are other types of systems like ATT, General Motors and even Arlington County, Virginia. There may be also a system already out there called North America.

In the next few minutes, I will touch on five topical areas:

1. The issue of social and political constraints on globalization;
2. The consequence of not having policies that address these constraints, creating what we shall probably soon term a "supply-side crisis" in international aviation;
3. Thoughts on U.S. negotiating policy;
4. Recent policy developments; and
5. Finally some thoughts on the C-Word: CABOTAGE.

1. **SOCIAL AND POLITICAL CONSTRAINTS**

The earth’s surfaces are finite, while people-numbers grow and demand expands — expands exponentially. Major challenge and major opportunity both confront global aviation. Opportunity is there because we can, to some extent, extend our use of scarce space vertically and airports demand only a fraction of the land needed by other transport modes. Challenge is there, because any one airport demands considerable space in any particular place. A famous acronym is NIMBY, not in my backyard. The more urbanized an area becomes the more its businesses and its inhabitants, as travelers and employees, need airports. Yet, the more urbanized and crowded it becomes, the less its inhabitants, as residents, want them.

The lesson of this is that classical economics, i.e. the "unseen hand," will have trouble solving this problem. This is not a self-regulating equation. Demand generates demand and ratchets up the shortfall in supply. In short, there have to be conscious political processes, i.e. land use policies that are simultaneously local, in terms of reaching a compact between communities, airports and airlines to meet the needs of the place, and large scale, in terms compatible with our need for uniform and efficient systems for national and international movement. Neither gov-
ernments nor industry can abdicate leadership in this discussion, unless they want to pay a painful perhaps terrible price.

2. INFRASTRUCTURE

Today nationally, regionally, globally, we face a creeping crisis covered by a rather creepy word: infrastructure. We creep along the rush hour routes or stare at watches in airports. We also creep along in our response to the problem.

We, and millions of others, are part of a huge global constituency that ought to be demanding priority action and getting it. But what happens? In an increasingly specialized world, businesses and even governments segment. The airline industry spends millions on studies documenting billions in losses, but cannot seem to mobilize action. The construction industry works up the problem separately and even calculates trillions in losses. But no one, at least in this country, seems able to put across the broader social point: A society that constantly puts consumption ahead of investment will soon start having less to consume.

What bad infrastructure also does more mundanely is become a piece of higher costs that have to be passed on to consumers or accepted as red numbers on airline balance sheets. Infrastructure shapes both competitiveness and competition. Our trade negotiating can talk all day in Japan, but when there are no airport slots available in the heartland of global economics, i.e. the Kanto and Kansai Plains areas, competitive products either can’t get in or must bear enormous supplementary costs in distribution. When we talk about the recent Heathrow deal, I will ask you to reflect on the fact that this transaction, which may have major policy effects on U.S./European aviation relations, has its genesis in an infrastructure factor.

3. U.S. NEGOTIATING POLICY

Let me now address U.S. international aviation policy which, since 1978, has been associated rhetorically with the term “Open Skies.” Reality might require us to change this to: “As Open as Possible Skies.” There has been a lot of sincere effort by our Government, but results are not unlike our Department of “Not too much Energy.”

With the exception of Germany, where the rules are very liberal, there is a noticeable fault line that runs across U.S. aviation agreements with major OECD countries, i.e.:

- Japan;
- The other four bigger players in Europe — the U.K., France, Italy and Spain;
- With big continental partners such as Canada, Mexico and Australia; and
In general, with virtually every state that can be said to have an internal aviation system of any consequence, U.S. negotiating outcomes since 1978, have become less liberal in structure. With such countries we have negotiated specific, and at times substantial, benefits point by point. However, liberal provisions such as multiple designation have been gutted and new mechanisms that frame, if not constrict, capacity growth, introduced.

Open Skies really has only been accepted by countries who operate primarily or even entirely international systems — e.g. small countries and islands with economies dependent on international trade and tourism. This points perhaps to a flaw in Open Skies — its weakness in terms of bridging mechanisms. Foreigners, rightly or wrongly, have perceived the US as simply trying to extend the U.S. system.

Thus when such countries have internal systems, even liberal internal systems, they are disposed to dig in and say “Wait a minute.” If U.S. commercial interests are nonetheless strong then the context of the negotiation can rapidly shift to just doing it their way. That is also why, even though there have been very interesting signs of intellectual movement in Mr. Skinner’s Department, it may be wishful to believe we can achieve anything revolutionary of even truly evolutionary (which might be better) either in the coming Canada-U.S. negotiations or with Europe as 1992 arrives.

4. RECENT POLICY DEVELOPMENTS

First, some observations about at the recent U.S./U.K. agreement involving Heathrow airport and, perhaps, a whole lot more. Should we call this Bermuda two point five? While it is risky this early to draw overarching conclusions, the footnote type arrangements reached between the U.S. and U.K. on March eleventh to create the possibility of new U.S. mega carrier participation at Heathrow, embody provisions and ideas that I believe could reach far beyond U.S. purposes.

Essentially, the entirety of the deal for the U.S. was the removal of restrictions denying transfer of incumbency rights at Heathrow Airport from Pan Am and TWA to other U.S. carriers. For Chicago Convention reasons, however, the U.K. had to perform this step unilaterally, i.e. remove its new entrant restrictions not just for us but for everyone. In exchange, the U.S. agreed to fly less than it otherwise could have on some of the biggest routes on the North Atlantic and freeze growth on beyond services for three years while allowing British carriers among other things to:

- Greatly expand their participation on existing gateways;
- Gain online access, through possible marketing agreements to any other U.S. point listed on line by any U.S. competitor;
Why did people agree to this? We come back to our creep word, infrastructure. In recent years, U.K. policy was to make all new carriers go to Gatwick (which in the meantime is also full). This had nothing to do with routes, it was an issue of slots, of so-called ATM’s, air traffic movements. Interestingly the March eleventh deal says not one word about slots. All it says is that now four (two U.S. and two — formerly just one — British) carriers may operate on the route description using Heathrow as the access ramp. There is no language, at least in the official public domain, that conditions the deal against subsequent loss of slots because of possible EC or British policy.

So, United and American really only buy designations on routes, i.e. something the U.S. disposes over unilaterally under the agreement, with the expectation (perhaps well founded but not guaranteed) that they will obtain and over time keep the slots they need to make this all work. So, if we wished to be harsh, we could conclude that because the British authorities already defaulted once on their implied obligation to provide the U.S. means to exercise its basic traffic rights under the agreement but, were [nonetheless] wise and/or stubborn enough to obtain U.S. acceptance of this state of affairs, that the U.S. now has to pay for compensatory mechanisms and again lacks protection for the future. So what does this say about the prospects or sense of just articulating the need to Open Skies, when closures on the ground can hammer you into a truly outrageous negotiating box? This question provides an apt introduction to a second larger area of significance the Heathrow deal addresses — how the North Atlantic market could work in relations with post-1992 Europe.

Terms of the new arrangement include joint venture rights uniquely for the U.K. So if any designated British carrier owns less than fifty percent of a German, French, Benelux or Irish carrier designated under another bilateral or otherwise operates a “joint venture,” a term which otherwise has no definition, that entity can operate full U.K. route authority (i.e. some twenty U.S. points plus newly added ability to match any U.S. online service through code sharing). Clearly it can also benefit from unrestricted capacity provisions found, for example, in the German and Benelux bilaterals. This provision could become quite interesting. Other countries possess far fewer points in the U.S. than does the U.K.

The U.K. also gets approval for unique rights now added to the British route description that permit up to forty two weekly frequencies to operate with non-stop sectors between Germany, France, Ireland and the Benelux countries. The U.S. agrees to waive all existing restrictions on change of gauge and fifth freedom capacity. What that means is that BA,
for example, may be able to hang several flight numbers on any plane going to Frankfurt and then up three long range wide bodies that would fly to cities like Denver not on Germany's present route description and then turnaround, operating the same scheme in reverse. Traffic could be 100% U.S.-Germany on both long haul sectors.

United Kingdom policies to exploit these new rights will, I fear, increasingly reflect a segmented regulatory approach. I say segmented, because on the one hand, the British have discovered a clear self interest in liberalizing, even integrating, market access within Europe — indeed they have been in the forefront of such efforts. At the same time, they continue to keep the bridges to the U.S. narrow and well staffed with toll keepers.

So here is the real world question: What becomes the model? Will Bermuda II and recent deals with Italy and France become the model for European relations with the U.S., just as the European states open up to each other within? Will we see a "Common air transport policy" akin to the Common Agricultural Policy — very open within but highly structured if not sharply restrictive without? There were some of us, four years ago, who urged unsuccessfully that it was then timely to develop a serious multilateral approach, when the situation still remained formative. Now the trains may have left the station.

While the above statement may open more questions than it provides answers, let me switch to say a few words about the Canadian negotiation, since European developments should also help put before us the issue of North American interest. Our negotiators need to face the question of North American competitiveness and ask whether there is not a level of interdependence in these economies that demands an aviation system that enables effectively integrated transportation.

Most of you know how bad these air services are now. Connections between major U.S. and Canadian cities are incomparably worse with respect to both routing and frequency than between comparable cities in Europe, for example. As explained thoroughly in Joe Chesen's book, *Canadian-American Air Service Negotiations: Ending the Gridlock*, institutional habits, as well as commercial perceptions, share responsibility for this state of affairs. Now, with unprecedented support from the respective Transport Ministers, it is up to the governments, and I suggest also to the industry and community interests working actively and interactively, to end the "gridlock."

The great risk is that institutional mistakes will be repeated — that the negotiating process may again begin to look like bean counting in a tornado. The prospects may depend on seeing that the new system is not an either/or proposition. The North American system can coexist symbiotically with local system needs.
5. CABOTAGE

I shall close by taking a look at the range of specific organizational and legal alternatives that we could consider, now that we dare utter that historical taboo word: CABOTAGE. Turning to a schematic that is at the end of my paper, let me put forth the proposition that an array of diverse regulatory, organizational and ownership options can be pursued or mixed and matched. Reason for considering any of them should be their ability to build NETWORKS at North American scale. The driving impetus should be this function.

In Option One, the foreign carrier integrates his schedules with a domestic joint venture partner, perhaps on a blocked space basis. Both hold national permits. Minority equity participations are possible but not at all critical. Critical to this is a synergistic service fit.

In Option Two, we have to permit foreign investment. An operator can create supporting networks in the other country, but his operations there are subject to that country’s regulation. As in the first option, employees are legal residents of the country they work in.

In Option Three, which is the basic Canadian proposal, carriers can pick up domestic traffic on sectors they fly behind the gateway to “fill up” their aircraft. This is cabotage pure and simple. It can also operate on the historic routes system that we have all grown to love so much. Licensing is the responsibility of the foreign country.

In Option Four A, there is an interesting twist. The traffic is cabotage, but all the flights occur on international sectors. An example is the package that moves from Toronto to Vancouver via Memphis. In Option Four B, you set up a hub in the other country, an idea that Joe Chesen thinks might help Canada. But you can still maintain an “international” route system by having flight number criss crossing your hub and leading back to your country. In Option Four C, you just do what you want — we have the North American market in toto. Logically DOT and Transport Canada in this option simply endorse each other’s inspection and licensing procedures.

The first two options, which involve rights of joint venture or establishment, arguably do not involve cabotage. The domestic traffic is carried by an operator licensed under the rules of the country. Rights of foreign ownership, provided under Option Two, could raise a political issue of foreign domination.

First, anti-trust policies would or could limit whatever takeovers — foreign or domestic — that curtail competition. Second, in issuing the 401 permit or its Canadian equivalent to the joint venture partner or subsidiary, licensing authorities could, perhaps should, make conditions that prevent abuse or even an establishment of a dominant position.
Cross border subsidiaries would have to meet national licensing rules and conditions. Those in the United States who worry, on national security grounds, that foreign owned equipment could disappear offshore, could ask for restrictions on deregistration of aircraft.

Rather than getting further immersed in questions of detail, let me now close to leave time for questions and for one last observation on my title: Organizing Globalization. This process can move on a variety of tracks including how we succeed or fail in relating across a set of regional thresholds. The nineties will also test the ability of developed countries to work with the developing world. In this respect aviation may find itself on the frontlines, often very dangerous frontlines. The Gulf Wars may have been good for morale, but they are poison for commercial aviation. No industry has a more vital interest in organizing peaceful world relationships. Few industries possess such potential to foster a new world order that sustains life and expands opportunity for our children.
Interstate Trucking: The Collision of Textbook Theory and Empirical Reality*

PAUL STEPHEN DEMPSEY**

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Deregulation, that powerful legal, economic, and political movement of the last decade, is beginning to reveal its profound impact upon the industries it has grasped. During the late 1970s and early 1980s, it embraced a multitude of diverse industries, including airlines, railroads, bus companies, telecommunications, broadcasting, banking, cable television, oil and gas, pipelines and motor carriers. Stripped bare of government bureaucrats and layers of red tape, firms in these industries were cast into the stormy seas of the free market, to sink or swim on their own.

Not unlike other deregulated industries, the decade of deregulation has been one in which the motor carrier industry has been plagued by severe economic problems. Indeed, perhaps the most onerous economic impacts of deregulation have been suffered by savings and loan institutions and motor carriers. Deregulation of the thrifts has made the headlines because the taxpayer has been saddled with more than $300 billion in federal insurance liability. But the trucking story has been left untold. Trucking only makes the local news when a semi turns over on the interstate and flattens a few automobiles. But make no mistake about it, the economic carnage in both industries has been relentless.

The level of bankruptcies and rate of concentration among motor carriers has been unprecedented in American business history. The public served by the trucking industry is paying highly discriminatory prices for service. Motorists are endangered by an unacceptable deterioration in the level of safety. As we shall see, these deleterious results of deregulation in the 1980s and 1990s parallel those which preceded economic reg-
ulation of motor carriers in the 1930s, and of the railroads in the 1880s.¹

Rate wars, bankruptcies, a deteriorating margin of safety, and consumer exploitation coalesced in the 1930s to prompt federal regulation of the motor carrier industry. In promulgating the Motor Carrier Act of 1935, Congress added trucking and bus companies to the jurisdiction of the Interstate Commerce Commission (ICC).² Destructive competition abated, and during the half century which followed, motor carrier service was ubiquitously available throughout the nation at a price which was "just and reasonable." Service was safe and dependable to large and small communities throughout the nation. As in telephone regulation, there was some measure of "cross subsidization" performed under the regulatory umbrella of the ICC (in interstate transport) and the State Public Utility Commissions (PUCs) (in intrastate transport), with more lucrative, denser traffic lanes paying a premium above marginal costs to subsidize rural and small community service.

Nearly a half century later, the fire kindled in a movement which found economic regulation wasteful and hateful, and deregulation was advanced as the means to achieving a more efficient and productive economy. The free market economists who promoted deregulation assumed that the motor carrier industry had relatively insignificant economic barriers to entry and economies of scale, that destructive competition was unlikely, and that deregulation would likely produce an atomistic market, with a large number of buyers and sellers in nearly textbook levels of healthy competition.³ Their efforts persuaded Presidents Carter and Reagan to appoint individuals strongly wedded to the ideology of *laissez faire* to the ICC, who began *de facto* deregulation of trucking in the late-1970s.⁴ Congress followed suit by promulgating the Motor Carrier Act of 1980, a modest bill aimed at regulatory reform, but which has been inter-

¹ Congress deregulated motor carriers with the promulgation of the Motor Carrier Act of 1980. But *de facto* deregulation preceded *de jure* deregulation in the United States by about two years, tracing its origins to decisions of the U.S. Interstate Commerce Commission in 1977 and 1978. *De facto* deregulation of the motor carrier industry began with the liberalized approach of the Interstate Commerce Commission in 1977 and 1978, when the ICC began issuing operating authority more broadly defined, from a commodity and territorial perspective, than ever before. The nation’s economic recession did not begin until 1979 and ended in about 1983, yet every leading economic indicator shows that the industry has progressively suffered virtually every year since 1977, both before and after the recession of the 1980s. See P. Dempsey, The Social and Economic Consequences of Deregulation 40 (1989) [hereinafter P. Dempsey].


³ For a more recent expression of the same views, see D. Owen, Deregulation in the Trucking Industry (1988).

interpreted as if it mandated comprehensive deregulation. These policies have crippled the industry. After a decade of empirical evidence, we see that the assumptions of the free market economists were erroneous, and hence, the predictions upon which they rested were, simply, wrong.

Their folly affects not only the motor carrier industry, which is perhaps the most important mode of for-hire transportation, but the entire nation. The movement of goods over the highways accounts for more revenue than all the other modes of transportation (i.e., air, rail, water, and pipeline) combined. Nearly everything we Americans consume—our clothes, our food, our furniture, our appliances—was at some point moved by truck. Moreover, transportation as a whole accounts for nearly eighteen percent of the U.S. gross national product. Hence, governmental policy here, good or bad, has profound implications.

In the first part of this article, we will review the principal theoretical underpinnings of deregulation. In the second, we examine the results of deregulation upon this important industry and the public it serves. Finally, we shall explore the theory of economic regulation, and advance a policy justification for a more responsible governmental approach to this important industry.

II. THE THEORY AND POLITICS OF DEREGULATION

The generation of Americans which lived through the Great Depression and World War II perceived government to be an essential companion—a friend who could achieve greater social good for society. The free market had produced the worst economic collapse in history, and millions of Americans lost their jobs, their homes, their self esteem, and their faith in the philosophy of laissez faire. They turned to government to find a solution. It was during this era that many of the independent regulatory agencies were born. Most were modeled after the first of these, the Interstate Commerce Commission, created in 1887 to reign in the monopoly railroads.

But the generation of Americans who lived through the 1960s and 1970s became cynical, perceiving government to be a malignant sore. Those on the left abhorred Watergate and the war in Vietnam. Those on the right opposed the Great Society and high taxes. Both converged on a path that viewed government with some hostility.

During the 1970s and early 1980s, deregulation became a bipartisan

movement, one which swept America profoundly and provided a new order of radically less government intervention in the market. Presidents Carter and Reagan led the crusade for significant deregulation of major industries — broadcasting, banking, telecommunications, oil and gas, airlines, railroads, and bus and trucking companies. That was coupled with deregulation in such less industry specific areas as antitrust, the environment, safety and health.8

The politicians saw it as a rallying point against inflation and high taxes, attacking “big government,” “red tape” and “federal bureaucrats.” Deregulation and the free market became as American as motherhood, apple pie and Chevrolet.

Free market economists, who had for years attacked the phenomenon of economic regulation, provided the intellectual justification. They insisted that government distorted the competitive equilibrium, created a misallocation of resources, was “in bed with” or “captured by” the industries it regulated, caused these industries to be inefficient and charge consumers excessive prices, and that the direct and indirect costs of regulation were exorbitant.9 Thus, society would be better off if we amputated the dead hand of regulation and replaced it with Adam Smith’s invisible hand, for we would then enjoy marginal cost pricing and near-perfect competition in a healthy competitive environment. The discipline of economics had not embraced an ideology with such religious passion since the Bolshevik Revolution.

In promoting motor carrier deregulation, most free market economists made wildly optimistic predictions about what deregulation would bring. Typically, they insisted that prices would fall, productivity would improve, and concentration would decline. The economists believed that there were few economies of scale in the trucking industry, and few significant barriers to entry other than the regulatory requirement that carriers secure certificates of public convenience and necessity. Moreover, we were assured that with the removal of licensing requirements, new entrants would spring up to rival established carriers, and that such new entry or the threat thereof would discipline the market in a way that would ensure that consumers would be protected. This was the essence of “contestability theory.”

Alfred Kahn is perhaps more responsible for transportation deregulation than any other single individual.10 While a number of scholars have

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10. It was he, as Jimmy Carter’s Chairman of the Civil Aeronautics Board, who forcefully lobbied in support of the Airline Deregulation Act of 1978, which, after a transition period, abol-
pointed out the existence of economies of scale in trucking,\textsuperscript{11} in urging deregulation, Kahn alleged that "there is very clear evidence that the relatively high concentration (in the motor carrier industry) . . . is, itself, a consequence of regulation. . . ."\textsuperscript{12} Kahn insisted that concentration levels were not the product of economies of scale,\textsuperscript{13} and that there were few economic barriers to entry.\textsuperscript{14} He also believed that the "... immediate and constant presence of potential competitors . . ." would discipline the market and protect consumers "... against excessively high prices or poor service."\textsuperscript{15} Kahn also declared, "I believe genuinely that (under de-


\textsuperscript{13} First of all, Senator Kennedy's own data, setting side by side a large number of comparable markets, strongly suggest that there is a wide range in the number of carriers than any given market will support, and that a principle determinant of how many there actually are is not the presence, or absence of economies of scale but the ICC's regulatory policy. The ICC undeniably restricts entry; one can hardly conclude in these circumstances that the dominance of some markets by a relatively small number of firms is the result of anything but those artificial restrictions themselves. \textit{id.} at 394.

\textsuperscript{14} In 1977, in testimony before the Senate Judiciary Committee, Kahn insisted that the economic barriers to entry and economies of scale were relatively insignificant:

If trucking is not potentially an effectively competitive industry, then I do not know any industry in the country that is. I do not know of any industry that more nearly meets the prerequisites of effectively functioning unregulated competition.

The capital requirements for entry are small. The ease of exit is very great. In other words, there is no reason why anybody need stay for years and years in a depressed market. What other industry do you have in which your capital equipment can itself get up on wheels and move? The economies of scale are so limited that I do not know anybody who believes that the most efficient performance of that market requires that you have one firm or only a couple of firms.

\textsuperscript{15} [T]he very mobility of trucks makes this an industry in which entry would, if the government would get out of the way, be very easy; existing companies among the thousands that ply their trade in the United States, could easily move into one another's markets. This immediate and constant presence of potential competitors on the outside of individual geographic markets is the best possible protection consumers need against excessively high prices or poor service.
regulation) we will have a more prosperous industry, both rail industry
and trucking industry."16

Thus, Kahn insisted that it was the ICC's entry policies, not econo-
 mies of scale, that were responsible for the "relatively high" concentra-
tion levels of 1979, that exploitation by a concentrated industry would be
exacerbated by potential competition, and that deregulation would make
motor carriage more prosperous. Because Kahn's basic assumptions
about the industry were specious, his predictions were significantly off the
mark.

Since 1980, the ICC has issued nearly 12,000 forty-eight-state irregu-
lar route general commodities certificates of public convenience and ne-
cessity.17 Nonetheless, not a single new firm has successfully entered
the national less-than-truckload [LTL] industry (Leaseway did briefly, but
retreated). As noted above, all the transport modes are more concen-
trated under deregulation than they were under regulation. It is clear that,
despite the assurances by the free market economists to the contrary,
there are significant economies of scale and economic barriers to entry
which restrict entry.

Alfred Kahn has since conceded that the less-than-truckload (LTL)
industry is not atomistic in nature, that there are economies of scale in the
business, and that successful entry into the national LTL industry has not
occurred.18 Specifically, he now admits, "there do seem to be econo-
 mies of scale in the LTL business—in the carriage of LTL shipments to
central collection points, assembling them in truckloads, and carrying
them to disassembly points for transmission to their ultimate destina-
tion."19 Since ICC licensing is de facto deregulated in trucking, only the
existence of large capital requirements and economies of scale can ex-
plain the fact that not a single new entrant has emerged in the LTL indus-
try since deregulation.

Why has deregulation failed to achieve much of what it has prom-
ised? Deregulation failed because it was a theory based on false as-
sumptions. In theory, regulation distorted efficiency. The transportation

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16. Id. at 416-17.
17. TRAFFIC WORLD, Dec. 5, 1988, at Supp. E.
Kahn on Behalf of Calif. Coalition for Trucking Deregulation) [hereinafter Kahn Calif. Testimony].
19. Id. [emphasis supplied].
industry was thought to be naturally competitive. It was perceived to have no economies of scale or scope of consequence. It was believed that there were no barriers to entry of significance except those of certificates of public convenience and necessity issued by regulatory authorities. It was thought that, if incumbent firms enjoyed market power and raised prices to supra-competitive levels, new entrants would emerge to restore the competitive equilibrium. It was also predicted that destructive competition would not occur.

But industry experts disagreed, insisting that, "Faced with excess capacity, carriers will use the increased pricing freedom to drop rates to variable costs in order to attract freight from competitors. The end result will be widespread price wars, bankruptcies, and chaotic conditions in the industry." To this, deregulation proponent John Snow replied, "Any tendency toward unsettled price conditions could be expected to be brief and mild." But as we shall see below, what we have experienced under deregulation is unprecedented losses, a high number of bankruptcies, a shakeout of many small producers, an industry which is highly concentrated, and one in which there has not been significant new entry. And none of this has been either brief or mild.

The theory of contestable markets has not been sustained by the empirical evidence. Leaseway was the only major carrier to enter the less-than-truckload sector of the industry, and it exited after several years of significant losses. There do appear to be significant economies of scale, scope, and density, and economic barriers to entry in the trucking industry. The LTL sector requires a significant multi-million-dollar investment in a network of terminals, a large number of employees, and skilled management.

Deregulation’s proponents also did not foresee the monopsony power of large shippers and the high level of discrimination it creates. This overwhelming strength of large carriers and large shippers has distorted the market for the sale of transportation services in a way that is antithetical to notions to achieving allocative efficiency.

III. THE TRUCKING INDUSTRY TODAY—THE EMPIRICAL RESULTS OF Deregulation

Deregulation has produced results wildly divergent from those ob-

served by deregulation theorists staring into their crystal balls. Unlimited entry and rate deregulation has created excessive capacity, declining productivity, destructive competition, discriminatory pricing, inadequate returns on investment, a deterioration in safety, a decline in wages, an erosion in labor-management relations, an enhanced number of bankruptcies, mergers, and acquisitions, and, in the long term, unprecedented concentration. The U.S. motor carrier industry is becoming dominated by a very small number of extremely large firms. In the long-term, deregulation appears to have created an oligopoly of megacarriers providing highly discriminatory pricing, as smaller firms fall into the social Darwinist abyss of bankruptcy. In the interim, the smaller firms endanger safety of those with whom they share the highways.

A. **THE TRUCKLOAD, LTL DISTINCTION**

We begin by noting one important distinction in the motor carrier industry. The motor carrier industry can be divided into two broad sectors — truckload and less-than-truckload. The economic characteristics of these sectors are significantly different. Typically, a truckload carrier picks up a large volume shipment filling an entire trailer and carriers it directly to destination without reloading.

In contrast, an LTL carrier must have a more sophisticated distribution system of a multitude of trucks stopping at numerous consignors, taking on small shipments, then aggregating them at a central terminal facility, consolidating them into larger shipments for long-distance transport to a remote terminal facilities, where they are disassembled and put on smaller trucks to be distributed to their individual consignees. As we shall see, the terminal facilities and regional distribution systems of LTL transportation require significant capital investments.

B. **EXCESSIVE CAPACITY AND DECLINING PRODUCTIVITY**

In his book, *Economic Principles of Transportation*, published in 1935, economist W. T. Jackman summarized the problem posed by the ease of entry into trucking by unsophisticated entrepreneurs which preceded the original Motor Carrier Act, promulgated that same year:

In most cases the truck owner has no knowledge of his costs and keeps inadequate, if any, accounts. He takes whatever business he can get at a rate which the shipper will pay, in the hope that in the aggregate the financial returns will be favorable. But the mortality in the motor truck field is very heavy . . . .

The shipper wants a small shipment taken . . . . and the motor carrier

24. P. DEMPSEY, *supra* note 1, at 129-69. Today, much of North America is dominated by its four largest trucking companies (*i.e.*, United Parcel Service, Yellow, Consolidated Freightways, and Roadway), or its single bus company (*i.e.*, Greyhound).
takes this, even if he has nothing else to make up a load, in the hope that by this service he may ingratiate himself with the shipper so as to get future traffic, and also anticipating that he may get something more along the route. On account of the many carriers, however, he may not get anything more, for there is not enough traffic to provide loads for all the operators. However, “hope springs eternal” and the operator continues to run his vehicle, even though he cannot get enough traffic to be reasonable remunerative. . . . Then, too, a man can get a truck, especially a second-hand one, for a small cash payment, and may intend to make it pay the balance of the cost by its use. Consequently, it is better for him to get a small amount of business than none at all; and, if traffic is scarce, he will cut his rates very low rather than see his truck lying idle. While others see such men operating trucks upon the highway, the normal inference is that there must be some profit in it, and they likewise enter the service . . . . As a result, the number of trucks in operation greatly exceeds the traffic needs, thus causing continuous, widespread, and discriminatory rate cutting, with other unwholesome competitive conditions, which have created serious problems for producers, the public at large, and the railways . . . .

Probably the greatest defect, is . . . the endless rate-cutting by a mass of carriers, each of which wants as large a share as possible of the business. The truck operators bid against one another for the available traffic and many shippers take advantage of this condition to beat down the rate to the lowest point, thus securing a rate which is wholly unreasonable.25

Precisely these consequences of destructive competition which preceded regulation in the 1930s emerged under deregulation in the 1980s. Indeed, one can dust off the history books of the 19th Century and find that many of these conditions existed in the railroad industry before it was regulated in 1887. For example, the unregulated railroads were beset with fierce price wars in competitive markets, while exacting highly discriminatory monopoly rates in markets in which they enjoyed market power. Destructive competition produced economic anemia which encouraged consolidations and monopolization.26 Federal economic regulation was able to protect the public against widespread pricing and service discrimination, and alleviate the dire financial straits in which the railroads found themselves.

The empirical evidence of motor carrier deregulation in the United States reveals that a large number of new carriers entered the truckload sector of the industry during the initial years of deregulation.27 Excessive

25. W. JACKMAN, ECONOMIC PRINCIPLES OF TRANSPORTATION 842-43 (1935) [footnotes omitted] [hereinafter W. JACKMAN].
26. See generally P. DEMPSEY, supra note 1, at 6-10.
27. According to one source, between 1980 and 1982, 11,000 new firms entered the industry. Richards, Independent Truckers Who Hailed Deregulation Reconsider as a Rate War Races and Taxes Rise, WALL ST. J., Mar. 31, 1983, at 56. According to another source, between 1980 and 1983, 49,726 new certificates for motor carrier operating authority had been granted by the ICC; this included certification of 13,806 new carriers. Rosenak, Address before the Motor Car-
capacity caused the proportion of empty trailers and the number of empty miles to increase and load factors to fall. The immediate response to declining rates was one of great public applause. This appeared to be a development of great benefit for shippers.

However, in the longer run, there are some distressing trends. Among them is declining productivity because more entry creates more capacity without stimulating additional freight, and that simply leaves trucks emptier over more miles. In the short run, wealth is transferred first from investors, and then from labor, to shippers, particularly large shippers. Productivity of interstate motor carriers has declined since federal deregulation began — this despite the introduction of larger and more efficient equipment. Tremendous overcapacity stimulated both by unlimited entry and the ruthless struggle for market share has decreased average load factors for general freight motor carriers. The average load for this segment of the industry fell from 13.5 tons in 1978 to 12.8 tons in 1987.

Total intercity tonnage increased eleven percent, from 2.26 billion tons in 1980 to 2.5 billion tons in 1989. But during the same period, the number of carriers issued certificates of public convenience and necessity by the ICC more than doubled, from 17,000 in 1979 to 45,000 in 1990.

De facto federal deregulation of the motor carrier industry began
under ICC Chairman A. Daniel O’Neal nearly three years prior to the promulgation of the Motor Carrier Act of 1980. Although productivity for general freight carriers grew by an average of 0.29% annually after 1969, it declined by 0.21% per year between 1978 and 1986. In contrast, productivity levels of all manufacturers increased an average of 2.4% per year between 1975 and 1986.34

Economist Dabney Waring, Jr., compared productivity levels of the trucking and railroad industries between 1970 and 1990. Chart I reveals his findings.35 By comparing the number of ton miles to employment, he reached the following conclusions:

Trucking productivity was increasing at an annual 1.9% rate from 1970

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34. Rate Discrimination, supra note 30. Professor Nelson’s study revealed that productivity grew from 1968 to 1978, but fell from 1978 to 1984. Nelson, Verified Statement in ICC Docket M 30408, General Increase M.W.M.F.B., Oct. 19, 1987, Appendix G. The entry of large less-than-truckload [LTL] carriers into territories previously served efficiently by regional carriers has caused per unit costs to increase as average load factors have declined. As a consequence, thousands of motor carriers have gone bankrupt or ceased operations in the post-deregulation era. Many more would likely join the ranks of the “belly up” were it not for the unfunded pension liability imposed by the Employee Retirement Security Act [ERISA]. Dempsey, Transportation Deregulation—On a Collision Course?, 13 TRANSP. L.J. 329, 346-49 (1984) and N. GLASKOWSKY, EFFECTS OF DeregULATION ON MOTOR CARRIERS 18-19 (1986) [hereinafter cited as N. GLASKOWSKY].

to 1979 while railroads were improving at a 3.6% annual rate. In 1980 trucking productivity dipped 4.1% and has stagnated since. Meanwhile, railroad productivity has accelerated to an 8.4% annual rate of increase. To what extent deregulation is responsible for the railroad fortunes is uncertain, but certainly federal deregulation has not been healthy for trucking.36

Similarly, Professors Ozment, Cunningham and Davis examined five measures of fuel efficiency and equipment utilization and found that “it cannot be concluded that energy efficiency and equipment utilization have improved since deregulation. In fact it appears that just the opposite has occurred. . . . [T]he net effect of deregulation on fuel efficiency and equipment utilization appears to be negative.”37 Professor Robert Gordon found that while productivity for railroads increased under deregulation, long term productivity improvements disappeared following deregulation in both the airline and motor carrier industries.38

Since transportation is an industry particularly susceptible to overcapacity, unconstrained entry must necessarily lead to distress sale pricing in those markets where competition is excessive, at least until waves of bankruptcies wipe out the smaller and weaker rivals.39 Since deregulation began, motor carrier profits, as measured by return on equity, have consistently fallen below the rate of all manufacturers, and declining productivity must bear at least part of the blame. Excessive capacity and lost productivity have eroded the profitability of carriers, creating an unprecedented wave of bankruptcies.40

Professor Martin Farris prophetically predicted that deregulation would cause a decline in efficiency and productivity prior to the promulgation of the federal Motor Carrier Act of 1980:

The concern over efficiency in the regulated sector is a real paradox. Critics of [economic regulation allege that it produces inefficiencies which are exemplified by] . . . low load factors in air transportation, empty backhauls in trucking, energy waste, excess capacity, and idle capital all around. To the critics it is obvious that these “wastes of regulation” could be avoided if regulation were abolished and the natural forces of supply and demand were allowed a free hand. The paradox arises in that the solution to these “inefficiencies caused by regulation” is more excess capacity, more duplica-

40. “Despite continued economic growth . . . bankruptcy remains one of the major financial problems of the decade. While many segments of the economy have been hard hit, nowhere is the problem more severe than in the transportation sector.” Chow & Gritta, Estimating Bankruptcy Risks Facing Class I and II Motor Carriers: An Industry-Specific Approach 55 TRANSP. PRAC. J. 352 (1988).
tion, more wasted energy, more idle capital, more empty back-hauls, and low load factors caused by allowing more competition in entry and price. As more firms entered these markets and competed on a price basis, excess capacity and waste would increase, not decrease.  

C. MONOPSONY/OLIGOPSONY AND DISCRIMINATORY PRICING

Under deregulation, the trucking industry experienced a phenomenon that was largely unanticipated — monopsony power of large shippers which can mandate highly discriminatory pricing. Very large shippers enjoy monopsony power because of their enormous volume of freight, which enables them unilaterally to dictate rates.

For example, between 1983 and 1988, the Interstate Commerce Commission approved ten general rate increases, totaling 51.3%. Discounts off the published rates are running up to seventy percent for the largest shippers, like J.C. Penny and Johnson & Johnson (and average between thirty five and thirty seven percent). But the steep discounts are enjoyed exclusively by large-volume shippers. Smaller shippers either pay the full rate or enjoy rather more modest discounts of, say, five to fifteen percent. In fact, many unsophisticated consignees pay the full undiscounted rate plus an additional five to ten percent surcharge. While most shippers perceive that they are getting a bargain, in fact, smaller shippers are paying significantly more for transportation today than they did prior to deregulation.

41. Farris, The Case Against Deregulation In Transportation Power and Communications, 46 ICC PRAC. J. 306, 329 (1978) [emphasis in the original].

42. Professor Grant Davis has observed that the nation’s largest shippers exert monopsony of the economic leverage they wield by conferring or withholding their vast volumes of freight. The Fortune 500 can unilaterally dictate rates at (and for cash-starved carriers, below) the marginal costs of trucking companies. Oversight of the Motor Carrier Act of 1980: Hearings Before the Subcomm. of Surface Transp. of the Senate Comm. on Commerce: Science and Transp., 99th Cong., 1st Sess. 234 (statement of Prof. Grant M. Davis).


44. Schulz, Rate-Cutting Competition Darken Profit Picture for LTL, TRAFFIC WORLD, June 4, 1990, at 15-16.

45. Similarly, full airline fares have increased 156% since 1978, twice the growth rate of the Consumer Price Index. Ott, Industry Officials Praise Deregulation But Cite Flaws, AV. WEEK & SPACETECH Oct. 31, 1988, at 88.


47. P. DEMPESEY, supra note 1, at 97-100.


49. A small shipper recently summarized the impact of transportation deregulation upon smaller enterprises in testimony before the U.S. House of Representatives: “the benefits promised by the Motor Carrier Act of 1980 have not reached the medium and small shipper. Small shippers are receiving discounts substantially below what the large shippers enjoy. Our markets
Moreover, this distortion in transport pricing distorts the broader market for the sale of commodities. If a large shipper can get his goods to market at a lower price than a smaller shipper, then the large shipper will, by definition, have a significant advantage in and access to the market for the sale of his commodities, one which might enable him to dominate that market.

The U.S. Supreme Court in its seminal decision of *Munn v. Illinois* recognized that transportation firms are the gatekeepers of the larger market for the sale of commodities; hence, it is imperative that their price and service offerings be nondiscriminatory. If the market for transportation services is distorted, the market for the sale of commodities will be distorted as well. A significant advantage that Fortune 500 companies enjoy under deregulation *vis à vis* their smaller rivals is of particular concern, unless one concludes that domination by huge corporations is not an undesirable phenomenon.

Two other developments which are products of the monopsony (or oligopsony) power of large shippers have manifested themselves in the United States. One is the ability of large shippers with market power unilaterally to dictate excessively low rates insufficient to allow trucking companies to cover their full costs of operation. This has a fatal economic impact on unsophisticated carriers with an inadequate understanding of costs and without the ability to counterbalance the monopsony power of large shippers. This causes carriers to underprice their services, which gives them insufficient resources to maintain a high level of safety. By underpricing their services, they also drag down efficient firms with them into the Darwinist grave of bankruptcy.

Wisconsin deregulated intrastate trucking in 1982. Since then, many carriers have spiraled downward in bankruptcy. As one Wisconsin carrier noted:

> The large shippers are demanding transportation rates that are below carriers' costs. Large multi-page invitations to bid are distributed by shippers that spell out conditions under which to bid. Many carriers are so desperate for the business that they are bidding each other to death just to generate additional revenues. Many of these bids are far below the operat-

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50. Pricing discrimination may cause serious injury to those enterprises or geographic regions disfavored by the pricing scheme. The U.S. Supreme Court has observed that "discriminatory rates ... may affect the prosperity and welfare of a State ... They may stifle, impede, or cripple old industries and prevent the establishment of new ones." *Georgia v. Pennsylvania R.R.*, 324 U.S. 439, 450 (1945).
51. 94 U.S. 113 (1876).
ing costs of carriers successful in securing the business; consequently these carriers have no choice but to make up the difference on small shippers. Cash flow pricing results in carriers operating in a weak financial condition. The weaker the carrier financially, the more important it may become just to generate revenue to meet payroll and debt. These companies fall as easy prey for shippers to place heavy pricing demands upon them. Demands are also being placed on carriers for discriminating and deceptive rate discounting, rebating to parties not responsible for payment of rate charges.  

Note the striking similarity between these observations of the deregulated trucking industry today with those of economist W.T. Jackman, above, who observed the same conditions in the trucking industry more than half a century earlier, before economic regulation.  

A second phenomenon which appears to be growing more widespread is the practice by large shippers of sending commodities “freight collect,” whereby the consignee pays the full, published rate for transportation. The large shipper then forces the carrier to rebate to the consignor the difference between the full, published rate and the significant discount of up to seventy percent off the published rate. This is nothing less than deliberate fraud being practiced on unwary consignees. Jackman noted that the practice of “secret and discriminatory rates and the prevalence of rebates” was widespread in the 1930s, before regulation.  

In sum, deregulation brought shippers an immediate fall in transport prices, followed by a longer-term increase in discrimination between large vis-à-vis small shippers, so that larger corporations today enjoy a significant advantage over their smaller competitors. This distorts the broader market for the sale of commodities, giving larger firms a decided advantage, and causes many motor carrier failures. 

Nonetheless, some deregulation proponents have made extraordinary claims as to the consumer benefits produced by deregulation. For example, a Cato Institute study authored by Robert Delaney claimed that trucking deregulation had (a) produced efficiency savings to the tune of $26 billion annually, (b) was largely responsible for the extended period of national recovery in the 1980s, and (c) had caused U.S producers and distributors to save between $56 billion to $90 billion annually in reduced inventories and improved efficiency. The many flaws in the study have
Dr. Silberman has assessed Mr. Delaney’s assertion that the United States enjoys a savings of between $60 billion and $80 billion annually as a result of just-in-time inventory, presumably a product of deregulation. Silberman notes that Delaney failed to adjust his data for inflation, and included services and government expenditures in his calculations of the Gross National Product. But more devastating to Mr. Delaney’s assertions was Dr. Silberman’s observation that Delaney had wholly failed to recognize the long-term secular relationship between the inventory/sales ratio and the business cycle. For all but one of the years between 1971 and 1987, constriction or expansion in the national economy correlates to the rise and fall in the inventory/sales ratio. As one would expect, as the economy expands, retailers and wholesalers cannot maintain their inventory levels, and inventories drop. As the economy slides into recession, inventories grow. The national economy enjoyed sustained expansion from 1983-87, and inventories fell. To attribute this fall to motor carrier deregulation is to ignore the long-term correlation between inventory levels and the business cycle. It is voodoo economics.

D. DESTRUCTIVE COMPETITION: INADEQUATE RETURNS ON INVESTMENT

The guru of transportation deregulation, Alfred Kahn, summarized the phenomenon of “destructive competition” which was the catalyst for promulgation of the Motor Carrier Act of 1935: “competition was intense, profits and wages depressed, and the safety and reliability of the services provided by the industry, and especially by many of the new entrants, left much to be desired . . .”60 Like many contemporary free market economists, he insists that it was the Great Depression that caused these economic problems, not any unique economic circumstances surrounding the transportation industry.

Yet each of the conditions he describes — the intense competition, depressed wages and profits, and deterioration of safety and reliability of service — which existed before regulation, have re-emerged under deregulation, even in the absence of a Depression. The U.S. Office of Technology Assessment (OTA) notes:

Profit margins have fallen even for the most successful carriers, a product of intense price competition caused partly by changes in manufacturing

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and partly by continuing overcapacity. Carriers' expenses per ton-mile are up 75 percent since 1978, while revenues have increased only 54 percent. General freight revenues . . . have not matched price increases in the general economy, particularly for large shippers and those in highly competitive city-pair traffic lanes. Carriers that serve small shippers and those in less competitive markets have fared better.61

Chart II—Operating Ratios
(1980–89)

61. OFFICE OF TECHNOLOGY ASSESSMENT, GEARING UP FOR SAFETY: MOTOR CARRIER SAFETY IN A COMPETITIVE ENVIRONMENT 26 (1988) [hereinafter OTA SAFETY STUDY].
Chart III--General Freight Carriers
Return on Equity

Return on Equity

Chart IV--General Freight Carriers
Return on Investment

Return on Investment
In order to provide an accurate picture of the anemic nature of the motor carrier industry under deregulation, several different pictures are offered in the preceding three charts, and all are grim. One measure of industry profitability is operating ratios — non-interest and non-tax operating expenses as a percentage of operating revenues. As Chart II reveals, operating ratios for the MC-82 carriers (those required to file financial data with rate bureaus subject to the ICC's order in Ex Parte MC-82) have been abysmal under deregulation, fluctuating between 94.2 (1986) and 99.2 (1982), and averaging only 96.4 since deregulation.62

Thus, the margin for interest, taxes and profit over the decade was a miserable 3.6%. In only a single year, 1986, did the industry achieve an operating ratio below ninety five. Dr. Irwin Silberman points out that this is all the more remarkable in light of the fact that the above data reflect operating ratios for the survivors, for a large number of MC-82 firms have disappeared, and their freight has been distributed among the remaining carriers.

Charts III and IV reveal the industry's performance in terms of return on equity [ROE] and return on investment [ROI], respectively.63 From 1976-79, ROE averaged 14.85; thereafter it fell to an average of 8.82. In contrast, average ROE for All Manufacturers (the target for the motor carrier industry embraced by the ICC) was 14.89 during the 1976-70 periods, or virtually identical to the motor carrier sector, and 12.21 from 1980 to 1989. Stated differently, the ROE average dropped forty one percent trucking after 1980, while dropping only eighteen percent for all

<table>
<thead>
<tr>
<th>Year</th>
<th>Operating Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>95.14</td>
</tr>
<tr>
<td>1977</td>
<td>94.45</td>
</tr>
<tr>
<td>1978</td>
<td>94.52</td>
</tr>
<tr>
<td>1979</td>
<td>96.52</td>
</tr>
<tr>
<td>1980</td>
<td>96.63</td>
</tr>
<tr>
<td>1981</td>
<td>97.31</td>
</tr>
<tr>
<td>1982</td>
<td>98.54</td>
</tr>
<tr>
<td>1983</td>
<td>95.67</td>
</tr>
<tr>
<td>1984</td>
<td>96.09</td>
</tr>
<tr>
<td>1985</td>
<td>96.35</td>
</tr>
<tr>
<td>1986</td>
<td>94.63</td>
</tr>
<tr>
<td>1987</td>
<td>97.04</td>
</tr>
<tr>
<td>1988</td>
<td>95.51</td>
</tr>
<tr>
<td>1989</td>
<td>95.51</td>
</tr>
</tbody>
</table>

62. I. SILBERMAN, GRAPHS FOR FOURTH QUARTER OF 1989 4 (1990). These data are compiled from the national database of MC-82 carriers, the largest in the industry.

