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A Century of Transportation Law

ROBERT B. YEGGE*

As the University of Denver College of Law celebrates its centennial in 1992-93, thoughts return to its inaugural year of 1892 when Denver was a developing land transportation center.

In the first days of the College, law students and practitioners were exploring and making law occasioned by railroads, beasts of transportation burden and developing mechanical transportation technology. Like today, there were many questions surrounding transportation involving the people, property and implements used and affected by a fast developing concern for the emergent mobile west.

At its 75th birthday, the College of Law intensified its concern about transportation law. It was in 1967 that Marian F. Jones, Esq., John P. Thompson, J.D. ’50, Alvin J. Meiklejohn, J.D. ’51, and others, approached me as Dean of the College of Law to join with the Transportation Lawyers Association (then the Motor Carrier Lawyers Association or MCLA) to establish an annual National Transportation Law Institute.

Since 1968, the College has cosponsored and produced with the Transportation Lawyers Association the annual Transportation Law Institute at which hundreds of attorneys and practitioners, as well as governmental and industrial executives from across the nation, gather for several days of intensive professional training and review of broad issues in transportation law. The institutes have also included updates on current

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legal and economic developments in such areas as legislative proposals for regulatory reform, computerized legal research, and antitrust developments in transportation law. Each annual institute proceeding has been bound in volumes which are significant research resources to those interested in transportation law.

The association with the Transportation Lawyers Association (TLA) has grown and flourished to this date. For example, in 1976, the Transportation Lawyers Association established a TLA Professorship at the College of Law, in which chair Professor Paul Stephen Dempsey is the current incumbent.

Upon establishment of the TLA Professorship at the College, the Transportation Lawyers chose to move this Transportation Law Journal to the College of Law. The Journal began in 1968 at Osgood Hall, University Law School of York University (Toronto, Canada) and was a publication of the MCLA Board of Governors. Upon moving the Transportation Law Journal to the College of Law in 1976, the Journal became a publication of the College and has been published by students at the College under the wise, watchful eyes of the TLA Professor.

College of Law students have intensified their interest in transportation law over the last 25 years as a result of the expanded academic offerings in transportation law and the work other student editors of the Journal have provided. A student Transportation Law Society was established and a Transportation Scholarship Fund bearing the name of one of the Institute’s founders, Marian F. Jones, allows a student to pursue specialized studies in the transportation law program.

The Institute, the Journal, the student Transportation Law Society, the enhanced transportation law curriculum, and the supporting scholarship fund, have established a strong, sound, singular, transportation law program at the College.

Those first law students and faculty in 1892 would be proud of their progeny.
I. INTRODUCTION

Rising majestically west of downtown Denver stands Mount Evans, towering 14,264 feet above sea level. The mountain was named after John Evans, a renaissance man. President Abraham Lincoln asked Evans to leave Illinois, where in 1851, he had founded Northwestern University (and after whom its city of Evanston is also named), and become Territorial Governor of Colorado, then largely an unspoiled wilderness. In Colorado, John Evans founded a second great educational institution — the University of Denver (originally Colorado Seminary), in 1864. Today, the University of Denver is the oldest and one of the largest voluntarily supported institutions of higher education in the Rocky Mountain region.

But Evans was not to leave his contribution to Colorado there. The first transcontinental railroads largely bypassed the Denver area, and only took in the corners of eastern Colorado. The Union Pacific cut north...
through Wyoming, then west to Promintory Point, Utah, where the link was completed on May 10, 1869. Denver began to decline as a commercial center, as many of its residents moved to Cheyenne and other towns along the railroad. The vice president of the Union Pacific, Thomas Durant, described Denver as “too dead to bury.”

But Denver was full of pioneer spirit, and not about to lie down and die. Recognizing the vital importance the rail avenue would play in the economic growth and prosperity of his adopted city, in 1867, Evans founded the Denver and Pacific Railway & Telegraph Co., which built the first rail line to Denver. The first train roared into Denver in 1870. Denver’s fortunes reversed, and the city again became the dominant commercial center of the Rocky Mountain West.

Evans had caught transportation fever, and it was now in his blood. In 1872, he founded the Denver, South Park and Pacific Railroad to serve the mining towns in the Colorado Rockies. In addition, he founded the Denver & New Orleans Railroad in 1881. His son, William Evans was also to become a rail baron, taking over the Denver, Northwestern, and Pacific Railroad, and supporting development of the Moffat Tunnel (cut through the continental divide) which was to provide Denver with a solid east-west transcontinental link. His grandson was elected chairman of the Denver & Rio Grande Western (now Southern Pacific).

During the ensuing years, Denver has become the dominant rail, highway, and aviation hub, and as a consequence the commercial, cultural and educational center, for the Rocky Mountain region. Much of that we owe to John Evans, and his profound insight into the vital importance of transportation and education, and his tenacious dedication to their growth.

In 1991, Chancellor Dan Ritchie announced the creation of a Center for Transportation Studies at the University of Denver. It is entirely fitting that Denver should be home to such an educational enterprise. As a center for highways, railroads and airline routes, Denver stands at the crossroads of the West. Northwestern University too, has been a major contributor to transportation education for decades. Both of John Evans’ creations are now firmly committed to the same endeavor.

The University of Denver’s Transportation Center builds on a foundation of educational activities offered since the inauguration of its Transportation Law Institute in 1967, and the creation of the Transportation Law

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1. Similarly, the Atchison, Topeka & Santa Fe reached Pueblo in 1876, then turned south to lay track over Raton Pass into New Mexico in 1878.
2. This railroad was taken over by the Union Pacific.
3. This railroad was subsequently renamed the Denver, Texas and Gulf Railroad, and acquired by the Denver, Texas and Ft. Worth Railroad.
The Transportation Center brings together various disciplinary perspectives, such as law, business, engineering, international studies, and other social sciences. It performs research, consulting, and outreach activities, including conferences and short courses for practitioners in specific areas relevant to transportation such as trade, terrorism, tourism, technology, translation, drug trafficking, public policy, law and regulation.

The Center intends to develop graduate and undergraduate programs in transportation. Initially, it will offer a set of courses that will provide the basis for dual degree majors (e.g., transportation-economics). At the graduate level, students will be able to specialize in transportation studies while pursuing M.S., M.A., M.B.A., Ph.D., and J.D. programs in the Graduate School of International Studies (GSIS), the College of Business Administration (CBA), the College of Law, and the Department of Geography. The opportunity for dual degrees (e.g., J.D.-M.B.A.) already exists at the University, and will be expanded to include transportation specializations, such as those which are already available in the College of Law.

This essay addresses the need for a multidisciplinary center for studies in domestic and international transportation, its goals and objectives, and the existing resources at the University of Denver.

II. DENVER AS TRANSPORTATION CROSSROADS

Denver's strategic location as a crossroads for road, rail, and air transportation is well known. Since its founding, Denver has flourished in large part because of its transportation connections. In the 19th and early 20th century, the advent of the railroad (facilitated by construction of the Moffat tunnel through the Rockies) made Denver an urban center and business, commercial and governmental headquarters for the region.

More recently, Denver's role as a major air hub has continued this historic trend and served as a catalyst for economic growth and development. Stapleton International Airport is already one of the busiest airports in the world.

No new major airport has been built in the United States since 1974,
when Dallas/Ft. Worth International Airport was opened. Yet Denver is building a new airport which will be larger than nearly any in the world — it will cover a land mass twice the size of Manhattan. Today, only three major airports are under construction — Munich, Osaka and Denver — each located about one-third the way around our shrinking planet. The new Denver International Airport is projected to be among the world’s busiest three by the year 2000. Denver’s strategic central location has proven of interest to the Japanese and the Europeans, and ensures that it will play a prominent role in the planned Canada-US-Mexico free trade zone. These developing trends create a need for education in transportation, and a market niche for the University of Denver.

III. THE NEED FOR THE CENTER

Advances in transportation and communications have transformed and continue to fundamentally alter our world. We no longer live in isolated communities; we live in an increasingly interconnected global village. Transportation is becoming ever more vital as people, goods, and information flow across space. Its importance to the nation is demonstrated by the fact that today 18% of our domestic gross national product is accounted for by this sector. Transportation is an infrastructure industry which serves as the foundation for commerce, communications and national defense.

The importance of transportation has been recognized by several universities which have established centers in this field. The most important of these are supported by the Department of Transportation and act as regional centers linked to other institutions in their area. In addition, the Federal Aviation Administration supports a number of specialized programs and projects in air transportation at these and other institutions.

Although each of these programs possess considerable strengths, none emphasize the multidisciplinary, multi-modal, and international orientation which the field of transportation studies requires. This leaves an important niche to be filled. We propose to do so not by competing with the existing centers, but rather by developing cooperative linkages with them.

In addition to the prospect of external research support, we believe that a significant number of graduate and undergraduate students would

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5. Atlanta’s Hartsfield International Airport was reconfigured on the same property in 1980.
6. In 1991, some 23 new airports were under construction somewhere around the world, although most were not nearly as large as these three. AVIATION DAILY, May 21, 1991, at 345.
7. In our region, North Dakota State University is the lead institution and is affiliated with University of Colorado-Denver, Colorado State University, University of Wyoming, University of Minnesota, and Utah State. In addition, Metropolitan State College offers training in aerospace science.
be attracted to the University of Denver if we offered transportation courses. Significant employment opportunities exist in the transportation industry, especially in the fields of management, operations, and policy. For example, a commercial pilot shortage is expected over the next two decades. Between 1995 and the year 2000, the number of pilots who normally retire will quadruple. Thus, there is a need for a traditional university undergraduate program which includes the opportunity to earn a commercial pilot certificate while completing a university degree. Captain Henry Duffy, former President of the Airline Pilots Association, identified the educational skills a commercial pilot should have: "A knowledge of the airline industry would be nice, a course in airline economics. Principals of leadership . . . [and courses which make the student] computer friendly . . . . And then enough flight time to have picked up all the basic skills."9

As part of its international orientation, the Center will operate a Technical Translation Unit on a fee basis that will provide a number of important services. It will facilitate our communication with persons, companies and institutions abroad who are not fluent in English. It will also serve as a key link between the regional transportation community and foreign organizations.

Furthermore, substantial outreach opportunities have been identified, including conferences, seminars, short courses, and workshops for practitioners and other interested parties. In 1991, the University sponsored two new major aviation conferences: the First Annual Conference on Drug Trafficking, Terrorism, and International Air Transportation, and the First Annual Conference on Airlines and the Future of Aviation.10 Both were highly successful. A major conference on "Airlines, Airports and Aviation", cosponsored with the Smithsonian Institution's Air & Space Museum, was held in Washington, D.C., in May, 1992.

IV. EXISTING UNIVERSITY RESOURCES

The University of Denver has substantial resources within the field of transportation in the form of faculty and associates in the College of Law, the College of Business Administration, the Graduate School of International Studies, the Denver Research Institute, and the Department of Geography.

The College of Law has a well-established program in Transportation

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9. Id. at 77.
10. GSIS, in cooperation with the Drug Enforcement Administration, recently sponsored the First Annual Conference on Drug Trafficking, Terrorism, and International Air Transportation. A second major transportation related conference, "Airlines and the Future of Aviation", was organized by the College of Law, with help from the Westinghouse Corporation.
Law which began in 1967 as a continuing legal education program for attorneys and practitioners — the Transportation Law Institute. Since its inception, the Institute has been jointly sponsored by the University of Denver and the Transportation Lawyers Association [TLA], and more recently, the Transportation Practitioners Association.\footnote{11}

In the mid-1970s, D.U.’s Transportation Law Program blossomed with the injection of a series of annual economic contributions by TLA. Its Director serves as Faculty Editor of the \textit{Transportation Law Journal}, for which the College of Law assumed responsibility in 1976.\footnote{12}

The College of Law offers several introductory and advanced courses and seminars in Transportation Law, as well as independent study and internship opportunities.\footnote{13} These attempt to provide educational exposure to the legal, regulatory, economic and political developments in transportation. Students in the Transportation Law Program have the opportunity to participate in externships in federal regulatory agencies or major transportation businesses. Today, the University of Denver offers the only multi-modal, and perhaps the most comprehensive, program in transportation law in the United States.

The principal strength of the College of Business in the transportation area lies in the number of faculty members who have prior experience in transportation research and management and who retain an interest in transportation issues. These include faculty with experience in the following areas:

- Aircraft design and structural analysis
- Airline yield management
- Airport feasibility studies
- Air quality and transportation policy
- Air transportation systems design

\footnote{11. The Transportation Law Institute is held annually, alternative years in Washington, D.C., and San Francisco, California.}
\footnote{12. The Transportation Law Journal is the only comprehensive law school publication in the area of transportation law. It is a major source of information for the practicing bar as well as for scholars. As such, it strives to provide its international readership with the highest caliber of writing. All members of the Transportation Lawyers Association receive the periodical as one of the perquisites of their membership. Of the legal periodicals published by the University of Denver, the Transportation Law Journal is the only one reproduced in the Westlaw and Lexis computer systems.}
\footnote{13. The College of Law offers the following courses related to transportation law:}
- Regulated Industries
- Administrative Law
- Transportation Law
- Aviation Law
- Law of Outer Space
- International Aviation Law Seminar
- Transportation Law Journal (student participation)
Alternative fuel production and distribution
Civilian STOL aircraft services
Logistics and distribution for international business
Network modeling and computer simulation
Passenger demand forecasting
Pipeline logistics planning
Railway operations research
Tourism
Transportation economics
Transportation systems analysis

The College of Business Administration (CBA) offers a complete range of courses in general management areas including accountancy, finance, hospitality management and tourism, labor relations, management information systems, marketing, organizational behavior, production and operations management, real estate and construction management, statistics, and urban and regional development. Most of these have relevance to transportation studies. The College is currently ranked in the top 5% of over 1,300 schools of business in the U.S. and has gained increased recognition recently through the introduction of ethics, communication, and cross-cultural components to the M.B.A. program. The University’s School of Hospitality Management and Tourism is in the process of developing a M.S. program in Domestic and International Tourism.

The Graduate School of International Studies (GSIS) has a well-established International Technology and Management concentration which attracts students from many countries. Within that program, several faculty and associates are working on research and course work within the broad field of transportation studies. In addition, other faculty members and students are concerned with various relevant problem areas. The general orientation is with the relationship between air transportation technology and national and international development and the international policy dimensions of air transportation. Specific areas of ongoing teaching, research and outreach include aviation security, prevention of terrorism and narcotics trafficking, air transportation technology transfer, cross cultural communications, and airport planning both in the U.S. and

14. A full spectrum of courses is presently offered in general management areas including: Accountancy, Finance, Hospitality Management and Tourism, Management, Management Information Systems, Real Estate and Construction Management, and Statistics and Operations Research. In addition, the new courses that have been proposed for the Tourism degree will be of particular relevance. Existing courses include:
   - International Marketing
   - Hospitality and Travel Market Environment
   - Domestic and International Tourism
abroad. A complete range of courses in international affairs including international politics, international economics, and comparative politics with emphasis upon methodology, global conflict, development, political economy, public policy, and technology.\footnote{15}

GSIS has been instrumental in forging cross-disciplinary linkages at the University. It possesses joint degree programs with the CBA and the College of Law. It has also been active in outreach activities as exemplified by its recent conference on International Terrorism and Drug Trafficking and is expanding its international contacts in the area of aviation.

The Denver Research Institute has been involved in research on various forms of transportation technology, including aircraft systems, automotive design, rail and pipeline operations, and the transportation of hazardous materials. It provides needed technical and engineering expertise in these and other relevant areas.

The Department of Geography has research and teaching interests in transportation, especially air, rail, and urban transportation. Specific research has involved the geographical significance of regulatory policy on the airline industry, airport planning, transportation and economic development, and passenger rail systems.\footnote{16}

As is evident, the University possesses considerable resources, notably a committed faculty with significant expertise in the key areas of domestic and international transportation. They have been actively engaged in research which has led to many important publications. Two books dealing with air transportation are presently being published and a third on the new Denver Airport is underway. Several successful conferences have already been held and more are being planned.

The Transportation Law Program provides us with a solid educational foundation. The other graduate level courses which are presently available can be integrated into a cohesive multi-disciplinary graduate program that should prove attractive to students and prospective employers.

\footnote{15}{The following are particularly relevant: Planning and Management of Technology Technology and Policy Planning: Theory and Practice Technology and International Affairs Technology and Economic Development Trade and Economic Development International Trade}

\footnote{16}{The Department of Geography offers the following courses of relevance: Urban Geography Urban and Regional Planning Land Use Planning Urban Transportation Planning}
V. GOALS OF THE CENTER

The Faculty of the Center for Transportation Studies has identified the principal objectives of the Center as follows:

1) to develop and implement significant research projects in the area of transportation involving students, faculty, and other professionals;

2) to develop and implement teaching programs at the graduate and undergraduate levels for students planning professional careers involving transportation;

3) to provide technical services in such areas as translation and interpretation for the transportation and related communities;

4) to provide information to the local community about major issues in transportation through conferences, workshops, and other outreach activities;

5) to act as a focal point for transportation research, education, and communication in the region by identifying individual and group expertise, establishing coordinating mechanisms to enrich existing activities, and developing cooperative programs;

6) to provide a vehicle for dissemination of existing knowledge and new research findings to industry and government through consulting, conferences, seminars, and short courses for practitioners; and

7) to assist in the development of coherent transportation policies at local and national levels, both in the U.S. and abroad.

VI. CONCLUSION

Transportation will continue to be a critical element of our local, regional, national, and international economy. The University of Denver finds itself uniquely and favorably positioned to contribute to a greater understanding of this vital activity.

A great University dedicates its physical, human and intellectual resources to serving its community, providing information, education and reasoned policy analysis. We are committed to making such a contribution. We have the opportunity to make a significant contribution to education in one of the world's most important industries. We do so with enthusiasm and dedication.
Transportation Attorneys Speak Out
on the Practice of Law

BRADLEY J. SLEEPER*
JAMES C. JOHNSON**
KENNETH C. SCHNEIDER***

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INTRODUCTION

One need only observe the frequency and hostility of the latest round

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of lawyer jokes to recognize the depths to which societal attitudes toward
the legal profession have descended. While some attorneys may brush
off this cynical humor as merely resentment born of envy, research indi­
cates a recognition and concern by lawyers that they are in the midst of a
危机 that jeopardizes our very system of conflict resolution.

We surveyed 167 transportation attorneys nationwide in an effort to
discover whether they share this general pessimism about their profes­
ion. We also hoped to gain a unique insight into the hands-on dynamics
of their practices and the inner workings of transportation administration.
Does their specialty insulate them from the turmoil in the profession gen­
erally? Is federal deregulation of the transportation industry still a factor?

What follows in Part I is a brief background of studies documenting
the distress suffered by lawyers and their clients. In Part II we summarize
our research methodology and in Part III explain our objective and subjec­
tive survey results. In Part IV we place our findings in context with other
studies and suggest perspectives from which the profession may seek
relief for itself and the society it serves.

I. RESEARCH BACKDROPP

As long ago as 1985 an American Bar Association national survey of
3,018 attorneys found that 16% were dissatisfied and another 8%
planned to leave the practice of law. A more recent study indicated that
as many as 41% of lawyers would have chosen another profession had
they known what it would be like. A reported 40,000 lawyers are leaving
law practice annually.

Many of the lawyers who remain in practice endure severe conse­
quences. A 1987 survey of over 800 lawyers in Washington state uncov­
ered alarming levels of personal distress symptoms. A surprisingly high
19% suffered from clinical depression, 23% from social alienation and
isolation, 12% from paranoia, and 10% from marital discord. Alcohol
abuse (at 18%) was nearly double that of national average. Furthermore,
these results were consistent with an earlier study of Arizona lawyers.

While the disposition of attorneys may not engender outpourings of
concern, its negative impact on legal services is a critical issue for every­
one. The Maryland State Bar Association interviewed over 200 private

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1. Joel S. Bainbridge, Jr., Dissatisfaction? MSBA Survey, 22 Md. BAR J., Mar./Apr., 1989,
at 28-31.
2. Craig Schreiner, You're Not Alone: Profession Responds to Lawyers' Stress and Job
Dissatisfaction, 63 WIS. LAWYER 17, 55 (Mar. 1990).
3. See generally DEBORAH ARRON, RUNNING FROM THE LAW: WHY GOOD LAWYERS ARE
4. WSBA Lawyers' Assistance Program Staff, Are Lawyers Distressed? . . . And How?! 42
WASH. STATE BAR NEWS 11-18 (Fall, 1988).
practitioners from firms of all sizes. Not only had more than one-third decided to leave the profession or had doubts about remaining lawyers, but only one-half were satisfied with the quality of service given clients and less than one-third were satisfied that the clients received fair value for the fees paid.5

Our conclusion from these studies is that attorneys generally agree with their critics - something is terribly wrong in the legal profession.

II. RESEARCH METHODOLOGY

Our sampling frame consisted of all attorneys listed in the membership rosters of the Transportation Lawyers Association and the Association of Transportation Practitioners. The two lists were combined in such a way as to eliminate from the sampling frame all members who are not attorneys as well as all duplicate names. Thus, the final sampling frame consisted of a reasonable cross-section of specialists in the field of transportation law.

An initial sample of 500 attorneys was then selected. Each was sent a one-page questionnaire along with a cover letter requesting the attorney’s participation. To help enhance the response rate, a preliminary letter was sent to each attorney approximately one week prior notifying him/her of the pending survey. A total of 167 attorneys responded to the survey, representing a response rate of 33%. This response rate is considered to be quite high, especially considering the professional status of the target sample.6

A brief demographic profile of the sample is presented in Exhibit 1. A broad age spectrum is represented, with about one-half the sample (49.7%) over fifty years old. About forty percent (39.2%) of those surveyed were admitted to the bar within the past twenty years, while the remaining sixty percent have been members of the bar over 20 years. It is apparent from these statistics that the survey was successful in reaching attorneys who have had extensive experience with transportation law, both before and after deregulation of the trucking industry.

Considerable diversity was found in the number of attorneys employed in the respondent’s offices. While nearly one-half the sample (47.8%) were employed in smaller firms (five or fewer attorneys), another

5. See Bainbridge, supra note 1.
6. All comparisons of results of the survey across sample subgroups in the discussion to follow were conducted with standard chi-square tests of independence. The reported “p-values” signify the proportion of time such test period will erroneously lead to concluding that some result is significantly different across subgroups. Following accepted convention, sample differences are considered significant only if the “p-value” is less than .10. When multiple responses were given to the subjective questions, we categorized the responses by the clearest or first given.
15.2% were employed in larger firms (more than thirty attorneys). Exhibit 1 also delineates the sample by annual income, which was originally measured by having each attorney check whichever multiple of $25,000 came closest to his/her annual income, and by gender.
III. SURVEY RESULTS

A. OBJECTIVE RESPONSES

Our survey initially asked the transportation attorneys to objectively measure three primary aspects of job satisfaction. Would they practice law again if given another career choice? Would they still specialize in transportation law? How does their income compare to their expectations?

### Exhibit 2

#### TRANSPORTATION ATTORNEYS' REACTIONS TO PRACTICING LAW

---

**If you could start your career over, would you still choose to practice law?**

<table>
<thead>
<tr>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Definitely Yes</td>
<td>47.9%</td>
</tr>
<tr>
<td>Probably Yes</td>
<td>40.1%</td>
</tr>
<tr>
<td>Probably No</td>
<td>12.0%</td>
</tr>
<tr>
<td>Definitely No</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

---

**And, would you still choose to specialize in transportation law?**

<table>
<thead>
<tr>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Definitely Yes</td>
<td>13.6%</td>
</tr>
<tr>
<td>Probably Yes</td>
<td>40.1%</td>
</tr>
<tr>
<td>Probably No</td>
<td>40.7%</td>
</tr>
<tr>
<td>Definitely No</td>
<td>5.6%</td>
</tr>
</tbody>
</table>

---
Exhibit 2 displays the undifferentiated responses from the total group of 167 attorneys. One immediately apparent fact is that while an overwhelming majority (88%) would still choose to practice law, nearly half (46.3%) have negative attitudes ("Probably No/Definitely No") toward doing so as transportation specialists. A large number of respondents clearly affirmed their career choice (47.9% "Definitely Yes"), yet only 13.6% felt that strongly about their niche as transportation lawyers.

The responses summarized in Exhibit 3 reveal a broad measure of

EXHIBIT 3
TRANSPORTATION ATTORNEYS' FEELINGS ABOUT INCOME (HOW HAS YOUR ANNUAL INCOME COMPARED TO WHAT YOU EXPECTED IT WOULD BE?)

- Much Better: 21.2%
- Somewhat Better: 24.2%
- About What Expected: 37.1%
- Somewhat Worse: 14.5%
- Much Worse: 3.0%

satisfaction with income. Fully 82.5% felt their income has been as much or better than expected. This finding will become important as we ana-
lyze the backgrounds of our sample population (Part B) and their open-ended responses (Part C).

B. RESPONDENTS' BACKGROUND

To better evaluate these findings, we sought significant relationships between the backgrounds of the respondents and their responses. By applying our statistical methodology, we found that the factors of age, gender, and length of experience bore no significant correlation to any of the three objective questions. However, the size of the respondents' firm was a significant factor in their responses to both transportation specialization and income expectations (Exhibit 4). Moreover, annual income was sig-

EXHIBIT 4
TRANSPORTATION ATTORNEYS' RESPONSES BY SIZE OF FIRM

<table>
<thead>
<tr>
<th>Number of Attorneys in Office</th>
<th>5 or Less</th>
<th>6 to 30</th>
<th>31 or More</th>
</tr>
</thead>
<tbody>
<tr>
<td>Still Choose to Practice Law (p = n.s.):</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Definitely Yes</td>
<td>49.4%</td>
<td>41.0%</td>
<td>60.0%</td>
</tr>
<tr>
<td>Probably Yes</td>
<td>40.5%</td>
<td>44.2%</td>
<td>28.0%</td>
</tr>
<tr>
<td>Probably/Definitely No</td>
<td>10.1%</td>
<td>14.8%</td>
<td>12.0%</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
<tr>
<td>Still Choose to Specialize in Transportation Law (p = .077):</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Definitely Yes</td>
<td>11.7%</td>
<td>10.0%</td>
<td>30.4%</td>
</tr>
<tr>
<td>Probably Yes</td>
<td>45.4%</td>
<td>35.0%</td>
<td>34.8%</td>
</tr>
<tr>
<td>Probably/Definitely No</td>
<td>42.9%</td>
<td>55.0%</td>
<td>34.8%</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
<tr>
<td>Income Compared to Expectations (p = .024):</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Better Than Expected</td>
<td>35.9%</td>
<td>45.9%</td>
<td>72.0%</td>
</tr>
<tr>
<td>About What Expected</td>
<td>46.2%</td>
<td>32.8%</td>
<td>20.0%</td>
</tr>
<tr>
<td>Worse Than Expected</td>
<td>17.9%</td>
<td>21.3%</td>
<td>8.0%</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

ificantly related to satisfaction with their legal careers and income expectations (Exhibit 5).

One clear relationship revealed by Exhibit 5 is that the predominant acceptance by the respondents of their career in law grew as income increased. The number of attorneys making under $87,500 who would definitely or probably again choose to practice law was 77.8%, compared to 89.2% for those earning between $87,500 and $112,500 and 93.5% for those earning over $112,500.

In addition, the strong level of discontent among the lawyers with their specialization in transportation law cut across all income and firm size categories. Nearly half of the highest-income lawyers (43.6% - see Exhibit 5) and a sizeable minority of lawyers in the largest firms (34.8% -
### Exhibit 5
TRANSPORTATION ATTORNEYS' RESPONSES BY ANNUAL INCOME

<table>
<thead>
<tr>
<th></th>
<th>Under $87,500</th>
<th>$87,500 to $112,500</th>
<th>Over $112,500</th>
</tr>
</thead>
<tbody>
<tr>
<td>Still Choose to Practice Law (p = .018):</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Definitely Yes</td>
<td>35.2%</td>
<td>40.5%</td>
<td>61.2%</td>
</tr>
<tr>
<td>Probably Yes</td>
<td>42.6%</td>
<td>48.7%</td>
<td>32.3%</td>
</tr>
<tr>
<td>Probably/Definitely No</td>
<td>22.2%</td>
<td>10.8%</td>
<td>6.5%</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
<tr>
<td>Still Choose to Specialize in Transportation Law (p = n.s.):</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Definitely Yes</td>
<td>13.2%</td>
<td>11.8%</td>
<td>14.5%</td>
</tr>
<tr>
<td>Probably Yes</td>
<td>37.7%</td>
<td>50.0%</td>
<td>41.9%</td>
</tr>
<tr>
<td>Probably/Definitely No</td>
<td>49.1%</td>
<td>38.2%</td>
<td>43.6%</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
<tr>
<td>Income Compared to Expectations (p = .001):</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Better Than Expected</td>
<td>16.7%</td>
<td>50.0%</td>
<td>67.8%</td>
</tr>
<tr>
<td>About What Expected</td>
<td>50.0%</td>
<td>33.3%</td>
<td>27.4%</td>
</tr>
<tr>
<td>Worse Than Expected</td>
<td>33.3%</td>
<td>16.7%</td>
<td>4.8%</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

see Exhibit 4) renounced their specialty, which challenges our expectation they would be largely content groups.

As for the responses to income satisfaction, it is evident, and perhaps tautological, that the highest-paid attorneys and those who are members of the largest firms are not among the few respondents experiencing less than expected income. Only 4.8% of the former group (Exhibit 5) and only 8% of the latter group (Exhibit 4) were disappointed financially. Exhibit 5 bears out the anticipated direct relationship between income satisfaction and compensation received. Two-thirds of the lawyers in the lowest income category felt they were paid as much or more than they expected, compared to 83.3% and 95.2% in the higher income categories. The survey indicates that the public perception of lawyers being well-paid is mirrored by the fulfilled expectations of the lawyers themselves.

### C. ATTORNEYS SPEAK OUT

The most revealing result of the survey was the variety and insight of the attorneys' subjective thoughts and feelings on what most frustrates and pleases them about their profession. They reacted with compelling candor and vigor to the following invitations: "Please tell us the ONE thing you enjoy most about being an attorney" and "Please tell us the ONE thing you find most frustrating about being an attorney." We believe what follows is an accurate and telling compendium of attitudes shared by attorneys across the country.
"MOST ENJOYABLE" RESPONSES

The largest group (53 - nearly 35%) among the 154 attorneys describing the most enjoyable aspect of their law practices articulated a deep sense of service to their clients and society. Respondents extolled the joy of identifying and solving client problems and professional pride in improving society by affecting and shaping the law. The respondents declared:

Assisting all levels of clients in cutting through the bureaucratic ways and in providing a sounding board for business judgments which they seem to want.

The understanding of how the legal system is supposed to work and the satisfaction of resolving a dispute within the system to a fair end.

The ability to respond to new clients (strangers) who have come to the door at the suggestion of other clients - the ultimate compliment - and being a force for what is "right" about me, the law and legal system.

Being able to help people in immediate trouble and plan and establish goals for those clients looking to the future.

Arguing issues of significance to an entire industry; having an effect upon how that industry operates.

The occasional feeling that I have helped sort out a problem in a way that benefits society as a whole helps me to justify my existence.

Nearly as popular (45 attorneys - 29%) was the group praising the intellectual rewards of the job. These lawyers enjoyed the stimulation of adversarial competition and strategy, the variety of cases and legal issues, and the challenges of learning and applying the law. Ironically, many of these same characteristics of legal practice were mentioned by many respondents as factors in their most severe frustrations, such as the tremendous time burden of keeping up with ever-changing laws and ethical violations committed in the heat of competition. Representative comments included:

Channeling aggression in a socially acceptable manner.

Intellectual stimulation and involvement with an industry that fascinates me.

Taking a group of building blocks (laws, witnesses, known data) and attempting to fit them together into a cohesive package that will result in success.

The variety of problems and challenges keeps it from becoming a bore.

The practice of law is essentially a search for truth. It is wonderful to participate in transportation regulations which is a challenge to all parties involved.

The third and final major category of attitudes reflected an appreciation for autonomy. Twenty-eight lawyers (18%) expressed this benefit variously as independence, freedom, control, authority, responsibility, and self-reliance. Again, we will find in the negative responses that what is a
key motivation for some attorneys is a source of dismay to others in the form of administrative headaches and the intrusion of business problems. Most statements in this regard were brief and specific, such as:

The ability to choose my own destiny.
The feeling of being my own business.

Less often mentioned but no less interesting were four secondary factors chosen as highlights of practice by a few attorneys. Eleven (7%) spoke well of their relationships with other attorneys (a minority view, as we shall see!) and with clients. Seven (5%) zoned in on the singular satisfaction of winning their cases. Four (3%) admitted an attraction to the ego gratification of public esteem and status.

What very much surprised the authors was the near absence of compensation and financial security as a source of satisfaction. Only three lawyers (2%) directly mentioned financial rewards and one of them cited autonomy as well. Either money is not important to these lawyers, or more likely they take it for granted, as supported by our finding that over 82% viewed their income as equal to or better than expected. This assumption is validated by the respondents remaining in practice despite their severely critical condemnations of its faults described below.

We note that among the three miscellaneous responses was one lawyer who enjoyed nothing. He made this sobering comment:

Nothing now. I lost my major transportation practice when I was too old to obtain another specialty. Therefore, I am engaged in a general litigation practice with some transportation work.

"MOST FRUSTRATING" RESPONSES

The 148 lawyers who told us the one most frustrating aspect of their practices did so without reservation. Many of their comments were graphic, intense, profane and supportive of the recent research and literature on distress in the legal profession.

The target of the greatest criticism (36 respondents or 24%) was the bureaucracy of the legal system. Specifically, this group decried (1) the inefficiencies, delays and paper requirements of court and agency administration, (2) the incompetence of judges and agency decision-makers in their application of statutes and regulations, and (3) the political process that produces bad laws. Consider the following illustrative comments for each subgroup:

(1) The paper shuffling and the adherence to rules that make absolutely no sense.
The bureaucratic nonsense at every level of government administering to the needs of the motor carrier industry.
The court systems, both federal and state - if they were corporations they would be bankrupt.
I am often astonished at how wasteful the processes of the law can be - it makes me feel that I am a part of a problem, rather than a part of its solution when I see waste occurring.

(2) Intelligence level and interest level of some deciders of fact and law.
Stupid judges!! Instead of the cream of the crop you get the bottom of the barrel.

Refusal of ICC and other agencies and Supreme Court to apply plain language of statutes rather than legislating their philosophies into law.

(3) Bad law, bad legislation, bad legislators.

In the next largest category, we find the effects of lawyer bashing. Twenty-six respondents (18%) were most frustrated with either the low public opinion of lawyers or the high demands of clients based on their perception that lawyers can solve all their problems even when a case is legally weak. From their vantage point, this is the worst of professional service worlds - abuse from clients after a loss, lack of cooperation and appreciation before and after an expected victory, and social ridicule all the time. The following observations accurately display the seriousness with which this problem was taken:

The image of attorneys as money grubbers.

The current public perception of attorneys is very negative, generally speaking, and that disturbs me.

Being asked to put out a fire immediately after it has been burning for a week.

Attorney jokes which speak volumes about what is happening to our profession which has deteriorated due to less control over character and integrity requirements.

Many attorneys shared the opinion that lawyers themselves are responsible for many of their problems. Twenty-four responses (16%) ranged from merely critical to blatantly hostile in attacking the ethics, irrationality, abuses of legal system, office politics, and even personalities of their peers, including these highlights:

Other attorneys’ abuse of process, especially in discovery, which the agency cannot or will not control. We need reform in this area.

Frustration over the time and energy it often takes to resolve an issue that is common sense but being fought out for purposes of delay or getting even.

The law practice has degenerated from an honorable profession to a dog eat dog rat race with the primary focus on money.

Dealing with office politics and dealing with other lawyers. As a general rule, lawyers are arrogant, stuffy, petty, amoral, dishonest, venal, narrow, shallow and dull. Other than that, they’re great guys.

Time pressures and the business aspects of law practice were only slightly less often mentioned irritations, each chosen by 21 lawyers (14%). The former group described the press of long hours, workload, and deadlines (**too much work and not enough time, even at 60
hours/week") and the latter bemoaned office management, marketing responsibility, accounting for billable hours, and bill collecting ("the perception that all attorneys are rolling in money and clients need not pay bills regularly - cash flow is a mounting problem"). Apparently the attorneys who loved their independence were not the ones involved in the business management of their firms.

The final significant category of frustration perhaps contributes strongly to the problems of time management and fee collection. Fifteen lawyers (10%) identified the rapid evolution and complexity of the law as their primary grievance. They wrote not only of the demands of the law upon them, but of the effects of higher fees and costs on clients, to the extent of rendering justice unaffordable. For example:

- The need to balance service against the client's means.
- Inability to devote large amounts of time to legal issues that are real and important from the client's standpoint but limited by the clients ability to pay for major dispute resolutions.
- The enormous expense of litigation and the overwhelming creation of new regulations.
- Not knowing enough law.

It was surprising, in light of the strongly negative reaction by the sample to their choice of transportation law as a career, that only two lawyers found deregulation to be a prime source of frustration. We can only speculate that since the 1980 Act the attorneys had adapted and integrated their knowledge into other aspects of transportation law.

IV. RESULTS IN CONTEXT

It is clear from relevant research that the frustrations of transportation lawyers are shared to an even greater extent by non-specialists. Here is a sampling:

- The three most common reasons given by successful lawyers for leaving practice were that they:  
  1. didn't like the adversary system and were tired of fighting;
  2. wanted more time for personal interests and a more relaxed lifestyle; and
  3. their duties were not as enjoyable as other things they could be doing.

Formal discipline against attorney misconduct is rising dramatically in many jurisdictions. Minnesota reports 61 cases of misconduct in 1990 receiving various sanctions, almost one-third more than in any prior year.  

In a 1989 survey of 1100 Maine attorneys, 60% stated they had all the work they could handle and one-third were overburdened.

7. ARRON, supra note 3.
Fully 94% of the lawyers in the Maryland study (cited in Section I above) believed their occupation had become more a business than a profession due to a preoccupation with money: 84% felt that public perception of lawyers was declining, with more than 75% of those perceiving damage to the profession from this negativism; about half felt that the relationships among lawyers was increasingly adversarial; and more than 75% worked more than 50 hours a week.10

Interviews with several Wisconsin attorneys who had left private practice repeated our survey themes of time demands, irrational and unhappy clients (services too expensive, unnecessary, or both) and guilt over the costs of the system to its users.11

The range and power of the frustrations expressed by our sizeable nationwide sample of transportation attorneys and the great extent to which their criticisms mirror these other studies leads us to conclude that the system of delivering legal services is overloaded. One critical factor functioning below the surface of the problems is the overwhelming number of lawyers in this country.

In 1920 there were under 123,000 attorneys or one for every 860 people. By 1989 there were over 725,000 or one for every 415 people.12 A more recent estimate puts the number at nearly 800,000 or one for 300 people.13 The trend is not diminishing. Nationally 95,000 people applied for admission to 175 accredited law schools in 1991, up 7.8% from 1990. That was the fourth consecutive annual increase in applications.14

As a result of its burgeoning size, the profession has evolved from a small, collegial, cohesive group to an anonymous, diverse and specialized collage of competitors.15 Though our study and related research deny that overpopulation has produced a work shortage, it appears to be an indirect cause of much distress.

With more competition for cases and fees, many lawyers may accept more cases for less money while facing increasing client expectations, an exploding body of laws, administrative requirements and delays in a system overburdened with frivolous claims and the business demands of a practice that must market and serve more clients. Lawyers attempt to do all this while maintaining a standard of living comparable to the days when law was relatively simple and clients were abundant.

Lawyers who are unable or unwilling to specialize so as to define and

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10. See Bainbridge, supra note 1.
15. See Newton, supra note 12, at 899.
limit their expertise and control their market of clients may be forced to examine their income expectations in light of their frustrations and personal values. The strong statement made by 88% of our transportation lawyers that they would again practice law may indicate that their specialty has spared them from the full economic effect of the frustrations they share with lawyers generally. While nearly half of them may regret their choice of transportation law, their overall contentment level reflects relatively good fortune as compared to their non-specialized colleagues.

And since the critical remarks of our respondents are reflected at crisis levels among their fellow attorneys, their reported self-satisfaction centered on generous compensation may be temporary and illusory. A majority of the Maryland attorneys who were interviewed, both partners and junior associates, felt they were overpaid. The researcher observed that their salaries were the result of and contributed to the economic pressures felt by most lawyers. It stated:

"Attorneys at all levels and in all size firms feel that they are reacting to an ever increasingly chaotic environment and do not see much hope for stemming the tide."  

Several solutions have been considered and adopted by lawyer organizations. One is to limit law school admissions and communicate realistic expectations to law school students. Another is to reform the legal system from conflict to mediation, from justice by combat to problem solving. Sanctions against attorney misconduct and system abuse should be clarified and rigorously enforced. Clients should be educated by the profession and individual attorneys should focus on resolution not revenge.

A few professional organizations have started educating and assisting their members to help them deal with the pressures of practice, but their funds and empirical data are limited. State associations have dealt with incivility through voluntary role-modeling programs and codes and creeds of civility.

Whatever the method, it appears certain that its effectiveness will depend upon the concern and cooperation among lawyers who have been trained and forced by economic expectations to compete with each other. Our society's ability to resolve conflict depends upon it.

CONCLUSION

Our survey indicates that transportation lawyers are basically satis-

16. See Bainbridge, supra note 1, at 31.
17. See Arron, supra note 3.
fied with their careers. They are happy being lawyers and they are being compensated as well or better than they expected, though roughly half of them would want to change their area of specialization.

When asked to specify what they enjoyed most about their jobs, the 154 responding lawyers specified the rewards of service to clients and society (34%), intellectual stimulation (29%), autonomy (18%), personal relationships (7%), winning cases (5%), prestige (3%), compensation (2%), and others (2%).

The 148 lawyers who shared their greatest frustration were dismayed and in some cases shocked by the legal bureaucracy (24%), lawyers' public image (18%), the lax standards of their colleagues (16%), time pressures (14%), the business aspects of practicing law (14%), the complexity of laws (10%) and others (4%).

We speculate that while these specialists may pledge contentment, the severity and breadth of their frustrations, combined with indications from other research of a great emerging distress among general practitioners, foretell a crisis in the profession - a crisis for clients who cannot afford to pay for justice and for lawyers who cannot afford the personal cost of providing it. We urge the profession to act.
Single-State Truck Transportation of Petroleum and Petroleum Products

FRITZ R. KAHN*

Recent decisions of the Interstate Commerce Commission hold the promise of reducing the cost of distributing petroleum and petroleum products from marine or pipeline terminals.

The savings to be achieved result from the differentials in the rates of interstate and intrastate truckers. The former to a great extent have been deregulated, and their rates are at fairly low levels. The latter, however, continue to be regulated in many states, and their rates remain relatively high.

For decades single-state truck transportation from marine or pipeline terminals had been held to be in intrastate commerce, notwithstanding that the petroleum or petroleum products came from out-of-state or overseas sources. The ICC, based on the facts of the cases, concluded that the interstate portion of the movements ended when the petroleum and petroleum products entered the terminal storage tanks from which they subsequently were sold and transported by truck.

Recent decisions of the ICC, however, have focused on the intent that the commodities be transported beyond the transfer points at the time

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of their introduction into the stream of commerce, making the subsequent single-state truck transportation a continuation of the commodities' movement in interstate commerce.

No less importantly, the ICC has backed away from its earlier holdings that for the commodities to have entered the stream of interstate commerce the initial transportation must have been by a carrier subject to its jurisdiction. Its decisions open the way for finding single-state truck transportation beyond terminals to be in interstate commerce, notwithstanding that the petroleum or petroleum products were transported from their out-of-state or overseas sources by private vessel or pipeline.

The question whether a particular truck movement is in interstate or foreign commerce and, hence, subject to its jurisdiction is one with which the ICC has had to grapple from the inception of motor carrier regulation more than half a century ago. The single-state truck transportation of no commodity or group of commodities more clearly has called for the ICC's delineation of its jurisdiction than has the distribution of petroleum and petroleum products from marine or pipeline terminals.

For decades the ICC held that single-state truck transportation of petroleum and petroleum products from marine or pipeline terminals was in intrastate commerce, beyond its jurisdiction to regulate. It did so largely on the facts of the cases before it, which almost invariably showed that there was a break in the continuity of the interstate movements when the petroleum and petroleum products were placed in the terminals' storage tanks, from which they subsequently were sold and transported by truck.

In one of the first of its motor carrier decisions, Bausch Contract Carrier Application, the ICC denied the applicant's request for contract carrier operating authority on the ground that the services it proposed to render were in intrastate commerce and, therefore, not within the ICC's power to approve. The applicant sought to render single-state truck

1. Section 202(b) of the Motor Carrier Act of 1935, gave the ICC jurisdiction, among other things, over "the transportation of passengers or property by motor carriers engaged in interstate or foreign commerce." 49 U.S.C. § 302(b) (1988). The term "interstate commerce" was defined, in part, as "commerce between any place in a State and any place in another State ... whether such commerce moves wholly by motor vehicle or partly by motor vehicle and partly by rail, express, or water." 49 U.S.C. § 303(a)(10) (1988). As recodified, the Act gives the ICC jurisdiction "to the extent that passengers, property, or both, are transported by motor carrier between a place in a State and a place in another State." 49 U.S.C. § 10521(a)(1)(A) (1988).

2. See, e.g., Ross Common Carrier Application, 1 M.C.C. 607, 609 (1937); Sproul Contract Carrier Application, 1 M.C.C. 465, 466 (1937); Nelson Extensions of Operations, 1 M.C.C. 285, 287 (1936).


transportation of refined petroleum products from a pipeline terminal at Superior, Nebraska, to which such products had been shipped from an out-of-state origin. The ICC noted, "No specific consignment or amount thereof is intended for any particular shipper to consignee when the products leave the refinery . . . . Such products are stored at Superior as property of the [oil company] and are sold at that point as required by the various dealers." The ICC Held, "It must be concluded, therefore, that products so transported are no longer in interstate commerce after delivery into the storage tanks at Superior, but have come to the end of their interstate journey, and any movement therefrom must be considered as another shipment separate and distinct from and not a continuation of the movement thereto."

A similar result was reached by the ICC a year later in Moses Contract Carrier Application. The single-state truck transportation of liquid petroleum products proposed by the applicant in that proceeding was from a terminal in Syracuse, New York, to which the products had been transported from an out-of-state refinery by tank barges or tank railroad cars. Again the ICC found:

It appears that no specific consignment or amount thereof is intended for any particular shipper or consignee when the products leave the [refinery] . . . . Such products are stored in storage tanks at Syracuse as the property of the [oil company] and are sold at that point as required by the various dealers and purchasers.

The ICC concluded:

Products so transported are no longer in interstate commerce after delivery into the storage tanks at Syracuse, but have come to the end of their interstate journey, and any movement therefrom must be considered as another shipment separate and distinct from, and not a continuation of, the movement thereto.

An application for motor common carrier authority to transport petroleum and petroleum products within Illinois was dismissed for want of jurisdiction in Eldon Miller, Inc., Extension — Illinois. The applicant proposed to render single-state truck transportation from barge and pipeline terminals, supplied from out-of-state sources. The ICC noted, "The terminal storage tanks are considered to be distribution points, from

5. Id. at 5.
6. Id.
8. Id. at 426.
9. Id.
which sales and shipments are made to the ultimate customer . . . .”\footnote{11} The agency concluded that the truck transportation was in intrastate commerce, saying:

The shippers do not make pipeline and barge shipments on through bills of lading to any points beyond the pipeline or barge terminal; they have no knowledge of the ultimate destination of the shipments beyond the knowledge that they will probably be consumed within the State; the shipments are not segregated as to a shipper or amount upon arrival at the terminal, and all go into storage at the pipeline or barge terminal, for some appreciable time.\footnote{12}

Common to its decisions was the ICC’s reliance upon the Supreme Court’s opinion in Atlantic Coast Line Railway v. Standard Oil Co..\footnote{13} In that case the oil company operated marine terminals in Florida, from which it distributed petroleum and petroleum products which it purchased from suppliers that brought them by vessels from refineries in Louisiana and Mexico. The issue was whether the subsequent railroad transportation of the petroleum and petroleum products from the marine terminals to the oil company’s bulk and service stations in Florida was in interstate or foreign commerce. The Supreme Court concluded that it was not, saying:

The important controlling fact in the present controversy, and what characterizes the nature of the commerce involved, is that the plaintiff’s whole plan is to arrange deliveries of all of its oil purchases on the seaboard of Florida, so that they may all be there stored for convenient distribution in the state to the 123 bulk stations and to fuel oil plants in varying quantities according to the demand of the plaintiff’s customers. . . . There is nothing to indicate that the destination of the oil is arranged for or fixed in the minds of the sellers beyond the primary seaboard storages of the plaintiff company at Tampa, Port Tampa, Jacksonville, or the St. Johns river terminal [where title passes].\footnote{14}

Interestingly, the ICC reached a different conclusion, finding the single-state truck transportation to be in interstate commerce, when there was no change in the ownership of the petroleum or petroleum products at the transfer point and their placement in the storage tanks was for a brief period of time and as an incident in their continuous transportation to

\footnote{11} Id. at 315.
\footnote{12} Id. at 319. The emphasis upon the through billing was to distinguish the case from Petroleum Carrier Corp. Common Carrier Application in which the ICC did grant single-state trucking authority from a pipeline terminal, to the extent “performed under the proportional rates and transit tariff of the pipe line.” Petroleum Carrier Corp. Common Carrier Application, 48 M.C.C. 719, 722 (1948).
\footnote{13} Atlantic Coast Line Ry. v. Standard Oil Co., 275 U.S. 257 (1927).
\footnote{14} Id. at 269; accord Alabama Highway Express, Inc. v. U.S., 175 F. Supp. 143 (Ct. Cl. 1959); Atlantic Coast Line Ry. v. Standard Oil Co. of NJ, 12 F.2d 541 (4th Cir. 1926); Washington Dehydrated Food Co. v. Great N. Ry., 102 I.C.C. 363 (1925); see also Burlington Northern v. Weyerhaeuser Co., 719 F.2d 304 (9th Cir. 1983); Southern Pac. Transp. Co. v. ICC, 565 F.2d 615 (9th Cir. 1978).
an out-of-state destination. In the *Eldon Miller* proceeding the applicant was granted single-state truck transportation authority to handle crude oil from Mississippi producing fields to pipeline pumping stations within the state. The ICC said:

"[T]he storage tanks at the pipeline pumping stations] are a facility necessary as a practical matter to accomplish the transfer of the products from motor-carrier tank vehicles to the pipeline . . . In the combined motor-pipeline operations for [the oil companies], the shipments are owned by the shipper from the time they are delivered to the originating carrier and are characterized by a retention of ownership throughout their interstate journey." \(^\text{15}\)

So, too, in *R.B. "Dick" Wilson, Inc., Extension — Petroleum*,\(^\text{16}\) the ICC found:

The record shows that these movements are from producing wells to out-of-State refineries, involving a combination of motor and pipeline transportation; and that it is the intention of the shipper at the time the shipments are dispatched from the well sites to the pipeline terminals by motor carrier that such shipments will continue beyond such terminals by pipeline to out-of-State destinations.\(^\text{17}\)

The ICC concluded, "We think it clear that the character of the motor movement from the wells to the pipeline terminals is definitely established as a portion of a through interstate movement, and that the entire movement, including the motor portion, is one in interstate commerce."\(^\text{18}\)

The status of single-state truck transportation of petroleum and petroleum products from marine and pipeline terminals was the subject of the ICC’s comprehensive investigation in *Petroleum Products Transported Within a Single State*\(^\text{19}\) in which the ICC concluded that it would look to the "bundle of circumstances" in determining "the essential character of the commerce."\(^\text{20}\) As applied to the type of traffic therein considered, continued the ICC, the intrastate character of the single-state truck transportation may be found in the following:

(1) At the time of shipment there is no specific order being filled for a specific quantity of a given product to be moved through to a specific destination beyond the terminal storage, (2) the terminal storage is a distribution point or local marketing facility from which specific amounts of the product are sold or allocated, and (3) transportation in the furtherance of this distribution within the single State is specifically arranged only after sale or allocation from storage.\(^\text{21}\)

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17. *Id.* at 173.
18. *Id.*** at 29.
20. *Id.* at 29.
21. *Id.*
As is evident, the agency's standards were little more than a reiteration of the indicia of intrastate transportation to which it had looked in its earlier determinations.

Significantly, the ICC's decision in its investigation proceeding did not address the question whether the transportation that preceded the single-state truck transportation needed to be by a carrier subject to regulation by the ICC. Arguably, having found in its earlier decisions that the distribution from marine and pipeline terminals was in intrastate commerce, the ICC did not have to reach the question whether the marine or pipeline transportation to the terminals was in interstate commerce. In fact, however, the ICC had treated the transportation that preceded the single-state truck transportation as if it were in interstate commerce, even when it was performed by the shipper in proprietary transportation not subject to the ICC's regulatory jurisdiction; for purposes of its decisions, the agency considered the marine or pipeline transportation to the terminals to be in interstate commerce.

In the *Bausch* case the ICC had noted that the petroleum products had been transported to the pipeline terminal at Superior "by the owner thereof . . . in its private pipeline." Nevertheless, as already noted, the ICC deemed such transportation to have been "in interstate commerce." Similarly, in the *Moses* case the ICC had noted that the petroleum products had been transported to the terminal at Syracuse "by the owner thereof . . . in [its] tank barges or tank cars," such transportation being "in interstate commerce." And in the *Eldon Miller* case the single-state truck transportation that was certified by the ICC as being a part of the crude oil's "interstate journey" was to the terminals of the oil company's "private pipeline."29

The ICC's decisions in that regard were consistent with its holdings in other cases, involving commodities other than petroleum and petroleum products, in which the agency found the single-state truck transportation to be in interstate commerce, when part of a continuous movement to or from an out-of-state locale, even though the connecting carriage was private and not for-hire.30

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22. The ICC does not have jurisdiction over the truck transportation by a person engaged in business other than transportation when such transportation is within the scope and in furtherance of such business. 49 U.S.C. § 10524 (1988).
24. Id. at 5.
25. Id.
27. Id. at 426.
29. Id. at 325.
30. Accord Haffner and Hanson Common Carrier Application, 69 M.C.C. 581, 584 (1957);
That changed, however, with the ICC's decision in *Motor Transportation of Property Within Single State*. The ICC observed:

Generally, whether transportation within a single state, is, in fact, interstate is determined by the essential character of the commerce, the most important factor of which is the presence or absence of a fixed and persisting intent of the shipper that his goods move to a destination in another state. *Baltimore & O.R. Co. v. Settle*, 260 U.S. 166 (1922).

Nevertheless, the ICC held that, for purposes of ascertaining the shipper's fixed and persisting intent, "transportation begins only when merchandise has been placed in the possession of a carrier subject to economic regulation." The agency added:

Under part II [relating to motor carriers], just as under part I [relating to railroads], the transportation must be considered as beginning at the point where the shipper tenders his goods to a for-hire carrier. If delivery is then made at a point in the same State, the relevant transportation is not interstate transportation.

The ICC rested its decision upon the Supreme Court's opinion in *Pennsylvania Railway Company v. Ohio Public Utilities Commission*. In that case the transportation of coal across the state line was by the operator of the mine, first in its own barges and then on its proprietary railroad. Only thereafter was the coal tendered for single-state transportation by a common carrier railroad. The Supreme Court, in upholding a decision of the Ohio PUC requiring adherence to the local switching charges said:

Transportation begins for [regulatory] purpose, if not for others, when the merchandise has been placed in the possession of a carrier.

* * *

The only transportation of this coal by a common carrier of merchandise either by railroad or by water was intrastate transportation in Ohio between Negley and Youngstown. The transportation between Pennsylvania and Ohio was by the owner, who was not a common carrier, but furnished implements of carriage for its own use exclusively.

The case might have been decided on the principles enunciated in *Atlantic Coast Line Railway Company v. Standard Oil Company of New*

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32. *id.* at 549-50.

33. *id.*

34. *id.*


36. *id.* at 175.

Jersey,\textsuperscript{37} for the movement of the coal was not a continuous one. Rather, at the end of the proprietary movement, the coal was dumped, washed and sorted into the sizes suitable for sale. "only then for the first time," said the Court, was it "ready for shipment to fill specific orders, which often are not received until after it has left the mines."\textsuperscript{38} The Court concluded, however, "[w]e have found it unnecessary to consider in the disposition of the case whether the treatment of the coal at Negley would break the continuity of the movement from the mines, even if interstate transportation would otherwise exist."\textsuperscript{39}

It was not only unregulated private carriage to a marine or pipeline terminal that would cause the subsequent single-state truck transportation to be in intrastate commerce, however; the ICC believed that for the single-state truck transportation to be in interstate commerce the preceding transportation must have been subject to its jurisdiction, even if performed by a for-hire carrier. Any doubt that remained that the ICC would expect the marine or pipeline transportation to the terminals to be by a carrier subject to its jurisdiction, was removed by Petroleum Products—Water-Motor—Inland Navigation Company.\textsuperscript{40} In that proceeding the ICC found that there was a break at the transfer facilities in the continuity of the movement of petroleum products, but it also found that the single-state truck transportation from the marine terminals was in intrastate commerce because the preceding barge transportation from without the state was exempt from the ICC's jurisdiction.\textsuperscript{41} Similarly, in Transport, Inc., Extension—Ex-Rail Cement\textsuperscript{42} and Behnken Truck Service, Ext.—Exbarge Traffic\textsuperscript{43} the ICC denied applications for authority to perform single-state truck transportation following unregulated barge movements from out-of-state origins in the belief that the principle of the Court's Pennsylvania Railway Company v. Ohio Public Utilities Commission\textsuperscript{44} decision "is applicable when the property is transported into the State by private carriage and is equally applicable when the property is transported into the State in for-hire carriage that is excepted or exempted from economic regulation under the act."\textsuperscript{45}

\textsuperscript{37} Atlantic Coast Line Ry. v. Standard Oil Co. of N.J., 12 F.2d 541 (4th Cir. 1926).
\textsuperscript{38} Pennsylvania Ry., 298 U.S. at 172.
\textsuperscript{39} Id. at 177.
\textsuperscript{41} Id. The ICC does not have jurisdiction over the transportation by water carriers when carrying not more than three commodities in bulk in the vessel or tow. 49 U.S.C. § 10542 (1988).
\textsuperscript{42} Transport, Inc., Extension—Ex-Rail Cement, 96 M.C.C. 671 (1964).
\textsuperscript{43} Behnken Truck Service, Ext.—Exbarge Traffic, 103 M.C.C. 787 (1967).
\textsuperscript{45} Behnken, 103 M.C.C. at 794-95; accord, Allen—Investigation of Operations and Practices, 126 M.C.C. 336, 349 (1977); Commercial Carrier Corp. Extension—Salt, 112 M.C.C. 415 (1970); see also Long Beach Banana Dist. v. Atchison, T. & S.F. Ry., 407 F.2d 1173 (9th Cir.
A marked change in the regulation of motor carriers was effected by the enactment of the Motor Carrier Act of 1980. As the Supreme Court observed in Maislin Industries United States v. Primary Steel, Inc.: The [Act] substantially deregulated the motor carrier industry in many ways in an effort to 'promote competitive and efficient transportation services.' In addition to loosening entry controls, the [Act] also created a zone of reasonableness within which carriers can raise rates without interference from the ICC.

Moreover, as the Court found, "The Commission has also relaxed the regulations relating to motor common carriers." It was not surprising, therefore, that, beginning with its decision in Armstrong, Inc. — Transportation Within Texas, the ICC has issued a series of decisions in which it has found the considered single-state truck transportation to be in interstate commerce, rather than in intrastate commerce. Its decisions pertained particularly to those states in which pervasive schemes of motor carrier regulation remained in effect and the truckers’ rates, accordingly, were relatively higher on intrastate moves than on comparable interstate moves.

Common to each of the ICC’s decisions is its observation, as in the Armstrong case:

It is well settled that characterization of transportation between two points in a State as interstate or intrastate in nature depends on the "essential character" of the shipment. Texas & N.O.R.R. v. Sabine Tram Co., 227 U.S. 111, 122 (1913). Crucial to a determination of the essential character of a shipment is the shipper’s fixed and persisting intent at the time of shipment. Baltimore & O.S.W.R.R. Co. v. Settle, 260 U.S. 166 (1922). This intent is

48. Id. at 2769.
49. Id. at 2770.
52. Armstrong, Inc. — Transportation Within Tex., 2 I.C.C. 2d 63 (1986), aff’d sub nom., Texas v. United States, 866 F.2d 1546 (5th Cir. 1989).
ascertained from all the facts and circumstances surrounding the transportation.\textsuperscript{53}

What the facts were that persuaded the ICC to conclude in the several proceedings that the shipper at the time of the shipment's inception had the fixed and persistent intent that the single-state truck transportation be a continuation and integral part of the preceding interstate movement varied with the proceedings. In \textit{Armstrong}\textsuperscript{54} it evidently was the motor carrier's storage-in-transit arrangement pursuant to which the carpeting was shipped from the out-of-state mills. In \textit{Matlack}\textsuperscript{55} it seemed to be the fact that most of the shipments involved supply contracts and other sales arrangements entered into prior to shipment. In \textit{Quaker}\textsuperscript{56} it appeared to be the use of forecasts of expected consumption of its products, giving the company an accurate idea in advance of their shipment where, beyond the transfer points or distribution centers, they were destined. In \textit{Victoria Terminal}\textsuperscript{57} it was the shipment of fertilizer pursuant to specific orders or customer estimates of their needs. In \textit{James River}\textsuperscript{58} it seemed to be the fact that shipments were made pursuant to long-term supply contracts and customers' past buying practices. No single indicium of interstate commerce was deemed to be controlling; all of the circumstances attending the transportation were considered by the ICC in reaching its conclusions.

In \textit{Bigbee},\textsuperscript{59} which involved the shipments of petroleum and petroleum products, the motor carrier seeking the declaratory order from the ICC argued that transportation practices in the industry had changed since the Supreme Court decided \textit{Atlantic Coast Line}\textsuperscript{60} and that it and the ICC's early decisions relying thereon no longer should be viewed as having precedential value. The motor carrier contended that the increase in pipelines and terminal facilities have made more common the transport of

\textsuperscript{53} Id. at 69.

\textsuperscript{54} Id. at 63.


\textsuperscript{56} The Quaker Oats Co. — Transportation Within Tex. and Cal. — Petition for Declaratory Order, Docket No. MC-C-30006, served Aug. 26, 1987 and Mar. 8, 1988 (unreported), aff'd \textit{sub nom.}, California Trucking Ass'n v. ICC, 900 F.2d 208 (9th Cir. 1990).


\textsuperscript{58} James River Corporation of Va. — Transportation Through Woodland, Cal. — Petition for Declaratory Order, Docket No. MC-C-30044, served July 15, 1988 (unreported), aff'd \textit{sub nom.}, International Bhd. of Teamsters v. ICC, 914 F.2d 904 (9th Cir. 1990).

\textsuperscript{59} Bigbee Transportation, Inc. — Transportation Within Alabama, Mississippi and Georgia — Petition for Declaratory Order, Docket No. MC-C-30065, served Nov. 1, 1988 (unreported).

\textsuperscript{60} Atlantic Coast Line Ry. v. Standard Oil Co., 275 U.S. 257 (1927).
petroleum and petroleum products by pipeline and then by motor vehicle to purchasers' final destinations.\textsuperscript{61} The ICC agreed, finding:

Here the record shows that ODO's intent is to ship fuel to a particular airfield, and that the particular installation's fuel needs is known in advance. DOD intends the fuel to continue its movement through the storage facilities for delivery to a known airfield. The fact that DOD's fuel may be temporarily stored does not destroy the continuity of the single interstate movement. DOD's intent at the time of the initial movement is that the jet fuel be delivered to various DOD installations.\textsuperscript{62}

Arguably, the ICC considered the same "bundle of circumstances" it identified the \textit{Single State}\textsuperscript{63} proceeding more than thirty years ago in determining whether the single-state truck transportation of petroleum and petroleum products was in interstate commerce. Thus, if the facts establish that, at their inception, the shipments were intended to satisfy requirements at destination, whether based upon specific orders, historical patterns or estimated needs, and that their storage at the transfer point was brief and in aid of the movement to their final site, the single-state truck transportation can be found to be an integral part of their transportation in interstate commerce. Such particularly is the situation if there is no change in the ownership of the shipments at the transfer point, and the sale occurs either at the commencement or conclusion of the journey. The court in \textit{Central Freight Lines v. ICC},\textsuperscript{64} however, said that the ICC "appears to have implicitly recharacterized the applicable test" of the \textit{Single State} proceeding.\textsuperscript{65} Similarly, the court in \textit{California Trucking Association v. ICC}\textsuperscript{66} said, "[e]ven though the ICC has never explicitly stated that it was abandoning the more structured \textit{Single State} test, it appears that its use of that standard has been refined, if not phased out."\textsuperscript{67}

The ICC appears no less to have come full circle with respect to the status of the carriage that precedes the single-state truck transportation in question. In \textit{May Department Stores}\textsuperscript{68} the ICC was concerned with the truck transportation within California of shoes and handbags imported from the Far East. Clearly, the ocean transportation that preceded the motor carrier movement was not subject to regulation by the ICC. Nevertheless, the ICC found the single-state truck transportation to be in interstate commerce stating, "The fact that this Commission does not regulate

\begin{itemize}
\item \textsuperscript{61} Bigbee, at 3.
\item \textsuperscript{62} Id. at 7.
\item \textsuperscript{63} Petroleum Products Transported Within a Single State, 71 M.C.C. 17 (1957).
\item \textsuperscript{64} \textit{Central Freight Lines v. ICC}, 899 F.2d 413 (5th Cir. 1990).
\item \textsuperscript{65} Id. at 421.
\item \textsuperscript{66} \textit{California Trucking Ass'n v. ICC}, 900 F.2d 208 (9th Cir. 1990).
\item \textsuperscript{67} Id. at 213.
\item \textsuperscript{68} The May Department Stores Co. and Volume Shoe Corp. — Petition for Declaratory Order — Transp. Within Single State of Merchandise Imported by Water, Docket No. MC-C-30146, served June 15, 1990 (unreported).
\end{itemize}
the water portion of the movement does not preclude our jurisdiction over the motor portion."

In reaching its conclusion, the ICC relied upon its earlier decision in *Victoria Terminal.* That proceeding also had a preceding water movement not subject to ICC jurisdiction, but in *Victoria Terminal,* unlike in *May Department Stores,* the preceding water movement was a domestic one. The ICC said:

The proposition that the ex-barge movements are not subject to Commission regulation was based in large part on a review board decision in Behnken Truck Service, Inc., Ext—Exbarge Traffic, 103 M.C.C. 787 (1967). *Behnken* in turn, was based upon a decision of the Supreme Court in Pennsylvania Railroad Co. v. Public Utilities Commission of Ohio, 298 U.S. 170 (1936). In *Pennsylvania,* the Court held that a single-state movement by rail was not part of interstate transportation (and thus could be regulated by the State) because the preceding movement into the State by private carriage was not "transportation" within the meaning of the Interstate Commerce Act.

* * *

Upon closer analysis, we believe the review board erred in the *Behnken* line of cases in applying the holding of *Pennsylvania,* regarding the extent of the ICC’s rail jurisdiction, to a determination of its motor jurisdiction. This conclusion is based on the original (pre-recodification) language of the Interstate Commerce Act setting forth the Commission’s jurisdiction over these modes. * * *

The statute does not preclude the Commission from licensing and regulating motor carriage that is conducted in interstate commerce, even if it does not regulate the transportation at the moment it crosses State lines [footnotes omitted].

Although in *Victoria Terminal* the ICC considered unregulated for-hire transportation preceding the single-state motor carrier movement, its rationale applies with equal force to preceding unregulated proprietary transportation. Indeed, *Altoona Express,* at least in part, involved the outbound transportation from distribution sites of products brought there in private carriage. Nevertheless, the ICC held:

69. Id. at 6.
72. Id. at 1-2.
74. The court in Central Freight Lines v. ICC, 899 F.2d 413, 425 (5th Cir. 1990), upheld the ICC’s conclusion but did not accept its rationale for overturning the *Behnken* decision. Id.
The regulatory status of the movement into a State does not dictate the interstate or intrastate nature of a subsequent, single-State movement by motor carrier. The nature of the subsequent motor movement is not affected by whether the initial movement across State lines is in regulated, private, or other exempt carriage.76

It appears, therefore, that an oil company that maintains control of its petroleum and petroleum products throughout their interstate transportation from refinery to its customers and arranges for their shipment so as to replenish supplies at intervening marine or pipeline terminals in accordance with the projected demands of its customers based upon prior purchases and anticipated sales can utilize ICC regulated motor carriers for the single-state truck transportation from terminals to customers and obtain the benefits of their reduced rates and charges. Moreover, the oil company can do so notwithstanding that the movement of the petroleum and petroleum products to the marine or pipeline terminals was performed by it in private carriage.

To the extent that there is any uncertainty of the oil company's ability to do so, it is for the ICC, the agency that granted the operating authority to the motor carriers in the first instance, to remove such doubt. As the Supreme Court said in Service Storage & Transfer Company v. Virginia,77 "[C]onflicts can best be avoided if the interpretation of I.C.C. certificates is left to the Interstate Commerce Commission."78 The agency's recent spate of decisions, while not rendering it certain, indicate fairly clearly which way it is likely resolve the question of whether single-state truck transportation of petroleum and petroleum products is in interstate or foreign commerce.

76. Id. at decision served Feb. 12, 1990, at 12; see also Amoco Oil Company — Petition for Declaratory Order — Ex-Pipeline Transp., Docket No. MC-C-30191, served September 1, 1992 (unreported).
78. Id. at 176.
Special Aviation Section

Drug Testing in Aviation: The Double Standard Continues

CARROLL E. DUBUC*

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I. INTRODUCTION

Substance abuse in the American workplace costs the economy between an estimated $25-33 billion annually\(^1\) in lost productivity. Drug testing programs, according to the implementing rationale, benefit the economy by preventing and discouraging drug use and, thereby, increasing safety.\(^2\) The primary impetus, then, for instituting mandatory drug

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2. See generally Michael J. Ogborn, *Substance Abuse in the Public Sector*, 32 S.D.L. REV. 252 (1987). In the aviation industry, however, the very programs instituted to enhance safety and aid in accident investigations strangle financially burdened airlines, infringing on employee’s traditionally protected privacy interests, while uncovering little to no drug use in an industry already pervasively regulated to ensure safety.
testing in the aviation industry was deterrence from use and ultimate safety of operations.

Before drug testing programs were implemented, the Department of Transportation (DOT) had predicted that 7.5% of aviation employees tested would test positive for illegal substances. But, an analysis of 120,642 drug tests conducted over a six-month period in 1990, showed positive findings in only 0.47% of the tests completed. Previous FAA and DOT testing have yielded similar results. When fully implemented, drug testing is expected to cover 538,000 aviation personnel and cost business approximately $24 million per year during the decade of the 1990s.

Besides its deterrence function, post-accident/post-incident drug and alcohol testing performs a natural role in aiding accident investigators in determining the cause of accidents by eliminating or confirming the role of drugs and alcohol in a particular accident. Yet, the National Transportation Safety Board (NTSB), the body charged with investigating and determining the probable cause of aviation accidents, is being unduly hampered in its investigatory role by regulations which invest government supervisors (with no accident investigatory duties or experience) with the power to decide which of their fellow employees, if any, might have contributed to an accident and whom should be tested. In the chaotic aftermath of an accident, this is a difficult task even for the seasoned investigator.

The NTSB is further hindered in its investigatory function by a regulatory and legislative scheme which denies it the ability to request testing of those individuals the Board believes might bear some responsibility for, or contribute to, an accident. With no independent authority to require

4. *Id.* During the testing period from Jan. 1, 1990 to June 30, 1990, 561 individuals were tested, with 61.5% of the positive findings detected in pre-employment tests. *Id.* Random testing accounted for 31.73% of the positives (178 cases) while periodic, post-accident, reasonable cause and return-to-duty testing accounted for 6.77% (38 cases). *Id.* The breakdown of the positive test results by occupation includes job applicants as well as those working in those positions: 18 pilots and other flight deck crew; 116 flight attendants; 300 maintenance personnel; 48 aircraft dispatchers; 41 security personnel; 5 flight instructors; 4 private air traffic control personnel (29 persons were not identified by job or were not properly reported). *Id.* Of the positives reported, 346 were attributed to marijuana, 196 to cocaine, 13 to opiates, 1 to PCP, and 15 to amphetamines. *Id.*
5. *Supreme Court Gives DOT Approval for Random Drug Testing*, AVIATION DAILY, May 1, 1990, at 205. DOT drug testing of 34,235 employees between September 1987 and April 1990 revealed 0.46% positives (159 individuals tested positive). *Id.* The FAA also tested 24,082 employees between September 1987 and November 1989 for illegal drugs with 0.5% positives (or 131 cases) discovered. *Id.*
Drug or alcohol tests, the NTSB must ask the government employee to voluntarily submit to testing or allow their results, if any, to be released to the Board. To date, no government air traffic controller has voluntarily released his/her test results nor voluntarily submitted to testing at the request of the NTSB, and few can be expected to do so. The result is that, following an accident, the NTSB has the testing results of pilots and other private sector employees, but is without similar test specimens from air traffic controllers.

Thus, in addition to being extraordinarily expensive programs yielding little tangible results, federal drug testing regulations are being inequitably applied. Specifically, in post-accident/post-incident testing, divergent standards prevent the testing of all potential contributors to an aviation accident. Private sector employees are subject to mandatory post-accident or post-incident testing with the results of those tests releasable without their consent. Government employees, DOT/FAA air traffic controllers in particular, are accorded greater privacy protection because the results of their drug or alcohol test may not be released without their express written consent. The result often is that one segment of the airline industry is being subjected without hesitation to mandatory post-accident drug and alcohol testing while another integral part of the commercial aviation system is not. In short, when an accident occurs, it is often only the pilots that are tested for drugs or alcohol irrespective of the role air traffic controllers might have played in the accident. The current drug and alcohol testing regimen, therefore, ignores the crucial role played by air traffic controllers in the aviation industry, affords greater privacy rights to government aviation employees while denying commercial sector employees similar protections, and diminishes the investigatory role of drug and alcohol tests in aviation accidents by arbitrarily limiting the scope of obtainable information.

This article explores drug and alcohol testing in aviation as promulgated by the Omnibus Transportation Employee Testing Act of 19917 and as implemented by the Department of Transportation's program governing federal aviation employees including air traffic controllers, and the Federal Aviation Administration's program extending drug testing to commercial aviation personnel.

II. DRUG AND ALCOHOL TESTING IN APPLICATION

A. PILOTS, NOT AIR TRAFFIC CONTROLLERS, TESTED

Three recent accidents highlight the divergent standards being applied in post-accident drug and alcohol testing of pilots and air traffic con-

controllers. Despite the apparent cause of the accident, pilots are often automatically subjected to drug and alcohol testing while inconsistent criteria are used to determine which controllers were involved and whom should be required to submit to post-accident toxicological testing.

1. **AVIANCA 052**

On July 19, 1989, Avianca Airlines flight 052 (AVA 052), a Boeing 707 with Colombian registration, crashed in a wooded residential area in Cove Neck, Long Island, New York. AVA 052 was a scheduled international passenger flight from Bogota, Colombia to John F. Kennedy International Airport, New York which, because of poor weather conditions in the northeastern United States, was placed in holding patterns three times by air traffic control. During the third holding period, the flight crew reported that the aircraft was running out of fuel, that it could not reach its alternate airport, Boston-Logan International, and that the flight could hold for no longer than 5 minutes. While trying to return to JFK after a missed approach, AVA 052 lost power to all four engines and crashed approximately 16 miles from the airport. Of the 158 persons aboard, 73 were killed.

The National Transportation Safety Board investigated and determined that the probable cause of the accident was the failure of the flight crew to adequately manage the aircraft’s fuel load and their failure to communicate an emergency fuel situation to air traffic control. Listed as a contributing cause of the accident was inadequate traffic flow management by the Federal Aviation Administration and the lack of standardized understandable terminology for pilots and controllers for minimum and emergency fuel conditions. U.S. air traffic controllers had been involved in handling AVA 052 from the time that the flight entered into U.S. controlled airspace near Miami (the flight traversed air traffic control facilities in Miami, Jacksonville, Washington, D.C., and finally, New York).

The Captain, Co-pilot, and Engineer of AVA 052 were fatally injured upon impact. Toxicology samples of their remains were negative for alcohol and drugs. The FAA obtained toxicological samples from five of the

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8. Avianca, The Airline of Colombia, Boeing 707-321B, HK 2016, Fuel Exhaustion, Cove Neck, New York, NTSB Aircraft Accident Report, Pub. No. 91-910404 at 1 (Jan. 25, 1990). The flight was operating under the regulations of Colombia and was certified to operate in the United States under the provisions of Title 14 C.F.R. Pt. 129 which governs the operations of foreign air carriers and foreign operators of United States-registered aircraft engaged in common carriage. Id.

9. Id. at 1-14 (providing a history of AVA 052).

10. Id. at 76.

11. Id.

12. Id. at 19.

13. Id. at 38. One laboratory sample, however, found very low levels of ethanol and 2-
New York ATC specialists who controlled AVA 052 in the latter stages of its flight. Under DOT regulations existing at that time, the FAA was not required to provide the results of those tests to the NTSB. NTSB investigators requested the results of those tests directly from the controllers themselves, but the controllers refused. The controllers also declined the NTSB's requests for separate toxicological testing.

2. **NORTHWEST 1482/299**

In December 1990, two Northwest Airlines aircraft collided on the runway at Detroit Metropolitan Airport. Northwest Flight 299, a Boeing 727, had been cleared by air traffic control for takeoff and was proceeding down the runway when Flight 1482, a McDonnell Douglas DC-9, wandered into its path. During the heavy fog engulfing the airport at the time, the pilots of Flight 1482 had missed a taxiway due to weather, poor airport markings, inadequate taxiway signs, and non-functioning runway lights. Air traffic control had also lost track of the aircraft. Eight people aboard the DC-9 were killed and numerous others injured.

Following the accident, the Captain and First Officer of the DC-9 provided blood and urine samples as did the Captain, First Officer, and Flight Engineer of the B-727 in compliance with Northwest’s drug testing program. These tests were negative for drugs and alcohol. The FAA Divisional Manager required one ground controller to submit to drug testing five hours after the accident. No positive results, however, were reported to the NTSB as required and the ground controller refused to provide the NTSB with additional blood and urine samples. The FAA decided not to test any of the other air traffic controllers. The NTSB requested post-accident drug tests of all tower personnel but none "volunteered", i.e., the air traffic controllers responsible for tracking Northwest Flights 1482 and 299 refused the NTSB’s request for post-accident drug and alcohol tests.

As noted, DOT procedures provide that an FAA management official has sole discretion to determine which FAA employees are to be drug tested. In one crewman's liver, however, the sample was determined to have been contaminated with external material. Id.
tested following an accident. After the collision of Flights 1482 and 299, the FAA Divisional Manager made this decision within 3 1/2 to 4 hours following the accident based on a hastily made judgment as to the cause of the accident. He did not hear the accident tapes prior to making his drug testing decisions and admitted during the NTSB accident investigation hearing that the only source of information for his decision whether to test FAA employees came from the facility involved in the accident.

During the NTSB hearing, the Divisional Manager indicated that, based on what he subsequently learned during the course of the investigation, he would have required more air traffic controllers to submit to drug tests. It was also suggested during the hearing that the FAA’s reluctance to test more controllers was influenced by labor-management factors as well as employee morale considerations.

3. **USAir 1493**

On February 1, 1991, USAir flight 1493, a Boeing 737, collided with Skywest flight 5569, a Fairchild Metroliner, while the USAir aircraft was landing at Los Angeles International Airport. The Skywest Metroliner was positioned on the same runway, awaiting clearance for takeoff, on which the USAir flight was landing. All 12 individuals on board the Skywest flight and 22 people aboard the USAir airplane were killed. 22

The NTSB blamed the Los Angeles air traffic controllers and the FAA for the collision. Specifically, the NTSB accident investigation determined that the probable cause of the accident was the failure of the Los Angeles Air Traffic Facility Management to implement procedures that provided sufficient redundancy in controllers’ operations and the failure of the FAA Air Traffic Service to provide adequate policy direction and oversight to its air traffic control facility managers. These failures, the NTSB found, created an unsafe environment in the Los Angeles Air Traffic Control tower that ultimately led to the failure of the local controller to maintain an appropriate awareness of the traffic situation, culminating in inappropriate clearances which resulted in the collision of the USAir flight with the Skywest aircraft. Listed as a contributing cause of the accident was the failure of the FAA to provide effective quality assurance of the air traffic control system. 23

Approximately 4 hours after the accident, two air traffic controllers submitted urine specimens for toxicological analysis at the direction of Federal Aviation Administration Air Traffic Control management and in ac-


23. *Id.* at 76.
cordance with DOT requirements. No positive results were reported following analysis of these specimens and a review of the case by the FAA Medical Review Officer. The individual controllers involved refused the NTSB's subsequent requests for blood and urine specimens.  

The first officer of USAir 1493 submitted a urine specimen following the accident in accordance with Federal requirements. At the NTSB's request, the first officer voluntarily provided a blood specimen and agreed to release his FAA medical certification records.  

The captain of USAir 1493 and both crew members of SKW 5569 were fatally injured in the accident. Toxicological specimens collected from the remains were negative for alcohol and drugs, although the presence of over the counter cold medication was discovered in the body of the Skywest first officer and phenobarbital for a gastrointestinal problem in the remains of the USAir captain.  

In analyzing the FAA post-accident toxicological testing, the NTSB found that, as a minimum, the FAA air traffic management personnel should have required that the ground controllers and the clearance delivery controller be tested under the FAA's drug testing program because three controllers were handling the accident aircraft and the clearance delivery controller committed an error with a misplaced flight progress strip used to monitor the progress of flights between controller positions. Recognizing that all the relevant facts and circumstances cannot be known in the period immediately following an accident and that it cannot be determined with certainty who should be subjected to drug testing at that time, the NTSB found that the FAA should test all individuals who may be reasonably associated with the circumstances of an accident, such as all controllers who had communications with an aircraft shortly before an accident and their supervisors. The NTSB proposed retaining those specimens until the investigation had established who was associated with the accident and then submitting only those specimens relevant to the investigation for analysis.  

Following the USAir accident, NTSB staffers met with the Department of Transportation Secretary's Special Assistant for Drug Enforcement and Program Compliance and others on the DOT staff to discuss DOT post-accident drug testing programs and the need to collect blood and urine specimens from all involved in an accident and to increase the number of

24. Id. at 31.  
25. Id.  
26. Id. at 31, 72.  
27. Id. at 72.  
28. Id. at 73. The NTSB further proposed returning those specimens not required for analysis to the individuals. Id. The NTSB also commended USAir's drug testing program for exceeding the FAA's post-accident drug testing provisions. Id.
drugs (including alcohol) in the program. The Secretary's Special Assistant indicated that DOT was currently evaluating the merits of establishing a separate program for drug and alcohol testing following accidents but DOT has not notified the NTSB of any planned action.29

Indeed, the NTSB took exception with the inconsistent approach taken by DOT in formulating regulations providing for the drug and alcohol testing of persons involved in accidents.30 The NTSB noted that under existing FAA post-accident regulations, NTSB investigators may not be able to determine whether surviving aircraft crew members or air traffic controllers caused, or contributed to, an accident because of drug or alcohol impairment.31

B. INEQUITABLE IMPLEMENTATION

These episodes illustrate how unevenly and inequitably federal drug testing programs are being administered in the aviation industry. Implemented to deter drug use and enhance safety, the drug and alcohol testing programs are operating with two different presumptions based on classification of the individual to be tested: for pilots—a presumption of guilt which must be refuted through a negative test result; for air traffic controllers—a presumption of innocence which must be overcome in the early phases of an accident investigation before drug and/or alcohol tests are required. The result when an accident occurs: pilots are tested for drug and alcohol, air traffic controllers often are not. If post-accident drug and alcohol testing is to be required, all potential contributors to an accident should be subjected to the tests. Post-accident drug testing, then, should be performed on a uniform basis with the same determining mechanisms and triggering events applied equally to all concerned.

The current regulatory scheme also infringes upon the role of the National Transportation Safety Board and denies the NTSB vital and complete information regarding the individuals involved in an accident.

29. Id.
30. See Id. at 145, app. J (Letter from the NTSB to the Secretary of Transportation (Dec. 5, 1989)).
31. Id. at 145-46 app. J. The NTSB raised the following concerns about DOT regulations incorporating guidelines established by the Department of Health and Human Services (DHHS): (1) the guidelines specify the collection of urine only; (2) the guidelines specify the analysis for only five drugs or drug classes which do not include alcohol - the substance of most frequent abuse - prescription medications, and other illicit drugs; (3) the presence of drugs of alcohol (if tests were required) cannot be related to a level of performance impairment without the analysis of a blood sample (which is not required); (4) the drug level in the urine may be below the measurement threshold cutoffs specified in the DHHS guidelines due to the high thresholds in these guidelines and due to delays in collection of urine following an accident; and (5) the DHHS guidelines were never intended to be used for forensic purposes (to determine the causal relationship of drugs or alcohol to a transportation accident), yet the guidelines are being made to serve that purpose by their incorporation in post-accident/incident testing regulations. Id.
Charged with investigating and determining the probable cause of an accident, the NTSB has no independent authority to subject individuals to drug or alcohol testing. Instead, with all its experience in determining causes of accidents, the NTSB is forced to wait on the sidelines while an FAA management official, who probably lacks comparable accident investigatory experience, evaluates the accident site and makes a preliminary determination as to the cause of the accident and the controllers involved, and then decides who is to be tested. If the FAA does not require one of its own employees to submit to testing, the NTSB is powerless to mandate drug and alcohol tests and must hope that the controller will voluntarily comply with the Board’s testing request — an unlikely result indeed.

The NTSB has raised this issue with DOT and urged DOT to eliminate the double standard between the disclosure of toxicological test results from private persons who have a direct responsibility for transportation and DOT employees who occupy safety sensitive positions. The NTSB contended that one of the most (if not the most) important objectives of post-accident drug and alcohol testing is to determine whether such substances caused or contributed to an accident. If DOT employees in safety sensitive positions are free to withhold the results of post-accident toxicological tests, the NTSB maintained that crucial information pertaining to the accident would be withheld from investigators thereby undermining the NTSB’s mandate to determine the probable cause of an accident and develop appropriate safety recommendations. While sympathetic to the NTSB’s dilemma, DOT declined to alter existing regulations citing statutory limitations concerning the release of test results involving DOT employees.

In fact, instead the DOT has sought to codify the disparate treatment accorded pilots and FAA air traffic controllers in recently published proposed alcohol and drug testing procedures implementing the Omnibus Transportation Employee Testing Act of 1991. The proposed rules, in general the proposed rules regarding alcohol would prohibit "covered employees" in safety sensitive positions from: (1) having an alcohol concentration of 0.04 or greater; (2) con-
for example, prohibiting certain alcohol-related conduct by airmen other than flight crew members perpetuate the disparity by defining "covered employee" as employees who perform air traffic control duties directly or by contract for an employer that is an air traffic control facility not operated by the FAA or the United States military. Thus, air traffic control facilities operated by the FAA, an overwhelming majority in the United States, are exempt from the general drug and alcohol regulations imposed on other segment of the transportation industry; instead the FAA maintains its own testing rules.

In short, under existing federal regulations, pilots but not air traffic controllers are being subjected to post-accident drug and alcohol testing while the body charged with determining the probable cause of an aviation accident is denied potentially vital investigatory information. How did such inequitable standards develop?

III. FAA REGULATIONS REQUIRING DRUG TESTING OF COMMERCIAL AIRLINE PERSONNEL IN SAFETY-SENSITIVE POSITIONS UPHeld

In 1991, in the first challenge to the FAA's regulations, the Supreme Court let stand the FAA's regulations requiring commercial airline pilots, flight attendants, maintenance personnel, and others employed in safety-sensitive positions to submit to random drug testing. Shortly after the
FAA implemented mandatory employee drug testing, various employees subject to the new regulations, industry labor organizations, and an organization of aviation employees and employers challenged the drug testing provisions as unreasonable searches in violation of the Fourth Amendment in Bluestein v. Skinner. The Ninth Circuit held that the unannounced drug testing of airline employees in safety-sensitive positions did not violate the Fourth Amendment and the Supreme Court refused to review the decision. In formulating its holding, the Ninth Circuit relied on Supreme Court decisions handed down the same day which reviewed the constitutionality of two federal drug testing programs in National Treasury Employees Union v. Von Raab and Skinner v. Railway Labor Executives' Association.

A. Von Raab: Testing Employees Seeking Transfers to Certain Positions Upheld

1. Customs' Program

In Von Raab, the Supreme Court held that the Customs Service's drug testing requirement for employees seeking transfers or promotions

41. Bluestein v. Skinner, 908 F.2d 451 (9th Cir. 1990), cert. den., 111 S. Ct. 954 (1991). Besides various employees, the plaintiffs included: the Air Line Pilots Association; the Association of Flight Attendants, International; the Association of Machinists and Aerospace Workers; the International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America; the Transportation-Communications International Union; Orange County Airport Association; the Independent Federation of Flight Attendants; the Association of Professional Flight Attendants; and the Independent Union of Flight Attendants. Id.
42. Id. at 453; see generally Michael R. O'Donnell, Employee Drug Testing—Balancing the Interests in the Workplace: A Reasonable Suspicion Standard, 74 Va. L. Rev. 969 (1988).
44. Skinner v. Railway Labor Executives' Ass'n, 489 U.S. 602 (1989). Other federal courts following the Bluestein decision have likewise relied on Skinner and Von Raab in upholding the constitutionality of drug testing of safety and security-sensitive workers in industries DOT regulates. See, e.g., International Brotherhood of Teamsters v. Department of Transp., 932 F.2d 1292 (9th Cir. 1991) (upholding constitutionality of Federal Highway Administration regulations requiring random, biennial, pre-employment and post-accident drug testing of commercial motor vehicle drivers operating in interstate commerce); Railway Labor Executives' Association v. Skinner, 934 F.2d 1096 (9th Cir. 1991) (upholding constitutionality of Federal Railroad Administration's regulations requiring random drug testing of railroad employees in safety-sensitive positions); United Steelworkers of America v. Skinner, 768 F.Supp. 30 (D. RI 1991) (upholding constitutionality of Research and Special Programs Administration's regulations requiring random, pre-employment, and post-accident drug testing of safety-sensitive employees engaged in natural gas, liquified natural gas and hazardous liquid pipeline operations).
45. The U.S. Customs Service, a bureau of the Department of the Treasury, is the federal agency responsible for processing persons, carriers, cargo, and mail into the U.S., collecting revenue from imports, and enforcing customs and related laws. Von Raab, 489 U.S. at 659. An important responsibility of Customs is the interdiction and seizure of contraband, including illegal drugs. Id.
to certain positions did not violate the Fourth Amendment. In response to a task force study exploring the possibility of implementing a drug-screening program at Customs, the Commissioner of Customs, in 1986, announced the implementation of a drug testing program for applicants to positions which (1) required direct involvement in drug interdiction; (2) required carrying firearms; or (3) allowed access to classified material.

After two months, the program was extended to current employees seeking a transfer to a covered position. Because no applicant for initial employment was a party to the suit, the Fifth Circuit and the Supreme Court considered only the constitutionality of the drug testing program as applied to employees seeking transfers to covered positions.

46. Id. at 656.

47. In December 1985, the Commissioner of Customs established a Drug Screening Task Force to consider implementing a drug screening program. Von Raab, 489 U.S. at 660. After the task force concluded "that drug screening through urinalysis is technologically reliable, valid and accurate," the Commissioner announced implementation of a drug testing requirement despite acknowledging that "Customs is largely drug-free." Id.

48. The covered positions start with top administrative posts and include criminal investigators, intelligence officers, customs inspectors, and even clerical workers assigned to the tasks described. National Treasury Employees Union v. Von Raab, 816 F.2d 170, 173 (5th Cir. 1987), aff'd in part and vacated in part, 489 U.S. 656 (1989).

49. Id. Customs did not, however, attempt to justify its drug testing program on the grounds that it suspected a significant level of drug use among its employees. Id. See also Andrea Neal, Mandatory Drug Testing: Court Weighs Civil Liberties Objections, A.B.A. J. Oct. 1, 1988 at 58.

50. Von Raab, 816 F.2d at 173.

51. Id. Under Customs' drug testing program, an employee who had qualified for and was tentatively selected to receive a transfer to a covered position was advised in writing that the appointment was contingent upon successful completion of a drug test. Nat'l Treasury Employees Union v. Von Raab, 489 U.S. 656, 661 (1989). If the employee then withdrew the application, the employee remained in his/her present position and no adverse inference was drawn from the decision not to pursue the transfer. Nat'l Treasury Employees Union v. Von Raab, 816 F.2d 170, 173 (5th Cir. 1987). At least five days after Customs notified the employee, id., an independent contractor contacted the employee to arrange for collecting the urine sample. Von Raab, 489 U.S. at 661. At the test site, an observer gave the employee a form to list any medications taken or any other legitimate reasons for exposure to illicit drugs during the preceding thirty days. Von Raab, 816 F.2d at 173-74. The form was sealed in an envelope that was not opened unless a positive test resulted. Id. at 174. After reporting to the test site, the employee had to produce a picture form of identification and surrender all outer garments and personal belongings to an observer who then gave the employee a collection bottle. Von Raab, 489 U.S. at 661. The employee could produce the sample behind a partition or in a bathroom stall. Id. In order to prevent tampering or substitution, the observer remained nearby to listen for the normal sounds of urination (the observer did not visually observe the act of urination). Id. Dye was also added to the toilet water to prevent the employee from using water to dilute the sample. Id.

Upon receiving the specimen, the observer inspected it to ensure its proper temperature; the observer was instructed to reject an unusually hot or cold sample. Von Raab, 816 F.2d at 174. After verifying the sample's temperature and color, the observer placed a tamper-proof seal on the bottle, had the employee initial the label, and otherwise verified that proper chain-of-custody procedures had been correctly followed. Von Raab, 489 U.S. at 661. The sample was then sent to the laboratory for testing for marijuana, cocaine, opiates, amphetamines, and PCP. Id. Initially, all samples were screened by the enzyme-multiplied-immunoassay technique.
Drug Testing in Aviation

2. **DISTRICT COURT ENJOINS TESTING AS OVERLY INTRUSIVE; FIFTH CIRCUIT REVERSES**

A union of federal employees and a union official challenged the Customs Service’s drug testing program as violating the Fourth Amendment. Acknowledging “the legitimate governmental interest in a drug-free work place and work force” the district court, nevertheless, agreed with the union and concluded that Customs’ drug testing plan “constitutes an overly intrusive policy of searches and seizures without probable cause, or reasonable suspicion, in violation of legitimate expectations of privacy.”

The district court, then, enjoined the drug testing program.

The Fifth Circuit Court of Appeals vacated the injunction. Noting that privacy interests were clearly implicated, the Court of Appeals, in a subsequently oft-quoted passage, explained:

> There are few activities in our society more personal or private than the passing of urine. Most people describe it by euphemisms if they talk about it at all. It is a function traditionally performed without public observation; indeed, its performance in public is generally prohibited by law as well as social custom.

Nevertheless, the Fifth Circuit concurred that Customs’ drug testing program constituted a search within the meaning of the Fourth Amendment, but found that search reasonable based on the government’s strong interest in employing individuals in key positions who are not drug users, the limited intrusiveness of the program, and the fact that employees subject to drug testing voluntarily sought a transfer, and, after notification of the requirement, consented to the drug test.

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(EMIT). *Von Raab*, 489 U.S. at 662. All positive test results had to be confirmed using gas chromatography/mass spectrometry (GC/MS). *Id.* The GC/MS confirmatory test was required because of the high incidence of false positives using EMIT. *Id.* at 174. GC/MS, however, is considered highly accurate. *Id.* Positive test results were reported to the Medical Review Officer (MRO) for review. *Id.* If the GC/MS test was positive, the employee could designate a laboratory to test the original sample independently. *Id.* Because EMIT will generally report the test for drug use as negative when five days have elapsed between the last use of drugs and the testing date, the test may have failed to detect the prior use of drugs by persons who had abstained for five days. *Id.* Customs employees who tested positive for drugs and could not offer a satisfactory explanation for a positive test result were subject to dismissal. *Id.* at 663.

54. *Id.* at 175.
55. *Id.* at 173, 177-80.
3. **SUPREME COURT AFFIRMS TESTING OF EMPLOYEES DIRECTLY INVOLVED IN DRUG INTERDICTION: CUSTOMS’ PROGRAM CLEARLY CONSTITUTES FOURTH AMENDMENT SEARCH**

The Supreme Court affirmed the Fifth Circuit’s decision as to employees directly involved in drug interdiction or required to carry firearms, but vacated the judgment requiring the testing of employees seeking positions involving classified materials.\[^{56}\] According to the Court, requiring employees to produce urine samples for chemical testing clearly implicates the Fourth Amendment because those tests invade reasonable expectations of privacy.\[^{57}\] The question, then, becomes whether Customs’ drug testing program meets the Fourth Amendment’s reasonableness requirement.\[^{58}\]

4. **SPECIAL GOVERNMENTAL NEED EXISTS TO CIRCUMVENT USUAL WARRANT AND PROBABLE CAUSE REQUIREMENTS**

Generally, the Court explained, a search must be supported by a warrant issued upon probable cause.\[^{59}\] Neither a warrant, probable cause, nor any measure of individualized suspicion is necessary, the Court reasoned, where the Fourth Amendment\[^{60}\] intrusion serves special

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\[^{56}\] National Treasury Employers Union v. Von Raab, 489 U.S. 656, 664-65 (1989). The Court found itself unable to assess the reasonableness of the government’s testing program for employees handling classified material. Id. at 677. The Court agreed that the government has a compelling interest in protecting truly sensitive information from those who might compromise it, id. (citing Department of the Navy v. Egan, 484 U.S. 518, 528 (1988)), but noted that it was not clear whether the category defined by Customs’ testing directive encompassed only those Customs employees likely to gain access to sensitive information or whether Customs defined this category more broadly than necessary. Id. at 677-78. The Court remanded the case to the Fifth Circuit to clarify the scope of employees subject to testing in the “classified materials” category. Id. at 678.

\[^{57}\] Id. at 665. The Court also noted that its earlier cases settled that the Fourth Amendment protects individuals from unreasonable searches conducted by the government, even when the government acts as an employer. Id. (citing O’Connor v. Ortega, 480 U.S. 709, 717, (1987) (plurality opinion); see also id. at 731 (Scalia, J., concurring in judgment).

\[^{58}\] Id. at 665.


\[^{60}\] The Fourth Amendment guarantees in part that: “[t]he right of the people to be secure in their persons, houses, papers and effects, against unreasonable searches and seizures, shall not be violated . . . .” U.S. Const., amend. IV.

The Supreme Court in Winston v. Lee reiterated that “the overriding function of the Fourth Amendment is to protect personal privacy and dignity against unwarranted intrusion by the State.”’ Winston v. Lee, 470 U.S. at 759-60 (1985) (quoting Schmerber v. California, 384 U.S. 757, 767 (1966)). The Fourth Amendment recognizes that values of individual privacy and dig-
governmental needs, beyond the normal need for law enforcement, and obtaining a warrant or requiring individualized suspicion would be impractical.\(^{61}\)

First, the Court examined whether special governmental need existed. Customs' drug testing program, the Court determined, clearly was not designed to serve the ordinary needs of law enforcement because the test results could not be used in a criminal prosecution without the employee's consent.\(^{62}\) Next, the Court noted that the purpose of Customs' program was to deter drug use among those eligible for promotion to sensitive positions and prevent promotion of drug users to those same positions.\(^{63}\) This substantial governmental interest, the Court concluded, presented a special need justifying a departure from the ordinary warrant and probable cause requirements.\(^{64}\)

The Customs Service, the Court reasoned, is entrusted with pressing responsibilities and its mission would be compromised if it were required to obtain a search warrant in connection with routine yet, sensitive, employment decisions.\(^{65}\) Explaining that a warrant serves primarily to advise an individual that the intrusion is authorized by law and limited in scope and to interpose a neutral magistrate between the individual and the law enforcement officer,\(^{66}\) the Court found that a warrant would provide Customs' employees with little or nothing in the way of additional protection of personal privacy because "the circumstances justifying toxicological testing and the permissible limits of such intrusions are defined narrowly and specifically . . . , and doubtless are well-known to covered employees."\(^{67}\)

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\(^{61}\) Von Raab, 489 U.S. at 665-66. The Court noted that the determination of impracticality is based on balancing the individual's privacy expectations against the government's interests. Id.

\(^{62}\) Id. at 666.

\(^{63}\) Id.

\(^{64}\) Id. The Court explained that requiring the government to procure a warrant for every work-related intrusion "would conflict with 'the common-sense realization that government offices cold not function if every employment decision became a constitutional matter.'" Id. (quoting O'Connor v. Ortega, 480 U.S. 709, 722 (1987) (quoting Connick v. Myers, 461 U.S. 138, 143 (1983))).

\(^{65}\) Id. at 667.

\(^{66}\) Id. at 667 (citing Johnson v. United States, 333 U.S. 10, 14 (1948)).

\(^{67}\) Id. (quoting Skinner v. Railway Labor Executives' Ass'n, 489 U.S. 602, 662 (1989)). In safeguarding "personal privacy and dignity against unwarranted intrusion by the State," Winston v. Lee, 470 U.S. 753, 759-60 (1985) (quoting Schmerber v. California, 384 U.S. 757, 767 (1966)), the Fourth Amendment explicitly protects against "searches" which occur when the
5. **COURT EMPHASIZES VOLUNTARINESS OF TESTING; EMPLOYEE NOT SUBJECT TO DISCRETION OF OFFICIAL IN THE FIELD**

The Court, then, focused on notice and voluntariness in upholding Customs' drug testing. Under Customs' program, every employee who seeks a transfer to a covered position knows that passing a drug test is a prerequisite and is probably aware of the procedures Customs utilizes in administering the tests.\(^{68}\)

The Court also focused on the fact that the covered employee is simply not subject "to the discretion of the official in the field"\(^ {69}\) because the process becomes automatic when the employee voluntarily applies for, and thereafter pursues, a covered position.\(^{70}\) Because Customs did not make a discretionary determination to search, there were "no special facts for a neutral magistrate to evaluate."\(^ {71}\)

6. **PROBABLE CAUSE WAIVED WHERE GOVERNMENT SEeks TO PREvent HAzARDOUS CONDITION OR GUARD AGAINST SUBStANTIAL HARM**

After dispensing with the warrant requirement, the Court moved next to the requirement of probable cause. Even when it is reasonable to dispense with the warrant requirement in a particular circumstance, the Court maintained that a search must be ordinarily based on probable cause.\(^{72}\) The Court, however, found this probable cause standard "peculiarly related to criminal investigations"\(^ {73}\) and not helpful in analyzing the reasonableness of routine administrative functions\(^ {74}\) especially where the government seeks to prevent hazardous conditions from developing or to

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\(^{69}\) Id. (quoting Camara v. Municipal Ct. of San Francisco, 387 U.S. 523, 532 (1967)).

\(^{70}\) Id.

\(^{71}\) Id. (quoting South Dakota v. Opperman, 428 U.S. 364, 383 (1976) (Powell, J. concurring)).

\(^{72}\) Id. (citing Skinner v. Railway Labor Executives' Ass'n, 489 U.S. 602, 624 (1989)).


detect violations that rarely generate articulable grounds for searching any particular place or person. In certain limited circumstances, the Court found, the government's need to discover such latent or hidden conditions, or to prevent their development, is sufficiently compelling to justify the intrusion on privacy entailed by conducting such searches without any measure of individualized suspicion.

In holding that the government's need to conduct suspicionless searches required by the Customs' program outweighed the privacy interests of employees engaged directly in drug interdiction and those required to carry firearms, the Court emphasized "the veritable national crisis in law enforcement caused by smuggling of illicit narcotics" and Customs' role in defending against this threat. The Court cited the government's compelling interest in ensuring that front-line interdiction personnel are physically fit and have unimpeachable integrity and judgment and forecast that the national interests in self-protection could be irreparably damaged if those charged with safeguarding it were "unsympathetic" to their mission because of their own drug use. The public interest, the Court reasoned, demanded effective measures to bar drug users from positions directly involving drug interdiction or from positions requiring them to carry firearms because the public should not bear the risk that employees suffering from impaired perception and judgment will be promoted to these types of positions.

7. **COMPELLING GOVERNMENTAL INTEREST BALANCED AGAINST
   INDIVIDUAL PRIVACY INTEREST; VOLUNTARY NATURE OF TEST
   EMPHASIZED**

This valid compelling governmental interest, however, must be balanced against individual privacy interests in determining the reasonableness of the urine tests. Because reasonableness is contextual, the

75. Id.; cf. Camara v. Municipal Ct. of San Francisco, 387 U.S. 523, 535-36 (1967) (noting that building code inspections, unlike searches conducted pursuant to a criminal investigation, are designed "to prevent even the unintentional development of conditions which are hazardous to public health and safety"); United States v. Martinez-Fuerte, 428 U.S. 543, 557 (1976) (noting that requiring particularized suspicion before routine stops on major highways near the Mexican border "would be impractical because the flow of traffic tends to be too heavy to allow the particularized study of a given car that would enable it to be identified as a possible carrier of illegal aliens").


78. Von Raab, 489 U.S. at 670.

79. Id. at 670-71.

80. Id. at 671.
Court found that Customs' employees directly involved in drug interdiction or required to carry firearms had a diminished expectation of privacy based on the nature of their job and its attendant physical requirements. Unlike most private citizens or government employees in general, the Court explained, employees involved in drug interdiction should reasonably expect inquiry into their fitness because the successful performance of their job depends uniquely on their judgment and dexterity. Again, the Court emphasized the voluntary nature of the tests when it noted that only employees who have been tentatively accepted for promotion or transfer to one of the categories of covered positions are tested and transfer applicants know at the outset that passing a drug test is a requirement for those positions. Furthermore, employees are also notified in advance of the scheduled sample collection thereby reducing to a minimum any "unsettling show of authority" that may be associated with unexpected intrusions on privacy.

Because the possible harm against which the government sought to guard is substantial, the Court found that the need to prevent the harm's
occurrence furnished ample justification for reasonable searches to advance the government’s goal. The Court concluded, then, that suspicionless testing of employees who apply for promotion to positions directly involving the interdiction of illegal drugs, or to positions that require the incumbent to carry a firearm is reasonable because “the government’s compelling interests in preventing the promotion of drug users to positions where they might endanger the integrity of our Nation’s borders or the life of the citizenry” outweighs the privacy interests or those who seek promotion to those positions who enjoy a diminished expectation of privacy by virtue of the special, and obvious, physical and ethical demands of those positions.

8. **Dissent Emphasizes Privacy and Personal Dignity**

In a spirited dissent, Justice Scalia, joined by Justice Stevens, denounced Customs’ drug tests as “particularly destructive of privacy and offensive to personal dignity.” Scalia noted that, until Von Raab and Skinner, the Court had upheld bodily searches separate from arrest and without individualized suspicion of wrong-doing only with respect to prison inmates. Scalia explained that he joined the majority’s opinion in Skinner because of the demonstrated frequency of drug and alcohol use by the targeted class of employees and the demonstrated connection between such use and the grave harm the government sought to protect against. With no evidence of a drug problem to be solved by drug testing, Scalia found the policies of prevention and deterrence insufficient to justify the intrusion into an individual’s privacy.

B. **Skinner: Post-Accident and Post-Violation Drug Testing Constitutional**

1. **History of Drug and Alcohol Abuse in Railroad Industry Cited**

In a case seemingly more analogous to aviation, the Supreme Court

87. Von Raab, 489 U.S. at 674-75. The petitioners had argued that there was no factual justification for imposing drug tests because Customs had no documented history of drug use. See also Bluestein v. Skinner, 908 F.2d 451 (9th Cir. 1990), cert. den., 111 S.Ct. 954 (1991). The mere circumstance that all but a few of the employees tested are entirely innocent of wrongdoing, the Court rationalized, does not impugn the program’s validity. Von Raab, 489 U.S. at 674.

88. Von Raab, 489 U.S. at 679.

89. Id. at 677-79.

90. Id. at 680 (Scalia, J. dissenting).

91. Id.

92. Id.

93. Id. at 681-86 (Scalia, J., dissenting).
In *Skinner v. Railway Labor Executives' Association*\(^{94}\) held that Federal Railroad Administration (FRA) safety regulations mandating or authorizing post-accident, post-incident or post-violation alcohol and drug tests without warrants or individualized suspicion did not violate the Fourth Amendment.\(^{95}\) Noting that the "problem of alcohol use on American railroads is as old as the industry itself" and that carriers' efforts to deter employee alcohol use began at least a century ago,\(^{96}\) the Supreme Court recognized that the FRA promulgated regulations providing for blood and urine tests following train accidents or rule violations based on a finding that alcohol and drug abuse by railroad employees posed a serious threat to safety.\(^{97}\)

In July 1983, the FRA had expressed concern that previous industry efforts were not adequate to curb alcohol and drug use by railroad employees.\(^{98}\) Pointing to evidence indicating that on-the-job intoxication was a significant problem in the railroad industry,\(^{99}\) the FRA reported that from 1972 to 1983 "the nation's railroads experienced at least 21 significant train accidents involving alcohol or drug use as a probable cause or contributing factor."\(^{100}\) Even without the benefit of regular post-accident testing, the FRA identified 34 fatalities, 66 injuries, and over $28 million in property damage (in 1983 dollars) that resulted from errors committed by alcohol and drug-impaired employees in 45 train accidents occurring be-

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95. *Id.* at 633-34.

96. *Id.* at 606. Railroads for many years prohibited operating employees from possessing alcohol, being intoxicated while on duty, or consuming alcohol while on-call for duty. *Id.* These prohibitions were recently expanded to forbid possession of use of certain drugs in "Rule G," an industry-wide operating rule promulgated by the Association of American Railroads and enforced by virtually every railroad in the country. *Id.* at 606-07.

97. *Id.* at 606.

98. *Id.* at 607. The FRA solicited comments from interested parties regarding various regulatory responses to the problem of drug and alcohol use in the railroad system. These comments indicated that railroads were able to detect a relatively small number of Rule G violations based primarily on their practice of relying on supervisors' and co-workers' observations to enforce the rule. *See 49 Fed. Reg. 24,266-67 (1984).*

99. *Skinner*, 489 U.S. at 607. A 1979 study examining the scope of alcohol abuse on seven major railroads found that "[a]n estimated one out of every eight railroad workers drank at least once while on duty during the study year." *48 Fed. Reg. 30,724 (1983).* Additionally, "5% of workers reported to work 'very drunk' or got 'very drunk' on duty at least once in the study year," and "13% of workers reported to work at least a little drunk one or more times during that period." *Id.* The study also found that 23% of the operating personnel were "problem drinkers," but that only 4% of these employees "were receiving help through an employee assistance program, and even fewer were handled through disciplinary procedures." *Id.*

100. *Skinner*, 489 U.S. at 607. These accidents "resulted in 25 fatalities, 61 non-fatal injuries, and property damage estimated at $19 million (approximately $27 million in 1982 dollars)." *48 Fed. Reg. 30,726 (1983).* The FRA identified "an additional 17 fatalities to operating employees working on or around rail rolling stock that involved alcohol or drugs as a contributing factor." *Id.*
Drug Testing in Aviation

2. Railroad Drug Testing Regulations Emphasize Triggering Event

Subpart C, entitled "Post-Accident Toxicological Testing," provides for mandatory testing following a "major train accident," an "impact accident," or any incident involving the death of an on-duty railroad employee. After the triggering event occurs, the railroad transports all crew members and other covered employees directly involved in the accident to an independent medical facility to obtain blood and urine samples. The regulations provide a limited exception from testing "if the railroad representative can immediately determine, on the basis of specific information, that the employee had no role in the cause(s) of the accident/incident." Because the FRA found it especially difficult to assess fault and degrees of fault in the aftermath of more substantial accidents, FRA does not provide an exception when a "major train accident" occurs. Blood samples are used to "provide a clear indication not only of the presence of alcohol and drugs, but also..."
their current impairment effects." Similarly, a positive urine test, the FRA found, taken in conjunction with specific information regarding a particular drug's pattern of elimination, the employee's behavior, and the circumstances surrounding the accident "may be crucial to the determination of" the cause of an accident. Subpart C, then, requires post-accident drug testing as an investigative tool to aid in determining the cause of a particular accident.

Subpart D, entitled "Authorization to Test for Cause" provides for permissive testing following (1) an accident or incident in which a supervisor has a reasonable suspicion that an employee's acts or omissions contributed to the accident, (2) a specific rule violation, and (3) a supervisor's reasonable suspicion that an employee is under the influence of drugs or alcohol. If an employee declines to give a blood sample, the railroad is entitled to presume impairment from a positive showing of controlled substance residues in the urine.

3. **District Court Holds Valid Fourth Amendment Protection Outweighed By Competing Governmental Interest; Ninth Circuit Reverses**

Following promulgation of FRA's drug testing requirements, the Railway Labor Executives' Association and various member labor organizations filed suit in the U.S. District Court for the Northern District of California seeking to enjoin the regulations on various statutory and con-

112. Id. The regulations also require that FRA notify and provide the employee with an opportunity to respond to a positive test result before a final investigative report on the accident is prepared. 49 C.F.R. § 219.211(e) (1992). Employees who refuse to provide blood or urine samples may not perform covered service for nine months. 49 C.F.R. § 219.213(a) (1992). They are, however, entitled to a hearing regarding their refusal to submit to mandatory testing. 49 C.F.R. § 219.213(b)(1) (1992).
115. 49 C.F.R. 219.301(b)(1) (1992). A railroad may require a breath test if a supervisor has a reasonable suspicion that an employee is under the influence of alcohol based on specific, personal observations concerning the employee's appearance, behavior, speech or body odors. Id. A railroad may require urine tests only if two supervisors make the appropriate determination. 49 C.F.R. § 219.301(c)(2)(i) (1992). If supervisors suspect impairment due to controlled substance use, at least one of the supervisors must have received specialized training in detecting the signs of drug impairment in order to require the employee to submit to a urine test. 49 C.F.R. § 219.301(c)(2)(ii) (1992).
116. Skinner v. Railway Labor Executives' Ass'n, 489 U.S. 602, 611 (1989). The railroad must provide detailed notice of this presumption and advise employees of their right to provide a contemporaneous blood sample. Id. If the results of either breath or urine tests are to be used in a disciplinary proceeding, the employee must be given the opportunity to provide a blood sample for analysis at an independent medical facility. 49 C.F.R. § 219.303(c)(1) (1992).
stitutional grounds. The district court concluded that railroad employees "have a valid interest in the integrity of their own bodies" that deserved Fourth Amendment protection\(^{117}\) but that this interest was outweighed by the competing "public and governmental interest in the . . . promotion of . . . railway safety, safety for employees, and safety for the general public that is involved with transportation."\(^{118}\) A divided Ninth Circuit reversed.\(^{119}\) The Ninth Circuit first found that the FRA drug tests constituted Fourth Amendment searches but that the "exigencies of testing for the presence of alcohol and drugs in blood, urine or breath require prompt action which preclude obtaining a warrant."\(^{120}\) Explaining that "accommodation of railroad employees' privacy interest with significant safety concerns of the government does not require adherence to a probable cause requirement," the court determined that the legality of the searches depended upon their reasonableness.\(^{121}\)

4. **Ninth Circuit Focuses on Reasonableness of Testing Involved; Requires Individualized Suspicion**

In examining the reasonableness of the testing involved, the Ninth Circuit concluded that particularized suspicion is essential.\(^{122}\) Requiring individualized and particularized suspicion, the Court of Appeals reasoned, would impose "no insurmountable burden on the government"\(^{123}\) and would ensure that the tests are confined to detection of current impairment as opposed to the discovery of the metabolites of various drugs which remain in the body following ingestion.\(^{124}\) The Ninth Circuit, then, invalidated the FRA regulations which did not require a showing of individualized suspicion.\(^{125}\)

5. **Supreme Court Reviewed Only Post-Accident/Violation Portions of Regulation; Finds Fourth Amendment Search**

The Supreme Court reviewed only the post-accident and post-violation portions of the FRA's regulations.\(^{126}\) After determining that the

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118. *Id.*
120. *Id.* at 583.
121. *Id.* at 587.
122. *Id.*
123. *Id.* at 588.
124. *Id.* at 588-89.
125. *Id.* The Ninth Circuit upheld FAA regulations authorizing breath and urine tests based on reasonable suspicion of drug or alcohol use, 49 C.F.R. §§ 219.301(b)(1) & (c)(2) (1987). *Id.*
Fourth Amendment applied to the FRA’s post-accident and post-violation drug testing regulations, the Supreme Court next examined whether the tests at issue constituted a search within the meaning of the Fourth Amendment.\textsuperscript{127} Recognizing that it has long found that a “compelled intrusio[n] into the body for blood to be analyzed for alcohol content” must

Ninth Circuit, the Supreme Court first examined whether administration of the drug tests at issue could be attributable to the government or its agents. Noting that the Fourth Amendment does not apply to a private party search or seizure unless the private party acted as an instrument or agent of the government, \textit{id.} at 614; \textit{accord} United States v. Jacobsen, 466 U.S. 109 (1994); \textit{see also} Burdeau v. McDowell, 256 U.S. 465 (1921), the Supreme Court determined that a railroad complying with Subpart C & D of the regulations does so by compulsion of sovereign authority, thereby implicating Fourth Amendment concerns. \textit{Skinner}, 489 U.S. at 614. Petitioners had contended that the Fourth Amendment was not implicated by Subpart D because Subpart D did not compel testing. \textit{id}. The Supreme Court rejected that argument. Determining whether a private party should be deemed an agent of the government for Fourth Amendment purposes, the Court explained, turns on the degree of the government’s participation in the private party’s activities in light of all the circumstances. \textit{id.}; cf. Lustig v. United States, 338 U.S. 74, 78-79 (1949) (plurality opinion). The fact that the government has not compelled a private party to perform a search does not, the Court reasoned, establish that the search is a private one. \textit{Skinner}, 489 U.S. at 615. Instead, specific features of the FRA regulations combined to convince the Court that the government did more than adopt a passive position toward the underlying private conduct. \textit{id}. Specifically, the Supreme Court noted that the regulations preempted state law and were intended to supersede “any provision of a collective bargaining agreement, or arbitration award construing such an agreement.” \textit{id.} (quoting 50 Fed. Reg. 31,552 (1985)); \textit{see also} 49 C.F.R. § 219.13(a) (1992) (FRA regulations pre-empt state laws, rules, or regulations covering the same subject matter). The regulations also permit the FRA to receive certain biological samples and test results procured by railroads pursuant to Subpart D. 49 C.F.R. § 219.11(c) (1992). The FRA, also, is not permitted to divest itself of or compromise by contract the authority vested in it by Subpart D. \textit{Skinner}, 489 U.S. at 615. Instead, the FRA explained that such “authority . . . is conferred for the purpose of promoting the public safety, and a railroad may not shackle itself in a way inconsistent with its duty to promote the public safety.” \textit{id.} (quoting 50 Fed. Reg. 31,552 (1985)). Furthermore, a covered employee may not decline the railroad’s request to submit to a drug test without being removed from service. \textit{See} 49 C.F.R. § 219.11(b) (1992). Because the government removed all legal barriers to drug testing contemplated by the regulations, indicated its strong preference for testing, and desired to share in the results of such intrusions, the government, the Court found, encouraged, endorsed, and participated in the railroads’ drug testing sufficient to implicate the Fourth Amendment. \textit{Skinner}, 489 U.S. at 615-16. The Court, therefore, rejected petitioners’ submission that tests conducted in reliance on Subpart D would be primarily the result of private initiative. \textit{id.} at 658.

\textsuperscript{127} \textit{Skinner}, 489 U.S. at 616-17. The Supreme Court noted that where the government seeks to obtain physical evidence from a person, the Fourth Amendment may be relevant at several levels. \textit{id.} at 616; \textit{see, e.g.}, United States v. Dionisio, 410 U.S. 1, 8, (1973). The initial detention necessary to procure the evidence may be a seizure of the person, Cupp v. Murphy, 412 U.S. 291, 294-95 (1973); Davis v. Mississippi, 394 U.S. 721, 726-27 (1969), \textit{cert. denied}, 409 U.S. 855 (1972), if the detention amounts to a meaningful interference with his freedom of movement. INS v. Delgado, 466 U.S. 210, 215 (1984); United States v. Jacobsen, 466 U.S. 109, 113 n.5 (1984). Obtaining and examining the evidence may also be a search, \textit{see} Cupp v. Murphy, 412 U.S. 291, 295 (1973); United States v. Dionisio, 410 U.S. 1, 8 (1973), if doing so infringes an expectation of privacy that society is prepared to recognize as reasonable. \textit{See}, \textit{e.g.}, California v. Greenwood, 466 U.S. 35, 43 (1988); United States v. Jacobsen, 466 U.S. 109, 113 (1984).
be deemed a Fourth Amendment search, the Supreme Court asserted that it is obvious that the FRA regulations providing for "this physical intrusion, penetrating beneath the skin, infringes an expectation of privacy that society is prepared to recognize as reasonable." The ensuing chemical analysis of that sample in order to obtain physiological data, the Court reasoned, is a further invasion of the tested employee's privacy interests. The Court, therefore, concluded that the collection and subsequent testing of the requisite biological samples constituted intrusions that must be deemed searches under the Fourth Amendment.

6. **Supreme Court Balances Privacy Interests Against Reasonableness of Search; Finds Special Governmental Need**

Noting that the Fourth Amendment only proscribes unreasonable searches, the Supreme Court proceeded to balance the respective in-

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129. *Skinner*, 489 U.S. at 616. The Court emphasized that this finding was based on society's concern for the security of one's person. *Id.*; *see, e.g.*, *Terry v. Ohio*, 392 U.S. 1, 9 (1968).

130. *Skinner*, 489 U.S. at 616; *cf. Arizona v. Hicks*, 480 U.S. 321, 324-25 (1987). Although no physical penetration beneath the skin is necessary with the breath-testing procedures required under Subpart D, the Court, nevertheless, found that the same rationale applied to the collection of this data. *Skinner*, 489 U.S. at 616-17. The Court explained that subjecting a person to a breathalyzer test, which generally requires "deep lung" breath for chemical analysis implicates similar concerns about bodily integrity and, therefore, constitutes a search. *Id.*; *see, e.g.*, *California v. Trombetta*, 467 U.S. 479, 481 (1984); *see also Burnett v. Municipality of Anchorage*, 806 F.2d 1447, 1449 (9th Cir. 1986); *Shoemaker v. Handel*, 795 F.2d 1136, 1141 (3d Cir. 1986); *cert. denied*, 479 U.S. 986 (1986). Even though the urine samples prescribed by the FRA regulations do not entail a surgical intrusion into the body, the analysis of these samples may reveal a host of private medical facts about an employee, thereby implicating privacy interests. *Skinner*, 489 U.S. at 617.

131. *Skinner*, 489 U.S. at 617-18. Because the Supreme Court concluded that both collection and analysis constituted a Fourth Amendment search, the Court found it unnecessary to characterize the employer's antecedent interference with the employee's freedom of movement as an independent Fourth Amendment seizure. *Id.* As the Court noted, not every governmental interference with an individual's freedom of movement raises the constitutional concern that there is a seizure of the person. *Id.* at 618; *see also United States v. Dionisio*, 410 U.S. 1, 9-11 (1973) (holding grand jury subpoena, though enforceable by contempt, does not effect a seizure of the person); *United States v. Mara*, 410 U.S. 19, 21 (1973). For purposes of reviewing the FRA post-accident and post-violation regulations, the Supreme Court found it sufficient to note that any limitation on an employer's freedom of movement necessary to obtain a blood, urine, or breath sample must be considered in assessing the intrusiveness of the searches. *Skinner*, 489 U.S. at 618; *cf. United States v. Place*, 462 U.S. 696, 707-09 (1983).

