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# THE TRANSPORTATION LAW JOURNAL

The Transportation Law Journal is a publication of the Motor Carrier Lawyers Association and is published in cooperation with Osgoode Hall Law School of York University.

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The publication of signed articles, notes or reviews in this Journal implies no adoption by the Association or the University of the views therein expressed.
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ANNOUNCING
THE HAROLD S. SHERTZ
TRANSPORTATION LAW JOURNAL
ANNUAL AWARD

An award of $250.00, named in honor of Harold S. Shertz, Esq., of the Philadelphia, Pennsylvania, Bar, will be given for the student article deemed best in the development of transportation problems. The Award was established by the Film, Air and Package Carriers Conference of the American Trucking Associations with the Motor Carrier Lawyers Association to honor Mr. Shertz' long service to the transportation industry and to the legal profession. The paper receiving the Award will be published in The Transportation Law Journal.

Open to all students of accredited North American law schools, the competition will focus upon any area of transportation law with special emphasis on the role of regulatory bodies, national or international.

Submission of manuscripts must be in conformance with the competition's rules as follows:

1. Participating Law Schools: All accredited law schools in Canada and the United States are invited to participate in the Competition.
2. Eligible Students: Any law student of a participating school is eligible.
3. Subject Matter: Any phase of Transportation Law.
4. Determination of Awards: The prize will be awarded to the student who shall, in the judgment of the Editor-in-Chief and the Board of Governors of The Transportation Law Journal, prepare the best article. The prize may be withheld if it is deemed that no worthy article is submitted.
5. Prizes: A prize of $250 will be paid. The winning paper will be published in The Transportation Law Journal.
6. Formal Requirements, Right of Publication, etc.:
   (a) Manuscript must be typewritten (double-space) on 8 1/2" x 11" paper, 1" margin all around.
   (b) Manuscript must not exceed 50 pages.
   (c) Citations must be in approved law review form.
   (d) Two copies of manuscript must be submitted.
   (e) Cover for manuscript: any standard form stiff cover with label on outside showing title of article, author's name and permanent home address.

The papers will be forwarded to the Editor-in-Chief, The
Any paper may be written in collaboration with others provided there is full disclosure.

8. Closing date: Papers must be received by March 1, 1976.
   Questions concerning the Competition may be addressed to the Editor-in-Chief, The Transportation Law Journal, Osgoode Hall Law School, York University, Toronto, Canada.
INTRODUCTORY NOTE

The Board of Governors takes distinct pleasure in announcing that future volumes of the Transportation Law Journal will be published in cooperation with the highly regarded College of Law of the University of Denver.

Editorial responsibility of the Journal will be assumed by the recipient of the Motor Carrier Lawyers Association's Chair of Transportation Law which was recently established as part of the Motor Carrier Lawyers Association's Continuing Legal Education program.

The Association looks forward to this new endeavor and is sure that its joint efforts with the Law School will result in success similar to that experienced by the annual Transportation Law Institute which is also sponsored by the parties.

It is also appropriate at this time for the Board to extend special gratitude and recognition to Professor Daniel J. Baum who has served as Editor of the Journal since its inception. Without Professor Baum's guidance, cooperation, and efforts, the Journal would not be in a position to pursue the growth course announced.

Although Professor Baum's formal responsibility as Editor terminates with the present volume of the Journal, the Board looks forward to his continued contributions in an advisory and editorial capacity.

The Journal's readers are also invited to contribute suggestions and editorial material. Such assistance will help the Association and Law School achieve their goal of making the Journal the most significant periodical in the area of transportation law.

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INTRODUCTION

There is perhaps no area of interpretation and application of the federal labor statutes which has been the subject of more dramatic developments within the last few years than the case law relating to sales and acquisitions of businesses, or parts of businesses.

For years, an often all too simplistic approach was taken to the labor related problems involved in such sales and acquisitions. The tendency was to group all the labor-related problems involved in or caused by the transaction together. All such labor-related problems were then resolved by determining whether or not the purchaser was a "successor" for labor-related purposes. This simplified approach ignored the fact that the vast majority of sales and acquisitions of businesses and operations involve a wide myriad of often complex and highly involved legal obligations, liabilities and practical considerations, involving the employees and the unions which represent them.

The United States Supreme Court recently recognized the complexity of the issues involved in, and the danger of an over-simplified approach to, the wide range of problems which might arise in respect to such transactions. In its recent and strikingly important decision, Howard Johnson, the court commented on the Circuit Court of Appeals' approaching labor problems involved in a sale of assets on the basis of whether or not the employer was a "successor employer". Justice Marshall, writing for the Court stated the following:

The Court of Appeals stated that "the first question we must face is whether Howard Johnson is a successor employer", ... We do not believe that this artificial division between these questions is a helpful or appropriate way to approach these problems. The question whether Howard Johnson is a

* Partner, Wick, Vuono & Lavelle, Pittsburgh, Pa.
“successor” is simply not meaningful in the abstract. Howard Johnson is of course a successor employer in the sense that it succeeded to operation of a restaurant and motor lodge formerly operated by the Grissoms. But the real question in each of these “successorship” cases is, on the particular facts, what are the legal obligations of the new employer to the employees of the former owner or their representative. The answer to this inquiry requires analysis of the interests of the new employer and the employees and of the policies of the labor laws in light of the facts of each case and the particular legal obligation which is at issue, whether it be the duty to recognize and bargain with the Union, the duty to remedy unfair labor practices, the duty to arbitrate, etc. There is and can be, no single definition of “successor” which is applicable in every legal context. A new employer, in other words, may be a successor for some purposes and not for others. (Citations omitted)\(^3\)

Accordingly, it should be apparent that there is a grave danger in oversimplifying or adopting a generalized approach to the labor problems involved in sales or acquisitions of businesses, operations or parts thereof. In analyzing one factor or set of factors and concluding that the purchaser is or is not a “successor” for all purposes, the practitioner may be exposing his client to liability in respect to factors which were not considered. Consequently, a cautious, wary and detailed approach must be taken to any sale or acquisition of a business. This is true whether or not any labor problems are initially visible.

In this paper, we will attempt to point out what those issues are which are involved in “successor” type relations, and some of the possible pitfalls which may be present in such transactions. We will also analyze the recent landmark decisions of the United States Supreme Court on “successor” type issues and the practical effects of such decisions.

THE DUTY OF THE PURCHASER TO BARGAIN WITH THE SELLER’S UNION OR TO ACCEPT THE SELLER’S COLLECTIVE BARGAINING AGREEMENT

In order to be able to evaluate the labor-related issues which may be present in a sale or acquisition of a business or assets of a business

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(in which category we include the sale of operating rights only), it is necessary first to examine the evolution and development of the National Labor Board and court case law in respect to such transactions.

**EARLY LABOR BOARD CASE LAW**

Litigation in respect to a change in ownership of a business or part thereof may arise in two basic ways. First, the issue may arise as a result of unfair labor practice proceedings or representation proceedings and charges filed with the National Labor Relations Board.

Very early in its administration of the National Labor Relations Act, as amended, the Board began issuing orders directed at remedying the unfair labor practices not only of the employer who had violated the Act, but also of his "successors and assigns". This practice of the Board was upheld by the United States Supreme Court in the *Regal Knitwear* case. In that case the Supreme Court set forth the principle that Board orders may be binding upon successors who operated merely as "a disguised continuance of the old employer". This was the "alter ego" theory. Even before this 1945 Supreme Court case and the endorsement of the "alter ego" theory, the Board had held on a number of occasions that a successor employer was required to bargain with the bargaining agent of the employees following a nominal change in corporate organization which did not materially affect the nature of the business or the employees.

After the *Regal Knitwear Co.* case, the Board ruled in several cases that the purchasing employer or successor was bound to the bargaining duty which had bound the seller or predecessor where there was no change in the essential attributes of the employment relationship. In so doing the Board went beyond the "alter ego" theory and ruled in several cases that even a purchaser or transferee of a business operation which changed hands in an arms-length transaction was bound to the union certification of the seller. In continuing to issue such bargaining orders and other remedial orders as a result of alleged unfair labor practice charges over the period of a number of years, the Board looked at several factors involved in the operation. In addition to looking to see if no essential attribute of the employment relationship was changed by the transfer, it more specifically looked at

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5. *Charles Cushman Co.*, 15 NLRB 90, 5 LRRM 113 (1939).
whether the successor continued to produce the same product at the same location with the same equipment, whether it served the same customers, and whether the employees of the predecessor were retained by the successor.\textsuperscript{8}

Although such Board decisions meant that an employer who succeeded to the business operation had to bargain with the union which had been certified or recognized by his predecessor, such decisions did not mean that the succeeding employer in all cases would be bound by the existing collective bargaining agreement between the union and the predecessor employer.\textsuperscript{9}

However, the Board ruled that a purchaser which continued operations of a company without significant change in the personnel or method of the seller had to bargain before changing the terms and conditions of employment established by the seller’s prior collective bargaining contract. In one case, the Board ruled that such an obligation to bargain existed, even though the agreement expired before the business was sold and the purchaser announced in advance his unwillingness to continue the wages and working conditions established by the contract. The Board ruled that it had authority to order the purchaser to restore the prior wages and benefits provided by the expired contract and to make the employees whole for losses caused by the unilateral change in wages and conditions.\textsuperscript{10} Such a remedy, set down at a time several months after the deal was consummated could be extremely costly and render the entire transaction a financial flop.

These principles we have discussed above and which were adopted by the National Labor Relations Board were upheld to a great extent by the various Circuit Courts of Appeals.\textsuperscript{11}

\textsuperscript{8} Johnson Ready Mix Co., 142 NLRB 437, 53 LRRM 1068 (1963); Stonewall Cotton Mills, supra.
\textsuperscript{9} Rohlik, Inc., 145 NLRB 1236, 55 LRRM 1130 (1964).
The second manner in which the issue of being bound to recognize the predecessor's union and to honor his collective bargaining agreement arises is as a result of actions filed under Section 301 of the Labor Management Relations Act. Section 301 provides a statutory cause of action for violations of a contract between an employer and a labor organization. The Wiley case, which was the first Supreme Court decision dealing primarily with the issue of successorship in a Section 301 action, was an extension of the Supreme Court's reliance upon arbitration as a means of effectuating solutions to labor problems. No one, however, can deny the impact of this decision on subsequent decisions of the National Labor Relations Board, both in respect to the question of the surviving binding effect of a labor contract and that of a surviving bargaining duty.

The Supreme Court's Wiley case involved a merger of a company employing 80 employees into a larger company. Of the 80 employees of the merging company, Interscience, 40 were represented by the Union. The surviving company had about 300 employees who had not been organized by a union. John Wiley and Sons, the surviving company, took the position that they did not have to honor the collective bargaining agreement of Interscience and did not have to bargain with the Union. The surviving company also took the position that it did not have an obligation to arbitrate claims in respect to "vested" rights which had been asserted by the employees of Interscience represented by the Union. The Union subsequently brought an action under Section 301 of the Taft Hartly Act to compel arbitration under the collective bargaining agreement.

The Court stated that there was a continuity of operations and that the national labor policy favored arbitration as the substitute of industrial strife. The Court found that in such a merger situation, the rights accrued under the contract with Interscience could be enforced against the surviving corporation, Wiley, even though Wiley had not agreed to be bound by the terms of such an agreement.

**AN EXTENSION OF WILEY'S PRINCIPLES**

Two Circuit Court cases followed Wiley within a short time. In the one, Wackenhut, the Ninth Circuit interpreted Wiley as imposing

13. Wackenhut Corp. v. International Union, United Plant Guard Workers of
upon a successor, even in an acquisition as opposed to a merger situation, the entire collective bargaining agreement of the predecessor. Along the same line, the Third Circuit in Reliance,\(^{14}\) ruled that the arbitrator had the discretion as to which portions of a predecessor’s union contract might be imposed upon the successor or not imposed upon the successor dependent upon the equities of the situation and changed circumstances.

It is clear that the Supreme Court’s Wiley decision and the subsequent decisions by the Circuit Courts of Appeal greatly influenced the National Labor Relations Board in its treatment of successor-employer obligations. Although in Wiley, the Court indicated that it was not ruling on representation issues and the question of recognizing the bargaining agent, the National Labor Relations Board took an aggressively or liberal viewpoint in interpreting the successor issue, culminating in a combined decision on four cases by the Supreme Court in 1970. It is this combined decision which, together with three subsequent decisions, presently form the basis for the determination of the issues and liabilities involved in a sale or transfer.

**THE BURNS CASE**

The lead case of the four combined cases gave the case its name, Burns.\(^{15}\) In its decision on Burns, the National Labor Relations Board a few years previous had made the sweeping ruling that when a business changed hands and no unusual circumstances were present, “the National Labor policy embodied in the Act requires the successor-employer to take over and honor a collective bargaining agreement negotiated on behalf of the employing enterprise by the predecessor.”\(^{16}\)

In the Burns case, the William J. Burns International Detective Agency became the successful bidder on a contract for protection of a Lockheed installation. This service had previously been performed by the Wackenhut Corporation who had a collective bargaining agreement with a certified bargaining agent, the United Plant Guard Workers of America. All bidders on the service were apprised of the

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\(^{14}\) Reliance Universal, Inc. v. United Steelworkers, 335 F.2d 891, 56 LRRM 2721 (CA 3, 1964).


\(^{16}\) Id., 74 LRRM at 1100.
existence of the collective bargaining agreement between Wackenhut and the Plant Guards prior to the bidding. The Burns service was successful bidder and hired 27 former Wackenhut guards and transferred 15 of its own employees to the Lockheed installation. This resulted in a majority of the work force being made up of the prior guard service's employees.

After the Union demanded that Burns recognize it and honor the collective bargaining contract, Burns refused and refusal to bargain charges were filed with the National Labor Relations Board under Section 8(a) (5) of the Labor Management Relations Act.17

The National Labor Relations Board ruled that Burns was a successor employer to Wackenhut in respect to recognition of the union and as to the terms of the predecessor's collective bargaining agreement. In so doing, the Board relied upon the Wiley rationale, declared that the "employing industry" had remained essentially the same despite a change in ownership and that there was no reason to believe that the employees within the bargaining unit had changed their minds on representation merely because the employer's identity had changed.

This was an important and far reaching decision. If sustained, it would have gone beyond affirming that a purchaser of an operation had the duty to recognize the Union and to honor the collective bargaining agreement of a seller. It would also have meant that one who had not even purchased the business but rather had taken over the performance of the same work, and hired as new employees a majority of the seller's employees was bound to the predecessor's labor obligations just as if there had been continuity of operations and a purchase.

On appeal, the Second Circuit Court of Appeals refused to enforce that part of the Board order which required the successor company to abide by all terms of the collective bargaining agreement negotiated between the predecessor and the union representing the predecessor's employees.18 The Court, however, did find that because Burns had hired a majority of the employees who had been represented by the Union, Burns was a successor as to the bargaining duty toward the Union. The Circuit Court thereby limited the operation of the Board's order and the employer's obligation to that of recogni-

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17. In addition, charges were also filed under other sections of the Act. However, those are not germane to the successor issue.
tion and the duty to bargain with the union. In a landmark decision which was probably the most widely discussed Supreme Court labor case that year, the Supreme Court upheld the Second Circuit's decision.

The Supreme Court agreed with the Board and the Circuit Court in *Burns* that Burns was obligated to recognize and bargain with the union. However, the Supreme Court also stated that it would have been a different case if Burns had not hired the majority of the employees already represented by a Union certified as bargaining agent. In fact, Justice White, writing for the Court stated in a footnote the following:

"The Board has never held that the National Labor Relations Act itself requires that an employer who submits the winning bid for a service or who purchases the assets of a business be obligated to hire all of the employees of the predecessor though it is possible that such an obligation might be assumed by the employer... However an employer who declines to hire employees solely because they are members of the Union commits 8(a)(3) unfair labor practice. (Citations omitted)"

The Court went on to state that it did not follow, however, from Burns' duty to bargain that it was bound to observe the substantive terms of the collective bargaining contract the union had negotiated with Wackenhut and to which Burns had in no way agreed. The Court further stated that the Board's decision was not in accord with prior Board decisions which had held that the success or employer was not bound by the substantive provisions of the collective bargaining contract negotiated by its predecessor. The Court distinguished *Wiley* on the basis that *Wiley* had arisen in the context of a suit under Section 301 of Labor Management Relations Act to compel arbitration while *Burns* had arisen in the context of a National Labor Relations Board proceeding wherein the Board was expressly limited by provisions of Section 8(d) of the Act. The Court went on to further distinguish *Wiley* by stating that *Wiley* was a narrow holding dealing with a merger occurring against a background of state law which embodied the general rule that in merger situations the surviving corporation is liable for the obligations of the disappearing corporation. The Court pointed out that there was no merger, no sale of assets, no

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20. *Id.*, 80 LRRM at 2230.
dealings whatsoever between Wackenhut and Burns in the *Burns*
case.

In very significant language, the Court stated the following:

A potential employer may be willing to take over a moribund
business only if he can make changes in corporate structure,
composition of the labor force, work location, task assignment,
and nature of supervision. Saddling such an employer with the
terms and conditions of employment contained in the old
collective-bargaining contract may make these changes impossi­
ble and may discourage and inhibit the transfer of capital.21

In an attempt to narrow its decision, however, the Court also
stated:

Also, in a variety of circumstances involving a merger, stock
acquisition, reorganization, or assets purchased, the Board
might properly find as a matter of fact that the successor had
assumed the obligations under the old contract.22

The Court further determined that Burns had not committed an
unfair labor practice by changing the terms and conditions of employ­
ment which had existed under Wackenhut and establishing initial
terms and conditions of employment as it saw fit. The Court stated
that at the time Burns offered initial terms of employment, it was not
clear whether Burns was going to hire a majority of the former em­
ployees, thereby incurring the duty to bargain with the union. As a
result, at the time Burns offered the initial terms of employment, it
had no duty to bargain. This duty matured later. Accordingly, Burns
did not violate the Act by offering initial terms of employment, in­
cluding wages at a lower level than were in existence under Wacken­
hut's contract. The implication of this latter holding is important.

What this in effect meant was that if an employer did not hire the
employees of his predecessor, he was bound neither to recognize the
predecessor's union as bargaining agent nor to honor the collective
bargaining agreement which the predecessor had. A caveat should
issue forth at this time, however. An employer cannot refuse to hire
employees of a predecessor merely because such employees belong to
a union or have engaged in concerted activity. Both pre-*Burns* and
post-*Burns* cases make it clear that in hiring its full complement of
employees, the successor employee violates the Act if it refuses to hire

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21. *Id.*, 80 LRRM at 2231.
22. *Id.*, 80 LRRM at 2232.
Such discriminatory hiring practices, however, the successor ordinarily has no obligation to bargain until after the transfer and after the rehiring is substantially complete, and then only if he hires a majority of the former union-represented employees. Accordingly, the duty to bargain arises too late to allow the union to apply pressure and to bargain over job security or the hiring of the predecessor's employees.

**IN THE WAKE OF BURNS**

The *Burns* decision left many unanswered questions. In the wake of *Wiley* and *Burns*, the United States Court of Appeals in Philadelphia ruled that a union's collective bargaining contract with a certificated common carrier does not necessarily terminate upon a sale of all the company's capital stock to a purchaser who changed the company name without substantially altering its business operations or hauling activity. 23

This case came before the Court on a motion for summary judgment by the Federal District Court for the Western District of Pennsylvania, and for purposes of its consideration of the case, the Court of Appeals considered all allegations in the union's complaint as being correct. In this case, the Court of Appeals accepted the facts presented by the union that the owner of a trucking company who had a labor agreement with a Teamsters' local sold his stock to another individual. The trucking company had in its name certificates of public convenience issued by the Pennsylvania Public Utility Commission. The day after the sale, the new owner of the corporation discharged the nine drivers who were represented by the union. The union subsequently brought a suit under Section 301 of the Labor Management Relations Act. The contention of the Union was that the contract with the employer survived the sale of stock and that the purchaser was bound under the contract. Accordingly, the discharge of the drivers violated the labor agreement. The Court of Appeals distinguished the *Burns* decision on the basis that the *Burns* decision

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stated it was only applicable to Labor Board determinations in which Section 8(d) of the Act was applicable. Moreover, the transaction in the Bill’s Trucking case was a purchase of stock rather than a substitution.

THE HOWARD JOHNSON CASE

Subsequently, in 1974, the Supreme Court issued another landmark decision which further extended the principles which it had set forth in Burns. This case, the Howard Johnson case²⁶ concerned the purchase of assets of a company. In the case, the Howard Johnson company was the bona fide purchaser of the assets of a restaurant and motor lodge. The union was the bargaining representative of the employees of the previous operator, and a collective bargaining agreement had existed with the predecessor. In commencing its operation of the restaurant, Howard Johnson conducted extensive interviews with prospective employees and ended up hiring only a small fraction of the predecessor’s employees. Taking a page from the Wiley decision, the union attempted to require Howard Johnson to arbitrate under the arbitration provision of the collective bargaining agreement of its predecessor the extent of Howard Johnson’s obligations to the predecessor’s employees.

In its decision in Howard Johnson, the Supreme Court struck down this attempt. In so doing, the Supreme Court recognized that the decision in Burns was somewhat inconsistent with the decision in Wiley. The Supreme Court retracted its prior distinction of a difference between predecessor-successor issues in Labor Board proceedings as opposed to judicial proceedings under Section 301 of the Labor Management Relations Act. The Court stated that such a distinction is inconsistent. The Court did say that there was a difference in the form of the transaction. Wiley involved a merger, as a result of which the initial employing entity completely disappeared. Accordingly, the disappearance of the original employing entity in Wiley meant that unless the union were afforded some remedy against Wiley, it would have no means to enforce the obligations in its collective bargaining agreement. The Court stated that Howard Johnson, however, involved only a sale of some assets, and the initial employer remained in existence as a viable corporate entity, which the union could look to to satisfy any obligation under its labor agreement. The Court found that since there was plainly no substantial continuity of ident-

ity in the work force hired by Howard Johnson with that of the prede­
cessor’s work force, and no express or implied assumption of the
agreement to arbitrate, the Circuit Court had erred in compelling the
company to arbitrate the extent of its obligations to the predecessor
employees.

The decision in Howard Johnson is important. Not only did it
specifically rule that in a transaction involving the purchase of assets,
the purchaser is not obligated to honor the collective bargaining
agreement of the predecessor nor to arbitrate liabilities under that
collective bargaining agreement, it also reaffirmed the Supreme
Court’s ruling on the lack of obligation to hire the predecessor’s em­
ployees and the right of a purchaser or successor in interest to set
unilateral terms and conditions of employment, providing such ac­
tion is taken before a duty to bargain on the basis of hiring a majority
of the predecessor’s employees matures. Of course, it must again be
emphasized that the Board and the Courts have scrutinized carefully
the purchaser or successor company’s failure to hire predecessor em­
ployees particularly when they were experienced or skilled and new­
hirees were inexperienced or unskilled. If such hiring is done, how­
ever, pursuant to good personnel practices, as was the case in Howard
Johnson, this problem can be overcome. However, proper planning
and counseling is necessary in respect to the hiring problem, as well
as to the problem of the setting of initial terms and conditions of
employment and the determination of when the obligation to bargain
matures in cases where a majority of the predecessor’s employees are
hired by the successor.

NATIONAL MASTER FREIGHT AGREEMENT PROVISIONS

Although many transactions which involve the sale of operating
rights or an operation would not involve companies which are signa­
tory to the National Master Freight Agreement with applicable local
supplements, many will. Accordingly, it should prove beneficial at
this point to consider briefly the successor or transfer language in that
agreement. Much of what we say may be applicable to other jointly
bargained labor agreements, such as Eastern Conference Tank Haul
Agreement or other such agreements.

The successor provisions of the National Master Freight Agreement
are perhaps the most sophisticated of any such clauses to be found
in any collective bargaining agreement in the United States. The
provisions affecting the parties to a sale of rights, to an operation or
to a business are found in two sections of the Master Freight Agree­
ment. The first such provisions are found in Article 1 of the Agreement, attached hereto as Appendix 1. The other provisions, which impose detailed interpretations on seniority applications, depending on the nature of the transaction, are found in Article 5, attached hereto as Appendix 2.

Aside from Board or Court case law, an obligation may arise from the terms of a master agreement to which both parties to the transaction are party, through participation in either joint or multi-employer bargaining.

The first paragraph of ARTICLE 1. Section 3. of the National Master Freight Agreement contains a usual type of successor clause found in many labor agreements. However, in succeeding paragraphs the ingenuity of the Teamsters International is again recognized. That language found in succeeding paragraphs is broad enough to cover almost any type of transaction. In addition, recognizing the fact that a successor clause may not be binding upon a purchaser who is not otherwise signatory to the agreement, the second paragraph of Section 3 attempts to place a blanket liability to the seller's employees upon the seller, until the purchaser agrees to assume "the obligations" of the agreement.

Firmly binding other signatories to the Agreement who may purchase rights from a signatory, paragraph 3 provides that such a signatory purchaser must accept the affected employees of the signatory seller in accordance with the seniority provisions of the Agreement applicable to sales or mergers, found in ARTICLE 5. Section 3. For some reason, probably pertaining to protection from a "hot-cargo" agreement charge, there is a provision that when rights are sold to a non-signator, and such purchaser is the sole bidder on such rights, the provisions of the National Master Freight Agreement shall not apply. This is an important exclusion which must be kept in mind by practitioners representing both signatory sellers and non-signatory purchasers alike.

The notice requirements are contained in the last paragraph of Section 3 and require that notice of the existence of the agreement shall be made in writing to the buyer at the time the seller executes the contract or transaction. A copy is to be sent to the Union. These
obligations are in addition to the obligations of the seller to bargain over either the sale or the effects of the sale, depending on the nature of the transaction, under the provisions of the Labor Management Relations Act. Such an obligation is discussed later in this paper.

Article 5 of the National Master Freight Agreement contains Section 3, dealing with seniority rights of employees in situations involving mergers, purchases, acquisitions, sales and so forth. Generally, the principle of dovetailing the seniority of the employees of the selling carrier with that of the purchasing carrier at the operation affected is followed. However, the provisions of Section 3 should be studied inasmuch as there are different provisions involving the acquisition of parallel, as opposed to non-parallel, operating rights. Moreover, where both parallel and non-parallel operating rights are involved, a combination of the guidelines are applied. Practitioners representing buyers especially, should be aware of sub-paragraph (5) of Section 3. That provision has to do with operations under temporary authority. The application of the paragraph is not entirely clear. However, the writer, in discussing the interpretation of this clause with employer-representatives on the employer's negotiating committee and with the employer secretary of one of the Conference grievance committees was informed that one possible interpretation could be that where permanent authority was disallowed, after operations had taken place under the temporary authority, a surviving company could face a possible liability and in the extreme, could be required to make those employees who suffered economic loss during the temporary authority operating period whole.

One possible way to determine what the seniority applications involved in a transaction will be before the closing date would be to make a timely submission to the Area Change of Operations Joint Committee. The danger in such a course of action, however, may be in prejudicing whatever right a purchaser may have to assert that it is not a successor as to any given location or terminal or in asserting that it does not face certain obligations in respect to a particular part of the transaction.

The practitioner handling an involved transaction wherein both the seller and buyer are signatories to the National Master Freight Agreement would do well both to analyze the contract and operations involved and to "sound out" local Motor Carrier Association Managers in the area, to benefit from their useful experience.
LIABILITY OF A SUCCESSOR FOR PREDECESSOR’S UNFAIR LABOR PRACTICES

In addition to the bargaining duty enforced by the National Labor Relations Board, and the question of contractual obligations and a possible 301 suit, an attorney representing a buyer must also evaluate possible liabilities involved in unfair labor practices committed by the employer. Generally, these involve violations of the Labor Management Relations Act which have occurred, but in respect to which either no charge has been filed, or no decision rendered. Such charges may run the gambit from unlawful discharges, to violations of rights to engage in concerted activity, to refusal to bargain charges.

ALTER EGO THEORY

One of the earliest positions taken by the National Labor Relations Board in respect to successors was in a case referred to earlier in this paper, the Regal Knitwear case.28 The Supreme Court, in upholding the Board in Regal Knitwear Co. discussed in great length the question of identity of interest between employers. Partly as a result of this, the theory continued to be applied by the National Labor Relations Board that if a company is closely related in a number of factors to a predecessor, that company will be held responsible for the actions of that predecessor in committing unfair labor practices under the Labor Management Relations Act.29 In the Atlanta Paper Co. case30 the Board declared some of those factors to be:

1. Stockholders and officers.
2. Operations.
3. Assets.
4. Employees.
5. Supervisory force remain the same.

It is fairly certain that if the National Labor Relations Board finds a company to be the alter ego of a predecessor, it will hold the successor company liable for the unfair labor practices of the predecessor.31

In a case a little over a year ago, to the interest of those of us involved in the motor carrier field, the Labor Board found that a

28. Regal Knitwear Co. v. NLRB, supra.
corporation engaged in the trucking and warehouse business was not the alter ego of a trucking company that had gone out of business after a union had negotiated a collective bargaining agreement with the company on behalf of its drivers and dock workers. Some of the factors we listed above were present in that case. In that case, Co-Op Trucking, both corporations were owned by the same individual, who was the sole stockholder of each. The Board found, however, that the corporations were individual corporations engaged in different businesses. Although the new corporation took over 6 percent of the former corporation’s business, the Board found that there did not appear to be a transfer of operations. Other dissimilarities in operating were also found by the Board. Also involved in the Co-Op case was a partnership composed of former officials of the trucking company that had gone out of business. In respect to such partnership, the Board pointed to the fact that the partnership only took over one-third of the company’s former customers and there was some difference in operations. However, the Co-Op case came dangerously close in the game of brinksmanship. Do not be misled by it. If there is a substantial common identity of ownership in a transfer of operating rights transaction, the practitioner must be very careful to set up the transaction so that the alter ego principle is not applied.

ARMS-LENGTH TRANSACTIONS

The Labor Board has altered its position over the years several times in respect to whether a good faith purchaser is liable for the unfair labor practices of the seller. At one point, the Board went so far as to state that it had no authority to enforce remedial orders in unfair labor practices against any party other than that party which had actually engaged in the violation of the Act. In that case, the Labor Board has altered its position several times in respect to whether a good faith purchaser is liable for the unfair labor practices of the seller. At one point, the Board went so far as to state that it had no authority to enforce remedial orders in unfair labor practices against any party other than that party which had actually engaged in the violation of the Act.33

The present Board law on this aspect was set down in the Perma Vinyl case.34

The key to the legal principles set forth in the Perma Vinyl case is notice. This writer does not feel that Perma Vinyl established that a purchaser must have actual knowledge of the unfair labor practice of the seller in order to be held liable. The actual holding in Perma Vinyl was that a purchaser which operates the business in a basically unchanged form under circumstances “which charge him with notice of

unfair labor practice charges against its predecessor”, will be held responsible for remediying these violations of the law.

Following on the heels of the decision in Burns, the Supreme Court ruled on the issue of a seller's liability for the predecessor's unfair labor practices in 1973 in Golden State Bottling Co. After some discussion as to actions being binding on defendants and those in "privity" with them the Supreme Court set forth that:

We hold that a bona fide purchaser, acquiring, with knowledge that the wrong remains unremedied, the employing enterprise which was the locus of the unfair labor practice, may be considered in privity with its predecessor for purposes of Rule 65(d).

In this case, the Court discusses “knowledge” as opposed to the test of being “charg(ed) . . . with notice of unfair labor practice charges against his predecessor” which we had pointed out to be present in Perma Vinyl.

Accordingly, care must be exercised in any purchase transaction. The question of being charged with notice was not actually resolved in the Golden State case, and possible liability to a purchaser could remain in cases of “knew or should have known”. We submit that it would be very easy for the Labor Board to find that a purchaser is charged with notice that an unfair labor practice existed, even if they cannot establish that he had actual knowledge of that unfair labor practice. The liabilities involved in such a finding could be great. Care must be exercised to insulate a client against such liability.

In fact, in justifying its application of the Perma Vinyl principles to a bona fide purchaser, the Supreme Court stated that the purchaser's liability for remedying the unfair labor practice may be reflected in the price he pays for the business, or he may secure an indemnification clause in the sales contract which will indemnify him for liabilities arising from the seller's possible prior unfair labor practices.

It would appear then that the courts would have little sympathy for a purchaser who acquired an operation or merely operating rights, was deemed to have operated under circumstances which charged him with notice of the unfair labor practice charges or possible charges against the seller, but had not obtained an indemnification clause from such seller.

In fact, even a release or agreement with the union to go along with such a sale would not relieve the purchaser from liability for an unfair labor practice as a result of charges filed by individual employees
under the Labor Management Relations Act.

One question which has not been answered by the courts, but which we submit is important, is the possible liability of a purchaser for the unfair labor practices of the seller in failing to discharge his duty to bargain with the union over the effects of the sale on seller's employees. This type of case has arisen frequently, but we know of no instance where the charging party attempted to hold the buyer liable. Quite frequently, however, a seller will have definite and sufficient information to charge him with notice that such a violation is occurring, and might even participate in the decision not to discharge the duty to bargain. Again, care in drafting must be taken to avoid what might be considerable liabilities under the *Perma Vinyl* and *Golden State Bottling Co.* principles.

**LIABILITY OF PURCHASER FOR SELLER'S VIOLATIONS OF TITLE VII OF THE CIVIL RIGHTS ACT.**

This area of the law is as of yet unsettled. The practitioner who handles the sale of an operation or of operating rights or of an entire business should keep in mind, however, a recent decision by the Sixth Circuit Court of Appeals. The issue in that case, 36 *MacMillan Bloedel Containers, Inc.*, is the same issue presented to the Supreme Court in *Golden State Bottling*, except in the context of Title VII of the Civil Rights Acts. In *MacMillan Bloedel Containers*, charges had been filed against the predecessor before MacMillan Bloedel Containers had taken over the operation. The Court divided this determination into two aspects. The first question presented was whether a company that acquired another company's facility could be liable under Title VII for the seller's unlawful employment practices. In answering this question, the Court of Appeals reviewed the various decisions of the United States Supreme Court regarding the successor issue. The court stated that interests of the employer and the discriminatee must be weighed in any successor case presented under Title VII. The Court pointed out that where the seller no longer had any assets, monetary relief as a result of a charge filed under Title VII would be precluded. Going further than the cases under the Taft Hartley Act, the Circuit Court charged that such a result could encourage evasion in the guise of corporate transfers of ownership. Addi-

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tionally, where the relief involved seniority, reinstatement, or hiring, only the successor company could satisfy any remedy. Accordingly, the Court of Appeals stated that it was borrowing from the administration of the Taft Hartley Act in finding that the purchaser could be liable for the Title VII violations of its predecessor.

The Second issue considered by the Court in *MacMillan Bloedel Containers, Inc.* was whether a new charge under Title VII had to be filed naming the purchaser before the EEOC or the discriminatee could proceed. The Court answered that no new charge had to be filed. *MacMillan Bloedel Containers, Inc.* had notice of the charge against the seller and had custody and control of all the related documents. Therefore, a second filing with the EEOC would serve no purpose other than a creation of an additional procedural legality.

Although the Court in *MacMillan Bloedel Containers, Inc.*, adopted the requirement set forth by the Supreme Court in *Golden State Bottling* as to knowledge by the purchaser of the claims against the predecessor, different problems are raised in the context of a proceeding under Title VII of the Civil Rights Act. Charges administered by the Regional Offices of the National Labor Relations Board under the Labor Management Relations Act are generally handled expeditiously, with a number of items of correspondence passing often within weeks of a charge being filed. Those who have experienced the administrative procedures of district offices of the Equal Employment Opportunity Commission will verify that charges are handled differently, and notice is not as definite or sure within the same time period.

Moreover, inasmuch as the Court of Appeals applied the principles set forth in the *Golden State Bottling* case, wherein actual knowledge was present, it would only be a logical extension to apply the wording in the *Perma Vinyl* case which talks about “circumstances which charge him with notice of unfair labor practice charges against his predecessor.” Accordingly, until the law is more settled in respect to this issue, those drafting agreements for the sale of an operation, the sale of rights or the sale of a business should attempt to include some protection for the purchaser of liability under Title VII charges. Warranties that no charges under Title VII of the Civil Rights Act have been filed should accompany indemnification provisions in the agreement.
MISCELLANEOUS LIABILITIES, PITFALLS AND PRATFALLS WHICH MAY FACE THE PURCHASER.

There are many miscellaneous pitfalls which face the unwary or the incautious in respect to the purchase of rights, an operation or a business. The presence or absence of many of these are controlled and determined by those principles set forth in the first section of this paper. It must first be determined whether the purchaser has the duty to bargain with the seller's union or to accept the seller's collective bargaining agreement. For the sake of this section of the paper, however, we will assume that the purchase does involve the type of transaction covered by the terms of the National Master Freight Agreement, to which both parties are signatories. Accordingly, under the concept of one multi-employer, multi-union bargaining group, the purchaser should be aware of miscellaneous liabilities it might face. The same might be said for any purchaser who assumes the bargaining agreement of the seller, or to a purchaser of the stock of a corporation or a survivor upon merger. These miscellaneous liabilities are in addition to those mentioned previously in the paper in respect to the National Master Freight Agreement and are set forth as follows:

First, it must be determined what vacation pay is owing the employees who either remain with the corporation in case of a sale of stock, or who are hired or retained by a purchaser pursuant to a collective bargaining agreement commitment or obligation. This is further complicated by the fact that vacation “year” periods vary from area to area and from collective bargaining agreement to collective bargaining agreement. If the purchase of a number of terminals with accompanying operating rights takes place, a purchaser may face several different determinations on vacation pay liability, depending on the area in which the terminal is located. Generally, the sales agreement should be drafted so that the seller remains liable for and provides a means for satisfying any vacation liability which has either become due or accrued prior to the effective date of the sale. The best arrangement is for such vacation pay liability to be escrowed at the time of the closing of the transaction. It is generally better for the parties to agree upon a means of prorating the vacation over the period of each vacation year to avoid double claims, or a claim against each employer based upon the employees possibly satisfying the eligibility requirements of what might be deemed as two separate employers for vacation pay purposes. The rate at which such vacation will be paid should be anticipated inasmuch as a wage increase might
Although at the time of the sale a lower wage rate was in effect, indemnification clauses are generally not adequate to protect a buyer inasmuch as large sums of money are often involved in vacation pay liability. This is an issue which should be carefully thought through.

Second, most agreements for sale of operating authority or of an operation or business contain guarantees that all workmen's compensation payments, social security payments, withholding tax payments and any other payment due the state or federal government will be discharged prior to the closing of the transaction. Of course, the nature of the transaction would effect the liability of the purchaser. A sale of stock in an operation would certainly involve different liabilities from the sale of a small part of operating rights from a going concern. However, this is an issue which should be analyzed and reviewed prior to the drafting of the sale agreement and all liabilities in respect to this issue should be taken care of at or prior to the closing of the transaction.

Third, purchasers have occasionally incurred an unexpected liability in respect to pay for a holiday which may occur on the day before or on the effective date of a transaction. In one particular transaction involving both the sale of operating authority as well as equipment and the leasing of a terminal, the purchaser moved the new equipment to the shipper's loading yard the day before the effective date of the transaction; then he attempted to claim that the seller was liable for the holiday which occurred on the day of the effective date of the transaction. Several thousand dollars in vacation pay were involved. This is not an issue which will always be present in any negotiations for a sale but is something that practitioners should keep in mind during discussions on the transaction.

Fourth, if a purchaser takes over an operation and the employees involved, together with the collective bargaining agreement, it should be fully aware of any "barn" conditions or local working conditions which have attained the status of past practices or come under a "maintenance of standards" clause and which the union and employees expect the purchaser to live up to. Every "barn" or terminal has its unique practices in respect to dispatch and conditions of work. A purchaser should not go into such a situation with his eyes closed. In evaluating whether or not an operation will be profitable, it is important to keep in mind any conditions or practices which may be imposed on the employer which would result in higher costs of operation. Sometimes after analyzing such barn conditions and the next category we will discuss, the purchaser loses interest in a seemingly
profitable extension of his existing operation.

Fifth, if a buyer accepts the seller's collective bargaining agreement and employees, he should be prepared to accept any local agreements which might exist. Such local agreements are sometimes more dignified lists of barn conditions to which an employer is bound. Such local agreements may also take the form of a rider to the National Master Freight Agreement with local supplements or to another multi-employer, multi-union master collective bargaining agreement. Again, without being apprised of the greater costs and obligations that such local agreements pose, a purchaser may not fully realize the restriction under which he may operate and the resulting increased costs on his balance sheet.

Sixth, one of the most commonly present liabilities are delinquencies on the part of the seller to the union's welfare fund and to the union's pension fund. Often a seller is selling because he has a cash flow problem. Accordingly, it is a strong temptation not to make up-to-date payments to the funds once a sale is in sight. Again, whether the purchaser has an obligation to pay into the welfare and pension funds for delinquencies of the seller depends in large upon the nature of the transaction and the labor agreements to which the parties are bound. It would be naive to assume in any given situation, without further investigating the issue, that the buyer will definitely not be stuck with any liability by a grievance award or a Labor Board decision in respect to such payments.