The ICC has concluded that a reasonable ROI for the motor carrier industry would be twenty one. As Chart III reveals, motor carriers averaged close to that, with 20.18, ROI from 1976-79. But from 1980-89, the average ROI dropped to 13.33.65

In 1980, there were 239 MC-82 general freight carriers in the United States. By 1987, only 125 such carriers remained, and fifty of those had operating ratios in excess of 100.66 Appendix A is a list of the 100 largest motor carriers in 1980; Appendix B is the same list in 1990, deleting carriers which had ceased operations, principally as a result of bankruptcy, merger or shutdown.

Lest one conclude that motor carriers have always been so anemic, Chart V compares carrier operating margins67 of the seven years preceding enactment of the Motor Carrier Act of 1980 with the eight years follow-

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64. Id. at 8.
65. Id.
67. Operating margin is defined as the difference between operating revenue and operating expense (excluding interest and profit) divided by operating revenue.
ing it. Thus, the average operating margin preceding promulgation of the Motor Carrier Act of 1980 was 5.17, but fell after 1980 to 3.58 — a deterioration of thirty percent. In contrast, the ICC has traditionally deemed a "reasonable" margin to be seven percent, and the United Parcel Service (UPS) companies earn about nine percent. Return on equity also fell significantly after deregulation. With profitability so poor, it is no wonder that bankruptcies have soared under deregulation, as is revealed by Chart VI.

<table>
<thead>
<tr>
<th>Year</th>
<th>Margin</th>
<th>Year</th>
<th>Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973</td>
<td>5.8</td>
<td>1980</td>
<td>3.4</td>
</tr>
<tr>
<td>1974</td>
<td>5.8</td>
<td>1981</td>
<td>2.8</td>
</tr>
<tr>
<td>1975</td>
<td>4.2</td>
<td>1982</td>
<td>1.3</td>
</tr>
<tr>
<td>1976</td>
<td>5.6</td>
<td>1983</td>
<td>4.6</td>
</tr>
<tr>
<td>1977</td>
<td>5.7</td>
<td>1984</td>
<td>4.0</td>
</tr>
<tr>
<td>1978</td>
<td>5.6</td>
<td>1985</td>
<td>3.9</td>
</tr>
<tr>
<td>1979</td>
<td>3.5</td>
<td>1986</td>
<td>5.7</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1987</td>
<td>2.9</td>
</tr>
</tbody>
</table>

Average 5.17


69. Id.


71. Bankruptcies and Profit Margins for Interstate Motor Carriers Vis-A-Vis Profit Margins for All Manufacturers Since 1978

<table>
<thead>
<tr>
<th>Year</th>
<th>Bankruptcies</th>
<th>Motor Carriers</th>
<th>All Manufacturers</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>162</td>
<td>2.92%</td>
<td>5.4%</td>
</tr>
<tr>
<td>1979</td>
<td>186</td>
<td>1.97</td>
<td>5.7</td>
</tr>
<tr>
<td>1980</td>
<td>382</td>
<td>1.73</td>
<td>4.8</td>
</tr>
<tr>
<td>1981</td>
<td>610</td>
<td>1.58</td>
<td>4.7</td>
</tr>
<tr>
<td>1982</td>
<td>960</td>
<td>0.77</td>
<td>3.5</td>
</tr>
<tr>
<td>1983</td>
<td>1,228</td>
<td>2.37</td>
<td>4.1</td>
</tr>
<tr>
<td>1984</td>
<td>1,416</td>
<td>2.24</td>
<td>4.6</td>
</tr>
<tr>
<td>1985</td>
<td>1,543</td>
<td>1.74</td>
<td>3.9</td>
</tr>
<tr>
<td>1986</td>
<td>1,564</td>
<td>2.64</td>
<td>3.8</td>
</tr>
<tr>
<td>1987</td>
<td>1,351</td>
<td>1.57</td>
<td>4.9</td>
</tr>
</tbody>
</table>

* profits are measured as after-tax earnings as a percentage of gross revenues.

These statistics were compiled by Ron Roth, Director of Statistical Analysis of the American Trucking Association (Jan. 1988). Profit margins are measured in terms of after tax earnings as a percentage of gross revenues. See also, R. ROTH, TRUCKING: AN OVERVIEW AND FOCUS ON PRESENT TIMES: THE MOTOR CARRIER INDUSTRY IN TRANSITION, IMPACTS AND IMPLICATIONS—A GRAPHIC PRESENTATION OF 1978-1986 (Sept. 1987), and DUN & BRADSTREET, FAILURE DATA (1987).
Chart VI--Motor Carrier Bankruptcies 1978-1990

Chart VII--Profit Margins
Motor Carriers/All Manufacturers

Profits are measured as after-tax earnings as a percentage of gross revenue.
The period of deregulation is the era of the lowest returns in the trucking industry's history. As Chart VII reveals, profit margins have been highly unsatisfactory. Bankruptcies have exceeded 1,000 a year each year since 1983, continuing long after the recession of the early 1980s abated, and fuel prices fell. In the less-than-truckload sector of the industry, more than half of the firms which existed before deregulation failed. Of the fifty largest trucking companies in 1965, only seven remained by 1992. In fact, more motor carriers failed in the decade of the...
1980s (11,496) than in the combined forty five years in which the ICC regulated the industry.  

Indeed, these data are conservative. Between 1980 and 1989, the ICC revoked 18,557 common and contract motor carrier operating certificates and permits for failure to maintain adequate insurance. This suggests that the failure rate may be much higher than that reported by Dun & Bradstreet, reflected above in Chart VIII.

The Reagan Administration’s Interstate Commerce Commission provided the following justification for abdicating its statutory responsibility to regulate entry in motor carriage:

Confronting the protestant with more vigorous competition—indeed, even competition which forces an existing carrier out of business—does not automatically cause harm to any aspect of the public interest. Congress, after all, requires us to foster efficiency in motor carrier transportation and there may be situations in which, considering the transportation industry as a whole, it is preferable to replace an inefficient operator with a more efficient one and promote the introduction of innovative services or prices.

There is absolutely no evidence to sustain the hypothesis that all these several thousand bankrupt carriers were inefficient. Unlimited entry has caused excessive capacity which in turn has led to lower productivity, which has caused unprofitability, and widespread bankruptcies, shutdowns and mergers. Even efficient carriers, pricing at marginal costs, find it impossible to stay in business if they do not eventually recover fixed costs. And those with shallower pockets have a more difficult time in a market as filled with economic turmoil as trucking has been under deregulation. As Chart VIII reveals, the failure rate of trucking firms under deregulation has significantly exceeded that of other American industries even though they all suffered the effects of the recession of the early 1980s.

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76. D. Bartlett & J. Steele, supra note 33, at 112.
Transportation economist Dabney Waring, Jr., has observed, "[P]rior to deregulation, the failure rates in the trucking industry were almost identical to the average for all-industry. In 1980, however, trucking failures began to rise much faster than all-industry, reaching a peak margin of more than sixty nine above the all-industry rate in 1984. It has since eased somewhat to a current level forty four percent above the all-industry rate, probably due to the expanding economy and the early destruction of the least healthy carriers."\textsuperscript{80}

In the deregulated environment, we often see the phenomenon of pricing at or below short-term marginal costs. In part, this is inspired by the instantly perishable nature of the service being sold and the monopsony power of large shippers.\textsuperscript{81}

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|c|}
\hline
Year & Trucking & All Industry & Ratio Trucking to All Ind. \\
\hline
1978 & 24.2 & 24 & 1.01 \\
1979 & 27.2 & 28 & 0.97 \\
1980 & 52.9 & 42 & 1.26 \\
1981 & 81.2 & 61 & 1.33 \\
1982 & 121.3 & 88 & 1.38 \\
1983 & 147.5 & 110 & 1.34 \\
1984 & 180.7 & 107 & 1.69 \\
1985 & 191.1 & 115 & 1.66 \\
1986 & 183.6 & 120 & 1.53 \\
1987 & 151.5 & 102 & 1.49 \\
1988 & 141.0 & 98 & 1.45 \\
1989 & 117.6 & 65 & 1.81 \\
1990 & 137.6 & 75 & 1.83 \\
\hline
\end{tabular}
\caption{Failure RATE PER 10,000 CONCERNS}
\end{table}

\textsuperscript{79} Waring Michigan Testimony, supra note 36, at 12, \textit{updated} by Waring Colorado Testimony, supra note 35, at 9. The failure rate per 10,000 firms was reported by Dun & Bradstreet.


\textsuperscript{81} P. DEMPSEY, supra note 1, at 84-85. Some free market economists insist that predatory pricing in the LTL industry is improbable, for it is unlikely that a carrier could recoup its losses once a competitor is driven from the market. Some suggest that the antitrust laws are a satisfactory means of dealing with the problem, and then goes on to cite several unsuccessful antitrust complaints. The evidentiary, legal and economic hurdles for successful civil prosecution of predatory behavior under Section 2 of the Sherman Act are formidable. Proving the existence of a conspiracy between competitors or other behavior designed to establish a monopoly is difficult, to say the least. And the reality is, the Justice Department has shown little enthusiasm in recent years for pursuing allegations of predatory behavior. And even if successful, antitrust remedies often only award monetary damages to the victor (and/or in a criminal action, imprisonment). They do not necessarily restore a lost competitor to the market. For example, a generous out-of-court settlement did not restore Sir Freddie Laker to the transatlantic passenger industry after his rivals drove him out of business with their predatory practices. Hence, while aggrieved firms may sometimes be vindicated, the consumers' interest in a healthy competitive environment is often left unprotected.

Alfred Kahn has expressed concern about predation in the airline industry. Said he, in a recent interview in \textit{Antitrust}, "the airline industry clearly demonstrates the dangers of permitting unrestricted responses by incumbents to counter competitive entry, particularly with selective, pinpointed, or targeted price reductions." \textit{Interview With Alfred E. Kahn, 3 ANTITRUST 7 (1988).}
Unlimited entry and rate deregulation have, as noted above, created excessive capacity, declining productivity, and therefore destructive competition which, in turn, has created inadequate returns on investment. This economic anemia has had other adverse consequences in addition to the high failure rate among trucking firms. It has had an adverse impact on labor-management relations and wages.

E. THE IMPACT OF DEREGULATION UPON LABOR

Because of the competitive pressures unleashed by deregulation, overall industry financial performance has declined to the point of inadequacy, despite the fact that the recession of the early 1980s has abated and fuel prices have fallen. Because so many motor carriers have terminated operations since 1980, more than 115,000 union members have lost their jobs.\(^\text{82}\) For the carriers that have survived, these competitive pressures have forced management to engage in hard negotiations to reduce labor costs and tighten work rules.

As a result of the severe rate competition engendered by excessive capacity, carriers cut costs wherever they can.\(^\text{83}\) The alternative, as noted above, is bankruptcy. For that reason, they have reduced wages

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Kahn continued, "The nature of entry is not independent of the policies of the incumbents. . . . If you know that if you enter a market you will immediately be met on the nose or even under the nose, that will affect your willingness to enter." Id. in testimony delivered in 1978 before the U.S. Senate Commerce Committee, in response to a question involving the tendency of airlines to purchase landing slots to gain control of an airport, Kahn said:

Well, what you are describing, Congressman, is the possibility that the airlines, the big ones, may engage in some sort of predatory tactics, and that is a kind of predatory tactic.

I happen to be one of the few economists in the country who still believes there is such a thing, that it is really a danger.

Safety and Re-Regulation of the Airline Industry: Hearings Before the Senate Comm. on Commerce Science and Technology, 100th Cong., 1st Sess. 162 (1987). In his article, "Deregulatory Schizophrenia," Kahn expounded upon the problem of allowing a competitor to be driven from the market via predatory means:

As for the increasingly respectable view among economists that predation is nothing to worry about—why incur the, cost of driving a rival from the market when you’re unlikely to be able to sustain monopoly profits because rivals can always reenter? My answer then was and still is: Does anybody really think that new price competitors will come to the consumer’s rescue as promptly as their defunct predecessors? As I once heard Irwin Stelzer observe, a hiker might not pay much attention to a “no trespassing” sign standing alone, but if he sees the field behind it, littered with bodies of previous trespassers, it’s reasonable to suppose he will respect it.


for drivers and mechanics.\textsuperscript{84} Between 1979 and 1985, trucking wages fell thirty percent in California, at a time when factory wages increased more than fifteen percent. By reducing pay, the job becomes less attractive, causing the industry to hire unskilled and untrained drivers. Chart IX reveals relative wage levels during the deregulation period.\textsuperscript{85}

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|}
\hline
Year & Avg. Wage per mile ($) & Avg. Wage per employee ($) \\
\hline
1978 & 0.27 & 24,508 \\
1979 & 0.33 & 26,455 \\
1980 & 0.35 & 30,027 \\
1981 & 0.36 & 33,349 \\
1982 & 0.37 & 33,365 \\
1983 & 0.39 & 34,244 \\
1984 & 0.36 & 34,005 \\
1985 & 0.36 & 33,194 \\
1986 & 0.34 & 34,236 \\
1987 & 0.35 & 35,235 \\
1988 & 0.37 & 38,101 \\
1989 & 0.36 & 37,336 \\
\hline
\end{tabular}
\caption{REAL AVERAGE WAGES FOR MILEAGE BASED DRIVERS (Class I carriers of general freight)}
\end{table}

\textsuperscript{84} An AAA study concludes that because there are few other areas in which to cut costs, motor carriers whose profit margins are squeezed have little alternative but to “run older equipment, pay less in wages, work drivers longer, and/or skip on maintenance.” F. BAKER, SAFETY IMPLICATIONS OF STRUCTURAL CHANGES OCCURRING IN THE MOTOR CARRIER INDUSTRY 15 (1985) [hereinafter AAA SAFETY STUDY].

\textsuperscript{85} Waring Mich. Testimony, \textit{supra} note 36, at 10, \textit{updated} by Waring Colo. Testimony, \textit{supra} note 35, at 11. Mr. Waring developed these indices from data published by the Interstate Commerce Commission in \textsc{Transport Statistics of the United States} for drivers paid on a mileage basis (line-haul drivers). The dollar amounts were deflated using the CPI-U. 1978 = 100. \textit{Id.} at 9. The specific data for Class I Carriers of general freight, unadjusted for inflation, is as follows:
One source estimates that unionized motor carrier employees wages have been reduced between $1 billion and $1.7 billion annually.86 Dabney Waring, Jr., observed, "Clearly linehaul drivers are finding their work significantly less remunerative: twenty six percent less remunerative per mile than in 1978, thirty percent less remunerative than in 1980. Further, their annual income has declined eighteen since 1978. But since this decline is less than the decline in wages per mile, they are driving more miles for less total income. This is not the sort of trend that will foster improved highway safety."87

86. Since 1983, with the continuing erosion of carrier profits the average driver’s wage per mile has been declining. In 1986, at $0.34 per mile, that figure was lower than any year since 1980 when the average was $0.36 per mile. During that same period, however, the average annual driver wage increased from $30,072 to $34,286. Therefore, drivers are driving more miles, but are doing so at less wage per mile. It is far from speculative to state that the increase in speed-related accidents is caused, in part, by the drivers’ need to cover more miles in less time in order to meet their income requirements.

M. Foley Mich. Testimony, supra note 46, at 21. Another source states that while wages in all industries rose 150% since 1979, all truck drivers’ wages rose only 130% and truckload drivers’, wages rose only 110%. Schulz, Smaller Profits, Higher Costs Cause Truckers to Increase Rates, TRAFFIC WORLD, Jan. 1, 1990, at 18.

87. Id. at 10.
Professor Grant Davis noted that "the impact on human capital as a result of the deregulation movement raises numerous public policy questions and may well result in costly industrial relation conflicts in the near future."88 Not only does a deterioration in labor-management relations create unnecessary enmity between groups that need to work together, it also may jeopardize the public's safety. Cost cutting may well have a deleterious impact on the margin of safety. While working longer for less pay theoretically increases efficiency, it can induce fatigue, which has a negative impact upon safety.89 As a study published by the American Automobile Association noted:

[S]tructural changes resulting from deregulation of the industry have produced a combination of rapidly aging equipment operated by underpaid and overworked drivers, many of whom are not intellectually or emotionally qualified for what they are doing, and these changes are threatening the safe operation of motor carrier equipment on the highways and endangering the lives of motorists and truckers alike. . . . By paying a driver less per mile, costs can . . . be reduced. However, it is axiomatic that a driver will run the miles necessary to meet the income needs of himself or his family. Excess driving hours threaten safety.90

F. THE IMPACT OF Deregulation UPON SAFETY

Under deregulation, motor carriage is an anemic industry with a high turnover rate among firms running aging and poorly maintained equipment and employing overworked and underpaid drivers.91 As wages are reduced by financially strapped carriers, drivers have a strong economic incentive to stay on the highway beyond the maximum hour limitations established by the federal government.92

The average driver believes that about one in four of his fellow drivers regularly operate their vehicles on the highway under the influence of illegal drugs.93 A recent National Transportation Board Study found that one-third of drivers killed in accidents had been drinking or using drugs.94 Drivers take amphetamines in order to fight the fatigue of staying behind the wheel excessive hours. Tight schedules and the pressure to make a living cause many drivers to speed.95 One driver wrote an published by

89. See R. Beilock, MOTOR CARRIER SAFETY STUDY 16 (1989).
90. AAA SAFETY STUDY, supra note 84.
91. P. Dempsey, supra note 1, at 120-125.
92. AAA SAFETY STUDY, supra note 84.
94. The study covered an eight state area over a period of one year. Rosenfeld, Fatigue, Alcohol and Drugs Identified As Prime Causes of Fatal Truck Accidents, TRAFFIC WORLD, Feb. 12, 1990, at 13.
the Wall Street Journal. He put it this way:

In 10 years of driving I have had no employer who expected less than twice the legally allotted number of hours. Many drivers, probably the majority, find themselves in similar binds. They must constantly break the law to keep their jobs. The resulting fatigue is the truck driver's real enemy and the true killer on the highway. . . .

About 4,500 people died last year in traffic accidents involving trucks. If the same official zeal were focused on shippers and employers who demand outlawry from drivers, the first step will have been taken toward reducing that number. Until then, shippers will expect 68-hour trips from California to Boston, and profit will be made because drivers disregarded the law. More important, public safety will continue to be jeopardized.  

Under federal regulations, log books are supposed to show eight hours rest after ten hours work;97 in the trucking industry, log books are referred to as "comic books."98 Drivers often exceed those limits. As one source noted, "There is far too much pressure on owner-operators and trucking companies to work their drivers seventy-eighty-ninety hours a week just to compete or keep their jobs."99 The result has been increased numbers of trucking accidents and related deaths and injuries. Fatigue has been cited by the National Transportation Safety Board as the largest single factor in causing fatal accidents.100

Many scholars have examined the relationship between trucking deregulation and the deterioration in safety. Daust and Cobb found a "relationship between federal economic deregulation and the substantial rise in safety related incidence. . . [as well as a] cause-and-effect relationship of driver fatigue and unqualified drivers on traffic crash occurrences."101 Carriers earning inadequate profits have cut training and forced drivers to work longer hours. Inexperienced drivers are three times more likely to

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97. Specifically, truck drivers may drive no more than 10 hours within a 15-hour period following eight consecutive hours off duty. In sleeper operations, the eight hours off duty can be divided into two periods. Drivers cannot drive more than 60 hours in a seven day week. Schulz, Truckers, Hours of Service Rules to Receive Comprehensive Study, TRAFFIC WORLD, Dec. 4, 1989, at 20.
98. Kalette, Truck Deaths: 41,500 a Year, 50+ Last Week, USA Today, Mar. 23, 1987, at 1, 2.
100. Rosenfeld, Fatigue Alcohol and Drugs Identified As Prime Causes of Fatal Truck Accidents, TRAFFIC WORLD, Feb. 12, 1990, at 13. An American Automobile Association [AAA] study reveals that driver fatigue is the probable or primary cause of 41% of heavy truck accidents. AAA FOUNDATION FOR THE TRAFFIC SAFETY, A REPORT ON THE DETERMINATION AND EVALUATION OF THE ROLE OF FATIGUE IN HEAVY TRUCK ACCIDENTS (1985). For purposes of this study, fatigue was defined as more than 15 consecutive hours of on-duty or defined activity time. Id. at 2.
have accidents than are experienced drivers.\textsuperscript{102} Under the National Accident Sampling System, the three largest causes of accidents were (1) speeding, (2) the level of training, and (3) the age of the vehicle.\textsuperscript{103} All of these factors seem to have grown worse under deregulation.

The industry also appears to be deferring new vehicle purchases.\textsuperscript{104} Because carrier profits have been so severely squeezed, the average age of equipment on the highway has increased dramatically since deregulation.\textsuperscript{105} The average age of trucks on the highway rose from 6.9 years in 1978 (when \textit{de facto} deregulation began) to eight years in 1987.\textsuperscript{106} According to Professor Evans, the number of trucks twelve years or older on the highway has more than doubled under deregulation.\textsuperscript{107} Charts X, XI and XII reveal these distressing trends.\textsuperscript{108}

\begin{tabular}{|c|c|c|c|}
\hline
Year & \textsuperscript{(1)} Age of all trucks & \textsuperscript{(2)} Number of trucks (millions), 12 years or older & \textsuperscript{(3)} Number of trucks in use (millions) & \textsuperscript{(4)} \% of trucks 12 years and older to total trucks in use, indexed at 1970 = 100 \\
\hline
1970 & 7.3 & 3.9 & 17.7 & 100 \\
1971 & 7.3 & 4.0 & 18.3 & 99 \\
1972 & 7.2 & 4.0 & 19.7 & 92 \\
1973 & 7.0 & 4.0 & 21.3 & 85 \\
1974 & 7.0 & 4.1 & 23.3 & 81 \\
1975 & 6.9 & 4.4 & 24.8 & 80 \\
1976 & 7.0 & 4.8 & 26.5 & 82 \\
1977 & 6.9 & 5.2 & 28.2 & 82 \\
1978 & 6.9 & 5.5 & 30.5 & 82 \\
1979 & 6.9 & 5.9 & 32.6 & 82 \\
1980 & 7.1 & 6.5 & 35.2 & 84 \\
1981 & 7.5 & 7.2 & 36.1 & 90 \\
1982 & 7.8 & 7.9 & 37.0 & 97 \\
1983 & 8.1 & 8.5 & 38.1 & 101 \\
1984 & 8.2 & 9.6 & 40.1 & 109 \\
1985 & 8.1 & 10.7 & 42.4 & 115 \\
1986 & 8.0 & 11.5 & 44.8 & 117 \\
1987 & 8.0 & 11.8 & 47.3 & 113 \\
1988 & 7.9 & 12.6 & 50.2 & 114 \\
1989 & 7.9 & 14.0 & 53.2 & 119 \\
1990 & 8.0 & 15.5 & 56.0 & 120 \\
\hline
\end{tabular}

\textsuperscript{(1)} Average age, all trucks.  \\
\textsuperscript{(2)} Number of trucks (millions), 12 years or older.  \\
\textsuperscript{(3)} Number of trucks in use (millions).  \\
\textsuperscript{(4)} Ratio of number of trucks 12 years and older to total trucks in use, indexed at 1970 = 100.
Chart X--All Trucks
Average Age (1970-90)

Chart XI--No. of Trucks
12 Years & Older (1970-90)
Chart XII--Ratio of No. of Trucks 12 Yrs. and Older/Total Trucks In Use

Chart XIII--Maintenance Expenses/Mile 1976-1987
Economically anemic carriers simply do not have the resources to invest in replacing (and in some instances, repairing) aged equipment. Older vehicles require greater maintenance, yet unfortunately, they are getting less. Carriers have cut maintenance expenditures up to 3.6% annually. This means that carriers are not buying spare parts when they need them and are not taking vehicles off the highway when they ought to be. Chart XIII sustains this dismal conclusion. Professor Bruning concluded as follows:

> [A]ccident rates are significantly related to the nature of the equipment employed over the road. The rate of defective equipment and the age of the vehicles are instrumental in accounting for accident rates of small and medium specialized carriers but not for general freight carriers. The results may be related to financial performance as well as to the level of safety enforcement by the regulatory authorities.\(^\text{109}\)

In 1985, checks of vehicles on the highway under the Federal Motor Carrier Safety Assistance program revealed that twenty nine percent of large trucks were insufficiently safe to be on the highway. In some states, the figures have been even higher.\(^\text{111}\) In 1986, studies in New York and Connecticut revealed that sixty percent of trucks were insufficiently safe to be on the highway.\(^\text{112}\) In 1988, the U.S. Department of Transportation rated 14,769 motor carriers as having unsatisfactory or conditional safety.\(^\text{113}\) In 1989, 31,522 driver/vehicle inspections were conducted at about 160 locations in forty seven states and Canada. More than 70,000 driver or vehicle violations were discovered; out of service orders were

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Waring Mich. Testimony, supra note 36, at 7. These data were based on the General Freight Instruction 27 Carriers, and are derived from ATA Financial and Operating Statistics, Summary Table III. Mr. Waring deflated maintenance expenses to constant dollars using the GNP deflator and then dividing by vehicle miles traveled. 1976 = 100.

109. INDEX OF MAINTENANCE EXPENSES PER MILE


111. P. Dempsey, supra note 1, at 122.


113. M. Foley Calif. comments, supra note 74, at 23.
issued against 10,134 trucks (32.1%) and 1,908 drivers (6.1%).114

An American Automobile Association [AAA] study found that because there are few other areas in which to cut costs, motor carriers whose profit margins are squeezed have little alternative but to “run older equipment, pay less in wages, work drivers longer, and/or skip on maintenance.”115 Similarly, Professors Corsi, Fanara, Jr. and Jarrell concluded:

[[In the competitive post [deregulation] environment there is a significant relationship between poorer operating performance and a higher accident rate. Despite claims to the contrary that deregulation and safety concerns are unlinked, it is clear that some firms operating in the new competitive environment in a precarious financial situation have significantly higher accident rates than do those not in financial distress.]116

Professor Garland Chow found that the carrier which eventually goes bankrupt spends less on maintenance and new equipment; he runs older equipment and uses more owner-operators.117 Professor Corsi found a correlation between owner-operator use and a higher accident rate.118

It is not only the carrier exiting the unregulated market which poses a serious safety hazard on the highway. The new, undercapitalized, shoe string operator is also a threat. Professors Corsi and Fanara, Jr., examined the impact of the Motor Carrier Act of 1980 upon safety and concluded that new entrants have accident rates between twenty seven percent and thirty three percent higher than established carriers.119 The Motor Carrier Act of 1980 exacerbated this problem by increasing the number of new entrants. Even Alfred Kahn admits, the safety record “is markedly worse for the most recent entrants.”120

Professor Grant Davis observed that “There may well be a strong

115. AAA SAFETY STUDY, supra note 84.
relationship between earnings, capacity and safety." Professor Nicholas Glaskowsky reached similar conclusions, noting that "After five years of deregulation three trends are fairly clear: (1) the equipment fleet of the motor carrier industry is aging, (2) a lot of maintenance (expense) is being deferred, and (3) the motor carrier accident rate is increasing." A recent study of the U.S. Office of Technology Assessment echoed these findings:

Overcapacity leads to price discounting and shrunken profit margins, creating difficult economic trade-offs for decisions about investment in safety-related equipment and safety-conscious hiring and scheduling practices. Competition, increased operating, costs, and low, erratic profit margins create a need to control costs that can lead to shortchanging safety-related driver training, truck maintenance, and equipment improvements. Costs and safety trade-offs are particularly problematic for owner-operators and small carriers, who have to generate revenue regularly to stay in business and may have no regular operations base or maintenance facility.

Some sources allege that the number of truck-related accidents and fatalities have decreased, on a per-mile basis, since promulgation of the Motor Carrier Act of 1980. But this allegation has not gone unchallenged. The U.S. Office of Technology Assessment [OTA] concluded that the number of accidents between 1981 and 1986 (which is, as we shall see, the last year for which accurate data are available) increased fifteen percent, more than the increase in truck-miles traveled during that period. Further, OTA found that the by 1990, the total cost of highway accidents reached $65 billion annually, far out-pacing any purported transportation pricing savings.

OTA’s findings with respect to fatality levels are also sustained by the American Insurance Association, which reported that the accident rate for interstate motor carriers increased from 2.65 per million miles in 1983, to 3.06 in 1984, to 3.39 for the first half of 1985. Professor Darwin Daicoff studied the data and concluded that, "deregulation has been associated with a deterioration in the rate of improvement of motor carrier safety whether expressed in motor carrier fatalities, injuries, or accidents.

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122. N. GLASKOWSKY, supra note 34, at 32.
123. OTA SAFETY STUDY, supra note 61, at 27.
125. OTA SAFETY STUDY, supra note 61. See also N. GLASKOWSKY, supra note 34, at 32.
126. OFFICE OF TECHNOLOGY ASSESSMENT, GEARING UP FOR SAFETY, SUMMARY REPORT 6 (1988).
127. N. GLASKOWSKY, supra note 34, at 32. A more recent decline in fatalities (if there has been one) despite the increase in the number of accidents may be attributed to mandatory 55 mph speed limits and mandatory state seat belt laws enacted during this period.
per truck mile."

Professor Glaskowsky points out that deregulation has produced aging equipment, deferred maintenance, and an increasing accident rate. Professor Daryl Wyckoff found a positive correlation between motor carrier regulation and safety; regulated carriers displayed a superior safety and compliance record vis-a-vis unregulated motor carriers. Another source concluded, "Deregulation compounded the problems by creating economic circumstances that made trucking far more dangerous."  

Recently, the U.S. General Accounting Office attempted to assess whether certain economic factors could be used as predictors of accidents in the motor carrier industry. It concluded:

[T]hree measures of profitability — return on equity, operating ratio, and net profit margin — were associated with subsequent safety problems as measured by accident rates. The data agreed with GAO's model for five of seven financial ratios: Firms in the weakest financial position had the highest subsequent accident rates. GAO also used a number of other factors to predict safety outcomes, including the following. First, the smallest carriers, as a group, had an accident rate that exceeded the total group's rate by 20%. Second, firms operating closer to a broker model — that is, those that rely on leased equipment and/or drivers to move freight — had a group accident rate 15 to 21% above the total group's rate.

With regard to two of the submodels (driver quality and compliance), driver's age, years of experience, and compensation were all good predictors of safety problems. GAO's evidence is generally consistent with the model's hypothesis since younger, less experienced drivers and lower paid company drivers posed greater-than-average accident risks.  

But does this overwhelming body of evidence conclusively prove, as the deregulators insist we must, that deregulation has caused a deterioration in safety? Probably not. Neither has the U.S. Surgeon General, with all the resources at his disposal, satisfied that burden in proving that cigarette smoking causes cancer. In both instances, the burden or disproving a link ought to be placed upon those who, common sense tells us, are jeopardizing public safety.

For its part, the Department of Transportation [DOT] has obfuscated the impact of deregulation upon motor carrier safety. One of the most significant problems of measuring safety is the integrity of the federal data base maintained by the DOT's Federal Highway Administration. On Janu-

129. N. GLASKOWSKY, supra note 34.
January 1, 1986, it more than doubled the reporting threshold for property damage accidents, from $2,000 per accident, to $4,200 per accident, and has raised it since.\textsuperscript{133} The definition of “bodily injury” was also made more rigorous.\textsuperscript{134} Thus, while the raw numbers suggests a significant reduction in the number of commercial motor vehicle accidents after 1985, the truth is that the two sets of data (pre-1986 and post-1986) are apples and oranges. Neither do the data account for the changes in the number of miles driven or the number of motor carriers.\textsuperscript{135} As the Congressional Research Service of the Library of Congress concluded, “Year to year comparisons of accident rate data . . . are subject to serious question because of differences, in sampling techniques, differences in the type of carrier sampled, and validity of the data collected.”\textsuperscript{136}

G. **UNPRECEDEDNT CONCENTRATION**

As a consequence of the ruthlessly competitive environment unleashed by deregulation, the U.S. transportation industry has become more highly concentrated than it has ever been.\textsuperscript{137} This high level of concentration has manifested itself not only among motor carriers, but also among airlines, railroads, and bus companies.\textsuperscript{138} The eight largest U.S. airlines accounted for eighty one percent of revenue passenger miles in 1978, and ninety two percent in 1990;\textsuperscript{139} the seven largest railroads accounted for sixty five percent of revenue ton miles in 1979, and eighty nine percent in 1987; the eight largest motor carriers accounted for twenty percent of industry revenue in 1978, and thirty seven percent in 1987; and the bus duopoly of Greyhound and Trailways which preceded deregulation became an effective national monopoly with their merger after deregulation.\textsuperscript{140} Because of the scale and network economies inher-


\textsuperscript{134} Id.

\textsuperscript{135} Id.

\textsuperscript{136} Id.

\textsuperscript{137} U.S. GEN. ACCT OFF., TRUCKING REG. 11, 14 (1987).

\textsuperscript{138} P. DEMPSEY, supra note 1, at 91-92. Even Alfred Kahn admits as much. See Kahn, Deregulation: Looking Backward and Looking Forward, 7 YALE J. REG. 325 (1990).


\textsuperscript{140} P. DEMPSEY, supra note 1, at 83-93, 129-93. Despite the freedom to raise prices and leave unprofitable markets created by deregulation, the bus industry suffered unprecedented losses under deregulation. Industry operating ratios exceeded 96.9 every year between 1982 and 1986. R. NATHAN, FEDERAL SUBSIDIES FOR PASSENGER TRANSPORTATION, 1960-1988: WINNERS, LOSERS, AND IMPLICATIONS FOR THE FUTURE, at Appendix C, Table C (1989). Part of this was due to “cream skimming” by new entrants which focused their operations on the denser, higher revenue traffic lanes. Excessive capacity in dense markets deprived carriers of the revenue needed to cross-subsidize weaker markets. Another part still was prompted by the impact
of the airline rate wars of the early 1980s, created by the destructive competition unleashed by the Airline Deregulation Act of 1978. Super saver air fares were luring passengers away from the bus stations and into airports. Even charter and tour deregulation had a deleterious effect upon carrier profitability. Jeremy Kahn painted the following portrait of the empirical results of deregulation:

[W]ith the exception of a handful of intercity carriers engaged in regular route transportation (be it true intercity transportation or even long distance commuter service within major metropolitan areas), charter and tour revenues provide a significant—if not the most, significant—proportion of most carrier’s revenues. Deregulation of charter and tour operations on the federal level (and, generally on the state level to varying degrees) has resulted in overcapacity, leading to severe price competition, resulting in a diminution of overall carrier profits. This, coupled with ever increasing costs of operation, including the staggering cost of the newest intercity motorcoaches, increased cost of labor, including benefits, and other operating costs, including taxes, has resulted in mere economic survival being a major issue for many smaller charter and tour carriers within the industry.

Regardless of the number of efficient management programs which are instituted, regardless of the modernization of maintenance facilities and customer service facilities, and regardless of computerization of record keeping and billing, many carriers are faced with a close-to-being-unbearable squeeze on their profits.

Many carriers are today operating aging fleets of equipment, with models costing the then significant amount of $155,000 now replaceable only with comparable models which cost twice as much.

In many instances, only new entrants, highly leveraged, and barely able to make lease payments on these expensive coaches, enter the charter market and provide fierce price competition, anxious only in the short run to meet their leasing obligations, thereby further exasperating this problem.


While deregulation initially increased price competition by flooding the market with excess capacity, it caused the industry’s profit margin to plummet, a large number of carriers to fail, and mergers to lead to unprecedented levels of concentration. All the while small and rural communities lost bus service or faced extreme price discrimination. Dempsey, The Experience of Deregulation: Erosion of the Common Carrier Obligation, 13 TRANSP. L. INST. 121, 172-75 (1981).

Thus, deregulation of the U.S. intercity bus industry has created an anemic monopoly pro-
Despite the predictions of the free market economists that deregulation would reduce industry concentration, there are far fewer LTL competitors now than before deregulation. As noted above, while the less-than-truckload sector of the motor carrier industry has experienced a shakeout of more than half of the firms which previously existed, there have been no new, major LTL entrants since deregulation began.\(^\text{141}\) Although there were nearly 500 LTL firms in 1973, fewer than 150 existed in 1986.\(^\text{142}\) Between 1978 (the year that de facto deregulation of interstate trucking began) and 1986, more than fifty four percent of the LTL trucking companies went out of business.\(^\text{143}\)

![Chart XIV--MC-82 Carriers Number (1980-1989)](chart)

viding poorer service than before deregulation. Even Alfred Kahn, the guru of deregulation, has acknowledged that bus deregulation was a threat to small communities, whose lifeline is the intercity operator; therefore, had he been at the helm of government, he probably would not have deregulated the bus industry. See Kahn Oral Testimony, supra note 120, at 6247-48.

The public has suffered unduly in the United States as free market economists played havoc with national transportation policy. Laissez faire has made impossible the achievement of the broader social and equity objectives of ubiquitous intercity passenger transportation linking all to the infrastructure, even those living in remote communities, for it has obliterated the delicate balance of cross-subsidies which only responsibly administered economic regulation can provide.


\(^\text{143}\) M. Foley Calif. comments, supra note 74, at 34.
The MC-82 carriers are the largest in the industry, required by the ICC to be reflected in rate filings by the independent rate bureaus. Chart XIV reveals the declining number of LTL carriers of size.\textsuperscript{144} Thus, sixty two percent of the largest general freight carriers have disappeared. A 1987 study of the General Accounting Office found that all geographic regions in the nation have experienced increased motor carrier concentration since deregulation began.\textsuperscript{145} The industry has also never been

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\textsuperscript{144} Irwin Silberman, Graphs for Fourth Quarter of 1989 (1990).

\textsuperscript{145} U.S. GEN. ACCT. OFF., TRUCKING REG. 11, 14 (1987).
more highly concentrated on the national level. Relative market shares pre- and post-deregulation are set forth in Chart XV.\textsuperscript{146} Stripped of entry regulation, the industry has become more highly concentrated that at any time in its history. The fact that not a single new LTL carrier of consequence has successfully emerged strongly suggests the existence of economies of scale.\textsuperscript{147} Note also that the growth in the rate of trucking concentration has outstripped even that of airlines, which have been longer and, with federal preemption, more comprehensively deregulated.\textsuperscript{148} Moreover, while no new major entrant has successfully emerged in LTL trucking, several new airlines have been launched.

The largest motor carriers are also the most profitable. \textit{Business Week} reported that in 1986, the ten largest LTL carriers accounted for sixty percent of LTL shipments, and ninety percent of its profits.\textsuperscript{149} In 1968, the four largest motor carriers accounted for 19.5\% of the top 100 revenue, and thirty one percent of the profits of the 100 largest carriers. In 1987, the four largest enjoyed forty percent of the top 100 revenue, and forty eight percent of the top 100 profit.\textsuperscript{150} The three largest LTL motor carriers (Roadway, Yellow and Consolidated Freightways) grew from twenty percent of the operating revenue and forty one percent of the operating income of the 100 largest carriers in 1979, to thirty one percent of the operating revenue and sixty one percent of the operating income in

\begin{itemize}
\item \textsuperscript{146} TRAFFIC WORLD, Dec. 5, 1988, at Supp. J.
\item \textsuperscript{147} Even Alfred Kahn now admits that LTL trucking has exhibited"... a trend toward increasing concentration at the national level." Kahn Oral Testimony, supra note 120, at 6246. A Standard & Poor's survey of the trucking industry indicates that all the major LTL motor carriers now operate in all 48 states. Kahn Oral Testimony, supra note 120, at 6167. True, nearly every carrier which has applied for it has received 48-State interstate general commodities motor carrier operating authority from an unusually liberal Interstate Commerce Commission, so they can surely hold themselves out as serving all 48 States. But the certificated authority and the real ability to serve all 48 states are often two entirely different things. It is unclear whether the Standard & Poor's reference refers to operating authority, interline ability, or actual operations.
\item \textsuperscript{148} The 10 most profitable carriers in 1984 accounted for over 80\% of all general freight carrier's profits. Between 1979 and 1983, the 75 largest general freight carriers increased their share of Class I less-than-truckload revenues from 79.2\% to 88.2\%. During this same period, the four largest carriers increased their market share from 26.4\% to 30.6\%, with the largest carrier increasing its share from 9.1\% to 10.1\%. D. Sweeney, C. McCarty, S. Kalish & J. Culter, Jr., \textit{Transportation Deregulation: What's Regulated and What Isn't?} 172 (1986).
\item \textsuperscript{149} \textit{Is Deregulation Working?}, Bus. Wk., Dec. 22, 1986, at 50, 52.
\end{itemize}
1985. The big three increased their relative market share by approximately forty percent in just six years. These three megacarriers, accounting for one-third of the operating revenue of the top twenty five companies before deregulation, by 1991 accounted for nearly half. Professor James Rakowski notes, "The concentration of revenue and, even more so, of profit is shown to have increased significantly in recent years while a large percentage of firms are shown to be losing money or, at best remaining barely profitable." Indeed, smaller carriers are being eclipsed by their larger competitors. Between 1980 and 1987, the market share of the all but the ten largest MC-82 carriers declined, whether measured in LTL revenue, tonnage, or shipment counts. These firms lost fifty five percent of their truckload tonnage and thirty percent of their LTL tonnage under deregulation. If these trends continue, smaller companies will play only a minor competitive role in general freight transportation. One source predicts that the next recession will result in a massive shakeout, ultimately leaving only about six carriers dominating the national network. Another anticipates that three or four megacarriers will dominate the industry, "forcing higher rates and fewer service options on shippers . . . ."

Professor Glaskowsky has disputed the essential assumptions upon which deregulation was predicated, saying:

The LTL for-hire carrier segment of the industry is not atomistic in any sense of the word. A small and still shrinking group of increasingly large firms dominates this traffic nationally. LTL operations do have significant economies of scale. The established large national LTL carriers are the beneficiaries of an almost insurmountable financial barrier to entry: their large and widespread terminal networks. . . .

A modern LTL operation of significant size involves an extensive net-

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151. Rakowski, Marketing Economies and the Results of Trucking Deregulation in the Less-Than-Truckload Sector, TRANSP. J., Spring 1988, at 11, 13. Another source states that these three trucking companies "raised their market share from 21.7% of LTL revenue in 1979 to 36.5% in 1988." Schulz, Rate-Cutting: Competition Darken Profit Picture for LTL, TRAFFIC WORLD, June 4, 1990, at 15, 17.


154. id.


156. id. at 19.

157. id. at 18.


159. Shulz, Rate-Cutting, Competition Darken Profit Picture for LTL, TRAFFIC WORLD, June 4, 1990, at 15, 16.

160. N. GLASKOWSKY, supra note 34, at 9.
work of terminals, a computerized management information system, a large number of employees, has a need for a highly skilled management, and must be able to cope with the fact that most of its costs are fixed in the short run and at least semi-fixed in the longer run. For these reasons, the barriers to entry in the LTL sector of the motor carrier industry are high.161

On the basis of the indisputable hard evidence, it is clear that one of the most significant results of deregulation of the motor carrier industry is that large scale interstate motor carriage has become a closed club with a dwindling number of members. . . .

The rate of growth of interstate LTL traffic concentration since deregulation is without parallel in American business history. It is unquestionably a direct result of motor carrier deregulation, and the increasing concentration of LTL traffic in the hands of a shrinking number of carriers is continuing.162

Professor Rakowski also points out that not only do economies of size and scope create advantages for larger trucking firms,163 marketing economies, or the ability of larger carriers to serve a broader geographic area ubiquitously, "exist in the LTL business which give the larger carriers an edge in securing traffic in the new deregulated environment."164

H. THE IMPACT OF DEREGULATION ON SMALL COMMUNITIES

Another adverse effect of deregulation is its impact upon small community service and pricing.165 In motor carriage, we have not yet seen the full impact of deregulation because there has been no federal pre-emption of intrastate trucking. Therefore, the deleterious consequences have been somewhat blunted. The overwhelming majority of states continue to regulate motor carrier entry and pricing.166

However, in those transport sectors where the federal government has preempted the states, the adverse impact upon small community service has been quite profound.167 For example, after enactment of the Staggers Rail Act of 1980, more than 1,200 small communities lost all of

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161. Id. at 25.
162. Id. at 26 (emphasis in original).
166. Since the Motor Carrier Act of 1980, only six states have deregulated their motor carrier industries. P. DEMPSEY, supra note 1, at 217.
167. Under the provision of the Airline Deregulation Act, state jurisdiction over intrastate air service is totally preempted, and the Bus Regulatory Reform Act of 1982 gave the Interstate
their rail service.\textsuperscript{168} Since promulgation of the Airline Deregulation Act of 1978, more than 130 communities have lost all air service.\textsuperscript{169} And four years after promulgation of the Bus Regulatory Reform Act of 1982, more than 4,500 communities had lost service, while fewer than 900 had gained it.\textsuperscript{170} Even Alfred Kahn saw a need for economic regulation to Commerce Commission jurisdiction to reverse Public Utility Commission denials at bus discontinuances and rate increases. P. DEMPSEY, \textit{supra} note 1, at 199.


170. Letter from ICC Chairman Heather Gradison to Senator Larry Pressler (Sept. 8, 1986). The Bus Regulatory Reform Act of 1982 [BRRA] significantly liberalized entry, exit and pricing of the U.S. bus industry, and largely preempted the states. 49 U.S.C. § 10922 et seq. Paradoxically, while the BRRA was premised on the notion that deregulation would enhance competition, the result has been a higher level of concentration than has ever existed in the industry, poorer returns than have ever been realized, and a large and growing number of small community abandonments.