132. *Skinner*, 489 U.S. at 619; *see also United States v. Sharpe*, 470 U.S. 675, 682 (1985); *Schmerber v. California*, 384 U.S. 757, 768 (1966). What is reasonable, the Court explained, "depends on all the circumstances surrounding the search or seizure and the nature of the search or seizure itself." *Skinner*, 489 U.S. at 619; *see also United States v. Montoya de Hernandez*, 475 U.S. 531, 537 (1986).
terests involved to assess the reasonableness of the testing. Except in certain circumstances, a search or seizure is not considered reasonable unless based on a warrant issued upon probable cause. Exceptions, however, are recognized "when 'special needs, beyond the normal need for law enforcement, make the warrant and probable-cause requirement impracticable.'" The Court found that the government's interest in regulating the conduct of railroad employees to ensure safety presented "special needs" beyond normal law enforcement that justified departing from the traditional warrant and probable cause requirements.

That special needs beyond normal law enforcement existed, the


137. The Supreme Court likened this function to the supervision of probationers, regulated industries, or the operation of a government office, school, or prison. *Skinner*, 489 U.S. at 620.

138. *Skinner*, 489 U.S. at 620; see also *Griffin v. Wisconsin*, 483 U.S. 868, 873-74 (1987). As in *Von Raab*, the Court noted that the essential purpose of the warrant requirement is to protect privacy interests by assuring individuals subject to a search that the intrusion is not the random or arbitrary act of government agents. *Skinner*, 489 U.S. at 621-22. The issuance of a warrant assures the individual that the intrusion is authorized by law, narrowly limited in scope, and approved of by a neutral magistrate. *Id.; see, e.g.*, *New York v. Burger*, 482 U.S. 691, 703 (1987); *United States v. Chadwick*, 433 U.S. 1, 9 (1977); *Camara v. Municipal Ct. of San Francisco*, 387 U.S. 523, 532 (1967). Applying the warrant requirement to the FRA program, the Court found, would do little to further the interests protected by the requirement because the FRA tests were narrowly defined in the regulations, were well-known to the employees, and contained virtually no facts for a neutral magistrate to evaluate. *Skinner*, 489 U.S. at 622; cf. *Colorado v. Bertine*, 479 U.S. 367, 376 (1987) (Blackmun, J., concurring). The Court further noted that the government's interest in dispensing with the warrant requirement is greatest when, as with the FRA toxicological tests, "the burden of obtaining a warrant is likely to frustrate the governmental purpose behind the search." *Skinner*, 489 U.S. 623 (quoting *Camara*, 387 U.S. at 530); see also *New Jersey v. T.L.O.*, 469 U.S. 325, 340 (1985).
Court opined, was evident from the purposes of the FRA's toxicological tests. The FRA prescribed toxicological tests, not to assist law enforcement in prosecuting drug using employees, the Court explained, but rather "to prevent accidents and casualties in railroad operations that result from impairment of employees by alcohol or drugs." Because alcohol and drugs are eliminated from the body at a constant rate samples must be taken, the Court reasoned, as soon as possible after the triggering event occurs. Imposing a warrant requirement, the Court concluded, would add little to the assurance of certainty and regularity already afforded by the FRA's regulations while significantly hindering or possibly frustrating the government's objectives.

7. **INDIVIDUALIZED SUSPICION NOT REQUIRED**

After dispensing with the warrant requirement, the Court considered whether probable cause or some measure of individualized suspicion was necessary to justify the testing. The Court balanced the relevant interests involved and disposed of the probable cause requirement as well. In assessing whether individualized suspicion was necessary, the Court explained that, in limited circumstances, where the privacy interests implicated by the search are minimal, and where an important governmental interest furthered by the intrusion would be jeopardized by requiring individualized suspicion, the search might be reasonable despite a lack of individualized suspicion.

The Court believed that the interference necessary to obtain the required blood, breath, or urine samples was minimal given the employment context in which the tests took place. By virtue of their voluntary

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140. *Id.* (quoting 49 C.F.R. § 219.1(a) (1987)). The Court found that this governmental interest in ensuring the safety of the traveling public and of the employees themselves plainly justified prohibiting covered employees from using drugs or alcohol on duty and also justified exercising supervision to assure compliance. *Id.*; see also *Griffin v. Wisconsin*, 483 U.S. 868, 875 (1987).


142. *Skinner*, 489 U.S. at 623; see also *Schmerber v. California*, 384 U.S. 757, 770-71 (1966). Although the metabolites of some drugs remain in urine for longer periods of time and may enable the FRA to estimate whether the employee was impaired when the triggering event occurred, 49 Fed. Reg. 24,291 (1984), the Court felt the delay necessary to procure a warrant might result in the destruction of valuable evidence. *Skinner*, 489 U.S. at 623.


146. *Id.*. The Court emphasized that it has made it clear that "a showing of individualized suspicion is not a constitutional floor, below which a search must be presumed unreasonable." *Id.*; see, e.g., United States v. *Martinez-Fuerte*, 428 U.S. 543, 561 (1976).

147. *Skinner*, 489 U.S. at 624. The Court explained that because an employee ordinarily consents to significant restrictions in his freedom of movement where necessary for his employ-
participation in an industry pervasively regulated to ensure safety, a goal dependent on the health and fitness of covered employees, the Court reasoned that railroad workers had a diminished expectation of privacy.\footnote{148} The Court, however, was careful to point out that it was not suggesting that the interest in bodily integrity enjoyed by those employed in a regulated industry must always be considered minimal.\footnote{149} Railroad workers, the Court emphasized, had long been a principal focus of regulatory concern,\footnote{150} no doubt stemming from the industry’s extended history of drug and alcohol abuse.

8. **COURT DECLINES TO EXTEND FINDINGS TO ALL REGULATED INDUSTRIES; FOCUSES ON DETERRENCE RATIONALE**

The Court expressly noted that its findings were not intended to be extended to include all regulated industries.\footnote{151} Instead, the Court noted that although some of the privacy interests implicated by the FRA’s toxicological testing might be viewed as significant in other contexts, given the railroad industry’s unique history, the post-accident and post-violation tests provided for in Subpart C & D posed only limited threats to the justification, any additional interference that occurs in the time it takes to procure a blood, breath, or urine sample for testing, cannot, by itself, be said to infringe upon significant privacy interests. \textit{Id.} at 624-25; see, e.g., INS v. Delgado, 466 U.S. 210, 218 (1984). The Court went on to reason that a blood test is not significant since such “tests are a commonplace in these days of periodic physical examinations and experience with them teaches that the quantity of blood extracted is minimal, and that for most people the procedure involves virtually no risk, trauma, or pain.” \textit{Skinner}, 489 U.S. at 625 (quoting Schmerber v. California, 384 U.S. 757, 771 (1966)). Breath tests, the Court concluded are even less intrusive than blood tests because they do not require piercing the skin and they reveal only the level of alcohol in the employee’s blood stream. \textit{Id.} Urine tests are more difficult but, the Court cited the procedures utilized as reducing the intrusiveness of the collection process and thereby making urine testing acceptable. \textit{Id.} at 626-27.

\footnote{148} Skinner, 489 U.S. at 627. The Court noted that the relation between safety and employee fitness was recognized by Congress when it enacted the Hours of Service Act in 1907, ch. 2939, 34 Stat. 1415 (1907) (codified as amended at 45 U.S.C. §§ 61-66 (1988)); see also Baltimore & Ohio R. Co. v. Interstate Commerce Commission, 221 U.S. 612, 619 (1911), and also when Congress authorized the Secretary to “test . . . railroad facilities, equipment, rolling stock, operations, or persons, as he deems necessary to carry out the provisions” of the Federal Railroad Safety Act of 1970, 45 U.S.C. § 437(a) (1988) (emphasis added). \textit{Skinner}, 489 U.S. at 627. The relationship between safety and employee fitness has also been recognized by state governments, and has long been reflected in industry practice, as evidenced by the industry’s promulgation and enforcement of Rule G. In fact, the FRA found that “most railroads require periodic physical examinations for train and engine employees and certain other employees.” \textit{Id.} 49 Fed. Reg. 24,278 (1984); see also Railway Labor Executives’ Ass’n v. Burnley, 839 F.2d 575, 585 (9th Cir. 1988) (acknowledging industry practice of periodic employee physical examinations); see also Railway Labor Executives’ Ass’n v. Norfolk & W. R.R. Co., 833 F.2d 700, 705-06 (7th Cir. 1987); Brotherhood of Maintenance of Way Employees, Lodge 16 v. Burlington N. R.R. Co., 802 F.2d 1016, 1024 (8th Cir. 1986).

\footnote{149} \textit{Skinner}, 489 U.S. at 628.

\footnote{150} \textit{Id.}

\footnote{151} \textit{Id.}
able expectations of privacy enjoyed by covered railroad employees.\textsuperscript{152} The employees' privacy interests were, therefore, outweighed by the government's compelling interest in preventing railroad workers from discharging duties "fraught with such risks of injury to others that even a momentary lapse of attention can have disastrous consequences."\textsuperscript{153}

The Supreme Court also focused on the deterrence rationale for implementing post-accident and post-violation testing.\textsuperscript{154} By ensuring that employees in safety-sensitive positions know they will be tested upon the occurrence of a triggering event, the Court reasoned that the FRA's regulations significantly increase the deterrent effect of the administrative penalties associated with the prohibited conduct, while increasing the likelihood that employees will forego using drugs or alcohol while on duty.\textsuperscript{155} Besides the deterrent effect, the Court was also influenced by the tests' use in accident investigations.\textsuperscript{156} The scene of a serious rail accident is chaotic, the Court noted, and investigators arriving at the scene might find it difficult to determine which train crew members contributed to its occurrence.\textsuperscript{157} Therefore, "[o]btaining evidence that might give rise to the suspicion that a particular employee is impaired, a difficult endeavor in the best of circumstances, is most impracticable in the aftermath of a serious accident."\textsuperscript{158}

The Court reasoned that it would be unrealistic in this post-accident situation and inimical to the government's goal of ensuring safety in rail transportation "to require a showing of individualized suspicion in these circumstances."\textsuperscript{159} Because blood and urine tests constitute highly effective means of ascertaining on-the-job impairment and of deterring drug usage, the Supreme Court found the FRA's post-accident toxicological testing reasonable and found that the government's compelling interest served by FRA's regulations would be significantly hindered if railroads were required to point to specific facts giving rise to reasonable suspicion before post-accident testing could occur.\textsuperscript{160} In light of the limited discretion exercised by railroad employers under the regulations, the surpassing safety interests served by post-accident and post-violation tests, and the diminished privacy expectation of the covered employees, the

\begin{itemize}
\item \textsuperscript{152} Id.
\item \textsuperscript{153} Id.
\item \textsuperscript{154} Id. at 629; see also 50 Fed. Reg. 31,541 (1985).
\item \textsuperscript{156} Skinner, 489 U.S. at 630.
\item \textsuperscript{157} Id. at 631.
\item \textsuperscript{158} Id.
\item \textsuperscript{159} Id. (emphasis added). Even if urine tests revealed nothing more than the recent use of a controlled substance, this information would provide the basis for further investigative work to determine if the employee was impaired by drugs at the time of the accident. Id. at 632.
\item \textsuperscript{160} Id. at 632-33.
\end{itemize}
Supreme Court upheld the FRA's testing in both Subparts C & D.\(^{161}\)

9. **CONCURRING OPINION REJECTS DETERRENCE JUSTIFICATION; DISSENT CLAIMS DOCTRINAL BASIS OR FOURTH AMENDMENT IGNORED**

In an opinion concurring in the judgment, Justice Stevens based his support of the challenged regulations solely on the public interest in determining the causes of serious railroad accidents.\(^{162}\) In rejecting the deterrence justification, Justice Stevens opined that most railroad employees do not go to work with the expectation that they will be involved in a major accident and, thus, forego using drugs or alcohol.\(^{163}\) Justices Marshall and Brennan, in their dissent, supported Justice Stevens' position that the majority holding was strongly influenced by the investigatory nature of the post-accident toxicological tests.\(^{164}\) According to Justices Marshall and Brennan, the majority's balancing approach ignores the text and doctrinal history of the Fourth Amendment which require that highly intrusive searches of this type be based on probable cause, not cost-benefit analysis conducted by judges or federal agencies.\(^{165}\)

The dissent explained that, until recently, an unbroken line of cases had recognized probable cause as an indispensable requirement for a full-scale search regardless of whether such a search was conducted pursuant to the warrant clause or one of its recognized exceptions.\(^{166}\) Only where the government action in question had a "substantially less intrusive" impact on privacy\(^ {167}\) and, thus, did not constitute a full-scale search, did the Court relax the probable cause requirement.\(^ {168}\) Except for those narrowly defined intrusions, the dissent observed, "the requisite

\(^{161}\) Id. at 634.

\(^{162}\) Id. at 634 (Stevens, J., concurring in judgment).

\(^{163}\) Id.

\(^{164}\) Id. at 635-36 (Brennan and Marshall, JJ., dissenting).

\(^{165}\) Id. Brennan and Marshall characterized the majority's acceptance of dragnet blood and urine testing as evidence that the "first, and worst, casualty of the war on drugs will be the precious liberties of our citizens." Id. The Court, the dissent noted, is moving closer toward reading the probable clause requirement out of the Fourth Amendment by permitting "special needs" to displace constitutional text in each of the four categories of searches enumerated in the Fourth Amendment: searches of persons, Id. at 613-14; houses, Griffin v. Wisconsin, 483 U.S. 868 (1987); papers, O'Connor v. Ortega, 480 U.S. 709 (1987); and effects, New Jersey v. T.L.O., 469 U.S. 325 (1985). Skinner, 489 U.S. at 635-36 (Brennan and Marshall, JJ., dissenting). As the dissent explained, without the content which those provisions give to the Fourth Amendment's overarching command that searches and seizures be "reasonable," the Amendment lies virtually devoid of meaning subject to interpretation based on the prevailing problems of the day. Id. at 637 (Brennan and Marshall, JJ., dissenting).


\(^{168}\) Id. at 214.
‘balancing’... is embodied in the principle that seizures are ‘reasonable’ only if supported by probable cause.”169 Even then, the Court almost always required the government to show some individualized suspicion to justify the search.170 By widening the “special needs” exception to probable cause to authorize searches of the human body, unsupported by any evidence of wrong-doing, the dissent observed that the majority has eliminated altogether the probable cause requirement and has substituted a manipulable balancing inquiry under which, the mere assertion of a “special need” is all that is needed to make even the deepest dignity and privacy interests vulnerable to governmental incursion.171

The dissent agreed with the majority’s threshold determination that covered railroad employees had been subjected to a search within the meaning of the Fourth Amendment but disagreed as to the nature of the search at issue.172 According to Justices Brennan and Marshall, three distinct searches were involved: (1) blood collection, (2) urine collection, and (3) sample analysis.173 While recognizing that the importance of collecting blood and urine samples before drug or alcohol metabolites disappear may justify waiving the warrant requirement for those two types of searches under the narrow “exigent circumstances” exception,174 the dissent emphasized that no such exigency prevents railroad officials from obtaining a warrant before testing the samples collected.175 The dissent reasoned that, because blood and urine do not spoil if properly preserved and railroad officials could easily become aware of the procedures utilized to obtain a warrant, dispensing with the warrant requirement to analyze the collected samples is wholly unjustified.176 Justices Brennan and Marshall also refuted the majority’s opinion that railroad workers possessed a diminished expectation of privacy based on their involvement in a pervasively regulated industry. The dissent maintained that the Court’s prior regulatory search decisions exclusively involved searches of employer property, with respect to which “[c]ertain industries have such a history of government oversight that no reasonable expectation of privacy

170. Skinner, 489 U.S. at 638 (Brennan and Marshall, JJ., dissenting). The dissent noted that the regulatory regime upheld requires the post-accident collection and testing of all covered employees even if every member of this group gives every indication of sobriety and attentiveness. Id. at 635.
171. Id. at 640-41 (Brennan and Marshall, JJ., dissenting).
172. Id. at 642 (Brennan and Marshall, JJ., dissenting).
173. Id.
174. Id.; see also Schmerber v. California, 384 U.S. 757, 770 (1966) (observing that “the delay necessary to obtain a warrant” may destroy evidence).
175. Skinner, 489 U.S. at 642 (Brennan and Marshall, JJ., dissenting).
176. Id. at 642-43 (Brennan and Marshall, JJ., dissenting); see also Chimel v. California, 395 U.S. 752, 761-64 (1969) (exigency exception permits warrantless searches only to the extent that exigency exists).
could exist for a proprietor over the stock of such an enterprise."177 According to the dissent, the Supreme Court has never "intimated that regulatory searches reduce employees' rights of privacy in their persons."178

C. BLUESTEIN: NINTH CIRCUIT EXTENDS VON RAAB AND SKINNER TO FAA'S DRUG TESTING PROGRAM; SUPREME COURT DECLINES REVIEW

1. SPECIAL NEEDS JUSTIFY ABROGATING TRADITIONAL FOURTH AMENDMENT RIGHTS

The Ninth Circuit stated that Von Raab and Skinner settled three threshold questions: (1) drug testing performed by private employers under compulsion of government regulations constitutes governmental action subject to constitutional restrictions;179 (2) urinalysis is considered a search under the Fourth Amendment because "it is clear that the collection and testing of urine intrudes upon expectations of privacy that society has long recognized as reasonable,"180 and, (3) the usual Fourth Amendment requirements of a warrant and probable cause do not necessarily apply in the drug testing context because, when a search "serves special governmental needs, beyond the normal need for law enforcement, it is necessary to balance the individual's privacy expectations against the Government's interests to determine whether it is impractical to require a warrant or some level of individualized suspicion in the particular context."181 After determining that Fourth Amendment conduct was involved, the Ninth Circuit focused on "special needs" analysis in upholding the FAA's drug testing requirements. In finding that the FAA regula-

181. Bluestein, 908 F. 2d at 455 (quoting National Treasury Employees Union v. Von Raab, 489 U.S. 656, 664-65 (1989)).
tions serve "special needs, beyond the normal need for law enforcement," the court emphasized the FAA's goals of deterrence and prevention: the FAA's program, the court noted, is designed to deter drug use among employees in safety-sensitive positions and to prevent the performance of safety-sensitive functions by employees under the influence of narcotics.182

2. GOVERNMENTAL INTERESTS WEIGHED AGAINST INDIVIDUAL PRIVACY INTERESTS

After praising the FAA program's goals, the court determined the constitutionality of the program by balancing the government's interests against the employees' privacy interests.183 First, the Ninth Circuit noted that the FAA rules specify that "[t]est results may not be used in a criminal prosecution of the employee without the employee's consent," thereby eliminating the threat of self-incrimination and subsequent criminal prosecution by submitting to drug testing. Next, the court examined the government's interests in subjecting individuals to the type of searches at issue. After concluding that the testing program under review in Von Raab invaded reasonable expectations of privacy and that the tests were motivated by special needs other than law enforcement, the Ninth Circuit explained that the Supreme Court had balanced the private and governmental interests at stake and found that the government's compelling interests in public safety justified the Von Raab testing program.185

As the Supreme Court did in Von Raab, the Ninth Circuit rejected the contention that there was insufficient evidence of a drug problem in the aviation industry to justify suspicionless testing.186 Evidence of drug use is not needed to establish the substantial governmental need necessary to justify drug testing because of the deterrent purposes of the program and the potential for serious harm.187 Nevertheless, although finding that no factual justification warranting drug testing was required, the Ninth Circuit found that the FAA administrative record included evidence that a

182. Id.
183. Id.
184. Id. (quoting National Treasury Employees Union v. Von Raab, 489 U.S. 656, 664-65 (1989)).
185. Id. at 455-56 (quoting National Treasury Employees Union v. Von Raab, 489 U.S. 656, 678-80 (1989)).
186. Id. at 456. The petitioners had argued that the FAA failed to demonstrate a sufficiently high level of drug use in the industry to justify its testing program. Id. The Ninth Circuit, however, focused on their concession that "the government has a strong interest in assuring aviation safety and that the drug-related job impairment of any safety-sensitive aviation employee is a basis for the most serious concern." Id. (quoting Reply Brief of Petitioners at 15-16).
187. Id. (citing National Treasury Employees Union v. Von Raab, 489 U.S. 656, 674-76 (1989)).
number of pilots and other airline crew members had received treatment for cocaine overdoses or addiction; that tests by companies in the industry had found drug use by pilots and mechanics; and that drugs were present in the bodies of pilots in two airplane crashes.\(^{188}\) Emphasizing the harm that can be caused by an airplane crash, the Ninth Circuit explained that the FAA's need for drug testing to prevent the type of harm that can be caused by drug impairment exceeded the need the Supreme Court ratified in \textit{Von Raab}.\(^ {189}\)

Although it found that the government's compelling interest in public safety justified testing, the Ninth Circuit recognized the intrusive nature of testing involved and the privacy interests infringed upon because the FAA's tests were random.\(^ {190}\) Despite the fact that the lack of notice in the FAA's testing program added "some weight to the 'invasion of privacy' side of the Fourth Amendment balance," the court found this insufficient to tip the scales against the FAA.\(^ {191}\) Instead, the Ninth Circuit focused on the FAA's deterrent justification for the plan. Privacy interests, the court explained, are outweighed by the FAA's "reasonable conclusion that random testing without advance notice will prove to be a greater deterrent than testing with advance notice."\(^ {192}\)

3. **ARGUMENT THAT FAA PLAN GRANTS TOO MUCH DISCRETION REJECTED**

The court similarly dismissed petitioners' contention that the FAA plan grants employers too much discretion.\(^ {193}\) First, the Ninth Circuit reasoned, the strict randomness requirements ensure that no employer will have discretion in deciding which employees should be searched.\(^ {194}\) Second, employers' discretion as to how to structure their testing programs will be limited by collective bargaining and the requirement that the FAA approve the plans of individual employers.\(^ {195}\) The court relied on the FAA's assertion that it will review individual programs to ensure that dis-

\(^{188}\) Id.; see also Harmon v. Thornburgh, 878 F.2d 484, 487 (D.C. Cir. 1989), cert. denied, sub. nom., Bell v. Thornburgh, 110 S.Ct. 865 (1990).

\(^{189}\) \textit{Bluestein}, 908 F.2d at 456.

\(^{190}\) Id.

\(^{191}\) Id. at 456-57; see also Harmon v. Thornburgh, 878 F.2d 484 (D.C. Cir. 1989). In \textit{Harmon}, the court upheld (as to some employees) a Department of Justice program testing plan that provided for random testing with notice "on the same day, preferably within two hours of the scheduled testing." \textit{Harmon}, 878 F.2d at 486. The court noted that the random nature of the testing program is a relevant consideration which would, in a particularly close case, possibly tip the scales. Id. at 489. The court, however, refused to take a fundamentally different approach to this aspect of the program than the Court had in \textit{Von Raab}. See \textit{id}.

\(^{192}\) \textit{Bluestein}, 908 F.2d at 457.

\(^{193}\) Id.

\(^{194}\) Id.

\(^{195}\) Id.
Thus, in upholding the FAA's regulations requiring random drug testing of commercial aviation personnel in safety-sensitive positions, the court focused primarily upon the government's compelling interests in preventing drug use by persons in safety sensitive positions regardless of demonstrated factual evidence of a drug use problem in the industry. Instead, the Ninth Circuit emphasized the Supreme Court's pronouncement that evidence of drug use is not necessary to establish the substantial governmental need required for intrusive searches. This governmental need can be found, then, in the program's deterrence purposes and in the potential for serious harm caused by a drug-related lapse.

IV. ORIGINS OF FEDERAL DRUG TESTING PROGRAMS

Finding that a significant proportion of the national work force used drugs resulting in billions of dollars of lost productivity each year, President Ronald Reagan established federal drug testing programs to combat the "serious adverse effects" illegal drug use is having on the national work force.197 On or off-duty illegal drug use by federal employees, according to Executive Order Number 12,564, "evidences less than the complete reliability, stability, and good judgment that is consistent with access to sensitive information and creates the possibility of coercion, influence, and irresponsible action under pressure that may pose a serious risk to national security, the public safety, and the effective enforcement of the law."198 Because "persons who use illegal drugs are not suitable for Federal employment," Executive Order Number 12,564 required that each executive branch agency establish mandatory programs to drug test employees in "sensitive positions", when there exists reasonable suspicion of drug use, or "in an examination authorized by the agency regarding an accident or unsafe practice."199 Each agency's drug testing program must comply with the procedures set forth in Executive Order Number 12,564 and must be carried out in accordance with guidelines established by the Department of Health and Human Services.200

196. Id. at 457 n.9; c.f. 53 Fed. Reg. 47,028 (1988).
A. DEPARTMENT OF TRANSPORTATION

1. DRUG TESTING PROGRAM

The Department of Transportation (DOT) became the first executive agency to implement a drug testing program pursuant to the President's Order. On December 1, 1989, DOT issued its final rule setting forth procedural requirements for drug testing, entitled, "Procedures for Transportation Workplace Drug Testing Programs." Each of DOT's six agencies issued its own rules addressing various drug testing issues relevant to that particular mode of transportation, such as which employees are subject to testing and how employers must maintain records and conduct tests. The Secretary of Transportation announced a comprehensive plan for drug testing certain DOT employees June 29, 1987, and the plan went into effect September 8, 1987.

201. See American Fed'n of Gov't Employees v. Skinner, 885 F.2d 884, 886-87 (D.C. Cir. 1989), cert. denied, 495 U.S. 923 (1990); see also Drug-Free Departmental Workplace, U.S. Department of Transportation Order 3910.1, J.A. at 17 (June 29, 1987) [hereinafter DOT Order 3910.1]. DOT regulates six modes of transportation through six of its agencies: The Federal Aviation Administration (FAA), Federal Railroad Administration (FRA), Federal Highway Administration (FHWA), Research and Special Programs Administration (RSPA), Urban Mass Transportation Administration (RSPA), and the United States Coast Guard (USCG). See 49 C.F.R. Pt. 40 (1992). The complete list of covered employees is as follows: Office of the Secretary: motor vehicle operators. United States Coast Guard: fire fighters, nurses, criminal investigators, vessel traffic controllers, maritime traffic controllers (pilot), electronics mechanics, metals inspectors, shipwright foremen, transportation equipment operation family, aircraft oxygen equipment mechanics, aircraft engine mechanics, aircraft mechanics, master pilots (ferryboat), chief engineers (ferryboat), oiler (ferryboat and diesel). Federal Aviation Administration: electronics technicians, civil aviation security specialists, aviation safety inspectors, air traffic control specialists, inspection/flight test pilots, transportation equipment operation family, aircraft mechanics. Federal Highway Administration: highway safety specialists, motor carrier safety specialists, transportation equipment operation family. Federal Railroad Administration: industrial hygienists (headquarters), general engineer (field and headquarters), civil engineers (field and headquarters), motor vehicle operators, safety engineer (headquarters), electrical engineers (headquarters), chemical engineer (headquarters), transportation specialists (headquarters). Saint Lawrence Seaway Development Corporation: lock and dam operators, vessel traffic controllers, transportation equipment operation family. Office of Inspector General: criminal investigators. Maritime Administration: transportation equipment operation family, engineers (watchstander), maritime general maintenance mechanics (deck/engine). See DOT Order 3910.1, supra, at App. A.

202. 49 C.F.R. Pt. 40 (1992). The DOT final rule includes preparation for testing, specimen collection procedures, laboratory requirements, Medical Review Officer qualifications and functions, reporting and transmission of test results and employee protection safeguards.

203. DOT has adopted the HHS guidelines, but those procedures apply only to employers (i.e., contractors) who conduct activities regulated by DOT. 49 C.F.R. Part 40.1 (1992). Testing requirements for employees of contractors (e.g. air traffic controllers not employed directly to DOT/FAA) are set forth in 14 C.F.R. Pt. 121, App. I (1992).

204. DOT Order 3910.1, supra note 201, at J.A., p. 17.
2. EMPLOYEE CLASSIFICATIONS

DOT Order 3910.1 establishes two categories of employees subject to testing based on the "safety and security criticalness of the employee's position."\(^{205}\) Category I employees have positions with a "direct and immediate impact on public health and safety, the protection of life and property, law enforcement, or national security and are subject to five types of testing: (1) random; (2) periodic, if required to take periodic physical examinations; (3) reasonable suspicion; (4) accident or unsafe practice; and (5) follow-up after return from rehabilitation program.\(^{206}\) Nearly 94% of the employees covered hold aviation related positions.\(^{207}\) Of these, approximately two-thirds of the employees subjected to random and periodic urinalysis testing are air traffic controllers.\(^{208}\) All applicants for Category I positions must submit to pre-employment or pre-appointment testing.\(^{209}\)

DOT classifies all other employees in sensitive positions as Category II employees, thereby subject to three types of testing: (1) reasonable suspicion; (2) accident or unsafe practice; and, (3) follow-up.\(^{210}\) Any employee "who refuses to provide a urine specimen or otherwise refuses to cooperate in the collection procedures will be removed from the Federal service."\(^{211}\)

3. DRUG TESTING PROCEDURES

Order 3910.1 explicitly provides that all DOT collection and drug testing be done in strict accordance with the guidelines for drug testing pub-

\(^{205}\) Id. at Ch. III, § 2, p. III-1.

\(^{206}\) Id. at Ch. III, § 3(A), p. III-1-2. Employees in these positions are selected for random testing through haphazard neutral computer selection. All employees subject to random testing have an equal statistical chance to be chosen for each testing list without regard to previous selections. Random testing is, of course, unannounced and could occur on any workday. Id. at Ch. III, § 4, p. III-2.

\(^{207}\) See American Fed'n of Gov't Employees v. Skinner, 885 F.2d 884, 889-90 (D.C. Cir. 1989), cert. denied, 495 U.S. 923 (1990). These positions include, air traffic controllers, electronic technicians, aviation safety inspectors and aircraft mechanics. Id. Additionally, fire fighters, nurses, railroad safety inspectors, armed law enforcement officers and "top secret" security clearance personnel are among those subject to random testing. Id.

\(^{208}\) Id. at 887. Nearly twenty-two percent are employed as "electronic technicians." The remaining twelve percent are, among others, aviation safety inspectors (3%), motor carrier and highway safety specialists (1%), railroad safety inspectors (1.1%), civil aviation security specialists (3%), aircraft mechanics (7.7%), and motor vehicle operators (2%). Id.; see also DOT Order 3910.1, supra note 201, at J.A., p. 769-70.

\(^{209}\) DOT Order 3910.1, supra note 201, at Ch. III, § 4(D), p. III-3. As of June 1987, DOT classified 30,000 of its approximately 62,000 employees in Category I. Id. at J.A., p. 769.

\(^{210}\) Id. at Ch. III, § 3(B), p. III-2.

\(^{211}\) Id. at Ch. VI § 1(c). See generally Daniel P. Mazo, Yellow Rows of Test Tubes: Due Process Constraints on Discharges of Public Employees Based on Drug Urinalysis Testing, 135 U. Pa. L. Rev., 1623 (1987).
lished by the Department of Health and Human Services (HHS) and even supplements the National Institute on Drug Abuse regulations with additional safeguards to be followed in both the sample-collection process and in the chain of specimen custody.\textsuperscript{212}

The HHS Regulations provide that, upon arriving at the collection site at an assigned time, the employee to be tested must remove any unnecessary outer garments and wash his/her hands. The employee is to "remain in the presence of the collection site person"\textsuperscript{213} and provide a sample "in the privacy of a stall or otherwise partitioned area" unless there is reason to believe that a particular individual may alter or substitute the specimen to be provided.\textsuperscript{214} The sample is then sent to an HHS-approved laboratory for testing.\textsuperscript{215}

4. \textit{Reporting Procedures}

In testing for the presence of marijuana, cocaine, PCP, opiates, amphetamines (or their metabolites), DOT considers a test positive only if positive in both an initial test using immunoassay methods and in the confirmatory test using gas chromatography/mass spectrometry techniques.\textsuperscript{216} DOT procedures provide that "[a]ll specimens negative on [the] initial test or negative on the confirmatory test \textit{shall be reported as negative.}\textsuperscript{217}

Before any official action is taken, positive test results are first reported to the Medical Review Officer (MRO). The MRO, then, contacts the employee and gives the employee an opportunity to explain the test results. The MRO also reviews the employee's medical records as well as any other biomedical factors necessary to determine whether there is a legitimate medical explanation for the positive test result. If the MRO determines that a legitimate explanation for the positive result exists, the test result is reported as negative.

DOT's plan permits an employee who has tested positive to insist that the sample be tested again, either at the original test sight, or at another qualified laboratory at the employee's expense.\textsuperscript{218} A Category I employee who tests positive may be assigned non-safety or non-security du-

\begin{footnotesize}
\begin{enumerate}
\item[212.] DOT Order 3910.1, supra note 201, at Ch. III, §§ 1, 8-10 J.A., p. 32-39; see also Mandatory Guidelines for Federal Workplace Drug Testing Programs, 53 Fed. Reg. 11,970 (1988) [hereinafter HHS Regulations].
\item[213.] HHS Regulations, supra note 212, at 11,980.
\item[214.] Id. at 11,980-81.
\item[215.] Id. at 11,981.
\item[216.] DOT Order 3910.1, supra note 201, at Ch. III, 11(A)(1)-(5); see also HHS Regulations, supra note 212, at § 2(4)(e)-(f); see generally Mark Rust, Drug Testing: The Legal Dilemma, A.B.A. J., Nov. 1, 1986, at 50.
\item[217.] DOT Order 3910.1, supra note 201, at Ch. III, 9(B) (emphasis added).
\item[218.] Id. at Ch. III, 9(E).
\end{enumerate}
\end{footnotesize}
ties; however, the employee may not be discharged based on a single positive test result.\textsuperscript{219} No disciplinary action other than an offer of rehabilitation services can occur with a first-time positive random urinalysis. Absent additional circumstances, an employee will be removed from federal service only after a second positive test result.\textsuperscript{220} Furthermore, no criminal use can be made of DOT’s drug testing results.\textsuperscript{221}

\textbf{B. FEDERAL AVIATION ADMINISTRATION}

1. FAA DRUG TESTING PROGRAM

The FAA initially proposed random drug testing in an advanced notice of proposed rulemaking published in 1986.\textsuperscript{222} After receiving over 650 written comments, the FAA issued the notice of proposed rulemaking two years later and held a series of public hearings. The final rule was issued November 21, 1988.\textsuperscript{223}

While recognizing that drug use is not “widespread” among commercial aviation personnel nor is there an “overwhelming” drug problem in the industry, the FAA nevertheless found “concrete evidence of drug use in the commercial aviation sector” and, therefore, implemented random drug testing “[i]n order to ensure that aviation safety is not compromised by a failure to detect drug users in the aviation industry.”\textsuperscript{224} The FAA subsequently adopted regulations requiring every Part 121 and 135 certificate holder (most commercial air carriers) and each air traffic control facility to conduct employee drug testing for marijuana, cocaine, opiates, phencyclidine (PCP) and amphetamines.\textsuperscript{225}

2. SUBJECT EMPLOYEES

According to the FAA regulations, the following employees must be tested: (a) flight crew members; (b) flight attendants; (c) flight instructors or ground instructors; (d) flight testing personnel; (e) aircraft dispatchers; (f) aviation security or screening personnel; and (g) air traffic controllers.\textsuperscript{226}

\textsuperscript{219} Id. at Ch. IV, § 6, J.A., p. 42, 45, § 1(B).
\textsuperscript{220} All disciplinary actions pursuant to further testing are subject to the Civil Service Reform Act of 1978. 5 U.S.C. §§ 1101-9101 (1988 & Supp. III 1991).
\textsuperscript{221} HHS Regulations, supra note 212, at § 2.8; see also Pub. L. No. 100-71, § 503(e), 101 Stat. 471 (1987); American Fed’n of Gov’t Employees v. Skinner, 885 F.2d 884, 889 (D.C. Cir. 1990), cert. denied, 495 U.S. 923 (1990).
\textsuperscript{224} 53 Fed. Reg. 47,025, 47,029, 47,030.
\textsuperscript{226} 53 Fed. Reg. 47,058 (App. I & III) (air traffic control facilities operated by, or under con-
Additionally, FAA regulations require six types of testing: (1) pre-employment, (2) periodic, during the employee’s first medical examination (for those employees required to take a Part 67 medical examination), (3) post-accident, (4) reasonable suspicion, (5) return-to-duty227 following a positive test result or a refusal to test, and (6) random.228 Following the first year of testing, employers are required to conduct random tests of 50% of their employees each year.229

3. FAA TESTING PROCEDURES

Like DOT’s procedures, the FAA closely follows HHS’s drug testing procedures for government employees.230 Upon arriving at the “collection site,” the employee must present photographic identification or be identified by a representative of the employer, and must remove any outer garments. The employee may choose to provide the required urine specimen in a stall or otherwise partitioned area. The toilet water is tinted with blue dye to prevent the water from being used to adulterate the specimen. An observer, of the same gender as the employee, must remain in the area, but outside the stall or partitioned area. After receiving the specimen, the observer must inspect it to ensure that it is of proper quantity, temperature, and color. The observer must then arrange, following specified chain-of-custody procedures, to ship the specimen to an HHS-certified drug testing laboratory.

As with DOT testing, the laboratory to which the specimen is sent must perform an immunoassay test. If the specimen tests positive, the test must be confirmed using gas chromatography/mass spectrometry techniques. If the initial positive test is confirmed, the employer’s Medical Review Officer (who must be a qualified physician) determines whether there is an “alternative medical explanation” and in that connection must provide the employee with an opportunity to discuss the result and submit any medical records regarding legally prescribed medication. The employee may also demand a retest of the original specimen at the original tract with, the FAA or the military are exempt). 53 Fed. Reg. 47,057 (App. I) (for the most part, controllers at these facilities are covered by other drug testing programs).

227. 53 Fed. Reg. 47,043-44, 47,058 (App. I & V) (return to duty testing is authorized if the employee has completed drug rehabilitation and the medical review officer approves the employee’s return to work).

228. To eliminate any supervisory discretion in selecting employees to be tested and to avoid “potential bias toward and selective harassment of an employee,” 53 Fed. Reg. 8,375 (1988), selection of employees to be tested is made using a random number table or a computer-based number generator that is matched with an employee’s social security number, payroll identification number, or any other alternative method approved by the FAA. 53 Fed. Reg. 47,058, § V.C. (1988).


laboratory or another HHS-certified laboratory. In addition, there is an absolute prohibition against the release of drug test results to third parties without the specific, written consent of the employee.

Employees who test positive for prohibited drugs and are unable to offer a satisfactory alternative explanation must be removed from their positions, and may not return to duty except upon the recommendation of a Medical Review Officer or the Federal Air Surgeon.

V. THE OMNIBUS TRANSPORTATION EMPLOYEE TESTING ACT OF 1991

A. ORIGINS OF THE LEGISLATION

Despite recent Supreme Court cases upholding the constitutionality of federal drug testing programs and in the face of overwhelming evidence that there is not a drug problem in the aviation industry, Congress proposed legislation to expand the scope of existing drug testing regulations to include tests for alcohol abuse as well. The Omnibus Transportation Employee Testing Act of 1991, introduced by Senator Ernest Hollings (D-SC) on March 14, 1991, and co-sponsored by 24 other senators was designed to require testing for alcohol abuse for "safety-sensitive" jobs in civil aviation, rail, motor carrier, and mass transit.231 The Senate drug testing bill required regulations within one year of enactment to require airlines (including foreign carriers) to conduct pre-employment, periodic recurring, random, post-accident, and "reasonable suspicion" testing of pilots, crew members, airport security screening contract personnel, and other air carrier and FAA employees responsible for safety-sensitive functions.232 Airlines were not required to reinstate employees testing positive following successful rehabilitation and could not reinstate to their previous positions employees who had performed their duties while impaired. The legislation required pre-employment, reasonable suspicion, post-accident, and random testing.233 Fearing challenges to DOT's authority to implement drug testing requirements, Senator Hollings explained, "We want to set a national policy and not leave it to the whims of DOT later on."234


234. See Transportation Drug-Testing Bill Reintroduced, supra note 232. Although Senators Danforth and Hollings sought to give existing drug testing regulations strength through legislation, these same regulations have consistently withstood constitutional and statutory challenges all the way to the Supreme Court. Id.; see Editorial, Improved Drug Testing, J. COM., Sept. 20, 1991, at 4A.
The Senate approved the legislation requiring alcohol as well as drug testing for all employees in safety-risk jobs in transportation and the bill was sent to conference with the House. The House of Representatives had previously refused to include alcohol testing in its legislation and the Senate, which had passed similar legislation 11 times in the past four years, declined to pass legislation that did not include it. House members had argued that alcohol testing should be "performance-related" and that there should be some determination whether the alcohol used impairs a worker's ability to do his job. Transportation Secretary Samuel K. Skinner had expressed concern that alcohol testing programs not linked to an employee's job performance could be vulnerable to charges that testing for legal substances violates the Fourth Amendment's ban on unreasonable search and seizure.

Reacting to a New York subway derailment which killed 5 people and injured approximately 200, the House altered its position regarding the inclusion of mandatory alcohol tests for transportation workers. The motorman in that subway accident had a blood alcohol level of 0.21 and empty vials of cocaine were found in the driver's cab. The accident prompted renewed calls for federal drug and alcohol testing legislation.

In an attempt to promulgate compromise legislation, the House and Senate conferees also dropped the provision that would have required a nexus between job performance and suspected alcohol use before allowing alcohol testing and paved the way for future challenges regarding the constitutionality of alcohol testing. The bill was then sent to President Bush, who signed it on October 28, 1991, exactly two months after the New York subway accident involving drugs and alcohol.

B. LEGISLATION AS ENACTED

Attached to a $31.8 billion transportation appropriations bill, the Omnibus Transportation Employee Testing Act of 1991 finds that the use of alcohol and illegal drugs has been proven to have been a critical factor in

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235. The Testing program was originally included in a $14.4 billion appropriation bill for DOT and was approved 95-3. See AIR SAFETY Wk., Sept. 9, 1991, at 6.

236. See Mark B. Solomon, Alcohol Testing Likely to Pass Hill Hurdle, J. Com., Oct. 3, 1991, at 1A. Prior to the New York subway accident, the legislation had encountered solid opposition from the House Energy and Commerce Committee, which oversees railroads, and from the House Public Works and Transportation Committee, which has jurisdiction over airline, trucking, and mass transit employees. Id.


238. Id.

transportation accidents\textsuperscript{240} and amends § 3(a) Title VI of the Federal Aviation Act of 1958\textsuperscript{241} by mandating pre-employment, reasonable suspicion, random, post-accident, and periodic recurring testing for air carrier and Federal Aviation Administration employees involved in safety-sensitive positions.\textsuperscript{242} The legislation also essentially codifies existing DOT testing rules.\textsuperscript{243}

The airline industry opposed the alcohol testing provisions as costly and unnecessary, explaining that alcohol-related incidents are isolated and have not affected the performance of most of the airline work force.\textsuperscript{244} Airline spokesmen believed the current practice of testing workers for alcohol following an accident or if reasonable cause exists was sufficient.\textsuperscript{245} Labor leaders predicted a flurry of lawsuits challenging the new law because, unlike drugs, a certain level of alcohol consumption is legal.\textsuperscript{246}

\textbf{VI. EXORBITANT COST WITH MINIMAL RESULTS}

As noted earlier, federal drug testing programs are extraordinarily expensive to implement. DOT estimates that compliance with drug testing programs will cost aviation employers $1.34 billion over 10 years.\textsuperscript{247} The Air Line Pilots Association has complained that the cost of drug testing is "astronomical" and will go higher even though "not even one-hundredth of one percent" of pilots tested positive.\textsuperscript{248} Costs may well double for the second year of testing when airlines must randomly test 50% instead of only 25% of their employees.\textsuperscript{249}

\textsuperscript{242} Omnibus Transportation Employee Testing Act of 1991, Pub. L. No. 102-143, § 3(A), 105 Stat. 917, 953-54 (1991). The legislation directs the FAA Administrator to promulgate regulations establishing drug and alcohol testing for domestic and foreign air carrier crew members, airport security screening contract personnel, and other employees responsible for safety-sensitive functions. \textit{id.} The legislation further directs the Administrator to establish a similar program applicable to employees of the Federal Aviation Administration. \textit{id.}
\textsuperscript{243} \textit{id.}, 105 Stat. at 955.
\textsuperscript{244} William DiBenedetto and Mark B. Solomon, \textit{Coast Guard, Aviation Industry Query Need for Alcohol Testing}, J. Com., Oct. 7, 1991, at 12B.
\textsuperscript{245} \textit{id.}
\textsuperscript{246} Mark B. Solomon, \textit{Senate Clears Bill on Alcohol Testing}, J. Com., Oct. 17, 1991, at 3B; \textit{see also} Solomon, supra note 236, at 1A.
\textsuperscript{248} \textit{Air Transport Association}, supra note 247, at 415.
\textsuperscript{249} \textit{id.}
The staggering costs of these programs are strangling financially burdened airlines while uncovering positive results in less than 1/2 percent of those tested. The fact that 61.5% of these positives were detected in pre-employment testing illustrates the infinitesimal amount of drug usage in the employed aviation community. If enhancing safety through drug tests was the goal of drug testing regulations, it seems there is little drug usage in the aviation industry to detect or deter.

VII. CONCLUSION

Existing alcohol and drug testing legislation and regulations in the aviation industry are based on questionable constitutional analysis, inap­posite industry comparisons, and inaccurate assumptions regarding the professionals to be tested. The Omnibus Transportation Employee Testing Act of 1991, with its constitutionally suspect provision mandating random tests for alcohol use as well, was enacted on the heels of a tragic subway accident in which the driver was found drunk with drugs in his possession. Despite the New York accident, test results consistently show that alcohol and drug abuse is not a problem in the aviation industry. Furthermore, the two pre-eminent drug testing regulations in the aviation industry seek to achieve the common goals of prevention, deterrence, and investigation, yet differentiate based on the occupational classification of the individual to be tested.

In expanding permissible Fourth Amendment searches to allow the types of intrusions contemplated by the Customs Service in Von Raab, the Supreme Court emphasized the “voluntariness” involved in the employee’s decision to seek a job transfer and subsequently submit to a drug test. Unlike with aviation personnel, Customs drew no negative inference from an employee’s decision to withdraw his application for a transfer. Those in the aviation sector who refuse to be tested are either fired or relegated to “non-sensitive” positions. Although a certain element of voluntariness appears where the FAA transmits the NTSB’s request for toxicological samples to the relevant air traffic controller, no such voluntariness exists with regard to the FAA’s mandating tests for its employees or with regard to drug testing pilots or other flight crew personnel.

In rationalizing drug tests, the Court in Von Raab also focused on the consensual nature of the tests involved by emphasizing that a Customs’ employee was not subject to the discretion of an official in the field. Yet, this is precisely the standard utilized when determining whether to test air traffic controllers who may have contributed to an accident. The Supreme Court in Skinner noted that the aftermath of a transportation accident is often chaotic and that investigators arriving at the scene might find it diffi-
cult to determine which individuals contributed to the accident. The Northwest, USAir, and Avianca accidents illustrate the difficulty of determining “in the field” who may have contributed to an accident.

Furthermore, the post-violation and post-accident drug testing regulations in *Skinner* were promulgated in response to an acknowledged industry-wide substance abuse problem. The Supreme Court expressly declined to extend this presumption to all regulated industries. As noted, the aviation industry is not riddled with substance abusers causing deadly accidents at an alarming rate. In numerous, successive tests, only one-half a percent of test results for aviation personnel were positive, and a great majority of those involved pre-employment drug testing. While pre-employment screening is valuable for weeding out drug users and post-accident drug testing could be an important accident investigation tool, the facts do not support, nor do the results justify, the exorbitant expense necessary to continue other phases of drug testing, random testing in particular.

In permitting drug testing regulations to be extended to commercial aviation employees, the Ninth Circuit in *Bluestein* relied on both *Von Raab* and *Skinner* yet found neither an acknowledged and pervasive industry-wide drug problem, a post-accident justification, nor an element of “voluntariness” relied upon by the Supreme Court. The Court of Appeals instead focused on the prevention and deterrence rationale. While well-intended, these regulations do not recognize the virtually non-existent drug usage in the aviation industry nor are they applied on a truly classless basis. As the Avianca, USAir, and Northwest accidents demonstrated, the FAA’s drug testing regulations require mandatory post-accident drug and alcohol testing for private sector employees while the regulations are discretionary for FAA air traffic controllers. The result: pilots are often subjected to mandatory post-accident drug and alcohol tests while “some”, i.e., FAA or military, air traffic controllers are not, unless their contribution to the accident is clear.

This disparity of treatment leaves the NTSB without comprehensive and valuable information concerning the potential impairment of all possible actors. Despite the Supreme Court’s sanctioning of drug testing, the NTSB lacks independent authority to require drug and alcohol tests. The NTSB must rely on FAA management personnel to select the appropriate air traffic controllers to be tested, or must hope that air traffic personnel will volunteer to be tested or have their records released to the NTSB. Since drug testing has survived Supreme Court scrutiny and the declared goal behind implementing post-accident drug and alcohol testing is to deter people from using drugs and alcohol and aid investigators when accidents occur, post-accident testing should be applied uniformly to all potential accident contributors regardless of their employer or their gov-
erning regulations. The bottom line, therefore, is why doesn't Congress provide the NTSB with the statutory authority to mandate such tests for appropriate individuals involved in the aftermath of an accident in the interest of aviation safety and protection of the traveling public?
Air Transport Competition in the European Economic Community: The Antitrust Procedures

JEFFREY GOH*

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INTRODUCTION

Until 1987, the air transport sector in the European Economic Community was the only one of two sectors of the economy (the other being maritime) excluded from the common transport policy. The distinctive features of the industry entailed the necessary subjection to a separate corpus of rules, but it was not until 30 years later since the inception of the Treaty of Rome in 1957 that specific regulations to implement the competition principles of the Treaty began to emerge. Various Council Regulations had been adopted for transport in general before then, but the air transport sector was excluded for reasons that are beyond the present scope.1

Article 84(2) of the Treaty provides the legal basis for the Council to adopt specific regulations to implement the competition provisions of Articles 85 and 86. Article 84(2) states: “The Council may, [acting by a qualified majority] decide whether, to what extent and by what procedure appropriate provisions may be laid down for sea and air transport.”2

In the period prior to the introduction of specific regulations, enforcement of the competition principles was implemented through Articles 88 and 89 of the Treaty, also known as the “Transitional Articles.” Article 88 vests in Member States the authority to enforce the competition principles. Article 89 on the other hand, empowers the Commission to exercise a broader default authority to initiate appropriate measures to require a violation of Articles 85 and 86 to cease. The 1986 decision in Ministere Public v. Asjes,3 more commonly known as the Nouvelles Frontieres’ Case, provided a significant impetus for the Council to exercise its authority provided in Article 84(2). Together with the continuing pressures arising from the liberalization and market harmonization commitment, the Council was left with little room to delay the adoption of some specific regulations. The following four measures were therefore adopted in 1987, comprising two Council Regulations, a Directive and a Decision:

(1) Council Regulation 3975/87 - lays down the general framework and the procedures for applying the competition provisions of Community law with respect to air transport.4

(2) Council Regulation 3976/87 - lays down the authority for the Commission to exempt certain categories of undertakings, agreements, decisions

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and concerted practices from the competition rules.\(^5\)

(3) Council Directive 87/601 - lays down the procedures for the submission and approval of air fares.\(^6\)

(4) Council Decision 87/602 - lays down the provisions to regulate the sharing of passenger capacity between Community airlines and access to certain Community routes which the airlines do not already operate.\(^7\)

The measure adopted by the Council for the concern of this brief comment is the core Regulation 3975/87 which details the antitrust rules of the European Community for the air transport sector. The further concern of the present note focuses on the subsequent provision adopted by the Commission empowered by Article 19 of Regulation 3975/87. The Commission adopted Regulation 4261/88 to give further and detailed effect to Articles 3, 5 and 16 of the core Regulation which deal with the procedures relating to complaints, applications and hearings.

**COUNCIL REGULATION 3975/87**

Several provisions of the core Regulation are worthy of note. The scope of the of the Regulation is restricted by Article 1 only to "international air transport between Community airports." This has the effect of excluding air services where one of its originating or destination point involves a non-Community airport. It also has the effect of excluding domestic air transport. This interpretation has recently been impliedly reinforced by a decision of the Court of Justice, which held that, "[i]t must be inferred...that *domestic air transport* and air transport to and from *airports in non-member countries* continue to be subject to the transitional provision laid down in Articles 88 and 89."\(^8\)

Articles 3-5 detail the procedures for the submission of a complaint

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5. Council Regulation 3976/87, 1987 O.J. (L 374) 9. This Regulation was subject to an expiry date, and it expired on January 31, 1991. The Council, however, felt it necessary in the transition to a more competitive environment to extend the exempting provisions. *See* now Council Regulation 2344/90, 1990 O.J. (L 217) 15. This regulation will now expire on December 31, 1992.


and its investigation process. Article 3 sets out the categories of complaint and complainants, which includes Member States and natural or legal persons with a legitimate interest. The Commission, however, reserves the right to initiate a complaint and "to initiate procedures to terminate any infringement of the provisions of Article 85(1) or 86 of the Treaty" following consultations with the Advisory Committee on Agreements and Dominant Positions in Air Transport. It is further provided by Article 3(2) that undertakings or associations of these may apply to the Commission for a certification that the agreement or conduct concerned would not be prohibited under Article 85(1) or 86 of the Treaty.

Article 5, on the other hand, provides for the procedures in which objections may be submitted by interested parties in the air transport sector. Where the Commission is satisfied from the evidence available that an enforcement order cannot be justified, then it must reject the complaint. In the event of a positive finding of an infringement, it may, by Article 4(1), issue a Commission Decision to require that the infringement be terminated.

The provisions for the hearings system are contained within Article 16 of the core Regulation. Before the Commission adopts a decision on the complaint, it shall "give the undertakings concerned the opportunity of being heard [and it] may also hear other natural or legal persons . . . when they show a sufficient interest."10

**COMMISSION REGULATION 4261/88**

The foregoing provisions create the general framework within which complaints for the violation of competition principles may be submitted. They also provide the general regulatory structure for the Commission to deal with applications under Article 3(2) with respect to their submission and determination. An implementing Regulation has since been adopted by the Commission for a detailed implementation of Articles 3(1), 3(2), 5, 16(1) and 16(2) of the core Regulation.

The aim of this Regulation seems to be three-fold. In the first place, it seeks to give a detailed effect yet by way of simplified procedures for the submission of complaints for a suspected infringement of the competition provisions (i.e. Article 3(1)) and the procedures for the submission of applications to the Commission for a certification that Article 85(1) or 86 does not apply to the agreement or conduct in question (i.e., Article 3(2)). The second objective of the Regulation is to seek to set up an effective hearings system for applications submitted in accordance with Article 3(2) to allow the other undertaking or undertakings to the agreement to

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put its case forward, given that some applications may have important legal consequences for each undertaking. Third, the Regulation sets up a mechanism for third-party participation provided, of course, sufficient interest can be established.

I. THE COMPLAINTS AND APPLICATIONS PROCEDURES

The Regulation contains two sections, the first dealing with the complaints and applications procedures whilst the second is concerned with the hearings procedures. The complaints provisions can be dealt with briefly. Article 1 sets out the requirement that complaints must be in writing and the range of complainants entitled to complain, namely, Member States or, natural or legal persons who claim a legitimate interest.

Articles 2 and 3 of Regulation 4261/88 are concerned with the applications procedures for a negative clearance or a disapplication of the competition rules. The negative clearance procedure under Article 2 is only available for the air transport sector, and it provides a useful means for an undertaking or undertakings to an agreement to seek the opinion of the Commission on whether the agreement in question or the behaviour of the arrangement is within the purview of Article 85(1) or 86. In the application to the Commission, the applicant will be required to provide reasons as to why Articles 85(1) and 86 are inapplicable, that is to say why the agreement does not have the object or effect of preventing, restricting or distorting competition within the Community to an appreciable extent, or that the agreement concerned does not entail a dominant position. On receiving an application for negative clearance, the Commission may certify to advise the undertaking concerned that, on the basis of the facts in its possession, there are no grounds on which the Commission will apply Article 85(1) or 86 against the agreement or its behaviour.

Notwithstanding that the negative clearance procedures provide an important channel for securing the opinion of the Commission, the Commission adopts a policy of discouraging such applications in cases where the agreements clearly do not come within the scope of either Article 85(1) or 86. In addition to simplifying procedures further, this attracts the benefits of expediency on matters relating to European competition. At any rate, where an application has been submitted, and the agreement is one which is clearly not within the competition rules, the Commission does not usually issue a negative clearance.\footnote{11}

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\footnote{11. A parallel concept was conceived in the United States when, in the 1930s, regulatory commissions were created to whom business undertakings could routinely turn for advance advice on the legality of a particular agreement or transaction. For many business managers, this was the great virtue of administrative regulation. Where litigation was formal and governed by elaborate rules of procedure, advance advice would be less formal and relatively unburdened by red tape. Where litigation}
It may be useful to note that in an application, the Commission is often engaged in a process of negotiation with the applicant. This is true in cases where the Commission feels that the agreement would fall foul of the competition principles but that a negotiated settlement could be achieved by extracting assurances from the undertakings concerned. In most cases, obtaining those assurances are unlikely to be difficult since a disagreement will probably lead to the Commission applying its formal authority under the competition rules. A helpful illustration can be found in the British Airways and British Caledonian merger proposal in 1987. The merger had been the subject of an earlier investigation by the United Kingdom Monopolies and Mergers Commission (MMC). The European Commission was, however, of the opinion that the assurances obtained by the MMC were inadequate. It therefore attempted to obtain, and successfully so, further commitments from British Airways that the merger would not operate against the competition requirements of the European Community.12

Article 5 of Council Regulation 3975/87 is the parent provision for an undertaking or undertakings to an agreement to apply to the Commission to give effect to Article 85(3) of the Treaty in relation to the agreement in question. Article 85(3) states,

The provisions of [Article 85(1)] may, however, be declared inapplicable in the case of-
(a) any agreement or category of agreements between undertakings;
(b) any decision or category of decisions by associations of undertakings;
(c) any concerted practice or category of concerted practices;
which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not-
(a) impose on the undertakings concerning restrictions which are not indispensable to the attainment of these objectives;
(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.13

Articles 2 and 3 of Regulation 4261/88 therefore spell out the procedures to be adopted to allow agreements which restrict competition to continue on the ground that these agreements are capable of generating

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13. Note that an application for an order to apply Article 85(3) is relevant only to cases which fall within the scope of Article 85 alone. An exemption cannot be obtained for Article 86 by this means.

some economic advantages, particularly those relating to technical and economic progress. What, however, appears to be lacking is a guideline as to the degree of economic advantage required before the Commission would apply Article 85(3) of the Treaty. It could, nonetheless, be presumed that the Commission would be seeking economic benefits that are likely to be substantial such that they outweigh the benefits that may be derived from greater competition. In all cases, however, the Commission would be expected to deal with each application in accordance with its particular circumstances or merits.

The applicant will be required to state in the application form several reasons as to why the Commission should apply Article 85(3) to the agreement. In particular, the Commission will need to be informed of the ways in which the agreement in question would contribute to improving and/or promoting economic progress, and that the restrictive provisions of the agreement are necessary to achieve that progress. The applicant would also be required to indicate the level of benefits that could be enjoyed by the consumer, or user in the case of air transport.

The procedures adopted by the Commission in considering whether to apply Article 85(3) to the agreement concerned are two-fold. Where the Commission does not entertain any serious doubts as to the applicability of Article 85(3), it need not take any further action. On this basis, Article 5(3) of the core Regulation provides that the applicant will be entitled to presume that the application to disapply Article 85(1) has been accepted, providing, however, 90 days has elapsed since the publication of that application in the *Official Journal of the European Communities*.

Where, however, there are serious doubts as to the applicability of Article 85(3), the Commission will be required to notify the applicant. In these cases, it is either because the Commission is not convinced of the economic advantages to be gained so as to apply Article 85(3), or because more information was required. Following a further consideration of the application and further representations, the Commission may decide either to uphold its original decision, or it may decide to apply Article 85(3) to the agreement concerned. In the latter situation, the Commission must stipulate what the period of that application is to be. In addition, the Commission may decide to impose obligations or attach conditions to its decision. At any rate, the Commission has the reserved authority to amend or revoke its decision, particularly in circumstances where the decision had been premised on incorrect information being supplied or where there has been a material change in the facts since its decision.

In cases where the Commission is minded to apply Article 85(3), it must submit a preliminary draft of its final decision to the Advisory Committee on Agreements and Dominant Positions in Air Transport. This prior consultation is a mandatory pre-requisite before the Commission adopts its final decision. The final decision will then be published in the *Official Journal of the European Communities*.

II. THE HEARINGS PROCEDURES

Section II of the Commission Regulation 4261/88 deals with the hearings to be conducted by the Commission. The holding of a hearing process is mandatory on the part of the Commission prior to its consultation with the Advisory Committee so as to allow representations to be made by the applicant and other interested parties. This process has been designed for objections to be raised against the application, either in a case of negative clearance or an application of Article 85(3), and to allow the applicant to make further representations in the light of those objections.

Article 8 of this Regulation requires the Commission to afford third parties with a sufficient interest the opportunity to put forward their views. This representation, however, shall only be made in writing and not orally. A particularly interesting provision in the hearings procedures that provokes the mind is that relating to the conduct of the hearing itself. Article 12(3) stipulates that “hearings shall not be public.” This allows the Commission to hear the cases of each party interested in the application behind closed doors. The basis for this approach seems to lie with the need to protect the legitimate interests of the parties and their business secrets. The Commission is therefore under a duty to ensure that the entire process does not unnecessarily prejudice the well-being of the parties involved in the hearing process. In order to expedite this process, the application form for a negative clearance or the disapplication of Article 85(1) or 86 is sectionalized so as to draw the attention of the Commission to the applicant’s request to protect any of its interests that may be harmed. There is, however, a requirement to justify the request.

It must seem, from a first impression, that this lack of transparency, contrary to the widely adopted policy and practice in the Community, is legitimated only in so far as it furthers the objectives of professional secrecy. Short of this claim, it is unlikely that the absence of openness will withstand the criticisms that can be levied at a process buried in secrecy.

III. SUPPLY OF INFORMATION

A brief reference was made above to the supply of information by the applicant to the Commission. Some observations may be in order. The
Commission places considerable emphasis on the need to provide complete and accurate information. A decision either to issue a negative clearance or to declare the application of Article 85(3) is usually based on the facts that the Commission possesses. The effect of providing incomplete or incorrect information would render ineffective the order of negative clearance, or voidable in the case of a decision to apply Article 85(3) to the agreement. To ensure that the Commission is supplied with all available evidence, it is conferred with some very effective powers of enforcement. Article 12(1)(a) of Regulation 3975/87 allows the Commission to impose pecuniary sanctions from 100 ECUs to 5000 ECUs for the provision of incorrect or misleading information regardless of whether it had been provided intentionally or negligently. The enforcement authority of the Commission in this respect carries with it considerable significance, not least because it encourages greater vigilance on the part of the applicant seeking to obtain a decision in its favour from the Commission.

The Commission, however, is minded of the extensive scope that "intentionally and negligently" entails. The powers under this provision will be exercised only in circumstances where false or grossly inaccurate information has been supplied by the applicant; or in cases where there has been a suppression of information; or the deliberate provision of false opinions.  

**CONCLUSION**

This brief comment has been intended to shed some light on the technical requirements of Community provisions on antitrust procedures in air transport, namely, that relating to negative clearance and an application of Article 85(3) of the 1957 Treaty. Whilst this Commission Regulation represents only an implementing provision, its significance stems from the concern of the Community for achieving a very large degree of uniformity in competition matters relating to air transportation, at a time when the liberalization process is gaining momentum. In the move towards greater competition and eventually the harmonization of the various independent air transport markets, the Council and the Commission have adopted several provisions that necessarily reflect the urgency of wider compliance by member countries with the policy objectives of the Community in air transport competition. The journey towards that end has seen not only a proliferation of Community provisions to enable a more effective process of surveillance by Community and national institutions, but has also widened the scope of scrutiny by including parties with legitimate interests from other member countries.

The distinctive features of the air transport industry, illustrated in par-

16. *Id.*, at Part VI.
ticular by the concept of air space sovereignty and thus the control over market access by national governments, are issues of great importance in the move towards greater liberalization and harmonization. It is unlikely that member countries tended to adopt a protectionist philosophy would be prepared to surrender an important concept of national identity and sovereignty without raising objections of considerable magnitude.

To a large extent, it may be true that Community policy on competition has been designed to achieve greater market harmonization in preparation for the eventual political unity, but the political sensitivity of some issues attached to several sectors of the economy is likely to slow down that process. There is at the same time an equal truth that the Council and the Commission have not been slow to avail themselves to Community instruments with more significant impact, and thus to step up the gear for speedier harmonization. In particular, and incrementally, the Commission has been vested with more regulatory and investigatory authority in order to perform its increasingly central role of harmonizing the economies of the Community. And this Regulation, adopted by the Commission, represents only one of the several far-reaching steps taken to achieve greater uniformity on the one hand, with the consequential effect on the other hand of widening the range of participants in the regulation air transport competition.
ARTICLE 84

(1) The provisions of this Title [Transport] shall apply to transport by rail, road and inland waterway.

(2) The Council may [acting by a qualified majority] decide whether, to what extent and by what procedure appropriate provisions may be laid down for sea and air transport.

ARTICLE 85

(1) The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which-

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;

(b) limit or control production, markets, technical development, or investment;

(c) share markets or sources of supply;

(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

(2) Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

(3) The provisions of paragraph 1 may, however, be declared inapplicable in the case of-

: any agreement or category of agreements between undertakings;

: any decision or category of decisions by associations of undertakings;

: any concerted practice or category of concerted practices;

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not-

(a) impose on the undertakings concerning restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.
ARTICLE 86

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in-

(a) directly or indirectly imposing unfair purchase or selling prices or unfair trading conditions;

(b) limiting production, markets or technical development to the prejudice of the consumers;

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(d) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

ARTICLE 87

(1) Within three years of the entry into force of this Treaty the Council shall, acting unanimously on a proposal from the Commission after consulting the Assembly, adopt any appropriate regulations or directives to give effect to the principles set out in Articles 85 and 86.

If such provisions have not been adopted within the period mentioned, they shall be laid down by the Council, acting unanimously on a proposal from the Commission and after consulting the Assembly.

ARTICLE 88

Until the entry into force of the provisions adopted in pursuance of Article 87, the authorities in Member States, shall 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, in particular paragraph 3, and of Article 86.

ARTICLE 89

(1) Without prejudice to Article 88, the Commission shall, as soon as it takes up its duties, ensure the application of the principles laid down in Articles 85 and 86. On application by a Member State or on its own initiative, and in co-operation with the competent authorities in the Member States, who shall give it their assistance, the Commission shall investigate cases of suspected infringement of these principles. If it finds there has been an infringement, it shall propose appropriate measures to bring it to an end.

(2) If the infringement is not brought to an end, the Commission shall rec-
ord such infringement of the principles in a reasoned decision. The Com-
mission may publish its decision and authorise Member States to take the
measures, the conditions and details of which it shall determine, needed
to remedy the situation.
Airline Deregulation: An Evaluation of Goals and Objectives

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I. INTRODUCTION

There has been much debate about the relative success of airline deregulatory policy. "Policy," however, involves politics and opposing opinions. Deregulation, therefore, may have a variety of meanings and expectations for different groups of people. Proponents and opponents alike seem to want to argue the relative merits of deregulation in accordance with contemporary and narrowly defined, sometimes self-serving views.¹ Seemingly ignored² has been the historical perspective and what deregulatory law was supposed to accomplish.

The purpose of this article is to focus upon original intent, and to "evaluate" the relative success of airline deregulation as measured by the explicit goals and objectives of the Airline Deregulation Act of 1978.

II. EVALUATION

There is no single accepted meaning for evaluation, but according to one definition, program evaluation entails the systematic collection of "information" about the outcome of (airline deregulatory) policy in order to decide upon its relative effectiveness.³ Program evaluation may, and often does, use traditional research methods to gather information. However, there evolved a "fact-value" debate in the search for a proper meth-

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¹. See M. Deutsch, In Defense of Deregulation, FREQUENT FLYER (Dec. 1990) 6 (In the August, 1990, issue of Frequent Flyer, Paul S. Dempsey, supported by Martin Deutsch, editor and publisher of Frequent Flyer, critically dissected airline deregulation. In the subsequent December issue, Robert Aaronson, president of the Air Transport Association, responded to Dempsey’s point of view. Not surprisingly, Aaronson did not agree with Dempsey, but it is interesting that Aaronson attempts to discredit Dempsey and Deutsch by stating that their conclusions are based upon "preconceived notions," when, as Deutsch points out, Aaronson, himself, as president of the ATA, has a (clearly biased) "position to defend and uphold.").

². PAUL S. DEMPSEY, FLYING BLIND: THE FAILURE OF AIRLINE DEREGULATION (1990) (This study examines the "promises" that were made by deregulatory proponents).

³. MICHAEL QUINN PATTON, UTILIZATION-FOCUSED EVALUATION 14 (2nd ed. 1986)(Patton defines program evaluation as the systematic collection of information about the activities, characteristics, and outcomes of programs for use by specific people to reduce uncertainties, improve effectiveness, and make decisions with regard to what those programs are doing and affecting.)
odology\textsuperscript{4} which led in the social sciences to general acceptance of a "multiplist" mode. The attempt in multiplist is to legitimate findings through "triangulation," or the use of multiple indicators to either measure a single concept, or to test the same hypothesis.\textsuperscript{5}

In conducting evaluation studies, it is accepted that they are different from scientific research, the latter of which is undertaken to discover unbiased "truth." Evaluation, on the other hand, weighs the preponderance of evidence. It is an adversarial approach, analogous to a court trial where opposing attorneys submit countering evidence. Moreover, it is tolerant of "subjective" input.\textsuperscript{6}

Program evaluation is similar to traditional research in that it may use scientific (quantitative) methodologies and other empirical methods to produce information. But unlike experimental research, which declares itself to be "objective" and scientifically neutral, program evaluation involves "policy" research, and is, therefore, motivated by politics and opposing opinions. By definition, "politics" entails competition between groups or individuals. Program evaluation attempts to balance these competing interests, and to be "fair" rather than value-free.\textsuperscript{7} Evaluation, therefore, by taking a position about how well a program is doing, is inherently political. In searching for fairness, evaluation also represents a more jurisprudential approach to discovering truth than does scientific research alone.

The following evaluation is presented in a journalistic style,\textsuperscript{8} using House's "behavioral objectives" approach,\textsuperscript{9} where the discrepancy between the outcomes and the stated goals and objectives (of the Airline Deregulation Act) is the measure of the program's success. It is a summary\textsuperscript{10} of the results of each of the goals prescribed in Section 102(a) of the Federal Aviation Act of 1958 (49 U.S.C. 1302[a]), as amended by the Airline Deregulation Act of 1978 (hereinafter ADA).

As outlined in Section 102, there are nine normative goals which were to be achieved by the ADA. It was to: (1) maintain "safety as the highest priority in air commerce. . ."; (2) make available "a variety of adequate, efficient, and low-priced services by air carriers. . ."; (3) place "maximum reliance on competitive market forces and on actual and po-

\textsuperscript{4} Frank Fischer, Politics, Values and Public Policy: The Problem of Methodology 19 (1980).
\textsuperscript{5} Mark Abrahamson, Social Research Methods 61 (1983).
\textsuperscript{6} Patton, \textit{supra} note 3, at 195-197.
\textsuperscript{7} Id. at 195.
\textsuperscript{9} Ernest R. House, Evaluating with Validity 21-42 (1980).
\textsuperscript{10} See Laurence GeSELL, AIRLINE RE-REGULATION (1990) (Presented in an expanded outline in Chapter 2).
tential competition”; (4) develop and maintain “a sound regulatory envi­
environment . . .”; (5) prevent “unfair, deceptive, predatory, or anticompetitive
practices in air transportation. . .”; (6) avoid “unreasonable industry con­
centration, excessive market domination, and monopoly power. . .”; (7)
encourage “entry into air transportation markets by new carriers. . .and
strengthen small carriers so as to assure a more effective, competitive
airline industry”; (8) maintain a “comprehensive and convenient system
of continuous scheduled service for small communities”; and (9) “en­
courage efficient and well-managed carriers to earn adequate profits and
to attract capital.”

The overall objective of airline deregulatory policy was to return the
industry to competitive capitalism,11 with many competing airlines, where
none could control the market, and where all would have to actively par­
ticipate in price competition. The scheme was to create a more perfect
economic model of competition wherein prices would be driven down and
the consumer would be the ultimate benefactor.

However, within only two years, the ADA was given an all new twist
by the Reagan administration, which, through “administrative regulation,”
redefined deregulatory policy. By the mid-1980s, the Department of
Transportation began granting large-scale and wholesale mergers of air­
line companies. The stage was being set for an organizational trend (back)
toward oligopoly, in contravention of the ADA. Consolidation elimi­
nated the possibility of competitive capitalism which was an underlying
construct critical to the success of deregulatory policy. Assumed in this
article is that the era of effective deregulatory policy (as defined by the
ADA) came to a close as early as 1987, but certainly no later than 1988,
when industry concentration reached pre-deregulation levels. As Senator
John McCain stated, the market forces allowed the major airlines to block
competition, resulting in de-facto reregulation — without the regulators.12
Hence, the “deregulatory era” is defined in this analysis as the years
1978 to 1988 (see “Competition,” infra).

III. SAFETY

If safety was to be given “the highest priority,” then one must ask

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11. J. INVERARITY, P. LAUDERDALE AND B. FELD, LAW AND SOCIETY: SOCIOLOGICAL PERSPEC­
TIVES ON CRIMINAL LAW 169 (1983) (The authors argue that during the Progressive Era [from
about 1890 until the beginning of World War I], “competitive capitalism,” exemplified by many
low technology enterprises, was transformed into “corporate capitalism,” wherein the laissez­
faire economic marketplace envisioned by Adam Smith was replaced by imperfect competition
and the concentration of capital into fewer and fewer companies in any given market [that is to
say, an “oligopoly”]).

12. L. McGinley, Republicans Are Joining Chorus of Airline Critics Seeking Partial Reregula­
what factors in deregulatory policy contributed to that objective. The principal argument that air transportation safety increased following deregulation seems to center upon fatal accident statistics. Morrison and Winston, for example, contend that safety improved, as evidenced by "the absolute number of fatal commercial accidents and midair collisions...", which, they conclude "...declined significantly, from 42 in the regulated period (1965-1975), to 15 in the deregulated period (1976-1986)."

The Morrison and Winston study, however, is seriously flawed by its definition of regulatory versus deregulatory eras, and by its fundamental reliance upon accident data alone. The study defines deregulation as beginning in 1976, when in actuality the ADA wasn't even passed until 1978. It seems unreasonable to have assumed changes in the system would have occurred instantaneously with passage of the ADA, let alone before the fact, as the Morrison and Winston model assumes.

Rather than accepting 1976 as the beginning of deregulation, an alternative proposal would suggest deregulatory policy was not formally adopted until 1978, did not become effective until 1979, and its impact upon safety was not actually manifested until perhaps sometime in the early to mid 1980's, with latent effects lasting perhaps into 1989 or beyond. By 1985, deregulatory policy was clearly operative, and 1985 was a year of significantly increased airline accidents! Perhaps it was just coincidence, but normatively, one could argue there is a correlation between the accumulative effects of deregulation and aircraft accidents, at least in that one isolated year, if not others. There were seven fatal accidents in 1985 alone, involving aircraft with more than 30 seats (i.e., excluding most commuters). The 31 accidents for scheduled airlines in 1987 were the most since 1974. Of those 31 accidents, four resulted in 231 fatalities, the highest number in five years. There were ten such accidents in 1989, more than double the annual average of 3.69 fatal crashes since 1976, and the highest since 1968.

If one accepts the argument that the actual safety-related impact of deregulation lagged until the early 1980s, the implications of the accident data suggest conclusions opposite from the Morrison and Winston findings. If the effective deregulation transition date was shifted to 1982, for example, looking at the seven years on either side of the demarcation

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14. Id. at 15 (The authors admit that their choice of 1976 as the beginning of airline deregulation introduces a bias and reduces the frequency of accidents during deregulation.).
date to equalize the duration of sample periods, there are more fatal accidents (33 versus 27) occurring in the “post-deregulatory” period (1983-1989). Should the impact date be delayed even further, to 1984, the “post-deregulatory” period (1985-1989), looking at five years on either side, contains a significantly greater number of accidents (28 versus 15).

The bottom line, however, is that accident data, alone, are unreliable predictors of safety. The accident statistics say nothing about potentially decreased emphasis on maintenance, lowered standards for hiring pilots, and other economic pressures which suggest that safety was negatively affected. Additionally, statistics, depending on how they are interpreted, may lead to contradictory conclusions. The picture can change overnight as demonstrated by the sharp increases in accidents in 1985, 1987 and 1989.

Something engendered a widespread perception that safety had declined, and it was not easily dismissed by looking solely at relative numbers of fatal accidents. Those who maintain there was an erosion in safety do not debate the accident statistics. Rather, they argue that air carriers, because of economic pressures and cost saving measures brought on by deregulation, no longer exceeded the minimum Federal Aviation Administration safety standards “to the same degree as prior to deregulation.” They say safety standards were lowered, and argue that there was an “insidious erosion” in safety maintenance. Nance, for example, submits that air transportation was and is safe, but still argues the safety “margin” eroded. He, therefore, seems to blame the airlines for much of the safety erosion.

Gerston, Fraleigh and Schwab seem to support this contention, and reveal that the number of mechanics employed by the major airlines decreased by 2,000 from 1974 to 1984, while the number of airliners in service dramatically increased. Golich indicates the number of maintenance workers employed may have decreased by nearly twice that many just between 1979 and 1984. Added to that, the number of federal safety inspectors fell by 700 during the same period.

By creating a surplus in the Aviation Trust Fund, monies were not

18. Larry N. Gerston, Cynthia Fraleigh and Robert Schwab, The Deregulated Society 95 (1988) (In debating the Kennedy-Cannon bill, that eventually became the Airline Deregulation Act, deregulatory opponents contended that as competition drove airlines to seek the lowest possible costs, mechanics would be encouraged to cut corners, older aircraft would remain in service longer, and the airline would tend to employ inexperienced pilots and ground crews who might make mistakes.).


20. Nance, supra note 19 at 105.


committed to expand the airway system infrastructure "made necessary because of increased traffic volumes caused by deregulation. Congress and the administration may have contributed to a reduced level of safety."23 "The truth...," says Senator Wendell Ford, "...is that the federal government allowed the system to be overwhelmed by predictable increases in air travel and bears much of the blame for its dangerous inadequacies."24 He also blames the Reagan administration and some members of Congress for having maintained an aviation surplus rather than spending it on air transportation improvements.

Tension clearly increased in the air traffic system following deregulation, and as McLure25 points out, "increasing competitive scheduling and hub-and-spoke operations created new peak air traffic periods." The growth of hub-and-spoke strategies can be directly attributed to deregulation. If hub-and-spoke activities, with their added congestion, lead even indirectly to safety problems, it follows that deregulation, which promoted hub-and-spoke congestion, led to a lowering of safety. It takes little imagination to see that traffic congestion around specified airports adds to the safety problem, since eighty percent of all aircraft accidents occur in the airport environment.26

There is a commonly held perception the airlines became less safe. There is evidence of airline reductions in labor, training, maintenance, and other safety-related operational costs. There is also evidence of a congested and over-worked air traffic and airspace system. Moreover, there was an apparent failure of the government to provide adequate numbers of controllers and safety inspectors. Added to this, there were significant influxes in accidents during the deregulated era, defined as 1978 to 1988. By triangulating the available information, and by using a statistical metaphor, the "beta coefficients"27 of the independent variables identified above, although perhaps not statistically significant, were nevertheless all moving in a direction which suggests that safety had eroded during the first decade of deregulation.

23. Morrison and Winston, supra note 13 at 15. See also Alfred Kahn, Deregulation: Is This The Tragic Consequences Of Low Fares, More Competition?, ARIZ. REP. (Aug. 23, 1987) (Kahn cites delays [in air traffic] as attributable to failures of the government to expand airport capacity, and states that the [Reagan] decision not to rehire the striking controllers "comes under the heading of vindictiveness.").


27. GEORGE BOHRNSTEDT AND DAVID KNOKE, STATISTICS FOR SOCIAL DATA ANALYSIS (1982) (The "beta coefficient" is a standardized regression coefficient indicating the amount of net change in standard deviations of the dependent variable arising from one standard deviation change in an independent variable.)
Still, the fundamental question may not be whether safety declined, but rather, whether it improved. An acceptable safety margin is not static. Safety programs warrant a continuous striving for improvement. A status quo in safety achievement, in effect, represents a de facto decline! If safety had indeed "eroded," or, for that matter, even remained at pre-deregulation levels without improvement, then safety was seemingly not given the "highest" priority stipulated as an objective of airline deregulatory policy.

IV. LOW-PRICED SERVICES

A second objective of the ADA was to provide "adequate, efficient, and low-priced services." In sum, this may be interpreted as a goal to achieve the common law duty of a carrier to charge "reasonable" rates. By "adequate" pricing, it is assumed the carrier's prices will cover its variable and traceable costs, and will provide sufficient revenues to apply something toward its fixed and common costs. In addition to adequate pricing, it may be further assumed "efficient" pricing is that which will provide adequate returns, while at the same time offering low prices to the consumer. Implicit in deregulatory policy is that sufficient competition (i.e., Adam Smith's "invisible hand") would force competitive pricing to occur, and potential profits generated by improved efficiency would be passed along to the consumer by way of lower prices.

One measure of economic efficiency in air transportation is load factors. Analyses of Department of Transportation "Air Carrier Traffic Statistics" for 1986 through 1988 show the average domestic load factors for the major airlines in 1986 were only 59%. Reports through 1988 show only a slight increase to about 61%, with an average between 1979 and 1988 of 60%. Load factors for the last year (1978) before full deregulation averaged 61%, thus indicating little or no change occurred subsequent to deregulation.

Still, it should be noted that it is a function of the airlines to strive for higher profits, and increasing load factors is the principal way of doing it in a competitive environment. In oligopoly, however, the way to account for lower seating capacity is to drive prices up.

30. D. Waldman, The Economics of Antitrust 148 (1986). See also Kahn, supra note 23 (Oligopolists prefer to compete through product differentiation and/or advertising. They typically do not engage in price competition. Hence, monopolistic [and oligopolistic] prices tend to remain high, and potentially higher than marginal costs of production. What disturbs some critics is that airlines appear to be raising air fares by "consensus." Antitrust law prohibits executives from
The airline industry entered effective oligopoly (see "Concentration," infra, at VIII), was no longer subject to meaningful competition, and managed to control (i.e., rationalize)\textsuperscript{31} the market, and therefore, was no longer required to push for higher profits through increased load factors.\textsuperscript{32}

The industry returned to oligopoly, and airlines could raise their fares relatively unrestricted, especially on uncontested routes and at hubs where they were dominant. "Pricing behavior, once mandated, controlled, and monitored by the Civil Aeronautics Board, was replaced with price rigidity similar to that of the regulated era."\textsuperscript{33} By 1988, fares were being significantly increased.\textsuperscript{34} Dempsey determined that by 1989, airline ticket prices were at least 2.6\% above the level for which they were headed before deregulation.\textsuperscript{35} "While a 2.6\% increase would hardly qualify as price gouging,"\textsuperscript{36} it is 24.6 to 27.6\% higher than the prices expected from deregulatory policy.\textsuperscript{37}

The airline industry contends that although prices may have risen, 90\% of all passengers travelled on a discount.\textsuperscript{38} This may be deceiving, however, since full-fare fliers were paying substantially more for their tickets than they did with the advent of deregulation.\textsuperscript{39} Although not readily apparent nor easily quantified, discounted tickets have associated costs discussing prices, but as Kahn says, they are doing the same thing via the computer reservations systems.).

\textsuperscript{31} MAX WEBER, GENERAL ECONOMIC HISTORY 207 (1961) (The rational capitalistic establishment is one with capital accounting, that is, an establishment which determines its income yielding power by calculation according to the methods of modern bookkeeping and the striking of a balance); see also R. COLLINS, WEBERIAN SOCIOLOGICAL THEORY 22 (1986) (Rational in this sense means "calculability." "Rational capitalism" means that it is methodical and predictable).

\textsuperscript{32} E. Harraf and W. Cheek, Deregulation-Oligopoly to Oligopoly, Address Before the Airshow Canada Symposium (Aug. 8, 1989) (Harraf and Cheek argue that "high load factors to offset cost reductions no longer have the same importance to airlines where their ability to establish prices well above marginal costs can easily generate revenue sufficient to gain high returns.").

\textsuperscript{33} Id. at 10.

\textsuperscript{34} LAURENCE GESELL, AIRLINE RE-REGULATION 42 (1990).

\textsuperscript{35} Dempsey, supra note 2, at 26.

\textsuperscript{36} Deutsch, supra note 1, at 6 (Robert Aaronson’s response to Dempsey’s claim of a 2.6\% fare increase).

\textsuperscript{37} GENERAL ACCOUNTING OFFICE, REPORT TO CONGRESS, LOWER AIRLINE COSTS PER PASSENGER ARE POSSIBLE IN THE UNITED STATES AND COULD RESULT IN LOWER FARES 11 (Feb. 1977). See also D. Strassman, IMPACTS ON AIR FARES AND TRAFFIC, IN AIRLINE Deregulation: THE EARLY EXPERIENCE (Auburn House eds., 1981); R. Kane, AIR TRANSPORTATION 9-1 (1990) (The GAO reported that regulated fares exceeded estimated deregulated fares by 22 to 25\%).

\textsuperscript{38} Deutsch, supra note 1, at 6 (Robert Aaronson speaking for the Air Transport Association).

beyond the price of the ticket. For example, a passenger required to stay over Saturday to obtain a lower air fare incurs additional per diem expenses such as food and lodging. Or, with certain non-refundable tickets, failure to meet a departing flight, no matter how reasonable the cause, can result in greater cost than paying for a regular fare in the first place. The consumer not only forfeits the cost of the discounted ticket, but must then pay for another ticket as well — ostensibly at a higher price than before deregulation. Non-refundable tickets are part of the market rationalization process which has advantaged the airline company, but at the expense of the consumer. Uncertainty for the airlines is reduced by shifting the risk to the (individual) consumer, but risk-taking can have a price attached to it if the gamble doesn’t work out.

Moreover, irrespective of the volume of tickets that are discounted, a discount on a higher fare still amounts to a higher fare, and higher fares was not a goal of airline deregulation.

V. Competition

A third objective of airline deregulation was to rely upon “actual and potential” competitive forces in a marketplace with freedom of entry. Free entry was to produce many airlines in an openly competing market that would provide the traveller with variety, choice and “natural” prices.  

As the deregulatory era unfolded, airline deregulation did, in fact, produce an openly competitive market of new entrants intermixed with older, established carriers. The consumer generally benefitted from the competition, but the excess capacity of over-competing airlines, coupled with a recession in the early 1980s, proved devastating for most carriers. By 1984, however, the dominant carriers began to overcome the financial setbacks of the earlier years, and seemingly to overtake any advantages of the low fares, post-deregulation, carriers may have acquired.

Mergers are likely to occur during periods of market disequilibrium, and almost as if to model the economic ideal, airline consolidation began in earnest as the airline industry came out of the recession of the early 1980’s. By 1986, there was an escalated merging of airlines which markedly altered the state of competition and pricing strategies within the industry.

Even with consolidation, airline management still maintained that competition in the industry remained intense. But the “competition” they referred to was in terms of national and world market shares, not at the individual level within local airport markets, and certainly not the price

40. Smith, supra note 29, at 56.
competition of an open marketplace of many competing carriers.41

In the event actual competition were to become a non-reality, the fallback position of deregulatory proponents was upon the "contestable market" theory. Although not called "market contestability" as such, the theory goes back at least to Adam Smith,42 but the more contemporary theory of the contestable market was developed in the late 1970's and early 1980's43 As a revived theory, it became a premise used to help justify adoption of the deregulatory policy in transportation. The results of adopting the contestability theory, however, have shown there was a misplaced trust in its applicability. As Dempsey states, "a decade of empirical evidence strongly suggests that the premises upon which deregulation were predicated were erroneous."44

The contestable market assumption is that there are no significant economies of scale or barriers to entry. Because there are no barriers to entry, the market, even in the absence of actual competition, is threatened (i.e., contested) by a prospective new entrant. Hence, the market is expected to behave in a perfectly competitive way.

Deregulation proponents, and those who espoused the contestability theory, expected there would be freedom to move in and out of markets with minimal costs. They placed maximum reliance upon competitive market forces and on potential as well as actual competition. Assumed was that contestable markets would prevent unfair, deceptive, predatory or anticompetitive practices. However, anti-competitive developments in deregulated airline markets were inconsistent with, and generally invalidated, the contestable market theory45

For market contestability to have worked, four conditions had to be present: 1) there had to be no barriers to entry; 2) no economies of scale; 3) consumers had to be willing and able to switch carriers; and 4) existing carriers could not readily lower their cost and price structures to meet the

41. See J. MALDUTIS, AIRLINE COMPETITION AT THE 50 LARGEST U.S. AIRPORTS SINCE Deregulation (1987). See also Gesell, supra note 34, at 57-59 (Maldutis states that measures of concentration, based on nationwide industry data are almost meaningless. Gesell points out that the individual passenger cannot take advantage of competing services at the national level, but rather, accesses the system at a single airport where competition may be limited. This is especially the case where a passenger must access or exit the system at less than hub origins or destinations.).

42. Smith, supra note 29, at 67.

43. See generally, W. Baumol, et. al., CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE (1982). See also Dempsey, supra note 2, at 24-25. See also Gesell, supra note 34, at 44-45.

44. Paul Dempsey, Deregulation Has Spawned Abuses in Air Transport, AVIATION WK. AND SPACE TECH. 147 (Nov. 21, 1988).

The competition of new entrants. What happened, however, is that incumbent carriers wasted little time in learning to adapt to the new (deregulatory) environment.

The existing airlines set out to reduce competition by developing a variety of new (effectively predatory) programs designed to disadvantage potential rivals, and to tear down the foundations that made contestability work. They erected physical, informational, and capital barriers to entry; developed economies of scope and density; and imposed switching costs that made initial trial of the competitor’s services difficult or expensive. (see "Anti-Competitive Practice," infra, at VII).

The innovations implemented by the larger, surviving airlines sheltered them from competition. Fawcett and Farris contend it is this adaptive ability of the airlines that has fundamentally led to the recent controversy about the efficacy of airline deregulation.

The innovations implemented by the larger, surviving airlines sheltered them from competition. Fawcett and Farris contend it is this adaptive ability of the airlines that has fundamentally led to the recent controversy about the efficacy of airline deregulation.

The "variety of adequate, efficient and low-priced services" gave way to oligopoly and monopolistic competition. So, too, did the competitive market forces upon which proponents of the ADA placed "maximum reliance." By the close of the first decade of deregulation, free-market competition in the airline industry was nearly non-existent.

VI. SOUND REGULATION

Melton argues that adoption of a total deregulatory policy was from the outset a mistake. To think that one could have the stability, reliable service, and social allocations that prevailed before deregulation, and at lower rates, was simply fallacious. "Inefficient regulation," he says "is one thing, no regulation at all is quite another."

Weber probably would have rejected the idea of total deregulation in a modern capitalist state as completely absurd. The concept of total deregulation is the antithesis of what he called the "rationality of economic action" and the necessity of a system of calculable rules and procedures.

46. Stanley Fawcett & Martin Farris, Contestable Markets and Airline Adaptability Under Deregulation, 29 TRANSP. J. 12, 14 (Fall 1989).
47. Id. at 17.
48. Id. at 18 & 19 (Economies of scope refer to advantages that result from being involved in more than one type of activity or more than one market. Economies of density refer to advantages that result from greater utilization of available capacity.).
49. Id. at 20 (Three incentive based programs in particular — frequent flyer programs, progressive commissions for travel agents, and corporate discounts — made switching to a rival airline less attractive.).
50. Id. at 21.
52. MAX WEBER, THE THEORY OF SOCIAL AND ECONOMIC ORGANIZATION, 184 (1947).
A fourth goal of the Act was to develop and maintain a "sound" regulatory environment, but the concept of "total" deregulation was, from the outset, a contradiction to this goal. Competition leads naturally to instability in the marketplace. As Kahn\textsuperscript{53} submits, instability is the price that must be paid for competition.

It is difficult to determine from reading the Act, what the authors meant by "sound," but Webster's defines it as "free from error . . . and . . . undisturbed," which are certainly not terms to be used in describing the environment which evolved following deregulation. Rather, there was an apparent consumer revolt over the deterioration of air service. Service eroded and the variety of alternative choices vanished in the midst of mergers. Unreliable airline schedules, delays, cancellations and lost baggage caused intense consumer frustration. The environment was anything but "sound!"

Congress has subsequently found itself on the horns of a dilemma between equally unattractive alternatives. There is general discontent with the results of airline deregulation, but there is equal concern about potential re-regulation of the industry.\textsuperscript{54}

**VII. ANTI-COMPETITIVE PRACTICE**

A fifth goal of the Act was to prevent "unfair, deceptive, predatory or anticompetitive practices in air transportation." But this goal, like the goal of a sound regulatory environment, was perhaps doomed to failure from the beginning. The problem with antitrust law is in enforcement. Historically, antitrust has been difficult to define, therefore difficult to prove, and hence nearly impossible to enforce. Its enforcement would seemingly have required a diligence that has not been seen in recent practice. The Reagan administration seemingly never even tried to enforce antitrust law!

Nevertheless, as Morash\textsuperscript{55} and Kahn\textsuperscript{56} indicate, the airline industry may be naturally predisposed to predatory pricing and to other antitrust violations. In the Weberian\textsuperscript{57} perspective these "natural predispositions" are but part of the market rationalization process. Kahn\textsuperscript{58} argues that although the airline industry has oligopolistic tendencies, it fails to behave


\textsuperscript{54} Gesell, *supra* note 34, at 119.


\textsuperscript{56} Alfred Kahn, *Is It Time to Re-regulate the Airline Industry?*, 5 WORLD ECONOMY 341 (1982).

\textsuperscript{57} WEBER, *infra* note 31.

\textsuperscript{58} KAHN, *supra* note 56, at 343.
like an “intelligent” oligopoly. One factor that made pricing so destructive was motivated by what he calls “disciplinary intention,” which he characterizes as predatory in nature, whether intentional or not.

This predatory intent (which might be defined more aptly as greed) can lead to enlarging the airline company beyond its ability to provide efficient economic return. Although there may be no economies of scale in the airline industry, there do seem to be potential economies of “scope” (or size) which seemingly provided dominant carriers with anti-competitive market advantages. Most academic theorists have found no significant economies of scale in airline operations, and yet, for some reason the industry concentrated into what could be characterized as an oligopoly (see “Concentration,” infra, at VIII).

Active predation in many instances invalidated the contestability theory. What Thornton59 calls the “weapons of war” became a new form of predatory practice which was designed to reduce, if not eliminate competition. These possibilities suggest new and innovative antitrust implications, for which there are seemingly no remedies in the antitrust laws.60

To ward off the competition in what Thornton61 called a “war” among the carriers, the contestants developed as weapons of war a set of operating procedures and marketing tools such as complex discriminatory fare structures, the exercise of “exclusive” rights to limited airport and airspace facilities, computer reservations systems bias, frequent flier programs, alignments of majors with regional counterparts, and hub-and-spoke networks; of which, the latter was perhaps the most effective. These “weapons” became formidable barriers to competition, and opened the path to consolidation.

Given regulatory freedom the economy rights itself by way of natural economic laws. Excess competition may be reduced or eliminated, if not by expansion and growth of surviving companies, then by merger, which leads to the next goal of consideration.

VIII. ECONOMIC CONCENTRATION

A sixth goal of airline deregulation was to avoid “unreasonable industry concentration, excessive market domination and monopoly power.” What constitutes “unreasonable concentration” is not defined in the Act, but one can assume that “reasonable concentration” means something less than what it was before deregulation.


61. Thornton, supra note 59, at 381.
Functioning seemingly within the free enterprise paradigm,62 the Department of Transportation adopted a policy for ease of entry as a key factor in its analyses of potential anti-competitive effects in merger cases.63 Between 1985 and 1987, DOT approved 25 mergers with remarkably few restrictions. The result was to effectively reconcentrate the industry to pre-deregulation levels.

By 1987 year end, there were 31 scheduled air carriers serving the domestic market. Of those 31 carriers, 10 had cornered 88.2% of the market, with the top four carriers controlling 56.4%. The subsequent year reflected a similar pattern, although individual market shares had shifted amongst carriers, with the smaller of the top ten carriers slightly increasing their shares. By 1988, the top four carriers held 56.4% of the market and the top ten had increased their aggregate share to 90.1%.64

Added to the predominance of the top ten airlines, the alignment of regional (commuter) carriers with a major counterpart increased industry concentration, and the market shares of the dominant carriers (see "Small Carriers," infra, at IX). Mergers in air transportation approved by the (Reagan) Department of Transportation permitted the largest airlines to dominate passenger services at individual airports and at highly concentrated hubs.

Kahn submits that two of the "surprises of deregulation" were: (1) the reconcentration of the industry, and (2) the intensification of price discrimination and monopolistic exploitation.65 Fawcett and Farris,66 however, suggest that the airlines' ability to adapt to competition should have come as no surprise. The airlines "...merely performed as the policymakers had hoped they would — as rational and innovative decision makers responding to the incentives of the deregulated market environment."

IX. SMALL CARRIERS

The seventh goal of the Act was to encourage "entry into air transportation markets by new carriers. . .and the strengthening of small carriers so as to assure a more effective, competitive airline industry." It should be observed that this goal is closely associated with the eighth goal of providing essential air service (EAS) to small communities.

62. D. Berman, Consumerism and the Regulatory System: Paradigms of Reform, 1 Pol. STUDIES REV. 454 (1982) (In a continuum of consumer interests, the free enterprise paradigm is at one extreme. It assumes that there should be little, or no, intervention in the marketplace by government—that consumers are individuals responsible for their own actions).
63. DOT Officials Say Ease Of Entry Key To Merger Reviews, AVIATION DAILY, May 5, 1986.
64. Gesell, supra note 34, at 39-41.
66. Fawcett & Farris, supra note 46, at 21.
There was a concern, prior to deregulation, that if the certificated carriers were allowed freedom of exit from less lucrative markets, the smaller communities would be left without service. The government made a commitment in Section 419, "Small Community Air Service," of the Act, to ensure continued air service to these remote communities. As the larger carriers were expected to withdraw from less lucrative markets, the government shifted its reliance upon the smaller, third level, or "commuter," carriers to insure service would be provided to smaller communities.

As deregulation unfolded, many new airlines entered the marketplace, and the once "third level" non-certificated carriers were allowed to grow into the "regionals" of today, with some remaining non-certificated (14 C.F.R. Part 298 exempt) carriers, while others became fully certificated (under Section 401 of the Aviation Act). But as the market began to consolidate, market forces allowed the dominant major carriers to block competition from newcomers, and few post-deregulation carriers above the regional level survived.

By 1985, the independent regional airlines began losing their individual identities by forging marketing and scheduling links with the larger airlines. They changed their names and colors to show alignment with the larger carrier. And, like their major counterparts, the numbers of regional carriers diminished as well.67 As the smaller carriers lost their identity, they became increasingly dominated by the major carriers. With many being purchased outright and others franchised, the market became vertically, as well as horizontally integrated.

Ironically, the alignment of the commuters with the dominant carriers may have provided for more reliable service to small community markets where heretofore the (eighth) goal of "maintaining a comprehensive and convenient system of continuous scheduled airline service for small communities" failed. However, it does not represent the kind of competition envisioned in the deregulation act — the healthy competition of many carriers in a free market. Rather, the competition amongst these carriers was of the destructive (predatory) variety which resulted in fewer numbers and less variety for the consuming passenger.

X. SMALL COMMUNITY SERVICE

Kahn68 argues that "the year or two after deregulation witnessed many improvements in service, for towns in all size categories, as measured by the frequency of departures and the convenience of schedules." It is of note that he grounds his judgement of consumer convenience

67. Kahn, supra note 65, at 49.
68. Kahn, supra note 56, at 354.
upon "frequency" of service. Morrison and Winston\textsuperscript{69} argue in a like vein that deregulation had not contributed to a net loss of service to small communities. Rather, they submit that deregulation moved the industry closer to a socially optimal configuration of fares and service, "with the largest gains coming from further increases in departure frequency, particularly in low-density markets."

One need only look at the much-referred-to Bakersfield, California, market to see the results of deregulation upon small communities. Smaller, essential service communities were, on the aggregate, not so much better off. Nor were they provided, as the Act required, with "comprehensive, convenient and continuous" air service. And, Bakersfield is perhaps the best example to argue the point.

Frequency of departures says nothing about quality of service. Deregulation was a disaster for Bakersfield, particularly in terms of "continuous" service.\textsuperscript{70} In 1978 Bakersfield enplaned 147,844 passengers, but United pulled out soon after enactment of the deregulation act. In 1979, enplanements dropped to 95,212, with Swift Aire Lines and Golden Gate Airlines providing turbo-prop\textsuperscript{71} service. In 1981 Swift and Golden Gate (which by then had been merged) went into Chapter 7 bankruptcy. In 1982 enplanements dropped to 49,538, the lowest since deregulation. Service was restored by Pacific Express and Continental Airlines, and enplanements picked up again to 76,025 in 1984. Then Continental and Pacific Express went into Chapter 11 and service was terminated. For an interim period American and United both entered the market, but subsequently both left. In 1986 Continental returned, and by 1987 annual enplanements were back up to 136,607, but unfortunately Continental announced its withdrawal effective May 7, 1988. Bakersfield was left with three, turbo-prop-equipped airlines, each of which was a commuter aligned with a major carrier (American Eagle, United Express and Westair).

According to then Bakerfield aviation director, Larry Galindo, the Bakersfield population grew 30\% from 1978 to 1987, yet in 1987 air traffic growth (measured in enplanements) was 8\% less than ten years before. One could hardly call this "convenient" air service, nor "continuous" according to the historical pattern.


\textsuperscript{70} Telephone Interview with Larry Galindo, Aviation Director for Bakersfield Airport. "Deregulation has really been a mess for us." Statistics for Bakersfield were obtained via telephone (April 7, 1988).

\textsuperscript{71} Swift Aire Lines operated Fokker F-27 aircraft, and Golden Gate Airlines operated DeHavilland Dash 7 airplanes into Bakersfield. Each type of aircraft is capable of carrying 50 passengers or more. Hence, these were not "small" commuter airliners. Still, they were not jets and the market diminished.
Kihl\(^{72}\) found similar results in her study of the deregulatory impacts on air service to small mid-western (specifically Iowa) towns with respect to schedules, service levels and fares. The overall pattern she discovered was one of: (1) schedule changes, (2) turnover in carriers, and (3) variance in fare structure.

What Kihl found in the mid-west seemed to mirror national results. Where large and medium hubs experienced an increase in enplanements of approximately 36-38% between 1978-1984, small hubs increased only 8%, and non-hubs declined 9.7%\(^{73}\).

In an analysis of essential air service to eight Southeastern states after deregulation, Vellenga and Vellenga\(^{74}\) concluded substantiating results. The vast majority of communities experienced increased flight frequencies, but at the expense of fewer weekly seats as commuters replaced larger carriers. They reported the “negatives” outweighed the “positives,” and that the most common complaint was about the relatively high fares for the short-haul markets.

The initial impact of deregulation was to increase service to larger airports while effectively decreasing the quality of service at smaller airports.\(^{75}\) In general, deregulated service was neither reasonable nor convenient for small communities.

It was convenient only if one was able to pay the fare and willing to trade the comfort and security of jet service for the “frequency” of smaller, demonstrably less safe commuter (turbo-prop) service.\(^{76}\) But as Morash\(^{77}\) submits, the airline industry is “vested with a public interest in commerce, national defense, and safety.” Passengers at small communities have a right to expect a safe, “convenient system of continuous, scheduled airline service,” as provided for in the Airline Deregulation Act, and which they apparently were not receiving during what has been defined herein as the “deregulated era.”

XI. PROFIT

The ninth goal of the Act was to “encourage efficient and well-managed carriers to earn adequate profits and to attract capital.” This is the


\(^{73}\) Id. at 245.


\(^{75}\) Kihl, supra note 72, at 245.

\(^{76}\) See Nance, supra note 20, at 118-123; see also Paul Proctor FAA Increases Texas Air Investigation to Include Continental Airlines, AVIATION WK. AND SPACE TECH. 97-98 (April 25, 1988); DEP’T. OF TRANSP., TRANSPORTATION SAFETY INFORMATION REPORT: 1987 ANNUAL SUMMARY, DOT-TSC-RSPA-88-3 (1988).

\(^{77}\) Morash, supra note 55, at 253.
second mention in the Act of "efficiency," which, again, refers to the common law duty of a carrier to charge "reasonable" rates, or ideally what Adam Smith referred to as "natural" price, or that which would result in a world of perfect competition. In the real world of imperfect competition, however, price results from complex decisions based not only upon market demands but also corporate objectives.\footnote{See Martin Farris et al., MODERN MANAGERIAL ECONOMICS 413-15 (1987) (outlining an approach to "real world pricing").}

Airline deregulation and the simultaneous reduction of government economic enforcement may have ushered in a new generation of managers with a focus upon profit as their only organizational goal.\footnote{Gesell, supra note 34, at 79.} The editors of Aviation Week and Space Technology,\footnote{Keep the Sharks Out of Airline Waters, AVIATION WK. AND SPACE TECH., 19 (Aug. 1989).} for example, observed that airlines in the United States had been traditionally managed by "airline people" committed to safety and service, but that they were being replaced by "finance entrepreneurs," whose primary commitment was to the "bottom line." This dramatic change in who was running the airlines, they argued, could seriously damage the air transportation system.\footnote{Paul Dempsey, Robber Barons in the Cockpit: The Airline Industry in Turbulent Skies, 18 TRANSP. L.J. 1 (1990) (referring to the new generation of airline managers as "robber barons").}

By at least one definition of financial entrepreneurship, empirical evidence does, in fact, indicate the relative proportion of "finance-oriented" airline managers increased from 25% in 1978 to 55% in 1988.\footnote{Gesell, supra note 34, at 95-97.} Although the effect of the transition to more finance-oriented management is not altogether clear, industry concentration, discriminatory pricing, hostile takeovers, and leveraged buyouts were all potentially the result of an airline culture dominated by finance-oriented management.

After 1987, and before the onset of the current recession, the financial condition of the airlines improved dramatically.\footnote{See J. Maldutis, The Financial Condition of the U.S. Airline Industry at Year-End 1987 1 (1988); see also American Statistical Index (1978-1988) (Following the recession of the early 1980's, the major airlines began to profit once again in 1984, but had a relapse in 1985 and 1986. The financial condition of the airlines then improved significantly in 1987. By the year's end, the airline industry cash position reached an unprecedented $6.0 billion—a 66.9% increase over 1986. By 1988 [when the market had been effectively concentrated into oligopoly], fares were being significantly increased, and the domestic market produced a net income of $880.3 million. The total net income in 1988 for the major airlines was $1.6 billion, as compared to $509.2 million in 1987.).} However, profiting by the airlines occurred in ways unforeseen by the airline deregulators. By 1987 the airlines were effectively concentrated more than before deregulation! Hence, the short-lived airline profitability was attributable more to concentration and market rationalization by the airlines than to deregulatory policy.
Although seemingly signalling a degree of success for this final goal of the Act, these profits did not come from the allocative efficiency of a highly competitive market, nor the economic efficiency of higher load factors. They were generated principally in two ways. First by raising fares uncontested, if not cooperatively. Second, and more importantly, profits were generated by adoption of new income tax guidelines allowed as the result of certain transitional rules contained in the Tax Reform Act of 1986 which provided windfall profits for some companies.

Nevertheless, the airlines were reportedly still below average when compared to U.S. industry overall. The average for U.S. industry profits in 1988 was 5%, while airline earnings were only 2-3%.

Recession beginning in 1990, and the inflated fuel costs attributed to the Persian Gulf crisis caused severe economic downturn in air transportation which signalled the likelihood of even more concentration. Concerns of industry analysts and of Congress pointed to the potential dangers of the high operating ratios that were the result of excessive debt incurred through leveraged buyouts, and which financially weakened a number of the major airlines. Suggested was that a prolonged recession could cause severe economic downturn in air transportation and the potential demise of key airlines. As it turned out, the recession did not have to last long. By early 1992, Eastern, Midway and Pan American Airways had ceased operations. And, America West, Continental and Trans World Airlines had filed for Chapter 11 protection.

XII. SUMMARY

As measured against the stated objectives of the Act, deregulatory policy failed to measure up to its obligations to the consumer. Identified in the Act are at least nine normative, mostly consumer-oriented goals, of which, the first and foremost objective was safety. The government was to maintain "safety as the highest priority in air commerce." Instead, the safety margin seemingly eroded.

The government was to make available "a variety of adequate, efficient, and low-priced services by air carriers." And initially there was a variety of airlines to choose from, each offering competitive prices, but the...

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84. High-Speed Changes Send Fares Up, Up, USA Today, Nov. 18, 1988 (Article references Alfred Kahn. Airlines enjoy unparalleled access to competitor's prices through computer reservation networks, the use of which seems tantamount to collectively setting prices. As Kahn remarks, "I don't see how this form of electronic consultation differs from meeting in a hotel room. Where you have a mechanism for trying...[a higher fare] in advance before trying it out in public seems indistinguishable from collusion.").
85. Gesell, supra note 34, at 69.
86. Kahn, supra note 84.
87. Gesell, supra note 60, at 195.
quality of service declined as managers continued to utilize low fares as their principal competitive tool.\textsuperscript{88} Consumer complaints began to mount until the industry was threatened with retaliation from Congress. Service related consumer complaints subsequently subsided, but the industry has been arranged to the airlines’ advantage and service related complaints have been replaced with concerns about rising air fares and lack of competition.

The government was to place “maximum reliance on competitive market forces and on actual and potential competition.” However, as the airlines became increasingly threatened financially by intense competition and the effects of economic recession in the early 1980s, the government shifted its reliance from “actual” to “potential” competition and relied almost exclusively upon the contestable market theory as it simultaneously authorized mergers which reduced real competition and effectively barred access to any potential new entrants.\textsuperscript{89}

The government was to develop and maintain “a sound regulatory environment.” But open competition leads to instability, and a market absent rules and regulations is, by definition, “non-rational.” The “totally” deregulated industry was anything but sound!

The government was to prevent “unfair, deceptive, predatory or anticompetitive practices in air transportation.” However, government not only underestimated industry’s ingenuity,\textsuperscript{90} but also its resolve to rationalize its economic environment. An array of unexpected “weapons”\textsuperscript{91} were drawn from airline company arsenals to combat competition.

The government was to avoid “unreasonable industry concentration, excessive market domination, and monopoly power.” Instead, the government allowed the industry to consolidate and to become even more concentrated than before deregulation, thus permitting the largest airlines to dominate passenger services at individual airports and at highly concentrated hubs.

The government was to encourage “entry into air transportation markets by new carriers . . . and strengthen small carriers so as to assure a more effective, competitive airline industry.” Instead, the government’s approval of mass consolidation allowed for fewer and larger airline companies, and the government seemingly advocated the horizontal and vertical integration of the industry. Large carriers merged, and rather than strengthening small carriers, the government sat idle while weaker com-

\textsuperscript{89} \textit{See} Levine, \textit{supra} note 45.
\textsuperscript{90} \textit{Id}.
\textsuperscript{91} \textit{See} Thornton, \textit{supra} note 59; \textit{see also} Levine, \textit{supra} note 45.
muters either ceased operating or were acquired by their dominant regional competitors.

The government was to maintain a "comprehensive and convenient system of continuous scheduled service for small communities." Instead, the promise of greater "frequency" of service brought with it disruptions in service and higher costs. Air carrier service to small communities was neither "continuous" nor "convenient" according to the historical pattern across the country.92

Finally, the government was to "encourage efficient and well-managed carriers to earn adequate profits and to attract capital." By extracting itself from the regulatory process, the government openly invited market rationalization and a simultaneous shift in management styles from a professional to a finance orientation.

Rather than creating a successful financial environment, deregulatory policy nurtured the conditions necessary for the self-destruction of all but a few of the remaining, elite survivors. The thin profit margin (i.e., 2-3%), coupled with high operating ratios, alarmed industry analysts who had predicted with accuracy that the heavily leveraged buyouts of the major airlines between 1985 and 1987 could severely hurt service, safety and fares — and dramatically if there were a prolonged recession.93

XIII. CONCLUSION

The Airline Deregulation Act was intended to correct the inadequacies of economic regulation, and the ideal of deregulation in air transportation was consumer advocacy. However, following centuries of regulation it seems, in retrospect, presumptuous to have thought that economic regulation could have been totally reversed overnight. Complete deregulatory policy failed to achieve its goals and, in only one decade, the "winds of change" were once again signalling the call for a change in "philosophy."94 But as Farris95 explains, while a policy may completely reflect the "philosophy" of regulation, the same policy does not always work out in practice to attain the goals desired by society. When this has been the case, society, acting principally through the United States Congress, has amended the regulatory laws or passed new regulation designed to once again attain the goals at a particular time.

"Re-regulation: dare we speak it," asks Dempsey.96 In response,

92. See Vellenga, supra note 74, at 48; see also Kihl, supra note 72.
96. Dempsey, supra note 2, at 46.
the answer is a resounding yes, but few would want to return to the tight-fisted regulation of before. The "politics" seemingly call for an altogether new model, or at most, a modest legislative agenda of regulatory reform and "light-handed" economic regulation.\(^7\)

\(^7\). *Id.* at 47, 50-59; *see also* Gesell, *supra* note 10, at Chapter 4 (Dempsey states that there are but four alternative regulatory strategies available, and suggests that a "modest legislative agenda" might put the airlines back on course. Gesell offers yet another solution. By re-defining "social regulation," he envisions an altogether new regulatory model of consumer advocacy that is conceptually grounded in the evolution of strict liability, modelled after worker's compensation, and undergirded by law that moves from the repressive to the restitutive.)
The State of the Airline, Airport & Aviation Industries*

Paul Stephen Dempsey**

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Airlines were among the first of the major infrastructure industries to be deregulated, with the promulgation of the Airline Deregulation Act of 1978. In that legislation, Congress took the unprecedented step of sun-
setting a major regulatory agency — the Civil Aeronautics Board, which had been established four decades earlier.

Beginning in the Carter Administration, and perfected to an art form in the Reagan Administration, federal oversight of industries as diverse as airlines, buses, railroads, trucking, telephones, cable t.v., radio and t.v. broadcasting, banking, savings and loans, and oil and gas was significantly trashed. The virus of deregulation was politically contagious.

The means applied to transform and radically shrink government proceeded along two planes, sometimes independently. Congress passed major legislation mandating various forms of deregulation between about 1976 and 1985, while successive Presidents appointed free market ideologues to the regulatory agencies with the mission essentially to exceed their legislative mandates and ignore their oaths of office.

The laissez-faire economists who convinced Congress to promulgate the Airline Deregulation Act of 1978 promised that deregulation would result neither in increased concentration nor destructive competition. This was true, they insisted, because the industry was structurally competitive, possessed few economies of scale, and was impeded by few barriers to entry. But compare those predictions and assurances with the unfortunate results of deregulation:

• Under deregulation, the airline industry lost all of the money it made since the Wright Brothers' inaugural flight at Kitty Hawk in 1903, and $1.5 billion more.
• After more than 150 bankruptcies and 50 mergers, we now fly the oldest and most repainted fleet of aircraft in the developed world.
• In 1991, fully 30% of the nation's fleet capacity was in bankruptcy or close to it.
• Of the 176 airlines to which deregulation gave birth, only one remains (America West) and sadly, it too, is in bankruptcy.
• United, American, Delta and Northwest now control about two-thirds of the market, up from 53% just four years ago. And those figures do not include the 4% handled by Pan Am before its death, to be divided between United and Delta. This is an unprecedented rate of concentration.
• All the U.S. airlines together are now worth less on Wall Street than Japan Airlines, individually, is worth on the Nikkei.
• Despite predictions to the contrary, deregulation has produced the highest level of national and regional concentration in history.
• Although more people are flying than ever before, the percentage increase in domestic airline passenger enplanements was lower during the first decade of deregulation than in every decade which preceded it.
• While most passengers now fly on a discounted ticket, the full fare
has risen sharply under deregulation, more than double the rate of inflation. The discounts are now encumbered with onerous prepurchase, nonrefundability and Saturday-night-stay-over restrictions. They are therefore an inferior product to the passenger flexibility offered under regulation.

- Despite allegations to the contrary, average real fuel-adjusted ticket prices are higher than they would have been had the pre-deregulation trend continued. Pricing has not only increased above pre-deregulation trend levels, it has grown monstrously discriminatory.

- For example, it recently cost less to take a taxi than fly from St. Louis to Kansas City, for the 90 cent a mile cab fare was lower than the $1.00 a mile plane fare. It cost less to take a bus from Atlanta to Birmingham, and there catch a flight to Atlanta and connect on to New Orleans, than it cost to fly from Atlanta to New Orleans nonstop.

- Industry costs increased sharply under deregulation, while the long-term trend in productivity improvements fell flat.

- Hubbing-and-spoking, the dominant megatrend on the deregulation landscape, has caused air travel in some markets to regress back to the DC-3 era, robbing aviation of its inherent advantage and man’s most precious commodity — time.

- Business travelers lose billions of dollars in productivity as a result of circuitous and time-consuming hub-and-spoke operations.

- Under deregulation, service has declined, while consumer fraud has increased.

- Although fatality statistics do not reflect it (thank God), the margin of safety has also declined.

- Labor-management relations have deteriorated.

- Americans now rate airlines as the industry with which they have least confidence.

Neither economic nor equity goals have been advanced by deregulation. The assumptions upon which it was based — that there were few scale economies in aviation; that destructive competition in this industry was unlikely; that “contestability” of markets (the purported ease of potential entry) would discipline pricing — the three legs of the theoretical stool — have proven false. Remarkably, despite the disintegration of the intellectual foundation of deregulation, its proponents swear the thing works.

Deregulation is a rather peculiar phenomenon. Its most fervent proponents continue to embrace it, not merely as an abstract economic theory, but with political, almost theological, devotion. No matter what evidence is adduced of widespread failure (and there is plenty), they tenaciously insist such evidence can be reinterpreted as success. Some
go so far as to assert that its failures can be attributed to a belief that we didn't deregulate enough.

The free market, laissez-faire movement has earned a special place in history. Not since the Bolshevik Revolution has the discipline of economics embraced an ideology with such passion.

With the collapse of Marxism in eastern Europe, no advocate of responsible public policy today advocates that government should apply command economy-type restrictions over price and supply. But some, including this author, do believe the appropriate level of government oversight for this critical infrastructure industry lies somewhere between the regulatory regime established for airlines in 1938, and the contemporary environment of laissez-faire market Darwinism.

II. THE HISTORY AND METAMORPHOSIS OF AIRLINE REGULATION AND DEREGULATION

A. INTRODUCTION

Aviation is among the most profound of man's technological accomplishments. Like no other invention, it collapses the time/space continuum. Aviation shrinks the planet, intermingling the world's cultures and economies. It is an integral part of the infrastructure essential to commerce, communications and national defense. Aviation is mobility for the human race, facilitating travel and tourism, and the world's largest single industry.

In October 1902, a couple of bicycle repairmen, Wilbur and Orville Wright, began to design the world's first motor driven airplane. Men had flown in balloons for decades, but the Wright brothers had something quite different in mind. On December 17, 1903, at Kitty Hawk, N.C., they successfully launched their oddly shaped vehicle into the air, and the world has never been the same since.

B. THE EARLY AIRLINES, FEDERAL SUBSIDIES AND AIR MAIL REGULATION

From its inception, the airline industry has been perceived as having tremendous potential as a catalyst for economic growth, and an essential means for facilitating communications and national defense. Early on, the U.S. government recognized its potential to serve the needs of a growing nation. As a consequence, our federal government has been active in promoting and encouraging its growth and development from the outset.

The government's responsibility to carry the mail as an essential means of communications was recognized by the framers of the U.S. Constitution, and embraced by that document. The compelling need for

1. PAUL DEMPSEY, LAW & FOREIGN POLICY IN INTERNATIONAL AVIATION 1 (1987).
expeditious mail service led the Post Office Department to develop the Pony Express, and to employ advanced technology as it emerged, beginning with the railroads.

The United States air transport industry owes its initial development to subsidies for carriage of the mail. As we shall see, the route structures of the largest airlines — United, American, TWA and Eastern — were largely the product of air mail contracts awarded by the Post Office Department in the 1920s and 1930s. Passengers rode on top, while mail was carried in the belly of aircraft.

Air mail service was inaugurated by the Army in 1918, on a route from New York to Philadelphia to Washington, D.C.\(^2\) By 1920, transcontinental route from Hazelhurst Field, N.Y., to San Francisco, Calif., had been established.\(^3\) By 1924, the Post Office Department had constructed nearly 2,000 miles of lighted airways, allowing pilots to make regular transcontinental night flights.\(^4\) The first pilots were daredevils; sadly, 31 of the first 40 pilots in airmail service died in crashes.\(^5\)

By the mid-1920s, Congress decided to privatize the carriage of mail. The Kelly Act (Contract Air Mail Act of 1925)\(^6\) authorized the Postmaster General to award contracts for the carriage of mail to private carriers.\(^7\) This marked the beginning of a viable private airline industry in the United States.\(^8\)

The first five contracts were awarded to National Air Transport, Varney Lines, and Pacific Air Transport (all of which subsequently joined the United Air Lines system), Colonial Air Lines (later to become an important part of American Airlines), and Western Air Express (which would be merged into the TWA system).\(^9\) The first air mail contracts established the route structure which would dominate air service for decades to come.

The Air Commerce Act of 1926\(^10\) vested jurisdiction over safety and maintenance of airways, airports and air navigation facilities in the Secretary of Commerce.\(^11\)

4. LOWENFELD, supra note 2, at I-2.
8. BOYNE, supra note 3, at 126.
9. LOWENFELD, supra note 2, at I-2.
11. DEMPESEY & THOMS, supra note 7, at 26-27.
In fact, federal regulation of aviation safety owes its genesis to the Air Commerce Act of 1926, which established a special investigation division in the U.S. Department of Commerce and gave the Secretary of Commerce power to investigate and publicize air navigation accidents. With promulgation of the Civil Aeronautics Act of 1938, Congress established the Civil Aeronautics Authority (subsequently renamed the Civil Aeronautics Board), and created therein an Air Safety Board with jurisdiction to investigate accidents, determine probable cause, issue reports, and recommend additional safety measures. These powers were augmented by the Federal Aviation Act of 1958.

With the creation of the U.S. Department of Transportation in 1966, Congress established therein an independent National Transportation Safety Board [NTSB], giving it power to conduct investigations and hold hearings to determine "the cause or probable cause of transportation accidents and reporting the facts, conditions, and circumstances relating to such accidents." The NTSB became truly independent and effectively autonomous from DOT with the Independent Safety Board Act of 1974.

After Col. Lindbergh crossed the Atlantic in the Spirit of St. Louis in 1927, the industry enjoyed explosive growth. Even the stock of Seaboard Air Line, a southeastern railroad, experienced an unprecedented increase because of speculators' belief that it was somehow connected to aviation.