**EMPLOYEE SUITS**

Among the miscellaneous pitfalls faced today by parties to a sales transaction is the specter of an employee's suit against either the seller or buyer. With the dawn of consumerism and the class action lawsuit, more and more direct suits are brought by employees against employers based on everything from age discrimination, to Title VII violations, to violations of the labor laws. Several transactions recently in the trucking field have fostered such suits. Accordingly, at this point we will review in depth the legal basis for such suits, and defenses available.

It is apparent from the discussions in this paper that either a seller or a purchaser may in some circumstances face liability if a suit is brought by the union under Section 301 of the Labor Management Relations Act. Certainly, it can safely be said that either the seller or the purchaser faces the possibility of such a suit, whether meritorious or not. By the same token, under certain circumstances either
the seller or the purchaser can face a suit brought directly by a group of employees or former employees under Section 301. Generally, such suits are barred unless the individual employees have first exhausted their remedies under the collective bargaining agreement and if the union is named also, under intra-union procedures. This rule was set forth by the United States Supreme Court in the Republic Steel case in which the Court stated:

As a general rule in cases to which Federal law applies, federal labor policy requires that individual employees wishing to assert contract grievances must attempt use of the contract grievance procedure agreed upon by employer and union as the mode of redress. If the union refuses to press or only perfunctorily presses the individual's claim, differences may arise as to the forms of redress then available. See Humphrey v. Moore, 375 U.S. 335, 84 S.Ct. 363, 11 L.Ed. 2d 370; National Labor Relations Board v. Miranda Fuel Co., 2 Cir., 326 F.2d 172.

However, the Supreme Court has also ruled that where a union breaches its duty of fair representation towards employees, they may bring an action under Section 301 of the Labor Management Relations Act against the employer for breach of a collective bargaining agreement. Such actions are quite common today and are brought through private counsel independent of the union. Generally, if the employees do not attempt to pursue the grievance procedure, the Court will rule against them at the summary judgment state of the proceedings based upon the principles set forth in Republic Steel Corp. and Vaca v. Sipes.

In order for the employee to have a right to bring the suit independent of the union under Section 301, as stated above, breach of the duty to fairly represent on behalf of the union must be alleged and proven. Generally the courts insist upon malice or bad faith being involved in such a breach by the union. Similarly, if the union is also named as a party defendant in the suit, exhaustion of intra-union grievance procedures is generally a condition precedent to a suit against the union. However, where attempts to exhaust intra-union procedures would be fruitless, the employees need not pursue those remedies before instituting direct court action against the union and

the employer.\textsuperscript{40} If the employee seniority question involved in the transaction is resolved by agreement with the union and the union agreement is in good faith and is without malice, the courts generally will hold that such agreement does not violate the union's duty of fair representation or cause an action to arise against the employer under Section 301 of the Act. A 1964 Supreme Court decision upheld such an agreement to dovetail seniority lists of two merging companies.\textsuperscript{41}

The Labor Board in one dovetailing seniority case in the motor carrier field held that a clause providing for dovetailing of seniority upon merger of two companies within a multi-employer unit was not a per se breach of the duty of fair representation even though the multi-employer agreement was not to be applied in a merger not involving companies outside of the multi-employer unit. The Labor Board ruled the interest of transferability of seniority within the multi-employer unit was of sufficient importance to support the application of the clause. However, although there was not a per se breach of the duty, actual and unlawful motivation in the application of the clause was proven in the case.\textsuperscript{42} In a Third Circuit Court of Appeals dovetailing case, \textit{Price v. Teamsters},\textsuperscript{43} the Court found no breach of fair representation in a situation where the union negotiated an agreement for dovetailing of seniority at a new facility to which certain employees were transferred. Such a finding was made even though the union had previously told employees that they would have to transfer to the new terminal at the bottom of the seniority list, and some employees had transferred pursuant to that advice. In fact, in \textit{Price} the Court again ruled that the existence of a contract clause which might be interpreted as prohibiting dovetailing did not prevent the union from agreeing to dovetail.

Although most courts have agreed that mere negligence on the part of the union is such a situation does not establish a breach of the duty of fair representation,\textsuperscript{44} at least one of these same Circuit Courts has

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\item \textsuperscript{40} \textit{Petersen v. Rath Packing Co.}, 461 F.2d 312, 80 LRRM 2833 (Ca 3). \textit{Vaca v. Sipes}, supra, also provides that where the union has breached its duty of fair representation and the employer has breached its contract, it is the duty of the court to fashion appropriate remedies in regard to the union and employer. Those appropriate remedies are obtained by apportioning the amount of damages to the extent that each party was responsible for such damages, according to the decision in \textit{Vaca}.
\item \textsuperscript{41} \textit{Humphrey v. Moore}, 375 U.S. 335, 55 LRRM 2031 (1964).
\item \textsuperscript{42} \textit{Teamsters, Local 17 (Colorado Transfer & Storage, Inc.)}, 198 NLRB No. 42, 80 LRRM 1682 (1972).
\item \textsuperscript{43} \textit{Price v. Teamsters}, 457 F.2d 605, 79 LRRM 2865 (CA 3, 1972).
\item \textsuperscript{44} \textit{Walden v. Teamsters, Local 71}, 468 F.2d 196, 81 LRRM 2608 (CA 4, 1972).
\end{itemize}
come very close to recognizing negligence as a breach of the duty of fair representation.\textsuperscript{46}

Generally, however, both the courts and the Labor Board require that the employees must demonstrate arbitrary, bad faith, fraudulent or discriminatory conduct on the part of the union to sustain that the union has breached its duty of fair representation, thereby allowing an action against both the union and the employer.\textsuperscript{46} Although in one case where the court found that the union was taking a realistic and prudent position by remaining neutral in its dispute between some of its members and the employer\textsuperscript{47} and in another where the court found that the union membership itself was sharply divided over the handling of grievances, that no breach of the duty of fair representation took place,\textsuperscript{48} the Labor Board in another case found that where a union established its intent only to represent a part of the unit, employees violated the provisions of the National Labor Relations Act.\textsuperscript{48}

The observation one may draw from an analysis of the cases involving action by the employees directly against the employer or the employer and the union under Section 301 is that such suits are very frequent although rarely successful. However, the practitioner should keep in mind that such suits are a possibility, and any indemnification clause should be broad enough to cover any liability and legal fees resulting from such an action. If union agreement can be obtained on such subjects as retention or placement of the employees of the predecessor, the risk of considerable liabilities as a result of lawsuits by the seller's employees can be minimized.

Any discussion of miscellaneous liabilities which may exist in a sale of operating rights, an operation or a business must also include a reference to a section of the National Master Freight Agreement which was referred to above. That is ARTICLE 5. Section 3.(5). That is the provision that sets forth that where only temporary authority is granted, the company which is to survive will assume the obligations of both collective bargaining agreements during the period of temporary authority. If both the seller and the purchaser are signatories to the National Master Freight Agreement, or if only one party

\textsuperscript{46} Griffin v. Automobile Workers, 469 F.2d 181, 81 LRRM 2485 (CA 4, 1972).
\textsuperscript{47} Morris v. Werner-Continental, Inc., 78 LRRM 2654 (DC Ohio, 1971).
\textsuperscript{48} Dean v. Roadway Express, Inc., 78 LRRM 2160 (DC NC, 1971).
\textsuperscript{49} Teamsters Local 671 (Airborne Freight Corp.), 199 NLRB No. 167, 81 LRRM 1454 (1972).
The National Labor Relations Board has consistently held that if an employer operates two or more plants or operations, the employer must bargain with respect to any decision to close one of these operations or to sell a part of the business. In nine out of ten sales, none of them may ever arise. However, when one of these problems does arise and that problem has not been anticipated, a promising acquisition or purchase may become an expensive nightmare. Careful analysis and investigation into possible liabilities or possible labor related pitfalls is essential for full protection of the client involved in the purchase. This is especially true when the seller may have taken his money and disappeared or may have sunk deeper into a judgment proof condition.

SPECIAL PROBLEMS OF A SELLER—THE DUTY TO BARGAIN UNDER THE LABOR MANAGEMENT RELATIONS ACT

Whether or not a duty exists to bargain with the union over a sale of operating rights or an operation or a business depends on the nature of the transaction. If the transaction is the sale of an employing enterprise, the decision to sell is a managerial decision over which the employer does not have to bargain with the union. In such a case, however, the employer must bargain with the union over the effects of the sale on the employees. In other words, no pre-sale bargaining of the decision is necessary, but once the sale decision in respect to the sale is made, the employer has the duty to discuss and bargain over the effect of such sale on his employees.

The above principle applies only to transactions where an entire enterprise is sold. The National Labor Relations Board has fairly consistently held that if an employer operates two or more plants or operations, the employer must bargain with respect to any decision to close one of these operations or to sell a part of the business. In one case, however, the NLRB found that the sale of one operation was in effect the sale of an independent business, even though partly related to the business the employer retained. Justifying its decision, the NLRB stated that the employer's decision to divest itself of one

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operation was a basic management decision entailing a substantial withdrawal of investment capital. At least one Court of Appeals, also, has ruled that an employer is not required to bargain with the union over a decision to merge with another employer. Such a decision to merge is managerial by nature and is the heart of entrepreneurial control. While such a transaction might involve job security, such an effect cannot be avoided and can be bargained about later. The Court acknowledged that merger negotiations require secrecy, flexibility, and timeliness.

Accordingly, any transaction involving sale of rights or an operation must be fully evaluated to determine whether or not it is of such a nature that a duty arises to bargain with the union over the decision to sell. Even if there is no duty to bargain over the decision, which would entail notification at the commencement of negotiations over the sale, the obligation will exist in most cases to bargain over the effect of the sale on the employees. The exception to this would appear to be where the employees were assumed by the successor along with the collective bargaining agreement and all terms and conditions of employment. Therefore, the sale would have little if no impact on the employees. It is important, however, for the seller's counsel to plan this aspect of the transaction very carefully. In at least one case, the National Labor Relations Board ordered a remedy of full back pay for the employees involved until a genuine impasse was reached in negotiations. This could be a very costly result.

**DUTY IMPOSED BY A COLLECTIVE BARGAINING AGREEMENT**

As referred to above, the National Master Freight Agreement, and by the same token many independent agreements, contain a notification provision and an assumption of contract provision operating on the seller. The typical notice requirement usually provides that the selling employer shall give notice of the existence of the labor agreement to any purchaser. It is also provided that such notice shall be in writing with a copy to the local union. More important, the National Master Freight Agreement imposes an obligation on the employer in respect to requiring assumption of the labor agreement. In an apparent and intelligent recognition by the Teamsters Interna-

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52. Kingwood Mining Co., 210 NLRB No. 139, 86 LRRM 1203 (1974).
tional that a successor clause in a collective bargaining agreement of a seller will not automatically make the purchaser a successor, the Master Freight Agreement provides that in the event the selling employer fails to require the purchaser to assume the obligations of the collective bargaining agreement (one can assume due to the seniority clause that this includes the employees and the committee-type grievance procedure), the employer shall be liable to the local union and to the employees for all damages sustained thereby. Keeping in mind that the Howard Johnson decision reestablished the obligation of the seller to arbitrate disputes under this contract even after the sale is completed and he is no longer the owner of the operation, the above referred-to provision could be a very important provision. If an obligation to submit grievances through the grievance machinery continues to exist, the employer may have the clause strictly enforced and face innumerable liabilities as a result of such application. Although there may be a serious question whether the clause is enforceable due to the fact that it requires imposition of the union security provisions in the collective bargaining agreement as well as the economic conditions, it still remains a dangerous provision to an unwary seller.

INJUNCTIVE ENFORCEMENT OF THE SUCCESSOR CLAUSE ON THE SELLER

Even prior to the Howard Johnson decision, unions had filed actions in Federal Court asking that the seller be restrained from completing a sale without including a clause in the sales agreement which would bind the purchaser to the collective bargaining agreement. In one such case, Meat Cutters, Local 590 v. National Tea Co., the District Court left the question of inclusion of the clause in the sales agreement to an arbitrator but granted the injunction against (1) terminating or laying off any of the company's employees pending the arbitration and (2) consummating a sale prior to the arbitration award without including a clause binding a purchaser to the collective bargaining agreement. The decision in Howard Johnson has left the door open to additional decisions along this line. In a footnote in that case, Justice Marshall wrote the following:

The Union apparently did not explore another remedy which might have been available to it prior to the sale, i.e., moving to

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enjoin the sale to Howard Johnson on the ground that this was a breach by the Grissoms of the successorship clauses in the collective-bargaining agreement. (Citations omitted).

In addition, as pointed out above, a seller might well face suits by individual employees alleging both a violation of the collective bargaining agreement and a failure of the union to discharge its duty to fairly represent the employees.

**SECTION 5(2) AND PROTECTIVE CONDITIONS**

This article is not intended to discuss fully the background and history of the Interstate Commerce Commission's rulings on Section 5(2) and protective labor conditions. That subject has been dealt with exhaustively in other articles in other years. We will deal with the subject briefly, however, as it effects the drafting of the application to be submitted to the Commission.

Although the motor carrier industry does not come under a specific provision imposing a definite mandate for the protection of interests of affected employees, such as is applicable to railroad mergers or acquisitions, the Commission is required to give weight to "the interest of the carrier employees affected" in any transaction under §5(2).

As a result, the Commission has attempted to determine in transactions under §5(2) whether the carrier's employees would be adversely affected by the proposed action. In so doing, the Commission frequently refers to and relies upon the representations made in the §5 application regarding the anticipated effect of the transaction upon carrier employees. Such statements are part of the record and have been accepted as evidence by the Commission and the courts. Accordingly, care must be exercised in drafting that part of the application.

56. See for example a paper presented by John A. Vuono, Esq., at the Continuing Legal Education Seminar sponsored by the Motor Carrier Lawyers Association and University of Denver College of Law, Employee Interests and Labor, August 18-22, 1969.


The Commission will generally impose protective labor conditions only if the employees are represented before the Commission and specifically request such relief.\textsuperscript{61}

However, where such relief is requested the Commission may either retain jurisdiction to evaluate the impact of the transaction on the carriers’ employees at a later date, or may impose conditions on the transfer, such as severance pay to affected employees.\textsuperscript{62}

Such protective conditions have been applied to both the seller and purchaser. Therefore, once again the draftsman of the sales contract must make allowance for this and provide either for indemnification or an escape clause in case this renders the transaction undesirable. This is further complicated, however, by the fact that the Commission will not impose such protective conditions during a period of operations under temporary authority. In one case, however, where the vendee refused to consummate a transaction that contained a reservation of jurisdiction and the only employees who could be adversely affected were the vendors, the Commission limited the condition to the vendor and its employees.\textsuperscript{63}

\textbf{CONCLUSION}

The labor-related problems connected with a Section 5 transaction, or any such transaction, have become increasingly complex. As this complexity grows, so do the demands on the draftsman of the written instrument upon which the transaction is based. In respect to the first draft of the instrument, the draftsman should attempt to protect his client from all possible exposure. As negotiations for the sale proceed, and depending upon the bargaining power and “leverage” of each party, certain protections may be bargained away. Such deletions in the original clauses can only take place, however, after the risks are reviewed and the client fully advised of his possible exposure. At that point he must weigh how hard to insist upon inclusion of the suggested provision protecting him and weigh the prospects of the benefits of closing the transaction against any possible exposure which

\textsuperscript{61} Bi-State Development Agency—Purchase—Vandalia Bus Line, 93 M.C.C. 579, 593 (1964).


\textsuperscript{63} Hudson Bus Lines, Inc.—Purchase—Boston & Maine Transportation Co., 58 M.C.C. 133 (1951).
may occur. Again, the nature of the transaction may greatly affect the labor relations liabilities which flow therefrom. Accordingly, advantages of, for example, a stock purchase or purchase of total assets must be considered in light of the various court and administrative body decisions set forth above, and the advantages weighed against possible disadvantages and liabilities. To achieve this, the draftsman and the "closer" of any transaction should be fully knowledgeable in all aspects of the possible labor-related problems which may arise.
APPENDIX I
NATIONAL MASTER FREIGHT AGREEMENT

ARTICLE 1.

Parties to the Agreement

Section 1. Employers Covered

The Employer consists of Associations, members of Associations who have given their authorization to the Associations to represent them in the negotiation and/or execution of this Agreement and Supplemental Agreements, and individual Employers who become signatory to this Agreement and Supplemental Agreements as hereinafter set forth. The signatory Associations enter into this Agreement and Supplemental Agreements as hereinafter set forth. The signatory Associations enter into this Agreement and Supplemental Agreements on behalf of their members under and as limited by their authorizations.

Section 2. Unions Covered

The union consists of any Local Union which may become a party to this Agreement and any Supplemental Agreement as hereinafter set forth. Such Local Unions are hereinafter designated as “Local Union.” In addition to such Local Unions, the Teamsters National Freight Industry Negotiating Committee of the International Brotherhood of Teamsters, hereinafter referred to as the “National Union Committee,” is also a party to this Agreement and the agreements supplemental hereto.

Section 3. Transfer of Company Title or Interest

This Agreement and the Supplemental Agreements hereto, hereinafter referred to collectively as “Agreement,” shall be binding upon the parties hereto, their successors, administrators, executors and assigns. In the event an entire operation, or rights only, are sold, leased, transferred to taken over by sale, transfer, lease, assign-
ment, receivership or bankruptcy proceedings, such operation or use of such rights shall continue to be subject to the terms and conditions of this Agreement for the life thereof.

On the sale, transfer or lease of an individual run or runs, or rights only, the specific provisions of this Agreement, excluding riders or other conditions, shall prevail. It is understood by this Section that the parties hereto shall not use any leasing device to a third party to evade this Agreement. In the event the Employer fails to require the purchaser, transferee, or lessee to assume the obligations of this Agreement, the Employer (including partners thereof) shall be liable to the Local Union and to the employees covered for all damages sustained as a result of such failure to require assumption of the terms of this Agreement, but shall not be liable after the purchaser, the transferee or lessee has agreed to assume the obligations of this Agreement.

When a signator to this Agreement purchases rights from another signator, the purchaser must accept the affected employees of the seller, in accordance with the provisions of Article 5, Section 3 before hiring any new employees. The applicable lay-off provisions of this Agreement shall apply. When rights are sold to a non-signator to this Agreement, and such purchaser is the sole bidder, the provisions of this Agreement shall not apply. However, in the event of multiple bids, one or more of such bidders being signator to this Agreement, and the seller elects to sell to a non-signator, then all of the provisions of Article 1, Section 3, shall apply.

The Employer shall give notice of the existence of this Agreement to any purchaser, transferee, lessee, assignee, etc., of the operation covered by this Agreement or any part thereof, including rights only. Such notice shall be in writing with a copy to the Local Union, at the time the seller, transferor, or lessor executes a contract or transaction as herein described. The Local Union shall also be advised of the exact nature of the transaction, not including financial details.
ARTICLE 5.

Section 1. Seniority Rights

Seniority rights for employees shall prevail under this Agreement and all Agreements supplemental hereto. Seniority shall be broken by discharge, voluntary quit, more than a three (3) year layoff, or for such greater period than three (3) years as a change of operations committee may direct during the third year as provided in Article 8, Section 6 herein, or as provided in any applicable provisions of the Supplemental Agreements. The extent to which seniority shall be applied and accrued as well as the methods and procedures of such application shall be clearly set forth in each of the Supplemental Agreements.

Section 2.

The Employer shall not require, as a condition of continued employment, that an employee purchase truck, tractor and/or tractor and trailer or other vehicular equipment, or that any employee purchase or assume any proprietary interest or other obligation in the business.

Section 3. (a) In the event that the Employer absorbs the business of another private, contract or common carrier, or is a party to a merger of lines, the seniority of the employees absorbed or affected thereby shall be determined by mutual agreement between the Employer and the Unions involved.

In the application of this provision, the following general rules shall apply when operations or terminals are merged, subject however to the provisions of Section 7 of this Article:

1. The active seniority roster (excluding those employees on letter of layoff) of employees involved in the merger of terminals or operations are to be "dovetailed" by appropriate classification (i.e., road, city,) in the order of the last date of Company employment in such classification. In addition, the inactive seniority rosters (employees who are on letter of layoff) shall be similarly "dovetailed" by appropriate classification. The active merged
seniority roster shall be utilized first to provide employment at the merged terminal or operation. If and when additional employees are required at the merged facility, they shall be recalled from the merged inactive roster and after recall such employees shall be "dovetailed" into the active roster with full seniority. Seniority rosters previously combining job classifications shall be continued unless agreed otherwise.

In the application of this rule, it is immaterial whether the transaction is called a merger, purchase, acquisition, sale, etc. It is also immaterial whether the transaction involves merely the purchase of stock of one corporation by another, with two separate corporations continuing in existence, and it is immaterial whether separate terminals of the Companies are physically merged or not, subject, however, to rules 2, 3, and or operation.

(2) If the transaction involved constitutes merely a purchase of permits or rights only by one carrier from another carrier, without the purchase or acquisition of equipment or terminals, the employees of the company selling the permits shall have the right to follow their jobs with dovetail seniority as provided herein.

(3) If the merger, purchase, acquisition, sale, etc. involves two Companies which do not have parallel operating rights then separate seniority lists will be maintained for the separate non-parallel operations. However, there will be one master seniority list for the purpose of fringe benefits, etc., and for the protection of employees laid off on one seniority board when work opportunities are available on the other seniority board and all eligible employees on such other seniority board are employed.
(4) Where the transaction involves both parallel and non-parallel rights then rule 1 above will apply to the parallel rights, and rule 3 will apply to non-parallel rights.

(5) Where only temporary authority is granted in connection with any of the transactions described above, then separate seniority lists shall continue only when terminals or operations are not merged, unless otherwise agreed. The Company which is to survive will assume the obligations of both collective bargaining agreements during the period of the temporary authority.

(6) If in connection with the transactions described in these rules the successor Company determines to discontinue the use of a Local Cartage Company, the employees of that Local Cartage Company who have worked exclusively on the pick-up and delivery service which is retained by the successor Company shall be given opportunity to continue to perform such service as an employee of such successor Company, and shall have their seniority "dovetailed" as described in the above rules.

(7) Area and/or State Committees created pursuant to Local Supplements which have previously established rules of seniority, not contrary to the provisions of such Supplements, and approved by the Joint Area Committee, may continue to apply such rules if such rules are reduced to writing.

(b) If the minimum wage, hour and working conditions in the company absorbed differ from those minimums set forth in this Agreement and Supplements thereto, the higher of the two shall remain in effect for the men so absorbed.

Section 4. The Union reserves the right to cut the road seniority board when the average weekly earnings fall to $200.00 or less. This is not to be construed as imposing a limitation on earnings. After the Union notifies the Employer verbally to cut the board and the Employer refuses to do
so, the Union shall immediately submit its request again in writing to the Employer. If the Employer still refuses to cut the board after receiving the written request, then his refusal to do so shall be considered a grievance to be handled in accordance with the grievance procedure set forth in this Agreement. After the Joint State Committee or the Joint Area Committee renders a decision favorable to the Union, if the Employer still refuses to cut the board then in such case the Union shall have the right to strike notwithstanding any provisions in this Agreement to the contrary, and the Employer shall be obligated to pay all employees under this Agreement for all time lost.

In determining whether average weekly earnings will fall to $200.00 or less, only the earnings of the lower twenty-five per cent (25%) of the drivers on the seniority board, counting from the bottom up, shall be considered. The average shall be calculated for the thirty (30) day period preceding the Union's original request. After such calculation is made, the average earnings of the drivers for the seniority board must also average the top seventy-five per cent (75%) of more than $200.00 per week, or layoff shall be made in accordance with seniority. The above provisions shall also apply to extra board for sleeper drivers exclusively.

Section 5.  (a)  

New Branches, etc.  

(1)  Opening of new branches, terminals, divisions or operations.

When a new branch, terminal, division or operation is opened (except as a replacement for existing operations or as a new division in a locality where there are existing operations), the Employer shall offer the opportunity to transfer to regular positions in the new branch, terminal, division, or operation in the order of their company or classification seniority, to employees in those branches, terminals, divisions or operations which are affected in whole or in part by the opening of the new branch, terminal, division or operation.

This provision is not intended to cover situations where there is replacement of an existing operation or where a new division is
opened in a locality where there is an existing terminal. In these latter situations laid-off or extra employees in the existing facilities shall have first opportunity for employment at the new operation in accordance with their seniority. If all regular full-time positions are not filled in this manner, then the provisions of the above paragraph shall apply.

(2) Any employee redomiciled by an approved change of operations or voluntary transfer to another point shall upon reporting to his new domicile be deemed to have relinquished his right to return, with seniority, to the domicile from which he was transferred, except under another approved change of operations. Employees who avail themselves of the transfer privileges because they are on layoff at their original terminal may exercise their seniority rights if work becomes available at the original terminal during the three year layoff period allowed them at their original terminal.

(b) Closing of branches, terminals, divisions or operations.

(1) When a branch, terminal, division or operation is closed and the work of the branch, terminal, division or operation is eliminated, an employee who was formerly employed at another branch, terminal, division or operation shall have the right to transfer back to such former branch, terminal, division or operation and exercise his seniority based on the date of hire at the branch, terminal, division or operation into which he is transferring provided he has not been away from such original terminal for more than three years.

(2) When a branch, terminal, division or operation is closed or partially closed and the work of the branch, terminal, division or operation is transferred to another branch, terminal, division or operation in whole or in part, employees at the closed or partially closed down branch, terminal, division or operation shall
have the right to transfer to the branch, terminal, division or operation into which the work was transferred prior to the recall of laid off employees at that location. Such employees transferring as a result of an approved change of operations, shall be dovetailed with their full classification seniority (city or road) into the active seniority roster at the point of redomicile, excluding those employees on letter of layoff. If and when additional employees are required at the point of redomicile, employees on layoff status at that location shall be recalled. When recalled, such laid off employees shall be dovetailed with their full seniority.

(c) When a branch, terminal, division or operation is closed and the work of the branch, terminal, division or operation is eliminated, employees who are laid off thereby shall be given first opportunity for available regular employment at any other branch, terminal, division or operation of the Employer within the Area of the Supplemental Agreement under which employed. The obligation to offer such employment shall continue for a period of three years from the date of closing. However, the Employer shall not be required to make more than one offer during this period. Any employee accepting such offer shall pay his own moving expenses. If hired, he shall go to the bottom of the seniority board but shall have company seniority for fringe benefits only.

(d) In all transfers referred to in Section 5(a), (b) and (c) above the employee must be qualified to perform the job by experience in the classification. If a driver test is required, such test shall be given by a qualified driver-supervisor or driver.

Section 6. The Union shall be entitled to a seniority list each six months upon request. The Employer shall post a seniority list at least once every twelve (12) months. Employees shall make written complaint to the Company and Union within 30 days after such posting. Any such complaint not settled between the Company and Union shall be submitted to the grievance procedure.
Section 7.

The parties acknowledge that the above rules are intended solely as general standards and further that many factual situations are presented to Committees which necessitate modification or amendment. Accordingly, the Employers and Unions acknowledge that questions of accrual, interpretation or application of seniority rights may arise which require different treatment and it is understood that the Employers and Unions jointly involved, and/or the respective grievance committees may mutually agree to such disposition of questions of seniority which in their judgment is appropriate under the circumstances. The Change of Operations Committee provided in the National Master Freight Agreement or the Supplemental Agreements shall have the authority to determine the establishment and application of seniority in those situations presented to them. In all cases the seniority decisions of the Joint Committees, including the Change of Operations Committees and Subcommittees established by the National Master Freight Agreement and the respective Supplemental Agreements shall be final and binding.
INTERSTATE DOCUMENTS OF TITLE: THE NECESSITY FOR MODERNIZATION

By
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In the contemporary business environment, organizational survival depends in part upon alert adoption of any innovation which will either improve profits or reduce expenses. Virtually, every segment of the private sector endeavors to discover and implement technological innovations that conceivably alter cost-sales ratios. However, as modern business practices become increasingly more complex almost daily, a pursuit of judicial and legal practices indicates that courts and laws have failed to develop concurrently with rapidly changing commercial activities. But, this is not to suggest that constant change of laws constitutes a societal goal to accommodate the business sector. Modification of statutes to coincide with technological change could doubtlessly prove to be polemical to society.

Numerous examples could be employed to demonstrate how laws have a propensity to change over time to accommodate comprehensive adoption of technological innovation. These observations, however, do not embrace current legal pronouncements pertaining to interstate movements of merchandise. This is to say, fast, and more dependable modes of transportation have evolved which subsequently has enabled firms to develop viable marketing strategies emphasizing customer service, inventory control, procurement, and traffic. Transportation progress has resulted in an ability to ship merchandise to distant points in a firm's channel of distribution and have the consignment arrive well in advance of normal mail service. A substantial amount of goods in transit, moreover, fall within the jurisdictional purview of federal law because of their interstate commerce dimension. But, legal recognition of modern means of transportation exists only for shipments moving in intrastate commerce.

General adoption of the Uniform Commercial Code (forty-nine of fifty states) has definitely modernized intrastate commerce laws. Although this modernization process required a time-span of almost twenty-five years to become fully effective, a similar movement at the

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federal level has not occurred. In fact, interstate commerce is still governed by legislation such as: The Uniform Bills of Lading Act of 1909; the Uniform Warehouse Receipts Act of 1906; and the Federal Bills of Lading Act of 1916.

In a recent issue of a major legal journal,1 an illustration was preferred regarding how the Uniform Commercial Code could be constructed to apply to cases involving interstate commerce in those circumstances where a discontinuity exists in normally appropriate law. In essence, the illustration depicted how federal law could be interpreted to permit the use of destination bills of lading in interstate commerce. Albeit businesses have employed complex legal techniques to circumvent the detrimental facets of antiquated legislation. A fundamental need exists to revise federal legislation and thereby eliminate the necessity of using tenuous legal routes to implement efficient technology in normal business transactions. This need, moreover, is manifest in the evolution of physical-logistics and marketing strategy.

The basic purpose of this paper is to establish a definitive need for modernizing federal legislation in certain select areas of interstate commerce. To accomplish this primary objective, the following subjects will be examined: (1) documents of title; (2) historical evolution of documents of title; (3) concept and need for the negotiability of documents of title; (4) risks associated with purchases of documents of title; (5) carrier liability; and (6) the need for modernization of restrictions of documents of title by business firms using high speed shipments of goods.

HISTORICAL EVOLUTION OF DOCUMENTS OF TITLE

The legal concept of title cannot be clearly attributed to any specific source. However, it appears that recognition of transfers of title can be said to have originated with Midieval "cash on the barrelhead sales". In those simple transactions, the time of passage of title was rather clear. Today, however, transactions are much more complex since sales execution has evolved from a face-to-face method to include modern facilitative elements such as deferred payment, deferred delivery, security agreements, and delivery by a third party as relatively common elements of negotiation. As business practices

developed more sophistication, a more complex and less rigid concept of title was required.²

Most of the problems surrounding title to merchandise result from the fact that title lacks both form and substance. That is to say, title is simply a concept which has been developed by attorneys and is located or placed wherever judges decide it should be. Indeed, when the legal system endeavors to adjudicate sale pyrotechnics by searching for all prevailing titles, numerous difficulties are encountered. For the most part, people do not care where title is located. They are only concerned that the law protects them, or that they have insurance against any damage or loss of goods. Sellers are concerned with title only when they must pay taxes or when confronted with a potential loss. Generally speaking, people become truly concerned with title only when they must pay taxes or when confronted with a potential loss. Realistically, people become truly concerned with title concepts only after a legal determination reveals that they have a problem which rests upon a decision as to who holds title to goods at the time of loss.

Early judicial decisions frequently neglected the intent of the parties even when provided with statements of intention by these parties involved.³ This practice was not universal, as some justices manipulated concepts of title to produce sensible results. But, the judiciary failed to provide generally reliable results in many cases arising from business transactions involving shipping goods from a buyer to a seller.⁴ Irrespective of any general stability, title of goods was a prime concept of the law of sales before the uniform commercial code. This is illustrated by the following statement from a precode textbook: “The approach of the prevailing sales doctrine is this: Unless cogent reason can be shown to the contrary, the location of title will govern every point which it can be made to govern. It will govern between the parties, risk, action for price, applicable law in an interstate transaction, . . .”⁵

Acting to alleviate this enigma in the law, drafters of the uniform commercial code found their attention on those important problems

surrounding title to merchandise. The purpose of Section 2-101 of the U.C.C. is: "To avoid making practical issues between practical men turn upon the location of an intangible something, the passing of which no man can prove by evidence and to substitute for such abstractions of proof of words and actions of a tangible character." 6

Widespread adoption of the U.C.C. reduced the contradictions and conflicts that existed prior to codification of the U.C.C. Hence, title no longer represents the primary tool for resolving sales controversies in states where the U.C.C. is in use. 7

The genesis of efforts to combine ownership of rights and of goods to a document of title dates back to antiquity. In early common law, courts were influenced by the needs of merchants and bankers and thus cooperated by recognizing certain documents which were used as collateral. Thus, the Bill of Lading evolved to become a symbolic representation of goods involved in a transfer from a seller to a buyer. The document represented goods in the sense that transfer fixed the transferee's rights against both the person making delivery and third parties. 8 Documents of title have been the principle subject of five uniform laws, notably: The Uniform Warehouse Receipts Act, 1906 (Hereafter UWRA); The Uniform Bill of Lading Act, 1909 (Hereafter UBLA); The Federal Bills of Lading Act, 1916 (Hereafter FBLA) which supercedes the Uniform Bill of Lading Act but for the most part is identical to it; and the Carriage of Goods by Sea Act, 1936 which covers ocean bills of lading for both export and import shipments.

DOCUMENTS OF TITLE

A document of title basically serves three functions: a receipt for goods which have been transferred to the issuer, a contract between the issuer and the depositor, and a document of title. As a receipt, it identifies the goods and functions as evidence against any possible denial by the issuer regarding receipt of goods.

With respect to contract features, the document of title may contain terms defining obligations of the parties. Other papers, of course, may contain some of the same information. Prior to the Uniform

8. A. R. Braucher, 4 UNIFORM COMMERCIAL CODE HANDBOOK, DOCUMENTS OF TITLE 6 (1968); 2 S. Williston, WILLISTON ON SALES 508 (revised 1948).
Commercial Code, commercial law recognized only bills of lading and warehouse receipts as documents of title. The code, however, has expanded the definition of documents title to include delivery orders, dock warrants, dock receipts, and other documents insofar as the "regular course" standard is met. But, a receipt becomes a document of title only if "in the regular course of business or financing," it is treated as adequately evidencing "that the person in possession of it is entitled to receive, hold, and dispose of the documents and the goods it covers" standard is met.

WAREHOUSE RECEIPTS

Under provisions of the Uniform Warehouse Receipts Act (UWRA) and the U.C.C., warehouse receipts may be issued by any warehouseman. Unless the issuer is involved in the business of storing goods "for hire," however, documents he issues do not fall within the accepted definition of a warehouse receipt, thus an individual cannot issue a warehouse receipt for his own goods. The UWRA and the U.C.C. stipulate essential terms for warehouse receipts which include: (1) location of the warehouse; (2) date of issue; (3) number of the warehouse receipt in some consecutive numbering system; (4) designation of the "obligee;" (5) rate or fees; (6) description of merchandise; (7) signature of the warehouseman or his newly appointed agent; (8) disclosure of any ownership of the goods on the part of the warehouseman; and (9) a statement of any liabilities for which a lien is claimed. Some slight although insignificant differences may exist between the UCC and the UWRA, particularly, in the enumeration of essential ingredients contained in a warehouse receipt.

BILLS OF LADING

The Code incompasses all bills of lading covered by the uniform bills of lading act or the federal bills of lading act; in addition to an express inclusion of air bills, air consignment notes, and airway bills. The UCC is more comprehensive in its coverage than either the UBLA or the FLBA in that common carrier; contract carriers, and freight forwarders are subject to provisions of the Code. Yet, the

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10. Uniform Warehouse Receipts Act § 1, § 58; Uniform Commercial Code § 7-401, § 7-102, comment.
UCC differs from the UBLA and the FBLA in another important area; namely, a unique set of provisions is contained in the Code which was created to govern through bills of lading, bills in the set, and permit distination bills of lading. Essential terms for a bill of lading are almost always identical to those for a warehouse receipt.

Common carriers are legally compelled to issue bills of lading and are required to have their bill of lading forms sanctioned by the Interstate Commerce Commission (hereafter, ICC). Furthermore, a common carrier is required to use only approved forms for all customer shippers without any discrimination. In fact, the ICC possesses a statutory authority to supervise and prescribe forms for common carriers subject to its jurisdiction. This authority has been employed by the Commission for many carriers. In most instances, forms filed by common carriers are used without discrimination in both inter and intrastate commerce; the net effects of the acts establishing bills of lading uniformity is to bind both shippers and carriers to some rights and duties, even though no bill of lading is in fact issued.

FREIGHT FORWARDER BILLS

Freight forwarders combine numerous less-than-car-load and less-than-truck-load shipments into full carload and full truck load shipments to benefit from less expensive volume breaks. Even though originating with railroads, freight forwarders have expanded into other modes of transportation. In order to resolve rate controversies, the Interstate Commerce Act was amended in 1942 to include Part IV. This amendment brought many freight forwarders under the jurisdiction of the ICC. One section of this statute requires freight forwarders regulated by the Commission to issue bills of lading, and rules governing the issuance of bills of lading are determined by that agency. In 1950, surface forwarders were required to comply with the FBLA by amendment to Part IV of that act which defines freight forwarder as “common carriers.”

MISCELLANEOUS DOCUMENTS TITLES

Most documents of title are either warehouse receipts or bills of

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13. 14 I.C.C. 346 (1908); 4 S. Williston, WILLISTON ON CONTRACTS 1073 (revised 1936).
lading, but the name of the document does not determine its true character. For example, a "dock warrant" may, or may not, be construed to be a warehouse receipt, depending upon the nature of the business of the issuer, not on the nature of the paper itself. Similarly, documents evidencing the receipt of goods for shipment are within the Uniform Commercial Code's definition of a bill of lading, event though a contract carrier is the issuer. Caution should be exercised with respect to "way bills," because these instruments appear to be restricted to instructions or operating procedures passed on from one carrier to a connecting carrier and are not usually considered documents of title.16

UNIFORM COMMERCIAL CODE - DOCUMENTS

The Code provides for "through bills of lading," while the FBLA does not. Also, the UCC creates a novel bill of lading designed to facilitate commerce which is designated "a destination bill of lading;" but the FBLA neither specifically permits, nor prohibits this form of a bill of lading.17 While the FBLA prohibits bills of lading from being issued in sets, except to Alaska, the UCC progresses one step further and prohibits bills in a set for either negotiable or non-negotiable bills of lading.18 All export bills of lading are governed by federal law, in this case, the FBLA, because of the Commerce Clause of the Constitution. It is exactly this type of modernization that is needed in federal laws governing interstate commerce. Recognition of the exigencies restricting efficient commerce resulted in modernization of state laws. The passage of time, moreover, has compounded the need for updating federal legislation under which economic activity is regulated.

NEGOTIATION

There are several important differences between documents of title which are negotiable and those which are non-negotiable. The primary distinction, however, is that negotiable instruments are more definite symbols of the goods they represent since the carrier or bailee is under a duty to surrender the document upon delivery of those

17. Uniform Commercial Code, § 7-305.
On the other hand, non-negotiable documents need not be surrendered on delivery, and in fact, goods may be delivered on a detached written authority.

The Uniform Commercial Code eliminates the possibility of confusing a negotiable and non-negotiable document by requiring that all negotiable documents by printed on white paper and all non-negotiable documents be printed on yellow paper. Both the UCC and the FBLA determine negotiation by the term of the document: thus, negotiable documents are deliverable to either the bearer or to the order of a named person. This in effect, makes documents of title similar to other commercial paper in that they frequently are negotiable instruments. In summary, documents of title are distinguished from commercial paper in that the former represent goods and the latter represent money.

CONCEPT OF DUE NEGOTIATION

Transactions do not necessarily terminate with the passage of goods from a seller to a buyer. A third party can gain title to goods by a subsequent sale. Documents of title are provided and provide a convenient instrument for the transfer of title and thereby they accommodate commerce. The document of title permits parties to deal with papers involved while leaving unchanged actual possession of the property in question. The purchaser of a negotiable document of title acquires a legally preferred position only in the event that the document was obtained through due negotiations. This basically means that the document must be in such condition that it can be negotiated either by delivery or by endorsement. “Delivery of the document will operate as a negotiation when no further endorsements are required to pass title.” The FBLA requires delivery of goods and endorsement of the person entitled to the goods through the document title but the UCC does not mention any holder in defining due negotiations. A second facet of due negotiation is that the purchaser must be a purchaser in good faith, which implies that the buyer must not have been given any notice of existence of a prior claim. Finally,

due negotiation cannot exist unless the transaction is customary in the trade. The uniform commercial code indicates that due negotiation will not exist where a person attempting to negotiate a document of title is outside of the trade or outside the regular course of business or financing. 23

RISK IN PURCHASING DOCUMENTS OF TITLE

The purchaser of a document of title is subject to risk that the goods may not be available when the document is surrendered to the holder. Or, the holder may be confronted with a risk that the goods are subject to a lien or a claim by a third person. Both the FBLA and the UCC depend upon the buyers classification to determine possibility of a loss. If he is a buyer in good faith, for value, and without notice of prior claims, his risk will be dependent on whether or not the instrument acquired in negotiable. His risk will also be dependent on whether or not a valid claim to due negotiation can be substantiated. 24

Additional risk may be faced if goods are tendered to a common carrier which may belong to someone else. Provisions contained in both the UCC and the FBLA stipulate the person "to whom documents have been duly negotiated acquires title to the goods and documents," a situation which is no better than title held by an individual who deposited the goods for transfer. This risk is the same for either a negotiable or non-negotiable document of title. 25

The practice of issuing bills of lading in sets is prohibited both by the FBLA and the UCC. The purpose of this proscription is to eliminate any risk of having sets separated so that apparently two or more negotiable documents are circulating for the same goods. In no way does this mean that substitute documents cannot be obtained in the event that the original document is lost or destroyed.