The BRRA liberalized entry by removing the requirement that applicants prove "public convenience and necessity," leaving them with the obligation to establish on that they are "fit, willing and able" to provide the proposed operations. A protestant must then prove that issuance of the authority sought will not be in the public interest. H. REP. No. 97-334, 97th Cong., 1st sess. 29 (1981). Abandonments become easier too. Moreover, industry proposed intrastate abandonments and price increases denied by the State PUC could now be appealed to the ICC, where they were almost always reversed. In the first year under the BRRA, the bus industry announced termination or reductions of service at 2,154 communities. U.S. DEPT. OF AGRICULTURE, \textit{RECONNECTING RURAL AMERICA} 20 (1989) [hereinafter \textit{RECONNECTING RURAL AMERICA}]. The ICC estimated that 1,045 communities that lost service in the first year of deregulation had no alternative intercity transportation. \textit{Id}. By late 1986, 4,514 communities had lost bus service, while only 896 gained it. The big losers were small communities — 10,000 or less. Letter from ICC Chairman Heather Gradison to Senator Larry Pressler (Sept. 8, 1986). This loss of service falls particularly hard on non-metropolitan and rural populations, which have a higher percentage of children and elderly who need access to public intercity transport, than do urban areas. \textit{See} \textit{RECONNECTING RURAL AMERICA, supra}, at 8.

Who suffers when bus service deteriorates or becomes more expensive? Individuals in the lowest income groups, people living in rural areas, and the young and elderly rely disproportionately upon buses than any other mode of transportation. During 1977, the last year the U.S. Department of Commerce performed a travel survey, 30% of all intercity bus passenger miles were traveled by individuals living in rural areas, compared to trains (20%) and airlines (15%); families earning less than $10,000 a year accounted for 45% of intercity bus passenger miles, compared to trains (25%), automobiles (18%), and airlines (15%). The trend continues. A 1988 survey by Greyhound Lines Inc. revealed that 44.8% of its passengers were from families which earned less than $15,000 a year. R. NATHAN, \textit{FEDERAL SUBSIDIES FOR PASSENGER TRANSPORTAT-
protect service to small communities, saying "I'm not sure I would ever have deregulated the buses because the bus is a lifeline of many small communities for people just to get to the doctor or to the Social Security

The Isolation of Rural America has had a pernicious social and economic impact. See Dempsey, Rate Regulation and Antitrust Immunity in Transportation: The Genesis and Evolution of this Endangered Species, 32 AM. U. L. REV. 335, 343-344 (1983). The U.S. Department of Agriculture recently summarized the impact of deregulation upon small towns and rural communities:

Many rural residents no longer have intercity public transportation available to them. It is no longer possible "to get from here to there." The combined effect or rail, air, and bus deregulation has simply removed many rural areas from the intercity transportation network. In those small communities where some form of intercity transportation is still available, the cost of travel has risen sometimes dramatically ... The net result for many rural residents is increased isolation from society at large, as liking with other communities becomes more and more difficult. An alternative for some elderly people is to move away from their homes in rural areas to an urban area — where they no longer have the support of their local community network and where they may require the support of human services agencies to remain independent. . . .

There may be an incremental addition to a larger trend toward increased isolation and rising costs for rural communities. As costs rise, businesses close, thereby reducing the number of services available locally. And as the number of services decline, residents are forced to travel farther to access medical care, shopping, employment opportunities, and social and recreational outlets. As people travel to meet basic needs, the cycle of decline is reinforced as individuals combine their trips to the larger community to include the doctor, the shopping center, and the theater—bypass the local business as an additional, unnecessary stop. Eventually population declines as access to basic services becomes to difficult or too costly for rural residents to sustain.

RECONNECTING RURAL AMERICA, supra, at 26-27. The U.S. intercity bus network is shrinking under deregulation. Peaking at 27.7% intercity passenger miles traveled in 1979, it has fallen steadily each year since to 23 billion passenger miles in 1987. R. Nathan, supra, at Appendix B, Table B-1.

Prior to its deregulation, industry officials predicted that deregulation would result in drastic service reductions to small communities. Harry Lesko, President of Greyhound of Arizona, said that "Eighty-nine percent of our routes are subsidized by the bread-and-butter primary routes ... If we are to keep our lines running and the scheduled miles operating on the primary routes to satisfy the high-density population factors, the rural areas are going to have to suffer because they are straining the main line system." INTERCITY BUS SERVICE IN SMALL COMMUNITIES: SENATE COMM. ON COMMERCE, SCIENCE AND TRANSP., 95th Cong., 2d Sess. 17, (1978). Similarly Charles Webb, President of NAMBO insisted that:

The one conclusive argument against removal of controls on entry by motor carriers of passengers stems from their obligation to provide service to thousands of small cities and towns and to vast rural areas without profit or at a loss, and from the fact that it would be unconscionable either to permit new entrants to skim the cream of traffic or to authorize existing carriers to discontinue bus service to thousands of communities having no other form of public transportation.


Moreover, the loss of bus service means the loss of the most fuel efficient and least pollutive mode of transport. R. Nathan, supra, at 20-24. In 1985, the various modes consumed the following amounts of fuel per passenger mile:

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office."¹⁷¹

The national air system, the national rail system and the national bus system have all suffered a loss in the number of communities served under deregulation.¹⁷² Paradoxically, the U.S. transportation system is shrinking despite the fact that the nation's population is increasing. The loss of transport services creates an out-migration of investment, jobs and population to crowded urban areas, a social consequence which may not be desirable.

Studies performed by DOT during the first five years of deregulation suggested that LTL service had increased for small communities. However, a more recent study of small community service finds the trend to be just the opposite. Comparing service between 1976 and 1988 at 4,326 points in thirteen western states, Folger Athearn, Jr., found that sixty six percent lost all their LTL service. He concludes:

This study, conducted more that three years after the last of the DOT studies, indicates that short-term gains have been replaced by long-term losses in LTL service due to numerous motor carrier bankruptcies and/or the abandonment of their common carrier obligations by financially distressed truckers. These results confirm the predictions of those who were opposed to trucking deregulation.¹⁷³

Prices also appear to have increased significantly for small towns which still receive service.¹⁷⁴ As we shall see below, many communities are served solely by United Parcel Service. UPS sets a price somewhat lower than the United States Postal Service for small parcels, but enjoys profit margins well above those of other industries, suggesting a pricing structure reflecting their monopoly position in the market.

Moreover, many large carriers are refusing to provide discounts on interline movements.¹⁷⁵ Hence, local regional carriers are unable to pro-

<table>
<thead>
<tr>
<th>Mode</th>
<th>Bus per passenger mile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buses</td>
<td>1,323</td>
</tr>
<tr>
<td>Trains</td>
<td>2,800</td>
</tr>
<tr>
<td>Automobiles</td>
<td>4,040</td>
</tr>
<tr>
<td>Commercial Aviation</td>
<td>4,376</td>
</tr>
<tr>
<td>General Aviation</td>
<td>11,339</td>
</tr>
</tbody>
</table>

¹⁷². Kahn Oral Testimony, supra note 120, at 6300-6301.
¹⁷³. Athearn, Jr., LTL Service In the West: Long-Term Losses Replace Short-Term Gains, TRANSF. RESEARCH FORUM 98 (1989).
¹⁷⁴. Thomas Gale Moore, a nationally recognized proponent of deregulation admits that 40% of small communities have suffered a loss of air service since deregulation began, while ticket prices have increased disproportionally for them. Moore, U.S. Airline Deregulation: Its Effects on Passenger, Capital, and Labor, 24 J.L. & ECON. 1, 15, 18, 28 (1986).
vide the small communities they serve with the discounts enjoyed in the national pricing structure. This means that pricing to and from small communities is higher, on average, than competitive rates in larger markets.

Some deregulation proponents contend that, prior to deregulation, the ICC took no action to ensure that regulated carriers provide service to small communities. In fact, the administrative scheme of licensing entry encouraged a continuation of service to small communities. Since new certificates would be granted where an applicant could establish that "existing service was inadequate", under regulation incumbents had an incentive to provide adequate service to all points in their certificated territories, so as to maintain the economies of density they enjoyed.\textsuperscript{176} Satisfaction of the common carrier obligation was mandated by the informal activities of the pre-deregulation ICC Bureau of Enforcement in response to service complaints.

Moreover, the overwhelming majority of states, both before and after federal deregulation, regulate intrastate motor carriage. In some states, rate averaging insures cross-subsidization for small community service. Hence, intrastate regulation assures that many small communities continue to receive adequate motor carrier service.

Prior to deregulation, small shippers enjoyed statutory protection against pricing and service discrimination.\textsuperscript{177} After deregulation, interstate pricing discrimination is pervasive. As noted above, large shippers with monopsony power unilaterally dictate significant discounts below the full published rates, which are climbing to make up for the erosion of carrier productivity.

Many deregulation proponents point to studies financed by the U.S. Department of Transportation [DOT] on intrastate deregulation in Florida and Arizona in 1982 and 1984 to support the hypothesis that rates have declined.\textsuperscript{178} Of course, that period of economic recession was the worst since the Great Depression, so one would expect transportation prices to fall as manufacturing declined. These studies were based on questionnaires, or attitudinal-perception data, rather than on "hard" data. Professor Chow notes that significant disparities can result in research prepared


\textsuperscript{177} Dempsey, Rate Regulation and Antitrust Immunity in Transportation: The Genesis and Evolution of This Endangered Species, 32 AM. U. L. REV. 335 (1983).

\textsuperscript{178} Virtually every study prepared or financed by the United States Department of Transportation during the last decade has concluded that transportation deregulation is a success.
under these alternative methodologies.\textsuperscript{179} For example, asking a small shipper who receives a five percent discount off the published rate whether he feels that rates are reasonable might elicit a different response if he was informed that the large shipper across the street enjoys a seventy percent discount for equivalent shipments.

The DOT studies also concluded that while "common carrier service [in small communities] is perceived to be of low quality accompanied, sometimes by high rates", service was considered to be adequate because of the existence of private carriage and United Parcel Service.\textsuperscript{180} That is, indeed, an interesting observation, for UPS has a virtual monopoly on small package shipments. UPS dominates about eighty percent of the small parcel market nationally, while the United States Postal Service carriers most of the rest (RPS is a distant third). UPS participates in proceedings of the U.S. Postal Rates Commission arguing for higher and higher U.S. Postal Service rates for small packages. The result is that UPS is able to capture the lion's share of the small parcel market simply by under-pricing the U.S. Postal Service. As Chart XVI reveals, UPS's market power has enabled it to earn supracompetitive profits, far higher than the rest of the motor carrier industry and, indeed, higher than the average for all American industry.\textsuperscript{181}

\begin{center}
\begin{tabular}{llll}
\hline
YEAR & UPS & OTHER US MOTOR CARRIERS & ALL US MANUFACTURERS \\
\hline
1978 & 2.70\% & 2.92\% & 5.4\% \\
1979 & 2.48 & 1.97 & 5.7 \\
1980 & 4.69 & 1.73 & 4.8 \\
1981 & 6.67 & 1.58 & 4.7 \\
1982 & 6.37 & .77 & 3.5 \\
1983 & 8.14 & 2.37 & 4.1 \\
1984 & 6.97 & 2.24 & 4.6 \\
1985 & 7.38 & 1.74 & 3.9 \\
1986 & 7.76 & 2.64 & 3.8 \\
1987 & 8.10 & 1.57 & 4.9 \\
\hline
\end{tabular}
\end{center}

\textsuperscript{179} Chow, An Evaluation of Less-than-Truckload Transport in Small Rural Communities of Western Canada, 19 LOGISTICS & TRANSP. REV. 225 (1983).

\textsuperscript{180} Beilock & Freeman, Deregulated Motor Carrier Service to Small Communities, TRANSP. J. 71, 74 (Summer 1984).

\textsuperscript{181}
Hence, during the 1980s, UPS has out-performed not only the ailing motor carrier industry, but the average of all manufacturing industries in the United States, even during the recession and the period of high fuel prices which dominated the early portion of this decade. This could not have occurred unless UPS has market power to set its prices above competitive levels. Market power is the ability of a firm to maximize profits by maintaining prices above or restricting output below the competitive level for a significant period of time.\textsuperscript{182} That results in the transfer of wealth from consumers to producers, and is therefore regressive in character.

In fact, UPS has grown to be the dominant transportation company of all modes, with gross revenues of $12.4 billion in 1989, and profits of nearly $700 million — the largest of any transportation firm in the nation.\textsuperscript{183} But if UPS is earning supracompetitive profits, why have new entrants not been attracted to its markets like sharks to the smell of blood? Under the theory of contestability (upon which deregulation was largely premised), new entry, or the threat thereof, should hold profit margins down to competitive levels. But entry into the less-than-truckload industry has proven difficult because of the high costs incurred in developing terminal operations geared to the movement of small shipments. As noted above, major LTL trucking companies utilize a network

\begin{flushleft}
\textsuperscript{182} See Dempsey, \textit{Antitrust Law & Policy in Transportation: Monopoly is the Name of the Game}, 21 GA. L. REV. 505 (1987).

\textsuperscript{183} The Service 500, \textit{FORTUNE}, June 4, 1990, at 164.
\end{flushleft}
of hub-and-spoke systems which include hundreds of satellite terminals and dozens of large consolidation centers. Such factors have coalesced effectively to prohibit a single major LTL carrier from emerging since de facto deregulation of U.S trucking began in 1978. In fact, not only has a new competitor not emerged, poor levels of productivity, excessive capacity, numerous bankruptcies, significant economies of scale and scope, and economic barriers to entry have caused the number of major LTL carriers to dwindle significantly since deregulation.

Under deregulation, pricing discrimination has become pervasive. This distortion in transportation pricing distorts the broader market for the sale of goods in a perverse way — a way in which larger producers are favored, and smaller and rural producers are disfavored.

IV. TOWARD A NEW THEORY OF ECONOMIC REGULATION

A nation’s government is inextricably intertwined with its economy. Neither trade nor, indeed, civilization can proceed without government. In modern western nations, government guarantees property rights, provides standards of fair trade, a forum for peaceful dispute resolution, and currency as a medium of exchange. These things are essential if commerce is to flow freely. Prospects for economic growth are dim in a state of chaos and anarchy. Order and predictability are required — sheriffs and marshalls are necessary to enforce legal rights and responsibilities. Even private consensual ordering via contract and property transactions requires government and its laws as a means of dispute resolution. Thus, government’s participation in the economy is inevitable.

In modern nations, the fundamental question is not whether government will participate, but to what extent it shall participate. Hence, governmental participation is a matter of degree. How shall a nation allocate decisional responsibility between private entrepreneurs and government over such matters as the price, quantity, and quality of goods produced, and the relationship between producers, on the one hand, and consumers, employees and the general public, on the other?

In socialist economies, the government itself owns the means of production and allocates resources by dictating the level of production, which goods shall be produced, and at what price. This is an extremely difficult task, and several European communist nations appear to be abandoning it as costly, inefficient and wasteful. In capitalist nations, most of these decisions are made by private entrepreneurs, driven by a profit motive to invest their own capital into privately owned and operated enterprises.

185. Id. at 53.
Profit is a two-edged sword. On the one hand, it serves as an effective stimulant for efficiency, productivity, and responsiveness to consumers, who cast votes of approval in the form of currency in favor of those entrepreneurs who best satiate their desires. The lure of profit encourages producers to trim costs and satisfy consumer tastes and preferences. In a fully competitive environment, consumers receive the goods and services they want at the lowest cost to society for their production — something economists describe as “allocative efficiency.”

But profit also inspires greed, producing the classic Scrooge, the miser, who will do anything to maximize his personal wealth — give workers slave wages and dangerous working conditions, pollute the air and the water with carcinogens, ruthlessly subvert competitors and competition, satiate the public’s hedonistic desire for sex and drugs, take candy from a baby’s mouth, or turn Bedford Falls into Pottersville, for example — all for the lust of wealth.

Many of these results are deemed undesirable by modern societies. So in capitalist nations, government is employed in a somewhat schizophrenic capacity — as a means of facilitating the attributes of freedom in a market, while circumscribing those noxious results of too free a market. Government intrudes both to facilitate the production of the cornucopia of goods and services private ownership can bring, and to protect the public against harm.

Again, line drawing becomes a problem. Which things ought to be encouraged in a market, and which discouraged? In democratic nations, these decisions are left to elected representatives, who essentially draw lines, generally reflecting the will of the people, in laws which define the metes and bounds of acceptable behavior.

Free market economists argue that the lines should be drawn in a way which attempts to create perfect competition, which will achieve “allocative efficiency.” While perfect competition exists in economic models, it rarely exists in the real world.186 Even in economics textbooks, it requires some rather strict assumptions — for example, that preexisting or resulting distributions of wealth are irrelevant, that consumers have perfect information, that they and producers behave rationally, and that no single producer has “market power” (the ability to increase profits by

186. According to theory, the market is self-correcting — demand adjusting the amount of supply to produce equilibrium. This, however, is a theory which can be demonstrated only in the laboratory. If there is any impurity in the real arena, the formulae break down. Unfortunately, impurities are not merely a possibility, they are a certainty. The free market extremists fail to perceive the noneconomic forces which abound: political forces, social forces, as well as the impossibility of manifesting an industry with the requisite characteristics of perfect competition.

unilaterally constricting production or raising price).\textsuperscript{187} Since these things often do not exist outside economics textbooks, government becomes involved to correct for “market failure,” trying to encourage fair competition. Antitrust laws are an example of governmental intervention designed to punish efforts to diminish competition.

But even if perfect competition could be achieved, economic goals are not the only goals of a nation. A nation is a political body, and sometimes it chooses to achieve social goals which may even diminish efficiency in the distribution of its resources. For example, it may decide to transfer wealth to the elderly or the poor, even though they are unproductive.

The choice among economic and social goals is a difficult one, and is further complicated by the wide variety of means available to achieve such goals once identified. Government can attempt to (1) completely ban the enterprise (illicit drugs and prostitution, for example); (2) own and operate the industry (public education and the postal system, for example); (3) regulate levels of pricing and service (electricity and telephones, for example); (4) regulate industry standards and qualifications (the legal and medical professions, or cigarette advertising, for example); (5) sanction undesirable behavior through the judiciary (antitrust and punitive damages for products liability, for example); (6) tax and spend (high taxes on alcohol, and subsidies for low-income housing, for example).

What is this thing, regulation, which had become such a monster that its eradication was pursued with such triumphant zeal? Regulation involves government oversight. In effect, and in a general sense, the government looks over the shoulder of the private entrepreneur and says to him:

\begin{quote}
You have an obligation to serve the public interest. You shall neither exploit nor harm your consumers, your workers, or others. You are entitled to make a fair profit, and no more. But you must also serve the public interest.
\end{quote}

And what is the public interest? It is the interest of all who are affected by the industry — consumers, shippers, consignees, stockholders, highway motorists, managers and employers, large and small, urban and rural — to enjoy safe, adequate and dependable service at a reasonable price ... to be treated fairly. It is also the national interest in such things as ubiquitous service and national defense.

Regulation is as old as the republic. Early on, the nation imposed tariffs upon foreign imports and set standards of weights and measurement. The modern age of regulation is commonly thought to have begun

\textsuperscript{187}. See Market Failure and Regulatory Failure as Catalysts for Political Change, supra note 9.
in 1887 with the creation of the Interstate Commerce Commission — the nation’s first independent regulatory agency — to regulate the most important infrastructure industry of the era, the railroads. Antitrust law (in effect, a regulatory enterprise employing different means) followed shortly thereafter, with the promulgation of the Sherman Act of 1890 and the Clayton Act of 1914.

A major growth of regulation occurred during the 1930s, in response to the economic collapse created by what then was perceived to be too free a market. During the New Deal, a number of additional regulatory agencies were created to regulate industries and enterprises important to the nation’s economy — including the Federal Communications Commission, the Securities and Exchange Commission, the Federal Power Commission, the National Labor Relations Board, and the Civil Aeronautics Board. The U.S. Supreme Court expressed the tenor of the times:

[There] has been a growing appreciation of public needs and of the necessity of finding ground for a rational compromise between individual rights and public welfare. The settlement and consequent contraction of the public domain, the pressure of a constantly increasing density of population, the interrelation of the activities of our people and the complexity of our economic interests, have inevitably led to an increased use of the organization of society in order to protect the very bases of individual opportunity. Where, in earlier days, it was thought that only the concerns of individuals or of classes were involved, and that those of the State itself were touched only remotely, it has later been found that the fundamental interests of the State are directly affected; and that the question is no longer merely that of one party to a contract as against another, but of the use of reasonable means to safeguard the economic structure upon with the good of all depends.\footnote{Home Building \& Loan Association v. Blaisdell, 290 U.S. 398, 442 (1934) (Johnson, J., concurring).}

The next major wave of regulation occurred during the 1960s, and it took a different form, focusing on problems of market failure in the environment, safety, health and consumer protection.

These instances of growing government reflect an evolution in the national psychology in which communitarian values came to supplant a traditional individualistic or more libertarian ideology. As noted above, it came to be recognized that in a crowded, interrelated society, the actions of individuals affect us all. It was the public interest that regulation was created to satisfy.

Government as a participant in economic decision making has come in for a rhetorical ravaging during the past decade, in a political movement which saw most restraints on economic freedom as a nuisance at best, and wasteful and unnecessary at worst. The political creed of “de-regulation” became the ideological centerpiece of an economic policy which had \textit{laissez faire} as its foundation.
In the 1970s, inflation drove many to complain about the aggregate drag on the economy provided by comprehensive governmental oversight. American business objected to the Kafkaesque metamorphosis of government into a grotesque creature it did not understand. Presidents Ford, Carter, Reagan, and Bush pursued an aggressive policy to eradicate regulation. In one instance, Congress abolished a regulatory agency (the Civil Aeronautics Board), and sowed the ground with salt.

In part, the new wave of individualism is a response to regulatory failure — the perceived inefficiency and waste engendered by an unresponsive and lethargic government bureaucracy. But it also reflects a more deep seated ideological notion of individual freedom, a notion which is at the root of the American experiment in liberty.

The trouble is, we cannot do without government. Someone must pave the roads, deliver the mail, and protect the borders. And collectively, we can do things we cannot do individually — like maintain parks in cities, and educate all our children. So again, it is not a question of whether we will have a government, but one of how much government we shall have, and what it shall do.

In a homogeneous society, such as many of the nations of Europe, communitarian values find less resistance. Collectively, there is a public consciousness and responsibility in these nations by those who have, to assist those who do not, for they are alike in race, religion and culture. But in a heterogeneous society, such as the United States, those in need are not like those who are not; hence, there is perhaps more resistance to communitarian values here than abroad.

But the pendulum on things political, legal and economic tends to swing as popular opinion evolves. Just as regulatory failure brought cries for deregulation, market failure will inevitably bring demands for reregulation.\(^{189}\) The excesses of one generation become the catalysts for reform of the next.

Indeed, that trend already appears to be emerging. Fresh with indigestion with a myriad of problems, Congress has recently considered bills proposing reregulation of various aspects of the cable television, railroad, airline, telephone, savings and loan, and broadcasting industries. Many politicians have expunged “deregulation” from their campaign speeches as the dreaded “D” word.

Thus, among the most important issues facing our government is what shall be the proper relationship between government and our economy, and how can government achieve desirable social and economic goals most efficiently and at least cost. How can we tailor the govern-

\(^{189}\) See Market Failure and Regulatory Failure as Catalysts for Political Change, supra note 9.
mental solution to our economic and social problems without making things, on balance, worse than they were before government intervened? It is the position of the author that neither extreme of rigid governmental supervision nor laissez faire is realistic or responsible. With that as a starting point, let us examine the origins of economic regulation of the motor carrier industry.

Problems of destructive competition in the motor carrier industry, seemingly endless bankruptcies, and the deterioration of wages, working conditions and safety they create gave birth to economic regulation in the 1930s. As this author has noted elsewhere:

During the Great Depression, the motor carrier industry was plagued with an oversupply of transportation facilities. Intensive competition among truckers suppressed freight rates excessively and caused hundreds of bankruptcies. Entry into the industry was easy. The ranks of the unemployed provided an endless pool of drivers; with a drivers license and a used truck they could haul goods for hire. Not knowing what their costs were, or victimized by shippers with greater market power, they frequently took traffic at below-cost rates. They drove for gas money, or to cover their monthly payments on the truck, and kept rolling until needed repairs brought the trucks to a halt. Soon they were bankrupt, while their truck was patched up and sold to yet another entrant and the cycle repeated itself. All the while, efficient and productive trucking companies and railroads were also hemorrhaging dollars.190

Even preceding the Great Depression, as early as 1926, the U.S. Department of Agriculture issued a report concluding that entry and rate stabilization of highway transport would be beneficial to prevent over-expansion.191 Beginning that year, Congress in each session considered bills for economic regulation of the motor carrier industry.

Several economists of the day also advocated the need for economic regulation. In 1928, at a meeting of the American Economic Association, William M. Duffus declared, "Most students of transportation will agree, I think... that there must be some sort of central planning looking toward the coordination of our various transportation agencies on a sound economic and financial basis"; Henry R. Trumbower argued that rail and motor carriage "should be regarded as a regulated monopoly".192

Other economists agreed. Shan Szto condemned excessive competition as of "no benefit to anyone," making the industry "unattractive to reasonable business people."193 Harold G. Moulton and his Brookings Institution associates criticized the waste and instability created by exces-

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190. P. DEMPSEY, supra note 1, at 16-17 [footnotes omitted].
191. W. JACKMAN, supra note 25, at 847.
193. Id.
sive competition and urged comprehensive coordination of transportation. 194 D. Philip Lockin summarized the inherent characteristics which warranted economic regulation: "The ruinous type of competition does develop; discrimination in rates does appear; the condition of over-capacity does not correct itself automatically; and the struggle for survival in the face of inadequate revenues leads to deterioration of safety standards, evasion of safety regulations, financial irresponsibility and generally unsatisfactory service." 195 Professor Paul Kauper noted that "The present demoralization of interstate motor transportation, due to unsound competitive practices, and the menace of much unrestrained competition to the detriment of the integrity of the national transportation system as a whole, creates problems that call imperatively for federal legislation." 196

The Great Depression exacerbated the problems which had surfaced in transportation. In 1933, the Interstate Commerce Commission concluded that the ease of entry and the inadequate knowledge by unsophisticated entrepreneurs of their costs "condemned the industry to chronic instability and excessive competition." 197 Specifically, the ICC found that rate instability resulted in "widespread and unjust discrimination between shippers ... the loss of much capital invested ... a tendency to break down wages and conditions of employment ... [and an] [i]ncrease in the hazard of use of the highways." 198 Two years later, the federal coordinator of transportation, Joseph B. Eastman, expressed even greater concern over the economic chaos plaguing the industry caused by unlimited entry and exacerbated by the Great Depression. 199 Note the striking similarity between these economic conditions which preceded deregulation with the empirical results of deregulation, summarized above.

In promulgating the Motor Carrier Act of 1935, which gave the Interstate Commerce Commission entry and rate regulatory jurisdiction over trucking and bus companies, the 74th Congress concluded:

Motor carriers ... are engaged in intensive competition with each other and with railroads and water carriers. This competition has been carried to an extreme which tends to undermine the financial stability of the carriers and jeopardizes the maintenance of transportation facilities and service appropriate to the needs of commerce and required in the public interest. The

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194. Id. at 8. Sadly, Brookings today is a bastion of *laissez faire* ideologues who attack economic regulation at every opportunity and who insist that deregulation has produced billions of dollars in consumer savings.

195. Id.


198. Id.

199. Id.
present chaotic transportation conditions are not satisfactory to investors, labor, shippers, or the carriers themselves. . . .

The ultimate objective of [the Motor Carrier Act of 1935] is a system of coordinated transportation for the Nation which will supply the most efficient means of transport and furnish service as cheaply as is consistent with fair treatment of labor and with earnings which will support adequate credit and the ability to expand as need develops and to take advantage of all improvements in the art. All parts of such a system of transportation should be in the hands of reliable and responsible operators whose charges for service will be known, dependable, and reasonable and free from unjust discrimination.200

In the eyes of the early advocates of regulation, transportation was particularly prone to alternative periods of destructive competition and monopoly or oligopoly. Because of the tremendous economies of scale along many different dimensions exhibited by much of the transport sector, the out-of-pocket or marginal cost of providing service tends to lie far below its full or average cost. Moreover, transportation firms sell what is, in essence, in the nature of an instantly perishable commodity. Once the truck leaves its terminal, any unused space is lost forever. It cannot be warehoused and sold another day as could, say canned beans.

Alfred Kahn once remarked that he could see no difference between transportation firms and grocery stores. Imagine a grocer who was selling commodities which had the spoilage properties of open jars of unrefrigerated mayonnaise. He would be forced to have a "fire sale" every afternoon in order to rid himself of unsold inventory, for it could not be warehoused and sold another day.

So it is with transportation capacity. Unlimited entry creates excessive capacity which, in turn, creates conditions conducive to destructive competition and economic anemia. Hence, unconstrained competition in these circumstances tends to drive the price down towards marginal cost, causing profits to disappear. Bankruptcies and mergers ensue as excess capacity is weeded out, and a profitable monopoly or oligopoly eventually emerges. The restoration of market power may well be accomplished by a blatantly discriminatory rate structure with price differences between markets reflecting not relative costs, but the differing degree of competition.

In the view of the early advocates of regulation these two phenomena — destructive competition and powerful monopolies — were simply two sides of the same coin. The purpose of regulation, under these circumstances, was to eliminate this Hobson’s choice for consumers: preventing the potential threats to safety, service and investment posed by destruct-

tive competition on the one hand, and the price-gouging and price discrimination associated with market power in a consolidated industry, on the other. In addition to the discriminatory pricing that deregulation has unleashed, declining productivity engendered by excessive capacity appears also to have caused destructive competition between the motor carriers themselves. And it is worse for motor carriers than it is for the other modes of transport.

Railroads and airlines have significant advantages that motor carriers do not. True, all sell an instantly perishable product, and the short term marginal costs of production are nil (adding an extra passenger to a scheduled flight costs the airline only a few additional drops of fuel and another cardboard meal). Yet (like telephone, electric and gas distribution companies) railroads and airlines can control a bottleneck — monopoly rail lines or airport infrastructure, respectively — and therefore exert market power to raise prices or reduce service levels to maximize profit. Thus, air fares for passengers who begin or end their trips at a concentrated hub airport are twenty one percent more expensive than for passengers who do not. Electric utilities claim their rail rates for coal from monopoly railroads are exorbitant.

In contrast, while a motor carrier can build a terminal facility which it operates exclusively, a competitor can build its terminal facility across the street. Thus, until the trucking industry becomes very highly concentrated, there will be relatively less opportunity to enjoy market power \textit{vis-à-vis} the other modes, for truckers control no equivalent bottleneck.

Second, airlines can, by lowering prices, tap the elasticities of demand to stimulate new business. Lower prices can lure the discretionary traveler to fill a seat which might otherwise go empty. A ninety nine dollar fare will fill planes with throngs of passengers off to Disneyland (or, for that matter, Wally World), who might not otherwise make the trip. In contrast, trucking companies cannot, by lowering prices, appreciably increase the volume of freight shipped, for transportation rates are too small a percentage of the total cost of most products to stimulate additional demand. Certainly, trucking companies can steal freight away from competing motor carriers, or from railroads, by lowering prices. But the aggregate volume of freight shipped will not grow appreciably.

Third, motor carriers are subservient to the whims of large shippers who, by threatening to withhold their vast volumes of freight, can unilater-

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ally dictate rates far below the carriers’ average costs. In order to survive, the carrier must cover its fixed costs by charging discriminatory prices — significantly higher rates charged to smaller and rural shippers.

Motor carriers have only a couple of shields from the ravages of destructive competition. First, an overwhelming number of states have rejected the federal experiment in motor carrier deregulation, and continue to regulate intrastate trucking. Second, the antitrust immunity accorded rate bureaus allows some rationality in the rate structure. But incredibly, the U.S. Department of Transportation would like to do away with both.

Surely, other industries sell services which are in the nature of instantly perishable commodities, which have *de minimis* short term marginal costs — hotels, movie theaters, bowling alleys, to name a few. Most can avoid destructive competition by making up fixed costs on auxiliary products and services. For example, concessions of popcorn and soft drinks are the real profit centers for the oligopoly theaters (they lose money or break even on admissions), and these are monopoly concessions for moviegoers in the theater. Hotels earn significant income from restaurants, room service, and leased space for shops in the lobby, and can differentiate their products based on location and class of service. Transportation firms have only two major variables with which to differentiate their product — speed and price — and have no auxiliary monopoly opportunities with which to make up fixed costs.

Moreover, transportation is even more prone to instant perishability than are hotel rooms or bowling alleys. Empty hotel rooms and unused bowling alleys can be sold ten minutes or several hours later. In contrast, once the truck leaves its terminal, the aircraft pulls away from its gate, or the train pulls its cars away from its siding, any empty space is lost forever.

Moreover, and more importantly, we do not care whether movie theaters become an oligopoly charging exorbitant or highly discriminatory prices, for we can stay home and watch television, or rent a movie for our VCR, or read a good book, or do a thousand different things with our leisure time. The numerous alternatives of leisure keep pricing in check.

But transportation is a *necessity*. It is the circulatory system of the nation — the veins and arteries through which commerce flows — and an important facilitator of communications. We *must* get our goods to market, and too often, we *must* travel to business meetings (teleconferencing has made only a small dent in this market). While discretionary airline travel is sometimes attractively priced (reflecting the varied alternatives to vacation time, including driving the station wagon to Lake Wobegon with the kids) business travel is not, and both are often restricted in onerous ways. If these markets are distorted by highly imperfect competition, we suffer distortions in other markets which depend upon them. Other busi-
nesses are adversely affected, and the ripple effect of distortion is pernicious.

Various sectors of the economy and various regions of the nation can be adversely affected by the aggregate impact of pricing and service discrimination. We depend upon the transportation network to allow us to exchange goods between all regions; this advances several economic and social goals, like promoting a geographic dispersal of population, avoiding the ills of overcrowding, allowing economic and social diversity and pluralism, expanding the production and consumption market, as well as promoting a geographic distribution of wealth.

Like telephone services, gas and electricity, access to the transportation infrastructure is a necessity for the public, and hence, in the nature of a public utility. None of the transportation firms individually are public utilities, but the national transportation system is at least a quasi-public utility. The system is the fabric that binds the nation together, and regulation is the glue that holds the system together. Prudently administered economic regulation assures that the national transportation system does not disintegrate into its antagonistic parts, and that individual firms cooperate to provide service which, from the perspective of the individual user, works effortlessly. Conversely, deregulation has deleterious systemic effects in creating a regime of transportation firms competing to the death rather than cooperating to ensure that operations flow smoothly.

Service must be ubiquitously available at an adequate level and a fair price or the public will suffer. The process of production is not complete until goods are in the hands of consumers. Just as a clogged artery can halt the flow of blood and seriously damage a body organ, a constipated transportation (or energy or communications) system will cause industrial organization to collapse. The infrastructure industries affect consumers and the economy in a way that bowling alleys do not.

While economists insist that only natural monopolies should be regulated, they ignore the necessity feature of the infrastructure industries. Moreover, all the infrastructure industries, including transportation firms, do tend toward concentration in reaction to destructive competition.

And further, we can regulate transportation firms with a clear conscience because they consume a public resource. Airports and airways and highways belong to the public. Our tax dollars built them, paved them and maintain them. Even the early railroads were given public land on which to build, and even those that were not, have used the government power of eminent domain to obtain their rights of way. Our taxes built the public infrastructure, and therefore, we have a right to exact a quid pro quo from the private firms which use them — that these public resources be used in the public interest. If we had laid the wood for bowling alleys, perhaps we could justify their regulation (although again, we
need not — they are not a necessity, other sectors of the economy do not depend upon them, and alternatives keep pricing in check).

We can legitimately insist that transportation firms satisfy the public need for ubiquitous service at a fair price, that the service not endanger public safety (we have a right not to be killed by the trucks with which we share the highways), and that they will serve the needs of national defense.

Prudently administered economic regulation can accomplish both economic and social goals deemed to be in the highest public interest. Among the economic goals are the prevention of distortions created by imperfect competition. Regulation can avoid the regressive wealth transfers created by market power, including the monopsony power of large shippers unilaterally to dictate rates which are noncompensatory. Additionally, regulation can ameliorate the market power of large carriers, preventing them from charging excessively high rates to small shippers and undercutting their competing carriers.

Regulation can also avoid the problem of externalities, which manifests itself in the impact of inadequate profits upon highway safety, and the discriminatory pricing and service provided to small communities. Shippers have a strong incentive to keep their private fleets of trucks repaired and driven by well trained drivers, for the tort system will hold them accountable for any innocent third parties injured or killed because of their negligence. In contrast, shippers can use unsafe common carriers with virtual impunity. They therefore have an economic incentive to shave the common carriers' profit margin to the bone, for their is no piercing of the corporate veil to hold shippers accountable for their ruthless greed, so to speak. Because the common carrier or its insurer pays for injury to the innocent automobile drivers, the shipper can externalize the cost of unsafe transportation.

Of course, some injured parties find the carrier in bankruptcy, or without insurance, and are never compensated. And however well money can ease pain, it often fails to restore health, and almost never restores life. Thus, exerting monopsony power to shave the common carrier's rate below compensatory levels can be economically rational for the shipper, while causing an undesirable externalized costs on society in terms of deteriorating safety, and loss of human life.

Regulation can not only ameliorate the problem of externalities, it can also accomplish a number of important social goals. It can engender a regime of cross-subsidization providing for equality of access to all shippers and to all communities, large and small. Regulation can create a geographic distribution of opportunity for economic growth spread over a larger and more diverse group of participants, thereby enhancing pluralism. It can ensure that small and remote users enjoy the same access to
the broader market for the sale of goods as do large firms, thereby enhancing competition in that broader market for the sale of goods.\textsuperscript{203}

Dabney Waring, Jr., eloquently summarized the appropriate role of government in the market with respect to motor carrier transportation:

Government has responsibilities, principal among which is maintaining the infrastructure of essential services necessary for the commerce and amenities of a civilized nation. Certainly the government would be a poor manager of the motor carrier industry or of any business. But is not management of the motor carriers which is at issue. It is the metes and bounds, parameters, if you will, of performance. It is requiring that carriers fulfill their common carrier obligation; of seeing that service is not abandoned when there is not a viable alternative; of monitoring service offerings to see that capacity is not so far in excess of demand that gross waste results; of opening entry selectively to assure adequate numbers of carriers; of preventing any semblance of predatory pricing; of forbidding exploitation of market dominance situations be they in the area of geography, commodity, size of a shipment, or whatever. Such regulation, however, should leave a significant latitude for managerial discretion in pricing, service options, and operational decisions.\textsuperscript{204}

V. CONCLUSION

Let us summarize what deregulation has produced in transportation:

- Not only has public sector disinvestment produced a level of deteriorating bridges and potholes on the highways that would embarrass a third world country, deregulation has caused a disinvestment in the private components of the infrastructure as well. Inadequate profits have denied the industry the economic resources to invest in newer and more productive equipment. Our geriatric trucks, busses and aircraft are now among the oldest in the developed world.
- Productivity in this essential infrastructure industry has declined.
- Bankruptcies have reached unprecedented levels.
- Pricing discrimination is widespread, and skewed against those producers (small businesses) which have traditionally created ninety percent of the nation’s jobs.
- Wages and working conditions for employees in the transportation sector have deteriorated.
- The public’s safety has been jeopardized.

If Congress had known that these would be the consequences of the Motor Carrier Act of 1980, would it have promulgated the legislation? The implicit thesis of the theology of laissez faire is that unconstrained human

\textsuperscript{203} P. Dempsey, supra note 1.
\textsuperscript{204} Waring, Motor Carrier Regulation—By State Or By Market, 51 ICC PRAC. J. 240, 242 (1984).
greed will produce a better society. The public is beginning to understand that deregulation is not all the free market ideologues promised it would be. 

Recently, the Consumer Federation of America issued a report revealing consumer perceptions of the impact of deregulation. It found: (a) a plurality, perhaps a majority of people, support enhanced regulation; (b) with respect to neither transportation nor communications does a majority believe that deregulation has been in the best interest of individuals or the nation; and (c) a plurality believes that deregulation has hurt consumers. According to the study, support for transportation and telecommunications regulation reached a low point in the early 1980s, but has since climbed back to the higher levels of the 1970s. Support for economic regulation has followed the reverse trend. In a *Business Week* poll conducted in 1987, forty nine percent of respondents said "no" when asked whether the results of deregulation of airlines, trucking and telecommunications has been positive, while forty six percent said "yes." It is clear that as Americans become better acquainted with deregulation, they become less enamored with it.

But not the U.S. Department of Transportation. Despite growing evidence of widespread failure, DOT continues tenaciously to insist that "moves to deregulation were almost universally needed and well-founded." Incredibly, DOT believes that even more deregulation would be better. This is the same DOT that issued a long-awaited National Transportation Policy which argued the states should pay for the deteriorating infrastructure of highways, but that they should be preempted from regulated intrastate motor carriage, thereby forcing them to follow the course of deregulation. Transportation is a part of the broader infrastructure which is the foundation for economic growth. In most nations, that infrastructure (communications, energy, and transportation) is owned, subsidized, or regulated by government. Only in North America have we entered the Brave New World of deregulation and the imperfect economic environment that it creates. Most nations view the infrastructure as an essential foundation for economic growth, and therefore, distortions in it cannot be tolerated. It is for that reason that these industries are treated differently from other sectors of the economy. There is also a strong public interest

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205. CONSUMER FEDERATION OF AMERICA, PUBLIC OPINION ABOUT REGULATION AND Deregulation in the Transportation and Communications Industries (May 1988).


in motor carriage because these firms are users of a public resource — highways — which are shared by nearly all citizens. If carriers are to use this scarce public resource, they have traditionally been required to do so in a way that achieves broader social goals.

The net impact of deregulation is that the social objectives for which regulation has traditionally been a catalyst have been abandoned. We have left the industry and the public it serves to a highly imperfect market which has created gross distortions between large and small firms. The net effect of deregulation is that the larger users of the system (the large shippers) in the short run, and the larger providers of the service (the large carriers) in the longer run, are its principal beneficiaries. Small shippers, small communities, and small transportation firms are clearly disadvantaged in an unregulated environment. Professor Rakowski succinctly summarized the results of motor carrier deregulation:

The results of deregulation in the LTL sector have been the opposite of what was predicted by the deregulators. Instead of more competition, ... [we have] increased concentration of both revenues and profits. Instead of more competitors, there are fewer firms in this segment of the industry now than prior to deregulation and open entry. Bankruptcies and voluntary departures (often because of impending doom) have thinned the ranks of competitors and there has been essentially no new entry.208

Throughout history, chaos in the rate structure has persuaded government to provide oversight and maintain stability. In the 1870s, widespread rate discrimination by railroads stimulated by excessive competition in competitive markets and inadequate competition in monopoly markets led to a public outcry. In rural areas served by a single railroad, farmers were enraged to see their crops moved at a higher rate to market than crops coming along the same line from a farther distance. But in Chicago, served by several highly competitive railroads, the price of shipping cattle to New York fell to a dollar a car. Jim Fisk, an owner of the Erie Railroad, responded by buying all the cattle he could find and shipping them aboard his competitor, the New York Central.209

These pricing anomalies caused two sets of problems — for the industry, profits were inadequate; for the shipping public, discriminatory prices had a deleterious externality. Disfavored regions or shippers found themselves significantly disadvantaged in the broader market for the sale of goods. The remedy was creation of the Interstate Commerce Commission in 1887, the nation’s first independent regulatory agency.

Revisionist historians have insisted that the natural monopoly characteristics of railroading at the time necessitated government regulation.

209. P. Dempsey, supra note 1, at 8.
But they had some trouble explaining the expansion of regulation to other transport modes in the 1930s, when certainly, the motor carriers had no such monopoly.

When the Great Depression broke, Congress was confronted with a national economic disaster, one which had hit the infrastructure industries particularly hard. As has been explained above, the economic condition of the trucking industry in the 1930s was intolerable. It was characterized (as it is today) by highly discriminatory pricing, inadequate profits, an astronomical number of bankruptcies, and legitimate concerns over high-way safety. Congress imposed regulatory controls with the promulgation of the Motor Carrier Act of 1935, making the rate structure more rational. For nearly half a century, the industry grew, became more productive, and prospered, and upon its shoulders, the nation grew.

In the late 1930s, Congress also examined on the state of the airline industry, concluding that the economic condition of the airlines was unstable and that a continuation of its anemic condition could imperil its potential to satisfy national needs for growth and development. The legislative history of the Civil Aeronautics Act of 1938 is replete with concerns over excessive and destructive competition, and the adverse effect that the economic crisis was having upon the industry and its ability to attract capital and maintain safe and adequate operations. Carriers were spiraling downward into a sea of red ink. Without governmental protection, bankruptcies proliferated. Colonel Edgar S. Gorrell, president of the Air Transport Association, observed:

> Since air transport was launched into meteoric growth, approximately $120,000,000 of private capital has been devoted to it, but, of that sum, there remains today scarcely fifty percent. Since the beginning of air transport, a hundred scheduled lines have traversed the airways in a struggle to build this newest avenue of the sky. But today scarcely more than a score of those companies remain. The industry has been reduced to the very rock bottom of its financial resources. . . .

There are only two ways whereby the necessary capital can be provided to this industry. One is the way toward which the governments of foreign lands increasingly tend — the way of mounting governmental subsidies, whereby public funds are poured without stint into air transport. The other way is the traditional American way, a way which invites the confidence of the investing public by providing a basic economic charter that promises the hope of stability and security, and orderly and intelligent growth under watchful governmental supervision.

Not only had private entrepreneurs invested considerable capital in the airline industry, but the federal and local governments had as well. That

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211. *Quoted in id.*, n.14.
investment needed protection.\textsuperscript{212} In order to avoid the deleterious impact of excessive and destructive competition and to avoid the economic "chaos" which had so plagued the rail and motor carrier industries, Congress established a regulatory structure similar to that which had been devised for an orderly development of those industries which had also been perceived to be "public utility" types of enterprises — the railroads and motor carriers.\textsuperscript{213}

Transportation was also viewed as different from other industries, with necessity characteristics making it in the nature of a "public utility", essential to the national economy and the national defense, therefore warranting protection of the "public interest" by government.\textsuperscript{214} ICC Chairman Joseph Eastman noted, "important forms of public transportation must be regulated by the government. That has been accepted as a sound principle in this country and ... in practically every country in the world. ... Transportation is of such vital importance to the public welfare and the business is so affected with a public interest that some measure of government regulation is ... necessary."\textsuperscript{215}

The same problems which exist today in a deregulated transportation environment are those which existed in the 1930s prior to motor carrier and airline regulation (or in the 1880s, prior to rail regulation) and differ only in magnitude.\textsuperscript{216} A nation that does not learn from its history is doomed to repeat it. The United States has an extremely short memory, and is prone to reliving its past. The time has come to roll back deregulation.