The McNary-Waters Act of 1930 established a formula for air mail payments based on the amount of mail transported. But Postmaster General Brown wanted to create a few large competing transcontinental airlines. Rather than determining the issuance of routes on the basis of competitive bidding, they were actually determined at secret meetings in May and June of 1929 — later called "spoils conferences" — of airline executives with Postmaster General Brown. He also encouraged mergers and consolidations of smaller airlines into larger, consolidated companies.

As a consequence, Northwest Airways served the northern tier states, though it lacked a transcontinental route. United Air Lines (organ-
ized in December 1928) obtained control of National Air Transport, Boeing Air Transport, Varney Air Lines, and Pacific Air Transport, giving it a route system extending from New York to Chicago to San Francisco, and north and south along the Pacific coast. Transcontinental and Western served the central United States, from New York to California via St. Louis and Kansas City. Eastern (then affiliated with Transcontinental) served the principal north-south routes, although United also had a route from Chicago to Texas.

Congressional discontent with the administration of the McNary-Waters Act led to an investigation of these practices by a special Congressional committee chaired by Senator Hugo Black. The revelations of this investigation convinced President Franklin Roosevelt to terminate all existing air mail contracts on the grounds that there had been collusion between the airlines and the Post Office Department in route and rate establishment. He directed the Army Air Corps to transport the mail. A series of tragic crashes, killing about a dozen Army pilots, proved that the Army was inadequately trained in air navigation, inclement weather and night flying, and that the private carriers were technologically proficient.

Congress responded by passing the Airmail Act of 1934 (Black-McKellar Act), which authorized the new Postmaster General to award mail contracts on the basis of competitive bidding (usually on an exclusive basis for a particular route). The system was to be comprised of four transcontinental routes, and an eastern and western coastal route. The legislation prohibited financial interests by airlines in other aviation companies, holding companies, and interlocking directorates. After the initial contract term, postal rates were set by the Interstate Commerce Commission [ICC]. Also beginning in 1934, federal funds became a primary source of airport funding.

C. GENESIS OF THE U.S. CIVIL AERONAUTICS BOARD

The 1934 Act also established a Federal Aviation Commission [FAC]
to study the entire field of aviation and report to Congress.\textsuperscript{32} The FAC submitted 102 recommendations on January 30, 1935. It contended that the orderly development of air transportation required two fundamental ingredients. First, in the interest of safety, certain minimum standards of equipment, operating methods and personnel qualifications should be maintained. Second, "there should be a check in development of any irresponsible, unfair, or excessive competition such as has sometimes hampered the progress of other forms of transport."\textsuperscript{33}

When the Great Depression broke, airlines were in their infancy. Congress was confronted with a national economic disaster, one which had hit the infrastructure industries particularly hard. Congress held hearings 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.\textsuperscript{34} Demand for air services had softened significantly during the Great Depression, and 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 50 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.\textsuperscript{35}

\textsuperscript{32} W. Jones, Regulated Industries 732 (1972).
\textsuperscript{34} Paul S. Dempsey, The Rise and Fall of the Civil Aeronautics Board — Opening Wide the Floodgates of Entry, 11 Transp. L.J. 91, 97 (1979).
\textsuperscript{35} Civil Aviation and Air Transport: Hearings on S. 3659 Before the Subcomm. on Interstate
Not only had private entrepreneurs invested considerable capital in the airline industry, but the federal and local governments had as well. That investment needed protection.\(^\text{36}\) In order to avoid the deleterious impact of competition described with pejorative adjectives such as "intensive," "extreme," "destructive," "cutthroat," "wasteful," "excessive," "unbridled," and "unrestrained," 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.\(^\text{37}\)

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.\(^\text{38}\) 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."\(^\text{39}\)

The FAC recommended an independent agency be vested with jurisdiction to regulate airline entry, rates, service, consolidations and government subsidies. President Roosevelt preferred vesting these powers in the existing transportation regulatory agency, the ICC, which had been established in 1887 to regulate the railroads, and whose jurisdiction had been expanded in 1935 to regulate the motor carriers and busses.\(^\text{40}\) But the industry feared that the ICC would protect the interests of the railroads, which were the dominant passenger carriers of the day, and sought creation of their own aviation regulatory agency.

Three years after motor carriers were brought under the regulatory umbrella, Congress added airlines to the regulatory scheme, promulgating the Civil Aeronautics Act of 1938. In so doing, Congress created a new regulatory body to regulate this industry, the Civil Aeronautics Board.

\(^{\text{36}}\) Dempsey, supra note 34, at 102.

\(^{\text{37}}\) Id. at 95-97.

\(^{\text{38}}\) Id. at 96 n.11.

\(^{\text{39}}\) Regulation of Transportation of Passengers and Property by Aircraft, Hearings on S. 2 and S. 17 Before a Subcomm. of the Senate Comm. on Interstate Commerce, 75th Cong., 1st Sess. 67 (1937) (statement of Joseph Eastman), quoted in Dempsey, supra note 34, at 100.

[CAB], folding into it the existing Bureau of Air Commerce and the Bureau of Air Mail. Like so many agencies created to engage in economic regulation, the CAB was modeled after its older sibling, the ICC.

The agency was a relatively small institution by Washington standards, comprised of five members (no more than a simple majority of whom could be members of a single political party) appointed by the President with the advice and consent of the Senate, for staggered terms of office. It was given jurisdiction over three major aspects of airline operations: (1) entry (where a carrier could fly), (2) rates (what it could charge), and (3) antitrust and business practices. Additional powers conferred over such things as subsidies, consumer protection and, initially, the establishment and maintenance of airports and airway navigational aids. But there were many significant aspects of airline operations over which it had no jurisdiction, including scheduling frequency, type of aircraft, or level of service.

The governing legislation encouraged the CAB to take several goals into account:

(a) The encouragement and development of an air-transportation system properly adapted to the present and future needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense;

(b) The regulation of air transportation in such manner as to . . . assure the highest degree of safety in, and foster sound economic conditions in, such transportation . . . ;

(c) The promotion of adequate, economical, and efficient service by air carriers at reasonable charges, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices; [and]

(d) Competition to the extent necessary to assure the sound development of [the] air-transportation system . . . .

D. REGULATION BY THE U.S. CIVIL AERONAUTICS BOARD

The CAB began by "grandfathering" in the existing airlines, or stated differently, issuing certificates of public convenience and necessity authorizing operations commensurate with the incumbents' existing operations (most of which were coterminous with their outstanding air mail contracts). In its first full year of operation, the CAB issued certificates of public convenience and necessity to 16 carriers:

41. The agency was initially named the Civil Aeronautics Authority. HARDWAY, supra note 31, at 13.

42. HARDWAY, supra note 31, at 13.


44. James W. Callison, Airline Deregulation — A Hoax?, 41 J. AIR L. & COM. 747, 758 (1975). Many, of course, had disappeared or merged with surviving airlines because of an inability to sustain profitability. Id.
American
Braniff
Chicago & Southern (subsequently merged with Delta)
Colonial (subsequently merged with Eastern)
Continental
Delta
Eastern
Inland (subsequently merged with Eastern)
Mid-Continent (subsequently merged with Braniff)
National
Northeast
Northwest
Penn Central (name changed to Capital; merged with United)
Transcontinental and Western (name changed to Trans World Airlines)
United
Western

The federal regulatory regime, coupled with subsidies, brought stability to this important industry which had been so plagued by economic losses. But soon America entered World War II, and much of her civilian fleet was dedicated to military service.

After the War, the CAB began to authorize "local service airlines" to provide feeder service to the "trunks" (grandfathered long-haul carriers) at regional gateways. Eventually, these local service carriers would grow to become regional airlines, with CAB authorization of their entry into denser and more lengthy routes beginning in the 1960s, competing with the trunk airlines.\(^{45}\) By 1972, there were nine such carriers: Allegheny, Air West, Hughes, Frontier, North Central, Ozark, Piedmont, Texas International and Southern.\(^{46}\)

Several thousand air taxis (originally termed "small irregular carriers") were also exempted by the CAB.\(^{47}\) Commuter airlines (which flew aircraft seating no more than 19 passengers, later 60 passengers) were exempted.\(^{48}\) This expanded service geographically and added a new group of airlines to the system. Between 1939 and 1975, the Civil Aeronautics Board certificated some 86 new airlines to compete with the 16 original carriers, and exempted thousands more from the certification re-

\(^{45}\) TRANSPORTATION RESEARCH BOARD, supra note 5, at 26.
\(^{46}\) Id. at 27; LOWENFELD, supra note 2, at I-17.
\(^{47}\) By 1971, more than 3,500 air taxis served the United States. LOWENFELD, supra note 2, at I-17.
\(^{48}\) TRANSPORTATION RESEARCH BOARD, supra note 5, at 27.
requirements. In addition, several intrastate airlines existed exempt from CAB requirements, including Southwest, Pacific Southwest, Air California and Air Florida.

In the 1950s, new generations of turboprop, then jet, aircraft spurred efficiency, productivity and speed, thereby reducing prices to consumers, while enhancing the margin of safety. Military research and development was a catalyst for technological development, for the World Wars had exhibited their proficiency at delivering bombs and soldiers. Each generation of aircraft was superior to its predecessor in its abilities and its economics. In the 1960s, airlines became even faster and more economical.

The Civil Aeronautics Act was recodified and restructured by the Federal Aviation Act of 1958, which spun off the navigation and safety responsibilities of the CAB into the newly created Federal Aviation Administration [FAA], originally a subsidiary of the U.S. Department of Commerce, and with the creation of the U.S. Department of Transportation [DOT] in 1966, a subsidiary of it. The accident investigation and recommendation responsibilities of the CAB was transferred to the FAA initially, and was redelegated to the National Transportation Safety Board, made independent in 1974. The CAB retained its jurisdiction over economic regulation of the nation’s airlines, and was split off from the Commerce Department.

Under economic regulation, America enjoyed the world’s finest system of air transport, one envied by every other nation. The time and space continuum, and indeed, the planet, was shrinking. Service and safety were improving. When adjusted for inflation, prices were falling. By the early 1970s, the industry was in a state of crisis. Excessive investment in wide-bodied aircraft (B-747s, DC-10s and L-1011s) had created excessive fleet capacity. That was coupled with an economic recession that suppressed passenger demand, as well as a fuel crisis stimulated by the Arab Oil Embargo of 1973. These events converged to create severe financial turbulence for the industry. The CAB believed that only a stiff dose of regulatory medicine would save the industry from disintegration.

In the early 1970s, the CAB took a number of steps to shore up the economic health of the airlines and avert catastrophe. First, the CAB implicitly entered a “route moratorium”, during which not a single new route application was granted. Second, the CAB allowed a number of major

49. Callison, supra note 44, at 758. These 86 include U.S. firms given scheduled or supplemental authority to enter domestic, territorial and international markets. Id. at n.36.
51. See Lowenfeld, supra note 2, at 1-15.
52. Hardaway, supra note 31, at 19, 21.
53. Id. at 18.
54. Dempsey, supra note 34, at 115.
carriers to enter into capacity limitation agreements whereby the number of aircraft flown in major markets was reduced.\textsuperscript{55} Third, the major international carriers, Pan Am and TWA, were allowed to swap routes, with TWA exiting the transpacific market, and Pan Am ceding southern Europe.\textsuperscript{56} Finally, the CAB imposed rigid pricing regulation.

Thus, the pendulum was pulled sharply toward greater governmental involvement in the airline market. This would be perceived as an anti-consumer movement and opposed by the antitrustors. Sir Isaac Newton noted that for every action, there is an equal and opposite reaction. The pendulum of public policy, having been pulled so sharply toward the regulatory end of the spectrum, would soon come roaring back in the other direction.

\textbf{E. THE POLITICS OF DEREGULATION}

Let us step aside for a moment and point out that regulatory reform and deregulation are not the same thing, although the political movement for the former probably served as a catalyst for the latter. But regulatory reform, as originally conceived, consisted of a modest political agenda for improvement of the regulatory process. There were valid criticisms of government which demanded relief. It was argued that government had become bloated, fat and lazy. Agencies were headed by political cronies rather than professional managers. Lethargy snuffed out innovation. The time and resources expended in complying with the regulatory labyrinth were excessive, as were the costs to taxpayers.\textsuperscript{57} The agencies had allegedly been “captured” by the industries they regulated.\textsuperscript{58} The regulatory reform movement, on the whole, seemed to appreciate the important public benefits that government was performing, but advanced a belief that the governmental function could be performed better, more expeditiously and economically. The regulatory reform movement focused largely on means. It called for greater regulatory flexibility to allow the industry to respond to market forces.

In contrast, the deregulation movement focused largely on ends. Deregulators wanted the very heart of the regulatory function amputated from the body politic, and free-market economists provided the intellectual cannon fodder, insisting that airlines were not public utilities, as they

\begin{footnotesize}
\begin{enumerate}
\item[55.] \textit{Id.} at 117-18.
\item[56.] See Paul S. Dempsey, \textit{The International Rate and Route Revolution in North Atlantic Passenger Transportation}, 17 \textit{COLUM. J. TRANSNAT'L L.} 393 (1978).
\item[58.] \textit{Id.} at 27.
\end{enumerate}
\end{footnotesize}
had been commonly perceived.59

The generation of Americans who grew up during the Great Depression and World War II, saw government as an essential companion — a mechanism for achieving greater social good, protecting the country from threats without and within. For most Americans, the Depression shattered confidence in the theory of laissez faire. But the generation which grew up in the 1960s and 1970s grew up cynical, perceiving government to be a malignant sore. Those on the left abhorred Watergate and the war in Vietnam. Those on the right were offended by the Great Society and high taxes. Both converged on a common path that viewed government with some hostility. That provided the foundation for a bipartisan political movement supporting radically less government.60

In the 1960s and 1970s, a number of economists also published literature critical of economic regulation. They criticized the CAB as being captured by the industry it regulated. Said George Stigler, "every industry or occupation that has enough political power to utilize the state will seek to control entry."61 They argued that regulation had made air transport more expensive than it need be, and that the level of service, although exemplary, was excessive.62 Principal among their criticisms was that pricing and entry restrictions gave consumers excessive service and insufficient pricing competition, inflated airline costs, and thereby made the industry's profits unsatisfactory.63 Deregulation would give consumers the range of price and service options they preferred, casting dollar votes of approval to firms which satiated their wants, as Adam Smith's invisible hand did its work. The market would define not only the dividing lines between price and service, but also how many and which


The Ford Foundation plopped $1.8 million on the Brookings Institution between 1967 and 1975 to study economic regulation, and virtually all of the free-market literature which emanated from it found cause for deregulation. After the Ford money dried up, the emerging right-wing Washington think tanks picked up the gauntlet, including the American Enterprise Institute. MARTHA DERTHICK & PAUL J. QUIRK, THE POLITICS OF DEREGULATION 36-37 (1985).

60. Dempsey, supra note 40, at xv.


airlines would serve individual city-pair markets.64

But the industry was hardly devoid of competition. By the early 1970s, nearly 80% of the nation's scheduled passenger traffic was already competitively served, and in many markets, multiple carriers had been certificated.65 Although the big four airlines (i.e., United, American, TWA and Eastern) controlled 82% of the market in 1938, their share declined to 68% by 1950, 66% in 1960, and 62% in 1970.66 By 1978, the market share of the top four had fallen to 59%.67 Although pricing competition was somewhat constrained, airlines were free to compete in terms of schedules, equipment, capacity and facilities in response to consumer choices.

On Capitol Hill, the opening salvo was fired by Teddy Kennedy in hearings he conducted as Chairman of the Senate Judiciary Subcommittee on Administrative Practice and Procedure.68 These hearings served as the political genesis of Congressional reform, jumping the gun on bills pending before the Senate Commerce Committee, the committee which actually had appropriate subject matter jurisdiction.69 Kennedy began the hearings by saying, "Regulators all too often encourage or approve unreasonably high prices, inadequate service, and anticompetitive behavior. The cost of this regulation is always passed on to the consumer. And that cost is astronomical."70

After extensive hearings in 1974 and 1975, the Kennedy staff released a comprehensive report on the Subcommittee’s behalf. The Kennedy Report concluded that deregulation would allow pricing flexibility which would stimulate new innovative service offerings, increase industry health, allow passengers the range of price and service options dictated by consumer demand, enhance carrier productivity and efficiency, and

64. See Dempsey, supra note 34, at 122.
66. See LOWENFELD, supra note 2, at l-21.
67. It would fall to 56% by 1983. Hardaway, supra note 62, at 143 [citation omitted].
68. Kennedy had been persuaded by subcommittee counsel Stephen Breyer that airline regulation was ripe for attack on behalf of consumers. DERTHICK & QUIRK, supra note 59, at 40. Breyer had previously been a Harvard Law Professor, and Brookings had published his book calling for natural gas deregulation. STEVEN G. BREYER & PAUL W. MACAVOY, ENERGY REGULATION BY THE FEDERAL POWER COMMISSION (1974). Breyer would go on to become a federal judge; but for the moment, airline deregulation was his crusade, and the Civil Aeronautics Board was his enemy. Jurisdictionally, it was an odd thing for a Judiciary subcommittee to take up airlines or their regulation, for there was an aviation subcommittee already established under the Senate Commerce Committee chaired by Howard Cannon. Nevertheless, Kennedy charged ahead.
69. Callison, supra note 65, at 963 n.4. Senator Howard Cannon, Chairman of the Senate Commerce Committee, introduced a number of bills considered in committee beginning in 1976. Id.
70. DERTHICK & QUIRK, supra note 59, at 41.
result in a superior allocation of society’s resources.\textsuperscript{71} Regulated prices were estimated to be some 40% to 100% higher than they should be.\textsuperscript{72} Deregulation, it was asserted, should drive prices down to costs.\textsuperscript{73}

Many carriers and observers argued that the net result of deregulation would be deleterious to the industry in the short term, and in the long run injure the public it serves. The Kennedy Subcommittee’s disagreed:

The major arguments against allowing freer entry and greater price competition rests upon the fear of: 1) predatory pricing; 2) destructive competition; 3) monopolization; 4) reduced service to small communis[sic]; 5) destruction of the existing air service network; 6) reduced safety standards; and 7) greater financing difficulties. The subcommittee examined each of these claims.

In the subcommittee’s view there is no substantial historical, empirical, or logical reason for believing that increased reliance upon competition would lead to predatory pricing, destructive competition, or risk of monopolization.\textsuperscript{74}

With Richard Nixon’s resignation in 1974, Gerald Ford became President. After pardoning Nixon, Ford’s immediate domestic problem was inflation. He believed that government was a major contributor to inflation.\textsuperscript{75} Ford embraced deregulation in his Presidential campaign:

By the spring of 1975, Ford was speaking of regulatory reform as if it were an end in itself, not just one element in an anti-inflation program, and he was rationalizing it on grounds that mixed popular culture, individual psychology and economics . . . .

Whereas Senator Kennedy had hewed consistently to a proconsumer theme, Ford’s criticisms of regulation were variously addressed to consumer interests, business interests, the traditional American attachment to free enterprise, and popular hostility to big government. Mass distrust of government was growing, and so was resentment of the costs of supporting it and bearing its intrusion on private activity. A policy stance that promised to reduce government activity therefore had some potential for mass appeal (and some potential utility for a president who would soon be asking the national electorate to return him to office).\textsuperscript{76}

\section*{F. The Airline Deregulation Act of 1978}

With the inauguration of Jimmy Carter as President in 1976, the

\textsuperscript{71} Dempsey, supra note 34, at 114-18.
\textsuperscript{72} \textit{Civil Aeronautics Board Practices and Procedures, Report of the Subcomm. on Administrative Practice and Procedure of the Senate Judiciary Comm., 94th Cong., 1st Sess. 189 (1975)} [hereinafter \textit{CAB Prac. & Proc.}]. Another study asserted that prices were between 45% and 84% higher than they would be without regulation. Keeler, \textit{Airline Regulation and Market Performance}, 3 \textit{Bell J. Econ. & Mgmt.} 399, 421 (1972).
\textsuperscript{73} Hardaway, supra note 62, at 145.
\textsuperscript{74} \textit{CAB Prac. & Proc.}, supra note 72, at 4.
\textsuperscript{75} Derthick & Quirk, supra note 59, at 45.
\textsuperscript{76} \textit{Id.} at 46-47.
movement had a firm disciple in the White House. Convinced by his staff that he could exploit the deregulation movement and make a "quick hit" politically, Carter embraced the deregulation movement even more strongly than his predecessor.77

Carter became a true believer in the deregulation of airlines, trucking and railroads. It was he who championed, then signed into law, the Air Cargo Deregulation Act of 1977, the Airline Deregulation Act of 1978, the Staggers Rail Act of 1980, and the Motor Carrier Act of 1980. It was he who appointed individuals strongly wedded to deregulation to the regulatory agencies — Alfred Kahn, Elizabeth Bailey, and Marvin Cohen to the CAB, and Darius Gaskins, Marcus Alexis and Tad Trantum to the ICC — known affectionately in each agency as the Three Marketeers.78

In 1977, Jimmy Carter tapped economist Alfred Kahn to serve as Chairman of the CAB. As Chairman of the New York Public Utilities Commission, Kahn had advocated deregulation before the Kennedy Subcommittee.79

Kahn criticized traditional CAB regulation as having "(a) caused air fares to be considerably higher than they otherwise would be; (b) resulted in a serious misallocation of resources; (c) encouraged carrier inefficiency; (d) denied consumers the range of price/service options they would prefer, and; (e) created a chronic tendency toward excess capacity in the industry."80

Being an economist, he was free of the fidelity to law held by his predecessor at the CAB, John Robson. Robson was Gerald Ford's CAB Chairman, and a lawyer. Being a lawyer, Robson felt constrained by his oath of office to roam only within the perimeters of the governing legislation, the Federal Aviation Act of 1958. The legislation would allow modest liberalizations, but no more. As CAB Chairman, Kahn would proceed a great deal farther down the path of laissez faire than could Robson.81

As CAB Chairman, Kahn implemented a number of revolutionary der-

77. Callison, supra note 65, at 963 n.4.
79. Kahn had previously, and would subsequently, serve as a free-market economics professor at Cornell. He would subsequently serve as a member of the board of New York Air, a subsidiary of Frank Lorenzo's Texas Air.
80. Quoted in Dempsey, supra note 1, at 24.
81. See Dempsey, supra note 34, at 118-19. Kahn loved to hold court. He used the opportunities of the Sunshine Act to hold most CAB meetings public, and the media loved his performance. Kahn made sessions at the CAB more than the public meetings that by law they now must be; he consciously made them public performances, a form of theater, at which the audience — the general press, the trade press, the industry, the CAB staff — watched him pursue with his pedagogue's passion for reasoned inquiry the question of why airline regulation was as it was and why it could not be done differently. DERTHICK & QUIRK, supra note 59, at 87.

regulatory initiatives which liberalized entry and pricing. Soon carriers were authorized to enter new markets, and offer consumers significant discounts over previous levels. The immediate results appeared overwhelmingly successful, with carriers in the late 1970s stimulating new demand by offering low fares, filling capacity, and enjoying robust profits.

This was the first taste of regulatory reform for the airline industry, and it appeared to be an immediate success. The rigid regulatory structure of the preceding decade had so shackled carriers that they were unable to tap the elasticities of demand to fill seats that otherwise would fly empty. As a consequence, capacity was not being filled, and airline profitability was weak.

Regulatory reform would change all that. By lowering prices, airlines were able to lure discretionary (vacation) travelers to fill seats which had theretofore flown empty. Consumers enjoyed a bonanza of lower fares. Airlines were able to fill empty capacity, and with an upturn in the economy, enjoyed higher profits. Regulatory reform appeared to be a win-win proposition. Politicians from both parties and from a wide spectrum of ideologies jumped on the deregulation bandwagon. If some regulatory reform was good, it was thought, then more will be better.

Kahn was quick witted, articulate, and could charm an overcoat off a freezing man. Working with the White House, Kahn put his charismatic personality solidly behind the legislative effort for reform. Kahn found allies in Federal Express and United Airlines, the latter the largest airline in the free world.

Federal Express had been held back for years by the CAB’s desire to protect the passenger carriers, which enjoyed incremental profits on cargo carried in the belly. Operating largely under exemptions for small aircraft, Federal had been prohibited from flying the larger aircraft which would reduce unit costs. United, the largest airline before and during the four decades of regulation, but whose market share had fallen under regulation (from 22.9% in 1938 to 22.0% in 1976), felt that the CAB nurtured the health and well-being of the smaller airlines to its detriment. The CAB had effectively stopped granting new routes to the largest trunk air-

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82. See, e.g., Oakland Service Case, CAB Order 78-4-121 (1978), CAB Order 78-9-96 (1978); Improved Authority to Wichita Case, CAB Order 78-3-78 (1978).

83. “These CAB actions happened to coincide with an upturn in the economy and the consequent return of prosperous times to the airline industry — a rapid traffic growth and increasing profits. This quasi-deregulation by the CAB was given credit by many for this airline prosperity. There is good reason to question the causal connection between these CAB policies and the favorable economic results which the industry experienced at that time, but the conditions helped Senator Cannon move a strong deregulation bill through the Senate in early 1978.” Callison, supra note 65, at 964 n.4.

84. Dempsey, supra note 34, at 115.
lines by the 1970s. United perceived itself big enough to grow and prosper in a deregulated regime.

Congress responded by promulgating the Air Cargo Deregulation Act of 1977 (known in Washington as the Federal Express Act, both for the speed by which it flew through Capitol Hill and the identity of its principal sponsor) and, in the closing hours of the 95th Congress, the Airline Deregulation of 1978.

The Air Cargo Deregulation Act included a rather clever provision allowing established air cargo companies a one year moratorium (from November 1977 to November 1978) during which they were free to enter any domestic markets of their choice; new entrants would be free to enter only after that period. Thus, established carriers like Federal Express expanded during that year to dominate the industry. Although "fitness" remains a requirement of entry, tariff filing requirements were eliminated in 1979.

The Airline Deregulation Act of 1978 called for a gradual transition from regulation to competition, eliminating most entry controls (except "fitness") on December 31, 1981, and domestic rate regulation on December 31, 1982. The Act also included an unprecedented provision mandating the extermination (a/k/a "sunset") of the U.S. Civil Aeronautics Board on December 31, 1984, — the first major federal agency to be obliterated in the nation's history.

The legislation received overwhelming bipartisan support, which was surprising in that the bills were advanced from the top down; they had no widespread grass-roots support among the people. Indeed, public opinion polls revealed that in 1978 Americans ranked airlines among the very top of all industries in terms of customer satisfaction and confidence. One industry executive who supported immediate deregulation conceded that four decades of regulation "... did produce the world's foremost air transportation system, with more service in more markets by more carriers with more competition with greater variety of lower rates

85. TRANSPORTATION RESEARCH BOARD, supra note 5, at 50.
89. DEMPSEY & THOMS, supra note 7, at 29.
90. This was the work of Rep. Elliot Levitas of Georgia, described as "the staunchest advocate of real deregulation on either side of Congress." Callison, supra note 65, at 964 n.4.
91. "The absence of a significant public role throughout this period is a most interesting facet of the airline deregulation movement. The impetus for change came almost entirely from the academics and politicians; the public never did call for deregulation of the airline industry." Callison, supra note 65, at 964 n.4.
92. Id.
and fares than existed anywhere else on earth."\textsuperscript{93}

The predictions as to what deregulation would bring were quite optimistic, in spite of strong misgivings by most industry executives. CAB Chairman Alfred Kahn characterized the opposition as follows: "The most general fear about [deregulation] is that when the CAB withdraws its protective hand from the doorknob, the door will open to destructive competition — to wasteful entry and cut-throat pricing — that will depress profits, render the industry unable to raise capital, and so cause a deterioration in the service it provides — on the whole, it must be admitted good service."\textsuperscript{94} Kahn saw the fear as unrealistic.

What about the prediction by many industry experts that deregulation would depress industry profits, discourage investment and the introduction of more technologically sophisticated aircraft, and lead to a deterioration of service, causing the industry ultimately to gel into a national oligopoly, or in many markets, a monopoly?\textsuperscript{95} Deregulation's proponents saw destructive competition as limited to circumstances where "capital is long-lived and immobile, and through miscalculation competitors irretrievably commit too much to a particular market ..."\textsuperscript{96} a situation not thought to exist in the airline industry because of the mobility of its resources.\textsuperscript{97} Concentration was also thought unlikely because: (1) barriers to entry were perceived low; (2) economies of scale were relatively insignificant; and (3) markets would be contestable — the three legs of the theoretical stool.\textsuperscript{98}

According to Alfred Kahn, "almost all of this industry's markets can support only a single carrier or a few: their natural structure, therefore, is monopolistic or oligopolistic. This kind of structure could still be conducive to highly effective competition if only the government would get out of the way; the ease of potential entry into those individual markets, and the constant threat of its materializing, could well suffice to prevent monopolistic exploitation."\textsuperscript{99} Kahn and his free market brothers saw few economies of scale or economic barriers to entry in the airline industry.\textsuperscript{100}

\begin{itemize}
    \item \textsuperscript{93} Id. at 968.
    \item \textsuperscript{94} Alfred E. Kahn, Talk to the New York Society of Security Analysts 14 (Feb. 2, 1978).
    \item \textsuperscript{95} Dempsey, \textit{supra} note 34, at 130-33.
    \item \textsuperscript{96} \textit{Oakland Service Case}, CAB Order 78-3-78 (1978), at 26.
    \item \textsuperscript{97} Dempsey, \textit{supra} note 34, at 130-31.
    \item \textsuperscript{98} Others disagreed, arguing that given the capital requirements of air transportation and the interrelationship of traffic flows which place a premium on the ability of a carrier to marshall traffic support from as many sources as possible, incumbent airlines could deter new entry by demonstrating they would respond sharply and swiftly to the inauguration of new service. Because potential entry could be deterred by potential response, the elimination of competition through the employment of predatory tactics would be economically rational. Dempsey, \textit{supra} note 34, at 132.
    \item \textsuperscript{99} Kahn, \textit{supra} note 94, at 24.
    \item \textsuperscript{100} \textit{Caves, supra} note 59; D. GILLEN ET AL., AIRLINE COSTS AND PERFORMANCE: IMPLICA-
CAB staff noted, "There are no structural traits inherent in domestic air transportation which indicate superior performance by large-size firms; nor are there traits which would significantly inhibit the entry of new firms into the industry."\textsuperscript{101} Deputy DOT Secretary John Snow agreed: "The evidence suggests very strongly that the optimal size of firms will be sufficiently small so that there will be room for a considerable number of competitive firms in the industry."\textsuperscript{102} Hence entry, or the threat of potential entry, would keep monopolists from extracting monopoly profits.\textsuperscript{103} This was the theory of contestable markets, upon which deregulation was largely premised.\textsuperscript{104} Essentially, should a monopolist or oligopolist begin to earn supercompetitive profits, new entrants should be attracted like sharks to the smell of blood.

The absence of barriers to entry would also subdue incentives for larger airlines to engage in predatory pricing to drive their weaker or smaller rivals out. It was believed irrational for a carrier to engage in predatory pricing.\textsuperscript{105}

Kahn was optimistic that the benefits of deregulation would be universally shared: "I am confident that... consumers will benefit; that the communities throughout the nation — large and small — which depend upon air transportation for their economic well being will benefit, and that the people most closely connected with the airlines — their employees, their stockholders, their creditors — will benefit as well."\textsuperscript{106}

In the late 1970s, the immediate results of deregulation seemed quite positive, and created a general euphoria in Washington and in the media that Congress had chosen the right path. In the short term, air fares plummeted (a bonanza for consumers) while carrier profits soared as low

\textsuperscript{101} STAFF OF THE CIVIL AERONAUTICS BOARD, REGULATORY REFORM 125 n.1 (1975).
\textsuperscript{103} Id. at 648. See Kahn, supra note 94, at 26.
\textsuperscript{105} BREYER, REGULATION AND ITS REFORM, supra note 63, at 30; Hardaway, supra note 62, at 142 [citation omitted].
\textsuperscript{106} Statement of Alfred E. Kahn Before the Aviation Subcommittee of the House Public works and Transportation Committee on H.R. 11145, 8 (Mar. 6, 1978)
fares led discretionary travelers to fill seats which otherwise might have flown empty. But in the fourth quarter of 1978, long before the recession of the 1980s, carrier profits began to plummet into a sea of red ink; the airline industry suffered the worst losses in the history of domestic aviation.

G. IMPLEMENTATION OF DEREGULATION

As noted above, the Airline Deregulation Act of 1978 was intended to provide a gradual transition to deregulated domestic entry and rates, with entry regulation ending on January 1, 1982, and entry regulation ending January 1, 1983. But the CAB quickly dropped any notion of "gradual" deregulation under Chairman Marvin Cohen.\footnote{107} Implementation of the new policy was immediate and comprehensive.\footnote{108}

The Airline Deregulation Act also called for the "sunset" of the CAB in 1985, when its remaining responsibilities were transferred to the U.S. Department of Transportation.\footnote{109} Those primarily involved the regulation of international routes and rates, small community subsidies, and mergers. The latter was transferred to the U.S. Department of Justice in 1989, following serious public criticism of DOT's approval of each of the 21 merger proposals that had been submitted to it during its brief reign over the matter.\footnote{110}

H. CONSEQUENCES OF DEREGULATION

It is difficult to ascribe the contemporary condition of the industry to deregulation, for so many other factors influence its product and condition — e.g., inflation or recession and their impact on passenger and cargo demand, airport infrastructure, and fuel costs. Nonetheless, widespread costs and benefits have been alleged.

Perhaps the most consistent theme expressed by deregulation's proponents is that deregulation has caused a significant decline in fares. For example, Steven Morrison and Clifford Winston of the Brookings Institution maintain that price savings have resulted in consumer savings amounting to some $6 billion a year.\footnote{111} About $4 billion of that is attrib-
uted to business traveler time savings because of more frequencies.

This has been a matter of some controversy. Some maintain that the hub-and-spoke phenomenon has caused the air transport system to become decidedly slower because both of circuitous routings, congestion, and delays at hub airports necessitated by passenger transfers. Moreover, much of the pro-deregulation literature fails to mention the pre-deregulation trend of declining fares which preceded 1978.112 In fact, except for a period of sharp fare declines from 1976 to 1979, fuel and inflation adjusted fares fell at a 30% faster rate in the decade preceding deregulation than in the decade subsequent to it.113 Both sides tend to agree that pre-deregulation price declines were driven by productivity improvements resulting from technological breakthroughs of aircraft. Each generation of aircraft is more efficient in terms of fuel consumption and passenger cost. Deregulation proponents insist that most of the major technological breakthroughs occurred prior to deregulation, and attribute ticket price declines to deregulation itself.

Recent literature shows a decline in the rate of airline productivity growth after 1978.114 Deregulation critics point out that the pre-deregulation trend of flying increasing numbers passengers nonstop in wide-bodied aircraft (Boeing 747s, McDonnell-Douglas DC-10s, and Lockheed L-1011s) was aborted with the development of hubs-and-spokes, which require smaller planes with higher seat mile costs.115 Hubbing also burns more fuel and consumes more labor and time.

Whatever the truth on whether deregulation has benefitted consumers, its impact on the industry itself has been profound. By 1992, the airline industry had suffered more than 150 bankruptcies, 50 mergers, and lost all the profit it had made since the Wright Brothers flight at Kitty Hawk, plus $1.5 billion more. Alfred Kahn, on balance still a defender of deregulation, admits, “There is no denying that the profit record of the industry since 1978 has been dismal, that deregulation bears substantial responsibility, and that the proponents of deregulation did not anticipate such financial distress—either so intense or so long-continued.”116

Since deregulation, national and regional concentration have reached unprecedented levels, although most city-pair markets were

112. See Brenner, Rejoinder to Comments By Alfred Kahn, 16 TRANSP. L.J. 253, 254 (1988).
served by more carriers than before. One source describes five major issues of concern of airline deregulation:

- The competitiveness of the industry (its effects on the fares and level of service provided to consumers today and the prospects of reduced competition from further industry concentration).
- The long-term financial stability of the industry.
- Possible discrimination against consumers of different types or in different parts of the country.
- The safety provided to the public by airlines and the FAA, and
- The ability of the federal government to respond to airport and airway capacity constraints.117

Because performance of the industry under deregulation has deviated significantly from the economic model of near perfect competition predicted, some of deregulation’s early proponents have reevaluated their hypotheses. Michael Levine, among the most staunch early proponents of deregulation, and whose early literature on the subject found no economies of scale of significance in commercial aviation,118 has more recently developed a theoretical justification for and found the existence of substantial economies of scale and scope in the industry.119

The early economics literature also emphasized the potential contestability of airline markets. Subsequent evaluation of commercial aviation finds little evidence of contestability.120 As Charles Rule, Assistant Attorney General for Antitrust observed, “[M]ost airline markets do not appear to be contestable, if they ever were. . . . [D]ifficulties of entry, particularly on city-pairs involving hub cities, mean that hit-and-run entry is a theory that does not comport with current reality.”121

III. THE CONTEMPORARY AIRLINE INDUSTRY — FROM A TO Z

A. AIRCRAFT

Aircraft is the single most important manufacturing export produced in the United States. The Congressional Research Service has estimated that for every dollar in aircraft exports, the U.S. economy increases by $2.30; for every billion dollars in aircraft exports, U.S. employment grows

117. TRANSPORTATION RESEARCH BOARD, supra note 5, at 43.
by 35,000 jobs.\textsuperscript{122} In 1990, U.S. manufacturers exported $16.7 billion in aircraft, while the United States imported only $737 million worth of planes.\textsuperscript{123}

Boeing is the largest commercial aircraft manufacturer, accounting for 47% of the market in 1990, followed by Airbus with 35%, and McDonnell Douglas with 17%.\textsuperscript{124} Lockheed exited the commercial aircraft industry in 1981, after losing $2.5 billion making L-1011 TriStars.\textsuperscript{125}

As 1991 drew to a close, the aircraft manufacturers had the following orders outstanding.

\begin{center}
\textbf{AIRCRAFT ORDERED, DELIVERED, BACKLOGGED}\textsuperscript{126}
\end{center}
\begin{center}
\textit{(cumulative, as of December 31, 1991)}
\end{center}

\begin{table}[h]
\begin{tabular}{|c|c|c|c|}
\hline
\textbf{CARRIER/AIRCRAFT TYPE} & \textbf{ORDERS} & \textbf{DELIVERIES} & \textbf{BACKLOG} \\
\hline
\textbf{AIRBUS INDUSTRIE} & & & \\
\textbf{A300} & 457 & 364 & 93 \\
\textbf{A310} & 251 & 200 & 51 \\
\textbf{A320} & 661 & 251 & 410 \\
\textbf{A330} & 143 & 0 & 143 \\
\textbf{A340} & 115 & 0 & 115 \\
\textbf{Total} & 1,767 & 815 & 952 \\
\hline
\textbf{BOEING} & & & \\
\textbf{707} & 1,010 & 1,008 & 2 \\
\textbf{737} & 2,929 & 2,184 & 745 \\
\textbf{747} & 1,160 & 892 & 268 \\
\textbf{767} & 766 & 413 & 353 \\
\textbf{777} & 597 & 404 & 193 \\
\textbf{Total} & 6,538 & 4,901 & 1,637 \\
\hline
\textbf{BRITISH AEROSPACE} & & & \\
\textbf{BAe 146 RJ70/80} & 229 & 191 & 38 \\
\hline
\textbf{CANADAIR} & & & \\
\textbf{Regional Jet} & 38 & 0 & 38 \\
\textbf{Fokker 100} & 248 & 103 & 145 \\
\hline
\textbf{MCDONNELL DOUGLAS} & & & \\
\textbf{MD-80} & 1,137 & 964 & 173 \\
\textbf{MD-90} & 61 & 0 & 61 \\
\textbf{MD-11} & 172 & 34 & 138 \\
\textbf{Total} & 1,370 & 998 & 372 \\
\hline
\textbf{GRAND TOTAL} & 10,190 & 7,008 & 3,182 \\
\hline
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\textsuperscript{125} Will Boeing's Tail Turn White?, \textit{ECONOMIST}, Apr. 13, 1991, at 61.
\end{flushright}

\begin{flushright}
\textsuperscript{126} Jet Orders, Cancellations, Net Orders and Delivery Summary, \textit{AVIATION DAILY}, Feb. 6, 1992, at 227.
\end{flushright}
Airbus is owned and subsidized by several European governments. Airbus’ growth has been robust. Its market share climbed from 16% in 1988 to 22% in 1989.127 U.S. aircraft manufacturers have complained about the $10 billion to $20 billion in subsidies given Airbus by several European governments.128 The United States claims that subsidies to Airbus total more than $13.5 billion, or $19.4 billion if interest costs are added.129 Alleged dumping of aircraft has led Commerce Department officials to suggest that the U.S. might escalate its dispute under the General Agreement on Trade and Tariffs, impose duties on other European products, or take other anti-dumping measures.130

McDonnell Douglas enjoyed an average of 23% of the commercial aircraft market over the past half century. But by 1991, McDonnell Douglas’ market share had fallen to 17%.131 In 1991, financially troubled McDonnell Douglas Corp. announced its intention to sell 40% of its commercial manufacturing operations to Taiwan Aerospace Corp. for about $2 billion.132 McDonnell needed the infusion to assist its development of the MD-12, a 400 seat wide-bodied tri-jet which would compete with Boeing’s 747. Currently, it produces only the narrow-body MD-80 and wide-body MD-11 (later versions of the DC-9 and DC-10, respectively).133

Some sources predict that worldwide traffic will double by the year 2005, requiring some 600 new aircraft a year.134 If so, the global commercial airline industry will need nearly 9,000 new aircraft through the year 2005, at a cost of some $617 billion.135

Boeing predicts that the world’s airlines will take delivery of nearly 6,000 new jets, worth about $380 billion, by the year 2000, and buy another $500 billion of new aircraft in the decade after that.136 Passenger traffic is estimated to grow 5% a year for the next two decades (it grew 7% a year in the two decades preceding 1990.137 Others see worldwide traffic slowing to between 3%-5%, half its previous rate.138

Much concern has been leveled at the age of the U.S. fleet, the oldest

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131. Wartzman, Carey & Mark, supra note 123, at 1.
133. Wartzman, Carey & Mark, supra note 123, at A9.
134. Will Boeing’s Tails Turn White?, supra note 125, at 61.
136. Will They Ever Fly Again, supra note 132, at 67.
137. Id.
in the developed world. The economic design life of a typical aircraft is 20 years or 60,000 cycles.\textsuperscript{139} Thirty-one percent of the U.S. fleet exceeds the economic design goals originally set by the manufacturers.\textsuperscript{140} By 1989, 32% of the U.S. fleet was more than 20 years old, the GAO predicts 64% will be by the year 2000.\textsuperscript{141} Aircraft corrosion and structural fatigue have been a factor in at least 36 aviation accidents since 1983.\textsuperscript{142}

### Average Fleet Ages in Years\textsuperscript{143}

<table>
<thead>
<tr>
<th>AIRLINE</th>
<th>NUMBER OF AIRCRAFT</th>
<th>AVERAGE AGE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1990</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1989</td>
<td>1991</td>
</tr>
<tr>
<td>American</td>
<td>510</td>
<td>9.4</td>
</tr>
<tr>
<td>Continental</td>
<td>331</td>
<td>11.0</td>
</tr>
<tr>
<td>Delta</td>
<td>421</td>
<td>8.7</td>
</tr>
<tr>
<td>Eastern</td>
<td>177</td>
<td>13.8</td>
</tr>
<tr>
<td>Northwest</td>
<td>326</td>
<td>14.1</td>
</tr>
<tr>
<td>Pan Am</td>
<td>162</td>
<td>12.8</td>
</tr>
<tr>
<td>TWA</td>
<td>213</td>
<td>14.3</td>
</tr>
<tr>
<td>United</td>
<td>443</td>
<td>13.6</td>
</tr>
<tr>
<td>USAir</td>
<td>453</td>
<td>9.0</td>
</tr>
</tbody>
</table>

By the time of Pan Am collapsed in December 1991, the average age of its fleet had grown to 18 years.\textsuperscript{144} In contrast, the average age of Singapore Airlines' fleet is only four years and nine months.\textsuperscript{145} Japan Air Lines' fleet is 8.6 years old, still younger than any U.S. airlines.\textsuperscript{146}

In 1990, concern over aircraft noise led Congress to promulgate legislation banning most of the 2,300 Stage Two aircraft in the U.S. fleet from U.S. airports by the end of 1999. Waivers can be granted until the end of the year 2003 if the airline has 85% of its fleet satisfying Stage Three

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\textsuperscript{141} Brannen, supra note 139, at 432 n.42.

\textsuperscript{142} Id. at 425-26.


\textsuperscript{144} \textit{Bulk of Pan Am Fleet Owned by Other Companies}, \textit{Aviation Daily}, Dec. 6, 1991, at 412.


requirements by July 1, 1999.147 This raises significant concerns among
U.S. carriers whose fleets are aging. The following chart reveals the pro­
portion of each major airline's fleet in Stage Two.

PERCENTAGE OF FLEETS IN STAGE TWO AIRCRAFT (1991)148

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>American</td>
<td>34%</td>
</tr>
<tr>
<td>Continental</td>
<td>50%</td>
</tr>
<tr>
<td>Delta</td>
<td>54%</td>
</tr>
<tr>
<td>Eastern</td>
<td>70%</td>
</tr>
<tr>
<td>Northwest</td>
<td>65%</td>
</tr>
<tr>
<td>Pan Am</td>
<td>60%</td>
</tr>
<tr>
<td>TWA</td>
<td>55%</td>
</tr>
<tr>
<td>United</td>
<td>49%</td>
</tr>
<tr>
<td>USAir</td>
<td>55%</td>
</tr>
</tbody>
</table>

In regulations promulgated in 1991, the FAA gave the airlines the
option of complying either by adding Stage Three aircraft to their fleets, or
reducing the number of Stage Two planes. The FAA timetable calls for
the phaseout of 25% of Stage Two aircraft by the end of 1994, a 50% re­duction by the end of 1996, and a 75% reduction by the end of 1998.
Their fleets must be 100% Stage Three by Dec. 31, 1999, except for a
few limited waivers. However, the FAA failed to preempt local airports
which impose phaseout schedules more stringent than the federal
schedule.149

The phasing out of Stage Two aircraft mandated by the year 2000 is
estimated to cost as little as $880 million (about 25 cents per passenger,
according to the Federal Aviation Administration [FAA]) $2.1 billion (ac­cording to the U.S. General Accounting Office [GAO]), or as much as
$100 billion (according to the Air Transport Association [ATA]).150 The
lower estimates are based on compliance solely by hushkitting, and the
larger estimate assumes replacing all Stage Two with new Stage Three
aircraft.151

In the late 1980s, major carriers placed massive orders for new air­craft. In 1986, Northwest ordered 50 Airbus A320s for $3.2 billion; in

149. Airlines Can Grow to Stage 3 Compliance; Preemption Left to the Courts, AVIATION DAILY, Sept. 25, 1991, at 567-68.
150. GAO Says Costs of Stage 2 Phaseout Much Lower than Industry Forecasts, AVIATION DAILY, July 18, 1991, at 105; Airlines Can Grow to Stage 3 Compliance; Preemption Left to the Courts, supra note 149, at 567-68.
151. Airlines Can Grow to Stage 3 Compliance; Preemption Left to the Courts, supra note 149, at 567-68.
1989, it ordered 90 aircraft worth $5.2 billion.\textsuperscript{152} In 1988, Delta ordered 215 jets, expanding that to 260 the following year.\textsuperscript{153} By 1992, Delta had 549 jets in its fleet, and another 454 on order or option.\textsuperscript{154} In 1989, United placed a record $15.7 billion order for 370 Boeing 737s and 757s; American ordered 561 planes, totaling $14.5 billion.\textsuperscript{155}

But the industry reversed itself in the early 1990s. Nearly 140 jet orders were canceled in 1991, the largest number of cancellations since 1982. Total new orders for 1991 were only 467, the worst year since 368 orders were placed in 1984.\textsuperscript{156} Only $32 billion in new planes were ordered, compared to $90 billion in 1989.\textsuperscript{157} By 1992, more than 1,000 aircraft, about 10% of the world’s commercial fleet, was parked in deserts or on the edge of airports.\textsuperscript{158}

American Airlines cut its five-year capital spending program by $8 billion, from $21 billion to $13 billion.\textsuperscript{159} In early 1992, United announced the cancellation of orders for 122 Boeing aircraft, mostly 737s and 757s, used in its domestic system, cutting its spending on aircraft by 22% between 1992 and 1995, and cutting capital spending by $6.7 billion, down from nearly $19 billion; United still intends to take delivery on 156 planes from 1992-1995, including many wide-bodied aircraft to serve its international routes.\textsuperscript{160} Some analysts anticipate that the cut in capacity may enhance carrier profitability.\textsuperscript{161}

Excessive capacity is seen is among the most significant problems facing the airline industry.\textsuperscript{162} Post deregulation load factors climbed to 60% from the 54% it averaged in the 1971-78 period.\textsuperscript{163} However the break-even level increased from 53% in the pre-deregulation period to 62% after it.\textsuperscript{164} But by 1991-92, load factors had fallen to the pre-dereg-

\begin{thebibliography}{99}
\footnotesize
\bibitem{156} \textit{Aircraft 1991 Order Cancellations Highest In a Decade}, \textit{AVIATION DAILY}, Jan. 24, 1992, at 149.
\bibitem{157} \textit{Will They Ever Fly Again?}, supra note 132, at 67.
\bibitem{158} Id.
\bibitem{159} Pulley \& Harris, Jr., \textit{UAL to Trim Capital Outlays by $3.6 Billion}, \textit{WALL ST. J.}, Feb. 11, 1992, at A3, A8.
\bibitem{160} Id. at A3, A8; \textit{UAL Slashes Jet Deliveries by 122, Spending by $6.7 Billion}, \textit{AVIATION DAILY}, Feb. 11, 1992, at 247.
\bibitem{161} Pulley \& Harris, Jr., supra note 159, at A3, A8.
\bibitem{162} Brenner, \textit{supra note 114}, at 204 (quoting Michael Levine).
\bibitem{163} Id. at 206.
\bibitem{164} Id.
\end{thebibliography}
Aviation litigation has severely strained the economic resources of general aircraft manufacturers. The general aviation industry sold only 1,021 aircraft in 1991, the lowest number in modern history.

B. AIRLINES

Part 121 of the Code of Federal Regulations defines carriers earning more than $1 billion as “majors.” Those earning more than $100 million but less than $1 billion are “nationals.” And carriers earning less than $100 million are “regionals.”

**U.S. MAJOR AND NATIONAL AIRLINES (1992)**

As of February 1992, the majors were:
- American
- America West*
- Continental*
- Delta
- Northwest
- Southwest
- Trans World*
- United
- USAir

The nationals were:
- Alaska
- Aloha
- American Trans Air
- Hawaiian
- Horizon
- Markair
- Midwest Express
- Tower
- Trump Shuttle
- Westair

* in bankruptcy

Commuter airlines, operating fewer than 60 seats, are governed by Part 135 of the Code of Federal Regulations. In 1978, 210 commuter airlines offered passenger service; by 1991, there were but 176, and the largest 50 carried 92% of all commuter passengers.

Of the 148 new carriers reporting financial data to the U.S. Depart-

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169. TRANSPORTATION RESEARCH BOARD, supra note 5, at 31.
Of the 176 airlines spawned by deregulation, America West is the only one which managed both to make it into the big leagues of the majors and to survive into the 1990s. America West has significant market share at its two hubs — Phoenix and Las Vegas — but in neither does it control more than 50% of the market. After a period of rapid and optimistic expansion, it struggles in Chapter 11 bankruptcy. As of this writing, its prospects for survival are less than overwhelming.

2. AMERICAN AIRLINES

American Airlines is the largest airline in the Western world, and one of the strongest. Under its tenacious and shrewd CEO, Robert Crandall, American has been an industry innovator. In 1984, American was the first airline to institute a two-tier wage structure, allowing it to expand at lower cost; today, more than half its employees are on the “B” scale. In 1981, it inaugurated frequent flyer programs. It pioneered computer reservations systems [CRS], and today owns one of the two largest, Sabre.

In addition to expanding its Dallas/Ft. Worth operations into a major hub (it moved its corporate headquarters there from New York in 1979), it established hubs at San Jose, Nashville, Raleigh/Durham and San Juan. American is the second largest airline at Chicago O’Hare, the world’s busiest airport, with 34.5% of the market, behind United’s 49.7%. It controls 61.5% of Dallas/Ft. Worth (compared to 34.5% flown by Delta), 82.4% of Raleigh-Durham, 65.1% of Nashville, 63.4% of San Juan, and 58.5% of San Jose.

American invested more than $1 billion in overseas expansion since 1989, beginning with the purchase of Eastern’s Latin American routes (which Eastern had earlier bought from bankrupt Braniff). Nonetheless, American Airlines still has a relatively weak presence in the Pacific Rim. American also purchased several of TWA’s routes to London Heathrow airport, and a Seattle-Tokyo route from Continental. American had planned to invest $20 billion in capital spending by 1995, mostly for new, fuel-efficient aircraft, and expanded domestic facilities. But as

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170. Id.
172. TRANSPORTATION RESEARCH BOARD, supra note 5, at 54.
profits plummeted, American rolled back capital spending plans by $8 billion through the mid-1990s.\footnote{Snapshot of the World’s Major International Airlines, supra note 173, at A8.}

American Airlines has the largest fleet in the U.S. industry, with 602 aircraft, of which more than 73% is Stage Three, and an average age of 9.6 years, the second youngest of any major U.S. airline. American anticipates it will have a fleet of 682 planes by 1995.\footnote{AMR, THIRD QUARTER REPORT 4 (1991).} American is well positioned eventually to dominate the U.S. domestic passenger market.

3. **CONTINENTAL AIRLINES**

Continental is a blend of corporate cultures and airlines. It has been described as “the product of myriad mergers, [with] a raucous recent history that sometimes bordered on the schizophrenic under former chairman Frank Lorenzo. It’s a crazy quilt of airlines forged from hostile takeovers, frequent bankruptcies, employee standoffs, midnight firings, and one shocking suicide.”\footnote{Lollar, It’s Not Easy Being Fourth . . . Or Fifth, FREQUENT FLYER, Nov. 1991, at 8.}

In the early 1980s, Frank Lorenzo’s Texas International acquired larger Continental in a leveraged buy-out; the two were consolidated. In December 1990, Continental Airlines entered Chapter 11 bankruptcy for the second time (some call it Chapter 22 bankruptcy). It had first entered bankruptcy in 1983 (at which time it tore up its union contracts), and emerged from it in 1986, in time for Lorenzo to go on a buying binge, picking up People Express (including Frontier Airlines, Britt and PBA), Eastern Airlines, and Rocky Mountain Airways.

Much of Continental’s debt was put on in its acquisition of People Express, Frontier and Eastern, which raised its long-term debt obligations to more than 78% of its assets, almost twice the percentage of the four largest airlines.\footnote{Continental, AVIATION DAILY, Dec. 19, 1990, at 525.} In addition to Continental’s debt, between $285 million and $403 million may come its way out of the Eastern Airlines’ bankruptcy as a result of the transfer of assets out of Eastern into the Texas Air empire by Frank Lorenzo at less than fair market value, as well as $752 million in Eastern’s unfunded pension liability.\footnote{See Mahoney, Airline Merger Brewing, DENV. POST, Dec. 13, 1991, at 1A, 14A; Eastern Assets, AVIATION DAILY, Jan. 22, 1991, at 134; Continental Withholds $17 Million Pension Payment, AVIATION DAILY, Oct. 10, 1991, at 67.}

In 1990, Continental Airline Holdings lost $2.34 billion on revenues of $6.23 billion; in 1991, it lost $341 million on revenue of $5.4 billion.\footnote{Mahoney, Continental Ekes Out Fourth-Quarter Profit, DENV. POST, Feb. 8, 1992, at 1C, 2C.} Lorenzo was ousted, although the company continues to suffer from an...
annual turnover of Presidents, a dominant management strategy for Con­
tinental throughout the 1980s.

Continental is dominant in Houston (80.2%) and Newark (53.2%). It
is the largest airline in Cleveland (36.7%), and the second largest in Den­
ver (35.5%, behind United with 47.7%).

In 1992, Continental proposed a plan of reorganization to trade debt
for equity, wiping out the stockholders, thereby reducing the company’s
long-term liability from $5.1 billion to $1.7 billion, and rolling back its inter­
est expenses by $270 million a year.181 SAS, which owned nearly 19%
of Continental, has written down its investment to zero.

4. **Delta Airlines**

Delta is generally regarded as providing among the highest level of
service in the industry and having the most loyal and best paid employ­
ees. It is also known as among the most conservative of airlines, although it
seems to be shedding that image as it has recently gone on a
buying spree. Before it acquired Salt Lake City hubbed Western Airlines
for $860 million in 1986, Delta had not acquired an airline since it
purchased Northeast in 1972.182

Delta is well positioned domestically with its hubs of Atlanta (89.2%),
Cincinnati (88.1%) and Salt Lake City (82.6%), and well positioned inter­
nationally with its purchase of Pan Am’s major transatlantic and European
services, hubbed in Frankfurt, and its Boston-Washington-New York shut­
tle.183 Delta is best positioned to capitalize on the economic growth of
Eastern Europe, although with European Community liberalization, EC
carriers will likely enter the type of destructive competition which charac­
terized the domestic U.S. market in the 1980s. Delta is also building a
Taipei hub and expanding in Asia.184 With Eastern gone, Delta will domi­
nate the southeast, and will fight smaller USAir for dominance of the
northeast.

In order to build global alliances and avoid a takeover attempt, in the
late 1980s Delta traded blocks of 5% of its stock with both Singapore
Airlines and Swissair, known in the industry as two of the highest service
airlines in the world. At 8.6 years on average, Delta’s is the youngest fleet
of any major U.S. airline.

One potential problem for Delta lies in litigation flowing from the de­
mise of Pan Am. Pan Am folded on December 4, 1991, a day after Delta

181. Mahoney, No Layoffs in Continental Plan, Stockholders Would Lose Equity, DENV. POST,
Feb. 7, 1992, at 1C; O’Brien, Continental Air Reorganization Plan Erases Stock, Makes Creditors
announced it would cut the flow of money it had allegedly promised. One suit, seeking $1.1 billion was filed by Pan Am employees thrown out of work.\footnote{185}{Delta Sued Again Over Pan Am Deal, DENN. POST, Mar. 13, 1992, at 2C.}

5. **NORTHWEST AIRLINES**

Northwest entered deregulation with perhaps the strongest balance sheet in the industry. Unfortunately, this would make it a prime candidate for a leveraged buy-out.

In 1986, Northwest acquired Republic Airlines for $884 million, itself a product of the mergers of North Central, Southern and Hughes Airwest. That gave Northwest significant domestic feed for its international routes (it is among the strongest transPacific carriers) and control of the hubs of Minneapolis/St. Paul (81.3%), Detroit (73.1%) and Memphis (82.1%). Of the three, Detroit is potentially the most important, with its huge O&D base of 4.7 million people.

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 81.5% debt and 18.5% 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 57% of the equity, for which KLM received 70% of Wings’ nonvoting preferred stock, 31% of its nonvoting common stock, and 4.9% 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 company) put up $80 million (or 11% of the equity, for which it received 16% of Wings’ nonvoting preferred stock, 15.4% of its nonvoting common stock, and 15.4% of its voting stock).\footnote{186}{In re the Acquisition of Northwest Airlines by Wings Holdings, Inc., DOT Order No. 91-1-41, at 2 (1991).}

Northwest spent more than $3 billion on the LBO. That is more than the purchase price of Pan Am’s transpacific division (bought by United for $715 million), Western Airlines (bought by Delta for $860 million), Ozark Airlines (bought by TWA for $250 million), Eastern Airlines and People Express (bought by Texas Air for $676 million and $112 million, respectively), and Air Cal (bought by American for $225 million), combined. For these purchases, these airlines acquired significant operating assets and market share. For its purchase, Northwest acquired the talents of Alfred Checchi.
Price Waterhouse recently concluded that Northwest was at a "critical juncture" and was facing "significant hurdles."\(^{187}\) Most stem from the $3.65 billion leveraged buy-out of the company by Alfred Checchi and partners (Wings Holdings, Inc.) in 1989, which saddled an almost debt-free company with enormous debt.\(^{188}\) Both mergers and route sales have been explored to shore up its financial condition and strategic position.\(^{189}\) Northwest has made a $7 billion commitment for new aircraft through 1995, which it desperately needs, for its fleet is 15.6 years old on average, and 65% is Stage Two.

Northwest earned record profits of $135 million in 1989; it earned $67 million in 1989. But it lost $302 million in 1990, and $317 million in 1991.\(^{190}\) According to one source, the heavy debt burden put on by the Checchi LBO, coupled with these tremendous losses, have caused Northwest's debt-to-equity ratio to soar to an unbelievable 30 to 1 ($4.2 billion in debt versus $141 million in equity).\(^{191}\) Others estimate that Northwest carries $1.4 billion in debt.\(^{192}\)

Annual interest expenses at Northwest are $7,835 per employee, compared to $2,534, $1,612 and $928 at United, American and Delta, respectively.\(^{193}\) Under Checchi, expenses have grown, and international routes, traditionally the solid profit base, have turned unprofitable.\(^{194}\) However, Northwest's deteriorating cash position was much bolstered by an infusion of several hundred million dollars by the state of Minnesota to lure the construction of maintenance bases in the state.

The difficulty Northwest faces is debt, debt and debt, followed by United's growing competitive threat in the Pacific, and United-American-Delta's expansion in the Atlantic.

6. **SOUTHWEST AIRLINES**

Under maverick Herb Kelleher, Southwest has been profitable by following a course alien to the other airlines. Instead of establishing a hub-and-spoke system, Southwest flies a linear route system across 14 states focused on frequent, short flights with no-frills service exclusively in Boeing 737s between smaller cities not generally served by the megacarriers.\(^{195}\) "We have sort of lived off the scraps of the table of the mega-

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189. *Id.* at A3.
191. *Id.*
192. Lollar, *supra* note 177, at 8, 12.
194. *Id.*
carriers," said Kelleher. "But I know lots of fat little puppies that have lived off table scraps." 196

Southwest began in 1971 as a Texas intrastate airline flying 737s between Houston, Dallas and San Antonio. The Wright Amendment restricts service at close-in Houston Hobby and Dallas Love airports to airlines flying from states contiguous to Texas. This has enabled Southwest to maintain a virtual monopoly at both airports, virtually free from competition at either. Southwest controls 70% of Houston Hobby and 100% of Dallas Love airports. Southwest was the only major airline to earn a profit in 1991. 197

7. TRANS WORLD AIRLINES

TWA entered deregulation as the nation’s fourth largest airline, although it had earlier suffered from the eccentricities of its owner Howard Hughes. In the late 1970s, TWA diversified into several noneconomic industries to balance its profit flow — Hilton International, Century 21, Canteen Corporation and Spartan Foods. This diversion was to cost it market share. Ultimately, it spun off these properties.

In the mid-1980s, TWA became the target of Frank Lorenzo, then Carl Icahn. Labor was willing to surrender significant concessions to Icahn to avoid the dreaded union-buster Lorenzo. Shortly thereafter, TWA executed a pre-existing plan to acquire Ozark, giving it a strangle hold on St. Louis Lambert International Airport, where it controls 76.4% of the market.

After its acquisition, Icahn took the company private and began cannibalizing many of its properties to finance raids on other companies. In 1992, Icahn announced a "pre-packaged" Chapter 11 filing, beyond which some analysts predict only another 18 to 36 months of life for this anemic airline. 198 One analyst gave TWA only a 50-50 chance of reorganizing successfully. 199

In 1990, TWA carried more than $2.5 billion in debt. 200 By 1991, it was reported that TWA’s debt had been reduced to $1.4 billion. 201 Interest payments recently exceeded 8% at both TWA and Eastern — the

197. Id.
201. Mahoney, supra note 179, at 1A, 14A.
highest in the industry. TWA flies the oldest fleet of aircraft of any major airline in the U.S. system (an average of 16.6 years) and consistently ranks among the worst airlines in terms of consumer complaints and on-time performance.

8. UNITED AIRLINES

United was the only major airline to support deregulation. As the nation’s largest carrier, with 17% of the passenger market, it thought itself better able to grow without the benevolent presence of the Civil Aeronautics Board. But under Richard Ferris, it blundered almost immediately, by pulling out of short haul markets (selling off scores of 737s, for example), and concentrating on long-haul traffic. United soon learned that the smaller airlines were not content to feed it, inaugurating their own long-haul routes. United soon reversed course, began buying smaller aircraft, and establishing hub-and-spoke systems.

United also got off course by buying related travel companies — it added Hertz Rent-a-Car and Hilton International Hotels to its existing Westin Hotel Chain under a holding company awkwardly named Allegis. Whatever the potential value of creating a one-stop travel conglomerate, United failed to integrate the system; the corporate raiders began to circle, and United reversed course again, spinning off the non-airline properties, and dropping the Allegis label.

In the meantime, United’s market share had slipped significantly. It was not able to achieve its pre-deregulation market presence until 1991, by which time American had surpassed it as the nation’s largest airline.

But United did a couple of things quite right. It established hub systems in San Francisco, Denver, Chicago and Washington (Dulles), covering both coasts and the interior with hubs spread about quarter way across the continent. It is the largest airline at Chicago O’Hare (49.7%), Denver (47.7%), San Francisco (39.4%), and Washington Dulles (39.4%). In 1991, United announced its purchase of Air Wisconsin, which will increase its number of slots at Chicago O’Hare, the world’s largest airport, by 16%, giving it clear dominance over American. American has filed an antitrust suit to block the transfer. Midway has disappeared from the Chicago market, which should allow both carriers to raise prices.

United also seized many the primary international routes of a disintegrating Pan Am. United purchased Pan Am’s transpacific operations for $715 million, its London Heathrow and fifth-freedom beyond rights for

$400 million, and its Latin American operations for $135 million. Most analysts predict international traffic will grow at a faster pace than the domestic market throughout the 1990s. United's fleet is growing at the rate of about one new aircraft a week, although it has recently canceled a large block of smaller aircraft. It left standing orders for Boeing 747 and 777 planes, which will be fed into United's growing international system. United's Apollo is one of the two strongest computer reservations systems.

United lost $94.5 million in 1990, and a record $331.9 million in 1991. CEO Stephen Wolf was paid a record $18.3 million in compensation in 1990, despite his company's poor performance. As a consequence of United's unprecedented losses, it cut capital spending by $6.7 billion, or 35%, between 1993 and 1995.

9. **US Air**

In 1987, USAir purchased Pacific Southwest Airlines for $400 million, and Piedmont for $1.56 billion. In 1989, USAir merged operations with Piedmont, although it has had considerable difficulty digesting that acquisition, with both service and profitability turning south. USAir had two miserable years financially in 1990-91, losing several hundred million dollars each year. US Air suffered a record net loss of $454 million in 1990, and $305 million in 1991. In order to cut costs, US Air pulled out of the competitive California markets it entered with the PSA purchase, laid off 7,000 employees, and asked the rest for 20% wage concessions.

US Air has relatively weak presence internationally, having bought TWA's authority to London from Philadelphia and Boston for $50 million. It may also need to trim a few of its hubs east of the Missis-

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207. *United Lays Off 534, Warns of More Cuts*, *supra* note 205, at 1C.
211. Pulley, *USAir May Have Trouble Getting Unions to Agree to Other Workers' Concessions*, *supra* note 210, at A4.
It now dominates Pittsburgh (89.6%), Charlotte (95.2%) and Baltimore (68.1%), and with the demise of Eastern and Midway has significant market share in Philadelphia (52.9%). It has dismantled the once-profitable Dayton hub it inherited from Piedmont, where in 1990 it had 77.8% of the market. USAir solidified its east coast operations with the purchase of Continental's new LaGuardia terminal and landing slots for $61 million, and the signing of an agreement to operate (and an option to buy) the Trump shuttle, which flies between New York's LaGuardia, Boston Logan, and Washington National Airports. The shuttle is saddled with some $380 million in debt, an enormous burden for such a small airline. Unfortunately, USAir must compete with mighty Delta in the shuttle market. USAir holds 168 jet slots and 28 commuter slots at LaGuardia, and 150 jet slots and 148 commuter slots at Washington National Airport. USAir has a relatively young fleet for a U.S. carrier, at 9.3 years on average.

C. AIRPORTS

In 1991, some 23 new airports were under construction somewhere in the world, with Denver International Airport scheduled to have the most runways — six — and to be the largest (at 53 square miles, covering a land mass twice the size of Manhattan Island). No major airport had been built in the United States since Dallas/Ft. Worth International Airport opened in 1974 and Atlanta Hartsfield International Airport was reconfigured on its existing property in 1980. The most expensive U.S. airport on the drawing board is Chicago’s Calumet, projected to open in the year 2005 at a cost of $10.8 billion.

Subsequent to deregulation, airlines began consolidating their operations around “fortress” hubs. Hubs account for 70% of the flights offered by domestic airlines. In selecting a city to serve as a hub, an airline looks for one with some of the following characteristics: (1) an interior point geographically situated for flow, preferably east to west, since that is the routing of most business travelers (the most lucrative share of the market); (2) a large population base to enhance origin and destination

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213. Pulley, USAir May Have Trouble Getting Unions to Agree to Other Workers’ Concessions, supra note 210, at A4.
[O&D] traffic, preferably white collar (again, because business travelers pay more for air transportation); and (3) preferably, no nearby hubs or competing airports dominated by another airline.

According to the 1990 census, the largest metropolitan area population of U.S. cities was as follows:

**LARGEST U.S. METROPOLITAN AREAS** \(^{220}\) (1990)

<table>
<thead>
<tr>
<th>Metropolitan Area</th>
<th>Population (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. New York</td>
<td>18.1</td>
</tr>
<tr>
<td>2. Los Angeles</td>
<td>14.5</td>
</tr>
<tr>
<td>3. Chicago</td>
<td>8.1</td>
</tr>
<tr>
<td>4. San Francisco</td>
<td>6.3</td>
</tr>
<tr>
<td>5. Philadelphia</td>
<td>5.9</td>
</tr>
<tr>
<td>6. Detroit</td>
<td>4.7</td>
</tr>
<tr>
<td>7. Boston</td>
<td>4.2</td>
</tr>
<tr>
<td>8. Washington</td>
<td>3.9</td>
</tr>
<tr>
<td>9. Dallas</td>
<td>3.9</td>
</tr>
<tr>
<td>10. Houston</td>
<td>3.7</td>
</tr>
<tr>
<td>11. Miami</td>
<td>3.2</td>
</tr>
<tr>
<td>12. Atlanta</td>
<td>2.8</td>
</tr>
<tr>
<td>13. Cleveland</td>
<td>2.8</td>
</tr>
<tr>
<td>14. Seattle</td>
<td>2.6</td>
</tr>
<tr>
<td>15. San Diego</td>
<td>2.5</td>
</tr>
<tr>
<td>16. Minneapolis</td>
<td>2.5</td>
</tr>
<tr>
<td>17. St. Louis</td>
<td>2.4</td>
</tr>
<tr>
<td>18. Baltimore</td>
<td>2.4</td>
</tr>
<tr>
<td>19. Pittsburgh</td>
<td>2.2</td>
</tr>
<tr>
<td>20. Phoenix</td>
<td>2.1</td>
</tr>
<tr>
<td>21. Tampa</td>
<td>2.0</td>
</tr>
<tr>
<td>22. Denver</td>
<td>1.8</td>
</tr>
<tr>
<td>23. Cincinnati</td>
<td>1.7</td>
</tr>
<tr>
<td>24. Milwaukee</td>
<td>1.6</td>
</tr>
<tr>
<td>25. Kansas City</td>
<td>1.6</td>
</tr>
<tr>
<td>34. Charlotte</td>
<td>1.2</td>
</tr>
<tr>
<td>38. Salt Lake City</td>
<td>1.1</td>
</tr>
<tr>
<td>40. Nashville</td>
<td>1.0</td>
</tr>
<tr>
<td>41. Memphis</td>
<td>1.0</td>
</tr>
<tr>
<td>44. Dayton</td>
<td>1.0</td>
</tr>
<tr>
<td>54. Raleigh-Durham</td>
<td>0.7</td>
</tr>
</tbody>
</table>

The following chart lists the largest airports in the United States:

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Chicago dominates U.S. air transportation because of geographic proximity and huge metropolitan population (8 million people, compared to Detroit's 4.7 million, St. Louis' 2.4 million, or Minneapolis' 2.5 million). Dallas dominates the south central region, and Atlanta the southeast, for the same reasons — population base and geographic proximity. Atlanta, for example, has but one airport serving a metropolitan population of 2.8 million compared to the surrounding southern hubs of Charlotte, Nashville, Raleigh, and Memphis of less than half the people. As we shall see, the three largest U.S. airports are dominated by the three largest U.S. airlines — American, Delta and United.

Compare these data with the number of passengers and operations at the largest foreign airports:

<table>
<thead>
<tr>
<th>AIRPORT</th>
<th>TOTAL PASSENGERS</th>
<th>COMMERCIAL OPERATIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>London Heathrow</td>
<td>42,647,235</td>
<td>388,289</td>
</tr>
<tr>
<td>Frankfurt</td>
<td>29,631,427</td>
<td>324,387</td>
</tr>
<tr>
<td>Paris Orly</td>
<td>24,205,570</td>
<td>191,421</td>
</tr>
<tr>
<td>Paris Charles de Gaulle</td>
<td>22,094,122</td>
<td>233,000</td>
</tr>
<tr>
<td>London Gatwick</td>
<td>21,047,089</td>
<td>203,211</td>
</tr>
<tr>
<td>Stockholm</td>
<td>14,822,450</td>
<td>257,606</td>
</tr>
<tr>
<td>Copenhagen</td>
<td>12,080,978</td>
<td>190,767</td>
</tr>
<tr>
<td>Dusseldorf</td>
<td>11,576,506</td>
<td>139,147</td>
</tr>
<tr>
<td>Munich</td>
<td>11,218,119</td>
<td>163,282</td>
</tr>
<tr>
<td>Vancouver</td>
<td>9,912,429</td>
<td>279,788</td>
</tr>
</tbody>
</table>

221. U.S. Large Airport Traffic, 12 Months 1990, AVIATION DAILY, Aug. 15, 1990, at 307. Enplaned passenger figures have been doubled to approximate total passengers, the standard used in the following chart for foreign airports. However, the reader should beware that a doubling of enplaned passengers may not be precisely the total number of passengers flown through the airport.

AIRLINE MARKET SHARES AT U.S. CONCENTRATED AIRPORTS
(20 airports where a single airline has more than 45% share)

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>ATLANTA</td>
<td></td>
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</tr>
<tr>
<td>Delta</td>
<td>52.6</td>
<td>57.1</td>
<td>89.2%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Eastern</td>
<td>40.2</td>
<td>35.7</td>
<td>0</td>
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<tr>
<td>BALTIMORE</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>USAir</td>
<td>24.5</td>
<td>13.7</td>
<td>60.0</td>
<td>68.1</td>
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<tr>
<td>CHARLOTTE</td>
<td></td>
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<tr>
<td>USAir</td>
<td></td>
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<tr>
<td>CHICAGO O'HARE</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>United</td>
<td>46.0</td>
<td>48.9</td>
<td>49.7%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>American</td>
<td>25.5</td>
<td>34.1</td>
<td>34.5%</td>
<td></td>
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<tr>
<td>CINCINNATI</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Delta</td>
<td>35.0</td>
<td>55.9</td>
<td>67.6</td>
<td>84.5</td>
<td>88.1%</td>
</tr>
<tr>
<td>DALLAS/FT. WORTH</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>American</td>
<td>62.0</td>
<td>62.8</td>
<td>61.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Delta</td>
<td>22.5</td>
<td>30.1</td>
<td>31.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>DENVER</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United</td>
<td>39.9</td>
<td>48.8</td>
<td>47.7%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Continental</td>
<td>23.4</td>
<td>34.0</td>
<td>35.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>DETROIT</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Northwest</td>
<td>11.9</td>
<td>64.9</td>
<td>69.4</td>
<td>73.1%</td>
<td></td>
</tr>
<tr>
<td>HOUSTON</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Continental</td>
<td>20.4</td>
<td>47.1</td>
<td>71.5</td>
<td>77.3</td>
<td>80.2%</td>
</tr>
<tr>
<td>MEMPHIS</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Northwest</td>
<td>nil</td>
<td>86.7</td>
<td>82.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MINNEAPOLIS/ST. PAUL</td>
<td>45.9</td>
<td>47.8</td>
<td>81.6</td>
<td>80.0</td>
<td>81.3%</td>
</tr>
<tr>
<td>NASHVILLE</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>American</td>
<td>28.2</td>
<td>22.0</td>
<td>60.2</td>
<td>65.1</td>
<td></td>
</tr>
<tr>
<td>NEWARK</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Continental</td>
<td>nil</td>
<td>48.2</td>
<td>53.2%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>PHILADELPHIA</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>USAir</td>
<td>23.8</td>
<td>46.1</td>
<td>52.9%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>PHOENIX</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>America West</td>
<td>18.4</td>
<td>45.8</td>
<td>47.1%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Southwest</td>
<td>14.0</td>
<td>21.3</td>
<td>23.2%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>PITTSBURGH</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>USAir</td>
<td>43.7</td>
<td>77.2</td>
<td>82.8</td>
<td>87.5</td>
<td>89.6%</td>
</tr>
<tr>
<td>RALEIGH/DURHAM</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>American</td>
<td>nil</td>
<td>78.6</td>
<td>82.4%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ST. LOUIS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TWA</td>
<td>39.1</td>
<td>57.9</td>
<td>82.3</td>
<td>78.7</td>
<td>76.4%</td>
</tr>
<tr>
<td>SALT LAKE CITY</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Delta</td>
<td>nil</td>
<td>74.5</td>
<td>83.7</td>
<td>82.6%</td>
<td></td>
</tr>
<tr>
<td>United</td>
<td>23.9</td>
<td>65.1</td>
<td>67.8%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Again, the three largest U.S. airlines — American, Delta and United, have the largest U.S. flag presence at the two largest foreign airports.

The dominant megatrend on the U.S. deregulation landscape is the growth of hubs and spokes. Some call them "fortress hubs", where a single airline controls the lion’s share of gates, takeoffs and landings, and passengers. Note that not a single major airport in the United States was dominated by one airline before deregulation; not one had more than 45% of any major airport. The preceding chart describes the growth in concentration at 20 U.S. airports which have become hubs.

Hubbing requires smaller aircraft flying shorter stage lengths and consuming more labor and fuel than a linear route system. Since smaller aircraft, like the hub favorite DC-9s, 727s, and 737s, have higher unit costs per passenger than the larger wide-bodied planes which were the growing trend pre-deregulation, why do airlines prefer them?

The U.S. General Accounting Office [GAO] has found that air fares during 1988-89 at concentrated airports were 27% higher than at unconcentrated facilities.224 Similarly, the DOT found that fares at concentrated hub airports were 18.7% higher than in more competitive markets of similar distance and size.225

The GAO has also found a correlation between higher fares on the one hand, and code-sharing agreements (2% higher), highly congested airports (2% higher), majority-in-interest clauses (3% higher), and slot limitations (4% higher), on the other.226 Of the 3,129 gates at the nation’s 66 largest airports, 88% are leased to airlines, and 85% of the leases are for exclusive use; 90% of leased gates are held by the eight largest airlines.227 According to the GAO, a 65% increase in a carrier’s market share on a route translates into 6% higher fares.228

As of 1988, the eight largest airlines owned 96% of the takeoff and landing slots at the four slot-constrained airports (i.e., Chicago O’Hare, Washington National, and New York’s LaGuardia and Kennedy). In 1985, before the DOT freed airlines to buy and sell slots in the market, these

---

224. GAO, AIRLINE COMPETITION; HIGHER FARES AND REDUCED COMPETITION AT CONCENTRATED AIRPORTS (1990).  GAO, AIR FARES AND SERVICE AT CONCENTRATED AIRPORTS (1989).  Higher Fares at Concentrated Airports Continue, GAO Says, AVIATION DAILY, July 13, 1990, at 81.  Other studies have revealed that fares are more than 18% higher per mile at airports where a single airline controls more than 75% of departures, than the national average.  Ground Control, We Seem to Have a Problem, ECONOMIST, Jan. 26, 1991, at 57, 60.


227. Intelligence, AVIATION DAILY, Aug. 20, 1990, at 323.

228. GAO Releases Findings on Concentration and Limited Entry, supra note 226, at 309.
airlines controlled only 70% of the slots. 229 An airline which doubles the number of its gates enjoys a 3.5% increase in fares. 230

American Airlines owns 528 jet slots at Chicago O'Hare airport, which it values at $1.056 billion. 231 In 1991, United owned 747 slots at O'Hare, worth nearly $1.5 billion, and had reached an agreement to purchase Air Wisconsin, which owned 118 commuter slots at O'Hare. 232 American recently offered $2 million per slot at O'Hare. 233

D. BANKRUPTCIES

Nearly 200 airlines have gone bankrupt since promulgation of the Airline Deregulation Act of 1978. 234 Beginning in 1989, several major airlines entered Chapter 11 (reorganization) bankruptcy, including Eastern, Pan Am, Midway, Continental, America West and TWA.

To date, not one major airline which entered Chapter 11 has emerged successfully (Continental emerged in 1986, then reentered in 1990). Eastern Air Lines, the nation's oldest (which began operations as Pitcairn Aviation on May 1, 1927) ceased operations on January 18, 1991. Pan Am, which began flying on October 28, 1987, ceased operations on December 5, 1991. Midway Airlines, a creature born of deregulation, ceased operations on November 14, 1991. 235

As of this writing, three major airlines — Continental, TWA and America West — are in bankruptcy. These three airlines account for between 15% and 20% of the market.

Several executives at the healthier airlines (e.g., American and Delta) have urged the Department of Transportation to revoke the certificates of airlines operating in Chapter 11 bankruptcy on grounds that they fail to satisfy the statutory standard of "fitness" required by section 401 of the Federal Aviation Act. 236 To date, DOT has shown little enthusiasm for the idea.

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230. Id. at 6.
232. Id.
233. Id.
E. CONCENTRATION

Prior to deregulation in 1978, 99% of the traffic was carried by the following 19 domestic trunkline and local service carriers:

TRUNKLINE AND LOCAL SERVICE AIRLINES (1978)

<table>
<thead>
<tr>
<th>TRUNKLINE AND LOCAL SERVICE AIRLINES (1978)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allegheny</td>
</tr>
<tr>
<td>American</td>
</tr>
<tr>
<td>Braniff</td>
</tr>
<tr>
<td>Continental</td>
</tr>
<tr>
<td>Delta</td>
</tr>
<tr>
<td>Eastern</td>
</tr>
<tr>
<td>Frontier</td>
</tr>
<tr>
<td>Hughes Airwest</td>
</tr>
<tr>
<td>National</td>
</tr>
<tr>
<td>North Central</td>
</tr>
<tr>
<td>Northwest</td>
</tr>
<tr>
<td>Ozark</td>
</tr>
<tr>
<td>Pan American</td>
</tr>
<tr>
<td>Piedmont</td>
</tr>
<tr>
<td>Southern</td>
</tr>
<tr>
<td>Texas International</td>
</tr>
<tr>
<td>Trans World</td>
</tr>
<tr>
<td>United</td>
</tr>
<tr>
<td>United</td>
</tr>
<tr>
<td>Western</td>
</tr>
</tbody>
</table>

In 1978, the eight largest airlines had a market share of 80%. However, as the following chart reveals, the market share of the eight largest airlines exceeded 90% in the 1990s, a level unprecedented in the history of U.S. aviation:

U.S. AIRLINE MARKET SHARES

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>United</td>
<td>17.4</td>
<td>16.0</td>
<td>15.5</td>
<td>12.5</td>
<td>16.4</td>
<td>16.7</td>
<td>18.5</td>
</tr>
<tr>
<td>American</td>
<td>12.8</td>
<td>12.7</td>
<td>12.4</td>
<td>13.3</td>
<td>17.3</td>
<td>17.0</td>
<td>18.6</td>
</tr>
<tr>
<td>TWA</td>
<td>11.9</td>
<td>10.1</td>
<td>9.6</td>
<td>9.6</td>
<td>8.3</td>
<td>7.5</td>
<td>6.3</td>
</tr>
<tr>
<td>Eastern</td>
<td>11.1</td>
<td>10.5</td>
<td>9.9</td>
<td>10.0</td>
<td>2.7</td>
<td>3.7</td>
<td>0</td>
</tr>
<tr>
<td>Delta</td>
<td>10.3</td>
<td>9.6</td>
<td>9.2</td>
<td>9.0</td>
<td>14.0</td>
<td>13.0</td>
<td>15.2</td>
</tr>
<tr>
<td>Pan Am</td>
<td>9.3</td>
<td>10.7</td>
<td>9.5</td>
<td>8.1</td>
<td>6.8</td>
<td>6.8</td>
<td>4.1</td>
</tr>
<tr>
<td>Continental</td>
<td>3.8</td>
<td>3.5</td>
<td>3.7</td>
<td>4.9</td>
<td>9.1</td>
<td>8.6</td>
<td>9.4</td>
</tr>
<tr>
<td>Northwest</td>
<td>3.1</td>
<td>6.6</td>
<td>6.7</td>
<td>6.7</td>
<td>10.8</td>
<td>11.3</td>
<td>12.0</td>
</tr>
<tr>
<td>USAir</td>
<td>1.8</td>
<td>2.7</td>
<td>2.8</td>
<td>2.9</td>
<td>8.0</td>
<td>7.8</td>
<td>7.7</td>
</tr>
</tbody>
</table>

By January 1992, the three largest U.S. airlines controlled 57% of the market; the top four had 70%.239 A doubling of an airline's market share on a particular route translates into a price increase of almost nine percent. In 1990, 76% of all passengers in domestic markets flew on routes served by three or fewer airlines; 45% flew on routes served by only one or two carriers.240

The following acquisitions of airlines and major airline properties, exceeding $13 billion, were consummated since 1986:

<table>
<thead>
<tr>
<th>ACQUIRED AIRLINE PROPERTIES</th>
<th>ACQUIRING AIRLINE</th>
<th>PRICE (in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986 Pan Am (transpacific)</td>
<td>United</td>
<td>$715</td>
</tr>
<tr>
<td>Republic</td>
<td>Northwest</td>
<td>$884</td>
</tr>
<tr>
<td>Ozark</td>
<td>TWA</td>
<td>$250</td>
</tr>
<tr>
<td>Eastern</td>
<td>Texas Air</td>
<td>$676</td>
</tr>
<tr>
<td>People Express</td>
<td>Texas Air</td>
<td>$112</td>
</tr>
<tr>
<td>1987 Air Cal</td>
<td>American</td>
<td>$225</td>
</tr>
<tr>
<td>Western</td>
<td>Delta</td>
<td>$860</td>
</tr>
<tr>
<td>Pacific Southwest</td>
<td>USAir</td>
<td>$400</td>
</tr>
<tr>
<td>Piedmont</td>
<td>USAir</td>
<td>$1,590</td>
</tr>
<tr>
<td>1989 Eastern (NY shuttle)</td>
<td>Trump</td>
<td>$365</td>
</tr>
<tr>
<td>Northwest</td>
<td>Checchi Group</td>
<td>$3,650</td>
</tr>
<tr>
<td>Eastern (Philadelphia)</td>
<td>Midway</td>
<td>$210</td>
</tr>
<tr>
<td>1990 Midway (Philadelphia)</td>
<td>USAir</td>
<td>$68</td>
</tr>
<tr>
<td>Eastern (Latin America)</td>
<td>American</td>
<td>$471</td>
</tr>
<tr>
<td>Eastern (LaGuardia slots)</td>
<td>American</td>
<td>$10</td>
</tr>
<tr>
<td>Eastern (Canadian routes)</td>
<td>American</td>
<td>$10</td>
</tr>
<tr>
<td>Continental (Seattle-Tokyo)</td>
<td>American</td>
<td>$150</td>
</tr>
<tr>
<td>TWA (Chicago)</td>
<td>American</td>
<td>$80</td>
</tr>
<tr>
<td>TWA (D.C. slots)</td>
<td>United</td>
<td>$19</td>
</tr>
<tr>
<td>Pan Am (London)</td>
<td>United</td>
<td>$400</td>
</tr>
<tr>
<td>Pan Am (Berlin)</td>
<td>Lufthansa</td>
<td>$150</td>
</tr>
</tbody>
</table>

239. See American Captures Nearly 21 Percent of Major's RPMs, AVIATION DAILY, Feb. 19, 1992, at 301.

1991
Midway (21 Chicago gates)  Northwest  $22
Eastern (Chicago & D.C. gates & slots)  United  $90
Eastern (LaGuardia gates & slots)  Continental  $54
Eastern (Canadian routes)  Delta  $243
Eastern (Atlanta and L.A. gates)  Delta  $63
Pan Am (European routes and NY shuttle)  Delta  $416
Pan Am (NY shuttle)  Delta  $113
Pan Am (Latin America)  United  $135
Air Wisconsin  United  $72
Pan Am Express  TWA  $28
TWA (Heathrow)  American  $515
TWA (Philadelphia and Baltimore — London)  USAir  $50
Continental (Air Micronesia)  investment group  $250

1992
Continental (LaGuardia terminal and slots)  USAir  $61

F. COMPUTER RESERVATIONS SYSTEMS

Ninety-five percent of travel agents use one of the airline-owned computer reservations systems [CRS]. According to the GAO, an airline which owns its own CRS stands between a 13% to 18% greater chance of selling its product through its system than does a competitor.

Covia (owned by United, USAir and British Air) operates and markets the Apollo CRS, developed by United Air Lines. American Airlines owns Sabre. Worldspan is owned by TWA, Northwest and Delta. It includes the Pars CRS, developed by TWA, and Datas II, developed by Delta. System One was developed by Eastern, and acquired by Continental.

Several smaller systems exist. Abacus is owned jointly by several airlines, including Singapore Airlines and Cathay Pacific. Gemini is owned by Air Canada and Canadian.

Sixty-six percent of all revenue booked by travel agents in the United States are booked on either Apollo or Sabre. Because of the dearth of competition in the CRS industry, United and American earn more than $300 million per year from weaker airlines beyond the cost of providing

241. GAO, AIRLINE COMPETITION; HIGHER FARES AND REDUCED COMPETITION AT CONCENTRATED AIRPORTS, supra note 224, at 27.
242. GAO, AIRLINE COMPETITION: IMPACT OF COMPUTERIZED RESERVATIONS SYSTEMS 5-6 (1986).
243. Amadeus, Sabre Sign Long-Term Marketing Agreement, AVIATION DAILY, Nov. 19, 1990, at 334. In 1990, Sabre signed a marketing agreement with the European CRS Amadeus, which is a consortium owned equally by Lufthansa, Iberia, SAS and Air France in 1987. However, the agreement was not consummated.
the service, according to the GAO.\(^{246}\) The DOT has concluded that booking fees charged other airlines were approximately double American’s or United’s average costs in 1988.\(^{247}\) These carriers enjoy rates of return on their CRSs of between 60% to 100% a year.\(^{248}\) Critics have asserted that this gives American Airlines fees in excess of costs approximately $215 million a year, and an advantage of $328 million a year as a result of the "halo" effect.\(^{249}\) An airline which owns a CRS stands between a 13% to 18% greater chance of selling its product through its system than does a competitor. American responds by insisting that Sabre’s annual profits are only about $78 million, and it pays some $57 million in booking fees to other CRS vendors.\(^{250}\) Some have also alleged that computer reservations systems facilitate implicit price fixing.\(^{251}\)

\(^{G.} \text{DEBT}\)

Anemic profitability in the 1980s coupled with leveraged buy-outs caused a number of airlines to increase their debt-to-equity ratios.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>America West</td>
<td>—</td>
<td>44.7</td>
<td>81.5</td>
<td>84.5</td>
</tr>
<tr>
<td>American</td>
<td>63.4</td>
<td>51.2</td>
<td>45.1</td>
<td>33.5</td>
</tr>
<tr>
<td>Continental</td>
<td>62.3</td>
<td>308.9</td>
<td>97.3</td>
<td>96.3</td>
</tr>
<tr>
<td>Delta</td>
<td>10.6</td>
<td>45.0</td>
<td>33.4</td>
<td>18.3</td>
</tr>
<tr>
<td>Eastern</td>
<td>78.5</td>
<td>93.2</td>
<td>90.7</td>
<td>n.a.</td>
</tr>
<tr>
<td>Northwest</td>
<td>5.4</td>
<td>8.2</td>
<td>50.8</td>
<td>n.a.</td>
</tr>
<tr>
<td>Pan Am</td>
<td>62.0</td>
<td>71.9</td>
<td>99.0</td>
<td>272.9</td>
</tr>
<tr>
<td>Southwest</td>
<td>38.0</td>
<td>29.6</td>
<td>35.3</td>
<td>33.4</td>
</tr>
<tr>
<td>TWA</td>
<td>61.8</td>
<td>65.4</td>
<td>94.2</td>
<td>114.8</td>
</tr>
<tr>
<td>United</td>
<td>45.2</td>
<td>41.5</td>
<td>45.8</td>
<td>46.1</td>
</tr>
<tr>
<td>USAir</td>
<td>44.0</td>
<td>31.8</td>
<td>24.8</td>
<td>44.8</td>
</tr>
<tr>
<td>INDUSTRY AVERAGE</td>
<td>53.5</td>
<td>57.3</td>
<td>56.8</td>
<td>56.2</td>
</tr>
</tbody>
</table>

In addition, the heavily leveraged airline industry carries considerable debt off its balance sheets in the form of sales of residual aircraft values

\(^{246}\) \textit{Intelligence}, AVIATION DAILY, Feb. 11, 1991, at 269.

\(^{247}\) \textit{Financial Condition, supra} note 225, at XVII. DOT, STUDY OF COMPUTER AIRLINE RESER-VATIONS SYSTEMS 110 (1988).

\(^{248}\) \textit{Id.} at XVIII.

\(^{249}\) \textit{Id.} at 65 (statement of Edward R. Beauvais).

\(^{250}\) \textit{Id.} at 595 (statement of William J. Burhop).


(the estimated value of the aircraft at the end of the lease term), while leasing back the planes.\textsuperscript{253} For example, adding the debt equivalent of aircraft leases to Delta’s on balance sheet debt (about $3 billion to the on balance sheet debt of $1.2 billion), increases the debt-to-equity ratio to 61\%.\textsuperscript{254} About fifty percent of the aircraft in the U.S. fleet are owned and leased by equipment leasing companies.\textsuperscript{255} Moreover, frequent flyer liability, totaling more than $100 million at some airlines, is also omitted from the balance sheets.

H. \textit{Economic Performance}

Worldwide, civil aviation generates gross revenue of some $700 billion.\textsuperscript{256} In the United States, airlines and airports produce gross revenue of $254 billion.\textsuperscript{257} Commercial air transportation is an integral part of the tour and travel industry, arguably the world’s largest single industry, creating revenue of $2.5 trillion, about 5.5\% of the world’s GNPs.\textsuperscript{258}

During the first decade of deregulation, the U.S. airline industry’s profit margin declined 74\%, from already unsatisfactory levels, to a paltry 0.6\% (compared with between 3.0\% and 6.0\% for all manufacturers).\textsuperscript{259} The following chart reveals profit margins in the airline industry pre- and post-deregulation:

\begin{table}[h]
\centering
\begin{tabular}{|c|c|}
\hline
Year & Profit Margin \\
\hline
1980 & 3.0\% \\
1990 & 0.6\% \\
\hline
\end{tabular}
\end{table}

\textsuperscript{253} Financial Condition, supra note 225, at 589-90 (statement of Timothy Pettee).
\textsuperscript{256} Eser, \textit{Airlines Bleeding to Death}, IATA REV., Apr. 1991, at 3.
\textsuperscript{257} TRANSPORTATION RESEARCH BOARD, supra note 5, at 21.
\textsuperscript{258} Eser, supra note 256, at 3.
\textsuperscript{259} US Airline Deregulation a Financial Disaster, AFN Study Shows, COMMUTER REGIONAL AIRLINE NEWS, Apr. 8, 1991, at 8.
The two year period ending June 30, 1989, was the most profitable period in airline history. But profitability turned south in 1990, when the domestic airline industry suffered an unprecedented net loss of $3.9 billion in 1990 — the worst losses in its history. U.S. airlines lost another $1.8 billion in 1991. The world's commercial airlines lost $2.7 billion in

261. Leveraged Buyouts, supra note 254, at 14 (statement of Timothy Pettee).
262. McGinley, Airline Industry Seen Posting Losses in Fourth Quarter, WALL ST. J., Oct. 8,
1990 and $4 billion in 1991 on international routes alone.\textsuperscript{263}

By the end of 1991, the U.S. airline industry had lost all the profit it had earned since the Wright Brothers flew at Kitty Hawk, plus nearly $2 billion more.\textsuperscript{264} It was predicted that the industry would earn only $300 million in 1992, representing a profit margin of only 0.3\%.\textsuperscript{265} The net cumulative earnings of the U.S. airline industry is reflected in the following chart.

**Cumulative Airline Earnings**\textsuperscript{266}

*(in million $)*

<table>
<thead>
<tr>
<th>YEAR</th>
<th>NET PROFIT (LOSS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981</td>
<td>3,499.2</td>
</tr>
<tr>
<td>1982</td>
<td>2,749.6</td>
</tr>
<tr>
<td>1983</td>
<td>2,474.3</td>
</tr>
<tr>
<td>1984</td>
<td>3,058.5</td>
</tr>
<tr>
<td>1985</td>
<td>3,894.9</td>
</tr>
<tr>
<td>1986</td>
<td>3,321.2</td>
</tr>
<tr>
<td>1987</td>
<td>4,176.0</td>
</tr>
<tr>
<td>1988</td>
<td>4,744.2</td>
</tr>
<tr>
<td>1989</td>
<td>3,267.8</td>
</tr>
<tr>
<td>1990</td>
<td>(470.4)</td>
</tr>
<tr>
<td>1991</td>
<td>(1,800.0)*</td>
</tr>
</tbody>
</table>

\* 1991 estimate

Anemic economic performance has forced nearly 200 airlines into bankruptcy since deregulation began in 1978. Some enter Chapter 11 reorganization bankruptcy, continuing operations while seeking to restructure debt. Because they are shielded from their creditors while in Chapter 11, many "trash" the fares in the markets in which they compete, much to the chagrin of carriers operating outside of Chapter 11. Executives at both American and Delta have urged the DOT to revoke the certificates of airlines in bankruptcy on grounds that they fail to satisfy the fitness obligations of the Federal Aviation Act.\textsuperscript{267}

The airline industry has placed approximately $80 billion in orders for new aircraft — two to three times the total invested capital in the indus-

\textsuperscript{263} Will They Ever Fly Again?, supra note 132, at 67.

\textsuperscript{264} Almost One in 10 Airline Workers Loses Job; Financial Losses Exceed Gains, AVIATION DAILY, Oct. 29, 1991, at 177.

\textsuperscript{265} McGinley, supra note 262, at A16.


The industry needs to raise between $130 billion and $200 billion by the end of the decade for new aircraft (investing between $15 billion and $20 billion annually), and another $50 billion for airport and infrastructure improvements. Bear in mind that the airline industry as a whole had operating cash of less than $5 billion and operating earnings of $2.3 billion in 1988, which was a very good year. Excessive debt can have a debilitating effect on the ability of airlines to make new aircraft purchases, expand operations, maintain competition, or withstand the vicissitudes of the market cycle.

I. EMPLOYMENT

Worldwide, civil aviation employs 21 million people. In the United States, more than 2 million Americans are employed in airline or airport operations. Commercial air transportation is an integral part of the tour and travel industry, arguably the world’s largest single industry, employing 112 million people. During 1990-1991, about 55,000 U.S. and Canadian airline employees, or nearly one in ten workers in this industry, lost their jobs.

J. EXPENSES

The airline’s operating expenses increased 94% during deregulation’s first six years. The following changes have occurred in selected expenses as a percentage of total operating expenses from 1980 to 1990:

268. Financial Condition, supra note 225, at 589 (statement of Timothy Pettee).
270. Leveraged Buyouts, supra note 254, at 3 (statement of Philip Baggaley); Id. at 73 (statement of Timothy Pettee).
271. Eser, supra note 254, at 3.
272. TRANSPORTATION RESEARCH BOARD, supra note 5, at 21.
273. Eser, supra note 254, at 3.
BREAKDOWN OF OPERATING EXPENSES (1980-1990)

<table>
<thead>
<tr>
<th>EXPENSE</th>
<th>1980</th>
<th>1990</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labor Salaries and Benefits</td>
<td>37.3%</td>
<td>33.8%</td>
</tr>
<tr>
<td>Aircraft Fuel and Oil</td>
<td>31.0%</td>
<td>17.7%</td>
</tr>
<tr>
<td>Travel Agent Commissions</td>
<td>3.4%</td>
<td>10.0%</td>
</tr>
<tr>
<td>Equipment Rentals</td>
<td>1.8%</td>
<td>7.1%</td>
</tr>
<tr>
<td>Landing Fees</td>
<td>1.7%</td>
<td>1.8%</td>
</tr>
<tr>
<td>Advertising and Other Promotions</td>
<td>1.7%</td>
<td>2.1%</td>
</tr>
<tr>
<td>All Other (e.g. maintenance, food, interest)</td>
<td>21.1%</td>
<td>27.2%</td>
</tr>
</tbody>
</table>

Note that the fastest growing costs during this period were equipment rentals (increasing 781% over this period), and travel agent commissions (rising 308%). Contrary to the assertions of former U.S. Secretary of Transportation Samuel Skinner, labor costs were not responsible for the disintegration of the economic health of U.S. airlines. As a percentage of operating expenses, labor costs declined during this period.

Every cent a gallon increase in jet fuel costs the industry about $150 million. Much of the industry’s economic anemia occurring in 1990-91 was blamed in the spike in fuel costs precipitated by Operation Desert Storm. Actually, aviation fuel cost more per gallon between 1981 and 1984 (when it ranged between $0.79 and $1.04 per gallon, or adjusted for inflation, between $1.40 and $1.47), than in 1990 (when it sold for only $0.80 per gallon). Fuel costs dropped 31% between 1985 and 1986. By December 1991, the spot price of aviation fuel was just $0.47 per gallon.

K. INTERNATIONAL AVIATION

The economic well being of some airlines appears to be driven by disproportionate profits earned on international routes. For example, between 1987 and 1989, Northwest earned between 68% and 91% of its total operating profit from international markets, while United earned be-

280. Flint, Don't Blame It All On Fuel, AIR TRANSPORT WORLD, Feb. 1991, at 32.
281. Id.
282. Plummeting Jet Fuel Prices to Have Little Effect on Air Ticket Prices, supra note 279, at 545.
between 24% and 34% from its international routes.\textsuperscript{283} 

The following chart identifies the source of foreign tourists in the United States.

**TOP TEN TOURIST GENERATING NATIONS\textsuperscript{284}
(January-May, 1991)**

<table>
<thead>
<tr>
<th>COUNTRY OF RESIDENCE</th>
<th>NUMBER OF ARRIVALS</th>
<th>PERCENTAGE OF TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>6,712,141</td>
<td>53.1</td>
</tr>
<tr>
<td>Japan</td>
<td>1,087,298</td>
<td>8.6</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>847,244</td>
<td>6.7</td>
</tr>
<tr>
<td>Germany</td>
<td>488,452</td>
<td>3.8</td>
</tr>
<tr>
<td>Mexico</td>
<td>469,811</td>
<td>3.7</td>
</tr>
<tr>
<td>France</td>
<td>271,080</td>
<td>2.1</td>
</tr>
<tr>
<td>Australia</td>
<td>166,373</td>
<td>1.3</td>
</tr>
<tr>
<td>Brazil</td>
<td>156,342</td>
<td>1.2</td>
</tr>
<tr>
<td>Italy</td>
<td>130,193</td>
<td>1.0</td>
</tr>
<tr>
<td>China</td>
<td>114,177</td>
<td>0.9</td>
</tr>
</tbody>
</table>

Of course, not all tourists fly. Many from Canada or Mexico drive their automobiles. A better indication of the nations which are responsible for generating the largest number of airline passengers is provided by the following chart:

**TOP TEN NATIONS GENERATING AIRLINE PASSENGER TRAFFIC TO AND FROM THE UNITED STATES (1989)\textsuperscript{285}**

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>TOTAL TRAFFIC (000)</th>
<th>% U.S. CITIZENS</th>
<th>% U.S. FLAG</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>9,166</td>
<td>50</td>
<td>51</td>
</tr>
<tr>
<td>Japan</td>
<td>8,199</td>
<td>24</td>
<td>55</td>
</tr>
<tr>
<td>Mexico</td>
<td>7,473</td>
<td>72</td>
<td>55</td>
</tr>
<tr>
<td>Germany</td>
<td>4,199</td>
<td>57</td>
<td>51</td>
</tr>
<tr>
<td>France</td>
<td>3,064</td>
<td>55</td>
<td>64</td>
</tr>
<tr>
<td>Bahama Islands</td>
<td>2,855</td>
<td>75</td>
<td>74</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>1,772</td>
<td>77</td>
<td>77</td>
</tr>
<tr>
<td>Jamaica</td>
<td>1,697</td>
<td>72</td>
<td>38</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1,467</td>
<td>49</td>
<td>14</td>
</tr>
<tr>
<td>Italy</td>
<td>1,440</td>
<td>62</td>
<td>54</td>
</tr>
</tbody>
</table>


\textsuperscript{284} Data shown are from January to May, 1991. Tourist Travel Rebounds in 2d Quarter 1991, Spending Also Up, AVIATION DAILY, Sept. 24, 1991, at 561.

\textsuperscript{285} Passenger Traffic to and from the U.S. and Other Countries, Top 50 Countries Ranked by Passengers, The Year 1989, AVIATION DAILY, July 18, 1990, at 112.
Forty-four million people will visit the United States in 1992.\textsuperscript{286} Brazil is expected to have the strongest growth in visitors to the United States in 1992, with traffic increasing 14\%, followed by Italy (12\%) and France (8\%).\textsuperscript{287} Foreign travel to the U.S. increased by 67\% between 1986 and 1991, while U.S. travel abroad rose only 23\%.\textsuperscript{288} Some 30\% of U.S. citizens were expected to travel abroad in 1992, with the most likely group between 45 and 49 years old and family income of more than $40,000 a year.\textsuperscript{289}

The following chart identifies the largest foreign airlines.

\textbf{TEN LARGEST FOREIGN AIRLINES\textsuperscript{290}}
(first half, 1989)

<table>
<thead>
<tr>
<th>AIRLINE</th>
<th>PASSENGERS</th>
<th>REVENUE PASSENGER KM</th>
</tr>
</thead>
<tbody>
<tr>
<td>British Airways</td>
<td>12,160,847</td>
<td>31,610,696</td>
</tr>
<tr>
<td>Lufthansa</td>
<td>10,462,100</td>
<td>19,335,800</td>
</tr>
<tr>
<td>Air France</td>
<td>17,462,529</td>
<td>17,462,529</td>
</tr>
<tr>
<td>Singapore Airlines</td>
<td>3,407,000</td>
<td>15,232,600</td>
</tr>
<tr>
<td>Qantas Airways</td>
<td>2,061,927</td>
<td>13,548,823</td>
</tr>
<tr>
<td>KLM Royal Dutch Airlines</td>
<td>3,523,888</td>
<td>12,422,988</td>
</tr>
<tr>
<td>Canadian Airlines Int'l</td>
<td>4,806,322</td>
<td>11,792,132</td>
</tr>
<tr>
<td>Iberia Airlines</td>
<td>7,513,147</td>
<td>10,257,747</td>
</tr>
<tr>
<td>SAS</td>
<td>7,321,000</td>
<td>7,943,000</td>
</tr>
<tr>
<td>Swissair</td>
<td>7,765,844</td>
<td>7,765,844</td>
</tr>
</tbody>
</table>

In recent years, foreign airlines have purchased major equity interest in U.S. flag carriers.

\textbf{FOREIGN AIRLINE OWNERSHIP OF U.S. AIRLINES}

<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>

\textsuperscript{287} Intelligence, AVIATION DAILY, Oct. 28, 1991, at 167.
\textsuperscript{288} Id.
Foreign equity alliances have also proliferated, as revealed by the following chart.

**CROSS OWNERSHIP AGREEMENTS BETWEEN 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>AerolineasArgentinias</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>

### L. PENSION LIABILITY

Several airlines have seriously unfunded pension plans. TWA’s pensions were unfunded by $190 million in 1990, $440 million in 1991, and $933 million in 1992. Concern over Carl Icahn’s privatization of TWA, and the potential that the taxpayer might be stuck with paying its unfunded pension liability led Congress to pass legislation making Mr. Icahn personally responsible for the bill. In 1990, United’s pension was unfunded by $57 million; Northwest’s was unfunded by $78 million. Continental’s was unfunded by $183 million, and the Pension Benefit

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294. Three Majors Among Top 50 Firms With Unfunded Pensions, supra note 292, at 355.
Guarantee Corporation [PBGC] filed a claim in Continental’s bankruptcy seeking to recover $752 million in unfunded Eastern Air Lines liability.295

Several carriers which have ceased operating left the PBGC holding the bag. These included Pan Am ($914 million unfunded), and as noted above, Eastern ($752 million unfunded).296 It has been predicted that unfunded pension plans left high and dry by the disintegration of airlines may ultimately cost the U.S. taxpayer $1.7 billion.297

In January 1992, the Pension Benefit Guaranty Corporation filed to block Continental’s $290 million sale of Air Micronesia to an investor group on grounds that Continental Airline Holdings owes approximately $700 million in unfunded pension liability.298

M. PRICING

By the end of the first decade of deregulation, the full unrestricted "Y" fare had increased 156%, double the inflation rate.299 With the full fare rising so sharply, relatively few passengers would pay it. During 1991, 95% of all passengers were flying on a discount, with the average discount some 66% off the full fare.300

Discounted fares are targeted at discretionary (vacation) travelers. So as to dissuade business travelers from using them, they ordinarily come saddled with restrictions — nonrefundability, advance purchase requirements, and Saturday night stay over obligations. However, large corporations can often negotiate a contract rate with airlines which includes the discounted fares, but is largely devoid of restrictions.301

Air fares at small and medium sized communities are nine percent higher, on average, than at large communities.302 And, as noted above, fares are some 27% higher for trips beginning or ending at concentrated hub airports.303 Fares in monopoly markets (about 10% of the total markets), are about 10% higher than competitive markets.304 In 1992, the U.S. Department of Justice launched an antitrust investigation of the air-
line industry for allegedly engaging in price fixing.\textsuperscript{305} An American Airlines vice president colorfully rebutted the contention of monopolization, saying, "We're obviously not enjoying monopoly prices because we're all losing our butts."\textsuperscript{306}

In 1992, American Airlines led a rate rationalization attempt which significantly reduced the number of fare categories, lowering the highest fares and raising the lowest fares. The new simplified rate structure would allegedly be easier for consumers to understand. It would also allow American to reduce the number of its employees devoted to yield management. Also, rate simplification might enable the industry eventually to roll back travel agent commissions, which have been the second largest increasing item of operating expenses. Critics charged that the fares might drive some of the airlines in Chapter 11 into the abyss of liquidation.

At any given time, consumers hold some $3.5 billion in prepaid tickets.\textsuperscript{307} Hence, bankruptcies can leave many travelers stranded, literally and financially.

\textbf{N. PUBLIC EXPENDITURES}

In 1991, the state of Minnesota gave an incentive package worth $838 million to Northwest Airlines to build an aircraft maintenance complex in the state.\textsuperscript{308} Included was $320 million in low-interest loans provided by the Metropolitan Airports Commission, operator of the Minneapolis/St. Paul Airport, as well as $350 million in bonds to construct the complex. The complex was expected to add approximately 1,900 new jobs to the state, on top of the 18,000 Northwest already employed in Minnesota.\textsuperscript{309}

A study performed by the European Community Commission conservatively estimated that the U.S. government gave the airline industry between $33.5 billion and $41.5 billion in direct and indirect support from the mid-1970s to present.\textsuperscript{310} The investment includes between $12.4 billion and $20.2 billion in aeronautics R&D from the U.S. Defense Department, between $1 billion and $1.2 billion in independent R&D reimbursed by the U.S. Department of Defense [DOD], and $17 billion from NASA

\textsuperscript{307}. Intelligence, \textit{supra} note 135, at 359.
\textsuperscript{309}. Id.
programs. It also estimated that total tax deferrals and exemptions granted the industry have exceeded some $3.5 billion since 1976.\footnote{311}

One criticism which has been levied at the U.S. Department of Transportation is that while it has accumulated some $16 billion dollars in the Airport and Airway Trust Fund,\footnote{312} it refuses to spend it, preferring instead to use it to offset a $15 billion piece of the $3 trillion U.S. budget deficit.

\section{Public Opinion}

In 1978, various public opinion polls revealed that airlines ranked at the very top of all industries in terms of consumer confidence and satisfaction.\footnote{313} But in 1989, when the \textit{Wall Street Journal} polled Americans to discern the industries in which they had most, and least, confidence, the largest number by far, 43\%, said they had no confidence in the airline industry.\footnote{314} The disapproval ratings for the industries which followed—insurance (27\%), banking (23\%), oil and gas (22\%), and stockbrokers (22\%)—was not nearly as high as that for airlines.\footnote{315}

The following chart reveals the comparative rankings of major airlines on the basis of consumer complaints filed with the DOT.

\begin{table}[h]
\centering
\begin{tabular}{lccc}
\hline
\textbf{AIRC\textit{LINE}} & \textbf{JANUARY 1989} & \textbf{JANUARY 1990} & \textbf{JANUARY 1991} \\
\hline
America West & 3.98 & 2.10 & 2.82 \\
American & 1.82 & 0.97 & 2.47 \\
Continental & 4.99 & 3.75 & 1.47 \\
Delta & 0.97 & 0.61 & 0.54 \\
Eastern & 4.06 & 4.72 & N/A \\
Northwest & 2.54 & 2.09 & 1.61 \\
Pan Am & 5.23 & 6.98 & 3.99 \\
Southwest & 0.81 & 0.58 & 0.68 \\
TWA & 5.48 & 7.80 & 7.19 \\
United & 2.63 & 1.74 & 1.77 \\
USAir & 2.39 & 4.29 & 0.67 \\
\textbf{AVERAGE} & 2.74 & 2.64 & 1.91 \\
\hline
\end{tabular}
\end{table}

\footnote{311} Id.
\footnote{313} Callison, \textit{supra} note 65, at 964 n.4 (citing 236 \textit{AVIATION DAILY} 118 (1978)).
\footnote{315} Id.
\footnote{316} Rankings of U.S. Carriers Consumer Complaints Per 100,000 Passengers, \textit{AVIATION
The following chart breaks down consumer complaints by type.

**CONSUMER COMPLAINTS BY CATEGORY\(^{317}\)**

<table>
<thead>
<tr>
<th>PROBLEM</th>
<th>NOV. 1988</th>
<th>NOV. 1989</th>
</tr>
</thead>
<tbody>
<tr>
<td>Flight Problems</td>
<td>32.8</td>
<td>37.5</td>
</tr>
<tr>
<td>Baggage</td>
<td>18.3</td>
<td>17.6</td>
</tr>
<tr>
<td>Refunds</td>
<td>7.8</td>
<td>11.3</td>
</tr>
<tr>
<td>Customer Service</td>
<td>10.8</td>
<td>9.6</td>
</tr>
<tr>
<td>Reservations, Ticketing, Boarding</td>
<td>7.2</td>
<td>8.8</td>
</tr>
<tr>
<td>Oversales</td>
<td>5.7</td>
<td>4.2</td>
</tr>
<tr>
<td>Fares</td>
<td>2.2</td>
<td>2.6</td>
</tr>
<tr>
<td>Smoking</td>
<td>3.2</td>
<td>1.8</td>
</tr>
<tr>
<td>Advertising</td>
<td>0.6</td>
<td>1.5</td>
</tr>
<tr>
<td>Tours</td>
<td>0.0</td>
<td>0.3</td>
</tr>
<tr>
<td>Credit</td>
<td>0.0</td>
<td>0.1</td>
</tr>
<tr>
<td>Other</td>
<td>10.9</td>
<td>4.2</td>
</tr>
</tbody>
</table>

Still another measure of service is on-time arrival, skewed somewhat because of the way in which DOT measures it (e.g., a flight must be more than 15 minutes late to be considered late):

**ON TIME ARRIVALS, BY CARRIERS\(^{318}\)**
(Sept 1987 - Aug 1991)

<table>
<thead>
<tr>
<th>RANK</th>
<th>AIRLINE</th>
<th>PERCENTAGE ON TIME</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>America West</td>
<td>84.1</td>
</tr>
<tr>
<td>2.</td>
<td>Southwest</td>
<td>82.3</td>
</tr>
<tr>
<td>3.</td>
<td>Midway</td>
<td>81.5</td>
</tr>
<tr>
<td>4.</td>
<td>American</td>
<td>81.3</td>
</tr>
<tr>
<td>5.</td>
<td>Alaska</td>
<td>80.1</td>
</tr>
<tr>
<td>6.</td>
<td>Northwest</td>
<td>79.8</td>
</tr>
<tr>
<td>7.</td>
<td>Eastern</td>
<td>79.5</td>
</tr>
<tr>
<td>8.</td>
<td>Delta</td>
<td>78.7</td>
</tr>
<tr>
<td>9.</td>
<td>Pan Am</td>
<td>78.6</td>
</tr>
<tr>
<td>10.</td>
<td>Continental</td>
<td>78.4</td>
</tr>
<tr>
<td>11.</td>
<td>USAir</td>
<td>78.0</td>
</tr>
<tr>
<td>12.</td>
<td>TWA</td>
<td>76.8</td>
</tr>
<tr>
<td>13.</td>
<td>United</td>
<td>75.7</td>
</tr>
<tr>
<td>AVERAGE</td>
<td></td>
<td>78.8</td>
</tr>
</tbody>
</table>

The American Automobile Association surveyed Americans to iden-
C. TENDENCIES

As noted in the preceding section, the number of passengers traveling by air has continued to increase, while the number of airline fatalities has declined. However, safety remains a concern for many travelers. A poll conducted in late 1992 by the Roper Organization revealed that 37% approved of the current level of government regulation of fares and service, while 33% thought there was not enough; 51% of Americans believe that safety regulation is not strong enough, while 21% believe that safety regulation is sufficient.\(^\text{320}\)

\section*{P. SAFETY}

Fatality rates suggest air travel is among the safest modes of transportation — 19 times safer than traveling by automobile. Between 1975 and 1989, the risk of death was only one in 10 million.\(^\text{321}\)

Although the long-term accident and fatality trend declined both before and after deregulation, the accident experience of U.S. passenger carriers became worse in the second half of the 1980s.\(^\text{322}\) In 1989, the industry suffered the highest number of fatal accidents since 1968.\(^\text{323}\)

More recently, the fatality and accident picture has improved. The U.S. commercial airline industry had but two fatal accidents in 1991, and six the previous year.\(^\text{324}\)

However, the commuter industry’s safety record in the post-deregulation period is about four times worse than that of the large commercial carriers.\(^\text{325}\) In 1991 commuter passenger fatalities reached their highest level since the NTSB began tracking it in 1977.\(^\text{326}\) In fact, the fatality accident rate was higher for commuter airlines using aircraft with 30 or fewer seats than the major carriers for every year during the 1980s.\(^\text{327}\)

\begin{footnotesize}
\begin{itemize}
\item\(^{319}\) Cost of Air Travel Replaces Safety As Main Concern to Travelers, AVIATION DAILY, Jan. 7, 1992, at 28.
\item\(^{320}\) Union Releases Survey on Deregulation With Mixed Findings, AVIATION DAILY, Nov. 25, 1991, at 342.
\item\(^{322}\) Bruggink, U.S. Aviation Accidents and Deregulation, AIR LINE PILOT, Mar. 1991, at 20, 24.
\item\(^{323}\) Fatal Accidents Highest Since 1968, Safety Board Reports, AVIATION DAILY, Jan. 18, 1990, at 122.
\item\(^{324}\) Few Bright Spots in 1991 for U.S. Carriers, supra note 262, at 466.
\item\(^{325}\) Bruggink, supra note 322, at 20, 23.
\item\(^{327}\) McGinley, supra note 326, at B1.
\end{itemize}
\end{footnotesize}
Some have argued that, under deregulation, economics drives the safety margin as they do all costs. In 1991, several former Eastern Airline employees were indicted by a Brooklyn grand jury on charges that they deliberately falsified maintenance logs and failed to perform maintenance on critical aircraft parts including altimeters, compasses, wing flaps, cockpit landing gear lights, auto pilot systems and fuel gauges.  

Q. TAXES

According to the Air Transport Association, taxes rose 81% from 1981 to 1991, and cost the industry $6 billion a year. Among the taxes imposed on individual tickets are the following: TICKET TAX (10%); PASSENGER FACILITY CHARGES (up to $12 per trip); CARGO WAYBILL TAX (6.25%); CUSTOM USERS FEE ($6); IMMIGRATION USER FEE ($5); and AGRICULTURAL PLANT/HEALTH INSPECTION SERVICE USER FEE ($2).  

In 1990 and 1991, several airlines proposed that the U.S. government allow it to borrow the 10% ticket tax it collects from passengers, which generates about $4 billion a year. U.S. airlines pointed out that the government of France had provided approximately $400 million to Air France, the Belgian government had given about $300 million to Sabena, and the Italian government was planning to give more than $300 million to Alitalia.  

R. WALL STREET STOCK VALUE

The combined value of all cargo and passenger airlines ranged from a high of $18.7 billion in May 1991 to a low of $15.6 billion in November 1991.336

IV. 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.337

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.338 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.339 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 Com-

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. 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.

In 1991, negotiations between Canada and the United States on a new bilateral air transport agreement included discussions of a partial exchange 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 potential destinations than would most other nations. But the United States has 24 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 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." The following chart reveals the disproportionate size of the U.S. market vis-a-vis foreign markets, and suggests that no foreign market would be of comparable size to justify an exchange of cabotage rights.

## 1990 AVAILABLE SEAT MILES BY GEOGRAPHICAL REGION
### ALL U.S. AND FOREIGN SCHEDULED CARRIERS

<table>
<thead>
<tr>
<th>MARKET CATEGORY</th>
<th>ASMs (billions)</th>
<th>PERCENT OF</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>MARKET CATEGORY</td>
</tr>
<tr>
<td><strong>U.S.-Related</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>U.S. Domestic</td>
<td>582.4</td>
<td>76.1%</td>
</tr>
<tr>
<td>U.S.-Europe</td>
<td>83.4</td>
<td>10.9%</td>
</tr>
<tr>
<td>U.S.-Far East</td>
<td>46.8</td>
<td>6.1%</td>
</tr>
<tr>
<td>U.S.-Other</td>
<td>52.6</td>
<td>6.9%</td>
</tr>
<tr>
<td><strong>Sub-Total U.S.</strong></td>
<td>765.2</td>
<td>100.0%</td>
</tr>
<tr>
<td><strong>Europe-Related</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Europe Domestic</td>
<td>58.0</td>
<td>17.2%</td>
</tr>
<tr>
<td>Intra-Europe</td>
<td>84.8</td>
<td>25.1%</td>
</tr>
<tr>
<td>Europe-U.S.</td>
<td>83.3</td>
<td>24.7%</td>
</tr>
<tr>
<td>Europe-Far East</td>
<td>44.0</td>
<td>13.0%</td>
</tr>
<tr>
<td>Europe-Other</td>
<td>67.1</td>
<td>19.9%</td>
</tr>
<tr>
<td><strong>Sub-Total Europe</strong></td>
<td>337.2</td>
<td>100.0%</td>
</tr>
<tr>
<td><strong>Asia-Related (Far East)</strong></td>
<td>67.9</td>
<td>24.7%</td>
</tr>
<tr>
<td>Asia Domestic</td>
<td>75.6</td>
<td>27.5%</td>
</tr>
<tr>
<td>Intra-Asia</td>
<td>47.6</td>
<td>17.3%</td>
</tr>
<tr>
<td>Asia-U.S.</td>
<td>42.1</td>
<td>15.3%</td>
</tr>
<tr>
<td>Asia-Rest of World</td>
<td>41.5</td>
<td>15.1%</td>
</tr>
<tr>
<td><strong>Sub-Total Asia Related</strong></td>
<td>274.6</td>
<td>100.0%</td>
</tr>
<tr>
<td>Rest of World</td>
<td>165.5</td>
<td>100.0%</td>
</tr>
<tr>
<td><strong>Total World</strong></td>
<td>1,542.6</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

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 in a scheme resembling 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 Act to allow the U.S. Department of Transportation to confer a 30-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.\textsuperscript{345}

The Department of Transportation has found that these requirements were satisfied in several emergency situations. For example, DOT granted an emergency cabotage exemption to allow Heavylift (a 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.\textsuperscript{346} 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.\textsuperscript{347}

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.\textsuperscript{348}

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.\textsuperscript{349}

\textbf{B. Code Sharing and Blocked Space Arrangements}

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

\textsuperscript{345} 49 U.S.C. § 1386(b)(7) (1988). 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. \textit{id.}

\textsuperscript{346} Application of Heavylift Cargo Airlines Ltd., DOT Order 89-10-7 (1989), at 2.