COMMON CARRIER OBLIGATIONS

Although common carriers have many legal obligations, this paper deals only with obligations concerning documents of title. It is significant to note that the issuer of a document of title, such as a bill of lading, is charged to "exercise the degree of care in relation to the

goods which a reasonably careful man would exercise under like circumstances."26 Failure to exercise reasonable care by a common carrier normally results in some form of loss or damage claim.

One of the important issues relative to obligations concerns failure to deliver goods tendered and accepted by a common carrier. A common carrier who creates a document of title is normally considered to be strictly liable for the delivery of the goods in his care. There are, however, seven circumstances in which the carrier is relieved of their liability in the event of nondelivery. The uniform commercial codes treat excuses for delivery failures in a comprehensive manner in lieu of fragmented treatment given under the BLA and the FBLA.27 Thus, a common carrier must deliver consigned goods unless one of the seven defenses can be established.28

A warehouseman is legally charged to exercise due care when storing property. This obligation, however, does not extend to an indefinite storage of goods. Provisions of the UWRA specify three conditions wherein goods stored in a public warehouse may be terminated: (1) when they are perishable; (2) when they will deteriorate in value; (3) because of owner, leakage, inflamability, or explosive nature of the goods and injury to other property is likely to be incurred.29

IMPACT OF TECHNOLOGY

Ascertaining appliable law in most cases involving documents of title poses little problem. But, some provisions of the UCC bear investigation. For example, the Code provides for a unique bill of lading designated a "destination bill of lading."30 which is specifically designed to facilitate rapid delivery of goods. No comparable form of a bill of lading exists in federal law. Traditionally, bills of lading have been issued by common carrier at the point of shipment. With modern means of transportation, merchandise frequently is able to reach its destination well ahead of the bill of lading, particularly if the bill of lading is mailed to the buyer.

Often, sellers of goods desire cash payment on delivery, in this situation, the shipment may be sent C.O.D. or a draft may be drawn on the buyer and transmitted to a collection agent along with a nego-

28. Uniform Commercial Code § 7-403, comments (1) & (2).
29. Uniform Warehouse Receipts Act § 34.
30. Uniform Commercial Code § 7-305.
tiable bill of lading. When the seller desires to conduct business by a draft, it is then the goods are apt to be delayed while waiting on arrival of the bill of lading. In an attempt to eliminate this possible delay, drafters of the UCC designed, or perhaps invented, destination bills of lading. This form of innovation or modification is advocated for federal legislation.

The UCC innovation, destination bill of lading, permitted a carrier to issue a destination bill of lading at the request of the seller, or “to any person entitled to the goods under an already issued bill of lading.”31 (in the latter case, the outstanding bill of lading would be removed from circulation and the destination bill issued in its place). The carrier could then issue a receipt to the seller of goods which would contain the carriers promise to issue the bill of lading to the buyer of the goods at the point of eventual delivery. In turn, the carrier notified his agent at destination, usually by wire, to issue an appropriate bill of lading to the sellers agent. Meanwhile, the seller notified his agent, commonly a bank, to draw a draft on the buyer. By employing this process, the transaction could be completed promptly to the advantage of all parties concerned. It is important to recognize that this form of bill of lading is unique to the UCC and Intrastate Commerce. Federal legislation, FBLA, governing Interstate Commerce fails to provide for his form.

Another significant provision of the UCC is the acceptance of the “through bill of lading.”32 The Carmack amendment to the Interstate Commerce Act requires common carrier to “issue a receipt of bill of lading,” and the initial carrier is responsible for damage caused by it or caused by a connecting carrier “when transported on a through bill of lading.”33

CONCLUSIONS

Unequivocally, the uniform acts were sincere attempts to modernize law regarding contemporary business functions. One element of commercial law, documents of title, directly affects wide segments of business practices. But, a substantial amount of commodity consignments occur in interstate commerce where little, or no effort toward modernization has taken place. This lack of modification will continue to exacerbate business practices given spatial relationships in

31. Supra note 22 at 720.
33. Supra note 9 at 839.
the private sector.

Most states have enacted the UCC which continues a significant advancement toward modernizing commercial law. However, no comparable action has occurred at the federal level. In this regard, Eli Goldston and Paul J. McKenzie observed: “Commercial law will become realistic, flexible, and modern only if the bar and bench become so, too.”

Business firms that have adopted the “systems concept” of business, together with market strategy that require high levels of customer service, are compelled to conduct their operations in such a manner to avoid litigation; agree to circumvent troublesome areas of law, or discover means of evasion. A congruous modification in interstate federal law is needed inasmuch as more and more firms are adopting marketing strategies that require rapid transportation and high levels of customer service.

Congress is obviously myopic regarding the necessity for modernizing interstate law dealing with transportation and documents of title. There is a need at the federal level, moreover, for comprehensive restatements of prior commercial law. If there were no need to reconstruct the law in this important area, the UCC would not have received such widespread acceptance by almost all of the states.

CONTAINERS: THEIR DEFINITION AND IMPLICATIONS

by Eric Rath*

One of the largest single growth potentials for U. S. Carriers is in the area of export movement of agricultural commodities. During the period 1970 to date, the market opportunity for perishable movement has increased at least three times with only limited advantage accruing to the benefit of U. S. operators of refrigerated containers in terms of increased volumes and varieties of products handled.

This technical change was accomplished in the life of the nations faster in the mechanical and engineering sciences than in the corresponding legal structures. However, the stability of this now-uniform world system of organized distribution of goods depends on the existence of a uniform code method where the facilities used and required for this service are treated equally by all nations, all political entities, the courts, the administrations and the people.

First came international conventions under the auspices of the United Nations and the International Maritime Consultative Organization dealing with just two of the international elements, namely, technology of the equipment and customs regulation of the treatment of this equipment.

The rules of the container world deal with the dynamics of the public law basis of an international, uniform structure with specific inter-relationships between far-flung owners, shippers and governments. In nearly all nations of the world there are urgent needs for codification of public activities related to the container. In very advanced countries, such as the United States, France, Germany and Great Britain, the rules deal with standards of simplification methods for use of the containers within and between the countries.

I. DEFINITIONS

A. DEFINITIONS UNDER INTERNATIONAL CONVENTION

Private cooperative understanding by the ISO international agreement led to basic container rules of the United Nations. Together with the Inter-Governmental Maritime Consultative Organization (IMCO), two agreements (CCC and CSC) were promulgated in November, 1972. The first international container agreements were

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mostly in terms to emphasize practical technical configuration and safety requirements for the container. Two conventions called “Customs Convention on Containers” (1972) and the “International Convention of Safe Containers” (1972) dealt exclusively with the seven most technical questions which have hampered the further development of the international inter-modal transportation. The Customs Conventions (CCC) concentrates on four subjects:

(1) **Technology**—The term “container” shall mean an article of transport equipment (lift-van, movable tank or other similar structure) fully or partially enclosed to constitute a compartment intended for containing goods;

(2) **Transfer**—This term designates that the container is designed for ready handling, particularly when being transferred from one mode of transport to another;

(3) **Facilitation**—This would indicate the container is easy to either fill or empty;

(4) **Accessories**—The term “container” shall include the accessories and equipment appropriate for the use intended, provided that the accessories and equipment are carried with the container.

On the other hand, the Convention for Safe Containers stresses the following:

(1) **Security**—Designed to be secured and/or readily handled, having corner fittings for these purposes;

(2) **Size**—Of a size such that the area enclosed by the four outer bottom corners is either:
   a. At least 14 sq. meters (150 sq. ft.) or
   b. At least 7 sq. meters (75 sq. ft.) if it is fitted with top corner fittings;

(3) **Definition**—The term “container” includes neither vehicles nor packaging; however, containers when carried on chassis are included.

**B. DEFINITIONS UNDER U. S. MARITIME LAW**

The “container” box is defined in terms of its use. There have been hundreds of mutually exclusive suggestions of the definition of the container, but the one most used seems to be that of the United States Coast Guard which coincides with the UN/IMCO Conventions of 1972 (cited infra):
"Container means an article of transport equipment (lift-van, portable tank, or other similar structure including normal accessories and equipment when imported with the container), other than a vehicle or conventional packaging—

(1) Of a permanent character and accordingly strong enough to be suitable for repeated use;
(2) Specifically designed to facilitate the carriage of goods by one or more modes of transport, without intermediate reloading;
(3) Fitted with devices permitting its ready handling, particularly its transfer from one mode of transport to another;
(4) So designed as to be easy to fill and empty; and
(5) Having an internal volume of one cubic meter (35.3 cubic feet) or more.

The fact that the definition contains the words “other than a vehicle” is important and must be dealt with.

II. Containers as Vehicles

A. Dictionary

Containers are a relatively new and certainly unique unit of transport. Due to these characteristics, the means of regulating their use are not uniform or stable. The problem confronting lawmakers is this: should this new form of transportation be regulated by contorting existing laws, or is it so important that new regulations should be established to fit the peculiarities of the container.

The purpose of the following discussion is to present definitions of “vehicle” and related transport equipment in federal and state jurisdictions as well as to investigate the applicability of particular statutes to the use of containers in motor vehicle transportation. Special attention will be given to the subject of vehicle requirements, tax liability and equipment safety standards.

As a point of reference, “container” in the forthcoming analysis means:

1. As exemplary definitions are presented, it will be noted that some are quite similar, demonstrating the effect of the Uniform Vehicle Code on the definitions and regulations used by the states and federal government. Specifically note the similarity in definitions of “semitrailer” U.V.C. §1-163, “trailer” U.V.C. §1-179, and “vehicle” U.V.C. §1-184.
[A] permanent reusable article of transport equipment durably made of metal . . . . It is designed to facilitate the handling, loading, . . . carriage and unloading and delivery of large numbers of packages of goods contained within . . . . It provides a means of transferring cargo from one form of transportation, such as a ship, to another form of transportation, such as rail or truck, without the necessity of loading and unloading the individual items of cargo each time the mode of transport changes. 2

Of primary significance is the fact that the containers referred to above, in order to facilitate intermodal transport, are not permanently equipped with wheels.

B. Containers Under Federal and State Jurisdiction

1. Interstate Commerce Act

Part II of the Interstate Commerce Act regulates highway motor transport engaged in interstate and foreign commerce. For the purpose of that Part, “motor vehicle” is defined as:

... any vehicle, machine, tractor, trailer, or semitrailer propelled or drawn by mechanical power and used upon the highways in the transportation of passengers or property or any combination thereof determined by the [Interstate Commerce] Commission, but does not include any vehicle, locomotive, or car operated exclusively on a rail. . . . 3

A container can be “drawn by mechanical power and used upon the highways in the transportation of . . . property,” but is it a “vehicle, machine, . . . trailer or semitrailer”? The “drawn by mechanical power . . . ” segment of the definition is merely a delimiting statement used to clarify the characteristics of a vehicle, machine, etc. which are subject to the Act. Thus, the meat of the definition is not very helpful for our purposes since nothing in the act further defines “vehicle,” “trailer” or “semitrailer” and these may or may not be a container.

Investigation of federal case law in which “vehicle” is defined casts some light on whether Part II applies to containers. 4 U. S. v. One 1936 Model Ford V-8, etc. 5 is a case cited for its definition of “vehicle.” In that case the Supreme Court pronounced the following concept:

That in or on which a person or thing is or may be carried from one place to another. A wheelbarrow, a covered wagon, a ‘Rolls Royce,’ the patient mule, a ‘Man of War,’ and possibly a Pullman car or oceanliner is a vehicle. 6

This definition is enlightening for it apparently proposed examples of every type of vehicle. The general proposition is that a vehicle carries an item from one place to another. Could it be, then, that a box filled with something and carried from one place to another would fall within the Court’s perception of vehicle? This hypothesis would be stretching the definition too far in view of the examples used in the case. A rereading of the list reveals that all the items are either self-propelled, have wheels, or in some other way are adapted to carrying objects over a medium in an efficient manner. These items, in and of themselves, display a characteristic that gives them an intrinsic purpose and usefulness. It is unlikely that the Court would have classified a wheelbarrow as a vehicle if it did not have a wheel, or a Man of War as a vehicle if it could not propel itself or at least be used as an efficient and normally desirable means of carrying objects over water.

The conclusion may be drawn that within the scope offered by the Supreme Court, a container, by itself, would not be a vehicle. It does not propel itself nor can it be used, without some form of wheel attachment, as a desirable form of transport over land. Therefore, it is not subject to Part II of the Interstate Commerce Act. Its characteristics seem to place it more within the concept of a package.

C. Container as Package

One important reason for the possible classification of a container as a package lies in the import-export clause of the U. S. Constitution. Pursuant to this clause, “No State shall, without the consent of the Congress, lay any imposts or duties on imports or exports

4. Whether the container would be required to display identification plates as a unit of interstate commerce would be one result of the Act’s application to containers. 49 U.S.C.A. §324, (1963) and see 49 U.S.C.A. §165 para. 5(e)(6)(D)(1951).
6. Ibid at 237 (citations omitted).
except what may be absolutely necessary for executing its inspection laws . . .”7 The leading case of Brown v. Maryland8 declared that in order to qualify for tax immunity under the clause, the imported item must be in its “original package” on the date that the local taxes are levied. However, if the items are sold, removed from the original package in which they were imported, or put to the use for which they were imported, then they are subject to local taxes since they have been injected into the stream of local commerce.6 Unfortunately, federal courts have yet to determine whether containers may specifically qualify as original packages.

The container as a package has received a relatively large amount of attention in relation to the limitation of liability clause found in the Carriage of Goods by Sea Act.10 Admittedly, the Act has little to do with interstate motor transport, but the definitions and tests imposed by the federal courts in this area of the law will help narrow the characterization of a container in its role in motor transportation.

The problem that arises is this: under COGSA, a shipper can collect no more than $500 for each package that is lost or damaged in shipment and for which no higher value has been claimed in the bill of lading. If a container is to be considered a package, its loss or damage (thereby harming its contents) could well represent a loss of over $100,000 worth of goods to the shipper.

Two theories have emerged in federal court to deal with the problem. One is promulgated by the United States Court of Appeals for the Second Circuit in Leather’s Best v. Mormaclynx.11 In that case the court found a container not to be a package within the meaning of COGSA, but rather a reusable metal container, “functionally a part of the ship,” in which the carrier caused the packaged goods to be “contained.”12 In the later case of Royal Typewriter v. Kulmerland13 a panel of three different judges from the same court

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7. U. S. Const. art I, §10, para. 2.
8. 12 Wheat 419 (1827).
10. [n]either the carrier nor the ship shall in any event be or become liable for any loss or damage to or in connection with the transportation of goods in an amount exceeding $500 per package . . . unless the nature and value of such goods have been declared by the shipper before shipment and inserted in the bill of lading. 46 U.S.C.A. §1304(5) (1958) [hereinafter cited as COGSA].
11. 451 F. 2d 800 (2d Cir. 1971).
12. Ibid at 815.
13. 483 F.2d 645 (2d Cir. 1973).
of appeals assembled a different test. Under their "functional economies test," or "functional package unit test," the first question to be asked is whether the contents of the container could be shipped overseas in the manner in which they were individually packaged by the shipper. If the shipper's packaging is not functional for overseas shipment, then the burden is on him to prove why the container is not a package for COGSA purposes. If the shipper's package is functional, then the burden is on the carrier to prove that the parties intended the container to be a package. The Federal District Court for the Southern District of New York cited both Leather's Best and Royal in Shinki Boeki Co., Ltd. v. S.S. Pioneer Moon, but it apparently used the Leather's Best test. It held that tanks used to ship liquid were "not functionally a part of the ship" and therefore were packages for COGSA purposes.

The above-mentioned cases are concerned with the function of the container, either as a part of the ship (or vehicle), or as a package. The courts are ultimately trying to define the container according to its use: if it is a functional part of the ship, then it is not a package; if it works as a functional form for overseas transportation of goods, then it is a package. Unfortunately, under normal containerized shipping, both functions are fulfilled by the container. Thus, although the salient characteristics of containers have been isolated for purposes of legal analysis, no single workable guide has yet been established for the purposes of fixing liability under COGSA. The same issues, slightly modified, may be superimposed on the use of containers in motor transport: are containers merely pieces of equipment of a larger vehicle or are they independent units of transport capable of being classified and regulated as vehicles in and of themselves. As in COGSA, the answer to this question is elusive.

D. Taxation of Containers

A federal excise tax of 10% is imposed on all manufacturers of chassis and bodies for trucks, buses, trailers and semitrailers. The U. S. Code section that sanctions such a tax also provides that an excise tax of 8% is to be levied on all parts or accessories sold by the manufacturer, producer or importer of the bodies and chassis.

17. Ibid §4061(b)(1).
Whether containers fall within the section's ambit as "bodies" has been decided in Revenue Ruling 60-185. This Ruling stated that "cargo-containers" which are designed for shipment of property by water, rail and highway are not taxable as trailer or semitrailer bodies even though they resemble such bodies. A later ruling held taxable containers which were primarily designed for use on highways and could only be moved by specially equipped trucks. That ruling distinguished cargo containers from highway containers as follows:

The basis for holding the 'cargo containers' nontaxable is that they are considered to be articles designed or adapted by the manufacturer for purposes predominantly other than the transportation of property on the highway, even though incidental highway use may occur.

In light of the above rulings, it may be concluded that if the container is only used for motor transport on the highways it is subject to the excise tax of U. S. Code Section 406(a)(1).

The container may also be involved in the compilation of the federal tax levied on the use of certain highway motor vehicles. The container, as a part of a trailer or semitrailer is not propelled by means of its own motor and therefore will not itself be subject to the tax. However, it will be used to determine the taxable gross weight of the towing vehicle which is used in combination with the trailer or semitrailer and container. This tax is payable by the person in whose name the motor vehicle (truck or truck-tractor) is registered.

E. Federal Motor Vehicle Safety Standards

The U. S. Code specifies safety standards for "motor vehicles" and "motor vehicle equipment." To be subject to these federal standards a motor vehicle may be "any vehicle . . . drawn by mechanical power manufactured primarily for use on the public streets, roads and highways . . . " Motor vehicle equipment includes "any system, part, or

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21. 26 C.F.R. 41 4482(a) - 1(b) (1974).
22. Ibid §41.4481-2(a).
component of a motor vehicle as originally manufactured . . . or sold . . . as any accessory or addition to the motor vehicle . . . " A container easily fits into one or both of the definitions and consequently is subject to federal safety standards for such things as lighting, locks, etc. Moreover, the container will have to display a label or tag certifying that the equipment conforms with safety standards. 24

F. Containers in State Jurisdiction

Although the container is usually an item of interstate transport, the federal laws and cases are not totally comprehensive nor do they suggest preemption in their treatment of this new means of cargo handling. The void is conceivably filled by the statutes and regulations created pursuant to the taxing and policy powers of the various states. As a sampling, the cases and statutes relating to motor vehicles in California, Florida, Kentucky and Minnesota will be analyzed in the following discussion with the perspective of how they apply to containers.

1. California

(a) Vehicle Code Definitions—Is a container a “vehicle” or can it be described as a trailer,” “semitrailer” or “detachable freight van”? For the purposes of the California Vehicle Code, a “vehicle” is:

a device by which any person or property may be propelled, moved, or drawn upon a highway, excepting a device moved by human power or used exclusively upon stationary rails or tracks. 25

A trailer, as defined by the Vehicle Code, is a vehicle which carries property or people and is drawn by a motor vehicle. It is constructed so that “no part of its weight rests upon any other vehicle.” 26 The Vehicle Code definition of a semitrailer comes somewhat closer to encircling the concept of a cargo container. “A ‘semitrailer’ is a vehicle designed for carrying persons or property, used in conjunction with a motor vehicle, and so constructed that some part of its weight and that of its load rests upon, or is carried by, another vehicle.” 27

Containers rest upon or are carried by other vehicles and are designed

26. Ibid §630.
27. Ibid §550.
to carry property. The above definition of semitrailer could be cited by an agency wishing to classify a container for the purpose of motor transport regulation, but it would have difficulty in explaining how the containers, if they truly are "semitrailers," would be equipped with brakes as required by Vehicle Code Section 26302. The clear implication of the requirement for brakes on semitrailers is that they have wheels—which are not standard equipment for cargo containers.

More to the point is Section 31540 regarding regulation of tank containers. This section falls within Division 13 of the Vehicle Code which concerns towing and loading equipment. The section declares that the Department of Motor Vehicles is to adopt and enforce necessary regulations for public safety involving the transportation of "freight van or tank containers which can be removed from the running gear or chassis of a truck or trailer . . ." "The regulations promulgated by the Department are limited to the loading securement and highway transportation of the freight vans or tank containers which are defined as

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\text{. . . readily removable cargo structures which are designed to be carried on frame—or chassis—type vehicles and are not welded or permanently bolted to the running gear or chassis of the transporting vehicle.}^{29}
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Without more, the California Vehicle Code definition of "vehicle" or "semitrailer" could fit a container as it is used on the public highways. However, the definitive treatment of a container as "cargo structure" negates its classification as a vehicle which would subject it to various Vehicle Code restrictions and regulations.

(b) Registration and License Fees—Even if a container could be classified as a trailer or semitrailer, it would not be subject to registration required by the Vehicle Code.\(^{30}\) Section 4009 states that a vehicle which is transported upon a highway, but is not touching the highway, is exempt from registration. This does not mean that the exempt vehicles float down the road, rather it provides for carriage of vehicles by other vehicles.\(^{31}\)

Imposition of a vehicle license fee, levied pursuant to the Revenue

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28. \text{Cal. Admin. Code, Title 13 §§1400-1406.}
29. \text{Ibid §1401(a).}
30. \text{Cal. Veh. Code §4000(a) (West 1971).}
31. \text{Although the container is not subject to registration, it may be argued that it is required to display special series plates required under §5000 of the Vehicle Code. This section requires special series plates or distinguishing marks for trailers, semitrailers or vehicles which are exempt from payment of registration fees.}
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and Taxation Code\textsuperscript{32} is not applicable to containers. This is because the vehicles subject to the fee are those which must be registered under the Vehicle Code,\textsuperscript{32} it being noted earlier that containers are not subject to registration. However, Section 10753 of the Revenue and Taxation Code may provide for the inclusion of the container in fixing the market value and consequent license fee of a semitrailer or trailer which uses the container for hauling purposes. 

The license fee issue was discussed in \textit{Consolidated Rock Products Co. v. Carter},\textsuperscript{34} The Court of Appeals in that case held that a self-powered cement mixing unit, easily removable from the truck chassis it was carried on, was to be included in the computation of the actual market value and license fee of the truck. The formula was permitted because the mixer and truck were considered to be a single unit of equipment. The court specifically pointed out that there had been no indication that the mixer had ever been removed or used independent of the truck. It further noted that the Department of Motor Vehicles “could have concluded” that the mixer was a “body” or “vehicle” within the intent, purpose and contemplation of the vehicle licensing statute.\textsuperscript{35} What may be gleaned from the case, in light of container usage, is that containers would not be included in figuring the market value of the vehicles with which they are used if it is proven that they are periodically removed or used independent of the vehicles.

\textit{(c) Business License and Ad Valorem Taxes (Package v. Instrumentalitty)}—In \textit{Volkswagen Pacific, Inc. v. City of Los Angeles}\textsuperscript{36} (hereinafter referred to as \textit{Volkswagen})—the California Supreme Court wrestled with the problem of containers as “original packages.” Pursuant to the import-export clause, if the containers could be considered original packages, the value of their contents would not be included in the computation of the Los Angeles city business license tax. One of the questions before the Court was whether the opening of the “sea van” and distribution of the articles inside constituted a breaking of bulk “for a sale or delivery of the separate parcels contained in it,”\textsuperscript{37} such action thereby removing the articles from the

\textsuperscript{33} Ibid §10702.
\textsuperscript{34} 54 Cal. App. 2d 519, 129 P. 2d 455 (1942).
\textsuperscript{36} 7 Cal. 3d 48, 496 P. 2d 1237 (1972).
\textsuperscript{37} Ibid at 55, citing F. May & Co. v. New Orleans, 178 U. S. 496, 508-09 (1899).
exempt status of imports. The Supreme Court's thinking followed these lines:

Although the parts were shipped in sea vans, it would not follow as a matter of law that merely because an importing agent removed the parts from the vans, they then lost the constitutional protection of imported articles. Because the size of modern sea vans or 'containers' is dictated both by modern shipping technology and by the necessity of reducing the costs of shipping, the opening of such a container by an importer may not necessarily be effected 'for the sale or delivery of the separate parcels contained in it . . .,' but may instead be accomplished so that the importer can by other means of transportation divert his imports to his outlets in different interior states. 38

The Court, however, held the distribution of the contents of the Volkswagen container subject to local taxes because once the contents were removed from the container they were immediately distributed to local dealers. The thrust of the case, as it applies to a container, indicates that the container will be an "original package" when the goods that it holds are to be distributed locally, whereas, if the goods are to be diverted by other means of transportation to other outlets in different interior states, the container is simply a means of transporting the "original packages" it holds. The net result seems to be that the goods shipped in a container will not be taxed unless they are distributed for local sale or use.

Sea-Land Service, Inc. v. County of Alameda 39 (hereinafter referred to as Sea-Land) - was a 1974 case in which the California Supreme Court held that cargo containers were instrumentalities of interstate and foreign commerce and as such were subject to ad valorem personal property taxes levied by the County of Alameda on an "average presence" basis. By its ruling the Court nullified Sea-Land's contention that the containers were exempt from local taxes under the import-export clause of the U. S. Constitution. The Court announced:

The protection from state and local taxation afforded by this clause attaches to goods and commodities in the import-export stream; it does not extend to containers, which are a means of transport suitable for repeated use. The distribution was re-

38. 7 Ca. 3d 48 at 55 (citations omitted).
recently recognized in Volkswagen Pacific, Inc. v. City of Los Angeles [see supra, note 38], in which we referred to containers as means of transportation and discussed the difference between the container and the separate parcels of goods contained within it. 40

The Sea-Land opinion characterized a container as an instrumentality of foreign and interstate commerce. In fact, the Court goes to great lengths in analogizing the container, for tax purposes, to flight equipment, railroad rolling stock, and vessels operating in inland waters. 41 In footnote 1 of the decision, the following description of "cargo shipping containers" was offered:

A cargo shipping container is a permanent reusable article of transport equipment durably made of metal and equipped with doors for easy access to the goods carried inside. It is designed to facilitate the handling, loading, stowage aboard ship, carriage, unloading and delivery of large numbers of packages of goods contained within, thus minimizing the costs and risks of processing each package individually. 42

The Court also noted that for purposes of the case at bar, the containers were subject to a personal property tax although new Section 232 of the Revenue and Taxation Code exempted specifically defined cargo containers from the tax. 43 Section 232 exempts only those containers principally used for transporting cargo by ships travelling in ocean commerce. The exemption is specifically denied any cargo-carrying vehicle which is subject to the registration provisions of Section 4000 of the Vehicle Code. 44 For purposes of Section 232,

The term ‘container’ means a receptable; (a) of a permanent character and accordingly strong enough to be suitable for repeated use; (b) specially designed to facilitate the carriage of goods, by one or more modes of transport, one of which shall be by vessels, without intermediate reloading; (c) fitted with de-

40. Ibid at 789.
42. 12 Cal. 3d at 775, n.1, citing Simon, supra note 2, at 513.
43. 12 Cal. 3d at 777.
44. See discussion accompanying note 30, supra. In light of this exclusive exemption, an interesting argument based on discrimination might be made on behalf of container shippers who transport goods interstate but only by rail or truck.
vices permitting its ready handling, particularly its transfer from one mode of transport to another; (d) so designed to be easy to fill and empty; and (e) having a cubic displacement of 1,000 cubic feet or more.

The composite of the *Sea-Land* and *Volkswagen* cases is this: the container is always an instrumentality of commerce, but it may also constitute a package for varying taxation purposes. Thus, an ad valorem tax will be levied on the container while a business license tax may or may not be assessed according to the value of the goods that the container holds. The first form of tax is tested by due process principles while the second falls under the scrutiny of commerce clause standards.45

(d) Insurance Code—Section 383.6 of the Insurance Code defines "motor vehicle" for the purpose of setting limits to the use of the term in motor vehicle insurance contracts. The definition includes "non-wheeled structures so made as to be capable of being moved as a compatible portion [of wheeled vehicles], or trailed behind, any motor vehicle . . . ." Containers would certainly fall within the penumbra of this definition.

2. Florida

(a) General Definitions—Unless otherwise stated, the following definitions determine what a "vehicle," "trailer" or "semitrailer" is for regulatory purposes in Florida.

Semitrailer.—Any vehicle with or without motive power, other than a pole trailer, designed for carrying persons or property and for being drawn by a motor vehicle and so constructed that some part of its weight and that of its load, rests upon or is carried by, another vehicle.

. . .

Trailer.—Any vehicle with or without motive power, . . . designed for carrying persons or property and for being drawn by a motor vehicle.

. . .

Vehicle.—Any device, in, upon, or by which any person or property is or may be transported or drawn upon a highway, except devices moved by human power or used exclusively upon stationary rails or tracks.46

All of these definitions are broad enough, on their face, to include containers. However, later in Section 316.261, it is required that all motor vehicles, trailers and semitrailers be equipped with brakes. The assumption that trailers or semitrailers can be fitted with brakes reveals the legislature's conceptualization of these means of transport, that is, wheeled vehicles. This analysis is not altogether conclusive, however, when one considers the additional definitions of "trailer" and "semitrailer" to be applied to the provisions of the Florida Motor Carriers, Freight Forwarding Act. There, the trailer and semitrailer classification "includes" vehicles with axles. 4 If the Florida legislature meant to utilize the limited, yet ordinary, concept of wheeled trailers or semitrailers in the general definitions noted at the beginning of this section, it would have included axles as it saw fit to do in the Freight Forwarding Act definitions. Since axles are not mentioned in the general definitions, the argument can be made that non-wheeled units, or containers, fall within the purview of those definitions. The safest conclusion that can be drawn from this quagmire of contradictions is that the statutory definitions do not help determine whether a container or its owner would be subject to various Florida vehicle regulations.

The Florida courts do not clarify whether a container would constitute a "vehicle" or "trailer," etc. A continually-cited case, Gibbs v. Mayo, 48 offered the Webster's Collegiate Dictionary definition of "vehicle" as authoritative: "... that in or on which a person or thing is or may be carried." Although this meaning may find broad application, the courts will consider definitions in a limited scope, taking into account public policy and the purpose that a particular statute attempts to serve. 49 Thus, the courts adopt various tests and perspectives to decide whether a specific item shall be classified as a vehicle.

(47), (59) and (64) (Supp. 1975-76).

48. 81 So. 2d 739, 740 (Fla. Sup. Ct. 1955).
49. In Gibbs v. Mayo, ibid, the petitioner was discharged by the Court because the information charged the petitioner with breaking and entering a "motor vehicle" rather than using the exact statutory language or its equivalent. In Seaboard Coastline Railroad v. O'Connor, 229 So. 2d 663 (D.C.A. Fla. 1969) a statute called for certain type vehicles to stop at railroad crossings, failure to do so resulting in a misdemeanor. The court in that case stated that such a statute is in derogation of common law and penal in nature. "As such, it must be strictly construed in favor of those it purports to regulate; and it will not be held to include anyone within its purview unless it clearly and unambiguously describes him therein." Ibid at 665.
(b) Registration, Licenses and Permits—Subject to normal reciprocity provisions among the states, every owner or person in charge of a motor vehicle, trailer or semitrailer that is operated on the highways of Florida must register the vehicle.\footnote{50} Upon registration there is a license fee that is payable annually.\footnote{51} The registration and license fee provisions use as points of reference the general definitions of "trailer" and "semitrailer" logged in Section 316.003.\footnote{52} The breadth of the definitions leaves a poignant gap in determining whether the registration of a container may be required under these statutes.

The hazy definitions also cloud permit and certificate requirements for motor carriers and freight forwarders. If the container is not a trailer or semitrailer, then the motor carrier supplying the wheels for carriage of the container will have to acquire the necessary motor carrier permits,\footnote{53} while the container owner, if a district entity, will have to obtain a separate permit or certificate as a freight forwarder.\footnote{54} The problems are numerous when one considers the ownership and permit variables involved in motor transport of containers, especially when the "container" is not defined for statutory purposes. The circumstances cited above can arise where both carrier and forwarder are operating intrastate in Florida. However, interstate exemptions and reciprocity\footnote{55} may remove many of the conceivable obstacles.

(c) License and Ad Valorem Taxes—The State of Florida levies a license tax in lieu of ad valorem taxes on motor vehicles, trailers, boats, etc.\footnote{56} It is incumbent upon the legislature to define what is a "motor vehicle" or "trailer" for tax purposes.\footnote{57} However, as pointed out above, it is uncertain whether a container could qualify as a "motor vehicle" or "trailer" pursuant to existing definitions. If containers cannot fall within the scope of the license tax, then they will be subject to ad valorem taxes as either tangible personal property or "inventory."\footnote{58}

The distribution between a trailer and property subject to ad valo-
rem taxes in Florida has been considered in relation to the use of house trailers or mobile homes. For purposes of analysis the treatment of this form of “trailer” is the closest indication of how a container would be judged. A Florida Attorney General’s opinion, in 1965, stated that house or other trailers not being used for general transportation purposes and not being drawn over the highways from one point to another were not motor vehicles within the purview of Article VII, section 1, of the Florida Constitution. Thus, they were not subject to license taxes, but rather were tangible personal property against which ad valorem taxes could be levied. The Florida Supreme Court, considering the same type of problem, produced the following test:

[Where] to all intents and purposes, the actual primary use of such a trailer bears no reasonable relation to customary motor travel or carriage and the trailer is found to be used . . . for non-transportation purposes, the exemption [from ad valorem taxes] does not apply. The reason being that . . . a trailer loses its primary character as a unit of motor vehicle transport and serves, for example, as an apartment or residence . . .

The decisions indicate that if it can be shown that a container is being used for “general transportation purposes” and that its “primary character” or use is as a “unit of motor vehicle transport,” the container may be exempt from ad valorem taxes and subject, instead, to license fees.

(d) Load and Equipment Requirements—Containers, as either trailers, semitrailers, equipment, or simply “loads,” will be subject to various sections of the Florida Uniform Traffic Control Law. Load-hauling requirements generally state that the load must be securely fastened to the vehicle. The container will also be subject to certain equipment specifications, particularly regarding width, height and length. Whether lighting requirements for clearance lamps and reflectors apply to containers is questionable since clearance lamps are to be mounted at the top of the “permanent structure” of the vehicle. The argument may be made that since the container is an integral part of the trailer upon which it is carried, any equipment

62. Ibid §316.196.
63. Ibid §316.225(2), §316.276.
requirements that would apply to the superstructure of a conventional box trailer would also apply to the container.

3. Kentucky

(a) Definitions—Chapter 186 of the Kentucky Revised Statutes provides guidelines and regulations according to which motor vehicles and trailers are to be registered and licensed. The licensing regulations use the following definition of “vehicle” for reference:

‘Vehicle,’ . . . includes all agencies for the transportation of persons or property over or upon the public highways of this Commonwealth and all vehicles passing over or upon said highways . . .

“Motor vehicle,” for licensing purposes, includes the above definition of vehicle with the condition that such vehicles are propelled other than by muscle power. Trailer registration and fees are subject to additional delineations:

‘Semitrailer’ means any vehicle designed for carrying persons or property and being drawn by a motor vehicle as is so constructed that some part of its weight and some part of its load rests upon or is carried by another vehicle.

“Trailer” is defined similarly except that no part of its weight rests upon the towing vehicle.

In light of the above definitions, one may conclude that containers could be considered vehicles or even motor vehicles within the meanings ascribed to those words for registration and licensing purposes. The semitrailer and trailer provisions are not as easily construed to apply to containers due to Section 189.090 (4) which, for vehicle equipment safety reasons, declares that all semitrailers and trailers be equipped with brakes. How brakes would be fitted to a sole container is not explained by the statute. Looking at the overall portent of the registration definitions, it is unlikely that containers would be made subject to registration requirements.

65. Ibid §186.010 (7)(a).
66. Ibid §186.010 (4).
67. Ibid §186.650 (1), (2).
68. But see Foose v. Engle, 174 S.W. 2d 5, 9 (Ct. App. Ky. 1943). The Kentucky Court of Appeals in that case stated that if housetrailers “were dismounted from their wheels, or otherwise rendered not readily movable, and allowed to remain [so] . . . for a
(b) Registration, Taxes and Identification—If containers do not come within the scope of registration requirements, then registration fees are not applicable to them. However, registration fees for commercial vehicles are fixed by declared gross weights of the vehicle and "any towed unit." Thus, the container as "towed unit" will be considered in computing the vehicle's registration fees; this would seem especially true when the trailer or semitrailer is only functional when carrying containerized goods.

When a motor vehicle is registered, it is considered consent by the owner for the State to assess a property tax on the vehicle according to a standard manual prescribed by the Kentucky Department of Revenue. If the container does not fall within the purview of the registration requirements, it will be subject to an ad valorem tax based on the situs of the container.

(c) Equipment—The applicability of Kentucky vehicle equipment safety standards to containers is doubtful. Probably the most significant safety equipment for containers mounted on semitrailers or trailers would be clearance lights since the trailer would have tail lights and brakes, etc. Section 189.050 of the Kentucky Statutes states that clearance lights are necessary for horizontal dimensions; no mention is made, however, of lights designating vertical clearance. A trailer may be equipped with the right and left clearance lights since containers normally will not overlap the bed of the trailer. Thus, but for height, width and length requirements, the vehicle equipment safety standards of Kentucky will find little if any application to containers. This conclusion does not consider containers travelling in interstate commerce which will be subject to equipment standards prescribed by the federal government.

sufficient length of time to indicate that their use as a vehicle had been abandoned," they would probably be considered residences and not vehicles. See, also, Ky. Rev. Stat. ch. 132, §132.720 and §132.750 (1970-74) re: house trailers considered as real estate when wheels removed and unit rests on fixed foundation.

69. Even if considered trailers or semitrailers the container may escape Kentucky registration requirements if used in interstate commerce under specific conditions. Ky. Rev. Stat. ch. 281, §281.751 (1970-74). Other exemptions from registration based on use in interstate commerce or recipocity may be found in Ky. Rev. Stat. ch. 186, §186.050(14) (a), §186.140 (1970-74).

72. Ibid §132.020 and §132.190.
4. Minnesota

(a) General definitions—Motor vehicles, generally, and highway traffic regulations, are respectively covered by chapters 168 and 169 of the Minnesota Statutes. For highway traffic regulation, the definition of “vehicle” is similar to the Uniform Vehicle Code rendition.\(^{74}\) “Motor Vehicle,” under both chapters is basically “. . . any self-propelled vehicle . . . and any vehicle propelled or drawn by a self-propelled vehicle . . . .”\(^{75}\) Semitrailers and trailers are within the category of “drawn” vehicles, the distinguishing characteristic between them being that a semitrailer has a considerable part of its own weight or load resting upon the towing vehicle while the trailer holds its own weight.\(^{76}\)

The problem witnessed in the previous sections of this study arises again. The above definitions are certainly broad enough to envisage a container as “motor vehicle” or possibly a “semitrailer.” However, by again referring to equipment requirements, it is evident that the legislature, or rather the compilers of the Uniform Vehicle Code from which the definitions are derived, had wheeled vehicles in mind when the definitions were established. Indeed, the definition of “vehicle” that is widely used today was originally adopted for the Uniform Vehicle Code in 1926.\(^{77}\) Thus, the Minnesota (as well as Kentucky, Florida and California) requirement that trailers be equipped with brakes\(^{78}\) is not surprising since cargo containers were not in existence at the time the law was originally engendered.

The history of the definitions is persuasive evidence of their cognizance of containers, but the argument may be made that the broad wording found in the definitions was used in order to include new “forms” of transport as technology advanced. Thus, although containers may not be semitrailers, they still may fit within the context of “vehicle” or “motor vehicle” as expressed in the statutes. Unfortunately, Minnesota case law is lacking by which the issue could be definitively resolved.

(b) Registration and Fees.—Motor vehicles, consequently trailers,

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76. Ibid ch. 168, §168.011 Subd. 14 (Supp. 1975-76); and see ibid ch. 169, §169.01, Subds. 10, 11 (1960).
and possibly containers, are subject to registration. The rate of the tax or license fee on trucks, tractors or combinations including semitrailers is based on the total gross weight. A container, as part of the functional hauling equipment of a semitrailer or truck, would be included in the gross-weight computation according to the following definition:

‘Gross weight’ means the actual unloaded weight of the vehicle, either truck or tractor, or the actual unloaded combined weight of a truck-tractor and semitrailer or semitrailers, or of the truck-tractor, semitrailer and one additional semitrailer, fully equipped for service, plus the weight of the maximum load which the applicant has elected to carry on such vehicle or combined vehicles...