\textsuperscript{212} Id. at 102.
\textsuperscript{213} Id. at 95-97.
\textsuperscript{214} Id. at 96, n.11.
\textsuperscript{215} Id. at 100.
\textsuperscript{216} In the 1930s, the world was ravaged by the worst economic depression of this century; during the early 1980s, the economy was struggling. After the recession, the economy has much improved. Yet, the same parallels exist between destructive competition in the 1930s preceding regulation and the destructive competition in the 1980s following deregulation. See, \textit{e.g.}, Dempsey, The Disintegration of the U.S. Airline Industry, 20 TRANSP. L.J. 9 (1991); P. Dempsey \& A. Goetz, AIRLINE Deregulation \& LAISSEZ FAIRE Mythology (1992).
### APPENDIX A

#### The Top 100 Carriers in 1980

<table>
<thead>
<tr>
<th>Rank</th>
<th>Carrier Name</th>
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<tbody>
<tr>
<td>1.</td>
<td>United Parcel Service</td>
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<td>2.</td>
<td>Roadway Express</td>
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<td>3.</td>
<td>Consolidated Freightways Corp.</td>
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<td>4.</td>
<td>Yellow Freight Services</td>
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<td>5.</td>
<td>McLean Trucking Co.</td>
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<td>6.</td>
<td>Ryder Truck Lines</td>
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<td>7.</td>
<td>North American Van Lines</td>
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<td>8.</td>
<td>Spector Red Ball</td>
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<td>9.</td>
<td>Pacific Intermountain Express</td>
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<td>10.</td>
<td>Allied Van Lines</td>
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<td>11.</td>
<td>Smith's Transfer Corp.</td>
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<td>12.</td>
<td>Arkansas-Best Freight System</td>
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<td>13.</td>
<td>Overtine Transportation System</td>
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<td>14.</td>
<td>United Van Lines</td>
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<td>15.</td>
<td>Carolina Freight Carriers</td>
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<td>16.</td>
<td>Transcon Lines</td>
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<td>17.</td>
<td>Interstate Motor Freight System</td>
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<td>18.</td>
<td>American Freight System</td>
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<td>19.</td>
<td>East Texas Motor Freight Lines</td>
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<td>20.</td>
<td>Lee Way Motor Freight</td>
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<td>22.</td>
<td>Mattack Inc.</td>
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<td>23.</td>
<td>Anchor Motor Freight</td>
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<td>24.</td>
<td>Signal Delivery Service</td>
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<td>25.</td>
<td>Aero Mayflower Transit Co.</td>
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<td>26.</td>
<td>Mason &amp; Dixon Lines</td>
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<td>27.</td>
<td>Chemical Leaman Tank Lines</td>
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<td>28.</td>
<td>Preston Trucking Co.</td>
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<td>29.</td>
<td>Central Freight Lines</td>
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<td>30.</td>
<td>IML Freight</td>
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<td>31.</td>
<td>Schneider National Van Carriers</td>
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<td>32.</td>
<td>TIME-DC Inc.</td>
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<td>33.</td>
<td>Associated Truck Lines</td>
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<td>34.</td>
<td>Bowman Transportation</td>
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<td>35.</td>
<td>Garrett Freight Lines</td>
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<td>36.</td>
<td>C &amp; H Transportation Co.</td>
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<td>37.</td>
<td>Jones Motor Co.</td>
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<td>38.</td>
<td>Gateway Transportation Co.</td>
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<td>39.</td>
<td>Delta Lines</td>
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<td>40.</td>
<td>Pilot Freight Carriers</td>
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<td>41.</td>
<td>Branch Motor Express Co.</td>
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<td>42.</td>
<td>Bekins Van Lines</td>
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<td>43.</td>
<td>Brown Transport Corp.</td>
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<td>Tri-State Motor Transit Co.</td>
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<td>Midwest Energy Freight System</td>
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<td>Pacific Trucking Co.</td>
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<td>Thurstom Motor Lines</td>
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<td>Maistia Transport</td>
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<td>Commercial Carriers</td>
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<td>Commercial Lovelace Motor Freight</td>
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<td>Coastal Tank Lines</td>
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<td>Murphy Motor Freight Lines</td>
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<td>Red Star Express Lines</td>
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<td>Campbell 66 Express</td>
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<td>Jones Truck Lines</td>
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<td>Global Van Lines</td>
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<td>Georgia Highway Express</td>
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<td>National Freight</td>
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<td>Santa Fe Transportation Co.</td>
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<td>Graves Truck Line</td>
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<td>United Transports</td>
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<td>Old Dominion Freight Line</td>
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<td>Milne Truck Lines</td>
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<td>Midwest Coast Transport</td>
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<td>Hemingway Transport</td>
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<td>A-P-A Transport Corp.</td>
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<td>Easor Express</td>
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<td>Willis Shaw Frozen Express</td>
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<td>Cooper Jarrett Inc.</td>
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<td>Chemical Express Carriers</td>
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<td>Refiners Transport &amp; Terminal Corp.</td>
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<td>Ruan Transport Corp.</td>
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<td>Interstate Contract Carrier Corp.</td>
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<td>Holmes Transportation</td>
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<td>Ace Doran Hauling &amp; Rigging</td>
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<td>99.</td>
<td>CRST Inc.</td>
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<td>100.</td>
<td>Duff Truck Line</td>
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APPENDIX B

The Top Carriers of 1980 and 1991

1. United Parcel Service  
2. Roadway Express  
3. Consolidated Freightways Co.  
4. Yellow Freight System  
5. North American Van Lines  
6. Watkins Motor Lines  
7. Merchants Fast Motor Lines  
8. Central Transport  
9. Commercial Carriers  
10. Schwerman Trucking Co.  
11. Red Star Express Lines  
12. Global Van Lines  
13. Georgia Highway Express  
14. National Freight  
15. Frozen Food Express  
16. Nu-Car Carriers  
17. Old Dominion Freight Line  
18. Midwest Coast Transport  
19. A-P-A Transport Corp.  
20. Groendyke Transport  
21. Willis Shaw Frozen Express  
23. Chemical Express Carriers  
24. Refiners Transport & Terminal Corp.  
25. Ruan Transport Corp.  
26. Ace Doran Hauling & Rigging  
27. CRST Inc.  

Workers' Compensation and the Use of Owner-Operators in Interstate Motor Carriage: A Need for Sensible Uniformity

JAMES C. HARDMAN

Workers' compensation was created by statute as a method and means of giving workpersons and their families greater protection and security against employment related injuries and death.

All fifty states have such statutes and, while constant as to objectives, they are so varied as to defy any meaningful general description. At best, it can be said that they impose on industry the burden of care with respect to disabled employees, or their dependents in the case of death, where an accident occurs in the course of employment. The burden is imposed without the necessity of finding fault or negligence on the part of the employer.

The statutes are a 20th century development which evolved as the country industrialized and the number of industrial accidents and personal injury suits increased. The problems of proving an employer negligent and avoiding common law defenses such as contributory negligence, assumption of risk, and negligent acts of fellow servants created a situation where it became evident that existing legal processes were too costly and acted harshly on claims of injured employees.

1. American Samoa, Guam, Puerto Rico and the U.S. Virgin Islands also have workers compensation laws. For a summary of such laws, see 1991 Analysis of Workers Compensation Law prepared and published by the U.S. Chamber of commerce. [Hereinafter "1991 Analysis"].
In essence, the statutes imposed liability without fault on the theory that the costs would be considered a necessary cost of production to be borne ultimately by the consumer who benefitted from the labor. The imposition of liability in this manner was considered a method of promoting the general welfare.

The statutes attempt to provide sure, prompt, and reasonable benefits to victims without burdening the court system and eliminating the costs and delay attendant thereto. Also, they encourage maximum employer interest in safety and rehabilitation through an experience-rating mechanism and thus promotes the frank study of causes of accidents as a means of reducing them.

While the statutes have accomplished many of the goals their sponsors sought, there are many problems with the system making the statutes expensive to administer and less equitable and less effective. Virtually all states have recently undergone major reform or attempts at such reform.2

The absence of a federal statute governing workers' compensation in interstate motor carrier operations leaves the motor carrier in a morass of confusion with workers' compensation statutes.3

DEFINING EMPLOYMENT

One of the more significant issues to motor carriers is what constitutes "employment." A large segment of the industry utilizes independent contractors or more commonly referred to as "owner-operators."4

Owner-operators are individuals who own one or more tractors or tractor-trailer units and who lease such vehicles with driver services to motor carriers. Normally, leasing is done on a long term basis.

The relationship is governed by a written lease, the terms of which, in part, are governed by regulations promulgated by the Interstate Commerce Commission4 and/or state regulatory agencies.5

While the requirements vary to some extent, the lease normally calls for the motor carrier lessee to:6

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3. Federal workers' compensation laws do exist. Two such statutes are The Federal Employees Compensation Act, 5 U.S.C. § 751 et. seq., which governs compensation of all federal government employees, and The Longshore and Harbor Workers Compensation Act, 33 U.S.C. § 901 et. seq., which provides job disability benefits for all U.S. maritime employment as well as others.
4. Lease and Interchange of Motor Vehicles, 49 C.F.R. § 1057 (1988) [Hereinafter ICC and/or ICC Regulations].
5. See, for example, Minnesota Rules § 7800.2600 (1989).
6. See, for example, ICC Regulations, 49 C.F.R. § 1057.12(c).
1. assume exclusive possession, control, and use of the equipment for the duration of the lease.

2. assume responsibility for the operation of the equipment.

The ICC Regulations have been characterized as a "truth in leasing" regulation and it is not atypical to see contracts which are ten to twenty pages in length since the Regulations also call for the contract to delineate the respective obligations of the lessor and lessee in areas such as taxes, road expenses, insurance requirements, and payment terms.

The contracts are normally drafted with the common law principles of an employer-employee relationship\(^7\) in mind and contain clauses which indicate that the parties contemplate an independent contractor relationship and not one of employment.

However, courts and administrative agencies have consistently indicated that substance is more persuasive than form and attach minor importance to the written intent of the parties.\(^8\)

The contract, in at least one instance, however, may have a significant bearing on the issue as to whether the owner-operator will be considered an employee for purposes of workers' compensation. Many courts and administrative agencies have adopted the position that the administrative requirements that a carrier-lessee have exclusive possession, control and use of the equipment and assume responsibility for its operation is \textit{prima facie} evidence of control evidencing an employer-employee relationship.\(^9\)

While the specific language on its face would tend to support such a position, an examination of the reasons for the ICC Regulations, the proceedings underlying their adoption, and related regulations leads to a contrary conclusion.

In reviewing the underlying reasons for the statutory provision and ICC Regulations, the ICC and courts have held that a carrier must control the service performance, but need only control the vehicle to the extent

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8. See Judy v. Tri-State Motor Transit Co., 844 F.2d 1496 (11th Cir. 1988); Yellow Cab Co. v. Industrial Comm'n., 124 Ill. App.3d 644, 464 N.E.2d 1079 (1984); Wenholdt v. Industrial Comm., 95 Ill. 2d 76, 447 N.E.2d 404 (1983); and Justice v. Belford Trucking Company, Inc., 676 So. 2d 131, 134 (Fla. 1993). Professor Larson, in his treatise on workers' compensation law, argues that the label given by the parties to their status should be entitled to great respect if it can be accurately ascertained. 1C Larson's Workmen's Compensation Law, § 46.30 at 8-263 and 8-264 (1986). [Hereafter "Larson"]

necessary to be responsible to the shipper, the public, and the ICC for the transportation. Historically, many operators were judgment proof and the public was not protected. The ICC Regulations were designed to enforce safety requirements and to fix financial responsibility for damages and injuries to shippers and members of the public.\textsuperscript{10}

The above concept is consistent with common principles of tort law. An individual or a corporation carrying on activity which can lawfully be carried on only under a franchise granted by public authority and which involves an unreasonable risk of harm to others or is obligated by statute or by administrative regulation to provide specified safeguards or precaution for the safety of others is subject to liability to third parties for harm caused by the failure of a contractor or the contractor's employer.\textsuperscript{11}

The tort liability flows from the franchise and/or statutory/administrative duty and not because there cannot be an independent contractor relationship for other purposes.

The "loaned servant" doctrine\textsuperscript{12} also lends support to the position that the ICC Regulations do not \textit{per se} create an employer-employee relationship between a motor carrier and the operator of the vehicle it leases.

In \textit{Occidental Fire & Casualty Co of North Carolina v. International Insurance Co.},\textsuperscript{13} a driver for a fleet owner was involved in an accident causing the death of the driver of the second vehicle. The carrier's insurer and the lessor-fleet owner's insurer litigated the issue as to which insurer was primarily liable for the settlement of the wrongful death claim.

The "loaned servant" issue became relevant as the court found that legal responsibility for the negligent action of the driver could only be attributed to the carrier if the driver was considered a loaned employee.\textsuperscript{14}

The court specifically considered the ICC Regulations, but found the control and responsibility provisions did not establish that the carrier had complete control over the driver of the truck for the purpose of determining which party "[w]as the employer of the driver . . . ."\textsuperscript{15}


\textsuperscript{11} RESTATEMENT (SECOND) OF TORTS, §§ 424 and 428.

\textsuperscript{12} Under the "loaned servant" doctrine, a servant of one master may be loaned to another and become the servant of the second master rather than the first for the special purposes for which he is loaned. Richards v. Illinois Bell Telephone Co., 66 Ill. App.3d 825, 383 N.E.2d 1242 (1978). Under the doctrine, however, one does become a loaned employee unless he is completely free from the control of the first employer and wholly subject to the control of the second employer. \textit{Id.} at 383 N.E.2d at 1249-1250. \textit{See also} Daily Express, Inc. v. Workmen's Compensation Appeal Bd., 46 Pa. Commw. 434, 436-37, 406 A.2d 600, 601-02 (1979).

\textsuperscript{13} F.2d 983 (7th Cir. 1986).

\textsuperscript{14} \textit{Id.} at 993.

\textsuperscript{15} \textit{Id.} at 994.
The driver was found not to be a loaned employee as the evidence established he was not wholly free from the control of the fleet owner who hired, trained, and paid the driver.\textsuperscript{16}

While the case involved a fleet owner using third party employees to drive as opposed to an owner-operator who drove the truck he leased, the principle involved is clearly applicable. An individual can be under the control of one party for certain purposes and still be in self-control, or in the control of a second party, for other purposes. The ICC Regulations did not really address the "employment" issue or preempt the issue so long as the public is financially protected.

**AGENCY RECOGNITION OF INDEPENDENT CONTRACTORS**

It is difficult to argue that the ICC Regulations abrogated the independent contractor relationship when the agency refers to that relationship in so many contexts, including the discussions underlying the leasing regulations themselves.\textsuperscript{17}

In *Leasing and Interchange of Vehicles By Motor Carriers*,\textsuperscript{18} the ICC noted that in the early years of regulation, the Bureau of Motor Carriers, on August 19, 1936, issued Administrative Policy No. 4,\textsuperscript{19} which provided, in effect, that if the vehicle was not owned by the carrier, it could only be used if the vehicle was driven by one of its employees.

Thereafter, the Commission stated:

Possibly subject to some qualifications, it may be stated that when a certificate or permit holder furnishes service in vehicles owned or operated by others, he need control the service, to the same extent as if he owned the vehicle, but need control the vehicle only to the extent necessary to be responsible to the shipper, the public, and the Commission for the transportation. If these tests are met, the vehicle operated in the holding out of service to the public could be provided by independent contractors.\textsuperscript{20}

In the above case, the Examiner had recommended that persons assigned to drive should be employees of the carrier.\textsuperscript{21} However, this requirement was not adopted by the Commission.\textsuperscript{22}

Equally significant is that the United States Department of Transporta-

\textsuperscript{16} Id. at 994.
\textsuperscript{17} The use of owner-operators has also been recognized in rate making proceedings. See Womack Cost of Service - The Owner Operator Dilemma, Tariff Rates and Practices - Motor Carrier of Property Part 1, Papers and Proceedings, 1970; Transportation Law Institute (Bobbs Merrill Co., Indianapolis, 1972) p. 325.
\textsuperscript{18} Lease and Interchange of Vehicles By Motor Carriers, 51 M.C.C. 461 (1950).
\textsuperscript{20} 51 M.C.C. at 466.
\textsuperscript{21} 51 M.C.C. at 534.
\textsuperscript{22} Lease and Interchange of Vehicles by Motor Carriers, 52 M.C.C. 675 (1951).
tion which has jurisdiction over the safety regulations governing interstate motor carriage also recognize the use of independent contractors by regulated motor carriers.

The term "employee," for example, is defined as follows in "Safety Regulations: General."\(^{23}\)

"Employee" means:

(a) a driver of a commercial motor vehicle (including an independent contractor while in the course of operating a commercial motor vehicle). ...

Similarly, in the DOT's drug testing regulations, it is stated:\(^{24}\)

"Drivers subject to testing" means:

employee drivers and contract drivers under contract for 90 days or more in any period of 365 days.

These types of references clearly indicate that the independent contractor status is recognized in motor carrier transportation by the federal government and that the Regulations dealing with the lease of vehicles with drivers do not create a \textit{per se} employer-employee situation.

Despite the strong arguments that the ICC Regulations do not create an employer-employee relationship, the courts have split on the issue and motor carriers are faced with the prospect that the owner-operators they engage may or may not be employees depending on the jurisdiction in which a claim is filed.

\textbf{JUDICIAL DECISIONS}

The decision \textit{Proctor v. Colonial Refrigerated Transportation, Inc.},\(^{25}\) is frequently cited as an example of a judicial decision in which the ICC Regulations were found to preclude an independent contractor relationship. In the case it is stated:\(^{26}\)

[\textit{The statute and regulating pattern clearly eliminates the independent contractor concept from such lease arrangements and cast upon [the authorized carrier] full responsibility for the negligence of [the contractor] as driver of the leased equipment.}]

While on the surface the above language tends to indicate that an independent contractor relationship could not exist, it should be noted that the court did not actually hold the contractor to be an employee of the carrier. In reality, it found that liability for personal injuries occurring in motor carrier operations could not be avoided by the carrier on the basis of an independent contractor concept.

In at least two instances, federal courts, however, have found drivers

\begin{itemize}
\item \textit{Id.} at 92.
\end{itemize}

\begin{itemize}
\item 49 C.F.R. § 390.5.
\item 49 C.F.R. § 391.81.
\item 494 F.2d 89 (4th Cir. 1974).
\end{itemize}
to be federal statutory employees for the purposes of the workers' compensation statute. In each instance, the court held that the amount of control contemplated under the ICC Regulations was tantamount to an employer-employee relationship.

In *Judy v. Tri State Motor Transit Co.*, however, the court found that an employer-employee relationship was not created *per se* by ICC Regulations, but that state law would have to be examined. In *Bryant v. Refrigerated Transp. Co.*, a state court reached the same conclusion stating that the ICC Regulations standing alone were insufficient to create an employer-employee relationship.

**STATE LAWS**

If a court or administrative body gets beyond the ICC Regulations, it will look to state law to see if an employment situation is involved.

A recent survey of workers' compensation statutes indicated that twenty nine states and the District of Columbia exclude owner-operators through application of a common law definition of employees. Nine states have excluded independent contractors through specific statutory language and seven states have specifically exempted owner-operators. The remaining five states exclude independent contractors through the courts' interpretation of statutes.

Minnesota is an example of a state that excludes independent contractors through the use of a common law definition. Minnesota also treats owner-operators directly through administrative rules. Its Rules, in the eyes of many, are a model in recognizing the intricacies of the industry within the concepts of workers' compensation.

The rules in Minnesota regarding "truck owner-driver" are as follows:

**Subpart 1. Definition.** A truck owner-driver is any individual, partnership, or corporation (hereinafter referred to as "individual") who owns or holds a vehicle as defined in Subpart 2 under a bona fide lease and who leases that vehicle together with driver services to any entity which holds itself out to and does transport freight as a for-hire or private motor carrier.

**Subpart 2. Independent Contractor.** In the trucking industry, an owner-op-
operator of a vehicle that is leased and registered as a truck, tractor, or truck-tractor by a governmental motor vehicle regulator agency is an independent contractor, not an employee, while performing services in the operation of his or her truck, if each of the following factors are substantially present.

a. The individual owns the equipment or holds it under a bona fide lease arrangement.

b. The individual is responsible for the maintenance of the equipment.

c. The individual bears the principal burden of the operating costs, including fuel, repairs, supplies, vehicle insurance, and personal expenses while on the road.

d. The individual is responsible for supplying the necessary personal services to operate the equipment.

e. The individual’s compensation is based on factors related to the work performed including a percentage of any schedule of rates or lawfully published tariff and not on the basis of hours or time expended.

f. The individual generally determines the details and means of performing the services, in conformance with regulatory requirements, operating procedures of the carrier, and specifications of the shipper.

g. The individual enters into a contract that specifies the relationship to be that of an independent contractor and not that of an employee.

Subpart 3. Employee. An owner-operator of a vehicle as defined in Subpart 2 is an employee, not an independent contractor, while performing services in the operation of the individual’s truck, if all of the following criteria are substantially met:

a. The individual is paid compensation for his or her personal services:
   (1) Based solely on wage by the hour or a similar time unit that is not related to a specific job or freight movement;
   (2) on a premium basis for services performed in excess of a specified amount of time; and
   (3) from which FICA and income tax is withheld.

b. The individual is treated as an employee by the firm with respect to fringe benefits offered to employees by the firm.

c. The individual usually works defined hours.

d. The employer requires that the individual must perform the work personally and cannot change drivers.

e. The individual has no choice in the acceptance or rejection of a load.

f. The individual and firm have no written contract; or, if there is a written contract, it does not specify the individual’s relationship with the firm as being that of an independent contractor.

States such as Oklahoma, Iowa, and Georgia, specifically deal with owner-operators in the statute itself. Oklahoma’s statutory provision, for example, reads:34

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34. 85 OKLA. STAT. ANN. Tit. 85, § 3(4) (1989 Supp.). The emphasized provision is directed to “lease-purchase” plans which many carriers have initiated. See Hardman, Administrative Bulls in the Delicate China Shop of Motor Carrier Operations, 18 TRANSP. L.J. 115, 122-125
Employee shall not include a person, commonly referred to as an owner-operator, who owns or leases a truck-tractor or truck for hire, if the owner-operator actively operates the truck-tractor or truck and if the person contracting with the owner-operator is not the lessor of the truck-tractor or truck. [Emphasis added]

In 1986, Iowa also enacted a statutory provision which specifically addressed owner-operators and exempted them from workers' compensation coverage. The statute sets forth six specific conditions which must be "substantially present" if an individual is to be considered an owner-operator. (1) the person must be responsible for the maintenance of equipment; (2) he or she must be principally responsible for the vehicle's operating cost; (3) he or she must supply the necessary driver personnel; (4) compensation must be based on factors related to work performed and not on the basis of hours or time expended; (5) the person must have the ability to determine the details and means of performing the service; and (6) a contract must be entered specifying the relationship to be that of an independent contractor.

Georgia, in its 1991 legislative session, amended its statute to specifically address owner-operators. In 1986, Iowa also enacted a statutory provision which specifically addressed owner-operators and exempted them from workers' compensation coverage. The statute sets forth six specific conditions which must be "substantially present" if an individual is to be considered an owner-operator. (1) the person must be responsible for the maintenance of equipment; (2) he or she must be principally responsible for the vehicle's operating cost; (3) he or she must supply the necessary driver personnel; (4) compensation must be based on factors related to work performed and not on the basis of hours or time expended; (5) the person must have the ability to determine the details and means of performing the service; and (6) a contract must be entered specifying the relationship to be that of an independent contractor.

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cifically exempt an owner-operator defined as "an equipment lessor who leases his vehicular equipment with driver to a carrier."\(^{39}\)

While the approach of states such as Oklahoma, Iowa, and Georgia is clearly advantageous to motor carriers, other statutes or interpretations of statutes by the courts can and agencies have caused carriers considerable problems.

**THE STATUTORY EMPLOYEE**

The concept of being a "statutory employee" was one which the industry grappled with in Wisconsin. Wisconsin had a statute in which the term "employee" included:\(^{40}\)

> Every independent contractor who does not maintain a separate business and who does not hold himself out to and render service to the public provided he is not himself an employer subject to the Chapter ... shall for the purpose of [workers' compensation] be an employee of an employer ... for whom he is performing service in the course of the trade, business, profession or occupation of such employer at the time of the injury.

In *Employers Mutual Liability Insurance Company v. Department of Industry, Labor & Human Relations*,\(^{41}\) the court found an owner-operator injured while maintaining his tractor to be a statutory employee because the evidence revealed the owner-operator had not driven for any other carrier or person for at least six years. This fact satisfied the requirement that he did not maintain a separate business. This same evidence, coupled with the absence of any evidence that the injured person held himself out to render service to the public, was used to establish that he did not hold himself out to the public.

Similar problems arose on the administrative level as the agency was on record as adopting the position that an owner-operator who was dependent on the operating authority of the carrier in the conduct of operation could not be deemed an independent contractor as he could not maintain a separate business or have full authority to conduct the business.

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40. WIS. STAT. ANN. § 102.07(8) (1988). The term "statutory employee" is also used in respect to the "carry over" liability of the subcontractor to its employee to the prime contractor if the subcontractor fails to provide workers' compensation coverage to the employee. See Roberts v. Gator Freightways, Inc., 538 So.2d 55 (Fla.App. 1989). This carryover is a generally accepted concept in the industry although motor carriers have had difficulty in policing subcontractor coverage. In Minnesota, if an insurance company and/or an agent issued the carrier a certification that such coverage exists and it does not and/or it is ceased thereafter in mid-term without notice to the carrier, the carrier is not held liable. The injured person receives coverage through the special compensation fund of the state. M.S.A. § 176.185 Subd. 1 (c) (1990).
41. 52 Wis.2d 515, 190 N.W.2d 907 (1971).
The basic guidelines that the agency followed were:  

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<th>CRITERIA</th>
<th>INDICATORS</th>
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<td>Maintaining a Separate Business</td>
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<tr>
<td>— Maintains a separate business</td>
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<td>— Holds a business permit</td>
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<td>— Entity is registered with Secretary of State</td>
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<td>— There is a discernible place of business</td>
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<td>— Tax filings are for a business</td>
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<td>— Equipment is fully owned by the individual and under his/her control with full authority to conduct the business</td>
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<td>Holds Self Out to the Public</td>
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<td>— Advertising</td>
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<td>— Phone listing for business</td>
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<td>— Ability to be found by the public (discernible place of business as above)</td>
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<td>Renders Service to the Public</td>
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<td>— Does work for a number of persons as shown by testimony or documents</td>
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In 1987, the state trucking association began an effort to resolve the problem created by Section 102.07(8). By 1989, a new statutory provision was enacted which provided that an independent contractor was not an employee if the contractor met all of the following nine conditions:

1. Maintains a separate business with his or her own office, equipment, materials and other facilities.
2. Holds or has applied for a federal employer identification number.
3. Operates under contracts to perform specific services or work for specific amounts of money and under which the independent contractor controls the means of performing the services or work.
4. Incurs the main expenses related to the service or work that he or she performs under contract.
5. Is responsible for the satisfactory completion of work or services that he or she contracts to perform and is liable for a failure to complete the work or service.
6. Receives compensation for work or service performed under a contract on a commission or per job or competitive bid basis and not on any other basis.
7. May realize a profit or suffer a loss under contracts to perform work or service.
8. Has continuing or recurring business liabilities or obligations.
9. The success or failure of the independent contractor’s business depends on the relationship of business receipts to expenditures.

The statutory amendment also provided that the agency “may not admit in evidence state or federal laws, regulations, documents granting

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42. Letter of Carol A. Lobes, Administrator, Workers Compensation Division of the Department of Industry, Labor and Human Relations, to Mr. Thomas A. Howells, President of the Wisconsin Motor Carriers Association (April 23, 1986).
operating authority or licenses when determining whether an independent contractor meets the conditions . . . ") in 1 or 3.44

The intent of the above provisions was to exclude from consideration control and direction resulting from governmental dictates. However, the wording appears to have the opposite effect. If a carrier requires a contractor to utilize certain routes because of the size or weight of the equipment and applicable state or federal traffic laws, it presumably could not introduce evidence of such laws to excuse the direction given to the contractor.

The amended statute also reflects another possible problem. It was designed to eliminate the need to show that a separate business was maintained, a provision necessitated by the old Section 102.07(8). However, the drafters for some unexplainable reason utilize the same wording in the amendment, although expanding upon it.

The end result, however, is that carriers are still faced with the issue of what constitutes a separate business. As previously noted in Employers Mutual Life Insurance Co.,45 the owner-operator was found not to maintain a separate business because the evidence revealed he did not work under lease for multiple carriers during a six year period.

The addition of the words "his or her own office, equipment, materials and other facilities" does not seem to address or solve the above issue, i.e. did he serve others. If anything, it creates other problems as it emphasizes a need for an office and other items. Typically an owner-operator's office is his tractor or his "kitchen table" and he does not maintain "other facilities." Repairs to the tractor, etc., are done at public garages.

The explanation given by a special task force to study the legislation to the Workers' Compensation Advisory Council in Wisconsin, in part, states:46

The requirement is designed to determine whether the individual makes a significant investment or incurs a significant obligation related to facilities (equipment of premises) or tools or materials used in performing services for another and which are not typically furnished by an employee.

To date, litigation has not arisen to determine whether the 1989 amendments have solved the problems of the "statutory employee" issue in Wisconsin.

44. WIS. STAT. ANN § 102.07(8)(c).
45. See note 42, supra.
46. Memorandum of Richard A. Westley, Esq., of Madison, Wisconsin, a task force member, dated January 30, 1990. The Council reviews all proposed legislation before introduction. One can only speculate why the criterion was not worded in terms of its intent.
Michigan has a statute similar to the prior Wisconsin statute and, while other states do not have statutes exactly like Wisconsin’s past “statutory employee” provision, they impose a similar test by administrative or judicial decision.

Apart from statute, the test is commonly referred to as “The Relative Nature of the Work Test.” States such as Missouri, Montana, New Jersey, and North Dakota will look to see if an owner-operator maintains a separate business and if he or she holds out service to the public.

**MAINTAINING A SEPARATE BUSINESS**

In determining whether a separate business exists, it would appear that the salient factors should be whether there is an investment of a substantial sum of equipment or tools, whether the individual bears a risk of loss attributable to the operations, whether the business may serve multiple accounts, and whether the business engages employees, helpers, or other businesses in conducting operations.

The criterion which appears to arise more frequently in a workers’ compensation context is whether the owner-operator is serving multiple accounts.

The nature of the motor carrier industry makes it difficult for owner-operators to serve more than one account. Until recently, the ICC Regulations required an owner-operator and motor carrier to enter into a long term lease giving the carrier exclusive use of the equipment. “Trip leasing” could only occur between carriers holding authority from the ICC. While independent contractors may now lease for one load, they still cannot be leased to more than one carrier at any one time. Thus, to “trip lease,” an independent contractor would have to cancel its contract with one carrier and execute a contract with the new carrier. This creates an administrative nightmare and not a realistic opportunity from a business standpoint.

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49. See note 32, supra.

50. See also Employers Mut. L. Ins. Co., at note 41, supra.

51. Trip leasing is a procedure where a motor carrier with operating authority from the ICC would sublease equipment and operator or that equipment to another similarly authorized motor carrier to haul a single load or make a “trip.”


Foremost among the problems is that carriers and owner-operators frequently register the vehicle jointly with states so that fuel tax reporting and other types of reporting are simplified. This could not occur if the owner-operator jumped from carrier to carrier. Similarly, compliance with many of the Safety Rules of the Department of Transportation or a carrier’s own safety or insurance requirements would be more difficult and costly. When a contractor contracts with a carrier, he or she is subject to drug testing, qualification tests, past experience investigations and other administrative matters.54

The real issue should not be whether the owner-operator may or can serve multiple accounts, but whether he or she may expand the business and use other equipment in the service of other carriers.

Because administrators of workers' compensation statutes seek broad coverage, a carrier may find it difficult to have the latter interpretation accepted.

**HOLDING OUT TO THE PUBLIC**

The requirement that the owner-operator hold itself out to the general public also creates problems in the motor carrier industry. Administrative agencies tend to equate this criterion to the normal business where the independent contractor has an office, a telephone listing, advertises, etc.55

It is difficult for them to think of a business where the demand for the provider is so great that advertising would be foolish.56 Similarly, an office is not required when work is essentially performed in the vehicle and on the road. A telephone listing is senseless if the main portion of the business calls are exchanged while away from the contractor’s home base.

In some instances, administrators, or courts will attempt to determine if there is integration, i.e., the motor carrier is so dependent upon the services of the individual under contract that the individual is necessarily subject to control establishing “employment.”57

In any business, however, two or more entities working on a common cause have an integration of interest. Each will accommodate the others interest if it means maximizing profits.

54. See generally, Qualifications of Drivers, 49 C.F.R. Part 391.
55. See note 42, supra.
56. Carriers assign numerous employees and spend considerable money to recruit owner-operators. There are numerous publications which exist only to carry advertisements of carriers for independent contractor or driver employees. See, e.g., PRO TRUCKER, a monthly magazine published by Ramp Enterprises, P.O. Box 549, Rosewell, GA 30077-0549.
57. See Morish v. United States, 555 F.2d 794 (Ct.Cl. 1977).
Apart from the above statutory and/or administrative situations, carriers also have difficulties with the courts' or agencies' interpretations of common law test in some states and frequently the common law differs on a state by state basis.

The industry is in many respects a unique one and thus traditional concepts of the "right to control," the "right to discharge," and other aspects of the common law tests are difficult to apply to motor carrier/owner-operator relationships. Thus, motor carriers are always fearful of forum shopping.

A state normally will take jurisdiction of a claim based on such factors as where the contract was executed, where the injury occurred, where the injured individual resides, or where the business was localized.

Thus, an injured individual frequently will file his or her claim in the state with one of the above contacts and with the best benefits. In the case of an owner-operator seeking workers' compensation coverage, the choice will frequently turn on the question of which of the states with possible jurisdiction has the most liberal definition of employment and/or favorable common law.

The issue of forum shopping might be overcome if the contract governing the relationship has a choice of law clause which has some reasonable relationship to the contracting parties' situation. This, however, is not assurance that an agency will apply the law of the state chosen. Most states will not recognize such contract clauses.

Since motor carriage is frequently or essentially an interstate business, the problem of forum shopping is a serious one. Workers' compensation should be resolved under the law which the employer and employee anticipate irrespective of the fortuitous circumstances which often determine the forum.

**Elective Coverage as a Possible Solution**

Many carriers have attempted to avoid the coverage problems discussed by requiring owner-operators to elect coverage as a condition of

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58. See Hardman, note 34, supra.


60. See Larson, note 8, supra, at § 87.71
the carrier contracting with them. Most states allow "sole proprietors" to elect coverage.\footnote{61}

While this may resolve the workers' compensation problem, it may create problems in other areas of the law and business. Many owner-operators do not desire coverage or feel they cannot afford it and they will not contract with carriers with such requirements. In a period where owner-operators are in short supply, it is difficult to adopt policies which hinder recruitment.

More significantly, however, is the requirement may trigger a finding that the owner-operator is an employee for other purposes.

The federal Internal Revenue Service in its "twenty questions" test to determine an individual's classification for employment tax purposes specifically covers inquiries whether the owner-operator is covered by workers' compensation.\footnote{62} While the coverage may be initiated only by the election of the individual, the provisions requiring such election as a condition of contract may be construed adversely to the carrier claiming the owner-operator is not an employee.

**LEGISLATIVE AND/OR ADMINISTRATIVE SOLUTIONS**

Initially, an amendment to the ICC Regulations could possibly solve some of the problems motor carriers face in the classification problem.

A paragraph could be added to the ICC Regulations clarifying that the control and responsibility provisions do not and were not intended to infer or result in the creation of an employer-employee relationship between lessor and lessee.\footnote{63}

This could be easily accomplished by adding a subparagraph to 49 C.F.R. § 1057.12(c) reading:

\(\text{(4) The provisions required by paragraph (c)(1) of this section are not intended to create an employer-employee relationship between the authorized carrier lessee and lessor or driver furnished by the lessor. An independent contractor relationship may exist when a carrier lessee complies with 49 U.S.C § 11107 and administrative requirements.}\)

The agency should be willing to accept this amendment because it is consistent with the history of the Regulations and their intent.

While this type of provision should help persuade some administrative agencies and courts to ignore the administrative "control and respon-

\footnote{61. See 1991 Analysis, note 1, supra.}
\footnote{62. See Hardman, note 34, supra, at 127-28.}
\footnote{63. The administrative rules governing the lease of motor carrier equipment from owner-operators in Minnesota, for example, specifically states: "the lease may include the services of a driver and nothing in this chapter shall be construed to require that such a driver be an employee of the motor carrier lessee." Minn. R. § 7800.2500 (1989).}
sibility" provisions in their determination of the classification issue, other problems such as forum shopping could and would continue.

While the concept of a federal workers compensation statute might in theory be attractive, it does not appear to be a politically viable solution particularly in light of the massive undertaking which would be involved in a political atmosphere which is essentially stated rights and \textit{laissez-faire} orientated. Further, there is a fear among industry observers and insurers that if a federal act were to be enacted it would likely incorporate the costliest, most comprehensive features of state programs\textsuperscript{64}.

A modified approach, however, might be feasible and it could solve many of the industry's problems. A federal statute could be enacted which would:

1. Mandate workers compensation coverage of all employees.
2. Define the term "employment" and "exceptions" to coverage.
3. Utilize the existing state systems\textsuperscript{65}.
4. Mandate the particular state law to be applied\textsuperscript{66}.

The proposal gives the industry the standardization it seeks; does not create a new bureaucracy as existing state systems will be utilized; affords protection and clarity to employers and employees; and, achieves the underlying goals of the workers' compensation system.

CONCLUSIONS

The \textit{Motor Carrier Employers' Liability Act}\textsuperscript{67} is a step towards sensible uniformity. While it does not resolve many differences which exist between states as to procedures, types and extent of benefits, the proposed statute does resolve some of the major problems facing motor carriers and also allows them to know with some clarity which workers' compen-

\begin{footnotesize}
\textsuperscript{64} Wicker and Williams, \textit{The Workers' Compensation System; A Primer For the Trucking Industry} (W.D.C.: ATA and RCCC 1988) at 304.

\textsuperscript{65} The use of state workers' compensation laws to cover a federal right is not a new concept. In providing for "black lung" benefits for miners, 30 U.S.C. § 931 (1988) provides for filing under such laws.

\textsuperscript{66} Mandating the particular state law to be applied affords a basis for motor carriers and insurers to resolve premium guideline problems. A leading insurance attorney claims that more truckers are purchasing their workers' compensation insurance in low rate states instead of their "home" state and, in an attempt to fool the system, are renting post office boxes or store fronts in low-rates states and using the address to represent their permanent business location. Campbell, \textit{Risky Practices in Workers' Comp. Could Lead to Loss of Coverage}, an unpublished article distributed in September, 1989, by Transport Insurance Company to industry members. The National Counsel on Compensation Insurance (NCCI) published guidelines as to where such insurance should be purchased, but the guidelines are not a paragon of clarity and one of the difficulties the motor carrier industry has had is applying them to truckload as well as less than truckload carriers. Letter of J.W. Morten, Risk Manager of Crete Carrier Corporation, a major truckload carrier to Kris. H. Ikejiri, General Counsel of the Interstate Truckload Carrier Conference of the American Trucking Associations, Inc., dated September 18, 1989.

\textsuperscript{67} See Addendum 1.
\end{footnotesize}
sation provisions will govern their operations and to take steps to meet such risks through insurance or otherwise. They will be faced with two statutes in lieu of the many which now govern multi-state operations.
Liability of carrier by motor vehicle, in interstate or foreign commerce, for injuries to employees.

Every carrier by motor vehicle within the jurisdiction of Title 49, United States Code, while engaging in commerce between any of the several States or Territories, or between any of the States and Territories, or between the District of Columbia and any of the States or Territories, or between The District of Columbia or any of the States or Territories and any foreign nation or nations, shall be liable to its employees for compensation in every case of personal injury or death of an employee arising out and in the course of employment without regard to the question of negligence, unless the injury or death was intentionally self-inflicted or when the intoxication of the employee is the proximate cause of injury or death.

Applicability of state law.

The liability of a carrier subject to the provisions of this chapter shall be determined under the compensation law of the state in which it has its principal place of business (except to the extent inconsistent with the provisions of this chapter) and such law shall be recognized and enforced by any and all state agencies and courts which assume jurisdiction of causes of action under this chapter.

Employees defined.

Any employee of a carrier, any part of whose duties as such employee shall be the furtherance of interstate or foreign commerce; or shall, in any way directly or closely and substantially, affect such commerce as above set forth shall, for the purposes of this chapter, be considered as being employed by such carrier in such commerce and shall be considered as entitled to the benefits of this chapter.

A person shall be considered an independent contractor and not an employee if each of the following factors are substantially present:

a. The independent contractor makes a significant investment or incurs a significant obligation related to facilities (equipment or premises) or tools or materials used in performing services which are not typically furnished an employee.

b. The independent contractor generally determines the means of performing service subject only to conformance with any regulatory requirements or those arising from any third party requirements.

c. The independent contractor has the principal burden of any operating and personal costs related to contract work.

d. The independent contractor's compensation is based on factors related
to the work performed and may realize a profit or suffer a loss based on
the relationship of business receipts and expenditures.

e. A written contract governs the relationship and specifies the relationship
of the parties to be that of independent contractor and not an employer-
employee relationship.

§ • Election of coverage.

To the extent the compensation act of the state having jurisdiction
pursuant to Section — of this Chapter allows corporate officers, corporate
directors, sole proprietors, and partners of partnership to elect coverage,
such an election may be made under this Chapter.

§ • Exclusive nature of remedy.

This chapter is exclusive and not cumulative.

§ • Non-impairment of duties, liabilities, or rights.

Nothing in this chapter shall be held to limit the duties or liabilities of
carriers or to impair the rights of their employees under any other Act or
Acts of Congress.
Collective Bargaining Under the
Railway Labor Act

WILLIAM E. THOMS* AND FRANK J. DOOLEY**

Our first national labor law, the Railway Labor Act (RLA)\(^2\) has govern­
ered labor-management relations on the airlines and common-carrier
railroads since 1926. Although significantly different in its approach from
the National Labor Relations Act (NLRA),\(^3\) the RLA is predominantly con­
cerned with settlement of labor disputes through collective bargaining, an
ongoing process involving unions and management. The RLA estab­
lishes clear statutory guidelines for bargaining between carriers and un­
ions to establish new contracts. The Act compels labor and management
to meet and confer about wages, hours, and terms and conditions of em­
ployment. There also is a duty to bargain in good faith.

I. THE RAILWAY LABOR ACT NEGOTIATING PROCESS

A. REQUIREMENTS OF THE RAILWAY LABOR ACT

The duty to bargain is expressed by the Railway Labor Act, which
views collective bargaining as essential to its statutory scheme. The RLA
requires that carriers and employee representatives meet and confer

\(^{1}\) Adapted, in part, from WM. THOMS & F. DOOLEY, AIRLINE LABOR LAW 57-117 (1990).
about wages, hours, and terms and conditions of employment. Both sides have a duty to bargain and to reach agreement. However, the law does not compel either side to reach a compromise or make a concession. At some point, impasse may be reached and the parties are then free to seek economic self-help.

The purposes of the RLA, as set forth in Section 2, are:

1. to avoid any interruption to commerce or to the operation of any carrier engaged therein;
2. to forbid any limitation upon freedom of association among employees or any denial as a condition of employment or otherwise, of the right of employees to join a labor organization;
3. to provide for the complete independence of carriers and of employees in the matter of self-organization to carry out the purposes of this Act;
4. to provide for the prompt and orderly settlement of all disputes concerning rates of pay, rules, or working conditions;
5. to provide for the prompt and orderly settlement of all disputes growing out of grievances or out of the interpretation of application of agreements covering rates of pay, rules, or working conditions.

These terms of art have developed special meanings. The phrase “avoid any interruption to commerce” means a statutory basis has been established to reduce the threat of unannounced strikes that would disrupt passenger travel and freight shipments. “Freedom of association of employees” means rail and airline employees are free to self-organize, to form, join, or assist labor organizations. Alternatively, employees are free to refrain from bargaining collectively if a union is rejected. “A ‘major dispute’ is one which arises over the formation of collective agreements or where there is no such agreement. A ‘minor dispute’ contemplates the existence of a collective agreement. . . the dispute arises over the meaning of the agreement or the proper application of the agreement.”

In regards to the fourth and fifth purposes of the RLA, the Act requires certain procedures be followed in resolving major and minor disputes. The law does not in itself settle major disputes or contract issues. Rather, “its underlying philosophy is almost total reliance upon collective bargaining for major dispute settlement.” Thus the parties are expected

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Collective Bargaining Under the RLA

1992]


to resolve major contractual issues through collective bargaining, and self-help (strikes and lockouts).

Further procedures of the Railway Labor Act are invoked only when the parties fail to reach an agreement. Minor disputes between air carriers and their employees are not strikeable but are settled by "system boards of adjustment." Minor disputes on the railroads are settled by the National Railroad Adjustment Board (NRAB).10

B. PROCEDURAL STEPS IN MAJOR DISPUTES

If a major dispute between management and labor arises, the RLA requires that the parties attempt to resolve their dispute through the collective bargaining process.11 However, the RLA process as it appears through collective bargaining has been so formalized that it bears little resemblance to dynamic bargaining. Unlike labor contracts in other industries, railroad and airline labor contracts usually have no expiration dates. They continue in effect until one of the parties is dissatisfied and wants to change them.