\textsuperscript{347} Application of North West Territorial Airways Ltd., DOT Order 89-4-1 (1989), at 2.

\textsuperscript{348} Application of Qantas Airways Ltd., DOT Order 87-6-63 (1987), at 2.

\textsuperscript{349} Application of Lineas Aereas Del Caribe, S.A., DOT Order 86-8-37 (1986), at 1.
programs.”

“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. They allow airlines the advantage of offering on-line connections and the potential to draw greater traffic as a result of having one carrier listed in the computer reservations systems, on timetables, and in advertisements, rather than two connecting carriers. 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.

The DOT categorizes “blocked space” agreements, “part-charter” agreements, “code share” agreements, and “wet-lease” agreements as constituting joint service operations, which must be reported to DOT. DOT regulations also require disclosure of code-sharing relationships to consumers. They specify that single air carrier designator codes by two or more air carriers are unfair and deceptive competitive practices within the meaning of section 411 of the Federal Aviation Act unless air carriers,

352. 14 C.F.R. § 217.10 App. (i)(1) (1992). These joint service operations must be reported in Form 41 Schedules T-100 and T-100(f) and fall within the following guidelines: (1) blocked-space, part-charter, and code-sharing agreements must be reported by the air carrier in actual operational control of the flight; (2) wet lease agreements must be reported by the lessee as though the leased aircraft and crew were a part of the lessee’s own fleet. 14 C.F.R. § 217.10, App. (i)(2). A blocked-space agreement which lasts more than 60 days, or is part of a series of leases that amount to a continuing arrangement lasting more than 60 days, will be construed as a “long-term wet-lease.” U.S. carriers file under 14 C.F.R. § 207; foreign air carrier lessors to U.S. carriers or foreign carriers file under 14 C.F.R. § 212. See Application of American Airlines, Inc., DOT Order 87-6-57 (1987), at 1. A “wet-lease” is a lease whereby the lessor provides both the aircraft and the crew.
in conjunction with the use of the shared codes, give reasonable and timely notice of the existence of such arrangements. Reasonable notice requires that air carriers, at minimum: (1) identify, with an asterisk or in some other manner, all flights in which the airline code differs from the code of the air carrier actually providing the service; (2) orally inform the consumer that the flight will not be provided by the air carrier whose code is used on the computer, but will instead be provided by a different carrier; and (3) provide frequent, periodic notice in advertising so that potential passengers and travel agents will be cognizant of the code-sharing relationship and the identities of the airlines which are actually providing the underlying service.353

Generally, "blocked-space" arrangements for the shipment of cargo have been allowed.354 For example, in 1986, the DOT granted Flying Tigers permission to enter into a "blocked-space" arrangement with Canadian Pacific Air Lines [CPAL] pursuant to which CPAL would lease half the cargo capacity on two Tigers' flights from New York to Hong Kong and return, marketing its share of the cargo under Tigers' name.355

However, "blocked-space" agreements regarding passenger space have been relatively less successful. For example, in 1987 American Airlines requested permission to enter into a "blocked-space" agreement with Qantas whereby American would provide 10 first class and 25 coach seats on some of its trans-continental flights from Los Angeles and San Francisco to New York, and return. These seats were to be held out as Qantas' with notification to passengers that the service would be provided by American. As a blocked space arrangement of more than 60 days, it was treated by DOT as a "wet-lease" transaction,356 which would have increased Qantas' capacity between Australia and New York from 0 to 840 seats per month. The DOT concluded that such an arrangement would not then be in the public interest for it would confer a valuable discretionary benefit upon Qantas under circumstances where U.S.-Australian aviation relations were under review.357 But in 1988, the DOT granted American's previously deferred application for a "blocked-space" arrangement with Qantas, citing changed relations between the United States and Australia.358

C. FOREIGN ALLIANCES: FREQUENT FLYER PROGRAMS, COMPUTER RESERVATIONS SYSTEMS AND FOREIGN OWNERSHIP

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. The following chart reveals the alliances of the two dominant European computer reservations systems.

EUROPEAN COMPUTER RESERVATIONS SYSTEMS PARTNERS

<table>
<thead>
<tr>
<th>COVIA</th>
<th>AMADEUS</th>
</tr>
</thead>
<tbody>
<tr>
<td>United</td>
<td>Texas Air</td>
</tr>
<tr>
<td>British Airways</td>
<td>Air France</td>
</tr>
<tr>
<td>KLM</td>
<td>Lufthansa</td>
</tr>
<tr>
<td>Swissair</td>
<td>Iberia</td>
</tr>
<tr>
<td>Alitalia</td>
<td>SAS</td>
</tr>
<tr>
<td>USAir</td>
<td></td>
</tr>
</tbody>
</table>

International airline alliances have been stimulated by the prospect for liberalizing European transport in 1992.\footnote{359. Paul S. Dempsey, Aerial Dogfights Over Europe: The Liberalization of EEC Air Transport, 53 J. AIR L. & COM. 615 (1988); DEMPSEY, supra note 342, at 93-108, 241-56.} Having witnessed the intense 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 the 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. The following chart depicts the substantial foreign airline interests in U.S. flag carriers:
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.\(^{360}\) (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. The following chart reveals the major ownership interests of foreign airlines:

\(^{360}\) Repeating Mistakes, J. Com., Aug. 30, 1989, at 8A.
CROSS OWNERSHIP AGREEMENTS BETWEEN FOREIGN AIRLINES

<table>
<thead>
<tr>
<th>PURCHASER</th>
<th>PERCENTAGE</th>
<th>OWNERSHIP 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>0%</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>AerolíneasArgentinas</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>

Here’s a college board exam question: if Delta owns 5% of Swissair, and Swissair owns 5% of SAS, and SAS owns 18.4% of Continental, how much of Continental does Delta control?

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 telecommunications, broadcasting, electric power production, nuclear power production, inland and intercoastal shipping, mining on federal

361. See authorities cited supra note 291.

362. 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. § 310(b) (1988).

363. 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. § 797(e) (1988).

364. 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. § 2133 (1988).
lands,366 and 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 75% 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.367

Section 408(a)(4) of the Federal Aviation Act made 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.”368 Historically, a presumption of control existed where ownership exceeded 10% of the airline.369 Securities and Exchange Commission reporting requirements are triggered by the acquisition of 5%. 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.370 But in the 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 of-

365. 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. § 883 (1988).

ficers thereof . . . [U.S. citizens and] at least 75 per centum of the voting interest is owned or controlled by persons who are citizens of the United States . . . .

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 25% of the voting stock of a U.S. airline.

DOT has also employed its fitness requirements under section 401(r) of the Act to monitor foreign control issues. 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 say-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.

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 81.5% debt and 18.5% 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 57% of the equity, for which KLM received 70% of Wings' nonvoting preferred stock, 31% of its nonvoting common stock, and 4.9% 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 company) put up $80 million (or 11% of the equity, for which it received 10% of Wings' nonvoting preferred stock, 16% of its nonvoting common stock, and 15.4% of its voting stock).

Both KLM and Elders had the right to name one representative to the 12-member Wings' Board of Directors. KLM had the right to name a 3-person committee to advise Wings on financial matters, and to enter into a

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373. In the matter of Intera Arctic Services, Inc., DOT Order 87-8-43 (1987), at 5.
variety of cooperative arrangements with Northwest and preclude such arrangements with other airlines.375

In 1989, Secretary of Transportation Samuel Skinner expressed 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 57% of total equity.376 Secretary Skinner appeared to interpret section 101(16) of the Federal Aviation Act to limit foreign equity to 25%. 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.377

In its first order, issued September 29, 1989, the DOT concluded that unless KLM reduced its equity interest to 25%, KLM could be in a position to exert actual control over Wings.378 DOT expressed concern 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 de facto one — we seek to discover whether a foreign interest may be in a position to exercise actual control over the airline, i.e., whether it will have a substantial ability to influence the carrier’s activities.379

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

375. Id.
377. Statement of Skinner, supra note 376, at 4-5. In September 1989, 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.
378. In the matter of the Acquisition of Northwest Airlines by Wings Holdings, Inc., DOT Order 89-9-51, at 3.
379. Id. at 4-5.
does not take the form of voting stock, particularly if there are other ties to the foreign entity."

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. 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 25%, its power to establish a financial advisory committee would be revoked, and Northwest would fulfill certain reporting requirements.

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. The DOT announced that it was adopting a new policy:

[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, and nonvoting equity and debt, on the other.

The DOT concluded that foreign equity ownership of up to 49% would be allowed, although foreign voting equity would be limited, as the statute required, to 25%. Foreign debt would not be treated as a control issue. The DOT also indicated that it would not ordinarily allow a foreigner to serve as Chairman of the Board. It had earlier approved the placement of three representatives of SAS on the Continental Airline Holdings’ board. KLM could have three seats on the 15 member Wings’ board. DOT warned, “the naming of a disproportionate

380. Id. at 6.
381. Id. at 5.
382. Id. at 8.
384. Id. at 9.
385. Id.
386. Id. at 11.
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."

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 25% of the voting stock of U.S. airlines, and no foreign airline can ply the domestic trade.

DOT announced that it will allow foreign equity ownership of up to 50%. Secretary Skinner has also proposed that statutory limits on voting ownership be increased to 49%. 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.

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.

V. CONCLUSION

One way of assessing deregulation is to ask what would have been different had the Civil Aeronautics Board [CAB] not been sunset. One might argue that with deregulation, we have replaced the five member CAB with the four or five top civil aeronautics executives [CAE].

1. Would prices have fallen? Adjusted for inflation, prices were falling steadily every decade preceding deregulation. As technological advances increased productivity, cost savings were passed through to consumers. Although prices fell dramatically in the 1977-79 period, adjusted for fuel costs and inflation they fell at a 30% slower rate in the decade following deregulation than in the decade preceding it. Hubbing, the dominant megatrend on the deregulation landscape, caused a shift away from larger aircraft. Hubbing also increases fuel and labor costs. Hub-

389. Id.
391. DEMPSEY, supra note 113, at 27-35.
bing likely would not have occurred under regulation. Productivity improvements would likely have driven prices downward.

2. Would the CAB have allowed the largest three airlines to dominate the three busiest airports in the nation? Never.

3. Would the CAB have given the largest airlines the lion's share of the scarce landing slots at the four slot constrained airports? No. Certainly, small airlines would have a significant presence under the CAB's tutelage.

4. Would the CAB have awarded the most important international routes to the three largest airlines? Absolutely not.

5. Would the CAB have allowed the corporate raiding of the 1980s to saddle the industry with enormous debt? The CAB would likely have scrutinized the leveraged buy-outs of Frank Lorenzo at Continental and Eastern, Carl Icahn at TWA and Alfred Checchi at Northwest carefully and concluded that they failed to satisfy the public interest standards of section 408 of the Federal Aviation Act and the fitness requirements of section 401.

6. Would the industry be in such dire financial condition had the CAB been in business? Profits were hardly robust under the CAB's tutelage, but they turned sharply south after deregulation. The CAB would likely have used a variety of regulatory mechanisms to restore profitability, including prohibiting corporate raids, authorizing lucrative market opportunities to weaker carriers, and prohibiting predatory pricing. The only thing the DOT has identified as a means of shoring up the financial condition of the disintegrating airlines is foreign ownership. Since most foreign airlines are governmentally owned or subsidized, this effectively means a government bail-out, with the novel twist that we are going to use the tax dollars of foreign citizens to rectify the mistakes of U.S. government policy, without ever having to admit that deregulation is a failure.

Another way to view the public interest in a market system is to defer to the system of private ownership by stockholders. These widely diversified companies are, after all, controlled by the public in the form of stockholders, are they not?

If stockholders controlled UAL, would it have paid its chief executive officer $18 million in a year when it was losing three times as much? Would it have turned down a bid for $240 a share (in April 1992, it was selling for almost half that)? If stockholders controlled Continental, would it have proposed to wipe out all the value of their stock in reorganization? No.

Tragically, Alfred Kahn was true to his promise. The eggs have been so scrambled that they can never be put together again. We can neither resurrect the proud airlines that have been lost, nor rectify the emotional and economic injury suffered by hundreds of thousands of loyal employees who have lost their jobs, and investors and creditors who have been
stiffed. But unless Congress acts quickly and meaningfully, it will forego its last opportunity to preserve competition.

This is not to suggest that the CAB should be resurrected in its 1938 clothes to fix what went wrong. That approach may have been appropriate then, but not now. Regulatory reform was a prudent dose of course correction that the CAB clearly needed. But instead of regulatory reform, by embracing deregulation, Congress threw the baby out with the bath water.

Unfortunately, the public policy debate has degenerated into two extremes — laissez faire deregulation, and New Deal reregulation. The appropriate solution probably lies between the two polarized extremes, or beyond them. Government oversight of competitors requires significantly less regulation than oversight of monopolists. Thus, the DOT must move expeditiously and forcefully to restore industry health, and thereby avoid further industry concentration.

Congress has several bills before it to deal with such problems as computer reservations systems, slot constrained airports, and such. The patient is flat on his back hemorrhaging unmercifully, and Congress is offering a couple of aspirin and a glass of water. The disease is deregulation, and the patient desperately needs to be moved to the operating room.

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 likely 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. Air transport is too critical to the productivity of the economy and the well-being of our citizens to abandon it to private concentrations of market power. The public will not tolerate a stranglehold upon America’s mobility by a handful of airline Chief Executive Officers sitting around a Monopoly Board. Eventually, Congress will be faced with the prospect of introducing public utility regulation to the few surviving firms, or failing that, nationalizing the industry. Regulated competition is preferable to regulated monopoly; regulated monopoly is preferable to nationalization; nationalization is preferable to unregulated monopoly.

Neither of the extremes of nationalization 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. How might that be accomplished?
Any comprehensive regulatory/legislative effort to solve the problems in commercial aviation must have three primary objectives:

1. It must attempt to rectify the financial crisis in the airline industry;
2. It must promote consumer equity; and
3. It must allow new firms equitable entry opportunities.

Addressing the financial crisis in commercial aviation must be the highest priority of the new Administration's DOT. The contemporary financial losses threaten to ground much of the industry. We need to explore creative means to rebuild our nation's aviation system.

While some have suggested certificate revocation of Chapter 11 airlines on "fitness" grounds, it is an undesirable alternative because it would necessarily reduce the number of competitors. Thus, this alternative is undesirable. Any new government approach must be implemented in a way that do not injure established carriers in the process. Unnecessary regulatory burdens must also be eliminated.

Fitness standards might be imposed prospectively to prevent the enormous debt such as now burdens Northwest, TWA, and Continental, and if need be, LBOs can be prohibited. What we do about the debt/equity ratios at the Chapter 11 carriers or those near it, is unclear. New accounting standards could be adopted to give a clearer picture of debt, such as by requiring capitalization of leases and other liabilities, and piercing the corporate veils of parent companies.

The capital requirements of the U.S. airline industry are enormous. With today's deficit, a government bailout, a la Conrail and Lockheed, is probably not feasible. Neither probably are tax credits for new equipment purchases. However, we might explore using some slice of the Airport and Airway Trust Fund to provide federal loan guarantees to domestic airlines for new aircraft.

If our government dedicates itself firmly and forcefully to shoring up the financial health and financial prospects of the industry, the private capital markets will become available quite quickly, creating stronger airlines better positioned economically and efficiently to serve the public interest.

New capital from any source should be welcome, particularly to shore up failing U.S. airlines. But foreign control should be avoided, for reasons of national security (the loyalty of the CRAF fleet), maintaining competition in international markets, preserving the integrity of the bilateral negotiating process, and recognizing that the foreign regime of government ownership, subsidies and regulation (and indeed, recent privatization, which creates foreign airlines with clean balance sheets) creates an unlevel playing field. The KLM/Northwest relationship produces difficult precedent, however. But at the very least, we ought to stop negotiating unbalanced bilaterals.
The problem is not just debt, of course, it is also the endless hemorrhaging caused by pricing the product below cost. Lowering costs can only be achieved in a limited number of ways — cutting labor expenditures, abandoning hubs, and removing taxes and costly regulations, for example. Labor costs have declined as a percentage of operating expenses since 1978. Further reductions would take a restructuring of the Railway Labor Act, which is probably politically infeasible.

The industry is beginning to realize that hubs are high cost methods of distributing passengers in terms of aircraft and labor utilization and fuel consumption. Cargo doesn’t seem to object to the inconvenience, but passengers detest it. Perhaps carriers seeking to serve nonstop routes not currently being served should be awarded limited-term exclusive nonstop route franchises as a means of stimulating nonstop service, thereby providing some collateral for lending. If price ceilings are imposed, the attractiveness of hubs diminishes, for they will no longer produce monopoly rents.

And as to taxes, they should be lowered, but the deficit realities may preclude that. Unnecessary and costly regulations, such as universal drug testing, ought to be trimmed.

But there may not be enough on the cost side that can be cut to restore profitability, so let’s visit the price side. First, the bankruptcy laws could be reviewed to prevent Chapter 11 carriers from pricing below fully allocated costs, assuming no bankruptcy. Undue pricing discrimination could be circumscribed to eliminate corporate discounting. Small businesses create the lion’s share of the nation’s jobs, and they are seriously disadvantaged by the contemporary transportation pricing structure. The Clinton campaign committed itself to job creation, so this type of discrimination might be challenged on equity and economic grounds. Of course, pricing differentials ought to be allowed for discretionary traffic, so as to allow airlines the flexibility to tap the elasticities of demand to fill seats which otherwise might fly empty.

Beyond that, a tiered price structure, like that American Airlines tried to implement, or the European Commission has adopted might be appropriate. Some have suggested resurrecting the old statutory just and reasonable and nondiscriminatory rate provisions of the Federal Aviation Act. Perhaps some of the regulatory reform pricing provisions of the Airline Deregulation Act or the new European rules might be appropriate.

Consumer equity requires some cleaning up of advertising, and perhaps requiring every change of plane to show a different flight number.

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Politically, it might not be feasible to eliminate frequent flyer programs, but they might be tightened a bit, or taxed.

Ultimately, any comprehensive statutory proposals have to address in some way the entry barriers of access to slots and gates, as well as computer reservations systems bias, but do so delicately, so that the established airlines aren’t financially injured in the process.

Finally, I want to share with you a statement made by a prior President of the Air Transport Association before the Senate Commerce Committee:

Since air transport was launched into meteoric growth, [hundreds of millions of dollars] of private capital has been devoted to it, but, of that sum, there remains today scarcely 50 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.393

Sadly, these words are as true today as they were in 1938, when Col. Edgar Gorrell spoke them.

Let us examine what new legislation might contain to accomplish these objectives.

1. Indirect Subsidies. Recognizing the importance of transportation to commerce, communications and national defense, Congress 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 as the government distributes the tremendously valuable public resources in the form of 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 are public

resources and should be used for the public good. They should be issued on a limited term basis, and awarded to whatever carrier fulfills public needs best at their expiration or upon their surrender.

2. 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 excessive fuel. Southwest Airlines has proven that the pre-deregulation linear route system is more efficient from the perspective of aircraft, labor and fuel utilization. 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 non-stop 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, 3-5 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 might 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. Pricing Discrimination; Ceilings and Floors. As a general rule, the government should stay out of the business of setting fares where sufficient competition exists to discipline airlines. Take some appropriate measure of competition at airports or in city-pair markets (e.g., some appropriate point on the Herfindahl-Hirshman Index), and let airlines price as they will. But carriers should be prohibited from extracting monopoly or oligopoly rents in markets where they enjoy market power. They should also be stopped from driving smaller carriers out by predatory pricing and other predatory behavior. Average fares per mile in any noncompetitive market should not exceed, say 15-25% of industry average fares for similar stage lengths, unless the airline can show good cause why they should, usually in the form of extraordinary costs attributable to serving the market in question, or thin demand. As to 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.

Pricing discrimination is another significant problem. The discounts offered large corporations should probably be eliminated, for they distort pricing for small businesses. Since small businesses create 90% of America’s jobs, they should not be disadvantaged with excessively high air fares which jeopardize their ability to get their sales forces out to market their products.

4. Airline agreements. Much could be done to alleviate congestion an
excessive capacity problems by allowing airlines to sit down and talk about solutions thereto. Cooperation between airlines can sometimes reduce industry costs while providing better service to the public. The government should, of course, monitor such discussions so as to protect consumers and other airlines from anticompetitive behavior. But antitrust immunity might be conferred for those arrangements which serve the public interest by better rationalizing the air transport system. This could help alleviate wasted capacity, ease airport congestion and delays, reduce fuel consumption, and improve the economic health of airlines.

5. Airline Mergers, Acquisitions and Antitrust. Anticompetitive mergers and undercapitalized acquisitions should be prohibited. Bias and discrimination must be eliminated from computer reservations systems, and charges for such services must be reasonable.

6. 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 codesharing and change-of-gauge, and demand based flight cancellations. Congress should adopt a Code of Fair Competitive Practices defining what is not permitted and providing penalties for violations. Alternatively, Congress could eliminate federal preemption over such questions, letting the state Attorney Generals loose.

7. Airport regulation. Airports are public resources. Federal preemption of noise and other environmental issues might well enable the needed additional infrastructure development. Peak period pricing could flatten congestion. The government should also have eminent domain power to seize gates or slots at congested airports, for just compensation, and sell them to airlines best able to enhance competition and public service goals.

8. 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. Fitness scrutiny might be exerted against any airline entering bankruptcy, or with an excessively aging or inadequately maintained fleet.

9. Foreign alliances. Foreign control tends to reduce competition in international markets and endangers national security. As Operation Desert Storm revealed, we need a loyal Civil Reserve Aviation Fleet to ferry U.S. soldiers and their supplies to distant battlefields during times of crisis. Stricter limitations should be placed on foreign equity ownership of U.S.
airlines. Also, again for national security reasons, cabotage restrictions should be retained.

10. U.S. Transportation Commission (or Court). During the past decade, the DOT has shown little 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.

Three 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 functions 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). The advantage here is that we would have eliminate a couple of existing agencies, and allow the survivor to coordinate intermodal transportation in a rational way. The third alternative would be to create a U.S. Transportation Court with appellate jurisdiction over the existing agencies, and hopefully, power to promulgate substantive rules.

Under either alternative, the agency (or court) should be headed by a collegial body of, say seven or nine commissioners (or judges) having long but nonrenewable 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. Nonrenewability is important so that these individuals don’t have to look to the White House for a job at the end of their terms. They should also be prohibited from taking a job with any industry they regulated after leaving the commission (or court). Autonomy, responsibility and fair mindedness is essential to good government.

LEWIS L. LASKA*
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PROLOGUE

The accident: The plaintiff, a thirty-seven-year-old quality control in¬
spector at a nuclear power plant, turned left across traffic to an intersect¬
ing road on a dark, rainy November evening. The intersecting road
crossed a right-of-way of the Burlington Northern Railroad. A freight train
was approaching from the opposite direction and the plaintiff’s vehicle
was struck by the train at the crossing. The plaintiff received severe or¬
thopedic injuries and was subsequently diagnosed as having a closed¬
head injury, leaving the plaintiff no longer able to do his job. By the time
of trial he was working in a greenhouse. At trial, the plaintiff alleged that
both the city and the railroad were negligent: the city should have placed
active warning devices at the intersection and the railroad should have
placed active warning devices at the crossing. Both defendants argued
the crossing was not hazardous and the plaintiff should have seen the
train and headlight and heard the train’s whistle.¹

¹ The reason this case was chosen as an example is because the plaintiff did not conform
INTRODUCTION

Who is legally responsible for the siting and construction of active warning devices (gates) at railroad crossings? From the experience of literally hundreds of lawsuits the answer should be clear, but it is not. In fact, the matter is now before the U.S. Supreme Court.2

...
In the last decade, the railroads, through their affiliated organization, The National Association of Railroad Trial Counsel\(^3\) began a concerted effort to convince the courts that the railroads have \textit{no} legal duty to site and construct active warning devices. Thus, despite state statutes and case law to the contrary in many states,\(^4\) the railroads have begun to argue that the responsibility to place gates (and make other types of improvement) has been placed \textit{solely} on the states and in some instances, local municipalities. This argument, called the doctrine of "preemption," is the subject of this Article.

\textbf{BACKGROUND OF THE PREEMPTION ARGUMENT}

In 1970 Congress passed the Federal Rail Safety Act (FRSA),\(^5\) which required the Secretary of Transportation to study and report to Congress on the problem of protecting grade crossings.\(^6\) The Act further required him to undertake a coordinated effort toward solving the grade crossing safety problem under FRSA authority, as well as under the federal statutes that gave him authority over highway traffic, safety and construction.\(^7\)

According to the railroads, the language contained in the FRSA contains the genesis of "preemption" because it contains the express pre-emption of state laws covering the same subject matter as that contained in the Secretary's regulations, orders and standards:

The Congress declares that laws, rules, regulations, orders and standards relating to railroad safety shall be nationally uniform to the extent practicable. A State may adopt or continue in force any law, rule, regulation,

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\(^3\) (a 1,400 member group of lawyers who represent railroads).

\(^4\) From time to time an attempt is made to compile the various state statutes applicable to railroad grade crossings. What appears to be the latest compilation was prepared in 1979 by the Association of American Railroads under contract with the federal government. Among the sixteen topic headings are "Warning Device," "Train Activated," and "Sight Distance." The name of the report is "COMPILATION OF STATE LAWS AND REGULATIONS ON MATTERS AFFECTING RAIL-HIGHWAY CROSSINGS: FINAL REPORT" FHWA-TS-83-203 (April, 1983) (available from GPO).


order or standard, relating to railroad safety until such time as the Secretary has adopted a rule, regulation, order, or standard covering the subject matter of such State requirement. A State may adopt or continue in force an additional or more stringent law, rule, regulation, order or standard relating to railroad safety when 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.8

No additional federal legislation was enacted affecting railroad safety until 1973. In the interim, the Secretary's annual reports made continuous reference to the need for greater governmental participation in siting and funding crossing improvements, the logic being that "increasing highway traffic is the controlling element in accident exposure at grade crossings."9

In 1973, Congress passed what the railroads insist is the necessary predicate to "preemption" — a statute which imposed on the states the duty to prepare state-wide surveys of all crossings and to implement a schedule of projects which require "separation, relocation, or protective devices."10 The relevant language reads:

(d) Survey and schedule of projects. Each State shall conduct and

9. See 322 I.C.C. 1, PREVENTION OF RAIL-HIGHWAY GRADE CROSSING ACCIDENTS INVOLVING RAILWAY TRAINS AND MOTOR VEHICLES (1964). The aphorism that motorists cause crossing accidents, not railroads, finds some support in the oft-quoted Supreme Court dictum, "The railroad has ceased to be the prime instrument of danger and the main cause of accidents. It is the railroad which now requires protection from dangers incident to motor transportation." Nashville, C & St. L. Ry. Co. v. Walters, 294 U.S. 405, 423-33 (1935). Few people citing this case have bothered to read it. But the basic factual pattern is surprisingly familiar—the railroad was objecting to having to upgrade a crossing. In particular, it challenged an order from Tennessee's Highway Commission (predecessor of today's Department of Transportation) which required the railroad to pay half the cost of a new grade crossing separation on a main highway by-pass (federally funded highway) near Linden, Tennessee on the main route between Memphis and Nashville. (The total cost of the project was $17,900; the non-railroad half was to come from federal funds.) The Supreme Court, per Justice Brandeis, agreed the statute/order was arbitrary because there was no rational basis for imposing one-half the cost on the railroad. The court went to great length to point out that this cost to the railroad accrued to the benefit of the railroad's competitors, especially "trucks, some of them 70 feet in length and many weighing with load as much as 50,000 pounds." Id. at 426. The Supreme Court did suggest that the railroad might be required to pay less than half the upgrading cost. Id. at 433.

This author suggests that the Court's substantive due process argument, abandoned by the newly re-constituted Supreme Court after 1937 is no longer the law. Moreover, the modern practice of federal participation makes the facts of the case largely obsolete.

But the question remains: Do gates (and separations) protect the railroad or the public? The answer depends on whether you feel that trains hit cars or cars hit trains.

10. This statute was an amendment to the Federal Highway Safety Act, 23 U.S.C. § 130. This was possible because the Act defines a highway to include "railroad-highway crossings": 23 U.S.C. § 101 (1992). Because federal funding of grade crossing improvements was conditioned on a state having fully complied with this amendment, such projects are generally referred to as "Section 130" funds/projects.
systematically maintain a survey of all highways to identify those railroad crossings which may require separation, relocation, or protective devices, and implement a schedule of projects for this purpose. At a minimum, such a schedule shall provide signs for all railway-highway crossings.

(g) Annual Report. Each State shall report to the Secretary...each year on the progress being made to implement the railway-highway crossing program authorized by this section and the effectiveness of such improvements. Each State report shall contain an assessment of the costs of the various treatments employed and subsequent accident experience at improved locations.

By 1975, every state had completed what is commonly called its railroad crossing inventory. Receipt of federal funds was conditioned on preparation of an inventory and some $4 billion in federal funds have been spent through state projects for crossings improvements since 1974. According to the federal government some 6,000 crossing projects are completed annually, including 2,300 active warning device projects; and that of the 222,000 public crossings some 36,000 involve grade separation and about 63,000 have active warning devices, of which about 17,000 utilize gates.

Both state and federal officials, as well as most observers, consider the inventory/federal funding scheme to have greatly enhanced railroad safety. Many are quick to point to the dramatic decline in crossing-related deaths as the end result of this program. And the numbers are impressive. In 1972, 1,190 motorists lost their lives in crossing-related accidents. By 1985 this had fallen to an all time low of 472.

11. RAIL-HIGHWAY CROSSINGS STUDY, Report of the Secretary of Transportation (Publication No. FHWA-SA-89-001) (1989). This report was required by the Surface Transportation and Uniform Relocation Assistance Act of 1987, Publ. L. No. 100-17, 23 U.S.C. § 130. For a brief background discussion of funding, see History of Section 130, 8 HIGHWAY & RAIL SAFETY NEWSLETTER 6-7 (June, 1990). (Note that the funding section was formerly Section 230 and for years was known as "Section 230 funding.")

12. Id. at 4.

13. There is dissent from the view that the primary cause for the decline in crossing-related accidents and deaths is attributable to the increased federal funding. Using the state of Michigan as a model, Peter M. Briglia, Jr., a former traffic engineer with the Michigan Department of Transportation, suggests the decline in railway road miles from a high of 6,159 in 1971 to 4,185 and a 35 percent reduction in the number of public grade crossings by 1983 are important factors. This, coupled with the 2.3 percent decline in train movements per year, and the 3.2 percent decline in the number of grade crossings per year was a significant statistic. He concludes, "[[t]he evidence presented here makes it difficult to attribute a major share of the credit for the reduction of rail-crossing accidents to the [203 Program]]. Evaluation of the Rail-Highway Crossing Safety Program in Michigan, 54 ITE JOURNAL 43-47 (February, 1984).

14. Note that even before the crossing inventory system was complete and the railroads began asserting the preemption argument, crossing accidents and fatalities had begun to decline but the costs of settlement and litigation expenses kept increasing. One study suggests that in 1978 alone the railroads paid out about $40 million in settlements, exclusive of litigation costs. See RAIL-HIGHWAY CROSSING ACCIDENT LIABILITY MANAGEMENT SURVEY 150 (Office of Safety, FRA) (1980).
But since that time the number has continued upward — 533 in 1987, 588 in 1988 and 680 in 1989. The reasons for the increase are the subject of much debate in the railroad safety profession and beyond the scope of this Article.

While the engineering criteria for determining the priority of crossing upgrades is beyond the scope of this Article, it is important to note that the specific changes to be made at a dangerous crossing must conform to "federalized" standards which are outlined in the Manual on Uniform Traffic Control Devices. The receipt of federal funds is conditioned on a state’s adoption of the Manual. More specifically, it is the standard for rail-highway grade crossing improvements pursuant to 23 C.F.R. § 646.214(b).

The crux of the railroad’s argument that "preemption" has been accomplished by state adoption of the Manual, and other federal regulations which outline the finding procedures for siting crossings, is language in the Manual, which says, "[t]he determination of need and selection of devices at a grade crossing is made by the public agency with jurisdictional authority," and "[t]he selection of traffic control devices at a grade crossing is made by the public agency with jurisdictional authority."


17. 23 C.F.R. §§ 655.601(a) and 655.505(a) (1990). The latter adopts the Manual as the standard for the federal government.

18. It is 23 C.F.R. § 1251.1 which effectively mandates state adoption of the Manual because it says, "in order for a State to receive funds under the Highway Safety Act, the Governor shall . . . "

grade crossing is determined by public agencies having jurisdictional responsibility at specific locations"20. The Manual continues:

Due to the large number of significant variables which must be considered there is no single standard system of active traffic control devices universally applicable for grade crossings. Based on an engineering and traffic investigation, a determination is made whether any active control system is required at a crossing and, if so, what type is appropriate. Before a new or modified grade crossing traffic control system is installed, approval is required from the appropriate agency within any given state.21

When it comes to the actual hands-on business of evaluating the engineering aspects of a particular crossing, the Manual is not the standard. Rather, highway engineers and railroads look to the Federal Highway Administration's RAILROAD HIGHWAY GRADE CROSSING HANDBOOK.22

Acceptance of the railroads' contention that the foregoing language amounts to a federal "preemption" is the linchpin of the preemption argument. However, such arguments miss two points. First, the language merely restates the procedures for the funding requirements; namely for a site to be upgraded with federal funds, a "public agency" must be involved in the decision. In other words, the federal government has no mechanism for giving money directly to railroads. Rather, the funds must be channeled through the states whose duty it is to see that the upgrade meets minimal standards set forth in the Manual.

Second, when it comes to the actual hands-on business of evaluating the engineering aspects of a particular crossing the Manual is not the standard. Rather, highway engineers and railroads look to the Federal Highway Administration's RAILROAD HIGHWAY GRADE CROSSING HANDBOOK.23 This document makes clear that it "does not constitute a standard, specification or regulation" of the federal government.24

From the foregoing arguments made by the railroads, it is clear that the central thesis supporting the concept of "preemption" is the notion that there are federal standards for the siting and construction of crossing upgrades. Yet evidence supports the conclusion that federal policy regarding crossings is to the contrary. The reasons are three-fold.

A. The Grade Crossing Inventory Was Not Intended by the Federal Government to Constitute a Preemption.

The railroads' notion that "preemption" occurred when the railroad

21. Id.
24. Id.
inventory was complete is wholly unsupported by any federal government (Federal Railroad Administration) statement that such was to be the outcome of the inventory process.

To illustrate, each year the Federal Railroad Administration (FRA) is required to report to Congress on the administration of the Federal Railroad Safety Act of 1970. The report for 1974 describes the Grade Crossing Inventory System (GCIS) project as being underway. The report says nothing about preemption but relates, "[o]nce established, the inventory's existence will make it possible to statistically isolate apparent accident contributing characteristics (by cross referencing to GCIS with the Rail Safety Information System), to determine cost benefit ratios for alternative grade crossing upgrades, to establish responsive "request" procedures to service entities needing inventory data and to provide states and railroads (emphasis added) with their portions of the data base." It was also at this time that the FRA published a study of how states use the inventory and seek funding. The report said nothing about preemption. In 1975, the FRA boasted that the data was 98 percent complete, and plans were underway to match accident specific data with grade crossing site specific data. It is anticipated that this effort will allow us [FRA] to statistically isolate accident contributing factors and to predict grade crossing accident rates.

With the subsequent introduction of economic information (improvement cost) a means for the systematic allocation of grade crossing improvement funds throughout the nation should be realized. Again, there was no discussion of "preemption," but rather a statement that the purpose of the inventory was to set standards for the payment of federal dollars.

By 1976, the inventory was beginning to be referred to by its official title, National Railroad-Highway Crossing Inventory, which the FRA report said was "funded jointly by the federal government and the railroad industry." The report stated flatly: "Inventory data has been supplied to states, cities, counties, and railroads who can use this data to plan and implement grade crossing upgrading programs (i.e. installation of gates

27. Id.
28. STATE GRADE CROSSING PROGRAMS: A CASE STUDY PB-244 175/AS (September 1974) FRA-OR&D-75-8.
30. Id. at 53.
and flashing lights and construction of grade separation.)"31

In 1977, the FRA report said that it had mailed "updated forms and procedure manuals [about the inventory] to all railroads and states."32 Said the report: "Completed forms are not being supplied to states, cities, counties, and railroads for use in planning and implementing grade crossing upgrade programs," i.e., installation of gates and flashing lights and construction of grade separation (emphasis added).33 The 1977 report said nothing about preemption but said that the FRA had conducted "case studies" of state management of the federally funded grade crossing program "to improve opportunities for improving program administration."34

The next year, 1978, the report said that 25,000 changes had been made between the 1975 publication and the publication of the June 1977 edition of the Inventory. "Two thirds of the changes were initiated by states, and one third by railroads."35 That completion of the Inventory was ipso facto preemption, and was certainly not the intention of the FRA in 1978. The report that year stated flatly:

A study assessing alternative means of liability management will provide options to the current practice of railroads assuming total liability for rail-highway crossing accidents. . . .36 The cost to railroads is approximately $40 million annually.37

The report said:

Among the alternatives to be considered are shared liability with public jurisdictions, liability limited by statute, no fault insurance, joint protective insurance, insurance plans among railroads and federal insurance.38


The 1983 Report said that, "[r]ail-highway crossing safety has also been designated an emphasis area by the Department of Transportation," with the FRA "enlarging its involvement. . . [and] continuing voluntary maintenance of the US DOT/AAR National Rail-Highway Crossing Inventory by States and railroads, and monitoring questions about the non-operations of rail-highway crossing warning devices."39

31. Id. at 53.
32. Id. at 36. (1977).
33. Changes had been made before the 1975 publication and publication of the June 1977 edition of the Inventory.
34. Id.
35. 1978 Report at 32.
36. 1978 Report at 33-34.
37. Id. at 33-34.
38. Id.
The 1985 Report stated, "FRA continues to be concerned about public safety at rail-highway crossings and held public hearings in 1984 and 1985 to explore feasible alternatives to improve this situation." In July, 1985, it was widely circulated to professionals concerned with railroad safety.

The 1987 Report outlined the steps taken to implement the better planning of crossing upgrades. It never suggested preemption. Its thrust clearly involved railroads in the process of planning crossing upgrades. The report emphasized greater effort in three areas: education, engineering, and evaluation. It was widely circulated to professionals concerned with railroad safety.

In 1987, the FRA made available two documents to assist the railroad and state program managers in planning and conducting the rail-highway crossing safety improvement programs. This procedure includes accident and severity prediction formulas and a benefit/cost ranking process which can be useful in setting priorities and assessing railroad crossing safety improvement programs. The formulas enjoy widespread use among states, railroads, counties, cities, regional authorities, Operation Lifesaver program planners and others concerned with railroad safety. Some states are beginning to experiment or at least compare the benefit/cost ranking process to their own in-house decision making procedures.

The 1988 Report expressed concern about the increase in crossing fatalities since 1984 but said nothing about preemption.

The 1989 Report was not cheerful. "During 1989, in the face of increasing train miles and highway travel, the number of highway-rail crossing accidents declined by 2.2 percent. However, the number of fatalities increased by more than 15 percent. Injuries were also up significantly. Highway-rail crossing accidents, though fewer, are becoming more severe!" The report said nothing about preemption. Again discussing the Inventory/Resource Allocation Procedure, the report said:

The accident prediction model enjoys widespread use among States, railroads and some cities and counties, while the fatal accident prediction capability is seldom used or requested. In light of the increasing number of fatalities and overall severity of highway-rail crossing accidents, the FRA will include, with each request for accident prediction list, a fatal accident prediction list.

From the foregoing it is clear — the concept of preemption was concocted by lawyers for the railroads — not by the federal government.

40. 1985 Report at 8.
42. Id.
44. 1989 Report at 11.
45. Id. at 12.
B. The Federal Government Has a Normal Rule-Making Procedure and Has Used It in the Past

In 1976, the FRA published a notice of proposed rule making on the establishment of federal standards for the inspection, maintenance, and testing of active warning devices. These proposed regulations said nothing about siting, constructing or upgrading of mechanical signals. After soliciting comments and conducting an extensive examination and analysis lasting over two years, the proceeding was officially terminated. The FRA concluded in 1978 that the issuance of a rule requiring standards for the maintenance, inspection, and testing of highway grade crossing warning devices could not be justified.46

It is worth mentioning that the Brotherhood of Railroad Signalmen has urged the adoption of such standards — but this stand has been criticized as being self-servicing because it would result in more work/job security for signalmen.47 However, ten years later the Federal Railroad Administration held hearings again on this issue finding that the Rail Safety Improvement Act of 1988 requires the FRA to issue regulations “as may be necessary” to insure safe maintenance, inspection and testing of signals. During hearings the Signalmen proposed the following regulation:

Within 240 days, each railroad shall submit for Federal Railroad Administration approval its own program for testing, maintenance and inspection of grade crossing. Each such program shall have requirements for periodic testing and inspection, responding to crossing malfunctions without undue delay, sight distance provisions for motorists, to the extent the matter is subject to the railroad’s control and record keeping.48

The Association of American Railroads has gone on record as opposing such standards.49 However, ten years later the FRA held hearings again on this issue, finding that the Rail Safety Improvement Act of 1988 requires the FRA to issue regulations “as may be necessary” to insure safe maintenance, maintenance and inspection of grade crossings.

46. One of the reasons the railroads are reluctant to erect mechanical gates is that they are responsible for maintaining them.
47. For a discussion of this issue see Automatic Traffic Control Devices at Rail Highway Grade Crossings: A Case for the Public Funding of Maintenance, Conrail, Public Information Office 1983. About a dozen states have provisions whereby they can or do share this cost to some extent with the railroads.
48. Cite?
49. One of the reasons the railroads are reluctant to erect mechanical gates is that they are responsible for maintaining them. The expense is not inconsequential. For a discussion of this issue, see Automatic Traffic Control Devices at Rail Highway Grade Crossings: A Case for the Public Funding of Maintenance Conrail, Public Information Office 1983. About a dozen states have provisions whereby they can or do share this cost, to some extent, with the railroads.
Each such plan shall have requirements for periodic testing & inspection, responding to crossing malfunctions without undue delay.

The Signalmen's logic behind crafting the rule this way was that it overcomes the argument that it is a "make work" proposal because the railroads would have effective input into their own responsibilities. The railroads responded vigorously by asserting that such regulations were unnecessary because based on the FRA's own records of some 2,857 accidents in 1987 where active warning devices were present, only one involved an alleged malfunctioning device. The Signalmen countered that FRA report forms are ambiguous and that it is not in the self-interest of railroads to accurately report such failures. Some support for the Signalmen's argument can be found in a pioneering study in Texas, which provided a means whereby motorists could use a toll free number to report signal malfunctions to a public agency. According to a preliminary review of the program, during the first year of the program the agency received over 2,500 calls — 88.7 percent of which concerned a signal that was operating but no train was visible. In September, 1990, the FRA concluded there was no need for federal regulation and proposed further study regarding the issue of malfunctioning signals.

However, in June, 1992, the FRA changed its mind and announced proposed rules in this area which require the railroads to establish a credible system for reporting malfunctions, require each railroad to issue operating rules that employees must report malfunctions, and require the railroads to inspect, test and repair malfunctions within a reasonable time.

C. How Railroads Raise the Preemption Doctrine

When confronted with a suit alleging that it failed to erect mechanical gates at a crossing, the railroad's strategy is to nullify two legal challenges. The first is the existence of statutes and case law which exist in several states that hold that railroads have a duty to install gates where the crossing is deemed to be "extra-hazardous." Proof of a particular crossing's hazardous nature depends on the facts and circumstances of each case. But the plaintiff will attempt such a showing by offering expert testimony from a railroad safety consultant whose factual data is drawn from the railroad's own records and admissions, and the criteria used to prioritize the crossing's place on the state inventory.

51. Id.
52. ??CITE??
53. 57 FR 28819 (June 29, 1992).
54. As will be discussed below, the actual state reports may not be used in a court proceed-
A second goal of the preemption argument is one of pure law: If the railroad had no duty whatsoever to site and construct crossing protection (because this has become under "preemption" a state duty) then it is free of any liability. This is because under the fundamental rules of American tort law, there can be no liability where there is no duty. Stated another way, if there is no legal duty then factual issues regarding the need for a mechanical gate at the crossing are never presented to the jury: the issue is pretermitted.

Hence, the importance of "preemption" cannot be overlooked, even when there are other factors that are alleged to cause the motorist's death, such as allegations that the train was speeding, or that visibility was obscured by misplaced railcars or overgrown vegetation. While reasonable minds might differ regarding the perceived versus actual speed of the train, one thing most persons (including jurors) will agree upon is that a properly functioning mechanical gate will protect motorists regardless of other factors. Conversely, the absence of the gate was a cause in fact of the accident. Not included in this Article are cases where a gate is in place and apparently working properly but an impatient and reckless motorist chooses to disregard the gate and intentionally "drives around" a gate. Regarding such conduct, both plaintiff lawyers and railroad lawyers are in rare agreement that the cause of the accident was the foolish behavior of the motorist.

II. THE LAW OF PREEMPTION GENERALLY

State law may be "preempted" by federal law in three ways. The first, known as "express" preemption, comes when Congress passes a specific law which preempts state authority in express terms. This is what the railroads argue has happened with the passage of Section 434 of the Federal Rail Safety Act. Second, absent explicit preemptive language, a congressional intent to occupy an entire field of regulation may be found from a "scheme of federal regulation .... so persuasive as to make rea-

55. The general citation is to a standard legal encyclopedia, 57 AM. JUR. 2d, Negligence § 86 (1990).
56. One of the factors frequently alleged as contributing to crossing accidents is the motorist's inability to see the oncoming train because his vision is obscured by overgrown vegetation or freight cars left standing on tracks. While each case must be determined on its own facts, there is some support for this contention generally. In 1985, the National Transportation Safety Board urged the FRA to issue a regulation requiring the railroads to maintain sight distances at grade crossings by ensuring that the railroad right-of-way is free of obstructing vegetation or other sight obstructions such as standing or stored railroad cars. NTSB SAFETY STUDY: PASSENGER/COMMUTER TRAIN AND MOTOR VEHICLE COLLISIONS AT GRADE CROSSINGS (1985) (NTSB/SS-86/04).
sonable the inference that Congress left no room for the states to supplement it."57 Finally, if "Congress has not entirely displaced state regulation in a specific area," it may nonetheless preempt state law "to the extent that [the state law] actually conflicts with federal law."58

The railroads insist that the Federal Rail Safety Act (FRSA) operates as an express preemption because it contains a specific section on the problem of grade crossing safety (the only specific subject addressed in the Act) which requires the Secretary of Transportation to study and report to Congress on the problem of protecting grade crossings, together with his general power over other highway related matters. Thus, the passage of § 434 was, argues the railroads, a limitation on the powers of the states because, "Congress was unwilling to provide the states any broader role because it did not believe that safety in the Nation's railroads would be advanced sufficiently by subjecting the national rail system to a variety of enforcement in fifty different judicial and administrative systems."59

The difficulty with the "express" preemption argument is two-fold. First is the plain language of § 434. It does not mandate national grade crossing standards. The first sentence reads, "[t]he Congress declares that laws, rules, regulations, orders, and standards shall be nationally uniform to the extent practicable." The subsequent text, which makes up the bulk of the statute, clearly provide that the states shall continue to have some role in railroad safety. The second sentence states clearly:

A State may adopt or continue in force any law, rule, regulation, order, or standard relating to railroad safety until such time as the Secretary has adopted a rule, regulation, order or standard covering the subject matter of such State requirement.

The third sentence goes even farther in suggesting a meaningful state role.

A State may adopt or continue in force an additional or more stringent law, rule, regulation, order or standard relating to railroad safety hazard, and when not compatible with any Federal law, rule, regulation, order, or stan-

57. Railroads and their lawyers are quick to point out that at least half the fatalities at gate-protected crossings are caused by drivers "driving around" gates. The question has been asked: Is it possible to design gates that prevent such irresponsible behavior? One noteworthy study found that a four quadrant gate system reduced the number of gate violations and would substantially increase crossing safety. See, Driver Response to Innovative Rail-Highway Warning Devices, 7 HIGHWAY & RAIL SAFETY NEWSLETTER 1-2 (December, 1989); Samuel C. Tignor, A Train is Coming! Full Barrier Gates Improve Safety at Railroad-Grade Crossings, TR NEWS 16-19, 26 (No. 147, March-April, 1990) (Cherry Street study described).


The second difficulty with "express" preemption is that to make vital the second sentence which speaks in terms of the Secretary's right to adopt rules and standards, it is necessary to ask both (1) when and (2) how the Secretary made such rules, in particular, rules regarding crossings.

No federal regulations mention preemption per se. Nevertheless, argue the railroads, the preemption was "completed" when the states completed their various crossing inventories and began accepting federal money and the actual "crossing rules" are found in the Manual, which every state has to follow if it wishes to receive federal dollars. Stated another way, the railroads suggest that federal regulations are actually state regulations as found in the Manual, and that this "preemption" has happened some time ago — long before the crossing accident that is the subject of the litigation at hand.

The necessity of tying section 434 to the Manual in order to show an express "preemption" flies in the face of both the legislative history of the FRSA and other actions by the Federal Railroad Administration regarding nationwide standards. First, the preamble to the FRSA says nothing about a purported "preemption." In fact, its language says the Secretary shall (1) prescribe, as necessary, appropriate rules, regulations, orders, and standards for all areas of railroad safety supplementing provisions of law and regulations in effect on October 16, 1970.61 Similarly, when federal regulations are intended to have preemptive effect, the preemptive effect is typically announced at the time the regulation is issued. For example, under 49 C.F.R. § 255.1, federal railroad accident reporting requirements are preemptive.62

In fact, federal regulations relating to grade crossings specifically indicate on-going railroad responsibility. After outlining those instances where automatic gates with flashing light signals must be placed, the federal regulations speak of situations where a diagnostic team has not recommended such protection. The regulations state: "The type of warning device to be installed, whether the determination is made by a State regulatory agency, State highway agency, and/or the railroad, is subject to the approval of FHWA. . . . Preliminary engineering and right-of-way acquisition costs [for crossing projects] which are otherwise eligible, but incurred by a railroad prior to authorization by FHWA, although not reim-

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61. Note that some states have elaborate rules regarding crossings, perhaps the leading state is Oregon. By Public Utility Commission order 83-143 the state adopted comprehensive rules which include such issues as responsibility for installation and maintenance, as well as replacement, of warning and experimental devices.
bursable, may be included as part of the railroad share of project costs where such a share is required."\(^{63}\)

Moreover, at least one court has agreed that there are no federal preemptive grade crossing regulations—even when that court upheld the concept of "preemption" with regard to local (municipal) train speeds. In Santini v. Consolidated Rail Corp.,\(^{64}\) the plaintiff argued that a municipal ordinance of the town of Goshen City, Indiana which required the railroad to install gates at the crossing in question was valid. The railroad said it was not, but did not raise the "preemption" issue directly. Instead, it said that under Indiana law there was "no enabling legislation that would permit the City to enact ordinances regarding crossing safety gates."\(^{65}\) The Indiana Court of Appeals seemed to agree but did not wholly endorse the concept of "preemption," saying:

\[w\]e conclude Municipal Ordinance No. 14-1, requiring Conrail to install and maintain railroad crossing safety gates at the intersection of its tracks with Monroe Street, is not a valid City ordinance and was not in force at the time of Nancy’s death. We find no federal authority regulating the installation or maintenance of crossing safety gates.\(^{66}\)

Railroad safety consultant Denis J. Bergquist, who testifies for plaintiffs in crossing cases, has suggested another reason why there has been no "preemption," or at least not a complete one as would be suggested by the railroads. He points to a funding-related regulation which would suggest that "preemption," if the law at all, is limited to federally aided projects.\(^{67}\) "Railroads may voluntarily contribute a greater share of project costs than is required. Also, other parties may voluntarily assume the railroad's share."\(^{68}\)

The legal status of the Manual is beyond the scope of this Article, but despite the fact that the federal government "requires" the states to follow it, the Manual is not necessarily *ipso facto* the legal standard of care of highway grade-crossing in each state. Rather, the Manual may be used as evidence of the prevailing standards. The Manual in many states, e.g. Indiana, provides in its introduction a preclusion of use as an "instrument to mandate the use of any of the control devices or procedures at a particular location. It is not intended as a legal requirement.

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64. 23 C.F.R. § 646.214(4) (1990).
66. Id.
67. Id.
68. 23 C.F.R. § 646 (1990). "State laws requiring railroads to share in the cost of work for the elimination of hazards at railroad-highway crossings shall not apply to Federal-aid projects." Bergquist further points out that even the funding-related regulations anticipate railroad involvement, citing 23 C.F.R. 646.210(a).
This Manual has been published as a guide. . . ."69 In short, there is a substantial question whether a state manual becomes a part of federal law simply because federal law directs its use — and then goes a further step and suggests that manual “preempts” state statutory or common law duties of private parties. To allow such an argument would do grave violence to the principle of federalism and overlooks the fact that the Manual is an evolving document which incorporates (and rejects) some concepts which the various state transportation officials hold dear.

A. *When Does (Did) Preemption Occur?*

Central to the concept of “preemption” is the issue of time. The railroads insist that “preemption” occurred when the inventory was complete and the state officials had not ordered the railroad to do anything the last time it had a chance, or when the state last decided what to do (or not to do) regarding the crossing in the particular case at hand. For example, assume the crossing was first inventoried in 1975. It may have been re-inventoried once or twice since that time the last analysis occurring in, say 1987. The accident happened in, for example, 1989. Under the “preemption” doctrine the railroad would argue that it had no legal duty as early as 1975 and certainly as late as 1987. First, because the doctrine says it no longer has any independent duty; second, the state officials did not order the railroad to do anything the last time it had a chance, namely 1987.

The effect of “preemption” in the foregoing illustration cannot be overstated. The doctrine nullifies case law antedating the preemption doctrine which repeatedly held the railroad had a duty regardless of state’s regulatory scheme. For example, in *Gamble-Skomos, Inc. v. Chicago & N.W. Transp. Co.*,70 the driver said that gates should have been in place since the overhead flashing lights were not effective because they were washed out by the sun. The railroad insisted that since the overhead lights had been installed pursuant to Public Service Commission order, it was inoculated against suit. The court pointed out that the Commission had not actually held a hearing to determine the public safety needs at the crossing, nor had it actually directed or required the installation of this particular type of device. Rather, the commission had merely made a pro forma approval of the installation amounting to a consent, “as distinguished from a command to the railroad after an evaluation of the need for safety in the area.” Accordingly, it was appropriate that the jury be allowed to determine, based on all the facts adduced, whether the

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69. Letter to Lewis Laska of 7/27/90 from Denis J. Bergquist, Kensington, Minnesota.
70. Indiana UMTCD, Part 1A-1.
crossing was adequate. (It was not; the railroad was found to be 60 percent negligent.)

A similar case is Koch v. South Pacific Transportation, Co.71 Here, suit was brought for the death of a teenage passenger whose car apparently ran a stop sign at Thurston Crossing. In the months prior to the accident, an application to the Public Utilities Commission had been made by the railroad to close the Thurston Crossing and install flashers at another parallel crossing down the track. While the work was still in progress, the accident occurred. The court said, in pre-preemption days:

Defendant is correct that it should not be found negligent for failing to install safety features which the Public Utilities Commission would not permit. However, there is no evidence that the Public Service Commission did not permit such improvements or that it would have refused to allow them in this instance had application been made. The duty of the railroad to install the crossing is not altered by the regulatory scheme unless it can be shown that the request had been denied. Further, the burden of proof to show such action is on the [railroad].72

A final argument against preemption, although it is seldom raised by plaintiffs, is the simple fact that the FRA apparently could, if it wished, simply adopt regulations which plainly and simply set out the rules for crossing upgrades without the necessity of the railroad having to make these complicated (and expensive) arguments on a case-by-case basis: The railroads could hardly complain that this amounts to "too much regulation" given that their argument is grounded on the fact that the federal government has already made such "regulations." Stated another way, the fact that no specific regulations regarding crossing siting (other than those relating to funding) are found in the Code of Federal Regulations itself tells something about the real policy of the federal government regarding this issue. This is especially true when one observes that so many other aspects of railroad safety are covered by federal regulations. Examples include noise emissions;73 track safety standards;74 freight care safety standards;75 operating practices76; alcohol and drug use77; radio standards and procedures;78 rear-end marking devices;79 safety glazing standards;80 locomotive safety standards;81 safety appliance

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71. 283 N.W.2d 744 (Wis. 1976).
73. id.
standards;\textsuperscript{82} power brakes and drawbars;\textsuperscript{83} signal and train control systems.\textsuperscript{84}

III. CASES UPHOLDING THE PREEMPTION DOCTRINE

Railroad crossing cases may be brought in both state and federal court. The latter forum is possible because in most suits the plaintiff and defendant are citizens of different states, invoking the federal courts' power to hear cases involving diversity of citizenship. When such diversity exists, a railroad also has the right to remove the case from state court over to federal court where it is less likely to face the animus of a "small town" jury. But regardless of which court is chosen, the doctrine of "preemption," if followed by the judge hearing the case, will have the same result — the case (or at least that portion of the case dealing with lack of mechanical gates) will be dismissed. Procedurally, the railroads usually raise the defense early in the litigation with a motion for summary judgment or a motion to strike portions of the plaintiff's complaint.

The railroads have had significant success in convincing both state and federal courts of the merits of the "preemption" doctrine in some cases.

A. \textit{State Cases}\textsuperscript{85}

One of the earliest railroad win cases came in a state trial court opinion in a hotly contested case involving a crossing collision between a train and a gasoline tanker. Here, there were actually two suits. One was brought by the railroad against the tanker company for damages to railroad equipment (and for indemnity); the second was a FELA case brought by survivors of the trainmen killed in the conflagration. The cases were joined for pre-trial discovery but later tried separately and/or settled. The judge in this case simply ruled that as against the tanker company the railroad was entitled to summary judgment as a matter of law, but also went on to rule that no witness could testify regarding any alleged failure of Southern Railway to "provide adequate warning devices at the Chimney Rock Road railroad crossing, and in particular, concerning the presence or absence of automatic gates at the crossing." The court cited 23 U.S.C. § 409 (discussed below), the Federal Highway Safety Act, 23 U.S.C. § 401, under Rule 402, and other considerations as its reason, but did not explain the basis for its decision.\textsuperscript{86}

\textsuperscript{82} 49 C.F.R. § 229 (1992).
\textsuperscript{83} 49 C.F.R. § 231 (1992).
\textsuperscript{84} 49 C.F.R. § 232 (1992).
\textsuperscript{85} 49 C.F.R. § 236 (1992).
\textsuperscript{86} For additional cases that do not preempt state negligence claims, see Martin v. Illinois Central Gulf R.R., Appellate Court of Illinois, First District, No. 1-90-0998, Dec. 31, 1991, \textit{and}
Another early railroad victory came in a North Dakota state trial court, which conjures images of every parent’s nightmare: the collision between a school bus and a train. Suit alleged negligence of both the bus driver and the railroad in an accident that happened at East Fairview, North Dakota on October 7, 1985. The claims against the railroad include speeding, failure to sound the whistle, and lack of proper gates. The children received multiple injuries. Ruled the court:

With respect to Burlington Northern Railroad Company’s Motion in Limine, the Court having considered the pleadings, arguments of counsel, and other matters properly placed before the Court, finds that the mentioning, directing or inducing, or introducing other evidence concerning any alleged failure by Burlington Northern to provide adequate warning devices at the East Fairview Elementary School railroad crossing, and in particular, concerning the presence or absence of signals at the crossing, both at the time of the collision between the school bus and the train on October 7, 1985, and subsequent to that time is inadmissible in light of 23 U.S.C. § 421 et seq., Rules 402 and 403 of the North Dakota Rules of Evidence, and would tend to prejudice Burlington Northern and confuse and mislead the jury regarding the issues properly before the Court.

It is worth noting that this and a companion case were settled. It may be argued that the railroad did not want to appeal this issue to the North Dakota supreme court.

Some state appellate courts have accepted the preemption doctrine. For example, Barger v. Chesapeake & Ohio Railway Co., accepted preemption. The facts in this case are similar to others discussed. On the evening of October 19, 1984, at approximately 9:00 p.m., Larry Barger was traveling westbound on Kinnear Road in the city of Columbus. At a point just west of State Route 315, Kinnear road bisects a set of railroad tracks. The crossing has three tracks; two mainlines, and an industrial spur. The appellant approached the crossing, and momentarily stopped at the flashing warning lights, and then proceeded to the first set of tracks, where he stopped again. He then proceeded slowly forward, where he ultimately collided with a train on the second set of tracks. In analyzing preemption, the court turned to 4 U.S.C. § 434 which stated: “The Con-


87. See Southern Ry. Co. v. Bralley-Willett Tank Lines, Inc. (General Court of Justice, Superior Court Division, Guilford County, North Carolina No. 87 CVS 8959 and 88 CVS 3898, Order, June 26, 1989).


89. See Southern Ry. Co. v. Singer, Guilford County Sup. Ct. Div. No. 87 CVS 8958 and 88 CVS 3898 (11th Cir., Logan County, Ill.), No. 84 L 29.

90. 70 Ohio App. 3d 307, 590 N.E.2d 1369 (10th Dis.).

91. Id.
gress declares that laws, rules, regulations, orders and standards relating to railroad safety shall be nationally uniform to the extent practicable. . . .

"92 The court stated that this provision "expressly vested the Secretary of Transportation with the authority to preempt state law by enacting regulations controlling railway safety."93 The Court then turned to the Highway Safety Act of 1966,94 which provided that the type of crossing warning devices required are to be determined by the local agency having jurisdictional control. Evidence showed that the local controlling agency, the Bureau of External Contracts, identified the Kinnear intersection as needing upgrade during the fiscal year 1984. The court stated that since a decision was made by a federally-authorized, local agency regarding warning signs, "the duty to install warning devices was no longer vested with the railroad, and any negligence action predicated upon the failure to install crossing gates could not be maintained [against the railroad]."95 The effect of this was that the railroad had no duty of care with regard to the placement of warning devices at this intersection."

In Walker v. St. Louis - S.W. Ry. Co.,96 the court addressed the issue of whether it was appropriate for a trial court to grant summary judgment based upon preemption. The court, citing Karl v. Burlington Northern,97 pointed out that there is a heavy burden to establish preemption, but that only "a small minority of jurisdictions have ruled that preemption does not apply to cases similar to the one at bar." This court did a preemption analysis based upon four theories; (1) did congress intend to preempt all State law, regardless of any express statement in the Statute? (2) did Congress expressly preempt State law? (3) did Congress refuse to act, deeming regulation in this area inappropriate at any level?98 (4) did a Congressional regulation, in combination with judicial support, manifest an intent to preempt State law? The court noted that the latter of these was not widely accepted, and said that this last one would only apply in the situation where there had been some determination as to what were appropriate warning devices.

The court also did an extensive "contingent preemption" analysis, focusing on the question of the case where the designated state agency had not determined appropriate railroad crossing warning devices. An argument was made that, even if no state agency action had occurred, preemption should still exist because the State had deemed it to be inap-

92. Id.
94. Supra note 89.
97. Id.
98. 880 F.2d 68 (8th Cir. 1989).
appropriate to establish any standards at all. The court rejected this argument, stating that for preemption to exist —

[The State entity which is in charge of determining the adequacy of a grade crossing must act affirmatively, or determine no action is appropriate, regarding any particular grade crossing as a condition precedent to the application of [the] Federal preemption doctrine. Inaction due solely to financial constraints does not trigger preemption.99

The court stated that the granting of summary judgement in this case was appropriate, because federal law had preempted any state claim based primarily upon the theory of contingent preemption.

Two state appellate courts have upheld the preemption doctrine, using very strong language suggesting that the railroad would be a trespasser if it erected gates on its own right-of-way, using very strong language suggesting that the railroad would be a trespasser if it erected gates on its own right-of-way, and a second case found preemption under the unique language of state, and a second case found a preemption under the unique language of state, not federal, law.

In *Duncan v. Union Pacific Railroad Co.*,100 the Utah Court of Appeals emphatically endorsed the concept of preemption but it did not mention any federal law or regulations specifically. The facts appear to present a straightforward crossing case. Four motorists were killed on the evening of April 9, 1983, when their car pulled in front of a train at a crossing in rural Tooele County. The crossing was protected by signs, but "there were no flashing lights or mechanical devices at the crossing to warn of an approaching train, but nothing obstructs a motorist's view of the tracks for several thousand feet."101 The suit alleged both the railroad and the State of Utah were negligent for failing to install mechanical gates. The defendants sought dismissal by summary judgment. The railroad argued preemption. The state asserted sovereign immunity.

The Utah Court of Appeals began its decision with a long discussion of the general duty of a railroad regarding crossings and said "the railroad is required to take every reasonable action to assure the safety of motorists who can reasonably be expected to cross the right of way... This is to be a jury question."102 The court further said:

In this case, there is nothing to indicate what could have made Union Pacific's right of way safer to motorists crossing on Droubay Road. The path of the train is clearly visible to oncoming motorists. Plaintiffs suggest that Union Pacific should have placed warning devices on Droubay Road, including automatic gates blocking traffic on the road from crossing the tracks when a train was approaching. It is not, however, the responsibility of the railroad to

99. This is referred to as "contingent preemption."
100. Supra, note 95.
102. Id. at 30.
place signs and devices on the public road. The railroad must maintain its own right of way, but it is not under any duty to place sign devices on the public road.\textsuperscript{103}

The court continued.

The design and maintenance of state roads and the control of traffic on state roads are UDOT's responsibilities and prerogatives.\textsuperscript{104} At common law, this responsibility at railroad crossings was shared with the railroad.

Here, in a footnote, the court said:

Although we hold that the railroad does not have authority or responsibility to place signs or roadblocks on the public roads, we note that the cost of protecting users of the public road continues to be shared with the railroad pursuant to Utah Code Ann. § 54-4-15.3 (1990). Thus, in \textit{English v. Southern Pacific Co.} [13 Utah 407, 45 P. 47 (1896)]..., the railroad was found liable for failing to flag motorists on an intersecting city street. Since \textit{English}, however, UDOT has been established, and the Legislature invested UDOT with "power to determine and prescribe the manner...[of] protection of each crossing" [citing Utah Code Ann. § 54-4-15(2) (1990)]. Although that responsibility in no way reduces the railroad's responsibility to maintain its right of way [citing \textit{Gleave v. Denver & Rio Grand Western Railroad Co.}, 749 P.2d 660, 664 (Utah, 1988)], it would nevertheless, under ordinary circumstances, place the railroad in the role of meddler, trespasser, or usurper\textsuperscript{105} if the railroad were to put signs on the public road or forbid traffic on the public road from crossing its right of way. Union Pacific, therefore, had no duty to place signs or roadblocking devices on Droubay Road, and it is not liable in tort for its failure to do so\textsuperscript{106}.

What about the potential liability of the State of Utah? Here the Court of Appeals said that the State's duty is only to provide minimal warning and control, and that it was immune from suit under governmental immunity. "The basis asserted here for recovery against UDOT is its failure to do more than minimal warning and control, we hold that plaintiffs cannot recover against UDOT or the State."\textsuperscript{107}

The Court of Appeals summarized the law of grade crossings in

\textsuperscript{103} \textit{id.} at 32.
\textsuperscript{104} \textit{id.} at 32.
\textsuperscript{107} \textit{id.} at 32.

The court's opinion in Duncan suggests that there might be some legal "penalty" for a railroad to attempt to enhance safety at crossings. However, it is noteworthy that the federal government conducted a study in 1980 to determine if the use of innovative warning devices at grade crossings increased a railroad's liability in the event of a grade crossing accident. The findings concluded there was no support for the premise that the use of innovative devices would increase railroad's liability. \textit{See}, \textit{LEGAL EFFECTS OF USE OF INNOVATIVE EQUIPMENT AT RAILROAD-HIGHWAY GRADE CROSSINGS ON RAILROAD'S ACCIDENT LIABILITY} (1979). FRA-RRS-80-01 (available from NTIS, PB80 137 888).
Utah, "The net effect of this holding is that if the railroad's right of way does not negligently obscure an oncoming train, the train is properly operated, and if some visible warning signage is present on the public road, then the plaintiffs are not entitled to relief in tort for an injury at the crossing. We do not consider this outcome to be harsh or unjust, although any tragedy in which life is lost or impaired is regrettable, whatever the cause."

The decision in *Duncan* was met with glee by the railroads. Promptly after the decision was announced, it was distributed by the American Association of Railroads. In a memorandum to the AAR Policy Committee in Highway-Rail Programs, the AAR's executive director Paul C. Oakley wrote as follows:

Please find attached a Utah crossing accident court decision which certainly should serve as a model with respect to railroad responsibility for highway-rail crossing safety improvements. As you will appreciate, decisions such as *Duncan v. Union Pacific Railroad Co.* do not happen by accident, rather they are the consequence of the creation, perpetuation, and expansion of public sector crossing improvement programs, such as the Section 130 Program. If they are not already familiar with *Duncan v. Union Pacific*, perhaps your law department should be alerted to this decision.

The Utah Supreme Court granted Certiorari for this case and heard it on April 6, 1992. The Court stated that "a railroad cannot be held liable for crossing conditions unless the crossing is more than ordinarily hazardous." The Court stated that it would be impractical to require a railroad to have to petition the Utah Department of Transportation in order to improve rail crossings. So unless the crossing was more than ordinarily hazardous, the current state standard would be sufficient to avoid negligence.

In determining whether or not the state could be held liable for establishing an inadequate standard for the crossing, the Court looked to Utah legislation that provides immunity for any discretionary function in the government. The court therefore upheld the granting of summary judgment by the lower court on both issues.

The unique legal holding in *Hunter v. Chicago & Northwestern Transportation Co.*, arose out of a very common crossing accident. The plaintiff was injured (suit alleged that his death 10 years later was acci-

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108. *id.* at 33.
109. *id.*
112. *id.*
113. *id.*
dent-related) when he drove his car across the Lake Avenue crossing in Glenview, Illinois at 7:30 a.m April 18, 1972, in front of a 30 mile per hour freight train. The primary factual issue was whether the crossing lights were working and/or whether they were obscured by dirt and snow. Testimony was contradictory on this point. The crossing was last signaled in 1959 and consisted of crossbucks, "four flashing lights mounted on masts on the roadside, four overhead cantilevers, and a crossing bell." The appellate court's opinion is long and deals with many issues relating to proof, none of which are relevant to this Article. However, the Court analyzed the statute, not utilizing a "preemption" argument to deal with the plaintiff's allegations that the railroad failed to install a gate. Said the court,

Plaintiff first argues that between 1959 and the date of decedent's collision, C&NW made no effort to determine the need for a crossing gate even though 18,000 vehicles traversed the crossing daily in 1972. . . . Defendant has responded that pursuant to an article in the Illinois Commercial Transportation Law, which governs the safety requirements for rail carriers [Ill. Rev. Stat. 1987, ch. 95 1/2 par. 18c-7401 (3)], once the Commerce Commission has ordered a particular type of warning device at a crossing, that device is "deemed adequate and appropriate." Defendant correctly maintains, citing the legislative debates relating to this law, that the legislative intent was that the issue of the adequacy of the warning devices at a crossing, once ordered by the Commission, would no longer be an issue in this type of litigation. Once the Commission has investigated and ordered the installation of a particular kind of warning device, its decision is conclusive, and the railroad is precluded from installing any other signal.

Curiously, the statute referred to above stated that it did not "adjudicate any pending litigation." Hence, because the present suit was filed March 13, 1978, it was pending at the time the law was passed. Thus, while the provisions under the safety requirements article represent the current state of the law in Illinois, this was not the applicable law at the time this lawsuit was filed and pending. Accordingly, the court decided the present case by the law which existed at the time of the accident which allowed the jury to decide whether the railroad should have erected a gate or not. A final aspect of the case is worth mentioning. The plaintiff motorist was found 95 percent responsible, the railroad only 5 percent. With damages set at $1.5 million, the plaintiff actually only received $75,000 because of the degree of his negligence. The jury rejected the claim that his death was actually caused by the wreck.

116. Id. at 2.
117. 82nd Ill. Gen. Assem., House proceedings, April 22, 1982, at 114-123.
B. FEDERAL CASES

The first prominent federal case was *Nixon v. Burlington Northern Railway*. The memorandum opinion by Judge James F. Battin came on a motion for summary judgment. Motorist Nixon was killed in the town of Plevna, Montana, lacking any mechanical signals at a crossing and the railroad’s failure to have installed such was alleged as negligence. However, the facts in the case were unique. Prior to the accident an agreement had been made between the Montana Department of Highways, the local county government (Fallon County) and the railroad wherein the parties agreed to install flashing light signals with automatic gates at the Plevna crossing. According to the court:

This agreement was the result of an evaluation and determination by the State Department of Highways as to the type of crossing protection warranted, and was subsequently approved by the Federal Highway Administration. The determination by the State Highway Department constituted a federal decision, reached through a state agency, on the adequacy of the warning devices at the crossing. Once that determination was made, any applicable state common law or statutory duty upon defendant became void, as federally preempted.120

In reaching this decision the court distinguished the case of *Marshall v. Burlington Northern* 121 (discussed below), by observing that in *Marshall* no decision had been made by “the locality in charge of the crossing" regarding the type of warning devices to be installed.122 The court in *Nixon* 123 also said the term “local agency” as contemplated in the *Marshall* decision was the state, not the city, but in any event it made no difference because the facts in *Nixon* showed that the Plevna town council had petitioned the state to install a flashing light signal with gates and this had been a part of the state’s decision to enter the contract.124 The Georgia federal courts also allow some aspects of the preemption doctrine but not others; in fact, with regard to mechanical gates it rejected it on the unique facts presented. The leading case is *Mahony v. CSX Transp., Inc.* 125 Eve Mahony was struck and killed by a CSX train as she walked

118. Supra, note 100, at 9.
121. Id. at 4
122. 720 F.2d 1149 (9th Cir. 1983).
123. Supra, note 118.
124. Supra note 119.
125. But in any event it made no difference because the facts in *Nixon* showed that the Plevna town council had petitioned the state to install a flashing light signal with gates and this had been a part of the state’s decision to enter the contract *See also* Russell v. Southern Ry. Co., (S.D. Ga., Brunswick Div. No. CV-2-89-059).
across a grade crossing. Suit alleged lack of mechanical gates, excessive train speed, and failure to erect a pedestrian overpass. When the suit was first filed, the railroad sought summary judgment contending the preemption doctrine barred any of these theories. The lower court judge began his discussion by explaining that Congressional intent in passage of the Rail Safety Act was to establish nationally uniform railroad safety and allowed a narrow spectrum of deviation from national uniformity by permitting state regulation under two circumstances only. First, a state may regulate railroad safety until the Secretary of Transportation has adopted a “rule, regulation, order or standard covering the subject matter.” Second, a state may regulate if the local measure is necessary to eliminate or reduce a local hazard, is not incompatible with federal law, and does not unduly burden interstate commerce. Ultimately the lower court judge granted summary judgment on both issues. The lower court in this case relied upon Marshall v. Burlington Northern and Donelon.

When Mahoney came before the Eleventh Circuit, a different panel of the circuit had already decided the Easterwood case. The relevant portion of the opinion is as follows:

Without intending to expand on the meaning of Easterwood, we note that at least two principles announced by that panel will have application to the present case on remand.

[Speed]
First, the plaintiffs' claim that CSX was negligent because the train was allegedly traveling too fast is preempted by federal law. As stated in Easterwood, a theory “that [an] accident was caused by specific federal regulations governing the speeds at which trains can travel on particular classes of track.” [Easterwood, 933 F.2d at 1553.] Because the CSX train that struck Mahoney was traveling below the maximum speed allowed under federal law, the plaintiffs may not attempt to establish CSX's liability on the basis of the train's alleged excessive speed.

[Warning Devices]
Second, the plaintiff’s theory of liability relating to the inadequacy of the railroad grade crossing (in particular, CSX's failure to install automated warning devices at the crossing) is not preempted by federal law. The Easterwood panel specifically noted that although the federal government was minimally involved in regulating the construction of safer railroad grade crossings, that involvement was not so substantial or specific as to preempt state tort suits based upon a railroad's failure to maintain a safe railroad crossing. Accordingly, in this case, the district court should not have dismissed the plaintiffs' claim that CSX negligently failed to install automated warning signals.

The case was vacated and remanded back to the trial court.

It is interesting to note that Easterwood was decided without the benefit of the citation of several applicable authorities. However, the court

126. 966 F.2d 644 (11th Cir. 1992).
bound itself to the *Easterwood* decision, stating that if the railroad felt that the *Easterwood* opinion was wrongly decided, CSX should file a motion to rehear the case *en banc*.

In *Edelman v. Consolidated Rail Corp.*,\(^{127}\) the Court did an extensive analysis of general preemption using a "plain language" standard that stated "Congress can define explicitly the extent to which its enactments pre-empt state law."\(^{128}\) When it analyzed the unsafe speed issue, the court had little difficulty in stating that a speed rule established by state case law was preempted, and did not fall within the "local problems" exception noted in the legislative history of the Act.

When looking at the crossing gates issue, the Court had more difficulty in applying preemption. The Court noted that the *Karl* decision provided for no explicit preemption, and the 11th Circuit decision in the *Easterwood* case also provided for no preemption of state tort claims. However, the Court immediately rejected the *Karl* case, stating that "the Court failed to consider the pre-emptory effect of section 434," and confined its discussion of preemption to the latter two types identified in *English* (Congressional intent to occupy a field and direct conflict analysis), stating that it "fail[ed] to answer the question presented by this case. Namely, does promulgation of the MUTCD by the Secretary [of Transportation] constitute a regulation concerning railroad safety, thereby triggering the preemptive effect of section 434?"

The Plaintiffs argued that the MUTCD was not a "regulation" because it was adopted by the Federal Highway Administration, and therefore does not preempt state law via the FRSA. They stated that the MUTCD had never been listed in the Secretary's [of transportation] annual report to Congress, contrary to the FRSA, which requires that all regulations and orders issued under the FRSA be reported to Congress.

The Court rejected the argument stating that it makes no difference under what authority the MUTCD was adopted. The relevant question is whether it contains rules, regulations or standards concerning railroad safety.\(^{129}\)

In addressing the *Easterwood* decision (discussed below), the Court relies upon the Ninth Circuit's decision in *Marshall v. Burlington Northern, Inc.* that discusses an interaction between the FRSA and the Highway Safety Act.\(^{130}\) The *Marshall* court in the *Marshall* case said that the Secretary of Transportation had "delegated federal authority to regulate grade crossings at local agencies." The court concluded that when

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127. *Id.* [Citing Donelan v. New Orleans Terminal Co., 474 F.2d 1108, 1112 (5th Cir. 1973)].
129. *Id.*
130. *Id.*
"standards contained in the MUTCD are applied to a particular crossing" preemption will occur.131

The plaintiff's also argued that their claim was not preempted under § 434 because the state tort claim was "necessary to eliminate or reduce an essentially local safety hazard," — a proscribed exception to § 434. The court stated that because the tort claim "is a rule which applies statewide it does not fall within the local hazard exception. . ."132

The final argument the Plaintiffs made was based upon the Restatement (Second) of Torts § 288C (1965) that states "compliance with a legislative enactment . . . does not prevent a finding of negligence where a reasonable [person] would take additional precautions." Citing the Eas­terwood case where the court rejected this argument with regards to speed and grade crossings the Court rejected this argument. The court also noted that "[d]espite the superficial appeal of this principle, its effect would be to undermine the national uniformity which the federal regulatory scheme seeks to establish."

The Court ultimately adopted the Marshall analysis, which was defined as a "two step process." The Court stated that first the Secretary of Transportation must take action, and then the state agency having jurisdiction over the crossing must take action. The Court stated that the promulgation of the MUTCD by the Secretary was sufficient to fulfill the first prong of the test.

In determining what fulfills the second prong of the test, state agency action, the Court rejected the dictum in the case Hatfield v. Burlington Northern Railroad Co.,133 that suggested that preemption would not occur until an enforceable agreement for the installation of new or additional warning devices is entered into by the railroad and the state. Instead of this threshold, the Edelman Court, to preempt state tort law, required only an "assessment under the MUTCD of the safety devices appropriate for the crossing. . ."134 Even under this analysis, the Court was unsure as to whether preemption actually occurred. The reason for this was that the State's manual, the Ohio Manual of Uniform Traffic Control Devices for Streets and Highways, may not be in conformance with the MUTCD. The Court stated that if the Manual conformed, there would be preemption. But if it failed to conform, since the second prong was not done pursuant to federal authority, there would be no preemption.135

Another case accepting the preemption doctrine is Neely v. Consoli-
On July 19, 1987 plaintiff's decedent was killed when struck by the defendant at the defendant's crossing on Waterloo Road in Portage County. There were warning signs and lights, but no crossing gates.

After the filing of suit, the defendant moved that the adoption of the FRSA by Congress in 1970 preempted the entire field of railroad crossing safety, eliminating any common law duty on the defendant to provide for safe crossings. The plaintiff, rather than directly challenging the preemption, claimed that no local agency decision had been made with regards to the crossing. Failure of the agency to act prevented the fulfillment of the second prong of the Marshall preemption test, local agency action. The evidence indicated that the Department of Transportation for the State of Ohio had programmed the Waterloo crossing for improvement, but funding for the project had not been received and construction had not commenced.

The court, rather than relying solely upon the Marshall decision, looked to the Karl and Nixon cases. The court concluded that the Nixon opinion was most on point, and that the agreement regarding improvement was sufficient to establish local agency action (and ultimately federal action), so any tort claim was preempted.

The plaintiff, after losing on this argument, claimed that Conrail's failure to install the gates that were discussed in the agreement breached its duty of care to provide a crossing gate at the intersection. The court had great difficulty in finding consistent precedent on the question of whether this kind of plan establishes an appropriate duty of care for the intersection. Ultimately the court stated that, while it was absurd that the passage of the federal statute, and the subsequent local action, eliminated any duty of care by the defendant, this was the case. The fact that the defendant could have added protection "does not negate the preemptive effect of the Railway Safety Act. . ."137

An often cited opinion in recent cases regarding the preemptive effect of the FRSA is Armijo v. Atchison, Topeka & Santa Fe Railway.138 This case, similar to others, arose out of a collision at a train crossing where there were no crossing gates, and in this case no warning lights. Early in the case the defendant moved for summary judgment pursuant to Rule 56.1b of the United States District Court for the District of New Mexico. The defendant cited Burlington Northern Railroad Co. v. Montana,139 in support of its motion, claiming that the FRSA preempts all state laws aimed at the same safety concerns addressed by federal regulations.

136. Id.
137. (N.D. Ohio, E. Div. No. 5, No.89 CV 0531).
138. Id.
The plaintiff made the argument that the crossing in question was "essentially a local safety hazard," and therefore subject to an exemption pursuant to section 434.

The court did an extensive factual analysis of the federal and state actions prior to the accident. The State of New Mexico adopted the MUTCD offered by the Secretary of Transportation, and prioritized and ranked railroad crossings that were in need of crossing gates. The court concluded that there had been sufficient action to create preemption, noting that "the scope of preemption under the FRSA has been broadly construed by the courts."\(^{140}\)

The court universally rejected the argument that the Plaintiff made regarding the section 434 exception, they based their decision on H.R. Rep. No. 91-1194\(^{141}\) that stated that the exception in section 434 was not intended "to permit a State to establish Statewide standards superimposed on national standards covering the same subject matter."\(^{142}\) The defendant's motion for summary judgement was granted.

A recent Sixth Circuit opinion has also accepted the preemption doctrine. In *Norfolk & Western Railway Co. v. Public Utilities Commission of Ohio*,\(^{143}\) the court addressed the issue of whether the FRSA preempted a state law requiring "A suitable walk or railing from which trainmen may walk shall be provided along at least one side of all bridge and coal, ore or other trestles." The Public Utilities Commission first argued that the walkways were not covered expressly in section 434 of the FRSA, and therefore regulation of such items was not preempted by federal law. The Federal Railway Administration (FRA) argued that the federal government had negatively preempted regulation of these walkways, by failing to promulgate any rules." The court accepted the argument by the FRA, stating that the Agency's explicit refusal to adopt a regulation requiring railroad bridge walkways was not appropriate, and thus amounted to negative preemption. The effect of this decision is that the FRA may be able to extend its preemptory powers far beyond its expected limits, by refusing to regulate in areas of railroad safety.

\[C\] The Easterwood Case

The most recent railroad victory has come in *Easterwood v. CSX Transportation, Inc.*\(^{144}\) It leaves no doubt that in the Northern District of Georgia — the same court but not the same judge that decided the *Mahony* case — preemption is the law.

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140. 880 F.2d 1104, 1106 (9th Cir. 1989).
141. Id.
143. Id.
144. 926 F.2d 567 (6th Cir. 1991).
Thomas Easterwood was killed on February 24, 1988 at the Cook Street crossing in the city of Cartersville, Georgia when his car was struck by a CSX train. The suit alleged a constellation of wrongs: excessive train speed, excessive vegetation blocking view, improperly working signals, and, of course, failure to have installed a mechanical gate.

The railroad filed a motion for summary judgment. The plaintiff attempted to file an affidavit from an expert to raise factual issues regarding the crossing, but did not do so in a timely manner. Therefore, the court was free to proceed and decide the legal issues, in particular preemption. After discussing the procedural aspects of the case and a few of the facts the court said:

It is well established that Congress, through the pervasive federal regulation of railroads in the Federal Railway Safety Act of 1970, ("FRSA") 45 U.S.C. § 421 et. seq., intended to establish national safety and preempt state regulation of railroads. See, Donelon v. New Orleans Terminal Co., 474 F.2d 1108 (5th Cir. 1976). The FRSA specifically controls the speed at which trains may operate by classifying sections of track and assigning to each classification a maximum speed limit. The track in question is classified as class four track and, according to federal regulations, the maximum train speed for class four track is 60 miles per hour. Based on the pervasive nature of federal regulation of the subject area, the court finds that train speed is expressly preempted by federal law. See Sisk v. Nat'l R.R. Co., 647 F.Supp. 861, 865 (D.Kan. 1986).145

Similarly, the court finds that the plaintiff's claim that the defendant was negligent in failing to install gate arms on the Cook Street crossing is preempted by federal law. Public agencies having jurisdiction over railroad crossings have the authority to select appropriate traffic control devices. Marshall v. Burlington Northern, Inc., 720 F.2d 1149, 1154 (9th.Cir. 1983). That is, federal authority to regulate railroad crossings has been delegated to local agencies whose decisions then constitute federal decisions and have a preemptive effect. Id. In early 1989 the Georgia Department of Transportation ("DOT"), acting pursuant to federally delegated authority, elevated railroad crossings in the Cartersville area and determined the warning devices necessary for the various crossings. Initially, DOT determined that gate arms should be installed at the Cook Street crossing, but the funds earmarked for this crossing were later transferred to other projects. The decision to install gate arms at the Cook Street crossing was placed on a list of projects to be considered at a later time.

Based on this evidence, the court finds that DOT made a decision not to install gate arms at the Cook Street crossing when it transferred funds to other projects and removed the Cook Street crossing from the list of crossings to receive gate arms. Accordingly, DOT's determination constitutes a federal decision in accordance with federal law, and the plaintiff's claim that the defendant was negligent in not providing gate arms is preempted.

The Eleventh Circuit took the *Easterwood*\(^ {146}\) case on appeal. The court did an extensive analysis of several claims raised by the plaintiff:

**Speed Limit**

In the original case, Easterwood claimed that the accident was caused in part because of a "negligently high rate of speed." The speed of the train at the time of the accident was testified to be between thirty-two and fifty miles per hour. The Court noted that the Secretary of Transportation had established regulations governing maximum speed limits for passenger and freight trains on various classes of track, and for this track the speed limit was sixty miles per hour. The plaintiff argued that the speed limit set was not for the purpose of avoiding accidents, but for several other purposes. The court rejected the plaintiff's argument and found that the speed limit of a train at a crossing was preempted by the Secretary's regulations.

**Vegetation**

The next issue raised by the plaintiff was that the excessive vegetation on the side of the track obstructed the views of the train engineers and the decedent, and that the defendant should have cleared the vegetation.\(^ {147}\) The court stated that with regards to vegetation that fit within this definition, state law is preempted. However, any vegetation that is not immediately adjacent to the railroad is not covered by this regulation, so any negligence claim based upon this type of vegetation being present is not preempted.

**Warning Devices**

The most important claim by the plaintiff, and the one discussed the most, is the question as to whether the warning devices at the intersection where the accident occurred were adequate. The court starts by separating the two sections of the United States Code that are in issue in this case.

The first statute referred to in the opinion is the Federal Railroad Safety Act. This act has preemptory language within it. However, "neither the Act nor the regulations specifically address the problem through federal regulation of the signals and the design of grade crossings."\(^ {148}\) The only requirements under this act are to "study problems with existing grade crossings" and to "create grade crossing and demonstration projects."\(^ {149}\) Because there is no explicit requirement to estab-


\(^{147}\) 933 F.2d 1548 (11th Cir. 1991).

\(^{148}\) 49 C.F.R. § 213.37 (1990). Federal regulations require that track owners "must keep vegetation on or immediately adjacent to the tracks under control."

\(^{149}\) Supra, note 4.
lish standards, preemption does not occur due to this section of the United States Code.

In an entirely separate section of the United States Code, Congress has passed legislation dealing with the grade crossing problem. 23 U.S.C. § 130 requires "states to conduct a systematic survey of all railroad crossings and then create and implement a schedule for bringing the grade crossings into compliance with the MUTCD." While this requires states to establish standards, there is no explicit preemptory language in this section of the code. The court goes further, stating that "this statute is not such a pervasive set of regulations that we could fairly imply a congressional intent to pre-empt the field." Therefore, the court held that there was no preemption with regards to state common-law liability claims based upon the negligence of maintaining or installing grade crossings.

The Hump in the Road

The last issue the court analyzes deals with the topography surrounding the railroad track. The plaintiff claimed that there is a steep hump in the road elevating the railroad track above the roadway. This hump forces traffic to slow down in order to navigate over this hump. CSX could not cite any federal statute or regulation regulating the angle of the roadway as it approaches the railroad track. Therefore the court held that this claim was not preempted.

The court ultimately reversed on the granting of summary judgment on three different issues: (1) the claim that vegetation on the side of the track contributed to the accident; (2) the claim that the hump in the road contributed to the accident; and (3) the claim that there were inadequate warning devices installed at the grade crossing.

The court did a final analysis in this case concerning contributory negligence. Under Georgia law, a plaintiff’s action is barred if he or she is more than 50 percent at fault. The court started its analysis of Georgia contributory negligence law by stating that contributory negligence is an issue of fact that is not to be determined by the courts as a matter of law except in palpably clear, plain, and undisputed cases. There were two Georgia cases where a driver was clearly contributorily negligent. These two cases require that either: (1) A driver be aware of a train, and attempt to beat it, or (2) The driver saw the train, or should have seen the train, and nevertheless continued across the tracks. Based upon the record, the court could not resolve this issue as an undisputed matter.

152. Supra, note 146.
Therefore summary judgment against the plaintiff because of contributory negligence was inappropriate.

Beyond the court’s opinion in the Easterwood case, the Georgia Trial Lawyers Association submitted a twenty-two page amicus brief arguing that the FRSA does not preempt Georgia’s common law of negligence.\(^{153}\)

IV. CASES REJECTING THE PREEMPTIVE DOCTRINE

A. STATE CASES

A state supreme court has rejected the preemption doctrine in crossing cases. Similar to Karl, the Montana Supreme Court in Runkle v. Burlington Northern,\(^ {154}\) turned aside the railroad’s arguments with the following:

The Federal-Aid Highway Act of 1973 represents an effort by the federal government to improve the safety of grade crossings, and to provide funding for the same. That Act does not lessen in any degree the duty, statutory or common law, of a railroad to maintain a good and safe crossing. The Manual on Uniform Traffic Control Devices (MUTCD), promulgated by the Montana Highway Department, may be considered as a standard or norm to be used for traffic control devices. It does not have the force and effect of law in determining the duties and responsibilities of a railroad with respect to the safety of grade crossings."\(^ {155}\)

B. FEDERAL CASES

One of the earliest cases rejecting the preemption doctrine in grade crossing cases where suit alleged the railroad should have placed a mechanical crossing is Karl v. Burlington Northern Railroad Company,\(^ {156}\) where the court said, “Burlington Northern can point to no case law or legislative history to support the theory that Congress intended to completely occupy the field of railroad safety governance.”\(^ {157}\) The facts in the case suggest a typical crossing suit. Betty Karl was severely injured when, as the court said, “her automobile collided with a Burlington Northern locomotive.”\(^ {158}\) Suit alleged a full range of alleged negligence by the railroad: (1) by failing to give plaintiff adequate notice of the approach of the train; (2) by operating the train at an excessive or unreasonable rate of speed under the circumstances or under applicable rules, regulations


\(^{154}\) The documents can be found in Easterwood v. CSX Transportation, 933 F.2d 1548 (11th Cir. 1991).

\(^{155}\) 613 P.2d 982 (Mont. 1980).

\(^{156}\) Id.

\(^{157}\) 880 F.2d 68 (8th Cir. 1989).

\(^{158}\) Id. at 76.
or statutes; (3) by failing to properly maintain the warning devices at the grade crossing at issue; (4) by failing to recognize that the grade crossing at issue was unusually hazardous, requiring traffic control devices beyond the minimum required by statute; (5) by failing to have warning devices in place at the grade crossing which would have provided a driver in the same circumstances as plaintiff with warning, notice of an approaching train, notice of the location and angle of the tracks and notice of a sage place to stop, and (6) by failing to upgrade the traffic control.\textsuperscript{159}

The precise location of the Iowa accident is not given in the opinion, but Iowa law controlled this federal diversity case. The preemption issue became important because the jury found the railroad liable only on allegation number six (failure to upgrade the crossing). After dealing with numerous other issues relating to the jury's conduct in reaching its verdict, the court finally said this about preemption:

Burlington Northern further contends that it did not have a duty to upgrade its traffic control and warning devices, and that the plaintiff therefore cannot recover under that theory of negligence. It first argues that federal safety and railway acts preempt any claim of common law negligence based upon the inadequacy of the warning devices at the crossing.

The court cited as a footnote the following:


The court contends that since federal law grants to the Secretary of Transportation the power to authorize a local agency to regulate grade crossings, and since the local agency in this case approved the warning devices, that approval preempts any common law negligence claims. We find no merit to this argument.

In general, state laws may be preempted if they actually conflict with an express or implied federal declaration, or if state law is in a field that is so pervasively controlled by federal law that no room is left for state rulemaking.\textsuperscript{160} Neither circumstance is present in this case. First, nothing suggests that the defendant was forced to choose whether to follow federal or state law, a traditional test of whether state and federal laws are in actual conflict.\textsuperscript{161} Additionally, Burlington Northern can point to no case law or legislative history to support the theory that Congress intended to completely occupy the field of railroad safety governance. Our conclusion is supported by \textit{Runkle v. Burlington Northern},\textsuperscript{162} where Bur-

\textsuperscript{159.} \textit{Id.} at 69.
\textsuperscript{160.} \textit{Id.} at 69-70.
\textsuperscript{162.} \textit{De la Cuesta}, 458 U.S. at 153.
lington Northern made a similar preemption argument with regard to the Federal-Aid Highway Act of 1973. The court held that the Act represents an effort by the federal government to improve the safety of grade crossings, but that it does not lessen the statutory or common law duty of a railroad to maintain a good and safe crossing.163 Similarly, in Marshall v. Burlington Northern Inc.,164 the court held that the Railroad Safety Act did not occupy the field of railroad safety governance. We conclude that plaintiff's negligence claim is not preempted by federal law.

Burlington Northern also argues that because Iowa statutes specifically set forth safety requirements applicable to grade crossings, and as Burlington Northern was not found to have violated these statutes, it should not face liability at common law for negligence. Here, the court cited the following as a footnote: “Burlington Northern specifically points to Iowa Code § 327G.2 (1985), which addresses the signals at road crossings.”165 It is well established, however, that “compliance with a legislative enactment or an administrative regulation does not prevent a finding of negligence where a reasonable man would take additional precautions.”166 While Iowa courts have not yet had occasion to apply this rule in the context of a railway crossing accident, courts nationwide have adopted the Restatement standard in circumstances similar to this.167 The district court did not err in submitting the issue of Burlington Northern's negligence to the jury.168

The railroads call the case an "aberration" and suggest several reasons why it should not be followed. First, it is the "only federal circuit decision which holds that where the Secretary has issued regulations, they are not preemptive of state law under the FRSA."169

None of these cases involve mechanical gates, however. The first case held that state caboose laws were preempted by 49 C.F.R. 221.5-16 providing for radio telemetry equipment instead. The second case held that state railroad accident reports were preempted by 49 C.F.R. 225.1 providing for federal accident reports. The third case held Louisiana local officials could not impose track safety standards that conflicted with federal ones codified in 49 C.F.R. 213.1-241. (Even in the latter case the court observed that state officials may participate in regulating railroad safety, even under the Railroad Safety Act.)

163. 188 Mont. 286, 299-300, 6 P.2d 982, 900-91 (1982).
164. Id.
165. 720 F.2d 1149, 1153 (9th Cir. 1983).
167. Restatement (Second) of Torts, § 288C (1965); accord Schmitt v. Clayton County, 284 N.W. 2d 186, 190 (Iowa 1979).
In fact, one of the leading “preemption” cases, Sisk v. Nat’l R.R. Passenger Corp.,¹⁷⁰ which held that local train speed ordinances are preempted, has not been followed without question. For example, a Florida appellate court explained the meaning of Sisk by saying:

We recognize that subsequent to the [Rail Safety Act] municipalities may not impose speed limits more stringent than federal regulations allow, and that this may impact on the admissibility of evidence in a negligence action in order to avoid doing indirectly what cannot be done directly without conflicting with the federal law.¹⁷¹

Citing Sisk in Chesapeake & Ohio Railway v. City of Bridgeman:¹⁷²

We reject the railroad’s contention that the federal act has preempted consideration of negligent conduct of a railroad and its agents when faced with a dangerous condition or event, notwithstanding that the acts of negligence involve failure to reduce speed below the maximum limit established by federal law. (Citing cases including Marshall, discussed below.)

Said the court:

Certainly it was not the intent of the act is to insulate railroads from liability for specific tortious acts in the face of hazardous conditions. Therefore, on retrial, the jury may properly consider evidence of the railroad’s failure to issue a slow order and the engineer’s failure to reduce speed or stop.¹⁷³

Second, the court in Karl did not understand the holding in Marshall because, according to the railroads, that decision actually held the FRSA was preemptive as to grade crossing warning devices when a state agency makes the determination as to what level of protection is required for a crossing. The railroads point out that the grade crossing in Karl had been approved by the local agency, and thus stands in direct conflict with the Marshall holding as to grade crossing preemption. The railroads like to point out that the “confusion” in Karl was that it did not discuss 23 U.S.C. § 130(1)d) (the requirement that states perform surveys), nor did it discuss the Secretary’s power under 45 U.S.C. § 433(b) to regulate grade crossing safety pursuant to his authority over highway safety.

Third, the court comment in Karl about the absence of “...case law or legislative history to support the theory that Congress intended to completely occupy the field of railroad safety governance” is off base, according to the railroads, because the court “completely overlooked the express provisions of the FRSA,” notably that it affects “all areas of rail-

¹⁷⁰ The support for this claim are four cases: Burlington N. v. Montana, 880 F.2d 1104 (9th Cir. 1989); Missouri Pacific R.R. Co. v. R.R. Comm’n of Texas, 850 F.2d 264 (5th Cir. 1988); Nat’l Ass’n of Regularity Util. Commissioners v. Coleman, 542 F.2d 11 (3rd Cir. 1976); and Donelon v. New Orleans Terminal Co. 474 F.2d 1108 (5th Cir. 1973).
road operations."\textsuperscript{174}

Fourth, the statement that no preemption is expressed or implied by the FRSA is wrong, contend the railroads, because of the language in 45 U.S.C. § 433(b) which speaks of "until such time as the Secretary adopts a regulation or standard covering the subject matter of the state requirement."

Regardless of what the railroads think about the ruling in \textit{Karl}, it remains an important decision of an appellate court of high rank, and until there is a United States Supreme Court decision on point, or has been expressly overturned, it is an important decision and remains the "best" rule.

As mentioned in the \textit{Karl} case, there are other decisions rejecting the preemption doctrine in crossing cases. In some respects, the decision in an earlier case, \textit{Marshall v. Burlington Northern},\textsuperscript{175} mentioned in \textit{Karl}, is arguably more important than \textit{Karl}. The reason is simple — its author is now Justice Kennedy of the United States Supreme Court.

Kenneth Marshall was killed when his car was struck by a train; the jury awarded $75,000 compensatory and $750,000 punitive damages. The plaintiff's case alleged two wrongs. The first was the failure of the locomotive to have strobe lights and oscillating lights; the second was the lack of a gate at the crossing. The verdict was overturned and a new trial ordered by the Ninth Circuit.

Judge (now Justice) Kennedy ruled for the railroad on the issue of lights. Here, the locomotive complied with the requirements of the Boiler Inspection Act\textsuperscript{176} with regard to its standard 800 foot visible beam. The Railroad Safety Act of 1970 did not subsume or recodify previously existing federal statutes on railroad safety. "Rather, it leaves existing statutes intact, including the Boiler Inspection Act, and authorizes the Secretary to fill interstitial areas of railroad safety with supplementary regulation."\textsuperscript{177} Moreover, the FRA had studied the strobe and oscillating light issue and found it did not promote safety. "The recent action of the FRA is support for the conclusion that the subject has been preempted by administrative action as of this date; but we rely on other indices of preemption we have discussed for our conclusion that state regulation was displaced at the time of the accident."\textsuperscript{178}

Turning to the issue of the gate protection argument, the opinion actually gave some support for the notion that the Manual on Uniform Traffic

\begin{footnotesize}
\textsuperscript{176}. 720 F.2d 1149, 1154 (9th Cir. 1983).
\textsuperscript{178}. \textit{id.} at 1152-53.
\end{footnotesize}
Control Devices is a federal regulation — an issue the railroads have urged with fervor in recent cases, despite the precise holding that no preemption had occurred in the case at hand. Here is the court's discussion:

Plaintiff contended at trial that the railroad was negligent in failing to provide a more adequate warning device at the crossing in question. Plaintiff's expert testified that the crossbuck, a sign with an X-shaped warning, was inadequate for the crossing, considering the multiple tracks, the possibility of two trains at the crossing, the use of high speed trains, and certain possible restriction on sight distance. He testified that an automatic gate with flashing lights should have been installed at the crossing. Burlington argues that evidence of the adequacy of its crossing should have been excluded because federal law also preempts this aspect of common law negligence. Burlington's preemption argument here is based solely on the Railroad Safety Act, since it is clear that the Boiler Inspection Act is not applicable. The question is whether the state is trying to regulate the same "subject matter" already regulated by the Secretary.179

The Railroad Safety Act requires the Secretary to study and develop solutions to problems associated with railroad grade crossings.180 The Highway Safety Act of 1966,181 directs the Secretary to develop uniform standards and to approve state-designed highway programs that comply with them, which are then eligible to receive federal financial assistance.182 The Secretary, through the Federal Highway Administration, prescribed procedures to obtain uniformity in highway traffic control devices and adopted the Manual on Uniform Traffic Control Devices on Streets and Highways,183 which also was adopted by Montana.184 The manual prescribes that the selection of devices at grade crossings and the approval for federal funds is to be made by local agencies with jurisdiction over the crossing. Thus, the Secretary has delegated federal authority to regulate grade crossings to local agencies.

The locality in charge of the crossing in question has made no determination under the manual regarding the type of warning device to be installed at the crossing. Until a federal decision is reached through the local agency on the adequacy of the warning devices at the crossing, the railroad's duty under applicable state law is to maintain a "good and safe" crossing. Mont. Code Ann. § 69-14-602 (1981) is not preempted. Evidence concerning the adequacy of the warning device at the crossing in question was properly admitted.185

Just as there are trial court orders upholding the preemption doctrine, there are trial court orders rejecting it too. In fact, there are proba-

179. Id. at 1154.
bly more trial court cases rejecting preemption than there are trial and appellate decisions accepting the doctrine, but these opinions are not generally available. There are two reasons for this. First, because the case was not appealed there is no way for plaintiffs' lawyers to "find" the cases and cite them in on-going litigation. Second, the railroad lawyers, in briefs arguing in favor or preemption, do not cite trial court decisions (which have no precedential authority anyway) which run counter to their preemption argument. The following trial court cases are illustrative.

In the case of Moore v. Soo Line Railroad Co. v. Overton,\(^{186}\) three

\(^{186}\) Id. at 1154.

A federal magistrate in Nebraska has rejected the preemption doctrine as it relates to grade crossing protection (but affirmed it regarding the sound level of the "audible warning device" on the train). In a very thorough opinion the magistrate began by summarizing the railroad's preemption argument, saying:

In arguing that federal law preempts the plaintiff's common law claims regarding traffic control of warning devices, the defendant asserts: (1) Nebraska has accepted, in exchange for federal highway funding, the obligations of implementing through its regulatory agencies the Secretary of Transportation's program for improving grade crossings; (2) the Nebraska Department of Roads had, before the accident in question, investigated the crossing at issue and began the procedure of acquiring additional crossing protection warning devices at the crossing in question; and therefore (3) the duty to install adequate crossing protection warning devices shifted from the railroad to the state" (p.6). Here is what the magistrate said regarding this issue: Karl v. Burlington N. Ry., 880 F.2d 68 (8th Cir. 1989), involved a railroad intersection collision. Id. at 69. The defendant railroad argued that it did not have a duty to upgrade its traffic control and warning devices and that the plaintiff therefore could not recover under that theory of negligence. The defendant argued that the FRSA and the FAHA preempted any claims of common law negligence based on the inadequacy of the warning devices at the crossing. The defendant then argued that as the federal law grants to the Secretary of Transportation the power to authorize a local agency to regulate grade crossings, and since the local agency approved certain warning devices, that such approval preempted any common law negligence claims. Id. at 75-76.

The Eighth Circuit determined that the plaintiff's negligence claim was not preempted by federal law for two reasons. First, the situation was not one of actual conflict between federal and state laws. [Here the magistrate recited that portion of the case saying that Burlington Northern "can point to no case law or legislative history to support the theory that Congress intended to completely occupy the field of railroad safety governance. ..."] ?? WHAT's this? Id. at 7. Concluded the magistrate: Acknowledging the Eighth Circuit's ruling in Karl, I find that the plaintiff's common law claims regarding crossing protection warning devices are not preempted by federal law. Therefore, insofar as these claims are concerned, the defendant's motion for summary judgment is denied ??(p.8). Carson v. Burlington N. R.R. Co., United States District Court, Nebraska No. CV-89-0-513 (Memorandum and Order, Magistrate Richard G. Kopsf, June 27, 1990).

A federal magistrate in Oklahoma has rejected the preemption doctrine, at least in part, in a case where the railroad (apparently) offered the Model Brief. The plaintiff was injured in an accident that happened at a crossing between 81st and 91st Streets in Broken Arrow, Oklahoma, on December 14, 1987. According to the railroad, "The grade crossing was initially numbered and relevant data obtained as to the crossing by the Oklahoma Highway Department in 1976, and was physically surveyed by Highway Department engineers sometime prior to 1987. Pursuant to that investigation authority to commence construction of warning devices at the subject crossing was issued by letter of H.R. Hoefner, Chief Traffic Engineer, Oklahoma Department of Transpor-
teenagers were killed when their car was struck at a crossing lacking
mechanical gates on West Street in Odon, Indiana. The lack of gates was one of the allegations of railroad negligence. But the facts are unique in that Soo Line was in the process of installing additional crossing protection pursuant to a joint agreement with the county and the state at the time of the accident.\(^{187}\)

In its motion to dismiss the claim relating to failure to upgrade the crossing, the railroad made all the arguments outlined above regarding preemption and insisted that "Soo Line was proceeding in its usual, expeditious fashion to complete the project."\(^{188}\) It argued that the facts of the case were virtually identical to *Nixon v. Burlington Northern*\(^{189}\) (discussed above) because the crossing had been identified as needing upgrading and obviously was in the process of improvement at the time. The railroad also argued that the crossing was not "extrahazardous" within the meaning of Indiana common law because the railroad had never been in an accident at the crossing involving either personal injury or property damage prior to the case at hand.

In opposing the motion to dismiss, the plaintiff recited the counterarguments and cases discussed above, e.g. no expressed preemption, no preemption in fact, and statutory law unique to the case, namely the fact that both public and private persons in Indiana can petition for grade crossing improvements, although such improvements must be "approved" by the Department of Transportation.

The plaintiff argued strongly that the latest meaningful United States Supreme Court decision on the issue of preemption was *Silkwood v. Kerr-McKee Corp.*,\(^{190}\) which rejected the preemption doctrine even in the area of nuclear energy safety concerns (although the states have no regulatory control in this area) with the statement that, "It is difficult to believe that Congress would, without comment, remove all means of judicial recourse for those injured by illegal conduct."

But perhaps the most telling document produced by the plaintiff was a report prepared by the School of Engineering, Purdue University entitled *Rail-Highway Grade Crossing Programs for Indiana County Highways and City Streets*\(^{191}\) which contained the statement, "The installation and maintenance of flasher signal devices at grade crossings is the responsibility of the railroad company since the device is owned and operated by

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188. The case illustrates the delay common in such matters. The state initiated contact with Soo Line's predecessor regarding the crossing in 1979. The contract to do the work—100 percent state funding—was not signed until 1986. According to the railroad some sort of work had actually begun in May 1986. The accident happened May 9, 1986.
189. Defendant's Memorandum of Law in Support of Motion to Dismiss Claim That Crossing was Inadequately Protected 13.
190. *Id.*
the railroad and is located on railroad right-of-way.” The document had been prepared in conjunction with the Highway Extension and Research Project for Indiana Counties and Cities. Without assigning reasons for its decision, the trial court denied the railroad’s motion regarding preemption.192

Four important federal trial court opinions also reject the preemption doctrine. Esters v. Seaboard System Railroad, Inc.,193 involved an acci-

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A Pennsylvania trial court decision also rejected the preemption doctrine, but here again, there was no written opinion, only a short court order rejecting it. The case is actually two cases, Miklos v. Seelinger v. Norfolk & Western Ry. and Paul M. Seelinger v. Norfolk & Western Ry., Erie County (PA) Common Pleas Court No. 799-A-1986 and 2258-A-1986.

The accident involved a collision on the night of December 16, 1984 at the Peach Street crossing in Erie, Pennsylvania. Both the driver, Mary T. Seelinger, and her passenger, Patricia Miklos, were killed when their car was struck by an eastbound Norfolk & Western freight train. The facts are somewhat complicated but the suit’s major contention was that the crossing should have been protected by “short arm gates.” According to the plaintiff’s proof, the Seelinger vehicle had just entered the crossing at a slow rate of speed. Seelinger stopped on the Norfolk & Western tracks short of the flashing signal standard which Norfolk & Western allowed to remain improperly located on in the Northwest quadrant of the crossing after Peach Street had become one-way northbound approximately 20 years prior thereto. According to the plaintiff, “Norfolk & Western decided to leave these signals improperly located on the outside chance that the City of Erie at some later time would make the street two-way.” Seelinger’s Brief In Opposition to Norfolk & Western’s Motion for Protective Order Regarding Pending Discovery. p.10. According to the plaintiff the signals had a history of malfunctioning, a common allegation in crossing cases, but very difficult to prove. Contended the plaintiff, “The flashing signals at this crossing were reported to have activated about half their intended cycle, i.e. 10 to 15 seconds prior to this train colliding with the Seelinger car. This was not unusual. The same flashing signals were found to have operated improperly at the time of a collision on December 9, 1984, between a northbound motorist and a Norfolk & Western freight train and when the crossing was inspected thereafter between December 9, 1984 and December 16, 1984. During this time period, Norfolk & Western never inspected the crossing to determine the adequacy of the warning system and claims they never malfunctioned or operated for time cycles less than 24 seconds prior to train arrivals at the crossing” Id. at 10.

The railroad’s preemption argument, namely that it had not been ordered to upgrade the crossing by the Public Utility Commission, was challenged by the plaintiff with two arguments. First, as a matter of general tort law mere compliance with state regulators does not inoculate a railroad from suit, citing two pre-Rail Safety Act cases, Stevens v. Norfolk & Western, 357 N.E. 2d 1, at 3 (Ind. App. 1976) and Dimenco v. Pennsylvania Railroad Company, 126 F.Supp. 417 (Del. 1954). The second reason may have been a crucial point. According to the plaintiff, “Pennsylvania Public Utility Commission’s railroad regulations adopted June 24, 1946, as revised on May 1, 1971, Rule 2A provide that a railroad operating in Pennsylvania through a grade crossing similar to Norfolk & Western’s operation or operations through the Raspberry Street grade crossing in Erie, Pennsylvania may voluntarily, by itself, increase the protection at any such crossing without being ordered to do so. The regulations provide that a railway company need not receive the Public Utility Commission’s prior approval to install additional temporary and/or experimental protection at such crossings and need only promptly notify the Commission of such an increase in protection at any given railway crossing. See also, 52 Pa. Code 33.21-33.23.” Id. at 20.

According to plaintiff’s counsel Andrew J. Conner, Erie, Pennsylvania, the trial court has
dent that occurred at about 11:00 p.m. on March 23, 1983. Plaintiff's decedent was traveling south on Main Street in the city of Biloxi, Mississippi approaching the east-west railroad track of the defendant. The train was traveling east at the alleged speed of 30 m.p.h. when it struck the decedent's auto on the passenger side. There were no activated signs or gates, only the standard crossbucks. According to the proof that plaintiff was prepared to offer, (1) there were nine train-auto collisions at this crossing in the seven years from 1976-1982; (2) the defendant had actual notice of each of these accidents; (3) that in 1981, the Main Street crossing had a hazard ranking of 8 out of 3,589; (5) that the defendant admitted that the Main Street crossing would have had a hazard ranking of 1 out of its 300 crossings in the State of Mississippi in 1981 and 1983; (6) that the sight distances at the Main Street crossing were grossly inadequate, in that the available sight distance from the north to south on Main Street was tentatively denied the railroad's motion in limine on the preemption issue. However, no opinion was issued (Letter from Andrew J. Conner to Lewis Laska, August 23, 1990). Likewise, a federal judge in Connecticut has rejected the preemption doctrine but no detailed opinion was written. As is customary, the railroad filed a motion for summary judgment asking that "Count One of the complaint [be dismissed] for the reason that, as a matter of law, any duty of Amtrak under state and common law regarding crossing bars, gates or other traffic safety devices at the Toelles Road crossing was preempted by the State's application of federal law and regulations." The court placed its ruling the motion itself, saying, DENIED upon a full review of the record. Summary judgment as to the Count 1 of the complaint is denied in view of the plaintiff's claim that defendant Amtrak was negligent in not petitioning to eliminate the allegedly dangerous conditions at the Toelles Road Crossing in accordance with CGS Section 13b-275. This denial is without prejudice to any motions in limine or requests for jury instructions that may be appropriate in view of the arguable federal preemption of any claim of Amtrak's responsibility for public safety at railroad crossings." Torres v. Consolidated Rail Corp. and Nat'l R.R. Passenger Corp., United States District Court, Connecticut N-87-16 (JAC) (Order/Ruling of January 12, 1990).

A state trial judge in Illinois has also rejected the preemption doctrine. The facts are interesting and not altogether unlike the Nixon case (discussed above). The decedent was killed in a collision with a Union Pacific train at Rezy Road Crossing, Madison County, on January 20, 1990. The railroad and the city (Olive Township) had been ordered/agreed to improve the crossing by the Illinois Commerce Commission on August 23, 1989. This, according to the railroad, meant that it had no more legal duty!that is, the state had made a decision that the crossing be signalized and therefore the railroad had no more legal liability. (In support of its position the railroads offered the usual unpublished opinions in Nixon and Mahony, discussed above.) Here is what the trial court ruled:

"The defendant Union Pacific Railroad Company's Motion to Dismiss Counts I and II of Plaintiff's Complaint having been taken under advisement, the Court now being fully advised in the premise finds as follows:
1. The defendant had a common law duty to provide adequate warning devices at the crossing, and the pleadings are sufficient to state a cause of action.
2. There being no showing that defendant had completed compliance with the 8-23-89 order of the ICC, defendant could not have been relieved of its duty by virtue of that order.
were 20 feet to the east and 27 feet to the west (direction from which defendant’s train struck plaintiff’s decedent, as compared to a “required” sight distance of 281 feet; (7) there is a visual clutter in the area which competes for the driver’s attention when approaching the crossing; and (8) there are parallel streets and a steep grade at the crossing that provides for difficult or complex driving maneuvers at the crossing.

The issue of preemption came before the court in an unusual manner. The railroad offered a proposed jury instruction which recited the facts of the case such as the fact that there were federal laws that provided for the funding of improvements, that the city had adopted a resolution calling for more protection and that the federal-state plan was a “fair and reasonable allocation of resources” and “since the defendant was a participant in the Federal and State railroad crossing program, you may not return a verdict for the plaintiff based on the fact that the defendant had not installed signals and gates before March 23, 1983.” In other words, the jury instruction itself incorporated the preemption doctrine and this was apparently urged upon the court by the defendant’s brief. Thus, it was the plaintiff who filed a motion in limine to block the use of the jury instruction. The plaintiff prevailed. While the court did not give a detailed reason for its ruling, its views were clear:

This matter having come to be heard on Plaintiffs’ Motion in Limine, dated February 20, 1987, the Court having considered the same, including briefs of counsel for the Plaintiffs and Defendant, finds that said Motion should be and is hereby sustained as follows:

1. That the Defendant, Defendant’s witnesses and counsel for Defendant shall not mention, refer to, or being before the jury, or potential jurors any evidence asserting and/or implying that the duties of the Defendant with respect to crossing protection under Mississippi law have been in any way preempted by the Federal-Aid Highway Act of 1973 and/or that its duties have been delegated to or are the responsibility of the Mississippi State Highway Department or any other person or entity by virtue of any written agreements or contract with the railroad-Defendant or any other person or entity relieving the Defendant of its duties, responsibilities and/or liability in its failure, if any, to carry out its duties under Mississippi law.

2. Further, that the Defendant, Defendant’s witnesses and counsel for the Defendant are prohibited from introducing, either testimonial or documentary in nature, evidence which would tend to suggest or imply, directly or indirectly, that the Federal Highway Act of 1973 or any agreements or contracts executed in compliance thereto as a result thereof relieved the Defendant of its duties and/or liability in its failure, if any, to carry out its duties under Mississippi law.

3. Further, counsel for the Defendant shall inform Defendant’s representatives and all witnesses called by Defendant to refrain from mentioning or referring, in any way, in the presence of the jury or potential jurors, to the matters set forth herein, unless specifically permitted to do so by ruling of this Court outside the presence of the jury.
4. However, the Defendant shall not be prohibited from introducing evidence which demonstrates Michael Esters' actual knowledge, experience and general awareness of risk and dangers associated with Main Street crossing Biloxi, Mississippi, in support of Defendant's affirmative defense of contributory negligence of plaintiff's decedent." (Order, August 26, 1987; 3 pages).

According to plaintiff's counsel Tim C. Holleman, Gulfport, Mississippi, the case was settled on the first day of trial. Another federal trial court which has rejected the preemption doctrine did so in McMinn v. Consolidated Rail Corp.194 The accident happened in New Jersey so the New York court applied New Jersey law in this diversity action. According to District judge John E. Sprizzo:

Plaintiff was driving her automobile toward a Conrail crossing, and she did not see the flashing lights at the crossing because glare from the sun washed out the lights. The crossing did not have automatic gates or bells, although there was testimony that the train's bell was ringing. Plaintiff approached the tracks slowly because she was aware of loose timbers on the track, and intended to change the gears of her standard shift auto when she slowed down. She stopped with the front end of the auto hanging over the tracks and then became aware of the train, but was unable to reverse in time. The train struck the front left of the auto195.

In affirming the $1.125 million verdict (reduced to $843,750 because of the plaintiff's 25 percent comparative negligence), the court dealt with several issues. But it said this about preemption:

Conrail next argues that it cannot be deemed negligent because the safety devices at this crossing had been approved by the State of New Jersey. However, a railroad is under a duty to consider changing conditions and alter its warning systems accordingly.196 Although Conrail argues that the crossing was approved by the state and that it could not have effected a change without the approval of New Jersey authorities, the duty to provide a safe crossing is on the railroad, and the railroad cannot absolve itself from liability on this ground because it was hardly vigorous in its effort to persuade the appropriate regulatory authorities that changes should be made at the crossing.197

**RECENT FEDERAL CASES**

Within the last three years there have been several federal courts that have rejected preemption on a variety of grounds. In Taylor v. St. Louis Southwestern R. Co.,198 Southwestern asked the court to determine, as a matter of law, that all issues with regard to railroad crossing safety be

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196. Id. at 2.
preempted by federal law. The court looked to the *Karl* case, which stated that negligence claims were not preempted. It indicated that "no federal decision had been reached through the local agency, and the railroad's duty under applicable state law is not preempted." Therefore, there was no preemption in this case. However, the court did say that if evidence was introduced that did indicate local action pursuant to the FRSA had occurred, it would preempt the negligence claim.

In *Brown v. Southern Pacific Transportation Co.*, the court indicated that "Preemption. . . should not be inferred from every Congressional enactment that overlaps with state regulation." Further, the court said that where there is no direct conflict, "courts should find federal law implicitly [preemptive] where the scheme of federal regulation is sufficiently comprehensive to make reasonable the inference that Congress 'left no room' for supplementary state regulation or where the field is one in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state on the same subject." The court pointed to section 434 of the FRSA which states that safety standards were to be "to the extent practicable." And stated this indicated a congressional desire not to totally preempt state regulation. The court ultimately concluded that "While the Federal Railway Safety Act of 1970 may represent an effort by the federal government to improve the safety of grade crossings, it does not lessen the statutory or common law duty of a railroad to maintain a good and safe crossing."

Recent cases have also considered the situation common law negligence applies when there has been no determination as to the appropriate warning device for a given crossing. In *Anderson v. Chicago Central and Pacific R.R. Co.*, the court stated that even under the doctrine stated in *Marshall*, if there hadn't been a determination by some governmental agency, preemption would not occur. However, the court also cited the *Karl* case, and stated that even if there had been some determination, a defendant could be subject to a common law negligence claim. In *Anderson*, there was no governmental determination, so the court ruled that under both doctrines preemption did not occur.

In a case decided in just this last year the District Court for the State of Nebraska held that there was no preemption. In *Duester v. Burlington Northern Railroad Co.*, the court did a brief three step analysis for federal preemption. The court looked to the *Karl* decision when writing its opinion. With regards to protection devices the court held that federal law does not preempt state common law in this instance.