The license fees are deemed to be both property and highway use taxes. These fees are levied in lieu of all other taxes except so-called wheelage taxes, which may be imposed by any city in Minnesota, and gross-earnings taxes paid by certain companies.

Registration and other certification requirements for motor vehicles in Minnesota are subject to a number of reciprocal exemption provided for by statute. For example, Section 168.187, subdivision 11, allows application for proportional registration of vehicles in a fleet which travel in more states than just Minnesota.

(c) Equipment—The container, if considered motor vehicle equipment, is subject to the safety standards adopted by the Commissioner of Public Safety for the State of Minnesota. As a guideline for such standards, the Commissioner may refer to the federal regulations adopted pursuant to the National Traffic and Motor Vehicle Safety Act of 1966. Containers will also be subject to Minnesota statutory limitations regarding height, length, weight and load limits.

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81. Ibid §168.011, Subd. 16.
82. Ibid §168.011, Subd. 6.
84. Ibid ch. 169, §169.467, §169.65 (Supp. 1975-76).
85. Ibid §169.468.
86. Ibid §169.80, §169.81, §169.83.
III. GENERAL CONCLUSIONS

A. GOVERNMENT AND SHIPPING

In 1875, the North of England Protecting and Indemnity Association, Ltd. brought out a book entitled, "Suggestions to Managing Owners and Their Captains." The large number of regulations dealing with the practical operations of ships laden with many types of commodities created an extensive body of jurisprudence and legal defenses related to the operation of ships at sea. Much of this law deals not only with seamanship but also with the carriage of goods and their safe stowage. The introduction to this book well reflects the significance of both legal and technical rules assembled in the book to assist both the ship master and the steamship company's operating department to understand problems relating to sea transportation as they existed at the time the book was written and as annotated when revised editions of the book appeared. The last paragraph of the introduction to the book deals with government and states:

"Government has been defined as 'A creeping disease' but it is generally recognized that the self government and organization of the shipping industry is the most effective instrument of its kind not only for good industrial relations but also in the wide sphere of matters affecting the trace and welfare of this country generally."

Since then, government is represented by the organization of a number of United Nations Commissions or related bodies, each of which is making significant strides in the area of world wide cooperation.

The United Nations Conference on Trade and Development, Trade and Development Board, Committee on Shipping, Sixth Session, on July 29, 1974, issued Item 9 of the Provisional Agenda by the Secretariat, entitled, "Container Standards for International Multimodal Transport." This delineates the work of a group of experts assigned the production of a document consisting mostly of technical material relating to containers and their cargo, scheduled to be completed before 1976.

B. THE UNIDROIT PLAN

In January, 1974, UNIDROIT cited its work program for the years 1975 - 1977 in a document (C.D. 53 - Doc. 3 Add 4) which specifies the work to be done. The pertinent text is herewith reproduced:
"During this decade unitization of cargo has continually increased. This new shipping and carrying technique is even gradually replacing the traditional methods on the most important world routes, not only by sea but also by land and in the air. From the viewpoint of private law, these developments have only been hitherto considered in an indirect manner, insofar as such equipment was instrumental in multimodal (combined) transport operations. Containerization was undoubtedly a promoting factor in the work of preparation of draft international instruments on international combined transport contracts, in which UNIDROIT took one of the leading parts and which is still in progress.

However, little or no attention seems to have been given on the international plane to the many private law problems to which such equipment directly gives rise: for instance, problems relating to the ownership of, and rights in rem over, such equipment, to the contracts concerning their use (leasing or hire purchase agreements) and to liability incurred in respect of other parties than those having title in goods stowed therein, i.e. relationship with the owner or operator of the vehicle that carries the unit load, with the forwarding agent acting as consolidator, etc.

Uniform provisions could provide solutions for these problems and thereby facilitate commercial operations involving the utilization of such equipment in the transport of goods."

The basic requirement for the control of containers as cargo transporters in international trade is in dealing with the registration of the unit with the government and the establishment of a certificate of title of the container. What we have mentioned previously from the suggestions of the North of England Protection and Indemnity Association applies to governments at large represented by the different organizations of the United Nations, and the various intergovernmental and non-governmental organizations concerned with peculiar aspects of the problems of international law in the field of transportation. In earlier centuries, the sovereign nations had not yet intervened through legislation in the regulation of trade by sea. In those days, merchants followed their own rules of conduct which were primarily derived from ancient maritime codes like the Sea Law Rhodes, Basilika, the Assizes of Jerusalem, the Rolls of Oleron, the Laws of Wisby, the Hanseatic Code, the British Admiralty's Black Book and the Consolato del Mare and many others (for detailed

C. AN INTERNATIONAL CONTAINER CODE

Modern container shipping regulations affecting transportation both on sea and land will have to be created so that the vehicles which carry the goods from origin to destination are under a uniform legal structure. The great event awaited in the present century is unification of the principles of the law in mass transportation to apply within one hundred and forty eight nations and the oceans between. Unification of the international civil law governing private containers is the first target required to be implemented in order to bring the regulatory rules of modern technology into the framework of today's life. The technology of the container provides through-service possibilities for at least two types of basic, fundamental mobility services. This means service on land and sea, on sea and air, or on land and air can be satisfactorily handled by any standard container, provided that the basic transportation carrier, be it a railroad car, ship or airplane, is made adaptable. Modern technology looking ahead to standardization in the transportation industry is bound to progress more and more toward completely multimodal cargo service. This technology counts on two basic events transpiring: (a) improved distribution systems of industry, agriculture and other production, (b) an expected increase in volume, practice and methods in using such types of multi-modal service. Therefore, the legal nature of the container will require that the codification of rules for this type of service be implemented uniformly world-wide. In the UNIDROIT work plan described earlier for the period of 1975 - 1977, the Institute points out that the particular subjects dealing with the civil law and private relationships which surround the container call for an extensive work plan. This, of course, is understandable since legal background requires correlation with the advances in container techniques already under way in the UNCTAD program during the same period.

The analysis of this legal background furnishes the main basic elements of unification of administrative international rules for implementation. These elements can be described as follows:

A. Standard international registration procedures;
B. Unification of documentation, equipment marking and recognition of the container;
C. International protection of property rights of the container;
D. Relationships in the container service between owners and operators in effective control.

These four areas of legal activities must be clearly defined among the nations if container service is to progress. Some of these matters deal only with administrative activities, others with the law of private property. Since the containers are in service transporting between nations possessing civil law principles entirely opposed to each other, the service cannot work properly until a standard container code has been established and accepted by the nations. Acceptance will place it on a unified international legal basis. Without this occurring, however, progress will be difficult and hard to obtain.

D. INTERNATIONAL REGISTRATION AND CERTIFICATION

No one will be entitled to use the container in international trade unless it is registered under the appropriate agency of the United Nations. Internal domestic organizations can, of course, be authorized by member nations as long as a central governing control authority maintains the registration system of the United Nations in each country. How long and how far a container can operate within its own state without being registered under the international rule depends upon local practices and the administrative rules applicable thereto. Application of the original registration of any container will be made only by or on behalf of the owner or his representative filed on the appropriate form supplied by the local authority. In any case, this application must provide the authentic full name and business address of the legal owner, the name of the country, province or subdivision of residence of the owner, the description of the container, including the manufacturer, and the date of construction. In order to avoid excessive marking on the container, the registered address of the manufacturer of the container shall be deposited in the central office of registration of the nation concerned.

If a container is registered in the name of two or more natural persons or legal entities, this must be recorded since such a container is held jointly. Each co-owner will be assumed to have the absolute right to dispose of the title and interest of the container, unless contrary instructions are registered with the central control authority. If a container is owned by the government of the state or nation itself, it must be treated the same way as a privately-owned facility since in its movement outside of the national border it would be considered the same way as a privately-owned container.
Registration and certification procedures should be subject to the same container standards for international multimodal transport as published by UNCTAD and should be marked in accordance with the International Organization for Standardization (ISO). Presently, there is a description in effect called ISO 2716 - 1972 (E). There is also a code representing the names of the countries of origin, which is now still in draft form. Its number is ISO/DIS 3166.2. The code to be used for containers would be indicated by the Alpha 3 Code. This comprises a list of all national entities described in three-letter codes. For example, Switzerland is marked “CHE,” and the United States is marked “USA.” The identification marking code carries an owner-code which is made up of four capital letters of the Latin alphabet. The rules of that standard provide letters both for the owners and the country of origin while numbers are used for the serial number and the size and type of the code of the container.

E. UNIFORM MARKING OF CONTAINERS

The International Container Bureau (BIC) published a register of internationally-protected “Identification Alpha Codes” of container owners. It is possible that the future may call for the selection of the organization established by the BIC as a registration center for execution of the registration method herein described.

One of the most important parts of registration deals with issuance of the certificate of ownership concurrent with the actual mechanics of registering the international container. The certificate of ownership should reflect the same conditions previously mentioned as requirements for the registration. However, the certificate of ownership is a document of title in possession of the owner or his representative. It may, therefore, be transferred to a new owner in the event of a sale and would also be used in legal, civil procedures dealing with the proof of ownership of the container. In other words, the certificate of ownership must at all times coincide with the data marked on the container. To validate this, the national members of the registration and certification authorities must provide regulations to protect against false evidence of a container both in the certificate of ownership and the registration marked on the container.

The container should be marked only one time, thus avoiding costly and complicated renewal of registration as occurs with motor vehicles. Also, it would be almost impossible, as a practical matter, to return a container to an authority of origin far removed from the physical location of the container at any particular time. Therefore,
the Maritime Administration of the United States is presently developing minimum required data on each container to be affixed by the manufacturer at the time of the sale and delivery to the original owner or his representative. If this American method is finally accepted by the United Nations Convention, it would carry the code shown above, engraved into the door sill of the container. The safest place for this required identification would be to emboss this marking on the bottom, underneath the floor of the door sill. Although this is somewhat difficult to see, it is also safe against erasures which, in turn, inhibits theft or unlawful conversion of the container.

With such registration and certification being the most significant legal procedure pertaining to the container, unification of documentation, equipment marking and other visible signs of the container are then based on a permanent system safe from the problems of misuse. Unified marking probably will have two parts. One, similar to railroad cars, showing the owner's code and the registration number on both sides of the container wall. It is not important as to where these markings are attached since they are basically painted on and renewed periodically. The second part of the marking procedure is contained in the certification of the title which is a document separate from the container. What is significant is that they both (equipment and document) coincide with each other. This means that there are five places carrying the same basic data, namely the original registration embossed in the container structure, the same numbers shown on the certificate of title and again the same numbers painted on each side of the container. These numbers would then be in two additional places, namely filed in the international registration authority for containers under the United Nations and in the National Agency or entity of the country of origin or ownership of the container.

The centralized container document additionally should contain the certification in compliance with the present UN/IMCO conventions, the CCC and CSC, one for custom purposes and one for safety control. Additionally, quite similar to the USA UMLER data card system, the complete data of the container from the time of construction until retirement will be available as a minimum at one document center, either the UN or the national agency representing the UN control.

As far as the rights of the owner of the container are concerned, UNIDROIT most likely will establish international rules of control, proof and conventional court procedures. It is too early to have pro-
posed rules now, since the many technical requirements advanced thus far are more in the nature of regulatory bases for the protection of the several nations, and description of carrier relationships according to state law of origin. No doubt a large body of private civil law concerning the container will have to be blended into one international civil container code, acceptable to the signatory powers and adhered to by the container-control agencies of the UN, UNCTAD, IMCO and similar organizations.

F. WORLD-WIDE RULES FOR WORLD-WIDE USE

Finally, there will have to be an international code covering the required relationships and obligations of service between the container owner and his lessor or otherwise authorized user. The protective measures in law to recover the property against the many hazards implicit in moving private property must be delineated in agreements to be worked out by UNIDROIT. Recovery of property, protection against loss and spelling out contractual relationships will be handled in describing the controlled use of containers in international traffic by sea, air and rail. All the results of these experiences will form the civil law of private property pertaining to the container. Only after this code is established by the participating nations will container traffic in transport be properly regulated. To be able to service this new, world-wide container operation, these nations will require a unified, international civil container code which can be enforced in the courts of all parts of the world, with the same speed as the means of movement for this type of traffic.

Some of the positions taken by the national transport interests in international transportation negotiations have been widely criticized for their failure to take into account the views of all concerned transportation interests, including consumers, shippers, forwarders, insurers, all classes of carriers and the regulatory agencies. We believe that those having responsibility for developing policy positions for international transportation negotiations should take steps to assure that their policy is developed with a sufficiently broad base of participation, so that they protect and serve the needs of consumers, shippers and carriers.

International agreements often have served to prevent conflict that otherwise might result from unilateral national regulations of international commerce. These agreements are not designed for intermodal transportation and are now inadequate. International efforts to re-examine them are needed now. Every state can participate in that
re-examination, relying on its ability to act unilaterally if the results are not satisfactory.

G. CONTAINER CARRIAGE IN THE UNITED NATIONS UNCTAD PLAN

Non-participation has the dubious benefit of deferring the need to make decisions—at the risk of the future place of carriers and shippers in international transportation. Any international agreement made without active participation is likely to be weighted against a state or, at best, to provide only partial solutions to a problem. Given such an outcome, that state would be confronted, belatedly, with an unpleasant choice: whether to operate within the framework of an international agreement that had been developed without adequate consideration of its interests or to attempt to impose increased unilateral regulations, which could easily lead to retaliation and tend to inhibit international trade.

Thus, it appears clear that all nations should take an active part in developing international solutions to intermodal transportation problems. To do otherwise would breed needless antagonism, and might limit the ability of a nation to influence international consideration of the problems of international containerization with an adequate private law basis.

H. RULES FOR INTERNATIONAL INTERMODALITY

The less developed nations oppose attempts to preempt development of internationally-accepted rules for container carriage. UNCTAD, which is weighted heavily in their favor, has begun an examination of the problem. Also, the developing countries are suspicious, sometimes with good reason, of attempts by the more developed countries to develop and impose rules governing international economic matters.

Because the less developed nations are, at present, only marginally involved in the current rapid growth of international containerized cargo movements, UNCTAD had been less motivated to resolve problems of intermodal transportation.

But the feasibility of UNCTAD being designated the primary forum of containerization is now being determined by international consultations, which are under way by UNCTAD.
Responding to the energy crisis, the Federal Energy Administration (FEA) has since late 1973 regulated the allocation and pricing of energy resources. Mandatory Allocation and Price Regulations (hereinafter sometimes separately referred to as the Allocation Regulations and the Price Regulations) have been promulgated which essentially freeze price and supply patterns as they existed at certain reference dates.

General regulations which essentially freeze relationships may have unintended consequences in specific circumstances, and thereby result in hardship or inequity to affected persons and entities. An exceptions process has been established to alleviate hardships and inequities resulting from the regulations involved. The FEA employs that process in appropriate circumstances to grant relief to entities affected by FEA Regulations. Generally, exception relief permits the applicant to ignore the requirements of the regulatory provisions to which an exception has been requested. Thousands of entities, including not only the major integrated oil companies, energy producers and retailers, but also endusers of energy resources such as common carriers, are affected by the FEA exceptions decisions. However, the exceptions process is not generally understood, particularly how the criteria involved, serious hardship and gross inequity, are to be applied in specific circumstances.

STATUTORY AND REGULATORY BASIS OF ENERGY REGULATION

The most important foundations of the control of energy prices and supply patterns by the federal government have been the Economic Stabilization Act of 19701 and the Emergency Petroleum Allocation Act of 1973 (EPAA). The EPAA provides that:

“... (T)he President shall promulgate a regulation providing for the mandatory allocation of crude oil, and each refined pe-
troleum product, in amounts specified in (or determined in a manner prescribed by) and at prices specified in (or determined in a manner prescribed by) such regulation."

The regulatory provisions promulgated in response to this statutory mandate have reflected its chief objectives and are principally concerned with controlling prices and supply patterns.

**Price Controls**

Under the FEA Regulations controlling the pricing of crude oil, a two-tier pricing system has been adopted by which the prices of domestic crude petroleum generally equivalent to 1972 production levels ("old" oil) have been frozen at the highest posted price in effect on May 15, 1973, at the field of production, plus $1.35, totaling approximately $5.25 per barrel, except that a dollar-for-dollar pass through of increased costs is generally allowed. Crude oil produced in excess of 1972 production levels from the same property ("new" oil) is exempt from price controls, and each barrel of new oil produced releases from controls a barrel of old oil ("released" oil). Furthermore, oil produced from new properties and oil produced from properties whose average daily production of crude oil for the preceding calendar year does not exceed ten barrels per well ("stripper" wells) is exempt.

Price Regulations were supplemented effective December 4, 1974, by promulgation of the Cost Entitlement Program under which refiners and non-refiner eligible firms are required to submit information whereby the FEA can calculate the national old oil and crude oil receipts ratio and individual old oil to crude oil receipts ratio. A refiner is issued a number of "entitlements" equal to the national old oil ratio. To the extent that his old oil ratio exceeds the national old oil ratio, he is required to buy additional "entitlements" from other refiners and eligible firms in order that his total "entitlements" equal his total number of barrels of old oil. An "entitlement" is the right to include one barrel of old oil in a refiner's crude oil receipts in a

2. EPAA §4(a), 15 U.S.C. §753 (1973). The EPAA expired on August 30, 1975, but at the time this article was written, was expected to be temporarily extended retroactive to September 1, 1975.
3. 10 C.F.R. §212.73.
4. 10 C.F.R. §212.82, 212.93.
5. 10 C.F.R. §212.72.
6. 10 C.F.R. §212.54.
particular month, or in essence, the right to refine one barrel of old oil in the refiner’s refineries.\footnote{7}

The prices of most finished petroleum products are controlled by Price Regulations that include three important features. First, price patterns existing on a reference date, May 15, 1973, have been frozen.\footnote{8} Secondly, cost increases are permitted to be passed through, generally on a dollar-for-dollar basis.\footnote{9} Thirdly, the profit margin\footnote{10} which a “firm”\footnote{11} established during a “base period”\footnote{12} is to be retained.\footnote{13}

**Allocation Controls**

The Allocation Regulations, which were issued January 14, 1974, require that supplier/purchaser relationships be maintained as they existed on certain reference dates. Relationships involving crude oil must be generally maintained as they existed on December 1, 1973.\footnote{14} In addition, large integrated refiners (classified as “refiner-sellers”)\footnote{15} are required to allocate a portion of their crude oil to small and independent refiners.\footnote{16} Presently, use of a “buy-sell” list, published by the FEA on a quarterly basis, controls these transfers.\footnote{17}

Base period relationships are also required to be maintained for finished petroleum products.\footnote{18} The controlling date for motor gasoline, for example, is the month of 1972 corresponding to the current month;\footnote{19} for residual fuel oils, it is the month of 1973 corresponding

\footnote{7} 10 C.F.R. §211.67.
\footnote{8} That date like all reference dates used by the FEA, has been selected because it is believed by the FEA to be both relatively recent and free of distorting influences such as the oil embargo and strict price controls by the federal government. Prices were relatively free of governmental control during Phase III of the Economic Stabilization Program which began January 11, 1973, and ended with a freeze of prices on June 13, 1973.
\footnote{9} 10 C.F.R. §212.83.
\footnote{10} 10 C.F.R. §212.31. Essentially, a firm’s profit margin is the ratio its net income before taxes bears to its net sales.
\footnote{11} FEA Regulations define “firm” to correspond generally to a business entity. See 10 C.F.R. §212.31.
\footnote{12} Generally, any two-year period following August 15, 1968, at the option of the firm. 10 C.F.R. §212.31.
\footnote{13} 10 C.F.R. §212.11.
\footnote{14} 10 C.F.R. §211.63
\footnote{15} 10 C.F.R. §211.62
\footnote{16} 10 C.F.R. §211.65.
\footnote{17} 10 C.F.R. §211.65(e).
\footnote{18} 10 C.F.R. §211.9.
\footnote{19} 10 C.F.R. §211.102.
THE EXCEPTIONS PROCESS

Statutory recognition of the need for the exceptions process is reflected in the specific directive that the President should provide for "special redress" and should "assure that energy programs are designed and implemented in a fair and efficient manner so as to minimize hardship and inequity while assuring that the priority needs of the nation are met." Founded on this statutory authority, FEA regulations provide that the FEA may grant an application for exception to the regulations to alleviate or prevent serious hardship or gross inequity.

The FEA has instituted procedures whereby:

(i) applications for exception to regulations involving adjustment of maximum supply volumes of gasoline, fuel oil or propane to which firms are allowed by law and to regulations controlling prices relating to the retail sale of gasoline, heating oil, diesel fuel or propane are properly filed with the appropriate FEA Regional Office (of which there are presently ten); and
(ii) all other applications are properly filed with the FEA's National Office of Exceptions and Appeals.

The FEA has held that:

"As indicated in Section 205.55(b)(1) of the FEA Procedural Regulations, exception relief is generally appropriate only where no other administrative procedure is available to the applicant."

Additionally, before considering exception relief, the FEA determines if any other alternative not involving FEA action exists which would effectively remedy the applicant's difficulties.

Furthermore, there must be causal connection between the hardship or inequity alleged and the regulations involved if exception

20. 10 C.F.R. §211.122.
23. 10 C.F.R. §205.55(b)(1).
24. 10 C.F.R. §205.52(b).
25. 10 C.F.R. §205.52(a).
relief is to be granted. The FEA has generally held that exception relief should be prospective only unless a firm presents compelling reasons demonstrating that retroactive relief is warranted or that it would experience irreparable injury in the absence of such relief. 27

**Importance of the Exceptions Process in Policy Development**

The exceptions process has played an important part in the development of energy policy by the FEA. The exceptions process has served to balance competing national policy objectives in several instances, including the following:

(i) in applications for exceptions to the requirements of the Old Oil Entitlements Program, to reconcile various conflicting objectives;
(ii) in applications for exception to base period supply relationships filed by minority-owned small businesses, to reconcile the Congressional goals specified in the Small Business Act and the Emergency Petroleum Allocation Act;
(iii) in applications for new refinery capacity to reconcile goals to the Crude Oil Allocation Program with the goals of expanding refinery capacity and stimulating production of new crude oil.

In defending use of the exceptions process to balance competing national policy considerations, the FEA has stated that the “process of reaching an accommodation between conflicting national policies is an inherent aspect of the regulatory review function.” 28

**CASE-BY-CASE DEVELOPMENT OF EXCEPTIONS CRITERIA** 29

**SERIOUS HARDSHIP**

The FEA has generally required that a firm’s viability be threatened before granting relief based on serious hardship. 30 In late 1974,

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28. Agway Petroleum Corporation, 2 FEA ¶ 80,600 (June 6, 1975).
30. More recently, the FEA has recognized that harm of sufficient magnitude is present if a firm’s competitive position is threatened. E.G., OKC Corporation, 2 FEA ¶ 83,074 (March 21, 1975).
the FEA characterized its approach to serious hardship determination as follows:

"... (T)he FEA utilizes a broad definition of serious hardship which embraces a wide range of evidential factors. The FEA's practice is to analyze the business operations of the firm, relying for example on such financial indices as markup data, gross margin data, competitive pricing, historic sales volumes, profits, revenues, product cost, and projections of financial viability ... "31

However, this statement should not be taken at face value. At the time it was made, the FEA had established by its record in granting serious hardship exceptions that a substantial decrease in net profits was in effect the only basis upon which exception relief would be granted. In fact, in twenty of the approximately twenty-one published decisions issued in 1974 in which relief was granted solely on the basis of serious hardship, the applicants had demonstrated present or projected operating loss. However, since late in 1974, the FEA has indicated that a firm need not necessarily demonstrate operating losses, that substantial decrease in profitability would be sufficient to establish serious hardship. Specifically, the FEA granted exception relief to a firm which indicated that its levels of profitability had declined 48%,32 relative to its recent financial history. In contrast, the FEA has specifically held that a reduction in profits of 16% does not constitute harm of sufficient magnitude to form the basis of a serious hardship finding.33

Recently, particularly in considering requests for exceptions to the requirements of the Entitlements Program, the FEA has placed increasing emphasis on another financial indicator, the profit margin of a firm. For example, in one case, the FEA emphasized profit margin as a gauge of serious hardship, and did not even indicate the percentage reduction in profitability of the firm. Specifically, the FEA held that a serious hardship was established where the firm demonstrated a 60% decline in its profit margin.34 However, if a 60% decline in profit margin establishes serious hardship, evidently a 16% decrease does not; the FEA denied relief where a firm's profit margin

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31. Martin Oil Service, Inc., 1 FEA ¶ 20,185 (November 19, 1974).
33. Morissette & Son Oil Company, 1 FEA ¶ 20,174 (November 7, 1974).
34. The Oil Shale Corporation, 2 FEA ¶ 83,103 (March 28, 1975).
had decreased from 9.2% in the past year to 7.78% in the current year.\textsuperscript{35}

The FEA has cited but not given controlling effect to other indices of financial distress in the exceptions it has granted including capital loss, excessive cost of fuel which cannot be effectively passed through to ultimate purchasers, cash flow problems preventing a firm from meeting its debt obligations, substantial reduction in revenues, substantial reduction in market share, substantial reduction in sales volume, and substantial loss of customers. The FEA has also applied various financial indices in denying exception relief including, return on investment, return on assets, earnings per share, return on equity, and even net income per barrel of crude oil refined.

In summary, although the FEA has applied various indices, the paramount test for granting exception relief based on serious hardship has been whether the applicant has suffered a substantial percentage decrease in net profits or profit margin.

A result of the FEA’s stringent conception of serious hardship has been that no major integrated oil company\textsuperscript{36} has yet received an exception based on serious hardship from the FEA. The major oil firms have made significant gains in net income in recent years (until 1975), and the FEA has consistently rejected the argument sometimes made by the major integrated oil companies (as well as small and independent firms) that a serious hardship is established if a firm’s profits would be less if exception relief were denied.\textsuperscript{37} (However, the FEA has extended exception relief based on gross inequity considerations to the major firms in several instances.)\textsuperscript{38}

Similarly, subsidiaries of major integrated oil companies have yet to receive a serious hardship exception. The FEA considers the subsidiary and the parent to be a single firm for serious hardship determination and pierces the corporate structures of the major integrated oil companies in examining net profits.

Serious hardship determination has been applied to consistently focus on the “firm”, which the FEA considers to include any entity which the applicant either controls or is controlled by. This broad concept of the firm was clearly illustrated in one case where an appli-

\textsuperscript{35} Plateau, Inc., 2 FEA ¶ 83,095 (March 27, 1975) in which the FEA emphasized that the firm’s total net profits had increased 20% despite its reduced profit margin.

\textsuperscript{36} Defined here to include only those firms classified by the FEA as “refinersellers” for purposes of the Buy-Sell List \textit{supra}.

\textsuperscript{37} See, e.g., Charter Oil Company, 2 FEA ¶ 83,077 (March 27, 1975).

\textsuperscript{38} Discussed \textit{supra}.
cantly established that it was incurring an operating loss, but FEA determined that there existed a close interrelationship between the applicant and another entity by virtue of the common management and control of the two firms. In denying relief, the FEA emphasized that an arithmetical combination of the operating results of the affiliated firms indicated at 63% improvement in net profits. Furthermore, not only is the FEA likely to apply an expansive definition of firm in particular circumstances, but also the Agency exercises the discretion to consider only that portion of an applicant’s operations which relates to products subject to FEA regulation (covered products). In further refinement of its applicable definition of firm, the FEA has refused to restrict its consideration to less than all of a firm’s covered product operations. For example, the FEA has held that declining sales in one product line does not constitute a serious hardship when the firm’s total petroleum operations are profitable. 41

The FEA generally grants exception relief based on serious hardship only when financial hardship is present or will be imminently experienced. The FEA has repeatedly stated that exception relief is not appropriate where alleged future difficulties are merely speculative.

If present or imminent financial difficulty is established, the FEA scrutinizes the firm’s financial history. The FEA has held that:

"... a comparison of a firm’s financial and operating posture prior to the inception of an FEA regulatory program and subsequent to the implementation of the program is a principal element of the exceptions process since exception relief on serious hardship grounds should generally be granted only to alleviate those serious hardships which result from application of an FEA regulatory program to the firm." 42

In this connection, the FEA has held that a firm is not incurring a serious hardship where present earnings in the absence of exception relief will be consistent with its historic earnings pattern. 43 Also, the FEA has held that a firm’s unprofitable history prior to promulgation

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39. Walter Simas/Simas Bros., 1 FEA ¶20,738 (December 13, 1974).
40. See, e.g., Industrial Oil Company, 2 FEA ¶ 83,016 (February 7, 1975) where at the suggestion of the applicant which primarily engaged in contract hauling services, the FEA considered only that portion of the firm’s operations which involved motor gasoline.
41. Weso Corporation, 1 FEA ¶ 20,706 (November 12, 1974).
42. OKC Corporation, 2 FEA ¶ 80,604 (June 5, 1975).
of FEA Regulations indicates a lack of causal connection necessary to support exception relief.\textsuperscript{44}

\textit{Causal Connection}

The specific requirements of causal connection necessary to support exception relief have not been clearly identified by the FEA. The agency has predominately required that financial difficulty result "primarily"\textsuperscript{5} from application of the FEA Regulations, but has not stated specifically the boundaries of that causation standard. Furthermore, in many instances the FEA has not clearly specified the standard of causal connection it has applied. Moreover, in one decision the FEA determined that only 21\% of a firm's operating losses were caused by application of the provisions of FEA Regulations; nevertheless, the Agency granted exception relief after concluding that FEA Regulations were "contributing significantly" to those difficulties.\textsuperscript{46} Application of the requirement that FEA Regulations contribute significantly to a firm's difficulties would seem to be considerably less stringent than the requirement that those difficulties result \textit{primarily} from FEA regulatory requirements. However, this distinction may be academic because the "significant contribution" test of causation has been applied in only one instance, and that single decision may therefore represent a temporary aberration.

\textit{GROSS INEQUITY}

In contrast to serious hardship determination, gross inequity analysis has involved an approach both more subjective and broader in scope. The FEA has refined and developed three general gross inequity criteria which the Agency presently applies. Gross inequity is present if it is demonstrated that:

\begin{enumerate}
\item The purpose of the regulatory provision involved would be distorted by strict application of its literal provisions; or
\item A firm is uniquely affected by a regulatory provision and is thereby experiencing a disproportionate burden relative to other similarly situated firms; or
\item Application of a regulatory provision frustrates the realization of a major national policy objective.
\end{enumerate}

\textsuperscript{44} See, e.g., Anderson Petroleum Company, 1 FEA ¶ 20,697 (November 7, 1974).
\textsuperscript{45} See, e.g., A&R Enterprises, Inc., 1 FEA ¶ 20,749 (December 23, 1974) and Clark Oil and Refining Company, 2 FEA ¶ 83,040 (February 12, 1975).
\textsuperscript{46} Taylor Butane Company, Inc., 1 FEA ¶ 20,726 (December 6, 1974).
Regulatory Purpose Distorted

An anomalous situation is almost invariably involved where a gross inequity finding is made based on distortion of regulatory purpose. In fact, the FEA has held that if an applicant argues that regulatory purpose is subverted in circumstances concededly not unique to the applicant, that the exceptions process is not an appropriate forum to evaluate the application because issues involving the general application of FEA Regulations are properly considered in rulemaking proceedings. In addition, an anomalous situation in which a firm is uniquely affected may not constitute a distortion of regulatory purpose. For example, where a firm alleged that its refining operations had been suspended because of a labor strike thereby resulting in a loss of entitlement benefits to the firm, the FEA held that even if the allegation were true, relief would not be appropriate because the Entitlements Program is designed to reward benefits only to the extent that a firm actually has crude oil refined.47

However, where an anomalous situation is established that does result in a distortion of regulatory purpose, exception relief based on gross inequity is appropriate. For example, the FEA has held that where a firm demonstrates that unusual or anomalous results occurred during a base period, exception relief should be granted.48 Similarly, where it is established that reference dates which control the setting of prices49 are unrepresentative, exception relief is usually granted.

Disproportionate Burdens Imposed

Just as an anomalous situation in which a firm is uniquely affected need not necessarily distort a regulatory purpose, neither need an anomalous situation in which a firm is uniquely affected necessarily result in an unfair distribution of burdens. In developing its conception of “disproportionate burden,” the FEA has observed that:

“The application of any general regulatory provision whatsoever will affect different firms in a different manner depending on the nature of their operations. The effect of any such regulation will also result in a particular firm being more adversely affected

47. Vulcan Asphalt Refining Company, 2 FEA ¶ 83,055 (March 6, 1975).
49. See, e.g., Carlos R. Leffler, Inc., 2 FEA ¶ 83,162 (May 30, 1975) where a firm’s markup on May 15, 1973 (the reference date for purposes of setting prices) was 1,051 percent lower than the markup used during its three previous years.
than any other firm. This result is an unavoidable element of the regulatory process, and exception relief is not appropriate under these circumstances solely on the basis of a showing that on a scale which measures the adverse impact of a particular regulatory provision a given firm is more adversely affected than other firms. However, exception relief may well be appropriate where a showing is made by a firm that in addition to experiencing a greater adverse impact as a result of a regulatory provision as compared to other firms, the nature or extent of the adverse impact on the firm significantly impedes its operations or places it in a substantially different position from other similarly situated firms when viewed in the context of the entire regulatory program.

It would not appear that financial difficulties of serious hardship magnitude are required to establish that a firm's operations are significantly impeded. However, more than minimal difficulty to the firm must be established. The FEA has held that a reduction in gross revenues of only 6.5% is insufficient financial difficulty to qualify for an exception based on gross inequity considerations. Even if a firm's operations are significantly affected, the firm may not be shouldering a disproportionate burden. For example, the FEA has concluded in the following instances that disproportionate burden is not established:

(i) A firm is denied the opportunity to earn revenues on its sales of a particular product which are at least equal to the revenues earned by its competitors;
(ii) A firm must purchase crude oil at a relatively high price to replace crude oil which it must sell as required by the provisions of the Mandatory Crude Oil Allocation Program;
(iii) A firm must purchase substantially more entitlements than other firms because its sources of crude oil are predominately subject to FEA Price Regulations.

In contrast, the FEA has found disproportionate burden in other

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52. See, e.g., Sun Oil Company, 2 FEA ¶ 83,101 (March 27, 1975).
53. See, e.g., Texaco, Inc. (J&W Refining, Inc.), 1 FEA ¶ 20,190 (November 21, 1974).
54. See discussion of the Entitlements Program, supra.
circumstances. For example, where a firm has made a substantial investment prior to promulgation of a regulatory provision which frustrates the purpose of that investment, the FEA has generally concluded that gross inequity exists. In more unique circumstances, the FEA held that certain low-volume service stations were disproportionately burdened by regulations limiting non-product cost pass-through which forced the stations to absorb the entire cost of installing vapor recovery units which benefited the entire community.

Frustration of National Policy Objectives

National policy objectives have been consistently cited by the FEA to mitigate for or against exception relief. In 1974, the FEA gradually evolved frustration-of-national-policy-objectives as a specific criterion of gross inequity determination. In an August 1974 decision, the FEA had specifically concluded that frustration of a national policy objective, conservation of energy supplies, did not constitute a gross inequity. In that case, a public transportation company had established that its higher than anticipated fuel costs would prevent expansion of its mass transportation facilities unless the FEA granted it an exception resulting in assignment to it of a lower-priced fuel supplier. Although the FEA did not make a gross inequity finding, in recognition of the national importance of conserving energy supplies, the Agency granted relief based on its power to afford special redress. Rather than relying on its special redress powers in subsequent cases of a similar nature, however, the FEA explicitly held in December 1974, that frustration specified in the EPAA or the Federal Energy Administration Act could, in appropriate circumstances, constitute gross inequity.

The FEA has granted exception relief where the following national policy objectives would have been otherwise frustrated:

(i) increasing domestic supplies of crude oil and scarce refined

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56. See, e.g., J&W Refining, Inc., 2 FEA ¶ 83,128 (April 25, 1975) and Saber Refining Company, 1 FEA ¶ 20,736 (December 13, 1974) where small refiners had made substantial investments in expanding refining capacity in reliance on contracts providing for dependable sources of crude oil, but FEA regulations controlling supplier/purchaser relationships preempted the contracts and prevented the firms from obtaining those crude oil supplies on a regular basis.

57. County of San Diego, California, 1 FEA ¶ 20,667 (September 27, 1974).


60. Apeco Oil Corporation, 1 FEA ¶ 20,750 (December 23, 1974).
petroleum products; (ii) restoring and fostering competition in the petroleum industry; (iii) preserving and enhancing the competitive viability of small and independent refiners; (iv) providing for equitable distribution of petroleum products at equitable prices; (v) protection of public health, safety and welfare (including maintenance of residential heating); (vi) expanding domestic refining capacity; and (vii) equitable distribution of the benefits of price-controlled oil;

In recognition that in some instances national policy objectives may conflict to some degree, the FEA has attempted to balance competing national objectives in several instances. 61

CONSIDERATION OF THIRD PARTY IMPACT

The FEA has generally considered third party impact in evaluating all exception applications. In fact, the FEA Procedural Regulations (10 C.F.R., Part 205) require that affected third parties be notified of exception applications and have an opportunity to respond. Moreover, the FEA has specifically granted applicants exception relief based on the finding that gross inequity would be experienced by third parties. For example, in several instances the FEA has increased the base period volume of an applicant service station where it has been established that a community is dependent on the station for its supply of gasoline and the station's gasoline supply is inadequate to substantially satisfy the community's requirements. 62 Furthermore, adverse impact on third parties has been often cited by the FEA as a reason to deny exception applications.

SCOPE OF EXCEPTION RELIEF

Exception relief is rarely granted in as broad a form as is usually requested. Rather, the FEA generally limits the relief provided to that which is sufficient to restore a firm to a financial and operating posture historically most representative. As might be expected, the

61. See, e.g., Pasco, Inc., 2 FEA ¶ 83,021 (January 20, 1975), and "Importance of the Exceptions Process in Policy Development", supra.
62. See, e.g., Corbin Produce and Service Station, 2 FEA ¶ 83,158 (May 23, 1975).
representative historical period chosen has varied from case to case. For example, in one instance a firm’s most recently completed fiscal year was selected. In another, the FEA granted relief designed to permit a firm to operate in a manner approximating its financial and operating posture achieved during its previous three fiscal years.

CONCLUSIONS

An application for an exception may be granted to alleviate or prevent serious hardship or gross inequity. Serious hardship exists where severe financial difficulties have been demonstrated, as indicated usually by a substantial percentage reduction in a firm’s net profits or in its profit margin, which reduction has primarily resulted from application of the FEA regulations. Gross inequity exists where it is demonstrated that because of an anomalous situation in which a firm is uniquely affected by a regulatory provision, either the regulatory purpose is distorted or the firm is disproportionately burdened. In addition, gross inequity exists if a national policy objective would be frustrated by strict application of the terms of a regulatory provision in particular circumstances.

The FEA has interpreted the exceptions criteria of serious hardship and gross inequity through an interative process in which published decisions have been issued on the merits of more than 400 exception applications. Although in many instances those decisions have not clearly set forth important factual elements involved or specifically identified the tests applied, nevertheless, increasingly precise standards have been stated and increasingly consistent treatment has been given similar situations. Because of the substantial published body of exceptions decisions rendered to date, it is now possible to forecast with increased certainty, the likely response of the FEA to particular problems identified in exception applications.

Although it is fair to expect that the specific meaning of the exceptions criteria in particular circumstances will continue to evolve, the large body of administrative decisions rendered to date ought to serve as a precedential foundation for future refinement of exceptions law. It would be a capricious act for the FEA, in exercising the considerable discretion it reserves to interpret the meaning of the exceptions criteria, to abruptly and fundamentally alter its basic interpretation. Instead, if the energy environment should substantially change, the

63. Pasco, Inc. 2 FEA ¶ 83,021 (January 20, 1975).
64. Famariss Oil Corporation, 2 FEA ¶ 83,080 (March 28, 1975).
more appropriate response would be for the federal government to change the applicable statutes and energy regulations accordingly.

If in response to fundamentally changed conditions, the central concept of the present regulatory scheme for energy - a freeze of relationships as they existed on a representative reference date - is abandoned, the exceptions process might play a less important role, and more traditional administrative procedures might become correspondingly more important. However, the nation's energy problems are so serious that the relatively severe regulatory method of freezing relationships may continue and, if this is the case, the exceptions process should remain a crucially important procedure.
THE REDEDICATION OF LIGHTLY USED OR ABANDONED RAIL RIGHTS OF WAY TO OTHER USES

BY CHARLES F. KALMBACH, JR.

Railroad rights of way represent one of the most valuable resources of our national transportation system, and yet great portions of the network are unused or underutilized and in a position to be lost entirely. This paper explores some of the legal and practical problems involved with the rededication of these important strips of land to other, and hopefully, higher, uses.

The Right of Way as a Valuable Resource.