If the parties cannot negotiate a settlement, the party seeking to change the existing contract may post a "Section 6 notice."12 The filing of a Section 6 notice invokes the collective bargaining procedures of the RLA. The notice must give the other party at least thirty days written notice of any intended changes in working conditions. "Oftentimes, the party who has been served the notice will file counterproposals for concurrent handling with the other party's notice, or, as an alternative, reserve the right to file counterproposals."13

A Section 6 notice filed by a carrier or its unions is the only recognized way for changing work rules and triggering the bargaining process. The process typically involves several steps before an agreement is reached between the carrier and labor. The parties must agree on a time and place to meet and confer within ten days of receipt of the notice. The conference must begin within the thirty days provided for in the notice. Neither party may change the existing rules or pay during this period.14

There is no time limit as to how long the parties may negotiate. Either party may notify the National Mediation Board (NMB) that they are unable to settle the dispute.15 In that case, the NMB will try to either mediate the dispute or recommend arbitration.

When a case goes to mediation, the NMB or a mediator works with

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the parties, trying to help them resolve their differences. The mediator will be present at negotiating sessions. The mediator may also meet privately with each side. No time limit exists for mediation.\textsuperscript{16}

If the efforts of a mediator fail to produce an agreement, the final act of the NMB is to proffer arbitration.\textsuperscript{17} The provisions for arbitration are found in Section 7 of the RLA.\textsuperscript{18} If arbitration is accepted, the dispute is resolved. However, either side is free to reject the NMB's offer of arbitration. Usually, arbitration is not accepted. If arbitration is rejected, the NMB must notify the parties in writing. Neither party may change the work rules until thirty days after the NMB has concluded its efforts.\textsuperscript{19}

Theoretically, the bargaining attempts would end there and the impasse could lead to a strike. However, the RLA provides that the NMB shall notify the President if it determines that a strike or lockout would "threaten substantially to interrupt interstate commerce to a degree such as to deprive any section of the country of essential transportation service."\textsuperscript{20} Almost every strike of a major railroad will deny some part of the country some essential services. Theoretically, the emergency provisions can also be triggered by a strike on an air carrier, but these procedures have been less frequent.

The wording of the statute is so broad that the NMB usually does notify the President. This notice sets another moratorium ticking. When the emergency provisions (Section 10) of the RLA are invoked, the President is asked to create an Emergency Board to look into the dispute.\textsuperscript{21} The President is not required to establish an Emergency Board. For example, President Bush refused to appoint an Emergency Board in the 1989 Eastern Airlines strike. Generally speaking, emergency boards have been established in railroad disputes but not in airline strikes since air deregulation.\textsuperscript{22}

The Emergency Board consists of knowledgeable, neutral individuals. Neither arbitrators nor mediators, the Emergency Board is given the investigative powers of fact finders. Within thirty days, the Emergency Board is to report to the President on the potential effects of the threatened strike and the underlying issues. The parties must maintain the status quo during the thirty days that the Emergency Board has to make its report.

\textsuperscript{17} 45 U.S.C. § 155 (1982).
Obviously, the President could also read about the strike and its causes in the daily newspapers. Thus, it is a fair assumption that one of the purposes of this section is to extend the cooling-off period for another thirty days. During this time the parties may be able to resolve the issues themselves. Meanwhile, the Emergency Board is supposed to investigate and possibly come up with recommendations. If the Emergency Board’s recommendations are ignored and no agreement is made, the parties are free to exercise “self-help.” This could include strikes, lockouts, or imposing new rules on the work force.

Until the 1980’s, rail unions and carriers bargained on a nationwide basis. That meant that a strike on one carrier could eventually be a strike against all, since the RLA does not prohibit secondary boycotts. When circumstances such as these arise, an additional ad hoc stage may be introduced to the negotiating process. If faced with the possibility of such a nationwide shutdown, Congress has opted for three types of resolution. First, Congress has appointed a board of arbitration to decide the dispute. Second, it has imposed a settlement that other unions had agreed to upon an uncompromising union. Finally, Congress has enacted a compromise package of its own.

Inherent in these resolutions by Congress is the expression of the very purposes for which government is present in the dispute in the first place. First, Congress aims to thwart interruption to the national transportation system by virtue of its emergency resolution. Second, it seeks to compel the parties to recommence a negotiated settlement of their dispute.

C. PROCEDURAL STEPS IN MINOR DISPUTES

Minor disputes between airline employees and management are handled by system boards of adjustment. Each carrier and labor union under contract is required to establish grievance machinery providing for a system board of adjustment. The authority and jurisdiction of the system board of adjustment are equivalent to that of the National Railroad Adjustment Board.

The NRAB has established formal rules and procedures to handle minor disputes in the rail industry. In contrast, there are no written rules or procedures in the airline industry as each carrier and its employees have their own system board of adjustment. Most airline labor contracts

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23. Id.
include specific provisions that govern grievance procedures. The contracts also usually include a clause that requests the NMB to designate a neutral referee if the parties cannot agree on one.

Minor disputes involving airlines are committed to a grievance-arbitration process before a system board of adjustment.\(^{28}\) Airline system boards of adjustment are financed by the parties, while the NRAB is financed by the taxpayers.\(^{29}\)

D. THE ROLE OF THE NATIONAL MEDIATION BOARD

The agency administering the Railway Labor Act is the National Mediation Board, an independent administrative agency.\(^{30}\) The members of the NMB are appointed by the President, with the advice and consent of the Senate.\(^{31}\) The NMB has three members, no more than two of whom may belong to the same political party, who serve staggered terms. None of them may be affiliated with a railroad or airline or unions which represent rail or airline workers.\(^{32}\) In addition, there are about twenty-five mediators throughout the country employed by the board. Mediators are not members of the NMB and are not subject to such political considerations as all being from the same political party.

The primary jurisdiction of the NMB is supervising the selection of a bargaining representative by a craft of airline or railroad employees and overseeing the bargaining process.\(^{33}\) Unlike other national labor agencies, the NMB does not have a detailed list of unfair labor practices to control. Rather, it is governed by general considerations of fair dealing and the duty to bargain toward an agreement.

Central to the NMB’S responsibilities is the duty to bargain in good faith.\(^{34}\) The NMB has the responsibility of seeing that the union is truly the representative of its craft and that the employees it claims to represent are, in fact, employees of that carrier. The parties must maintain the status quo while the bargaining process goes on.\(^{35}\) The NMB may be asked to participate by one of the parties, or the board may proffer its services at any time during the bargaining process. The NMB has several other responsibilities. First, NMB may proffer its services to help the parties mediate major disputes.\(^{36}\) Second, it appoints neutral arbitrators (also called

\(^{28}\) International Bhd. of Teamsters v. Texas Int’l Airlines, 717 F.2d 157, 158 (5th Cir. 1983).
\(^{29}\) Sanchez v. Eastern Airlines, Inc. 574 F.2d 29 (1st. Cir. 1978). See also Northrup, supra note 22 at 477.
\(^{32}\) Id.
referees or umpires) for tripartite arbitration as well as for the system boards of adjustment on airlines.\textsuperscript{37} Third, the NMB controls the arbitration process stipulated in Section 7 of the Railway Labor Act.\textsuperscript{38} Fourth, it interprets agreements which have been reached through mediation. Finally, the NMB notifies the President of the United States that an emergency exists, so the president might name an Emergency Board to handle the dispute.\textsuperscript{39}

\section*{E. MANDATORY BARGAINING SUBJECTS}

Unlike the NLRA, the RLA does not distinguish between mandatory and permissive bargaining subjects. There are, however, certain subjects that appear to be within the unique competence of management. These include corporate policy considerations such as the routes and services that the carrier should offer. Management will usually insist on a "management rights clause" that stipulates which subjects are within management's sphere of authority.

Indeed, the use of the mandatory/permissive distinction under the RLA is entirely consistent with its statutory framework. Section 2, First, provides that parties "exert every reasonable effort to make and maintain agreements concerning rates of pay, rules, and working conditions."\textsuperscript{40} It is self-evident that, unless parties are to be required to bargain over every issue, the mandatory subjects under the RLA must be limited to those enumerated in the Act. From this it logically follows, that given the parties' duty to exert every reasonable effort to reach agreement on these mandatory subjects, a refusal to bargain over these issues until an agreement is reached on a nonmandatory subject would violate a party's duty to bargain under Section 2, First.\textsuperscript{41}

\section*{F. THE DUTY TO BARGAIN IN GOOD FAITH}

The duty to bargain implies recognition and respect for the opponent's representatives. The union must deal with the management representative selected by the carrier.

Many carrier management personnel have come up from the ranks. A good number of this group hold on to their union membership, possibly to retain retirement benefits, or perhaps because of a feeling of solidarity and sentiment.\textsuperscript{42} Retaining union membership also protects the individual

\begin{itemize}
\item 41. Airline Pilots' Ass'n. v. United Air Lines, 802 F.2d 886 (7th Cir. 1986).
\item 42. Unlike the NLRA, The Railway Labor Act includes "subordinate officials" as employees. See Northrup, supra note 22 at 481.
\end{itemize}
if he or she should be bumped from a management position back to the rank and file. For the union to discipline a member because of its dissatisfaction with his or her activities as a negotiator or an adjuster for management would be coercion of the carrier in its selection of representatives.\(^\text{43}\)

Similarly, the carrier must deal with the union as the sole representative of its employees. There should be no going around the union or attempting to interfere with its position as the exclusive bargaining representative. Neither side may use self-help until impasse has been reached. Until that time, the duty to bargain over mandatory bargaining subjects remains.

No matter how weak a union is economically, the employer has a duty to bargain with it. No matter how much an employer is despised, the union has a duty to bargain with it. The RLA states, “it shall be the duty of all carriers, their officers, agents, and employees to exert every reasonable effort to make and maintain agreements.”\(^\text{44}\)

II. SETTLEMENT OF DISPUTES

A. MAJOR AND MINOR DISPUTES

The language of the RLA does not use the words “‘major’ and ‘minor.” However, labor lawyers and courts use these terms to differentiate the types of conflict (besides representation cases) that arise under the RLA.

Major disputes are those that arise in contract negotiations.\(^\text{45}\) They are the subject matter for contracts, having to do with wages, hours, and work rules. The resolution of a major dispute is either an agreement or an impasse. The latter can lead to economic self-help such as strikes and lockouts.

Minor disputes, on the other hand, concern the interpretation or application of an existing contract.\(^\text{46}\) A railroad or airline labor agreement is often hammered out after weeks or months of tough negotiation. The parties often reduce their understanding to writing under last-minute pressures. In many cases, the final contract contains compromise words that may encompass different meanings.

Thus, a contract, reached to settle major disputes, may be so vague that it gives rise to minor disputes. The Railway Labor Act requires that minor disputes be “adjusted,” that is, submitted to compulsory arbitra-

tion. The RLA provides an automatic and decisive mechanism for its settlement of minor disputes. Strikes can occur only over major disputes; minor disputes are adjusted. However, the distinction between "major" and "minor" disputes is not as clear as it might be. The facts of a case often do not indicate to which category a dispute might belong.

Depending on the facts of a particular case, one party may prefer presenting the case as a major or minor dispute. For example, since a Section 6 notice is required to initiate a major dispute, the parties are likely to serve such a notice in any dispute arising out of any ambiguous situation to make the controversy appear more like a major dispute. However, it has been "pointed out that undue emphasis must not be placed on the maneuvers of the parties." Furthermore, the parties cannot agree to specify the type of dispute. "[E]ven though the parties thought it was a major dispute, their designation is not controlling."

1. INTEREST ARBITRATION OF MAJOR DISPUTES

The RLA is detailed as to the rules for voluntary arbitration of major disputes. Section 7 of the Act provides for tripartite arbitration of major disputes. This means that each side names an arbitrator and the two arbitrators agree upon a neutral referee. If the two arbitrators cannot agree upon a third person for the neutral, the National Mediation Board will select the referee. Either a three or six person arbitration panel will be chosen by this method.

The agreement to arbitrate must be in writing and must refer to the RLA. The decision of the arbitrators is final, but is limited to the questions placed by the agreement to arbitrate. In addition, the "award," as the decision is called, may not be appealed. However, it can be "impeached." Impeachment occurs if the court is convinced that the arbitrators acted ultra vires (beyond their powers granted by the agreement), or that the award was obtained by bias or fraud, or was not in conformity with the procedures of the RLA.

Despite RLA provisions, voluntary arbitration for major disputes (interest arbitration) is rare in the railroad and airline industries. Carriers and unions want to retain control over the bargaining process. Both parties are reluctant to hand over their powers to an arbitrator who may act in an

unforeseen manner.\textsuperscript{54} There are special procedures for emergency boards to investigate labor-management disputes on commuter railroads with a quasi-compulsory settlement procedure.\textsuperscript{55}

2. \textit{Boards of Adjustment}

The 1936 amendments to the RLA, which extended coverage to the airline industry, provided for a National Air Transport Adjustment Board.\textsuperscript{56} However, no such board has ever been established. Unlike the National Railroad Adjustment Board (NRAB) in the rail industry, there is no formal statutory authority for minor disputes on airlines.

Instead, each airline has a system board of adjustment.\textsuperscript{57} The board of adjustment is the final arbitrator of minor disputes arising out of air labor contracts. The term "adjustment" actually stands for compulsory arbitration of minor disputes.\textsuperscript{58}

Airline system boards of adjustment have been commended for being much faster than the railway industry’s resort to the NRAB. However, airlines are finding that even system boards of adjustment are too slow. Some carriers are negotiating faster systems, such as using a single arbitrator for discharge-and-discipline-based questions.\textsuperscript{59} The system board is retained for system-wide precedential cases.

The grievance chairperson has a role similar to that of a shop steward in NLRA governed industries. The chairperson has the duty to process meritorious grievances in an equitable fashion. The chairperson cannot refuse to go forward with a grievance because of personal or political consideration. The chair owes this duty to all within the bargaining unit, union member and nonmember alike.\textsuperscript{60} Under Section 3 of the RLA, the parties are required to first handle minor disputes directly between them up to the highest officer of the carrier designated to handle these cases.\textsuperscript{61} There are no formal procedures for a system board of adjustment found in the RLA. Thus, the parties must look to the collective bargaining agreement for procedures in filing and processing grievances. System boards of adjustment awards are reviewable by the court to the

\textsuperscript{54} Northrup, supra note 22 at 462.
\textsuperscript{56} 45 U.S.C. § 185 (1982).
\textsuperscript{60} Steele v. Louisville & Nashville R.R. Co., 329 U.S. 129 (1944).
\textsuperscript{61} J. Gohmann, AIR AND RAIL LABOR RELATIONS at 321 (1979).
same extent as those of the NRAB. 62

"Minor" disputes are committed to a grievance-arbitration process before a system board of adjustment, which is the mandatory, exclusive, and comprehensive system for resolving grievance disputes. "Neither federal nor state courts have jurisdiction to interpret labor contracts subject to the Act; that function is assigned exclusively to the system boards of adjustment." 63

B. SELF-HELP AFTER IMPASSE

1. ECONOMIC SELF-HELP

The state of impasse is reached when bargaining can go no farther, the parties are fixed in their positions, and mediation has failed. At this point, the union is free to strike. 64 Conversely, the employer is free to take defensive action. 65

In NLRA cases, the employer may shut down the operation and lock out the employees. 66 Rather than waiting for the union to strike, this is an attempt to get a settlement more favorable to the employer.

There is a complicating factor in railroad and airline strikes. The carrier is under a duty to serve the public, that is, to operate as is feasible under the circumstances. 67 This duty arises from the traditional definition of a common carrier. The carrier was a corporation which had been given a license and protection from competition by the government. In return for this privilege, the carrier had the duty to maintain operations for shippers and passengers. 68

A strike does not sever the relationship of carrier and employee. 69 However, the contractual relationship between them is suspended during the strike. 70 The carrier is free to permanently replace the strikers. 71 Re-

65. Id. at 282.
68. The first purpose of the Railway Labor Act is stated "to avoid any interruption to commerce or to the operation of any carrier engaged therein," 45 U.S.C. § 151a (1990).
turning strikers are, however, placed on a preferential hiring list. Strikers cannot be fired for striking. That is a cold comfort to an employee who finds that his job has been given to a replacement.

Because a strike is so dangerous, unions have tried many devices short of strikes. These include job actions, refusal of overtime, informing prospective passengers about strike conditions, slowdowns, and misrouting of baggage. Recently, unions have opened negotiations with “white knights” about to take over a carrier and free it from an anti-union management. This would appear to be a breach of the duty to bargain with the carrier’s management.

2. LIMITS OF SELF-HELP

The union may or may not have the right to engage in sympathy strikes. This is based upon the limitations of any no-strike clause in its agreement with the carriers. Even nonunion employees may engage in a sympathy strike, if it is “concerted activity.” Particularly since the deregulation movement began in 1978, there are actually few statutory or judge-made constraints against the right of either party to engage in self-help. Unless the parties limit themselves by contract or mediation, there is a great potential for a “law of the jungle” situation in rail and airline labor relations. The extent of this freedom from injunctions has yet to be determined. The Norris-LaGuardia Act barring the use of labor injunctions in federal courts is broad in its application.

During the 1989 Eastern Airlines strike, striking machinists placed a picket line outside New York’s Grand Central Terminal, used by rail carriers Amtrak and Metro-North Commuter Railroad, both subject to the Railway Labor Act. The picketing was enjoined by a U.S. District Court, but few limits have been placed on inter-airline or inter-railroad picketing.

72. Id.
73. The Northwest-Republic merger of 1986 resulted in a number of slowdowns, including tearing off baggage tags from passenger’s luggage. Virtually all these activities have been enjoined.
74. In cases involving Frank Lorenzo, carrier employees negotiated with any outsider in an attempt to deliver them from Lorenzo — even the dreaded Carl Icahn! Similarly, railway unions were instrumental in the rescuing of Delaware and Hudson from anti-union Guilford Transportation and its eventual inclusion in Canadian Pacific’s system.
77. Long Island R.R. v. International Ass’n. of Machinists, 874 F.2d 901 (2d Cir. 1989).
C. STRIKES, BOYCOTTS, AND INJUNCTIONS

1. RIGHT TO STRIKE

A strike is an all-or-nothing proposition in the United States. The type of situation one sees in Europe, where railroad workers lay down tools for an hour or more in a day to select certain targets for strike action is unknown. Here, partial strikes or work interruptions are not allowed and may be enjoined.

A strike is pure economic warfare. Historically, a strike was waged by the union in hope of attaining its economic goals. More recently, it appears that unions have become concerned with keeping their status intact rather than losing hard-won gains to management cost cutting.

When a carrier is on strike, its employees are the first to suffer. They receive no wages and must depend on whatever war chest a union has managed to amass for a strike fund. Management also suffers from strikes. Idled planes and locomotives continue to require maintenance costs and interest payments. After deregulation, management also suffers diversion of passengers and freight to other carriers. This gives carriers an incentive to resume operations with management or replacement personnel.

When a legal strike is called, the membership is asked for a "strike vote" to authorize the action. Union members are advised to withdraw their services. A picket line is placed at areas where the carrier does business, including its corporate headquarters, downtown ticket offices, and stations, served by the carrier. They not only communicate the union's message, but they act as a signal to would-be passengers. The messages say, "please don't patronize; join us in our struggle; or at least stay neutral." To union members it is a sign to stay away. There is an implied promise that if you honor our picket line, we may help you if you go on strike against your employer.

2. RIGHT TO PICKET AND BOYCOTT

Because of the implicit tension and possibility of violence, courts

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79. "Concerted activity" is protected, but shutting down a railroad for an hour a day (during the commuter rush) has not been considered protected activity. Strikes are only protected if Section 6 procedures are used and bargaining has proceed to impasse. There is no right to strike over grievances. See generally, Lynch, Statutory Rights and Arbitral Values: Some Conclusions, 44 U. OF MIAMI LAW REVIEW 617, 620-625 (1989).
80. Railroad strikers can be eligible for unemployment benefits after the strike lasts over four weeks.
have taken a strict look at picketing.\textsuperscript{82} The right to march on public property with picket signs is not protected by the First Amendment.\textsuperscript{83} Courts have upheld time, place, and manner restrictions on picketing, reasoning that picketing is free speech plus a signal. The National Labor Relations Act, for example, contains explicit restrictions on what can be placed on signs.\textsuperscript{84} The Railway Labor Act, on the other hand, was conceived of as mediatory legislation.\textsuperscript{85} As such it is ill equipped to referee disputes that have turned to self-help during strikes.

With no content restrictions on signs, messages have not only been economic, but openly political. In 1989, strikers at Eastern made the personality of Texas Air Chairman Frank Lorenzo the topic of their strike. "Stop Lorenzo" shirts and buttons were passed out or sold to passengers.\textsuperscript{86} During the Continental strike, striking pilots intimated that airline safety would suffer with inexperienced nonunion pilots at the controls.\textsuperscript{87} On the political front, compromises have often been used to avoid strikes. In 1981, The Air Line Pilot's Association (ALPA) threatened a nationwide work stoppage. The strike threat was related to the FAA's certification of new aircraft capable of being operated by two, rather than three pilots.\textsuperscript{88} In 1972, the International Federation of Airline Pilots' Associations tried to ground the world's commercial aircraft in protest against the United Nations' failure to take action against hijacking and air piracy.\textsuperscript{89}

Because the railroad system is a unified skein of tracks 4' 8 1/2" wide, the framers of the Railway Labor Act realized that interconnectivity is a fact of life. In recognition of that reality, no restrictions on secondary boycotts were placed in the RLA.\textsuperscript{90} Unions may and do engage in sympathy strikes in support of job actions on other carriers. Absent any contractual limits on secondary activity air and rail employees generally have

\begin{itemize}
\item \textsuperscript{83} Id. at 246-55.
\item \textsuperscript{84} 29 U.S.C. § 158(b)(4) (1990).
\item This campaign, which involved sale or gift of souvenir items, could not be considered picketing, as no attempt was made to interrupt the movement of passengers or planes. Rather, it was an attempt to enlist passengers in a campaign to oust unpopular management.
\item \textsuperscript{87} This example may be the extreme in free speech, as disparaging a product or libelling the carrier's safety record could be grounds for dismissal on the basis of insubordination.
\item \textsuperscript{88} This strike never came to pass, as it was settled by certain assurances given to the pilots' organization by the FAA. In any case, such a walkout would not appear to be a labor-management dispute under the Railway Labor Act.
\item \textsuperscript{89} Conway, Standards Governing Permissible Self-Help, in CLEARED FOR TAKEOFF 201, 214 (J. McKelvey ed. 1988).
\item \textsuperscript{90} Northrup, supra note 22 at 507-509.
\end{itemize}
the right to do so. The right to strike and picket, then, is only restrained by contract. There are few safeguards against the dispute spreading to other carriers.

III. THE RLA AND THE FUTURE OF TRANSPORTATION

The Railway Labor Act was conceived in the post-World War I days when railroads were the preeminent carriers of passengers and freight. It was extended to airlines in 1936, largely on the behest of the Airline Pilots' Association, who wondered about the constitutionality of the newly-passed Wagner Act, and wanted a tried and true system for adjudicating disputes. During the first fifty years of the Act, both railroads and airlines were heavily regulated by Federal agencies, along the lines of public utilities.

Since 1978, substantial structural change has occurred in both industries. Regulation has been relaxed and oligopoly has replaced competition in many markets. Several major railroads dominate the industry; airlines have been reduced to five or six viable carriers. There have been mergers within the rail and air unions as well. In view of the striking changes in the framework of the industries, many commentators have questioned whether or not the two separate streams of labor law should remain.

However, few of these criticisms come from within the railroads or aviation labor bar. Practitioners and the parties involved have long preferred working with a statute where the results are predictable, and where labor peace is given a high priority. Commentators have insisted that agreements be made by the parties involved, and that each change be heavily deliberated. Nonetheless, with management pushing for structural changes in the workforce of both airline and railroad industries, the status quo presumption arising from the operation of Section 6 in major disputes tends to favor labor. Management would favor making most changes appear to be "minor disputes" and set them for adjustment,

91. Id.
94. Stone, supra note 81 at 1486-1493.
96. See Wilner, supra note 92 at 281.
rather than making them strikeable issues. Therefore it is for the courts to finally resolve what is and what is not a major dispute and a subject of bargaining.

Recently, the Interstate Commerce Commission (ICC) has gotten into the act, with its statutory mandate to impose labor protection. ICC has jurisdiction over sale of properties from Class I railroads to shortline railroads. As a rule, the Commission has not imposed labor protection provisions, and the Supreme Court has indicted that such a transaction may be made without the requirement of bargaining over a major dispute by the parties. More recently, in the lease of the Guilford Transportation Company to the Springfield Terminal Railroad (a wholly-owned subsidiary), the ICC provided for a near seventy five days of labor protection payments, then let the transaction go through without any collective bargaining agreement being reached during that time.

In Norfolk & Western Ry. Co. v. American Train Dispatchers Association, the Supreme Court of the United States held that once the ICC has approved a merger, such a consolidation is exempt from antitrust law "and all other law . . . as necessary to carry out the transaction." By a 7-2 decision, the Court indicated that this exemption included the Railway Labor Act, and that law's duty to bargain over labor protection provisions. The Court held that the ICC was authorized to issue orders exempting parties from provisions of collective bargaining agreements.

The N&W case originated with the Norfolk Southern merger. In approving the merger, the ICC had imposed the standard New York Dock protective provisions but had noted the possibility that future displacements of employees might arise as additional consolidations occur. In 1986, the merged Norfolk Southern decided to consolidate all locomotive dispatching in Atlanta, thus closing the N&W power distribution center in Roanoke. The unions had claimed that the moving of engine dispatchers would be a change in an existing collective bargaining agreement. The Court held that the ICC's decision allowing consolidation of the two railroads superseded collective bargaining obligations via the RLA.

This may not be the end of the matter. The exemption from "all

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laws” includes only such exemptions as are necessary for the transaction. Section 11347 of the Interstate Commerce Act still requires the ICC to impose labor-protective conditions in mergers.\footnote{107} Nonetheless, the N&W case broadens the ICC’s authority in mergers at the expense of collective bargaining and the National Mediation Board.

Frank Wilner, a long-time student of rail labor and spokesman for the Association of American Railroads (as well as a proponent of the Railway Labor Act) mentions, in regard to the transfer of lines (and possibly labor agreements) to regional railroads,

> What is needed are simple, clear and certain procedures. So far, Congress has been unwilling to legislate them and collective bargaining has failed to produce them. This is an unfortunate state of affairs.\footnote{108}

108. Wilner, supra note 92 at 281. On June 26, 1992, President Bush signed into law a bill passed in the wee hours by Congress ending a nationwide rail lockout. The shutdown began with a strike called two days previously against CSX Transportation by members of the Machinists’ Union. Concurrently, a strike vote had been taken against Amtrak by several operating and shopcraft unions, and contract negotiations with Conrail had also reached impasse. The passenger trainmen postponed their strike against Amtrak, but, once the picket lines went up at CSX, all Class I freight railroads locked out their employees, not only paralyzing freight shipments, but locking Amtrak trains off their tracks. (The exception was the Boston-Washington corridor, where Amtrak owns the railroad). The back-to-work law, based on an artificial emergency (the railroads had locked out their employees, in part, to force congressional action) calls for compulsory arbitration of the dispute. It requires:  
A cooling-off period of 35 days  
A requirement that labor and management resume collective bargaining  
Submission of best final offer from each side in the three labor disputes to the arbitrators within 25 days of the beginning of negotiations  
At the end of 35 days, the arbitrator is directed to pick and choose the best final offer from either labor or management in each dispute  
The arbitrator’s recommended settlement goes to the President, who has 3 days to accept or reject it.  
If approved, the President’s decision goes into effect as a contract.  
If disapproved, the unions regain the right to strike and management the right to lock out. Denver Post, June 26, 1992, p. 18A, c. 1.  
This marks the twelfth time that Congress has legislated an end to a rail strike, and Congress’s constant interference makes the right to strike and the duty to bargain collectively somewhat illusory. See Thoms, The Vanishing Fireman, 14 LOYOLA L. REV. 200 (1967).

Jordan Jay Hillman*

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Federal preemption offers a mechanism for promoting social welfare through a proper allocation of regulatory functions between federal and state authority. To that end, the following assessment of preemption under the Hazardous Materials Transportation Act ("HMTA") is guided by two premises. First, federal preemption in hazardous materials ("HazMat") transport should aim to promote an efficient balance between the societal costs and benefits attributable to a regulation. Unless the total incremental benefits of a regulation at least equal its total incremental costs, society is burdened with waste. Second, the dual task for Congress is to (i) establish preemption standards conducive to such efficiency and (ii) provide for their effective implementation through objective and efficient decisional processes.

The quest for regulatory efficiency requires an objective balance of the welfare concerns of at least the three principal parties to the regulatory process. These include: (i) entrepreneurial concerns of transporters and shippers; (ii) general welfare concerns represented by the federal government; and (iii) local welfare concerns represented by state or local governments.

In general, the achievement of regulatory efficiency requires broad knowledge of the economic and operational characteristics of the regulated activity. Equally important for the efficient allocation of regulatory functions through federal preemption is particular knowledge of the social concerns and political factors affecting local attitudes toward the regulated activity. It is these concerns and factors which shape the character of state and local regulations as they affect wider national interests.

The vital role of commercial transport in interstate commerce and its important local effects have assured its central role in the development of preemption doctrines. In particular, Congress and the courts have dealt extensively with federal preemption in the context of transport safety. Their enactments and precedents might be assumed to provide a useful model for latter day preemption policies governing the regulation of HazMat transport safety. But this is true only to the extent that the social and political forces shaping state/local HazMat transport regulation are essentially the same as those affecting general transport safety.

The main thesis here is that the differences are sufficient to require a greater departure from existing preemption standards governing general transport safety than has yet been achieved. Also, to promote greater decisional consistency and procedural efficiency, changes are warranted in the processes through which preemption standards are implemented.
While the 1990 HMTA amendments are useful in both respects, they remain incomplete. Further improvements are needed.

In many cases, of course, local welfare gains from a regulated activity are thought to outweigh any potential welfare losses. These circumstances create state or local incentives for permissive regulatory standards intended to assure retention of the highly valued activity. As perceived gains to the locality increase, so may local incentives to discount risks or to ignore external costs.

At the national level, however, the balance of welfare gains and losses from competitively induced state and local standards may be less favorable. Some measure of federal preemption may then be warranted to prevent more permissive local standards from undermining whatever stricter national standards are found justified by broader welfare concerns. (In the same way, the welfare interests of an entire state may diverge from those of a particular locality.)

In contrast to this "race to the bottom" regulatory phenomenon are the well known NIMBY ("Not In My Back Yard") aspects of HazMat transport. This factor operates with far greater force in relation to HazMat transport than to general transport. The public within a locality is more likely to view HazMat transport as a "no win" activity, except where it is tied to a highly valued local economic activity. More often, however, such transport is merely in transit or otherwise lacks major offsetting benefits.

The natural impulse within the locality is toward regulations calculated to reduce the apparent risks and amounts of HazMat transport. The focus in such efforts is on local concerns. Here the role of preemption is to maintain regulatory ceilings (rather than floors) which best balance legitimate local concerns against broader societal impacts. The question is to what extent should a state or locality be able to serve its own welfare by detracting from the broader general welfare? Another factor complicating the search for an answer is that cost transfers permitted to one locality may soon be claimed by others.

A decision on the use federal preemption in regard to a particular state/local regulation requires a comparison of the welfare consequences of regulatory uniformity or diversity. Due to the difficulties of risk assessment and of quantifying social costs and benefits, the task can be formidable. Nor is total scientific objectivity in this political context a realistic

1. In the context of Federal preemption the term "race to the bottom" has been applied to State incorporation laws which are claimed to vest excessive control in managements to the detriment of shareholder interests. The competitive motive of states in such cases is to induce corporate decisions, generally dominated by managements, to incorporate in a particular state. Cary, Federalism and Corporate Law: Reflections Upon Delaware, 83 YALE L.J. 663, 666 (1974). Preemptive "federal legislation" is one widely suggested remedy for protecting shareholders against the alleged excesses of "hospitable jurisdictions." Id.
goal. But the effort must be to minimize the influence of uninformed speculation, uninstructive rhetoric and irrelevant biases, whether favoring federal or state authority.

II. PROBLEMS IN THE USE OF CONSTITUTIONAL DOCTRINES FOR PROMOTING EFFICIENCY THROUGH FEDERAL PREEMPTION

A. THE CONSTITUTIONAL FRAMEWORK FOR FEDERAL PREEMPTION

The Constitutional framework governing the use of federal preemption consists of the following principal provisions:

1. **Article I, Section 8, Clause 3.** "The Congress shall have Power...To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

2. **Article VI, Clause 2.** "This Constitution, and the Laws of the United States...and all Treaties...shall be the supreme Law of the Land..."

3. **Amendment X.** "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

The first and third components of this framework provide for the separate, but overlapping, powers of federal and state authority. The Article I clause establishes federal power over interstate commerce. The Tenth Amendment reserves to the states a broad range of police powers. Where conflicts occur in the use of these powers, Article VI establishes the supremacy of the federal power. Accordingly, even if otherwise lawful under the Tenth Amendment, state police powers in conflict with the federal commerce power may be nullified, or "preempted." Subject only to other Constitutional constraints, Congress has plenary authority under Article I to exercise the federal power to regulate commerce.

Congress, of course, can not possibly delineate the intended roles of federal and state authority in advance of every conflict which might arise. In regard to a given conflict, it is likely that Congress has dealt with the matter of its intent by one of the following means: (i) through total silence; (ii) through a broad legislative scheme which does not speak directly to federal preemption, but whose breadth suggests a possible intent to "occupy the entire field"; (iii) through statutory provisions which otherwise offer ambiguous clues to intended preemption; or (iv) clear statutory provisions which are either decisive in themselves or which offer meaningful decisional guidelines.

The advantages of using means (iv) to express the preemption intent of Congress in transportation safety regulation is suggested by experience in the use of others.
B. JUDICIAL PREEMPTION UNDER THE "DORMANT" COMMERCE POWER AS APPLIED TO STATE HIGHWAY SAFETY REGULATION

By its nature, Means (i) calls for direct judicial resolution of preemption disputes under the dormant commerce power. Its role in federal pre-emption has been described by the U.S. Supreme Court as follows: "the constitutional grant to Congress of power to regulate interstate commerce has been held to operate of its own force to curtail state power in some measure . . . even though Congress has not acted." The Court has based the power "upon the implications of the commerce clause . . . or upon the presumed intention of Congress, where Congress has not spoken."

As to transport safety and the dormant commerce power, several U.S. Supreme Court cases involving state regulations of motor carrier design are instructive.

In South Carolina v. Barnwell, the Court, in 1938, upheld state truck width and loaded weight limits. In Raymond Motor Transportation, Inc. v. Rice, the Court, in 1978, struck down a state law which, with discriminatory exceptions, barred single and multi-trailer trucks exceeding specified lengths. In Kassel v. Consolidated Freightways, the Court, in 1981, also struck down a state law limiting the length of double-trailers. Of the varying decisional principles invoked by Justices in these cases, efficiency considerations were among the least significant.

This result is most pronounced in the earliest South Carolina decision. For a unanimous Court, Mr. Justice Stone set out the following guidelines for exercising judicial authority in "dormancy" cases. Absent legislation, "the judicial function under the commerce clause . . . stops with the inquiry whether the state legislature . . . has acted within its province, and whether the means of regulation chosen are reasonably adapted to the end sought." In evaluating reasonableness "courts . . . cannot act as Congress does when, after weighing all the conflicting interests, state and national, it determines when and how much the state regulatory power shall yield to the larger interests of national commerce." The opinion goes on to accord greater fact finding finality to state legislatures than to

3. Southern Pacific v. Arizona, 325 U.S. 761, 768 (1945). The distinction between these two sources of the "dormant" commerce power in theory affects the way in which judges consider and decide cases. In drawing on "implications of the commerce clause", Supreme Court Justices, as ultimate interpreters of the Constitution, enjoy greatest decisional discretion. Where recourse is to "the presumed intention of Congress", however, judges are technically subject to the constraints imposed by an effort to fulfill the aims of someone else.
4. Supra, n. 2.
5. 434 U.S. 429 (1978)
federal courts. "Since the adoption of one weight or width regulation, rather than another, is a legislative and not a judicial choice, its constitutionality is not to be determined by weighing...the merits of the legislative choice and rejecting it if the weight of the evidence presented in court appears to favor a different standard." 7

In Raymond, the guidelines of the Court's deceptively unanimous opinion (one member not participating) were blurred by an added separate concurring opinion of four members. The principal opinion initially seemed to call for careful judicial scrutiny of facts bearing on national and state/local interests. The need in such dormant power cases was for "a sensitive consideration of the weight and nature of the state regulatory concern in light of the extent of the burden imposed on...interstate commerce." 8 Nevertheless, "those who would challenge state regulations said to promote highway safety must overcome a 'strong presumption of their validity.'" 9

Whatever the strength of this presumption, in Raymond two factors worked against its use. First, "The State...virtually defaulted in its defense of the regulations as a safety measure." Second, several exceptions to the regulations favoring Wisconsin industries were held to weaken the presumption "because they undermine the assumption that the State's own political processes will act as a check on local regulations that unduly burden interstate commerce." The Court deemed its holding "narrow" in that similar laws might be upheld "if the evidence...on...safety...were not so overwhelmingly one-sided as in this case." 10

The complete absence of any plausible safety rationale for the particular length limits was the decisive factor in the Court's opinion. Given the state's failure to demonstrate a legitimate safety issue, the need to balance national and state/local interests was eliminated. Had the state advanced plausible safety considerations, the balance would have been reached under South Carolina's doctrine of a "strong presumption" favoring state regulation "said to promote highway safety."

The added thrust of the concurring opinion was its rejection of balancing tests which might bring non-illusory state safety regulations into question. Also drawing on South Carolina, the four concurring Justices argued, "[I]f safety considerations are not illusory the Court will not sec-

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7. The three preceding quotations are at supra, n. 2 at 190-91. The Court by dictum also suggested a basis for a broader Federal preemption role in railroad regulation. "Unlike the railroads, local highways are built, owned and maintained by the state or its local subdivisions." 303 U.S. 187.
8. Supra, n. 5 at 441.
9. Id. at 444.
10. Id. at 444, 447.
ond-guess legislative judgments about their importance in comparison with burdens on interstate commerce."

The one opinion in South Carolina, and the two in Raymond, grew to three in Kassell.

The facts of Kassell as to truck length limits and discriminatory exceptions were much like those in Raymond. Added to them, however, was the State of Iowa’s vigorous defense of its regulation on safety grounds. Eroding its effort was a legislative history supportive of a predominant intent to force the transfer of large interstate rigs to highways in more permissive adjoining states. A majority favoring invalidation of the state law was reached through a four Justice principal opinion and a two Justice concurrence on different grounds. Three other Justices filed a dissenting opinion.

The Federal District Court in Kassell had observed that “[t]he total effect of the law as a safety measure is so slight and problematical that it does not outweigh the national interest in keeping interstate commerce free from interferences that seriously impede it.” In affirming the Trial Court and Court of Appeals, the four Justice opinion observed that “Iowa made a more serious effort to support the safety rationale of its law than did Wisconsin in Raymond, but its effort was no more persuasive.”

With reference to these facts, the opinion held the dormant commerce power to require invalidation where “the State’s safety interest has been found to be illusory . . . .” But to this it added the phrase “and its regulations impair significantly the federal interest in efficient and safe transportation . . . .” In this view, even where enforcement of a state’s “illusory” safety interest imposes a totally useless burden on commerce, it is not necessarily “undue.” Nevertheless, in a subtle transmutation, the four Justice Kassell opinion also restricted Raymond’s “strong presumption” favoring state regulations from those “said to promote highway safety” to “bona fida safety regulations.” The principal Kassell opinion relied also on discriminatory exceptions favoring local interests as grounds for withdrawing the “special deference” normally accorded to state highway safety requirements. The two Justice concurring opinion, essential to a binding majority, centered its analysis on this issue of moti-

11. Supra, n. 6 at 668.
12. Id. at 671-72.
13. Id. at 671.
14. Id. at 670 and supra, n. 5 at 444. Rather than citing Raymond, however, the opinion cites Bibb v. Navajo Freight Lines, 359 U.S. 520, 524 (1959). This is another significant highway safety case in which the Supreme Court struck down an Illinois law requiring motor carrier mudguards different than those prevailing in most other states. As to highway safety regulations in general, without reference to their actual credibility, the Bibb Court said “These safety measures carry a strong presumption of validity when challenged in court.” Literally, this formulation seems closer to Raymond than to the Kassell reformulation.
vation. Its touchstone for legitimizing the state regulation was not in purposes "suggested after the fact by counsel", these being subject to "the vagaries of litigation." It was instead whether "an examination of the evidence before or available to the lawmaker indicates that the regulation is not wholly irrational in the light of its purposes."

In general, assuming a semblance of rationality, "the burdens imposed on commerce must be balanced against the local benefits actually sought to be achieved by the State's lawmakers . . . ."\textsuperscript{15} Thus, any need to balance national and state interests would depend on the character of motives drawn from the pertinent legislative history. Given the predominance of its "protectionist" purposes, this particular state highway safety regulation required no balancing of benefits and burdens. It was by its own background "impermissible under the Commerce Clause."\textsuperscript{16}

This leaves open how these two Justices would view the role of "special deference" and "strong presumption" in balancing conflicting interests in a context of legitimizing motives. The only clue lies in their approving citation of a principle from the \textit{Raymond} concurring opinion. The present concurring Justices found in that doctrine "a judicial disinclination to weigh the interests of safety against other societal interests, such as the economic interest in the free flow of commerce."\textsuperscript{17} For these two Justices, the answer to whether a state regulation should prevail is a function of its purpose, not its impact.

In contrast, the three dissenting Justices in \textit{Kassell} would have relied on the "strong presumption of validity" accorded highway safety regulation to uphold the state's position. Their interpretation of how "the safety purpose in relation to the burden on commerce" should be given "sensitive consideration" has particular relevance here.

When engaging in such a consideration the court does not directly compare safety benefits to commerce costs and strike down the legislation if the latter can be said in some vague sense to 'outweigh' the former. Such an approach would make an empty gesture of the strong presumption of validity accorded state safety measures, particularly those governing highways.

Indeed, the limited purpose of the "sensitive consideration" is simply to determine "...if the asserted safety justification, although rational, is simply a pretext for discrimination." Based on the trial court record (rather than the legislative history), the dissenters had "no doubt that the challenged statute is a valid highway safety regulation . . . ." In the context of the dormant commerce power, the dissenters were especially averse to "compelling Iowa to yield to the policy choices of neighboring states." Only Congress through actual exercise of its commerce powers

\textsuperscript{15} Supra, n. 6 at 680.

\textsuperscript{16} Id. at 685.

\textsuperscript{17} Id. at 686.
could "preempt the rational policy determinations of the Iowa legislature...." \(^{18}\)

These three Supreme Court decisions involving the validity of highway safety regulation under the dormant commerce power establish an important point. In all of the varying doctrinal formulations, efficiency as a decisional factor was thoroughly subordinated to considerations of comity and motivation.

C. PREEMPTION ISSUES ARISING FROM AMBIGUITIES IN FEDERAL TRANSPORTATION SAFETY STATUTES AND REGULATIONS

Where the allocation of regulatory authority depends on inferences of Congressional intent drawn from statutes, judges appear to place no greater reliance on efficiency values. The trio of U.S. Supreme Court opinions in \textit{Ray v. Atlantic Richfield Co.}\(^ {19}\) demonstrate the point.

Various requirements of Washington State law regulating tankers navigating Puget Sound were claimed to be preempted, largely by a specific Federal Act\(^ {20}\), but in part by the dormant commerce power. These were: (1) that tankers of 50,000 DWT or larger employ a pilot licensed by the state while navigating Puget Sound and adjacent waters; (2) that tankers from 40,000 to 125,000 DWT possess each of five "standard safety features"; or, alternatively, move under tug escort; and (3) that tankers over 125,000 DWT were barred. The difficulties in discerning an intended role for federal preemption on issues 2 and 3 are reflected in three opinions from which a majority on each issue was eked out.

The clarity of the statutory scheme affecting preemption as to issue 1 produced unanimity. In 1871, Congress acted to limit traditional state authority over the licensing of pilots for ocean vessels operating in navigable coastal waters. It did so by vesting exclusive authority in the federal government to license pilots on ocean vessels in domestic trade. Authority to license pilots on "other than coast-wise steam vessels" (i.e. vessels in foreign trade) was left in the states.\(^ {21}\)

All five "concurring or dissenting" Justices joined the four Justice "Opinion of the Court" ("principal opinion") in upholding preemption as

\(^{18}\) The preceding quotations from the dissenting opinion in \textit{Kassel} are at 450 U.S. 692 and 699.

\(^{19}\) 435 U.S. 151 (1978).


\(^{21}\) The statutory basis for the bifurcation of pilot licensing authority as of the 1978 \textit{Ray} decision is set out at 435 U.S. 159-60. It was first established in 16 Stat. 455 (1871). Current statutes which maintain the bifurcation are 46 U.S.C. Secs. 8501, 8502 and 8503. Primary authority over vessels in foreign trade remains with the states. Absent licensing by a particular state, the Secretary of Transportation may impose pilot licensing on such vessels in navigable waters within that state's primary authority.
to tankers in domestic trade, but not in foreign trade. Since the holding was clearly ordained by the statutory scheme, there was no occasion to consider any factors bearing on the original or continuing efficacy of the substantive result.

Ambiguities of intent may abound, however, where Congress acts less decisively to foreclose state authority. As a guide in such cases, the Ray opinion set out the established Supreme Court standard of inconsistency. It can be broadly viewed as an effort to accomplish what Congress would have thought sensible in the circumstances.