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CONCLUSIONS ON PREEMPTION

The developing view of the railroads’ argument regarding preemption is that preemption does occur in these cases. This is especially true at the state level. If this view is adopted by both state and federal courts, potential plaintiffs’ only possible area of recovery will be from individual states and localities, which in itself presents a whole series of problems which will now be discussed.

V. STATE LIABILITY FOR NEGLIGENCE IN SITING AND CONSTRUCTING MECHANICAL GATE GROSSINGS

The doctrine of preemption, if followed to its logical conclusion, means that the state is the only potential defendant in a suit alleging failure to erect proper mechanical gates. Thus, while the plaintiff may name the railroad, the state, and possibly local governing entities such as counties or cities, the doctrine will leave the later governmental entities as the sole remaining defendants.

Have the states assumed the responsibility for grade crossing protection? This is both a legal and policy question.

VI. LEGAL IMPLICATIONS OF STATE DUTY TO SITE AND CONSTRUCT MECHANICAL GATE CROSSINGS

A. GENERALLY

The prevailing legal rule at this time is that the various states do not have a legal duty to site and erect mechanical gate crossings. While there are some exceptions, the general rule is that suggested by the Utah Court of Appeals in the Cooper case: “The basis asserted here for recovery against UDOT is its failure to better warn and control traffic at the crossing. Since we have concluded that UDOT is immune for its failure to do more than minimal warning and control, we hold that plaintiffs cannot recover against UDOT or the State.”

203. At least one influential person long involved with the issue of grade crossing safety appears to agree with the decision in Duncan. Dr. Hoy Richards, publisher of the newsletter Highway & Rail Safety Newsletter, said Duncan “clears the air” on several elements of the issue of state v. railroad responsibility. In introducing the case, Richards gave the following background:

Several years prior to the creation of the U.S. Department of Transportation, the Interstate Commerce Commission found that highway-rail safety is a public responsibility. The establishment of Section 203 grade crossing safety improvement program early in the 1970s demonstrated that the U.S. Congress also believed that the public should finance the major portion of the cost associated with grade crossing warning devices. The Congress also empowered the Federal Highway Administration to establish specific procedures for states to receive and expend federal-aid highway funds for crossing safety improvements. In this process, the states establish priorities for selecting crossings for improvement, conduct field evaluations to deter-
The reason there can be no state liability in the typical failure-to-install gates case is two-fold. First, the doctrine of sovereign immunity prevents suits for money damages from being brought in state courts naming the state as a defendant. While many states have altered or waived sovereign immunity in certain types of cases, such as where active negligence of a state employee can be shown (e.g. the driver of a state vehicle causes a collision with another motorist), most sovereign immunity “waiver” statutes contain exclusions which bar suits where the activity was “discretionary” in nature. Thus, the “discretionary function” exception would virtually bar a crossing claim. This is because the decision to site and construct a crossing gate (or the decision to order the construction of a gate) involves a professional engineering assessment. This is a classic example of a discretionary function.

A typical example of how this logic works is the case of Barger v. Chesapeake & Ohio Railway Co.\(^ {204} \) In that case the railroad is urging the appellate court to affirm the trial court's adoption of the preemption doctrine. In arguing against preemption the plaintiff has explained that the Ohio courts have already rejected any state liability in the case at hand.\(^ {205} \) The reason was explained in the State's brief:

Gates and warning lights are the responsibility of the railroad company to install and maintain under Sections 4907.47 and 4907.49 Revised Code, after a hearing and determination by the Public Utilities Commission of Ohio. Speed regulations and traffic warning signs are the responsibility of the country, or township, on country or township roads. (Citing 4511(a), Revised Code.)

The State's position was further stated as follows:

As has already been stated, ODOT has no responsibility for the installation of warning devices a railroad crossings. Further, DOT has no responsibility for the regulation of safety at railroad crossings. Again, ODOT merely identifies statistically dangerous crossings and informs local authorities and railroad companies of its findings.

ODOT does have the authority to recommend the installation of gates,
and other types of warning devices at railroad crossings, pursuant to the powers granted it under Section 5523.31, Revised Code. However, that Section limits ODOT's authority to conducting statistical surveys at all railroad crossings that have a high probability of accidents. Based upon the survey information obtained, ODOT identifies the highest priority crossings, then it may negotiate with the railroad companies affected, and local subdivisions, to arrange for the installation of warning devices by the railroad company. (ODOT Reply Brief in Support of Motion for Judgment on the Pleadings, January 31, 1989).

There is a dearth of case law on the issue of whether a state bears legal liability for failure to upgrade a railroad grade crossing. The reason is this. The theory that states are responsible for crossing protection has arisen only recently, coincident with the erosion of the doctrine of strict governmental immunity and the rise of the preemption argument. Many cases name the state (or municipality) as a defendant largely for tactical reasons, not because of a clear belief that a judgment can be gotten against the state. That is, plaintiffs' lawyers sue the state in order to take the depositions of appropriate officials who will (1) explain the engineering criteria by which dangerous crossings are determined; (2) explain that the railroad knew or had reason to know of the dangerous nature of the crossing; and (3) the state would have given permission for the railroad to upgrade the crossing had the railroad asked. In short, the purpose of suing the state is to find a credible witness who will pin liability on the railroad. Sophisticated state transportation officials know this. Those who do not, tend to over-react and attempt to avoid involvement by invoking 23 U.S.C. § 409. The net effect, however, hardly promotes railroad safety. Where preemption prevails the railroads do little or nothing in the crossing area (except urge greater public awareness of the dangers of "beating the train" and the like); and states lose any leverage they have to "force" the railroads to upgrade crossings.

Cases where states have settled cases where this is an allegation may be found, but they are not very instructive and do not represent the norm. In Prescott v. Burlington Northern Railroad, a jury slapped the railroad with $5.2 million compensatory and $18 million punitive damages for the massive injuries suffered by two sisters, ages 24 and 27, whose car was struck at an unprotected crossing. The collision occurred in the evening hours at a crossing bordering the city of Longmont in Boulder County, Colorado. Visibility was restricted by trees and brush, the advance warning sign was down, and the pavement markings were not in place. The train was travelling slightly above the municipal speed limit. Suit alleged the railroad acted recklessly (justifying punitive damages) by not providing active protective devices, especially given the restricted vis-

206. Boulder County (CO) Dist. Ct., No. 83 CV 8842 (December 17, 1984).
ibility, and due to excessive speed. Evidence revealed that for 12 years prior to the collision, the county and state had notified the railroad that the crossing warranted upgraded activated protective devices and had cited the crossing as the second most hazardous in the state. Noteworthy is the fact that the State of Colorado and the county settled the case prior to trial for $850,000.

Parenthetically, it should be mentioned that at least one state has codified the rule that railroads have no duty to erect mechanical gates unless told to by government. While the wisdom of such a statute can be debated, at least it makes clear when the railroads' duty to act arises. The state is Michigan, whose statute provides, "The erection of or failure to erect, replace, or maintain a stop sign or yield sign or other railroad warning device, unless such devices or signs were ordered by public authority, shall not be a basis for an action of negligence against the state transportation department, county road commissions, the railroads, or local authorities." MCL 257.668(2); MSA 23.68(2). The statute was found to be "clear and unambiguous" in Baughman v. Consolidated Rail Corp., 460 N.W.2d 895 (Mich. App. 1990) in which the court barred the use of Michigan Department of Transportation files as evidence in the case (the court did not cite 23 U.S.C. § 409, however) and served to effectively bar the plaintiff from bringing a case against Conrail alleging failure to erect mechanical gates.

B. The Eleventh Amendment

There exists a constitutional impediment in finding a state liable where a case is brought in federal court, namely, the Eleventh Amendment to the United States Constitution. This amendment has been interpreted to bar a suit for damages against a state where the plaintiff is alleging negligence. Thus, in the typical crossing case brought in federal court it will be literally impossible to hold the state liable. As explained above, many crossing cases are brought in federal court by the plaintiff. Other cases, where the railroad deems it strategically advisable, will be removed to a federal court by the railroad. Regardless of whether the suit begins in or is removed to federal court, the result as to the state defendant is the same: it will be dismissed against the state on Eleventh Amendment grounds.

208. For additional federal cases accepting the preemption doctrine, see Connor v. Missouri Pacific Railroad Company, (D. Ok.) No. 90-C-562-E, (March 1991), Cothron v. CSX Transportation, Inc. (M.D. Tenn, Nashville Div.) No. 3-89-0960 (April 1991). Another case, that isn't directly related to federal preemption, is Moore v. Atchison, Topeka and Santa Fe Railway Company, 966 F.2d 199 (8th Cir. 1992). In this case, rather than looking to the federal acts, the court cited Missouri law that gave immunity for the installation and maintenance of warning devices at crossings where the MDOT had taken over jurisdiction. See § 389.640.2, R.S. Mo. (1986).

Negligence in failing to install gates is commonly alleged in crossing accidents but it is very difficult to prove. The plaintiff must offer expert testimony to show that the crossing, by virtue of the number of trains and motor vehicles, as well as their type (such as school buses) and other factors, was "extra hazardous." That is, the mere fact that an accident occurred does not raise the inference of negligence, nor is a railroad crossing a hazardous condition which in and of itself requires the highest form of protection that technology can create.

Proving the "extra hazardous" nature of the crossing requires the expert witness to rely on data which was in existence prior to the accident, which the railroad can be deemed to have actual or constructive notice. Notable among these data are survey reports and any special reports prepared by state officials as part of the federally-mandated inventory process. Likewise, accident reports of prior accidents at the crossing are required by law to be sent to the FRA to serve as a basis for testimony.

Here, the plaintiff will encounter two difficult obstacles. First, accident reports which are sent to the FRA may not be offered in evidence for proof of the matter contained therein. This is because in 1910 the Congress passed, at the behest of the railroads, 45 U.S.C. § 41 which bars the admission of such records.

State crossing inventory data and reports were admissible until 1987. However, that year, at the behest of the railroads and the states, Congress passed 23 U.S.C. § 409, an amendment to the Highway Safety Act which provides:

Notwithstanding any other provision of law, reports, surveys, schedules, lists or data compiled for the purpose of identifying, evaluating, or planning the safety enhancement of potential accident sites, hazardous roadway conditions, or railway-highway crossings, pursuant to sections 130, 144, and 152 of this title or for the purpose of developing any highway safety construction improvement project which may be implemented utilizing Federal-aid, highway funds shall not be admitted into evidence in Federal or State court or considered for other purposes in any action for damages arising from any occurrence at a location mentioned or addressed in such report, surveys, schedules, lists, or data.

The railroads argue that this statute is further proof of the fact that Congress was preempting the issue of railroad safety by making it a state responsibility. The argument is based upon a May 4, 1983 internal Memorandum of the Federal Highway Administration signed by Marshall Jacks, Jr. Associate Administrator for Safety to Mr. D.L. Ivers, Chief Coun-
sel which urges passage of a bill containing the language now found in 23 U.S.C. § 409 and assigns the following reason:

It is the intent of this provision to prevent the unauthorized disclosure of information that States compile in good faith to meet the purposes of federal-aid highway programs to eliminate or reduce hazardous roadway conditions.\(^\text{209}\) It is also the intent to protect information that may be compiled by railroads or utility companies for States in identifying hazards in connection with these programs.

The issue of keeping such data from plaintiffs’ attorneys was the subject of testimony by railroad officials in hearings in 1985 as well. According to one view,

Frequently such information, in the form of surveys and reports, has been used by attorneys representing plaintiffs in trials involving highway-railroad crossing accidents. As a result of this practice, states have understandably been reluctant to identify hazardous situations on a priority basis because of exposure to potential liability. Railroads, as well, have been cautious in supplying information to the states to be used in identifying hazardous crossings. These reports and surveys are developed in good faith to aid in the effectiveness of the Section 203 programs and should not be permitted to be used against states or railroads in personal injury or property damage litigation.\(^\text{210}\)

This statute flies in the face of the modern rules of litigation which foster broad discovery. Most courts allowed the plaintiff to discover such materials.\(^\text{211}\) Other courts barred discovery as well.\(^\text{212}\) This includes barring discovery of data that was collected prior to enactment of the statute but the suit was filed after its passage.\(^\text{213}\)


\(^{210}\) The Eleventh Amendment provides: “The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.” The amendment was adopted in response to Chisholm v. Georgia, 2 U.S. 419 (1793) whereby a citizen of South Carolina brought suit against the state of Georgia to recover on a debt relating to the Revolutionary War. The amendment was quickly passed to keep such “foreigners” (including persons who had been loyal to Britain) from bringing suits in the federal courts. The amendment was soon interpreted as a bar against any suit against a state where the plaintiff was seeking money damages and the state had not “consented” to suit. See, Hans v. Louisiana, 134 U.S. 1 (1890). There are very few such “consents” (none done intentionally) even where a state has partially waived its sovereign immunity in suits brought in its own courts under a state tort claims act. The Eleventh Amendment is probably the most criticized of all amendments, even by supreme court justices themselves. See, John R. Pagan, Eleventh Amendment Analysis, 39 Ark. L. Rev. 447-498 (Spring, 1986).


\(^{213}\) Another relevant case is Neely v. Consolidated Railway, U.S. Dist. Ct., N.D. Ohio, No. 5-89CV-0531 (Order, January 8, 1990). Recently, the Missouri Supreme Court, barred use of such data in Federal Employer’s Liability Act (FELA) cases as well. This statute, under fierce attack by
Today, survey data is neither discoverable or admissible. In 1991, the Administration, at the behest of the states and railroads, urged an amendment to section 409 which makes it clear that "data, reports and surveys" may not be discovered in pre-trial proceedings in "any action for damages arising from any occurrence at a location addressed by such information."214

D. POLICY IMPLICATIONS OF A STATE DUTY TO SITE AND CONSTRUCT MECHANICAL GATES AT CROSSINGS

Apart from a state’s legal duty is the question of public policy—should the state, as a matter of transportation policy, take upon itself the duty to site and construct gates? The answer to this question is beyond the scope of this Article, but the complete answer begins with another question: Do the various states currently see themselves as having the duty which the railroads suggest is theirs? The answer is no.

During the summer of 1990, the author wrote letters to the state transportation officials of the 50 states asking them the following question:

...
Is it the policy of your state that it (your state) has assumed the duty to prioritize and order the construction of mechanical gates at crossings and by assuming such duty the policy of your state is that individual railroads have no independent duty to construct such gates on their own without a prior order from proper state officials?

The responses were clear: Of the thirty-six states responding, only two—California and North Carolina—suggested or implied that the state had assumed the total responsibility in this matter. At least nineteen others plainly stated—sometimes with emphasis—that state involvement in upgrading crossings did not obviate the railroad’s independent duty to site and construct mechanical gate crossings. This is true even in those states where there are now court opinions ruling that the railroads have no duty, the prime example is Georgia. The following is the response received from Georgia:

We have a section within my office that is responsible for inspecting railroad crossings over the State. Information compiled from these inspections are used to assist in identifying those crossings over the State where additional safety equipment will produce the greatest accident and fatality reduction. Those crossings so identified are put on a list and designated as priority locations to be considered for signalization. This listing is sent to the Federal Highway Administration for their approval and verification should Federal Aid Safety Funding be requested to fund safety improvements for the identified crossings.

Georgia law gives the Department review and approval authority when active railroad crossing safety equipment is installed at public crossings within the state. This is to insure that all crossing signal equipment is installed in accordance with the Manual on Uniform Traffic Control Devices. The railroad companies are totally responsible for designing the crossing signals, drafting the necessary circuit plans, installing the equipment, plus maintaining the equipment. There are no restrictions whatsoever that prohibit the railroads from funding and installing active railroad crossing signal equipment at crossings identified by them as needing such.215

The majority view regarding this issue was succinctly expressed by a Nebraska official responding to the author’s inquiry; “The State of Nebraska does prioritize public grade crossings in the State to use as a starting point for our Diagnostic Inspections for signal projects utilizing State or Federal safety funds. We do not perceive that this puts the entire responsibility on the State or that it takes away any responsibility that the railroads have.”216 Likewise, the response from the State of New York summarizes most states’ positions and sheds an insight into the policy

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216. Letter from Ellis Tompkins, Railroad Liaison Engineer, Project Development Division, Nebraska Department of Roads to Lewis Laska, June 12, 1990.
implications of the current status of site selection. Responded a New York official:

This State has assumed the responsibility for prioritizing the order of funding for installation or upgrading of grade crossing warning devices under the federally funded Section 130 Program, which is administered by this Department. The assuming of this responsibility is not considered to relieve the railroads or highway authorities of any responsibilities they might have.

It is this Department’s position that both the Railroad and the highway authority independently evaluate their transportation facilities (track and highway) and take steps to address priority safety matters. This includes grade crossing safety. The Section 130 Program is viewed by this Department as one source nor should the NYSDOT be viewed as having sole responsibility for addressing the grade crossing safety needs of a railroad or a non-state highway authority. New York State Railroad Law provides a mechanism for non-section 130 improvement proposals.

Practically speaking, the Section 130 Program’s existence has probably encouraged the railroads and highway authorities to defer these grade crossing safety needs in hopes that the State will eventually give them priority.217

One finding of the survey was that officials in at least twelve states could not (or would not) give a clear statement of what their states’ policy was on this narrow question. Their responses tended to simply describe the prioritization process and avoid answering the question. In answering, most of these twelve made it clear that nothing in way of state policy truly interfered with the railroads’ coming forth independently and suggesting/making improvements. The response from Texas was illustrative:

[Texas] policy, as administered by this Department, can be summarized by our efforts to comply with the Federal Rail Safety Act of 1970. These efforts do include the compilation of accurate records for all at-grade crossings, prioritizing the hazard rating of each crossing, and budgeting all available state and federal funds for upgrading the protective devices at the most hazardous crossings. The Department does not prohibit the construction of gates or other protective devices by the independent railroad companies it, in fact, encourages local entities and railroad companies to provide gates or other protective devices to obtain the maximum protection for the motoring public.218

The Wisconsin response was also illuminating:

A regulatory agency, the Office of the Commissioner of Transportation, has legal authority to order crossing warning devices to be installed by railroad companies, after public hearing. The Commissioner’s priority is based

on which crossings are petitioned for investigation, although the Commissi-
one may petition if he feels the need. Department policy and state law do
d not prohibit a railroad company from installing warning devices, including
gates, on its own and at its own cost. It is our perception, however, that the
railroads operating in Wisconsin rarely do crossing protection work on their
own initiative. For liability purposes they may feel more comfortable doing
work after it has been ordered by the regulatory authority.219

Fifteen states did not respond to the survey. Not surprisingly, some of
these were states where the issue is now before the courts, including
Utah, Mississippi, and Michigan.

E. UNITED STATES DEPARTMENT OF TRANSPORTATION POLICY
REGARDING STATE DUTY

What is the official position of the United States government regarding
the issue of state duty to site and construct crossings? Is it consistent
with what the individual states think? Does the USDOT agree with the
railroads?

To gain an answer to these questions, author Lewis Laska contacted
his congressman, the Honorable Bob Clement (5th District, Tennessee)
and asked him to query Gilbert Carmichael, Administrator of the Federal
Railroad Administration. The reply from Mr. Carmichael was both predict­
able and surprising. It was predictable in that he restated federal policy
regarding the issue of the source of funding for crossing improvements.
But it was surprising in this regard: Mr. Carmichael said he had “neither
seen nor had the opportunity to study” the issue of preemption. The fol­
lowing is the full text of his letter:

August 22, 1990
The Honorable Bob Clement
House of Representatives
Washington, DC 20515-4205

Dear Mr. Clement:

Thank you for your recent letter in which you forwarded a letter from a
constituent regarding federal policy with respect to the siting and construct­
ing of “mechanical gates” at railroad crossings.

Your constituent asks whether FRA agrees with the “position of the rail­
roads,” which they have apparently taken in the course of litigation. Of
course, I cannot agree or disagree with a position I have neither seen nor
had the opportunity to study. However, I am pleased to discuss the general
area your constituent is concerned with.

For many years, it has been the generally accepted view that grade
crossing protection in the form of grade separation and warning devices are
primarily for the protection of the motoring public.

In 1964, the Interstate Commerce Commission stated: [t]hat highway

users are the principal recipients of the benefits flowing from rail-highway grade separations and from special protection at rail-highway grade crossings. For this reason the cost of installing and maintaining such separations and protective devices is a public responsibility and should be financed with public funds the same as highway traffic devices is a public responsibility and should be financed with public funds the same as highway traffic devices. 322 I.C.C. 87 (1964). This policy is expressed today by Federal Highway Administration regulations governing Federal-aid highway projects.

Indeed, the regulations themselves made the point that grade crossing improvements are of “no ascertainable net benefit to the railroads” and therefore the railroads should not be required to share the costs of the improvements. 49 C.F.R. 646.210(b)(1)

We should think it senseless if a highway were constructed to cross an airline runway. Of course, a train, given its great momentum and weight, requires even more distance to stop than does an airplane landing or taking off and, like the airplane, the train cannot stop quickly for automobiles, trucks, or anything else in its path.

In addition to the deaths, injuries, and damages that occur at grade crossings in the United States, collectively they have slowed the fuel-efficient, very safe railroad system down so that it loses much of its efficiency and timeliness. If, like European and Japanese high-speed rail lines, our main freight and passenger lines did not have at-grade crossings, the speed of our trains and the financial health of our transportation system, as well as its safety, would be dramatically improved.

Sincerely yours,
Gilbert E. Carmichael
Administrator

Despite FRA Administrator Carmichael’s never having “seen or had the opportunity to study” the preemption issue, it is clear that the FRA practice has been to encourage railroads to participate actively in site selection and upgrading.

For example, a 1978 FRA report examined the practices in five states (Massachusetts, New York, Louisiana, Texas, and Oregon) but contained no mention of this being solely a state government responsibility.

To the contrary, in discussing Massachusetts, the report says:
Since the railroad must prepare the specifications for the projects, improvements cannot be undertaken unless the railroads cooperate. Of course, if a crossing is extremely dangerous the [Mosey governmental authority] could order it to be improved, but to our knowledge this has not occurred.220

In discussing the New York situation, the report said:
The Traffic and Safety Division, the group within the New York Department of Transportation which has regulatory powers, can influence the use of innovative signal devices through its review process. However, once again the railroads must initiate a proposal for a new signal system.221

221. Id. at 22.
In discussing the Louisiana experience the report states: "State and FHWA officials are CK3 about the effectiveness of gates, but where the railroad can justify them, they are installed."222 The report implicitly rejects the notion that the MUTCD is a mandatory federal standard. "Applying the MUTCD suggestion that multiple track crossings be considered for automatic gates, one finds that there is potential for more work in Louisiana."223

The report summarized the problem with getting the railroads to upgrade crossing, citing Massachusetts as typical.

The railroads are responsible for maintenance of all signal equipment after installation. In addition, the railroads have muse for maintaining all crossbucks whether installed by the state using federal funds or by the railroad with its own funds.224

The report indicates clearly why the railroads have been slow to innovate.

There are two factors which have discouraged the railroads from upgrading their signals to incorporate motion sensor or constant warning time (CWT) devices. First, sophisticated equipment is costly to maintain; railroads, in general, want to avoid higher maintenance charges. The railroads are also concerned with potential liability in the event of an accident. The railroads claim that they do not know what their liability would be should an accident occur at a crossing where an innovative device was used.225

Again from this it is clear. The FRA does not act in a manner consistent with the railroads’ notion of preemption. In fact, the FRA has always acted in a manner that recognizes an ongoing duty by the railroads to keep crossings safe.

F. THE PROBLEM OF DELAY IN CONSTRUCTING GATES ONCE A DECISION HAS BEEN MADE THAT THEY BE INSTALLED

It is not unusual for many months, sometimes years, to pass between the time a state agency serves notice upon a railroad that it should upgrade a crossing and the time the actual work is complete. There are several reasons for this. One is simply the fact that railroads do not want to bear the expense of signal upkeep and drag their feet in order to save money. Other reasons include delays in finalizing the financial details of

222. Id. at 25.
223. Id. at 26.
224. Id. at A-16.
225. Id.

The outcome of the case mentioned in the Introduction is as follows. The jury awarded $1,125,812 but found the plaintiff thirty percent negligent, bring his recovery down to $788,068. Because the defendants offered a joint defense they agreed before trial to share a verdict equally; this was done. Roy Polly v. Burlington N. R.R. and City of Lacey, Thurston County (WA) Superior Court No. 84-2-1523-1.
the crossing project. While the bulk of the funding comes from the federal government it must pass through state hands where approval delays occur; moreover, some states require local governing bodies to share what is a small percentage of the cost and local funding approval brings about more delay.

Where it is clear that the railroad showed conscious indifference to the consequences when it knows that an injury could occur, at least one court has allowed punitive damages against a railroad. The facts in Brown v. Missouri Pac. R.R.226 are extreme but illustrative. The train collided with the decedent's pickup truck at a crossing in Arkansas. A crossbuck was present but no active protection devices had been installed despite the fact that the state highway department had rated the crossing among the ten percent most dangerous in Arkansas. Suit sought punitive damages for the railroad’s reckless disregard for the public’s safety by refusing to install safety devices. The jury awarded $80,000 compensatory and $62,000 punitive damages. The Eight Circuit affirmed reciting testimony, albeit hearsay, that a railroad employee suggested to city fathers at a Kiwanis Club meeting that the railroad did not install safety devices at its crossings between 1947 and 1976 because it was “cheaper to be sued than to protect railroad crossings.” Under Arkansas law, a railroad has a duty to provide active warning devices at abnormally dangerous crossings. Here the evidence showed that punitive damages were appropriate. (This is one of the most controversial crossing cases in recent times. The railroad employee vigorously denied making the statement.)

Another case tells a similar story. Plaintiff Bjugstad, a twenty-one-year-old college student, was riding in a tractor-trailer being driven by her fiance which became “hung-up” while attempting a left turn in a busy intersection during rush hour traffic and the driver apparently never saw the approaching train. The intersection had been identified as a problem intersection for large trucks. Several years before the accident the State Department of Highways had considered modifications to eliminate the problem. No action was taken although the modifications would have cost only $500. In 1981, the City of Sheridan had requested federal funding to install automatic gates at the crossing because the accident rate was one of the state’s highest. The funding was approved in early 1982, but no gates had been installed at the time of the accident in September, 1985. Plaintiff’s (and apparently some of the defendants’) experts agreed that the gates would have probably come down in front of the truck before it crossed over the tracks, preventing the accident. Substantial modifications were made both to the road and the crossing in 1987.

226. 703 F.2d 1050 (8th Cir. 1983).
The plaintiff, who was severely burned, received a structured settlement of some $3.4 million. It is not clear who contributed but the suit named several railroads as well as the city and state.227

Only one case can be found where a state was held liable for delay in bringing about an upgrade of a crossing. Of course, the facts are unique, but they are at the same time familiar. Here is what the Louisiana Court of Appeals said in upholding a verdict against both the railroad and the state in Herbert v. Missouri Pac. R.R. Co.,228 which involved an accident that occurred on December 6, 1974:

As early as 1969, the dangerous nature of this crossing was brought to the attention of the Highway Department and Missouri Pacific. Due to accidents occurring at the crossing, the St. Laundry Police Jury passed a resolution asking the parties concerned, the Highway Department and Missouri Pacific, to take steps to protect the public from the hazard.

Lawrence Harry, an engineer for the Highway Department, made a survey of the crossing in 1969 and found that the sight distances were less than minimum requirements. He calculated the hazard rating as 2.32, meaning that he projected that number of accidents to occur over a five-year period. He recommended that the crossing be equipped with flashing lights, warning bell and advance warning signs. Mr. Harry made another survey in 1973 with the same result.

Mr. Harry submitted his findings to Turner Lux, Jr., agreement engineer with the Highway Department. Lux sent the report and recommendations to Missouri Pacific in 1970. Missouri Pacific responded two years later, in 1972, offering to install the signal equipment if the Highway Department would pay 90% of the costs. There was an exchange of communications between the Highway Department and Missouri Pacific was consummated in June, 1974. The installation took place in 1975, after the accident in question.

The railroad had knowledge of the need for automatic signals at this crossing for over five years before it installed same. This need was shown, not only by the surveys of the engineers but by the fact that William McClendon, claims man of Missouri Pacific, stated that five accidents occurred at this crossing between 1959 and 1974.

Automatic signals serve the same purpose as a whistle or bell on an approaching train. These devices all warn the motorist that impending danger exists as a train is approaching the crossing and is in the immediate vicinity of same. Under the unusual circumstances presented herein, the unreasonable delay in the railroad's installation of the safety devices was negligent and such negligence was a proximate cause of the accident.229

Continued the court:

In connection with the liability of the railroad, we have discussed the sequence of events that led up to the installation of the automatic signaling

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229. Id. at 611-12.
devices which were installed after the accident. As early as August 1973 the Highway Department agreement man had authority to accept Missouri Pacific's prior offer of 90%-10% participation in costs. The acceptance wasn't prepared and entered into until June 1974. The explanation given for the unusual delay was that the agreement office personnel were busy with other work. We have examined the testimony of the Highway Department personnel and conclude that in view of the risk to the public that was involved, the cost of the installation (approximately $25,000.00), and the knowledge by the Highway Department of this dangerous condition, the delay was unjustified.

We conclude that under the particular and unusual circumstances presented, the trial court was correct in its conclusion that the Highway Department had violated its duty to the public and such was negligence that was a proximate cause of the accident. 230

VII. LIABILITY OF STATES IF THEY CONSTRUCT A WARNING DEVICE

There has been one case where a court has held a state may be held liable if it constructed a warning device, and then failed to maintain it. In *Huseby v. Board of County Commissioners of Cowley County, Kan.*, 231 the court had before it a case where the local government had installed an advance railway warning sign, two sets of rumble strips, a warning symbol on the pavement, and a crossbuck warning sign. The state had required that this crossing also needed an electronic lighted signal. The Defendant in this case had not installed the electronic signal, and had allowed the rumble strips and various warning devices to come into disrepair. The court stated that once the warning devices had been put in place "the defendant had the duty to inspect and maintain the [warning signals]." The court held that the government was not immune from liability in this case because it had taken on an affirmative duty of protection by installing and periodically inspecting this crossing.

G. PERSONAL LIABILITY OF GOVERNMENT OFFICIALS

Public officials cannot be held personally liable for negligence with regards to the maintenance of railroad warning devices. In *Ingle v. Ridge*, 232 James E. Harrington, former Secretary of the North Carolina Department of Transportation was named as a co-defendant in a railroad crossing suit. Mr. Harrington moved for dismissal for failure to state a claim upon which relief may be granted under rules 12(b)(1) and (6). The court granted this motion noting two things: (1) Mr. Harrington was a "Public Official" at the time of his serving in has capacity as Secretary; and (2) he had not acted in a corrupt or malicious manner during his

230. Id. at 612-613.
tenure. Based upon these two facts and *Wiggins v. City of Monroe*, the court allowed the motion, and dismissed Harrington.

**CONCLUSIONS ON STATE LIABILITY**

Finding States and localities liable for injuries that occur at railroad crossings would place an undue burden on government. It would force governments to build the best warning devices available at the expense of the taxpayers, when it should be at least paid for in part by the co-beneficiary of the devices, the railroads. This kind of liability would fly in the face of the long held tradition of sovereign immunity, except in the case where the government is acting as a market participant. This result is neither desirable, nor an efficient method of distributing liability.

**VIII. WHAT NEXT AFTER PREEMPTION DOCTRINE IS ADOPTED REGARDING THE DUTY TO CONSTRUCT GATES**

The most recent attempt by the railroads to urge the preemption doctrine regarding mechanical gates is part of a concerted effort to assert the doctrine in all aspects of railroad operations. For example, state laws regarding cabooses, train speeds, and train lengths have already been successfully challenged, based on specific federal regulations.

What will be the next area where the railroads will assert the doctrine? The answer is this: track maintenance. The doctrine was recently tested in the case of *Southern Pac. Transp. Co. v. Maga Trucking Co.*, which involved a suit brought by (not against) the railroad. The defendant's tractor-trailer became stuck on the tracks and was struck by the Southern Pacific train which derailed. The railroad sued the trucking company for property damage. The trucking company counterclaimed saying the cause of the accident was the poor condition of the crossing which caused the truck to "hang up" across the track. The railroad asserted that under Nevada law it does not have the duty to maintain crossings (at least the crossing in question) and filed a motion to strike the counterclaim. In denying the counterclaim, the court ruled:

Plaintiff has moved to strike defendants' counterclaim alleging property damage proximately caused by Southern Pacific's negligent maintenance of the crossing at the intersection of the railroad with Hershell Road west of Winnemucca, Humboldt County, Nevada. The allegation is that Herschell crossing was in such deplorable condition the defendants' tractor-trailer became stuck on the tracks and was run into by the oncoming train.

The thrust of the motion is that all areas of rail safety have been pre-

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233. 73 N.C. App. 44, 49, 326 S.E.2d 39, 43 (1985). Public officials are immune from liability for mere negligence in the performance of their duties.
empted by the Railroad Rail Safety Act of 1970\textsuperscript{235} and the Highway Safety Act\textsuperscript{236}. Particular reliance is placed on 45 U.S.C. § 434. Here the court recited the entire language of Section 434. Unquestionably, these statutes do preempt certain areas of the subject matter of railroad safety.\textsuperscript{237} The lesson to be learned from \textit{Marshall v. Burlington Northern},\textsuperscript{238} is that preemption by the Railroad Safety Act is selective and the tenants of state common and statutory law are not preempted in areas in which is selective and the tenets of state common and statutory law are not preempted in areas in which the federal and regulations have not sought to control. Counsel have directed our attention to no such regulations and we have found one. Part 213, 49 C.F.R. deals with "Track Safety Standards" with the following subheadings: "Roadbed," "Track Geometry," "Track Structure," "Track Appliances and Track Related Devices," "Inspection." While on the surface some of these would seem to encompass the area of our dispute, a careful reading of the regulations discloses that all are designed for the safety of the trains. Not one speaks to the design of tracks, design and construction of roadbeds and the like for the safety of vehicular and other traffic crossing the railroad right of way at designated crossings. Nothing is directed at track and roadbed maintenance to protect against crossing vehicles becoming struck on the right of way. In \textit{Marshall} the court said: "The locality in charge of the crossing in question has made no determination under the manual regarding the type of warning device to be installed at the crossing. Until a federal decision is reached through the local agency on the adequacy of the warning devices at the crossing, the railroad's duty under applicable state law to maintain a "good and safe" crossing\textsuperscript{239} is not preempted. Evidence concerning the adequacy of the warning device at the crossing in question was properly admitted.

In the instant case the railroad has a common law duty of care to all persons crossing the right of way at designated crossings. The standard of care is to use the care in construction and maintenance of its roadbed and tracks that ordinary persons would use in the same of similar circumstances. That standard of care has not been preempted by the Railway Safety Act and restrictions.\textsuperscript{240}

**CONCLUSION**

Close analysis of federal laws, together with current regulations, reaches the conclusion that the doctrine of "preemption," as it relates to abrogating the railroads' duty to site and construct mechanical gates, is without substantial legal support. Rather, what has happened is that the railroads have taken a scheme which was designated to promote railroad safety by assuring that states systematically determine safety needs and

\begin{itemize}
  \item \textsuperscript{235} 45 U.S.C. § 421 (1992).
  \item \textsuperscript{236} 23 U.S.C. § 130 (1992).
  \item \textsuperscript{237} Donelan v. New Orleans Terminal Co., 474 F.2d 1108 (5th Cir. 1973).
  \item \textsuperscript{238} 20 F.2d 1149 (9th Cir. 1983).
  \item \textsuperscript{239} Mont. Code Ann. § 69-14-602 (1981).
  \item \textsuperscript{240} Order Denying Motion to Strike, August 29, 1990.
\end{itemize}
allocate federal funds in a logical manner, and have used it as a device for avoiding legal responsibility.

The doctrine of "preemption," if it becomes the prevailing legal view, along with the current presumption of sovereign immunity of states means that an individual injured or killed at a railroad crossing with inadequate warning devices will in almost all instances have no ability to recover for his or her injuries. Moreover, there is manifest confusion regarding state transportation policy in this area. A survey of state transportation officials indicates that only two states in the continental United States agree with the railroads' contention that the state has primary legal responsibility (and the railroads have none). Officials in at least nineteen states take a wholly contrary position, namely that state participation in the siting and funding of crossing upgrades does not in any way relieve the railroads of their independent duty under state statutory or common law to upgrade dangerous crossings. Transportation officials in at least thirteen states could not (or would not) give a clear statement of what their states' policy was on this narrow question, although most made it clear that nothing in their states' laws prevented a railroad from proactively upgrading a dangerous crossing. At the federal level, FRA Administrator Gilbert Carmichael has said that he had "neither seen nor had the opportunity to study" the issue of preemption.

The doctrine of "preemption," if it becomes the prevailing legal view will mean that most motorists injured or killed in grade crossing collisions will be unable to recover where the primary contention is the crossing should have had mechanical gates. This is because with states as sole defendants a recovery will generally be barred by the doctrine of sovereign immunity. As interpreted by most courts, even in those states where the sovereign immunity doctrine has been relaxed, the decision to site and construct a mechanical gate is a "discretionary function" for which no liability will attach. Moreover, suits brought in federal court against states for alleged negligence in failing to order the construction of such gates will be barred by the Eleventh Amendment.

Will the doctrine of "preemption" promote public safety? While the answer to that question is beyond the scope of this Article, the tentative answer is that it will not. In full flower the doctrine will remove a significant incentive for railroads to be watchful for crossing hazards, namely, the legal liability that attaches and financial responsibility that flows from a finding of negligence.241 Likewise, if states are found to be the sole defendant they will likely choose to pass statutes granting themselves further immunity from suit rather than spend more money in upgrading

crossings. With the state having immunity there will be less state motivation to upgrade crossings, further placing the public at risk.

In the final analysis, the decision whether states should bear the legal responsibility for upgrading crossings (and railroads have none) is a matter of state and national transportation policy and should not be decided on a case-by-case basis by courts. A strong argument can be made that this should be a state responsibility. But to accomplish this there must be a full airing of the issues and public debate. A federal statute could be passed which places this duty on the states, but if so, that statute should make clear that states can be sued (including use of federal courts) for negligence in carrying out their duties. Until this issue is placed on the national agenda of transportation policy debate, however, more cases will arise where the doctrine is asserted and more courts may unwittingly adopt a train of legal thought going in the wrong direction.

242. The question of whether Congress should pass such a statute is separate from the question of whether it can. The author's opinion is that it can. In 1964, the Supreme Court ruled that states could be sued under the Federal Employer's Liability Act when they conduct interstate railroad operations. The court reasoned that in doing so the state (Alabama) had "consented" to suit under the FELA by conducting such operations. Parden v. Terminal Railway, 377 U.S. 184 (1964). In 1990 the Supreme Court turned aside the opportunity to overturn this ruling in Port Authority Trans-Hudson Company v. Feeney, 495 U.S. 299, 110 S. Ct. 1868 (1990). For a general discussion of this issue, see Jesse Michael Feder Note, Congressional Abrogation of State Sovereign Immunity, 86 Colum. L. Rev. (Nov. 1986) 1436-52. Feder explains that Congress must make its "intention unmistakably clear" that it is abrogating the states' constitutionally secure immunity from suit in federal court when it passes such a statute, citing Atascadero State Hospital v. Scanlon, 105 S. Ct. 3142, 3147. Additional Sources

INTRODUCTION

On June 1, 1992, the U. S. Supreme Court announced two related decisions concerning interstate transport of waste. The twin cases, Chemical Waste Management, Inc. v. Hunt and Fort Gratiot Sanitary Landfill, Inc. v. Michigan Dept. of Natural Resources, aligned themselves with a nearly two century tradition buttressing the dormant Commerce Clause of the U. S. Constitution, to preserve historic national, economic unity against current, local environmental concerns.

In April 1990, the Alabama Legislature enacted a bill imposing a dual fee structure upon the disposing of hazardous waste at commercial facili-
ties. The state charged both a Base Fee, as well as an Additional Fee for all waste generated outside of, but disposed in facilities within the State of Alabama. The operator of the hazardous waste disposal facility brought suit to permanently enjoin Alabama from imposing the Additional Fee structure. The Alabama trial court ruled that the Additional Fees violated the Commerce Clause. The Alabama Supreme Court reversed, upholding the constitutionality of the act. The U.S. Supreme Court reversed the Alabama Supreme Court holding.

In an analogous act, Michigan amended its Solid Waste Management Act ("SWMA") to require explicit county approval for disposal of waste generated outside each county. Fort Gratiot Sanitary Landfill, Inc. brought suit to declare that the revised SWMA was unconstitutional. The federal district court and the Supreme Court of Michigan upheld the legislation; the U.S. Supreme Court reversed.

The Supreme Court released the two decisions simultaneously, internally cross-referenced to each other. One opinion was written by Justice White and the other by Justice Stevens. Chief Justice Rehnquist dissented in both, only joined by Justice Blackmun in *Fort Gratiot Sanitary Landfill*.

This note will analyze a continuing tradition of non-interference with interstate transport culminating in *Chemical Waste Management* and *Fort Gratiot*. In both cases, states had acted to protect local environmental and health interests by imposing fees or restrictions on the transportation and dumping of out-of-state waste. The Supreme Court has consistently struck down statutes interfering with interstate commerce. However, here, each state argued that less burdensome alternatives were not available to protect the health and safety of its citizens.

**HISTORICAL CONTEXT**

The Commerce Clause of the Constitution confers upon Congress

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8. Id.
9. Id.
11. Id.
12. Id.
the power "*[t]*o regulate Commerce with foreign Nations, and among the
several States, and with the Indian Tribes."15 Joseph Story in his Com-
mentaries, stated, "*[t]*he want of this power. . . . was one of the leading
defects of the confederation, and probably, as much as any one cause,
conducted to the establishment of the constitution."16 Justice Story wor-
rried that states would, and before the Constitution did, unduly burden
commerce "under the stimulating influence of local interests."17 Thus,
states would struggle against each other for the benefit of foreign nations.
Justice Story admonished that Switzerland and Germany had enacted
similar laws of commerce for identical, historical reasons,18 and insisted
that commerce clause powers were distinct from the states' powers to
regulate health, turnpikes, roads and ferries except where in conflict with
Congress.19

In 1824, the U.S. Supreme Court decided Gibbons v. Ogden20 in
which Chief Justice Marshall opined:

> Commerce among the States must, of necessity, be commerce with the
> States . . . . The power of Congress, then, whatever it may be, must be
> exercised within the territorial jurisdiction of the several States. The sense
> of the nation on this subject, is unequivocally manifested by the provisions
> made in the laws for transporting goods . . . .
> It is the power to regulate; that is, to prescribe the rule by which com-
> merce is to be governed. This power, like all others vested in Congress, is
> complete in itself, may be exercised to its utmost extent, and acknowledges
> no limitations, other than are prescribed in the constitution.21

Marshall envisioned a federal power that maintained the country as one
economic unit, that ruled over intercourse between states and that
reached into the sovereignty of states, themselves.22 Rather than promot­
ing 'dormant' powers of the Constitution, Marshall, as Justice Felix Frank­
furter explains, "furthered the idea that though we are a federation of
states we are also a nation and . . . state authority must be subject to the
limitations as the Court finds it necessary to apply for the protection of
the national community."23 Justice Frankfurter notes that Marshall practically
applied possibilities in Gibbons. "Imminent in the commerce clause were

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15. U.S. Const. art. 1, § 8, cl. 3.
16. JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 507
   (1833).
17. Id. § 515 at 364.
18. Id. § 519 at 365.
19. Id. § 519 at 368.
21. Id. at 196.
23. FELIX FRANKFURTER, THE COMMERCE CLAUSE: UNDER MARSHALL, TANEY AND WAITE (re-
   printed by Quadrangle Paperbacks 1964) (1937) 19.
severe limitations upon the powers of the states to tax as well as regulate commerce." 24 In a later opinion, Chief Justice Marshall states, "[w]e do not think that the act... can, under all the circumstances of the case, be considered as repugnant to the power to regulate commerce in its dormant state." 25 Frankfurter suggests that Marshall intended to harmonize free trade among the states, 26 and concludes, "[t]he history of the commerce clause, from the pioneering efforts of Marshall to our own day, is the history of imposing artificial patterns upon the play of economic life whereby an accommodation is achieved between the interacting concerns of states and nations." 27

In recent times, two cases prior to those at hand have determined the parameters of Supreme Court decisions regarding the dormant Commerce Clause. In 1978, Justice Stewart delivered the majority opinion in City of Philadelphia v. New Jersey; 28 (then) Justice Rehnquist, joined by Chief Justice Burger, dissented. The 1973 N.J. Laws 29 read in part: "No person shall bring into this State any solid or liquid waste which originated or was collected outside the territorial limits of the State... until the commissioner... shall determine that such action can be permitted without endangering the public health, and welfare...." 30 Private landfill operators brought suit to overturn this law. The trial court in New Jersey declared the law unconstitutional. The New Jersey Supreme Court reversed finding that the law "advanced vital health and environmental objectives, with economic discrimination against, and with little burden upon, interstate commerce, and... [thus] permissible under the Commerce Clause... ." 31

The New Jersey Supreme Court tried to limit the Commerce Clause from illegitimate objects of commerce that would spread "disease pestilence and death" from other objects of commerce upon which the federal government would have sweeping control. 32 If New Jersey thought that that policy would pass muster, they were wrong. The U.S. Supreme Court noted in reversing the New Jersey Supreme Court: "We think the state court misread our cases, and thus erred in assuming that they re-

24. Id., referring to Brown v. Maryland, 25 U.S. (12 Wheat.) 419 (1827). For example:
That which is not supreme must yield to that which is supreme.... the taxing power of
States must have some limits.... It cannot interfere with any regulation of commerce.
26. FRANKFURTER, supra note 23.
27. Id. at 21.
31. Id. at 620.
32. Id. at 622 (referring in part to Bowman v. Chicago & N.W. R. Co., 125 U.S. 465, 489
(1888)).
quire a two-tiered definition of commerce. . . . All objects of interstate trade merit Commerce Clause protection . . . ."33 Although many subjects of potential regulation may escape scrutiny due to "local character . . . number and diversity."34 Justice Stewart then stated: "[O]ur economic unit is the Nation. . . . [I]ts corollary [is] that the states are not separable economic units."35 The majority decided not to be concerned with whether New Jersey wished to extend the lives of its landfills, or discriminate against entrepreneur operators, or even to protect the local environment.36 Rather the "[s]tate has overtly moved to slow or freeze the flow of commerce for protectionist reasons."37 Although there are certain quarantine laws that "were directed against interstate commerce",38 their "very movement risked contagion and other evils." The traffic would have been destroyed whatever their origin.39 Here, since the problems arise only after the waste has been dumped, "there is no basis to distinguish out-of-state waste from domestic waste."40 The Court concludes that although today Pennsylvania sends its waste to New Jersey, tomorrow the flow may change direction; each state thus is being safeguarded from each other.

The dissent declared that landfills generate currently unsolvable problems.41 While the volume of garbage continues to grow, incineration may no longer be utilized due to environmental pollution.42 Thus, growing landfills generate a whole host of environmental and aesthetic problems from rodents to fires, to scavenger birds, to noise, water and air pollution.43 Justice Rehnquist questioned why the quarantine laws do not apply, such that "a State may ban the importation of items whose movement risks contagion, but cannot ban the importation of items which. . . will simply pile up in an ever increasing danger to the public’s health and safety."44 Justice Rehnquist states that the in-state, out-of-state distinction is pointless.45

33. Id. (emphasis added).
34. Id. at 623.
36. Id. at 625-627.
37. Id.
38. Id. at 628.
39. Id. at 629. For example diseased animals would be destroyed whether they came intra- or inter-state.
40. Id.
41. Id. at 630 (Rehnquist, J., joined by Berger, C.J., dissenting).
42. Id.
43. Id.
44. Id. at 632-633.
45. Id. at 633.
Maine v. Taylor\(^{46}\) is the paradigm quarantine case, distinguishing itself from the flow of essentially 200 years of Commerce Clause protection against legislative impediments to interstate commerce. Robert Taylor operated a bait business in Maine. Despite Maine laws to the contrary, he attempted to have \(158,000\) live baitfish (golden shiners), delivered to him from out-of-state.\(^{47}\) Maine argued that its own population of baitfish, including golden shiners, "would be placed at risk by three types of parasites prevalent in out-of-state baitfish, but not common in Maine."\(^{48}\) Scientific experts explained that Maine's lakes contain "unusually clean water" a "delicate community of just a few fish" and that there was no satisfactory way to inspect shipments of baitfish.\(^{49}\) Utilizing tests for strict scrutiny and whether alternative means exist, the District Court Magistrate decided that irreparable harm could be done to Maine's pristine waters and that due to scientific uncertainty in testing no alternative means existed.\(^{50}\) The District Court thus found in favor of Maine.\(^{51}\)

The Court of Appeals, 1st Circuit reversed.\(^{52}\) Justice Blackmun speaking for the majority in the U.S. Supreme Court reversed the judgment of the Court of Appeals.\(^{53}\) Justice Blackmun stated:

\[\text{We agree with the District Court that Maine has a legitimate interest in guarding against imperfectly understood environmental risks, despite the possibility that they may ultimately prove to be negligible . . . . [T]he constitutional principles underlying the commerce clause cannot be read as requiring the State of Maine to sit idly by and wait until potentially irreversible environmental damage has occurred or until the scientific community agrees on what disease organisms are or are not dangerous before it acts to avoid such consequences.}\(^{54}\)

Justice Blackmun concluded:

\[\text{The Commerce Clause significantly limits the ability of States and localities to regulate or otherwise burden the flow of interstate commerce, but it does not elevate free trade above all other values . As long as a State does not needlessly obstruct interstate trade or attempt to 'place itself in a position of economic isolation,' Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 527 [1935] . . . it retains broad regulatory authority to protect the health and safety of its citizens and the integrity of its natural resources . . . . This is not a case of arbitrary discrimination against interstate commerce . . . .}\(^{55}\)


\(^{47}\) Id. at 132-133.

\(^{48}\) Id. at 141.

\(^{49}\) Id.

\(^{50}\) Id. at 145-146.

\(^{51}\) Id.


\(^{54}\) Id. at 146 (citing U.S. v. Taylor, 585 F.Supp. at 397).

\(^{55}\) Id. at 151 (emphasis added).
Justice Stevens dissented, urging that Maine show with more specificity why it cannot meet its environmental concerns in the same manner as other states.\(^{56}\)

Maine is distinguished from Philadelphia v. New Jersey in that in Maine, there was a scientific uncertainty of the existence of alternate means of preserving the state's clean water, and that along with the possibilities of irreparable harm, action against Taylor was apparently justified. Philadelphia v. New Jersey was seen to be clearly a case of economic protectionism and local interests that balanced against the needs of the nation for economic unity could not stand.

**CASE ANALYSIS**

**CHEMICAL WASTE MANAGEMENT v. HUNT**

As well as imposing a Base Fee of $25.60 per ton and an Additional Fee of $72.00 per ton, the Alabama act also set a cap limiting the total amount of hazardous waste that could be disposed at commercial facilities which dispose of 100,000 tons or more per year.\(^{57}\) The cap amount would be determined by the amount disposed during the first year the fees were in effect.\(^{58}\) Only one facility qualified by virtue of the amount of waste disposed: the Chemical Waste Management, Inc. ("CWM") plant in Emelle, Alabama.\(^{59}\)

CWM filed for declaratory relief against the Alabama Department of Revenue, challenging the constitutionality of the act as violative of the Commerce Clause of the U.S. Constitution, the Equal Protection Clause of the U.S. and Alabama Constitutions, and the Due Process Clause of the Alabama Constitution.\(^{60}\) CWM contended that the cap provision was preempted by various federal statutes.\(^{61}\) CWM sought a preliminary and a permanent injunction to enjoin the State from enforcing the act.\(^{62}\) The trial court declared that the Base Fee and cap provisions were constitutional, but the Additional Fee provisions were "impermissible and invalid," as violative of the Commerce Clause.\(^{63}\) CWM appealed the trial court holding on the Base Fee and cap to the Alabama Supreme Court.

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\(^{56}\) Id. at 153.


\(^{59}\) Hunt, 584 So.2d at 1369.

\(^{60}\) Id. at 1369-1370.

\(^{61}\) Id. at 1370 n.1.

\(^{62}\) Id. at 1369-1370.

\(^{63}\) Id.
The State of Alabama appealed the additional fee invalidation. The Alabama Supreme Court upheld the constitutionality of the Base Fee and cap and reinstated the Additional Fee provisions.

This appeared to be a victory for environmentalists. In adopting the decision of the trial court, the Alabama Supreme Court held that “clearly, the state of Alabama has a legitimate interest in imposing fees on commercial hazardous waste facilities to address the serious financial, environmental and other risks they create.” The Alabama Supreme Court reported the legislative findings that animated the enactment of the bill. The Court noted that the Alabama legislature voiced concern that Alabama was becoming “the final burial ground” for hazardous waste that was primarily generated outside the State. The Court also stressed that, the future, this hazardous waste would present “public health

64. Id. at 1370.

65. Id.

The Base Fee does not facially discriminate against out-of-state waste. All waste disposed of at Alabama commercial hazardous waste facilities is subject to the $25.60 fee. Consequently the Pike v. Bruce Church balancing test will be applied to assess the fee’s constitutional validity. In balancing the interests at stake, the Court finds that the burden the Base Fee imposes on interstate commerce is not clearly excessive in relation to the benefits it produces. The fee benefits the state, on the other hand, by compensating it for the financial responsibilities and risks it bears on account of commercial hazardous waste disposal activities. Thus, a comparison of the Base Fee's local benefits to its alleged burden on interstate commerce establishes that any such burden is not clearly excessive. Furthermore, to the extent that the Base Fee does deter hazardous waste landfilling, the fee is a proper instrument of deterrence. . . . Finally, in view of the financial, safety, environmental and other objectives of Act No. 90-326 and the fact that the Base Fee falls evenhandedly on interstate and intrastate waste, it is difficult to imagine how these objectives could be accomplished in ways that have a lesser impact on interstate activities. Id. at 1377-1378.

66. Id.

67. Id. at 1376.

68. Id. at 1370-1371.

The Legislature finds that:

1) The state is increasingly becoming the nation’s final burial ground for the disposal of hazardous wastes and materials;

2) The volumes of hazardous wastes and substances disposed in the state have increased dramatically for the past several years;

3) The existence of hazardous waste disposal activities in the state poses unique and continuing problems for the state;

4) As the site for the ultimate burial of hazardous wastes and substances, the state incurs a permanent risk to the health of its people and the maintenance of its natural resources that is avoided by other states which ship their wastes to Alabama for disposal;

5) The state also incurs other substantial costs related to hazardous waste management including the costs of regulation of transportation, spill cleanup and disposal of ever increasing volumes of hazardous wastes and substances;

6) Because all waste and substances disposed at commercial sites for the disposal of hazardous waste and hazardous substances, whether or not such waste and substances are herein defined as hazardous, contribute to the continuing problems created for the state, and because state and federal definitions of ‘hazardous wastes’ have regularly changed and are likely to change in the future to include waste not previously defined as hazardous, it is necessary that all waste and substances disposed of at a
problems",\textsuperscript{69} and problems in preserving the environment.\textsuperscript{70}

The trial court found and the Alabama Supreme Court affirmed the following facts:

CWM is a Delaware Corporation with Oak Brook, Illinois as the principal place of business. . . .

Emelle, Alabama was one of 74 potential sites for hazardous waste landfills identified by the EPA in a 1973 study. . . .\textsuperscript{71}

In 1985, the Emelle CWM facility received 341,000 tons of waste, while in 1989, 788,000 tons were received.\textsuperscript{72}

The Supreme Court of Alabama noted that in essentially a quarantine argument, Alabama had been singled out to be a repository for the nation's hazardous waste. Said the Court:

Although hazardous waste landfills can be designed and engineered to operate in practically every state of the United States, only a very few commercial sites presently exist. \textit{Efforts to obtain permits for new sites in other states are resisted by citizens of those states}. . . . According to the testimony presented at trial, only one additional hazardous waste landfill has been permitted in the United States since . . November 17, 1980. That facility, in Last Chance, Colorado, has never operated or accepted waste and is presently commercial site for the disposal of hazardous waste or hazardous substances be included within the requirements of this act;

(7) The legislature finds that the public policy of the state is to encourage business and industry to develop technology that will eliminate the generation of hazardous waste and substances. . . .

(8) Since hazardous wastes and substances generated in the state compose a small proportion of those materials disposed of at commercial disposal sites located in the state, present circumstances result in the state's citizens paying a disproportionate share of the costs of regulation of hazardous waste transportation, spill cleanup and commercial disposal facilities.


\textit{Also see "Legislative Finding Purpose and Intent":}
The Legislature finds that increasing quantities of hazardous wastes are being generated in the State and that without adequate safeguards from the point of generation through handling, processing and final disposition, such wastes can create conditions which threaten human or animal health and the environment. The Legislature, therefore, declares that in order to minimize and control any such hazardous conditions it is in the public interest to establish and to maintain a statewide program to provide for the safe management of hazardous wastes.


69. \textit{Hunt}, 584 So.2d at 1371.
70. \textit{Id}.

To prevent threats to the health of the population of this state and to the soundness of the environment of this state and to prevent an artificial decrease in fees during the twelve-month period beginning July 15, 1990, and ending July 14, 1991, this act provides a cap on the amount of hazardous waste and hazardous substances disposed during the twelve-month period beginning October 1, 1991, said cap being a function of the amount of hazardous waste and hazardous substances disposed during the twelve-month period beginning July 15, 1990, and ending July 14, 1991.

Act § 1, Code § 22-308-1.1. Legislative findings.

71. \textit{Hunt}, 584 So.2d at 1372.
72. \textit{Id} at 1373.
for sale. . . . Eighty-five to ninety percent of the tonnage permanently buried at Emelle is from out-of-state. Emelle received two years ago approximately 17% of all hazardous wastes commercially landfilled in the United States.\textsuperscript{73}

The trial court discussed the dangers surrounding the disposal of hazardous waste\textsuperscript{74} and the difficulty in containing certain classes of waste.\textsuperscript{75} The court noted that the Emelle facility was within an earthquake risk zone and that an earthquake could open one-half cracks allowing movement of leachate and hazardous waste.\textsuperscript{76} Of the 40,000 truckloads of waste transported to the facility, the court noted, 90% were from out of state.\textsuperscript{77} "Some trucks destined for Emelle have been involved in accidents causing hazardous waste to be spilled or released into the environment."\textsuperscript{78} This parade of horribles was reflected in judicially noted scientific findings. Here, the State of Alabama in pressing its sovereign rights wished to avoid high probabilities of eventual toxic damages by finding less objectionable alternatives.

CWM argued that "the trial court erred in finding the Base Fee constitutional and . . . that it clearly discriminates against interstate commerce in violation of the Commerce Clause."\textsuperscript{79}

The Alabama Supreme Court adopted the conclusions of law regarding the Base Fee found by the trial court, Judge Phelps:\textsuperscript{80} States retain broad authority to regulate matters of legitimate local concern, following

\textsuperscript{73} Id. (emphasis added.)
\textsuperscript{74} Id. at 1373.

Such waste consists of ignitable, corrosive, toxic and reactive wastes which contain poisonous and cancer causing chemicals and which can cause birth defects, genetic damage, blindness, crippling and death. Should a sudden or non-sudden discharge or release occur, hazardous wastes could pollute the environment, contaminate drinking water supplies, contaminate the ground water, and enter the food chain. Among these are arsenic, mercury, lead, chromium and cyanide. \textit{Id.}
\textsuperscript{75} Id. at 1374:

The testimony at trial was that it appears that leakage has already occurred with respect to at least some of the closed trenches. Leachate is presently pumped only from closed Trench 19 and open Trench 21. It is stored in above ground storage tanks with a capacity of 5 million gallons. From 10 million to 15 million gallons annually of leachate and surface water are gathered, stored and transported from Emelle at a cost of $2 to $3 million. . . . EPA has found that absolute prevention of migration of hazardous waste through synthetic trench liners is beyond the current technical state of the art, and that some migration will occur. \textit{Id.}
\textsuperscript{76} Id. at 1375.
\textsuperscript{77} Id.
\textsuperscript{78} Id.
\textsuperscript{79} Id. at 1376.

CWM further proffered arguments based on Equal Protection and Due Process. CWM argues further that the Base Fee violates the Equal Protection Clause, because, it claims, the classifications are not rationally related to a legitimate state interest. CWM finally argues that the Base Fee violates the Due Process Clause.

\textit{Id.} (These arguments were not reviewed by the U.S. Supreme Court. \textit{See} discussion \textit{infra}.)
\textsuperscript{80} Id. at 1376-1377.
When a police power regulation is challenged under the Commerce Clause, one of two tests is applied. If the regulation is discriminatory on its face or in practical effect, the state must show that (1) the regulation has a legitimate local purpose; (2) the regulation serves this interest; and (3) reasonable nondiscriminatory alternatives, adequate to preserve the legitimate local purpose, are not available.

The Alabama courts found the Base Fee evenhanded in its treatment and with respect to the Equal Protection Clause, "rationally related to legitimate state interests." The court proclaimed, "[t]he state has a clear and legitimate interest in conserving its natural resources." Citing Bill Kettlewell Excavating, Inc. v. Michigan Department of Natural Resources, the court continued: "[A] statute requiring county approval for disposal of out-of-county solid waste served legitimate purpose of extending lives of the county's landfills . . . ."

The most difficult question that the court countenanced concerned the Additional Fee, since this fee clearly had a regulatory impact. This is perhaps just another way of saying that what may appear to be a 'discriminatory' provision in the constitutionally prohibited sense—that is, a protectionist enactment—may on closer analysis not be so.

The Alabama Court of Appeals had declared the Additional Fee to be unconstitutional; here the Alabama Supreme Court reversed. Assuming that hazardous waste is an article of commerce, the Court declared: "We believe that a statute such as the one before us, which advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives, can be valid under the Commerce Clause."

The Alabama Supreme Court declared that the burden imposed upon interstate commerce must be weighed with regard to state regulatory concern, and that the Additional Fee was merely a means of dealing with legitimate local concerns, and therefore was permissible under the Commerce Clause. The Court distinguished this case from the City of Phila-

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83. Hunt, 584 So.2d at 1376-1377.
84. Id. at 1378.
85. Id. at 1379.
86. Id. at 1380.
88. Hunt, 584 So.2d at 1386.
89. Hunt, 910 F.2d at 721.
90. Hunt, 584 So.2d at 1387.
91. Id. at 1386.
92. Id. at 1388.

**Transportation Law Journal**

In concurrence, and perhaps in anticipation of the judgment being overturned, Justice Houston of the Alabama Supreme Court, states:

> Until the United States Supreme Court holds that hazardous waste (waste that the trial court found contained poisonous chemicals that can cause cancer, birth defects, genetic damage, blindness, crippling, and death) is an article of commerce protected by the Commerce Clause of the United States Constitution, I refuse to declare the additional fee provision of Act No. 90-326, which was duly enacted by the Alabama Legislature and approved by the Governor of Alabama, unconstitutional as violative of the Commerce Clause of the United States Constitution.

The U.S. Supreme Court granted certiorari only to the Commerce Clause challenge to the Additional Fee, even though CWM had appealed every issue related to the Act. Justice White speaking for the majority reversed and remanded, restating a fundamental idea in the tradition of Commerce Clause cases: "No State may attempt to isolate itself from a problem common to the several States by raising barriers to the free flow of interstate trade."

The opinion immediately refers to *Fort Gratiot*, where Justice White reaffirmed a tenet of the *Philadelphia v. New Jersey* opinion of 1978: "The evil of protectionism can reside in legislative means as well as legislative ends." Justice White, allowing that Alabama’s needs for controlling are real, warned, "a presumably legitimate goal was sought to be achieved by the illegitimate means of isolating the State from the national economy."

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93. 437 U.S. 617 (1978). (A state may not limit importing of waste as a form of economic protectionism.)


95. 477 U.S. 131.

96. Id.

97. Id. at 1390.

98. Only Chief Justice Rehnquist dissented.


100. Id. at 2012 (emphasis added).


103. Id.

104. Id. (citing Philadelphia v. New Jersey, 437 U.S. at 627).
tion," which the Supreme Court has consistently been found to be constitutionally invalid.\textsuperscript{105}

The Court acknowledged that though there may be legitimate local interests, "only rhetoric, and not explanation, emerges as to why Alabama targets only interstate hazardous waste to meet these goals."\textsuperscript{106} Thus, interstate commerce is unduly burdened. Justice White quoted the trial court judge: "[T]here is absolutely no evidence before this Court that waste generated outside Alabama is more dangerous than waste generated in Alabama."\textsuperscript{107} Justice White then reasoned that although Alabama's concern for conservation, health and safety is related to the volume of material, a state may not unduly burden interstate commerce.\textsuperscript{108}

The Court distinguished the case at hand from \textit{Maine v. Taylor},\textsuperscript{109} in that the danger in the commerce is independent of point of origin, within or outside of the state.\textsuperscript{110} More significantly, Justice White, suggested alternatives:

Less discriminatory alternatives, however, are available to alleviate this concern, not the least of which are a generally applicable per-ton additional fee on all hazardous waste disposed of within Alabama . . . or a per-mile tax on all vehicles transporting hazardous waste across Alabama roads . . . or an evenhanded cap on the total tonnage landfilled at Emelle . . . which would curtail volume from all sources.\textsuperscript{111}

Thus, a door is left open to charge various usage fees. But unless the waste from out-of-state sources presents different problems \textit{per se} — such as irreparable harm to the environment,\textsuperscript{112} or immediate dangers of health and safety\textsuperscript{113} — than local waste, the Additional Fee in its stated

\textsuperscript{105} Id. at 2013.

\textsuperscript{106} Id. at 2014.

\textsuperscript{107} Id. at 2015.

\textsuperscript{108} Id.


\textsuperscript{109} Chemical Waste Management, 112 S. Ct. at 2016.

\textsuperscript{111} Id. at 2015.

\textsuperscript{112} See generally Maine v. Taylor, 477 U.S. 133 (1986).

\textsuperscript{113} This, in fact, has been Alabama's and the Alabama Supreme Court's rationale all along.

\textit{Also see:}

Until the United States Supreme Court holds that hazardous waste (waste that the trial court found contained poisonous chemicals that can cause cancer, birth defects, genetic damage, blindness, crippling, and death) is an article of commerce protected by the Commerce Clause of the United States Constitution, I refuse to declare the additional fee provision of Act No. 90-326, which was duly enacted by the Alabama Legislature and approved by the Governor of Alabama, unconstitutional as violative of the Commerce Clause of the United States Constitution.
form is deemed to impermissibly discriminate against interstate commerce.\textsuperscript{114}

In dissent, Chief Justice Rehnquist considered this interpretation of the Commerce Clause to force an all or nothing approach to regulation of hazardous wastes and conversely to consider the commodity at stake a “safe and attractive environment.”\textsuperscript{115} Rehnquist acknowledged the alternatives mentioned by the majority, but warned that these were ‘gymnastic’ and that only more litigation would follow as states continued to rightfully protect themselves in creative ways against analogous situations created by hazardous, industrial waste.\textsuperscript{116}

\textit{FORT GRATIOT SANITARY LANDFILL, INC. v. MICHIGAN DEP’T. OF NATURAL RESOURCES}\textsuperscript{117}

In the case first brought to federal District Court,\textsuperscript{118} Bill Kettlewell Excavating, Inc. (doing business as Fort Gratiot Landfill) sought declaration that the Michigan Solid Waste Management Act (“SWMA”),\textsuperscript{119} was unconstitutional and to enjoin Michigan from enforcement. In the alternative, Kettlewell asserted that St. Clair County (Michigan) government entities unconstitutionally applied the SWMA. The Michigan SWMA provides that each county must have a solid waste management plan, and that solid waste must only be disposed of in the county it is generated in, or the disposition must be explicitly authorized in both the receiving and exporting county’s solid waste management plan.\textsuperscript{120}

Recognizing that interference with the transport of waste addressed the 'dormant' aspects of the Commerce Clause, federal District Judge James Harvey attempted to ascertain whether these laws were basically

\begin{flushright}
Hunt v. Chemical Waste Management, 584 So.2d at 1390-1391 (Houston, J., concurring in the judgment).
\textsuperscript{114} Chemical Waste Management, 112 S. Ct. at 2017.
\textsuperscript{115} Id. at 2018.
\textsuperscript{116} Id. at 2019.
\textsuperscript{120} Bill Kettlewell Excavating, Inc., 732 F.Supp. at 762.
\end{flushright}

A person shall not accept for disposal solid waste that is not generated in the county in which the disposal area is located unless the acceptance of solid waste that is not generated in the county is explicitly authorized in the approved county solid waste management plan. . . . In order for a disposal area to serve the disposal needs of another county, state, or country, the service must be explicitly authorized in the approved solid waste management plan of the receiving county. With regard to intercounty service within Michigan, the service must also be explicitly authorized in the exporting county’s solid waste management plan.

\textit{Id.}
protectionist in nature or "can fairly be viewed as... law[s] directed to legitimate local concerns, with effects upon interstate commerce that are only incidental." However, the Court noted that since the policies applied equally to other Michigan counties as well as out-of-state entities, it was evenhanded, and thus following *Pike v. Bruce Church*, the Court finds that the SWMA imposes only incidental effects upon interstate commerce, and may therefore be upheld unless the burden imposed "is clearly excessive in relation to the putative local benefits." Judge Harvey concludes that a legitimate local goal is fulfilled by extending the useful lives of the County's landfills, and that this purpose outweighs the minimal burdens on interstate commerce, and thus, upholds the Michigan laws and County policies.

Kettlewell declared that having set aside sufficient disposal sites for 20 years local waste production, their application was promptly denied by the St. Clair County Solid Waste Planning Committee. Kettlewell appealed claiming Commerce Clause violations and also denial of Due Process. Citing *Philadelphia v. New Jersey*, the U.S. Court of Appeals for the Sixth Circuit, in reviewing the determination of the District Court, de novo, noted that the New Jersey statute’s intent was to protect the environment through limiting the volume of waste imported. The circuit court recalled *Maine v. Taylor* stating: "[T]he Supreme Court held that once a state law is shown to discriminate against interstate commerce 'either on its face or in practical effect,' the burden falls on the State to demonstrate both that the statute 'serves a legitimate local purpose,' and that this purpose could not be served as well by available nondiscriminatory means." The Circuit Court concluded by upholding both the logic

121. Id. at 763 (quoting City of Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978)).
122. Id. at 766. "Indisputably, St. Clair County's challenged policy treats most in-state waste in the same manner as out-of-state solid waste by prohibiting the importation of either into the county." Id.
125. Id. at 766.
127. Id. at 415.
128. 437 U.S. 617.
129. *Bill Kettlewell Excavating, Inc.*, 931 F.2d at 416.
130. 477 U.S. at 138.
and conclusions of the District Court. 132

On March 30, 1992, the final appeal was argued before the U.S. Supreme Court. 133 Justice Stevens, speaking for the majority, (and incidentally answering a question posed in Chemical Waste Management): 134 Chemical and solid waste falls squarely within the realm of interstate commerce. 135

In reversing the Sixth Circuit Court of Appeals, the U.S. Supreme Court warned Michigan that no county, nor locality, nor state may isolate itself from the national economy. 136 Justice Stevens, as did Justice White in Chemical Waste, invalidated the SWMA by suggesting perhaps reasonable, less burdensome, alternatives:

Michigan could attain that objective without discriminating between in- and out-of-state waste. Michigan could, for example, limit the amount of waste that landfill operators may accept each year. See Philadelphia v. New Jersey, 437 U.S., at 626 . . . . There is, however, no valid health and safety reason for limiting the amount of waste that a landfill operator may accept from outside the State, but not the amount that the operator may accept from inside the State. 137

After distinguishing Fort Gratiot from Maine v. Taylor, 138 Justice Stevens concluded that Michigan laws and policies "unambiguously discriminate against interstate commerce and are appropriately characterized as protectionist measures that cannot withstand scrutiny under the Commerce Clause." 139

In his dissent, Chief Justice Rehnquist, joined by Justice Blackmun,

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132. "We find no error in the conclusion of the district court . . . ." Id. at 417.


134. See supra, note 113. Judge Houston states that until the U.S. Supreme Court so declares, he does not consider waste to be an article of interstate commerce. Chemical Waste Management, 584 So. 2d at 1390 (Houston, J., concurring).

135. Id. at 2023.

136. Id. at 2024.

137. Id. at 2027.


139. Fort Gratiot, 112 S. Ct. at 2028.
noted the increased volumes of hazardous waste, the substantial risks inherent in waste sites, and the repugnancy states and communities have for the prospect of dumping.\footnote{Id.} Rehnquist commended Michigan for confronting the problems of hazardous waste as one part of a comprehensive plan that demands that each community deal with its own waste.\footnote{Id. at 2029.} The Chief Justice continued that, analogously, states have been allowed to address major environmental threats caused by the uncontrolled transfer of water: here substitute the words “attractive and safe environment” for “water”, and the present case is described.\footnote{Id. at 2030. (citing Sporhase v. Nebraska ex rel. Douglas, 458 U.S. 941 (1982). (Rehnquist, C.J., dissenting.))} Chief Justice Rehnquist warned that these twin decisions will encourage states to dump their hazardous waste in other states where land is cheapest, and land is less populated, rather than directly confronting problems that they themselves create.\footnote{Id. at 2031-2032.}

**CONCLUSION**

The U.S. Supreme Court has set guidelines that may be followed into the twenty-first century:

1. That whenever reasonable and adequate alternatives may be found to deal with local or state policies and practice, those local laws that burden interstate commerce will be struck down.\footnote{Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951). In *Dean Milk*, the Court struck down a Madison ordinance requiring that all milk sold in Madison be bottled within 5 miles of Madison, ostensibly to aid in health inspections. The Court stated: It appears that reasonable and adequate alternatives are available . . . . *Id.* at 354. Thus, what is or isn’t a burden to interstate commerce must ultimately be decided by Congress.\footnote{Id. at 356.} Congress has yet to enact a comprehensive national policy. There is a pressing need to face these

\footnote{Id. at 2031-2032.}

\footnote{Id. at 354.}

\footnote{Id. at 356.}
unpleasant problems.146

*Chemical Waste Management* and *Fort Gratiot* both align themselves with Commerce Clause cases from Chief Justice Marshall to the present. A free and unburdened interstate commerce is and has been considered to be of paramount importance to a unified nation. *City of Philadelphia v. New Jersey* is paradigmatic of the judicial analysis of the needs of interstate commerce vis à vis dormant Commerce Clause interpretation. Only Maine, presented with a threat of irreversible harm to its pristine shores, and yet with a vacuum of alternate scientific or legal solutions, has prevailed in enforcing laws that burden interstate commerce.147

In *Chemical Waste Management*, the State of Alabama attempting to burden out-of-state hazardous waste, was forced by the U.S. Supreme Court to become one of the nation’s repositories for toxic substances. Michigan, on the other hand, sensibly required that each county plan for its own waste needs. In *Fort Gratiot* the U.S. Supreme Court struck down these measures so as to unburden interstate commerce.

Corporate entrepreneurs benefit most from these judgments: they continue to do business, while state and local laws banning or restricting interstate transport of hazardous substances and waste are overturned. Chief Justice Rehnquist noting the current insolvability of modern waste problems, sides with the notion of each state fending for itself. States naturally wish to buttress themselves against foreign pollution, albeit imported legally in commerce. Michigan attempted to organize local waste solutions, Alabama attempted to enjoin Chemical Waste Management. In both states, local legislatures felt justified in protecting the health, well-being, aesthetics and citizenry from potential harm. Chief Justice Rehnquist agrees.148

States may take actions legitimately directed at the preservation of the

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"[T]he First Law of Garbage is: 'Everybody wants to pick it up, and nobody wants us to put it down.'" *Id.* (quoting OFFICE OF SOLID WASTE, UNITED STATES ENVIRONMENTAL PROTECTION AGENCY, THE SOLID WASTE DILEMMA: AN AGENDA FOR ACTION 6 (1989)).

147. See *Maine v. Taylor*, 477 U.S. at 152:

"There is something fishy about this case. Maine is the only State in the Union that blatantly discriminates against out-of-state baitfish by flatly prohibiting their importation . . . . This kind of stark discrimination against out-of-state articles of commerce requires rigorous justification by the discriminating State. 'When discrimination against commerce of the type we have found is demonstrated, the burden falls on the State to justify it both in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives adequate to preserve the local interests at stake.' *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333, 353 (1977)."

*Id.* (Stevens, J., dissenting).

148. "The substantial environmental, aesthetic, health, and safety problems flowing from this country’s waste piles were already apparent at the time we decided Philadel-
State’s natural resources, even if those actions incidentally work to disadvantage some out-of-state waste generators. See Fort Gratiot Sanitary Landfill, Inc. v. Michigan Dept. of Natural Resources...149

Thus States are now hamstrung between Congress’s lack of a comprehensive national policy and the Supreme Court’s strict admonitions against local protectionism.

As ecological concerns about the biosphere move steadily to the forefront, as trade barriers with foreign nations continue to fall, and as volumes of waste both hazardous or simply offensive continue to exponentially grow, Chief Justice Rehnquist’s position - that State’s must be allowed to manage their own waste, hazardous or not—will continue to challenge federal unity in potential legal conflict.

States and localities are facing the destruction of their own resources through the proliferation of garbage and the dangers of dumping and transporting hazardous waste. The Supreme Court, acting consistently with a tradition of broadly and actively enforcing the Commerce Clause of the U.S. Constitution, has disallowed states from taking the initiative to ban import of out-of-state garbage and waste or to burden that import in a discriminatory fashion. The twin pronouncements of the Supreme Court on June 1, 1992, Fort Gratiot and Chemical Waste Management, can be interpreted to challenge and demand that Congress and industry develop effective, scientific means of dealing with a national problem. Inherent in this is the requirement for a comprehensive national policy. If Congress fails in this, then there is a likelihood that our states will once again wage legal war with each other. At the time of the American Revolution, states vied with each other for business, and the Supreme Court acted to create and preserve national unity. Now we are faced with a crisis in garbage and hazardous waste. States now compete to exclude each other’s toxic refuse. The twin dissents of Chief Justice Rehnquist may be interpreted as a warning to Congress to face environmental adversity or weaken national economic unity.

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Federal Express v. California Public Utilities Commission: The Ninth Circuit Court of Appeals, the Airline Deregulation Act and State Regulation of Intrastate Trucking

PAMELA B. WILLIAMS*

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I. INTRODUCTION

The Airline Deregulation Act ("ADA") has become the center of a legal firestorm touched off by the Ninth Circuit Court of Appeals' interpretation of the preemptive effect of the ADA. The decision reached in Federal Express Corp. v. California Public Utilities Commission dramatically expands federal preemption of state surface transportation regulation. The Ninth Circuit decision has far reaching effects regarding the state's regulation of public safety on their highways. More than any other state, California, with its complex freeway system, needs to be able to regulate the drivers and equipment on California highways. This decision has seriously put the safety of Californians into jeopardy.

The Ninth Circuit's decision has led to confusion and criticism. Indeed, there is a meaningful and broad based legal assault on its decision. The willingness of the Ninth Circuit to give broad preemptive effect to the provisions of the ADA has been a veritable call to arms for state regulatory agencies.

Regulated utilities and industries rely heavily on the clear requirements which are imposed upon them by government. The cases, statutes and regulations related to a particular regulated industry can be described as the "rules of the game." Changing the rules of the game for regulated utilities and industries can often cause problems for those entities. There is nothing more problematic for regulated utilities and industries than not knowing to which regulatory body and regulations it must answer. Although there are some who contend that the Ninth Circuit's decision disposes of the problem of regulatory duality, the legal question remains open. If changing the rules of the game for utilities is problematic imagine the effect on utilities if the rules of the game are the wrong rules. Divining which set of rules to follow and which regulatory agency has ju-

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2. Brief Amicus Curiae of Forty-Six States in Support of Petitioners, Federal Express v. CPUC, 112 S.Ct. 2956 (1992) (No.91-502). The same day the CPUC filed its brief for certiorari the forty-six states, by and through their respective Attorneys General; the National Association of Regulatory Utility Commissioners; the California Trucking Association; and the International Brotherhood of Teamsters all filed amicus curiae briefs in support of the CPUC. The only states not submitting amicus curiae briefs were: Delaware, Massachusetts, Tennessee and Wisconsin.
risdiction is fundamental to the business of regulation. The intrastate trucking industries (and certain air carriers) are faced with the dilemma of ascertaining the regulator. Even more importantly the intrastate trucking companies will conceivably be swallowed up by the now state unregulated giant - Federal Express. This paper serves as a resource for those facing issues related to the preemptive effect of the ADA and the Ninth Circuit's decision.

Federal Express, an interstate air package delivery service brought action against the California Public Utility Commission (CPUC) challenging the state's regulation of Federal Express' ground transportation operations. The trial court held that the ADA did not preempt state ground regulation of Federal Express and further that the ADA did not impliedly preempt state regulation of air carrier ground transportation operations. On cross motions for summary judgment, the CPUC prevailed on both the preemption claims and the commerce clause claim.

On Federal Express' appeal, a three judge panel for the Ninth Circuit reversed the district court decision, holding that the ADA required preemption of state regulations concerning integral trucking operations of an air carrier which were an integral segment of the air carrier's operations. The court also held that Federal Express' trucking operations were an integral segment of the air carrier's operations and therefore constituted a "service" under the ADA of 1978, which preempted the CPUC's regulatory powers.

This Comment examines the Ninth Circuit decision and its significant expansion of the federal government's preemption powers regarding the state regulation of trucking operations of an interstate carrier. In section


6. Id. at 1303.

7. Id. at 1304.

8. The preemption claim Federal Express v. CPUC, 716 F. Supp. 1299; the commerce clause claim Federal Express v. CPUC, 723 F. Supp. 1380.

9. Federal Express, 936 F.2d at 1075. The court never articulates the type of preemption employed to justify preemption of the purely intrastate truck operations.

10. Id.


   Except as provided in paragraph (2) of this subsection, no State or political Subdivision thereof 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 having authority under subchapter IV of this chapter to provide air transportation.

12. Federal Express, 936 F.2d at 1078.
II, the development of the federal preemption of state regulation doctrine is explored. Section III discusses *Federal Express v. CPUC*. The comment analyzes the court’s rationale for its decision in section IV. Section V criticizes the decision and explores the potential impact on state regulation of highway safety and competition among the carriers.

II. FEDERAL PREEMPTION DEVELOPMENT

The *Federal Express* decision expanded the federal government’s right to preempt traditional state law. The development of the different types of federal preemption needs to be explored to understand the magnitude and potential impact of *Federal Express*.

Article VI of the United States Constitution grants to the federal government the right to preempt state law. The Federal government’s right to preempt was created in the Supremacy Clause; however, it is through federal statutes that the right is implemented. This section discusses the three kinds of preemption: express, implied and conflict preemption.

A. EXPRESS PREEMPTION

Express preemption of state law occurs when Congress specifically states that a state law will be preempted by a federal statute. The U.S. Supreme Court generally favors preemption only when Congress clearly states an intent to preempt. The leading case on the issue of express preemption is the U.S. Supreme Court case, *Hillsborough County v. Automated Medical Lab., Inc.* Hillsborough County adopted ordinances and

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13. *This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treatises made, or which shall be made, under the Authority of the United States, 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.*

U.S. CONST. art. VI, cl. 2.


16. Shaw v. Delta Airlines, 463 U.S. 85, 95-96 (1983)(Congress may, in enacting federal law, explicitly determine the parameters by which it intends to preempt state law.); see also Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)(holding that state police power is not to be preempted by federal law “unless that was the clear and manifest purpose of Congress.”); Mauer v. Hamilton, 309 U.S. 598, 614 (1940)(no inference of congressional intent to preempt unless that intent is clear); see e.g. Pacific Legal Foundation v. State Energy Resources Conservation and Dev. Comm’n, 461 U.S. 190, 206 (1983)(state police powers apply unless clear congressional intent otherwise).

17. See Ronald Rotunda, *Sheathing the Sword of Federal Preemption*, 5 CONST. COMMENTARY 311, 317 (1988) (discussing the Court’s increasing reluctance to find preemption “unless Congress clearly and explicitly provides for it by statute”).

promulgated implementing regulations to be applied to centers collecting blood plasma within the county. One of the ordinances required donors to be tested for hepatitis, as well as, a breath analysis for alcohol. A local operator of a blood plasma center contended that the county ordinance violated the Supremacy Clause and was preempted by federal regulations.\textsuperscript{19} The Court upheld its belief that express intent was required to protect state interests. The Court stated that the traditional police powers of the States are not to be superseded by federal acts unless that was Congress' clear and manifest purpose.\textsuperscript{20} Justice Marshall, writing the opinion for the Court, reasoned that "to infer pre-emption whenever a federal agency deals with a problem comprehensively would be tantamount to saying that whenever the agency decides to step into a field, its regulations will be exempt."\textsuperscript{21} The Court has consistently held\textsuperscript{22} that where congressional intent is ambiguous it is reluctant to find preemption.\textsuperscript{23}

In a more recent U.S. Supreme Court decision, the Court reaffirmed its preference for express preemption in \textit{Puerto Rico Department of Consumer Affairs v. ISLA Petroleum Corp.}\textsuperscript{24} The case involved several oil companies that alleged the Emergency Petroleum Allocation Act (EPAA)\textsuperscript{25} enacted in response to an Arab oil embargo, preempted gas regulations\textsuperscript{26} instituted by Puerto Rico.\textsuperscript{27} Congress amended the EPAA and terminated the federal government's regulatory authority.\textsuperscript{28} ISLA claimed that federal preemption continued over Puerto Rico's regulations because Congress had intended to comprehensively regulate, through the EPAA, the price of gasoline.\textsuperscript{29} To support the claim for preemption ISLA had no statutory language, upon which to rely, that indicated state regulatory measures were preempted. The Supreme Court held that, "There is no text here...to which expressions of preemptive intent might attach...Without a text that can, in light of [legislative history], plausibly be interpreted as prescribing federal pre-emption it is impossible to find that a free market was mandated by federal law."\textsuperscript{30} It is suggested from

\textsuperscript{19} Id. at 708.
\textsuperscript{20} Id. at 715 (citing Jones v. Rath Packing Co., 430 U.S. 519, 525 (1977), (citing Rice v. Santa Fe Elevator Co., 331 U.S. 218, 230 (1947))).
\textsuperscript{21} Id. at 708.
\textsuperscript{22} Rice, 331 U.S. at 230; Mauer, 309 U.S. at 614. See e.g., Pacific Legal Found., 461 U.S. at 206.
\textsuperscript{23} Laurence Tribe, American Constitutional Law § 6-25, at 479 (2d ed. 1988).
\textsuperscript{24} Puerto Rico Dep't of Consumer Affairs v. ISLA Petroleum Corp., 485 U.S. 495 (1988).
\textsuperscript{26} Puerto Rico Dep't of Consumer Affairs, 485 U.S. at 496.
\textsuperscript{28} Puerto Rico Dep't of Consumer Affairs, 485 U.S. at 499.
\textsuperscript{29} Id.
\textsuperscript{30} Id.
the Supreme Court's recent decision that Congressional intent to expressly preempt must be manifested in statutory language.31

B. IMPLIED PREEMPTION

Lacking the express intent of Congress to preempt state law, courts developed the method of implied preemption. If reasonable to infer that Congress intended and "left no room" for state regulation state law is preempted.32 Preemption is implied if Congress intends to completely occupy the field. Two lines of theory have developed to determine whether Congress occupies the field. First, whether the federal government regulated a particular field entirely so as to "leave no room" for state regulation. A case illustrating this point is Burbank v. Lockheed Air Terminal33 which involved a Burbank city ordinance limiting air traffic hours due to the noise it created for surrounding neighbors. The Supreme Court preempted the ordinance finding that the Federal Aviation Act and the Environmental Protection Agency, while lacking specific preemption clauses, were granted "pervasive control" of navigable airspace.34

The second approach concerns whether or not the field is of peculiar federal interest. An illustration of this analysis is Hines v. Davidowitz.35 Hines involved a Pennsylvania state statute requiring aliens to register with the state authorities.36 The Pennsylvania statute was adopted prior to enactment of a federal statute requiring a similar registration. The Court preempted the state statute because alien registration was a field that could affect international affairs and therefore was a peculiar federal interest.37 A dominant federal interest is assumed to preclude the enforcement of the states' laws regarding the same area.38

C. CONFLICT PREEMPTION

Finally, state law is preempted if the law conflicts with the purpose of federal law.39 The Florida Lime & Avocado Growers, Inc. v. Paul case set forth a test40 to determine whether there was a conflict between state and federal regulation. The test examines whether the state regulation

31. Starr, supra note 27, at 18.
32. Rice, 331 U.S. at 230.
34. Id. at 638 (holding was a five-four decision).
37. For a further discussion on this issue see generally Kenneth Starr et al., The Law of Preemption, A.B.A. SEC. ANTITRUST (1991).
38. Rice, 331 U.S. at 230; Hines, 312 U.S. at 52.
40. Hines, 312 U.S. at 67. The test was first articulated in the Hines case.
"stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."41 In Florida Lime & Avocado Growers, Inc. Florida growers sued state officers of California. The growers contended that the California Agriculture Code which prohibited the transport and sale in California of avocados containing less than eight percent of oil by weight was unconstitutional. Appellants argued that under the Supremacy Clause the California statute was preempted by the federal standard for determining the maturity of Florida grown avocados.42 The court held, among other things, that there was no inevitable collision between the federal and state schemes of regulation.43 Where state and federal laws conflict the Court has determined that there is no requirement of Congressional design.44

A more recent conflict preemption case is illustrated in Paper Co. v. Oulette45. In Oulette, property owners filed a state law nuisance suit to stop a paper mill from discharging toxins into a lake.46 The court concluded that the Clean Water Act47 preempted the common-law state nuisance action. Although the Act provided a clause allowing private citizen suits to be brought, the Court felt that the property owners' suit would frustrate Congressional intent to create "clear and identifiable"48 discharge standards.49 Private actions such as this would only leave the door open to indefinite potential regulations.50

D. THE AIRLINE DEREGULATION ACT

The statute the court considered in Federal Express v. CPUC was the ADA.51 Section 1305(a)(1) of the ADA operates to preempt state regulation of any "law, rule, regulation, standard or other provision having the force and effect of law relating to rates, routes, or services of any air carriers..."52 Significantly, the court analyzed whether Congress intended

41. Paul, 373 U.S. at 141.
42. Id. at 132.
43. Id. at 142-43.
44. Id. ("A holding of federal exclusion of state law is inescapable and requires no inquiry into congressional design where compliance with both federal and state regulations is a physical impossibility....").
46. Id. at 484.
48. Oulette, 479 U.S. at 496.
49. Id.
50. Id. at 499.
to preempt Federal Express' transportation by truck of intrastate cargo.53

The court struggled with the interpretation of the phrase: "relat[e] to rates, routes, or services of any air carrier to provide air transportation."54 In the instant case, Federal Express used legislative history to persuade the court that Congress intended that packages carried solely by truck in California were to be preempted.55 Congress in enacting the ADA stated that "maximum reliance on competitive market forces" would best foster "efficiency, innovation, and low prices" in addition it would foster "variety [and] quality . . . of air transportation services."56 Congressional intent in enacting the ADA was couched in broad policy considerations.57 The policies offered included:58 "The prevention of any deterioration" of safety procedures; encouragement of entry into air transportation markets by new carriers and adaption of air transportation systems to the present and future needs.59 The broad language employed in the ADA will be a continuing process for the courts to define the boundaries of the preemptive clause in the ADA.

E. PRIOR CASE LAW

The trial court relied on the U.S. Supreme Court case Raymond Motor Transportation, Inc. v. Rice60 for guidance on the issue of state regulations.61 In Raymond several interstate trucking companies brought suit on the grounds that Wisconsin regulations not allowing operations of sixty-five foot doubles burdened and discriminated interstate commerce. The Court held these regulations were a burden on interstate commerce. However the court articulated their view on state regulations concerning safety,

53. Id.
54. Morales v. Trans World Airlines, Inc., 112 S.Ct. 2031 (1992). Note that in a recent U.S. Supreme Court decision the court held that the term "relates to" in § 1305(a)(1) must be given a broad preemptive purpose. All state laws having a construction with or reference to airline rates, routes or services are to be preempted. The court held that fare advertising provisions of the National Association of Attorneys General guidelines were preempted by the ADA. The Morales case is distinguished from the Federal Express case. The Morales case deals with whether Congress intended the ADA to single out the airline industry as opposed to all other industries for immunity from state enforcement of deceptive advertising laws. Whereas, Federal Express sought to determine whether Congress intended to render all activities of air carriers immune from state regulation.
56. Federal Express, 716 F. Supp. at 1299 (quoting Wardair Canada, Inc. v. Florida Dept. of Revenue, 477 U.S. 1, 6 (1986)).
58. Id. at § 1305(a)(1).
59. Id.
The Court has been most reluctant to invalidate 'state legislation in the field of safety where the proprietary of local regulation has long been recognized. [I]n no field has this deference to state regulation been greater than that of highway safety regulation . . . . Thus, those who would challenge state regulations said to promote highway safety must overcome a "strong presumption of [their] validity."63

The Raymond Court explicated that the challenge to a state's highway safety regulations must overcome a strong presumption of their validity.

The following will be a synopsis of the cases the Ninth Circuit relied upon in this decision. In the U.S. Supreme Court case, California v. ARC America Corporation64 a class action suit was brought by several states65 alleging price fixing by certain cement producers. The Court, reversing the appellate court, held that state indirect purchaser laws were not preempted by federal law.66 The Court's rationale centered on a presumption against preemption in areas traditionally regulated by the states.67

An additional case, West v. Northwest Airlines,68 also relied upon a presumption against preemption in areas traditionally regulated by the state. In West a passenger sued Northwest Airlines for failing to provide a seat because of overbooking.69 The appellate court incorporated the Supreme Courts' reasoning in ARC and concluded that there is a presumption against preemption in areas of traditional state law claims such as common law tort and contract remedies.70 The Court held that state law was neither expressly or impliedly preempted nor was it preempted due to conflict.71

Another case relied upon by the court in Federal Express was Hingson v. Pacific Southwest Airlines72 a blind passenger brought suit against an airline because he was told that he had to sit in the front of the plane due to his handicapped status. When Hingson refused to abide by the demand, PSA had police officers escort him off the plane.73 The court found preemption of the airlines' seating policies. The court held that such regulation of handicapped seating policies was within the meaning of services in 49 U.S.C. § 1305(a)(1).74 However, the court held that

63. Federal Express, 723 F. Supp. at 1384 (quoting Raymond, 434 U.S. at 443-44).
65. ARC, 490 U.S. at 93. The states involved were: Alabama, Arizona, California and Nebraska.
66. Id. at 106.
67. Id. at 101.
68. West v. Northern Airlines, Inc., 923 F.2d 657 (9th Cir. 1990).
69. Id. at 657.
70. Id. at 659.
71. Id.
72. Hingson v. Pacific Southwest Airlines, 743 F.2d 1408 (9th Cir. 1984).
73. Id. at 1411.
74. Id. at 1415.
Hingson's claim of intentional infliction of emotional distress was not preempted. The Hingson court's rationale for not preempting the claim was based on a comparison to Farmer v. United Brotherhood of Carpenters & Joiners. Richard Hill was a carpenter and a member of Local 25. The Union provided to its members a hiring hall for employment referral of carpenters. Hill became president of the Union and subsequently had a dispute with the Union Business Agent. Hill alleged that due to the dispute the Business Agent discriminated against him in referrals to employers. It was Hill's contention that as a result of his complaints he was subjected to a campaign of personal abuse and harassment, as well as, discrimination in referral from the hiring hall. The Court held that the National Labor Relations Board Act did not allow for preemption of a claim for intentional infliction of emotional distress.

In Federal Express, the Ninth Circuit decision of Air Transport of America v. Public Utilities Commission of California was interpreted differently by the District Court than by the Ninth Circuit. In Air Transport several airlines and the Airline Trade Association brought suit challenging the California Public Utilities Commission regulation prohibiting California telephone customers from recording or secretly overhearing conversation without knowledge by the parties. The airlines monitored conversations of their reservation agents and customers. The Air Transport Court held that state regulation of telephone conversations was not preempted because reservation operations are not unique to the airline industry but are common to the car rental and hotel industries as well. The Ninth Circuit held in Air Transport that reservations were not "services" under 49 U.S.C. § 1305(a)(1) and therefore was not preempted.

The District Court in Federal Express relied on this narrow interpretation of the Air Transport reasoning and the Ninth Circuit relied on the caution expressed in Air Transport. The Air Transport court stressed that its decision was not a final resolution of the scope of preemption under the Airline Deregulation Act. The Ninth Circuit encouraged a narrow reading of its holding in Air Transport as allowing states to act in areas of non-

75. Id.
77. Id. at 292.
78. Id.
80. Id. at 200.
81. Id. at 202. The monitoring was argued to ensure that accurate information was given both effectively and courteously.
82. Id. at 207.
83. Id.
The impact of these cases on Federal Express is questionable. It appears that the meaning of the word "services" will provide a continuing struggle for the courts. Some general principles, however, can be derived from these cases. The ARC and West cases hold that there is a presumption against preemption in cases of traditional state law, for instance common-law tort and contract law. Hingson strengthened protection of states' common-law tort actions by finding there was no preemption for intentional infliction of emotional harm.

The impact of Air Transport continues to develop. The disparity of treatment in this case by the District Court and the Appellate Court is a demonstration of its ambiguity. On the one hand, the Air Transport court provided that "services" must be unique to an industry to require preemption, yet the court also issues a warning that its decision is not a definitive resolution of the problem. The court concludes that it still allows for non-economic regulation, but what constitutes non-economic regulation is uncertain.

III. Federal Express v. CPUC

Federal Express brought suit against the California Public Utilities Commission to declare that the Commission's regulations imposed an unconstitutional burden on interstate commerce. Federal Express also alleged the regulations were preempted by the ADA. The District Court for the Northern District of California, while considering cross-motions for summary judgment, held that State regulation was not preempted by the Airline Deregulation Act. Federal Express appealed this decision to the United States Court of Appeals for the Ninth Circuit. The Ninth Circuit reversed the District Court and entered judgment for Federal Express.

Federal Express is a carrier exclusively transporting cargo. In the communities it serves, a van collects the packages and delivers them to an airport, where they are transported to a "hub" for sorting. After sorting the packages are flown to a regional hub and then trucked to their final

84. Federal Express, 936 F.2d at 1078.
86. Hingson, 743 F.2d at 1415 (held that regulation of an air carrier's seating policies for their handicapped passengers was within the meaning of services under 49 U.S.C. § 1305(a)(1)).
87. Air Transport, 833 F.2d at 207.
88. Federal Express, 936 F.2d at 1076.
89. Id.
90. Federal Express, 716 F. Supp. at 1299.
91. Federal Express, 936 F.2d at 1076.
destination. Memphis is the main hub\textsuperscript{92} while Oakland, California is a regional hub.

Packages routed through the Regional Oakland hub and bound for Los Angeles are transported in one of the following ways: (1) by air the main hub in Memphis then to Los Angeles by air; (2) by air to Los Angeles directly from Oakland; or (3) by truck to Los Angeles directly from Oakland in the event of inclement weather or lack of capacity on the plane.\textsuperscript{93} Any package that does not fit on the night flight from Oakland to Los Angeles are trucked to Los Angeles.\textsuperscript{94} The bulk of these packages fall within interstate commerce; some trucks, however, transport purely intrastate packages.

Federal Express relies on alternative modes of transportation to meet its speedy delivery requirements.\textsuperscript{95} Time is of the essence in Federal Express' business - a delay of even thirty minutes can be crucial.\textsuperscript{96} Federal Express could not meet its deadlines without the use of several modes of transportation.

To meet its delivery needs Federal Express operates over 2,600 trucks in California licensed by the CPUC. Federal Express paid quarterly fees based on its estimated gross operating revenues until early 1987.\textsuperscript{97} The CPUC had authority to regulate common carriers on California's highways.\textsuperscript{98} The CPUC regulates tariffs,\textsuperscript{99} bills of lading, freight bills and "accessorial services" documents issued by common carriers.\textsuperscript{100} The CPUC allows for carrier variances and considers its regulatory program adaptive.\textsuperscript{101}

\textsuperscript{92} Id. Each evening 700,000 packages are sorted and re-routed at the Memphis facility. Over 200,000 packages each week have both their origin and destination within California.

\textsuperscript{93} Id.

\textsuperscript{94} Id. at 1077. One truck runs from Oakland to Los Angeles and two trucks run from Los Angeles to Oakland.

\textsuperscript{95} Id.

\textsuperscript{96} Id. Federal Express guarantees delivery by 10:30 a.m. If the package is even one minute late Federal Express grants a full refund.

\textsuperscript{97} Id. These fees were assessed by the P.U.C. under, [Cal.Pub.Util.Code] § 5003.1. §§ 5003.1 and 5003.2 require "exempt" carriers to pay a fee currently equal to 1/10 of 1% of gross operating revenues which underwrite the cost of the CPUC's safety-related programs.

\textsuperscript{98} Id. The P.U.C.'s authority is granted under the California Constitution, Art. XII; § 4 Cal. Pub. Util. Code §§ 1063 and 3501.

\textsuperscript{99} Id. The P.U.C. issues orders governing tariffs of the common carriers, General Order 80-C, February 7, 1990; tariffs for suspension, General Order 113-B, July 2, 1980; and public inspection, General Order 139, September 1, 1976.

\textsuperscript{100} Id.

\textsuperscript{101} Id.
IV. FEDERAL EXPRESS V. CPUC RATIONALE

A. MAJORITY OPINION

Federal Express appealed to the Ninth Circuit on two grounds. First, California’s regulation was an excessive burden on interstate commerce; second, state regulation was preempted by act of Congress. The court concluded that the first ground did not need to be addressed because statutory preemption existed.\textsuperscript{102} Since the legal conclusion on the second issue was dispositive, there was no need for further proceedings.\textsuperscript{103}

In distinguishing the \textit{Air Transport} \textsuperscript{104} case the court reasoned that \textit{Air Transport} should be interpreted as allowing the state to act in only non-economic regulation. Since only economic regulation is challenged in the instant case, the \textit{Air Transport} holding is not applicable.\textsuperscript{105}

The court also reasoned that despite the ADA’s\textsuperscript{106} broad language it should not be taken literally but should be restricted by common sense and common practice.\textsuperscript{107} Looking to the statute’s purpose and “\textit{[I]n context of other laws,}”\textsuperscript{108} the court held the Airline Deregulation Act did preempt the CPUC from regulating Federal Express’ ground transportation operations.\textsuperscript{109} The majority made the distinction that Federal Express’ trucking operations are so integral to the business’ overall operations that it could not separate the trucking and air carrier operations.\textsuperscript{110}

Additionally, the court held that the CPUC had overstepped the agency boundaries established by Congress. The court felt that the CPUC’s regulation of rates, discounts, overcharges, bills of lading and freight bills were economic and beyond the granted scope of authority.\textsuperscript{111} Furthermore, the CPUC’s regulatory scheme was not a restatement of tort or contract law\textsuperscript{112} and the their regulations went far beyond safety concerns and therefore the state had no authority to regulate. However, the court also explained that California’s safety requirements for trucks traveling on the California highways did apply to Federal Express.\textsuperscript{113} Significantly, the court reasoned that the CPUC’s regulations were economic in orientation because regulation of a business’ bill of lading directly affects

\textsuperscript{102} \textit{Id.}
\textsuperscript{103} \textit{Id.}
\textsuperscript{104} \textit{Air Transport}, 833 F.2d at 200.
\textsuperscript{105} \textit{Federal Express}, 936 F.2d at 1078.
\textsuperscript{107} \textit{Federal Express}, 936 F.2d at 1078.
\textsuperscript{108} \textit{Id.} It should be noted that the court does not cite authority for this proposition.
\textsuperscript{109} \textit{Id.}
\textsuperscript{110} \textit{Id.} “\textit{[T]hey [the trucking operations] are part and parcel of the air delivery system.”}
\textsuperscript{111} \textit{Id.}
\textsuperscript{112} \textit{Hingson}, 743 F.2d 1408.
\textsuperscript{113} \textit{Federal Express}, 936 F.2d at 1078.
a carrier's services and that determines cost.\footnote{114} Finally, the court explained its interpretation of the Federal Aviation Act's purpose in an attempt to confirm their "plain meaning" interpretation of the statute.\footnote{115} The goal of preemption of the Act is to prohibit states "[F]rom enacting any law, establishing any standard determining routes, schedules, or rates, fares or charges in tariffs of, or otherwise promulgating economic regulations, for any carrier certified by the Board."\footnote{116} The court looked to the Federal Aviation Act of 1958 and concluded that it granted the federal government the authority for "promotion of adequate, economical, and efficient service by air carriers at reasonable charges."\footnote{117} The Court raises as evidence several of the Congressional aims in the 1977 amendments to the 1958 act. Congress desired a "sound regulatory environment" so decisions would be: (a) promptly dispatched (b) "an expedited all-cargo air service system"\footnote{118} would be encouraged and (c) development of an "integrated transportation system."\footnote{119} Based on these congressional goals the court decided that Federal Express was exactly the integrated system foreseen by Congress. Under the court's analysis even the intrastate use of trucks does not destroy Federal Express' status as an air carrier.

\subsection{DISSENT}

Judge Singleton filed the dissent in this case.\footnote{120} Judge Singleton felt that Congress did not intend that the states be preempted from regulating Federal Express' shipments that were purely by truck and were intrastate in nature.\footnote{121}

Judge Singleton began his dissent with an analysis of Congressional intent. Singleton argued that the majority is not applying the plain meaning of the statute and incorrectly relies on the word "services" instead of relying on the phrase, "services of any \textit{air carrier}".\footnote{122} An air carrier as defined by Congress is a person engaged in \textit{air transportation}.\footnote{123} Congress defined air transportation, in part, as \textit{interstate} aircraft transporta-
The most compelling evidence of the Congressional intent regarding an integrated transportation system is its definition of “interstate” transportation. Congress defined interstate air commerce as commerce which is transported either entirely by air or, in part, by other modes of transportation. Singleton argued that to determine which activities are exempt it is necessary to identify the packages that never see the interior of a plane. This point is crucial because the state conceded that transportation of any package carried either solely by air or partially by air and another mode of transportation are indeed exempt. Based on these considerations, the dissent found that the transportation of packages entirely by truck within California is not an air carrier service.

Singleton made a cogent argument against the majority’s conclusion that Federal Express’ trucking and air activities are so integrated that California’s attempt to regulate the trucking will necessarily regulate the air operations. At its most extreme any business that mixes exempt and non-exempt activities may not be regulated by the state. Singleton in his argument looked to the future problems in distinguishing what percentage of exempt and non-exempt activities it will take for the activity to lose regulation by the state.

The dissent’s policy considerations are also persuasive. The majority was influenced by the fact that only a small portion of goods are carried solely by truck; however, this decision leaves the door wide open for Federal Express to increase freely its trucking operations. It will provide Federal Express with an enormous advantage over other companies which must comply with state regulations such as purely trucking companies. Furthermore, the dissent argued, if the majority was intent on making this kind of decision it should have established some guidelines, such as: (1) how many airplanes must Federal Express fly to Sacramento each month to insulate the trucking operations from state regulation?; (2) how many packages must be carried — one or thousands?

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125. 49 U.S.C. § 1301(23) (1988) "‘Interstate air commerce’...means the carriage by aircraft of persons or property...whether such commerce moves wholly by aircraft or partly by aircraft and partly by other forms of transportation." *id.*
126. Federal Express, 936 at 1080 (Singleton, J., dissenting). Singleton makes an interesting analogy between packages that never see a plane to caterpillars having the potential to become butterflies.
127. *id.*
128. *id.*
129. *id.*
130. *id.*
131. *id.*
132. *id.* (according to the dissent).
Based on these considerations, the dissent would have affirmed the trial court's decision. Federal Express' air operations and other transportation of goods using both air and other forms of transportation should be preempted. However, purely trucking operations within the state should be state-regulated. The dissent argued that the commerce clause issues raised needed to be explored and therefore should be remanded for further findings of fact and law.

V. CRITIQUE OF THE FEDERAL EXPRESS DECISION

The Ninth Circuit's decision in Federal Express is potentially one of the most expansive decisions affecting the field of transportation in years. This case effectively expands not only the federal government's preemption of state law, but also allows Federal Express to expand its trucking operations without fear of state regulation. The decision reached by the Ninth Circuit will have detrimental results both on safety and carrier competition.

A. PLAIN MEANING STATUTORY CONSTRUCTION

Recently the courts have struggled to interpret the meaning of "services" within § 1305(a)(1). The Hingson court found that an airline's seating policies was within Congress' meaning of "services." This classification is understandable because seating policies are an unextricable component of an airline's services. The Air Transport court decided that airline reservation systems were not within the meaning of services for two reasons: they were not unique to the airline industry and they were non-economic in nature.

Perhaps the most egregious error made in the Ninth Circuit's decision was its disregard for the plain meaning of the statute. The majority dismisses the plain meaning found within the statute by stating "[D]espite the very broad and apparently all-inclusive language of the statute, common sense and common practice have forbidden that the statute be taken literally and have restricted its range." The majority decided that services were preempted by the statute if they are economic in nature. The majority makes an illogical leap and concludes that regulation of a business' bill of lading relates to the terms which the air carrier offers its service. To regulate a service is to determine cost. However,
it is difficult to imagine that Congress intended that an intrastate truck's bills of lading would be construed as effecting an air carrier's service. It is even more difficult to conceive that Congress intended the state's regulation of safety, insurance and licensing to be preempted. If non-economic regulation is the only regulation that is tolerated than under the majority's analysis no regulation of the airline industry will be permitted, directly or indirectly, because it would be impossible to find a regulation that was non-economic.

One must look to the plain and literal meaning of a statute. In this instance congressional intent is made clear by examining definitions of air carrier, air transportation or interstate transportation. The court should have examined 1301(3), (10) and (23) of the Act, which clearly state Congress' intent of § 1305(a)(1). Instead, the court ignored these definitions which are vital to understanding the scope of § 1305(a)(1). If 1305(a)(1) is read in context with § 1301(3), (10) and (23) it is clear that cargo carried exclusively by truck is not within the definition of interstate air commerce and therefore is not preempted by 1305(a)(1).

The U.S. Supreme Court has recently spoken on the issue of "relating to" and "services" within § 1305(a)(1) in, Morales v. Trans World Airlines. This case involved whether enforcement of the NAAG guidelines on fare advertising through a state's general consumer protection laws is preempted by the ADA. The court found that these guidelines were preempted because almost everyone of the provisions included a direct reference to "air fares." The court listed the guidelines of NAAG and they all literally referred to "air fares." This is a far different fact pattern than found in Federal Express. In Federal Express the CPUC's regulations never mention "air fares."

The Morales court went further to say that "some state actions '[m]ay affect [airline fares] in too tenuous, remote or peripheral a manner' to have pre-emptive effect." The Federal Express case falls within this last category. At no point does the CPUC regulations mention air fares. The CPUC regulations have far too remote an effect on "services" for the state regulations to be preempted. The Morales case came out after the Ninth Circuit's decision in Federal Express, but illustrates that the CPUC's

140. See infra notes 132-134.
141. 49 U.S.C. § 1301(3) (1988). "'Air carrier' means any citizen of the United States who undertakes, whether directly or indirectly or by a lease or any other arrangement, to engage in air transportation. . . ."
142. 49 U.S.C. § 1301(10) (1988). "'Air transportation' means interstate, overseas, or foreign air transportation or the transportation of mail by aircraft."
145. Id. at 2039
146. Id. at 2040 (quoting Shaw, 463 U.S. at 100, n. 21).
regulations are too tenuous to be considered a "service" according to case law interpretations of 1305(a).

**B. No Express, Implied or Conflict Preemption**

The Ninth Circuit's decision to give the government preemption power over intrastate trucking operations of an air carrier was not substantiated by express, implied or even conflict preemption. It is impossible to see this decision as anything more than active judicial policy making. Such judicial reasoning becomes judicial activism when it makes or applies policies not found in the Constitution or statutes. Our federal system maintains a high regard for states' rights and a judge should not lightly dispense with those rights.

The court's holding that the CPUC regulation of Federal Express was preempted under 49 U.S.C. § 1305(a) is not substantiated under express preemption. It is understood that Congress did preempt air carriers transporting goods entirely by air or partially by air and partially by other modes of transportation. There is no express intent, however, that Congress intended to preempt goods carried intrastate entirely by truck. The statute provides for preemption of "air transportation." Air transportation is defined as "interstate, overseas or foreign air transportation." At no point does the statute expressly provide for preemption of the motor carrier services of an air carrier. It has been established that where congressional intent is ambiguous it is reluctant to find preemption. The Supreme Court holdings in *Hillsborough* and *ARC* discourage preemption regarding traditional police powers of the States, unless that was the clear and manifest purpose of Congress. Intrastate trucking, in light of the Supreme Court's reasoning, should not be preempted. If Congress were going to dispense with a traditional state power it seems reasonable that they would manifest their intent expressly so that it would be clear they were usurping jurisdiction.

Implied preemption was also lacking in the preemption of the CPUC's regulation of Federal Express. For preemption to be implied the court needed to find an intent by Congress to preempt a field covered by state law. However, there is no evidence of Congress' intent to preempt

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147. See *supra* note 27 at 40-55, explaining judicial movement away from implied preemption towards clear statements of preemption to protect the notion of federalism.

148. See *Bork, infra* note 171, at 184.

149. See *Starr, supra* note 27, at 50.


154. *Wardair Canada, Inc.* v. *Florida Dep't of Revenue*, 477 U.S. 1, 6 (taxation of airline fuel by the states was not preempted by the FAA).
state regulation of the purely trucking operations of a carrier. The only mention of ground transportation is found in Congress' definition of "interstate air transportation" and "interstate air commerce." The inclusion of the term ground transportation in these definitions is only in reference to operations that are both by air and ground transportation. It cannot be implied based on these definitions that "purely" ground intrastate transportation was impliedly preempted by Congress. There is no evidence that Congress intended that purely ground transportation was to be included in the definition of air carrier. As the District Court suggested although the legislative understanding "may be short-sighted" it is up to Congress alone to make a correction.

The District Court also perceptively compared the fact that other legislation by Congress on transportation revealed no intent by Congress to preempt interstate ground transportation by the federal government. In fact, the Motor Carrier Act of 1980 expressly reserved the authority of the states to regulate their own intrastate truckers. The government's regulation is not so comprehensive that it "left no room" for state regulation. The court creates a strained analysis to find implied preemption. Especially when the judiciary analyzes preemption questions with a "presumption that Congress did not intend to pre-empt areas of traditional state regulation." In the Burbank case the Court was dealing with navigable air space, which the FAA and EPA concededly have pervasive control over. However the Federal Express case does is not concerned with air space, but with purely intrastate trucking operations. Regulation of intrastate trucking has traditionally been in the hands of the states.

Regulation of intrastate trucking is not a peculiar federal interest. This is evidenced by the Motor Carrier Act which expressly reserved to the states regulation of their intrastate trucking. Not only is regulation of intrastate trucking not a peculiar federal interest it is a traditional state power. The Court in Hines found preemption of a Pennsylvania alien registration statute because alien registration could affect international affairs and by its nature was a peculiar federal interest. It is quite

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155. 49 U.S.C. §§ 1301(23), (24) (1988). The reference in these definitions refer to movement of commerce in part by aircraft and in part by "other modes of transportation."
156. Federal Express, 716 F. Supp. at 1304.
157. Id.
162. Hines, 312 U.S. 52.
understandable that the Court found a statute that could possibly affect international affairs to be a peculiar federal interest. The CPUC regulations, however, do not reach this magnitude. The CPUC regulations are a peculiar state interest, the regulations not only regulate bills of lading, but also fund the state’s licensing and safety of intrastate trucking. Based on these considerations it is evident that there also is no implied preemption.

Lastly, there was no evidence of conflict preemption in the Ninth Circuit’s finding of preemption. It was neither physically impossible for Federal Express to comply both with the federal government’s and the CPUC’s regulations nor did the CPUC’s regulations “stand as an obstacle to the purposes and objectives of Congress.” As a matter of fact, the Ninth Circuit’s decision to preempt some air carrier’s motor operations will impede Congress’ intent to create a competitive market while maintaining low prices.

The CPUC expressed that their regulatory scheme was adaptive. Federal Express argued that they did not know which of their packages would remain in trucks traveling intrastate and therefore could not derive fees to be paid to the CPUC; they complained that this would be too burdensome. However, the CPUC had already been accommodating Federal Express’ needs. The CPUC had allowed Federal Express to simply estimate their shipments of intrastate truck carriage and fees would be assessed according to these estimates. Therefore, even if there had been some conflict the CPUC could have reorganized its regulatory scheme to comply with a no conflict policy. Additionally, by maintaining regulation over Federal Express’ intrastate ground operations the CPUC would be fostering Congress’ objectives of creating a competitive market.

The District Court made a sagacious analogy in determining whether conflict preemption existed between the state and federal regulations. The court made an analogy to the Interstate Commerce Act which deprives the Interstate Commerce Commission (ICC) jurisdiction over motor carriers when air transport is involved. Additionally, the ICC is denied jurisdiction over motor carriers performing in emergencies as a substitute for air transportation. The court explained that these exceptions from jurisdiction suggest Congress’ intent to keep ground transportation and air transportation in separate regulatory schemes, except in the most ex-

163. Federal Express, 936 F.2d at 1077.
165. Id. "Indeed, during the calendar years 1985 and 1986 and through the first quarter of 1987 Federal Express paid quarterly operating fees to the CPUC under a formula arrived at by the CPUC and apparently agreed to by the plaintiff." Id.
traordinary circumstances. The ICC analogy seems quite logical in determining Congress' intent and should be used in interpreting 49 U.S.C. § 1305(a).

C. CPUC'S SAFETY REGULATIONS WERE NOT GIVEN PROPER WEIGHT

The Tenth Amendment confirms that federal powers were intended to be limited and that the powers not lodged in the national government remained to the states. Clearly this case represents a clashing of two powerful conservative issues - federalism and laissez faire capitalism. The fight between these philosophies continues and perhaps will only intensify as government expands. Much controversy has arisen since the creation of the constitution concerning the federal government's preemptive powers. In fact, opposition to the U.S. Constitution centered on the fear that the national government would usurp state powers. More fear, perhaps, should be expressed over the power of the judiciary to usurp the states' rights.

The Ninth Circuit's decision has caused confusion, their statement that Federal Express was bound by California's safety requirements "only economic regulation is challenged." Whether the court intended that the CPUC retain its authority to regulate safety, insurance and licensing is unclear. The CPUC's regulation of safety, insurance and licensing protects all California citizens regardless of whether they are customers of the carrier. The regulation of a carrier's rates, routes and services is to protect a carrier's customers from market monopoly. Due to the ambiguous nature of the Ninth Circuit's decision forty-six of the fifty states submitted amicus curiae briefs in support of the CPUC because, inter alia, of their concerns over safety.

The CPUC cooperates with the Department of Motor Vehicles ("DMV"), the California Highway Patrol ("CHP") and the Department of Industrial Relations ("DIR") to maintain safety on the California high-

170. U.S. CONST. amend. X. The Tenth Amendment provides that, "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."
174. Federal Express, 936 F.2d at 1078.
175. CAL. PUB. UTIL. CODE § 5003.2(a) authorizes the CPUC to regulate safety, insurance and licensing. CAL. PUB. UTIL. CODE § 5003.2(a) (West 1989).
176. CAL.PUB.UTIL.CODE § 5001.5(b) The purposes of safety, insurance and licensing are distinct from the purpose of regulation of rates. CAL. PUB. UTIL. CODE § 5001.5(b) (West 1989).
ways.177 The CPUC has the authority to impose penalties, as well as, to suspend or revoke operating authority and to see that motor carriers comply with the state traffic laws, the DMV Pull Notice program, equipment listing, driver safety, driver education and vehicle maintenance requirements and requirements documenting compliance with safety standards.178 The CPUC's safety, insurance and licensing regulations were never specifically discussed in the Ninth Circuit's decision and therefore it is unclear whether the Ninth Circuit intended that these regulations be preempted.

The trial court did address the safety regulations of the CPUC.179 The trial court held that the California legislature recognized the role in safety the CPUC plays, as evidenced by their legislating more responsibility to the CPUC in monitoring vehicle safety and driver qualifications.180 The quarterly fees181 paid to the CPUC are used for California's maintenance and safety programs.182 The trial court recognized that the California legislature perceived the CPUC's safety regulations "as a significant public benefit."183 Furthermore, the trial court explained that the U.S. Supreme Court has determined that safety, "is essentially a matter of public policy, and public policy can, under our constitutional system be fixed only by the people acting through their elected representatives."184 The California legislature's perception of the importance of safety, based on the Supreme Court's analysis, is quite compelling.

The trial court also correctly relied on the U.S. Supreme Court case, Raymond Motors Transportation, Inc. v. Rice.185 The Raymond court concluded that those challenging a state's highway safety regulations must first overcome a strong presumption of their validity.186 The trial court recognized this presumption and therefore held that Federal Express did not overcome the strong validity of the CPUC's regulations. The Court in Raymond further solidifies the necessary presumption by adding that "[i]n no field has this deference been greater than that of highway safety regulation."187 The Ninth Circuit dismissed this issue immediately

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179. Federal Express, 723 F. Supp. at 1383-84.
180. Id. at 1383.
181. The fees are paid based on a carrier's gross operating receipts. CPUC has indicated that over 20,000 intrastate motor carriers in California pay such fees.
183. Id. at 1384.
184. Id. (quoting Brotherhood of Locomotive Firemen and Eng'rs v. Chicago Rock Island and Pac. R.R. Co., 393 U.S. 129 (1968)).
186. Id. at 443-44.
187. Id. at 443.
by saying there was an excessive burden, but never addresses their rationale.

It is hard to believe that Congress intended to preempt the States' police powers, especially in California which is home to perhaps the most unique and complex highway system in the United States. To pull the authority to regulate safety from the CPUC will surely have devastating effects on the highway safety of California. It is imperative that each state be able to regulate their own special safety needs. Imagine the federal government implementing a safety, insurance and licensing program that would accommodate the needs of disparate cities such as Los Angeles, California and Ashville, North Carolina.

D. ANALYSIS DOES NOT ADDRESS CPUC’S ARGUMENT

The court never addressed the CPUC’s argument, as evidenced by their statement, “every truck carries packages that are in interstate commerce by air.”188 The CPUC concedes that packages carried via air or only partially by air are preempted. Again, its argument was regarding packages travelling solely by truck within California. There is no contention as to the trucking being an integral component of the air-modal movements but movements made entirely by truck are not integrated within the operation of the air carrier. The district court also correctly found that post-1978 legislation reserves to the states the regulation of intrastate motor movements.189 Notably, the majority perceives that the CPUC’s regulatory schemes such as bills of lading, freight charges and promotional pricing “relate to” the carrier’s service.190 This is true with respect to the all air or partial air movements, but not to the movements made exclusively by truck.

E. JUDICIAL ACTIVISM

The Ninth Circuit opinion represents the most destructive kind of judicial activism. The opinion constitutes de facto legislation of policy. While preemption of the states’ regulatory practices may be beneficial so that a private company such as Federal Express does not have to incur costs to comply, the judicial creation of such a policy is completely at odds with the concept of federalism.191 Without a clear and manifest purpose to

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188. Federal Express, 936 F.2d at 1078.
190. Federal Express, 936 F.2d at 1078.
preempt the judiciary takes the role of the legislature thereby exceeding its authority.