Although few parcels of land along a right of way may have great value in an alternative use, the monetary value of a right of way actually exceeds the sum of the values of each contributing parcel of land by a sum known as an assemblage cost. This cost can increase the real value of the strip by as much as a factor of two to three times the sum of the segment costs and reflects the obvious fact that a right of way must be continuous. The segment costs, themselves, have increased in value many times over since the assembling of the rights of way as long ago as the first half of the nineteenth century. In short, the mere monetary value of the real estate that comprise the rights of way would demand a high use for them.

The value of the rights of way, however, transcend their monetary worth. At a time when travel time to the center of metropolitan areas is constantly increasing due to auto congestion (energy crisis or not), the potential of the rights of way that probe to the very core of many of our cities becomes obvious.

No better example of this potential could be found than the Philadelphia to Lindenwold high speed rail line of the Delaware River Port Authority (DRPA). PATCO (Port Authority Transportation Company), as it is now called, combined an unused subway line in Philadelphia with an underutilized branch of the Pennsylvania Reading Seashore Line to create a highly successful high speed passenger service. A more detailed analysis of the experience of the DRPA in organizing PATCO appears hereafter.

Assembled rights of way are of value in other than an urban com-

The need for more facilities plus new and imaginative outdoor recreational programs to fulfill the public's demand for urban recreation is an ever-growing reality. Trails, especially those using rights of way, are beginning to and increasingly will play an important role in meeting this need. Although the National Trails System Act of 1968 encouraged the use of rights of way for the development of recreational trails, little has been done by states and municipalities to utilize these routes for this purpose.²

The State of Wisconsin has converted four abandoned rail lines into state parks for hiking and bicycling,³ one of which was a 32-mile line acquired in 1965. More than 50,000 people each year, use the park which cost $62,000 to acquire and convert and $5,000 each year for maintenance.⁴ Similar conversions are planned by the states of Illinois, Texas, Iowa and Minnesota.⁵

The Right of Way as an Available Resource

Nothing could be more basic to the operation of a railroad than rights of way, and yet there are many thousands of miles of unused lines or lines on which operations are unprofitable, and are therefore potentially available for other uses. The U.S. DOT reports that the:

. . . railroad industry in 1971 was operating 205,000 route miles of line. Of these, approximately 21,000 miles were light density branch lines on which the carrier incurred losses. It is estimated that by ceasing operation of these uneconomic lines the railroads would save up to $42 million annually.⁶

Some commentators would go further: "Abandonment now threatens whole systems: and even the surgery required to save them may involve abandonment on an unprecedented scale."⁷ Some of the reasons

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⁴ N.Y. Times, May 20, 1973, Section 10, p.34.
⁵ Productivity Task Force, supra note 3 at 185.
⁷ Economics of Railroad Abandonments, Department of Transportation Sympos-
for this state of affairs will be presented hereafter.

The Federal Government has responded to the present rail situation by enacting "The Regional Rail Reorganization Act of 1973." The ways in which this Act makes rights of way more available will be described and contrasted to the prior procedures.

Legal Problems in Rededication.

From the moment the very first rail was put in place, the law has taken special note of the railroads. The relevant authorities are often found in court decisions of the last century. On the other hand, economic conditions along the way have created special needs which have been addressed by legislation. Federal and state regulatory law must therefore be discussed, as well as the federal bankruptcy act. The ability and power of state and local government to retain or acquire rights of way is an important issue which includes consideration of federal/state allocations of power. On top of all the above must be superimposed the true uncertainties of the Rail Reorganization Act of 1974 whose very constitutionality is presently being litigated.

The Broader Implications of Rededication Policy.

Beyond the "mechanics" of rededication lies an important administrative agency policy issue. In brief, the question is, to what extent should (or can) the procedures and rules of an independent agency promote the development of new technology. In part this is a question relating to the delegation of power issue and in part to the question of how an agency should make use of expertise.

The policy of the ICC relating to the ease by which a carrier may abandon unprofitable operations affects the development of transportation technology in at least two ways. A carrier which is being made to absorb great losses on a branch for a long period of time has that much less profit with which to experiment with new forms and techniques of service. In addition, a restrictive policy towards abandonment makes branch lines that much more unavailable to short line operation who often have the willingness as well as incentive to experiment with new technology and new operating procedure. In other words, instead of protecting the shipping public, the ICC could very well do it great harm through an unduly restrictive abandonment policy.

The degree to which the ICC through, for example, its rededication procedures should take into account competing or potential technology is an issue whose time for consideration has come. The further question of the degree to which the ICC should positively encourage the development of transportation technology is a crucial one for a congress legislating at this time in our railroad history. The answers lie at the heart of the nation's transportation policy. But far from being a simple matter of developing a doctrine, the issue has economic, antitrust, and procedural aspects of significant complexity. The single point of how and where an agency like the ICC is to obtain technological evaluations, much less predictions, is imbedded in the current debate over the merits of national planning.

This article concentrates on the mechanics of rededication, and leaves these other intensely interesting matters to future study.

PROPERTY LAW AND REDEDICATION—DEFINITIONS.

The term "right of way" has a two-fold meaning. "It sometimes is used to describe a right belonging to a party, a right of passage over any tract; and it is also used to denote that strip of land which railroad companies take upon which to construct their road bed."8 As a privilege to pass over another person's land, the right of way never exists as a natural right, "but always must be created by a grant or its equivalent."9

Herein the term right of way will refer to the strip of land on which the railroad operates. In each case, therefore, it will be necessary to define the nature of the railroad's interest in the land comprising the right of way with the additional label of fee or easement.

"An easement involves primarily the privilege of doing a certain class of act on, or to the detriment of, another's land, or a right against another that he refrain from doing a certain class of act on it or in connection with his own land."10 In other words, one can speak of "affirmative" and "negative" easements. "An affirmative easement is one which authorizes the doing of acts which if no easement existed, would give rise to a right of action while a negative easement is one the effect of which is not to authorize the doing of an act by the person entitled to the easement, but merely to preclude the owner of the land subject to the easement from the doing of an act which,

10. Id.§756.
if no easement existed, he would be entitled to do.” Since the use of a piece of a person’s land as a right of way involves the creation of a privilege rather than the withdrawal of a privilege, a right of way to the extent that it is an easement would be an affirmative easement.

Although an easement is an interest in land, it is not a possessory interest. “The owner of it, therefore, is not entitled to the protection which is given to those having possessory interests. The fact that the owner of an easement is not deemed to have a possessory interest in the land with respect to which it exists indicates a lesser degree of control of the land than is normally had by persons who do have possessory interests. Thus, a person who has a way over land has only such control of the land as is necessary to enable him to use his way and has no such control as to enable him to exclude others from making any use of the land which does not interfere with his.”

Easements can be further distinguished as easements in gross or easements appurtenant. The latter occurs when the easement is intended to benefit the owner of a piece of land in his use of that land. The former applies to an easement that belongs to a particular person independent of any land owned by that person. “Insofar as the railroad company merely has an easement of a right of way, that is, the privilege of having its train pass over another’s land, it is necessarily on easement in gross and not easement appurtenant.”

In order to have a possessory interest in land (or a “fee”) a person must have “a physical relation to the land of a kind which gives a certain degree of physical control over the land, and an interest as to exercise such control as to exclude other members of society in general from any present occupation of the land.” There are three interests of importance to this study. The first is the “fee simple absolute” which is a possessory interest of potentially infinite duration which is not subject to any limitation or condition. The other two interests evidence less than absolute ownership. The “fee simple subject to a special limitation” is ownership that automatically expires if and when the stated event occurs. On the other hand, the “fee simple

11. Id.
13. Id. §453.
14. Id. §454.
15. Tiffany, supra note 9 §772.
16. Restatement, supra note 12 §7(a).
17. Id. §15.
subject to a condition subsequent” is a form of conveyance which enables the conveyor, or successor in interest, to terminate the interest subject to the named condition. However, the interest continues until this power is exercised. The fee simple subject to special limitation gives the conveyor or his successor a possibility of reverter, while the fee simple subject to a condition subsequent gives the conveyor a power of termination.

Means of Acquiring Rights of Way.

Subject, of course, to its charter of incorporation, a railroad may acquire land for its rights of way by public, private or implied grant, by purchase, by dedication, by adverse possession, by license, by estoppel of a dispossessed owner to sue, or by condemnation to a public use under a power of eminent domain.\(^\text{18}\)

The nature of the railroad’s interest in the acquired land varies according to how the land was obtained. If conveyed through a contract, the land is subject to the conditions of the contract. The grant may be good only for as long as the land is used for railroad purposes or for railroad operations with possibilities of reverter or powers of termination. Other provisions that have been held enforceable are the stipulation of the running or stopping of certain trains on the right of way, the granting of free transportation to the granter, the erection and maintenance of a station, the continuation and maintenance of fences, sidings, and private crossings.\(^\text{19}\) Furthermore, some courts have held that a successor to the original promisor railroad is bound by the promise to perform certain of these services. For example, one court found that covenants requiring the removal of ice and snow from and furnishing light for, platforms, ramps and access ways to and from railroad station facilities, whether on the parcel conveyed by the railroad or on the parcel retained by the railroad bound successors of the corporation to whom the railroad originally conveyed the parcel.\(^\text{20}\)

Another issue with respect to these promises is whether they run with the land of the promisee. That is to say, is the physical use of promisee’s land involved to the extent that the usual “touch and concern” requirement is satisfied. The present state of the law in New

\(^{18}\) B. Elliot, Law of Railroads, §1150 (3d ed. 1921).


York, for example, is that "affirmative covenants may be enforced against subsequent holder of the originally burdened land whenever it appears that (1) the original covenantor and covenantee intended such a result; (2) there has been a continuous succession of conveyances between the original covenantor and the party now sought to be burdened; (3) the covenant touches or concerns the land to a substantial degree."\(^{21}\) On the other hand, New Jersey courts will not enforce affirmative covenants.\(^{22}\)

If it is an easement that has been obtained by grant, a change in the use of the right of way which results in the easements being used more constantly could affect the existence of the easement. For example, it was held in Illinois\(^{23}\) that the grant of the right to use a switch track in front of a lumber yard did not justify the use of the same track for carrying coal to an electric plant, built on the site of the lumber yard. However, the issue is one of construction of the grant.

Another means of acquiring a right of way is through adverse possession. "A railroad company may acquire title to land by adverse possession for the full period presented by the statute of limitation in the same manner as an individual. But such possession must be continuous and under claim of right, and of such a character as to give notice to the land-owner of the company's claim of title to the land."\(^{24}\) However, in a 1907 Pennsylvania case,\(^{25}\) the court held that a railroad cannot acquire title by adverse possession if it can take land by a power of eminent domain without compensation.

The problem in states where a railroad may acquire interest in land through adverse possession is the nature of that interest. The mere act of laying track does not seem to distinguish between claiming an easement through prescription and a fee through adverse possession. Presumably the exclusivity of the railroad's possession will be the same in either case as will be its use. "On the face of the matter, then, no definite conclusion can be drawn merely from the acts of user or possession."\(^{26}\) However, the general conclusion is that the railroad acquires only an easement through prescription.\(^{27}\)

\(^{24}\) Elliot, supra note 18 § 1174.
\(^{26}\) Note, Extent of Title Acquired by Railroad by Adverse Possession, 39 Mich. L. Rev. 297 (1940).
\(^{27}\) See Elliot supra note 18 §§462, 463.
The ability to acquire land by condemnation under a power of eminent domain is conferred by statute. Usually the extent of the interest acquired is an easement which, however, can be perpetual in duration.28 The nature of the acquired right is particularly important if a private easement is being condemned. "When the [private easement] is condemned for a railroad right of way, and the owner of the easement is made a party to the proceeding, the easement is extinguished if the railroad acquires the fee, while if the railroad acquires merely the easement of a right of way, it does not seem that the private easement is extinguished, though its exercise is for the time being rendered impossible. If the owner of the easement is not a party to the proceeding, his easement, it seems, is not affected thereby."29

Nature of the Interest When Right of Way Conveyed by Deed.

One must also determine whether a fee or an easement is obtained when conveyance is by deed.

The two polar situations are the deeds in which "land" if conveyed and where a "right" is conveyed. The former generally speaking results in a fee title while the latter results in an easement. The problem, of course, appears between these extremes. It is further complicated when reference to the purposes of the conveyance are made or the conveyance occurs around the time condemnation proceedings were initiated. For a more complete analysis of this problem, the reader is referred to the reference in the notes.30

When it is a strip, piece, path, or tract of land that is being conveyed without other description or reference to the land in the way of diminishing the interest conveyed, the interest passed is generally a fee. For example, in Kyerd v Hulen,31 the following language appeared in a warranty deed and was held to pass a fee and not an easement: "all that certain tract, lot or parcel of land . . . being more particularly described as follows, to wit: A strip of land one hundred feet wide, being fifty feet on each side of the center of the main line track of [a certain railroad] as the same may hereafter be constructed, laid and fixed by said company upon, over and across the following tract of land owned by us."

The two-fold meaning of "right of way" discussed above32 is the

28. Id. §1222.
29. Tiffany, supra note 9 §823.
30. See generally Elliot, supra note 18 §1158, 6 A.L.R. 3d. 973.
31. 2 F.2d 160 (5th Cir. 1925).
32. Ivy, Supra note 8.
possible source of the problem in analyzing deeds conveying a strip, tract, piece or parcel of land which also contains reference to "right of way". Some of the ways that this reference can appear are as follows: "Deed to right of way" may be the heading of the document; words like "I hereby grant and convey the following described strip to be used for right of way purposes" may be used; the land may be described as being a "right of way". Courts will often inquire into whether the term is used to define and therefore limit the estate conveyed, or whether the term is only a description of the intended purpose of the property. If the term makes the deed ambiguous, other factors are sometimes considered to determine the parties' intention. In the cases in which a court arrived at the conclusion that the interest conveyed was a fee rather than an easement, two theories prevailed: (i) the granting clause is to take precedence over a later clause in conflict; or (ii) reference to a "right of way" after an unambiguous granting clause is taken as describing the land rather than limiting the estate (i.e. the second meaning of "right of way" is assumed).34

Another problem in deeds granting a strip, tract, piece or parcel of land is the notation that the land is for "railroad purposes". Three approaches have been taken by courts to this notation: 1. "When the granting clause provides for a certain or specific estate, and the character or nature of real estate is changed or lessened by some interlocutory clause, . . . , the granting clause should prevail".35 2. The language creates a fee simple subject to a special limitation or subject to a condition subsequent; 3. The language displays intent to convey an easement rather than a fee. The following language was construed to grant only an easement by the court in Alabama Corn Mill Co. v. Mobile Docks Co., "Also that certain strip of land one hundred feet wide, commencing at a point on the north side of Marion Street, . . . ; the object of this last-described piece being to give track facilities in to and from the property herein first conveyed."

Finally, in other cases where the railroad company is supposedly being granted "land" (as opposed to a "right"), courts have sometimes seized on certain rights retained by the grantor to hold the conveyance to be one of easement instead of in fee. For example, the right to take stone and earth or to cultivate up to the roadbed have

37. St. Louis-San Francisco R. Co. v. White, 199 Ark. 56,132 S.W. 2d 807 (1939).
38. 200 Ala. 126, 75 So. 574 (1917).
been held to reduce the conveyance to an easement.\textsuperscript{39} However, in \textit{Gabbard v Hart},\textsuperscript{40} the court construed general warranty deeds as passing fee title. "The added provision in the deeds covering removal of timber and buildings and additional land for slope protection of cuts, fills and slides, the use of stone from granters' land, ingress and egress, and compensation for future damages, to remaining land are not inconsistent with a fee simple title."\textsuperscript{41}

The court in \textit{United States v. 1.44 Acres of Land},\textsuperscript{42} had to construe the effect of two deeds relating to the same piece of land. The first read in part: "Give, grant, bargain and sell, alien, enfeoff, release and convey unto the party of the second part, the successor and assign, forever the following described land and premises . . . containing 12,840 square feet, together with the rights to cut and fill in and upon said lands as may be required for the railway of the said party of the second part . . . " Although rights were granted to the railroad "which are completely unnecessary if a fee has been granted and which are indeed repugnant to a claim of fee",\textsuperscript{43} the court held the conveyance to be one of fee title. However, the second deed was held to grant only an easement. The deed read in part:

"I . . . , do hereby grant and convey unto the plaintiff, the Washington Railway and Electric Company . . . a right of way for its chartered purposes upon and over the strip of land in controversy in said case . . . "

The court wrote: "While a railroad may have the power to take in fee, it need not necessarily do so, and in fact railroads customarily hold their right of way by easement. And while the terms 'right of way' may be used in either fee or easement context, as a general rule only an easement is meant . . . The court cannot help but equate the term 'for its chartered purposes' with the term 'for railroad purposes' . . . These factors all reinforce the plain language of the Talbot deed granting an easement."\textsuperscript{44}

At the other polar position, courts usually construe a grant as conveying an easement rather than a fee when instead of conveying a

\textsuperscript{40} 351 S.W.2d 510 (1961).
\textsuperscript{41} 351 S.W.2d 510, 511.
\textsuperscript{42} 304 F. Supp. 1063 (1969)
\textsuperscript{43} 304 F. Supp. 1071-72.
\textsuperscript{44} Id. p. 1071.
strip, piece, parcel or tract of land, the deed conveys a right (including the "right or privilege of constructing, operating, or maintaining a railroad" as well as a right of way). The effect of a later reference to a right of way on an unambiguous granting clause was discussed above. In the analogous case of a granting clause clearly giving an easement with a reference to a fee simple, courts generally do not allow an enlargement of the title to a fee.

Of course, there are cases of deeds conveying both a right and land as well as obscurely worded deeds mentioning neither. Finally, three factors other than the actual language of a deed can influence a court. A state statute which empowers a railroad company to hold land only as an easement, has been used to overrule clear language in a deed conveying a fee, and vice versa. Sometimes the relative position of the parties or even the amount paid for the conveyance have been determining factors.

Why Classification of Interest is Important.

Knowing the nature of a railroad's interest in a right of way is of course crucial if one wishes to take over the railroad operation as the DPRA did to create the Lindenwald Line. However, the nature of the original interest of the railroad is equally important in the case in which the railroad no longer operates on the right of way. This section discusses the status of land to which the railroad had less than fee simple absolute title and on which operations have since been "abandoned". What constitutes abandonment will be discussed later, but it is important to note here that the use of the word abandon in property law is not the same as the use of the word by the Interstate Commerce Commission.

At this point, therefore, it is assumed that the railroad had obtained an easement or a fee subject to a condition subsequent or subject to a special limitation by grant or had acquired the right of way by condemnation and then ceased operations on the land.

"Where land has been conveyed to a railroad company under a

45. e.g. Lockwood v. Ohio River R. Co., 103 F. 243 (4th Cir. 1900).
47. e.g. Alabama G.S.R. Co. v. McWhorter, 202 Ala. 455, 80 So. 839 (1919).
48. e.g. Detroit, H. & I.R. Co. v. Forbes, 30 Mich. 165 (1874).
49. e.g. Chouteau v. Missouri P.R. Co., 122 Mo. 375, 97 N.E. 1004 (1912).
50. e.g. Highland Realty Co. v. San Rafael, 46 Cal. 2d 689, 298 P. 2d 15 (1956)
deed which creates an easement in favor of the company rather than
a title in fee, and such land is subsequently abandoned for railroad
purposes prior to any other conveyance thereof by the original owner,
there is no doubt but upon abandonment title reverts to such original
owner or his heirs, or, more accurately speaking, the title of the origi-
nal owner is relieved of the easement to which it had previously been
subject.  The court of appeals of Kentucky clearly faced the issue
in a case involving a railroad which had acquired a two mile strip
for a right of way from a number of landowners. It later stopped
operations, tore up the tracks and attempted to convey its interest
to a National Park. The deed read in part: “for and in consideration
of running their contemplated Road on and along their land, as well
as in consideration of the sum of One Dollar, to them in hand paid
. . . hath given, granted, bargained and sold, and by these presents
doeth give, grant, bargain and sell to the said Mammoth Cave Railroad
Company, and their successors and assigns, the Right of Way, de-
scribed below, over which to pass, at all times, in any manner they
may think proper, and particularly for the purpose of running, erect-
ing, and establishing a Railroad. To have and to hold the same unto
the said Mammoth Cave Railroad Company, their successors and
assigns, to their own proper use, benefit and behoof forever, in fee
simple, under condition, and it is expressly understood that should
the said railroad contemplated as aforesaid, be not located and estab-
lished on and along said strip, tract, or parcel of land, described in
the above and foregoing indenture, then said indenture is to be wholly
null and void, and of no effect.” The court decided that the deed
gave only an easement to the railroad and distinguished the case from
another in which the railroad was clearly given a fee interest. The
only issue left was whether the road had been abandoned and, if so,
to whom the title reverted. “Forfeiture of easements like other forfei-
tures are not favored by the courts, and mere non-use or temporary
suspension of use without adverse possession is not alone sufficient
to establish abandonment . . . . While long-continued non-use or
suspension of use are not of themselves conclusive evidence, they are
factors to be considered when coupled with other acts evidencing the
intention to abandon, in determining whether an easement has been
relinquished . . . . The record clearly discloses that the railroad com-

52. 136 A.L.R. 296.
769, 88 S.W. 2d 930 (1935).
54. Id. p. 933.
pany, by abandoning the use of its railroad, tearing up and removing the tracks, and attempting to convey the land to others to be dedicated for other purposes, abandoned its right of way, and the lands thereupon reverted to the grantor or their successors in title.\(^5\)

If the original owner of a right of way easement across or along the edge of his property conveys the entire tract (including the strip or a tract abutting on the right of way), the grantee would hold the fee discharged of the easement upon the forfeiture of the easement. The only modification of this would seem to be the language in some decisions to the effect that the grantee acquires a fee title only to the center of an abandoned right of way that abuts on the tract conveyed.\(^9\)

If the railroad company holds the right of way in fee subject to a special limitation or to a condition subsequent, violation (or occurrence) of the condition returns the title to the grantor in the first case, or gives him a power of termination in the other. For example land has been conveyed for the “purpose of erecting and maintaining a section house”\(^5\) and for “railroad purposes”.\(^9\) Occasionally a court has considered the condition that the land be used for “railroad purposes” fulfilled if it was so used for a number of years. Such “sufficient” compliance supposedly increased the railroad’s title to fee simple absolute.\(^6\)

The question of the effect of the attempted conveyance of the property which has been already conveyed to a railroad in fee subject to a special limitation or to a condition subsequent is hard to answer. One court has held that the conveyance to the railroad of the rest of a person’s land after the person had granted the railroad a right of way in fee subject to a condition subsequent ended the person’s interest in the compliance of the railroad to the condition.\(^4\) However, the broader problem is the alienability of possibilities of reverter and powers of terminations. Generally the latter are considered to be neither alienable nor assignable and are extinguished by an attempt to convey them.\(^4\) The authorities are in conflict over the alienability

\(^5\) 88 S.W. 2d 934-35.
\(^6\) 136 A.L.R. 296.
\(^7\) St. Louis Southwestern R. Co. v Carter 113 Ark. 92, 167 S.W. 489 (1914).
\(^8\) Romero v. Department of Public Works, 17 Cal. 2d 189, 109 P.2d 662 (1941).
\(^12\) Id. §210.
of the former. However note that even in jurisdictions in which those rights or powers are not alienable, a court could construe the deed so as to give the railroad and easement (rather than a defeasible fee) and so leave the grantor with an alienable interest.

The effect of abandonment of land acquired through condemnation is controlled by the state statute authorizing condemnation. Generally, if the statute gives the land in fee simple absolute, subsequent abandonment does not cause the land to revert to the grantor. However, if the interest in the land was less than a fee simple absolute "the title to the land condemned reverts to the original owner, or his heirs or assigns, upon abandonment therefore for railroad user."65

What Constitutes Abandonment

The question of what constitutes abandonments in the property law sense is, in the first instance, one of fact.66 Furthermore since the crucial fact is one of intent, there must be found acts which evidence the intent to abandon67 and which are clear and convincing.68

Generally speaking, proof of mere nonuser of a right of way is not sufficient to prove abandonment.69 However, nonuser along with certain other circumstances have proven sufficient. For example, where there existed a contract between the grantor and grantee that nonuser would amount to abandonment, the court enforced the reversion upon the cessation of railroad operations.70 Similarly where the consideration for the grant of the land was the construction of a depot and maintenance of rail service and the depot was never built and the service ceased.71 Growth of trees of up to 17 inches in diameter between the rails has been held to be conclusive proof of abandonment.72

Seemingly one exception to the requirement of proof of intention to abandon, at least in California, is where the right of way was an easement acquired by prescription. One court held nonuser to be sufficient to terminate the easement.73 It is also possible for the legis-

64. Id. §206.
65. 136 A.L.R. 296 §III.
68. St. Louis-San Francisco R. Co. v. Relland, 43 S.W. 2d 1034, 328 Mo. 1154.
69. 95 A.L.R. 2d 468, §3.
70. Atlantic Coast Line P. Co. v. Sweet, 177 Ga. 698, 117 S.E. 123 (1933).
71. Lyman v. Suburban R. Co., 190 Ill. 320, 60 N.E. 515 (1901).
lature to deem a right of way abandoned that has not been used for a certain period of time.  

Courts have found it easier to hold that an abandonment has occurred where there has been adverse possession of the right of way. However, this fact is far from conclusive.  

A much clearer indication of intention to abandon is the removal of tracks from the land. Nonuse of right of way in conjunction with the use or acquisition of a new route has also been taken as evidence of abandonment.  

Although application for authorization from a regulatory agency to discontinue service is a factor to be weighed in considering whether abandonment has taken place it is usually not sufficient by itself.  

However, removal of tracks pursuant to agency authorization has been held to prove abandonment.  

In spite of cases like those previously cited indicating that use of a right of way different from that contemplated when granted or condemned may cause abandonment, "the courts have usually refused to base a finding of abandonment on such evidence, particularly where the new use is in some way associated with the business of the railroad."  

Connected with the problem of new use of a right of way is that of a new owner of the right of way. As long as the new owner continues to use the right of way as a right of way, the courts seem to refuse to find abandonment. A Minnesota Court faced the problem of conveyance of a right of way obtained through condemnation to another railroad company which constructed and ran a railroad on the right of way. The court reversed a lower court's finding of abandonment:

> In theory the land was taken, and the right to apply it to the public use proposed acquired, for the state. It is true, the title to the right thus acquired yested in the corporation, but it so

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74. e.g. Central I.R. Co. v. Moulton I.A.R. Co., 57 Iowa 24a, 10 N.W. 639 (1881).  
75. 95 A.L.R. 2d 468, §4.  
76. Id. §6.  
80. 95 A.L.R. 2d 468, §9.  
81. Boston v. Jarvis, 218 Ky. 239, 291 S.W. 38 (1927) held that a railroad had only an easement rather than a fee title and so conveyance for a non railroad use made the land revert to the grantor or his successors.  
82. Crolley v. Minneapolis & St. Louis Ry. Co., 30 Minn. 541, 16 N.W. 422 (1883).
The court reaffirmed the principle that "the law abhors forfeitures surfaced rights to a portion of its rights of way for use as a highway. In a more recent case, the railroad company conveyed to the city to serve the public needs. When taken for railroads the land is taken under authority of the state, to be applied under the same authority to a public use, to wit, to a highway, public in a certain sense. Upon no other theory can the taking and holding of real estate of private persons, without their consent, be justified. It is the purpose for which the land is taken, and not the particular corporation which the state authorizes to take it, that determines whether the use is public or not. In this case the state authorized the taking for the purpose of a railroad from the city of Minneapolis to the south shore of Lake Minnetonka. The use would have been the same had it authorized any other company than the Northwestern to take it for that purpose. Who holds and uses the land for the purpose for which it is taken, does not affect the character of the use.

So long as the land continues to be applied to the purpose for which it was taken—to wit, as a right of way for a railroad between the two points indicated,—the use remains the same whether it be so applied by the corporation which originally took the land or by some other. Who owns the railroad, whose duty it is to maintain and operate it for the benefit of the state and the public, and who does in fact so maintain and operate it, is immaterial so far as the character of the use if concerned. When the St. Louis Company took the transfer of the right of way, and constructed, maintained, and operated a railroad over it, having authority from the state to acquire and hold rights of points, it applied the right of way to the very use for which it was taken. The right of way seems to have been transferred for the purpose of having it so applied; not for the purpose of giving up the enterprise, but for the purpose of having it carried out by the grantee company. We fail to see how that can be deemed an abandonment of the use or of the right of way. A sale of a right of way is not equivalent to an abandonment.

In a more recent case, a railroad company conveyed to the city surface rights to a portion of its rights of way for use as a highway. The court reaffirmed the principle that "the law abhors forfeitures

83. Midwestern Developments Inc., v. City of Tulsa, 374 F.2d 683 (10th Cir. 1967).
and favors the duration of rights of way so long as compatible with railroad use". However, the court found a clear manifestation of intent to abandon railroad use, albeit involuntary (since under the threat of condemnation). In spite of this, the plaintiff was denied relief due to application of the rule of an earlier case which treated the facts as if the city actually had used its authorized power of condemnation against the railroad. In such a case the railroad easement would have been terminated simultaneously with the taking of the highway rights of way and plaintiff could only recover in a reverse condemnation action.

The conclusion, therefore, is that conveyance of a right of way to a public or non-public entity would not amount to abandonment as long as rail operations were continued. However, only a public agency with authorized power of eminent domain could take over private rights of way for non-rail uses like bus rights of way, or bike paths. It is to be noted that resort to eminent domain would not be necessary if the court could be persuaded to equate rail rights of way with a more general category of rights of way for mass transportation. This would save the agency money and also probably would be in keeping with the grantor's original intention.

**Power of a State to Acquire and Retain Rights of Way**

It can be seen from the previous section that a state can most likely acquire a right of way from a railroad for continued use in rail operations without fear of interference from the granter of the right of way. However, the use of the right of way for purposes other than those for which the land was granted can raise problems based on the title of the land acquired. In addition to the problem of how a state can perfect its title to the land, the question of how a state becomes aware of impending line abandonment in time to act and of whether a state can enlarge its acquisition in anticipation of future needs are herein discussed.

New Jersey and New York are two states which have sought to solve the problem of being notified of disposition of railroad property in sufficient time to take action to acquire it for the state by means of "first option" statutes. In passing the statute, the New York Legis-

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84. 374 F.2d 689.
85. Woodville v. U.S., 152 F.2d 735 (10th Cir.).
86. 48 N.J.S.A. 12-125.1
lature footed that “abandoned railroad transportation property often possesses unique and irreplaceable value particularly suitable for public transportation purposes and nontransportation purposes, as well as for joint public uses. Such utilization of these existing land corridors, especially when used jointly, significantly reduces land acquisition and development costs to be public and, at the same time, minimizes disruption and displacement of families and businesses. Accordingly, it is the purpose of this act to establish a procedure by which state and local government agencies, and public utilities, will receive timely notification of railroad transportation property which has been or is almost to be abandoned, and to assure the availability of such property for public utilization whenever desirable.”

These first option laws forbid the railroad from disposing of property, at least within a certain period commencing with the notification of the state and local governments, without a release of the preferential right. (While the intent of the shorter New Jersey statute seems clear, its words do not request notification by a railroad disposing of land for which no permission of the ICC is needed.)

Once the state finds out about the proposed disposition and acts to acquire it, the question is what title can the railroad convey. Presuming that the state does not plan to continue the exact use for which the land was obtained by the railroad, conveyance to the state could mean an end to the easement, if that is how the right of way was held. The land would revert to the grantor or his successor in title. If the railroad has a possessory interest but one that is less than simple absolute, it is the heirs of this grantor (and not usually his assignee, as discussed above) about which the state must be concerned. Assuming that the railroad is still using the land for the use for which it was granted, the title conveyed would be subject to a possibility of reverter or power of reentry. The value of such a conveyance especially under the assumption that the state will use the land for some purpose other than that for which granted is difficult to ascertain. The answer may be that for grants dating back to the nineteenth century, the possibility of an heir of the grantor exercising his right or power is too remote for concern. In at least one case, it has been determined that the expense in tracking down the heirs of the grantor of a right of way exceeded the risk of their exercising their rights.

On the other hand, if the railroad has already ceased using the land for the granted purpose, its title in fee simple subject to a special limitation raises additional problems. In particular, upon cessation of use, the title automatically reverts to the grantor or his heir. Therefore, the railroad no longer legally owns the land. If, as found along one track of the New Jersey Central, one grantor out of many retained a possibility of reverter instead of a power of termination, and the railroad had abandoned operations along the line, the state should at the least refuse to pay for this one piece of land. Since the railroad owned the rest of the right of way (because the other grantors or their heirs had not yet exercised their power of termination), a conveyance of the railroad’s interest in these parcels would be of value. The state could then seek to trace the one grantor with the reverter, or merely commence adverse possession.

Ordinarily, one would not anticipate any problem in the cases in which the railroad owned the land in fee simple absolute. However, one must keep in mind those instances mentioned above in which courts have construed such interests as mere easements.

Of course, instead of negotiating for the sale of a right of way, the state could condemn it. The power of eminent domain (or the taking of private property for a public use) is an incident of sovereignty, subject to the due process and just compensation clauses of the Fifth Amendment as applied through the Fourteenth Amendment to state as well as federal action. A typical pre-1937 statement of the limitation of eminent domain was: “There must be a use, or a right to use, by the public, or some limited portion of the public. An incidental benefit, resulting to the public from this mode in which individuals in pursuit of their own interests use their property is not a public use.” The Federal Housing Act of 1937 started a movement away from the definition of public use as requiring public user to one requiring the accomplishment of a public purpose.

In any event, the state should have no problem in condemning a right of way for any present public use. The only question would be that of allocating the compensation between the railroad and the grantor or his heir or assignee. The much harder problem is whether

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93. Frasnowciki, Ownership and Development of Land
the state can use eminent domain to acquire or preserve rights of way for which it has no present use. A recent study94 looked at the related problem of whether a state agency can condemn property for possible future expansion of a rail line. Since a specific reason for condemnation is often all that is needed to satisfy a court,95 the necessity of advanced state planning becomes apparent.96

Procedure for Abandonment—History of Federal Regulations

It was the conventional wisdom of many American Historians that the imposition of federal regulation of the railroad was done over the strenuous opposition of the railroads in order to restrain their monopolistic practices. This concept along with one which held that the railroad industry was and is inherently non-competitive has been recently challenged.97

Indeed, organizations like the Order of Patrons of Husbandry (Grange) advocated Federal Regulation.98 However, the most important single advocates of regulation was the railroad industry itself. "Consciously or operationally most railroad leaders increasingly relied on a Hamiltonian conception of the National Government. They saw in a certain form of federal regulation of railroads the solution to many economic problems as well as the redirection of public reform sentiments toward safer outlets."99

The results of over a decade of discussion was the Act to Regulate Commerce (Interstate Commerce Act) of 1887100. The act required the publication of tariffs and adherance to the tariff as publicized. Notice had to be given of fare increases and a major price abuse of charging more for short than long hauls was greatly controlled. However, the statute also prohibited pooling, (i.e. the "agreement between competing railways for a division of the traffic or for a pro rata distribution of their earnings united into a 'pool' or common fund")101. It was the inability of the railroads themselves, to stabilize pooling arrange-

95. State Road Department v. Southerland, Inc., 117 So. 2d 512 (Fla. 1960).
100. Interstate Commerce Act, 1887.
ments (at least legally within the common law)\textsuperscript{102} that had led to the call for federal regulation. The excessive investment in overextended branch lines that characterized the industry in 1887 made the stabilization of pools imperative. The Act to Regulate Commerce of 1887, therefore, resulted in a non-pooling (i.e. non quota issuing) cartel. “Many of the most undesirable aspects of American freight transport regulation are a consequence of the non-pooling nature of the cartel.”\textsuperscript{103} Senator T.C. Platt recognized the problem at the time:\textsuperscript{104}

And right here I want to call attention to a glaring inconsistency in this proposed legislation. The proposed prohibition of pooling does not prohibit the railroad companies from making rates. Indeed, the whole bill compels agreements between competing roads for the making of rates. The section does not propose to prohibit hard and fast agreement between railroads to maintain rates. Indeed, it almost compels it. It does not propose to interfere with any other means which railroads may adopt, which are inducements to the railroads themselves to maintain rates. All that it does propose to do is to make criminal the apportionment of freight between competing railroads. With that criminal clause in the bill, it would still be open to railroads to enter into any other kind of contracts which they might invent for the purpose of maintaining rates agreed upon . . . It does not apply to a hundred means by which railroad companies may in some way make it for their interest to maintain the rates which they themselves have fixed and legally agreed to maintain under the bill.

It was not until the Transportation Act of 1920 that Section 5(1) was amended to legalize agreements between carriers (if approved by the ICC) for the pooling of freights of different and competing railroads or to divide between them the aggregate or net proceeds of the earnings of such railroads or any portion thereof. The years between 1887 and 1920 were hard ones for the ICC. It did not take the courts long after the passage of the Sherman Act of 1890 to hold the rate bureaus to be a combination in restraint of trade.\textsuperscript{105} “This left the Interstate Commerce Commission in the unenviable situation of being established to facilitate something which had been

\textsuperscript{102} Chicago M. and St. P. R. Co. v. Walach St. L. and P.R. Co., 61 Fed. 993 (1894).
\textsuperscript{103} Rail Productivity Report supra note 3 at 189.
\textsuperscript{104} 3 Interstate Commerce Commission.
\textsuperscript{105} See U.S. v. Trans Missouri Freight Assn. 166 U.S. 290 (1897).
come unambiguously illegal.”106 Other deficiencies of the act were addressed in three major amendments: the Elkin Act of 1903107 the Hepburn Act of 1906108 and the Mann-Elkin Act of 1910109 “Through these enactments Congress had succeeded by the eve of the First World War in the pointless, if not perverse course which it had set itself in 1887, stabilizing the railroad cartel without pooling.”110

By the time the Transportation Act of 1920 turned the ICC into a public cartel from its initial role of facilitator of private cartelization, the railroads had just almost peaked in mileage. The problem of the succeeding decades of contraction of the railroads were met by giving the ICC jurisdiction over competing means of transport: motor carrier in 1935111 water carrier in 1940112 and freight forwarders in 1942113 The ICC has, therefore, become an allocator of traffic between the modes with only the vaguest of guidelines at its disposal such as the prohibition of destructive competitive practices that appeared in the “National Transportation Policy” set forth in the preamble to the Transportation Act of 1940114 In some sense, the policeman has become the guardian.

It was not until the Reed-Bulwinkle Act of 1948115 that transportation cartels were finally exempted from Sherman Act prosecution. It took 61 years for Congress to clarify the legality of what it organized the ICC to do.

This approach to transportation regulation in the United States has not been without criticism:116

In the light of nearly 80 years of experience, complaints that the Interstate Commerce Act was an inadequate cartelizing device pale beside the observation that it was a cartelizing device at all. The Act is open to the most hostile criticism that one may lay against any statute: it perpetuated the problem with which it was designed to deal. In retrospect, the railroad problem of the 1880’s was a temporary and self-limiting one. The industry

110. Hilton, supra note 106 at 111.
114. 54 Stat. 898.
had attracted enough resources that the railroads would shortly have had to behave competitively whether they wished to do so or not. This prospect was widely looked upon as intolerable because it promised widespread bankruptcy and a long period of outflow of resources as a consequence of a chronically low rate of return. In retrospect, these circumstances were unavoidable, once the industry began to decline...

An organization of the industry in which firms were free to quote prices, to enter or leave the industry, and to diversify, but not to collude, is diametrically opposite the present organization of the transportation industry. Thus, what the market processes and the Sherman Act would have created in absence of the Interstate Commerce Act is at present a goal which may be achieved only after arduous political effort and difficult transitional adjustments of the sort usually encountered upon ending cartels.”

The particular portion of transportation regulation pertinent to this paper is that of abandonment control. The rest of this section analyses the history and procedure for abandonment of rail service.

Abandonment Before and After the 1920 Transportation Act

Problems of rate making, discrimination, and safety were early abuses attacked by state regulations and, eventually, federal regulation. Regulation over abandonment followed this pattern of state then federal attention but it lagged behind the above problems. Primarily, of course, this is because in the early days of railroading the systems were expanding and it was construction not abandonment, that drew attention. When the issue of abandonment did arise, the issue was local in nature and was decided by means of private litigation. Since a court is limited to the particular facts of the case before it, and is interested primarily in settling the narrow dispute, simple rules were developed dealing with duties to individuals rather than the public as a whole. (This was to be an important factor in the abandonment policy adopted by the ICC). One such rule was that as long as the railroad as a whole was profitable, the company could be prevented from abandoning an unprofitable branch. 117

The basis for such a rule was sought in the obligation the company

acquired in return for privileges like eminent domain. A Connecticut Court\(^{118}\) described the situation as follows:

One public right consists in the continuous uses of the railroad, its franchises and corporate property, in the manner and for the purposes contemplated by the terms of the charter. All these corporate franchises and this property are held subject to and charged with this obligation.

It is true that the charter is permissive in its terms, and probably no obligation rests upon the corporation to construct the railroad. The option to exercise the right of eminent domain and other public rights is granted. And when that option has been made, and the corporation has located and constructed its line of track, exercising the power of the state in taking property of others; and, in so locating and constructing its road, has invited and obtained subscriptions upon the implied promise to construct and operate its road, has commenced to operate the road under the granted powers, thereby inducing the public to rely, in their personal and business relations, upon that state of affairs, by so accepting and acting upon the chartered powers a contract exists to carry into full effect the objects of the charter, and the capital stock, franchises, and property of the corporation stand charged primarily with this trust. The large sovereign powers given by the state to railroad corporations are granted and exercised only upon the theory that these public rights are to be used to promote the general welfare. Having exercised those powers, the corporation has no right, against the will of the state, to abandon the enterprise, tear up its tract, and sell its rolling stock and other property, and divide the proceeds among the stockholders.