Even if Congress has not completely foreclosed state legislation in a particular area, a state statute is void to the extent that it actually conflicts with a valid federal statute. A conflict will be found ‘where compliance with both federal and state regulations is a physical impossibility,’ [Case cited.], or where the state ‘law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.’[Cases cited.]22

All nine members of the Supreme Court joined in this Part II of the opinion. The stunningly varied fruits of its judicial application, however, are found in the principal and two concurring and dissenting opinions discussed below.

As to Issue 2, the principal opinion read the PWSA as establishing “that Congress intended uniform national standards for design and construction of tankers that would foreclose the imposition of different or more stringent standards.” More specifically, under Title II of the Act, “Congress anticipated the enforcement of federal standards that would pre-empt state efforts to mandate different or higher design requirements.”23 Since the vessels met existing federal standards, state regulation of vessel design was barred.

As noted, the state exempted vessels moving under tug escort from its conflicting design and construction standards. In the principal opinion, this alternate requirement was viewed as an operating condition. Under Title I of the PWSA, the Secretary of Transportation (“DOT”) was authorized, but not mandated, to issue operating condition standards. Absent the issuance of such preemptive federal standards (as in this case), states were authorized to regulate operating conditions. On the matter of statutory preemption, therefore, the principal opinion upheld the alternative tug escort requirement for vessels not in compliance with the state's “standard safety features.”24

Also in issue was the validity of the tug escort requirement under the Commerce Clause. Here the Court was a bit more inclined to allude to issues of relative efficiency. The principal opinion viewed the requirement

22. Supra, n. 19 at 158.
23. Id. at 163.
24. Id. at 171-72.
as an essentially local regulation, similar to local pilotage requirements. Since compliance with it had no practical effect on operations beyond the locality, the tug-escort requirement "is not the type of regulation that demands a uniform national rule." Nor was the State barred from waiving the requirement for vessels meeting its design standards. The added cost of "less than one cent per barrel of oil" established the absence of any significant impediment to "the free and efficient flow of foreign and interstate commerce."

In comparison, the three Justice "concurring and dissenting" opinion relied on the tug escort exemption to sustain the State's "standard safety feature" requirements. These Justices noted that no tanker operating in Puget Sound waters had ever complied with the design requirements. Due to the tug escort exemption they had become a dead-letter. Accordingly, the State law was no obstacle to the operation of federal law. These Justices joined the principal opinion in sustaining the tug-escort alternative on statutory and Commerce Clause grounds.

In an ironic twist, these dissenters found assurance in the "relative expense of compliance" that the "standard safety features" would remain a dead-letter. Under this view, a state regulation subject to pre-emption because compliance costs were low enough to be met might be saved by costs high enough to assure non-compliance.

The third opinion, by two "concurring and dissenting" Justices, agreed on invalidating the "standard safety feature", but dissented from the validation of the tug-escort requirement. Rather than viewing this requirement as an exemption, the third opinion characterized it as "an inseparable appendage to the invalid design requirement", constituting a "special penalty" for non-compliance.

The opinion did note the "small" annual compliance cost of $277,500 imposed on ARCO by the tug-escort requirement. But once the principle was allowed, this single minor burden could be exacerbated through "addition and multiplication by similar action in other states."

Issue 3 involved the state ban in Puget Sound on tankers over 125,000 DWT. On this issue the two Justice concurring opinion provided

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25. Id. at 172-73.
26. Id. at 180-87.
27. Id. at 181.
28. Id. at 187-90.
29. Id. at 189. This broader impact would fall as heavily on an independent tug-escort requirement as on an "inseparable appendage" to an invalid regulation. The dissenters, however, distinguished the burdens of an "inseparable appendage" from those of "general rules imposing tug-escort requirements. . . ." It posited that the modest costs of compliance with the tug-escort requirements might constitute a burden on commerce only when tied to invalid state regulation. In such case, costs deemed modest when weighed against the benefits of non-conflicting state regulation might constitute an "obstacle" to the Congressional goal of uniform vessel design.
the necessary majority. The main disagreement between the principal and the three Justice dissenting opinion was over the scope of relevant preemptive rulemaking authority, if any, exercised by DOT.

Title I of the PWSA authorized DOT to establish "vessel size and speed limitations." The principal opinion, drawing on statutory language and legislative history, ascribed the following relevant intent to Congress: "it desired someone with an overview of all the possible ramifications of the regulation of oil tankers to promulgate limitations on tanker size and that he should act only after balancing all the competing movements." Regulations, which DOT was also authorized but not mandated to issue, would preempt state law to the extent of their coverage. The question was whether the tanker size limit was preempted by federal regulations covering the same subject.

The principal opinion held the state law to have been preempted by virtue of the manner in which DOT's authority had been exercised. In part, the opinion relied on an unwritten Coast Guard "local navigation rule" prohibiting passage of more than one 70,000 DWT vessel at a time through Rosario Strait. In bad weather the limit was 40,000 DWT. From this local rule the principal opinion found it "sufficiently clear that federal authorities have indeed dealt with the issue of size and in what circumstances tanker size is to limit navigation in Puget Sound."

The jump from the Coast Guard's narrow local rule to this sweeping conclusion might seem unduly expansive. Perhaps to buttress its position, the principal opinion also drew on the failure of DOT to issue additional regulations on tanker size limits. From that failure it inferred DOT's judgment that "no such regulation is appropriate or approved pursuant to the policy of the statute." Justices joining in the principal opinion were thus satisfied that "the Secretary has exercised his authority in accordance with the statutory directives. . . ."

The analysis of the three Justice dissenting opinion was predicated on the limited scope of the Coast Guard's local navigation rule. It found "... no indication that in establishing the vessel traffic rule for Rosario Strait the Coast Guard considered the need for promulgating size limitations for the entire Sound." Moreover, it found no conflict between the Coast Guard rule and the state's size limitation applicable to tankers moving throughout Puget Sound. From the state law's statement of purpose, the dissenters concluded that the size limitation was "tailored to respond to unique local conditions" including "susceptibility. . . to damage from large oil spills and. . . peculiar navigational problems . . . ." It made no

30. Id. at 173-78.
31. Id. at 183. The opinions did not identify the location of Rosario Strait or indicate the percentage of Puget Sound tankers affected by the Coast Guard rule.
32. Id. at 184-85.
effort to weigh the broader economic impact of barring larger tankers from Puget Sound against these asserted state interests. Justification was found in the tanker operators failure to establish that any impact on commerce was "... clearly excessive in relation to the putative local benefits." 33

It appears that in applying the "inconsistency" standard in Ray, recourse by Justices to efficiency values was opportunistically selective. While efficiency factors were used to support conclusions reached on other grounds, no systematic invocation of efficiency as a decisional factor is evident. The widely differing opinions are best explained as projections by Justices of their own ideological views on the proper relationship between federal and state authority.

D. SUMMARY

Where Congressional enactments offer ambiguity in place of silence, the court in theory is obliged to strive toward the result most likely intended by the enacting Congress. Since the nature of that intent is rarely clear, courts must serve as proxies for Congress. In determining the ultimate question of whether "a state statute ... actually conflicts with a valid federal statute", judges in theory may impute efficiency goals to Congress. Costs incurred or benefits lost as a result of state regulations are surely relevant in identifying "obstacles" to the accomplishment of Congressional purposes. In their implementation of federal preemption policies, however, there is little in these Supreme Court opinions to suggest the imputation of efficiency goals to Congress.

III. FEDERAL PREEMPTION UNDER THE 1975 HAZARDOUS MATERIALS TRANSPORTATION ACT: A CRITICAL OVERVIEW

A. THE STATUTORY FRAMEWORK

The provisions of the 1975 Hazardous Materials Transportation Act allocating regulatory authority between federal and state governments are much the same as those of the Senate Bill. 34 The House Bill made no provision for preemption and limited DOT's regulatory authority to interstate and foreign commerce. Subject to exceptions on request, the Senate Bill preempted all state and local requirements "inconsistent" with the Act and DOT's regulations. It also extended DOT's authority directly to intrastate commerce. 35 As described in the Conference Report, the com-

33. Id. at 187.
35. The House and Senate Bills, H.R. 15223 and S. 4057, were reported in House Rep. No.
promise kept the Senate's preemption provisions but narrowed DOT's authority over intrastate commerce to that affecting interstate or foreign commerce.\textsuperscript{36}

The granting of exceptions from the statutory preemption of "inconsistent" state and local requirements was delegated to DOT. Statutory waivers would be allowed, in effect, upon DOT's determination that: (i) the requirement in issue affords public protection equal to, or greater than, that afforded by the Act or DOT's regulations and (ii) it does not unreasonably burden interstate commerce.\textsuperscript{37}

Because of its theoretical importance in expanding the grounds for exceptions, the introduction of "unreasonably" into the Act to modify "burden" warrants a brief comment. It confirms occasional rumors of a mysterious mutability in the statutory drafting process.

The Senate Bill as reported and passed in the Senate did not include "unreasonably."\textsuperscript{38} The Conference Report accurately described the grounds in the Senate Bill for excepting "inconsistent" state/local regulations from preemption as follows: "where they afford an equal or greater level of protection and they do not burden interstate commerce."\textsuperscript{39} The Conference Report then described the final preemption agreement: "The conference substitute adopts the Senate provision on preemption [subject to an added unrelated exclusion of personal firearms and ammunition from the Act]."\textsuperscript{40} Despite the purported adoption of the Senate proposal in which "unreasonably" had never appeared, the term worked its way into the text of the Conference Bill.\textsuperscript{41}

Modifying "burden" by "unreasonably" operates to justify waivers that might be denied absent such modification. Thus, the inclusion of "unreasonably" would further the House aim of limiting statutory preemption. How its insertion into the final text was effected may never be known to those not privy to the process. In Senate proceedings on the Conference Report, however, a Senate manager complained of "the way in which the conference on this bill was mishandled by staff." His immediate concern involved a separate issue, but the "staff" alluded to was a particular staff member "of the House Interstate Commerce Commit-
These events occurred on December 18, 1974, two days prior to *sine die* adjournment amidst the usual turmoil of the period.

The Senate Report set out the Committee's intent in regard to the Act's preemption provisions.

The Committee endorses the principle of federal preemption in order to preclude a multiplicity of state and local regulations and the potential for varying as well as conflicting regulations in the area of hazardous materials transportation. However, the Committee is aware that certain exceptional circumstances may necessitate immediate action to secure more stringent regulations. For the purpose of meeting such emergency situations, the Committee has provided that any state . . . may request . . . approval of regulations which vary from federal regulations.43

Although House members had accepted the statutory preemption provisions of the Senate Bill, they had not agreed to the text of the Senate Report. In particular, they might well reject "exceptional circumstances" or "emergency situations" as limiting conditions for excepting "inconsistent" state and local regulations from preemption.

**B. ADMINISTRATIVE IMPLEMENTATION OF PREEMPTION UNDER THE HMTA**

1. **DOT'S DECISIONAL STANDARDS IN INCONSISTENCY RULINGS AND NON-PREEMPTION DETERMINATIONS**

To define "inconsistent", DOT drew on U.S. Supreme Court decisions dealing with preemption under Congressional enactments. *Ray* had not yet been decided, but DOT found guidance in earlier decisions. The following tests were thus adopted:

1. Whether compliance with both the state or political subdivision requirement and the Act or regulations issued under the Act is possible; and
2. The extent to which the state or political subdivision requirement is an obstacle to the accomplishment and execution of the Act and the regulations issued under the Act.44

The first test (also termed the "dual compliance" or "direct conflict" test) corresponds to the "physical impossibility" test of *Ray*.45 As noted below, the second test varies in one important respect from its formulation in *Ray* and earlier Supreme Court decisions.

The two tests of inconsistency differ in their reliance on issues of fact or judgment. The first test is largely factual. The impossibility of dual

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42. 120 Cong. Rec. 40680.
44. These tests are found in 49 CFR § 107.209 (c). See also, 41 Fed. Reg. 38167, 38171, Sept. 9, 1976. 49 CFR §§ 107.201-225 contain DOT's regulations on preemption in general.
45. Supra, n. 22 and related text.
compliance in any respect or degree (greater than *de minimis*) creates an "inconsistency." No substantial question as to the scope of the "impossibility" is presented.

In contrast, once the existence of an "obstacle" short of an "impossibility" is determined, the second test becomes judgmental.\(^{46}\) Is "the extent" to which such an obstacle impedes the purposes of federal regulation sufficient to constitute an inconsistency? This differs from the usual inquiry suggested by *Ray* and its predecessors. These decisions (if taken literally) look only to whether a state regulation "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."\(^{47}\) DOT's formulation of the second test, at least facially, offers greater freedom not to find inconsistency in "obstacles" not rising to the level of "impossibility."

In itself, a finding of inconsistency carries no implication of how it should be removed. Does it make sense, therefore, that a finding of inconsistency should force the state or locality to initiate proceedings for an *ex post facto* exception from preemption? The answer lies in the Supremacy Clause, the logic of which supports an initial presumption favoring removal of an inconsistent state requirement. That logic, however, extends only to the burden of presenting a case for retaining the inconsistent requirement. In assessing the consequences of preemption, the added burden of a presumption against the substance of the state regulation should be avoided. To so presume would preclude an objective evaluation of opposing federal and state claims for regulatory authority.

In regard to non-preemption (or waiver) determinations, the HMTA also vested broad decisional discretion in DOT. Like DOT's dual tests of inconsistency, the Act's dual waiver of preemption standards included a largely factual and a largely judgmental test. Whether a state/local requirement affords "an equal or greater level of protection" than that afforded by federal regulations is largely factual. (However, the complication of assessing tradeoffs between multiple facets of a single regulation might arise.) Conversely, whether a requirement "unreasonably burdens" commerce (as compared to whether it simply "burdens" commerce) almost always involves a subjective judgment.

DOT has viewed as a "question of fact" the balancing of "the states'... interest in public health and safety against the national interest in maintaining a free flow of commerce."\(^{48}\) Its calculus for identifying

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\(^{47}\) *Supra*, n. 21 and cases cited.

"unreasonable" burdens, however, involves issues considerably more subjective than those found in "pure" fact determinations. The rationality and effectiveness of the state/local requirement is first balanced against "the extent to which increased costs and impairment of efficiency result from [that] requirement." DOT then considers the balance in relation to "the need for uniformity" and the prevalence or absence of the requirement in other jurisdictions. For better or worse, these standards create a far broader potential for not preempting inconsistent state regulations than the "emergency situations" and "exceptional circumstances" cited in the Senate Report.

2. DOT'S PROCEDURES FOR INCONSISTENCY RULINGS AND NON-PREEMPTION DETERMINATIONS

The 1975 Act explicitly gave DOT original jurisdiction to issue non-preemption determinations, but was silent on the source of inconsistency rulings. Although the Senate Report did not address this issue, it is a reasonable inference that Congress viewed courts as that primary source. The Report, however, did describe DOT's rulemaking authority as "a broad mandate so that comprehensive regulations can be issued as the need arises covering whatever facet of the transportation requires regulation."

DOT used this expansive implementational authority under the 1975 Act "to facilitate" advisory inconsistency rulings through self-established concurrent jurisdiction. Thus, "the opportunity to seek administrative rulings as to . . . inconsistency" was accorded to "states and their political subdivisions and persons affected by [their] requirements . . . " Parties within these categories were authorized to request DOT to issue an administrative ruling on the inconsistency of any particular state/local requirement. Applications from "persons affected" were served by applicant(s) on the "concerned" state or political subdivision. Applications from governmental entities were served by DOT directly on persons "readily identifiable" as affected persons or by Federal Register publication. DOT could also initiate proceedings for inconsistency rulings in the absence of an application.

Proceedings were by informal investigation, with opportunities for all parties to make "submissions . . . relevant to the application . . . ." Hearings or conferences could be used in DOT's discretion.

Appeals from an initial administrative determination were taken to DOT's Administrator, Research and Special Programs Administration.

49. 49 CFR § 107.221.
Appeals had to be filed within 30 days of service of an initial ruling, but no time limit was set for the Administrator's ruling.51

In regard to non-preemption determinations, an application by states or political subdivisions pertaining to a particular requirement had to be preceded by a final court or DOT ruling, or an acknowledgement, of inconsistency.52 Primary responsibility was on the applicant for service on "reasonably ascertainable" affected persons. Where service by applicants proved impractical, DOT could supplement, or assume the primary responsibility for, service. As with inconsistency rulings, DOT could proceed less informally by investigation, hearing or conference. A DOT ruling became final in the absence of a timely appeal from the initial administrative ruling or by service of the Administrator's order on appeal.

DOT's regulations provided that "to the extent possible" each application "will be acted upon in a manner consistent with previous applications for non-preemption determinations."53 This is presumably intended to assure parties of reasonable decisional consistency. Where the material facts of separate proceedings were much the same, however, "to the extent possible" could invite as much concern as it offers assurance. Where they differ, the "assurance" had little purpose.

DOT's non-preemption procedures treat as a denial of an application the failure to issue a final order within 90 days of the receipt of all necessary substantive information.54 Appeal procedures from an initial administrative order on non-preemption are the same as those governing inconsistency rulings. As with inconsistency rulings, DOT's non-preemption procedures impose no time limit on the Administrator's order on appeal.

DOT's 1975 Act procedures relating to inconsistency and non-preemption seem capable of eliciting the information needed to resolve these issues. The substantive standards covering both types of proceedings, however, called for judgmental evaluations requiring broad discretion. Overall, the regulations offered a potential both for objectively considering efficiency concerns and for favoring a possibly inappropriate institutional perspective. In short, the implementation of these regulations (as is true of most administrative regulations) requires a measure of judicial oversight. The only questions are how and how much.

51. 49 CFR Sec. 107.211.
52. DOT procedures governing Non-Preemption Determinations are codified in 49 CFR Sec. 107.215-225.
53. 49 CFR Sec. 107.219 (e).
54. 49 CFR Sec. 107.223. Time runs from DOT's service of notice of such receipt on the parties. See 49 CFR Sec. 107.219 (d).
3. RELATIONSHIPS BETWEEN DOT AND THE COURTS IN IMPLEMENTING HMTA PREEMPTION POLICIES.\textsuperscript{55}

A. PRELIMINARY COMMENT: INCONSISTENCY RULINGS

The fact of concurrent judicial and administrative jurisdiction over inconsistency rulings creates a potential for conflict between DOT and the courts. Ultimately, the courts must prevail. Their supremacy is assured, not necessarily by greater competence or impartiality in the rendering of initial decisions, but by their unique enforcement authority. The logic of a DOT inconsistency ruling may in itself invite compliance by state or local regulators. If it does not, the matter of barring enforcement of the state/local regulation in issue rests with the courts. Conversely, states or localities seeking to enforce their regulations must look to the courts for vindication. In either case, enforcement ultimately depends on a \textit{de novo} court resolution of the inconsistency issue. Prior DOT rulings on the same issues are advisory at most. Relationships which have developed in these circumstances between the courts and DOT are discussed below.

B. PRIMARY JURISDICTION

The existence of concurrent judicial and administrative jurisdiction to decide complex issues of fact and policy may lead courts to seek guidance from the more specialized and experienced administrative agency. Primary jurisdiction involves discretionary court deferral to an administrative agency for an initial decision on a designated issue. Its common uses have been summarized as follows:

1. when resolution of the case involves complex factual inquiries particularly within the province of the regulatory body’s expertise;
2. when interpretation of administrative rules is required; and
3. when interpretation of the regulatory statute involves broad policy determinations within the special ken of the regulatory agency.\textsuperscript{56}

In the matter of inconsistency rulings, courts have made little use of primary jurisdiction. Its use has been largely confined to federal courts in the First Circuit. Initially, that Circuit’s Court of Appeals affirmed a District Court’s preliminary injunction against enforcement of three Rhode Island liquid energy gas (“LEG”) equipment regulations. Further decisions were

\textsuperscript{55} In preparing this analysis the aim was to utilize all judicial preemption decisions obtainable with reasonable effort. A few unreported decisions not available through usual library sources, including computerized services, were not considered. However, all cases obtainable through these sources were considered. These are numbered essentially in chronological order in a Case Appendix titled “Court Decisions Relating To HMTA Preemption (1975-90).” (Two “primary jurisdiction” cases, however, relate only indirectly to preemption. See, \textit{infra}, n. 61.) Citations are to Case Appendix Numbers (e.g. Case App. No. 1).

deferred pending the issuance of DOT inconsistency rulings. DOT advisory rulings involving all Rhode Island LEG regulations had been requested by the defendant-state two days prior to the District Court hearing on plaintiff-transporter’s injunction request.

When DOT failed to meet the original expiration date, the District Court extended the preliminary injunction. The Court of Appeals upheld the District Court’s deferral to DOT as a proper exercise of discretion. It also observed that the District Court was free to proceed to a final decision on the merits should it become “no longer reasonable to await DOT action.”

For whatever reasons, the transporter and the state at this stage of HMTA experience differed as to whose initial rulings might prove most advantageous. DOT eventually ruled on the state’s request. As to the regulations which had been preliminarily enjoined, DOT found two inconsistent and another not inconsistent. In 1982, the transporter-plaintiff renewed the effort begun in 1978 for a permanent injunction and the state withdrew the two equipment related regulations found inconsistent by DOT.

In a subsequent case, the First Circuit Court of Appeals observed that “district courts are free . . . to use the ‘flexible tool’ of primary jurisdiction . . . where doing so will expedite just resolution of the controversy.” The comment followed DOT’s declination of the Court’s invitation for an amicus brief on a pending inconsistency issue. DOT’s stated reason was its reluctance to express an opinion absent the opportunity for a “decision likely based on a more complete record and informed by greater expertise . . . .” Its aim was to encourage initial use of its own procedures. In the end, the Court of Appeals decided the matter without input from DOT. Having found “the legal questions . . . not particularly difficult”, it sought to avoid “significant additional delay.” In general, courts have not used primary jurisdiction in determining inconsistency.

C. THE STATUS OF A PRIOR DOT INCONSISTENCY RULING IN SUBSEQUENT COURT PROCEEDINGS

This section reviews five court cases in which acceptance or rejec-

57. Case App. No. 4, at 824-5.
60. Id.
61. In circumstances not involving DOT inconsistency procedures, two federal courts remitted litigants to DOT’s “primary” HMTA rulemaking jurisdiction as a condition for further judicial proceedings. See, Case App. Nos. 1 & 3.
tion of a prior DOT inconsistency ruling on the state/local requirement in issue is central to the court’s decision. Taking the cases chronologically, the first is an exception to the more common judicial adherence to prior DOT inconsistency rulings.\textsuperscript{62} In Appendix Case No. 5, the District Court considered DOT’s ruling that certain City of Boston regulations governing the transport of various flammable materials were inconsistent and thus preempted. These regulations established a morning rush hour curfew and required special permits for the use of city streets conditioned on compelling need. DOT had found these requirements inconsistent mainly on the basis of HMTA regulations intended to prevent traffic diversions and unnecessary delays. DOT also expressed its view that Boston had failed to act “through a process that adequately weighs the full consequences of its routing choices and ensures the safety of citizens in other jurisdictions . . . .”

The District Court rejected DOT’s ruling and denied the transporter’s request for a preliminary injunction. Boston’s regulations, it noted, had been submitted to the state’s Department of Public Safety and Fire Marshals in neighboring jurisdictions. Since these submissions were “information not made available to DOT”, the Court could find Boston’s requirements “fully consistent with federal law . . . without reflecting on [DOT’s] considered and expert views.”\textsuperscript{63}

In balancing the equities for granting or denying an injunction, the court put forward this case for Boston:

Boston’s unique geography and the accidents of its historical development have resulted in a highway system that is peculiarly vulnerable to the dangers of transporting hazardous materials.

Under the HMTA, of course, this consideration pertains to a waiver from preemption rather than to an inconsistency ruling.

In Appendix Case No. 7, the District Court gained Court of Appeals approval for enjoining the previously discussed Rhode Island LEG regulations found inconsistent by DOT. At the same time, the transporter’s Constitutional preemption claims against other regulations found not inconsistent by DOT were rejected.

In accepting DOT’s rulings on inconsistency, the District Court spoke deferentially of “the experience and judgment of those with nation-wide responsibility who rendered the inconsistency determination . . . .” The court found further support for DOT’s findings of no inconsistency in Constitutional standards governing preemption under the dormant commerce power.

Although a primary Congressional objective was . . . uniform, national stan-

\textsuperscript{62} The ruling was IR-3, 46 Fed. Reg. 18918 (March 26, 1981) and 47 Fed. Reg. 18457 (April 29, 1982).

\textsuperscript{63} All quotations from Case App. No. 5 are found at pp. 58,626-27.
dards in hazardous materials transportation, preemption of state regulations regarding highway safety is not to be undertaken lightly. [citing Raymond, supra] . . . . Deference should be given to state highway safety regulations because the state generally knows best how to handle problems unique to the area. [citing Ray, supra.] Consequently, state highway safety regulations carry a strong presumption of validity. [citing Raymond and Bibb, supra] This presumption, however, clearly is not irrebuttable.64

These doctrines are also extraneous to HMTA preemption standards.

Two other cases involved the circumstance of a DOT rule (HM-164) which included (as Appendix A) DOT’s own “interpretation of the general preemptive effect of its regulation . . . .”65 It was therefore possible, absent a DOT ruling, for the parties and courts to agree from the facts that DOT, if requested to rule, would find inconsistency.66 The first of these involved one of several disputes between New York City and DOT regarding population density as a preemption factor.67

The New York City Health Code barred the transport of large quantity shipments of radioactive materials (“RAMs”) in or through the City. In early 1977, various RAM shippers sought an inconsistency ruling from DOT. DOT denied the request on the grounds that it had not as yet issued routing regulations with which the City’s routing requirements might prove inconsistent.68 DOT then initiated a rulemaking proceeding leading to Rule HM-164, governing RAM transport.

The City sued to invalidate Rule HM-164 or bar its preemption of the City’s regulation. The District Court characterized HM-164 as:

arbitrary, capricious, and an abuse of discretion insofar as it overrides nonfederal bans on truck transportation of spent fuel and other large-quantity radioactive materials through densely populated areas such as New York City.69

As to localities of lesser density, the District Court found the record insufficient to sustain a broader injunction against the rule.

A divided Court of Appeals (2-1), in reversing the District Court, upheld the validity of HM-164, including its inconsistency standards. In essence, the Court of Appeals faulted the District Court view that DOT should have determined the safest mode for moving RAMs in and about New York City. It saw as DOT’s proper role the development of acceptable levels of safety for all modes engaged in the transport. Thus, highway

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66. See 539 F. Supp. 1248 and 772 F.2d 1113.
69. 539 F. Supp. 1293.
transport at acceptable levels of safety was not to be barred because barges might be inherently safer. The Court of Appeals was also critical of the District Court’s treatment of the case as “an inquiry into DOT’s anticipated denial of the City’s request for a non-preemption ruling . . .”.\textsuperscript{70}

If the District Court could be fairly faulted on these grounds, it could also be complimented on the standards it applied in deciding for non-preemption. The Court was unremittingly concerned with the possible existence of local safety problems arising from high population density which might render DOT’s general rule inapplicable to New York City. It avoided reliance on Constitutional Commerce Clause presumptions favoring state/local highway regulations. It approached the issue before it as less a matter of general highway safety and more a matter of the particular problems associated with HazMat transport.

A second case involving HM-164 arose from a local township ban on the importation of radioactive waste and spent nuclear fuel for storage. The Court of Appeals affirmed a District Court judgment that the importation ban was preempted by the DOT rule.\textsuperscript{71} Specifically, the Court of Appeals construed the rule to render the routing ban inconsistent as a prohibition of transportation “on routes or at locations” authorized by the DOT rule.

The final case in this category dealt with a municipal annual permit requirement for the loading, unloading and storage of hazardous materials by railroads. In rejecting DOT’s finding of inconsistency, the District Court summarily dismissed its “Advisory Ruling” as “poorly reasoned, based primarily on speculation . . .”.\textsuperscript{72} In contrast, the Court of Appeals found substantial overlap between DOT regulations covering loading, unloading and storage and the City’s permit requirements. In reversing the District Court, the Court of Appeals emphasized the trial court’s failure “to accord sufficient deference to [DOT’s] ruling.”

Generally, but not invariably, courts have deferred to prior DOT inconsistency rulings on the subject matter of a particular case. As has been noted, however, there is a persistent tendency for courts to combine the separate statutory standards of inconsistency and preemption waivers into a single judicial standard of preemption. Its roots are in the decisional needs of an injunctive proceeding and the simultaneous consideration of statutory and Constitutional issues.

\begin{footnotesize}
\begin{itemize}
\item[70.] 715 F.2d 752.
\item[71.] Case App. No. 12. The Court also held the township ban preempted under the Atomic Energy Act and the Commerce Clause.
\item[72.] Case App. No 18. This was preceded by DOT’s ruling of inconsistency in IR-19, 52 Fed Reg. 24404 (June, 30, 1987) and 53 Fed. Reg. 11600 (April 7, 1988).
\end{itemize}
\end{footnotesize}
D. JUDICIAL APPLICATION OF THE INCONSISTENCY STANDARD ABSENT A PRIOR DOT RULING ON THE IDENTICAL SUBJECT MATTER

These decisions fall into two sub-classes: (i) those reached without reference to other arguably relevant DOT inconsistency rulings, and (ii) those in which such rulings figure prominently.

As would be expected, the two decisions in the first sub-class shed little light on judicial deference to DOT or its expertise. In both cases, however, a state or local regulation applicable to HazMat transport was held preempted under the HMTA. In three other decisions the courts relied significantly on other DOT inconsistency rulings. A fourth proceeding in this same class, however, requires fuller attention as a prototype of the substantive and procedural problems inherent in the original 1975 HMTA.

On August 27, 1980, New York City obtained a state court temporary restraining order against defendant-transporters ("defendants") barring further violations of municipal regulations governing hazardous gas highway transport. Following the court's stated intent to grant a preliminary injunction, defendants removed the action to the Federal District Court. Defendants then moved to vacate the preliminary injunction on grounds of statutory and Constitutional preemption.

On September 26, 1980, defendants also requested DOT to rule the City's regulations inconsistent under the HMTA. On October 16, 1980, following an October 8, 1980 argument on the preliminary injunction, defendants filed cross complaints in the District Court against enforcement of the City regulations. Pending a District Court decision on the same statutory issue, DOT deferred action on its own ruling.

The principal regulations in issue conditioned highway transport of hazardous gases in New York City on a Fire Commissioner permit fixing route and curfew restrictions. In claiming inconsistency under the HMTA, defendants relied on a DOT regulation barring "unnecessary delay in movement of shipments." The thrust of this argument was perhaps blunted by added reliance on a motor carrier safety regulation which DOT had expressly not incorporated into its HMTA regulations. That regulation

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73. Case App. Nos. 9 and 19.
74. Case App. No. 19, however, contains intimations, without specific citation, of Court reliance on IR-19 (supra, n. 72) involving unnecessary delays in transit. 747 F. Supp. 1403.
75. Case App. Nos. 10, 14 and 17. In No. 14, however, the Court of Appeals relied wholly on the preemptive effect of the Federal Railroad Safety Act. The significance of that Act to preemption under the HMTA is discussed below.
77. The events concerning DOT's role are set out in IR-5, 47 Fed. Reg. 51991 (Nov. 18, 1982), issued after the District Court and Court of Appeals opinions in Case App. No. 6.
required, in the absence of a "practical alternative", that motor vehicles carrying hazardous materials "must be operated over routes which do not go through or near heavily populated areas . . . tunnels, narrow streets or alleys."

In viewing the non-HMTA regulation as relevant to "the question of preemption", the District Court found the City regulations "entirely consistent" with the HMTA and applicable DOT regulations. It did so following a review of principal Supreme Court decisions applying the "inconsistency" standard under the Supremacy Clause in the context of conflicting federal and state/local regulatory requirements. What proved dispositive, however, was the Court's ultimate recourse to the basic principle of comity governing highway safety regulation under the dormant commerce power.78

In addition to providing general rules regarding preemption in the cases cited earlier, the Supreme Court has given a specific direction as to preemption in highway safety cases. The Supreme Court has stated that local highway safety regulations should be given deference and that they enjoy a strong presumption of validity. Raymond Motor Transportation, Inc. v. Rice, 434 U.S. 429, 443-44 (1978).

Thus, for the statutory preemption standards of the HMTA, a District Court once more substituted a Constitutional preemption doctrine under the dormant commerce power.79 In its separate rejection of defendants' added Constitutional claim of preemption based on a "disproportionate burden on interstate commerce", the District Court again cited Raymond as its principal authority.80

In affirming the District Court's conclusion of non-preemption under the Constitution and the HMTA, the Court of Appeals was better able to separate these two strands of its decision. Its statutory holding reflected its view that DOT had not extended the goal of national uniformity "to embrace the local routing necessary to avoid the very dangers contemplated by [its rules]." The Court of Appeals, however, remanded the issue of the possible inconsistency of the City's hazard class definitions to the District Court. Finding the record "scanty" on this issue, the City proposed to "defer to the DOT, before which there is currently pending an

78. 515 F. Supp. 670.
79. In Case App. No. II the District Court was even more resolute in melding the distinctive preemption standards of the dormant commerce power and the HMTA into a single overarching principle. (1986 Fed. Carr. Cas. at p. 58,017).
Although a primary Congressional objective in enacting the HMTA was promulgation of uniform, material standards for hazardous materials transportation, preemption of state regulations regarding highway safety is not undertaken lightly. [citing Raymond.]
The answer, of course, is that preemption under the HMTA should reflect its unique statutory goals rather than broad Constitutional doctrines.
80. 515 F. Supp. 672. See, Raymond, supra, Part II. B.
inconsistency action." The Court of Appeal's remand allowed the District Court "to take more evidence or to await DOT action, which it is not bound to do . . . ."

Thereafter, the City, as well as the initial petitioners for the DOT inconsistency ruling, returned to DOT for a ruling on this remaining issue. DOT then issued an initial ruling of inconsistency from which it does not appear that an appeal was taken.

In itself, the wastage of decisional resources resulting from the concurrent initial jurisdiction of DOT, state courts and federal courts over the issue of inconsistency is of no small concern. It is of less concern, however, than this further demonstration of the substantive confusion to which courts are prone in simultaneously applying the Constitutional and statutory standards of preemption.

Whatever the basis for deference to state/local regulation in the context of general highway safety, Congress in the HMTA treated HazMat transport as a separate problem. The preemption provisions of the HMTA were intended to reflect that difference by basing preemption on the standard of inconsistency. Under established judicial doctrine, a finding of inconsistency in itself, whether under the "physical impossibility" or the "obstacle" test, results in federal preemption under the Supremacy Clause.\textsuperscript{81} The 1975 HMTA assigned solely to DOT the separate task of waiving preemption of inconsistent state or local regulations. It is only this waiver process which calls for consideration of the relative merits of inconsistent regulations.

Courts undermine HMAT preemption goals when they apply doctrines covering general highway safety under the dormant commerce power to statutory waiver decisions. This practice ignores those elements of HazMat transport which led to a separate regulatory structure. The fault lies as much in the Act, however, as in the courts. The Act's use of a "burden" standard for preemption waivers might well be taken by courts as a green light to proceed over the more familiar routes of Constitutional interpretation.

\textbf{E. JUDICIAL AND ADMINISTRATIVE ACCOMMODATION OF PREEMPTION UNDER THE MULTI-MODAL HMTA AND SPECIFIC MODAL SAFETY STATUTES}

The application of HMTA preemption policies to HazMat transport is further complicated by other statutory preemption policies governing general transport safety. One problem is the preemptive effect of DOT's Federal Motor Carrier Safety Regulations, incorporated by DOT into its HMTA

\textsuperscript{81} Cf. Ray, supra, 435 U. S. 151, 158; Florida Lime, supra, 373 U. S. 132, 142; Jones, supra, 430 U.S. 519, 540-543.
regulations. Even when applied to HazMat transport, preemption is determined under Motor Carrier Safety Act, rather than HMTA, standards.

The Motor Carrier Safety Act covers the general safety regulation of commercial motor vehicles. It vests authority in DOT to determine the enforceability of state highway laws or regulations in accordance with the Act's standards. Those which have the "same effect" as a DOT regulation may remain in effect. Laws or regulations "less stringent" than DOT's are preempted. State requirements "additional to or more stringent" than DOT's are enforceable unless DOT finds: (i) an absence of safety benefit; (ii) incompatibility with a DOT regulation; or (iii) "an undue burden on interstate commerce." DOT may waive determinations of preemption when satisfied that a waiver is consistent with the public interest and the safe operation of the motor vehicle.

DOT has issued extensive regulations under the Act. In regard to their effect on "state and local laws" these regulations include the following general standard:

Subchapter B of this chapter [i.e., DOT's Federal Motor Carrier Safety Regulations] is not intended to preclude states or subdivisions thereof from establishing or enforcing state or local laws relating to safety, the compliance with which would not prevent full compliance with these regulations.

Several court decisions have construed this regulation to cover only the first "direct conflict" test of the inconsistency standard and not the second "obstacle" test.

When DOT incorporated its Federal Motor Carrier Regulations into its HMTA regulations in 1978, its sole stated aim "was to make civil penalties and other enforcement tools of the HMTA applicable to those hazardous materials carriers already subject to Parts 390-397." DOT disavowed any intent "to preempt state or local law not preempted by the FMCSR . . . ." This creates the anomaly of an entire class of HMTA regulations not subject to preemption under the HMTA.

Whether DOT may modify the HMTA in this manner need not be pursued here. However, the better part of administrative valor might lie in a legislative solution. If retention of current general motor carrier safety pre-

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83. 49 U.S.C. App. Sec. 2505 (c) and (d). See, also, id., Sec. 2509 regarding State inspection powers.
84. In particular see 49 CFR Parts 390-397. These Parts are included in Subchapter B of Chapter III, "Federal Highway Administration, Department of Transportation."
85. 49 CFR § 390.9.
86. See, Case App. No. 11 at p. 58,020; No. 6 at 670 and No. 7 at 515-16. For further discussion of the preemption policy of the Motor Carrier Safety Act of 1984 see Specialized Carriers & Rigging v. Commonwealth of Virginia, 795 F.2d 1152 (6th Cir. 1986).
87. 43 Fed. Reg. 4858 (Feb. 6, 1978). All such regulations were so incorporated except 49 CFR §§ 397.3 and 397.9.
emption standards is desired, Congress could simply authorize HMTA penalties against motor carriers in violation of general safety regulations while transporting hazardous materials. Conversely, if incorporation of general safety regulations into the HMTA is thought useful, then why should HMTA preemption standards not apply? The inclusion of a class of motor carrier safety regulations under the HMTA subject to lesser preemption standards only encourages further judicial erosion of HMTA motor carrier preemption standards.88

Much thornier problems now exist in coordinating the separate statutory preemption standards governing the safety of general railroad operations and those involving hazardous materials. DOT regulates general railroad safety under the Federal Railroad Safety Act ("FRSA").89 The FRSA preemption standard reflects the traditionally greater concern for national uniformity in rail safety regulation as compared to highway safety regulation. In essence, a state rail safety regulation becomes ineffective upon DOT’s issuance of a regulation “...covering the subject matter of such state requirement.” In the case of “more stringent” state requirements, however, the following class of exceptions to preemption are provided:

[W]hen necessary to eliminate or reduce an essentially local safety hazard, and when not incompatible with any federal law, rule, regulation, order, or standard, and when not creating an undue burden on interstate commerce.

The major differences between HMTA and FRSA preemption standards are readily apparent. HMTA preemption applies only where concurrent federal and state local requirements are inconsistent. FRSA preemption applies to any state requirement whose subject matter is covered in DOT regulations. Neither statute explicitly assigns responsibility for initial preemption decisions, but exceptions from HMTA preemption require initial administrative determinations by DOT. Exceptions to FRSA preemption arise directly from the Act itself (subject to judicial resolution of disputes). Several courts have held the FRSA exception applicable only to state, and not local, requirements.90

Substantively, where state or local requirements afford “equal or greater” protection, HMTA exceptions are available for those which “[do] not unreasonably burden commerce.” Under the FRSA, an otherwise preempted “more stringent” state requirement remains effective if, as a first condition, it is “necessary to eliminate or reduce an essentially local hazard ... .” Thus, the immediate focus is on the character of the particular hazard which is claimed to require a more strict regulation. Regard-

88. Case Appendix No. 11 effectively illustrates how the narrower motor carrier preemption standard may operate in this manner. See, 1986 Fed. Carr. Cas. at p. 58,020.
89. 45 U.S.C. §§ 421 et seq.
90. Case Appendix No. 16, 705 F.Supp. 387-88, and cases cited.
less of the severity of that hazard, the state must then run two further gauntlets on the path to an exception. It must demonstrate that its requirement is "not incompatible" with any federal requirement and does not create "an undue burden on interstate commerce."

The problems of accommodating statutory preemption provisions relating to railroad safety with HMTA preemption are the opposite of those relating to motor carrier safety. Motor carrier safety regulations incorporated by DOT into the HMTA are nevertheless declared by DOT to remain subject to the preemption standards of the Motor Carrier Safety Act. In contrast, FRSA preemption provisions begin with this declaration: "[T]hat laws, rules, regulations, orders, and standards relating to railroad safety shall be nationally uniform to the extent practicable." (Emphasis added.)

Putting aside the possible ambiguities of "to the extent practicable", the fact is that FRSA preemption literally covers the entire field of railroad safety. Does this mean that FRSA preemption extends to railroad safety laws governing the rail transport of hazardous materials? Conversely, does it mean that in regard to rail transport, HMTA preemption is superseded by the FRSA? Under current case law, the answer to both questions is "Yes".

An early indication of the potential confusion arising from these overlapping preemption provisions occurred in 1977. The Illinois Commerce Commission had issued General Order 200 having statewide application to the use of certain railroad tank cars carrying hazardous materials. The District Court held the regulations preempted under both the FRSA and the HMTA. With regard to the FRSA, the court held that General Order 200 dealt with the subject matter of an existing FRSA regulation. Moreover, being statewide, it could not qualify as relating to "an essentially local hazard." An exception from FRSA preemption was therefore not possible.

While the court also found General Order 200 preempted because of inconsistency with DOT's HMTA regulations, procedural confusion marked its decree. The Commission was barred from enforcing its order until it obtained "...an appropriate non-preemption determination issued by [DOT] pursuant to 49 U.S.C. Sec. 1811(b)." That order in itself, of course, could not operate as an exception to FRSA preemption unless FRSA preemption was thought to be superseded by HMTA preemption. The court did not address the issue.

A second court case considered claims by affected railroads that a

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91. 45 U.S.C. Sec. 434, first sentence.
92. Case Appendix No. 2.
state law requiring cabooses on most trains was preempted by the FRSA and the HMTA. The District Court held the State law preempted under both Acts. As for the FRSA, the Court found that DOT had considered and rejected a proposed rule requiring cabooses or alternative equipment on trains. It viewed DOT’s inaction as “an affirmative ruling that caboose regulation is inappropriate.” Since the subject matter was thus covered by DOT, the FRSA required preemption. Also, because the law operated statewide, the court found it did not “address a local safety hazard.”

The caboose requirements specifically covered trains longer than 2,000 feet carrying certain designated hazardous materials. The court found that this requirement, “... insofar as it purports to regulate hazardous materials”, was inconsistent with the HMTA. The District Court left in limbo, however, some questions of practical concern. Would a HMTA preemption waiver from DOT serve to eliminate FRSA preemption as to hazardous materials? Or, would FRSA preemption supersede a HMTA waiver because the statewide regulation “relating to railroad safety” served no essentially local safety purpose?

In affirming the District Court judgment, the Court of Appeals did not address these questions. Instead, it based its affirmance not on HMTA preemption, but “on the clear application of the FRSA and its preemptive effect...” The role of HMTA preemption was not decided. The Court of Appeals appeared to construe the FRSA as covering the entire state law, including its application to hazardous materials. If so, it managed in the process to eliminate any role for an HMTA preemption waiver directed solely to HazMat transport by rail.

In 1990, the 6th Circuit Court of Appeals put the issue in these terms:

The question before us is simply this: Should a train carrying a load of hazardous waste be considered a railroad which happens to be carrying hazardous waste (thus suggesting the application of the FRSA preemption provision) or hazardous waste which happens to be carried by rail (thus suggesting application of the HMTA preemption provision)?

Its answer was unequivocal:

In this case, the decision of the district court, applying the FRSA preemption provision to regulations promulgated under the HMTA, retains the essential character and purpose of both statutes. The national character of railroad regulation and the need for regulation of hazardous materials transportation on an intermodal basis are both respected.

An important element of the court’s analysis was the “plain mean-

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95. 850 F.2d 265.
96. Case Appendix No. 20 at 501.
97. Id. at 503.
In denying certiorari the Supreme Court took no position on the Court of Appeal's holding.

For the present, the prevailing view in the federal courts is that the preemption standards of the FRSA supersede those of the HMTA in regard to the rail transport of hazardous materials. This poses a major policy issue. Should rail safety regulation directed solely to HazMat transport remain subject to FRSA preemption, or should HMTA preemption apply uniformly to all modes?

IV. SUMMARY OF 1990 AMENDMENTS AFFECTING HMTA PREEMPTION

The Hazardous Materials Transportation Uniform Safety Act of 1990 ("HMTUSA") is the first general overhaul of the 1974-5 HMTA. Many Congressional hearings were held in the intervening sixteen years on the subject of HazMat transport. The principal hearings of the 100th and 101st Congresses are listed in the Hearing Appendix. These include a variety of perspectives and proposals on the subject of federal preemption. They are background to the following major 1990 changes from previous HMTA preemption policies, standards and procedures.

SECTION 2. FINDINGS

The Congressional findings place added emphasis on the role of federal preemption in the regulatory scheme. Finding 3 speaks of state/local "laws and regulations which vary from federal laws and regulations", thereby creating "the potential for unreasonable hazards in other jurisdictions and for confounding shippers and carriers which attempt to comply with multiple and conflicting ... regulatory requirements." Finding four declares "consistency in laws and regulations" as "necessary and desirable" given the "potential risks...posed by unintentional releases of hazardous materials."

Finding five speaks to the need for federal regulatory standards applicable to "intrastate, interstate and foreign commerce" in order "to achieve greater uniformity and to promote public health, welfare, and safety at all levels." Finding eight defines the movement of hazardous

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98. Id. at 501.
100. The occasional citations will be to Hearing Appendix Numbers (e.g. Hearing App. No. I).
materials in commerce as "necessary and desirable to maintain economic vitality and meet consumer demands. . . ." To these ends it posits the aim of "efficient" as well as "safe" transport.