The ADA included a series of public interest considerations. Some of these considerations did include the development and maintenance of a sound regulatory environment\(^{192}\) and the encouragement and development of an integrated transportation system.\(^{193}\) The court fails to mention perhaps the most important public interest consideration - the prevention of unfair, deceptive, predatory, or anti-competitive practices in air transportation and furthermore the avoidance of unreasonable industry concentration and monopoly power.\(^{194}\) By disregarding these policy considerations the majority has quite effectively given Federal Express an unfair advantage over competing intrastate truck companies. The congressional policy considerations have been violated and the affect of the court’s holding has condoned the very policy considerations congress had tried to legislate against. Federal Express has been given a decided advantage in the intrastate truck delivery service.

**F. THE DECISION HAS PROPAGATED TWO BILLS**

The *Federal Express v. CPUC* decision has propagated two bills. These bills are H.R. 3221\(^{195}\) and H.R. 4668.\(^{196}\) H.R. 3221 seeks to codify the *Federal Express v. CPUC* decision. The bill would preempt State laws relating to the regulation of rates for surface transportation of motor and air carriers. Conversely, H.R. 4688 would seek to clarify that the Federal Aviation Act of 1958 was not intended to prohibit the states from regulating the air carrier’s intrastate motor carriage operations.

It is not surprising that H.R. 3221 has received a plethora of opposition. Among those opposing this bill is the National Association of Regulatory Utility Commissions (NARUC).\(^{197}\) Regulating the intrastate transportation of common carriers is just one of NARUC’s duties.\(^{198}\) It is also the obligation of NARUC to assure services and facilities for the public’s convenience and necessity at rates that are just and reasonable.

NARUC opposes H.R. 3221 because it will effectively confer private benefits on the intrastate trucking operations of a very few express delivery companies, meanwhile the thousands of smaller trucking companies

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193. § 1302(b)(2).
194. § 1302(a)(7), (a)(7)(A).
198. NARUC is a quasi-governmental, non-profit organization founded in 1889. Membership in NARUC consists of governmental agencies of the fifty states, the District of Columbia, Puerto Rico and the Virgin Islands.
will still have to meet the CPUC regulations. For instance, the trucking companies within California who conduct purely intrastate trucking operations must still abide by the CPUC regulations. These trucking companies, although not using any air operations are still in competition with Federal Express for business within California. Federal Express no longer must satisfy the CPUC’s regulations. H.R. 3221 will clearly put the intrastate trucking companies at a substantial disadvantage. In fact, the Ninth Circuit has transformed Federal Express into a state unregulated giant. This giant will undoubtedly put many of the intrastate trucking companies out of business.

It is not difficult to fathom the concerns of NARUC in regard to H.R. 3221. This bill will only serve to exaggerate the consequences of the Ninth Circuit’s decision. The bill will effectively eliminate the small trucking companies within California from being able to compete with companies such as Federal Express.

VI. CONCLUSION

Perhaps the most prevailing affect of the Federal Express case will be the creation of an atmosphere of unfair competition for the intrastate trucking companies who must still abide by federal and state regulations. These other carriers do not now have the advantage, as does Federal Express, to disregard state regulation. This advantage does not bode well for the future of other carriers and could mean monopolization by Federal Express.

The Federal Express case has a devastating effect: the weakening of already severely diminished state’s rights. There is no argument that the vitality of the Tenth Amendment has been almost completely encroached by the Supremacy Clause. Therefore the preemption of one of the last bastions of state regulation, intrastate trucking of an air carrier, is a travesty. Especially when the preemption has not been substantiated by express, implied or conflict preemption.

If the court intended that the CPUC’s safety regulations be preempted this too will have a devastating effect on the highway safety in California. The loss of funding from Federal Express and the other similar carriers will be a significant loss of income for the state of California’s safety regulation and enforcement.

Finally, the court left no guidelines by which to delineate state regulation and federal regulation when there is a mixture of exempt and non-exempt activities. After reading the holding it would seem that federal preemption will be required anytime a carrier uses trucks in their operations, but as the dissent illustrated this taken to the extreme would lead to
ridiculous results.\textsuperscript{199} It will be interesting to see how this is resolved in future cases and also to observe how the \textit{Federal Express} decision will have on other motor carriers.

\begin{quote}
\textsuperscript{199} \textit{Federal Express}, 936 F.2d at 1080. Thus, if Federal Express diversifies into the florist or pizza business in San Francisco and uses its fleet of trucks to deliver flowers or pizza in the Bay Area, presumably the selling of flowers or pizza become activities preempted from state regulation whether planes play any part in the delivery or not.
\end{quote}
Navigating in the Zone of Confusion—Reflections on Illegal Air Taxi Operations

Alan Armstrong*

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This article will not attempt to distinguish between legitimate aircraft operations conducted under Part 91 as opposed to illegal air taxi operations, to the extent the reader might expect to obtain some answers about how to circumvent operation of Part 135. As will be apparent from the discussion which follows, this is an area plagued with uncertainty requiring the exercise of utmost caution and independent judgment.

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I. INTRODUCTION

Airmen or aircraft operators who contemplate transporting passengers for compensation or other benefits in an aircraft without an air taxi certificate should be cautioned with respect to the regulatory dangers presented by such a proposed course of action. The area of illegal air taxi operations, in juxtaposition to the legitimate flights of leased aircraft under Part 91 of the Federal Aviation Regulations (FARs), is an area fraught with confusion and uncertainty. Conventional wisdom abounds in the aviation community about the propriety of passengers leasing aircraft and also hiring their own flight crew. Although many aviators, and perhaps some lawyers, believe this to be a legitimate basis for avoiding operation of the requirements of Part 135, the Federal Aviation Administration and its lawyers take a dim view of these practices and employ amorphous concepts appearing in the regulations and case law to the FAA’s maximum advantage.

II. AIR TAXI REGULATORY UNDERPINNINGS

Part 135 of the Federal Aviation Regulations (FARs) governs “[t]he carriage in air commerce of persons or property for compensation or hire as a commercial operator . . .” Further, Part 135 provides that “[n]o person may operate an aircraft under this Part without, or in violation of, an air taxi/commercial operator (ATCO) operating certificate and appro-

4. 14 C.F.R. § 135.1(a) (3). Part 135 applies to the carriage of persons in aircraft with a seating capacity of less than 20 passengers or a maximum payload capacity of less than 6,000 pounds or, with respect to flights “entirely within any state of the United States in aircraft having a maximum seating capacity of 30 seats or less or a maximum payload capacity of 7,500 pounds or less.” Id.
Illegal Air Taxi Operations

appropriate operations specifications issued under this Part." Additionally, persons operating aircraft under Part 135 are obligated to comply with its rules.6

An air taxi operator is required to have a director of operations,7 a chief pilot,8 and a director of maintenance.9 Additionally, pilots flying for Part 135 operators must receive initial and recurrent pilot training,10 must complete pilot proficiency checks,11 and must undergo pilot-in-command line checks.12

To the extent that Part 135 applies to "a commercial operator",13 the FARs define a commercial operator as:

. . . a person who, for compensation or hire, engages in the carriage by aircraft in air commerce of persons or property, other than as an air carrier or foreign air carrier under the authority of Part 375 of this Title. Where it is doubtful that an operation is for "compensation or hire", the test applied is whether the carriage by air is merely incidental to the person's other business or is, in itself, an major enterprise for profit.14

"Operational control" frequently becomes an issue in litigation concerning alleged unauthorized air taxi operations, and this concept means "with respect to a flight, . . . the exercise of authority over initiating, conducting or terminating a flight."15 Finally, to the extent the FAA asserts that one or more flights were conducted in violation of the requirements of Part 135, the Agency may also assert that the airman operated "an aircraft in a careless or reckless manner so as to endanger the life or property of another."16

The FAA has published an Advisory Circular discussing the difference between private carriage as opposed to common carriage of persons or property.17 The ostensible purpose of this Advisory Circular is to inform "interested segments of industry with general guidelines for determining whether current or proposed transportation operations by air con-
 constitute private or common carriage."18 Further, the Advisory Circular states, "Operations that constitute common carriage are required to be conducted under Federal Aviation Regulations Parts 121 or 135. Private carriage may be conducted under FAR Parts 125 or 91, Subpart D."19 Additionally, the Advisory Circular recites that charges can be made in the context of time-sharing provisions of the FARs but notes that lease agreements are subject to truth-in-leasing clause requirements.20

According to the Advisory Circular, "[a] carrier becomes a common carrier when it 'holds itself out' to the public, or to a segment of the public, as willing to furnish transportation within the limits of its facilities to any person who wants it."21 Further, the Advisory Circular recites that the four elements defining a common carrier consist of, "(1) a holding out of a willingness [sic] to (2) transport persons or property (3) from place to place (4) for compensation."22

The holding out may be accomplished by, inter alia, (1) "signs and advertising",23 (2) "through the actions of agents (who) . . . procure passenger traffic from the general public,",24 (3) developing "a reputation to serve all,",25 (4) carrying plane loads of passengers, cargo or mail on a charter basis if it so holds itself out,26 (5) flying charters for only one organization if the organization is open to a significant segment of the public,27 and (6) providing free transportation to the general public incident to promotions by hotels or casinos.28

The Advisory Circular recites that private carriage is "carriage for hire which does not involve 'holding out'."29 The Advisory Circular further recites that private carriage may be present if one provides transportation "for one or several selected customers, generally on a long-term basis,"30 and further recites that "[p]rivate carriage has been found in cases where three contracts have been the sole basis of the operator's

18. Id. at 1.
19. Id.
21. AC 120-12A, supra note 17, at 1.
22. Id.
23. Id.
24. Id. at 2.
25. Id.
26. Id.
27. Id.
28. Id.
29. Id.
30. Id.
business."\textsuperscript{31} Conversely, the Advisory Circular indicates that "[a] carrier operating pursuant to 18 to 24 contracts has been held to be a common carrier because it held itself out to serve the public generally to the extent of its facilities."\textsuperscript{32}

In its continued discussion of the distinction between private and common carriage, the Advisory Circular recites that if an entity is a common carrier in a certain field but contends it engages in private carriage in another field, it "must show that the private carriage is clearly distinguishable from its common carriage business and outside the scope of its holding out."\textsuperscript{33}

Finally, the Advisory Circular recites that "only in rare instances could carriage engaged in by a common carrier be legitimately classified as private."\textsuperscript{34} The Advisory Circular concludes by advising persons to "look cautiously at any proposal of revenue-generated flights which most likely would require certification as an air carrier,"\textsuperscript{35} and invites persons "to discuss their proposed operation with the Regional Counsel of the FAA . . . in which it intends to establish its principal business office."\textsuperscript{36}

III. A REVIEW OF CASES AND OTHER MATERIALS INVOLVING ILLEGAL AIR TAXI OPERATIONS AS OPPOSED TO LEGITIMATE AIRCRAFT LEASING

A. THE NTSB HAS HELD THAT A PILOT CAN BE A COMMERCIAL OPERATOR

Even though Part 135 applies only to "[t]he carriage in air commerce of persons or property for compensation or hire as a commercial operator"\textsuperscript{37} and even though the regulation defining a commercial operator purports to exclude operations unless they are "a major enterprise for profit,"\textsuperscript{38} the National Transportation Safety Board declared that a pilot was a commercial operator in Administrator v. Jones.\textsuperscript{39} In Jones, the airman possessed an airline transport rating and had at one time held an ATCO operating certificate.\textsuperscript{40} However, at the time period pertinent to the case, the airman worked as the airport manager and served as a part-time corporate pilot for two corporations including Wells Sales Company.

\textsuperscript{31} Id.
\textsuperscript{32} Id.
\textsuperscript{33} Id. at 3.
\textsuperscript{34} Id.
\textsuperscript{35} Id.
\textsuperscript{36} Id.
\textsuperscript{38} 14 C.F.R. § 1.1.
\textsuperscript{40} Id.
When Jones was approached by a former customer with reference to providing air transportation, he advised that he no longer held an air taxi certificate. The customer then requested that Jones inquire as to whether or not Wells would permit use of its aircraft in connection with flying several directors of the customer’s company to a meeting. Wells acceded to the pilot’s request on behalf of his former customer, and the pilot consulted with counsel prior to conducting the flights and was advised “that such an operation would not be in contravention of the regulations.”

After completing the two flights, the pilot invoiced the customer, since Wells was not in the air taxi business. The pilot prepared the invoices, delivered them to the customer and received checks in full payment, which he deposited in his account. The pilot then wrote a personal check on his account to Wells representing the difference between the total amount charged and his fee for pilot services.

The Agency sought to suspend the airman’s certificate for 180 days asserting that he had flown an aircraft for compensation or hire when he did not possess an ATCO operating certificate. Following an evidentiary hearing, Judge Davis rejected the airman’s argument that he was not a “commercial operator” and reduced the period of suspension from 180 days to 30 days. The Board affirmed, rejecting the airman’s argument that he was not a commercial operator since these activities were not a “major enterprise for profit,” the Board observing that the pilot “was not only the pilot-in-command, but was also instrumental in making the arrangements for the flights and in billing, collecting and distributing the fees therefor.”

Members McAdams and Haley dissented advancing the better-reasoned argument, which was as follows:

The certification requirement contained in Section 135.9 was intended to apply solely to entrepreneurs who engaged in commercial operations and not to pilots employed by such commercial operators. Otherwise, Section

41. Id.
42. Id. at 1870.
43. Id.
44. Id. at 1871.
45. Id. at 1870.
46. Id.
47. Id.
48. Id. at 1869. The basis for the Administrator’s charge was 14 C.F.R. § 135.9, which is now found at 14 C.F.R. § 135.5. Id.
50. Id. at 1875.
51. Id. at 1870.
52. Id. at 1871.
61.139 FAR, which sets out the privileges and limitations applicable to the holder of a commercial pilot certificate, would be meaningless. While Part 135 does, in some respects, regulate the qualifications and operating practices of pilots of air taxi and commercial flights, it is clear that there was no intent to require each pilot-in-command of such a flight to possess an ATCO certificate.

When the complicated arrangements surrounding these flights are untangled, it can be seen that respondent was merely serving as the pilot-in-command of an aircraft owned by Wells in his capacity as Wells' corporate pilot. In other words, we conclude that respondent did not "operate" these flights within the meaning of Section 135.9.54

Query, would the outcome in Jones have been the same if the customer had leased the aircraft directly from Wells and if the customer had made payments separately to Wells and to the pilot?

In Administrator v. Graves and Davis Air Service,55 the Board, again, declared that it was the pilot's responsibility to possess an ATCO certificate on a rental flight. In Graves, a pilot recently employed by Davis Air Service undertook a round trip flight, but the aircraft crashed, and there were no survivors.56 The pilot had been previously employed by another air taxi operator but had not been qualified under Part 135 before commencing the flight.57 The record indicated that Davis Air Service undertook to contact the customers before the flight when it discovered that a qualified pilot would not be available.58 Because Davis Air Service was unsuccessful in contacting the customers, when they appeared at the airport on the day of the proposed flight, the pilot was told to advise the passengers that they could either reschedule the flight or rent the plane and make their own arrangements with him.59 The pilot spent 5 to 10 minutes before the flight discussing the situation with the passengers, and the air taxi operator collected no payment for the flight in advance, nor was a manifest prepared in accordance with the operations manual required for air taxi flights.60

Based upon this evidence, Judge Faulk found that the flight was a rental operation and dismissed the charges against the air taxi operator arising out of this incident.61 The Board, in affirming Judge Faulk's dismissal of those charges, made the following observation:

The Administrator also raises two legal objections to the law judge's conclusion that this was not an air taxi flight by respondent. First he asserts that the

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54. Id. at 1872.
56. Id.
57. Id. at 3900-3901.
58. Id. at 3901.
59. Id.
60. Id.
61. Id. at 3901, 3908.
flight cannot be considered a rental operation because the passengers were not themselves pilots. However, apart from an opinion to that effect by one of his witnesses, the Administrator has cited no authority for the proposition that a non-pilot cannot rent an aircraft, and we are unaware of any such authority. Secondly, the Administrator argues, citing Administrator v. Sabar, N.T.S.B. Order EA-1528 (Jan. 26, 1981), that even if this was a rental operation, Part 135 would nevertheless apply to it under section 135.1(a)(3) (sic) since the pilot would have been transporting passengers for hire. The Administrator's argument overlooks the fact that if this were a rental operation to which Part 135 applied, the pilot, not respondent, would have had the duty of compliance with the requirements of that Part.62

To the extent the Board affirmed Judge Faulk in Graves, was it on the basis that the 5- or 10-minute conversation between the pilot and the customers when they were alerted to the fact that the aircraft could not be flown on behalf of the pilot's employer thereby rendering the flight "private carriage", the air carrier's "holding out" to the public notwithstanding?

Alternatively, can it be said that the basis for Judge Faulk's decision and the Board's affirmance in Graves relied on the fact that Davis Air Service had no "operational control" over the flight? Also, if this second explanation is considered, one must bear in mind that that aircraft had been maintained and fueled by Davis Air Service before the crash, and one must assume that Davis Air Service would have received compensation for use of the aircraft had it returned from the flight. It is in this light that the issue of operational control must be considered.

Administrator v. Patterson,63 involved an air taxi operator who shared office space with some pilots.64 Eastern Metro Express had, essentially, a rental agreement with Patterson whereby Patterson made an aircraft available on a steady basis for when Eastern Metro Express needed to transport parts or a mechanic.65 After each flight, Patterson and the pilot would invoice Eastern Metro Express separately.66 There was no evidence that the pilots were subject to Patterson's influence in conducting the flights.67 This resulted in a finding by Judge Faulk which reversed the order revoking Patterson's air taxi certificate, since it was determined that Patterson lacked operational control over these flights.68

Examining the record before it, the Board affirmed Judge Faulk and

62. Id. at 3901 n.3 (emphasis added).
63. Administrator v. Patterson, N.T.S.B. Order No. EA-3762 (1993). Mr. Patterson was represented by Gerrald Cunningham, Esq. of Atlanta, Georgia.
64. Id. at 2.
65. Id.
66. Id. at 2-3.
67. Id. at 2.
68. See Administrator v. Patterson, NTSB Docket No. SE-10608, at 13 (Initial Decision by Faulk, Judge).
held: "[w]e agree with the law judge that this evidence simply does not show operational control by the respondent of the Eastern Metro Express flights."\textsuperscript{69}

Although the FAA argued on appeal that the "two check routine" did not eliminate operational control\textsuperscript{70}, the Board nevertheless affirmed observing: "However, neither does the 'two check routine' indicate guilt."\textsuperscript{71} Finally, the FAA argued "that some individuals within Eastern Metro Express believed they were getting air transportation rather than rental."\textsuperscript{72} The Board dismissed this argument observing: "While the Board has considered such a factor in connection with determining whether certain flights were made for compensation or hire, see, e.g., \textit{Administrator v. Southeast Air}, 4 NTSB 517 (1982), we do not think that this type of evidence is particularly relevant to the resolution of control issues."\textsuperscript{73}

The decision in \textit{Patterson} illustrates sound reasoning by Judge Faulk and by the Board. However, it is unsettling that the Administrator even sought to pursue the matter given that the respondent so clearly lacked the requisite control over the pilots.

\textbf{B. THE BOARD HAS HELD THAT PILOTS ARE NOT REQUIRED TO MAKE A PROFIT, THE REGULATIONS ON THIS SUBJECT NOTWITHSTANDING}

Even though Part 135 applies only to a commercial operator,\textsuperscript{74} and even though a "commercial operator" embraces "the carriage by air... (which is) a major enterprise for profit,"\textsuperscript{75} the Board has declared in at least three cases that there is no requirement that the pilot make a profit in order to suffer a violation for alleged operations in violation of Part 135: \textit{Administrator v. Lewis};\textsuperscript{76} \textit{Administrator v. Rountree};\textsuperscript{77} and \textit{Administrator v. Motley}.\textsuperscript{78}

In \textit{Lewis}, a commercial pilot received $80 for two round trip flights indicating he did not believe Part 135 applied "where expense sharing was involved."\textsuperscript{79} Because the airman invested a considerable sum of money in purchasing two aircraft in order to conduct operations legally and obtained the necessary operating certificate following the flights,

\textsuperscript{70} Id. at 3 n.4.
\textsuperscript{71} Id.
\textsuperscript{72} Id. at 3.
\textsuperscript{73} Id. (emphasis added).
\textsuperscript{75} 14 C.F.R. § 1.1 (1992).
\textsuperscript{76} Administrator v. Lewis, 3 N.T.S.B. 400 (1977).
\textsuperscript{77} Administrator v. Rountree, 2 N.T.S.B. 1712 (1975).
\textsuperscript{79} Lewis, 3 N.T.S.B. at 402.
Judge Woodlock imposed no sanction and overruled the FAA's 90-day order of suspension.

Reversing Judge Woodlock and imposing a 30-day suspension of the airman's certificate, the Board declared:

Respondent maintained that the payment for the flights represented the incurred expenses and he apparently believed that profitability was a necessary component of compensation. It is well settled, however, that there can be compensation where the payment covers only cost and no actual profit is derived. . . We therefore conclude that an ATCO operating certificate was a prerequisite to the flight and respondent was in violation of section 135.3(a) and 135.9 of the FAR (sic).80

Rountree is testament to the adage that "no good deed goes unpunished." Buck Owens, a well-known entertainer, was in need of transportation for himself and his party from Bakersfield to Los Angeles, California.81 Two aircraft were employed for this purpose, a Cessna 182, which was on an air taxi certificate and a Cessna 310, which was not.82 An invoice was submitted to Buck Owens Enterprises by Rountree Flying Service for $216, the invoice including the phrase "air taxi".83 Although Rountree claimed that the Cessna 310 was flown "on a cost or below cost basis",84 the Board nevertheless affirmed a 15-day suspension of his certificate for flying without a flight check85 and careless or reckless aircraft operations.86

In affirming Judge Geraghty’s order reducing the 30-day suspension sought by the FAA to 15 days, the Board declared:

Even if we were to accept respondent's claim that the Cessna 310 flight was billed on a cost basis, rather than the regular charter rate, we would, nevertheless, find that said flight was operated for compensation. Without reaching the question of whether the expectation of future economic benefit in itself is a form of compensation, it is well settled that there can be compensation where the payment covers only costs and no actual profit is shown.87

In Motley, the FAA sought to revoke the airman's commercial pilot certificate where (1) on five occasions, he carried human remains for compensation in an aircraft, (2) he carried three passengers for hire from Beaufort to Florence, South Carolina and returned, and (3) he allowed parachute jumping from his aircraft on two occasions without first estab-

80. Id. at 401 (emphasis added).
81. Rountree, 2 N.T.S.B. at 1713.
82. Id.
83. Id.
84. Id.
86. See 14 C.F.R. § 91.13 (1992); 14 C.F.R. § 91.9 (1975); Rountree, 2 N.T.S.B. at 1714.
87. Rountree, 2 N.T.S.B. at 1713-1714 (emphasis added).
lishing contact with the nearest FAA facility. The FAA claimed that the airman had conducted flights for compensation or hire without the requisite ATCO certificate in violation of the then FAR section 135.9. The airman argued that there was "no systematic operation or showing of profit or public 'holding out' of services . . . to support (the) violation." Rejecting the arguments advanced by the airman and affirming a 180-day suspension of his commercial pilot's certificate, the Board declared:

Respondent quoted the $60 price to his passengers and there is no evidence other than his testimony to indicate that it was insufficient to cover the cost of the flight. Further, the Courts have held that no actual profit need be shown to constitute compensation or hire; it is sufficient that the pilot be furthering his economic interests through the operation.

Lewis, Rountree, and Motley all indicate that the Board has ignored pleas of airmen that they are not commercial operators, the definition of this term with respect to "a major enterprise for profit" in the regulations notwithstanding. The Board has declared that the profit element is satisfied in every case where a pilot receives compensation or flies with the expectation of economic gain in situations where passengers and/or property are transported. The FAA's burden of proof with reference to establishing that the pilot was a "commercial operator" has thereby been greatly reduced. More importantly, a valuable defense to the pilot has been eliminated.

C. THE PUBLIC AIRCRAFT ARGUMENT

In Administrator v. Sexauer, officials of the City of Perryville, Missouri, were provided transportation on an ad hoc basis utilizing the pilots and the aircraft that happened to be available at that particular time. In response to an action by the Agency to revoke the airman's commercial pilot certificate, he argued that the operations related to public aircraft which were exempt from the requirements of Part 135. Citing United States v. Aerospace Lines, Inc., the Board observed that in that case, the aircraft "was used exclusively by the governmental agency for an ex-
tended period (10 months) under a contract which provided that the plane (modified for governmental use) and the crew were under the government's control.98

Accordingly, the Board rejected the argument that the flights concerned public aircraft, finding that the airman had violated pertinent provisions of Part 135 and affirming a revocation of his commercial pilot certificate.99

D. EXPENSE SHARING AS A DEFENSE

The NTSB has decided several cases concerning the "sharing of expenses" by a private pilot with his passenger[s] allowed by the Federal Aviation Regulations.100

In Administrator v. Sabar,101 Dr. Fairbairn, after being quoted a fee of $1,000 by various charter outfits to transport his family, spoke with his friend Dr. Renner, who suggested that a call be made to the airman.102 When Dr. Fairbairn contacted the airman, there was discussion about a cost of $12 per hour for a pilot.103 However, a charge of $680 was finally negotiated with the doctor's check being payable to Associates Flying Club for the purpose as indicated on the check of a charter flight from Denver, Colorado to Dubois, Wyoming and return.104 The airman flew the doctor and his family to Dubois, and another pilot who received no compensation and was ignorant of the financial arrangements, transported the doctor and his family to Denver on the return trip.105 Although the airman who flew the doctor and his family to Dubois claimed it was his intention that the flight be one where the expenses would be shared and/or where he would charge the doctor $12 per hour for flight instruction,106 Judge Geraghty found that the airman "did hold himself out to be operating as a charter pilot for purposes of taking Dr. Fairbairn and his family to Dubois and returning them from Dubois to Denver.107 Further, the Judge found that there was no indication as to what respondent Sabar's share of the

98. Sexauer, 5 N.T.S.B. at 2457.
99. Id.
100. See 14 C.F.R. § 61.118(b)(1992); see also cases cited infra notes 111-115.
102. Id. at 3123.
103. Id. at 3124.
104. Id.
105. Id. at 3124, 3127; see also Administrator v. Conahan, N.T.S.B. Order No. EA-4044 (Dec. 14, 1993), at 17 (board affirming an initial decision exonerating a pilot charged with violating Part 135); Administrator v. Fulop, N.T.S.B. No. EA-2730 (1988) (where the pilot was told by his employer that the cargo was owned by the employer company, and the flights were governed by Part 91, not Part 135). Mr. Conahan was represented by Mark T. McDermott, Esq. and Peter J. Wiernicki, Esq. of Washington, D.C.
106. Sabar, 3 NTSB at 3126.
107. Id. at 3129.
expenses was to be. The entire cost of the trip was born by Dr. Fairbairn.\footnote{Id.} 108

Finding that Mr. Sabar was in violation of Part 135, Judge Geraghty nevertheless reduced the period of suspension from 180 days to 120 days,\footnote{Id. at 3132.} but the Board reduced the period of suspension to 30 days observing, ""It would ignore the reality of this transaction to assume that this respondent did anything to undermine the general public’s or Dr. Fairbairn’s reliance on the high degree of care and judgment to be expected of commercial operators, as the Administrator appears to suggest through, among other things, urging such a severe sanction.""\footnote{Id. at 3121.}

The Sabar case demonstrates that contentions of shared expenses and flight instruction must be \textit{bona fide}. More interestingly, the case is significant to the extent the Board directed a substantial reduction in sanction to the extent the record demonstrated that Dr. Fairbairn appreciated he was not purchasing the services of an air taxi operator.

In \textit{Administrator v. Carter},\footnote{Administrator v. Carter, N.T.S.B. Order No. EA-3730 (Nov. 6, 1992). Mr. Carter was represented by Mr. J. Scott Hamilton, Esq. of Louisville, CO.} the respondent, upon the request of an acquaintance, transported the acquaintance’s sick father from Imperial, Nebraska, to Lincoln, Nebraska for admission to a hospital for a medical emergency. The NTSB concluded that even though the respondent had never ""held himself out as available to perform such a flight for compensation or otherwise,"" it was clear that the respondent and his friend’s sick father had no common purpose in flying to Lincoln . . . and that his transporting of that individual . . . was not incidental to a previously planned, though unscheduled, trip to enable respondent to have his aircraft radio checked out. Finally, respondent’s essentially admitted subsequent efforts to recover, as had apparently been promised to him, the \textit{full} cost of the trip precludes any conclusion that the flight falls within the only regulatory exception of the prohibition against a private pilot’s acceptance of payment for a flight; namely, where the expenses of a trip are \textit{shared} with passengers. See \textit{61.118 (b)}.\footnote{id. at 6-7.}

The Board, citing Sabar and \textit{Administrator v. Jones},\footnote{Administrator v. Jones, 2 N.T.S.B. 1869 (1975).} recognized that the respondent was forced with making a difficult choice in accommodating the desires of a friend when it reduced the respondent’s suspension from 180 to 30 days.\footnote{Carter, N.T.S.B. Order No. EA-3730 at 7-8.} It however stressed the importance of ""compliance with regulations despite the difficult choices that strict adher-
ence to them may occasionally entail."

E. PRIVATE CARRIAGE VERSUS PUBLIC CARRIAGE IN THE CONTEXT OF TIME SHARING AND INTERCHANGE AGREEMENTS

Subpart F (formerly Subpart D) of the FARs permits the operation of large and turbine-powered multi-engine airplanes under Part 91 as opposed to Parts 121, 125, 129, 135 and 137. Although such aircraft may be operated under Part 91, the authorization to engage in such operations is only valid "when common carriage is not involved." Subject to that important qualification, Subpart F permits, inter alia, demonstration flights, and "[t]he carriage of company officials, employees and guests of the company on an airplane operated under a time-sharing, interchange or joint ownership agreement as defined in paragraph (c) of (Section 91.501)."

A time-sharing agreement defined by Subpart F means "an arrangement whereby a person leases his airplane with flight crew to another person, and no charge is made for the flights conducted under that arrangement other than those specified in paragraph (d) of (Section 91.501)."

An interchange agreement means "an arrangement whereby a person leases his airplane to another person in exchange for equal time, when needed, on the other person's airplane, and no charge, assessment or fee is made, except that a charge may be made not to exceed the difference between the cost of owning, operating and maintaining the two airplanes."

With respect to, inter alia, demonstration flights and time-sharing flights, the following may be charged as expenses for a specific flight:

(1) Fuel, oil, lubricants and other additives.
(2) Travel expenses of the crew, including food, lodging and ground transportation.
(3) Hangar and tie-down costs away from the aircraft's base of operation.
(4) Insurance obtained for the specific flight.
(5) Landing fees, airport taxes and similar assessments.
(6) Customers, foreign permit and similar fees directly related to the flight.
(7) Inflight food and beverages.
(8) Passenger ground transportation.
(9) Flight planning and weather contract services.

115. Id.
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(10) An additional charge equal to 100% of the expenses listed in para-

graph (d)(1) of this section [sic].122

F. TRUTH-IN-LEASING REQUIREMENTS AS RELATED TO LARGE AIRCRAFT

Section 91.23 of the FARs123 imposes certain obligations on "the parties to a lease or contract of conditional sale involving U.S.-registered large aircraft entered into after January 2, 1973."124 With respect to such aircraft, it is mandatory that a written lease or contract be executed and that it include "a written truth-in-leasing clause as a concluding paragraph in large print, immediately preceding the space for the signature of the parties."125 The truth-in-leasing clause must contain the following information:

(1) Identification of the Federal Aviation Regulations under which the aircraft has been maintained and inspected during the 12 months preceding the execution of the lease or contract of conditional sale, and certification by the parties thereto regarding the aircraft's status of compliance with applicable maintenance and inspection requirements in this part for the operation to be conducted under the lease or contract of conditional sale.

(2) The name and address (printed or typed) and the signature of the person responsible for operational control of the aircraft under the lease or contract of conditional sale and certification that each person understands that person's responsibilities for compliance with applicable Federal Aviation Regulations.

(3) A statement that an explanation of factors bearing on operation control and pertinent Federal Aviation Regulations can be obtained from the nearest FAA Flight Standards district office [sic].126

Certain leases or contracts of conditional sale are exempt from truth-in-leasing requirements, i.e., (1) if the party to whom the aircraft is furnished is a foreign air carrier or certificate holder under Part 121, 125, 127, 135 or 141; (2) if the party furnishing the aircraft is a foreign air carrier, certificate holder under Part 121, 125, 127 or 141 or is a Part 135 certificate holder having authority to engage in air taxi operations with large aircraft; and (3) if it involves a contract of conditional sale 'when the aircraft involved has not been registered anywhere prior to the execution of the contract, except as a new aircraft under a dealer's aircraft registration certificate issued in accordance with § 47.61 of (the FARs)."127

122. 14 C.F.R. § 91.501(d)(1)-(10) (1992). The punctuation is that found in the original text of the regulation.
125. Id.
126. 14 C.F.R. § 91.23(a)(1)-(3) (1992) (emphasis added). The punctuation is that found in the original text of the regulation.
The truth-in-leasing requirements which pertain to large civil aircraft of the United States Registry prohibit operation of the aircraft subject to a lease or contract of conditional sale unless the following conditions are satisfied:

(1) The lessee or conditional buyer, or the registered owner if the lessee is not a citizen of the United States, has mailed a copy of the lease or contract that complies with the requirements of paragraph (a) of this section within 24 hours of its execution, to the Aircraft Registration Branch, Attn: Technical Section, P.O. Box 25724, Oklahoma City, Oklahoma 73125;

(2) A copy of the lease or contract that complies with the requirements of paragraph (a) of this section is carried into the aircraft. The copy of the lease or contract shall be made available for review upon request by the Administrator, [sic] and;

(3) The lessee or conditional buyer, of the registered owner if the lessee is not a citizen of the United States, has notified by telephone or in person, the FAA Flight Standards District Office, nearest the airport where the flight will originate. Unless otherwise authorized by that office, the notification shall be given at least 48 hours before takeoff in the case of the first flight of that aircraft under that lease or contract and inform the FAA [sic]
(i) The location of the airport of departure;
(ii) The departure time; and
(iii) The registration number of the aircraft involved. 128

Further, the truth-in-leasing provisions of the FARs indicate that the commercial or financial information contained in the lease or contract is privileged by reason of which it "will not be made available by the FAA for public inspection or copying under 5 U.S.C. 552(b)(4) [sic] unless recorded with the FAA under Part 49 of (the FARs)." 129

Finally, under the truth-in-leasing provisions of the FARs, a lease is defined as "any agreement by a person to furnish an aircraft to another person for compensation or hire, whether with or without flight crew members, other than an agreement for the sale of an aircraft and a contract of conditional sale under section [sic] 101 of the Federal Aviation Act of 1958. The person furnishing the aircraft is referred to as the lessor, and the person to whom it is furnished the lessee." 130

G. LITERATURE PROMULGATED BY THE FAA WHICH IMPACTS ON TRUTH-IN-LEASING REQUIREMENTS

The FAA has promulgated an Advisory Circular 131 and an Order 132 which relate to the obligations of the aircraft operator and the Agency in

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128. 14 C.F.R. § 91.23(c)(1)-(3), (i), (ii), (iii) (1992).
129. 14 C.F.R. § 91.23(d) (1992).
130. 14 C.F.R. § 91.23(e) (1992).
132. FAA Order No. 8720.1A (Sept. 25, 1979) [hereinafter Order 8720.1A].
the context of large civil aircraft operated under Part 91. AC 91-37A recites that "[t]here have been instances wherein users of charter aircraft became the victims of certain operators." Further, it recites that "[i]n many instances lessees and conditional buyers of aircraft did not realize that they were legally responsible for operational control of the aircraft as defined in Part 1 of the . . . FARs." Further, it recites that, "[t]his evasion of compliance made it appear that the lessees and conditional buyers were responsible for operational control, when in fact they did not have that responsibility." The Advisory Circular alludes to charter flights, air taxi and commercial operators, and to FAA proficiency standards which relate to scheduled air carriers, and observes that "there are . . . dozens of other companies or individuals who have no operator's certificate but who are willing, for the sake of profit, to violate the law by evading safety requirements. Before you sign for a charter, ask to see the air carrier, commercial operator or air taxi operating certificate issued by the FAA." After making reference to definitions of a lease, a conditional sale, a conveyance, a large aircraft [sic] in excess of 12,500 pounds maximum certificated takeoff weight, what it means to operate an aircraft, and the concept of "operational control", the Advisory Circular distinguishes between a "wet lease" and a "dry lease." The Advisory Circular describes "wet leases" as being leases in which the lessor provides both the aircraft and the crew while leasing an aircraft without the crew is considered to be a "dry lease." The author of the Advisory Circular is J. A. Ferrarese, Acting Director, Flight Standards Service. In the Advisory Circular, Mr. Ferrarese concedes that dry leasing versus wet leasing is not a clear dichotomy, since he wrote as follows: 

Normally, in the case of a "dry lease", the lessee exercises operational control of the aircraft. Conversely, in a "wet lease", the lessor normally exer-

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133. AC 91-37A, supra note 131, at para. 3.
134. Id. at para. 3(a).
135. Id. at para. 3(b) (emphasis added).
136. Id. at para. 3(c).
137. Id. at para. 3(d).
138. Id. at para. 3(e).
139. Id. at para. 3(f).
140. Id. at para. 4(a).
141. Id. at para. 4(b).
142. Id. at para. 4(c).
143. Id. at para. 4(d).
144. Id. at para. 4(e).
145. Id. at para. 4(f).
146. Id. at para. 5.
147. Id.
148. See id. at 7, which is signed "J. A. Ferrarese, Acting Director, Flight Standard Service."
cises operational control. The determination of each situation as to whether the lessor or lessee exercises operational control requires consideration of all relevant factors present in each situation. The terms of the lease itself are important but since they may not reflect the true situation, the actual arrangements and responsibilities should be given very careful consideration.

There may be situations during which the lessor provides both the aircraft and the flight crew (pilots, flight engineers and flight navigators) but the lessee provides the cabin crew (flight attendants). In this case the lease would be considered a "wet lease." On the other hand, when the lessor provides the aircraft and the lessee provides the flight crew and the cabin crew, it would be considered a "dry lease."  

The Advisory Circular signed by Mr. Farrarese indicates that "WHEN YOU 'DRY LEASE' AN AIRCRAFT FOR YOUR USE, YOU NORMAL ES THE AIRCRAFT OPERATOR. Conversely, when you 'wet lease' an aircraft, the lessor is normally the aircraft operator." Further, Mr. Farrarese wrote:

> When dry leasing, you do not need an FAA-issued operator's certificate as long as you do not carry persons or property for compensation or hire . . . .

Wet leasing aircraft is a common and approved practice, carried out by hundreds of legitimate organizations. Unfortunately, there are some irresponsible companies which may use various ways to confuse the issue concerning who is the actual aircraft operator. For example, the sham "dry lease" has been used, whereby you are provided with an aircraft on a lease basis, although it is actually serviced and flown by the leasing company. Such an arrangement (depending upon the terms of the lease) may make you the operator of the aircraft, although you do not intend this and have in fact assumed no operational responsibilities. Some groups seeking charter services may knowingly enter into an evasively worded arrangement, if the price is made attractively low. If you are tempted to do so, consider that if you accept what amounts to charter service from a company that is not certificated to operate charters, you may forego the protection of certain safety standards required by the FAA. You may also violate the law.  

Although the author of the Advisory Circular opines that "[p]ersonnel from an FAA general aviation district office, air carrier district office of flight standards district office will gladly explain the factors bearing on responsibility for operational control and the pertinent FARs," the discussion on operational control is further confused to the extent the Advisory Circular recites that "operational control may in fact remain with the lessor even though the lease is characterized as a 'dry lease' and expressly states that items such as flight following, dispatch, communica-

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149. Id. at par. 5(a)(b).
150. Id. at par. 6.
151. Id. at par. 6(a), (b), (c) (emphasis added.)
152. Id. at par. 8.
tions, weather and fueling are to be performed by the lessee.”

The Advisory Circular indicates that "[w]here a lease agreement is not clear in regard to operational control of the aircraft, the FAA may ask the parties to amend the lease to properly reflect the party having operational control.” Additionally, the Advisory Circular states the following:

Insofar as our safety regulations are concerned, the FAA has taken the position that if a person leases an aircraft to another and also provides the flight crew, fuel and maintenance, the lessor of the aircraft is the operator. If the lessee makes a charge for the aircraft and services, other than as provided in Subpart D to Part 91, the operation of the aircraft, is subject to FAR Parts 121, 123, 127, 129 or 135 depending on the type or size of the aircraft.

The Advisory Circular discusses the necessity of sending a copy of the lease or conditional sale contract to the FAA in accordance with truth-in-leasing requirements, but indicates that "[f]iling a lease or contract of conditional sale under FAR section 91.54 to satisfy 'truth-in-leasing' requirements does not constitute filing under FAR Part 47 or Part 49 to register the aircraft, or to record public notice,” since the document must also be recorded with “the FAA Aircraft Registry, P.O. Box 25504, Oklahoma City, Oklahoma 73125.”

The Advisory Circular reiterates the obligation to give notice to an appropriate FAA office at least 48 hours prior to the first flight of an aircraft subject to truth-in-leasing requirements and contains a sample truth-in-leasing clause.

Order 8720.1A is signed by Kenneth S. Hunt, the Director of Flight Operations, Federal Aviation Administration, and concerns truth-in-leasing notification. The Order indicates that no purpose may be served by a ramp inspection if the owner is known “to have a good compliance and safety record.” However, in the context of whether or not a ramp inspection is indicated, “[i]t may be appropriate to give greater consideration to an aircraft involved in passenger-carrying operations than one limited to cargo only.” If an aircraft has been maintained under Part 121 or Part 135, “there may be little need for an airworthiness inspec-

153. Id. at par. 8(a).
154. Id. at para. 8(b) (emphasis added).
155. This is now Subpart F to Part 91, i.e., 14 C.F.R. § 91.501 (1992).
156. AC 91-37A, supra note 131, at para. 8(c).
157. Id. at para. 9(a).
158. With the revision of Part 91, this regulation is found at 14 C.F.R. § 91.23 (1992).
159. Id. at para. 9(b) (emphasis added.)
160. Id.
161. Id. at para. 10; para. 10(a), (b).
162. Id. at para. 11.
163. Order 8720.1A, supra note 132.
164. Id. at para. 7(a).
165. Id. at para. 7(c).
tion."166 Conversely, if the aircraft "has been operated as a public aircraft immediately preceding the current lease agreement, consideration should be given to an inspection to determine if the airworthiness certificate is still valid."167

Agency employees who conduct the inspection may employ a Ramp/Base Inspection Report or an Inspection and Surveillance Record.168 According to the Order, a request for an aircraft logbook endorsement or a signed statement that truth-in-leasing provisions have been complied with "MUST BE DENIED."169 The Order signed by Mr. Hunt concludes with this language:

The findings of the inspection will dictate what, if any, follow up action is called for. If obvious violations are noted, appropriate enforcement actions should be taken. If there is reason to suspect or anticipate non-compliance with appropriate FARs, it may be necessary to request assistance from another office. This could include meeting the aircraft at its destination or verifying the maintenance program from the office having jurisdiction over the maintenance facility.170

H. THE BOWEN CASE UPHOLDING TIME-SHARING UNDER PART 91

In Administrator v. Bowen,171 the FAA brought an emergency action to revoke Captain Bowen's airline transport certificate asserting that he operated 67 "passenger-carrying flights for compensation or hire."172 It was asserted that Captain Bowen "endangered the lives and property of others"173 and that he "failed to adhere to the standards of character required of an airline transport pilot . . . ."174 Further, the Agency asserted violations of, inter alia, sections 91.13(a), 135.3(a) and 135.5 of the FARs.175

The record demonstrated that Captain Bowen met a local businessman who was interested in buying a corporate aircraft.176 Captain Bowen assisted the businessman and subsequently created Dominion Bizjets, Inc. ("Dominion") for the purpose of brokering the purchase of aircraft

166. Id. at para. 7(d).

167. Id.

168. Id. at para. 8(a); see also FAA Forms 8430-15 and 3112.

169. Id. at para. 8(b).

170. Id. at para. 9.


172. Id. at 2.

173. Id. at 3.

174. Id.

175. Id. at 4.

176. Id. at 6.
and also to facilitate managing, maintaining and flying those aircraft.\textsuperscript{177} In the furtherance of Dominion's business, Captain Bowen opened an office, hired a secretary/bookkeeper, as well as several pilots.\textsuperscript{178}

As Captain Bowen's reputation concerning the purchase, maintenance and operation of Lear jets grew, other businessmen sought his expertise.\textsuperscript{179} In light of the expense of operating sophisticated aircraft, some of Captain Bowen's "clients wanted to find ways to defray some of their operating and maintenance costs."\textsuperscript{180} Captain Bowen sought and followed the advice of counsel experienced in aviation matters and "negotiated various agreements for and between his clients, whereby they could recoup some of their expenses."\textsuperscript{181}

Captain Bowen negotiated a lease with option to purchase agreement whereby one client could use another client's aircraft over a 6-month period to evaluate the feasibility of purchasing the aircraft.\textsuperscript{182} Other clients made oral contracts whereby they could use each other's aircraft.\textsuperscript{183} Because one client wanted to make his aircraft available to the public for compensation or hire, Bowen applied for a Part 135 operating certificate.\textsuperscript{184} Subsequently, Captain Bowen inserted a clause in management contracts with his clients to the effect "that he would charter their aircraft in accordance with his Part 135 operating certificate."\textsuperscript{185} A pilot formerly employed by Dominion contacted the FAA and alleged that Captain Bowen was running a charter operation without a Part 135 operating certificate.\textsuperscript{186}

The charges made by Dominion's former employee resulted in the issuance of an emergency order of revocation concerning Captain Bowen's airman's certificate.\textsuperscript{187} In addition, three days before issuing the emergency order of revocation, the Agency issued an order of civil penalty directed to Dominion.\textsuperscript{188}

Judge Coffman overruled the order of revocation finding that the four flights where Captain Bowen served as pilot-in-command "were Part 91 operations."\textsuperscript{189} Further, with reference to the 63 flights which could be

\begin{itemize}
\item 177. Id.
\item 178. Id.
\item 179. Id.
\item 180. Id.
\item 181. Id. at 7.
\item 182. Id.
\item 183. Id.
\item 184. Id.
\item 185. Id.
\item 186. Id. at 8.
\item 187. Id.
\item 188. See id.; Initial Decision of Judge Jimmy N. Coffman, June 5, 1991, appended to the Board's Opinion and Order at 633 [hereinafter Initial Decision].
\item 189. Initial Decision, supra note 188, at 638.
\end{itemize}
attributed to Dominion, Judge Coffman opined that "it is this Court's opinion that the 63 flights operated by Dominion Bizjets, Inc. were legitimate Part 91 operations."\textsuperscript{190}

In making his findings, Judge Coffman observed that the discretion of a trial judge should be given heavy weight in the context of "credibility decisions,"\textsuperscript{191} since the Court sat through three days and nights of trial, heard from 14 or 15 witnesses, and considered some 95 exhibits.\textsuperscript{192} With reference to a letter written by Craig Weller, Esq., a former FAA attorney who testified on behalf of Captain Bowen, Judge Coffman made the following observation:

Perhaps the FAA at headquarters level — I understand this would not be a Region function, but someone at the headquarters level should take Mr. Weller's letter and analyze it and perhaps go into such things in the regulations that I don't think are covered with enough specificity in 91.501. There are obvious items that aren't specifically addressed, such as pilots and pilot services. There's not enough definition as to swap time. There's not anything that I've seen that addresses management companies, aviation management companies. So this is a grey area.\textsuperscript{193}

Judge Coffman found that based upon the testimony of the FAA's own expert witness, even if the flights were in violation of Part 135, Captain Bowen could be held liable for only four of those flights as the pilot-in-command, since Dominion would have been responsible for all 67 flights as an alleged operator.\textsuperscript{194} In addition to adopting Mr. Weller's opinion that "Dominion Bizjets business is perfectly consistent with the requirements of Part 91",\textsuperscript{195} Judge Coffman was persuaded that the status of the passengers on the four flights flown by Captain Bowen were persons authorized to be in the aircraft under section 91.501 of the FARs.\textsuperscript{196} Additionally, with reference to a demonstration flight, the perspective purchaser did sign an aircraft demonstration agreement.\textsuperscript{197}

The Board affirmed Judge Coffman's initial decision overruling the Order of Revocation observing that the testimony of a former FAA regulatory attorney (Mr. Weller) demonstrated that the payments were "the permissible charges an owner can earn from the use of his aircraft by others (and) are limited so that an owner could never earn enough compensation to be tempted to hold his aircraft out for charter to the public."\textsuperscript{198} To

\textsuperscript{190} Id. at 638-639.
\textsuperscript{191} Id. at 631.
\textsuperscript{192} Id. at 629-631.
\textsuperscript{193} Id. at 634 (emphasis added).
\textsuperscript{194} Id. at 635.
\textsuperscript{195} Id. at 634.
\textsuperscript{196} Id. at 637.
\textsuperscript{197} Id. at 638.
the extent that the Agency asserted that payment for the flight crew was improper, the Board observed that when former FAR section 91.181 was originally promulgated, it allowed for payment of the salary of the flight crew.\textsuperscript{199} When the FAA modified this provision in 1973, it inserted sub-section (d), together with 10 subparagraphs, the tenth paragraph authorizing an additional charge equal to 100\% of the charges for fuel, oil, lubricants and other additives.\textsuperscript{200} The Board observed that "where there is a conflict between the interpretation the FAA advances in a given case in the FAA's articulation of its policy during the genesis of the rule, we will defer to the more authoritative rule making interpretation."\textsuperscript{201} Accordingly, the Board reasoned that "the Administrator recognized that expenses including flight crew salaries would be permissible charges provided the expenses did not exceed the 100\% formula."\textsuperscript{202}

Finally, with reference to evidentiary matters, the Board reasoned that the Agency had made a \textit{prima facie} case of a charter operation by introducing the list of flights.\textsuperscript{203} However, once Captain Bowen rebutted the allegation that he was running a charter operation, it was incumbent upon the FAA "to introduce specific evidence which established that these flights were made with passengers whose status took the operation outside of one of the regulatory exceptions, and/or that they were charged amounts that were not permitted by section 91.501."\textsuperscript{204}

Because the Agency failed to meet its burden, the Board concluded that the Judge properly dismissed all of the allegations as to Part 135.\textsuperscript{205}

The Bowen case highlights the ambiguity and uncertainty associated with time-sharing agreements and indicates that the Agency construes deficiencies in its regulations to the detriment of those who pursue literal compliance. Especially troublesome is the notion that after recognizing payment of the flight crew was authorized in the initial promulgation of the time-sharing regulation, the Agency took a "position" in litigation which was contrary to articulated policy appearing in the Federal Register.\textsuperscript{206}

\textsuperscript{199} Id. at 11-12; see generally 37 Fed. Reg. 14763 (July 25, 1972) (now codified at 14 C.F.R. § 91.181 (1992)).
\textsuperscript{200} Bowen, N.T.S.B. Order No. EA-3351 at 12.
\textsuperscript{201} Id. at 11.
\textsuperscript{202} Id. at 12.
\textsuperscript{203} Id. at 15.
\textsuperscript{204} Id.
\textsuperscript{205} Id.
\textsuperscript{206} See, e.g., 37 Fed. Reg. 14763 (July 25, 1972) (the initial promulgation of 14 C.F.R. § 91.181, together with 38 Fed. Reg. 19024 (July 17, 1973), deleting references to payment of the flight crew but adding subparagraph (d)(10) permitting an additional charge not to exceed 100\% of the charges for fuel, oil, lubricants and other additives).
I. THE PART 91 PROTECTION AFFORDED BY TIME-SHARING IS LOST IF THERE IS A HOLDING OUT TO THE PUBLIC TO PROVIDE COMMON CARRIAGE

In Administrator v. Woolsey,207 the airman appealed an emergency order revoking his commercial pilot certificate where the Agency asserted he had violated, *inter alia*, section 91.13(a) of the FARs by serving as pilot-in-command on 53 flights for compensation or hire without the training and examination requirements of Part 135.208 The airman's defense was that the aircraft was operated under Part 91, specifically FAR section 91.501.

The record demonstrated that Prestige Touring, Inc. ("Prestige") was a Part 125 operator that had carved out a niche in the air transport business by carrying rock-n-roll groups.209 In 1989, Mr. Woolsey tried to capture the market of country and western entertainers who largely traveled by bus.210 Mr. Woolsey mailed and faxed brochures of Prestige to those stars soliciting their business.211 Narvell Blackstock, the husband of Reba McEntyre, testified by deposition that he was very impressed with Prestige's materials,212 and McEntyre contracted with Prestige to finish up her 1989 tour.213 Subsequently, she contracted with Prestige for her air transportation for the 1990 and 1991 tours as well.214

As part of its evidence, the FAA produced (1) press kits which Prestige sent to more than 1 potential client, (2) an advertisement which Prestige placed in a music industry magazine, (3) a promotional article carried in a music industry magazine, and (4) a yellow pages listing for the company under the caption, "Aircraft Charter".215

In furtherance of his argument that the aircraft was operated under a time-sharing agreement, Mr. Woolsey asserted that the name "Shelby's Express" was placed under the pilot's window "because she apparently used the aircraft after each performance to get home to her son, Shelby."216 Additionally, Ms. McEntyre's personal belongings remained

207. Administrator v. Woolsey, N.T.S.B. order No. EA-3391 (Sept. 9, 1991). Mr. Woolsey was represented by J. Scott Hamilton, Esq. of Broomfield, Colorado, and the FAA was represented by Tim Duff, Esq. of the Regional Counsel's Office for the Southwest Region. Deputy Chief Judge Jimmy N. Coffman of the N.T.S.B. conducted the trial in Woolsey following the trial in Bowen.
208. *Id.* at 1-2.
209. *Id.* at 4.
210. *Id.*
211. *Id.*
212. *Id.*
213. *Id.*
214. *Id.*
215. *Id.* at 5.
216. *Id.* at 5.
on the aircraft throughout the term of the lease. Further, the aircraft’s registration number was N49RJ, and Mr. Woolsey testified that air traffic controllers referred to the aircraft as "49 Reba Jet." Mr. Woolsey further indicated that the aircraft was based near Ms. McEntyre’s home during the term of the lease and he housed his pilots in a corporate apartment nearby so the aircraft would be available for her use at all times. Finally, Woolsey asserted that the charges of Prestige for leasing the aircraft "were only those allowable under FAR section 91.501."

Notwithstanding these assertions, Judge Coffman affirmed the order of revocation because the respondent "failed to meet the threshold requirement of not being 'common carriage'."

Citing AC 120-12A, the Board observed that the four elements of holding out to engage in common carriage were satisfied by the record in Woolsey. Further, the Board observed:

As the law judge found in the instant case, there was a "direct, open, obvious solicitation of business for an on-demand air charter", i.e., a holding out. Because of this holding out, Prestige’s operations were "common carriage."

Further, the Board observed that the holding out found in Woolsey "clearly distinguishes the facts in (Woolsey) from those found in Administrator v. Bowen . . . ." The logic of Judge Coffman and the Board in Woolsey appears to be correct to the extent that FAR section 91.501 permits operation of "turbojet powered multi-engine civil airplanes of U.S. registry . . . when common carriage is not involved."

J. THE "HOLDING OUT" ARGUMENT HAS LIMITS

With reference to Part 125 operators, FAR section 125.11(b) provides as follows:

No certificate holder may conduct any operation which results directly or indirectly from any person’s holding out to the public to furnish transportation.

In Go Leasing, Inc. v. NTSB, the Ninth Circuit Court of Appeals declared that "the term ‘holding out’ is not so vague as to render the
regulation (FAR § 125.11) unconstitutional." Although the Ninth Circuit has declared this provision does not violate the Fifth or Fourteenth Amendments, it does have limits. In Administrator v. C&M Airways, Inc., Armadillo and Century Airlines ("Century") were located in Detroit, Michigan, Armadillo being a Part 125 cargo operation which transported automotive cargo for the big three auto makers, i.e., General Motors, Ford and Chrysler, while Century was a Part 121 certificate holder that also specialized in the transportation of automotive cargo. However, Century carried a listing in the Detroit, Michigan yellow pages under the index heading, "Air Cargo & Package Express Service."

Based upon Century's listing in the yellow pages, the Agency brought an action to revoke Armadillo's Part 125 certificate asserting a violation of FAR section 125.11(b) on the theory that Armadillo's operations were tainted, i.e., it "must itself be deemed to have resulted, at least indirectly, from Century's holding out." Seeking to distinguish precedent decided by the Civil Aeronautics Board ("CAB") in the form of Automotive Cargo Investigation, the Agency argued that Century did not have written contracts with auto makers thereby allegedly distinguishing Automotive Cargo. However, the Board observed that in Automotive Cargo, each carrier had only one contract with the three auto makers and relied on unwritten agreements with respect to the other two manufacturers. Further, the Board observed that in Automotive Cargo, "virtually all requests for transportation of non-automotive cargo were declined."

Having concluded that the Agency failed to establish that Century had been engaging in common, rather than private carriage, the Board reversed the initial decision of Chief Judge Fowler in favor of the Agency and observed:

... [W]e find ourselves unable to dispel the impression that this prosecution reflects a belief by the Administrator not so much that respondent's conduct was not permitted by precedent as that the underpinnings of the precedent itself may require re-examination. It seems to us that an enforcement proceeding is not the appropriate forum for the resolution of the purely economic issues a re-examination of the CAB's decision would entail.

After Armadillo secured a reversal of Judge Fowler's initial deci-
Illegal Air Taxi Operations

K. WHO HAS OPERATIONAL CONTROL?

According to the FARs, "operational control" means, with respect to a flight, "the exercise of authority over initiating, conducting or terminating a flight."241 However, this limited or specific definition of operational control appears to have been ignored by the FAA and the Board. In Administrator v. Gilbertson and Martin,242 the Agency asserted false entries were made in flight log sheets to make it appear that airmen were current for purposes of Part 121 operations when they were not.243 The operations concerned a Douglas DC-6 aircraft, and with respect to a flight of August 1, 1978, Mr. Gilbertson admitted he was not current for purposes of Part 121 on the date of the flight. However, Gilbertson argued that the aircraft had been operated under Part 91 since Pacific Alaska Airlines ("PAIX") had entered into a 6-month lease of the aircraft with Whitney Fidalgo for the purpose of carrying Fidalgo's property.

The lease recited: "Lessee is responsible for the operational control of the aircraft under this lease and lessee certifies that it understands its responsibilities for compliance with the applicable Federal Aviation Regulations."244

Affirming a revocation of Gilbertson's airline transport certificate, the Board stated:

Notwithstanding the terms of the lease agreement quoted above, it is apparent that PAIX, and not Whitney Fidalgo, was the real operator of the flights. The Board has heretofore held that a lease such as that involved herein does not shift the role of operator to the lessee where the lessor supplied both the aircraft and the flight crew. The FAA has taken the official position as pub-

236. Id. at 10.
239. Id.
240. Id. at 15.
243. Id. at 1683-1686.
244. Id. at 1688.
lished in an Advisory Circular, that where a lease provides that an aircraft, flight crew, fuel and maintenance are furnished, the lessor is the operator. . . . Inasmuch as PAIX was the operator of the flights under the lease, and was paid at the rate of $4.30 per mile, the flights clearly came within the purview of Part 121.

. . . PAIX continued to own the aircraft, which remained on PAIX's operating specifications, and supplied the flight crews, operating expenses (such as fuel), and maintenance during the period of the lease. The only element of control exercised by Whitney Fidalgo was to direct where and when the flights were to be made and what property and personnel were to be carried. All operational and maintenance decisions remained with PAIX, which in our view, constitutes the type of "control" within the intendment of section 121.155. Even if it is assumed arguendo that Whitney Fidalgo was given "exclusive use" of the aircraft, this would not remove the flights from Part 121 since PAIX would still be operating the plane for compensation. It would only mean that PAIX was also in violation of section 121.155.245

It would appear that the narrow definition of operational control, which, if adopted, could exonerate airmen in enforcement litigation is abandoned to find connections between the aircraft owner and the aircraft, the express terms of a written contract notwithstanding. Further, if the retention of receiving compensation and making maintenance decisions was the governing consideration in Gilbertson and Martin, on what basis was Davis Air Service exonerated in Graves?

IV. CONCLUSION

Confusion continues to abound concerning legitimate avoidance of air taxi/air carrier requirements as opposed to illegal evasion of those requirements. As observed by Judge Coffman in Bowen, the time-sharing provisions of the FARs present a "grey area" to the aviation practitioner, and those provisions may raise as many questions as they purport to answer.

Armadillo indicates the Agency's orientation to push its authority to the limit and challenge existing precedent by seeking revocation of a Part 125 operator's certificate of authority.

Whether due to confusion or conscious indifference to regulatory requirements, this continues to be a troublesome area. For example, consider the order assessing a civil penalty of $350,000 concerning two Miami companies where the contention was advanced that there had been unauthorized air carrier operations.246

The current state of affairs appears to be one in which ambiguities in regulations are construed against airmen and aircraft operators even in

245. Id. at 1689-1690.
the context of situations where they pursue compliance. The cases of Bowen and Jones illustrate this point.

The marked degree of confusion in this area of the law could be reduced by the Board’s adherence to the meaning of terms as they are defined in the Federal Aviation Regulations. If a commercial operator must be “a major enterprise for profit”, this should be an essential element of proof in a case where the FAA asserts that an air taxi certificate was required of the airman and/or aircraft operator. The cases where the Board has declared that the pilot need not be shown to have made a profit should be overruled.

To the extent the area of alleged illegal air taxi operations is of concern to the FAA and/or the N.T.S.B., an increased emphasis on education and awareness would appear to be in order. This could be integrated into the flight training of airmen and could also be the subject of discussions at seminars conducted by FAA Accident Prevention Specialists and other FAA inspectors.

As long as amorphous concepts like “operational control” and “holding out” determine who prevails in the context of enforcement litigation, it would appear aircraft operators and their counsel will be called upon to navigate in a troublesome and confusing area. Hopefully, this paper will contribute to an understanding of the problem, if not a solution.

I. SUMMARY OF DEVELOPMENTS

Since my survey of railroad equipment financing in 1989, the business has re-emerged as a significant method of capital formation. During the mid-1980's, the railroad industry had a surplus of equipment and many car-builders closed their shops, but by the end of the decade, equipment orders began to increase. In 1990, railroads and private car

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lines in the United States took delivery of about 32,000 freight cars and about 600 locomotives, representing a total value of about $2 billion. The economic downturn reduced those numbers somewhat for 1991 and 1992, but the industry expects a stable flow of new equipment for the foreseeable future. Aging equipment must be replaced, and new types must be brought in to continue gains in productivity. Institutional investors will be financing these acquisitions through the special instruments of railroad equipment finance.

In addition to new rolling stock and motive power, many of the railroads have undertaken major rebuilding programs. Under Rule 88\(^2\), rebuilt rolling stock can be given a new "birthday" for purposes of car hire charges (which are based on age and value). Locomotives have gone into railroad shops, rebuilding facilities, and even the builders' works for recycling into "remanufactured" units. Institutional investors also finance much of this rebuilding.

As has been the custom, railroad equipment financing is arranged and repaid without rancor or controversy, so there is little case law to provide grist for the legal writers' mill. But aircraft financing has many parallels with railroad equipment financing, and there has been no shortage of controversy in aircraft financing in recent years.\(^3\) Railroad equipment financing once set the pattern for aircraft financing\(^4\), but now the opposite is true. We look to aircraft financing for both the form and substance of railroad equipment financing transactions.

The bankruptcies of Eastern Airlines, Continental Airlines, and Pan Am, all with substantial equipment obligations on the books, have kept bankruptcy and appellate courts busy interpreting section 1110 of the Bankruptcy Code,\(^5\) a special protective provision for aircraft financing. The railroad industry counterpart is section 1168.\(^6\) The common heritage and the similarities in language of the two sections impel us to consider the effect of those airline decisions on railroad equipment financing.

On the positive side, the airlines and their financers have developed some interesting techniques that can be applied to railroad equipment financing. Transactions to finance equipment with some foreign content can be arranged to take advantage of tax benefits of equipment ownership in two jurisdictions—a "double dip." And the financing cost of rail-

road equipment for export can be reduced by the use of Foreign Sales Corporations.

We must mention one legislative development limited to railroad financing transactions—the repeal of section 10 of the Clayton Act.7 This section, on the books since 1914, prohibited transactions between common carriers and other entities with common officers or directors, unless the transaction was done pursuant to competitive bidding.8 We need no longer face the task of searching out such interlocks, or put warnings in offering memoranda for railroad equipment obligations.

II. SECTION 1168 AND THE AIRLINE BANKRUPTCIES

A. SECTION 1110 AND SECTION 1168

Section 1168 of the Bankruptcy Code provides special protection for holders of certain types of railroad equipment obligations in bankruptcy.9 This section overrides the automatic stay in bankruptcy, and permits equipment creditors and lessors to recover equipment if the obligations relating to that equipment are not kept current.10 We explored the history

10. The commencement of a case under the Bankruptcy Code operates as a stay against any action to enforce a lien or recover possession of property from the bankrupt debtor. Secured
of this provision and some interpretive issues in the earlier article. 11

Section 1168 of the Bankruptcy Code, and its predecessor in the old
Bankruptcy Act, the last sentence of section 77(j) 12, have been success­
ful. Equipment creditors enjoy special protection through railroad reorga­
nizations, and as a result, weak and strong railroad companies enjoy
access to capital at reasonable cost. 13 The only controversy regarding
this special status of railroad equipment obligations arose in the Penn
Central reorganization: The railroad assumed and serviced its equipment
obligations early in the reorganization but ran out of cash later on, and the
court temporarily enjoined repossession of the equipment by the creditors
until the federal government could step in and assume the obligations. 14

The success of old section 77(j) in preserving access to capital for
railroads was a topic of some envy in the airline industry. In 1957, faced
with enormous capital needs to finance new generations of turbo-prop
and turbojet aircraft, the airlines sought, and obtained, similar protection
for aircraft equipment creditors—section 116(5) of Chapter X of the old
Bankruptcy Act. 15 At the time, the Securities and Exchange Commission
opposed the legislation. The SEC pointed out that equipment represented
a much higher proportion of total assets of an airline than of a railroad,
and that giving aircraft equipment creditors special treatment would seri­
ously impair or even eliminate the prospects of a successful airline
reorganization. 16

Sections 116(5) and 77(j) survive as sections 1110 and 1168 of the
Bankruptcy Code. Their language is very similar, reflecting their common
root, old section 77(j). 17 Both protect "The right of a secured party with a
purchase-money equipment security interest in, or of a lessor or condi­
tional sale vendor of . . ." carrier equipment. In construing section 1168,

11. Railroad Equipment Financing, supra note 1, at 106.
13. Both Moody's Investors Service and Standard & Poor's Corp., the leading rating serv­
ices, have rated railroad equipment trust obligations having the protection of section 1168 of the
Bankruptcy Code in one of the three highest grades, regardless of the rating assigned to other
debt of the railroad issuing the obligation. Railroad Equipment Financing, supra note 1, at 105.
Standard & Poor's has recently dropped its "guideline minimum rating" for these issues to its
fourth highest grade, "BBB-." This is still regarded as "investment grade." Standard & Poor's
Developments Concerning Equipment Financing, a Position Paper of the Committee on Develop­
a court would inevitably look to cases construing section 1110 for guidance. Consequently, we must consider the implications of recent section 1110 airline cases for railroad equipment financing situations.

B. THE SALE-LEASEBACK CONTROVERSY

Both section 1110 and section 1168 of the Bankruptcy Code explicitly protect lessors. Some leases in which these lessors participate are acquisition transactions, that is, the lessor purchases the aircraft or railroad rolling stock and leases it to the carrier. In other circumstances, the carrier may already own the equipment, and will then sell it to the lessor and lease it back. This is quite common in the airline industry. Sometimes an airline will sell and leaseback older aircraft in the fleet, to raise capital, but more often the airline will simply take delivery of new aircraft and then arrange financing by sale-leaseback a few weeks or months later, when it senses that conditions are right in the money markets. Railroads do that, too, but to a lesser extent; most railroad equipment leases are arranged and closed at the time of delivery of the equipment. However, railroads often finance rebuilding programs by sale-leaseback, and because these rebuilding programs run over for a significant period of time, the lease financing may not be consummated until the rebuilding program is virtually complete, and many of the rebuilt units have already gone into service.

The history of sections 77(j) and 116(5) of the old Bankruptcy Act, the predecessors of section 1168 and 1110 of the Bankruptcy Code, clearly indicate a Congressional intent to promote acquisition of equipment by carriers. This notion was carried over into sections 1110 and 1168 of the new Bankruptcy Code. Certainly the phrases "purchase-money equipment security interest" and "conditional sale" in the statutes contemplate acquisition transactions. But certain individuals suggested, in a published article, that the term "lessor" should also be limited to acquisition situations. Thereafter, parties to sale-leaseback transactions have been concerned that a court would take the same position and would not apply the protection of section 1110 or section 1168, as the case may be, to a sale-leaseback.

This issue first came before a court in the second Braniff bankruptcy. In the first bankruptcy, part of the reorganization plan involved a conveyance of some of Braniff’s aircraft to a special trust, from which the airline


leased the aircraft back. Then in the second bankruptcy, the airline sought a declaratory judgment that section 1110 did not apply to that lease, because the leased aircraft were originally owned by the airline; the lease did not involve acquisition. Judge Corcoran considered the arguments of the airline, derived from legislative history, but concluded that he "must apply the statutory language as written; Section 1110 is not limited to leases that permit aircraft to be newly acquired by the lessee."

The Braniff decision was reached in a Bankruptcy Court in the Middle District of Florida, and not appealed, so there remained some concern that another court might conclude otherwise than Judge Corcoran. This concern was well-founded. When Continental Airlines sought the protection of the bankruptcy laws in late 1990, its capital structure included an overwhelming amount of lease transactions. Of its fleet of 365 aircraft, 259 were leased; off-balance sheet lease obligations exceeded $4 billion. Thus appeared the problem predicted by the SEC prior to the passage of section 116(5), section 1110's predecessor: the cash flow demands of the protected obligations seriously impaired the prospects of successful reorganization. To obtain relief from the burden of meeting these lease obligations, Continental urged the Bankruptcy Court for the District of Delaware to take a very narrow view of section 1110, and to hold that the protection of that section was not applicable to aircraft sale-leasebacks that did not involve acquisition.

Judge Balick, the Bankruptcy Judge hearing the matter, accepted Continental Airlines's position and held that a sale-leaseback transaction would not be covered by section 1110 unless the transaction was a "package deal" with the acquisition of the aircraft. That raised a ruckus in the aircraft financing community; new financing by lease was suspended. The affected aircraft lessors immediately appealed; they were supported by a group of major carriers, which filed a brief as amicus curiae. The decision was reversed by the District Court, Judge Gawthrop holding that leases resulting from sale-leaseback transactions are indeed entitled to section 1110 protection. The Third Circuit affirmed that decision.

Pan American had petitioned for reorganization under the Bankruptcy Code a few weeks after Continental. The same issue of sale-leasebacks and section 1110 arose in that case, because Pan Am's capital structure was also dominated by aircraft leases, and servicing those leases would be a substantial, perhaps crippling, burden on the bankrupt estate. Pan Am proposed to treat all sale-leaseback transactions as not

covered by section 1110, and to suspend lease payments while retaining the aircraft.

Although the matter came before the Bankruptcy Court (in the Southern District of New York) after the Bankruptcy Court decision in the Continental case and before that decision had been reversed, Pan Am got nowhere with its efforts to avoid section 1110 protection for sale-leasebacks. The Bankruptcy Court disagreed with Judge Balick and held that sale-leasebacks were covered by section 1110,24 the District Court affirmed,25 and the Second Circuit affirmed that decision, per curiam.26 The Supreme Court denied certiorari.27

So the world was again safe for sale-leasebacks. Although these cases put to rest the sale-leaseback issue, another issue emerged. The District Court in the Pan Am case and the Third Circuit Court of Appeals in the Continental case emphasized that only "true" leases, not disguised loans, would be covered by the "lessor" and "lease" language of section 1110.

C. THE "TRUE" LEASE ISSUE

The threat of judicial recharacterization of a transaction styled as a lease as a secured transaction is very real in both the airline and the railroad settings. While there are situations in which a carrier hires equipment from another carrier or from an owner that maintains an inventory of equipment for lease, most of the lease transactions in which section 1110 and section 1168 questions arise are financing transactions: the typical lessor purchases the equipment and leases it to the carrier as a financial accommodation. The carrier selects and orders the equipment, bears the burden of maintenance and the risk of loss, pays the insurance and all taxes, and agrees to pay the rents come Hell or high water. Consequently, there is a rather fine distinction between this type of finance lease and a secured loan.

That distinction is drawn in three separate contexts: accounting, tax, and secured transaction law. Accountants have developed a quantitative method of distinguishing between a "capital" lease, which must appear on the lessee's balance sheet as a liability, like debt, and an "operating" lease, which need not.28 The Internal Revenue Service, concerned with whether a nominal lessee should be entitled to deduct from income the

full amount of rents or only a portion allocable to interest, and whether the lessor should be entitled to the tax benefits of ownership, has distilled from case law some standards for determining what kinds of lease transactions should be regarded as secured loans. The I.R.S. has also developed quantitative guidelines for recognition of a true lease for ruling purposes. The distinction made by courts for other than tax purposes usually involves an interpretation of Section 1-201(37) of the Uniform Commercial Code, the definition of "security interest."

Parties to lease financing transactions usually pay close attention to the first two types of distinction between a lease and secured loan, accounting and tax, because the transactions are driven by certain accounting and tax objectives. But the distinction as a matter of secured transaction law has not received much attention in this context, perhaps because the federal recordation statutes for aircraft and railroad equipment cover both types of transactions; it would not matter if a transaction styled as a lease becomes recharacterized as a secured loan because the federal recordation of the instrument would protect the financer either way.

But the distinction will matter very much in cases under section 1110 and section 1168 of the Bankruptcy Code. If a sale-leaseback transaction is recharacterized as a secured loan, the benefits of section 1110 or 1168 will be lost. If the transaction cannot be regarded as a lease, the protection of section 1110 or 1168 will only be available if the transaction can be characterized as a "purchase-money equipment security interest" or conditional sale. Both of these alternatives require acquisition.

Bankruptcy courts look to state law on the recharacterization issue, and there is a troublesome lack of uniformity of decision in distinguishing between leases and secured loans. Many of the carrier lease transactions exhibit characteristics that judges in many jurisdictions have found to indicate secured loans.

In the case of the airlines, financers must be concerned about recharacterization of individual lease transactions and possible loss of

33. There will be greater certainty in this area as the various states adopt Article 2A of the Uniform Commercial Code, covering leases of personal property. Article 2A validates the notion of finance leases, and brings with the new Article a revised section 1-201(37) definition of security interest. This new definition is more comprehensive than the old, and confines judicial discretion in this area.
section 1110 protection, on a case by case basis.\textsuperscript{34} That is also true in the case of railroads and section 1168. But in the case of railroads and section 1168, we also must consider the vulnerability of an entire class of transactions—"Philadelphia" plan equipment trusts. This venerable financing device, as old as railroading, is based on a lease that by any modern test would be regarded as a secured loan.

The Philadelphia plan equipment trust is a title-retention security device, invented before Article 9 of the Uniform Commercial Code gave us the concept of a security interest and discarded the notion of "title" for personal property. Under the Philadelphia plan, a railroad conveys into trust the equipment to be financed, and then leases the equipment back for the period of the financing, usually 15 years. The trustee issues certificates to purchase the equipment; the obligation represented by the certificates is payable only out of the rent from the equipment. The rent payments under the lease are measured by the interest and installments of principal to be paid on those certificates; at the end of the term, when the obligations on the certificates were fully discharged, the trustee conveys the equipment back to the railroad for no additional consideration.

The proceeds of the sale of certificates in a Philadelphia plan equipment trust are often paid directly to the suppliers of the equipment covered by the trust. But more often, the equipment would already have been delivered to the railroad, paid for, and put into service, and the proceeds of the sale of certificates is paid to the railroad to reimburse it for amounts previously paid for the equipment. This is because an order of railcars is not delivered all at once, but over a period of months, and the car-builder expects to be paid as the cars are delivered, not when the order has been completed.

In the first hundred years of railroading, rolling stock was often constructed in a railroad’s own shops. To avoid conflict with system mortgages having after-acquired property clauses,\textsuperscript{35} during construction the equipment would be held in the names of individuals, usually employees of the road. These individuals then sold the equipment to the trustee of the equipment trust when the financing was arranged. They were sometimes called "straw men."

When the "modified Philadelphia plan" was adopted toward the mid-

\textsuperscript{34} Pan American attempted to disqualify a transaction as a true lease on the basis that the agreement permitted the lessee to substitute engines for the engines originally covered by the lease. The court held that this feature (an altogether common one) did not disqualify the lease as a "true" lease, and accordingly, the protection of section 1110 of the Bankruptcy Code was available. \textit{In re} Pan American Corp., 130 B.R. 409 (S.D.N.Y. 1991). Railroad equipment leases usually permit the lessee to provide substitutes for units that are lost or wrecked during the lease term.

\textsuperscript{35} Most mortgages on railroad property covered equipment then existing or "hereafter acquired."
Middle of this century, most railroad mortgages had provisions for releasing recently acquired equipment for a financing. Thus there was no need to insulate the equipment under construction from the mortgage, and the use of the straw men as vendors was discontinued. The railroads simply bought and paid for the equipment, and later conveyed it to the trustee under an equipment trust. The typical railroad equipment trust form contemplates financing equipment in service for a period of up to six months or a year prior to the date of the trust.

The lease in the Philadelphia plan equipment trust is clearly what was contemplated by the last sentence of section 77(j) of the old Bankruptcy Act at its passage in 1935, even though such a lease is not a true lease. The Congressional report accompanying its passage is clear on that point. And whatever was protected under that old language was intended to be protected by sections 1168 and 1110 of the Bankruptcy Code. The Congressional report accompanying the passage of the Bankruptcy Code is clear on that point. But the courts in the Continental and Pan American section 1110 cases, having in mind, no doubt, the meaning of the term “lease” in the context of aircraft financing practice in 1978, when the Bankruptcy Code was enacted, limited their decisions to “true” leases. The lease in a Philadelphia plan equipment trust does not meet current criteria for a “true” lease.

The Continental and Pan American cases can certainly be distinguished, because they construed section 1110 and not section 1168. The analysis of section 1110 involved examination of aircraft financing practice; decisions under section 1168 should be made by reference to railroad equipment financing practice. The terms “lessor” and “lease” in section 1168 should be construed to cover the bailment lease in a traditional Philadelphia plan equipment trust, even though it does not meet the criteria for a “true” lease, and even though the resulting security interest does not meet the criteria for a “purchase money equipment security interest.”

That’s what a court should do. But we cannot be confident that that’s what a court would do.

D. Purchase Money Equipment Security Interests

If there is doubt that an equipment financing transaction meets the criteria for a “true” lease (or if there is no doubt that it doesn’t), railroads and their financers can look to the other categories of transactions covered by section 1168 of the Bankruptcy Code: “purchase-money equip-

The reference to "conditional vendor" and "conditional sale contract" in section 1168 are carried over from section 77(j) of the old Bankruptcy Act. In 1935, when the last sentence of section 77(j) was enacted with these words, conditional sale agreements were commonly used for railroad equipment financing. Their use continued long after the adoption of the Uniform Commercial Code made such forms obsolete, because of a loophole in the scheme of securities regulation by the Interstate Commerce Commission. Since the loophole was enlarged to admit other forms in 1985, the conditional sale format has largely been abandoned.

In the traditional conditional sale format, the railroad agrees with a car or locomotive builder to pay the purchase price of the cars or locomotives in installments, with interest on the unpaid balance. The builder immediately assigns this obligation to a group of institutional investors, in an integrated transaction arranged by an investment banker acting for the railroad. The builder thus does not actually extend financing, but joins in as a party to the documents as an accommodation in order to create the conditional sale form.

Outside of the railroad industry, the conditional sale form has been replaced by the notion of a "purchase money security interest" under Article 9 of the Uniform Commercial Code. This can be "taken or retained by the seller of the collateral to secure all or part of its price." That is what happens in a conditional sale. But a purchase money security interest can also be "taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or use of the collateral." This avoids the need to involve the seller of the collateral: the secured party can extend credit directly to the debtor, if the debtor uses the money to pay the seller.

The term used in section 1168 of the Bankruptcy Code, "purchase-money equipment security interest," is slightly different from the "purchase money security interest" of the Uniform Commercial Code.

40. See ASSET FINANCING, supra note 18, at 65.
41. Association of American R.R.s v. United States, 603 F.2d 953 (D.C. Cir. 1979); see also Railroad Equipment Financing, supra note 1, at 100.
44. Id., at cl. (a).
45. Id., at cl. (b).
The Bankruptcy Code term was added by the drafters of the new bankruptcy law to avoid confining financing parties to the old forms, conditional sales and equipment trusts, contemplated by section 77(j) of the Bankruptcy Act. This new term is not defined in the Bankruptcy Code. The extra hyphen and extra word suggest that the drafters of the Code wanted to provide some room for judicial maneuvering beyond the confines of the Uniform Commercial Code usage of the similar term. But when courts were obliged to construe the term under the Bankruptcy Code under section 1110, the provision for aircraft correlative to section 1168, they concluded that a "purchase-money equipment security interest" could be nothing other than a "purchase money security interest" within the meaning of section 9-107 of the Uniform Commercial Code. Thus we must look to U.C.C. section 9-107 and its interpretive gloss.

The language of section 9-107 suggests a direct connection between the advance made by the financer and the acquisition of the collateral by the debtor. But that requirement presents practical difficulties in railroad equipment financing. Railroad cars and locomotives are delivered unit-by-unit as they are built over a period of time, and the builder expects to be paid upon delivery. Thus there may be situations in which a financing enables the acquisition of equipment, but without a direct connection or payment flow from the financer to the seller of the equipment.

This may seem to be a technical problem, but it is not one to be ignored in the structure of a transaction. Professor Gilmore, in his treatise on Security Interests in Personal Property, comments that there is an evident intent on the part of the draftsmen of Article 9 to free the purchase-money concept from artificial limitations and particular formalities and sequences. But he adds that "no lender in his right mind will deliberately experiment with how much play there is in the joints . . .." The lender will make the loan before acquisition and making a loan direct to the seller. Case law supports the notion that the language of clause (b) of section 9-107, "to enable the debtor to acquire rights in or the use of collateral," disqualifies a situation where the debtor already has possession and ownership of the collateral when the advance is made.

When the railroad already has all elements of ownership of the equipment, qualification of a financing transaction as a "purchase-money equipment security interest" under section 1168 of the Bankruptcy Code

48. 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 782 (1965).
49. Id.
50. E.g., North Platte State Bank v. Production Credit Ass'n of North Platte, Nebraska, 200 N.W.2d 1 (Neb. 1972).
is thus doubtful, too doubtful to be offered to institutional investors. The notion then comes to mind of constructing a transaction to qualify as a conditional sale contract under section 1168, by having the railroad sell the equipment to an agent or trustee for financing parties, and then buying it back under a conditional sale. This has always been regarded as bogus, however, and nothing more than a chattel mortgage. 51 Professor Gilmore says that "the keystone of modern conditional sale theory came to be that the device was limited to use in financing sales transactions." 52

It is apparent from the literature that conditional sales and purchase money security interests have much in common, and that the latter is the modern counterpart of the former. 53 Thus if the circumstances preclude a purchase money security interest, they will also preclude a conditional sale. 54

This is not a major problem for the railroads, once the requirements of a purchase-money equipment security interest are recognized, and taken into account in planning financing programs. The principal task is convincing railroad financial and purchasing people that the opportunity for section 1168 protected financing can be lost unless current practices are revised. Railroad equipment destined for a financing cannot be paid for upon delivery; arrangements must be made to defer some significant part of the acquisition until the "permanent" financing is available. 55

Two techniques come to mind. The first is some sort of interim lease or security agreement with the builder of the cars or locomotives, so that the builder retains either ownership or a security interest in the equipment until the permanent financing is put in place and the builder is paid. This, of course, puts the builder in the position of financer until the permanent financing is arranged, and this may not be practical. In such a case, the railroad may be able to arrange for short-term financing to be extended to

52. 1 GILMORE, supra note 48, at 68.
53. 2 Id., at 743.
54. There is precedent in the railroad industry for conditional sale financing of rebuilding programs, whereby the railroad would sell the huks to an outside agency which would then contract with the railroad for rebuilding. The conditional sale would involve that outside agency as vendor. In the usual course, the vendor would assign the conditional sale indebtedness to another agent, acting for the institutions providing the financing. The proceeds of the financing would be paid to the vendor, which in turn would pay the same to the railroad in discharge of the vendor's obligations under the rebuilding contract. See Leonard D. Adkins & DeForest Billyou, Current Developments in Railroad Equipment Financing, 12 Bus. Law. 207, 212 (1957). This creation of a conditional sale was intended to avoid the securities regulation jurisdiction of the Interstate Commerce Commission. See Railroad Equipment Financing, supra note 1, at 89.
55. A similar connection between acquisition and financing is necessary to obtain the exemption from registration available under section 3(a)(6) of the Securities Act of 1933. See Railroad Equipment Financing, supra note 1, at 100, 104.
the car-builder, secured by the obligation of the railroad to purchase the
equipment. Such financing should come from outside sources, not the
railroad itself. When the "permanent" financing is arranged, the interest
in the equipment retained by the builder (or the interim financer) would be
reassigned to the trustee or agent for the long-term debt participants.

The second technique involves the creation of an equipment trust
before delivery. The trustee would issue certificates to a party providing
interim financing, perhaps a bank that has an existing line of credit in
place for the railroad, or enter into a noteless form of borrowing arranged
and guaranteed by the railroad. The proceeds would be used to pay the
builder for the cars or locomotives. The trustee would hold a security
interest in the locomotives for the benefit of the certificate holders. When
the permanent financing is arranged, the certificates would be amended
to reflect the then-market rate, and sold to the new debt participants.\textsuperscript{56}

With proper planning, the railroad could arrange for the issue of long-
term equipment trust certificates or other method of permanent financing
before the first deliveries of equipment. The proceeds of the issue of cer-
tificates would be deposited with the indenture trustee pending "take-
down" from time to time as equipment is delivered; pending such deliver-
ry, the proceeds would be invested in short-term obligations meeting
some standard of investment quality. The disadvantage of this arrange-
ment is that the short-term investments inevitably earn less than the inter-
est due on the long-term certificates, and the railroad must make up the
difference. Most railroads prefer to use some sort of interim financing
arrangements to cover the cost of the equipment until a large enough
group has been assembled for an issue of equipment trust certificates or
other medium of long-term financing.

\section*{III. SOME TAX TOPICS}

\textbf{A. THE FOREIGN TAX CREDIT}

Railroad companies in Canada and the National Railways of Mexico
participate in the system of interchange of railroad equipment promul-
gated by the Association of American Railroads. Thus railroad rolling
stock, placed in interchange service, occasionally may be used outside of
the United States. This may have some income tax consequences for
lessors of railroad equipment; while limited foreign use of leased equip-

\textsuperscript{56} The drafter of this arrangement must take considerable care to ensure that the long-term
debt does not constitute a novation, extinguishing the original debt and the purchase money
security interest that goes with it. \textit{See, e.g., In re Hassebroek}, 136 B.R. 527 (Bankr. N.D. Iowa
1991). The interim financing arrangements should clearly contemplate the ultimate long-term
debt, and the initial security instruments should be flexible enough to be retained for the long-
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ment may not jeopardize the accelerated cost recovery deductions, some portion of the rental income and transaction losses\(^{57}\) would be attributable to the foreign use, and would have an effect on the lessor's foreign and domestic tax liability. The issue of foreign source income always comes up in the negotiation of an equipment leasing transaction, and it can be troublesome, indeed.

Section 901 of the Internal Revenue Code\(^{58}\) provides that a taxpayer is entitled to a credit against its United States income taxes in the amount of any income, war profits, and excess profits taxes paid or accrued to any foreign country. There are limitations on that credit specified in section 904 of the Code: In general, the total amount of the credit taken cannot exceed the same proportion of the tax against which the credit is taken which the taxpayer's taxable income from sources without the United States bears to its entire taxable income for the same taxable year.

This can be expressed as follows:

\[
\frac{\text{Foreign tax credit}}{\text{Total U.S. tax liability}} < \frac{\text{Taxable income from foreign sources}}{\text{Total taxable income}}
\]

In the early years of a lease financing, the transaction generates losses for the lessor. A taxpayer is required to allocate depreciation deductions and interest deductions with respect to property ratably to sources of income, within and without the United States. As a result, transaction losses in those early years follow the equipment, and foreign use means foreign source losses. Losses from foreign sources reduce equally both the numerator and the denominator of the fraction on the right (thus reducing the magnitude of the entire fraction), and this has the effect of reducing the limit on foreign taxes creditable against United States taxes; if the taxpayer has other foreign activities generating foreign tax liability, part of the credit for that liability may be lost. That is why foreign source losses are unwelcome, even though leveraged lease transactions are designed to show losses for tax purposes.

In the case of railroad rolling stock, there is some relief from this problem. Section 861(e) of the Internal Revenue Code provides that income from leases of railroad rolling stock leased to domestic railroad companies be treated as income from sources within the United States if the use of the rolling stock is expected to be within the United States. That requirement is satisfied if the only use outside of the United States is in Canada or Mexico on a temporary basis, which is not expected to exceed 90 days in any taxable year.

57. Lease transactions are usually designed to produce tax losses in the early years, when accelerated cost recovery deductions and interest deductions for acquisition debt exceed the rental income. These transactions are tax shelters for large corporate taxpayers.

Thus the foreign source income and loss problem can be disregarded for most leases involving railroad equipment in interchange service, even though there may be occasional use in Canada or Mexico. But for section 861(e) to be applicable, the lessee must be "a domestic common carrier by railroad or a corporation which is controlled, directly or indirectly, by one or more such common carriers." Thus a lease to a private car line would not have the benefit of section 861(e), unless the private car line is owned or controlled by a railroad or railroads.

As for autoracks owned and financed separately from the flat cars on which they are erected, the applicability of section 861(e) turns on the meaning of "railroad rolling stock." That is not defined in the regulations for section 861; another Treasury regulation, section 1.48-1(g), defining rolling stock for certain purposes of sections 38 and 48 of the Internal Revenue Code, speaks of "locomotives, freight and passenger train cars, floating equipment, and miscellaneous transportation equipment on wheels" that are included in a railroad's equipment accounts. The part about wheels suggests that highway trailers would be included, but it is more difficult to make a case for containers and autoracks.

There is more to the foreign tax credit than that, of course. There are some very interesting problems relating to the allocation of items of expense to sources within and without the United States, particularly the interest expense in leveraged lease transactions.

B. DOUBLE DIPS

Different nations have different notions of the distinction between a lease and a secured loan. In the United States, that distinction is based on the economic substance of the transaction.59 In some other countries, particularly those with a civil code heritage, there may be greater reliance on form. And even in those countries that look to the economic substance of the transaction, the measures may be different from ours.

These differences make possible a sort of arbitrage. If an equipment financing transaction across international boundaries, styled as a lease, is treated as such in the lessor's country but regarded as a secured loan in the lessee's country, then the lessor would be regarded as the owner of the equipment in its home country, and the nominal lessee would be regarded as the owner of the equipment in its home country. Thus there can be two owners of the same equipment, and two sets of tax benefits of ownership—depreciation deductions or whatever—available for the same

equipment. Such a double-dip of tax benefits can substantially reduce the financing cost of equipment for which such transactions are possible. Cross-border lease financing of aircraft is quite common around the globe.

Needless to say, tax authorities are not entirely enthusiastic about the effect on the national revenues of such practices. In the case of cross-border leasing of equipment for use in the United States, the domestic tax effects are nil, because someone in the United States would be entitled to the accelerated cost recovery deductions for the equipment in any case. Thus the Internal Revenue Service has not actively opposed the practice, and indeed, another government agency, the Federal Aviation Administration, has adopted specific guidelines to accommodate cross-border leases.

But in the home country of a lessor that has leased equipment into another country, the tax benefits are there to reduce tax revenues but the equipment is not there to increase productive capacity. Thus tax authorities in the country on the "lessor" side of a transaction do not favor cross-border leasing, unless they perceive some benefit to that country. If the equipment subject to the lease, or significant parts of that equipment, are manufactured in the lessor's country, then tax authorities can look upon the transaction as a form of export support, and give their blessing (or withhold objections). Consequently, most cross-border transactions involve a lease from the country where the equipment is built into the country where it is used.

This hardly seems relevant for railroad equipment financing, because railroad cars and locomotives used in the United States are built here. But electric locomotives have been imported (and financed with cross-border leases), and new generations of locomotives will have traction motors and other equipment originating in Europe. In addition, almost all public transit equipment—subway cars, commuter cars and light-rail cars—are manufactured by foreign builders, although assembly often is done in the United States. Thus the home countries of the manufacturers of this equipment and components would be potential hosts for cross-border transactions. Finally, Japanese cross-border leasing remains available regardless of the origin of the equipment or its components.

62. Treatment of Leases with an Option to Purchase, 55 Fed. Reg. 40,502 (1990); see also Aircraft Finance, supra note 3, at 1042.
63. An exception is Japan, which has permitted its taxpayers to take the benefits of equipment ownership for equipment leased to other countries, but not manufactured in Japan. See Koffey & Umbrecht, supra note 60.
64. See Koffey & Umbrecht, supra note 60.
C. FOREIGN SALES CORPORATIONS

The current need to rebuild railroads in many countries of the world suggests new vigor in the export market for American railroad equipment, particularly locomotives. Cross-border lease transactions in the outbound direction can be designed to employ tax-oriented techniques to reduce financing costs for the ultimate user in a foreign country. The conventional type of double-dip is not possible: tax authorities in the United States take perhaps the strictest view in the world of what constitutes a lease, so that it has not been possible to design a lease from an American lessor to a foreign lessee that would be treated as a lease under U.S. tax rules and a secured loan under foreign rules, creating two tax owners. Further, if equipment is used predominantly outside of the United States by a foreign lessee, the most favorable accelerated cost recovery deductions are not available.65

Comes now the FSC, the Foreign Sales Corporation. This is a tax-incentive for export sales; the special benefits of the FSC are available for lease transactions as well as sales. A Foreign Sales Corporation, owned by an American corporation but organized outside the United States,66 can exclude from its taxable income 16% of certain qualified export income (called "foreign trade income") from a transaction in which the FSC buys export property from a related supplier and sells or leases the property to an unrelated buyer or lessee, or acts as a commission agent to assist a related company in selling or leasing export property to an unrelated buyer or lessee.67 A FSC can also exclude from its taxable income 32% of its rental income from equipment, purchased from an unrelated entity, and leased to an unrelated foreign lessee.68 This income can be transferred to the parent corporation without additional tax under the dividends-received deduction.

Airline financers have adapted the FSC to reduce the cost of leasing

65. Under the accelerated cost recovery system, railroad equipment (other than tank cars) is regarded as "7-year property," and can be depreciated over that period to a zero salvage value using the 200% declining balance method. I.R.C. § 168(b) (1988). For equipment used predominantly outside of the United States, the depreciation deduction is determined by using the straight-line method over the class life, which is a longer period than the recovery period under I.R.C. § 168(a). I.R.C. § 168(g) (1988). There is an exception for railroad rolling stock "used within and without the United States" belonging to a domestic regulated carrier, or to another United States taxpayer if the rolling stock is not leased to foreign persons for more than 12 months in a 24-month period. I.R.C. § 168(g)(4)(B) (1988). If equipment is leased to an entity other than a United States taxpayer, the "recovery period" (the depreciation period) cannot be less than 125% of the lease term. I.R.C. § 168(g)(3)(A) 1988).
66. Usually Barbados, Bermuda, or the U.S. Virgin Islands.
68. Id.
aircraft to be used predominantly outside of the United States. The first technique, called a "commission FSC," has been used for leases of aircraft both to foreign lessees and to domestic lessees for use on foreign routes.\textsuperscript{69} The lease structure is straightforward: a lessor, a United States taxpayer, leases equipment to a foreign user (or to a domestic user for foreign routes). The lessor leverages the transaction by borrowing most of the purchase price of the equipment from institutional lenders on a non-recourse basis, that is, the lenders agree to look only to the stream of rent payments for debt service. The lessor organizes a subsidiary Foreign Sales Corporation, and up to 23% of the rental income is allocated to the FSC as a commission for arranging the transaction.\textsuperscript{70}

Lease transactions, particularly leveraged lease transactions, are designed to show tax losses in the early years, due to the allowances for depreciation (or accelerated cost recovery) of the leased equipment and for interest on the acquisition debt exceeding the rental income. Thus a commission FSC may not have foreign trade income subject to the exclusion until the later years of the lease. Losses in the early years can also cause problems with the foreign tax credit.\textsuperscript{71}

In order to enhance the yield from a commission FSC lease transaction, financers look for ways to separate the debt from the lease income. Usually, the interest expense for non-recourse debt must be allocated to the income generated by the property acquired with the debt. If that interest can be allocated by the lessor to general indebtedness and not set off against the rental income, more of the rental income would be available for the 15% exclusion. Another technique to enhance yields is the use of a short lease term, to shorten the depreciation period,\textsuperscript{72} and a long debt term, to spread out the debt service.

While these techniques can be regarded as aggressive, they are not thought to be offensive because the result is a lower financing cost for equipment exported from the United States. The commission FSC can be used for domestic railroads with lines outside of the United States, for foreign railroads, and for private cars used outside of the United States.

Exclusion of 32% of income from taxes is better than exclusion of 16% of income, so financers have developed the "ownership" FSC transaction to lease equipment directly. In these transactions, the Foreign

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\textsuperscript{69} The depreciation deductions are more favorable for aircraft registered with the Federal Aviation Agency and operated "to or from the United States" or "under contract with the United States." \textsuperscript{13} I.R.C. § 168(g)(4)(A) (1988).

\textsuperscript{70} To give credence to this, some of the negotiations must take place where the FSC is organized. \textit{See Aircraft Finance, supra} note 3, at 1042.

\textsuperscript{71} \textit{See discussion supra} part IIIB.

\textsuperscript{72} If equipment is leased to a foreign entity or an tax-exempt entity, the recovery period for depreciation deductions cannot be less than 125% of the lease term. \textsuperscript{13} I.R.C. § 168(g)(3)(A) (1988).
Sales Corporation itself purchases the equipment and leases it to a foreign user. In order to obtain the most favorable yield, however, it is necessary to employ some of the same strategies as in the commission FSC: separation of the debt service from the rental income, and shortening the lease term to enhance the depreciation deductions.

Separating the rental income from the debt is a major challenge in these transactions. The Foreign Sales Corporation owns the equipment and is the lessor under the lease; but it cannot be the borrower under the acquisition debt: if so, the interest would be deducted from the rent income, reducing (or even eliminating) the income for which the 32% exclusion is available, and destroying the yield from the transaction. In order to overcome this, the corporation that owns the FSC borrows the money, entering into the acquisition debt, and injects the loan proceeds into the FSC as capital. Thus the FSC has rental income subject to the exclusion without interest deductions, and the parent of the FSC has interest available to deduct from other income.

The catch, however, is that the borrower is the parent of the FSC, not the FSC itself, and that parent is not the owner of the equipment and cannot grant a security interest in the equipment to support non-recourse debt. The lenders in these transactions are asked to make the loan without a security interest in the equipment. Instead, the lenders receive a pledge of the stock of the Foreign Sales Corporation. This is enough of a departure from the traditional structure of a leveraged lease transaction to chill the enthusiasm of lenders, unless both the ultimate lessee and the lessor are quite credit-worthy.

Purveyors of ownership FSCs use the same yield enhancement technique as the commission FSCs involving leases to foreign entities: the lease term is shortened to enhance the depreciation deduction, while the term of the debt is much longer, perhaps twice the initial lease term. At the expiry of the initial lease term, the lessee must either purchase the equipment or arrange a replacement lease with payments sufficient to discharge the debt and preserve the lessor's yield. This is called a "Pickle" lease, because the Internal Revenue Code provisions establishing the depreciation period for equipment leased to entities that do not pay United States income taxes—125% of the lease term—were installed by the amendments sponsored, in part, by Congressman Pickle.73

An ownership FSC can be used to finance railroad equipment manufactured in the United States and used in foreign countries. Canada and Mexico are foreign countries.

The accelerated "Pickle" lease, developed in the context of FSC

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transactions, has also been used for sale-leaseback financing by American investors of railroad equipment in foreign countries.

IV. MEXICAN INTERCHANGE

Financers of railroad equipment used in Canada (whether directly by Canadian railroads or through interchange with U.S. railroads) have the comfort of a central recording statute for interests in railroad equipment, section 90 of the Railway Act. This is quite like the federal recording statute in the United States, in that this central filing is "valid against all persons" and there is no need for any local filing or perfection of security interests.

Mexico has no such central filing procedure. This has not been regarded as a significant problem in the past, although the Ferrocarriles Nacionales de Mexico (The National Railways of Mexico), the government entity that operates most of the railroad mileage in Mexico, participates in the equipment interchange system of the Association of American Railroads. Thus any railroad rolling stock placed in interchange service in North America could, at some time or other, be used to carry goods to Mexico and be operated over Mexican trackage.

The current development of a free trade agreement with Mexico offers the prospect of significant increases in rail traffic between Mexico and the United States. Efficient handling of this traffic suggests equipment interchange, perhaps even run-through service. But the parties who finance that equipment like to have their interests in the equipment protected by some form of perfection or public recordation. Insist on it.

The only system of "perfection" now available in Mexico is registry with the public registries of property and commerce, which exist in the Federal District and in every major city and area. Each property registry covers only local real property, but the laws of the Federal District and of most state civil codes classify rolling stock as "immovable," or real property, so interests in railroad cars could be registered in those property registries. But that is not now done: the process would involve translation of the documents into Spanish, perhaps conversion into civil code forms, engaging local lawyers, and inevitable procedural delays.

Mexican lawmakers have never seen the need for a central registry for recordation of interests in railroad rolling stock, like the ICC registry or that maintained by the Registrar General of Canada. The Mexican railway

74. R.S.C., ch. R-3, § 90. Formerly ch. R-2, § 86; see also Railroad Equipment Financing, supra note 1, at 98.
75. See 49 USC § 11303 (1988).
76. E.g., C.C.D.F. Art. 740 (X).
77. L.V.G.C., Art. 93.
system is run by a government agency, created in accordance with the Mexican Constitution and a special organic law\textsuperscript{78}, and the railways' property cannot be levied against for execution.\textsuperscript{79} There is no need to protect rights of creditors secured by interests in railroad rolling stock, because there aren't any such creditors in Mexico. The only significant private interests in railroad rolling stock would be those of foreign owners and creditors, and why should Mexico provide a registry for them?\textsuperscript{80} When the question comes up, Mexican counsel usually advise that the courts will generally apply United States law in determining the ownership of cars from the United States and will give effect to security interests validly created abroad.\textsuperscript{81}

For equipment creditors, this advice is adequate for the usual transaction involving hundreds or even thousands of railcars in domestic interchange service, because only a few of those cars might be in Mexico at any given time. But in a transaction involving locomotives for a railroad with connections into Mexico, or for equipment that might be dedicated to service Mexican traffic, financing parties may want more concrete assurances.

We are unlikely to see Mexico adopt a central system for recordation of interests in railroad equipment, like the U.S. and Canadian systems. But a more realistic hope is the adoption of a bilateral treaty providing for international recognition of interests in railroad equipment.

The model for this would be the Convention on International Recognition of Rights in Aircraft, adopted in 1948 in Geneva.\textsuperscript{82} The United States and Mexico are parties to this multilateral treaty, although Mexico has made a reservation to certain terms. This convention provides for international recognition of rights in aircraft that have been constituted in accordance with the law of the nation of registry of the aircraft. Thus, in the case of an aircraft registered in the United States, recordation of interests in that aircraft with the FAA under section 503 of the Federal Aviation Act\textsuperscript{83} serves to protect financers of the aircraft in the 51 other nations that have adopted the convention.

Of course, railroad cars are not "registered" like aircraft. But a close-

\textsuperscript{78} L.O.F.N.M. (1985).

\textsuperscript{79} id., Art. 18.

\textsuperscript{80} There are a few hundred private cars in Mexico, not enough to create any pressure for special legislation to facilitate financing. Privatization of the Mexican National Railway, that is, sale of the railway to private investors, has been mentioned but does not appear to be in any way imminent.

\textsuperscript{81} C.C.D.F. Art. 13 (IV).

\textsuperscript{82} 4 U.S.T. 1830, T.I.A.S. No. 2847, 310 U.N.T.S. 151. See generally \textit{Asset Financing}, supra note 18, at 266; \textit{Aircraft Finance}, supra note 3 at 1054.

\textsuperscript{83} 49 U.S.C. app. § 1403 (1988); see generally \textit{Asset Financing}, supra note 18, at 251; \textit{Aircraft Finance}, supra note 3, at 1040.
enough equivalent is found in the system of reporting marks identifying car owners promulgated by the Association of American Railroads. A bilateral treaty could be based on recognition of the laws of the nation of domicile of the entity, railroad company or otherwise, whose AAR reporting marks are on the equipment.

Such a treaty would provide complete coverage, for railroad equipment financers, in North America. The integrity of the system is assured by the track gauge: the tracks in the southern part of Mexico and the adjoining central American countries are narrow gauge, so standard-gauge equipment cannot escape that way.

V. RECOMMENDATIONS

We can distill from the recent airline bankruptcy cases and aircraft financing practice some guidelines for railroad equipment financing, to be considered along with the recommendations published earlier: 84

1. A railroad company should make financing arrangements for rolling stock or locomotives before delivery and payment to the builder, or interim arrangements must be made in contemplation of the ultimate financing arrangements. Otherwise, the protection of section 1168 of the Bankruptcy Code may be lost to the ultimate financers, and with it, the most favorable financing terms.

2. A debt financing of railroad rolling stock or locomotives should adhere to the rules for "purchase money security interests" under Section 9-107 of the Uniform Commercial Code, in order to assure the availability of the protection of section 1168 (and, incidentally, to preserve the ability to issue equipment obligations under the exemption from registration available under section 3(a)(6) of the Securities Act of 1933).

3. If a lease financing transaction is planned, and the transaction would not qualify as a "purchase money security interest" if it is ultimately determined to be a security agreement rather than a lease, the railroad should carefully examine the law governing the transaction on the point of the distinction between a lease and a security interest. In this regard, selection of a state that has adopted Article 2A of the Uniform Commercial Code is helpful. If the railroad's or the lessor's home state has not so adopted Article 2A, the equipment should be conveyed to an owner trust, established in an appropriate state, and that state's law selected to govern the transaction.

4. If railroad equipment with significant foreign content is to be financed, a cross-border lease from the country of origination of the equip-

84. See generally Railroad Equipment Financing, supra note 1, at 113.
ment should be examined for potential savings in financing cost arising out of tax benefits in that country.

5. Exporters of railroad equipment, and foreign users of U.S. manufactured equipment, should consider financing through a Foreign Sales Corporation.

6. The railroad industry and its financers should promote the establishment of a bilateral treaty with Mexico, or a multilateral North American treaty, regarding international recognition of rights in railroad rolling stock.
The U.S. Short Line Railroad Phenomenon:
The Other Side of the Tracks

PAUL STEPHEN DEMPSEY*
WILLIAM G. MAHONEY**

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I. INTRODUCTION

Short line railroads have always been a part of the U.S. rail network. Nonetheless, their growth during the past decade has been little short of explosive. Much has motivated this proliferation of short lines, including the desire of Class I railroads\(^1\) to eliminate less profitable routes, relieve themselves of maintenance of rights of way obligations thereon and eliminate employees and labor contracts. None of that would have been possible without the extreme receptivity of the Reagan and Bush Interstate Commerce Commission (I.C.C.), which largely swept aside the procedural and legal restrictions.

Much of the literature praises the short line phenomenon. For example, one source notes, "In many cases, the new local carrier can offer more customized, responsive service than its larger predecessor, and often on a more efficient and lower-cost basis."\(^2\) Certainly also, some short lines have been created, and become successful, where the spur lines they replaced would otherwise have been wholly abandoned, thereby saving that finger of the national rail network and benefitting the shippers and communities which rely upon it.

Nonetheless, much of the literature on the subject largely subdues or ignores the other side of the picture — the impact of short line creation on labor, the problems of undercapitalization on safety and stability of service, the overall constriction of the national rail network, the captivity of short lines to the Class I railroads which dominate them, and other problems. This article seeks to fill that gap in the literature.

II. THE HISTORICAL TREND TOWARD RAIL CONSOLIDATION

In earlier periods of United States history, small rail lines were consolidated to form longer systems to provide better service to the public. In 1857, Cornelius Vanderbilt observed that passengers traveling from New York to Chicago were forced to spend 50 hours on trains, making some seventeen connections from one small rail line to another. Commodore Vanderbilt sold his steamboat empire, which had made him the richest man in the nation, and began buying railroads. By 1869 he had consolidated these short rail lines into one huge railroad he called the New York

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1. Class I railroads are those which have more than $50 million in annual operating revenue. Most "short line" railroads classify as Class III railroads, with less than $10 million in annual operating revenue. 49 C.F.R. pt. 1201 gen. instruction 1-1(a) (1992).
Central. Although a number of large railroads linked the nation by the turn of the twentieth century, literally hundreds of short line and regional railroads made up the bulk of our national rail network.

After World War I, the United States Congress enacted the Transportation Act of 1920, mandating that the Interstate Commerce Commission develop a plan to consolidate the nation’s fractured system of short lines, regional, and large Class I railroads into a unified system of larger and fewer railroads. However, this proposal of merger according to a preconceived governmental plan simply died stillborn.

In 1940, Congress enacted a voluntary merger scheme in the Transportation Act of 1940. Beginning in 1957 with the Norfolk & Western-Virginia Railway merger and continuing with only a brief respite caused by the collapse of the Penn Central merger, railroad consolidations proceeded rapidly in the next quarter century as nearly forty railroads were merged and merged again into seven massive systems. The following chart reveals the major rail mergers which have been consummated since 1960.

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4. Ch. 91, 41 Stat. 456, 481 (1921); Pub. L. No. 66-152.
III. THE ABANDONMENT AND SPIN-OFF PHENOMENA OF THE 1980s

The trend toward consolidation reversed itself sharply in the 1980s when the nation's largest railroads, Class Is, began spinning off branch lines, dead-end spurs and some parallel tracks to newly formed companies which became regional and short line railroads. As one source has noted,

The railroad industry, built over many decades by constant consolidation and merger, suddenly seems to be scattering itself like confetti across the country. Increasingly, the industry may be evolving into a handful of giant cross-country railroads—the railroading equivalent of interstate highways—augmented by small or regional lines that are mostly spin-offs of the big ones.\(^8\)

Today, short line railroads account for twenty-four percent of United States trackage, up from six percent two decades ago.\(^9\) Between 1950 and 1980, some seventy-five new short line railroads (or two and one-half per year) were created;\(^10\) between 1980 and 1988, some one hundred ninety new short lines (nearly twenty-four per year) began operation—a rate nearly ten times faster than the historical trend.\(^11\)

The trackage operated by Class I railroads declined nearly twenty-six percent, from 177,710 miles of road in 1978 to 132,220 miles in 1987.\(^12\) Of that, 27,971 miles (about sixteen percent) were lost under certificates of abandonment, while 19,083 (about eleven percent) were sold to newly formed corporations that became short line and regional railroads.\(^13\) Since 1980, Class I railroads have reduced employment by more than 200,000 workers or nearly fifty percent.\(^14\) Thus, Class I trackage declined twenty-six percent while employment was cut nearly in half.

IV. THE INTERSTATE COMMERCE COMMISSION'S STIMULATION OF SHORT LINES

The explosive growth of short lines was stimulated by the Interstate Commerce Commission's extreme receptivity to deregulation. It began in

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13. Id.
1982 with the ICC's refusal to impose labor-protective provisions in the sale of lines by major railroads to non-carriers and was expanded in 1985 when the I.C.C. promulgated regulations formally exempting short line sales from virtually all regulation. This class exemption effectively relieved the selling railroad of any obligation to compensate the employees for the loss of their jobs as a result of the sale and relieved the short line or regional railroad successor of an obligation to employ the displaced workers. Further, it virtually eliminated all potential opposition by shippers concerned about a potential loss of service.

Former ICC Chairman Heather Gradison once described the short line phenomenon as an "unexpected dividend" of the Staggers Rail Act of 1980. Nonetheless, these exemptions, as well as ICC's liberalized handling of railroad applications since 1982, have been the subject of continuing legal challenges. They were embraced during a period when the ICC was criticized as being excessively infatuated with the ideology of laissez-faire and failing to perform its statutory obligations in a responsible manner.

Prior to 1980, virtually all cases involving sales of rail lines were between two existing railroad carriers and arose under section 11343 of the Interstate Commerce Act, which required the involved carriers to agree, as a condition of ICC approval, to an arrangement which would protect the economic interests and collective bargaining agreement rights of employees affected by the sale. The ICC concluded that if it could eliminate the requirement of employee protection (i.e., if it could "deregulate" the railroads' obligation to protect their employees), the sales of short lines would soar. Thus, the ICC decided to employ another provision in the Act dealing with construction of railroad lines and the extension of lines resulting from purchases. By using this provision, the ICC relieved itself of its responsibility to protect employee interests in approving appl-

16. See ex parte 392, 1 I.C.C.2d 810, 811 (1985); see also Wilner, supra note 10, at 61; Thoms, supra note 12, at 75.
17. The decision of the U.S. Supreme Court in Pittsburgh & Lake Erie R.R. v. Railway Labor Executives' Ass'n, 491 U.S. 490 (1989) is distinguishable from most short line sales because the sale there was not a true short line spin-off, but the sale of an entire railroad. The seller was not maintaining any contractual or other relationship with the new company and the unions had not requested the ICC to issue labor protective provisions. Thoms, supra note 12, at 83.
cations for acquisition. The imposition of such protection was, under section 10901, left to the discretion of the ICC. Although section 10901 explicitly stated that it was to be available to "a rail carrier providing transportation subject to the jurisdiction of the Interstate Commerce Commission," the ICC creatively interpreted the statutory language as applying only to a non-carrier not providing transportation subject to the jurisdiction of the ICC. In short, the ICC limited the use of section 10901 to corporations created solely to buy and operate a particular rail line, i.e., companies that could not "provide transportation" until after the ICC approved their purchase of a railroad line.

At first, the ICC held that it would not impose employee protective conditions in such cases unless adverse effects upon employees were significant and could be proved. But when such proof was presented in a case involving the sale of virtually all of what had been the Gulf, Mobile and Ohio Railroad before its merger with the Illinois Central (involving over 700 miles of line), the ICC refused to impose employee protective conditions, holding it would do so only in "unusual circumstances." It has yet to find such "unusual circumstances" to exist.

As a matter of practice and procedure, the ICC has virtually withdrawn from the regulatory arena where short lines are concerned. With its creation of a "class exemption" in 1985, the ICC relieved new corporations of a need to obtain advance approval of the acquisition or to seek prior exemption of that acquisition from such approval. Today, the ICC merely requires the perfunctory filing of a seven-day notice of intent to purchase a line, "thereby ensuring the narrowest window for potential opponents [including shippers] to object." At the end of the seven-day period, approval of the sale is automatic. Further, unless the applicant has lied in its application with respect to a significant material fact, no one can secure revocation of that approval. The filing of a notice permits the non-carrier to proceed without any further action on the part of the ICC except for the publication of a short description of the transaction in the Federal Register. Under the class exemption, the non-carrier has no obligation to make offers of employment to the employees of the selling carrier, nor does the selling carrier have any obligation to provide compensation for those of its employees who are thrown out of work as a result of the sale. If the employees seek any compensatory protections, they must file an after-the-fact "petition to revoke" the exemption for pur-

23. Id. § 1150.32.
24. Dowd, supra note 2, at 71.
poses of providing benefits for employees.\textsuperscript{26} In order for a trunk line carrier to transfer a line to another entity, the two parties need only agree on a sale or lease arrangement and the transferee or lessee then need only file written notice to that effect with the ICC.

Since beginning its exceptionally permissive approach on these issues, the ICC has imposed labor protective provisions in only one case, and that was because the sale was held to be subject to section 11343 (requiring such a provision), as entire railroads were involved in the sale. On November 10, 1992, the ICC unanimously imposed labor protection on former workers of the Fox River Valley and Green Bay & Western Railroads, whose companies were acquired by the Wisconsin Central Limited (WCL), a 2,500 mile rail system.\textsuperscript{27}

Kevin Dowd has identified the \textit{post hoc} remedies available to shippers under the Interstate Commerce Act:

1. \textit{Prescription of Rates}. Where a transaction leaves a shipper "captive" to a single carrier, an excessive rate level or surcharge may be challenged as unreasonably high under 49 U.S.C. § 1071a, and, subject to prevailing guidelines, ordered reduced.

2. \textit{Terminal Trackage Rights}. Disposition of origin/delivery lines in or around a terminal area under circumstances which restrict service options could be actionable under 49 U.S.C. § 11103(a), which empowers the ICC to require one carrier to give operating rights to another if it is shown to be "practicable and in the public interest."

3. \textit{Directed Service}. Section 11125 empowers the ICC to direct that one carrier's traffic be handled over its lines by another, if the first carrier is unable to transport traffic tendered to it due to bankruptcy or a negative cash flow.

4. \textit{Reciprocal Switching}. Where necessary to provide competitive rail service, the ICC may act under 49 U.S.C. § 11103(c) to require rail carriers to enter into reciprocal switching arrangements, to ensure timely handling of traffic and preserve access to other carriers serving a terminal area.

5. \textit{Financial Assistance}. Under 49 U.S.C. § 10905, a line proposed for abandonment may be ordered sold to a "financially responsible person," including a shipper, in order to preserve service. As an alternative, the abandoning carrier can be required to accept a subsidy to continue operations.\textsuperscript{28}

\section{V. The Economics of Short Line Spin-Offs}

\subsection{A. The Class I Railroads}

The economics driving Class I railroads to spin off lines to new com-

\textsuperscript{26} 49 U.S.C. § 10505(d) (1988); 49 C.F.R. § 1150.32(c) (1991).


\textsuperscript{28} Dowd, \textit{supra} note 2, at 73.
companies are powerful. Short lines have become a means whereby Class I railroads have shed themselves of thousands of workers, spinning off feeder lines to low overhead operators while keeping their high-density core routes. The short line phenomenon has also enabled Class I railroads to eliminate obligations to maintain thousands of miles of right of way and to realize significant profits by liquidating major capital assets, while avoiding ICC abandonment proceedings with their compulsory economic protection for affected employees.

Some argue that the creation of short lines is the only alternative to abandonment. Sometimes they are, although not as often as claimed. The fact is that short lines have not been created exclusively from branch or spur lines, but have also been formed from main or secondary main line track, some connecting major cities with significant traffic. Indeed, a number of the "short lines" are acknowledged large regional railroads.

Rail lines have been transferred to short line operators because they were either asserted redundant (e.g., the 631 mile Chicago, Missouri & Western), did not fit into the trunk line carrier's changing operating emphasis (e.g., the 772 mile Chicago, Central & Pacific), a combination of these two factors (e.g., the 2,000 mile Wisconsin Central Limited), or because they served to "punish" labor organizations that were not pliable to a particular carrier's views regarding changes in work rules. Much of the trackage likely could not have been lawfully abandoned even under the ICC's liberal abandonment procedures because it involved profitable main lines connecting major cities with significant traffic.

B. THE SHORT LINE AND REGIONAL RAILROADS

The new short lines have some cost advantages in terms of doing the job with fewer workers earning less pay under less favorable working conditions and milder safety regulation enforcement. But the short lines lose the economies of scale of large railroad operations and are often established with unsatisfactory debt-to-equity ratios causing their operating profits to be squeezed by high interest obligations. Moreover, many of the short lines are "captive" to the Class I railroads they feed, giving the Class I's almost absolute power to dictate unilaterally joint-line rates and conditions of service. Their captivity and, for many, gross undercapitalization, have led to a significant turnover rate and, arguably, a nar-
rower margin of safety. Derailments appear to be a problem with some regional and short line railroads and are of particular concern where they carry hazardous materials. When they go "belly-up," their lines may be abandoned, leaving the dependent shippers without service and further constricting the national rail system.

C. LABOR

For the industry's workforce, the new regime looks particularly grim — fewer jobs, less pay, and dilution of benefits, work rules, and safety standards. One critic has noted, "Railroads are selling off lines merely to circumvent their collective bargaining agreements." United States Representative Thomas Luken described short line sell-offs as a "merely subterfuges" by railroads seeking to avoid their contractual obligations to unions. Indeed, some line sale agreements have been explicitly contingent upon there being no employee protection provisions imposed and no union organizing campaign.

Other such efforts have been more imaginative. For example, the Norfolk Southern's Thoroughbred Program, under which the Norfolk Southern (NS) provides a cashless lease, relieves the operator from the responsibility for paying rent so long as he meets his quota. Norfolk Southern also provides rail cars and helps with marketing. The real change is that service previously provided by the Norfolk Southern is replaced by a new operator employing fewer workers at lower wages.

Unregulated short line sales and leases have resulted in furloughs of the employees of the seller/lessor carriers, decreases in wages for employees of those carriers who were hired by the new carriers, and changes in the work rules in effect on the rail lines involved. Typically, short line railroad companies have employed significantly fewer workers than did the selling/leasing railroads for operations of the transferred lines; usually the employees of the sellers/lessors were not guaranteed rights to transfer with the lines and often were required to relocate great distances. Employees who were furloughed in connection with line sales/leases but were able to obtain positions with the short line railroads generally suffered significant reductions in pay and the loss of contract benefits and protections.

33. See Phillips, supra note 8, at H7.
34. Machalaba, supra note 11, at 9.
The impact of such transactions on employees is illustrated by several examples. The Chicago and Northwestern Transportation Company (C&NW) had employed approximately 330 employees on the line it sold to FRVR Corporation, but FRVR hired only approximately 200 people at wages fifteen percent below the C&NW pay levels. \(^{37}\) CSX Transportation Inc. had employed approximately 220 workers on the lines in western New York State which it sold to the Buffalo and Pittsburgh Railroad (B&P), but B&P hired only 160 persons who suffered a fifteen percent reduction in compensation. \(^{38}\) A fifteen percent reduction also resulted from the sale of the Gulf and Mississippi R.R. Corporation track in Mississippi, Alabama, and Tennessee to Southeastern Rail Corporation. The result of Wheeling Acquisition Corporation's acquisition of 576 miles of trackage rights of the Norfolk and Western Railway Company (N&W) in Ohio, Pennsylvania, West Virginia and Maryland, was the displacement of 425 N&W employees, only 190 of whom were offered jobs with Wheeling Acquisition. \(^{39}\)

The major Class I railroads employed 458,322 workers in 1980, when the Staggers Rail Act was passed. By 1988, employment had fallen to only 235,880, a loss of more than 222,000 jobs in merely eight years. \(^{40}\) During this period, job losses totaled nearly 28,000 a year, nearly three times the rate of job losses in the 1970s.

In 1988, Class I railroads employed an average of 1.6 workers per mile of railroad line; regional railroads employed .72 workers per mile; and local (short line) railroads employed .44 workers per mile. \(^{41}\) In other words, short line railroads employed less than twenty-eight percent of the workers per mile vis-a-vis Class I railroads. Stated differently, more than seventy percent of Class I employees lose their jobs when lines are spun off to short line railroads. Using both conservative and liberal assumptions, the number of workers per mile falls between fourteen percent and twenty-eight percent, while the number of net jobs lost ranged between seventy-two percent and eighty-six percent; the total net jobs lost was...