The possible effects of the exercise of such a claimed power are utter disaster to the great interests of the state, certain destruction of private property, in which whole communities, created and existing upon the faith of the continuous use of the chartered powers, are interested, and indeed, the life of the citizen, as well as his property rights, are thus jeopardized. Upon principle it would seem plain that railroad property, once devoted and essential to public use, must remain pledged to that use, so as to carry to full completion the purpose of its creation; and that

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this public right, existing by reason of the public exigency, demanded by the occasion, and created by the exercise by a private person of the powers of a state, is superior to the property rights of corporations, stockholders, and bondholders.

A rise in the number of abandonments in the year just before the enactment of the Transportation Act of 1920 may have had something to do with the inclusion of control over abandonment in Sec. I, although it probably was an afterthought. In any event, Paragraph 18, Section I included the following: “No carrier by railroad subject to this Chapter shall abandon all or any of a line of railroad, or the operation thereof, unless and until there shall first be obtained from the commission a certificate that the present and future public convenience and necessity permit of such abandonment.”

This is hardly a detailed legislative mandate. Of great significance to the operative effect of this provision is the interpretation of the term “public.” In view of the brief description of the prior history of abandonment given above, it is hardly surprising that the ICC decided to concentrate on the local public rather than on the nation as a whole. In addition, the uncertain position of the ICC vis-a-vis possible conflict between state and federal regulation may have kept the attention of the ICC focused on the narrow facts of each abandonment application. In any event, the policy of the ICC towards abandonment remained focused on local needs and divorced from other aspects of its regulatory work.

The process by which abandonment decisions are made by the ICC has from the beginning been best described as a “balancing of interests.” “The benefits to particular communities and commerce of continued operation must be weighed against the burden thereby imposed upon other commerce . . . . Whatever the precise nature of these conflicting needs, the determination is made upon a balancing of the respective interests - the effort being to decide what fairness to all concerned demands.” Some writers have advocated the elimination of this balancing and the granting of an absolute right to the railroads to abandon after a waiting period. Others would broaden

120. 49 U.S.C. 1.
121. Cherington supra note 119 at 42.
122. Id. p. 242.
124. e.g. Conant, Railroad Consolidation and the Regulation of Abandonments, 32 Land Econ. 318-25 (1956).
the ICC's enquiry from the particular local facts (i.e. the "particularist" approach) to resolution in terms of a national policy.

The fact is, however, that the ICC has chosen neither of these alternative approaches, and so one is left to discerning the standards used in its particularist balance. The discouraging fact is that no such standard can be articulated in spite of an initial legislative goal of the competitive ideal. The ICC approaches each application on a case by case basis with its discretion well protected from probing judicial review by the traditional respect afforded administrative decisions. On the other hand, the courts have injected elements into the process. The old idea that a railroad was not a strictly private enterprise has been continually reinforced. Frankfurter in 1951 stated "unlike a department store or a grocery, a railroad cannot, of its own free will, discontinue a particular service to the public because an item of its business has become unprofitable." In addition, the Supreme Court has required the ICC to consider displaced workers and if necessary attach conditions protecting their interests to the abandonment certificate.

A recent study looked at the effectiveness of the ICC abandonment procedure and concluded in part:

Rail line abandonments are rapidly becoming sensitive political issues as well as economic issues, and there is substantial justification in favor of careful assessment of the continued operation of some rail lines just as there is substantial justification for the discontinuance of some other lines. The cases that we assessed are almost as remarkable for the information they failed to consider as for the information they did consider. There is never a finding of the aggregate impact of the discontinuance on the community, but there is always a finding of the aggregate effect on the railroad.

In these older cases there was never an environmental assessment of the impact of shifting substantial tonnages to highway transportation from rail. In fact, there is no assessment of how much of the traffic moving by rail is likely to continue moving by rail after transshipment to the next closest railroad. In the

case of some Wisconsin lines it appears that a "domino" effect may be observed: one rail abandonment was justified partially on the basis of the close proximity to an alternative line which line itself, five years later, appears to be under consideration for abandonment.

The parties appear almost invariably to be pushed into extreme positions: the railroad seeks abandonment because the consideration of alternatives (such as increased rates or arbitraries) is too cumbersome or contrary to ICC practice. The shipper, who may be willing to pay an increased rate rather than lose rail service altogether, is afforded little opportunity for compromise. Because of the rigidities of the negotiating process, and because of the virtual certainty that the ICC will permit abandonment, a vast middle ground for compromise is left unexplored once the machinery of the abandonment proceeding is set into motion.

The lack of specific standards for abandonment can be costly to everyone. A contested abandonment can cost a railroad in excess of $50,000 and this does not include the extreme ill will generated in the community towards the company. A recent attempt has been made by the ICC to "permit a more expedient and economical disposition of the majority of abandonment application while maintaining the protections of due process." By order of the ICC in Ex Parte 274, a "34 car rule" was advanced which, operationally, would serve to shift to the shipper and public the burden of going forward to prove that the proposed abandonment was not in the public interest. A Temporary Restraining Order was entered against imposition of the procedure, but the rule was implemented anyway. Later, the court challenge was dismissed.

The rule provides that a presumption that the public convenience and necessity does not require the continued operation of a line upon the showing that fewer than 34 carloads of weight per mile were carried over the line during the prior twelve months.

129. Rail Productivity Report, supra note 3 at 168.
131. For a detailed critique see Simat, Evaluation of Proposed I.C.C. Railroad Line Abandonment Standards.
135. 49 C.F.R. 1121.23.
Complications for a Railroad in Reorganization

The fact that a railroad is in reorganization adds another layer of complication on the abandonment problem. In particular, the Federal District Court becomes an active factor in the railroad operation. When individuals and most companies are unable to meet their financial obligations, the Federal Bankruptcy Act affords a means of voluntary or involuntary relief. Railroad companies are subject to a special section of the Bankruptcy Act for reasons discussed below. This section, §77 provides for the reorganization of the company, instead of dismemberment and distribution to its creditors. In brief, the sixteen lettered paragraphs of §77 deal with five subjects: initiation of proceedings in reorganization; appointment and power of trustees; development of a reorganization plan; acceptance and confirmation of the plan of reorganization; dismissal of proceedings in reorganization.

The major provision affecting the rededication of rights of way is §77(C)(2) which provides for the continuing operation of the railroad, but under a court appointed trustee. The significance of this is that the provisions of the Interstate Commerce Act are still applicable, including, of course, those dealing with abandonment of service. In addition, however, before the railroad can apply to the ICC, it must secure the permission of the trustee, and in some cases, the court. The experience of the Penn Central has been that the court has approved all the abandonments approved by the trustee. This is hardly surprising since it should not take much persuasion to lead a court to agree that it makes sense for a company in reorganization to stop performing services on which it is losing money. It should also be obvious that the mere process of reorganization tends to make abandonment more likely. This is due to the requirement of financial supervision by the trustee and court over all expenditures. In such a situation, funds for track repair and maintenance seem not to be provided and the road bed deteriorates.

Therefore, when it comes to stopping operation, the major hurdle is still the ICC, albeit with the added task of persuading the trustees to support the program. If the railroad owns the land in less than fee simple absolute, the cessation of operation leads to the kind of legal

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problem discussed above with no further regard to the reorganization problem.

The picture is considerably different if the railroad owns the right of way. Although the court is quite willing to see unprofitable activities halted, the piecemeal disposal of a debtor's property is not a likely outcome. The creditors are quite aware of the value of the assembled right of way and are not likely to agree to the sale at anything approaching a bargain rate. There are ways of approaching this problem. However, it is enough to state here that the fact of reorganization makes the sale of unwanted rights of way much more difficult.

There are two reasons why analysis of §77 of the Bankruptcy Act is of little further concern to this study. The first is that a major revision of the Act has been proposed. The second is that the Rail Reorganization Act of 1973 (discussed in Section F) creates an entirely new approach to abandonments.

While the mechanics of the previous Bankruptcy Act are of little concern, the history behind the Act is important as background to the Rail Reorganization Act. The fact that a special section is devoted to railroads in the Bankruptcy Act is not surprising.

The common law placed a duty to serve the public on common carriers.

Looking then, to the common law, from whence came the right which the Constitution protects, we find that when private property is "affected with a public interest, it ceases to be juris privati only . . . ." Property becomes clothed with a public interest when used in a manner to make it of public consequence, and affects the community at large. When, therefore, one denotes his property to a use in which the public has an interest, he in effect, grants to the public an interest in that use, and must submit to be controlled by the public for the common good, to the extent of the interest he has thus created. He may withdraw his grant by determining the use; but, so long as he maintains the use, he must submit to the control.

Public interest and the interests and rights of the owner of a profitable railroad are usually reconcilable. Requirements to operate cer-

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139. Proposed Bankruptcy Act.
tain unprofitable lines can be viewed as the price a railroad pays for its franchise. However, when the railroad is insolvent, unprofitable operation in favor of the public works a relatively greater hardship on the owner and creditor of the company. There can be little doubt how the present §77 operates. Although §77(9) provides for the dismissal of the reorganization proceedings if there is "undue delay in a reasonably expeditious reorganization of the debtor", proceedings are rarely dismissed. The Missouri Pacific spent 23 years in reorganization, Florida East Coast spent 20 years, and the Rock Island and St. Louis-San Francisco each spent 14 years. The Rock Island, of course, is now back in reorganization.

However bad this may seem for creditors, the provisions of the Rail Reorganization Act have been received with even greater dislike. In viewing the historical development of railroad reorganization it is important to remember that there has not always been a Federal Statute in the Acts. One expert has in fact recognized five historical periods of railroad reorganization, with a Federal Act appearing only in the fifth period.

The first period, which ended with the panic of 1857, actually involved failures of promoters, rather than of railroads. Since the usual cause was insufficient capital to cover underestimated costs of construction, the usual cure was sale of more stock.

The second period, following the panic of 1857, involved large reorganizations of the "conventional" type, i.e. caused by insufficient earnings. The Pittsburgh, Fort Wayne & Chicago and the New York & Erie collapsed in 1861 and 1862.

The railroad panic of 1884, started the next period of reorganization which was marked by the insolvency of many partly finished systems. For example, the Atchison, Topeka & Santa Fe expanded from a $5 million profit earning system of 2800 miles to a 7000 mile system showing a $3 million deficit. The period was also marked by the emergence of "buccaneering enterprises" like the New York, West Shore & Buffalo, built on the opposite side of the Hudson from the Hudson River Railroad. "Certain . . . competitive railroads were built in fully developed territory for the single and avowed purpose of being bought out by stronger rivals. They were too weak even to initiate the struggle, much less carry it to a successful issue."143

The panic of 1893 started the fourth stage of railroad reorganiza-

143. Id. at 4,5.
tion, according to A.S. Dewing, which for the first time affected completed and established systems.

Throughout the first four periods of reorganization, the means of effecting reorganization was the equity receivership. Under the equity procedure, the court appointed a receiver who could continue to operate the railroad while a plan of reorganization was developed. The important advance of this procedure was the prevention of dismemberment of the railroad system through seizure by individual creditors. These seizures were possible because by the time of the second period of reorganization the railroad mortgage had appeared as a popular means of financing, and default of interest meant possession by the creditor in courts which construed liens strictly.

Although the equity receivership provided the environment in which reorganization could take place by preventing the assertion of individual claims and the dismemberment of the system, this procedure did not advance the actual reorganization of the railroad. “Among [the shortcomings of the equity, receivership] were: heavy legal and other costs; the long time consumed by the proceedings; the necessity of appointing ancillary receivers in other federal districts in which the railroad had property; minimal court control over security holders in protective committees; lack of court authority to subordinate any liens in favor of new creditors who could supply fresh funds (the court could only grant priority to those who extended credit for receivership expenses and some priority to receivers’ certificates); and little court control over the reorganization plan. Whichever group controlled the reorganization committee could designate preferential treatment under the plan.”

The fifth period of reorganization marked the direct entry of the federal government into railroad reorganization. Section 77 of Bankruptcy Act was passed in 1933 with no public hearings and little debate. As amended in 1935, the section gave greater power of control to the ICC and the courts and greatly diminished the ability of creditors to block reorganization.

Enough has been written in previous sections to indicate that the railroads have entered a sixth stage of reorganization. One cannot help but read the words of ICC Commissioner Joseph B. Eastman in 1933 as applying to §77 reorganizations today as well as equity receivership in 1933. He complained of the “great incidental expense which they have involved, the continued domination of the property by the

144. Id. at 9.
interests which may have been responsible for its financial trouble, failure to deal fairly with the interests of the various classes of security holders, and failure to accomplish a reorganization which sufficiently protects the future of the property."

The response to the crisis in 1973 as well as in 1933 was federal legislation. Enough has been written to question the ability of regulations to correct structural problems of the railroad industry. At least the present response attempts to eliminate some of the layers of regulation and supervision which have been discussed.

The Uncertainties Due to the Rail Reorganization Act of 1973

The Rail Reorganization Act of 1973 (RRA), or H.R. 9142, was reported out of the committee of conference on December 20, 1973, as Report No.93-744. The committee hoped that the Bill would “restore, support and maintain modern, efficient rail service in the Northeast region of the United States: ... designate a system of essential rail lines in the northern region; ... provide financial assistance to certain rail carriers.”

The Act became law in January 1974, and created two new organizations: the United States Railway Association (USRA) and the Consolidated Rail Corporation (Conrail). The former was to organize and plan for the acquisition by the latter of a viable rail network in the Northeast.

The major responsibilities under the Act were distributed among the Department of Transportation, the ICC (Rail Service Planning Office), USRA, Conrail, and a Special Court.

The purpose of Congress for erecting this structure, as stated in the Act, is to provide for

1. the identification of a rail service system in the midwest and northeast region which is adequate to meet the needs and service requirements of this region and of the national rail transportation system;
2. the reorganization of railroads in this region with an economically viable system capable of providing adequate and efficient rail service to the region;
3. the establishment of the USRA . . . ;
4. the establishment of Conrail . . . ;

145. Id. at 11.
146. See, for example, T. Schmidt, Government Regulation v. the Free Market, St. Louis University, December 9, 1974.
(5) assistance to States and local and regional transportation authorities for continuation of local rail services threatened with cessation; and
(6) necessary Federal financial assistance at the lowest possible cost to the taxpayer.\footnote{147}
Congress set up a tight two-year timetable to achieve the above.\footnote{148}

A closer look at the provisions on termination of rail service is necessary for this report. Section 304, dealing with discontinuance and abandonment, emerged from the conference committee in form similar to the Senate amendment to the original House Bill. Both documents had provided for expedited procedures as part of the reorganization process.

The final version of the Act takes away from the ICC jurisdiction over certain discontinuances and abandonments taking place within two years of the effective date of the Final System Plan. Provided that the particular property is not designated to carry rail service by the FSP, all that is required is that notice by certified mail of the intention to discontinue be sent to the Governor, the State DOT, the government of each political subdivision in which the property exists, and each shipper who has used rail service during the previous 12 months. This notice gives a shipper or a government the opportunity to apply for a rail continuation subsidy or outright purchase of the line.

The abandonment of service along a line designated by the FSP as one to be operated, requires ICC approval and is therefore subject to the requirements discussed in an earlier section. Of greater current interest are procedures for interim abandonment. Before the FSP is approved, \S 304f requires the authorization of the USRA before discontinuance or abandonment can occur. Therefore, the issue is taken away from the ICC, but the Act also requires that "no affected State or local or regional transportation authority reasonably [oppose] such action". During 1974 the meaning of this requirement has been addressed by a Court, and regulations for interim abandonment have been filed.

\footnote{147}{87 Stat. 985 \S 101(n).}
\footnote{148}{Department of Transportation News, Timetable of Major Events Under H.R. 9142.}
This article was the winning entry in The Harold S. Shertz Transportation Law Journal Essay competition for the year 1974-1975.
BOOK REVIEW

WHAT EVERY LAWYER KNOWS by Walter T. Fisher, Nimrod Press, Boston, Massachusetts, 1974, pp. 91, $1.75.

Reviewed by James C. Hardman*

It is an exciting experience to find a book which deals with a subject of immediate and personal interest and which does so in an excellent manner.

In a post "Watergate" era when the legal profession is experiencing derogation of its role in society, it is encouraging to have a successful, if not renowned, lawyer concisely summarize what "lawyering" is all about.

This book discusses basic and critical issues many of which involve the lawyer-client relationship. Some of the chapter titles include "What Lawyers Do For Clients", "What Loyalty To Your Clients Demands", and "When Conflicts Of Interest Between Client and Lawyer Are Tolerated".

The reader should not get the idea that the book is a treatise for the scholarly legal philosopher. On the contrary, the views and observations of the author are expressed in such clear and simple language that David F. Carvers, Fessenden Professor of Law, Emeritus at Harvard Law School, writing the Foreword, states that the book could be a guide for clients and students as well as attorneys and suggests that a lawyer could do himself, his profession, and his clients a favor by leaving a copy in the office waiting room.

One of the sage observations made by the author on the lawyer-client relationship is the recognition that the independence-servitorship paradox creates complex and troublesome issues the resolution of which lies at the heart of the lawyer's function in society. "Watergate" occurred in many respects because the lawyers advising the President failed to resolve the question the author poses "The Lawyer: Mogul or Stooge?" As the author observes, the manner in which each lawyer resolves the dilemma of being both loyal to his client and independent of him is the touchstone of his professional stature and his private character.

In addressing himself to the question of what lawyers do for clients, the author makes two general observations. First, the author notes that clients generally have only a limited comprehension of what

lawyers do or might do for them, and secondly, many clients do not realize the full depth and extent of their lawyer's loyalty to them and of his responsibility for the work he has undertaken for them.

The author discusses some simple, logical ways in which to overcome the above problems. They are not necessarily novel solutions, but ones which bear review and consideration. For example, many authors have suggested that clients be kept informed of what you are doing. The author echoes such advice, but goes one step further advising that even if you have done nothing, keep the client advised so that he knows he has not been overlooked. Other similar earthy advice is dispensed.

In discussing the loyalty due clients the central theme of the author is that the lawyer owes his client independent judgment based on full knowledge of the client's case. The author asserts that lawyers must think deeply enough for full understanding and not be awed by existing court decisions or other authority. The conclusion a client is entitled to is the lawyer's own conclusion—whether it is one the client likes or not.

This same type of informative and provocative discussion occurs in other chapters of the book which deals with subjects such as "Mumbo Jumbo and Other Communications" and "Wrinkles in Communication".

In the above sections of the book, the author notes that "language" molds the public's thoughts about lawyers and is a big factor in determining the public attitude towards the legal profession, and in the long run, the attitude toward those institutions largely in the hands of the lawyers: the law, the courts, and the government itself.

As a result of the above, the author concludes that it is in the public interest that lawyers be thought of, not as manipulators of esoteric technique, but as candid and forthright persons, whose special experience and wide point of view make them helpful in solving problems.

Readable English, the author asserts, will not only communicate more clearly to the client, but will in the process give the client a better picture of the lawyer as a practical and helpful person.

The author concludes with a discussion of the satisfaction that a lawyer gets from his work. The reviewer feels that it behooves every attorney to evaluate his personal experience in terms of the insight offered by the author. Hopefully, such evaluation will lead to the conclusion of the author, "... it has been fun".

If the reader questions the appropriateness of this review in a Journal covering transportation law, it might be noted that part of the
The author's more than fifty years of law practice included service as Chairman of the administrative agency regulating transportation in Illinois. More relevant, however, is the fact that "transportation specialists" are, in fact, first lawyers and, as such, this book synthesizes what we know—or ought to know.

Don't miss this book!
THE INTERSTATE COMMERCE ACT AND THE ALLOCATION
OF THE RISK OF LOSS OR DAMAGE IN THE
TRANSPORTATION OF FREIGHT

By James C. Hardman* and Joseph Winter **

Common carriers of property, which are now governed by the Interstate Commerce Act,1 have been subjected to a high standard of care by that statute as well as the common law. Between the shipper and the carrier who has undertaken to carry the goods for compensation, the burden of the risk of loss has been placed on the carrier. Although the carrier's liability is not absolute, the areas of its liability are extensive.2

To reduce the effectiveness of this harsh doctrine of liability carriers have historically attempted to limit their liability and to shift or allocate the risk of loss.3

The devices utilized have varied and often been ingenious. They have not merely involved the shipper - carrier relationship, but have extended into the relationship between carriers themselves when multiple-carrier service or facilities were involved.

This article will examine the standards of liability and two of the most common and interesting devices utilized to allocate the risk of loss, i.e., “benefit of insurance” and “hold harmless” clauses.

1. 24 Stat 379 (1887), 49 U.S.C. 1 et seq., hereinafter referred to as “ICA”. The law concerning carrier liability for air carriers and carriers of goods by sea have developed independently from carriers governed by the ICA resulting in significant variations in both the allowable exemptions from liability and the limitations of liability applicable to each mode of transportation.


3. Shippers have also attempted to make the carrier an absolute insurer of carriage. In National Tank Truck Carriers, Inc., Petition for Declaratory Order -Hold Harmless Agreement, No. 35501, 1973 CCH Fed. Car. Cases Par. 36,702, for example, the shipper attempted to condition its tender of freight on the motor carrier's willingness to sign a hold harmless agreement exempting the shipper from any liability for loss or damage to the goods. The agreement was found to violate Section 217(b) of the ICA, 49 U.S.C. 317(b) as a preferential treatment in the form of a concession or rebate.
Liability Under the Common Law

Under the common law, common carriers of property were regarded as insurers of safe carriage except for losses resulting from an act or default of the shipper, or owner of the goods, an act of God, the public enemy, or public authority, or a loss due to a defect or vice in the goods. 4

To avoid or reduce their liability, the carriers frequently provided in their contract of carriage for an exemption from liability or for the limitation of liability to an agreed value.

Except where the common carrier attempted to exempt itself from liability for its own negligence, limitations such as those above were upheld if they were just and reasonable. 5

In Pennsylvania Railroad v. Hughes 6 however, the Supreme Court held that a state had the right to require a common carrier to be liable for the full value of goods which were lost or damaged despite the existence of a special contract limiting the carrier's liability to a stated amount or agreed value.

The above decision and the diversity of approaches taken by the states on the subject matter 7 ultimately led to the enactment of the Carmack Amendment. 8

The Carmack Amendment

When the ICA was initially passed in 1887, it contained no provision concerning the liability of carriers for loss or damage to goods and carriers were not prohibited from exempting themselves from or limiting their liability. 9

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5. Railroad Co. v. Lockwood, 17 Wall (U.S.) 357 (1873). Some early cases even allowed a carrier to contract out of negligence liability. 1 Hutchinson, Carriers Sec. 450-451 (3 Ed. 1906).
6. 191 U.S. 477 (1903).
9. For a legislative history of the ICA see Miller, The Legislative Evolution of The Interstate Commerce Act, (1930 Ed.) and 1 Knorst, Interstate Commerce Law and Practice, 51-200 (1953 Ed.)
The Carmack Amendment,\textsuperscript{10} passed in 1906 as part of the Hepburn Act, specifically prohibited all exemptions from liability by contract or rule and made the receiving carrier liable for any loss or damage caused by it or by any connecting carrier to which the property might be delivered.\textsuperscript{11}

Carriers were later made liable for the "full actual loss or damage or injury" to property by the Cummins Amendment\textsuperscript{12} enacted in 1915. This legislation also added a proviso for goods hidden from view when the carrier was unable to determine the character of such freight. In such instances, the shipper could be required to state the value of the freight and the carrier was relieved from liability beyond the stated amount or released value.

This exception for released value is no longer limited to goods hidden from view and a carrier can limit its liability if the carrier and shipper have agreed upon a released rate and that rate has been approved by the Interstate Commerce Commission as part of the carrier's tariff.\textsuperscript{13}

Except for the limited statutory exclusions discussed above, the originating carrier and delivering carrier on a movement on a thru bill of lading are liable to the lawful holder of the bill of lading or delivery receipt or any party entitled to recover thereon, for the full actual loss, damage, or injury to the property being transported caused by it or any common carrier, railroad, or transportation company on which line the property moved. The statute specially provides that no contract, receipt, rule, regulation or other limitation of any character shall exempt the carriers from such liability.\textsuperscript{14}

The bill of lading governing the legal relationship between the carrier and shipper also normally embraces the common law exemptions from liability providing that the carrier shall not be liable for loss of damage cause by an act of God, the public enemy, authority of law, an act or default of the shipper or owner, natural shrinkage, or losses resulting from a defect or vice in the property shipped.\textsuperscript{15}

To establish liability under the Carmack Amendment, a shipper

\begin{itemize}
\item \textsuperscript{10} See f.n. 8.
\item \textsuperscript{11} Despite this the Supreme Court in Pierce Co. v. Wells Fargo & Co., 236 U.S. 278 (1915) permitted to limit its liability to $50.00 on a $15,000.00 carload of automobiles, though the carrier knew what was in the railroad car.
\item \textsuperscript{12} 38 Stat 1197 (1915), as amended, 49 U.S.C. 20(11).
\item \textsuperscript{13} 39 Stat 441 (1916), as amended, 49 U.S.C. 20(11).
\item \textsuperscript{14} ICA Sec. 20(11), 49 U.S.C. 20(11).
\item \textsuperscript{15} Miller, Freight Loss and Damage Claims, 32-33 (2 Ed. 1961)
\end{itemize}
may proceed against either the receiving or delivering carrier\textsuperscript{16} and in most instances need prove only that the shipment was tendered in good condition to the initial carrier and either was not delivered, delivered short, or delivered damaged. Such a showing establishes \textit{prima facie} liability.\textsuperscript{17}

\textbf{Insurance As A Method of Allocation}

Because carrier liability is not absolute and because the amount of damages sustained is always a potential issue,\textsuperscript{18} most shippers are insured against loss or damage to their property while being transported.

Carriers are also required to be insured for cargo losses and furnish evidence of such insurance or evidence of self-insurance to the ICC.\textsuperscript{19}

As a result, litigation concerning cargo loss is most frequently carried on between insurers rather than between carriers and shippers.

One area of considerable litigation has involved attempts by carriers to limit their liability to the extent of the amount that a shipper has been compensated for his loss by his insurance carrier.

Carriers have attempted the above by inserting in the bill of lading a provision giving the carrier the benefit of insurance effected upon the shipment.\textsuperscript{20}

The validity of such benefit of insurance clauses under the common law was established and if the carrier was given the benefit of the insurance available the shipper, the insurer lost its right of subrogation.\textsuperscript{21}

Many insurance companies attempted to counter the practice by

\begin{itemize}
\item\textsuperscript{16} See statute cited note 14 \textit{supra}. Under the common law, the initial carrier was not liable for damage not occurring while in its possession. \textit{Goliger Trading Co. of N.Y. v. Chicago & N.W. Ry. Co.}, 184 F. 2d 876 (7 Cir. 1950).
\item\textsuperscript{17} \textit{Missouri Pac. R. Co. v. Elmore and Stahl}, 377 U.S. 134 (1964) reh'g. den., 377 U.S. 984 (1964). The theory behind this principle is that the relationship between the shipper and carrier is basically \textquotedblleft bailed-bailee\textquotedblright and the carrier as bailee is in a better position to know the reasons for damage.
\item\textsuperscript{18} See Miller, \textit{op cit, supra}, note 15, Chap. V, 522-808.
\item\textsuperscript{19} Section 215 ICA, 49 U.S.C. 315. See also Surety Bonds and Policies of Insurance, 49 C.F.R. Part. 1043.
\item\textsuperscript{20} A typical clause would read: \textquotedblleft Any carrier or party liable on account of loss or damage to any of said property shall have the full benefit of any insurance that may have been effected upon or on account of said property.\textquotedblright
\item\textsuperscript{21} \textit{Phoenix Ins. Co. v. Erie and Western Trans. Co.}, 117 U.S. 312 (1886); \textit{Luchenback v. McCahan Sugar Ref. Co.}, 248 U.S. 139 (1918); and \textit{Great Lakes Transit Corp. v. Interstate SS. Co.}, 301 U.S. 646 (1937).
\end{itemize}
providing that the insurance would be void if the insured shipper entered into an agreement giving the carrier the benefit of such insurance.

When faced with both provisions, the courts held that both agreements were ineffective with the result that the carrier received nothing and the shipper also failed to receive the insurance proceeds. 22 The carriers then amended their bills of lading to provide that they would have the benefit of the shippers' insurance "so far as this shall not avoid the policies or contracts of insurance." 23 Thus, if an insurance company neglected to provide that the policy would be void if the carrier received the benefit of the shipper's insurance, the carrier received the benefit of such insurance.

**Benefit of Insurance Clauses Under the ICA**

Although benefit of insurance clauses were valid under the common law, there is and has been some question of their validity under the ICA.

In *China Fire Insurance Co. v. Davis* 24 the benefit of insurance provision in the bill of lading was held to be void as an unlawful discrimination prohibited by Section 2 of the ICA 25 This provision of the ICA prohibits a carrier from receiving from any person, directly or indirectly, a greater compensation for transportation of property than it receives from any other person for a like and contemporaneous service under similar conditions.

In the *China Fire* case, the insurance company was suing to recover money remitted by the insured shipper to the rail carrier. The shipper and the carrier had entered an agreement whereby the carrier agreed to pay the shipper for its loss if the shipper them filed a claim against its insurer, attempted to collect from the insurer, and remitted the amount collected less the cost of collection to the carrier. This was done without the knowledge of the insurer who paid the claim.

Judge Learned Hand, writing for the Court, found that since the shipper was free to insure the carrier or not, as he chose, the insurance was "compensation" within Section 2 of the ICA since it had a present value aside from whether it cost anything to the shipper. 26

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24. Ibid.
In a somewhat similar factual situation, the Eighth Circuit in *National Garment Co. v. New York & St. L.R. Co.*\(^{27}\) also held that the "benefit of insurance" clause violated Section 2 of the ICA.\(^{28}\) The case is of interest because the rail carrier attempting to overcome the claim of discrimination which arose in the *China Fire* case inserted a proviso in its bill of lading which required the carrier to reimburse the shipper for the cost of the shipper's insurance.\(^{29}\) The Court, however, decided that this modification did not warrant a change in the *China Fire* finding.

The Court found that insurance for the benefit of a carrier is of value to the carrier from the beginning of the transportation and the value is received irrespective of whether a loss occurs and thus the carrier receives the compensation forbidden by the Act at the expense of the shipper. Addressing itself to the reimbursement procedure, the Court further stated:\(^{31}\)

> In the event of loss the carrier, if it so elects, returns to the shipper the cost of the compensation [the premium] which it was forbidden by the Act to receive in the first place, avoids its liability as a carrier, and deprives the insurer of its rights under a valid contract.

The judiciary, however, has not been unanimous in finding benefit of insurance clauses illegal. In *Home Ins. Co. v. N.P.R. Co.*,\(^{32}\) the Supreme Court of Washington refused to follow the *China Fire* case.

The Court found that a carrier did not render service to a shipper at any less rate than the regularly published tariff rate charged all shippers by becoming the beneficiary of any shipper's insurance. The Court noted that the insurance was not given or received as compensation for service, but merely to reimburse the carrier for what it had paid to shipper.\(^{33}\)

\(^{27}\) 173 F. 2d 32 (8 Cir. 1949).

\(^{28}\) 49 U.S.C. 2

\(^{29}\) The proviso read "... Provided, that the carrier reimburses the claimant for the premium paid thereon." 173 F. 2d at 33. The clause was the same as provided in the Uniform Bill of Lading adopted by the Interstate Commerce Commission for use in domestic transportation by rail carriers subject to the ICA. See *In re Bills of Lading*, 52 I.C.C. 671 (1919) and 64 I.C.C. 357 (1927).

\(^{30}\) 173 F. 2d at 38.

\(^{31}\) Ibid.

\(^{32}\) 18 Wash. 2d 798, 140 P2d 507 (1943).

\(^{33}\) 18 Wash. 2d at 809.
The Court felt it logically followed that if a carrier can secure insurance from an insurer to protect itself against loss, it can be the beneficiary of such insurance by contract with the shipper.34

The Seventh Circuit, in United States v. Auto Driveaway Company,35 has also upheld the validity of benefit of insurance clauses. This case involved a motor common carrier engaged in driveaway services36 and thus the Court construed such clauses in light of Section 216(d) of the ICA.37

Section 216(d) provides that all charges for services rendered by motor common carrier shall be just and reasonable and that every unjust and unreasonable charge for such service shall be unlawful. Similarly, it is unlawful for any such common carrier to make, give, or cause any undue or unreasonable preference or advantage to any person or geographical entity or to subject such person or geographical entity to any unjust discrimination or any undue or unreasonable prejudice or disadvantage.

The government contended that the benefit of insurance clause operated to give an unlawful preference to non-insured owners, since the carrier's insured owners paid the cost of transportation and the premium for insurance if their car was not involved in an accident while the non-insured paid only the transportation cost.

The Court found that no preference was granted uninsured motorists in the wording of the clause. No insurance was required of any shipper and all shippers were charged the same tariff rate. It was also noted that the clause presupposed the customary owner's liability insurance which the owners would carry even if the carrier's services were not used.38

The China Fire and National Garment cases were distinguished. It was noted that, while Section 2 prohibited "greater compensation" to the carrier, Section 216(d) prohibited "unjust and unreasonable"

34. Ibid.
35. 464 F. 2d 1380 (7 Cir. 1972).
36. Driveaway service consists of the transportation of automotive units under their own power, and also the towing or hauling of additional units by the use of tow-bars, saddle mounts, and full mounts. George F. Burnett Co., Inc., Ext.-Maine and Other States, 22 M.C.C. 663, 664, (1940).
37. 49 U.S.C. 316(d). The clause was also challenged as being a device whereby the carrier-defendant sought to avoid liability under Section 20(11) of the ICA, 49 U.S.C. 20(11). This argument was rejected on the basis that the benefit of insurance clause presupposed the carrier's liability for the "full" loss in conformity with Section 20(11) and only became effective on that basis. 464 F. 2d at 1382-1383.
38. 464 F. 2d at 1385.
charges and "undue and unreasonable preferences." 39

The Court also noted that in National Garment and China Fire the insurance was purchased primarily to cover the shipping of the lading whereas in the factual situation before it, the shippers purchased insurance primarily to cover the use of the vehicle and not the shipping of the vehicle. 40

The distinctions made by the Court in the Auto Driveaway case might be thought by some as ones without significant differences. In Salon Service, Inc. v. Pacific & Atlantic Shippers, Inc., for example, the New York Court of Appeals found a benefit of insurance clause in a bill of lading of a freight forwarder to be invalid and in violation of Section 1004(b) of the ICA. 41

Section 1004(b) of the ICA, 42 like Section 216(d), prohibits freight forwarders 43 from giving an unreasonable preference or advantage to any person or to subject such person "to an unjust discrimination or any undue or unreasonable prejudice or disadvantage . . . ." 44

The Court felt compelled to follow the federal cases in deciding the issue and, based on its interpretation of such cases, found the clause invalid. 45

The defendants argued that the prior federal decisions only involved the validity of the clause under Section 2 of the ICA and thus were not controlling.

The Court disposed of the argument. After noting that Parts II, III and IV of the ICA were each added to deal separately with the functional segments of the interstate transportation industry and yet form an integrated and harmonious scheme for the regulation of the entire industry, the Court stated: 46

39. Ibid at 1384
40. Ibid.
42. 49 U.S.C. 1004(b).
43. A "freight forwarder" may be described as one who specializes in the transportation of less-than-carload and less-than-truckload freight and who undertakes to see to it that freight is carried from a point of origin to a point of destination. It utilizes the services of carriers by rail, water, or motor vehicle, separately or in combination, in order to accomplish the movement economically and expeditiously. See Section 402(a)(5) of the ICA, 49 U.S.C. 1002(a)(5).
44. 49 U.S.C. 1004(b).
45. 24 N.Y. 2d at 20. In Home Ins. Co. v. N.P.R. Co., op cit, note 32, supra, the Washington Supreme Court considered this issue, but declared the rule of that state to be that the construction placed on a federal statute by federal courts other than the Supreme Court is entitled to great weight, but is not binding. 18 Wash. 2d at 808.
46. 24 N.Y. 2d at 20-21.
Thus, Section 1004(b) of the Act, contained in Part IV and specifically applicable to freight forwarders such as the defendant, parallels Section 2 in the prohibition of discrimination in providing services in interstate commerce. The rationale of the cited cases dealing with the effect of Section 2 on bills of lading used by carriers is therefore similarly applicable to the parallel provisions of Section 1004(b) and defendants' argument in this regard merely presents a distinction without a difference.

Thus, until the Supreme Court of the United States acts, the validity of benefit of insurance clauses will depend upon which Court considers the question, the type of carrier involved, and the factual situation.


It is felt that the China Fire approach to the problem is not a reasonable one in the absence of any evidence that the carrier is requiring the shipper to carry insurance for the carrier's benefit. No per se discrimination results from benefit of insurance clauses as all shippers pay the same rate and receive the same service. Shippers have legitimate reasons for carrying such insurance and a carrier receiving the benefits of it is a mere incidental beneficiary. In most instances, the carrier would not even know whether the shipment was insured or not.

Although the insurance may have a value ascertainable by actuarial calculation, it is clearly a highly theoretical one and is not compensation paid or received for the transportation service.

If the theory of the Court in China Fire were carried to an extreme, many of the actions of the shippers could be construed as violations of the ICA.

For example, a shipper who did not press a damage claim, settled such a claim more favorably than another, or collected from its insurer rather than suing the carrier, could be accused of granting the carrier a preference or additional compensation.

Carried to a further extreme, a shipper who used better protective containers to ship its products and minimize or eliminate damage would, under the theory expressed in China Fire, be granting a preference to the carrier over a shipper who used the minimal quality

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containers required under the carrier's tariff.

The above actions have not been considered as illegal acts and should not be so considered. A carrier should not be precluded from receiving incidental benefits from a shipper or shippers so long as the benefits received do not result in one party being favored to the detriment of the other. This is the actual objective of the various statutory provisions.48

The present system of compensating shippers for cargo loss is unduly costly because of the overlapping duplication of insurance. The duplication of coverage increases the cost of the shipment of goods and must be borne by the carrier and/or shipper.

The shipper's insurance company is actually the most logical party upon whom the ultimate economic burden of the risk of loss of damage should be placed. The insurer receives its compensation specifically for assuming that risk. A carrier, on the other hand, is compensated primarily on the cost of transportation.

Inter-Carrier Liability

Two types of situations are most prevalent in respect to the allocation of risk of loss or damage between carriers.

In the first type of situation a carrier will lease its equipment to a second carrier for the duration of one trip, all of which is conducted via the operating authority of the second carrier.49 This practice can arise because the lessor-carrier desires to move its equipment to the destination point of the trip or in the general direction of the destination. In some instances, the lessee-carrier might desire to utilize the equipment under lease because it does not have its own equipment available to handle the load or could not handle the freight as efficiently or economically on its own equipment. In some instances, trip leasing is done between carriers on a regular and reciprocal basis merely to allow each to improve the efficiencies and economies of their operations.50

The second situation involves interchange service. Interchange

49. This type of situation is referred to in transportation parlance as a “trip lease”. The trip must be in the direction of a point which lessor is authorized to serve and a written lease must be executed. Lease and Interchange of Vehicles, 49 C.F.R. 1057.3(a).
50. A vehicle cannot be “trip leased” on successive movements. A vehicle which is “trip leased” may only again be trip leased following its usage in the authorized service of the lessor carrier. Booth, Motor Carrier Leasing Regulations of The Interstate Commerce Commission. (Common Carrier Conference-Irregular Route, Inc. 1961), p.8.
service involves the movement of freight via the combined operating authority of two or more carriers. One of the carriers participating in the joint movement will lease its equipment to the other carrier to be utilized on the portion of the movement conducted via the second carrier's operating authority. This practice allows carriers jointly to expand the scope of the service they hold out to the shipping public, and by eliminating the necessity to transfer lading from one vehicle to another at the common point of service, they can provide a service more closely emulating single line service. This latter consideration is extremely important in soliciting and securing business since shippers frequently avoid the use of interchange service because of the real or alleged delays and damage to or loss of freight when and if lading is physically transferred between vehicles at the interchange point.

Both lease situations are governed by federal regulations which deal in part with the question of lessee's liability to third parties. Because of the silence of such Regulations on inter-carrier liability relationships, considerable litigation has evolved on the issue.

51. Motor Haulaway Co. Contract Carrier Appln., 27 M.C.C. 19, 23-24 (1940). Sometimes the word “interchange” and “interline” are used interchangeably. “Interline”, however, is a practice whereby the freight is physically transferred between carriers at the common point of service whereas “interchange” contemplates the freight moving from initial origin to ultimate destination in the same vehicle. See Gilbertville Trucking Co. v. United States, 371 U.S. 115, 121 (1962).