**SECTIONS 3 AND 4. INTRASTATE COMMERCE.**

In substance, the pre-1990 HMTA (Sec. 103, 49 U.S.C. § 1802) defined domestic "commerce" to include (i) interstate commerce and (ii) intrastate commerce "which affects" interstate commerce. The task of determining which aspects of intrastate commerce affected interstate commerce was left to DOT. In turn, DOT was authorized to issue "regulations for the safe transportation in commerce of hazardous materials."

(Sec. 105, 49 U.S.C. § 1804). The definition was thus consistent with the limitation of DOT's intrastate commerce authority to those aspects "affecting" interstate commerce.

Section 3 of HMTUSA leaves the definition of "commerce" intact. Section 4, however, directs DOT to issue regulations for the safe transportation of hazardous materials in "intrastate, interstate and foreign commerce." Failure to amend the definition was possibly an oversight; but if so, one shared by three reporting Committees. Oversight or not, the directive that DOT issue regulations governing the whole of intrastate commerce seems a more decisive expression of intent than the failure to amend the definition of commerce. In any case, ambiguities now arise from other provisions of HMTUSA limiting application of DOT regulations to "Commerce" (presumably as defined). A clarification of Congressional intent would be useful.

In Constitutional terms, the direct application of federal authority to the whole of the intrastate transport of hazardous materials implies a Congressional determination that all such commerce "affects" interstate commerce. Minor differences may exist in the operational characteristics of intrastate and interstate HazMat transport. But the similarities and func-

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104. For example, Section 4 (amending § 105, 49 U.S.C. § 1804 (a) (3)) covers the applicability of DOT regulations to various categories of persons with functions relating to packages or containers. Such regulations are limited to packages and containers intended "for use in the transportation in commerce of hazardous materials." Does this limitation to "commerce" imply that DOT may not issue regulations covering packages and containers used in intrastate commerce absent a determination that it "affects" interstate commerce? This seems unlikely. See also, § 105 (b) (3) (F) in Section 4 of the 1990 HMTA.
tional relationships of the two sectors seem sufficient to support unified regulation. 105

SECTION 13. RELATIONSHIP TO OTHER LAWS: STANDARDS

Most notably, the pre-1990 preemption standard of "Inconsistency" is replaced by the following:

[Any state/local requirement]106 is preempted if—

1. compliance with both the [state/local] requirement and any requirement of this title or of a regulation issued under [it] is not possible,
2. [the state/local] requirement as applied or enforced creates an obstacle to the accomplishment and execution of this title or the regulations issued under [it], or
3. it is preempted under section 105(a)(4) or section 105(b).

Insofar as paragraphs (1) and (2) essentially replicate the judicially formulated Constitutional standard of inconsistency (i.e. the "impossibility" and "obstacle" tests), the change would seem purely formal. The proper comparison, however, is with the inconsistency standard as formulated by DOT. DOT's "obstacle" test differed from the judicial formulation by purporting to consider "[t]he extent to which" the state/local requirement operated as an "obstacle." 107

It is not readily apparent that DOT's administration of its own version of the "obstacle" test led to different results than would have been reached under the judicial formulation. Nevertheless, it seems useful to simplify the preemption standard itself by minimizing its balancing elements. Where an obstacle has no more than a de minimis impact, it may be treated as a non-obstacle whose removal would serve no purpose. An obstacle of any greater impact, however, once identified, should be preempted. At that point, the burden of proceeding to justify the obstacle as an overriding need of local safety should be assumed by the state or locality.

HMTUSA's recital of the two inconsistency tests provides a sharper focus on the presence of an obstacle. This will better serve the new em-

105. The extension of direct regulatory authority to intrastate commerce was supported by several major shipper and transporter organizations: the Office of Technological Assessment; the HazMat transport expert of the Congressional Research Service, Library of Congress; and ultimately by DOT. The City of New York was opposed.


106. The general statutory reference to a "state or political subdivision thereof or Indian tribe" is shortened herein to "states and localities" or "state/local."

107. See, supra, nn. 44-47 and related text.
phasis on "consistency" and "greater uniformity" by clearly delineating the initial technical test of preemption from the balancing test for waivers.

To the preemption standards of paragraphs (1) and (2) requiring administrative or judicial determinations, paragraph (3) adds two categories of broader and direct statutory preemption. Section 105(a)(4) (See Section 4, HMTA) preempts by statute any state/local regulations "not substantively the same" as the HMTA, or regulations under it, as to five covered subjects. In substance, these relate to: (i) designation, description and classification of hazardous materials; (ii) packing, labeling and placarding; (iii) shipping documents; (iv) written notification, recording and reporting of unintentional releases in transportation; and (v) packages and containers.

Direct statutory preemption reflects the judgment of Congress that the requirements of uniformity are sufficiently compelling to warrant eliminating the statutory processes for determining preemption. In the interest of procedural efficiency, widespread acceptance was expressed in the hearings for the principle of direct preemption by statute of limited subjects. Views on particular subjects varied, but the final statutory selection reflects a broad (if not a total) consensus on appropriate coverage. 108

Notwithstanding their broad preemption by statute, the usual opportunity for a waiver of preemption is accorded on these five covered subjects. This allows for the needed flexibility to consider claims of local necessity. The arrangement thus combines greater decisional efficiency with the opportunity to maximize substantive efficiency.

By its reference to section 105(b)(4) (Section 4, HMTA), paragraph (3) applies the same procedures to the statutory preemption of the federal highway routing standards of section 105 (b). Subject to the detailed provisions of section 105 (b), DOT by regulation must issue standards for use by states and localities in:

establishing, maintaining, and enforcing (A) specific highway routes over which hazardous materials may and may not be transported by motor vehicles, and (B) limitations and requirements with respect to highway routing.

Thereafter, subject to the statutory time schedule, no state or locality may establish, maintain or enforce:

(i) any highway route designation over which hazardous materials may or may not be transported by motor vehicles, or

(ii) any limitation or requirement with respect to such routing, [except] in accordance with [the procedural and substantive requirements of the federal standards].

108. See, Hearing Appendix No. I, pp. 101, 134-5, 163, 364, 373-4; No. II, pp. 70, 74-5, 81-2, 156-7, 162; No. IV, pp. 564-6, 580-1, 584, 737, 805, 815, 817, 829; No. V., pp. 583, 754, 789, 794, 1628; No. VI., pp. 335, 355, 407, 420; No. VIII, pp. 30, 33-4, 120, 125, 162, 272. Among the proposed subjects not included for statutory preemption was pre-notification of movements.
Among the more contentious preemption issues under the HMTA have been those involving local routing bans or constraints. Especially intense have been disputes involving routing restrictions against radioactive materials, as a commodity class, and based on population density, as a geographical factor. Most intense, have been these two in combination. The use of preemption to enforce uniform federal standards responds to the previously noted "NIMBY" motivations of state and local governments. As with the "covered subjects", procedural and substantive efficiency are well served by including DOT's routing standards under direct HMTA preemption.

Previous HMTA standards governing waivers of preemption were not changed.

SECTION 13. RELATIONSHIP TO OTHER LAWS: PROCEDURES.109

HMTUSA addresses the matter of concurrent preemption rulings by DOT and the courts. It accords statutory status to DOT's determinations of preemption under the modified standards. It also authorizes DOT to determine whether state/local requirements are preempted under the statutory provisions governing "covered subjects" and "routing." Concurrent court jurisdiction continues as to all categories of preemption.

As for DOT's jurisdiction, any state or locality or any person "affected by any [state or local requirement]" may apply to DOT for a determination of preemption. DOT must provide notice of the application by publication in the Federal Register. Following publication, applicant is barred from seeking judicial relief on the same issue until the earlier of DOT's final action, or 180 days after filing the application. Concurrent court jurisdiction to make preemption determinations is expressly preserved. Any party authorized to apply to DOT for a determination may also seek it "in any court of competent jurisdiction in lieu of applying to [DOT]." Thus, the only restriction on concurrent jurisdiction is the maximum 180 day delay imposed on a party who has initially applied to DOT. Parties remain free to continue the race to the forum they perceive as most favorable.

The amendments continue the formality of DOT's exclusive role in granting initial waivers of preemption. The one stated condition for filing a waiver application is acknowledgement by the state/local applicant that the subject requirement is preempted under the HMTA. Final court or DOT determinations of preemption would presumably constitute acknowledgement. More to the point, however, a voluntary acknowledgement can obviate the need for a prior determination.

Any party to a DOT preemption determination or waiver decision may seek judicial review "by the appropriate district court of the United

States." Absent other HMTA provisions governing the appeal, the standards of judicial review and procedures would be determined under the Administrative Procedure Act (APA).110

SECTION 30. HMTA PREEMPTION AND RAIL TRANSPORT.111

The most recent Court of Appeals decision to hold the rail transport of hazardous materials subject to preemption under the FRSA, rather than HMTA, was issued on April 13, 1990.112 The final House and Senate votes on HMTUSA were on October 25 and 26, 1990 respectively.113 Attention was given in the House to the decision and the certiorari petition pending in the Supreme Court.114

In a floor colloquy a member stated his understanding of the Court decision and posed a question:

"[T]he Sixth Circuit ruled that section 205 [of the FRSA] encompasses hazardous materials, so that if DOT has promulgated regulations in a subject area pertaining to hazardous materials, the states cannot.115 The preemption sections of this bill, then, do not address the scope of section 205?

In reply the bill's manager observed that "...the gentleman is correct. The preemption provisions of this bill, Sections 4 and 13, do not address that issue." This statement confirmed his previous assurance that "[n]othing in this bill affects in any way the scope of section 205 of the Federal Railroad Safety Act."

He was correct. Section 30 of the bill (as enacted), which he might well have cited, said just that: "Nothing in this Act, including the amendments made by this Act, shall be construed to alter, amend, modify or otherwise affect the scope of section 205 of the [FRSA]."

Court decisions holding that FRSA preemption supersedes HMTA preemption, in regard to HazMat transport by rail, find support in the literal provisions of the 1970 FRSA. The legislative history of the 1974-5 HMTA, however, carries no hint of any intended modal bifurcation of its preemption provisions.

Section 30 of HMTUSA constitutes acceptance by Congress of the interpretation placed by courts on the applicability of FRSA preemption to rail transport of hazardous materials. Its inclusion in the legislation was hardly necessary because, absent any amendments restoring HMTA preemption, judicial accommodation of the two statutes would prevail. There

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111. 104 Stat. 3277.
112. See, supra, nn. 96-98 and related text.
114. Id., House, at H 13648-9.
115. See, supra, n. 89 and related text.
was, however, a possible purpose for enacting Section 30. This would be to forestall an argument that the failure of the more recent HMTUSA to exclude railroads from its preemption provisions implied a rejection of the judicial interpretation.

None of the three Committee reports recommended Section 30, or its substance, although two came well after the Court's April 13, 1990 decision (the other preceding it by 10 days).\textsuperscript{116} It seems doubtful that its real significance as a major HMTA amendment effected through subtle reference to another statute was understood by many in Congress. Also, in late 1990, a reversal of prevailing judicial doctrine was still possible. Had this occurred, HMTA preemption would have been simply restored to the modal uniformity more likely assumed by Congress in the 1974 HMTA. For those favoring FRSA preemption over HazMat rail transport, the insertion of Section 30 could provide potential benefits without risk.

\textit{Misce\-llany}

Apart from the foregoing amended preemption provisions, HMTUSA broadens the scope of federal preemption by expanding subjects covered by the Act or DOT regulations. Among these are Personnel Training (Sections 7 and 17), Fees (Section 13) and State Motor Carrier Registration and Permitting Forms and Procedures (Section 22).

Of particular interest is an ancillary disavowal of federal preemption, possibly intended to resolve an issue in litigation between the State of Colorado and the Department of Defense.\textsuperscript{117} The question is whether the sovereign immunity of the United States should extend to DOT contractors hired to haul nuclear materials. Section 20 places such contractors in the same status as other HazMat transporters.

\section*{V. Conclusion: Recommended Changes in HMTA Preemption Provisions and Practices}

\textbf{A. Introduction}

If justification can exist for an article of this length, it lies in the effort to set out the considerations which give rise to the recommendations which follow. These include:

(i) the need to give effect to the distinctive social and political factors which underlie the use of federal preemption in the field of HazMat transport;

\textsuperscript{116} The Reports are cited supra, n. 103. At various hearings the Association of American Railroads presented a case for the exclusive use of FRSA preemption for the rail transport of hazardous materials. Hearing Appendix No. IV, 699, 711-12; No. VI, 100-01 and No. VIII, 99-100. Its basic contention was that "There should be total federal preemption except where state regulation is necessary to deal with essentially local hazards." Hearing Appendix No. VI, 101.

\textsuperscript{117} See, Hearing App. No. V, at 450.
(ii) the difficulties encountered by courts in separating customary Constitutional doctrines of federal preemption as applied to general highway and rail safety from the statute directed exclusively to the needs of HazMat transport;

(iii) a tendency of courts to resolve close questions of statutory construction involving federal preemption through reliance on broad ideological preferences regarding federal/state relations rather than on comparative efficiency;

(iv) the procedural inefficiencies generated by the concurrent authority of the courts and DOT to issue preemption decisions or opinions;

(v) the need for a unified and efficient decisional process which promotes the objective resolution of conflicting claims for uniformity and diversity and elicits public confidence in that resolution.

(vi) the need to minimize statutory ambiguities in the interest of administrative consistency and efficiency; and

(vii) the need to maintain uniform standards and procedures for preemption and waivers which, as to all modes, effectively balance State/local safety concerns with broader national interests.

B. SECTION 3. DEFINITION OF "COMMERCER"

For the reasons previously stated, the definition of "Commerce" should be amended to include intrastate commerce.\footnote{See, supra, nn. 102-05, and related text. The same concern might logically apply to "foreign" commerce, which has the same status under Section 4 in regard to DOT regulations as intrastate and interstate commerce. It is conceivable, however, that foreign commerce may be subject to unique considerations under international arrangements not applicable to domestic commerce. In any case, the present concern is with Federal preemption as it affects domestic commerce.}

C. SECTION 13. PREEMPTION AND WAIVER STANDARDS

Two changes in the statutory standards of Section 13 are proposed, one relating to preemption determinations and the other to waivers of preemption.\footnote{With regard to the inclusion of Motor Carrier Safety regulations under the HMTA, a change in DOT regulations is also recommended. As incorporated in the HMTA, these regulations, where hazardous materials transport is involved, should be given the same preemptive effect as all other HMTA regulations. Supra, nn. 83-88 and related text.} The proposed changes will be stated first and brief rationales will follow.

A waiver of preemption is presently available for a state/local requirement which: (i) affords protection "equal or greater" than HMTA requirements; and (ii) "does not unreasonably burden commerce." It is first proposed to eliminate the second standard as a basis for waivers but to utilize it as an added standard in determining preemption.

A model of sorts is found in the bill reported by the House Committee on Energy and Commerce. Under that proposal an added basis for preemption would have been that the state/local requirement as applied or
enforced “imposes an unreasonable burden on commerce.”

The second proposed change in Section 13 standards is for a replacement of the current “burden” standard for waivers. The new standard, drawn essentially from the FRSA, would focus on the need for any added safety requirements arising from unique or unusual local conditions. Whether local safety factors create a need for more stringent regulation than that provided by the HMTA should be approached from the perspective of the “Findings” of HMTUSA. That is, do any unique or unusual local safety factors create added risks sufficient to warrant an exception to the statutory principles of “uniformity” and “consistency?” Would a waiver of preemption in the circumstances serve better than enforced uniformity in furthering the ultimate statutory aim of “safe and efficient” HazMat transport?

These proposals are rooted in the judicial administration of the “burden” standard and the added emphasis on consistency and uniformity in HMTUSA. In the role of a “loophole”, this standard has become a repository for ideological preferences regarding the proper relationship between federal and state authority in a federal system. As applied by courts, it contributes little to the use of federal preemption in promoting safe and efficient HazMat transport.

The “burden” standard could be kept, however, as a supplemental preemption test rather than as the basis for granting waivers.

In this role the standard under the HMTA may add no more to the preemption of state/local HazMat transport regulation than it has under the Supremacy Clause. But in either context it permits preemption where the added costs of state/local regulation unduly burden HazMat transport without transgressing other statutory preemption tests.

D. SECTION 13. PREEMPTION AND WAIVER PROCEDURES

As in the discussion of preemption standards, the statement of each proposal will be followed by its rationale.

The first proposal is to eliminate the concurrent jurisdiction of courts

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120. House Rep. 101-444, Part 1, supra, n. 103, at 84. Without explanation of how the same standard would operate for the two different purposes, the Committee also chose to retain the “burden” standard as grounds for a waiver of preemption. Id., at 48-50.

121. Supra, n. 89 and text following.

122. It should be noted that under the 1974-5 HMTA virtually no use has been made of DOT’s “exclusive” waiver of preemption jurisdiction. See, Case Appendix No. 15, at 1297-98. An earlier waiver request to DOT was processed as a preemption determination. 49 Fed. Reg. 3166 (Jan. 25, 1984). An important reason has been the previously noted practice of the federal courts, in exercising jurisdiction over preemption determinations, to decide the waiver issue as well. The proposals made here as to preemption and waiver standards and procedures are likely to increase the number of waiver requests. This would result from both the 1990 expansion of HMTA preemption and, as proposed, the elimination of initial concurrent judicial jurisdiction.
to rule on preemption. In addition, HMTA procedures should constitute the only method by which preemption and waiver issues covering HazMat transport under the HMTA are determined. \footnote{123. The single temporary exception would be for injunctive proceedings involving the operation of a state/local requirement prior to the invocation of DOT jurisdiction. See procedural proposal \textit{3, infra.}}

Federal preemption under the HMTA should be guided by the special circumstances relating to the regulation of HazMat transport and the specific purposes of Congress in enacting the HMTA. The "uniformity" and "consistency" sought by Congress in HMTUSA can best be realized through the unified administration of the statutory preemption standards. This will lessen the tendency to rely unduly on preemption doctrines developed in other contexts, or used to implement views on federal/state relationships. In addition, the wasteful procedural inefficiency resulting from split jurisdiction would be eliminated.

The second proposal is to revise the administrative processes through which DOT issues preemption and waiver rulings.

Initial decisions should be issued by, and developed under the aegis of, an Administrative Law Judge (ALJ) as provided in the APA. \footnote{124. 5 U.S.C. §§ 551, et seq. In particular see §§ 554, 556 and 3105.} The ALJ should have discretion to proceed by written testimony, absent prejudice to any parties and subject to appropriate oral cross examination.

Appeals from initial decisions should be to a Special Appeals Board empowered to issue Final Agency Orders. The Board would consist of the following DOT officials: (i) the Administrator of the Research and Special Programs Administration (as administrator of the HMTA); (ii) the relevant modal Administrator (i.e., of the Federal Highway, Railroad or Aviation Administration or the Coast Guard); and (iii) the General Counsel. Because the composition of the Appeals Board could be established by order of the Secretary, a statutory amendment may not be necessary. Greater permanence might be assured, however, through an appropriate statutory provision.

These procedural proposals governing DOT's initial and final orders stem from the near monopoly over preemption and waiver decisions conferred on DOT under the preceding proposals. The increase in DOT's decisional authority creates a need for increasing the credibility and public acceptance of its decisions. \footnote{125. As noted, DOT inconsistency rulings have been largely well received by courts. Nor did the legislative hearings reveal any general lack of confidence in the integrity or objectivity of those rulings. Nevertheless, concerns were expressed. See, Hearing Appendix No. II, 187; No. V, 512-22; VI, 337; VIII, 272.} The use of an ALJ will reduce any possible influence of irrelevant or inappropriate institutional biases in the initial decision. Although the Special Appeals Board consists of DOT offi-
cians, the three members would bring the distinctive perspectives of their differing responsibilities to the appeal process. They should provide a beneficial balance conducive to an objective review of the initial order.

The third proposal is for DOT authority to issue a type of interim cease and desist order. This should be issuable, prior to a final order, on sufficient showing of need based on HMTA goals of "safe and efficient" transport. Pending a final order, a state or locality might be barred from enforcing a particular requirement. Conversely, an order denying interim relief would operate as a preliminary and tentative ruling of non-preemption. Interlocutory appeals from interim DOT orders could be taken in the manner provided for appeals from final orders (see proposal D. 4., infra). Provision should also be made for emergency judicial authority to grant injunctive relief prior to the invocation of DOT's jurisdiction. This would become ineffective to the extent that the subject matter was covered in any subsequent final order by DOT.

Interim cease and desist orders of the type proposed and subject to judicial review seem a consistent and necessary aspect of DOT's expanded jurisdiction. The proposal would balance any need for emergency judicial intervention with DOT's primary responsibility for the uniform and consistent application of the HMTA.

The fourth procedural proposal is for direct appeals from final DOT preemption and waiver orders to a Court of Appeals. Specifically, appellants could choose between the District of Columbia Circuit or the Circuit in which the subject matter is located. Authority to enforce DOT orders relating to preemption and waivers would, of course, remain in the Federal District Courts.

As implied by direct appeal to a Court of Appeals, judicial review would not involve de novo hearings. Review would be on a record compiled in proceedings conducted by an ALJ under APA standards. The APA standard of review would also apply. Direct appeals to Courts of Appeal seem warranted in the interest of decisional efficiency. The use of an ALJ to compile the record under APA standards should minimize problems of fairness and completeness. The composition of the Special Appeal Boards should assure that the initial order has received balanced and attentive scrutiny from a variety of perspectives. De novo, or other, proceedings in a federal District Court

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126. Technically, this change in appellate procedure would require amending 49 U.S.C. App. § 1811(e) (Section 112 (e) of the HMTA, as amended) which presently provides for District Court review. The direct appeals jurisdiction of Courts of Appeal is covered generally in 5 U.S.C. § 2342, which should also be amended to include this category of appeals.

127. For an analogous arrangement see 5 U.S.C. § 2321 covering judicial review of Interstate Commerce Commission orders.

would simply impose an added decisional stage to the process of reaching a final resolution.

E. SECTION 30. RAILROADS

Section 30 should be repealed and the HMTA amended to provide expressly that all federal preemption for HazMat transport is subject to the HMTA, without modal distinction. The need for efficiently balancing the claims for uniformity and diversity in HazMat transport regulation applies equally to all modes. In particular, all modes should be subject to the same standards and decisional processes for determining whether unique or unusual local safety factors require exceptions to the principles of uniformity and consistency. Other proposed changes in HMTA preemption and waiver standards would assure that highly integrated railroad operations need forgo the benefits of uniformity only to meet compelling local safety needs.
CASE APPENDIX

Court Decisions Relating to HMTA Preemption (1975-90).

No. CV-N.86-444-BRT (D. Nev. 1988); *rev’d and rem’d* 909 F.2d 352 (9th Cir. 1990).


HEARING APPENDIX


Federal Preemption in the Area of Airline Services and Tort-Shopping—The Air Carrier’s Dilemma

JOHN D. CLEMEN* AND JODI SYDELL ROSENZWEIG**

INTRODUCTION

Defense strategy in aviation litigation frequently begins with an analysis of whether federal law preempts state law requiring a dismissal of state statutory and common law claims. Federal preemption is the displacement of state common law or statutory causes of action by federal standards. Congressional interest in uniformity is the motivating factor behind preemption.1 In areas where safety is the primary concern - as in

1. See, e.g., H.R. Rep. No. 12611, 95th Cong., 2d Sess. 16, reprinted in 1978 U.S. CODE CONG. & AD. NEWS at 3751-52. With respect to airline routes, rates and services, Congress was concerned with the uncertainties and conflicts created by the lack of specific provisions on the jurisdiction of the states and federal government. Id. By way of example, Congress recognized that air carriers were required to charge different fares for intrastate and interstate passengers traveling between the same two cities in the same state. Id. The states regulated the fares of intrastate passengers (those whose entire journey was between two cities in the same state), and the Civil Aeronautics Board regulated the fares of interstate passengers (those who traveled
the area of airline services - the states must not be permitted to enact or 
enforce conflicting rules of law. Rather, air carriers must be free to do 
whatever is necessary to insure the safety of flight, within the confines of 
federal law, without fear of reprisal suits by disgruntled passengers.

The issue is whether state law merely supplements a federal stan-
dard or whether state law is entirely displaced by a federal standard. It is 
resolved by resort to Congressional intent. Generally, preemption may 
be (1) express by specific language contained in a particular federal stat-
ute; (2) implied by a pervasive regulatory scheme; or (3) applied when 
state law conflicts with federal law or interferes with Congressional 
objectives.

The preemption concept is by no means new; it finds its roots in the 
supremacy clause of Article VI of the United States Constitution. However, in 1978, when Congress enacted the Airline Deregulation Act, adding a federal preemption provision to the Federal Aviation Act, attention was drawn to the issue of preemption, resulting in a plethora of dismissal motions based upon express preemption.

Section 1305(a)(1) of the Federal Aviation Act provides, in pertinent part:

[N]o State or political subdivision thereof and no interstate agency or other 
political agency of two or more States shall enact or enforce any law, rule, 
regulation, standard or other provision having the force and effect of law 
relating to rates, routes or services of any air carrier.

Congress intended to prevent conflicts and inconsistent regulations by 
eliminating state jurisdiction over airline routes, rates or services. The 
implication is that an air carrier which performs services in accordance 

between the same two cities and then connected to another carrier to complete an out-of-state journey.

To prevent such inconsistent regulations, Congress enacted a preemption provision which provided the federal government with jurisdiction over routes, rates and services of air carriers. 


4. Rice, 331 U.S. at 230.
6. Article VI of the United States Constitution provides:
The Constitution, and the Laws of the United States which shall be made in Pursuance thereof ... shall be the supreme Law of the Land; and the Judges in every state shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.
with federal regulations may not be subject to legal actions based upon state statutes or common law. Some courts, however, have been reluctant to find preemption - either express, implied or by conflict. The courts have focused upon the nature of the state statute or tort instead of the conduct of the carrier, creating a forum for tort-shopping.

For example, the Western District of Tennessee has excluded intentional torts from preemption, and the Ninth Circuit has gone to the extreme of concluding that only state laws which are exclusive to airline services - not state laws which merely have an effect on services - are preempted. As a result, an air carrier's federally-sanctioned conduct is left unprotected so long as the plaintiff provides a proper label for his cause of action. The air carrier's conduct is irrelevant in this analysis. This article discusses the undesirable effects of this misplaced analysis.

**Hingson and an Initial Approach to Preemption**

The issue of federal preemption in the area of airline services first arose in *Hingson v. Pacific Southwest Airlines*. In Hingson, a blind person who was escorted off the aircraft by police officers when he refused to sit in a bulkhead seat, brought an action for intentional infliction of emotional distress and a claim arising under the California Civil Code which required that handicapped persons be given "full and equal access" to accommodations of all airplanes. The Ninth Circuit held that regulation of air carrier seating policies involved regulation of services within the meaning of § 1305(a)(1) and, accordingly, the plaintiff's claims under the California code were expressly preempted. The court held, however, that the plaintiff's claim for intentional infliction of emotional distress, although arising directly from the carrier's seating policy, was not preempted.

The *Hingson* court cited *Farmer v. United Brotherhood of Carpenters & Joiners of America* to support its holding that the plaintiff's emotional distress claim was not preempted. In *Farmer*, the United States Supreme Court held that the National Labor Relations Act did not preempt the state tort action for intentional infliction of emotional distress arising in connection with alleged employment discrimination because the conduct

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11. 743 F.2d 1408 (9th Cir. 1984).
13. 743 F.2d at 1415-16.
14. Id. at 1416.
16. Hingson, 743 F.2d at 1416.
was alleged to be outrageous.\textsuperscript{17} The Court noted:

On balance, we cannot conclude that Congress intended to oust state-court jurisdiction over actions for tortious activity such as that alleged in this case. At the same time, we reiterate that concurrent state court jurisdiction cannot be permitted where there is a realistic threat of interference with the federal regulatory scheme. Union discrimination in employment opportunities cannot itself form the underlying "outrageous" conduct on which the state-court tort action is based; to hold otherwise would undermine the pre-emption principle. Nor can threats of such discrimination suffice to sustain state-court jurisdiction. It may well be that the threat, or actuality, of employment discrimination will cause a union member considerable emotional distress and anxiety. But something more is required before concurrent state-court jurisdiction can be permitted. Simply stated, it is essential that the state tort be either unrelated to employment discrimination or a function of the particularly abusive manner in which the discrimination is accomplished or threatened rather than a function of the actual or threatened discrimination itself.\textsuperscript{18}

The \textit{Hingson} court's reliance on \textit{Farmer} is unexplained other than in its citation and parenthetical containing the Supreme Court's holding.\textsuperscript{19} Reference to the above quotation from \textit{Farmer} reveals that the Ninth Circuit's reliance is misplaced. Accepting the \textit{Farmer} rationale, the air carrier's seating policy and manner of enforcement of that policy - which was not merely compelled by the plaintiff's refusal to obey the carrier's instructions, but was also in accordance with federal regulations\textsuperscript{20} - cannot itself form the basis for the state court tort action.

Yet, this was the sole basis for the plaintiff's claim of extreme or outrageous conduct. Even the Ninth Circuit, in affirming the directed verdict in favor of the air carrier on the ground that the evidence was insufficient to support the plaintiff's claim for emotional distress, recognized that the carrier's employee's conduct could not "plausibly be characterized as either extreme or outrageous."\textsuperscript{21} The Supreme Court in \textit{Farmer} could not have meant to permit concurrent state court jurisdiction based upon bare allegations of outrageous conduct. Otherwise, every disgruntled plaintiff could circumvent federal standards by simply labeling the carrier's conduct as "outrageous."

\section*{Uniform Application of Preemption}

The \textit{Hingson} court left open the issue of which tort claims constituted

\begin{itemize}
\item \textsuperscript{17} Farmer, 430 U.S. 290.
\item \textsuperscript{18} Id. at 305.
\item \textsuperscript{19} Hingson, 743 F.2d at 1416.
\item \textsuperscript{20} Section 1511(a) of the Federal Aviation Act provides, in pertinent part: [A]ny such carrier [may] . . . refuse transportation to a passenger . . . when, in the opinion of the carrier, such transportation would or might be inimical to safety of flight. 49 U.S.C. § 1511(a).
\item \textsuperscript{21} Hingson, 743 F.2d at 1416.
\end{itemize}
an exception to federal preemption. Initially, the courts hardly considered
the exception, simply dismissing claims relating to airline services as ex­
pressly preempted.

In Anderson v. USAir, Inc.,22 a blind person brought an action
against an airline for the tort of outrageous conduct, breach of contract
and violation of a common law obligation to "provide equal and courte­
ous service to all," arising out of the airline’s refusal to seat him next to an
emergency exit. The United States District Court for the District of Colum­
bia dismissed the complaint, holding that the state law obligation to give
courteous service was expressly preempted by § 1305,23 and the District
of Columbia Circuit affirmed.24 The court did not consider the application
of preemption to the plaintiff’s claims of breach of contract and tort of
outrage. With respect to these claims, the District of Columbia Circuit
simply affirmed the district court’s dismissal based upon the plaintiff’s fail­
ure to present sufficient evidence.25

In O’Carroll v. American Airlines, Inc.,26 the Fifth Circuit held that
§ 1305(a)(1) expressly preempted state law claims for damages by a
passenger who was excluded from a flight after creating a disturbance on
the aircraft. In Baugh v. Trans World Airlines, Inc.,27 the Fifth Circuit went
so far as to find personal injury claims preempted where the injury was
allegedly caused by a flight attendant’s negligence while acting within the
course and scope of her employment.

In Von Anhalt v. Delta Air Lines, Inc.,28 a passenger asserted numer­
ous state law claims against an airline including assault and battery, defa­
mation and negligence, after she was escorted off the aircraft when she
refused to allow a flight attendant to stow away her carry-on baggage.
The United States District Court for the Southern District of Florida con­
ccluded that § 1305(a) "unmistakably manifests the intent of Congress to
preempt such state common law tort claims as related to the services of
aircrafts and the safety of passengers."

In Smith v. America West Airlines, Inc.,30 the United States District
Court for the Southern District of Texas held that § 1305(a)(1) preempts
state law claims against a carrier for negligence and gross negligence in
allowing a passenger to board and hijack the aircraft.

24. 818 F.2d 49.
25. Id. at 56-57.
27. 915 F.2d 693 (5th Cir. 1990).
29. Id. at 1031.
In *Fressie v. Trans World Airlines, Inc.*, a passenger who refused to change his seat was escorted off the aircraft by the Port Authority police. The United States District Court for the District of New Jersey held that § 1305(a)(1) preempts the plaintiff's claims for malicious prosecution, false arrest and punitive damages. The remaining count of breach of contract was then dismissed for lack of subject matter jurisdiction and because the amount in controversy fell short of the statutory requirement for diversity jurisdiction. The *Fressie* case is now pending appeal.

In *Ricci v. American Airlines, Inc.*, a scuffle ensued after two passengers had a dispute about smoking on the aircraft. The plaintiff brought an action against the air carrier for negligence and insult to passenger in the Superior Court of New Jersey. The court granted the carrier’s motion for summary judgment, concluding that Congress unmistakably preempted state law.

**THE PLAINTIFF'S RECOURSE**

The plaintiff’s bar, threatened by dismissal based upon preemption, attempts to invoke the savings clause, contained in the Federal Aviation Act, which provides:

> Nothing contained in this chapter shall in any way abridge or alter the remedies now existing at common law or by statute, but the provisions of this chapter are in addition to such remedies.

This section was taken intact from a predecessor provision of the Civil Aeronautics Act of 1938. In *Hingson*, the Ninth Circuit noted that the legislative history of the Airline Deregulation Act of 1978 does not explain the relationship between the savings clause and the preemption provision. The court concluded that because the Civil Code would involve regulation of the services of an air carrier, the plaintiff's claims were preempted notwithstanding the savings clause. In *O'Carroll*, the Fifth Circuit denied a petition for rehearing based upon the savings clause since the federal preemption provision was enacted well after the savings clause. In *Von Anhalt*, the Southern District of Florida concluded that the savings clause did not conflict with the preemption provision because

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32. *Id*.
33. *Id*.
35. *Id*.
38. *Hingson*, 743 F.2d at 1416, n.11.
39. *Id*.
it expressly saves state law remedies and not state law claims.\textsuperscript{41}

Finding no comfort in the savings clause\textsuperscript{42} and faced with the threat of dismissal, the plaintiff’s attorney argues that if the state action is preempted, the plaintiff has a private right of action for violation of the Federal Aviation Act. More specifically, arguments are made that the carrier exercised discriminatory treatment pursuant to § 1374(b),\textsuperscript{43} failed to “provide safe and adequate service” pursuant to § 1374(a),\textsuperscript{44} or abused its discretion pursuant to §§ 1374 and 1511(a).\textsuperscript{45}

Some courts considered the private right of action for violations of §§ 1374 and 1511(a) to be the plaintiff’s recourse.\textsuperscript{46} In O’Carroll, the Fifth Circuit recognized an implied cause of action under § 1374 for abuse of discretion by virtue of § 1511.\textsuperscript{47} In Von Anhalt, the Southern District of Florida relied upon § 1511(a) to conclude that the plaintiff could challenge the reasonableness of the carrier’s conduct.\textsuperscript{48} Neither the Fifth Circuit nor the Southern District of Florida, however, discussed or considered the repeal of § 1374 and the effect of the repeal on any express or implied private right of action.\textsuperscript{49}

\textsuperscript{41} Von Anhalt, 735 F. Supp. at 1031.

\textsuperscript{42} But cf. Stewart v. American Airlines, Inc., 776 F. Supp. 1194 (S.D. Tex. 1991) (“to the extent that a claim is not preempted by Section 1305, it is expressly preserved by § 1506”). In Stewart, the plaintiff alleged that he was injured when the aircraft malfunctioned. The court held the plaintiff’s allegations to be more akin to those arising out of an air crash and, accordingly, not necessarily services within the meaning of § 1305. The court also recognized, however, that state law is preempted where it creates a different standard than that created by the Federal Aviation Act.

\textsuperscript{43} Prior to its repeal, § 1374(b) of the Federal Aviation Act provided:

No air carrier or foreign air carrier shall make, give, or cause any undue or unreasonable preference or advantage to any particular person, port, locality, or description of traffic in air transportation in any respect whatsoever or subject any particular person, port, locality, or description of traffic in air transportation to any unjust discrimination or any undue or unreasonable prejudice or disadvantage in any respect whatsoever. 49 U.S.C.A. § 1374(b)(West 1976), repealed by 49 U.S.C.A. §§ 1511(a)(2)(B) and 1511(a)(4)(C) (West Supp. 1991).

\textsuperscript{44} Prior to its repeal, § 1374(a) of the Federal Aviation Act required that the airlines maintain a certain level of service, equipment, facilities, rates, fares, charges, classifications, rules, regulations and practices. 49 U.S.C.A. § 1374(a) (West 1976 & Supp. 1991), repealed by 49 U.S.C.A. §§ 1551(a)(2)(B) and 1551(a)(4)(C) (West Supp. 1991). Section 1374(a) was repealed, except for the requirement that carriers “provide safe and adequate service.” 49 U.S.C. §§ 1551(a)(2)(B), 1551(a)(4)(C).

\textsuperscript{45} See supra note 22.

\textsuperscript{46} O’Carroll, 863 F.2d at 13; Von Anhalt, 735 F. Supp. at 1031.

\textsuperscript{47} 863 F.2d at 13.

\textsuperscript{48} 735 F. Supp. at 1031.

\textsuperscript{49} Section 1374 was repealed, except for the requirement of § 1374(a) that carriers “provide safe and adequate service.” See note 46, supra. It is not clear whether or not the O’Carroll incident occurred prior to the effective date of the repeal. However, the Von Anhalt incident clearly occurred after such date. With the repeal came the elimination of any express or implied private right of action under § 1374. Anderson, 818 F.2d at 54; Smith v. America West Airlines,
Except for the requirement that carriers provide "safe and adequate service," § 1374 was repealed by the Airline Deregulation Act of 1978, as amended by the Civil Aeronautics Board Sunset Act of 1984. Prior to the repeal, passengers had a private right of action for discriminatory treatment pursuant to § 1374(b). There was no private right of action under § 1374(a) as it existed prior to the repeal or as it now exists requiring that air carriers "provide safe and adequate service." Accordingly, with the repeal of § 1374(b), there is no longer an express or implied private cause of action under § 1374. Nor is there an implied right of action under § 1374(a) in conjunction with § 1511(a).

In Salley v. Trans World Airlines, Inc., the United States District Court for the Southern District of Louisiana was so concerned with the elimination of a private cause of action under § 1374 that it reconsidered and vacated its earlier decision dismissing the plaintiff's state law claims based upon express preemption. Initially, the court read O'Carroll to hold that "no state law claims may be brought in suits complaining of airline services." Concerned that the plaintiffs would have no recourse, the court reinterpreted the O'Carroll decision to conclude that § 1305(a)(1) preempts only those state laws which interfere or conflict with federal law. It is clear, however, that in O'Carroll, the Fifth Circuit held § 1305(a)(1) to be express preemption, not conflict preemption.

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52. Anderson, 818 F.2d at 54; Hingson, 743 F.2d at 1411-12; Diefenthal v. Civil Aeronautics Board, 681 F.2d 1039, 1050 (5th Cir. 1982), cert. denied, 459 U.S. 1107 (1983).
53. Hingson, 743 F.2d at 1414, Diefenthal, 681 F.2d at 1049-50 (applying four-prong test of Cort v. Ash, 422 U.S. 66, 78 (1975)).
55. In Smith, the court rejected the plaintiff's argument that an implied private right of action exists under §§ 1374(a) and 1511(a) to allege abuse of discretion in permitting a hijacker to board the aircraft. No. H-91-1550. But see Von Anhalt, 735 F. Supp. at 1031 (plaintiff may assert a claim under § 1511(a) challenging the reasonableness of the carrier's conduct); see supra text accompanying notes 50-51; Salley, 723 F. Supp. at 1166 (court implied a possible private right of action if § 1511(a) applies); see infra text accompanying notes 58-61.
56. 723 F. Supp. 1164.
57. Id. at 1165.
58. Id. at 1166.
59. In O'Carroll, the court discussed the three instances where federal law preempts state law: (1) express preemption, (2) preemption inferred from a pervasive federal regulatory scheme, and (3) preemption where state law conflicts with federal law or interferes with the achievement of congressional objectives. 863 F.2d at 12 (citations omitted). The court concluded that there was "no need to rely upon inference alone as Section 1305 which is entitled Federal Preemption, expressly preempts state law." (emphasis added). Id. at 13. See also Gay v. Carlson, No. 89 Civ. 4757, slip op., (S.D.N.Y. Feb. 22, 1990), where the court, while holding
Salley court’s narrow reading of O’Carroll is clearly erroneous and at odds with the Anderson, Baugh, Von Anhalt, Smith, Fressie and Ricci courts' application of the preemption provision.

The Salley court’s concerns about the plaintiff being left without a cause of action are unwarranted. The airline must provide safe and adequate service, and private parties may pursue administrative remedies. The Department of Transportation or Federal Aviation Administration may bring suit directly against the carrier.

**RECENT EROSION OF THE PREEMPTION PRINCIPLES**

In Anderson, O’Carroll, Baugh, Von Anhalt, Smith, Fressie and Ricci, the courts applied the preemption statute uniformly to all state claims relating to, or arising out of, airline services. There was no uncertainty. Where a claim arose out of an accepted airline practice or policy, there could be no state action. Some courts, however, have focused on the Hingson exception to provide passengers with the means to evade federal preemption. In adopting that approach, however, the courts have erroneously focused on the nature of the state action instead of the carrier’s conduct. Thus, the courts have taken a step backwards.

An example of this misguided analysis is Williams v. Express Air Lines I, Inc. In Williams, a passenger was denied boarding as a result of the air carrier’s policy of prohibiting wheelchair users from flying on its aircraft. The passenger brought an action against the carrier for breach of contract, negligence and false imprisonment. The United States District Court for the Western District of Tennessee concluded that the plaintiff’s breach of contract and negligence claims related to the services of the air carrier and were expressly preempted by § 1305. With respect to the plaintiff’s claim of false imprisonment, however, the court held that intentional tort claims are not preempted, relying on Hingson. The plaintiff alleged that the defendant unlawfully prevented him from board-

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An airline is in the business of providing air service to passengers. The issues of to whom to provide that service, and whom to exclude from a flight, clearly are issues relating to services of an air carrier. 49 U.S.C. App. § 1305(a). A state law remedy for a passenger who felt wrongly excluded from a particular flight would contravene the express intent of Congress to ensure that such decisions are governed by federal standards.

60. See supra text accompanying notes 52-53.
61. Anderson, 818 F.2d at 55; Smith, No H-91-1550.
62. Id.
64. Id. at 13155.
65. Id. at 13156, n.3.
ing the flight and intentionally permitted that flight to depart without him. The court held that these allegations were sufficient to state a claim of false imprisonment under Tennessee law.66

The Western District of Tennessee’s holding is irrational and inconsistent with Congressional intent. Seating policies involve the regulation of services within the meaning of section 1305(a)(1), and state claims based upon seating policies are preempted.67 Carriers may exclude passengers who refuse to follow the carrier’s instructions or create a disturbance on the aircraft if, in the carrier’s opinion, transportation “might be inimical to safety of flight.”68 Accepting the Tennessee court’s rationale, the carrier that is protected from liability for properly carrying out procedures relating to airline services may still be held liable if state law provides the passenger with intentional tort claims based upon the very same protected practice.

As if this inconsistency were not enough, the Ninth Circuit took another bite out of federal preemption. In West v. Northwest Airlines, Inc.,69 a passenger with a valid ticket was denied boarding on an overbooked flight. The passenger brought an action against the carrier for breach of the covenant of good faith and fair dealing under Montana law. The district court granted summary judgment in favor of the carrier on the ground of preemption.

On appeal, the Ninth Circuit agreed with the trial court that the plaintiff’s claim for punitive damages was preempted, but reversed and remanded the case to the district court to determine if the plaintiff had a meritorious claim for compensatory damages under Montana law.70 In reaching that result the court first held that § 1305(a)(1) does not expressly preempt the plaintiff’s state law claim.71 While the court recognized that “services” include boarding policies,72 it held that the preemption provision does not apply to all state laws that affect airline services.73 The court observed:

Instead, we find that Section 1305(a)(1) preempts claims only when the underlying statute or regulation itself relates to airline services, regardless of whether the claim arises from a factual setting involving airline services. Thus, state laws that merely have an effect on airline services are not preempted.74

66. Id. at 13156.
67. Hingson, 743 F.2d at 1415.
68. 49 U.S.C. § 1511(a); see supra note 22.
69. 923 F.2d 657 (9th Cir. 1991).
70. Id.
71. Id. at 660.
72. Id. at 660.
73. Id.
74. Id. at 660 (emphasis in original).
The United States Supreme Court decided the same issue, albeit in the context of ERISA's preemption provision, in *Shaw v. Delta Airlines, Inc.* There, the Court held that Congress used the words "relate to" in their broad sense, noting, "[w]e must give effect to this plain language unless there is good reason to believe Congress intended the language to have some more restrictive meaning." Based upon the "plain language of [the section], the structure of the Act, and its legislative history," the Court concluded that the preemption provision applied to laws which were not specifically designed to effect employee benefits. In a footnote, however, the court noted, "[s]ome state actions may affect employee benefit plans in too tenuous, remote, or peripheral a manner to warrant a finding that the law 'relates to' the plan." The Court refused to draw the line.

The Fifth Circuit also considered the impact of state legislation on the Federal Aviation Act in *Trans World Airlines, Inc. v. Mattox.* In concluding that State deceptive practices law was preempted by federal law insofar as it applied to advertising airline rates, the Fifth Circuit held, "[a]lthough the state laws against deceptive advertising are not aimed specifically at airlines, and clearly do not attempt to set rates, the conclusion is inescapable that such laws do relate to rates when applied to airline fare advertising." In *West,* however, the Ninth Circuit relied on *Air Transport Ass'n v. P.U.C.,* a case involving an airline trade association's challenge of a regulation prohibiting telephone customers from surreptitiously overhearing or recording conversations. In that case, the court held that the regulation was not preempted because the type of telephone operation was not peculiar to airlines. Further, the court could find no evidence that Congress intended to preempt state regulation of utilities when they affected airlines.