\(^{41}\) See ASSOCIATION OF AMERICAN RAILROADS STATISTICS OF REGIONAL AND LOCAL RAILROADS 3 (1988).
between 20,000 and 29,000.\(^{42}\)

Those who are lucky enough to find a job at the short line earn wages up to forty percent less.\(^{43}\) They are often forced to relocate great distances even if seniority permits them to retain a position on the selling carrier. The short lines operate free of work rules and manning levels required of the unionized railroads\(^{44}\) and the stricter Class I safety requirement enforcement. For example, in 1986, when the C&NW provided the capital and management to set up the Dakota, Minnesota and Eastern (DM&E), it offered existing workers on the 1,000 mile line an ultimatum—if you want a job, resign from the C&NW, waive all your legal rights against it, then you will be *considered* for a job at the DM&E at lower pay.\(^{45}\) Again, the impact on workers is clear—fewer jobs, more onerous working conditions, and less pay.

Employees of lines sold or leased to short line railroads have been

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In 1982, Class I railroads employed 378,904 people and operated 173,656 miles of track, or 2.18 employees per mile. In 1987, Class Is employed 235,814 and operated 147,568 miles, or 1.59 employees per mile. Figures on short line railroads are, understandably, less precise. In 1987, the Short Lines employed between 6,536 and 4,600 individuals and operated between 14,534 and 15,400 miles of track, or between 0.45 and 0.30 workers per mile.

The net loss in jobs is derived by taking the number of employees per mile for Class Is and multiplying it by the number of miles operated by Short Lines, then subtracting the number of workers employed by Short Lines. With 2.18 employees per mile in 1982 multiplied by 14,534 and 15,400, we see that between 31,648 and 33,572 employees have been affected. Subtracting from that the number of people employed by Short Lines reveals the net loss in jobs between 25,148 and 28,972.

A more conservative way to calculate it is to use the 1987 Class I employment figure of 1.59 workers per mile. Using the same methodology, this results in a net less of between 16,473 and 19,886 jobs. This is still significant and it must be remembered that these data take us only to 1987, before the recession of 1990-93.


44. *Id.*

45. In 1986, the Chicago & Northwestern Railroad decided to relieve itself of some 1,000 miles of line across the northern tier of the United States. A “paper” corporation named the Dakota, Minnesota and Eastern was created to “buy” and operate the line. C&NW supplied seed money to DM&E for its startup and C&NW middle management officials “retired” from C&NW and were hired by DM&E. They immediately ranged across this 1,000-mile sparsely populated region of the United States informing C&NW employees (some with 40 or more years of service) that they were to be discharged upon consummation of the sale, that their unions could do nothing for them as there would be no unions on the property after the sale, and that if they resigned from the C&NW and waived any and all rights or claims under contract or otherwise they might have against the C&NW, they would then “be considered” for employment with DM&E at lower pay. Take it or leave it. Given their age, their specialized skills, and the lack of any employment within hundreds of miles, these employees had little choice but to accept whatever was offered them.
adversely affected by explicit provisions in the sale and lease contracts. The CNW-FRVR agreement contained a provision typical in such transactions whereby the sale was voidable if any form of employee protection arrangement was imposed as a condition of authorization of the transaction. The provision went as far as to say that the transaction was voidable if a union organizing campaign was in progress at the time of the sale.\footnote{FRVR Corp. Acquisition and Operation Exemption, Fin. Docket No. 31205, 1987 ICC LEXIS 49, at *12 (Feb. 21, 1989).}

Another example of such a restrictive condition in a sales agreement was a provision in the agreement for the sale of 1,200 miles of Soo Line Railroad trackage in Wisconsin to the Wisconsin Central Limited, which was designed to reduce the Soo Line’s obligation to its employees under an existing lifetime compensation arrangement. Soo identified those employees as “protected” and offered WCL a bounty of $40,000 per employee for each “protected” employee WCL hired over a 350 base figure.\footnote{See Soo Line R.R. v. Wisconsin Cent., Ltd., Civ. No. 4-88-900 (D. Minn.) (affidavit of John C. Miller).}

Employees have also been adversely affected by unregulated short line sales and leases which were specifically designed to nullify union contracts. An example of such an arrangement is the Norfolk Southern Thoroughbred Program, in which lines were leased to reduce labor costs under existing contracts without a loss to NS of long haul traffic.\footnote{See Railway Labor Executives’ Ass’n v. Chesapeake W. Ry., 738 F. Supp. 1544 (E.D. VA.), modified, 915 F.2d 116 (4th Cir. 1990), cert. denied, 112 S. Ct. 1312 (1991).}

Perhaps one of the clearest examples of unregulated transactions designed to take advantage of the ICC’s abdication of regulatory oversight, so as to avoid existing collective bargaining agreements, is the series of leases among the Guilford Transportation Industries (GTI) family of railroads. Timothy Mellon’s Guilford Transportation attempted to lease the Boston & Maine, Maine Central, and Delaware & Hudson to another subsidiary, the Springfield Terminal, a small former terminal rail line in New England.\footnote{See Railway Labor Executives’ Ass’n v. Guilford Transp. Indus., Inc., 667 F. Supp. 29 (D. Me. 1987); Delaware and Hudson Ry. Lease and Trackage Rights Exemption, Fin. Docket No. 30964 (Oct. 4, 1990); Thoms, supra note 12, at 75, 81; see generally, DEREGULATION, supra note 18, at 148.}

During the early 1980s, GTI acquired the Maine Central Railroad Corporation (MEC), Portland Terminal Corporation (PT), Boston and Maine Corporation (B&M), Springfield Terminal Railway (ST) and the Delaware and Hudson Railway (D&H) through consecutive acquisitions.\footnote{See Guilford, 667 F. Supp. 29, at 30-31.} In the fall of 1986, in order to reduce its work force, lower wages, and obtain more advantageous work rules, GTI arranged the lease of all the MEC, PT and
B&M operations and trackage to ST. Springfield Terminal Railway, a five-mile terminal rail line, had a collective bargaining agreement which provided lower pay rates and gave management greater flexibility in work rules than Class I railroad agreements. The effect of these leases was to transfer the employees from the relatively standard B&M, MEC and PT Class I agreements to the less beneficial ST agreement. The leases followed several unsuccessful efforts by GTI to negotiate significant changes in the work rules of the standard agreements. These changes were accomplished gradually, on a piecemeal basis. They were put into place through seven-day notices of exemption until all of the lines of those railroads were operated by the ST. 51

In essence, GTI accomplished a restructuring of its entire rail system and the avoidance of existing agreements on the B&M, MEC and PT through short line transactions accomplished without regulatory oversight. Rail labor protested each lease, arguing that the leases were designed purely for labor relations rather than transportation purposes and that many workers were denied the opportunity to follow their work. The ICC refused to block any MEC and PT leases and almost all B&M leases, asserting that it could retroactively remedy any adverse effects on employees, and warning GTI that the leases would be entered subject to revocation and retroactive remedies. 52 When the D&H began leasing its lines to ST and it became apparent that the entire GTI system was being leased to ST, the ICC halted further leases, but did nothing regarding the existing leases. 53 GTI subsequently put the D&H into bankruptcy reorganization proceedings and the trustee of the D&H subsequently filed suit alleging that GTI improperly transferred D&H assets to ST. 54

As a result of the leases many employees of MEC, PT and B&M lost work. Those who went to work for ST received lower wages under less advantageous work rules. ST also hired some individuals "off-the-street" in preference to the former B&M, MEC and PT workers. In 1988, the ICC finally held that B&M, MEC and PT employees had a right to follow their work and ordered arbitration. 55 In 1988 the employees won under arbitration. In 1989 the award was affirmed in part, but vacated in regards to the allowance of the employees to work under their old agreements on the leased lines. 56

52. Id. at 325 n.5, 327.
53. Id. at 327.
55. Delaware & Hudson R.R., 4 I.C.C.2d at 331.
A final arrangement governing the rights of MEC, PT and B&M employees was mandated by an arbitration award issued in March 1990 and affirmed by the ICC in October of 1990. In a subsequent decision, the ICC sua sponte reduced the make-whole period for employees who had been wrongfully deprived of employment to only seventy-five days. Thus, despite the fact that many employees had lost months or years of work between the leases in 1986 and the ICC decisions, many employees had retired and/or died during the course of these proceedings.

Beyond the direct effects upon employees' jobs and incomes, the short line program is being used as a vehicle to pressure Congress into eliminating a number of employee related statutes because, according to the short lines, the statutes are too expensive for short line railroads to comply with or are inappropriate for application to small railroads. These statutes include the Railway Labor Act, the Railroad Retirement Act, the Railroad Retirement Tax Act, the Railroad Unemployment Insurance Act, and the Federal Employers' Liability Act.

The ICC recently increased the revenue criteria for qualification as Class I and Class II rail carriers. The effect of this change is to place some of the larger short lines in the Class III category which are subjected to lesser safety enforcement by the Federal Railroad Administration. Most short lines are generally Class III carriers with lowered safety standards.

VI. CAPITALIZATION AND HIGH FAILURE RATE

Critics of the short line phenomenon insist that short lines have "splintered the railroad system, displaced thousands of workers and left track in the hands of poorly capitalized, poorly maintained railroad companies one disaster from bankruptcy." Yet another commentator...

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Kasher, Arbitrator). In the meantime, ST's operation of the GTI system involved the use of employees across craft lines which gave rise to allegations that the railroad was not being operated by qualified individuals and ultimately resulted in a strike which was subsequently held to be a lawful safety strike under additional arbitration.


59. The ICC also allowed modifications of the work rules applicable to the leased lines, including a seniority ranking whereby employees of MEC, PT and B&M furloughed at the time of the leases would have less seniority than employees hired by ST "off-the-street" after the leases.


63. 45 U.S.C. § 51 (1988). (This act permits civil recovery by employees against their employers for negligence causing employee injury.)

64. Machalaba, supra note 9, at A1.
In the case of a Complete Spin-Off, a principal concern for shippers may be the financial viability and operational reliability of the new carrier. Particularly if the acquiring entity is new to the railroad industry . . . there may be legitimate doubts whether it will have the capacity to maintain—much less improve upon—prior service levels. . . 

Acquisition of these lines by an inadequately capitalized firm, or through a leveraged transaction which leaves the new carrier heavily burdened with debt, could set the stage for abrupt economic dislocations or business failure and eventual abandonment. A shipper dependent on the continued availability of rail service would have a direct interest in the financial wherewithal of the prospective purchasers of the facilities needed to provide that service. Operational reliability also may be an issue, both in terms of adequacy of service and availability of equipment.  

Many short lines are inadequately capitalized (some, the product of leveraged buy-outs [LBOs]) and therefore have severe cash problems when confronted by unanticipated losses such as a tort liability judgment or a loss of equipment or track in, for example, a derailment. To the financial community, short lines have two values—the “going concern” value as a rail line and the liquidation value of the capital assets, mostly real estate, should the new railroad go “belly up.” While the public may have an interest in continued rail service in the geographic region, the bank may see prime residential, commercial, or industrial property over the horizon. Many of these short line rail companies lack sufficient capital for long-term maintenance and cannot take advantage of the economies of scale of larger railroads. Some are mom-and-pop operations, run like family farms with the owners eking out a fourteen hour day hand-to-mouth existence, praying for no derailments the way a farmer prays for rain.

Let us examine several of the poorly capitalized railroads. The Chicago, Missouri and Western Railway Company (CMW) was created as a non-carrier subsidiary of the Venango River Corporation (Venango), a holding company that already controlled another short line carrier, the Chicago, South Shore and South Bend Railway Company. Venango incurred a debt-to-equity ratio of 1,700 to 1 in its leveraged buy-out of the CMW. In 1987, the LBO artists put up only $55,000 in equity for the

65. Dowd, supra note 2, at 68.
66. See Phillips, supra note 8, at H1. ("They often throw every penny they have into their new ventures and usually go deeply into debt with major lending institutions . . . . ").
67. See Machalaba, supra note 9, at A6.
68. See generally, Bob Wiedich, Optimism Rolls On Short-Line Railroads, CHI. TRIB., June 29, 1990, at 3.
69. Dempsey & Thoms, supra note 20, at 69-73.
$105 million purchase of the 631 mile line from the Illinois Central Gulf (ICG) running from Chicago through St. Louis to Kansas City by using a section 10901 7-day notice of exemption procedure.

Beginning in 1986, prior to consummation of the purchase, and continuing in 1989, the ICC rejected complaints by labor unions and others challenging CMW’s acquisition of the line on grounds that it could not survive due to the highly leveraged nature of the purchase. The new company suffered operating losses from the start, losing $1.7 million in the first two full months of operation. In 1988, one year after it began operation, the new company filed for Chapter 11 bankruptcy, the victim of “operating losses, high debt, rotted track, and traffic levels far below projections.” By September 1989, it was virtually cashless. It was broken in two and sold off to two other short line railroads.

Numerous other railroads, including the Chicago, Central & Pacific Railroad (CCP) and the Gulf & Mississippi Railroad, have been restructured. The Cedar Valley Railroad Company (CVAR) was formed in 1984 to purchase 112 miles of rail line in Iowa and Minnesota from the ICG. In 1984, the CVAR reported revenues of $263,000 and expenses of $558,000. In late 1985, the owner of the CVAR purchased another 670 miles of ICG rail line in Iowa for $75 million. The acquisition was effected by a newly created non-carrier, the CCP. The purchase was financed in the form of a $65 million mortgage and $10 million in preferred stock.

When protesting parties questioned the competence of CCP management, the ICC responded that “managerial prowess is not germane to a Section 10901 application.” Subsequently, the owner of CVAR sold his interest in CCP, but maintained ownership of CVAR. However, CVAR ceased operations abruptly without ICC abandonment approval in May 1991 when the carrier defaulted on two bank loans exceeding $3 million. As a consequence, fifty-eight outbound rail cars loaded with grain were stranded on CVAR lines. In an emergency proceeding, the ICC approved CCP’s operation of CVAR up to January 1992. During that time

71. Machalaba, supra note 11, at B10.
72. The purchasers were SPCSL Corp., a short line created by the holding company that controls the Southern Pacific, St. Louis Southwestern and Denver and Rio Grande Western railroads, and Gateway Western Railroad Company, a short line captive of the Atchison, Topeka & Santa Fe Railway Company.
73. Machalaba, supra note 11, at B10.
75. Id.
78. Id.
CCP created a new noncarrier subsidiary, Cedar River Railroad Company, that acquired the assets of CVAR.

In 1979, four individuals, each investing between $160 and $255, and Beloit corporation, which invested $11 million through a holding company called PLECO, acquired the Pittsburgh & Lake Erie (P&LE), which had always been a profitable railroad. The acquisition of P&LE was performed through a leveraged buyout in which the funds for the entire purchase price of P&LE were obtained through a loan secured by all of P&LE's assets. As a result, the four individual investors each obtained between 8.4% and 13.4% control of P&LE for their nominal investments of between $160 and $255. With the decline of the steel industry in Pittsburgh, P&LE suffered losses. Pittsburgh & Lake Erie then entered into a debt reorganization plan with its creditors and agreements with its employees for reductions of wages and hours. In 1986, Beloit sold all of its holdings in PLECO to the management shareholders. The following year P&LE sought to sell all of its assets to a short line railroad for $75 million. Because the work force would be reduced by two-thirds without severance benefits and because the wages of retained employees would be reduced by fifteen percent a strike ensued. After many years of litigation and negotiations, portions of the P&LE were sold and the P&LE was reorganized. The restructurings which followed displaced two-thirds of the former workers on the line. Although the P&LE surely would have suffered as a result of the downturn in the Pittsburgh economy, its ability to weather this adversity was severely hampered by the debt assumed to support the leveraged buyout.

The consequences of undercapitalization are significant. Costs must be slashed and maintenance and new equipment purchases must be deferred. Track deterioration and the threat of derailments ultimately result in significant speed reduction. Deterioration of track, road bed, and rolling stock may go so far that the investment for rehabilitation may dissuade another entrepreneur from trying to make another go of it. The banks, of course, will step in at default and liquidate all the assets to recover their investment.

Where the line in question is profitable, its spin off to an undercapitalized short line may well jeopardize its long-term viability. The debt burden has too often crushed operating profits. Capital assets are encumbered by debt owed to financial institutions which often predicate their loans on the liquidation value of the properties. As just noted, a

short line operator on his way to insolvency may be forced to defer track and equipment maintenance. Not only does this jeopardize rail safety, it deprives the line of viability for any successor interested in picking up the pieces of the failed entrepreneur. Thus, should a governmental unit decide that the line is too important to communities which rely upon it to allow its track to be ripped up in abandonment, it may nonetheless find the economic burden of paying off the banks and rehabilitating the deteriorated line to be prohibitive.

The fatality rate of short lines has been quite high. Of the 138 regional or short line railroads created in 1986, twenty-nine failed within one year, a twenty-one percent failure rate. Some maintain the failure rate is between fifteen percent and twenty percent, although these figures preceed the recession of the early 1990s.

In the end, the harsh reality of a short line failure shows itself in the permanent abandonment of track and the eventual and somewhat inevitable replacement of switching and maintenance yards to other property uses such as office buildings and malls. Once a track is ripped up it is almost always gone, and gone forever. Recognizing this result, U.S. Senator Tom Harkin noted that the public interest in rail service warranted stronger governmental oversight of undercapitalized short line railroads: "Railroads are crucial to the movement of agricultural commodities, manufactured goods, coal and many other products. Their maintenance and continued operation at a proper level of service are essential for our national productivity."

VII. HOLDING COMPANY ACQUISITIONS

ICC deregulation of acquisitions of portions of large railroads has allowed the formation of rail systems without government oversight. Many transactions which have been presented as acquisitions of small portions of rail lines by new corporations have actually been acquisitions by rail systems under holding companies and composed of affiliated railroad corporations. Through this device, the holding companies have obtained control over hundreds and sometimes tens of hundreds of miles of connecting rail lines. In some instances, this has resulted in the formation of large connecting rail systems without any regulatory oversight. Often these acquisitions are accomplished through leveraged buyouts in which

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all of the assets of the acquired lines are pledged as collateral to lenders and the parent companies guarantee the loans.

While the absence of regulatory oversight over the acquisition of a small line arguably may not be serious, the consequences can be extremely serious when multiple lines and especially multiple connecting lines are acquired without any governmental assessment of the fitness of the operators or the financial soundness of the conglomerated operations. If the parent corporation or the common enterprise are not competent, or if financial difficulties occur, an entire region can find itself without competitive rail service or with no rail service at all.

Another deleterious consequence is that employees on the transferred lines have no right to continued employment on the lines and no severance pay or other economic rights to cushion their immediate loss of income; indeed, these transactions typically do not involve retention of the existing work force. Let us examine several of these rail conglomerate holding companies.

Itel Rail Corp. which controlled several rail carriers including the 250 mile Green Bay and Western Railroad Company (GB&W) formed a subsidiary, FRVR Corp. (FRVR) to acquire 200 miles of C&NW lines in Wisconsin which connected with the GB&W at Green Bay. Itel provided approximately twenty-five percent of the purchase price for the line and financed the balance by a loan secured by the property acquired by FRVR and guaranteed by Itel. The acquisition was accomplished through a seven day notice of exemption. C&NW employees were denied a right of hire on the line and FRVR was operated as a non-union operation even though GB&W employees were unionized. Itel encountered financial difficulties and entered into an agreement to sell FRVR and GB&W, to the Wisconsin Central Ltd. (WCL). WCL, an almost 2,000 mile non-union operator, effectuated the acquisition through its own newly formed subsidiary using the seven day notice of exemption and thereby merging 2,500 miles of rail line without regulatory oversight.

MidSouth Corporation (MidSouth) is another holding company that controls several short line railroads—MidSouth Railroad Company (MRC), MidLouisiana Railroad Company (MidLou) and SouthRail Corporation (SRC). MidSouth now operates 1,215 miles of rail line, formerly a part of the Illinois Central Gulf Railroad (ICG), which it acquired either through direct subsidiary purchase or indirectly by the acquisition of short lines created from former ICG track.

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MidSouth began this process by creating MRS to acquire ICG lines in Mississippi and Louisiana, which was concluded in 1986. MidSouth Corp. Continuance in Control Exemption, Fin. Docket No. 31186 (Feb. 12, 1987), aff'd sub nom. Railway Labor Executives' Ass'n v. ICC, 869 F.2d 1492 (6th Cir. 1989). Two years later, SRC was created to acquire the assets of the Gulf & Mississippi Railroad Company (GMRR), a short line created from other ICG rail lines in Mississippi and Alabama. MidSouth Corp. Continuance in Control Exemption, Fin. Docket No. 31186 (Feb. 12, 1987), aff'd sub nom. Railway Labor Executives' Ass'n v. ICC, 869 F.2d 1492 (6th Cir. 1989). GMRR's lines ran north to south and connected with MSR's east to west tracks at several locations. GMRR was yet another leveraged purchase that had failed to turn a profit and its sale was stimulated by creditor pressure. Both the MSR and SRC acquisitions as well as GMR's acquisition of ICG lines were concluded in a manner that resulted in furloughs of a number of employees formerly working on the line and the retention of the remaining workers at lower pay.

Other examples of the formation of rail systems without regulatory oversight are the GWI Corporation, Kyle Railways Inc., and RailTex, Inc. GWI, through consecutive transactions, has obtained control over four connecting rail lines in western New York. GWI owned two small connecting railroads; it formed the Rochester & Southern Railroad to acquire 91 miles of a connecting line and then became half owner of the Buffalo and Pittsburgh Railroad, which acquired a 369 mile line which connected with the R&S. Thus, through the notice of exemption process, GWI now controls almost 500 miles of rail lines through four corporations which share many common officers, directors, and executives.

Kyle Railways has obtained control of nine different carriers involving more than 730 miles of track through notices of exemption and it now seeks to acquire control over another 300 miles of track through a tenth subsidiary, the San Joaquin Valley R. Company.

RailTex, Inc. (RailTex) controls and/or manages at least six Class III regional railroads totaling over 1,100 miles of line. Typically, there is an overlap, sometimes complete, in the Boards of Directors and corporate officers between RailTex and the railroads it controls. Also characteristic of RailTex's method of operation is for it to hold at least a controlling interest, and sometimes absolute ownership, in the stock of each railroad in
return for serving as guarantor on the primary loans used to finance the purchase of the railroad. Additionally, RailTex often requires its subsidiaries to lease equipment, including locomotives, and to contract for management services such as operations, accounting, and payroll from RailTex itself.94

VIII. COMPETITION AND THE FREE MARKET

Although much of deregulation was premised on the notion that the eradication of government oversight would allow free market forces to work toward enhanced competition, such has not been the case with many of the short lines. Many, as we have seen, remain "captive" to the Class I railroads which spin them off. Because many of these purchased branch lines do not physically connect with any other railroad, they serve but one master. Sales and leases of other lines create different problems because the lines are dependent on the large railroads for income from "overhead" long haul traffic. Thus, they are subservient to the large Class Is that feed them.95

Typically, the sale and/or lease of so-called marginally profitable lines to new corporations involves the sale or lease of a branch or feeder line which connects with a trunk line of the large railroad; the large railroad retains the long haul traffic which is generated by the branch or feeder line, but has no obligation to provide service on that line or maintain it.

For example, when the Montana Rail Link (a 944 mile line formerly belonging to the Northern Pacific) was spun off the Burlington Northern, the Burlington railroad retained the main line section at Garrison, Montana, thereby controlling access to the Union Pacific at Silver Bow, Montana. Similarly, when the Illinois Central Gulf spun off a 600 mile parallel line from Chicago to St. Louis to the Chicago, Missouri & Western, it retained the Chicago connection so that it controlled all Chicago traffic.96

The Norfolk Southern Corporation's (NS) Thoroughbred Program serves as yet another example. The standard Thoroughbred transaction is a "cashless lease" which provides that if the new operator maintains the same level of service and carloading on the line and delivers those

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95. See Brian S. Moskal, Short Lines; The Little Trains That Can, INDUS WEEK, Nov. 14, 1983, at 71; see generally, Dowd, supra note 2, at 68 (describing such captivity as a "Tethered Spin-off").

carloads, actual cash payments must be to NS. Moreover, NS aids the operator in marketing rail services and providing rail cars to the operator to handle outbound carloads. The only real change effected is a reduction of employees on the transferred lines. In essence, NS simply has contracted out its common carrier obligations to a lessee.97

Because of the market power they wield by virtue of their monopoly access, the Class Is can unilaterally dictate joint-line rate divisions that favor them. Friction has also emerged between short lines and Class Is over surcharges.98

Dependent lines are those lines that, while marginally profitable, no longer fit into the corporate plans of the larger railroads. They often consist of main lines on the periphery of the larger system or parallel secondary main track. Some Class I railroads have sold off less desirable parallel track (less desirable in terms of route, grade, maintenance or customer base) to newly formed companies. Severance of these dependent lines from the larger rail system requires the new operator to create a stand-alone "regional" rail carrier out of marginally profitable lines whose capital requirements were subsidized, in part, by revenue from other operations in the larger rail system and without revenue from traffic destined for other parts of the large carrier’s system. This need to create a stand-alone operation is often complicated by the highly leveraged nature of the original purchase of the dependent line from the large railroad. If the new carrier is denied access to major transportation markets, is deprived of the feeder traffic enjoyed by the original railroad, loses the long-haul connecting freight previously routed over the line or is discriminated against by the seller in other ways, such as the rerouting of traffic or car supply, the new carrier’s continued operation is at risk. In the likely event of financial failure, the options left are disparaging. The new carrier may chose to abandon operations, in which case the result is a loss of service to the area (note that the line would not have been abandonable if it was still owned by the larger carrier); or it may sell the line to another carrier which will then be faced with the contradictory tasks of obtaining new business

97. In a turnabout on this practice, CSX Transportation (CSX) has recently reacquired a rail line which had previously been sold by a CSX component railroad, the Louisville & Nashville R.R. (L&N) to TransKentucky Transportation Railroad, Inc. (TTR). CSX Corp. Control, Fin. Docket No. 31991 (April 15, 1992). This transaction should be beneficial to CSX because TTR is profitable. However, CSX has not reacquired the line directly, but rather through a subsidiary that operates 18 miles of track. This transaction suggests the potential either for large railroad reacquisitions of profitable branch and feeder lines (particularly where profitability results from reduced labor costs through lower wages and elimination of labor contracts) or abandonments by the new owners of branch and feeder lines which are not profitable, even though the lines would not have been abandoned in the first instance by their original owners.

98. Moskal, supra note 95, at 71.
for the line, while at the same time, attempting to rehabilitate a physical plant that has deteriorated under its prior owner.

For example, in 1985, the ICG spun off 700 miles of track which parallel its lines between New Orleans and Memphis and Mobile and Memphis to the GMRR. Once severed from the ICG system, most "overhead" long haul traffic was rerouted to the parallel ICG line and the GMRR was forced to meet its financial obligations largely from local traffic. However, the GMRR lines were "light density", in that there was little local traffic originating or terminating on the lines. Once these lines were severed from the ICG system traffic and revenue plummeted. By 1987, GMRR had defaulted on loans totaling $21 million, failed to pay almost $1.5 million in interest payments, and had suffered a net loss of $4.7 million for the year.\(^99\) Moreover, the railroad was in such a state of disrepair because of deferred maintenance that speed was reduced to 10 miles per hour on two-thirds of its lines. By October 1987, the GMRR had defaulted on another $21.9 million in loans. Its $2.5 million line of credit was revoked.\(^100\) Ultimately, it sold out to the SouthRail Corporation which abandoned 75 miles of its track.\(^101\)

As noted above, the CMW was a highly leveraged transaction that ultimately failed. A substantial reason for its failure was its inability to obtain direct access to the Chicago transportation hub. Although the CMW purchased more than 600 miles of rail line from the ICG, CMW could operate over the ICG lines into Chicago only via a trackage rights arrangement that prohibited CMW from serving customers directly in the Chicago area. Instead, CMW merely delivered cars to the ICG and other carriers for delivery to customers. Moreover, CMW's main line between Chicago and St. Louis ran parallel to ICG's existing main line between those cities. While the sale agreement between CMW and ICG required ICG to exert its best effort to help maintain historic traffic routings over the CMW line, CMW ultimately petitioned the ICC to revoke the authority for the transaction because of ICG's alleged rerouting of traffic from CMW's line to the parallel ICG line.\(^102\) Many small railroads also complain that large railroads cancel join-rates and through routings, particularly where they


\(^{100}\) Id.

\(^{101}\) SouthRail Corp. Abandonment, ICC Docket No. AB-301, ICC LEXIS 131, at *1 (June 3, 1991). The abandonment eliminated SRC rail service to the port of Mobile, Alabama, and left the ICG as the only major north-south rail carrier serving that major port.

\(^{102}\) Rio Grande Indus. Inc. Purchase & Trackage Rights, 5 I.C.C.2d 952 (1989). Although this petition was withdrawn in June 1989, CMW sold its operations to SPCSL and Gateway Western only three months later because of CMW's continuing financial problems.
IX. CONCLUSION

The economic rudder of the United States was guided by laissez-faire ideology in the 1980s like no time in American history since the 1920s. The implicit thesis of the theology of laissez-faire is that unconstrained human greed will produce a better society. Deregulation and leveraged buy-outs are two consequences of that political movement which have coalesced in the rail industry to cause fundamental changes, some positive and some not. While much of the literature applauds the success stories of the short lines, and indeed there are several as this article has suggested, not all is well on the monopoly board of railroad—not for labor, not for communities and shippers which lose rail service because of the failure of undercapitalized short lines, and not for anemic short lines which find themselves under the thumb of a monopolistic Class I railroad.

The real issues raised by short lining are: who should own and operate otherwise viable lines of railroad which were formerly parts of larger rail systems and how should the public interest in the transfers of these viable rail lines be protected. Some assert that it is appropriate to evaluate a trunk line carrier as simply the sum of discrete parts instead of looking at it as an integrated operation where less profitable branch lines are parts of rail systems in which the trunk lines derive essential revenue from traffic which rolls off the branch lines.

Those branch lines which are transferred to short line operators remain linked to the trunk line carrier in many ways. Operationally, the branch line feeds traffic to and receives traffic from the trunk line. As noted above, in the case of Norfolk Southern's Thoroughbred Program, the trunk line carrier even continues to market service on the transferred line. Financially, the traffic generated from the branch line results in line haul revenue accruing to the trunk line carrier. Therefore, whether or not the trunk line carrier owns the branch line, that line is still linked in a symbiotic relationship with the rest of the trunk line carrier's system. Since the short line will remain linked to the rest of the nation's rail network, the fundamental policy question is whether the decision to create a short line from the trunk carrier's operations should be subject to meaningful governmental oversight or whether such decisions should rest entirely with the trunk carrier. As always, in essential infrastructure

104. See generally BARLETT & STEELE, supra note 81.
industries such as transportation, the real question is where does the public interest lie.

Because transportation is an essential part of the infrastructure of our nation's commerce, enhanced public scrutiny is warranted. Indeed, the Interstate Commerce Commission was established precisely in order to protect that public interest. Among the factors which arguably should be assessed by the ICC to determine the economic viability of short line railroads are: (a) the existence of a renewable traffic base, (b) the financial ability of the purchaser, and (c) the competence of its management. For equity purposes the impact on labor should also be assessed. Procedurally, sufficient time should be allowed to assess these transactions in terms of their impact upon the public interest. The public interest lies in encouraging the creation and preservation of well managed, adequately capitalized railroads providing safe, adequate, dependable, and reasonably priced rail transportation.
The Downside of Motor Carrier Deregulation

DABNEY T. WARING, JR.*

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In the latter part of the 1970's decade (1978 is generally accepted as
the watershed year) the Interstate Commerce Commission (ICC) began to
deregulate the motor carrier industry administratively. Entry barriers were
lowered considerably and decisions in the MC-297 series of proceedings
curtailed the strength of the collective action of the carriers.

These changes, plus additional measures of a deregulatory nature,
were codified in the Motor Carrier Act of 1980 (MCA). However, the new

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law was far from complete deregulation. The statute retained provision for significant regulation by the ICC. It may be something of a simplification to say that the ICC has elected to exercise the very minimum amount of regulation authorized. In fact, the argument can be made (and has been made) that the ICC has actually failed to regulate to the degree contemplated and required by MCA. In any event, that argument will not be pursued here. What is intended is to examine some of the effects of the lessened regulation, inaccurately but conveniently referred to generally as deregulation.

It is difficult to pinpoint the motivation of the deregulators. For some it appears to be entirely ideological: “free enterprise” is a goal that must not be questioned, must not be compromised, must not be restricted. For others it is merely greedy exploitation of power: the super shipper who can command concessions greater than average. For others it is a smattering of both plus the regrettable philosophy that cheaper is better and the mistaken belief that regulation necessarily means higher prices.

To the first group it can only be hoped that they will pause to reflect that extremes are never good answers and that textbook models and real world conditions are not the same. To the second group it must be said that if their world is entirely short run they may be serving themselves well but if they have any interest in long term consequences the facts which follow should be noted. Perhaps the best response to the last group comes from Dr. W. Edwards Deming, arguably the most respected management consultant in the world today, certainly recognized as the man most responsible for rebuilding industry in post-war Japan. Dr. Deming has said, “The policy of forever trying to drive down the price of anything purchased with no regard for quality and service, can drive good vendors and good service out of business.”

TRUCKING IS UNIQUE

To begin with, it must be recognized that, absent the restraining hand of government intervention, the trucking industry is uniquely constituted to spiral itself into self-destruction. Trucking is different because, first of all, it is a service industry with a perishable product: capacity available today cannot be inventoried and sold tomorrow. Of course, this is true of many service industries but there are other differences which, taken together, set trucking aside. One such difference is the high proportion of joint costs. At a minimum, the prevalence of joint costs makes cost analysis difficult and susceptible to subjective pricing influences; at worst, joint

1. W. EDWARDS DEMING, QUALITY, PRODUCTIVITY AND COMPETITIVE POSITION 23, (Massachusetts Institute of Technology, Center for Advanced Engineering Study 1982).
costs are irresistibly easy to ignore completely when calculating the cost of handling traffic for which there is strong competition.

Further, few service industries engage in the high-pressure sales competition prevalent in trucking. Truckers don't wait for the phone to ring or for a customer to walk in the door: the waiting room of the traffic manager of every major shipper is always full of trucking salesmen anxiously soliciting business. One reason for the sales frenzy is the need to prevent or minimize unused capacity. This is not to be confused with "excess capacity" in the sense normally used by economists. Such excess capacity as did exist (a product of the flight of TL traffic) in the early 80's was eliminated by the spate of bankruptcies the LTL industry has since suffered. On the other hand, unused capacity is a natural, chronic problem of the LTL general trucking industry which is characterized by peaks and valleys. Carriers must be prepared to handle the peaks or risk the enmity of shippers. Consequently, during the valleys, there are equipment, facilities and employees waiting to be used.

SAFETY

A simple measure of safety performance before and after changes in regulation is not available for several reasons. First of all the statistics are not there. Where accident records are kept miles travelled are not, plus there are major problems in under-reporting accidents. In addition, the criteria for what constitutes a reportable accident have been changed, thus making trend analysis impossible. Finally, safety programs at both the federal and state level have been stepped up greatly during the period since 1980, making it impossible to isolate the separate and opposite effects of deregulation and increased safety programs.

However, it is logical to assume that if deteriorating financial health has been experienced, short cuts around safety will follow — whether at the firm level or at the individual level. That is to say, if squeezed for profit, the company will find the temptation to defer maintenance irresistible. Similarly, a driver whose pay rate per hour or per mile is reduced will be sorely tempted to offset the cut by working more hours per day or driving more miles per hour.

This is not an idle or particularly personal supposition. One of the most ardent deregulators in the land, Thomas Gale Moore, lately of the President's Council of Economic Advisors, a Senior Fellow at the Hoover Institute, Stanford, an adjunct at the American Enterprise Institute, etc., etc., has stated "... theory suggests that safety might be lower in a competitive market ..." and then adds "... regulation may provide incentives
for above-optimal levels of safety."2 The same thought was echoed by Stiglitz and Arnott "... it should not be assumed a priori that the current level of transport accidents is too high."3 What these economists are saying is that everything has a price and you elect to pay for just so much safety; perhaps we don't want to pay for more safety. Regrettably, those who make the payment and choose how much safety they are willing to pay for are not trading for their own safety. It is the safety of third parties, not parties to the rate-safety negotiation, whose safety is being traded.

The Office of Technology Assessment, reporting to Congress on its study of the trucking industry made an observation in the same vein:

In fleets having financial difficulties, vehicles are not as well maintained and equipment tends to be older. . . . Overcapacity leads to price discounting and shrunken profit margins, creating difficult economic trade-offs for decisions about investment and 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. Carriers are, in general, interested in safety but they will measure investments in new safety equipment and technologies against tangible economic reward. Cost and safety trade-offs are particularly problematic for owner-operators and small carriers, who have to generate revenue regularly to stay in business and they have no regular operations base or maintenance facility. . . . To compete successfully as individual entrepreneurs, owner-operators must drive long hours and accept TL backhauls at low rates, circumstances that create physical, psychological and economic hardships.4

Glaskowsky recognized the same link in his study of the effects of deregulation, commissioned by the Eno Foundation:

Many aspects of deregulation are subject to disagreement and debate as to their effects, but safety is not one of them. Safety costs money where transportation operations are concerned and it was inevitable that deregulation would put much financial pressure on a many [sic] motor carriers. Corners are being cut by financially strapped carriers and the accident rate is rising. This was a clearly foreseeable consequence of deregulation. Failure to take it into account and head it off by appropriate action is no credit to the deregulators.5

The relationship, obvious to the informed, was validated in a study by Chow where it was found that:

the financial condition of the carrier does make a difference. The carrier which eventually goes bankrupt spends less on safety and maintenance, has older equipment and depends on owner operators more than carriers not going bankrupt. As these financially distressed carriers approach their eventual demise, they spend even less on safety, on new equipment and more on subcontracted linehaul.6

In 1991, the Government Accounting Office (GAO) released its report FREIGHT TRUCKING: PROMISING APPROACH FOR PREDICTING CARRIERS’ SAFETY RISKS.7 This report also validates the relationship between financial distress and safety deterioration in unequivocal terms. The report was a response to a request by the Chairman of the House Committee on Public Works and Transportation, to determine if certain economic and other conditions could be used as predictors of safety outcomes.

In approaching the study, the GAO asked the question, “[h]ave the economic pressures on trucking firms led to practices that endanger public safety?” The study was designed to test the hypothesis:

that a decline in economic performance among motor carriers will lead to declining safety performance in one or more ways, described by five submodels: (1) a lowering of the average quality of driver performance, (2) downward wage pressures encouraging noncompliance by drivers with safety regulations, (3) less management emphasis on safety practices, (4) deferred truck maintenance and replacement, and/or (5) introduction of larger, heavier, multitrailer trucks.8

With regard to driver quality, the study hypothesized:

if economic conditions in the trucking industry deteriorated, then carriers’ restricted financial resources would place a downward pressure on wages and lessen job security through carriers’ reducing their number of employees or exiting the industry. In turn, if lower wages and less job security made working in the industry less attractive, then the industry would be less able to retain and attract high quality drivers.9

As with most studies of this sort, the final analysis made strong positive findings on some points, found weak support for others and was inconclusive on others. On three points, the GAO had no trouble making firm statements:

(1) [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.

8. Id. at 2.
9. Id. at 50.
(2) Firms in the weakest financial position had the highest subsequent accident rates.

(3) "Driver's age, years of experience, and compensation were all good predictors of safety problems." For company drivers, "lower paid drivers were more likely than their higher paid counterparts to violate safety regulations."10

In all candor, it must be conceded that the Department of Transportation, under Administration mandate to foster and promote deregulation at every opportunity, did not concur in the GAO findings. DOT argued that "GAO's findings were not strong enough to warrant either the conclusion contained in the title of the report or the recommendations and inferences contained in the executive summary."11

CARRIER FINANCIAL DETERIORATION

If, then, financial distress impacts negatively on safety as well as the carriers' ability to survive and serve, what evidence is there that deregulation adversely affects the financial condition of the carriers? In a word, plenty!

Table I chronicles the deterioration of the profitability of general freight carriers in terms of the three most common measurements of carrier profitability.12

ROE, return on equity, is after-tax income divided by the net of stockholders' and proprietors' equity less intangible property, signifying the return to owners of the value of their holdings. Note that from 1976 through 1979 ROE averaged 14.85; from 1980 through 1992 it averaged 8.91. The ICC decided in docket 29772 in 1979 that a fair measure of a reasonable ROE for the motor carrier industry would be that obtained by All-Manufacturing. ROE for All-Manufacturing averaged 14.89 for the 1976 to 1979 period (virtually identical to that of the motor carriers) and dropped to a 10.88 average for the period 1980 to 1992. For the two periods, trucking dropped 40% while All-Manufacturing dropped only 27%.13

ROI, return on investment, is before-tax income divided by the sum of working capital and net carrier operating property, signifying the return on the value of the investment. In that same docket 29772, the ICC decided that a reasonable ROI for the motor carriers would be 21. Note that the carriers averaged 20.18 from 1976 to 1979, whereas the average was 13.35 for the years 1980 to 1992.

10. Id.
11. Id. at 83.
13. BUREAU OF THE CENSUS, QUARTERLY FINANCIAL REPORT.
In 1964 the ICC declared that 93.0 was a reasonable operating ratio for the industry. Table I shows that for the years 1976 to 1979 the average operating ratio was 95.16 which rose to 96.37 for the next 10 years, a 25% deterioration in operating margin.

It is clear that regardless of which of the three measurements is used, the carriers were distinctly more profitable prior to the Motor Carrier Act of 1980, or, more to the point, before the ICC administratively loosened regulation drastically. In this regard, note that there was nothing about the pre-1980 period which could properly be called excessive profitability. Therefore, the subsequent deterioration in profitability was from a level which was already inadequate. Furthermore, the deterioration in profitability becomes more startling when it is realized that the carriers comprising the group in the late years are the survivors; the weakest carriers had been eliminated which should have improved the earnings indicators.

A sadder statistic to contemplate is the business failure rate. Table II shows the trend in trucking industry failures and the rate per ten thousand concerns as well as the comparison of that rate to that of All-Industry.
TABLE II

<table>
<thead>
<tr>
<th>Year</th>
<th>Trucking Failures</th>
<th>All-Industry Failure Rate</th>
<th>Ratio Trucking Rate to All Ind.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Rate</td>
<td>Number</td>
</tr>
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<td>65</td>
</tr>
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<td>1990</td>
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<td>76</td>
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<tr>
<td>1991</td>
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<td>178.3</td>
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</tr>
<tr>
<td>1992</td>
<td>2259P</td>
<td>173.4P</td>
<td>126P</td>
</tr>
</tbody>
</table>

P = Preliminary

Note that in the closing days of pre-1980 regulation the failure rate of the trucking industry was virtually identical to that of all industry, but as deregulation took its toll, through the decade of the 80's, the failure rate of trucking relative to all industry grew dramatically and continues so. Preliminary data for 1992 suggests the distortion is abating but at best it has hardly given cause for complacency. This is the inevitable consequence of the financial deterioration of the industry seen in Table I.

It was stated in the quoted comments that financial distress would impact the condition of the equipment operated by the carriers. A good measure of that characteristic can be found in the data maintained by the Motor Vehicle Manufacturers Association pertaining to the age of trucks. This is shown in Table III.
TABLE III
AGE OF TRUCKS
(numbers of trucks in millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Age All Trucks</th>
<th>Number of Trucks 12 Years and Older</th>
<th>Number of Trucks All ages</th>
<th>Ratio 12 Year Olds to Total*</th>
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</thead>
<tbody>
<tr>
<td>1970</td>
<td>7.3</td>
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<td>24.8</td>
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<td>4.8</td>
<td>26.5</td>
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<td>1977</td>
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<td>5.1</td>
<td>28.2</td>
<td>82</td>
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<td>1984</td>
<td>8.2</td>
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<td>40.1</td>
<td>109</td>
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<tr>
<td>1985</td>
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<td>10.7</td>
<td>42.4</td>
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<td>1986</td>
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</tr>
<tr>
<td>1992</td>
<td>8.4</td>
<td>18.3</td>
<td>61.2</td>
<td>136</td>
</tr>
</tbody>
</table>

* Indexed (1970 = 100)
Source: Motor Vehicle Manufacturers Association: Facts & Figures

These figures show that the average age of trucks in use was climbing steadily through the early 80's, whereas it had been dropping through the 70's, and has resumed its climb currently. The same must be said, even more emphatically, about the trucks 12 years old and older. Measured another way, the proportion of the nation's fleet of trucks 12 years old or older which was dropping through the 70's has been climbing since the watershed of 1980 — the 1992 ratio was 170% higher than the trough in 1975!

**DRIVER LOSSES**

It was stated earlier that the drivers have been impacted by the competitive frenzy just as the carriers have or perhaps it would be more to the point to say that the pressure on the carriers is in part passed on to the
drivers. In any event, evidence of what linehaul drivers have experienced under deregulation is found in Interstate Commerce Commission data published in *Transport Statistics in the United States* shown below in Table IV. The data are for Class I common carriers of general freight engaged in intercity service.

**TABLE IV**

<table>
<thead>
<tr>
<th>Year</th>
<th>Avg Wages Per Mile</th>
<th>Avg Wages Per Year</th>
<th>Index of Avg Wages Per Mile</th>
<th>Index of Avg Wages Per Year</th>
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</thead>
<tbody>
<tr>
<td>1978</td>
<td>0.27</td>
<td>24,608</td>
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<td>100</td>
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<tr>
<td>1979</td>
<td>0.33</td>
<td>26,455</td>
<td>110</td>
<td>97</td>
</tr>
<tr>
<td>1980</td>
<td>0.36</td>
<td>30,072</td>
<td>106</td>
<td>97</td>
</tr>
<tr>
<td>1981</td>
<td>0.36</td>
<td>33,349</td>
<td>96</td>
<td>97</td>
</tr>
<tr>
<td>1982</td>
<td>0.37</td>
<td>33,565</td>
<td>93</td>
<td>92</td>
</tr>
<tr>
<td>1983</td>
<td>0.39</td>
<td>34,244</td>
<td>95</td>
<td>91</td>
</tr>
<tr>
<td>1984</td>
<td>0.36</td>
<td>34,055</td>
<td>84</td>
<td>87</td>
</tr>
<tr>
<td>1985</td>
<td>0.36</td>
<td>33,194</td>
<td>81</td>
<td>82</td>
</tr>
<tr>
<td>1986</td>
<td>0.34</td>
<td>34,286</td>
<td>75</td>
<td>83</td>
</tr>
<tr>
<td>1987</td>
<td>0.35</td>
<td>35,235</td>
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</tr>
<tr>
<td>1988</td>
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<td>1989</td>
<td>0.36</td>
<td>37,336</td>
<td>70</td>
<td>80</td>
</tr>
<tr>
<td>1990</td>
<td>0.38</td>
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</tr>
<tr>
<td>1991</td>
<td>0.37</td>
<td>40,399</td>
<td>66</td>
<td>79</td>
</tr>
</tbody>
</table>

It will be seen that wages per mile (unadjusted for inflation) increased through 1980 and then hit a plateau. Since 1980, the level is virtually unchanged. At the same time, annual income increased at about the same pace through 1980 but continued a moderate increase thereafter, indicating an attempt to deal with inflation by working more hours — or more miles. The true plight of these workers can only be seen in inflation adjusted data which are found in the last two columns of the table (deflated by the CPI). The pay rate (wages per mile) has dropped 40% in constant dollars since the peak in 1979! Is it any wonder that there is concern about a driver shortage? To make matters worse, it is, logically, the best drivers who will leave first. While wage rates were dropping 40%, income per year was dropping 19%. This tells us that the effort to offset the plunging wage rate by driving faster and/or longer was only partially effective and still left them with a significantly lower standard of living. And as the GAO report found, safety inevitably suffers.

What does all this do to the carriers' operations: this lower return, this threat of bankruptcy, this older equipment, these under-paid drivers? The
answer can be found in the productivity trends shown in Table V where trucking productivity from 1970 through 1990 is shown and is compared to that of the railroad industry for the same period.

### Table V

**PRODUCTIVITY IN TRUCKING AND RAILROADS**

<table>
<thead>
<tr>
<th>Year</th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
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<tr>
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<td>412</td>
<td>999</td>
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<td>771</td>
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<td>91.9</td>
<td>746</td>
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<td>783</td>
<td>575</td>
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<td>505</td>
<td>1096</td>
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<td>858</td>
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<td>261.4</td>
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</table>

P = Preliminary  
(1) Billions of Ton-Miles, Trucking  
(2) Employment, Thousands, Trucking  
(3) Productivity, Trucking = (1)/(2) indexed to 1979 = 100  
(4) Billions of Ton-Miles, Railroads  
(5) Employment, Thousands, Railroads  
(6) Productivity, Railroads = (4)/(5) indexed to 1979 = 100

Sources: Employment: BLS — Employment and Earnings  
Ton-Miles: TRANSPORTATION IN AMERICA, Eno Foundation

The first thing that emerges from Table V is the fact that the solution for one industry’s problems may not be the solution for another industry’s problems. Productivity in the railroad industry which was positive during the 70’s took off like a sky rocket after deregulation. On the other hand, trucking productivity which was experiencing modest improvements in the 70’s, turned absolutely flat after 1980.

It is important to consider the reasons for the dramatic improvement
in rail productivity. It is safe to say that in the mind of any student of transportation the principal explanation is reduction in service. With release from the requirement to justify abandonment of branch lines, the rails eliminated branch lines with a frenzy, leaving small shippers, particularly in remote areas, high and dry.

The situation is much akin to that in the bus industry. For sixty years or more, the bus linked rural America with the rest of the country. No matter how remote your home, the bus made it possible to visit friends and relatives, to get to doctor's offices, to get to a college or the new job and to get back home for a visit.

But the great freedom of deregulation was granted to the rails and to the bus industry. In the exhilarating new world of opportunity, every service that was not completely self supporting was dropped. Bus service, as rural America knew it, is dead. The rails have fared well as have some of their customers, notable exceptions being shippers of coal and the small shippers on now-abandoned branch lines.

To the urban business traveler, loss of the busses went unnoticed, but the small town resident is deserted. To the major corporation, rail service is still there, but to the minor corporation it's a different story.

THE COST BASIS OF RATES

Contrary to the assurances of the advocates of deregulation ten years ago, ratemaking has trended away from a cost basis since 1980. Not that costs are completely disregarded in making rates today, but there is far less conformity to cost as a direct basis. Other considerations weigh far more heavily than they ever did prior to 1980. This trend is the direct result of the ICC adoption of a free market policy on rate regulation.

In the pre-1980 era, the standard, the point of reference for all rates, was the class rate structure. This structure was designed to recognize precisely three elements: classification rating, weight of shipment and distance. The general rate level was based on industry operating costs and revenue need considerations.

The first element, classification rating, was dominated first by consideration of density and second by other transportation related characteristics, in order to reflect differences in the handling of commodities. Value of service at one time was a factor in classification, but when it was eliminated from consideration by edict, there was no observed change in class ratings or published rates; the fact is, it had been disappearing from consideration for years.

The element of shipment weight was implemented in discrete increments and was for the sole purpose of recognizing differences in cost of handling.
The third element, distance, also was solely a cost factor.

If there were imperfections in the class rate structure as a measure of cost differences, as no doubt there were, they were attributable to the problems of trying to keep a pricing structure timely in response to changing products and product make-up. There was no motivation other than to reflect costs, nor any reason for there to be one.

Special situations arose involving both specific shipment cost matters and elasticity of demand. These were handled by exceptions to the classification for the transportation of commodities over wide geographic areas, or point-to-point commodity rates for more specific movements. In either case, cost was always considered together with marketing justification. The basic criterion for cost was that direct expenses must be covered plus some contribution to indirect expense.

The class rate structure is still in place and still governed by the same three criteria. It is still a cost based instrument. Exception ratings and commodity rates are also still in existence but, by and large, their roles have been replaced by discounting. Discounting, as observed today, differs from the use of exception ratings and commodity rates, in several ways — probably the most significant is that during the past ten years, ICC practice has been that discounts haven't had to be cost justified and consequently have not been cost related.

**WHY DISCOUNTS CAN BECOME EXCESSIVE**

The advocates of deregulation assured all that carriers would not price below cost, that whatever anomalies might develop in the short run, while carriers adjusted to the market place, normalcy would return as excess capacity was worked off. Eleven years have elapsed since the Motor Carrier Act of 1980 and the financial condition of the industry survivors, the stronger carriers, is worse than that of the industry before the weaker carriers were eliminated. As predicted, carriers have failed, but in numbers far exceeding expectations and the result is a weaker not a stronger industry.

**THE CONSEQUENCES OF EXCESSIVE DISCOUNTING**

There are two serious dangers attendant to differential pricing in general which are brought to fruition by excessive discounting. The first is the matter of equity among shippers. There is no disputing that differential pricing can be beneficial to all parties, but there are conditions. As one of the early sages of transportation, D. Philip Locklin, once said:

If the distinction between constant and variable expenses has been fully grasped it will be apparent that preferential rates relieve rather than increase the burden on other traffic if two conditions are fulfilled. These are that the
rate must more than cover the direct costs; and that the traffic will not move at higher rates. When these conditions are fulfilled preferential rates are of benefit to all concerned.\textsuperscript{14}

Dr. Locklin's points are essential to equity among shippers. There is no error in unequal distribution of the overhead burden among shippers \textit{provided} that the shipper enjoying the "preferential" rate pays not only the direct costs but also \textit{all} of the indirect costs it can afford. Needless to say, if the preferred shipper is not even paying the direct costs, the inequity is completely out of hand.

The other danger is proliferation of the excessive discounts. When the "preferred" shippers begin to multiply, there may not be enough "non-preferred" shippers left to cover the indirect costs. \textit{Indirect costs must be recovered in full from someone and there is no source other than shippers.} When the complete recovery of all costs fails, the matter of inequity among shippers is exacerbated by foundering carriers.

\textbf{THE EVIDENCE OF EXCESSIVE DISCOUNTING}

It is generally accepted that ideal rate making will bear some relationship to the cost of providing the service. This is usually interpreted to mean that any difference in rates must be justified by corresponding differences in cost, absent special circumstances.

Differences in cost can result from many factors. The shipping platform may contain too few bays for the quantity of freight moving — this would cause delay for the carrier. The shipper may be in a congested downtown location — more delay. The general attitude of the shipper's dock personnel — uncooperative — can spell delay. Conversely, adequate shipping facilities, convenient location and more productive personnel mean cost savings to the carrier.

Other cost factors concern the carrier's operating situation. Chronic empty back haul, as a prime example, introduces a new cost algorithm.

Setting those special conditions aside, it is important to the present inquiry to examine potential cost differences which may be due solely to volume, in terms of number of shipments, tendered to a carrier at one time. "Multiple tender", as it is known, is the most prevalent basis cited for rate discounts or reductions.

To fully understand the opportunities for such cost savings, it is necessary to review what happens, physically, to a shipment moving in motor carrier transportation. The handling of a shipment involves a series of necessary steps:

\textbf{Pickup:}

1. Pickup truck moves to pickup area, i. e., the first stop. (stem time).

\textsuperscript{14} D. PHILIP LOCKLIN, ECONOMICS OF TRANSPORTATION 161 (1938).
2. Truck is backed up to the dock; driver presents himself to the dock foreman. (contact time).

3. Driver is given Shipping Orders (copies of Bills of Lading) and presented with freight. Loading commences. (loading time).

4. Driver signs Bills of Lading. (this with handling of Shipping Orders in step 3 is shipment-constant time).

5. Driver pulls away from dock and drives to next stop. (variable running time).

6. Driver completes pickups/deliveries and returns to terminal. (stem time).

Platform Handling:

Pickup truck is unloaded, each shipment being taken to a linehaul trailer at another door which is being loaded for a specific terminal. The shipment is loaded on that trailer. This is often one continuous movement via forklift or dolly. When there is not a trailer available for the destination terminal, the shipment is temporarily set on the floor of the dock until a trailer is made ready.

Linehaul:

Linehaul driver is assigned to the waiting tractor-trailer and dispatched to the destination terminal or to a relay terminal. At the relay terminal another linehaul driver is similarly dispatched with the same rig to the destination terminal or to another relay terminal. The relay terminal may also be a "breakbulk terminal" for less than truckload freight, where the freight on the incoming trailer is unloaded and reloaded on other outbound trailers just as the pickup truck was unloaded at the origin terminal.

Platform Handling:

Trailer is unloaded, each shipment being taken to a delivery truck at another door which is being loaded for a specific section in the terminal area. The shipment is loaded on that truck. This is often one continuous movement via forklift or dolly. When there is not a truck available for the destination section of the delivery terminal area, the shipment is temporarily set on the floor of the dock until a truck is made ready.

Delivery:

1. Delivery truck moves to delivery area, i.e., the first stop. (stem time).

2. Truck is backed up to the dock of the consignee; driver presents himself to the dock foreman. (contact time).

3. Driver presents Delivery Receipts for the receiver to check freight and commences to unload. (unloading time).

4. Driver gets signature on Delivery Receipts. (this with handling of papers in step 3 is shipment-constant time).
5. Driver pulls away from dock and drives to next stop. (variable running time).

6. Driver completes pickups/deliveries and returns to terminal. (stem time).

Billing and Collecting:

Rate clerks rate and extend the charges on the bills of lading. Clerks prepare freight bills and trip manifests. Clerks prepare and mail statements.

To repeat, this discussion will focus on those activities which are affected by tenders of large numbers of shipments to a carrier simultaneously as opposed to the tender of just one shipment at a time. Size of shipment is not at issue; rate schedules are designed to recognize the economies of handling a large shipment as opposed to a small shipment and such economies are equally available to the large shipper and the small shipper. Likewise, the difference in cost of handling two different commodities is not at issue; classification, except where it is negated by freight-all-kinds (FAK) rates, takes care of those differences and applies equally to all shippers.

What then are the elements of service which can be eliminated by tendering a large number of shipments as opposed to the same shipments being tendered one at a time by a multitude of shippers? Linehaul is obviously not a candidate. It is a matter of complete indifference in the linehaul operation whether the trailer is loaded with shipments from one shipper or a hundred shippers. The same can be said of the Platform Handling. When the pickup truck is being unloaded at the terminal, the operation is exactly the same for each shipment; it matters not at all whether successive shipments are from the same shipper or different shippers.

On Billing and Collecting, the rate clerk's job is essentially the same in either case, though it may be argued that multiple shipments from one shipper coming to him in a batch will probably save some time because of the repetition. The clerk who prepares the freight bills and manifests will probably save nothing. There will be some saving in postage, if nothing else, in sending a statement to one shipper for many shipments than to a multitude of shippers for one shipment each. It is probably stretching things a bit but to be generous let's say the per-unit billing and collecting cost can be cut in half.

Pickup and Delivery holds the greatest promise for savings. The pickup and delivery service can be broken down into the following elements of activity:

1. Stem time (between terminal and pickup/delivery area).
2. Variable running time (between stops).
3. Stop time:
   a. Contact time
   b. Loading/unloading time
   c. Shipment constant time

   Of these, stem time is unchanged by the number of stops on a trip or the quantity of freight handled at any stop. Variable running time is affected; in fact, it can approach zero if the number of shipments handled at one stop fills the truck making it a one-stop trip, but on the pickup only. The character of the delivery trip is indifferent to whether all of the shipments delivered at one stop came from one shipper, or from one shipper for each shipment. At the stop, contact time is the same per stop regardless of the number of shipments handled and is thus a potential saving. Loading time varies linearly with the quantity of freight; there are no economies of scale. Shipment-constant time is the same regardless of whether the shipments are tendered in a batch or singly.

   This then, is the tally for pickup and delivery:
   1. Stem time: no reduction.
   2. Variable running time: reduction on pickup; potentially 100% of pickup or 50% of total pickup and delivery.
   3. Stop contact time: reduction, assume 100%.
   4. Stop loading/unloading time: no reduction.
   5. Stop shipment constant time: no reduction.

   To quantify this potential, we have the aggregated Highway Forms B of the MC-82 carriers upon which the Rate Bureaus base the traffic analyses accepted by the Interstate Commerce Commission as representative of the less than truckload industry. These show that Pickup and Delivery accounted for 31.2% of fully allocated total expenses in 1989 (the latest available at this moment) and that Billing and Collecting accounted for 3.0%.

   In order to further dissect the Pickup and Delivery expense, we must turn to the latest ICC regional cost studies (1982). There is good reason to assume the relationships which will be used have not changed materially since then.

   The data from the Rocky Mountain Regional study show that for shipments in the 1000 to 1999 pound weight bracket, pickup and delivery time was divided 19% stem, 28% variable running and 53% stop time. Further, loading and unloading constituted 21% of the man minutes at stops. There is no way to determine the breakdown between contact time and shipment-constant time so, to be conservative, both contact time and shipment-constant time will be assumed to be entirely eliminated (79% of Stop Time).

   The final breakdown is, therefore:
Potential cost reduction due to multiple tender

From Pickup and Delivery:

<table>
<thead>
<tr>
<th></th>
<th>% of Total P &amp; D</th>
</tr>
</thead>
<tbody>
<tr>
<td>Variable running time (pickup only)</td>
<td>14.0</td>
</tr>
<tr>
<td>Contact and shipment constant time (79% of 53%, total stop)</td>
<td>42.0</td>
</tr>
<tr>
<td>Total from pickup and delivery</td>
<td>56.0%</td>
</tr>
</tbody>
</table>

From all sources:

<table>
<thead>
<tr>
<th></th>
<th>% of Total Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pickup and delivery (56% of 31.2%)</td>
<td>17.5</td>
</tr>
<tr>
<td>Billing &amp; Collecting (50% of 3.0%)</td>
<td>1.5</td>
</tr>
<tr>
<td>Total, all sources</td>
<td>19.0%</td>
</tr>
</tbody>
</table>

Thus, absent special circumstances which might be demonstrated by the carrier, it would appear that the maximum (actually overstated in some respects) that can be saved by tendering large quantities of freight at one time is 19.0% of the total expense.

It may be contended that this overlooks overhead and managerial economies. I think not. The "top level" team meetings required to negotiate these discounts, do not obviate routine sales contacts, which go on anyway. Moreover, tariff publication is complicated by the need to provide these special rate schedules in addition to the basic class rate schedules, already published, and which would apply in the absence of the discount provisions.

As suggested earlier, there may be other economies related to shipping conditions and in some cases costs may be influenced by otherwise empty backhaul movements. However, the prevalence of discounting arouses concern that rate-discounted freight, justified by backhaul considerations, may be moving in opposite directions in many traffic lanes. Concern may also be directed to the question of whether this is traffic which would not move at higher rates (Dr. Locklin's point); in this connection, note that this is traffic which moved by motor carriage before the Interstate Commerce Commission sanctioned discounting.

The stark truth is, as Attachment A documents, there is traffic moving at "on bill" discounts as high as 70% while there is substantial traffic moving at zero "on bill" discount. For clarification, "on bill" discounts are those ascertainable at the time of the shipment and which appear on the freight bill. There are also "off bill" discounts which do not appear on the bill because they cannot be ascertained until after the shipment is made. That is because this type of discount is contingent upon quantity shipped in a given period of time. The Attachment A analysis is incom-
complete in that it embraces "on bill" discounts only. However, that shortcoming does not materially alter the conclusions for two reasons. First, "off bill" discounts are much smaller than "on bill" discounts. Second, "off bill" discounting goes principally to the traffic enjoying the highest "on bill" discounts and thus exacerbates the potential for discrimination.

There is another side of discounting that is perhaps more reprehensible than the discrimination aspect. This is the practice which has developed in recent years of refunding to the shipper a stipulated discount on freight-collect shipments, for which the consignee pays the full, or perhaps slightly discounted, rate. The question of legality has been raised but never tested — fear of retribution by these major shippers silences acquiescing carriers. The ICC will not be aroused. This is the sort of thing that develops when the atmosphere of deregulation abounds. Other little peccadillos that appear are services rendered but not billed, such as late payment, duplicate copies of bills, waiting time, inside delivery, etc.

**INTRASTATE DEREGULATION ACTIVITY**

It is instructive to note what deregulation has taken place within the states. A quick answer is: not very much. Obviously inspired by the 1980 federal legislation which moderated regulation substantially, many states immediately began a reconsideration of intrastate motor carrier regulation. Many enacted legislation similar to the Motor Carrier Act of 1980. In every case there was a substantial lobby of the giant shippers seeking to extend the modification of regulation to a complete elimination. The political clout of such entities is not to be taken lightly. Nevertheless, complete intrastate deregulation got off to no more than a snail's pace which soon fizzled out completely. Adding to the two states which never were regulated (New Jersey and Delaware), six more states enacted complete deregulation over the course of the next five years: Florida, Arizona, Maine, Wisconsin, Alaska, and Vermont. Since 1985, not one state has found complete deregulation to be in the public's interest. Most have considered the notion and rejected it.

This turning away from the hot 1980 fashion-of-the-moment was best recognized in a paper entitled *Public Opinion about Regulation and Deregulation in the Transportation and Communication Industries* produced by the Consumer Federation of America (CFA) in May 1988. The paper cites numerous surveys dating from the mid 70's to 1987 on public attitude towards regulation/deregulation in which very clear secular trends can be seen. Support for regulation of telephones and all transportation modes, including trucking, according to CFA, declined to a low point in the early 80's and since had climbed back to the levels of the 70's. Support for deregulation had naturally followed the reverse trend. The latest
poll cited which dealt directly with trucking deregulation was taken by Business Week in July of 1987. When asked whether the results of airline, trucking and telecommunications deregulation had been positive, 49% of respondents said "no" while 46% of respondents said "yes." Note that the question was directed only to the partial deregulation that had taken place, not to whether further deregulation should be undertaken. What further trends have taken place in public opinion since 1987 is speculative but with the banking turmoil, the savings and load crisis and the airline failures there is reason to expect the trend in favor of regulation has continued.

THE COST OF TARIFF PROLIFERATION

The competitive activity engendered by the Motor Carrier Act of 1980 and fostered by the Interstate Commerce Commission (ICC) in its misguided regulatory posture, has resulted in a proliferation of tariff material, to the consternation of ICC staff and to those who would use the ICC tariff files: shippers, carriers and a vast army of attorneys, economists, academicians and data-gathers in general.

"Would use" is, regrettably, the appropriate verb form because many who, prior to 1980, made use of the files for a variety of purposes are inhibited from doing so today by both the staggering quantity of the files and by the break-down in both the filing requirements and the files themselves. Furthermore the tariffs, once located, are now so coded and structured that in many cases it is literally impossible to determine the applicable rate for a given movement.

Ironically, during the march towards regulatory reform in the late 70's, one of the rallying cries of the extremists was that current tariffs were too complicated, and too numerous. The marvelous simplicity of United Parcel Service tariffs was often cited as an example of what could be for the LTL carriers if freed of regulatory restraints.

Eleven years after enactment of the reforming legislation the score can be read. Regulatory change has drastically weakened rules prescribing the way rates must be presented in tariffs and bureau publication is an often rejected option with carriers — as intended by the deregulators. But the effect is the reverse of the promise! Complexity rather than simplification has resulted; volume has magnified rather than diminished. Oddly enough, it is the bureaus that have streamlined tariffs. Were it not for the explosion in individual tariffs, the ICC tariff library would be smaller and the contents more useable than in the 70's. But, individual tariffs, spawned by regulatory reform, have overwhelmed the system.

In 1980, according to the ICC Annual Report for 1980, there were 566,000 motor carrier tariff filings. According to ICC testimony at the Sep-
September 19, 1991, Senate Oversight Hearing, approximately 1,300,000 filings were made in 1990, consisting of some 6,500,000 pages.

This glut of tariff material has overloaded ICC facilities and now consumes 6500 linear feet of shelf space for the current tariffs alone (tariffs applicable for the current year and two years past). This increase was entirely predictable, the contrary and naive expectations of the deregulators, notwithstanding.

This retrograde evolution in tariff preparation and filing has another quite significant and adverse consequence: increased cost to the carrier. Table VI is self explanatory.

### Table VI

<table>
<thead>
<tr>
<th>Year</th>
<th>Traffic and Sales Expense as a Percent of Total Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Year</td>
</tr>
<tr>
<td>1974</td>
<td></td>
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<tr>
<td>1975</td>
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<tr>
<td>1976</td>
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</tr>
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<tr>
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</tr>
<tr>
<td>1979</td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td></td>
</tr>
</tbody>
</table>


Note in the table that Traffic and Sales expense hovered in the range of 3.1 to 3.5 percent of total expenses prior to 1980, averaging 3.33 for the six year period. After 1980 it started climbing steadily, reaching 4.7% in 1986, 41% greater than the pre 1980 average. This is added expense, coming right off the bottom line, which the carriers suffer for the privilege of being able to develop special rates for each major shipper, rather than reference an industry standard. Expenses of this sort produce no additional benefit to the carriers or to the shipping public.

Translating the above loss into dollars, the carriers included in ATA’s 1987 data incurred expenses of $666,841,000 for Traffic and Sales that year. Had the expense been at the pre 1980 level of 3.33%, the expense would have been $472,598,000. The increased cost to that group of carriers, then, can be estimated at $194,243,000. Of course, all Instruction 27 carriers did not get into the ATA report so the actual figure would be somewhat higher.
CONCLUSIONS

The public good requires a financially viable industry, adequate to serve the needs of commerce at reasonable rates without discrimination.

These objectives cannot be met without regulatory oversight to prevent the carriers from the inevitable destructive competition which would ensue from a *laissez faire* attitude. The experience of eleven years since MCA has shown the consequences of abandoning this responsibility. The evidence of the calamity of this course of action is abundant.

Unrestrained competition needlessly tests the limits of carrier safety programs and driver practices in a multitude of ways.

Failure to actively regulate rates has spelled the death knell of cost-based rate making. Cost-based rate making has almost completely given way to marketing considerations since 1980.

Marketing considerations are proper elements of differential pricing but not to the total disregard of cost relationships. Not only should every rate return to the carrier the direct costs of providing transportation service but in addition it should also return as much of the indirect costs as possible — the criterion for this lower limit of indirect cost coverage being the rate above which the shipment would not move. It is shown that differential pricing has reached levels that far exceed any demonstrable cost justification.

The encouragement by the ICC and major shippers for carriers to eschew cooperation among themselves and act independently has resulted in a proliferation of tariff material which is bewildering, incomprehensible and costly.

The uniqueness of the motor carrier industry is sufficient to explain why and how carriers will permit this to happen. Unless the government steps in to exert a moderating influence, carriers will weaken themselves financially and shippers will inequitably share the carrier cost burden.
## Motor Carrier Deregulation

### ATTACHMENT A

**DISTRIBUTION OF MC-82 CARRIER TRAFFIC BY TYPE OF RATE**

<table>
<thead>
<tr>
<th>Type of Rate</th>
<th>Percent of Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Class Rate</td>
<td></td>
</tr>
<tr>
<td>no discount</td>
<td>19.684</td>
</tr>
<tr>
<td>&lt; 10% discount</td>
<td>.301</td>
</tr>
<tr>
<td>10 to &lt;20% discount</td>
<td>2.211</td>
</tr>
<tr>
<td>20 to &lt;30% discount</td>
<td>5.588</td>
</tr>
<tr>
<td>30 to &lt;40% discount</td>
<td>13.113</td>
</tr>
<tr>
<td>40 to &lt;50% discount</td>
<td>18.231</td>
</tr>
<tr>
<td>50 to &lt;60% discount</td>
<td>8.128</td>
</tr>
<tr>
<td>60 to &lt;70% discount</td>
<td>.556</td>
</tr>
<tr>
<td>70% or more</td>
<td>.004</td>
</tr>
<tr>
<td>Freight All Kinds (FAK)</td>
<td>1.436</td>
</tr>
<tr>
<td>Contract</td>
<td>9.168</td>
</tr>
<tr>
<td>All other</td>
<td>21.579</td>
</tr>
<tr>
<td>Total</td>
<td>100.000</td>
</tr>
</tbody>
</table>

Source: Aggregated 1988 Continuing Traffic Studies of Central States Motor Freight Bureau, Eastern Central Motor Carriers Association, Middle Atlantic Conference, Midwest Motor Freight Bureau, Rocky Mountain Motor Tariff Bureau and Southern Motor Carriers Rate Conference. Note: "All other" includes Exception Rated, Commodity Rate, Section 22, Non-regulated, Released Value and Assembly and Distribution shipments expense.
1993 HAROLD A. SHERTZ AWARD WINNER

The Production of Civil Aircraft:
A Compromise of Two World Giants

MICHAEL J. LEVICK*

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* J.D., University of Georgia School of Law, 1993. B.A., University of Michigan, 1990.
The European Community and the United States represent the two largest economic trading blocs in the world. Over the past decade, the trading balance between the two parties has been relatively even. One area of trade which threatens this balance is the production and sale of civil aircraft.

Aircraft represent the largest exporting industry in the United States, and aircraft production affects nearly 80% of the U.S. economy. This sector of the trade relationship between the U.S. and the EC is critical. The amount of capital transferred in a single aircraft sale can have an immediate and profound impact on the entire monthly trade balance between these two trading partners. Since most of the current world market for civil aircraft is located within the United States and the European Community, international regulation of this trade is both politically and economically sensitive. Any domination of the aircraft market would profoundly upset the current balance of trade between them.

The United States, not particularly concerned with regulation in this area for a long time, has changed its course in large part because its once dominant position in the market has evaporated. Indeed, the United States once held as high as 90% of the world production in this area.

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4. For example, each time one Boeing 747 airplane is shipped to a major trading partner, the trade balance shifts $150 million in the U.S.’s favor. Robert Wrubel, The Last Titan, FIN. WORLD, Dec. 8, 1992, at 54. See also Robert E. Dallos, Airbus Soars as U.S. Grumbles, L.A. TIMES, June 22, 1991, at D1 ("[T]he sale of even one plane can have an impact on monthly trade balance figures.").
Today, U.S. market share is sharply lower principally because of Airbus, which now accounts for at least 30% of all worldwide sales of civil aircraft.

In July, 1992, the European Community and the United States signed a bilateral treaty outlining narrower rules on the trade of large civil aircraft. This new agreement raises hopes that rules for a level playing field have finally been agreed to in this area. However, there is room for skepticism, since other instruments that attempted many of these same objectives have generally failed to make a strong impact on the practices of the industry.

Will the same result occur with this agreement? Part One of this article identifies the primary complaints pressed by each party over the past decade and the historical justifications for their positions. Traditionally, the U.S. has cried foul at the European Community’s direct subsidization of Airbus and the commitment of Airbus’ partner governments for funds in research, production, and export assistance. Additionally, the U.S. points to the use of loans, loan guarantees, equity infusions, tax breaks, debt forgiveness, marketing assistance, and bail outs. The European Community has responded to these allegations by identifying the longstanding policy of the U.S. to assist its aerospace industry with large government procurements for aerospace research and development. The EC also notes some examples of U.S. government bail outs, tax concessions, and tariffs.

Part Two examines the legal instruments which apply in this area of trade. Notions of the overall GATT approach to trade are important. The GATT itself has addressed the issue of subsidies with a multilateral agreement on subsidies and a supplemental agreement regulating the production and sale of civil aircraft. Pertinent domestic U.S. and European Community laws are summarized as well.

Part Three introduces the reader to the most recent agreement regarding civil aircraft trade between the parties, and offers supplementary analysis comparing the treaty to former efforts. It also details the need for multilateral agreements, identifies the future competitive threats of other nations, and delineates the hurdles to implementing the latest bilateral treaty to a multilateral forum.

Part Four summarizes the approach the Clinton administration has taken toward the bilateral Agreement. It identifies the U.S. use of legal

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6. Agreement Concerning Application of the General Agreement on Tariffs and Trade to Trade in Civil Aircraft, Signed by the European Economic Community and United States July 17, 1992, 9 Int’l Trade Rep. (BNA) No. 30, at 1273 (July 24, 1992) [hereinafter Agreement] (At time of submission for publication, no official source citation was available).
mechanisms contained in the treaty and highlights the early tensions between the two sides on the enforcement of the bilateral Agreement.

I. U.S. AND EC COMPLAINTS REGARDING THE TRADE OF CIVIL AIRCRAFT

A. THE U.S. COMPLAINT

The U.S. has complained that the Airbus Industrie, a European consortium of four companies,\(^7\) has an unfair advantage in the trade of civil aircraft. Airbus was founded in 1967 as a consortium of the French, British, and German governments. Its goal was to develop and sell a wide-bodied aircraft, with a large seating capacity, for medium range flights. By acting together, the European governments were able to share capital financing and research and development costs, while dispersing the risks associated with a new company.

Initially, the United States did not see this collaboration as a serious threat to its stronghold in the industry. The earlier European collaboration on the supersonic transport (SST) project appeared to be an economic disaster, with no real possibility of profitability. More importantly, the SST project affected a very limited sales market of highly specialized routes. While the new European collaboration concentrated on a broader market base; providing a more quiet and fuel efficient plane, with a large load capacity, for short, popular routes; the U.S. did not take the threat seriously.\(^8\) Indeed, even the European airlines did not take the project seriously, despite the company's plan to bolster aircraft production in Europe.\(^9\) Despite this global pessimism, a new global competitor emerged for U.S. manufacturers.

The heart of the present controversy rests with the purpose of the Airbus consortium. Airbus was designed to further political goals rather than create profit.\(^10\) As was shown in the Concorde experience, the EC was willing to commit large sums without an economic return to achieve greater political goals. The survival of Airbus meant positive political re-

\(^7\) Today, Airbus Industrie is a consortium of Aerospatiale (37.9%), Deutsche Airbus (now owned by Daimler Benz) (37.9%), British Aerospace (20%), and CASA of Spain (4.2%). It is formed under French law as a Groupment d'intérêt Economique (GIE), which allows for such cooperation, along with other favorable organizational and tax standing. OFFICE OF TECHNOLOGY ASSESSMENT, supra note 2, at 353.

\(^8\) BILL GUNSTON, AIRBUS, 10 (1988).

\(^9\) Id.

\(^10\) As the Office of Technology Assessment notes:

European planners value aircraft manufacture explicitly for the employment it creates. An Airbus official explained that the main reason the collaboration works is that by creating jobs in an export industry, Airbus enables the member countries to capture jobs from other parts of the world . . . With government commitment to full employment, policymakers view the thousands of jobs Airbus creates in England, France, Germany, and other European countries as well worth the costs of the supports provided.

OFFICE OF TECHNOLOGY ASSESSMENT, supra note 2, at 352.
turns in such areas as balance of payments, technological spin-off, and employment.\textsuperscript{11} As a result of these motivations, public money allowed the European manufacturer to stay in business when American companies would have been forced to "cut their losses" and dissolve in a similar situation, giving Europe an unfair advantage.\textsuperscript{12}

The U.S. aerospace industry has, therefore, objected to the significant advantage the Europeans have had in selling aircraft, due to the willingness of the Airbus' government sponsors to commit large sums of money for research, production, and export assistance. Direct financial support has taken the form of government contracts for the development of commercial models, loans and loan guarantees covering both development and production costs, guarantees against losses caused by exchange rate fluctuations, equity infusions, tax breaks, debt forgiveness, and bailouts.\textsuperscript{13}

This direct support provides several clear advantages over the commercial lending used by U.S. companies to finance their projects. First, government financing allows Airbus to move more rapidly in getting new models to the market quickly, even where the cash flow from previous models is insufficient to convince a commercial lender to provide financing.\textsuperscript{14} Timing is essential in this industry. Since initial entry into a new market may deter others from entering, thus establishing a monopoly position.\textsuperscript{15} Second, the interest rates that the consortium governments charge for development and production loans are much lower than commercial rates, multiplying the effect of such financing.\textsuperscript{16} Third, the consortium partners offer low financing rates to buyers of aircraft, creating

\begin{itemize}
\item \textsuperscript{11} Keith Hayward, International Collaboration in Civil Aerospace, 162 (1986).
\item \textsuperscript{12} Id. Other examples of Airbus survival where a U.S. firm would otherwise fail include: (1) Airbus survived its first five years with only ten orders and (2) Airbus built $1.25 billion worth of unsold planes for inventory during recession. Neither practice could be financed by a U.S. company. U.S. CIVIL AVIATION MFG. INDUS. PANEL, COMM. ON TECHNOLOGY AND INT'L ECON. AND TRADE ISSUES, THE COMPETITIVE STATUS OF THE U.S. CIVIL AVIATION MANUFACTURING INDUSTRY 44-5 (1985).
\item \textsuperscript{13} OFFICE OF TECHNOLOGY ASSESSMENT, supra note 2, at 353.
\item \textsuperscript{14} Id. at 354.
\item \textsuperscript{15} Id. at 354 & n.66.
\item \textsuperscript{16} One writer notes: A recent study by the U.S. Commerce Department says the companies that make up the Airbus consortium have been subsidized by their respective governments to the tune of $13 billion since Airbus' founding. If commercial interest rates were applied, the value of such support would be $25 billion. Dallos, supra note 4, at D1.
\end{itemize}
Finally, direct support has not been limited to financing. European governments have also influenced the procurement decisions of their nationalized airlines and have even granted foreign policy concessions in efforts to guarantee continued Airbus sales. Since the aircraft industry is one of traditionally cyclical demand, political influence has allowed Airbus to weather bad economic times when pure market forces may have dictated otherwise.

B. THE EUROPEAN COMMUNITY RESPONSE AND COMPLAINT

To understand the European Community’s response to U.S. concerns and its complaint against U.S. practices, one must first acknowledge the differences between American and European market philosophies. The European business culture is radically different in terms of its attitude toward state-subsidization of industry. Unlike the U.S., many European nations have traditionally used subsidies as a key component in their industrial policies. Most European subsidization takes the form of direct relief, largely in the form of direct grants and tax concessions.

The European Community argues that the figures used by the U.S.

17. Stephen S. Cohen & John Zysman, The Mercantilist Challenge to the Liberal International Trade Order, 1 INT'L TAX & Bus. LAW. 1, 17 (1983). Indeed, financing can create purchases that otherwise would not occur. For example, a 2% advantage on financing terms will outweigh over a 5% advantage in fuel efficiency. Id. at 36.

18. Examples of government intervention in procurement decisions include:
   1. French government successfully forcing Air France to buy General Electric engines instead of Pratt & Whitney engines for the A310 because of GE’s close ties to French engine maker SNECMA,
   2. Air France’s and Lufthansa’s current position as having only Airbus planes where Airbus and U.S. makers compete,
   3. British Airways’ current fleet uses only Rolls-Royce engines,
   4. Key timing of launch orders from European carriers which has allowed the maker to continue production when new models may not otherwise have been launched.

19. An excellent example of this interplay occurred when the Australian government announced that a condition of its purchases of Airbusses would be French government backing of increases of access for Australian sheep within the European Community. Cohen & Zysman, supra note 17, at 35.

20. In the mid-1980s, total aid to industry amounted to 4.0% of industrial output (GNP) while similar aid the U.S. amounted to a mere 0.5% of industrial output. Glennon J. Harrison, Subsidies in the European Community, in HOUSE SUBCOMM. ON TECHNOLOGY AND TRADE, 102d CONG., 2d Sess., AIRBUS INDUSTRIE: AN ECONOMIC AND TRADE PERSPECTIVE 24, 45 (Comm. Print 1992). The manufacturing sector of industry is the primary recipient of such aid, with 41 percent of national government subsidies in the EC going to the manufacturing sector, roughly 8 times the amount of U.S. subsidies to manufacturing. Id. at 27.

21. From 1986-88, the U.K. gave 74% of its subsidies in direct grants, tax reductions and loan guarantees; Germany 91%; France 64%. Id. at 28 (Table 4).
create an argument of form rather than substance. It claims the U.S.'s long-standing procurement for aerospace research and development has the same adverse affect on competition as the EC's traditional use of direct grants to Airbus. Indeed, while the EC's direct subsidization of Airbus is not a well-kept secret, U.S. practices of state support are more difficult to identify. The EC points to U.S. dependence on government support in research, development, and large military procurement as evidence of indirect subsidies in the production of civil aircraft.22 These practices include not only loan bailouts from the government, but also tax concessions on purchases by U.S. airlines, and tariffs.23 These efforts have given U.S. manufacturers an ability to assume greater risk than they otherwise could. The steady cash flow resulting from these indirect subsidies has given U.S. manufacturers an improved credit rating.24 Indeed, before the 1980s, U.S. industry financed less than a quarter of its research and development costs from private sector sources.25

The U.S. was motivated by the defense needs of cold war and by the need for a rapid mobilization capacity to promote the industry.26 At the same time, the U.S. political climate encouraged the concept of free-market economics, making direct aid to the industry politically sensitive. As a result, direct subsidization from the U.S. government has only occurred when market realities began to threaten the mobilization capacity of the


23. <i>Hayward, supra note 11, at 159. The European concern over U.S. tax concessions is even more real after the signing of the bilateral agreement. The Agreement does not regulate this area directly. In September 1992, the EC reopened the aircraft subsidies dispute by objecting to US tax concessions to American industry. They claimed that tax law is being "manipulated to support domestic sales to US airlines." Mary Fagan, Row Simmers Over Aircraft Subsidies, INDEPENDENT, Sept. 7, 1992, at 18.</i>

24. <i>Hayward, supra note 11, at 159-60.</i>

25. <i>BARRY BLUESTONE, ET AL., AIRCRAFT INDUSTRY DYNAMICS, 158-59 (1981).</i>

26. General Hap Arnold, Chief of the Army Air Corps at the end of World War II: 

"[I]n each war there has been time for the mobilization of [] power and the U.S. has been the determining factor in the defense of civilization ... There will be no opportunity for gradual mobilization ... It is of the utmost importance that our first line of defense, in the air, must be manned and fully supplied with modern equipment ... The U.S. must be the world's first power in military aviation.

<i>AIRCRAFT INDUSTRIES ASSOCIATION, AIRCRAFT MANUFACTURING IN THE UNITED STATES, in THE AVIATION ANNUAL OF 1946, (Reginald M. Cleveland & Frank P. Graham eds., 1945) reprinted in HISTORY OF THE AMERICAN AIRCRAFT INDUSTRY, 162, 178 (G.R. Simonson ed., 1968) [hereinafter SIMONSON]. See also OFFICE OF TECHNOLOGY ASSESSMENT, supra note 2, at 344 ("The greatest benefits for U.S. commercial aircraft manufacturers have been side effects of the government's commitment to building and maintaining a strong defense industrial and technology base.").</i>
industry. Hence, the EC asserts that indirect support of the U.S. civil aircraft industry through such devices as NASA research assistance and military spending has provided the same type of government assistance as the Europeans, but in a different, less identifiable form.

C. NEGOTIATIONS TO RESOLVE COMPLAINTS OF THE EC AND U.S.

Negotiations began in the early 1970s to resolve these complaints, but such efforts failed to produce an agreement. An increasing deficit in the U.S. balance of payments, a history of failure in negotiations, and expanded European penetration into the U.S. civil aircraft market, pressured the Carter Administration into signing the GATT Agreement on Civil Aircraft despite the agreement's adoption of European views on non-tariff barriers.

The need to renegotiate the Aircraft Code surfaced almost immediately after its signing. With many trade barriers removed for the European Community, Airbus cut into the market share of American manufacturers both at home and abroad. Efforts to alleviate growing tension took a more structured tone on October 27, 1987, when both sides agreed to some basic negotiating principles and objectives, including using the GATT as a vehicle to formalize "mutually satisfactory solutions." Indeed, these objectives are prominently noted in the declarations of the formal agree-

27. In the past, Europeans have pointed to three specific actions: (1) development of the military's KC135, minimizing the costs of Boeing's initial entry into the civil jet market; (2) in the 1960s, Lockheed's ability to transfer money authorized for military development to its civil aircraft efforts, and its later receipt of Federal loan guarantees; and (3) federal loan guarantees and questionable procurements of additional aircraft approved for McDonnell Douglas when the threat of insolvency began to loom. Hayward, supra note 11, at 157-58. "Neither Douglas nor Lockheed had to pay the ultimate price of commercial misjudgment, and, in extremis, their survival had depended upon state aid." Id. at 158 citing M. Edmonds, Market Ideology and Corporate Power in the United States, in Industrial Crisis, 81-87 (K. Dyson and S. Wilkes eds., 1983).

It was also this type of public and private intermixing of capital that helped foreign firms such as Rolls Royce argue for direct government assistance to develop new products. See Hayward, supra note 11, at 158-59.


29. Indeed, the 1978 "Arrangement on Guidelines for Officially Supported Export Credits" specifically excluded aircraft sales from its scope. Id. at 37.


31. Hayward, supra note 11, at 175.

32. Specifically, these objectives included: (1) that the current dispute should be resolved through the GATT, (2) a commitment to find "mutually satisfactory solutions in a spirit of mutual understanding...to promote international competition and facilitate the development of aircraft manufacturing in a fair economic environment, (3) resolve interpretive differences involving Article IV of the [Aircraft Code], and (4) a mandate for resolution of government support in the development of long-range civil aircraft." U.S., EC Negotiators Given December Deadline to Resolve Civil Aircraft Subsidies Dispute, Int'l Trade Rep. (BNA) No. 42 at 1312 (Oct. 28, 1987).
ment itself.\textsuperscript{33}

Still lacking a formal agreement on the 1987 objectives, the United States filed a formal complaint with the GATT Subsidies Committee over German subsidies in February 1991.\textsuperscript{34} The U.S. made an additional complaint to the Subsidies Committee in May 1991, requesting the elimination of direct government subsidies.\textsuperscript{35} The United States then heightened tensions by threatening to impose a tax on Airbus imports.\textsuperscript{36}

In June 1991, the European Community asked the GATT if the matter could be resolved through renegotiating the Aircraft Code.\textsuperscript{37} However, the critical shift in the negotiations came after a GATT panel ruling that German payments as part of exchange rate guarantees to Airbus were illegal.\textsuperscript{38} It was this striking blow to the European bargaining position, and it accelerated the negotiating process. By the end of March 1992, both parties reached a tentative agreement,\textsuperscript{39} which was later finalized into the current bilateral accord.

The bilateral Agreement represents the culmination of twelve years (1980-92) of continuous complaints from both European and American aircraft producers to resolve each side's perception of unfair trade practices. Like the Aircraft Code, it too was signed in the dwindling months of an administration pressured to promote American exports in light of a worsening balance of payments deficit and even further European integration in the U.S. market.

II. LEGAL CONTEXT

The Agreement represents a major compromise by both sides after many tense years of negotiations. Now that there is an accord, the question remains whether it can be used as a model for revisions to the Aircraft Code or any other future multilateral agreement, as both sides hope.

To understand the implications of the Agreement, an investigation of instruments which affect current trade in this area is required. This sec-

\textsuperscript{33} Agreement, supra note 6, at 1273.
\textsuperscript{37} EC Asks GATT that U.S. Airbus Complaint be Settled Under Civil Aircraft Pact, 8 Int'l Trade Rep. (BNA) No. 25, at 947 (June 19, 1991).
\textsuperscript{39} EC and U.S. Reach Accord in Aircraft Subsidy Dispute, 9 Int'l Trade Rep. (BNA) No. 14 at 575 (Apr. 1, 1992).
tion highlights the policy changes between the General Agreements on Tariffs and Trade (GATT), Subsidies Code, Aircraft Code, U.S. trade law, and EC law on state subsidies.

A. THE GATT APPROACH TO TRADE

Most international trade is governed by the rules and arrangements set forth in the General Agreement on Tariffs and Trade (GATT). The GATT was founded on the premise that trade would be conducted by private individuals in markets where the unobstructed interplay of supply and demand set prices. The objective of the GATT, from its inception, was to reduce tariffs and other barriers to trade through agreements among the GATT's trading partners and, at the same time, to insure that all contracting nations would receive most-favored nation status. The founders believed such unrestricted, non-discriminatory trade would increase market efficiency.

The GATT approach embodies four main assumptions. First, it assumes that trade arrangements constructed from multilateral negotiations are preferable to bilateral or other agreements. It does not anticipate negotiations between individual nations. Second, it assumes that private persons shall conduct trade in an atmosphere of free interaction of supply and demand. Third, it assumes that such free trade shall result in the expansion of all economies. Fourth, it assumes that government intervention distorts the market in a way that delays internal adjustment to international prices.

Despite the GATT's general premise that government intervention is not economically efficient, its regulation of government subsidies was weakly constructed. Indeed, the original GATT agreement had only a reporting requirement for subsidies. It did not include an outright prohibi-

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42. Aircraft Code, supra note 30.
43. GATT, supra note 40.
45. "Any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for all other contracting parties." GATT, supra note 40, art. I, para. 1.
46. Cohen & Zysman, supra note 17, at 3.
47. Id.
48. "If any contracting party grants or maintains any subsidy ..., it shall notify the con-
The Production of Civil Aircraft

The original agreement was later amended to restrict and prohibit certain subsidies on exports, but such provisions apply only to domestic subsidies and only to the nations which accepted the amendment. The term "subsidy" itself is not clearly defined in the GATT.

The GATT also imposes regulations on "state enterprises." Article XVII defines which organizations may be classified as state enterprises and provides standards for such organizations. However, Article XVII has been largely ineffective in practice. While Article XVII requires that state enterprises notify GATT members of all products that are imported or exported by such organization, most nations do not provide any notification voluntarily. If a government were to do so, it would, in effect, concede the operation of a state enterprise and thus be subject to special GATT rules for such companies. Hence, there is a disincentive to voluntarily notify other nations that a state enterprise exists. The practical reality is that governments neither notify other contracting nations of state enterprise practices nor comply with the standards set forth in the GATT. While European officials have clearly admitted in private that Airbus benefits from state subsidies, the European Community has re-
fused to label its relationship with Airbus as a state enterprise.\(^{59}\) The United States also refuses to categorize its relationship with the civil aerospace industry as one which includes the granting of special privileges.\(^{60}\)

Nonetheless, the GATT provides measures for contracting nations to protect themselves against foreign-subsidized products. Article VI states that an importing country may impose a "countervailing duty"\(^{\text{61}}\) if the effect of a subsidy is "to cause or threaten material injury to an established domestic industry."\(^{\text{62}}\) The imposition of such a duty compensates for the amount of total subsidy which a foreign government has provided to a producer.\(^{\text{63}}\)

The GATT has been unsuccessful in establishing an effective system of enforcement which does not rely largely on the power of retaliation. Since the GATT was negotiated on the premise that free trade is a natural, universal motivator, it did not envision a need for powerful enforcement mechanisms. Unlike most international agreements, contracting parties are not required to comply with official recommendations or rulings.\(^{\text{64}}\) The GATT takes a flexible view that its policies are merely desired conduct,\(^{\text{65}}\) despite the fact that today's modern trade practices require a strict legal standard. The GATT heavily emphasizes the use of consultation as a means of dispute resolution. Nineteen clauses of the GATT agreement require consultations between adverse parties.\(^{\text{66}}\) Hence, the enforcement provisions of the GATT rely too heavily on flexible suggestions rather than a base of authority to impose recommendations for dispute resolution. As a result, in order to properly resolve subsidy disputes, further agreement between disputants is traditionally required under the GATT.

B. THE GATT SUBSIDIES CODE

Countervailing duties most often replaced consultations as the immediate response to disputes under the original GATT text. Member nations

\(^{\text{59}}\) Dallos, supra note 4, at D1.


\(^{\text{61}}\) GATT defines a "countervailing duty" as: "a special duty levied for the purpose of offsetting any bounty or subsidy bestowed directly or indirectly, upon the manufacture, production or exportation of any merchandise." GATT, supra note 40, art. VI, para. 2.

\(^{\text{62}}\) Id. at art. VI.


\(^{\text{65}}\) For example, GATT provides an exception to its nondiscrimination policy where national industries are in trouble and require temporary flexibility. Id.

\(^{\text{66}}\) Id. at 98.
became increasingly concerned with the ease with which others could impose destructive tariffs as a response to disputes. Because of a quirk in the GATT's legal requirements for administering countervailing duty measures, the United States was once able to impose such duties without any showing of injury. As a result of the fear of retaliation and the shift toward non-tariff concerns in the 1970s, the GATT Subsidies Code was negotiated as a supplemental agreement in the Tokyo Round of GATT negotiations (1973-1979), outlining in greater detail the proper use of such procedures.

In practice, however, the Subsidies Code did little more than require the United States to show injury before imposing countervailing duties. It lacked clear guidelines for determining which government benefits may be treated as subsidies. While it provides that benefits "granted with the aim of giving an advantage to certain enterprises" are a possible ground for defining a subsidy, the Subsidies Code does not state that such advantages are actionable as subsidies.

C. THE LAWS OF THE UNITED STATES RELATING TO SUBSIDIES

Despite being constrained by its obligations under the GATT, the United States has produced its own unique set of legislation intended to address the problem of foreign government subsidization. In practice, the U.S. government is selective in its use of countervailing duties. It must

67. Under the "grandfather clause" of the Protocol of Provisional Application of the GATT, contracting nations may follow their prior inconsistent domestic legislation in respect to GATT Articles VI and XVI. The United States relied on the grandfather clause to apply countervailing duties without a showing of injury to domestic U.S. industry. As a result of this practice, the Subsidies Code was negotiated. Theodore W. Kassinger, Introduction to Agreement on Interpretation and Application of Articles VI, LVI and XXIII of the General Agreement on Tariffs and Trade (GATT Subsidies Code), 1 Basic Doc. Int'l Econ. L. (CCH) ¶ 79 (1990).

But note the United States still has the power to impose countervailing duties without a showing of injury on non-duty free products from all GATT nations who have not ratified the GATT Subsidies Code. Stephen F. Benz, Note: Below-Cost Sales and the Buying of Market Share, 42 STAN. L. REV. 695, 721 (1990).

68. Lay, supra note 52, at 1496.

69. The Subsidies Code now requires the following: the simultaneous investigations of subsidization and injury, reasonable notice of investigations and a reasonable opportunity to participate in such investigations, and that investigations must be concluded within one year. Subsidies Code, supra note 41, art. 2, para. 4, 5, and 14.


71. Subsidies Code, supra note 41, art. 11, para. 3.

72. Id.

73. See Hearing on Dual Pricing, supra note 70, at 22 ("[governments do not attempt to counteract] every conceivable Government program under the sun") (testimony of Alan. F. Holder, General Counsel, U.S. Trade Representative).
walk a thin line: attempting to avoid antagonizing its trading partners and provoking retaliation, while at the same time protecting domestic businesses from unfair practices.\textsuperscript{74} Certainly the Airbus subsidy complaint is highly delicate for the United States, since the European Community is the largest trading block in the world and the U.S. has a trade surplus with the Community in the field of civil aviation.\textsuperscript{75}

The Subsidies Code was made a part of U.S. law with the enactment of the Trade Agreements Act of 1979.\textsuperscript{76} However, unlike GATT and its codes, U.S. legislation attempts to provide a specific definition for the term "subsidy" as part of the Act.\textsuperscript{77} This Act established a two-step process to determine if a benefit given by a foreign government is an actionable subsidy subject to countervailing duties under U.S. law.\textsuperscript{78} It is

\begin{itemize}
\item \textsuperscript{74} Gary N. Horlick, \textit{et al.}, \textit{The Counteravailability of Subsidies: Specificity 38} (Oct. 28, 1985) (unpublished manuscript on file with the \textit{Columbia Law Review}) as cited in Lay, \textit{supra} note 52, at 1498.
\item \textsuperscript{75} In 1991, the United States shipped $7 billion worth of civil aircraft products to the European Community as compared with imports of only $1.3 billion. William J. Eaton, \textit{U.S., EC Sign Accord to Limit Aircraft Subsidies}, L.A. \textit{TUES}, July 18, 1992, at D1.
\item \textsuperscript{76} \textit{Pub. L. No. 96-39, 93 Stat 144} (codified in scattered sections of 19 U.S.C.).
\item \textsuperscript{77} \textit{See} 19 U.S.C. \textsuperscript{77}§ 1677(5) (1992). A list of illustrative domestic subsidies follows the definition:
\begin{itemize}
\item (I) The provision of capital, loans, or loan guarantees on terms inconsistent with commercial considerations.
\item (II) The provision of goods and services at preferential rates.
\item (III) The grant of funds or forgiveness of debt to cover operating losses sustained by a specific industry.
\item (IV) The assumption of any costs or expenses of manufacture, production, or distribution.
\end{itemize}
\textit{Id.} at § 1677(5)(A) (This is not an exhaustive list).
\item \textsuperscript{78} 19 U.S.C. \textsuperscript{78}§§ 1671-1677k (1992). The first stage determines if the benefit constitutes a "subsidy" under the statutory definition. This is done by the Commerce Department’s International Trade Administration. 19 U.S.C. \textsuperscript{78}§§ 1671(a)(1), 1677(1), (1992); \textit{Id.} at § 2171 notes transfer of power from Secretary of Treasury to Secretary of Commerce.
\item If a subsidy is determined, the International Trade Commission then looks to whether there is material injury or a threat of material injury. \textit{Id.} at §§ 1671(a)(2). If both a subsidy and a material injury is found, the Commerce Department may seek to impose a countervailing duty. \textit{Id.} at § 1673.
\end{itemize}
through this process that the "specificity test" is administered. While this test provides the United States a means of regulating the use of countervailing duties, the process has proven inadequate at screening when the United States should administer such duties. Indeed, the GATT panels continue to hold that the U.S. practices violate the intent of the international guidelines to which it must conform.80

As a result, the Airbus subsidy dispute succeeded in shifting attention not only to the inadequacies of the GATT Subsidies Code, but also those of the United States Trade Acts. The Subsidies Code proved unable to deal with complex disputes. Its language is too vague. Indeed, it does not outline what actions constitute a "subsidy." Further, it does not provide a clear mandate for action.81

At the same time, the revisions to the Subsidies Code made upon its adoption by Congress have not advanced U.S. trade interests in this case. The "specificity" test, with the ad hoc nature of its application, does not provide a consistent, clear policy on subsidies which can be relied upon by domestic or foreign corporations.82 As a result, U.S. law has provoked anger and warnings from the GATT.83 Indeed, throughout the history of U.S. trade policy, the primary policy response to situations where domestic industry has been "jolted" by international competition is to invoke protectionist measures.84 The challenge now is to construct a framework whereby the U.S. may find its interests protected without hav-

79. Hearing on Dual Pricing, supra note 70, at 22 (statement of Alan F. Holder, General Counsel, U.S. Trade Representative).


81. See also supra notes 73-4 and accompanying text.


83. Johnson, supra note 80.

D. EC POLICY REGARDING STATE AID

The EC attitude toward government support for commercial industry differs greatly from that of the United States. The EEC Treaty is the primary source of guidance for EC policy in the area of state aid. While the European Court of Justice and the Commission of the European Communities (the "Commission") would probably define the actions of the Airbus consortium as state aid, the Treaty carves out several exceptions to a general rule against this type of assistance.

First, the Treaty provides that state aid is generally presumed to be "incompatible with the common market" if administered in a form which distorts competition. While the EC and U.S. certainly disagree on the distortional effect of Airbus subsidies, the intent of the Treaty provision is to focus on the European common market rather than on international trade distortions outside of Europe.

Second, the Treaty permits state aid "to promote the execution of an important project of common European interest . . . [and] aid to facilitate the development of certain economic activities . . . " Here, the Treaty carves out an exception to the general rule against state aid. Since Airbus was founded in the common European interest to develop a large civil aircraft industry in the European Community, any attempt to utilize EC law as a means of curbing state aid to the Airbus consortium could be thwarted easily.

85. This same concern was expressed by the former Senator and Vice-President in Dan Quayle, United States International Competitiveness and Trade Policies for the 1980s, 5 NW. J. INT'L L. & BUS. 1-2, 36-39 (1983).
88. Treaty, supra note 86, at art. 92, para. 1.
89. Id. at art. 92, para. 3(b)-(c).
90. Indeed, the Commission relied on this language in its defense of its subsidies to Daimler Benz, the owner of Deutsche Airbus:
Finally, the Commission is given broad discretionary power to determine what financing constitutes illegal state aid under the EEC Treaty.\textsuperscript{91} Therefore, if the United States or even a European aircraft maker were to file a complaint under Community law, there is little likelihood of a successful suit since the same political forces funding the Airbus consortium hold powerful positions within the Commission.

Nonetheless, the Europeans are motivated to end subsidization for political rather than legal reasons. The goal of a single internal market has put extra emphasis on the abolition of state aid within the European Community.\textsuperscript{92} Certainly, now that Airbus has established profitability, the practice of soliciting contributions from its sponsoring governments appears inappropriate when a crackdown on other uses of state aid is underway.

\textbf{E. THE GATT AGREEMENT ON TRADE IN CIVIL AIRCRAFT}

Realizing its rapid loss of world market share of civil aircraft in the 1970s, the U.S. insisted upon the inclusion of civil aircraft as part of the Tokyo Round of GATT negotiations. Its efforts were concentrated on abolishing government support for development and export subsidies. At the same time, the EC focused its efforts on gaining even greater access to the U.S. market. Despite U.S. initiation of discussions, the European Community exerted more influence over the final draft of the agreement. The U.S., facing a growing balance of payments deficit and increasing foreign penetration into its markets, was under great pressure to sign any deal which may promote American exports and curb European excesses.\textsuperscript{93}

Understanding this weakness, the Europeans remained firm. As a result, the language restricting Europeans practices was left extremely vague and almost unenforceable, while language aimed at advancing European concerns is closer to EC objectives.

The Aircraft Code did little to change the regulations on government support. The Aircraft Code expressly relies on the Subsidies Code to out-

\begin{quote}
In view of the economic and technological importance of the aviation industry to the Community, the Commission considered that the [subsidies to Daimler] would strengthen the overall competitiveness of the sector and thus concretely serve the general interest . . . . It therefore considered that state aids qualified for exemption under Article 92(3)(b) (execution of an important project of common European interest).

Commission of the European Communities, Nineteenth Report on Competition Policy 157-58 (1990), as cited in Harrison, supra note 20, at 35.

\textsuperscript{91} See e.g., State Subsidies: An Exercise in Ingenuity, 138 New L.J. 810, 811 (1988).

\textsuperscript{92} See Commission of the European Communities, Sixteenth Report on Competition Policy, 135 (1987) (Community’s efforts to complete a single unified internal market by 1992 . . . . lend added weight and importance to the enforcement of competition rules, and in particular the rules on State aid”) as cited in Evans & Martin, supra note 87, at 101.

\textsuperscript{93} HAYWARD, supra note 11, at 175.
\end{quote}
line its position on government supports. But even this provision has little real impact, considering the Aircraft Code also includes language recognizing that government supports are a "special factor" inherent to the industry. The Aircraft Code requires that pricing need only involve a "reasonable expectation of recoupment of all costs." How to determine what constitutes a "reasonable" return remains extremely unclear.

The Aircraft Code created new rules regarding aircraft marketing practices, but they were drafted in a manner giving them little practical significance. Rules in the area of marketing are important, since most firms which produce civil aircraft, as well as a majority of the world's scheduled airlines, are also wholly or partially-owned by their governments. Therefore, for most carriers and producers outside the U.S., the purchase of aircraft involves both financial and political considerations. As a result, government influence quickly becomes a factor in marketing.

While the Aircraft Code forbids government pressure on airlines, aircraft manufacturers, and "other entities," to make purchases of civil aircraft from a particular source, its provisions are couched in language so vague such restrictions are essentially unenforceable. Here again, the drafters of the Aircraft Code use a "reasonable" standard:

Signatories shall not require airlines, aircraft manufacturers, or other entities engaged in the purchase of civil aircraft, nor exert unreasonable pressure on them, to procure civil aircraft from any particular source which would create discrimination against suppliers from any Signatory [italics supplied].

The resulting agreement thus contains a huge loophole destroying much of its original spirit. Indeed, the Aircraft Code merely restates much of the GATT standards already in place relating to state trading and marketing.

94. Aircraft Code, supra note 30, at art. 6, para. 6.1 ("Signatories note that the provisions of the [Subsidies Code] apply to trade in civil aircraft.").
95. Id. at art. 6, para. 1.
96. Id. at art. 6, para. 2.
98. Id. at 75.
99. Aircraft Code, supra note 30, at art. 4, para. 2. See also Id. at art. 4, para. 4 ("Signatories agree to avoid attaching inducements of any kind to the sale or purchase of civil aircraft...").
100. Id. at art. 4, para. 2.
101. The Aircraft Code provides: Signatories agree that the purchase of products covered by this Agreement should be made only on a competitive price, quality, and delivery basis... [A] signatory may, however, require that its qualified firms be provided with access to business opportunities on a competitive basis and on terms no less favourable than those available to the qualified firms of other Signatories.
Id. at art. 4, para. 3.
This is substantially similar to the provisions for state trading in the main body of GATT: [State trading] enterprises shall, having due regard to the other provisions of the [GATT], make... purchases or sales solely in accordance with commercial considera-
The Aircraft Code provides no restriction on the use of government export credits, a major interest of the U.S. in light of the failure to include aircraft in the 1978 Arrangement on Guidelines for Officially Supported Export Credits. As a result, the Export-Import Bank ("Exim") has become more heavily relied upon to minimize unfair practices, producing both an additional cost and a philosophical compromise from a strict private enterprise philosophy.

The European Community, on the other hand, was more successful in negotiating terms that would facilitate its goal of opening markets. The Aircraft Code provides clear language eliminating customs duties on aircraft products, parts, and repairs; reiterates the commitment to the provisions of the GATT Agreement on Technical Barriers to Trade; and eliminates both quantitative restrictions and licensing requirements on imports and exports. In these ways, the EC managed to enhance its objectives while the U.S. was forced to accept less imposing language to address its concerns. As a result, the U.S. manifested its frustration with the initiation of complaints about European support practices throughout the 1980s.

III. ANALYSIS OF THE BILATERAL AGREEMENT AND ITS IMPLICATIONS

Like the Carter Administration, which signed the last major agreement involving civil aircraft trade, the Bush Administration faced similar economic and political pressures to reach an accord. The U.S. balance of payments deficit was even higher in 1992. So too was European penetration into the U.S. and world aerospace markets. These were the driving factors for the Carter Administration to sign the Aircraft Code, and these same pressures drove the Bush Administration to sign the Agreement.

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102. See also supra note 29.
103. HAYWARD, supra note 11, at 175.
104. Aircraft Code, supra note 30, art. 2, para. 1.
105. Id. at art. 3, para. 1.
106. Id. at art. 5, para. 1-2.
A. **THE TERMS OF THE AGREEMENT BETWEEN THE UNITED STATES AND THE EUROPEAN COMMUNITY SIGNED JULY 17, 1992**

The Agreement between the United States and the European Community contains several major advancements towards creating a level playing field for both sides. First, the Agreement provides for a ban on all future production subsidies and a limit on development subsidies at 33% of total cost. Second, it reinforces current language to further prohibit government assistance in marketing. Third, it increases reporting requirements, creating greater transparency in the marketplace. Finally, it limits indirect government aid to 3% of annual industrywide turnover and 4% of the turnover for each individual manufacturer.

1. **NEW RULES ON DIRECT SUBSIDIES**

The Agreement bars all future production subsidies and limits current development subsidies to 33% of the total development costs on new aircraft. The U.S. had originally hoped to resolve the dispute by a total ban on all subsidies. This objective can be traced back to the Carter Administration's goals in negotiating the Aircraft Code in 1979. The failure of the Aircraft Code to place an outright ban on subsidies left continuing tension between the two parties.

These provisions represent some gains for the United States on an initial bilateral basis, since it will curb some of the disputed trading practices. Yet at the same time, the limits on subsidies points to the weaknesses in the current multilateral framework. As noted earlier, GATT does not contain an outright ban on subsidies. Indeed, it does not even define what qualifies as an actionable subsidy. This flaw has not been corrected in the Agreement, which still does not define a "subsidy" or when an action constitutes "government support." Nor does the Agreement establish a new framework for dispute resolution. Consequently, there is no showing that this new Agreement will eliminate these problems associated with the current GATT framework.

However, by at least banning future production subsidies, the United

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110. Id. at art. 4, para. 1-3.
111. Dallos, *supra* note 4 ("Neither the U.S. government nor the U.S. industry is prepared to live with the current situation where privately financed companies compete against government-subsidized entities.") (quoting U.S. Transportation Secretary Samuel K. Skinner).
112. *See supra* notes 49-52, 70-72.
114. The dispute mechanism for the Agreement shall be the general GATT provision as agreed to in the Uruguay Round. Agreement, *supra* note 6, art. 12, para. 1.
States gained an additional legal tool to combat any European claims that government production supports do not hinder free trade. In addition, the compromise to limit developmental support to 33% of total costs demonstrates a strong reduction from current practices of supporting 75%-100% of all such costs.115 Also as part of the concessions on development cost subsidies, the European Community has agreed to force Airbus to repay cash advances at levels of interest closer to market rates than was previously practiced.116 This limitation will greatly reduce Airbus' advantage in being able to accept lower-than-market rates of return in its orders.117 Its elimination shall have an immediate impact, since financing considerations were a primary part of Airbus' strategy to gain market share.118

Surprisingly, Congress has been most critical of the direct subsidy regulatory provisions of the bilateral Agreement. It has treated the new ceiling on such spending as a "legitimization" of European subsidies at the expense of American industry.119 Despite the satisfaction of both the Bush Administration and European Community with the Agreement, Congress has been hostile to the accord. Both the House of Representatives and the Senate have passed non-binding resolutions calling on the United States not to "condone or legitimize" subsidies that cause injury to U.S. companies.120 Their expectations of the Agreement have run counter to political reality. Resolutions passed in Congress criticize the Agreement: (1) for allowing subsidies to continue, rather than imposing an outright ban, and (2) for not requiring Airbus to repay the full value of past subsidies. While Congressional approval was not required for the execution of the Agreement, Congressional consent will be required for any future multilateralization of the Agreement.121

However, the election year context of these Congressional efforts makes these actions a less credible threat to any future multilateral agreement. As Ann Denman predicted in 1988, tough talk about trade law and strong, unrealistic remedies are commonplace in election year

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115. Eaton, supra note 75. See also Dallos, supra note 4 ("On the average, 74% of the cost to develop new aircraft has been provided Airbus governments.").
116. Eaton, supra note 75.
117. A recent study by the U.S. Commerce Department says the companies claims: [T]he Airbus consortium have been subsidized by their respective governments to the tune of $13 billion since Airbus' founding. If commercial interest rates were applied, the value of such support would be $25 billion. Dallos, supra note 4.
118. Cohen & Zysman, supra note 17, at 17. Indeed, financing can create purchases that otherwise would not occur. For example, a 2% advantage on financing terms will outweigh over a 5% advantage in fuel efficiency. Id. at 36.
Undertones of protectionism seem to swell in the presidential campaigns as well. Hence, while on their face these objections seem terribly damaging to the goals of the Agreement, criticism of the Agreement should lessen in the United States as election year politics fade.

2. **Rules on Sales and Marketing of Aircraft**

The Agreement bars state efforts in sales and marketing. Historically, this was a concern of the United States. European governments did not hide the interplay between government action and aircraft sales. Airbus sales have been discussed at a number of meetings between high level European officials and other nations, producing agreement for Airbus purchases as part of broad economic, political and cultural packages. Indeed, part of Airbus' market strategy has been to invoke political pressure from its sponsoring governments and use state influence in markets outside Europe and the United States. The fact that a majority of the world's airlines outside the United States continue to be state-run amplifies the ability of state governments to influence the civil aircraft market.

The Agreement builds on the Aircraft Code's efforts in this area.

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1. **Specifically, Denman made the following comment:**
   Efforts [to amend trade laws and provide sanctions against violators of GATT rules on state enterprises] are made as part of election year "hype" when, responding to a rising tide of protectionist sentiment, legislators tend to propose powerful remedies without first carefully defining the problems posed by state trading.


3. Also note the comments in the final presidential debate of October 18, 1992: "We won't be making airplanes in this country 10 years from now if we let deals like this go through." Clinton, Buyouts Have Wrecked the U.S. Airline Industry, Reuters, Oct. 19, 1992 (AM Cycle) (Comments of Ross Perot, Independent Candidate for President, referring specifically to European ownership of U.S. airlines).

4. "Even Boeing is losing market share — because we let the Europeans spend $25 to $40 billion on Airbus without an appropriate competitive response." Id. (Comments of Bill Clinton, Democratic Candidate for President).

5. An excellent example of this interplay occurred when the Australian government announced that a condition of its purchases of Airbusses would be French government backing of increases of access for Australian sheep within the European Community. Cohen & Zysman, supra note 17, at 35. Airbus salesmen have also been said to threaten cuts in European imports of tapioca, Thailand's second largest export, if an aircraft order was switched to Boeing. Michael Harrison, Book Review: Jumbos Scrambling for the Public Trough, Independent, Feb. 25, 1993, at 23 (reviewing Ian McIntyre, Jumbos Scrambling for the Public Trough).

6. Id. at 18.

7. Article 4 of the Aircraft Code was given the following narrow interpretation by the US/EC Agreement:
As noted above, the Aircraft Code created a restriction on "unreasonable" government pressure tactics in marketing.\textsuperscript{128} This latest Agreement specifically defines what constitutes "unreasonable government pressure" and gives examples.\textsuperscript{129}

The Agreement prohibits the use of offset concession demands as a prerequisite for the sale of aircraft.\textsuperscript{130} This is a significant change from the Aircraft Code that expressly allowed such pressure tactics.\textsuperscript{131} Offset concession demands were commonplace in the industry as a means to gain technology and jobs for the purchasing nation in exchange for the capital to develop aircraft. Ironically, this was a key tactic the United States used during the infancy of its aircraft industry to establish itself.\textsuperscript{132} Later, the Europeans used this same tactic to solidify adequate technology transfer from the U.S.\textsuperscript{133} In the 1980s and early 1990s the Pacific rim nations, along with other significant buyers of aircraft, have attempted to use their strong capital position as a means to bring the technology and jobs created from offset concessions to their developing civil aircraft industries. Therefore, while the EC and the United States may no longer demand offset concessions to develop their own industry, the real challenge will arise when the parties try to multilateralize the Agreement and simultaneously place this restriction on those nations with emerging aerospace industries who currently demand concessions.

\begin{itemize}
\item All participants of signatories in the domestic political decision making process shall not take any action, including but not limited to political representations, pressure or inducements to other governments or foreign airlines . . . .

Agreement, supra note 6, anx. I. Cf. Aircraft Code, supra note 30, art. 4, para. 2, 4.

\item \textsuperscript{128} See supra notes 114-15 and accompanying text.

\item \textsuperscript{129} The Agreement provides:

Unreasonable pressure is any action favoring products or suppliers, or which influences procurement decisions in a manner which creates discrimination against suppliers from any other signatory [examples then follow].

Agreement, supra note 6, anx. I, art. 4.2.

\item \textsuperscript{130} Specifically, the Agreement states: "a signatory may not require that a vendor must provide offset, specific types or volumes of business opportunities or other types of industrial compensation." Id. at anx. I, art. 4.3.

\item \textsuperscript{131} The Aircraft Code provides:

In conjunction with the approval or awarding of procurement contracts for products covered by this Agreement a Signatory may, however, require that its qualified firms be provided with access to business opportunities on a competitive basis and on terms no less favourable than those available to the qualified firms of other Signatories.

Aircraft Code, supra note 30, art. 4, para. 3. This language was specifically reinterpreted in the Agreement to mean merely that a signatory may require that manufacturers not discriminate against the signatory's qualified firms. Agreement, supra note 6, anx. I, art. 4.3.

\item \textsuperscript{132} United States was a net importer of aircraft technology in the early years of aviation. This helped the American industry close this early technological gap. BLUESTONE, supra note 25, at 18.

\item \textsuperscript{133} See U.S. DEPARTMENT OF COMMERCE, supra note 5, at 78.
\end{itemize}
3. NEW RULES OF DISCLOSURE: TRANSPARENCY

The Agreement also provides for greater "transparency" of state support. This has been a longtime concern of the United States.134 Airbus benefits from unique rules of incorporation under French law. These rules state that Airbus is unable to retain any of its earnings. Thus it is not required to report financial results and is not liable to pay taxes on profits.135 In addition, Airbus owns no production facilities. Rather, production work is done under contract to Airbus by the partners. Each contract for production is negotiated separately. The partners do not know the terms of each production subcontract.136 As a result of this peculiar system, even Airbus does not know the costs to the individual members.137 This makes it all but impossible to determine profitability, since neither profit nor loss from these subcontracting arrangements are disclosed. Further, the Airbus consortium does not publish the amount of profit or loss distributed to its member companies.138

As a result of these highly secretive and unorthodox accounting techniques, the United States has been unable to determine the exact amount of direct support member nations have given. It is impossible to tell whether the subcontracting agreements do, in fact, reflect market conditions, as required by the GATT Aircraft Code.

In many respects the Agreement goes farther than earlier efforts to compel the disclosure of some of the manufacturers' financial information. The Agreement contains specific, mandatory notification and reporting requirements, unlike the general GATT provisions.139 It requires notification of the amount of government support, planned repayment schedules of such support, annual disbursements and other highly specific data.140

However, the complexity of Airbus' accounting structure has proved a very real obstacle to the enforcement of the transparency requirements set forth in the bilateral agreement. The publication of detailed accounts for Airbus, which the United States has argued is required by the transparency provisions, was expressly overruled by the ministers of the four

135. OFFICE OF TECHNOLOGY ASSESSMENT, supra note 2, at 353. Every 15 days, Airbus either distributes funds to its members or requests more funds if needed. The members are fully and separately liable for all Airbus activities. Id.
136. Id.
137. Id.
138. Id.
139. There is no need to determine if a state enterprise or actionable subsidy is involved. Agreement, supra note 6, art. 8.
140. Id. at art. 8.
consortium partners.\(^{141}\) While officials claim this noncompliance is simply due to an inability to disentangle Airbus interests from those of the manufacturers,\(^ {142}\) their action appears in direct violation of treaty language.\(^ {143}\) It therefore appears the next round of disputes may center on enforcement and verification of the Agreement.

4. **ENFORCEMENT**

While the transparency requirements are highly specific so as to avoid any interpretive arguments between the parties, the overall enforcement mechanisms of the Agreement mirrors the broad, traditional GATT language. As noted earlier, GATT utilizes a flexible approach to dispute resolution.\(^ {144}\) Like the GATT, the Agreement provides for an exception to its provisions in cases where a key manufacturer’s financial viability is threatened.\(^ {145}\) It also requires consultation as its main dispute resolution device.\(^ {146}\) Hence, the current Agreement does little to improve on the dispute resolution procedures of the GATT. Instead, it provides that the parties shall propose to incorporate any improvements in dispute settlement procedures agreed to in the Uruguay Round in revisions to the Aircraft Code.\(^ {147}\)

5. **NEW RULES ON INDIRECT SUBSIDIES**

Finally, the Agreement limits indirect government supports to 3% on the value of annual industrywide sales and 4% of the value of each company’s annual sales.\(^ {148}\) This provision is a major U.S. concession, since large military spending and NASA research traditionally assist U.S. aircraft producers, while there is less such assistance in Europe.\(^ {149}\) No


\(^{142}\) Michael Heseltine, then head of the U.K. Board of Trade claimed, “We have not seen a way which we could publish accounts in a detailed way.” Id.

\(^{143}\) The actions of the ministers appears to directly violate the Agreement, which states: The Parties will encourage firms engaged in the manufacture of large civil aircraft to increase the public disclosure of disaggregated financial results of their civil aircraft operations and the adoption of lines of business financial reporting. These disaggregated financial results would at a minimum be expected to include information on sources and uses of funds including specific information on revenue, operating income, net assets, capital investment and government equity infusions.

\(^{144}\) See supra note 65 and accompanying text.

\(^{145}\) Agreement, *supra* note 6, art. 9, para. 1. Compare with supra, note 66 and accompanying text.

\(^{146}\) Agreement, *supra* note 6, art. 11, para. 1-3. Compare supra, note 67 and accompanying text.

\(^{147}\) Agreement, *supra* note 6, art. 12, para. 1.

\(^{148}\) Id. at art. 5, para. 1-3.

\(^{149}\) Note that the European efforts at government sponsored civil aeronautical research and development, while supplying research facilities like NASA, have limited beneficial effect, since
such limitation existed under the Aircraft Code.