52. Motor common carriers of property are not now obligated, but rather are permitted, under Section 216(c), of the Act, 49 U.S.C. 319(c) to establish through routes and joint rates with each other covering the provision of interline service. However, once such interline arrangements or concurrences are established and published in their tariffs pursuant to Section 217(a) of the Act, 49 U.S.C. 317(a), the concurring carriers are under a legal duty to provide the interline service described in their tariffs. A motor common carrier has the obligation to accept and transport all freight (including interline freight) tendered in accordance with the provisions of its published tariffs. See Galveston Truck Line Corp. v. Ada Motor Lines, Inc. 73 M.C.C. 617 (1957); and Burlington Truck Lines, Inc. v. I.C.C., 194 F. Supp. 31, 56-57 (S.D. Ill., N.D. 1961), reversed on other grounds sub nom Burlington Truck Lines v. United States, 371 U.S. 156 (1962). This obligation has been characterized as an almost absolute duty, and for the adequate protection of the public, motor common carriers of property are held strictly accountable for its performance. Braswell Motor Frt. Lines, Inc.-Investigation, 118 M.C.C. 392, 411 (1973).

53. Lease and Interchange of Vehicles, 49 C.F.R. Part 1051. Hereinafter referred to as the “Regulations”.

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Trip Leases

Under the Regulations, a lessee-carrier in a trip lease situation is specifically made responsible for damages to third parties. 54

Because the Regulations are silent as to the liability between the lessee and lessor carriers, it has been contended that the common law rule of indemnification should be applicable or, if the carriers contracted on the issue, that their private agreement should control. 55

A lessee-carrier is anxious to contract for indemnification because in the normal trip lease situation the equipment is leased with the driver of the lessor, and thus the lessee-carrier feels it often has minimal control over the operations under lease. Likewise, the inspection called for under the Regulations 56 is often done by agents who are frequently gas station or truck stop attendants. Lessee-carriers often feel this becomes a prefunctorial task which will not result in the discovery of all defects in the equipment being leased. Thus, the lessee-carrier assumes considerable liability even though the lessor-carrier receives substantial compensation under the lease. Lessor-carriers are willing to assume the liability arising in a lease situation because they normally already are insured against the loss or adequately compensated under the lease to assume the risk.

The very reasons which have prompted lessee-carriers to shift liability, however, has led to considerable litigation and, despite such litigation, the question of the validity and enforceability of hold-harmless provisions 57 in trip leases, or the application of common law indemnification principles in such a situation has just recently begun to be resolved.

In some instances the hold-harmless clauses were held to be void and unenforceable as against public policy. This position, for example, was espoused in Alford v. Major. 58

54. 49 C.F.R. 1057.3(a).
56. 49 C.F.R. 1057.4(c).
57. Part of the difficulties in resolving the issue in this area of the law may result from the failure of the courts to consider hold harmless clauses in terms of the clear distinction between an exculpatory clause and an indemnity contract. In the latter, a risk of damage or injury to third persons is shifted to the indemnitor. With an exculpatory clause, the person who would have to carry the risk of his own negligence attempts to shift it onto the person who would be injured by his negligence. See Northern Pac. Ry. Co. v. Thorton Bros. Co., 206 Minn. 193, 287 N.W. 226 (1939).
In that case, a lessee-carrier seeking indemnification under a contractual provision in a trip lease admitted that its compliance with the Regulations was a mere formality and that it had never assumed actual control over the vehicle-with-driver being leased.

The lessee-carrier advanced the argument that the Regulations were designed merely to assure that if a third party was injured the responsible carrier would be financially able or have the requisite insurance to meet the obligations.59

The trial court rejected the argument, however, and found that the Regulations were promulgated to insure that the regulated carriers would be responsible in fact, as well as in law, for the maintenance of leased equipment and the supervision of drivers of such equipment. The Regulations were found to involve broader policy considerations than mere financial responsibility to an injured party.60 The Seventh Circuit affirmed the decision emphasizing these public policy considerations.61

The decision was also grounded, in part, on the principle that the lessor and lessee carriers, by violating the Regulations, became joint wrongdoers and forfeited any right to recover from each other.62

The Alford view was adopted in Denver Midwest Motor Freight, Inc. v. Busboom Trucking, Inc.63 In this case, the Supreme Court of Nebraska found the following disadvantages could flow as a result of hold-harmless clauses in trip leases:

1. The clauses might adversely affect the safety of operations.
2. The clauses would inject an element of uncertainty into lease negotiations and blur lines of responsibility to the public by lessor and lessee.
3. The clauses would increase the prospect of litigation between carriers or their insurers without any corresponding benefit to the public.
4. The clauses might adversely affect the insurance coverage of carriers.

59. 314 F. Supp. at 982.
60. 314 F. Supp. at 982-983.
61. 470 F. 2d 132 (7 Cir. 1972).
62. 470 F. 2d at 135. See also Carrier Insurance Exchange v. Truck Insurance Exchange, 310 F. 2d 653 (4 Cir. 1962).
5. The clauses would enable lessees effectively to circumvent the requirements of the Regulations.

The Court concluded that if such clauses were unenforceable, the uncertainties mentioned above would be removed, statutory and regulatory provisions could be fully enforced, and public policy could be best served.

Other courts, however, were not unanimous in the adoption of the Alford view.

In S & N Freight Line, Inc. v. Bundy Truck Lines, Inc." a clearly opposite result was reached. A hold-harmless clause was enforced even though actual control over the vehicles was retained by the lessor-carrier. The Court found that the Regulations were applicable only to the lessee's liability to consignors,65 consignees,66 and third parties generally and that they did not apply to the rights or liabilities between the lessor and lessee carriers. The same conclusion was reached in Cooper-Jarrett, Inc. v. J. Miller Corp.67

Courts of Appeal in the Fourth,68 Fifth,69 and Sixth Circuits70 have also upheld the validity of hold-harmless clauses in trip leasing situations. In each case the Court found that the lessee-carrier had full and actual control over the leased vehicle and the driver, and thus there was no violations of the Regulations. Based on the absence of any statutory violations, the Alford decision was distinguished, and the Courts held that the Regulations did not prohibit the two contracting carriers from determining as between themselves which party would ultimately bear the cost of damages to third parties.

In Transamerican Freight Lines v. Brada Miller Freight System,71

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64. 3 N.C. App. 1, 164 S.E. 2d 89 (1968).
66. A consignee is one who receives the freight being tendered, Ibid.
67. 70 Misc. 2d 88, 332 N.Y.S. 2d 177 (1972).
70. Jones Truck Lines, Inc. v. Ryder Truck Line, Inc. 507 F. 2d 100 (6 Cir. 1974), cert. pending, No. 74-973. See also Indiana Insurance Co. v. Parr Trucking Service, 510 F. 2d 490 (6 Cir. 1975), and Indiana Refrigerator Lines, Inc. v. Dalton, 516 F. 2d 795 (6 Cir. 1975) cert. pending No. 75-211. In the Jones case, the court appears to treat the case as one involving a trip lease situation. The facts of the case, however, suggest an interline or interchange situation was involved.
the U.S. Supreme Court found that an indemnification clause in and of itself does not conflict with the control and responsibility requirements or the safety provisions in the Regulations. The Court indicated an indemnification agreement violates the Regulations only if accompanied by other indicia demonstrating that the lessor was in control of the service provided as well as the physical operation of the vehicle. In Transamerican it was determined that control over the vehicle had remained in the lessee; in Alford, “other indicia” had been present.

Common Law Indemnification

In Newsome v. Surratt,72 the lessee-carrier sought indemnification against the lessor-carrier under the common law rule73 as well as under a contractual provision in the lease. Although it is not clear from the printed decision on which specific basis indemnification was allowed, the Court accepted the validity of the common law rule in the context of a trip lease.

The opposite view was expressed in Cooper-Jarrett, Inc. v. J. Miller Corp.74 In this case, in which a contractual provision was enforced, the Court specifically indicated it would not permit common law indemnification because of the “... statutory nondelegable active liability imposed on a lessee pursuant to the I.C.C. rules and regulations.”75

Since the leasing of equipment is covered by regulation under statute, it would appear that the view expressed in the Cooper-Jarrett76 case is the more logical one and the result which would be reached in the majority of cases.

Interchange Situations

Under the ICA, either the initial or delivering carrier in an interchange situation is liable to the claimant-shipper for loss or damage

73. Under the common law rule, a party whose liability results solely from a nondelegable duty is entitled to indemnification, even in the absence of contract, from the person whose wrongdoing was the actual cause of the injury. See McClish v. Niagara Machine & Tool Works, 266 F. Supp. 987, 990 (N.D. Ind. 1967).
74. See f.n. 67.
75. 332 N.Y.S. 2d at 179.
76. See f.n. 67.
to freight. This includes any loss or damage caused by connecting carriers.\textsuperscript{77} The initial or originating carrier, however, has a cause of action against the carrier at fault.\textsuperscript{78}

Since it is often difficult to determine the actual responsibility for loss or damage, many rail and many motor carriers have established claims organizations which attempt to allocate the responsibility for loss.\textsuperscript{79}

Despite such voluntary attempts to resolve the problem, resort to the judicial system by carriers is still quite common. Since the Regulations do not specify where responsibility in an interchange situation lies,\textsuperscript{80} questions regarding ultimate inter-party liability similar to those as in trip lease situations have arisen.

The Commission has held that the carriers under whose operating authority the equipment is operated shall be considered the owner of the equipment while moving to ultimate destination or for return to the lessor-carrier.\textsuperscript{81}

In Watkins Motor Lines v. Zero Refrigerated Lines,\textsuperscript{82} the Seventh Circuit, which had handed down the Alford decision, upheld an indemnity provision on the basis that the Regulations covering interchange arrangement did not require complete assumption of responsibility by the lessee as do the Regulations covering triplease situations. As such, Alford was deemed inapposite and indemnification was allowed.

Other circuits have not ruled on this issue. However, there is little, if any, reason to believe that their viewpoints would differ from those expressed in their opinions involving triplease situations. In view of the Supreme Court’s decision in Transamerican, the same policy and legal considerations would appear to be present in each situation.

\textsuperscript{78} ICA, Section 20(12), made applicable to motor carriers, 49 U.S.C. 312.
\textsuperscript{79} The American Association of Railroads and the National Freight Claims Council of the American Trucking Association, Inc. have attempted by voluntary established rules to simplify the allocation among its members of responsibility for loss or damage. See Sigmon, Miller’s Law of Freight Loss and Damage Claims, 4th Ed. 1974.
\textsuperscript{80} 49 C.F.R. 1057.5.
\textsuperscript{81} 49 C.F.R. 1057.5(d). It should be noted that the Regulations are not clear as to whether the term “owner” applies universally or merely to third parties.
\textsuperscript{82} ___ F. 2d ___ (7 Cir. 1975), 1975 CCH Fed. Car. Cases, Par. 82,565.
Conclusions

A fair reading of the legislative history of the ICA as it applies to loss or damage to freight indicates that the legislators desired to assure that carriers were financially stable and responsible to shippers and the general public and that simplified procedures existed to facilitate recovery for such losses or damages.

To the extent that the statute itself or administrative regulations assure such results, it would appear that the business relationship between carriers themselves is of little import and not the concern of public regulation.

Many of the periphery objectives, such as safety of operations, which the regulations might achieve can be accomplished by other means, the prime of which is an effective enforcement program. Furthermore, monetary liability, particularly in view of insurance coverage, may not be the only or most important means of achieving such periphery objectives. 83

It is unfortunate that uncertainty and confusion still exist in the two major areas discussed. The decision of the Supreme Court in Transamerican and its anticipated decisions in the Carolina and Jones cases should resolve the issue of inter-carrier liability. The “benefit of insurance” issue may be subject to more protracted litigation.

83. Factors other than tort liability may be of equal force in encouraging safe conduct. Professor James has suggested that danger to the negligent party, disruption of normal business routine, destruction of the negligent party’s property, and bad public and labor relations are some considerations of this nature. James, “Accident Liability Reconsidered: The Impact of Liability Insurance,” 57 Yale L.J. 594 (1948). Professor James was primarily concerned with personal injury liability rather than damage to property. The same reasons could appear to apply in each instance. Furthermore, no distinction can be made in terms of inducing carelessness between an exculpatory clause and a contract of liability insurance. See, for example, Griswold v. Illinois Central Ry. Co., 90 Iowa 265, 57 N.W. 843, (1894).
MOTOR CARRIER SECTION 22 TENDERS: DO THEY COVER VARIABLE COSTS?

BY ENRICO L. DIGIAMMARINO, JR.*

&

DONALD F. WOOD**

INTRODUCTION

In 1887 President Cleveland signed into law the Interstate Commerce Act. Included in the original Act under Part I was Section 22. This section specifically stipulated: “that nothing in this act shall prevent the carriage, storage, or handling of property free, or at reduced rates for the United States, State, or municipal governments.”

Initially, Section 22 provided the avenue by which non-Land Grant Act railroads could legally bid with competitive rates for a share of the government traffic that Land Grant Act railroads were required to move at reduced rates. As the Land Grant Act shows, the idea of giving rate privileges to the government was not a novel product of Section 22 of the Interstate Commerce Act. On the contrary, it uses an outgrowth of English Common Law and earlier American legislative history, with much of the American legalistic thinking being imported from England. The fact that Section 22 was not repealed with the repeal of the Land Grant Acts in 1946 indicates that this philosophy of rate reductions for the government was a specific intention of the law makers. Numerous changes and amendments have been made to Section 22 over the years, but the provision of “free or reduced rates” has remained intact. Section 22 has been expanded to include motor carriers, water carriers, and freight forwarders; but at no time has it affected any other provisions of the Act beyond those of minimum rates.

In the study of highway motor carriage, Section 22 assumes added importance because in this arena carriers are permitted to enter

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3. Ibid.

freely into rate competition. Data available from the Department of Defense, as the largest single purchaser of motor carrier transportation under Section 22 tenders, provide a source of information from which to draw some conclusions about possible carrier activity in an environment of deregulation. Proponents of regulation argue that since the Interstate Commerce Commission is charged with maintaining a viable transportation industry, Section 22 should be eliminated because of its promotion of competitive bidding to the point that carriers must bid below costs in order to move government freight. They further argue that this practice is sufficient to drive many carriers out of business. On the other hand, supporters of Section 22 say that the competition is at a healthy level and constitutes a direct savings to the taxpayers.

The importance of this topic is the need for executives of the motor carrier industry to have information regarding cost and rate relationships within the realm of Section 22. The same type of information coupled to a definitive statement concerning carriers’ ability to remain solvent and operational under the competitive pressures of Section 22 will assist legislators in dealing with the issue of Section 22’s future.

Considering only the highway motor carrier industry in a situation where rate competition is permitted, Locklin says that “Short-run variable costs, rather than long-run variable costs, will determine what rate he [the motor carrier] charges.” The problem then becomes one of whether highway motor carriers cover their short-run variable costs in competitive bidding for government traffic under the provisions of Section 22 of the Interstate Commerce Act.

**HYPOTHESIS OF THIS STUDY**

The hypothesis to be tested is whether highway carriers submitting tenders under the provisions of Section 22 of Part 1 of the Interstate Commerce Act to the Department of Defense for movement of military freight within the geographical area of responsibility of the Western Area Military Traffic Management and Terminal Service Headquarters have generally covered their short-run variable costs. To test

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this hypothesis, a sample of tenders will be examined. The sample is subject to certain limitations, which are:

1. The Buyer:
The Department of Defense is the largest single purchaser of transportation under the provisions of Section 22 with an annual outlay in the area of 500 million dollars. The traffic management function of the Department of Defense is carried on by the Military Traffic Management and Terminal Service and its two subordinate elements, Eastern Area and Western Area. The Western Area Headquarters, located in Oakland, California, maintains files of tenders applicable to the western half of the country. Only Section 22 tenders from this file were used to make up the statistical sample for this study.

2. The Tenders:
The Section 22 tenders maintained by the traffic managers in Oakland are filed by the state of origin of the move. For the purpose of this study a random selection was made of tenders from the California file by carrier name. The sample was completed by selecting additional tenders from the same carrier as well as from other carriers from the same movement. After deletion of eleven observations that dealt strictly with sea vans and were not comparable with the remainder of the data, the final number of observations was 89.

3. Cost Data:
The data concerning cost figures were taken primarily from information gathered by the California Trucking Association from motor carriers operating within California.

4. The Seller:
Because of the method of selection of the tenders, the sellers of transportation are limited, for the purposes of this study, by the fact that they had submitted the particular tender that was selected for inclusion. All were necessarily a party to tenders submitted under Section 22 for the movement of Department of Defense freight within California.

RESEARCH METHODOLOGY

The study consisted of two phases, the first of which involved the application of a stepwise multiple regression analysis of data ex-

tracted from the observations to establish the effect certain factors have on the rate per hundredweight listed on the Section 22 tenders. The second phase consisted of a comparison of the Section 22 rates with representative cost data. The ultimate goal was to determine whether carriers submitting these tenders were covering their short-run variable costs. The analysis was based on the following assumptions:

1. that each carrier acted as the classical economic theorists' "Rational Economic Man." This supposes that each carrier made an effort to evaluate his situation and did not intentionally make decisions that would have jeopardized his economic future.
2. that all tenders included in the sampling were valid tenders still in an active category, and that superceded tenders had been purged from the system by the Department of Defense traffic managers in their annual reviews.
3. that the carriers' variable costs include direct vehicle operating costs, direct labor costs, direct terminal costs, and that portion of the administrative costs, such as billing and supervision, that directly affects the move for which the tender is submitted.
4. that these variable costs are a function of the length of haul and minimum weight of the bid.
5. that other factors such as the routing, the possibility of backhaul, length of leadtime before the shipment must be delivered, delays in loading and unloading, claims, and insurance will have a negligible impact on the variable costs, and those carriers who assign some weight to these factors will include them in the percentage affect that length of haul and minimum weight have on the tender rates.
6. that minimum class rates approved by the California Public Utilities Commission represent fully allocated costs for the particular move.

THE BUYER, MTMTS

The Military Traffic Management and Terminal Service (MTMTS) was chartered in 1965 as the Army activity responsible for

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9. This article is based on a longer study entitled "Multiple Regression Analysis to Establish the Degree that Section 22 Tenders are Compensatory." Copies are available for $3 apiece from Student Research Associates, c/o School of Business, San Francisco State University, San Francisco, CA 94132.
performing the traffic management functions of the Department of Defense for shipments within the continental United States. MTMTS is divided into three elements. The Headquarters, located in Washington, D.C., carries on liaison with the other services in the Department of Defense and, in addition to its other transportation-oriented activities, conducts major negotiations with carriers for certain types of high volume, high value, or otherwise unique shipments. The country is divided so that the western fourteen states, Alaska, and Hawaii fall under the Western Area Command, and the remainder of the country falls under the Eastern Area Command.

The purpose of MTMTS' traffic management activity is the conduct of negotiations with carriers and directing the consolidation and shipment of goods moving among the various installations while achieving the greatest possible savings to the government. The military traffic managers function just as the traffic managers of any of the larger commercial corporations. The commercial traffic manager, with control over all the shipping of the corporation, plans the movement of raw materials and finished products among different locations in a manner that will keep the transportation costs minimal. He knows of the up-to-date charges that involve volume rates and fees for services, and, through negotiations with various carriers, he strives to obtain the best service at the lowest total cost. The military traffic manager combines these activities with the advantages of being able to accept bids tendered under the provisions of Section 22. This release from the fetters of minimum rate regulation provides increased savings through reductions in cost of transport.

Military items can be divided into those that are similar or identical to civilian commercial products and those that are unique to a defense effort. The development and application of commercial rate classifications to military freight is difficult when the items are not duplicated in the civilian realm. Consequently, applying a rate from an analogous commercial shipment is frequently difficult, if not impossible. The commercial rate structure is the product of a long slow process involving the docketing of proposed rates being established as the necessity arises for new unique shipments. This process requires a great deal of time, and current rate tables are the product of many years of toil. In military shipments, the key requirement is that a speed in execution without the long drawn-out delays of the regulatory procedures to establish rates. This flexibility is provided by Section 22 tenders.

The origin and destination points of military cargo are generally military installations which are normally located outside the geo-
graphical confines of the major metropolitan centers. This should be contrasted with the location of commercial facilities, which generally revolve around economic factors with transportation costs playing a key role.

Tracing the flow of a shipment through its various stages will provide a better understanding of how MTMTS operates. Each military installation has a Transportation Officer who acts as the shipper for the particular installation. He is authorized to route and select carriers for moves involving weights under 10,000 pounds. Larger shipments must be routed by the appropriate MTMTS Area Command. The Transportation Officer submits his requirement for a move to the Area Command. The Directorate of Freight Traffic at the Area Command reviews the request, approves the existing routing or selects more efficient routing, and selects the carrier based on submissions of tenders by all carriers wishing to provide this particular transportation service. If no tender is on file for that particular commodity or destination, the Area Command or the Headquarters will request bids on the particular commodity or routing. Once the tender is submitted and the carrier selected the shipment can then be released for movement.

Section 22 provides the framework for competitive bidding for government traffic, but opponents of Section 22, such as the Transportation Association of America, argue that the competitive bid mechanism forces carriers out of business. MTMTS, on the other hand, considers competitive bidding, since it is permitted under Section 22, as the method by which a public organization, especially the military, can dispense contracts to private firms in a manner which, when properly governed, prevents favoritism or personal gain from influencing decisions.

The competitive bid system provides a tool by which that portion of the Department of Defense's budget for transportation can be most judiciously dispensed. General Lang, the commander of MTMTS from 1969 until 1973, stated:

The agency (MTMTS) influences the expenditure of more than $2 billion annually, at a management cost of less than one percent, thus saving the Defense Department about $2.50 in direct economies for every dollar spent on traffic management activities.\(^\text{11}\)

\(^{10}\) Transportation Association of America, Report, op. cit.

Although this statement considers the entire scope of MTMTS activities of which highway transport management is but one part, it gives an indication of the funds involved.

The prime function of military traffic managers is to save money. Nowhere is there any overt or covert attempt to influence any carrier's solvency as an ongoing concern. The carrier is expected to conduct his business in a rational manner with the understanding that MTMTS is not a financial aid agency for ailing transportation business.

Under certain circumstances involving extraordinary shipments, long term repetitive requirements or other unusual situations, formal negotiations may be required. Within the course of these negotiations the carrier's ability to perform the service at the rate he is quoting may be questioned. This is the only time that the degree to which a carrier covers his costs is considered by the military traffic managers. Tenders developed as a result of these formal negotiations account for approximately two percent of all Section 22 tenders utilized by the military.\(^{12}\) The remainder are tenders submitted by carriers on a voluntary basis in response to actual or anticipated demands on the part of the military.

The military traffic managers make no effort to evaluate the tender when it is submitted. It is merely filed until such time as it can be applied against a specific requirement. When an Installation Transportation Officer submits a request for a movement that falls within the scope of the particular tender, then it and all other tenders quoting specifics of commodity and routing which agreed with the request are evaluated. The prime consideration is the rate, so those tenders quoting the lowest rates come under the closest scrutiny. The next hurdle is that of ability to perform the service requested. For this evaluation, records of past performance on similar commitments are examined for each carrier eligible for consideration. Each of the carriers who have survived to this point are again evaluated on the basis of which carrier provides the best additional services. This evaluation is frequently the only subjective determination entered into during the entire process, and includes such factors as flexibility of pickup and delivery times, claim service, and degree of security as well as the prime consideration of length of delivery time. If for some reason this carrier is unable to accept the commitment, the next best choice is selected, and so on.\(^{13}\)


\(^{13}\) Interview with Captain Don Strassenberg, WAMTMTS Directorate of Freight
MTMTS maintains a public file of all tenders that are submitted as well as promoting a policy in which military traffic managers are available to meet with any carrier representatives who may have questions concerning the conduct of business with the military. Nowhere in the above discussion of evaluations nor in the day to day operations do the traffic managers consider whether the carriers submitting tenders are covering all or any part of their costs. The one time that the subject may be broached is during discussions with carriers wishing to enter into business with the military for the first time when the conversation turns to the carrier's ability to perform. This phase of the discussion is especially critical when the carrier is a small family-operated sole proprietorship or partnership. The traffic manager takes great care in explaining the requirements that the military expects the carrier to be able to perform. These small one or two truck operators are carefully instructed to consider their costs in computing the rate at which they intend to bid.\textsuperscript{14}

To show the volume of voluntarily submitted tenders received by MTMTS, the following statistics were published in the MTMTS Quarterly Progress Report:

"During the 1972 fiscal year 30,006 voluntary submissions of Section 22 tenders were received. Of these, 7,091 were for the movement of household goods and the remaining 22,915 were for the movement of general freight.\textsuperscript{15} MTMTS views these Section 22 tenders as an effort for the government to be granted commodity rates for traffic that might otherwise be moved under the higher class rates. It is felt that these so-called commodity rates are justified on the basis of unique military shipping requirements.\textsuperscript{16}

\textbf{THE SELLER}

William Bresnahan, President of the American Trucking Association in 1972 said,

Eminently adaptable in form and purpose, the truck has become the most indispensable unit at every level of production,
distribution, and marketing. It links the shipper and the consumer with every other transport mode.\textsuperscript{17}

During the trucking industry's infancy, its chief competition was the railroads. Since World War II the intercity motor carriers have increased their share of the regulated traffic from 15 percent to 53 percent in 1972 while the railroad's share dropped from 80 percent to its present 39 percent with the remaining 8 percent divided between pipelines, air, and water carriers.

The chief area of competition that the motor carrier of today need concern himself with is the division of the current 53 percent market share among the various motor carriers. Due to the economic regulation that common carriers are subject to in their day-to-day operations, there is little opportunity for competition in the realm of rates. Therefore, competition places the greatest stress on the area of service.

Motor carriers are regulated by the Interstate Commerce Commission, the Department of Transportation and various state regulatory bodies. The jurisdiction of these agencies extends to virtually every phase of carrier activity.

. . . The ICC approves rates, routes, type of service, and types of commodities transported. . . . Common carriers are available to the general public to transport, at published rates, a given type of freight between points which they have authority to serve . . . . Every interstate carrier, in order to operate, must prove to the ICC the need for its specific services before it can be certified for those services.\textsuperscript{18}

Included within this realm of regulation is the submission of certain reports to the regulatory body and adherence to explicit accounting procedures as well as compliance with requirements concerning stock distribution and acquisition or merger activities. The necessity for approval of acquisitions or abandonments as well as proof of public need act as a stabilizing force for the industry by posing barriers to ease of entry and to uncontrolled expansion by purchasing existing carriers.

The motor carrier industry, having a high percentage of its expenses tied to labor, is characterized by a high proportion of variable cost to fixed cost. This is of importance when one considers the economic


\textsuperscript{18} American Trucking Association, \textit{Trends, op. cit.}, p. 36.
efficacy of abandoning a fully allocated costing structure in favor of one which considers only variable costs, an action recommended for development of a pricing policy during short run periods of highly intensive competition. Locklin describes the truckers' cost structure thusly:

... the conclusion that motor carrier costs are mostly variable is based on the fact that the equipment used can be readily adjusted to the volume of traffic. In terms of economic theory we are dealing with the "long run" period, since that term is defined as one in which plant can be adjusted to changes in the volume of business. In the motor carrier industry, however, the long run is short in terms of calendar time, unlike the situation in industries which have difficulty in adjusting their plant and equipment to changes in the volume of output.

He continues by showing that in the short run, motor carriers have a substantial part of their costs fixed or constant:

... This can be seen by considering the case of an individual who undertakes to engage in for-hire transport with only one or two vehicles. If he finds it difficult to obtain business, he is tempted to take any business that he can get at a cut rate price, which may be a price that will give him some revenue above gasoline and oil costs and any other immediate outlays. Under these circumstances he recognizes that interest on investments in vehicles, property taxes on the vehicles, motor vehicle registration fees, and at least part of the depreciation on the vehicle are fixed costs and incurred whether he moves any traffic or not.

In summation, Locklin concludes that: "Short-run variable costs rather than long-run variable costs, will determine what rate he (the carrier) charges. . . . The situation. . . often occurs in the trucking industry and shows . . . short run pricing . . . a problem for the industry."19

A Consolidated Freightways publication, in discussing the trucking industry, adds that:

The (motor carrier) industry is highly unionized, with considerable uniformity in wage rates among competing companies. Labor costs including fringe benefits average approximately 60% of revenue. This results in a relatively high proportion of

variable as opposed to fixed costs, which allows carriers to adjust rapidly in fluctuations in volume."\textsuperscript{20}

Further characteristics of the industry cost picture involve a relatively low rate of return on revenue but a good return on capital. Investment consists mainly of vehicles, terminals, equipment, and inventories of tires and spare parts. Business is mainly on a cash basis and credit extensions kept to a minimum because of ICC regulation. Problems of obsolescence and inflation that plague capital intensive industries are negated in the rapid turnover and high cash generation of the short-lived revenue equipment.\textsuperscript{21}

The requirement for rates to be published, and to be nondiscriminatory in addition to being reviewed by the regulatory body for reasonableness causes rates that reflect the cost picture projected by the average carriers who are party to the tariff. Carriers who are either much more efficient or who, at the opposite end of the spectrum, have proportionally higher costs will enjoy different profit margins based on their degree of efficiency. Rate regulation, since it permits only competition in service, acts as an incentive to improve the quality of business or traffic actively sought, and thereby improve the average revenue.\textsuperscript{22} Because rate regulation exists, it necessarily affects calculations concerning costs and future rate submissions. On the other hand, given a rate regulation vacuum, carriers become free to more closely evaluate their expense picture and their operational requirements. Depending on the intensity of current competition, carriers will adjust their cost allocation between fixed and variable costs to the degree necessary to insure active participation in the available business.

Section 22 provides the rate regulation vacuum in which carriers are free to bid the rates which they feel appropriate based on current service needs. Under these conditions rates will be established based on costs, degree of competition, current unused capacity, size of the carrier, as well as all other business decision factors.

\textit{LARGE VS. SMALL CARRIERS}

Large carriers can be described as having major investments in terminals and maintenance facilities. They normally have authority

\textsuperscript{21} Ibid.
\textsuperscript{22} Ibid.
over large geographical areas. An example would be any of the transcontinental carriers such as Time D.C., Transcon, C.F., or California carriers such as O.N.C., or Crescent. Each of these carriers has refined sales and operations staffs organized for round-the-clock operations. Many of these carriers operate runs to certain destinations over given routes on a rigid schedule. Highly paid unionized drivers, dockworkers, and clerical or administrative personnel characterize these carriers. These are the carriers whose numerous trucks are immediately recognizable to any who would peer at a freeway.

At the opposite end of the spectrum are the carriers with one or two trucks. These are family business affairs frequently with the husband acting as salesman, mechanic, driver, and dockman while the wife assumes the duties of clerk, billing, rating, and tracing. Perhaps a friend or relative handles the second truck or helps where needed. At best, it is a “shoe-string” operation, but all the functions performed by the large carrier must be performed by this family operation. The major differences are in operating costs and range of services provided. The question of service provided is subjective and depends on the particular move in question. The small carrier represents one extreme with the other represented by the gargantuans of the industry.

The small carrier is able to provide services on a personal level. Often the same individual who approaches a potential customer in the capacity of salesman will also be the person who will load the freight, drive the truck, and unload the freight at the destination. The customer can be assured that his instructions will be carried out to the letter. The carrier can predict accurate delivery dates and run less risk of damaged or lost freight. On the negative side, the smallest incident causing a claim on high value freight can be financially disastrous to the small carrier. He is normally limited to a small geographical area and suffers from limited types of equipment for special cargo and cannot tie up any given piece of equipment for a customer without adequate compensation.

The large carrier serves a much wider area with direct service to numerous points and interline connections to other points. He has a larger selection of equipment to fill a customer's needs. With more equipment available, the larger carrier can, during periods of suboptimal equipment utilization, permit preferred customers to use trailers as storage for short periods. Other characteristics revolve around the large operating staffs with each element handling one portion of the operation. Examples are the rating and billing section, tracing, pickup and delivery dispatch, freight operations (cross dock
activity transferring freight from smaller city rigs to over-the-road equipment and back at the destination), line dispatch for intercity movement, maintenance, marketing, and administration. Each area becomes a small empire among which information and customers' instructions frequently "get lost" or "forgotten." The sales staff may promise the customer perfect service, but the customers' instructions may never be implemented. No carrier could stay in business for long is this were the routine for every customer, but the larger carrier can absorb a greater degree of counterproductivity based on employee and "hired" management apathy than can the small proprietorship carrier.

As differences in service develop based on size, so do differences in cost structures. The larger carrier has the opportunity to profit from economies of scale and a larger base over which to spread cost. He has the ability to eliminate marginally productive equipment and facilities during a period of "belt-tightening." Because of his control over plant, as mentioned before, the larger carrier has the ability to shorten the calendar time encompassed by his long run cost curves, thus converting more items of expense to variable costs. By the same token, the large carrier's single most expensive item is labor, with wages and fringe benefits taking 59.8 cents out of every truck revenue dollar in 1970. By investment in modern technological equipment, larger carriers have been able to extract greater productivity to offset the high labor costs. An example would be the use of two trailers (called "doubles") for intercity movement, or computerized dispatch and on-line computerized billing and tracing.

The small carrier, either because of limited capital or credit, is less able to adjust his "plant" to changing economic situations. As such, more of his expenses are fixed over a longer period of time. Vehicle registration is a good example. The small carrier who registers one or two vehicles may only have to pay the fee once a year. Once it is paid it is a fixed cost for him for the year. On the other hand, the larger carrier who is adding vehicles to his fleet may pay fees on different vehicles all year long. The larger carrier can alter his fleet size by registering or not registering vehicles at any time. Thus he is able to make this item a variable cost. The small carrier, not using as much union help, is able to reduce his labor expense considerably in relation to his larger counterpart.

CARRIERS AND GOVERNMENT TRAFFIC

Information concerning government traffic that other carriers are bidding for under Section 22 is available from many sources. Carriers subscribe to the *Digest of Section 22 Quotations* by Transportation Services, a private company in Washington, D.C.,24 the *Daily Section 22 Reporting Service* by the American Trucking Association, Inc.,25 or to bulletins published by traffic or rate bureaus such as the Rocky Mountain Motor Traffic Bureau, Inc.26 Each of these sources provide up-to-date information on the most recent tenders submitted under the provisions of Section 22. From these sources, combined with personal contact with the government agencies in question, carriers can determine in what government traffic they would like to share, and bid accordingly.

Large and small carriers actively seek government traffic that they feel is beneficial to their organizations. An example can be seen by looking at Consolidated Freightways, Inc. (referred to as CF). CF considers government traffic important enough to warrant two sales managers specifically for that purpose. One is located in Washington, D.C., and is responsible for east coast activity, while the west coast is covered by a manager located in Hayward, California. In addition CF has a chapter in its sales manual on selling to the government.

“CF is definitely interested in government traffic,” the manual says and it continues by stating:

Remember, Sell the Government Traffic Manager just as you would a commercial traffic manager. Sell him these points:
1. CF coverage and service
2. CF serves more government shipping and receiving points with direct service, than any other motor carrier.

Managers should assign sales personnel to individual government accounts just as they would to a commercial account.27

Larger carriers, whether after government or commercial traffic, are not interested in carrying all available freight. They actively seek

only freight, referred to as "quality traffic," which moves at high rates while simultaneously causing relatively little expense. This philosophy emphasizes shipments of between 500 and 20,000 pounds, or even larger. In seeking government traffic, exempt from rate regulation, this philosophy causes the larger carriers to consider only those shipments for which competition has not driven the tendered rate below that which provides an adequate "profit to revenue" ratio as determined by the corporate staff. Herein lies the difference between the larger and smaller carriers. The smaller carrier, who may be less refined in his approach to marketing, frequently wastes much effort by seeking any traffic and ends up with less income than if he sought only "quality traffic." He may be doing a nice volume of business, but be heading for bankruptcy.

What impact does all of this have in the quotation of Section 22 tender rates? The small carrier comes into the government transportation office and asks if there is something he can move. Frequently the carrier will review tenders in the public file to establish a pricing base. In interviews with the carriers, traffic managers see the "shoe string" operator relying on intuition and past experience rather than on highly refined data collection and analysis characterized by the pricing decisions of the larger carriers. 28

The analysis entered into by the larger carrier resembles the following:

The carrier starts out by knowing what origin terminal and destination terminal is involved and the linehaul distance between them. They consider the weight of the shipment and compute the expense of the move by figuring the linehaul cost from the distance and the carrier's cost per mile multiplied by the percentage of load factor. This cost is doubled if the matching return trip must be deadheaded back to the origin. The cost per mile is computed including the driver's wages, operating costs of the vehicle, a share of line dispatch administrative costs, all of which are based on accurate record keeping and computer analysis. This is added to the cost per pickup at the origin terminal and cost per delivery at the destination terminal given in a rate per cwt. Monthly statistics are kept for each terminal in the system showing the breakdown of all terminal expenses and applying these against the weight picked up and delivered, as well as those expenses that are applied to the line haul. The

28. Interview, Hebert, op. cit.
final element of expense to be added is the percentage of revenue for corporate overhead. In the case of commercial traffic under regulated rates, the expense total is compared with revenue computed from the legal rate. If the resulting operating ratio (expense to revenue) is satisfactory according to corporate standards, the shipment is actively sought.

In the case of Section 22 traffic, the cost estimate and the minimum operating ratio at which the carrier will seek a shipment combine to determine what minimum rate will be bid. Of course, they will bid as high above this minimum as competition will permit, but following the theory of "quality traffic," large carriers will not actively seek government shipments for which competition has driven the rate below the satisfactory minimum.

COLLECTING THE DATA

The first phase of data collection centered around the price that was bid by motor carriers under the provisions of Section 22. Copies of all Section 22 tenders submitted for the movement of Department of Defense shipments are maintained at the Directorate of Freight Traffic within WAMTMTS located at the Oakland Army Base.

Personal interviews were conducted with members of the Directorate of Freight Traffic staff and permission received to extract information from the 1973 operation file of Section 22 tenders. Since all sample observations were drawn from the working files used by the traffic management technicians, they were considered to be still in effect although their individual dates of submission ranged as far back as 1961. (Tenders are maintained on file until they expire, if an expiration date has been assigned by the submitting carrier or until they are rescinded or superceded by a later submission by the same carrier.)

The Section 22 tenders provide information concerning the carrier, the commodity stated as either a specific commodity or FAK (mixed freight), the origin and destination of the movement stated as either specific locations or general points within a larger geographical area, minimum weight applicable for that particular rate, and the rate per hundredweight in cents. Other information contained on the tender...
includes specifics such as accesorial services and charges, nature of payment, exclusions, as well as any other specifics the carrier may have wanted to include.

The second phase of data collection concerned carrier costs. The California Trucking Association, Inc. (CTA), which, among its other activities represents its members in actions before the California Public Utilities Commission (PUC), maintains a division level staff which has as one of its functions the requirement to generate current and historical cost data to support the CTA's presentations at PUC hearings. Because the research conducted by the CTA is directed toward supporting proposed increases in minimum class rates, the cost data are generally oriented toward full allocation of costs, which includes net revenue after expenses and operating expenses. Rate hearings before and approval by the California PUC are based on the actual cost of transportation as opposed to the "fair return upon the fair value of their property" as used by the ICC. This means that in California the rate for any particular move must cover the fully allocated costs of that move, where the ICC rate policies consider the overall financial solvency of the carrier.

The statistics used in compiling the final California rates are derived from the broad spectrum of carriers from the very large to the very small. Because of the sheer volume of data generated by the larger carriers, they tend to over-balance the data in their own favor. The rates tend to be inflated due to the larger carriers' higher costs such as labor costs while some tendency to reduce the rates is generated by the larger carriers' greater efficiency. The primary impact of the rate structure is that, because the small carriers are able to operate at lower labor costs, they find the rate structure provides a higher percentage return over their costs than is provided to the larger carriers for the individual move. Larger carriers tend to reduce this gap by utilizing economies of a scale inherent in their size. The fact that many larger carriers are using computers to improve vehicle and personnel utilization, better monitor lay times in intercity relay operations, and better control cross dock freight operations contributes to reduction of the costs of individual moves and is ultimately reflected in requests for smaller rate increases.

Statistics generated by both the American Trucking Association

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32. Interview with Mr. Peter Shaw, Division of Transportation Economics, California Trucking Association, Burlingame, Ga., February 4, 1974.
33. Locklin, op. cit., p. 421.
and the California Trucking Association gave the breakdown of operating expenses found in Table 1. The ATA statistics represent information gathered in 1961 from a sample of Class I, II, and III carriers operating within California. Even though there are nine years difference in these percentages, they represent a striking similarity with the exception that the CTA TERMINAL EXPENSES are nearly five percent lower while their OTHER EXPENSE is 2.4 percent higher and their EQUIPMENT MAINTENANCE is 1.5 percent higher.