The *West* court found its analysis consistent with *Hingson,* noting that *Hingson's* emotional distress claim involved the airline's services. However, the underlying law, the tort of intentional infliction of emotional distress, was not specifically designed to effect employee benefit plans.
tress, was not addressed exclusively to airline services.\textsuperscript{85}

The Ninth Circuit also rejected any claim of implied preemption. Here, the court held that retention of the savings clause demonstrated Congressional intent not to preempt all common law remedies.\textsuperscript{86} Finally, the court held that there was no conflict preemption since airline overbooking regulations contemplate that customers choose between liquidated damages or state common law remedies.\textsuperscript{87}

The \textit{West} decision is puzzling. A passenger cannot bring an action for failure to provide “full and equal access” to accommodations of airplanes, but can bring an action for breach of the covenant of good faith and fair dealing. The focus is on the label of the cause of action and not on the carrier’s conduct.

Ironically, the Ninth Circuit held that the plaintiff’s claim for punitive damages was preempted since federal regulations contemplate overbooking as an acceptable practice and, accordingly, “any scheme that \textit{punishes} the practice would be inconsistent with applicable federal law.”\textsuperscript{88} If federal regulations permit carriers to overbook flights, then any and all state actions arising out of overbooking must be preempted. The preemption provision is not limited to claims for punitive damages but applies to all state laws relating to airline services.

To put it simply, air carriers must not be held liable for federally sanctioned conduct regardless of the label attached to the state cause of action or the nature of the damages claimed. Any other result is illogical and at odds with the concept of uniformity which is the cornerstone of the preemption doctrine.

\section*{CONCLUSION}

The courts have undermined the preemption principle, reducing it to a nullity. Passengers bringing actions arising out of airline services need only identify their claims to fall within the \textit{Williams} or \textit{West} exceptions. Imagine the passenger who creates a disturbance on an aircraft when he is asked to change his seat for safety reasons. The sole interest of the carrier is the safety of flight and passengers. Imagine, however, that the passenger refuses to change his seat, delaying the flight and causing an uproar. Left with no alternative, the carrier requests that local authorities escort the passenger off the aircraft. The passenger has no state cause of action regarding the carrier’s seating policy or his removal from the aircraft.

\begin{thebibliography}{99}
\bibitem{85} West, 923 F.2d at 660.
\bibitem{86} Id. at 661.
\bibitem{87} Id.
\bibitem{88} Id. at 661 (emphasis in original).
\end{thebibliography}
However, if the passenger calls his cause of action intentional infliction of emotional distress, false imprisonment, or the like, he can take discovery and litigate the matter until the court rules, as a matter of law, that the carrier's conduct was not outrageous. Court and attorney time, resources and expenses will be wasted only to discover that the passenger has no claim. Had the initial focus been on the carrier's conduct instead of the label of the passenger's cause of action, the passenger's entire complaint would have been preempted.

If, on the other hand, the court allows the case to proceed and a jury finds the carrier liable, the carrier has no basis on which to model its future conduct. Does it change its safety policy? Does it make exceptions for those passengers who demand seating arrangements which conflict with the carrier's policies? Or does it merely hope that the result of the next case will be different?

The carrier must not be faced with this dilemma. Uniform preemption of state claims relating to airlines services is the only way to promote safety.

Until the courts agree to focus on the carrier's conduct, as clearly intended by Congress, air carriers will continue to be left in the "Catch 22." They may be held liable for doing that which is accepted, sanctioned and, sometimes, required by federal regulations.

**AUTHORS' NOTE**

After the article was authored, the United States Supreme Court recognized the folly of the *West* rationale. In *Morales v. Trans World Airlines, Inc.*[^89] the Supreme Court rejected the precise argument adopted in *West*—albeit in the context of airline rates—as "an utterly irrational loophole (there is little reason why state impairment of the federal scheme should be deemed acceptable so long as it is effected by the particularized application of a general statute)."[^90] It is in light of the Supreme Court's decision in *Morales* that certiorari was granted in *West*, the judgment was vacated and the case was remanded to the Ninth Circuit.[^91]

The Supreme Court in *Morales* also rejected the misplaced reliance

[^90]: Id. at 2038.

A superb example of the "irrational loophole" is contained in Abou-Jaoude v. British Airways, 281 Cal. Rptr. 150 (Cal. App. 2 Dist. 1991). Abou-Jauode was a discrimination case. The California court relied on West to conclude that a state statute which regulated the services of common carriers and prohibited the discriminatory conduct of which plaintiff complained was expressly preempted, but another state statute which prohibited discrimination generally and applied to all business establishments was not. The ruling permits passenger-plaintiffs who cannot rely on the applicable state law, that is, law that expressly applies to the services of carriers, to search for other state law, which may not necessarily apply but will not be preempted.

on the savings clause of the Federal Aviation Act,\textsuperscript{92} which provides:

Nothing contained in this chapter shall in any way abridge or alter the reme-
dies now existing at common law, or by statute, but the provisions of this
chapter are in addition to such remedies.\textsuperscript{93}

The court noted, "a general 'remedies' saving clause cannot be allowed
to supersede the specific substantive pre-emption provision. . . ."\textsuperscript{94}

\textit{Morales} is a step in the right direction. It remains to be seen, how-
ever, what other loopholes the courts will create to avoid preemption.

\textsuperscript{92} 112 S. Ct. at 2037.
\textsuperscript{94} Morales, 112 S. Ct. at 2037.
The Integration of Aviation Law in the EC: Teleological Jurisprudence and the European Court of Justice

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I. INTRODUCTION

There are currently twelve members in the European Community.¹ More are knocking on the door.² As the Member States become more integrated, the EC sets a striking example as the most effective trade bloc and the first operative supranational government.³ One of the most important and least understood institutions in the EC is the Court of Justice of the European Community.⁴

This paper focuses on the role that the Court plays within the institutional framework of the European Community. This study demonstrates the Court’s effect on integration by analyzing a line of decisions that led to EC governance of air transportation.

BACKGROUND

International aviation law is characterized by countless bilateral agreements that allow exceptions to the Chicago Convention’s mandate of complete national sovereignty over airspace. Almost every major EC carrier is government owned or subsidized.⁵ In negotiating bilateral agreements, governments make arrangements to protect their carriers from normal market conditions. There are a number of reasons why EC Member States prefer protection instead of liberalization which the application of EC law entails.

National airlines, know as “flag carriers”, are used to serve a variety

1. European Community hereinafter referred to as EC and Community. The 12 nations are Belgium, Netherlands, Luxembourg, France, Germany, Italy, (original members); Denmark, Great Britain, Ireland, Spain, Portugal, and Greece. See generally, P. KAPTEYN, INTRODUCTION TO THE LAW OF THE EUROPEAN COMMUNITIES (1989), P. MATHIJSEN, A GUIDE TO EUROPEAN COMMUNITY LAW (1985).

2. The most recent expansion resulted from the reunification of Germany. East European countries such as Hungary also want in. It is doubtful that they would be given full membership at this time due to their economic woes. Membership would almost certainly beget a transfer of populations from Eastern to Western Europe, and a transfer of EC development funding away from the Mediterranean Member States. Turkey has been kept out for the same reasons, although it does have an associative membership. This probably is the most likely solution for Eastern European countries at this time. Most likely candidates presently are the EFTA countries. With the thawing of the cold war, neutrality has become moot. This helped lead to the recent free trade agreement between the EC and EFTA which expanded the common market significantly. Austria appears to be on deck for full membership. Norway was slated to join in 1973, but opted out by referendum. They are likely candidates. Instead of joining one by one, it is possible that all of the EFTA nations will join under the same act of accession.

3. For a view that an EC-type community is the solution to problems in the Middle East see Cobban, THE SUREST WAY TO MIDDLE EAST PEACE, CHRISTIAN SCIENCE MONITOR Dec. 5, 1991, p. 19.

4. Hereinafter referred to as the European Court of Justice, ECJ, Court of Justice, and the Court.

5. The most notable exception is British Airways.
of state interests such as foreign policy, economic policy, social policy, national prestige, and national defense. The political exchanges that make up the myriad of bilateral agreements among the EC states, and between EC states and non-EC states, are unlikely to be readily denominated into a common EC policy. More importantly, the EC nations and their flag carriers feared changes that would lead to a move towards a more competitive commercial climate and a system whereby competition laws would apply to airline activities. Governments whose airlines are so important to them are understandably hesitant to yield control to a supra-national organization aimed at reducing barriers to competition. The result of this desire to keep air transportation out of the Community legal system is reflected in the treaty establishing the European Economic Community.8

Commonly referred to as the Treaty of Rome, the EEC Treaty is one of the broadest multilateral agreements ever signed. The most important institutions called for by the Treaty are the Court of Justice, the Commission, and the Council. The Commission is a pro-federalist institution that consists of seventeen members whose independence is beyond doubt.9 The Council, on the other hand, consists of partisan representatives from each of the Member States. The Council prefers intergovernmental decision-making over the Commission’s vision of federalism. Generally, legislation is entered pursuant to the Treaty by the Council’s acceptance of a Commission proposal.10

The Treaty has several provisions which are concerned with transportation. Article 3 of the Treaty of Rome sets out the “activities of the Community.”11 One of the eleven stated activities of the European Economic Community is to adopt “a common policy in the sphere of transport.”12 Articles 74-84 specifically relate to the development of the Common Transport Policy. Article 84 is probably a reflection of the hesitancy of the contracting states to alter their complete control of their nation’s international aviation industry.13 Article 84 explicitly states that the transport provisions do not apply to air (and sea) transportation. It goes

6. i.e. Air France flying to former colonies, for political as well as economic reasons.
7. i.e. Olympic Airways forms a unifying social link for the Greeks who are scattered on the islands.
11. Treaty of Rome art. 3.
12. Treaty of Rome art. 3(e).
on to say that the council may decide on measures for air (and sea) transportation if it acts unanimously. Therefore, each contracting state agreed to keep air transport out of EC control, unless they all agreed at a later date to include it in the EC framework. Given the interests of the Member States and the requirement of unanimous action by the Council, it is not surprising that it took thirty years for the Council to adopt regulations for air transportation. What is surprising is that the Council did eventually act. Part II of this paper is a chronological analysis of the line of cases which led to that action.

II. CASES AND EVENTS

THE FRENCH MERCHANT SEAMEN CASE

In 1973, the Court of Justice of the European Communities made its first move in the aviation field. Re French Merchant Seamen: E.C. Commission v. France14 revolved around Article 84 and its provision allowing the Council to determine the extent to which sea and air transport would be regulated by the EC.

The facts are simple. France had a law which favored the hiring of French nationals in the French maritime industry. The Commission brought the claim under Article 169 claiming that France failed to comply with Article 48 which prohibits discrimination on the basis of nationality. Because the Court has implemented very strict standing requirements under certain treaty provisions,15 France’s first argument was that the Commission did not have standing under Article 169 because it had no legal interest in the matter.

The Court was quick to hold that the Commission did not need a legal interest to bring a case under Article 169.16 The importance of this holding is that the Court has granted the Commission complete standing under Article 169. Since the Commission is a pro-EC institution, the Court, in effect, is encouraging the Commission to bring cases so that the Court can have the opportunity to further EC integration.

The second, and most important, argument that France brought in this case concerned sea transportation. France acknowledged that transportation is one of the areas governed by the Treaty of Rome. Article 3(e) and Articles 74-84 refer to a common transport policy and give the guide-

15. Most notable is the Court’s standing requirements for Article 173. Here the Court has disallowed standing for persons, forcing them to take their case to national courts, which can then refer the case to the ECJ for a “preliminary ruling” under Article 177. In this way, the ECJ has positioned itself as a supreme appellate court. See Rasmussen, Why is Article 173 Interpreted against Private Plaintiffs?, 5 E.L.R. 112 (1980).
lines with which it is to be developed. But Article 84(2) leaves it up to the Council to decide the extent and procedure for regulating sea and air transport. France argued that since the Council did not develop any provisions on sea (and air) transport, sea (and air) transport were not subject to the Treaty. The Court held that Article 84(2) only pertained to the provisions relating to the development of a common transport policy (Articles 74-84). The Court went on to hold that sea and air transport are “subject to the general rules of the Treaty.”

In order to apply the Treaty to the facts in the case, the Court decided the case as if the Treaty governed transportation generally. The flaw in the Court’s analysis is that the Treaty of Rome does not purport to govern transportation in the general sense. Instead, all of the Treaty provisions relating to transportation speak of a common transport policy that falls under the aegis of the Treaty.18 The Court’s sneaky decision violated the Treaty of Rome’s provisions on common transport policy and egregiously sidestepped the plain meaning and intent of Article 84(2).19

The Court could have limited its holding by stating that the free movement of workers (Articles 48-51) provisions apply to sea and air transport. Instead, it left its holding wide open by making sea and air transport subject to the “general rules” of the treaty.20 “General rules” could easily be construed to include the Treaty’s provisions on Competition, Right of Establishment, and Taxation. The Court used a low-profile maritime case21 to take a giant step toward bringing sea and air transportation under the Treaty of Rome.

This is not to say that the ECJ was poised to judicially enforce the Treaty in this area right away. It may be an activist Court, but it is also a shrewd one. It knows when to step and how far to walk. If the Court lashed out and applied the competition provisions of the Treaty to aviation, it would probably have been crippled by political criticism from the governments which created it. What the Court did in French Merchant Seamen was to send a clear message to the Council that legislation in this area is necessary. The Court let it be known that it was moving toward

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17. *Id.* at 229.
18. Treaty of Rome art. 3(3), 61, 74-84.
19. “The Council may, acting unanimously, decide whether, to what extent and by what procedure appropriate provisions may be laid down for sea and air transport.” Treaty of Rome art. 84(2).
21. The decision mentions that France was in the process of changing its discrimination law, but not because it was contrary to EC law. Since the French government was working to change the law, and since the injury claimed was not significant in magnitude, it is likely that the case did not attract a lot of attention. It is interesting to note that the Court used a seemingly insignificant case about maritime affairs to slip in a few words which subjects aviation to the Treaty. This is not Cardozo, but it is equally masterful in its own way.
applying the competition rules of the Treaty to aviation. This would mean that aviation in Europe would be radically liberalized, and in the absence of secondary legislation, governed by the whims of a Court’s interpretations of a few ambiguous treaty provisions. This would truly be a nightmare for the protected European carriers. In essence, the Court began to create an environment whereby the Member States (in the Council) would demand a detailed aviation policy.

The next decision that played a role in the development of EC aviation law was the Commission of the European Communities v. Kingdom of Belgium. Unlike French Merchant Seamen, this case concerned rail transport which was part of the existing legislation on transportation. The issue was whether Belgium’s subsidies to its railroad were in violation of Article 92 which is a general prohibition on state aid to industry.

Article 92 begins with “‘[s]ave as otherwise provided in this Treaty, any aid granted by a Member State ... [is] incompatible with the common market.’” Since Article 92 begins in this fashion, and since Article 77 deals exclusively with aid to transport, Belgium made the highly plausible argument that Article 92 did not apply to the facts at hand. Belgium argued that Article 77 governed the case. Article 77, which is under the Transport Title of the Treaty of Rome, allows for aid if it meets “the needs of coordination of transport” or if it represents reimbursement for obligations taken for “public service”. Since Belgium’s aid to its railway industry arguably satisfied at least one (probably both) of Article 77’s conditions, Belgium’s position seemed rock solid. But again, the Court refused to apply the Treaty provision that was on point.

The Court held that “‘Article 77 of the Treaty ... cannot be to exempt aid to transport from the general system of the Treaty concerning aid granted by the states and from the controls and procedures laid down therein.” In other words, Article 77 does not mean what it says it

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23. The Council had already begun to regulate surface transport. Whether the Council’s activities in this area were sufficient to constitute a “Common Transport Policy” is addressed in the Transport Policy Decision.

24. Supra n. 22 at 1894.

25. This is not the primary holding of the case, according to the way in which the ECJ structured its decision. (Did they put it in a less conspicuous place because it is a controversial and insupportable conclusion?) Regardless of the structure of the Court’s analysis, for the purposes of this paper, it is the holding.

26. Supra n. 22 at 1894-1895. The Court’s rationale is not provided in the decision. ECJ decisions are a unique hybrid of common law and civil law; the Court creates precedent like a
does.\textsuperscript{27} This decision, taken in conjunction with \textit{French Merchant Seamen}, was the writing on the wall for government subsidized airlines. The Court said in \textit{French Merchant Seamen}, that air transport remains "on the same basis as the other modes of transport, subject to the general rules of the Treaty." Since the Court decided, in \textit{Belgian Railways}, that rail transport is subject to Article 92 concerning state aid (despite Article 77), then it follows logically that Article 92 is also applicable to air transport. If that was not enough to provoke the reluctant Council, there was one other ramification that is even more threatening to the protected flag carriers of Europe.

The Court's application of Article 92 (State Aids) to railway transport left no obstacle to the imposition of Articles 85 and 86 on the EC aviation industry. Article 92 comes under the same Treaty Title as Articles 85 and 86 ("Rules on Competition"). The Court said, in \textit{French Merchant Seamen}, that "air transport . . . remains, on the same basis as the other modes of transport, subject to the general rules of the Treaty."\textsuperscript{28} Since rail transport was now subject to the Rules on Competition, then arguably, air transportation was also subject to the Rules on Competition. The Rules on Competition (Articles 85 and 86) are the basis of the EC's antitrust law. Article 85 prevents price fixing that has a detrimental effect on competition.\textsuperscript{29} This could be worrisome for European airlines who are accustomed to fixing their prices in the International Air Transport Association.\textsuperscript{30}

Article 86 proscribes "any abuse by one or more undertakings of a dominant position . . . " It is likely that the European carriers are all dominant in at least one market. The abuse of their dominant positions could be in the form of price fixing, capacity limitations in bilateral agreements, discrimination in airport user fees, etc. Since most, if not all, European carriers are implicated in at least one of the above activities, they would have much to fear if the Court generally applied Articles 85 and 86 to their industry. The effect of these two cases was to put the Council in a difficult

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{27} "Aids shall be compatible with this Treaty if they meet the needs of coordination of transport or if they represent reimbursement for the discharge of certain obligations inherent in the concept of public service." Treaty of Rome art 77.
\item \textsuperscript{28} Supra n. 22.
\item \textsuperscript{29} Treaty of Rome art. 85(1)(a).
\item \textsuperscript{30} Dempsey, Aviation Law and Regulation, European Aviation Law, Butterworth (1992). "The International Air Transport Association is composed of more than 100 air carriers, including airlines from all EC Member States except Luxembourg. More than 70% of IATA member rates involve Europe. As one of the most influential airline organizations in the world, the IATA organizes conferences for the coordination of tariffs."
\end{itemize}
\end{footnotesize}
position: it could either adopt a detailed policy for aviation or risk the Court’s application of the Treaty of Rome’s provisions on competition.

**THE COMMISSION’S RESPONSE**

After *French Merchant Seamen*, the Commission took an active role in promoting legislation for air transportation. In 1979, the Commission submitted its first proposal to the Council on the regulation of aviation. The proposal, known as *Memorandum 1*, sparked a debate among EC and private organizations. Despite the Commission’s efforts, the Council was unable to develop the political will to subject the European carriers to greater competition.

In 1984, amidst a climate characterized by recession and an apparent success with deregulation in the United States, the Commission issued *Memorandum 2*. This memorandum put together principles and proposals for a common air transport policy in more precise detail than before. It called for less regulation and greater competition on flights between Member States. After issuing the memorandum, the Commission took an extraordinary step to encourage action by the Council.

**RE: OLYMPIC AIRWAYS AE**

The Commission has the authority under Article 89 to investigate any suspected infringements of Articles 85 and 86. “If the infringement is not brought to an end, the Commission shall record such infringement of the principles in a reasoned decision.”

The Commission acted on a complaint that Olympic Airways enjoyed a monopoly in the provision of baggage handling services at Greek airports. The Commission requested business records from Olympic Airways to determine whether it was “abusing” its dominant position.

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36. *Supra* n. 33 at 18

37. *Supra* n. 31 at 659.

38. Treaty of Rome, art. 89(2).


40. “Abuse...of a dominant position” is the antitrust wording in Article 86.
Olympic Airways refused to relinquish their records, maintaining that Articles 85 and 86 do not apply to air transport. The Commission, in its reasoned decision, stated that "there is no legal basis for claiming, as Olympic Airways claims, that Articles 85 and 86 do not apply to air transport." It went on to justify this statement by citing French Merchant Seamen and the Belgian Railways cases. This opinion, by the Commission, gave greater strength to the two ECJ decisions. More importantly, it paved the way for the ECJ to apply Articles 85 and 86 to air transport.

**THE TRANSPORT POLICY DECISION**

The Treaty of Rome's provisions on the establishment of a Common Transport Policy (Articles 74-84) set-up a time frame within which the Council must establish the common policy. The European Parliament became impatient with the Council's inability to develop that policy.

In September of 1982, the Parliament began threatening the Council that it would bring a claim under Article 175 for "failure to act." The parliament remained unsatisfied after a series of communications with the Council. Finally, on January 24, 1983, the European Parliament filed a claim against the Council.

Although Article 84 exempts air transport from being part of the Common Transport Policy (unless the Council decides otherwise), both the Parliament and the Commission argued that the obligation to adopt a common transport policy extended to air (and sea) transport. Thus, the Court had another opportunity to further EC aviation law.

On February 7, 1985, Advocate-General Lenz filed his opinion of the case. He agreed with the Parliament and Commission's view that the Common Transport Policy includes air (and sea) transport. It appeared that the Court was now in a position to rule that the Council was obligated to adopt a common aviation policy.

Before addressing the Court's decision, it is fruitful to point out some differences between the Transport Policy Decision and the earlier cases where the Court made an activist move.

The disputes in the French Merchant Seamen and Belgian Railways
cases pertained only to a specific industry in one Member State. The decisions would have ramifications throughout the EC, but the disputes themselves were largely localized. Furthermore, the claims had to do with mild infringements of the treaty by a Member State. In short, they were not the kind of cases that attract a lot of attention. Nor were they the kind of cases whereby one would expect a decision of great significance to EC aviation laws.

On the other hand, the Transport Policy Decision was a very high profile case. The Parliament’s claim against the Council was the first of its kind. This alone made it stand out. More importantly, the European Parliament demanded that the Council adopt a policy for all Member States in their most important transportation modes: road and rail.49 On its face, the claim was sure to have far-reaching impacts on the Member States’ economies. Governments, industries, and consumers all had a stake in the decision. The press was attracted and all eyes shifted to the Court of Justice.50

The Court’s decision was very conservative in light of the possibilities available to it. The Court determined that the Council had breached its treaty obligation to “ensure freedom to provide services in the sphere of international transport and to lay down the conditions under which non-resident carriers may operate transport services in a Member State.”51 The Court did not go so far as to say that the Council had an enforceable duty to introduce a Common Transport Policy,52 nor did it even discuss air transport. Despite its anti-climax, the Transport Policy Decision had two significant effects on the development of aviation law.

First, the decision sped up the process of developing a common transport policy for surface transport. It required the Council to introduce legislation on the freedom to provide transportation services within a reasonable period of time.53 The decision, and the case in general, put transportation at the head of the EC’s agenda. The pressure on the Council to take greater steps in transportation certainly gave more strength to calls for an aviation policy.

The second significant effect of the Court’s decision on aviation was

49. Inland waterways also come under the Common Transport Policy provisions.
51. Supra n. 44 at 206, 208.
52. Id. at 139, 203. The Court focused on the absence of measures that would define a common transport policy. The rationale it used is that since the meaning of “common transport policy” is imprecise, it cannot constitute an enforceable duty.
53. Id. at 206, 208.
the confirmed availability of an enforcement tool for the Commission and the Parliament. Since the Court gave the European Parliament standing under Article 175 to bring a claim against the Commission for failure to act, the Council could be threatened with a lawsuit if the argument could be made that it was obligated to develop a common aviation policy. In fact, the day after the Court issued its opinion, Transport Commissioner Stanley Clinton Davis threatened to take legal action against the Council for not taking steps to allow greater competition in aviation. 54

**NOUVELLES FRONTIÈRES**

On April 30, 1986, the European Court of Justice issued its decision on several joined cases. 55 The combined case, known commonly as **Nouvelles Frontières**, involved criminal prosecution of Air France, British Airways, KLM, Air Lanka and a number of travel agents, most notably **Nouvelles Frontières**. 56 The defendants were charged by the French Ministere Public with violating the French Civil Aviation Code which requires government approval for all air fares. 57 Each of the defendants had sold tickets under the officially sanctioned rate. As is customary under Article 177 of the EEC Treaty, the French tribunal referred several questions of EC law to the Court of Justice. The airline and travel industries watched closely for what many expected would be a major decision. 58

The Court’s decision is a masterpiece in that it pleased everyone, 59 and at the same time, furthered its agenda of integration. The Court’s pronouncement that the Treaty of Rome’s Competition provisions (Articles 85 and 86) were applicable to air transportation 60 surprised nobody. The Court and the Commission’s activism in this area had started more than ten years prior to the **Nouvelles Frontières** decision. 61 By moving slowly toward this major change in EC aviation law, the Court’s pronouncement seemed conservative.

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54. Commissioner Threatens Legal Action Over Air Fares, **REUTERS NORTH EUROPEAN SERVICE** May 24, 1985.
56. Comment, *Competition and Deregulation: Nouvelles Frontières for the EEC Air Transport Industry?*, 10 FORDHAM INT’L L.J. 808 (1988). Which states that Nouvelles Frontières has been used over one hundred times for illegal discounting. Nouvelles Frontières is France’s second largest travel agency and is known for its very low air fares and its impact on the French travel industry.
58. European Court Rules Air Fair Price Fixing Illegal, **REUTERS NORTH EUROPEAN SERVICE** Apr. 30, 1986.
59. *Supra* n. 56 at 823. “Media reaction following the case decision heralded the end of Europe’s air cartel and the inauguration of an era of ‘open skies’. Others, however, claimed ‘nothing had changed’.”
60. *Supra* n. 55 at 215.
The next major issue the Court dealt with was whether Articles 85 and 86 have "direct effect" in air transport, or in other words, whether an EC citizen has rights protected by the Articles. This was very important because direct effect would have allowed immediate enforcement of Articles 85 and 86 in the national courts. The Court held that Articles 85 and 86 do not have direct effect when there are no regulations to further define the requirements of the Articles. Thus, the Member States, who are interested in protecting their airlines, won on this issue. However, the Court did outline two ways that Articles 85 and 86 could be enforced in national courts, even in the absence of secondary legislation.

The Court said that if either "the competent national authorities" or the Commission find that a breach has occurred, then the national courts can act upon complaints against the breaching party. In other words, with a finding by either a Member State or the Commission, direct effect exists with respect to the breach in question.

The basis for this holding is Articles 88 and 89, which allow Member States and the Commission to guard the principles of Articles 85 and 86. Article 88 authorizes the Member States to "rule on the admissibility of agreements, decisions and concerted practices and on abuse of a dominant position in the common market in accordance with the law of their country and with the provisions of Article 85 ... and of Article 86."

Article 89, as alluded to above in Olympic Airways, allows the Commission to investigate suspected infringements of Articles 85 and 86. If an infringement is found, Article 89 only allows the Commission to "propose appropriate measures" and to "authorize Member States to take the measures." Neither Article 88 nor Article 89 mention anything about judicial enforcement, not to mention, judicial enforcement of private claims in national courts. But this is exactly what the Court read into these articles in Nouvelles Frontières.

As hinted above, the Court's decision is a strategic masterpiece. It is the equivalent of a sugar-coated poison pill. The Court spent the first part of the decision discussing jurisdictional issues. Then its discussion focused on the applicability of Articles 85 and 86 to air transportation, an

62. Supra n. 55 at 219. In a case decided after the adoption of the first liberalization package, the Court gave Articles 85 and 86 direct effect status in the aviation context Case 66/86, Ahmed Saeed Flveriesen and Silver Line Reisebüro v. Zentrale zur Bekämpfung unlauteren Wettbewerbs EV, reprinted in 38 ZEITSCHRIFT FÜR LUFT-UND WELTRAUMRECHT [ZLW] 124 (1989). This case is also significant in respect to this article since its holding is consistent with the theoretical perspectives set out in Part III.
63. Supra n. 15 for more on direct effect.
64. Supra n. 55 at 219.
65. For example, if the Commission determines in a reasoned decision that the European carriers are violating Articles 85 and 86 by fixing air fares in IATA, then passengers can bring antitrust suits against the airlines in the various national courts.
issue which by that time was accepted by the Member States. The Court then came to the smoke screen conclusion that there is no direct effect for Articles 85 and 86 in air transportation absent legislation from the Council. This appeared to be a huge victory for the Member States because Articles 85 and 86 would be unenforceable as long as they did not promulgate any secondary legislation. Then toward the end of the decision the Court said that national courts can apply Article 85\textsuperscript{66} if a Member State or the Commission finds a breach of either Article 85 or Article 86. The part about a Member State finding a breach is a red-herring that makes the latter part more palatable. The Member States are not about to declare their airlines in violation of antitrust law. However, the Commission is, and if in fact the Commission does, then \textit{de facto} direct effect exists. Since the Commission did not issue a "reasoned decision" prior to the adjudication, Nouvelles Frontières actually lost the case. Unless you read the fine print, you might think that the Court switched to the protectionist camp.

It follows from the decision that the Commission has the power to determine the situations in which Articles 85 and 86 are to be enforced by the national courts. This was a frightful prospect for the Member States and their protected carriers who wished to maintain the \textit{status quo}. There could hardly be a greater incentive for the Council (Member States) to develop an agreeable aviation policy pursuant to the Treaty's provisions on competition.\textsuperscript{67} In a case that drew criticism for being a non-decision,\textsuperscript{68} it follows from the decision that the Commission has the power to determine the situations in which Articles 85 and 86 are to be enforced by the national courts. This was a frightful prospect for the Member States and their protected carriers who wished to maintain the \textit{status quo}. There could hardly be a greater incentive for the Council (Member States) to develop an agreeable aviation policy pursuant to the Treaty's provisions on competition.\textsuperscript{67} In a case that drew criticism for being a non-decision,\textsuperscript{68}

\textsuperscript{66} The Court said that national courts could "apply" Article 85(2). Article 85(2) makes agreements and decisions contrary to the Article void. Thus, the enforcement of Article 85(2) by the courts is \textit{de facto} the application of the entire article.

\textsuperscript{67} P. Haanappel, \textit{The External Aviation Relations of the European Economic Community and of EC member states into the Twenty-First Century}, 14 AIR LAW 69, 75 (1989).

\textit{[T]he decision would constitute an important impetus towards the adoption under Article 87 of regulations implementing the competition rules of Articles 85 and 86 for air transport, since the Court allows national action and Commission action against air tariff agreements and their governmental approval, whereafter such agreements would be null under Article 85(2) of the Treaty. Obviously uniform EEC regulations in this field are preferable to different national actions possible under Article 88 and to Commission infringement procedures under Article 89.}

\textsuperscript{68} See Clarke, \textit{New Frontiers in EEC Air Transport Competition}, 8 NW. U.L. REV. 470, 475 (1987), which discusses "the decision's procedural shortcomings" and that "the conflict between Member State interests in nationalized airlines and a deregulated community air transport policy exacerbate the weaknesses in the Community's governing structure and in the Nw Frontiers decision itself. The result is an absence of uniformity and certainty as to what the law actually means." Actually, it's the threat of an absence of uniformity and uncertainty that impels the Council to develop a common policy under the Treaty, thereby strengthening the Community's governing structure. \textit{See also European Court Blocks Bid to Halt Fare Regulation, AVIATION WEEK AND SPACE TECHNOLOGY p. 34. "[T]he thoroughness with which the Court made this a non-judgment has been a surprise."

\textsuperscript{68} See also Wassenbergh, \textit{The Nouvelles Frontières Case, AIR LAW 161 (1986). "The decision did not bring, however, a clear solution to the question of the direct applicability of the competition articles...[the decision at best inspires the Commission or...}
the Court surreptitiously took a large step toward free competition which effectively compelled the Council to adopt a common air transport policy.

**LE COUP DE GRÂCE**

The Commission was quick to act on the power afforded it by the *Nouvelles Frontières* decision. On July 9, 1986, the Commission asked the Member States to restrict the price-fixing activities of their airlines.\(^6^9\) Later, the Commission sent letters to the airlines warning them to stop their cartel practices or be faced with a "reasoned decision under Article 89", which would open them up to litigation in accordance with *Nouvelles Frontières*.\(^7^0\)

With this threat, the Commission was able to get all of the airlines around the bargaining table.\(^7^1\) Despite the Treaty's authorization for the Council to develop air transport policy, the Commission used its *Nouvelles* power to create guidelines that could only be breached at the risk of legal action.\(^7^2\)

**THE COUNCIL ACTS**

In June 1987, the Council of Ministers came very close to adopting a liberalization package on air transportation.\(^7^3\) All Member States were in agreement, except Spain.\(^7^4\) Since Article 84(2) of the Treaty of Rome demanded unanimity, the Council was still unable to adopt the proposals. But this lack of unanimity did not matter for long.

On July 1, 1987, the Single European Act (SEA) went into effect.\(^7^5\) In addition to targeting December 31, 1992 for the completion of the Common Market, the SEA also changed the Council's voting procedure from unanimous to qualified majority.\(^7^6\) As a result of the SEA, Article 84(2) now only requires a qualified majority instead of a unanimous vote.\(^7^7\)

Finally, in December 1987, the Council adopted the First Package of

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70. *Id.; Supra* n. 30 at 47.
71. *Supra* n. 30 at 48.
72. *Supra* n. 31 at 671-672.
73. *Id.*
74. The Spanish veto was due to their dispute with Great Britain over Gibraltar. Gibraltar has an airport which would have been subject to the EC legislation as a British airport. Apparently, the disagreement centered on whether the airport lies in Spain or in the area of Gibraltar ceded to Great Britain in 1713 by the Treaty of Utrecht. See *supra* n. 33 at 20.
76. *Supra* n. 30 at 54-55.
77. *Supra* n. 67 at 72.
Liberalization for air transportation.\textsuperscript{78} It took thirty years since the signing of the Treaty of Rome for the EC to have a common air transport policy. The legislation sets forth a uniform policy on setting prices, access to markets, capacity sharing, and other matters that create a unified and relatively complete legal regime for international aviation in the EC.\textsuperscript{79}

III. THEORETICAL ANALYSIS

ULTRA VIRES JURISPRUDENCE

The line of cases analyzed in Part II raise several issues of significance concerning the development of law in the EC. One of the most notable aspects of the decisions is the Court's lack of respect for the plain meaning and intent of various provisions in the Treaty of Rome. Activism of this sort is not envisioned in the Treaty. The Treaty of Rome gives only a brief description of the Court's duty. Article 164 states in toto "[t]he Court of Justice shall ensure that in the interpretation and application of this Treaty the law is observed." The Court is \textit{not} given a mandate to further the goals of the Treaty in an active sense. Absence of a mandate does not preclude it. What does preclude the Court from legitimately taking an active role are the numerous provisions\textsuperscript{80} which leave that role to the Member States (Council), and on a more limited basis, the Commission.\textsuperscript{81} Thus, the Court, which is actively establishing a constitutional system, operates as if it does not have to answer to its Constitution.\textsuperscript{82} In French Merchant Seamen, the Court of Justice chose not to decide the case according to Article 84(2) which was clearly on point. In addition,

\textsuperscript{78} See, e.g., Ebke, \textit{Liberalizing Scheduled Air Transport Within the European Community: From the First Phase to the Second and Beyond}, 19 DENV. J. INT'L L. & POL'y 510; supra n. 33.

\textsuperscript{79} Id.

\textsuperscript{80} See, e.g., Article 6, "Member states shall take all appropriate measures, whether general or particular, to ensure fulfillment of the obligations arising out of this Treaty. . ." \textit{See also}, Articles 6, 8, 8B[SEA], 8CA[SEA], 27,64, and in particular Article 84(2).

\textsuperscript{81} This argument relies on the accepted maxim \textit{expressio unius est exclusio alterius}. The task of carrying out the teleological function is divided among other actors. Furthermore, the Court is expressly given the duty to see to it that "the law is observed." Thus, the \textit{expressio unius} argument has two prongs; both of which cast doubt on the legitimacy of the Court's approach.

\textsuperscript{82} The similarity of the ECJ with the U.S. Supreme Court in its infancy is striking. For example, see Marbury v. Madison, 1 Cranch (5 U.S.) 137 (1803) and McCulloch v. Maryland 4 Wheat. (17 U.S.) 316 (1819). In McCulloch, Marshall states that the power of the U.S. Constitution comes from the people, not the states who are yielding sovereignty. This view fits squarely with the ECJ's decision-making. Despite legal criticisms of the Court, it has accomplished much for citizens of the EC. If it is the citizenry, and not the Treaty, that the Court must answer to, then the Court has succeeded tremendously. This scenario, however, raises the question of limits on the Court. For an idealistic view that courts should respond to society, tempered with the recognition of the need for checks and balances, see M. CAPPELLETII, \textit{THE JUDICIAL PROCESS IN COMPARATIVE PERSPECTIVE} 112-113 (1989).
the Court disregarded the spirit of the Treaty's provisions on transportation to hold that transportation, in a broad sense, is governed by the general rules of the Treaty.

In *Belgian Railways*, the Court refused to respect a treaty article which allows governments to subsidize their transportation industry. In this case, the Court applied a general competition provision to deny Belgium's right to subsidize its railway.

In the *Transport Policy Decision*, the Court back-peddled. While the Court did not distort or ignore treaty provisions to further the integration of transportation, it seems to have twisted the remedy for failure to act in order to avoid compelling the Council to develop a common transport policy.

In *Nouvelles Frontières*, the Court announced that the Rules of Competition would apply to air transportation. Then the Court devised a method by which the Rules could be enforced by every person in the EC through adjudication. This decision was the equivalent of removing Article 84 from the Treaty, and at the same time, rewriting Articles 88 and 89.

**TELEOLOGY AND COVERT ACTIVISM**

There has been a great deal of theoretical work aimed at describing the Court's jurisprudence. The perspective that is most important to our understanding of the aviation cases is that the Court decides cases to further the broader purposes of the Treaty of Rome. Instead of seeking to objectively apply the positive law, the Court views itself as an actor in the attainment of the Treaty's goals, namely the establishment of the Common Market.

This teleological analysis fits squarely with the decisions that led up
to the First Liberalization Package of Air Transport. Clearly, the Common Market would be seriously lacking if transportation were outside of its scope. By disregarding specific Treaty provisions that lead to unfavorable results, the Court is able to pursue its agenda of greater integration. But despite its validity, teleology cannot explain the Transport Policy Decision. In that case, the Court passed up its greatest opportunity to bring transportation under the EC umbrella. The Court should have compelled the Council to develop a common transport policy (for surface transportation) according to the requirements of the Treaty, but the Court chose not to.

To understand this, it is necessary to understand that the Court is subject to political constraints. It derives its power from acceptance by the governments and people of the Community. Thus, to protect its power, the Court cannot afford to become disfavored. This avoidance of a negative image explains why the Court affected major changes in aviation law in the French Merchant Seamen and Belgian Railways cases. These cases were not important on their faces, and not likely to attract attention in aviation circles. By taking big steps in small cases the Court is able to avoid criticism which could erode its power. Thus, the Court prefers covert activism to accomplish its teleological mission most effectively.\(^88\)

The Nouvelles Frontieres Case attracted a fair amount of attention and was expected to be the definitive decision on aviation. The Court decided the case so that Nouvelles Frontieres would lose the battle and the Member States would win on the smoke screen issue of direct effect. But the Court made it so that in the future, the full force of the Rules of Competition could be hurled upon the airlines at the whim of the Commission.

The Transport Policy Decision attracted the most attention of any of the cases. It had ramifications for every aspect of EC economics. Furthermore, since the largest and most important transportation companies in the EC have traditionally been partially or wholly owned by governments, the case also involved important issues of Member State sovereignty. The Court's political acumen steered it clear of conflict by not coercing the Member States to the extent the Treaty calls for. Nevertheless, the decision provided a strong impetus for the adoption of a common transport policy.

Aside from exhibiting the Court's decision-making, these four cases

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\(^88\) For a critical look at the Court's covert activism, see H. RASMUSSEN, ON LAW AND POLICY IN THE EUROPEAN COURT OF JUSTICE, Chapter 12 (1986).
also demonstrate the extraordinary role that the Court of Justice plays in the EC polity.

**THE SUPRANATIONAL ENGINE (OF INTEGRATION)**

The Commission’s purpose is to further the goals of the Treaty. In zealous pursuit of this teleological function, the Commission has strived for greater integration on all fronts. The built-in check on the Commission’s aspirations is the Council. By not accepting the Commission’s proposals, the Council is able to slow the process of integration. With the Court joining the Commission on its teleological mission, the scales have been tipped in favor of further integration. In effect, the balance of legislative power envisioned by the Treaty has been upset by the Court’s teleological activism. The aviation line of cases exemplifies this remarkable phenomena. The following is a chronological review of the Court and Commission’s activities leading up to the adoption of the First Liberalization Package.  

The Commission brings France to the Court in *French Merchant Seamen*. The Court keeps standing open for the Commission to haul in Member States who are suspected of violating the Treaty. The holding furthers the federalist agenda of the two institutions. Most notable for our purposes, the holding allows for the application of the general rules of the Treaty to air transport.

In the *Belgian Railways* case, the Commission brings Belgium into the Court. The Court applies a competition rule to transportation. The two holdings together make a strong argument for application of the Rules of Competition to aviation. If the Rules of Competition are applicable, then detailed secondary legislation is necessary. The Commission submits its aviation liberalization proposal known as *Memorandum 1* to the Council.

The Commission takes action against Olympic Airways based on the Rules on Competition. The Commission cites *French Merchant Seamen* and *Belgian Railways*. This bolsters the status of those holdings and makes it easier for the Court to apply the Rules on Competition to aviation in the future.

The Commission argues in the *Transport Policy Decision* that the Council is obligated to establish a common transport policy which includes aviation. The Court’s Advocate General agrees. The Court confirms the Commissions ability to sue the Council for failure to act. The Council is threatened by Transport Commissioner Davis with suit for failing to take steps to allow greater competition in aviation.

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89. For a more detailed analysis of these events, see Part II of this article.
90. Although the Parliament filed this claim, the Commission would have had standing had it acted instead. The Commission’s arguments were made on intervention.
In *Nouvelles Frontières*, the Court announces that the Rules on Competition apply to aviation. The Court gives the Commission tremendous leverage by allowing the Commission to determine the aspects of the Rules that are to be enforced.

Then, the Commission threatens airlines with enforcement of the Rules unless they abide by the Commission’s guidelines. As a result of *Nouvelles Frontières*, the Commission is creating de facto legislation and wields its powers of enforcement to ensure compliance.

Finally, the Council capitulates and accepts the First E.C. Aviation Liberalization Package.

What is fascinating is that the Council is composed of the Member States which created the Treaty of Rome.91 Through the Treaty, the Member States agreed to create the Court and the Commission. They also agreed to reserve for themselves the right to make (and by implication the right not to make) a common air transport policy. The effect of the Court’s teleological slant was to remove the Member States’ power not to have an air transport policy, the power that the Member States reserved for themselves in Article 84(2).

By using and playing off of one another, the Court and the Commission were able to compel the Member States to establish a detailed air transport policy pursuant to the competition provisions of the Treaty of Rome. This meant liberalization of a government protected, and in many cases, government-owned industry.

IV. SUMMARY AND CONCLUSIONS

This paper has examined the events leading up to the adoption of the First Liberalization Package for aviation in the European Community. In particular, the analysis focused on the role of the European Court of Justice in bringing about the adoption of the Liberalization Package.

The conclusions reached in the analysis suggest that at least with respect to the aviation line of cases the Court does not decide cases according to the positive law of the European Community. Instead, the Court’s jurisprudence is guided by its assumption of a teleological function. In the context of this study, the Court exploited its adjudicative authority to bring aviation under the control of EC law despite the contrary intentions of the Member States. In addition, due to an aversion of debilitating criticism, the Court employed covert activism in this line of cases.

Since the Court is effective in furthering integration, it has altered the balance of power between the Council and the Commission. The Court

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91. Original signatories of the Treaty were France, West Germany, Italy, Belgium, Netherlands, and Luxembourg. *Supra* n. 1.
and the Commission have enough legal tools so that if they each carry the same purpose, as is witnessed in this study, they are able to take steps which compel the Member States to integrate further. This has tremendous implications not only for the future of aviation in the EC, but for the economic and political future of Europe as a whole.

It is the hope of this author that this paper raises more questions than it answers. The author would like to use his discretion to conclude by addressing a philosophical question.

The analysis of the Court of Justice’s jurisprudence which has been offered in the analysis above begs the conclusion that there is something wrong with the Court’s tactics. But before one evaluates the Court, one must have a standard of measure. If you feel that a court should apply the positive law as objectively as possible, then you are probably not satisfied with this Court. On the other hand, if you favor the integration of Europe, then the Court becomes your ally.

Perhaps in a democratic society, everyone should be taken into consideration when determining the standard by which a court (and law in general) is to be measured. In short, perhaps the test should be whether the court affects the lives of the citizenry in a way that positively relates to their collective values.92

It is the opinion of this writer that the benefits of the Court of Justice’s activist furtherance of European integration are consistent with the net societal values of the European Community.

92. What is meant by “collective values” is better understood by the phrase “net societal position.” This is a paradigmatic attempt at determining a society’s values from a constructivist perspective. Each has his own position (views) which causes the net societal position to sway in his direction the distance equal to one divided by the total number of members in the society. For a practical example, if two people have opposing values of the same magnitude, then they cancel one another out and effect no change on the net societal position. The paradigm assumes that the societal position is the sum of all its parts.