In reality, however, the foregoing provision will have little effect. The military and NASA have dramatically reduced their spending in areas directly applicable to civil aircraft development since the 1960s. The theory of indirect subsidization was more applicable during America's dominance thirty years ago than today. Nonetheless, it continues to provide the EC with political justification for some subsidies, since the U.S. is entitled to some limited subsidization with this provision.

6. THE MULTILATERAL FUNCTION OF THE EC-U.S. AGREEMENT

The current Agreement was negotiated bilaterally, allowing for great concentration on the concerns of the EC and the U.S., the two dominant makers of civil aircraft. Nonetheless, the underlying goal of the accord is to impose the terms of their bilateral compromise onto a multinational playing field. The Agreement provides that both parties shall "make their utmost efforts to ensure that these or similar disciplines are incorporated into the [GATT Aircraft Code]." Indeed, both parties have taken initial steps to include this bilateral Agreement as a framework for establishing a multilateral accord. Further, the GATT civil aircraft committee has agreed to renegotiate the GATT Aircraft Code as part of the Uruguay Round. The recognized importance of this interest is symbolized by Article 12.3 of the bilateral agreement, which states: "[i]f multilateralization has not yet been achieved in one year, the Parties shall review the question of continued application of this bilateral Agreement." In this

work is often inefficiently duplicated by Germany's Deutsche Forschungsund Versuchsanstalt fur Luft- und Raumfahrt (now DLR), Britain's Royal Aircraft Establishment (RAE), and France's Office National d'Etude et de Recherches Aerospatiale (ONERA). OFFICE OF TECHNOLOGY ASSESSMENT, supra note 2, at 358.

150. See U.S. CIVIL AVIATION MFG. INDUS. PANEL, COMM. ON TECHNOLOGY AND INT'L ECON. AND TRADE ISSUES, supra note 12, at 135-39. By 1983, aeronautical research made up only 5% of NASA's total research and development budget. Id.

151. In 1963, civilian aircraft sales represented less than 3% of the dollar sales for the entire aircraft industry. SIMONSON, supra note 26, at 227. By 1989, Boeing's military sales represented only 23.4% of revenues; McDonnell Douglas had 55.5% of its revenues from military aircraft and related sales. OFFICE OF TECHNOLOGY ASSESSMENT, supra note 2, at 357 (Table 8-5).

152. See U.S. and EC Sign US/EC Civil Aircraft Agreement and Suggest Renegotiations of GATT Agreement, EUROPEAN COMMUNITY NEWS (EC Office of Press and Public Affairs, Washington, D.C.), July 20, 1992, ("The Commission considers that the results concerning direct and indirect support are reasonably equivalent.").

153. Agreement, supra note 6, art. 12, para. 2.

154. See Frances Williams, GATT Offered Airliner Subsidy Model, FIN. TIMES, July 17, 1992, at 5.

155. GATT States to Renegotiate Civil Aircraft Code, Reuters (Reuters) (July 16, 1992) (BC Cycle).

156. Agreement, supra note 6, art 12, para. 3.
sense, the driving purpose of the Agreement was to create a bilateral accord for multilateral adoption.

B. UNIQUE ECONOMICS OF CIVIL AIRCRAFT PRODUCTION NECESSITATE MULTILATERAL RULES

For the United States, future expansion of civil aircraft demand rests in foreign markets. Since the 1970s, growth in the U.S. air travel market has been the slowest of all major world regions. Today's U.S. civil aviation market has matured to such an extent that any rise in domestic demand is simply a function of a cyclical need to re-equip aging fleets. The Asian sector is by far the fastest growing aircraft market, since the need for modern transport links has risen dramatically with the area's tremendous economic growth.

Communist China and former communist nations may also become larger markets for civil aircraft as costs to develop other modes of modern transportation are higher and completion of construction slower. In all of these markets, however, U.S. manufacturers must face competition from Airbus, as well as Russia, their traditional supplier. Hence,

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157. See U.S. CIVIL AVIATION MFG. INDUS. PANEL, COMM. ON TECHNOLOGY AND INT'L ECON. AND TRADE ISSUES, supra note 12, at 55 (The U.S. has had about 5% annual growth whereas other regions average about 9%).

158. Airbus estimates a constant growth of 7% for the region over the next 20 years, which in turn means a demand for 2,800 additional aircraft. Karl Wilson, China: Battle for Skies Heats Up, S. CHINA MORNING POST (Reuter Textline) (Oct. 25, 1992).

159. A 1980 World Bank report notes that air transportation is more important to developing nations than developed countries. Development costs are cheaper and construction time faster than road or rail networks. Charles Barton, China's Growing Airlines and Aviation Industry, in JOINT ECONOMIC COMMITTEE, 102d CONG., 1ST SESS., CHINA'S ECONOMIC DILEMMAS IN THE 1990s: THE PROBLEMS OF REFORM, MODERNIZATION, AND INTERDEPENDENCE 469, 472 (S. Print 1990).

160. The Russians have aggressively moved to enter the world civil aircraft market. Aviastar, the leading Russian transport plane producer intends to become the third largest civil aircraft maker, after Boeing and Airbus. The Russian government has allowed up to 50% of the company to be owned by Western investors. Low wage costs, coupled with a relatively modern plants already in place, support the Russian claim that its costs to produce aircraft are 20-25% lower than Western rivals. Peter Gregson, Russian Aircraft Maker Bids to Break into Global Market, Reuter Library Report, (Reuters) (Oct. 6, 1992) (BC Cycle).

161. For example, Chinese civilian transport needs are expected to demand an additional 500 aircraft in the near future. Its civilian aerospace demand is the highest growth rate in the world. Wilson, supra note 156. While China has greatly expanded its domestic production capacity through foreign offset concessions, its infrastructure was built by Russia in the 1950s, and continues to have a fleet partially composed of Soviet-built aircraft. See Barton, supra note 159,
while the United States remains the largest civil aircraft market, its makers must look to other areas of the world for the best opportunities to sell new planes.

The Asian nations, generally rich with capital, have demanded offset concessions as a precondition to civil aircraft purchases.\textsuperscript{162} As a result, the U.S. producers are under tremendous pressure to accept such conditions. The loss of military orders from the end of the Cold War, coupled with huge development costs,\textsuperscript{163} make U.S. makers dependent on such financing.\textsuperscript{164} The recent increase in Exim bank financing,\textsuperscript{165} while helpful, has not effectively lessened the need to look internationally for financing of new aircraft development.\textsuperscript{166}

Large costs have not only increased financing pressures, but questions are now being raised as to the economic feasibility of large civil aircraft development and production without government assistance. The U.S. aerospace industry’s return on sales and assets is significantly below the average of the total manufacturing base in the country.\textsuperscript{167} These high initial costs and the unpredictable nature of future demand make the development of new aircraft a tremendously high risk venture.\textsuperscript{168} One

\begin{thebibliography}{9}
\bibitem{162} Japan, for example, has taken advantage of offset agreements, giving it a 15\% share of production in the 767, and supplied various component parts for the 737, 747, 757, DC-10, and the L-1011. \textit{U.S. Department of Commerce}, supra note 5, at 71-72. If the United States continues to pressure Japan to assume more of the burden of its defense, surely the civil aircraft industry in that nation will expand further as a result of greater government research and involvement. \textit{See Cohen \& Zysman, supra note 17, at 40-41.}
\bibitem{163} For example, the Boeing 777, its latest model, is estimated to cost over $5 billion in development, more than three times the $1.2 billion required to develop the 747. \textit{Office of Technology Assessment}, supra note 2, at 343 (Table 8-2).
\bibitem{164} One industry insider told a House Foreign Affairs Subcommittee on Economic Policy and Trade: “No major commercial aerospace program today can be launched without some form of international collaboration—the costs and risks are too high.” \textit{Aircraft Executives Urge Government “Cooperation”}, Int’l Trade Daily (BNA), Aug. 10, 1992.
\bibitem{166} However, some in the aircraft industry fear increases in Exim financing may soon level off. \textit{USA: Exim Cuts and Runs — New Aircraft Financing to be Limited}, \textit{Airline Business} (Reuter Textline), Mar. 1, 1993.
\bibitem{167} Even Boeing, which has traditionally been described as a “go-it-alone” company, has now publicly invited more global collaboration. It recently established agreements with three Japanese aerospace companies for its super-jumbo project. Paul Betts, \textit{Boeing to Open Itself to Wider Global Collaboration}, \textit{Fin. Times}, Sept. 2, 1992, at 18.
\bibitem{168} This reality has led some to conclude that “launching a new large transport is equivalent
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analyst claimed that since 1982, less than 10% of all commercial jets developed have been profitable ventures.\textsuperscript{169} Recovery of the initial capital requirements of launching a new aircraft typically requires 10 to 15 years.\textsuperscript{170} This history, coupled with increased financing demands, and a tougher battle for ever-diminishing market share makes an unregulated world market a threat to the entire industry. The implication of greater competitiveness in the world marketplace could be devastating for all producers.\textsuperscript{171}

If more competition ensues, makers may be less willing to enter certain markets for fear that its potential market share is too small to sustain profitability. Thus subsidies will, more than ever, tilt the balance of power in the field of civil aviation. If such unfair competitive advantages continue in other parts of the world, the U.S. will have to increase spending on the Exim bank even further to protect the industry from unfair financing.\textsuperscript{172} Otherwise, its only option is to place protective tariffs on foreign products, which would cripple an industry increasingly dependent on export sales. Hence, it is in the interest of both the United States and Europe to multilateralize the current agreement to establish a level playing field, not only amongst themselves, but to ward off any unfair competition from other emerging aerospace nations.

\textsuperscript{169} Specifically, the study found that only two of twenty-two commercial aircraft developed had been profitable, the Boeing 707 and 727. John Newhouse, A Reporter at Large. A Sporty Game II: Big, Bigger, Jumbo, NEW YORKER, June 28, 1982, at 58. See also Aerospace Survey, ECONOMIST, Aug. 30, 1980, at 5-22 (it found only three profitable commercial jets, the Boeing 707, 727, and the McDonnell Douglas DC-8). By 1991, only four planes were considered profitable, with a fifth model close to profitability. OFFICE OF TECHNOLOGY ASSESSMENT, supra note 2, at 342 & n.6.

\textsuperscript{170} The launch of both the 747 and the DC-10 represented development costs over three times greater than the entire capitalization of their respective companies. OFFICE OF TECHNOLOGY ASSESSMENT, supra note 2, at 343.

\textsuperscript{171} The presence of Airbus alone is estimated to have forced Boeing to lower its pricing of comparable aircraft by 40%. Richard Baldwin & Paul Krugman, Industrial Policy in Wide-Bodyed Jet Aircraft, in TRADE POLICY ISSUES AND EMPIRICAL ANALYSIS 45, 68 (Richard E. Baldwin, ed., 1988). The results of the empirical study hint that the world market cannot support more than two makers producing aircraft that are close substitutes in demand, and perhaps could only support one without government intervention. Id. at 71.

IV. CLINTON'S UNCERTAIN APPROACH TO THE AIRBUS DISPUTE

The Clinton Administration has led many to believe the bilateral Agreement may quickly be unravelling. On February 25, 1993, the United States formally requested "consultations" with the European Community.\footnote{United States asks EC Commission for Consultations on Airbus Pact, Int'l Trade Rep. (BNA) Mar. 3, 1993.} Technically, these consultations are to take place biannually under the terms of the Agreement,\footnote{Agreement, supra note 6, art. 11, para. 1.} but due to "technical reasons", the two sides had not yet met.\footnote{United States asks EC Commission for Consultations on Airbus Pact, Int'l Trade Rep. (BNA) Mar. 3, 1993.} The administration has been criticized by Brussels for displaying a "good-cop, bad cop"\footnote{See Tom Buerkle, EC Summons U.S. to Clarify its Position in Trade Feud, Washington Approach 'Good Cop, Bad Cop' is Decried by Brussels, INT'L HERALD TRIB. (Mar. 18, 1993); Lyndsay Griffiths, Jekyll-and-Hyde U.S. Trade Policy has Allies Worried, Reuters Asia-Pacific Bus. Rep. (Reuters) Mar. 8, 1993.} strategy on trade issues.

For example, in defending its position that consultations were needed, the White House replied, "there have been some discrepancies over the amount of subsidies that have gone to Airbus and how you count the direct and indirect subsidies, and a lot of people make a very strong case that some of the subsidies may, in some way, be improper."\footnote{United States Asks EC Commission for Consultations on Airbus Pact, Int'l Trade Daily (BNA) Mar. 1, 1993 (quoting remarks made by White House Communications Director George Stephanopoulos on Feb. 25, 1993).} These comments came just two days after the EC External Economic Affairs Commissioner, Sir Leon Brittan, issued a statement acknowledging he had received "assurances [that] the administration does not intend to reopen the Airbus agreement."\footnote{Id. (quoting Feb. 23, 1993 statement of EC External Affairs Commissioner, Sir. Leon Brittan).} Those assurances were prompted by President Clinton's remarks the previous day that "we're going to try to change the rules of the game."\footnote{United States Asks EC Commission for Consultations on Airbus Pact, Int'l Trade Daily (BNA) Mar. 1, 1993 (quoting the Feb. 22, 1993 remarks of President Clinton).}

Regardless of whether the intent of such maneuvering was to renew the trade controversy, clearly U.S. allegations of EC impropriety were the catalyst to recent EC allegations of U.S. impropriety. Specifically, the EC alleges possible U.S. violations of caps on indirect subsidies.\footnote{Specifically, Sir Leon Brittan said that "very possibly the U.S. may be exceeding the authorized level of indirect subsidies." EC Will Seek Clarifications from U.S. on Airbus During Meeting Later this Month, Int'l Trade Daily (BNA) Mar. 18, 1993.}

Additionally, the EC notes that while it has already sent a proposal to the GATT for transforming the bilateral agreement into a revised multilat-
eral code, the U.S. has failed to send a proposal or comment on the EC draft.\textsuperscript{181} Despite this record, the Clinton Administration continues to make public statements in support of a multilateral agreement.\textsuperscript{182}

Realizing the great potential for a trade war in this area, both sides have left some room for the other to maneuver, while at the same time continuing to profess compliance with the bilateral agreement. The consultations were preceded by tough talk from both sides. The EC threatened to issue a formal complaint with the GATT regarding the tax concessions given to U.S. export trading companies in civil aerospace\textsuperscript{183} as well as challenging the U.S. to consent to international arbitration on the issue.\textsuperscript{184} The U.S. heightened tensions with the introduction of two bills in Congress. The Civil Aircraft Trade Enforcement Act of 1993,\textsuperscript{185} if passed, will formally initiate a countervailing duty investigation regarding Airbus' production of civil aircraft. This is certainly contrary to the industry's wishes, since it could jeopardize American joint ventures and customers in Europe.\textsuperscript{186} Additionally, the Aeronautical Technology Consortium Act of 1993 was introduced.\textsuperscript{187} If passed, this act would provide more direct financial assistance to aircraft manufacturing companies, as well as greater governmental coordination and financial assistance in the research and development of civil aircraft. In effect, these two bills set the stage for renunciation of the bilateral agreement and a large and expensive subsidies battle.

Realizing the increasing potential of a trade war and renunciation of the Agreement, the two sides toned down their rhetoric during the formal consultation period and, at the time of this writing, both sides appear to be

\textsuperscript{181} Id.

\textsuperscript{182} Specifically, Mickey Kantor, the U.S. Trade Representative, said he wants "'further improvement of rules in government support to aircraft through multilateral negotiations in the GATT aircraft code.'" Kantor Sees Problems Ahead with Europe, Japan, China, Reuter European Community Report (Reuters, Ltd.) Mar. 7, 1993 (BC cycle). See also EC Official Says Aircraft Talks Should Lead to a Less Contentious Period, Int'l Trade Daily (BNA) Apr. 2, 1993 (U.S. official stating "'both sides 'are looking to implement the agreement and to multilaterize [sic] it.'").


\textsuperscript{184} Boris Johnson, Brittan's New Trade Threat to America, DAILY TELEGRAPH, Mar. 18, 1993, at 13.

\textsuperscript{185} S. 418, 103d Cong. 1st Sess. (1993).

\textsuperscript{186} Paul Maidment, Does Airbus Cheat? Does Boeing, NEWSWEEK, Mar. 8, 1993, at 44.

\textsuperscript{187} S. 419, 103d Cong., 1st Sess. (1993).

The Clinton Administration has sent mixed signals as to whether it fully supports such increased direct subsidization as proposed by this bill. Compare Jeff Cole, U.S. May Try to Stop Airbus From Using 'Walkaway' Leases, WALL ST. J. A3, Mar. 22, 1993, at A8 ("Vice-President Al Gore has said he considers the creation of a research consortium aiding aerospace companies to be a top priority.") with Clinton urged to veto subsidy bills, FIN. TIMES, Apr. 2, 1993, at 8 ("[the Administration will] inform Congress where it believed legislation was contrary to other trade commitments.").
willing to recognize an informal "cooling off" period.\textsuperscript{188} For its part, the Clinton Administration acknowledged doubts about the proposed legislation, promising to eliminate language in the legislation contrary to existing trade commitments.\textsuperscript{189} Additionally, the Administration has provided reassurance that it has no plans to withdraw from the Agreement.\textsuperscript{190} The EC has backed off as well, stating the consultations should "lead to a less contentious period."\textsuperscript{191} The issue may heat up again in the summer of 1993, since under the terms of the Agreement, neither party can request to withdraw from the treaty until one year has expired.\textsuperscript{192} Even if a party decides to withdraw, the Agreement remains valid for an additional year after an expression of such intent.\textsuperscript{193}

V. CONCLUSION

The bilateral agreement's potential multilateral implications for the United States, the European Community, and the world trade of aircraft are enormous. Effective multilateralization of the accord would have a positive effect on U.S. trading interests.

First, U.S. civil aircraft makers have used the export market as a means to expand demand, overcome any downturns in the domestic market, and improve their capital position to develop new technology. If restraints on international subsidies are not put in place, foreign buyers may choose to finance the development of their own civil aircraft industry rather than looking to the United States to purchase aircraft.

Second, the emergence of new producers threatens the ability of existing U.S. makers to maintain profitability, since a high percentage of market share is needed to offset the large development costs inherent to the industry. It is essential that the Agreement be expanded internationally. Entry of new, heavily subsidized makers on the world market, immune to the financial risks inherent to the industry, could force further consolidation of the world's aircraft makers. If multilateralized, the provi-


\textsuperscript{189} Clinton Urged to Veto Subsidy Bills, FIN. TIMES, Apr. 2, 1993, at 8.

\textsuperscript{190} EC: Consultations on Aid to Civil Aeronautics Confirm Willingness by both EC and U.S. to abide by 1992 Accord, AGENCE EUROPE (Reuter Textline) April 3, 1993 ("it is now clear [after the consultations] that the Clinton Administration does not intend putting the accord into question.").


\textsuperscript{192} Agreement, supra note 6, art 13, para. 3.

\textsuperscript{193} Id.
sions of the treaty would protect against this competition, by providing a legal tool to prevent heavily subsidized new makers of competitive aircraft from entering the world market.

Finally, the Agreement would continue to provide a legal tool to insure an end to perceived unfair trade practices of the European Community in this area.

Similar interests of the European Community would also be furthered by multilateralization of the bilateral agreement. They too are threatened by emerging, unregulated competitors. At the same time, the Agreement would continue to provide a policing mechanism for the EC to oversee indirect government financing in the U.S.

Recognizing a common interest in maintaining their combined stronghold on the international civil aircraft market, both the U.S. and the EC have actively encouraged greater involvement of the emerging aerospace nations with the Agreement. The survival of the U.S. and the EC aircraft industries surely depends on each maker maintaining stable market share. New entrants in the world market mean not only lower profits for both industries, but may mean the potential destruction of an essential industry to both Europe and the United States.

Continued unregulated, subsidized competition could foreclose the opportunity for any one maker to profitably sell aircraft without government supports. Without international safeguards, the threat of an international subsidies war looms large.

EPilogue

The threat of an international subsidies war has increased dramatically since the completion of the above article. The failure to include a civil aircraft provision to the Uruguay Round of GATT negotiations casts a shadow of uncertainty as to what legal standards will apply to the


195. For example, in July 1992 representatives from the US, EC, Japan and 10 other countries met along with representatives from the Japanese Ministry of International Trade and Industry (MITI) in the hopes of creating international guidelines regarding government subsidization of civilian aircraft development. Meeting to Discuss Aircraft Subsidy Rules About to Begin, REPORT FROM JAPAN (Yomiuri News Service) (July 10, 1992).

South Korea, despite only a small aerospace industry, was invited by the United States to take part as an observer in the multilateral negotiations associated with the Agreement since it has an active policy of government subsidies. South Korea: Efforts to Enter Aircraft Industry Encounter Difficulties, KOREA ECONOMIC DAILY, (Reuter Textline), Sept. 26, 1992.

industry in the future. As noted above,197 the express purpose of the Agreement was to facilitate a multilateral set of rules in the Uruguay Round of GATT negotiations. The failure to multilateralize a new agreement on civil aircraft means that the bilateral Agreement still represents the legal instrument with the most specific language to combat claims of improper subsidies in the United States and the European Community. Further, it remains an important model for future multilateralization efforts. Despite the recent political setback, efforts to multilateralize the Agreement should continue, since legal concessions granted to the Europeans as part of the Uruguay Round will expire at the end of 1994 should no new aircraft code emerge.198

In the meantime, however, the actions of both the United States and the European Community represent an open affront to current legal instruments. The European Parliament, acknowledging the economic pressures for international cooperation and integration, has called for a central industrial strategy for the Europe's aircraft manufacturing sector, including a call for direct subsidies.199 At the same time, member states such as France and Germany have now called for increased indirect subsidies.200 These political moves imply potential violations of the Agreement's ban on future production subsidies and caps on indirect subsidies.201

The United States, under the Clinton administration, has furthered its early tactic of sending mixed signals regarding its intention to uphold the Agreement. On the one hand, the administration immediately sought refuge in the language of the Agreement as an adequate safeguard shortly after the failure of the Uruguay Round of the GATT to adopt a new aircraft code.202 On the other hand, the President of the United States personally undertook the role of aircraft salesman by calling King Fahd of Saudi Ara-

197. See supra, note 156 and accompanying text.
198. The EC successfully negotiated two footnotes exempting subsidies for large civil aircraft from the newly negotiated GATT Subsidies Code. First, the agreement upholds the legality of development loans which are not repaid because of slow sales. Second, the general rule that a maker has the burden of proof to show a subsidy is fair if the subsidy accounts for more than 5% of the product's value will not apply to aircraft makers. Post - GATT Talks Face Deadline for 'Tailor Made' Aviation Code, AVIATION EUROPE (McGraw-Hill, Inc.) (Dec. 23, 1993).
201. See supra, notes 109, 148-52 and accompanying text.
bia and encouraging him to buy American-made aircraft for the state-run airline, soon after rolling back Saudi military debts, and then by the President himself announcing the completion of the aircraft deal. Additionally, the United States allowed Kazakhstan its first purchase of Western civil aircraft “immediately after signing of a commercial agreement”. These incidents demonstrated a blatant affront to Article IV of the Aircraft Code and the Annex of the Agreement, prohibiting the use of government pressure to induce purchase agreements. Because of these actions, the Aircraft Code and the Agreement have taken on great importance as legal tools for European retribution.

Both sides continue to recognize the importance of multilateralizing the Agreement despite their respective shortfalls in upholding the spirit of the Agreement. The civil aircraft industry is facing the toughest economic climate in its history. As the financing and development pressures increase, so too does the need for international rules on subsidies in civil aircraft. Without a legal framework to control these pressures, the United States and the European Community run the continued risk of wild government involvement in the industry.


205. See supra, notes 99-101, 130-131 and accompanying text.


208. Struggling to Get Back in the Air - Manufacturing in Civil Aviation, ENGINEER (Reuter Textline) (Jan. 20, 1994).
Note

Enlightened Regulation of Computerized Reservations Systems Requires a Conscious Balance Between Consumer Protection and Profitable Airline Marketing

Marj P. Leaming*

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I. INTRODUCTION

Computerized Reservations Systems ("CRSs") evolved from a marketing tool for the airlines into global informational platforms. The United States government is now faced with a difficult choice of encouraging economic and technical development by aggressive world-wide competition and living with the consequences of a resulting oligopoly, or protecting consumers from the results of deceptive practices, unfair competition, and alleged antitrust violations in the air transportation industry.

Congress granted the administrative agencies, Civil Aeronautics Board ("CAB") and its successor, the Department of Transportation ("DOT"), authority to promulgate and enforce regulation of the airline industry. However, the most important period in airline history for monitoring and guiding the CRS industry was at the same time when proponents advocated deregulation of the airlines. Instead, a "laissez-faire" policy of the agencies contributed to a crisis in the industry. Now, more than ever, legislators, airlines, travel agencies, CRS owners and consumers debate where the balance should be set between allowing the industry to be solely driven by the profit motive in a free marketplace and safeguarding consumer protection.

A more important question is whether the government has finally achieved a conscious balancing of objectives through its new rules for CRSs, effective December 1992 ("1992 DOT Rules"). A comparison of the status of the CRS industry under the 1992 DOT rules with the European Community's Code regulating CRSs reveal that the DOT still has not achieved an optimal balance.

II. HISTORY OF COMPUTERIZED RESERVATIONS SYSTEMS

Prior to 1978, the airline carrier, an interline partner, or a travel agent authorized by the Air Traffic Conference of America sold and distributed airline tickets. The CAB approved prices at levels which ensured that efficient carriers earned a reasonable rate of return. Travel agents soon accounted for slightly more than 50 percent of total sales.¹

Beginning in the 1960s, efforts were made to provide travel agents with automated flight and ticket information. One promising program, Automatic Travel Agency Reservations System (ATARS), attempted to provide a CRS commonly sponsored by travel agents and the airlines.

¹. Airlines Sue Over Reservations Squeeze, AIRLINE BUSINESS, Jan. 1986, at 28.
ATARS triggered an investigation by CAB into the impact of an industry-wide, single system on the air transportation environment.\(^2\) The CAB refused to grant antitrust immunity to facilitate the development of a CRS to be owned and operated by a consortium of 21 airlines in 1967.\(^3\)

After 1976, American Airlines, Inc. ("American") and United Air Lines, Inc. ("United") each vertically integrated to tighten control of the passenger market and strategically reshape the transportation distribution system. To capture the lucrative market for air transportation services, travel agents and corporate travel departments became part of the air carrier's distribution system.

When the major airline carriers developed their CRSs, a new industry emerged. American's SABRE and United's APOLLO lead air transportation into a new era of computerized marketing. The American Society of Travel Agents, along with some airlines, initiated an effort to create an industry-wide system called Multi-Access Agent Reservation System, ("MAARS").\(^4\) By 1983, SABRE commanded 43 percent, and APOLLO, 27 percent, of the domestic revenues from CRSs in all travel agencies. MAARS achieved only 2 percent of the market.\(^5\)

The burgeoning air transportation market became dependent on the technological innovation of the CRS. By efficiently integrating the constant changes to accommodate marketing and pricing decisions, the CRS vendors effectively captured both consumer and business travel dollars. By 1987, 95 percent of all domestic travel agencies used CRSs and travel agents booked 92 percent of the domestic airline sales through them.\(^6\) According to the U.S. General Accounting Office ("GAO"), there is a 13 to 18 percent greater likelihood that agents will sell products of the CRS vendor than of a competitive carrier.\(^7\)

Today, the four U.S. airline-owned CRSs are: APOLLO, through Covia Partnership, Rosemont, IL;\(^8\) SABRE Travel Information Network,
Dallas/Fort Worth, TX; System One Corp., Houston, TX; and Worldspan, Atlanta, GA. Presently, APOLLO and SABRE have obtained 71 percent of the U.S. airline ticket sales. It is estimated that the recently merged APOLLO will have 31.7 percent of its terminals world-wide; SABRE, 28.2 percent; Worldspan, 13.6 percent; Systems One, 10.4 percent; and foreign CRSs, 16.1 percent. A brief description of these CRSs follows.

1. Covia Corp. ("Covia") markets through 25,000 travel agency locations. In April, 1992, Covia agreed to merge with the European-based system, Galileo Distribution Systems in the United Kingdom. The owners also hold a one-third interest in the Gemini Group. Covia, earning about $475 million in 1991, continues to aggressively add agency locations and CRTs to complete its global network.

2. American Airlines solely owns SABRE. It has installed its CRS in over 22,000 agencies. With estimated revenues in 1991 of $655 million, SABRE continues to safeguard its domestic market share from Covia while it builds on its international base in Europe and Canada.

3. System One, developed by Eastern Airlines, was subsequently
acquired by Continental Airlines. It is installed in over 7,500 locations. Amadeus Global Distribution and Tarex are international affiliates. While System One earned an estimated $378 million in revenues in 1991, it dropped in agency locations and number of CRTs, and lost 9 percent in revenues from the previous year.21

4. Worldspan is a combination of PARS, developed by Trans World Airlines ("TWA"), and DATAS II, developed by Delta.22 The CRS is installed in 10,180 locations that have almost 42,000 CRTs.23 Worldspan has international affiliation agreements with Abacus Distribution Systems Pte. Ltd. and Infini Travel Information.24

III. How COMPUTERIZED RESERVATIONS SYSTEMS OPERATE

The airlines electronically load their fares through a clearinghouse, the Airline Tariff Publishing Company ("ATPCO"). This corporation was formed in 1965 "after having been the 'Tariffs' Department of the Air Transport Association of America for 25 years."25 Three major departments—tariffs, computer services, and administration—enable the corporation to collect and disseminate rules, fares and rate information relative to air transportation on behalf of more than 200 domestic and international air carriers. The CRSs, travel agents, and airlines subscribe to the clearinghouse for passenger fares, rules, routings, cargo rates, and car rental rates on magnetic tape or by data line transmission.

The CRS vendors then supply their subscribers (usually travel agents) with a database and equipment, such as processors, monitors, and telecommunications links. A travel agent using a CRS "calls up" a screen display of airline schedules, fares, seat availabilities, and other services.

19. 1992 Directory, supra note 13. It has 50 airlines, 23 hotels and six car rental agencies as direct vendors. Id.
20. Id. Amadeus, headquartered in Madrid, Spain, has about 12,557 agency locations.
22. 1992 Directory, supra note 13. PARS has 45 airlines, 29 hotels and 10 car rental agencies, while DATAS II has 35 airlines and 29 hotels as direct access vendors. Id.
23. Id.
24. Between the Lines, supra note 14. Abacus, jointly owned by several airlines including Singapore Airlines and Cathay Pacific, has 2,400 agency locations. Infini, owned by Japan, has about 1,881 agency locations. Id.
coded information concerning flights. The CRS expedites the functions of looking for options, booking travel, and storing information for travelers.

Reservations are made by automatically routing booking information to the central data base of the CRS vendor which in turn, if necessary, relays the information to the computer of the air carrier on which the seat is being assigned. Both reservations and sales confirmations are communicated through ARINC, a communications switching center, or by a dedicated communications link between a CRS vendor and a participating carrier.26

The CRS technology is essential to manage effectively frequent changes in prices, schedules, and restrictions. In a typical day, domestic carriers change about 133,000 fares and more than 3,000 flight schedules. Carriers adjust discount seat allocations at least 12 times during the life of a typical flight.27 Complementary to the CRS services, the travel agencies or third-party vendors have developed compatible software for trip planning, pre-travel quality control, pre-travel reporting, remote ticketing, travel management reporting, and accounting and expense management to further facilitate the reservation function.

Travel agents, as experts in travel and tour planning, efficiently book flight reservations using leased CRSs in a manner similar to airline personnel using the carrier’s internal reservations systems. Agents subscribing to a particular airline’s CRS, “choose that airline 41 percent of the time for business travelers and 55 percent of the time for leisure travelers.”28

By annexing travel agents as a partner in the airline distribution system, the revenue stream for the CRS vendors has been lucrative. Income is generated through: a) installation and operation fees from subscribers (agents) for terminals and other equipment leased to them, b) fees for each flight booked on the CRS paid by participating carriers, and c) incremental revenues gained by the airlines owning the CRS. Therefore, fierce competition in the airline industry is now fought electronically through the CRSs. More airline failures will, “prove that mega-airlines’ CRSs, slot control, and frequent flyer programs are more effective ‘regulators’ [of the airline industry] than the former federal regulatory body, [the CAB].”29

26. BRENNER, supra note 2.
27. SYSTEM ONE, The Business of Travel, (advertisement, undated).
IV. CRS Regulation Increased as Airlines Became Deregulated

Economists widely believed that deregulation of the airline industry would improve society's economic welfare. Some economists predicted positive results in socially optimal levels of fares and quality of service to consumers. "Social optimality requires that fares and service quality, or in this case, frequency of service, be set to maximize the sum of travelers' and carriers' welfare." 30

Proponents of the Airline Deregulation Act of 1978 31 based their arguments on an assumption that an absence of economies of scale would ensure a large number of competitors in the airline industry. The markets that were naturally monopolistic or oligopolistic would become competitive due to low barriers to entry and an absence of sunk entry costs. 32 "The one point on which all of the pro-deregulation economists, policy makers, and interest groups agreed was that a government-enforced airline cartel was bad for the airlines' customers and bad for the national economy." 33

When American and United announced their intentions to develop separate CRSs in 1976—just two years before deregulation—the economists failed to predict the amount of power that an airline, individually, would ultimately be able to wield in the air transportation and reservation markets. American and United invested over $1 billion to produce SABRE and APOLLO, respectively. 34 Delta followed by developing DATAS II; Eastern, SODA; Northwest, PARS; and Texas Air, System One. 35 As more efficient marketing and distribution channels evolved, the CRSs facilitated "real-time" travel services through the use of state-of-the-art information technology.

It was alleged that the CRS vendors substantially reduced airline competition through their sophisticated marketing and pricing structures and that they became a barrier to the entry of new airlines because of the high capitalization required to create and maintain the CRS technology. The CRSs gathered a plentitude of data from which the CRS owners developed astute business strategies. Through an analysis of the booking history of participating carriers and travel agencies, CRSs had the capa-

bility to skew information provided to the travel agents to their benefit without detection.

As the CRS became the cornerstone of a blossoming automated industry, profitability became even more dependent on producing, distributing, and retrieving timely and accurate information. Prior to airline deregulation, travel agents booked less than 40 percent of all tickets. Currently, at least 70 percent of all airline tickets are sold by travel agents and 95 percent of travel agencies use one of the CRSs. Abusive competitive practices by CRSs and affiliated travel agencies would result in denial of complete, accurate, and impartial information on all available airline services to the travelling public.

The marketing innovation for airline services increased the accessibility of information and contributed to higher profits for both travel agencies and CRS owners. Airline deregulation allowed greater flexibility in changing fares and establishing conditions and restrictions to meet the needs of the marketplace. As the participating airlines changed flight schedules, fares, or travel limitations, this information was automatically integrated by the CRS. As the carriers grew, the economies of scale improved and the learning curve for automating the travel agencies decreased. The CRS functioned as a cost-reducing innovation that, when operating at optimal levels, could almost approach Pareto-efficiency. At this level, allocative efficiency necessary to meet consumer needs is maximized.

Although many economists have continued to support the notion that the CRS industry should be free from regulation to allow the marketplace to achieve social welfare maximization, both Congress and the Executive branch became increasingly concerned about the concentration of market power in the hands of a few CRS vendors. Beginning in 1983, the CAB, under pressure from Congress and the Department of Justice, investigated the CRS market domination and alleged abuses.

On July 27, 1984, CAB identified the five CRSs as barriers to new

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37. Dempsey, Disintegration, supra note 9, at 18.
38. Airline Marketing, supra note 7.
39. BRENNER, supra note 2. In 1983, in the 29 urban markets with air travel revenues exceeding $100 million, SABRE captured Anchorage (92 percent of the market share), Dallas-Ft. Worth (88 percent), Cincinnati (84 percent), Phoenix (69 percent), Boston (69 percent), Rochester (69 percent), Houston (68 percent), San Diego (54 percent), Detroit (53 percent), and Washington D.C. (51 percent). APOLLO captured Denver (72 percent), Portland (66 percent), Cleveland (64 percent), Milwaukee (57 percent), Sacramento (52 percent) and Salt Lake City (52 percent). Id.
airline entry and adopted regulations addressing them.40 "The 1984 rules provide[d] only basic competitive protection, outlawing overt 'display bias' in favor of particular airlines and the most objectionable practices in contracts with travel agents."41 After promulgating rules for CRS operation, the CAB stated that,

We cannot measure precisely the extent or duration of the market power or the limitations on it . . . . Our proposed rules should be sufficient to alleviate the major problems that we have identified, but still give CRS owners great latitude in the design and marketing of their systems.42

On December 20, 1985, the Department of Justice reported to Congress that CRS vendors continued to possess market power and that their pricing practices for participating airlines were discriminatory. In May 1986, the GAO reported43 to Congress that the potential for anti-competitive practices, such as the generation of incremental revenues by CRS vendors existed. A House bill44 providing for binding arbitration to resolve participating carrier and subscriber disputes with CRS vendors, was introduced on February 2, 1987. Contemporaneous with this congressional action, the DOT, as successor to the CAB, announced it would again review allegations of abuse of market power.45 In spite of more stringent rules finally promulgated by DOT in 1992, abuses of market power and anti-competitive practices by CRS vendors continued to be alleged.

The laissez faire policy followed by the DOT concerning CRSs has not produced the results that deregulation proponents promised. In response to the announcement by the DOT in 1989 that it again intended to change existing rules in effect since the mid-1980's, the president of a large international travel agency proposed allowing the existing rules to expire without replacement. He stated:

Let the marketplace dictate competition in the airline and agency automation business. The issue is not whether a rule is good or bad, the issue is whether the government should at all be involved in regulating business . . . . [The DOT] acted irresponsibly during this whole rulemaking process . . . The waste in time and money has been enormous . . . The expenditure in legal

42. CAB Moves Ahead With Rules to Address Computer Bias, AVIATION DAILY, June 1984.
45. Rein, supra note 34.
fees alone by all parties involved has probably been over $1 million.\textsuperscript{46}

The CRS industry has now attained productive efficiency. A new industry of third-party vendors has developed. Firms are flooding the market with new software, hardware, and methods to satisfy consumer wants. They are continuously researching more effective and user friendly means for travel agencies to inform consumers of their expanding choices. The competitive edge of enhancements to the CRS has become so short that vendors have even supported efforts of these third-party vendors. One CRS marketing director said, "If we can't do it in six months, we start all over."\textsuperscript{47} A motivation for continued innovation is based on the need to further increase efficiency leading to higher profits. "Congress, courts and regulatory agencies must first take into account the economics of entrepreneurship and innovation if they seek to design CRS rules that maximize consumer welfare."\textsuperscript{48}

Likewise, the CRS industry has increased allocative efficiencies, lowered costs to consumers, lowered transaction costs to travel agents, decreased transaction time, expanded accessibility to information, and satisfied consumer needs while air carriers, travel agents and CRS vendors continue making profits.

V. CONCERNS THAT HAVE ARisen FROM AIRLINE CONTROL OF CRSs

This author believes that simply because alternative distribution systems can not effectively compete against CRS vendors is not a sufficient basis to justify tight-listed regulation that could squelch future investment to expand and improve the CRS innovation. Measures that simply decrease profits without preventing deceptive practices may cause undue harm to both the airline and travel industries without improving consumer welfare. Yet, the many concerns voiced by Congress, airlines, travel agents, and travelers must be properly addressed by the DOT. A discussion follows regarding the concerns of: barriers to entry into the CRS industry, incentives to shift sales to CRS vendors, the effect of corporate discounts and incentives, display bias, restrictive contract clauses, the regulatory impact on domestic and foreign direct access vendors, CRS vendors and carriers, and the impact of foreign control.

\textsuperscript{46} Agent, Airline Groups Submit Comments on CRS Rules, TOUR & TRAVEL NEWS, Mar. 9, 1992, at 14.
\textsuperscript{47} Feldman, supra note 8, at 51.
\textsuperscript{48} Ellig, supra note 3, at 295.
A. NEW AND SMALLER CARRIERS CANNOT COMPETE WITH EXISTING CRS VENDORS, SO THEY MUST ACCEPT CO-HOST AGREEMENTS.

Proponents of deregulation have agreed with their critics that "the major airlines through their extensive network of affiliated travel agents and CRSs can make it difficult for new entrants and smaller airlines to enter new markets."49 The lead time, level of technology, scale of economy and investment required to develop a competitive CRS prevent new entrants from easily developing their own CRSs.

While direct booking by the airline could circumvent dealing through travel agents and joining a CRS,50 extensive multi-media advertising over a long period of time is necessary to attain sufficient name recognition to generate consumer demand. Small carriers do not have a sizeable advertising budget that would be required to overcome the industry practice of locating flights using the CRS. Instead, these carriers enter into co-host agreements with at least one of the major CRS vendors as a more viable and less costly opportunity—at least in the short term—to marketing their own services.

For example, because American Airlines dominates the Dallas/Ft. Worth hub, any airline serving the Dallas/Ft. Worth region and utilizing travel agents who are already on the SABRE system must pay an access charge. A similar incentive for carriers to access Covia's APOLLO system exists for hubs dominated by United. "[T]he advantage of being listed in the computer as an 'on line' connection with one of the major airlines has led 48 of the 50 small air carriers to affiliate themselves with the megacarriers" through co-host agreements.51 Therefore, the CRS vendors do not have to rigorously compete for participating carriers.

As part of the agreement, the participating air carriers pay booking fees to the CRS vendor based on the flights reserved through the system. The booking fee consists of an established amount charged for each segment of a flight. For example, a round-trip flight from Denver to Honolulu may require a stop and change of plane in San Francisco. In this example, the carrier would have to pay the CRS vendor four "segment fees" (i.e., Denver-San Francisco, San-Francisco-Honolulu, Honolulu-San Francisco and San Francisco-Denver). Prior to 1984, some airlines were not charged for being listed by the CRS. Presently, it is alleged that the least-favored carriers pay as much as $3 per booking while other participating carriers pay as little as thirty cents.52 The differential of segment

50. Boudreaux and Ellig, supra note 33, at 581.
51. FLYING BLIND, supra note 32, at 22.
52. Airline Marketing, supra note 7.
fees is allegedly based on whether the carrier directly competes with the CRS owner.

The GAO concluded in its September 1988 testimony "that CRSs earn profits exceeding those that could reasonably be expected to be earned in a competitive market."53 Through booking fees that substantially exceed the transaction costs, "the non-CRS carriers are financing American's and United's dominance of the air transportation industry."54 Booking fees produce a rate of return on invested capital of 50 percent for United and 75 to 90 percent for American.55 The mega-carriers owning CRSs make over $300 million per year from the weaker airlines.56

The disfavored carriers allege that they receive poor service and the screens, prepared by the CRS vendor, showing their flights, are subject to display bias. These participating carriers allege that they receive inadequate billing information from the CRS vendors, impairing their ability to audit its accuracy.

Since the profitability of a carrier's service in any market can be radically changed by the addition or loss of a few passengers on its flights in that market, no carrier can afford to lose sales from any significant group of agencies, so each carrier must participate in each system.57

When selecting a CRS, travel agents "prefer a system offered by a carrier with a large airline market share in the agency's city, since a large proportion of the agency's business will be with that carrier."58 In effect, each CRS vendor creates a geographic marketing niche around the hubs of its CRS owner that results in oligopolistic power over other carriers who seek business in the same areas where the CRS vendor has contracted with a significant number of travel agents. In turn, co-host agreements with participating carriers serving in the region make the CRS vendor even more attractive to the travel agents also serving the same region.

B. TRAVEL AGENT COMPENSATION AND INCENTIVES ENCOURAGE SHIFTING SALES TO CRS VENDORS.

In 1977, the year before airline deregulation, all domestic travel

57. Airline Marketing, supra note 7.
58. Id.
agents sold $4.4 billion dollars worth of tickets.\textsuperscript{59} In contrast, in 1991 just the top ten travel agencies generated almost $12 billion dollars in air sales.\textsuperscript{60} Currently, agents on performance contracts book about 65 percent of SABRE’s business, 66 to 75 percent of Covia’s tickets and 25 percent of the System One’s reservations.\textsuperscript{61} Since subscriber success is measured by the number of bookings, commission payments and other incentives are structured to encourage agencies to shift more bookings to the CRS vendor.

Essentially, airlines offer four basic types of volume incentives to travel agents. Approximately 75 percent of the agents enjoy at least one type of incentive.\textsuperscript{62} First, agents enjoy override commissions based on the volume of business booked with the airline offering this bonus. Second, agents may be given membership in the airline’s VIP club, providing a special waiting area and additional services for members. Third, while flights may appear on the CRS screen to be completely booked, agents have overbooking privileges on the carrier that owns the CRS. This privilege is particularly useful to agents who must reserve last-minute trips—generally for their business customers. Finally, airlines provide free tickets through an award system similar to frequent flyer plans for their passengers. Airlines will also offer sales incentives through free or reduced fare tickets to employees of travel agents.

Based on a study, the GAO projects that 41 percent of travel agents nationally use free tickets, 11 percent enjoy free VIP club memberships, 36 percent get overbooking privileges, and 52 percent earn override commissions.\textsuperscript{63} These incentives allow high-volume travel agencies to hire better employees by providing a more attractive benefits package and to fly employees to sales meetings less expensively than their competitors.\textsuperscript{64} The CRS vendors routinely provide account sales assistance and training to improve their subscribers’ productivity. Travel agencies may also receive supplementary funding for advertising to increase their customer base.\textsuperscript{65}

The CRS vendors offer productivity-based contracts that provide

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\textsuperscript{59} Mifsud, supra note 54.
\textsuperscript{60} Between the Lines, supra note 14, at 12. The top ten travel agencies, in order of sales generation, include: American Express, Carlson Travel Network, Thomas Cook Travel, Rosenbluth Travel Agency, USTRavel, Maritz Travel Co., IVI Travel, Wagnons-Lits Travel USA, Omega World Travel, Inc. and World Travel Advisors. id.
\textsuperscript{61} Focus on User Productivity Vs. Winning Clients, BUSINESS TRAVEL NEWS, May 25, 1992, at 80.
\textsuperscript{62} U.S. GENERAL ACCOUNTING OFFICE, Airline Operating & Marketing Practice, supra note 28.
\textsuperscript{63} Id.
\textsuperscript{64} Paul S. McGreen, Airline Industry— Re-regulate?, DEF. TRANSP. J., June 1992, at 18.
\textsuperscript{65} Id.
pricing incentives to travel agencies for using their automation efficiently. Depending on the number of bookings made in the previous year, agencies can obtain a discount of 60 percent or more as a standard ticket rate. Although discounts and override commissions vary with average ticket price, account size, set-up, location, and destination mix, this practice has the effect of discouraging agencies from using direct links to another carrier's internal reservations system or using other databases or systems that do not provide the extra benefits.

The tying of travel agent commissions to bookings by a carrier not only affects competition among the CRS vendors, the travel agencies and airlines, but it also ultimately impacts the consumer. While travel agents can offer significant benefits to their customers by saving time in researching the available alternative schedules and rates, some travel agents, with an eye to earning extra commissions, steer passengers toward more expensive tickets offered by their CRS-affiliated airlines. When agencies shift a disproportionately large share of their bookings to the CRS, its vendors gain "incremental revenues." Some agents admit that they can influence 25 percent of all business travelers and 50 percent of all leisure travelers to choose a particular airline.

In a recent poll taken of lead travel agents during the period from 1991 to 1992, commission overrides increased in every travel product category, including domestic air tickets, international air tickets, car rentals, cruises, tour packages and hotel rooms. An agent in a leading travel network estimated that 85 percent of her total annual sales volume generated override commissions, that the highest override generators are airline tickets, furthermore, another leading travel agency reported that 90 percent of its airline ticket sales generate overrides.

When the average ticket price for air travel decreases, travel agencies must work harder for fewer dollars. During the month of June, 1992, travel agency commissions totaled over $590 million for processing an annual high of over 23 million tickets, however, the average commission per ticket plummeted to only $25.30—a 19 percent reduction from average commissions in June 1991. Prolonged lower airfares not only shrink overrides for individual travel agents but can also damage the travel agency industry's financial stability. The Airline Reporting Corp. reported that from 1990 to 1991 travel agency defaults and voluntary closures increased 43 percent, while 11 percent fewer retail locations

68. Airline Marketing, supra note 7.
opened. Therefore, neither the airlines nor the travel agents have incentives to promote savings to consumers through low airfares.

C. CRS VENDORS CAPTURE BUSINESS LOYALTY THROUGH CORPORATE DISCOUNTS AND AUTOMATED TRAVEL PLANNING.

Over 40 percent of the typical corporate travel and entertainment budget is spent on air travel. From 1990 to 1991, business fares increased 21 percent, while the average leisure fares decreased by 4 percent during the same year. In reaction to this discrepancy, businesses contain their costs by continuing to reduce their travel and by working with travel agencies or their own travel departments to capture the shrinking quantity of lower, restricted fares.

While frequent flyer mileage programs lock in the carrier loyalty of corporate employees travelling on business, company discounts with airline carriers ensure repeat business. Corporate discount packages are typically valid for six to twelve months. Because domestic carriers offer corporate discount percentages based strictly on how much incremental market share it provides, savings shrink when business travel is reduced. Corporations having a high volume of business travel can negotiate a discount of about 50 percent off published full-coach fares, as well as a waiver of the conditions on restricted fares. Businesses with smaller volumes can expect a 20 to 40 percent discount. Sometimes carriers will offer a flat discount at the time of ticketing or a "meetings fare deal" applying to travel by ten or more people to the same destination at one time.

It is alleged that carriers quickly terminate negotiations with a corporation if it is found engaging in comparative shopping. In negotiating contracts with airlines, one business executive pointed out that "[a]irlines are now actually looking for hard copies of our MIS [reports] from our agency . . . [t]hey want to know what their market share is, and what additional new business I can guarantee them." The CRS vendors compare their internal data with corporate- and agency-produced usage information before establishing a discount rate. Regardless whether firms agree to provide the data, the "[a]irlines hosting a CRS] devote people and time to scoping out particular deals. It’s like intelligence work . . . . They can see

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73. Avg. Fare Paid Drops 4% From '91, But Restrictions Tighten, CORPORATE TRAVEL, Mar. 1992, at 8.
74. The Official Business Travel Handbook, supra note 72, at 66.
what's being booked [through the screens provided by the CRS vendor]."76

"The carriers are tightening up on companies that have loose poli­
cies or don't mandate use of their contracted rates."77 CRS vendors also
retain the right to unilaterally terminate fare contracts with a 30-day notice.
Although the CRS vendors implement various safeguards to "lock in"
businesses, there are strong incentives for corporate loyalty. "Airlines
often give free tickets to agents to distribute to its corporate custom­
ers."78 These free tickets, along with all expense paid trips for the agent
or corporate travel manager, help solidify his or her loyalty to the CRS
vendor.

Additionally, as a subscriber to a CRS, corporate department manag­
ers can monitor employee travel regularly to ensure that the most conve­
nient schedules at attractive rates have been booked. Large travel
agencies offer similar software to their corporate clients to track employee
travel selections. This information helps the corporation ensure that em­
ployee travel selections are based on reduced costs rather than on the
advantages of frequent flyer mileage to its employees.79

The irony is that each year businesses award major contracts to
travel agencies that assure that travel decisions are based on the lowest
cost. Many of these agencies, however, only have one leased CRS and
are motivated to support that particular CRS vendor to obtain productivity­
based incentives.

D. UNDETECTED BIAS INCREASES SALES TO CRS VENDORS.

The CRS vendors can increase incremental revenues through both
architectural and display bias. Architectural bias refers to the use of
"faster and more reliable computer procedures and communications
links that result in agents obtaining more accurate information on vendor
airline services or recording bookings with greater speed and cer­
tainty."80 Display bias results when the information seen by its subscrib­
ers on their screens is incomplete, distorted or inaccurate. Display bias
may take various forms, such as:

1) omitting or delaying display of information on fares;
2) omitting information on all the connecting services at a given hub;

76. Id.
77. Air Discounts Survive, BUSINESS TRAVEL NEWS, Apr. 6, 1992, at 1.
78. McGreen, supra note 64.
1987) (advertisement).
80. Airline Marketing, supra note 7.
3) displaying "change of gauge" flights using a single flight number for an entire trip, rather than indicating stops or changes by the aircraft, at which time other connecting flights could be booked;
4) limiting the amount of information provided for competitive carriers;
5) padding displays by listing code-sharing flights for the carrier operating the flight and again by its partner that shares the code;
6) establishing an advantage by an algorithm for editing and ordering the displays;
7) providing inadequate or skewed information on connecting services for each city to protect dominance of a hub; and
8) displaying the CRS vendor's flight information on the first screen or requiring use of secondary displays which provide preferential treatment to the carrier.

Because the travel agents work under significant time pressure, they are more likely to book flights that are listed on the first screen rather than scrolling through subsequent screens. Ninety percent of the agent's reservations are booked from the first screen of the video display.\(^81\) More than 50 percent of the tickets are sold for the first flight listed on the screen that matches the customer's basic requirements.\(^82\) The CRS vendor stacks the first screen with flight information favoring its airline by establishing an algorithm with various weights for departure time, arrival time, equipment types, connecting city pairs, maximum connecting time, and other criteria. By placing its own information on the first screen, United estimated that use of this type of bias increased its revenues by 13 percent.\(^83\)

A spokesman for American recently contended that SABRE "presents information on all flights of all airlines equally . . . . Smaller carriers actually benefit from [the CRS] . . . because their flight schedules are included."\(^84\) Even if flight schedules are presented fairly, bias can occur, such as when American delayed displaying Continental's new discount fares for several months. "If the reservation information is not accurate, it has a domino effect and will impact the traveler, accounting, management reports, and vendor negotiations."\(^85\)

Although the CRS vendors can generate marketing, booking, or

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\(^{81}\) Mifsud, supra note 54.


\(^{83}\) Airline Marketing, supra note 7.

\(^{84}\) Suzy Hagstrom, Beauvais Calls for Federal Probe of Airlines, THE DENVER POST, May 6, 1992, at 3C.

sales data from the reservations made on their systems, the participating carriers cannot access similar data generated from the travel agency's bookings. Unless agencies can construct their own database interfaces or will take the time to compare flight information from various CRSs for each transaction, neither the subscriber nor the participating carrier can easily determine the extent to which any display or other residual bias exists. Subscribers are not required to disclose their relationships with particular CRS vendors, nor the nature of their productivity overrides to their customers. Therefore, customers cannot readily ascertain whether an agent failed to select the best flight for their needs or if changes in the availability of seats and fares by the carrier precluded their obtaining the "best deal."

E. RESTRICTIVE LEASE CLAUSES FORCE SUBSCRIBERS TO INVEST IN THE SUNK COSTS OF INVESTMENT IN THE CRSs.

The CRS vendors compete by targeting travel agencies with the greatest potential to produce, regardless if they are located beyond their hub cities. Because most travel agencies now have contracts with a CRS, the vendors must encourage agencies to convert to their system, rather than simply developing new accounts. The incumbent vendor, therefore, cuts favorable leasing deals with the travel agents for booking additional flights on its host airline. The other vendors lure an agency to switch CRSs by paying that agency the amount of liquidated damages due to the incumbent CRS for breaking the current contract.

Once an account is secured, the usual contract term prior to the 1992 DOT rules was five years. This period was approved by the DOT in 1984 to allow the CRS owner to realize an investment tax credit. Although such tax credits are no longer available in 1993, the tradition of a five-year period continues since the new DOT rules allow for a voluntary five-year option.

Targeted travel agencies often receive CRS services at minimal or no cost. The pricing structure rewards the mega-travel agencies since the heaviest users pay the least amount. In contrast, agencies that are not large producers pay fees for CRS services in the form of monthly lease charges. Further, new or smaller agencies lack the track record or bargaining power to negotiate a more favorable contract. Once contracted, the liquidated damages clauses do not allow these agencies to easily switch to another CRS. Prior to the 1992 DOT rules, such clauses required that agencies pay remaining lease payments, as well as installa-

86. McGreen, supra note 64.
87. Airline Marketing, supra note 7.
tion and other costs, if the subscriber switched systems prior to expiration of its contract.

Prior to the 1992 DOT rules that eliminated minimum-use clauses in the contract, such clauses deterred subscribers from booking a substantial amount of business on other systems. The CRS vendors often required a subscriber to book at least 50 percent of its flights on its system. These clauses also served as a basis for ascertaining damages resulting from a breach of a subscription agreement.

When the major carriers leased their CRSs prior to the 1992 DOT rules, the vendors locked the travel agency into exclusively using their equipment that accessed only their systems. Roll-over clauses were also used to condition the automatic renewal of the contract upon the agency's agreement to upgrade to new equipment or to open a new location. When the agency received one new piece of equipment, the agency's contract was renewed for all of its CRS equipment. The contract term was then extended accordingly. The new DOT Rules have eliminated this restriction.

Through what might be considered a modification of tying restrictions and exclusive dealing clauses, the CRS vendors require subscribers to obtain the vendor's consent before using equipment or software acquired from third-party firms in conjunction with use of the CRS. Lease clauses continue to prohibit the use of leased equipment to access other CRSs from a single terminal belonging to a CRS vendor. Such clauses have effectively resulted in hindering smaller CRS vendors and third-party vendors of computer hardware or reservations systems from entering existing markets.

Even if multiple CRSs were affordable, most small to medium size travel agencies cannot afford the cost of installation, space requirements, and training costs associated with acquiring additional special-function equipment; nor are agents willing to take the time to switch to several, separate terminals to access information on different CRSs concerning various carriers to determine the best possible services for their customers. The profitability of the reservations industry remains fixed by the number of completed transactions. Therefore, maximizing the use of existing equipment and saving time are the primary business objectives of subscribers.

Most subscribers prefer to use their own personal computers ("PCs") as their CRS terminals. With their own PCs, agents can improve efficiencies by increasing their technical capabilities. While the large agencies have several CRSs and their own monitoring programs, most agents want a single box that can quickly and reliably process multiple

88. Ellig, supra note 3, at 291.
databases linked directly with the internal reservations systems of carriers. They want to re-design screen displays and automate additional travel agency functions through application of their own or third-party hardware and software in conjunction with the CRS. However, this improvement is still not readily available to subscribers.

F. REGULATION OF CRSS WILL IMPACT DOMESTIC & FOREIGN CRS VENDORS, DIRECT ACCESS VENDORS OR CARRIERS.

More complex reservations systems and linkages are evolving to not only increase convenience for customers, but also to expand the marketing reach of carriers and direct access vendors throughout the world. "Tighter regulation of computer reservation systems would penalize the leading firms for being the first to recognize and develop the tremendous potential of their information-processing technology." Regulation to remove biased, discriminatory, or deceptive practices may prove unworkable if regulators do not understand how the role and function of the CRSs expand globally as technology improves. CRSs "are both complex and constantly undergoing change. Innovation is the lifeblood of the CRS industry and is the reason that the United States currently leads the world in this industry." Further, the DOT rules will impact upon multiple industries that facilitate the global travel and tourism.

For example, because of the advances in technology and computer software, about 7 percent of the major hotel chains over the last two years have loaded their corporate negotiated rates into airline CRSs, and as one vice president of sales claimed "we are showing the greatest-ever increases in reservations through the CRSs." Booking hotel reservations on the CRSs makes it easier to track room-usage because all the information is in one database.

Third-party vendors have upgraded the CRS database to allow input of more tiers of rates. Now direct access vendors can use the CRS as an inexpensive marketing channel to expand sales. For example, the Radisson Hotels International is encouraging travel agents to use CRSs through a contest that rewards them based on the frequency and value of their bookings. The agents earn points that can be redeemed for merchandise, travel prizes and free stays at the hotels. "Of all reservations made with the Radisson, 28 percent are booked through travel agents and 72 percent of that total comes through the CRS." Travel agents now have

89. Boudreaux and Elig, supra note 33, at 595.
additional incentives to steer business to the CRS vendor that has established alliances with hotels, properties, and car rental agencies that are compatible with their client's preferences.

Foreign carriers and direct access vendors seek inclusion in travel packages and frequent flyer programs that offer greater sales and more effective marketing than advertising in the U.S. Recently, Asian airlines bought into hotel businesses so they could feed passengers into their own hotels. As examples, Japan Airlines owns Nikko Hotels, All Nippon Airways has ANA Hotels and Garuda Indonesia owns Aerowisata.93 Within the last year, seven major Asian hotel chains and properties have developed alliances with the CRS vendors. As already discovered by their European counterparts, Asian hoteliers are finding that, "[t]ying in with airlines is one of the best ways to sell to the American corporate market," as well as capture the leisure stop-over programs.94

Foreign airlines are developing marketing partnerships and alliances to expand sales opportunities. For example, Delta Air Lines, Singapore Airlines and Swissair, each of which owns an equity interest in the other, have connected their in-house automation systems. Now their passengers may update their reservations through any of the three carriers' city ticket offices, check-in counters, or reservations centers.

G. PUBLIC POLICY MUST CONSIDER THE IMPACT OF INCREASING FOREIGN CONTROL OF U.S. AIRLINES AND CRSs.

"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."95 Section 101(16) of the Federal Aviation Act provides that foreign equity ownership be limited to 25 percent of the voting interest in U.S. airlines and the president and at least two-thirds of its board of directors and other managing officers must be U.S. citizens. However, as former DOT Secretary Samuel Skinner interpreted the statute, the 49 percent equity ownership of Northwest Airlines by KLM in 1989 was within the law.96 Prior to Covia's merger with the newly formed Galileo International, Covia was 39 percent foreign-owned.

Stimulated by the need for additional capitalization and cooperative service providers both domestically and abroad, U.S. CRS vendors are participating in complex global alliances. Three examples of such alliances include: 1) KLM owns about 12 percent of Galileo (Covia) and has

94. Id.
95. DEMPSEY, Disintegration, supra note 9, at 37.
96. Id.
an alliance with Northwest which owns 32 percent of Worldspan of which Abacus owns 5 percent; 2) Delta owns 38 percent of Worldspan that has alliances with Singapore Airlines, also owned by Abacus; and 3) Air France owns 33 percent of Amadeus, an affiliate with System One and partners with Sabena. Sabena was a Galileo owner.97

Many proponents of deregulation and laissez-faire support foreign ownership of domestic airlines as a means of mitigating the U.S. industry’s economic crisis. However, when considering that "most foreign airlines are owned, in whole or part, by their governments," others fear that foreign ownership, code sharing and marketing alliances will allow "control" by foreign governments over a basic U.S. infrastructure industry—the domestic air transportation industry.98

CRS carriers are now merging resources and negotiating joint marketing strategies. As the result, the CRS industry will likely be dominated by only a few global CRS vendors. Because of the ongoing technological improvements, the CRSs have already evolved from being simply a marketing tool for individual airlines to a cooperative, world-wide "information platform."99 "As the global economy enters the information age, it would indeed be unfortunate if the DOT started penalizing American firms for launching dramatic innovations in information management."100 Policy-makers must recognize the impact of foreign investment and its influence on the management and operations of the CRS industry or else face the potential of creating mega-airlines and mega-CRSs that are not U.S. controlled.

VI. RECENT EFFORTS TO ENSURE FAIR BUT PROFITABLE COMPETITION AMONG CRSs IN THE U.S. HAVE FAILED.

Recent efforts have been aimed at eliminating alleged abuses by the CRS vendors. These approaches include anti-trust suits by individual airlines, congressional proposals, and the DOT promulgation of new rules. Only the latter has brought some satisfactory results. However, it appears that there are still gaps that the DOT must fill.

A. ANTITRUST HAS BEEN AN INEFFECTIVE APPROACH.

Section 411(a) of the Federal Aviation Act authorizes the DOT to in-

97. Feldman, supra note 8, at 49. The following is another example in the South Pacific. "In 1989, Quantas and American created Fantasia—a company that markets SABRE in the South Pacific. Australian and Ansett formed Southern Cross to market Galileo in the region. The merged Quantas-Australian and Ansett will own TIAS II which will contain both Fantasia and Southern Cross." Id.
98. Id.
99. Id.
100. Boudreaux and Ellig, supra note 33, at 595.
vestigate and determine whether any air carrier or ticket agent has been or is engaged in unfair or deceptive practices or unfair methods of competition. However, the DOT historically has failed to pursue this function aggressively. "Nor is it clear that traditional antitrust remedies are socially desirable in cases, such as air transport, where there are significant real economies of size, scope, and density."101

During its recent review for adopting new rules, the DOT found that a CRS vendor does not have a monopoly of the market in a conventional sense. However, CRS vendors have substantial market power "to force a purchaser to do something that he would not do in a competitive market,"102 as defined by the Supreme Court.103 Because of the small number of CRS vendors and the presence of sunk costs, a CRS vendor could use its control to eliminate competition in an individual hub, even if it is unable to make an impact nation-wide.

The DOT supports the applicability of the "essential facility doctrine" to a CRS.104 This doctrine follows the antitrust theory that a firm controlling a facility must give its competitors access on reasonable terms if the facility is essential for competition and cannot be feasibly duplicated by a competitor.105 However, this doctrine permits "competitors to avoid all the risks and yet reap all the fruits of the CRS owners' investments."106

The U.S. Supreme Court denied certiorari of a seven-year antitrust action filed against SABRE and APOLLO for monopolizing interstate trade and commerce in the Ninth Circuit.107 The plaintiffs—Alaska Airlines, Northwest Airlines and Southwest Airlines—complained that internal bias and discriminatory pricing for CRS services constituted illegal behavior under the Sherman Antitrust Act. "American and United, however, persuaded the court that there was lack of proof that the smaller airlines had been harmed by the CRS practices."108 The Ninth Circuit rejected the "monopoly leveraging theory," that a firm may not illegitimately use its monopoly power in one industry to acquire unfair competitive advantage in another industry.

The "monopoly leveraging theory" has been accepted as a valid antitrust principle in the Second and the Sixth Circuit Courts.109 It has been argued that "antitrust is an inadequate substitute for responsible eco-

101. FLYING BLIND, supra note 32, at 48.
102. Airline Marketing, supra note 7.
104. Airline Marketing, supra note 7.
106. The Legal and Regulatory Implications, supra note 82.
109. Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263 (2d Cir. 1979), cert. denied,
nomic regulation in protecting public interest values of assuring a healthy competitive environment and advancing social objectives. . . ." 110 Generally, the courts have declined to find CRS vendors guilty of monopolization, attempted monopolization, or unreasonable restraint of trade.

In the Second Circuit,111 a plaintiff claimed that restrictive clauses in its contract supported APOLLO’s attempted monopolization of its CRS market. However, this U.S. Court of Appeals upheld APOLLO’s rollover, minimum use and liquidated-damage provisions when the plaintiff travel agent switched to System One. In subsequent cases, the courts have declared that the CRS market is competitive.112

Further, it appears that the antitrust laws do not provide adequate protection against pricing discrimination in service industries. The Robinson-Patman Act addresses the sales of goods. It has been argued that it may be "time to consider either amending the Robinson-Patman Act to prohibit discrimination in the sale of services, or reestablishing the regulatory mechanism for its prohibition."113

B. CONGRESS HAS NOT ENACTED EFFECTIVE LEGISLATION.

The "Air Passenger Protection Act of 1987,"114 if passed by Congress, would have protected passengers from losing unused tickets of bankrupt airlines. An 18-member commission was to study the impact of deregulation, including the CRS industry.

In 1989, the "Airline Competition Enhancement Act"115 was introduced based upon a review by the Senate’s Aviation Subcommittee of several studies prepared by the DOT and the GAO. One of the provisions of the Act required divestiture of the CRSs by the mega-carriers to non airline companies. This bill was tabled.

Senator McCain introduced the "Airline Computer Reservation System Availability Act of 1991"116 that would have required that "after January 1, 1992, no air carrier or air carrier affiliate shall own, operate, or control a computer reservations system." The reasons given for recommending divestiture were the continued discriminatory practices by the major CRS vendors and the significant incremental revenues they enjoy.


110. FLYING BLIND, supra note 32, at 48.
111. United Air lines, Inc v. Austin Travel Corp., 867 F.2d 737 (2nd Cir. 1989).
113. FLYING BLIND, supra note 32, at 53.
In the same year, a three-part act, "Airline Competition Enhancement Act of 1991" proposing improved competition, was unsuccessful. Part 1 addressed airport slots and Part 2 increased the allowable foreign ownership of U.S. airlines from 25 percent to 49 percent of the voting stock. Although Part 3 did not require divestiture, it would have capped participant fees to an "arbitrary," fair, and reasonable figure. Senator McCain later introduced the "Airline Competition Equity Act of 1991," a comprehensive piece of legislation which also required divestiture of the CRSs.

The U.S. Senate considered the "Airline Competition Enhancement Act of 1992," a bill to enhance competition in essential air service. Provisions in the bill mandated all CRS vendors within one year to serve all participating carriers equally in function, timeliness, completeness, accuracy, or efficiency, commonly referred to as "equal functionality." Within three years, airlines owning a CRS would be required to separate their internal reservations system from the CRS, commonly referred to as "de-hosting" CRSs. The bill proposed to limit travel agency automation contracts to two years, to limit liquidated damages clauses, to bar minimum-use requirements, and to provide for arbitration of participant fees. In July of 1992, Senator McCain proposed an amendment to this bill which dropped the "dehosting" requirement and allowed use of third-party software on CRSs.

The House of Representatives considered the Airline Competition Enhancement Act of 1992 in tandem with the Senate bill and passed the House bill with a vote of 230 to 160. The purpose of the Act was to "enhance competition among air carriers by prohibiting air carriers who operate a CRS from discriminating against other air carriers participating in the system and among travel agents which subscribe to the system." Effective September 30, 1994, the provision would have prohibited vendor discrimination through the CRS integrated displays and through restraint

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124. The Airline Competition Enhancement Act of 1992, H.R. 5466, was introduced and referred to the House Public Works and Transportation Committee on June 23, 1992. It was approved without amendment by the Aviation Subcommittee on June 25, 1992. An order was reported with amendment by the Committee on July 1, 1992. On August 5, 1992 a rule granted the amendment, H. Res. 541. As amended, H.R. 5466 was passed by the House (230 to 160) on Aug. 12, 1992.
clauses in the subscriber contracts, including liquidated damages. The proposed bill established a reporting and monitoring system effective no later than March 31, 1993.

In response to these legislative efforts, American Airlines president, Robert Crandall, criticized the congressional efforts for placing a penalty to American and United "which have achieved leadership in the CRS industry." Covia president, Allan Z. Loren, stated that the bill "won't help airlines compete better or be more profitable or save money .... It will do the exact opposite by creating additional automation costs that airlines eventually will be asked to pay for."125

C. THE DOT IMPOSED NEW BUT NOT ENLIGHTENED REGULATION OF CRSs.

The 1984 DOT regulations of the CRS industry were originally scheduled to expire on December 31, 1990. After Congress proposed the two recent bills to enhance competition among air carriers and after three years of solicited comments and research and postponed deadlines before announcing a readoption of rules governing the CRSs, the DOT issued new rules effective December 11, 1992, to govern the CRS industry until December 31, 1997.126

Some agencies are critical of the DOT because the rules do not address airline divestiture, retention of discounts, and other sales incentives based on productivity-based performance by subscribers, elimination of contractual liquidated damages clauses, nor de-hosting of CRSs.127 However, the DOT's new provisions address nondiscriminatory fees among participating carriers, display bias, subscriber vendor contract terms, software and equipment use, and the provision of information by the CRS vendors.

1. COVERAGE OF THE RULES.

The rules apply to a "system," defined as a CRS, offered by a carrier or its affiliate to subscribers for use in the U.S. that provides both airline information and a booking and ticketing capability "if it charges any other carrier a fee for system services."128 The rules apply only to domestic or foreign, airline-affiliated CRSs used by travel agencies in the U.S. System owners are defined as a carrier and/or its affiliate(s) which hold at least 5 percent of the equity of the CRS.

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In dealing with a foreign carrier that engages in discriminatory practices, the CRS vendors are not required to comply with the obligations "14 days after it has given DOT and such foreign carrier written notice of its intent to deny such foreign carrier any or all of the protections of this part of the rules."\(^{129}\) Systems used by hotels, car rental agencies, other modes of transportation, or for tour products, as well as corporate travel departments and home computer users, are not covered by the regulations. Although the rules do not apply to a carrier's internal reservations system, if a travel agent accessed it through a direct link that enabled it to function as a CRS, it would then become subject to the rules if the carrier charged for its services.

2. \textit{Contracts With Participating Carriers.}

The rules prohibit CRS vendors from discriminating among participating carriers in booking fees.\(^{130}\) Although differing fees for the same or similar levels of services will be presumed to be discriminatory, the DOT does not establish a standard for participation fees based on the costs of the transaction or overall service. Participating carriers must "ensure that complete and accurate information" is provided to each system in a form such that the system is able to display its flights in accordance with the display requirements.\(^{131}\)

3. \textit{Display Bias.}

The DOT readopted rules that prohibit biased integrated displays constructed by vendors to show schedules, fares, rules, and availability of all participating carriers. "[H]owever, the proposal leaves it open for travel agencies to construct their own potentially biased secondary displays."\(^{132}\) Major provisions of the rules require the following.\(^{133}\)

- The CRS vendors may order the information, including connecting flights, on the basis of any service criteria as long as they do not use any factors directly or indirectly relating to carrier identity.
- The CRS vendors must provide, upon request, the current criteria used in editing and ordering flights, including connecting flights.
- A CRS vendor shall apply the same standards of care and timeliness in loading information concerning participating carriers as it applies to the CRS owner.
- In constructing connecting flights for display, participating carri-

\(^{130}\) Id. at pt. 255.6.
\(^{131}\) Id. at pt. 255.4(6)(f).
\(^{133}\) 14 C.F.R. pt. 255.4.
ers are entitled to request up to five connect points (and double connect points); the CRS must use at least 15 points and after September 15, 1993, six double connect points unless there are fewer points that meet the service criteria.

— The display shall indicate when a flight requires a change in aircraft at a point before the final destination.

— Within 10 days after the CRS vendor receives information concerning on-time performance from the participating carriers or third parties, the CRS must display such information in accordance with the rules.

4. **SUBSCRIBER-VENDOR CONTRACT TERMS.**

Subscribers will have more flexibility in diversifying their CRS use, and there will probably be less incentive for CRS vendors to pursue converting travel agencies to use their systems. The prohibition against minimum-use clauses eliminates any revenue guarantees upon which attractive buyout offers by other CRS vendors were previously based. Instead, to safeguard their revenues, CRS vendors may increase targets in their productivity-based pricing agreements with current subscribers or even establish artificially high rack rates. The DOT determined that commission overrides calculated upon productivity should continue to encourage efficient use of the system, even though it may deter agencies from using other sources of travel information or means for booking services.

While it did not ban liquidated damages clauses, the DOT weakened the basis for calculating lost booking fees by prohibiting the CRS vendor from requiring subscribers to use the system for a minimum volume of transactions. Since the DOT permits productivity pricing, CRS vendors still have an avenue to obtain adequate compensation for services and damages in the event of a breach of contract because it, in effect, shifts the burden of risk from the CRS vendor to the travel agent.\(^\text{134}\) For example, if the market declines and the agent cannot book the sufficient number of tickets to earn its rack rate, it will still be bound to pay a monthly equipment fee to the CRS vendor. This fee could serve as a basis for estimating liquidated damages.

Other DOT rules concerning contracts provide that:\(^\text{135}\)

— The maximum contract term will be reduced from five years to three years, although a CRS vendor may also offer a voluntary five-

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year option. (Therefore, most contracts will probably continue to have five year terms).

— The CRS vendors are prohibited from using minimum-use clauses, rollover clauses, and limitations on the number of other CRS terminals that an agency may use. These provisions will be invalidated in existing contracts.

5. SERVICES, SOFTWARE, AND HARDWARE USE.

Corporations and large travel agencies will benefit most from the greater flexibility in automation planning afforded by the new DOT rules. Subscribers with the technical resources can now establish: a) multi-access systems that directly link the agent’s workstation to a particular carrier’s internal reservations system and then deliver more information to points of purchase; b) economies in purchasing and training by standardized booking procedures across multiple locations; and c) preferred vendor agreements in all segments which will allow bookings to be made directly on the supplier’s system at proprietary rates that will not be displayed in the CRSs. Under this arrangement, suppliers will not have to pay a booking fee to the CRS vendor.136 A summary of specific DOT rules follows:137

— If a CRS vendor offers a service enhancement to its owner or a participating carrier, it shall offer it to all participating carriers on a non-discriminatory basis.

— A CRS vendor must offer its system enhancements, such as seat maps and boarding passes, to other systems under commercially reasonable terms.

— CRS vendors must allow agencies who now own their own computer terminal to access other CRSs and informational databases on the same equipment.

— Agencies may now use compatible software and hardware from third-party vendors in conjunction with their CRS’s services. Further, the CRS vendor is allowed to certify third-party products without causing undue delay or unnecessary testing. However, the CRS vendor is not required to let agencies access other systems from equipment that the CRS owns.

— The CRS vendors must make available to third-party vendors non-proprietary information concerning architectural specifications and other technical information; but are not required to develop or supply hardware, software or services to support third-party prod-


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ucts. (This means each subscriber must work out the details with all of its information suppliers).

6. **PROVISION OF INFORMATION.**

A stipulation\textsuperscript{138} that U.S. carriers may acquire international marketing information from the CRS vendors will expand their present capability to design agency override commissions based on their international market share. Foreign airlines whose countries do not reciprocate with data "will find it difficult to compete with U.S. carriers' marketing programs."\textsuperscript{139} The DOT rule specifies that:

- The CRS vendor shall make available to all participating carriers on a non-discriminatory basis, all marketing, booking and sales data related to carriers that it elects to generate from its system.
- The CRS vendors must make available any data they generate concerning international bookings to U.S. airlines and to foreign carriers on a reciprocal basis.

However, the DOT supported the view that the CRS vendors are entitled to take advantage of the systems' ability to improve their yield management and pricing control programs and to use data concerning domestic marketing acquired from the CRSs for their competitive positioning. With use of detailed market data, the CRS vendors can more quickly respond to price cuts by a competitor with a capacity-controlled discount fare. Because the DOT supports the notion that the CRS owners should enjoy the fruits of their investments, the market dominance by SABRE and Covia will not be limited by the DOT rules.

7. **ENFORCEMENT.**

Pursuant to Section 411(a) of the Federal Aviation Act, the DOT upon its own initiative or upon receipt of a complaint may conduct investigations and hearings. Upon finding unfair or deceptive practices, the DOT shall issue a cease and desist order or assess civil penalties for each violation.

8. **GENERAL COMMENTS.**

Although the DOT did not propose regulations on all of the measures requested by travel agencies and a group of suppliers headed by Worldspan,\textsuperscript{140} they were encouraged by the rules that were proposed. Worldspan stated that "[w]e think it recognizes some basic changes that are

\textsuperscript{138} Id. at pt. 255.10.
\textsuperscript{139} CRS Rules Open, supra note 136.
\textsuperscript{140} The Worldspan group included Alaska Airlines, America West Airlines, Association of Retail Travel Agents, the Aviation Consumer Action Project, British Airways, Consumer Federa-
needed in the industry. Generally, it will increase competition in the industry and be to the benefit of travel agents and consumers.\textsuperscript{141} A vice president of Information Systems for a travel agency pointed out that "[t]he rules will make the CRS and the airline industry more competitive, but not the way the DOT intended . . . . They'll make the big stronger yet, and rapidly force the smallest out."\textsuperscript{142}

A representative from SABRE noted that "[w]e find it ironic that DOT is proposing new CRS regulations when it has not even sought to enforce the present rules."\textsuperscript{143} One observer remarked, "even once the rules are adopted, there will undoubtedly have to be modifications."\textsuperscript{144} Based on DOT's pattern of being slow to change and its reputation for "hands-off administration," the rules may be coming too late to properly address some of the problems.

\section{Comparison with European Liberalization of Air Transportation}

In March 1957, a Treaty creating the European Economic Community ("EEC") was signed in Rome.\textsuperscript{145} The EEC's goal was to establish a single internal market by 1992. Although the EEC has established many common policies, the goal of a genuine, barrier-free internal market has yet to be achieved.

There is a single passport for EC citizens and no restrictions on the movement of tourists or workers within the Community. The customs union was completed in 1968, so tariffs on non-EC goods are identical in each Community country (and free to each other) . . . . Under the "1992" legislative program, more progress has been made . . . in deregulating ground, air and water transportation . . . .\textsuperscript{146}

The 1987 Single European Act\textsuperscript{147} streamlined the decision-making process and facilitated the development of a united European market by amending and adding new provisions to the Treaty of Rome. The EEC Commission drafts directives that may be adopted by the Council of Min-

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\item 141. DOT's CRS Rulemaking, supra note 132.
\item 142. CRS Rules Open, supra note 136.
\item 143. Id.
\item 144. Id.
\item 145. Treaty Establishing the European Economic Community, (signed in Rome on Mar. 25, 1957 and generally referred to as the Treaty of Rome). art. 2, 298 U.N.T.S. 11. The original member countries were Belgium, France, Federal Republic of Germany, Italy, Luxembourg and Netherlands. In 1973, Denmark, Ireland and the United Kingdom (U.K.) became members; in 1981, Greece joined; and in 1986, Spain and Portugal became members.
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isters by a qualified majority vote. Although the European Parliament has the power to amend or reject legislation approved by the Council, the Council may overrule Parliament by a unanimous vote. The Parliament also amends or rejects the budget and approves its adoption. By 1990, the preliminary EEC budget was about $56 billion, "financed by a customs duty, 1.4 percent value added tax collected on goods and services consumed in member states and a percentage donation based on each member countries' gross national product." 148

The Commission, headquartered in Brussels, consists of 17 commissioners appointed by their national governments. It oversees the implementation of the EEC treaties, prepares the EEC budget, and proposes EEC policy to the Council and Parliament. By late 1989, the Commission formally proposed 386 directives and regulations to harmonize market conditions for an EEC-wide gross domestic product of $4 trillion. 149 Once a directive is adopted, the member countries must bring their domestic legislation into conformity with the objectives of Community law by a specified date.

The U.S. government addresses the trade and investment aspects of the EEC's "1992 program" through an Interagency Task Force. The Task Force, established in 1988, is located in Washington, D.C. Seventeen federal departments and agencies, including the DOT, comprise the Task Force, which also works closely with the private sector. Eleven working groups focus on specific program aspects, including Civil Aviation, and report to the Task Force. Although each agency is the contact point for information concerning its constituencies, the U.S. Mission to the European Communities ("USEC") located in Brussels and U.S. diplomatic missions located in the 12 EEC member countries provide information and analysis of EEC developments and represent U.S. interests. 150

"Thousands of differing national regulations are being replaced by a few hundred European rules . . . . Business travelers will be affected most by new rules deregulating the airline industry, and by rules and policies regarding customs." 151 Independently, the Association of Car Rental Industry Systems Standards 152 has obtained informal EEC approval of rules standardizing CRS listings of car rental products involving eight car-class categories. "New hotel regulations are few, but moves to standardize value-added taxes ("VAT") are under way and should make that line

148. BUREAU OF PUBLIC AFFAIRS, supra note 146, at 11.
150. BUREAU OF PUBLIC AFFAIRS, supra note 146, at 10.
152. Members include Avis Europe, Budget Rent a Car Corp., EuroDollar International, EuropCar InterRent and Hertz Corp. Thrifty Car Rental in Europe, Africa and the Middle East, although not a member of ACRISS, plans to adopt the same standards.
on a hotel bill more readily recognizable. The EEC required member nations' VAT to be a minimum of 15 percent, although higher prevailing rates in other EEC nations will remain.

A. THE EEC GOAL IS A FULLY LIBERALIZED AIR INDUSTRY.

While Articles 85 and 86 of the Treaty of Rome established the pertinent rules of competition, it was not until December 1987 (three decades after their promulgation) that the EEC passed its first package of regulations addressing competition in scheduled air transport, air fares, flight capacity allocation and group exemptions among the 12 EEC countries. In November 1990, the second legislative package increased liberalization of air fares and allocation of routes while enforcing competition regulations and adopting new regulations concerning intra-EEC air transportation. In July 1991, a third package was adopted by the Commission but it must still be approved by the Council and Parliament. The proposed legislation will reduce bureaucracy and further equalize the EEC market.

Sir Leon Brittan, Vice President of the EEC Commission in charge of Competition Policy, summarized the EEC's goal for a fully liberalized air transportation industry by the end of 1993 as, "[w]hat we need is less regulation, less bureaucracy, more competition, and cheaper fares." Unlike how the U.S. administered the 1979 airline deregulation, Brittan explains:

The antitrust authorities in the United States have been criticized for failing to oppose even a single merger or to challenge a single suspected case of predatory pricing. This kind of laissez-faire policy is not one that we intend to adopt in the Community. Anti-competitive behavior by dominate airlines will have to be strictly controlled . . . The challenge for the Community will be learn from the U.S. experience and avoid the pitfalls encountered there. Both the Commission and the Association of European Airlines ("AEA") are "determined to avoid American-style deregulation, which they believe would lead to the emergence of competition-killing giants."

B. THE COUNCIL HAS IMPOSED A CODE OF CONDUCT FOR CRSs.

In July 1989, the Council adopted a Code of Conduct for Computer-

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153. D'Ambrosio, supra note 151.
155. Id. at 2342/90 and 2343/90.
157. Id.
ized Reservations Systems ("Code"). \(^{159}\) In December 1990, the Commission adopted a block exemption for CRSs from the exclusivity and non-competition clauses pursuant to Article 85(3) of the Treaty of Rome until December 31, 1992. \(^{160}\) This exemption applies to agreements concerning joint purchase or development of a CRS; creation of CRS vendors to market and operate a CRS; and regulation of distribution facilities to display flight information to subscribers of the CRS or distributors. \(^{161}\)

On September 23, 1992, the Commission proposed a new Code (COM 92/404) that will eliminate some obstacles to competition that U.S. CRS vendors have faced in Europe. \(^{162}\) Subject to approval by the Council, the Code is scheduled to take effect January 1, 1992, and to expire on December 31, 1997. A summary of the provisions of the current and proposed Codes is provided below.

1. **Coverage of the Code.**

The proposed rules expand the scope of the Code to include charter flights along with the scheduled air service. However, the charters must be clearly identified and travel agents may choose to display only the scheduled flights. \(^{163}\) The proposed Code has clarified that it also applies in the CRS vendor’s own travel agencies, although it will "be exempted from the provisions on the listing and presentation of other companies’ flights on their CRS screens." \(^{164}\)

The Code currently covers any domestic or foreign system providing airline information used in the EEC for the distribution and sale of air transport products, regardless of the source of information used, the location of the central processing unit or the geographical location of the air transport product concerned. \(^{165}\) System vendors are defined as any entity and its affiliates which are responsible for the operation or the marketing of a CRS. A CRS refers to:

A computerized system containing information about air carriers’ schedules, availability, fares, and related services with or without facilities through which reservations can be made or tickets may be issued to the extent that some or all of these services are made available to subscribers. \(^{166}\)

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\(^{159}\) Council Reg., supra note 154, at 2299/89 of July 24, 1989.


\(^{162}\) Mary Brisson, EC Moves to Boost CRS Competition In Europe, BUSINESS TRAVEL NEWS, Oct. 19, 1992, at 17.

\(^{163}\) Air Transp.: Proposal on Computerised Reservation Systems, EUROPEAN REPORT, Sept. 26, 1992 at § IV, No. 1798.

\(^{164}\) Id.

\(^{165}\) Council Reg., supra note 154, at art. 1.

\(^{166}\) Id. at art. 2(b).
A. COMPARISON

The scope of the EEC Code and the 1992 DOT rules is limited to systems providing airline information. The Code applies to a wider classification of entities, while the DOT regulations narrowly focus on airline-affiliated CRSs. The 1992 DOT rules apply only to carriers and/or affiliates which own at least 5 percent equity in the CRS. The CRS vendor must provide airline information on other carriers, have ticketing capabilities and charge a fee for its services. In contrast, the Code applies to system vendors that are also responsible for the marketing or operation of CRSs made available to subscribers for selling air transport products.

2. CONTRACTS WITH PARTICIPATING CARRIERS.\(^{167}\)

The CRS vendor must allow any carrier the opportunity to participate on an equal and non-discriminatory basis and without unreasonable conditions, subject to capacity and technical constraints. A carrier may belong to multiple CRSs and may terminate its contract with a CRS vendor without penalty upon giving six months prior notice after completion of its first year. While the Code does not attempt to establish a standard, "[participation] fees must be non-discriminatory and reasonably related to the cost of the service provided and used."\(^{168}\) Fees must be the same for the same level of services.

The Code places an obligation on participating carriers and other information providers to "ensure that the data submitted are comprehensive, accurate, non-misleading, and transparent . . . [CRS vendors must] load and process data provided by participating carriers with equal care and timeliness," subject to the constraints and formats of the system.\(^{169}\)

A. COMPARISON

Both the EEC Code and the 1992 DOT rules prohibit discrimination by the CRS vendor against participating carriers. The Code bases the "reasonableness" of participation fees on costs, while the DOT employs a free market standard based on same or similar levels of services. Both regulations place an obligation on participating carriers to provide accurate and complete information to the CRS vendor.

3. DISPLAY BIAS.\(^{170}\)

The Code prohibits in the principal display any inaccurate or misleading information and bias based on carrier identity. Although the Commis-

\(^{167}\) Id. at art. 3.
\(^{168}\) Id. at art. 5(1).
\(^{169}\) Id. at art. 4(1),(3).
\(^{170}\) Id. at art. 5.
sion published a Sample Display in its explanatory note,\textsuperscript{171} the proposed rules further clarify how flights are to be ranked. For example, when carriers sell seats on the same flight on the same plane pursuant to a "blocked space arrangement," each carrier may display the same flight, while the competitors' flights may be listed on the second page. However, if a joint-venture flight has the same code for both carriers (i.e., "code sharing"), it may be listed only once. Although the Code requires a minimum of 9 connecting points for constructing connecting flights, the Commission stated that it might be worth while for the EEC to increase its maximum to 15 as required in the 1992 DOT rules "to achieve, as far as possible, globally accepted common rules on CRSs."\textsuperscript{172}

The Code recognizes the need for agents to meet their customer's preference and allows subscribers to either use alternative displays or reorder the data in the principal display in any single transaction.\textsuperscript{173} For example, the Code allows agents to create secondary displays for information and booking purposes based on an express request by a company for booking its employees only on a specific airline.\textsuperscript{174} In effect, this provision permits "travel agents to bypass the principal display and use biased secondary displays when bias is not the feature the customer asked for."\textsuperscript{175}

However, the Code places the burden on the CRS vendor, if it is aware or should be aware of inaccurate or misleading information, to ensure, either through technical means or through the contract with the subscriber, that the principal display is provided for each individual transaction and that the subscriber does not manipulate material supplied by CRSs in a manner that would lead to inaccurate, misleading or discriminatory presentation of information to consumers.\textsuperscript{176}

A. COMPARISON

Although there are differences, both the EEC Code and 1992 DOT rules attempt to eliminate bias based on carrier identity on displays constructed by the CRS vendor. The DOT further requires the CRS vendor to publish its display criteria. The Code places the burden on CRS vendors to ensure unbiased displays are used. While the Code also attempts to place some obligations on subscribers to use unbiased displays, it permits agencies to create secondary displays based on carrier identity if a customer requests bookings with a particular carrier. However, because

\textsuperscript{171} Id. at Explanatory Note, 1992 O.J. 90C 184, no. 11.

\textsuperscript{172} Lisa Gaines, EC Members Mull CRS Code Changes, TRAVEL WEEKLY, Mar. 19, 1992, at 21.

\textsuperscript{173} Crans and Biesheuvel, supra note 161.

\textsuperscript{174}Council Reg., Explanatory Note, supra note 171.

\textsuperscript{175} Gaines, supra note 172.

\textsuperscript{176}Council Reg., supra note 154, at art. 9(5).
subscribers may not be compensated based on productivity-based agreements, there is less incentive to create and consistently use biased secondary displays.

In contrast, the DOT determined not to adopt regulations concerning travel agency displays, nor require agencies to provide notice to customers that they use a CRS affiliated with one or more carriers and that such affiliation could affect the information provided. Therefore, it is possible for either the subscriber or a third-party vendor to create and regularly employ "back-door" biased displays without detection.

4. **SUBSCRIBER-VENDOR CONTRACT TERMS.**

Under the Code, the CRS vendors must not discriminate in making services and enhancements available to subscribers. Subscriber contracts must be nonexclusive and without unreasonable conditions. Subscribers may terminate the contract without penalty upon three months prior notice after completion of the first year. A carrier may not require use of any specific CRS, nor link commissions or other incentives for the sale of tickets for any of its air transport products.\(^{178}\)

   A. **COMPARISON**

While both the EEC Code and the 1992 DOT rules prohibit exclusivity and minimum-use clauses, DOT permits productivity-based pricing. Although the DOT weakened the basis for damages available to CRSs, under the permitted liquidated damages clauses and, in effect, continued five-year contract terms, subscribers are still essentially locked into their contracts with U.S. CRS vendors. In contrast, European subscribers enjoy a greater freedom to switch vendors.

5. **SERVICES, SOFTWARE, AND HARDWARE USE.**

The Code allows subscribers to use technical equipment offered by third-party vendors, as long as it is compatible with the CRS. However, CRS vendors may "not impose any obligation on a subscriber to accept an offer of technical equipment."\(^{179}\) The CRS vendors must make available to interested parties the details of current procedures, fees, systems facilities, editing, and display criteria used. However, the CRS vendors are not required to provide proprietary information such as software programs.\(^{180}\) Neither a parent carrier nor a participating carrier may require an agent to use any specific CRS for any sale or issuance of tickets or

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177. Id. at art. 9(1),(2),(3),(4).
178. Id. at art. 8(1),(2).
179. Id. at art. 9(6).
180. Id. at art. 10(3).
other transport products that such carrier may provide either directly or indirectly. \(^{181}\)

### A. COMPARISON

Both the EEC Code and the 1992 DOT rules permit third-party vendors to enter the CRS market and respect the proprietary information of CRS vendors. Neither regulation completely clarifies the responsibilities, liabilities, or allocation of costs for certifying the compatibility of products offered by third-party vendors. As the result of this ambiguity, the subscriber must establish its own specifications and coordinate with product suppliers without knowing for sure that the CRS will certify the planned expansion.

However, European manufacturers, in close cooperation with the travel industry, "have already established the standards and norms necessary to ensure the smooth and reliable flow of information." \(^{182}\) For example, one manufacturer offers personal computers "with text processing capabilities in all nine official EEC languages using a single keyboard." \(^{183}\) Accordingly, European CRS vendors have a certification process and have already developed different pricing structures for subscribers using their own equipment, equipment from third-party vendors, and for those who will lease equipment from the CRS vendor.

### 6. PROVISION OF INFORMATION.

The Code provides that, upon request, CRS vendors must reveal the "details of current procedures, fees, systems facilities, editing and display criteria used." \(^{184}\) The Code recognizes the privacy of specific statistical or other types of information by requiring consent by the consumer, air carrier concerned, or carriers participating in a specified service covered by a booking, aggregated or anonymous marketing data. When such information is requested by any carrier, it must "be offered to all participating air carriers on a nondiscriminatory basis." \(^{185}\)

### A. COMPARISON

Both the EEC Code and the 1992 DOT rules require the CRS vendor, upon request, to offer marketing data to other participating carriers on nondiscriminatory terms. However, the DOT regulations limit the flow of information to domestic carriers unless foreign carriers are willing to re-

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181. Id. at art. 8(2).
183. Id.
184. Council Reg., _supra_ note 154, at arts. 5(1),(2),(3).
185. Id. at art. 6(b).
ciprocate with comparable data and the CRS vendor must provide written notice to the participating carriers concerning this exchange.

7. **ENFORCEMENT.**

The Commission may act on its own initiative or upon receipt of a complaint from an aggrieved party and initiate investigations and hearings. To remedy an infringement, the Commission may exercise its discretion in imposing fines upon infringers "up to a maximum of 10 percent of the annual turnover for the relevant activity of the undertaking concerned." Such fines may be appealed to the European Court of Justice.

To safeguard against blatant anti-competitive behavior, the Council conditioned the benefits of the block exemption accorded to an European carrier upon compliance with the Code. Since many European airlines are owned, "flag carriers" for their governments, heavily subsidized by their governments and/or operated as a joint venture, the sanction of removing the block exemption could have the effect of terminating operations. The Code also contains a "third-party" clause that releases the European CRS vendors from meeting the obligations of the Code in dealings with a non-EEC country's carrier that engages in discriminatory or deceptive practices.

C. **THE CODE OF CONDUCT AND THE DOT REGULATIONS ARE COMPATIBLE.**

Europe has followed the lead of U.S. deregulation of the airline industry. One European commentator explained,

The main difference between European liberalization policies and U.S. deregulation is the time scale: Europe has not been willing to adopt the U.S. big bang approach. But the end result will eventually be the same. Governmental ownership "can be viewed as an extreme form of government regulation . . . . Privatisation can therefore be considered a form of deregulation, even though the change in ownership itself may not affect competition." Since most European airlines have been at least substantially government-owned, the time frame necessary to achieve com-

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186. *id.* at art. 11.
187. *id.* at arts. 13, 19.
188. *id.* at art. 16.
189. *id.* at art. 17.
191. Council Reg., *supra* note 154, at art. 7(1), (2).
complete liberalization is dependent on whether EEC member countries privatize their airlines. For example, British Airways was once controlled by the U.K. government, but it now is fully privatized. The German government has reduced its interest in Lufthansa from more than 70 percent to slightly more than 50 percent. KLM, Swissair, and SAS still retain a small government ownership. Presently, there are over 40 airlines throughout the world in which full or partial privatization has been completed or is under consideration.\footnote{\textit{Airlines: Europeans Threatened by American Giants?}, \textit{Transport Europe}, Jan. 26, 1992, at 14.}

The withdrawal of governments from owning airlines is clearly the ideological trend. However, until economic disengagement is complete, the EEC block exemptions will continue to be necessary. Additionally, the European airlines believe that additional protection is necessary to level the playing field with the "Big Three"—American, United, and Delta. The president of the AEA, Mr. Bisignani, stated, "seen like this, group exemptions should be of indefinite duration."\footnote{\textit{Airline Marketing}, supra note 7.} Because the European airlines are permitted to collaborate jointly in specified areas, both the U.S. air transportation industry and the Commission must watch these activities to discover if any anti-competitive and discriminatory practices are also established.

Although there are differences in opinion as to what a "level playing field" means, it appears that the EEC Code is "close enough to the DOT's new requirements . . . that an owner airline complying with one set of rules would meet the other as well."\footnote{\textit{Brisson}, supra note 162.} The DOT noted "that the major foreign systems—Amadeus and Galileo—operate under the more stringent European rules; so they should be able to comply with our rules without difficulty."\footnote{\textit{Airline Industry Round Table}, supra note 190.} For example, Air France accused American of delays in posting schedule changes and a Dallas travel agency of making at least 1,152 false reservations on Air France flights in March and April, 1992, using SABRE to prevent real passengers from obtaining seats on the flights. European commentators concerning this dispute apparently would agree with the DOT. They say that under the Code, European CRS vendors would not be able to commit such violations.\footnote{\textit{Air Transp.}, supra note 198.}

\section{VIII. Strategies for Improved Regulation of CRSs}

Since the 1970s, the government has reviewed the results of regula-
tory regimes against their objectives with some disappointment. Some regulations were designed to guarantee the supply of a particular service by requiring its subsidy by profitable activities. The result often was the oversupply of uneconomic services at excessive costs and at standards exceeding what consumers were willing to pay.

However, liberalization has not always been a panacea. For example, the deregulation of financial services increased consumers' choices of suppliers and services. However, anti-competitive practices emerged and new entrants found that national markets were difficult to penetrate. Similarly, because of the quasi-public utility nature of the transportation industry, perhaps "[e]lightened regulation can provide an equitable balance of public interest objectives with market imperatives in those singular cases where the market alone produces socially undesirable results." Where free market conditions are not adequate to perpetuate expanded competitive markets, some form of regulation may be required to address prices or profits but not to discourage competition and efficiency.

Over the last five years, both the Senate and House of Representatives have sent a clear signal to improve government policy by proposing legislation directed at enhancing competition in the CRS industry. While the sponsors of the bills concerning the CRS industry have not advocated re-regulation of the airline industry, they have attempted to level the playing field between the major CRS vendors and other airline carriers through regulation. "The absence of full-bodied CRS competition translates into diminished airline competition, with consumers paying the price." One CRS vendor accurately pointed out that the DOT efforts, thus far, have simply not been enough:

[D]espite seven years of DOT regulation, despite aggressive market initiatives by smaller CRS vendors, despite litigation and threats of legislation, and despite rafts of government and private studies detailing the adverse consequences of the CRS duopolists' practices.

The 1992 DOT rules potentially strengthen governmental oversight of the CRS industry and attempt to weaken the grip of CRS vendors over the information they provide to their subscribers. The DOT correctly observes that vendors have continued to invest large sums into their CRSs and

200. Lacey, supra note 193, at 13.
201. Id., at 11.
202. FLYING BLIND, supra note 32, at 49.
203. Lacey, supra note 193, at 12.
206. Id.
should be allowed some return on these improvements that also pro-
duced great benefits for consumers, travel agencies, and the airline indus-
try. Accordingly, the DOT chose not to propose new rules that could
impose undue burdens on the CRS owners that could outweigh the bene-
fits to the consumer.

However, the GAO recently endorsed the equal functionality concept.
It has called for yet another study on architectural bias. The critics of
the 1992 DOT rules say the new measures have not gone far enough to
ensure competitive markets in the travel reservation, CRS, and airline indus-
tries. Staff aides in the House and Senate aviation subcommittees
said that because the 1992 rules failed to ease congressional concerns,
there is a "strong sentiment . . . for a bill to address anticompetitive prac-
tices . . . ." One smaller CRS vendor points that "[t]he regulatory is-
sue, therefore, should not be whether to eliminate host advantages [of the
two major CRS vendors], but how to do it." The following is the au-
thor's assessment of two strategies that continue to be suggested for im-
proved regulation of the CRS industry in spite of the promulgation of the
1992 DOT rules. These strategies are dehosting and divestiture.

A. SOME SAY DE-HOSTING IS NECESSARY TO ELIMI-
NATE INCUMBENT
ADVANTAGES THAT RESTRAIN COMPETITION AND CONSUMER
BENEFITS.

The smaller CRS vendors have proposed "a mandatory 'no-host'
CRS environment in which CRSs would be separated from the airline ven-
dor's internal reservations systems." Both SABRE and APOLLO are
hosted by a single computer system that includes their internal reserva-
tions system and their CRS operations. The smaller CRS vendors claim
that hosted systems will always continue to enjoy incumbent, competitive
advantages, as well as greater accuracy, better functionality, and less
keystrokes to confirm bookings. Regardless of the delay and inconve-
niences that may be experienced by subscribers of hosted systems, pro-
ponents of de-hosting agree with the DOT that mandatory no-hosting is
essential in guaranteeing equal functionality for all carriers.

What is required to create a de-hosted environment is primarily a re-

design of the system using new software. Although falling short of com-

207. U.S. GENERAL ACCOUNTING OFFICE, Computer Reservation Systems: Action Needed to
208. Proposed Rules on CRS Operations Fail to Ease Congressional Concerns, AVIATION WK.
& SPACE TECH., Apr. 8, 1991, at 37.
209. Worldspan, supra note 205.
210. Roberts and Mietus, supra note 41, at 3.
211. Telephone Interview with AI Lenza, General Counsel to System One (Nov. 3, 1992).
212. Id.
complete functionality, American is offering "seamless connectivity," which means that "SABRE users will have automatic transparent access to other data bases for the purpose of obtaining information and confirming reservations." While hosted CRSs may initially lack efficiency because of the time required to develop such software, proponents believe that as long as the CRS has its own internal reservations system attached, it will continue to enjoy an agency preference that yields lucrative incremental revenues.

Proponents of de-hosting assert that architectural bias of a hosted environment causes agents to prefer booking customers on flights of the CRS carrier for three reasons. First, the information in the system has greater reliability. Second, the communications links offer faster and more accurate transmission. And third, there is greater ease of completing the transaction with fewer keystrokes. For example, a CRS serves as a big message center, listing pricing information and available seats. A hosted CRS provides not only overbooking privileges to its subscribers, but also more accurate information on its seat inventory and last seat availability. No additional keystrokes are necessary for a travel agent using APOLLO's "Inside Link" to confirm whether the seat information on a United flight is accurate. The complete procedure for an APOLLO agent to book a round-trip consisting of four flight segments is 74 keystrokes.

In contrast, if the same agent were requested by the customer to book the same trip on TWA and the screen displayed no seats available, APOLLO's "Inside Link" would not provide last seat availability in the primary display for nonhost carriers. Therefore, assuming the communications link between the CRS and TWA functions properly, the agent must enter 18 percent more keystrokes to check the "real" flight inventory and obtain a seat on the nonhost flight.

Proponents of de-hosting assert that while a few more keystrokes and a small delay in communication time may be seemingly insignificant, the overall savings of time translate to faster customer service and greater agency revenues. Others correctly point out that the newest enhancements of CRS software is still in its infancy. As improvements are made and hardware and communication links function more quickly, excess keystrokes will be eliminated as all the systems completely attain equal functionality.

215. Interview with Gregory A. Conley, Vice President and General Counsel, Covia, in Denver, Colo. (May 27, 1993).
Computerized Reservation Systems

1993

Smaller CRS vendors claim that the owners of hosted CRSs gain incremental revenues resulting from their direct access capability. Worldspan estimated that American and Covia "would each gain $200 million or more in additional airline revenues each year if architectural bias caused each carrier to get one more booking per week from each CRS terminal used by its system's subscribers."216 Certain, the two dominant CRS vendors do not want their systems turned into neutral boxes that will cause the loss of extra owner-airline sales and that will deny the fruits of their investment in continuously enhancing the capabilities of their CRSs.

However, improvements in technological capabilities by the smaller CRSs, such as System One's "look and book" direct access features, are eroding the effects of alleged architectural bias.217 "The architectural bias is being worked out of every system in operation today."218 Further, airlines have found ways to circumvent the CRS. For example, British Airlines "uses public lines for agent videotext displays to sell tours at fares unavailable on CRS screens . . . . All CRSs are developing automated tour programs."219 One airline owning Abacus predicts that "[t]he next wave, from an airline point of view, is how to bypass your CRS."220

Presently, the CRSs link directly with the internal reservations systems of all participating carriers that can afford it. "What results are several multiaccess systems, paid for several times instead of just once."221 Both the time for transmission and cost of transactions can be significantly reduced if the CRSs simply link to each other. Although the technology is expensive, integrated availability expands the CRSs' direct access capabilities. "When a subscriber request comes in, CRSs will identify the airlines, ask them individually what availability they want to display, and produce an integrated response—all in 3 seconds."222 "Eventually, CRSs will act simply as giant switching systems."223

Further, the DOT determined that the cost of applying a no-host rule affecting primarily only SABRE and APOLLO could not be justified without "solid evidence that such a rule would provide substantial benefits."224 American reported that de-hosting will cost over $215 million over a three-year period and "will require substantial increases in booking fees

216. Airline Marketing, supra note 7.
217. Id.
219. Feldman, supra note 8, at 52.
220. Id.
221. Id.
222. Id.
223. Id.
224. Airline Marketing, supra note 7.
and subscriber charges."225 Galileo and Amadeus have begun "wean­
ing subscribers away from CRSs provided largely by national carriers and
onto mainframes at new central computer sites."226

Northwest estimates that it will cost about $50 million and take about
30 months to achieve dehosting.227 Worldspan is evaluating whether to
create a hostless system to replace PARS and DATAS II228 but it has
estimated its one time programming costs to permit equal functionality to
be $3.5 million.229 System One is a hostless system because its original
owner, Eastern Airlines, went bankrupt. It reported that "a carrier would
have to spend $5 million to participate in the upgraded functionality re­
quired by an equal functionality rule."230

Meanwhile, American and fourteen carriers associated with
Amadeus have agreed to "undertakings" required of the EEC that include
nondiscriminatory provisions requiring, in essence, equal functionality.
The EEC undertaking is an interim measure to govern the conduct of CRS
operations in Europe until the EEC issues its new rules. Unlike Amadeus
and Galileo (Covia’s European counterpart), SABRE is a hosted CRS.
Therefore, American will need to develop some new software or at least
an enhancement to its "seamless connectivity" to provide real time avail­
ability for its primary display to be used in Europe. This author queries
whether the same software can be modified by American to ensure com­
pletely equal functionality in the U.S. market.

Proponents of de-hosting claim that even the hundreds of millions of
dollars transferred from carriers to the two giant CRS owners does not
adequately describe the degree of market power wielded by the
megaCRSs. "Of even greater importance is the cost to consumers
steered to less convenient and less efficient services, possibly at higher
fares, because of bias. These costs pale in comparison to the cost of
eliminating host preferences."231

This author questions to what extent the DOT has enforced its own
rules against unfair competition. Despite an antitrust analysis by the DOT
and the increased empirical evidence of restraint of trade and barriers to
entry caused by CRSs, frequent flyer programs and other marketing tech­
niques, the DOT continues to maintain a hands-off approach. This author
recommends that the DOT take immediate and affirmative action based

225. Id.
226. Gaines, supra note 172.
227. Id.
228. Telephone Interview with Douglas Abramson, Vice-President, General Counsel and Sec­
retary to Worldspan (Nov. 2, 1992).
229. Worldspan, supra note 205, at 16.
231. Worldspan, supra note 205, at 16.
upon the multitude of studies and comments supplied to it during its recent rule-making procedure. Unfair host preferences can be minimized and software can be modified or enhanced to meet the required "equal functionality" concept defined in the 1992 DOT rules.\textsuperscript{232} The DOT must, however, properly monitor CRS operations to detect deviations from the regulations and then take affirmative action to enforce the penalties provided in the rules.

\section*{B. Some Critics Say Regulatory Attempts Have Failed and Recommend Complete Divestiture.}

Some travel agencies, travel associations, and domestic and foreign carriers believe that the DOT cannot effectively issue and monitor appropriate government regulation that will enhance sufficient competition to relax the grip of the CRS vendors. Some critics recommend that "[d]ivestiture of CRS owned by the airlines should also be considered, for opportunities for anti-competitive conduct of their owners are, quite simply, excessively abundant."\textsuperscript{233} Champions of divestiture warn that unless no-host CRSs are mandated by regulated divestiture, only a few mega-airlines will control a mega-CRS industry serving the world.

More cautious commentators point out that divestiture will deprive the mega-CRSs from benefiting from their investment in innovation. They present the concern that while divestiture may prevent the motivation for display bias, it will not remove functional bias resulting from good business relationships between a vendor and its customer. Nor will divestiture guarantee the elimination of market power. Further, foreign ownership of CRSs will now complicate divestiture rules.

The idea of divestiture has been bandied about for years, however, and has never gathered much support. Even if it caught on now, legal battles would probably last years. Smaller carriers fear that by then it may be too late.\textsuperscript{234}

\section*{IX A Recommendation for Enlightened Regulation}

Currently, the travel and tourism industry is the world's biggest and fastest growing business activity. In 1991, the industry generated over $3 trillion in gross output, of which 50 percent was spent in goods and services for other industries. The travel and tourism industry contributed $400 billion in direct, indirect, and personal taxes. By 1992, the industry will have employed over 130 million people or one in every 14 workers

\textsuperscript{232} Telephone Interview with Darryl Jenkins, TravelTechnics, Ltd. (Nov. 8, 1992).
\textsuperscript{233} FLYING BLIND, \textit{supra} note 32, at 54.
However, the travel and tourism industry is conscious of the leisure traveller's dwindling discretionary income. Even corporations have initiated cost control measures concerning business travel. To be profitable, companies in the travel industry—including CRSs, participating carriers, and travel agents—must offer products and services that are competitively priced, as well as appropriately packaged, to genuinely meet the needs of their targeted marketing niches.

If the costs of divestiture, de-hosting, equal functionality, or other changes required by regulation of CRSs are to be added to the price of air transportation products, the demand for required services will be decreased or, at best, supplanted by less expensive options. The overall effect will be a negative impact upon the travel and tourism industry. Accordingly, regulations must allow incentives for CRS owners to continue their investment in enhancements and innovation, yet restrain them from passing all of the costs of changes necessary to enhance competition to the customer. The Chief Executive for British Airways, Sir Colin Marshall, summarizes the problem to consumers:

The [travel and tourism] industry is a soft target for government treasuries . . . . There are, for example, more than 500 ticket, airport or disguised user charges/taxes plaguing travelers around the world. In most cases there is no apparent justification for the imposition of taxes on travellers. The transient passenger, who does not have the normal taxpayer's right of a vote in the countries visited, is easy prey for unscrupulous treasuries.236

The marketplace without intervention by the DOT has not effectively provided countervailing forces to ensure that CRS vendors do not prejudice the competitive environment. However, the harsh remedy of divestiture would unfairly deprive the megaCRSs from any benefit from their risk taking and investment in initially creating the CRS innovation and continuously expanding its capabilities. A requirement for de-hosting may needlessly impose additional costs and interference with management decisions in response to domestic and foreign market forces.

This author recommends more enlightened regulation and monitoring of both the CRS and travel agency industries; and then, more active enforcement on the part of the DOT. Some vigilance must be initiated to frustrate CRS vendors from using their systems to create an unfair advantage in the marketplace over competitor carriers and to ensure that travel agents provide their customers complete and impartial information concerning air transportation services. Enlightened regulation must encourage improved customer service and promote the transformation of

236. Id.
the CRSs from an airline marketing tool into an independent industry that serves as an information platform for travel, tourism, and other industries.
Yes, airline labor law is unusual. It is unionized, but also supervised by the government under a federal mandate to protect public interest. The federal government supervises through the Departments of Transportation and Justice, the Federal Aviation Administration, and the National Mediation Board, while airports are under the jurisdiction of state and local governments. This book concentrates on the regulation of airline labor and management relations provided under the Railway Labor Act.

The seven chapters in the text take the reader from the origins of airline regulation, through the processes of the Railway Labor Act and the effect of other statutes on labor relations, and up through current issues affecting aviation labor law. Replete with case law and authoritative commentary, this book will be a significant asset to regulators, union leaders, and transportation attorneys and students.

Chapter 1 reviews the background of how airline labor law came to be covered under the Railway Labor Act instead of the subsequently-enacted National Labor Relations Act. The Railway Labor Act of 1926 came about as a result of lessons learned from earlier laws enacted to deal with rail labor disputes. The goal was to institute a mechanism to keep the primary interstate carriers of passengers and goods—the railroads at that time—in service during labor disputes. Disputes had led to strikes, lockouts, and physical violence, such that the national economy suffered. To minimize disruption of the national economy, the Railway Labor Act set forth the rights and duties of both carriers and their employees, and set up federal machinery to facilitate settlement of disputes.

When the air transport industry was still in its infancy, Congress became concerned that an intensely competitive environment could inhibit sound development. Congress, therefore, sought a regulatory structure that would provide standards of safety and satisfy the needs of commerce, public interest, and the national defense. As such, Congress in

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1936 extended the Railway Labor Act's provisions for settlement of labor disputes to employees of air carriers engaged in interstate commerce.

Chapter 2 is a detailed presentation of the Railway Labor Act's representation process. This process reflects the major objective of the Railway Labor Act—the avoidance of industrial strife by conference between the authorized representatives of the employer and employee. Some underlying concepts necessary to this process are described: the definition of the term "employee," the principal of exclusivity, the right to organize, and the duty of fair representation. The chapter then explores the employer's options for response to unionization.

Chapter 3 presents a broad overview of the Railway Labor Act in the negotiation process. The Act requires much, but it does not mandate that the parties reach a compromise. At impasse, the parties are free to seek economic self-help.

An understanding of the negotiation process requires a basic knowledge of dispute terminology. A "major dispute" arises in the formation of a collective agreement or the lack of one, while a "minor dispute" arises in the proper meaning or application of an agreement. The Railway Labor Act's process differs for each dispute. Minor disputes, for which there are not strikes, are settled by system boards of adjustment. Major dispute resolution follows a lock-stepped formalized procedure, which the authors set out in detail—including a convenient chart. These procedures rely on the Railway Labor Act's philosophy of collective bargaining, along with the National Mediation Board's mediation and optional arbitration.

If all this fails, the President may create an Emergency Board to investigate the dispute and make recommendations. In the event an agreement is still not reached, the parties may exercise self-help: strikes, lockouts, or imposition of new rules on the work force. At that point, however, Congress has been known to intervene to thwart interruption in the national transportation system. The chapter concludes with a description of the National Mediation Board's duties, central of which is the duty to bargain in good faith.

Chapter 4 examines the way in which case law has applied the negotiation provisions of the Railway Labor Act to six specific areas of dispute settlement. The areas detailed are: the distinction between major and minor disputes; the role of the system boards of adjustment; the purpose of the emergency boards; the concepts of impasse, economic self-help, and reinstatement; strikes, secondary boycotts, and injunctions; and restrictions on sub-contracting.

In Chapter 5, other laws having serious impact on the employment relationship are succinctly outlined: The Civil Rights Act of 1964, the Age Discrimination in Employment Act, the Bankruptcy Act, the Airline Deregulation Act of 1978, and the National Labor Relations Act. The authors'
commentaries are a reminder that the Airline Deregulation Act was, in fact, a comprehensive over-haul of the governmental regulatory scheme and grossly affected provisions for labor protection.

Chapter 6 is a clear and detailed presentation of the past and current status of labor protection provisions, such as those being a form of mitigation of effects of company mergers on airline employees. The Civil Aeronautics Board had traditionally required labor protection provisions in merger situation. However, with the advent of the Airline Deregulation Act, the Civil Aeronautics Board’s responsibility in this area shifted to the Department of Transportation and then to the Department of Justice. The Civil Aeronautics Board’s position had been that imposition of labor protection provisions was consistent with its regulatory structure and necessary to protect the interests of carriers, passengers, shippers, and employees in acquisition or merger situations.

Since deregulation, new federal policy requires labor protection provisions only in rare circumstances. However, the collective bargaining core of the Railway Labor Act may prove to be the airline employees’ strongest source of protection. The core afforded airline employees, through their unions, to negotiate labor protection provisions into their labor contracts.

The final chapter addresses the newest challenges facing airline labor relations. The Railway Labor Act, although old and possibly archaic by some standards, remains the tool with which to deal with new issues. These issues include: employee drug testing, the blurring distinction of the traditional roles of management and labor in an era of leveraged buyouts, mergers, and employee stock ownership plans.
Book Note


by THOMAS J. WHALEN*

When difficult legal issues have arisen in the United States about the Warsaw Convention\(^1\), practitioners in the field have generally rounded up the usual texts: Goedhuis,\(^2\) Drion,\(^3\) Shawcross & Beaumont,\(^4\) the Warsaw Minutes\(^5\) and more recently Mankiewicz.\(^6\) Now there will be another text practitioners will want to consult: Giemulla/Schmid/Ehlers, WARSAW CONVENTION, published by Kluwer Law and Taxation Publishers in 1992.

The book is a thoughtful and thought-provoking, up-to-date exposition of the Warsaw Convention articles and a worthy addition to Warsaw Convention scholarship.

The Warsaw Convention is a multilateral treaty governing the liability of air carriers for damages sustained by passengers and shippers during the course of international air transportation. One of the purposes of the Convention is to establish uniform rules of airline liability applicable throughout the world. As most nations of the world are parties to the Convention or the Convention amended by the Hague Protocol,\(^7\) decisional law of foreign courts on Warsaw Convention issues should be useful precedent for practitioners in the United States. This new Kluwer WARSAW

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5. SECOND INTERNATIONAL CONFERENCE ON PRIVATE AERONAUTICAL LAW MINUTES (R. Horner and D. Legrez, trans. 1975).


CONVENTION text offers references to hundreds of foreign cases on Warsaw Convention issues, as no other text has done.

The authors' plan is to treat each of the Convention's articles separately. In this first edition, the authors treat Articles 1 through 3, Articles 5 and 8, and Articles 17 through 23. The treatment of other Articles will follow in the future.

As the authors state up-front, this text is not simply a compilation of cases. The authors offer their own commentary on the Convention and provide a different, European point of view. For example, the authors take on one of the most disputed areas of Warsaw Convention law in this country: the role of national law in cases governed by the Convention.

Most American courts have taken the position that the Warsaw Convention exclusively governs the carrier's liability, if the claim is one which falls within the scope of the carrier's liability covered by the Convention. Proponents of this view argue that if the Warsaw Convention applies to the transportation and does not afford a remedy to the passenger, the passenger has no remedy. Others have taken the position that the Convention is preemptive. If the Warsaw Convention covers the claim, it preempts national law. If it does not, national law can fill the gap, since the Convention is not exclusive. The authors take the latter position, that "[n]ational law is only substituted by the Convention and its supplements where claims relate to damages resulting from the specific dangers of air transportation." WARSAW CONVENTION, Introduction, p. 17.

The authors write, for example:

One who carefully follows the development in the case law concerning Articles 17-19 will see that particularly U.S. courts tend to construe the individual prerequisite for liability (e.g., accident, embarking, disembarking) quite liberally, thereby trying to protect the passenger as best as possible. However honorable this consumer-friendly intention may be, it is faced with strong opposition. The authors of the Convention left open many questions, which now call for an answer. These loopholes in the Convention are to be closed, as far as they were left open on purpose, by the relevant applicable national law. Chapter III, p. 2.

The issue of the role of national law in adjudicating a Warsaw claim may be illustrated by a claim of injury sustained in an aircraft hijacking. This issue arose in Husserl v. Swiss Air Transport Co. Ltd., which the authors often cite. As one of the attorneys representing Swiss Air in the case, I had argued that hijacking is not an "accident" covered by the Convention. Accordingly, the carrier is not liable for injuries sustained in a hijacking that occurs in the course of Convention transportation. Be-

8. See In re Air Disaster at Lockerbie, Scotland, December 21, 1988, 928 F.2d 1267 (2nd Cir. 1991).
cause the Warsaw Convention exclusively covers the liability of the carrier, we argued that the passenger had no other remedy against the carrier. The Court rejected our argument and ruled that a hijacking was an "accident" covered by the Convention.

The authors disagree with the Court's opinion in *Husserl* that hijacking is an "accident." Based upon their view of the role of national law, the authors would no doubt take the position that the carrier's liability, if any, would be outside the Convention and governed by the national law. If liability were found, the damages would be unlimited in amount. The authors also discuss several other events which they say are not "accidents," for example, consuming spoiled food. Some of these events have been held to be "accidents" by U.S. courts. The authors reach this conclusion on the premise that the liability rules of the Convention "were intended to cover solely the inherent risks of air traffic but not such damage occurring by mere coincidence during air transportation, i.e., damage which could also happen in any other sphere of life." Chapter III, p. 10. However, by narrowing claims within the purview of the Convention, the authors necessarily expand the role of national law in adjudicating claims arising in the course of international transportation. This European view, as the authors acknowledge, is contrary to the developing case law in the United States.

The authors address a number of interesting questions which have arisen recently, simply because a 1929 Convention is being applied to 1992 airline and airport operations. In their discussions of "accidents" in the course of "embarking" and "disembarking," the authors take a pragmatic approach and generally include forced stopovers and feeder services within Convention coverage. Their views are buttressed by European decisions on certain questions which as yet have not been addressed by American courts. The authors address the interesting question whether a private jet for hire (not an airline) could be covered by the Convention (yes) and whether freight forwarders, tour operators and others may, under certain factual circumstances, could be covered by the Convention as carriers or agents (yes). This latter view is consistent with the trend in this country that all "agents" and "independent contractors" which perform services in furtherance of the contract of carriage are covered by the Convention as carriers or agents.¹⁰ The authors also deal with the recurring issue whether denied boarding is covered by the Convention under Article 19. No, say the authors.

For those who have studied in some depth the Convention, or who are active practitioners in the field, the text offers a new and interesting study of the Convention, from a different, decidedly European view point.

The text's coverage of decisions worldwide is impressive and should make the volume a valuable research tool.