### TABLE 1

**Net Operating Expense Breakdown by Percent of Total**

<table>
<thead>
<tr>
<th>Expense Category</th>
<th>1971 ATA</th>
<th>1961 CTA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment Maintenance</td>
<td>9.4%</td>
<td>10.9%</td>
</tr>
<tr>
<td>Transportation</td>
<td>44.5%</td>
<td>45.2%</td>
</tr>
<tr>
<td>Terminal</td>
<td>21.4%</td>
<td>16.7%</td>
</tr>
<tr>
<td>Traffic</td>
<td>2.8%</td>
<td>2.3%</td>
</tr>
<tr>
<td>Insurance and Safety</td>
<td>4.5%</td>
<td>4.3%</td>
</tr>
<tr>
<td>Administrative and General</td>
<td>6.5%</td>
<td>7.3%</td>
</tr>
<tr>
<td><strong>Sub-total</strong></td>
<td>89.1%</td>
<td>86.7%</td>
</tr>
<tr>
<td>Other Expenses</td>
<td>10.9%</td>
<td>13.3%</td>
</tr>
<tr>
<td><strong>TOTAL OPERATING EXPENSE</strong></td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

The CTA computed INDIRECT COST, which is included in operating expenses and is given as a percentage of total revenue, ranged from 17.5 percent to 20.5 percent. The actual percentage is assigned on the basis of weight groupings and length of haul. During a short run situation in which variable cost pricing techniques were being considered, these indirect costs would be classified as fixed costs, and as such, would be deleted from the data used to determine the rate.³⁵

The mileage used by the military traffic managers was converted to constructive mileage by the use of Distance Table #7.³⁶ This step was necessary because the minimum class rates approved by the California PUC are computed on the basis of constructive mileage.

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³⁵. Ibid.

³⁶. California Public Utilities Commission, *Distance Table #7*, (San Francisco, Cal., Cal. PUC, January 1969, with changes through February, 1972. Constructive mileage takes into account changes in elevation and other factors which influence costs of operating a truck over a given route.
The next step involved assigning commodity classifications to the observations. This proved to be the most subjective part of the operation because the commodity descriptions on the tenders were not specific enough to match with those commonly accepted descriptions used for rating purposes. The final step in this sequence involved reviewing the Minimum Rate Tariff for the year of each observation and assigning the appropriate rate.

DATA ANALYSIS

The results of the multiple regression application yields the following equation for estimating a Section 22 tender rate in cents per hundredweight (Y) when the two independent variables of minimum weight in pounds (X2) and distance in miles (X1) are known:

\[ Y \text{ (rate)} = 87.523(cwt) - 0.002X2 \text{ (minimum weight)} + 0.167X1 \text{ (distance)} \]

Table 2 contains the comparison of the calculated rates with the actual rates for two examples taken from the sample observations. In both examples, the minimum weight remains the same, 40,000 pounds, but the distance changes. For observation number 78 the formula gives a computed rate that is 95.4 percent of the observed rate, while for observation number 22 the formula accounts for 80.1 percent of the actual rate.

COMPARISON OF TENDER RATE TO COSTS

In order to verify the hypothesis that carriers are covering at least their variable costs in submitting Section 22 tenders, it was necessary to compute what portion of fully allocated costs represented the variable costs and then to establish to what degree the Section 22 tender rates exceeded or fell short of this level.

Discussion with Mr. Shaw of the CTA emphasized the probability that in a variable cost pricing situation, the main determinants of minimum variable cost would be incorporated in the TRANSPORTATION and TERMINAL categories of operating expenses, with the majority of the remainder of these categories, including EQUIPMENT MAINTENANCE, being deleted from consideration in establishing the rate. Using the information contained in Table 1 to develop a mean percentage representative of those two categories after

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37. Interview, Shaw, February 11, 1974, op. cit.
The deduction of indirect costs, a minimum variable cost limit of 63.9 percent of operating expenses was computed. Completion of the analysis required that this percentage representing variable cost be converted to a percentage of fully allocated cost. The operating expense, including indirect costs, consisted of the amount remaining when net revenue after expenses is deducted from the fully allocated cost as applied to the minimum class rates.38

**TABLE 2**
Comparison of Computed and Observed Rates

<table>
<thead>
<tr>
<th>Regression Formula with Coefficients</th>
<th>Computations for Observation #78*</th>
<th>Computations for Observation #22**</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>87.523</td>
<td>87.523</td>
</tr>
<tr>
<td>$B_i$</td>
<td>$-0.002$</td>
<td>$-0.002$</td>
</tr>
<tr>
<td>$X_i$</td>
<td>$X_i$</td>
<td>40,000</td>
</tr>
<tr>
<td>$B_iX_i$</td>
<td>$-0.002X_i$</td>
<td>$-80,000$</td>
</tr>
<tr>
<td>$B_i$</td>
<td>$+0.167$</td>
<td>$+0.167$</td>
</tr>
<tr>
<td>$X_i$</td>
<td>$X_i$</td>
<td>412,000</td>
</tr>
<tr>
<td>$B_iX_i$</td>
<td>$+0.167X_i$</td>
<td>$+68.804$</td>
</tr>
<tr>
<td>Computed rate</td>
<td>$Y_c$</td>
<td>76.327 cwt</td>
</tr>
<tr>
<td>Actual rate</td>
<td>$Y$</td>
<td>80,000 cwt</td>
</tr>
<tr>
<td>Computed rate as a percent of the observed rate</td>
<td>$Y_c$</td>
<td>95.40%</td>
</tr>
</tbody>
</table>

*Observation number 78 was tendered by the Little Debra Shipping Company in 1971 to move FAK commodities in 40,000 pound minimum truckload lots from Oakland, CA. to Long Beach, CA. (412 miles) at a rate of 80 cents per hundredweight.

**Observation number 22 was tendered by the C.Q. Trucking Company to move lumber and building materials in 40,000 pound minimum truckload lots between points in California not exceeding 100 miles distance at a rate of 30 cents per hundredweight in 1969.

The deduction of net revenue after expenses was justified on the basis that this net figure includes deductions for income taxes and the remaining profit. In a situation in which only variable costs are

considered in setting the price, there will be a net accounting loss on
the individual move and, consequently, no contribution to profit nor
income taxes attributed to the move. The mean net revenue for the
period of the sample observations was computed from expense and
revenue statistics published by the American Trucking Association.
The mean net revenue corresponding to the sample observations
amounted to 4.4 percent of total revenue.39

The CTA computed indirect costs as a percentage of total revenue
and based on the weight group and distance of each move, this is then
applied to each category of operating expenses. The mean indirect
cost applicable to the Section 22 tenders amounted to 18.9 percent
of total revenue or fully allocated costs.

Setting fully allocated costs as 100 percent and deducting the 4.4
percent representing net revenue leaves 93.6 percent to cover operat­
ing expense. With the minimum variable cost being set at 63.9 per­
cent of operating expense, the minimum variable cost level translates
to 61.34 percent of fully allocated costs. The establishment of fully
allocated costs for the sample observations was based on the Califor­
pnia PUC approved minimum class rate in effect for the particular
move at the time that each Section 22 tender was submitted to the
military traffic managers. The Section 22 tender rate was then con­
verted to a percentage of the fully allocated cost. In those cases where
the Section 22 rate exceeded 61.3 percent of fully allocated cost, the
carrier exceeded his minimum variable cost.

The mean fully allocated cost for the sample observations was 54.7
cents per hundredweight, and the mean Section 22 tender rate was
37.3 cents per hundredweight or 68.2 percent of fully allocated costs,
which exceeds the 61.3 percent minimum variable cost level. In order
to establish that the difference between the 68.2 percent of fully
allocated costs representing the sample is statistically significant
from the 61.3 percent minimum variable cost level the Students-t test
was used. The null hypothesis was formed by stating that there was
no statistical significance to the difference between 68.2 percent and
61.3 percent. The calculated Students-t statistic was 3.55 which ex­
cceeds the table value of 2.642 for a 99.5 percent confidence level. This
calls for the rejection of the null hypothesis and acceptance of the
alternate hypothesis that, with 99.5 percent confidence, the mean
rate of the sample, expressed as a percent of fully allocated cost, is
greater than the minimum variable cost limit, also expressed as a
percent of fully allocated cost, by a statistically significant difference.

SUMMARY

In summary, the purpose of this study has been to establish the degree to which bids submitted under the provisions of Section 22 provide for adequate revenue to cover the carrier's costs. The approach utilized was establishment of the impact of the factors of minimum weight and length of haul on the rate per hundredweight bid on Section 22 tenders. This phase was computed from inference of the results of a stepwise multiple regression analysis of a sample of Section 22 tenders on file at WAMTMTS in Oakland.

The second phase consisted of establishing fully allocated costs for each observation by using the minimum class rates approved by the California Public Utilities Commission and comparing these costs with the rates quoted on the tenders. The results of this analysis provide the basis for acceptance of the hypothesis that highway carriers submitting tenders under the provisions of Section 22 of Part I of the Interstate Commerce Act to the Department of Defense for movement of military freight within the geographical area of responsibility of the Western Area Military Traffic Management and Terminal Service Headquarters have generally covered their short-run variable costs.
RECENT DEVELOPMENTS IN INTERPRETATION OF THE APA: FLORIDA EAST COAST AND ITS PROGENY

REPORT OF JUDICIAL REVIEW COMMITTEE OF THE ADMINISTRATIVE LAW SECTION OF THE AMERICAN BAR ASSOCIATION†

Ever since the decision of the United States Supreme Court in United States v. Florida East Coast Railway,¹ there has been developing in various federal administrative agencies and in the United States Courts of Appeals, a view of the Administrative Procedure Act which we believe is plainly contrary to its correct interpretation. This erroneous view is primarily concerned with the application of the procedural requirements of §556 and §557 (the original sections 7 and 8) of the Act² to rule making proceedings including ratemaking proceedings under various regulatory statutes which were already in effect when the APA was adopted—statutes such as the Interstate Commerce Act, the Federal Power Commission Act, the Natural Gas Act and the Federal Communications Act. This view holds in effect that the procedural requirements of those sections of the APA do not have to be complied with when the agency chooses instead to conduct rulemaking proceedings in accordance with §553 of the APA. It is based on the theory that such rules are not “required by statute to be made on the record after opportunity for an agency hearing” within the meaning of §553(c) of the APA.³

The origin of this extremely restrictive interpretation of §553(c) of the APA is primarily the opinion of Mr. Justice Rehnquist for the Court in Florida East Coast. That case involved an order of the Interstate Commerce Commission establishing Incentive Per Diem Charges to be paid by railroads for the use of cars which they do not

† This report was prepared by Messrs. Nathaniel L. Nathanson Aloysius B. McCabe and Francis M. Gregory, Jr., Chairman and Vice-Chairman of the Judicial Review Committee of the Administrative Law Section of American Bar Association. It has been circulated to the Judicial Review Committee and approved by the Council of the Administrative Law Section at its meeting on October 4, 1975. The report draws freely upon more extended treatment of the subject which appears in Nathanson, “Probing the Mind of the Administrator: Hearing Variations and Standards of Judicial Review Under the Administrative Procedure Act and Other Federal Statutes”, 75 Col. L. Rev. 721 (May 1975). Reprinted with permission from Ad. L. Rev. _____.
2. 5 U.S.C. 556-57.
3. 5 U.S.C. 1553.
own to the railroads that own the cars. This order was issued under the authority of §14(a) of the Interstate Commerce Act which reads in part as follows:

The Commission may, after hearing, on a complaint or upon its own initiative without complaint, establish reasonable rules, regulations, and practices with respect to car service by common carriers by railroad subject to this chapter, including the compensation to be paid and other terms of any contract, agreement, or arrangement for the use of any locomotive, car, or other vehicle not owned by the carrier using it (and whether or not owned by another carrier), and the penalties or other sanctions for nonobservance of such rules, regulations, or practices . . . .

To some extent, in reaching this result, Mr. Justice Rehnquist was simply relying upon his previous opinion for a unanimous Court in *United States v. Allegheny Ludlum Steel Corp.* holding that a previous rule of the Commission, also issued under §1(14)(a) of the Interstate Commerce Act and requiring prompt return of non-owned cars after unloading, did not have to be issued in compliance with §556 and §557 because there is no statutory requirement in §1(14)(a) or elsewhere in the Interstate Commerce Act that such a rule should be made "on the record". However, in *Florida East Coast*, reliance upon *Allegheny Ludlum* alone was not a sufficient response to the dissenting opinion of Justices Douglas and Stewart, which argued that the rule involved in *Florida East Coast* was more like a rate order because it established the charges to be paid and was therefore sufficiently adjudicatory in nature to lay the basis for a due process right to a full hearing. In response to this line of argument, Mr. Justice Rehnquist suggested that ratemaking on an industry-wide scale was primarily legislative in character, rather than adjudicatory, in accordance with "a recognized distinction in administrative law between proceedings for the purpose of promulgating policy-type rules or standards, on the one hand, and proceedings designed to adjudicate disputed facts in particular cases, on the other." Mr. Justice Rehnquist also suggested that even if §556 and §557 of the APA did apply, the complaining railroad might not be entitled to have the order set aside because of the exception in §556(d) permitting a rulemaking proceeding to be

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6. 410 U.S. at 251.
7. 410 U.S. at 245.
restricted to written submissions rather than oral examination and cross-examination, when "a party will not be prejudiced thereby." If the Florida East Coast decision had rested entirely on this last alternative ground, we would have no objection to it. Indeed we might have welcomed it as an enlightened application of the APA comparable to a similar approach adopted by Judge Friendly, speaking for a three-judge court in Long Island R.R. Co. v. United States, which concerned the same ICC order. However, the principal ground relied upon by Mr. Justice Rehnquist, the absence of the phrase "on the record", or its equivalent, in section 14(a) of the Interstate Commerce Act, as a reason for treating as entirely inapplicable sections 556 and 557 of the APA, constitutes an unduly restrictive interpretation of the statute which threatens to render it largely inapplicable to the rate-making and other rulemaking functions of several of the major regulatory agencies. Under this new interpretation, such functions, which had previously been generally regarded as subject to sections 556 and 557 of the APA, will be subject only to the procedural requirements of section 553 of the APA.

Examples of this tendency may be found in recent decisions of the Courts of Appeals dealing with orders of the Federal Power Commission and the Federal Communications Commission. In Mobile Oil Corporation v. FPC, for example, the Court of Appeals for the District of Columbia, in an elaborate opinion by Judge Wilkey, assumed that an order of the FPC establishing minimum rates for natural gas, did not have to be issued in a proceeding complying with sections 556 and 557 of the APA, because the ratemaking provisions of the Natural Gas Act do not contain the phrase "on the record" or its equivalent. Nevertheless, Judge Wilkey also held that, because such orders had to be reviewed on the administrative record of the Commission, in accordance with the substantial evidence rule, the procedures of the Commission had to satisfy the basic elements of fairness in resolving

8. 5 U.S.C. §556(d); 410 U.S. at 246. The district court in Florida East Coast recognized the possibility of confining the hearing to written submissions under sections 556(d), but held that exception inapplicable because the complaining roads had made a sufficient showing that they were "prejudiced by the summary procedures of the Commission." Florida East Coast Ry. v. United States, 327 F. Supp. 725, 728 (N.D. Fla. 1971). The dissenting Justices in the Supreme Court were apparently of the same opinion. See 410 U.S. at 247, n. 1.


11. Such provisions do, however, require a hearing. 15 U.S.C. 1717c(e) and 1717d(a).
all contested issues of fact. In this respect the procedures of the FPC were found seriously deficient. Similarly, in Bell Telephone Co. of Pennsylvania and A.T.T. v. Federal Communications Commission, Judge Garth, speaking for the Court of Appeals for the Third Circuit, assumed that an order of the FCC issued under sections 201(a) and 205(a) of the Communications Act, requiring the Bell System to provide interconnection facilities to certain named specialized common carriers, did not have to be issued in proceedings conforming to sections 556 and 557 because neither section 201(a) nor section 205(a) contains the phrase "on the record" or its equivalent. Nevertheless, Judge Garth also held that Commission had to comply with the essential requirements of due process in resolving any contested issues of fact. But in Bell Telephone, unlike Mobile Oil, the Commission's order was sustained because the Court found that the essential elements of due process had been satisfied. Thus the results of these two cases do not offend essential considerations of fairness but the opinions cast a pall over the proper application of very significant provisions of the APA and engender confusion with respect to the exact procedural steps which should be taken in order to satisfy the minimum requirements of due process or intelligible judicial review.

12. 483 F.2d at 1257; 15 U.S.C. §717r(b) (1970). Judge Wilkey also rejected the views of the majority in Phillips Petroleum Co. v. F.P.C., 475 F.2d 842 (10th Cir. 1973), approving the use of §553 proceedings by the FPC in establishing rates under the National Gas Act. Instead, Judge Wilkey expressed agreement with the dissenting view of Judge Seth that the Commission was required "to create a record that would adequately support the factual findings and permit judicial review . . . ." 483 F.2d at 1262. But compare American Public Gas Ass'n v. F.P.C., 498 F.2d 718 (D.C. Cir. 1974) (per curiam), sustaining the use of § 553 proceedings for the issuance of an FPC order establishing "initial rates at which sales of natural gas in the Rocky Mountain area are to be certificated without refund obligation for sales made under contracts dated after June 17, 1970." Id. at 721. Conceivably this decision may be distinguished from Mobile Oil on the ground that it involved not a rate order issued under the ratemaking provisions of the Natural Gas Act but a regulation issued under section 16 of the Act, 15 U.S.C.7170. Nevertheless, the Commission, on the authority of American Public Gas, Mobile Oil and Phillips Petroleum, rejected challenges to the use of §553 proceedings, rather than §556-§557 proceedings, for the establishment of a uniform national base rate for the various types of natural gas in Opinion No.699, National Gas Rate, D.K. F. No. R - 3890B, CCH Util. L. Rep. ¶ 11,549. This order after several revisions, is now on appeal in the 5th Circuit.

13. 503 F.2d 1250 (3d Cir. 1974). In the Bell Telephone case, unlike Mobile Oil, the Court sustained the Commission's order because it found that the essential elements of due process had been satisfied.

14. 47 U.S.C. §201(a), 11205(a). Both of these sections require an opportunity for hearing, but do not use the language "on the record".

15. 503 F.2d at 1266-1268.
The Florida East Coast interpretation of the APA is not justified even by a literal reading of the section 553(c), especially in the light of the Supreme Court’s previous decision in Wong Yang Sung v. McGrath\(^{16}\) interpreting the cognate provision of section 554(a), which refers to “every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing . . . .” In Wong Yang Sung, the Court, in an opinion by Mr. Justice Jackson, held that the absence of any express requirement of opportunity for an administrative hearing in the Immigration Act did not render this particular phraseology of section 554(a) inapplicable to deportation proceedings because the Immigration Act had been consistently interpreted to require such a hearing in order to satisfy the constitutional requirements of due process. The general principle of Wong Yang Sung has been applied to several other statutes which contain no explicit requirement for a hearing.\(^{18}\) The Interstate Commerce Act provision involved in Florida East Coast did contain a requirement of opportunity for hearing but did not contain an explicit requirement that the hearing be “on the record” or that rule or order involved be “made on the record”. Nevertheless, the accepted interpretation of the Interstate Commerce Act, ever since the decision of the Supreme Court in Interstate Commerce Commission v. Louisville & Nashville RR. Co.,\(^{19}\) had consistently held that ICC rules or orders issued under statutory provisions which required only a hearing, and said nothing about the hearing being conducted “on the record” or the rule or order being “made on the record”, should be made and reviewed on the administrative record of the administrative hearing.\(^{20}\) So long as that interpretation of the Interstate Commerce Act is followed,\(^{21}\) and

17. 339 U.S. at 48-51.
18. See, e.g., Riss Co. v. United States, 341 U.S. 907 (1951) (denial of motor carrier certificate by ICC); Cates v. Haderlein, 342 U.S. 804 (1951) (post office fraud order); Adams v. Witmer, 271 F.2d 29 (9th Cir. 1958) (denial of application for patents to mining claims); Door v. Donaldson, 195 F.2d 764 (D.C. Cir. 1952) (post office order banning obscene films from the mails).
20. Compare Baltimore & Ohio R.R. v. United States, 298 U.S. 349, 362-72 (1936) (recognizing the right to introduce new evidence upon judicial review of allegedly confiscatory ICC order) with Manufacturers Ry. Co. v. United States, 246 U.S. 457, 480-90 (1918) (emphasizing that all pertinent evidence should be submitted in the first instance to the Commission, and that reversal of ICC action is unlikely to be based “upon evidence newly adduced but not in a proper sense newly discovered”).
21. This interpretation of the statutory review provisions applicable to the ICC is now in effect codified by the recent amendment of the Hobbs Act transferring judicial review of most ICC orders to the Court of Appeals, and thus providing explicitly for
is deemed to apply to section 14(a) of the Act, as well as to the
ratemaking sections of the Act, the principle of *Wong Yang Sung*
seems to us equally applicable, with the result that orders of the ICC
issued under such sections should be regarded as “required by statute
to be made on the record” within the meaning of section 553(c) of the
APA. The only possible qualification of this view which seems to us
rational is that section 14(a) of the Interstate Commerce Act might
be treated differently than the ratemaking sections of the statute
either because of its particular language (i.e., its use of the word
“hearing” rather than “full hearing” as in the ratemaking provisions)
or its legislative history, or both; and that orders issued under that
section are not required to be made on an administrative record or
to be reviewed on that record.\(^\text{22}\) This qualification is not, however,
consistent with the opinion in *Florida East Coast*, which did not limit
its holding to the peculiar language of section 14(a), or suggest that
review could be on anything but the administrative record.

Whatever may be thought of this possible interpretation of section
14(a) of the Interstate Commerce Act, it certainly has no application
to rate orders issued under the Natural Gas Act, or to the type of
order issued by the FCC in the *Bell Telephone* case. As Judge Wilkey
recognized in the *Mobile Oil* case, FPC rate orders issued under the
Natural Gas Act must be made on an administrative record and must
be reviewed on that record, in accordance with the substantial evi-
dence rule. This was made explicit by the judicial review provisions
of the statute.\(^\text{23}\) Similarly, the order of the FCC involved in the *Bell*

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\(^{22}\) The validity of this distinction is not enhanced by the fact that the amendment
of 1975 (P.L. 93-584) transferring review to the Court of Appeals, makes an exception
for orders “for the payment of money, or the collection of fines, penalties and forfei-
tures” leaving them to be reviewed in the district courts. This simply continues in
effect a similar exception from the three-judge requirement of the previous statute, 28
U.S.C. §2321. It was obviously not considered applicable to orders establishing per
diem charges in *Florida East Coast*. Cf. *United States v. Interstate Commerce
Commission*, 337 U.S. 426 (1949) (holding the exception applicable to an order denying
a reparations award to a shipper).

\(^{23}\) See note 12 supra. This is equally true with respect to other rate orders of the
FPC issued under the Federal Power Act (16 U.S.C. §8251(b)), and rate orders of the
CAB, under the Civil Aeronautics Act (49 U.S.C. §1486(e)). Regulations issued by the
FPC and CAB under provisions granting rulemaking authority without any applicable
requirement for hearing, or explicit provision for judicial review, are presumably sub-
ject to review either in enforcement proceedings or in suits for declaratory judgments
or to enjoin enforcement. Cf. *United Gas Pipe Line v. FPC*, 181 F.2d 796 (D.C. Cir.
1950); *Air Line Pilots Ass'n Int. v. Quesada*, 278 F.2d 892 (2d Cir. 1960) with *United
Telephone case was required to be made on an administrative record and to be reviewed on that record, although this was not made explicit by the original Communications Act, which simply adopted by incorporation the procedures for judicial review of the ICC in the three-judge district courts. However, the legislative history of the Act and subsequent Supreme Court decisions interpreting it established quite clearly that, at least whenever the Communications Act itself provided for an administrative hearing, review was to be on the record of the administrative hearing. This was made even more explicit with the adoption in 1950 of the Hobbs Act when review of most FCC orders was shifted to the Courts of Appeals. It is our belief that the only sound interpretation of the APA, as applied to these and similar regulatory statutes in existence at the time the APA was adopted, is that, to the extent that rules and orders of the agencies were reviewed on the record of the administrative proceedings, they were also understood to be rules “required” to be made “on the record” within the meaning of section 553(c) of the APA.

This rather obvious and natural meaning of the APA is fully borne out by its own legislative history. When bills most comparable to the

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(a) Unless determined on a motion to dismiss, petitions to review orders reviewable under this chapter are heard in the court of appeals on the record of the pleadings, evidence adduced and proceedings before the agency, when the agency has held a hearing whether or not required to do so by law. 28 U.S.C. 2347 (1970).

This provision is applicable to all orders of FCC made reviewable by section 402(a) of the Communications Act. It is also applicable to certain orders issued by the Secretary of Agriculture, the Federal Maritime Commission or Maritime Administration, the Atomic Energy Commission and now, by virtue of P.L. 93-584, supra note 21, to most orders of the ICC.

APA were first introduced in Congress they did not contain the rather peculiar definition of "rule" now contained in the APA, making the definition inclusive of rules of "particular" as well as "general" applicability, and explicitly including the prescription of rates, wages, financial structures, etc. Neither did those bills contain the various exceptions for rulemaking procedures, introduced into the original sections 7 and 8 of the APA, and now contained in sections 556 and 557. It was the concern of regulatory officials, such as Commissioner Aitchison of the ICC, that the procedures specified in section 7 and 8 would cripple the ratemaking and similar procedures of the regulatory agencies, that prompted the inclusion of ratemaking and other specific policy functions in the definition of rule, and the addition of the special exceptions for rulemaking and initial licensing so as to permit more flexible procedures in the performance of those functions. This legislative history would make no sense at all if it was also the understanding of the responsible draftsmen and sponsors of the APA that requirements of sections 7 and 8 would have no mandatory application to most, if not all, of the ratemaking and comparable rulemaking functions of the major regulatory agencies then in existence. Yet that is the effect of the interpretation adopted in Florida East Coast, especially if it is carried to its logical conclusion, as demonstrated in the Mobile Oil and Bell Telephone.

We recognize that the harmful effect of this interpretation is considerably mitigated by the application of the judicial review and due process principles adopted in the Mobile Oil and Bell Telephone opinions. But the exact requirements of that approach are extremely variable and uncertain and may themselves generate considerable unnecessary litigation, which would be obviated by adherence to the procedures outlined in sections 556 and 557 of the APA. Furthermore, we are quite satisfied that, insofar as the Florida East Coast, Mobil Oil and Bell Telephone approach promotes flexibility in administrative procedures, substantially the same results could be obtained by a careful but imaginative use of the exceptions of the sections 556 and 557 of the APA, as demonstrated by Judge Friendly's opinion in the Long Island Railroad case. Similarly, the procedures adopted by the FCC in Bell Telephone could have been justified by the FCC under sections 556 and 557 of the APA, with the possible

addition of a tentative opinion in the place of the final opinion. The same could probably be said for the procedures used by the FPC for the issuance of its order establishing a Uniform National Rate for sale of natural gas, now on appeal in the 5th Circuit. On the other hand, the procedures followed in Mobile Oil would have been clearly in violation of the APA, just as Judge Wilkey held them invalid under his "flexible interpretation" of the APA, relying primarily upon the requisites of fair hearing and substantial evidence. In any event, the extent to which greater flexibility is required for such proceedings than is now permitted by the APA is plainly a legislative question which should be frankly faced as such, instead of being achieved through an obvious distortion of the original meaning of the Act.

In a somewhat ambiguous fashion, this question has been faced on a legislative level in recent environmental and safety statutes where Congress has explicitly provided for direct judicial review in the Courts of Appeals of rules apparently intended to be issued in accordance with §553 procedures rather than in accordance with §556-§557 procedures. Since these were all statutes enacted after the APA, they stand on a somewhat different level of interpretation than the statutes in existence at the time of the APA's adoption. To the extent that these statutes have deliberately chosen to direct the use of §553 rather than §556-§557 proceedings for the creation of an administrative record, which will constitute the basis for judicial review as well as for administrative action, they may be regarded as creating ad hoc exceptions to the general command of section 553(c) that administrative rules required to be made "on the record" must be conducted in accordance with sections 556 and 557 of the APA. This is far from saying, however, that such statutes have solved all the problems of creating an adequate record for judicial review and satisfying the requirements of due process in the resolution of contested issues of fact, as demonstrated by some of the leading opinions strug-

30. Supra note 12.

gling with these problems. It is also noteworthy that in even more recent statutes, Congress has demonstrated its growing concern for these problems by providing for additional procedural safeguards to be attached to the bare bones of §1553 rulemaking proceedings whenever contested issues of fact are developed.

Whether the spread of the Florida East Coast interpretation of the APA is sufficiently detrimental to suggest the desirability of a legislative curb, either through the amendment of the APA or of the regulatory statutes involved, is a very difficult question to answer at the present time. This is particularly so because it is not yet clear that the Florida East Coast opinion will be deemed applicable to the ratemaking and comparable regulatory functions of the major regulatory agencies. If the position of FPC on this point is sustained by the Court of Appeals for the 5th Circuit, and eventually by the Supreme Court, in the National Gas Rate case now pending, then it would be clear that the broadest interpretation of Florida East Coast had carried the day, and we would have no hesitation in recommending remedial legislation. If, on the other hand, this broad interpretation were rejected, and Florida East Coast were to be authoritatively limited to section 14(a) of the Interstate Commerce Act, there would be no need for remedial legislation. Consequently, we recommend that the Administrative Law Section withhold any legislative proposals until the full scope of the Florida East Coast opinion has been further developed.


34. In this connection, account should also be taken of pending ABA proposals for amendment of the APA. Particularly pertinent is S. 796, 94th Cong., 1st Sess. (introduced by Senators Kennedy and Mathias), which would amend the definition of rule to read as follows:

(4) "rule" means the whole or a part of an agency statement of general applicability and future effect designed to implement, interpret, or prescribe law or policy or to describe the organization, procedure, or practice requirements of an agency.
In the meanwhile we recommend that the Section make known its disapproval of the *Florida East Coast* opinion, at least in its broader implications, and take appropriate steps to secure its limitation.

The effect of this amendment would be to include within the definition of adjudication ratemaking and similar orders of particular applicability. It would not, however, seriously militate against the flexibility of §556 and §557, as applied to such orders, because the exceptions applicable to rulemaking and initial licensing would also be made applicable to "ratemaking and cognate proceedings." This proposed amendment would not significantly affect the *Florida East Coast* problem, particularly so far as ratemaking orders of general applicability are concerned, since they would still be treated as "rules" for the purpose of the APA. The general philosophy of *Florida East Coast* also has some possible relevance to cases of "adjudication under §554 of the APA, as indicated by *International Tel. & Tel. Corp. v. Local 134, Int. Brotherhood of Electric Workers*, 95 S.Ct. 600 (1975), where the Court, in a unanimous opinion by Justice Rehnquist, held that the determination of a jurisdictional dispute by the NLRB was not an "adjudication" subject to §1554 of the APA. In our judgment, however, the specific holding in *International Tel. & Tel.* is much more justifiable than the interpretation of "on the record" in *Florida East Coast*. 
On January 2nd, 1975 the Congress of the United States passed Public Law 93-584 the effect of which was felt on March 1, 1975. This Act was the culmination of years of arguments, recommendations, persuasion, counter-argument and lobbying in an effort to make the procedure to test the validity and constitutionality of an Interstate Commerce Commission order conform with the procedures applicable to review of orders of other agencies.

As far back as 1941, Mr. Justice Frankfurter described the prior three judge court appeal procedure as "A serious drain upon the federal judicial system particularly in regions where, despite modern facilities, distance still plays an important part in the effective administration of justice". Ever since then, and probably before, there has been an ongoing effort to make the appellate procedure governing I.C.C. orders more efficient and economical in order that the orders may be fully reviewed but under a well thought out viable system.

Such I.C.C. orders are now finally within the fold where they had heretofore been the only remaining federal agency decisions which were routinely reviewed by a three judge court with expedited appeal to the Supreme Court as a matter of right.

The technical changes brought about by the recent enactment generally provide for review by a circuit court as a matter of right and appellate review by the Supreme Court upon petition of certiorari as in most other appeals from circuit court decisions.

The efficiency of this system has been long recognized and the recent efforts to bring I.C.C. orders under such mechanism were unopposed except in two minor areas which were unsuccessfully propounded by the commission.

The I.C.C. initially desired review to be only by the circuit in which the petitioner resided and wished to eliminate the option of having a review petition filed in the District of Columbia circuit. For various

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* Partner, Morgan, Lewis & Bockius, Philadelphia, Pa. This paper is a condensation of a paper delivered by Mr. Littleton at the 1975 annual conference of The Motor Carrier Lawyers Association.

1. Except an Order for the payment of money or the collection of fines, penalties, and forfeitures, enforcement or suspension of which is vested in the District Courts of the United States, 28 U.S.C.A., §1336(a) as amended.

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reasons as set forth in the reports to the House and the Senate\(^2\) this proposal was rejected and jurisdiction remained on an alternative basis of the petitioner's circuit or the D.C. circuit.

The second proposal was that the Commission would have complete control over the defense of its order, independent of the discretion of the Attorney General of the United States.

The Congress saw no merit in this contention particularly since the existing law provided that the agency whose order is under attack may appear on its own motion and has a right to be represented by its own counsel. In addition under the same section\(^3\) the Attorney General may not dispose of the proceeding if the agency objects thereto.

The reports of the houses of Congress conclude by assessing the advantages of placing review of I.C.C. orders under the so-called Hobbs Act\(^4\) in that (1) the problem of multiple suits challenging the commission order in different locations before different courts would disappear; (2) the appeal must now be brought within sixty (60) days of the date of entry (of this, more later); (3) the agency must file the record but only in minimal form and thus ease a financial burden heretofore on the parties; (4) it provides a quorum review by the Courts of Appeals; and (5) this bill would now make the rules and regulations of the I.C.C., reviewed by the same judicial tribunal which has jurisdiction to review adjudicated orders of that agency.

Your writer has been asked to set forth the practices and procedures before the Circuit Courts of Appeal that will now apply to the majority of I.C.C. orders and to provide forms and other technical data so that this new method of review will be more familiar to attorneys who practice before the I.C.C. almost exclusively.

THE HOBBS ACT\(^5\)

Under the Hobbs Act, as amended, the definition of "agency" now includes the Interstate Commerce Commission. The Court of Appeals that has venue of review petitions from orders of the I.C.C. is that circuit within which the petitioner resides or has its principal office or in the alternative in the Court of Appeals for the District of Columbia. This is an optional venue which gives the petitioner the choice

\(^2\) House of Representatives Report No. 93-1569, 93rd Congress, First Session.
in determining in which court the ultimate decision will be made. Under the provisions of the Act, the court in which the petition is first filed is the court which has exclusive jurisdiction over appeals from the same I.C.C. order except for its inherent right to transfer said petition to another circuit if it feels that the interest of justice and other considerations so require.

Under Section 2112(a) of Title 28, the agency must file its record in that court in which a proceeding in respect to such order was first instituted. Thus the choice of a forum is in the petitioner's hand and counsel will be well advised to become familiar with the various philosophies, procedures, and opinions of that circuit as well as the District of Columbia circuit so that he might best advise in which forum petitioner would receive more favorable consideration.

Under the same section all other courts of appeals in which proceedings are subsequently filed concerning the same order must transfer them to the original court of appeals.

The only exception to this is provided in Section 2112(a) wherein the circuit court first having venue may "for the convenience of the parties in the interest of justice" thereafter transfer all proceedings to any other court of appeals. While this transfer authority exists, a search of the cases does not reveal that it is often exercised.

It is thus clear that THE CHOICE OF FORUM IS THE PETITIONER'S.

The petition must be filed within 60 days after "entry of the order", since the statute authorizing the appeal of the agency controls.

It is interesting to note that while section 2344 states this period as "within 60 days after its (the order) final entry" the reports of the Congress do not seem to distinguish between "entry of the order" and "service of the order", often treating the two items as equivalents. In fact, the conclusion reached by the House report makes the statement that one of the advantages to be derived from the change is that an appeal must be filed within 60 days "from the date of service".

Despite this congressional statement, it is clear that the statute as enrolled measures the time period from the date of entry. While even some cases have talked about 60 days from "service", lawyers would

7. 28 U.S.C.A., §2112(a) last sentence.
be well advised to make their decision and file the petition based upon the date of entry even though that as a practical matter may well shorten the time within which the petitioner has for consideration of steps to be taken.

In this regard, it is to be noted that under Section 2344 the agency is required to “promptly give notice” of the final order. If the agency does not live up to this mandate of prompt notification and thereby reduces the period within which the petitioner has to consider appeal, get the documents prepared, etc. to an unreasonably short period of time, it might well be that the circuit court, in the exercise of its equitable powers, would permit a late filing. However, the testing of this proposition is not to be encouraged.

It is interesting to note also that in a few cases concerning appeals from other agencies heretofore subject to the Hobbs Act, the running of the 60 day period has been held to commence with the entry of the last order dealing with the agency decision being appealed, such as a denial of a petition for rehearing, although the circuit courts differ in this conclusion.11

It is thus obvious that SAFETY DICTATES THE PETITION BE FILED WITH THE APPROPRIATE CIRCUIT CLERK 60 DAYS AFTER THE ENTRY OF THE ORDER being appealed, pending petitions for rehearing notwithstanding.

The actual document bringing about review of the final order of an agency is a Petition for Review setting forth the four requirements contained in Section 2344 and naming the United States as respondent.

Any party aggrieved by a final I.C.C. order must file a petition containing a concise statement of (1) the nature of the proceedings as to which review is sought; (2) the facts upon which venue is based; (3) the grounds upon which relief is sought, such as an arbitrary, capricious abuse of discretion, unconstitutionality, evidentially unsupported order or other such; and (4) the relief prayed for. The petition must attach as an exhibit a copy of the order being appealed.

In preparing the petition counsel should also review in great detail Federal Rule of Appellate Procedure 15(a) which sets forth the items that must appear within the petition and indicates the agency shall be named as respondent also.

Upon the filing of a petition the Clerk of the Court serves a copy upon the agency and upon the Attorney General.

While the Attorney General is responsible for the Government's interest, the agency or any party in interest who may be affected if the order of the agency is or is not enjoined may appear on their own motion as of right and be represented by counsel.\textsuperscript{12}

The Circuit Court has a number of options as to the subsequent handling of the petition.\textsuperscript{13} Briefly it may hold a prehearing conference with the parties or direct a judge of the court to hold such. This particular option does not seem to have been invoked often, or if so, the matter has never been judicially discussed. Presumably each circuit court acts on its own in the handling of such possible conferences.

The matter may also be determined on a motion to dismiss if the respondent so files.

Unless so determined, the court will hear the case on the record made before the agency when the agency has held a hearing.

However, when the agency has not held a hearing, the court of appeals shall determine whether hearings are required by law. If it determines that a hearing is so required it will remand it to the agency to hold such.

If, however, it determines that a hearing was not required or was in fact held whether required or not, it will pass on the issue presented based upon the pleadings and affidavits filed if they reveal no genuine issue of material fact.

But, if a genuine issue of material fact is presented by the pleadings and affidavits, it shall transfer the proceedings to a district court in and for the petitioner's district for determination of such issues of fact.

A party also has the option,\textsuperscript{14} once the petition has been filed with the circuit court, to apply to the court for leave to adduce additional evidence by satisfying the court that (1) the additional evidence is material and (2) there is a reasonable explanation for the party's failure to present such evidence before the agency. In this instance the court may order the additional evidence and contrary evidence to be taken by the agency.

Interestingly enough, the agency may thereafter modify its finding of fact and modify its order or set it aside. If it does so, it would file with the Court of Appeals the additional evidence, the modified findings of fact and modified order and could even set aside its original order.

\textsuperscript{12} 28 U.S.C.A., §2348.
\textsuperscript{13} 28 U.S.C.A., §§2345-2347.
\textsuperscript{14} 28 U.S.C.A., §2347(c).
Once the Circuit Court has received the agency file and/or docket that particular court has jurisdiction of all proceedings involving that order. It has the power to vacate stay orders or interlocutory injunctions previously granted by any court and has exclusive jurisdiction to enter a judgment determining the validity of enjoining or suspending in whole or in part the order of the agency.¹⁵

**STAY OF THE ORDER**

However, the filing of the petition does not itself act as a stay but the Court of Appeals may in its discretion restrain or suspend the entire order or any part thereof pending such final hearing and determination.¹⁶

If the petitioner wishes to make application for such an interlocutory injunction, at least five days notice of the hearing must be given to the agency and to the Attorney General.

In cases where irreparable damage would otherwise result, the court after a hearing of which "reasonable notice" to the agency and the Attorney General has been given may enter a stay of suspension of the order for not more than sixty days. Specific findings by the court of irreparable harm must however be made.

The procedure for a stay is further governed by Federal Rule of Appellate Procedure 18 which requires that application for a stay pending direct review by a Court of Appeals should ordinarily be made to the agency in the first instance.

Under this Rule a motion for such relief may be made to the Court of Appeals or a judge thereof but must show that (1) the petitioner has applied to the agency for the relief sought and has been denied the relief with the reasons given for its denial or (2) an application for relief to the agency is not practicable or (3) the action of the agency in response to the application did not afford the relief which the applicant had requested.

A motion for a stay under Rule 18 must also show the reasons for the relief requested and the facts relied upon. The court may condition relief by bond or other appropriate security.

Hearings on applications for interlocutory injunctions are to be given preference by the circuits and expedited hearings shall be held at the earliest practicable date.¹⁷

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SUPREME COURT REVIEW

The order granting or denying an interlocutory injunction or a final judgment of the Court of Appeals in a proceeding to review an agency order are subject to review by the Supreme Court by a normal writ of certiorari. Application for the writ must be made within 45 days after the entry of the order and within 90 days after entry of the judgment, as the case may be.\(^{18}\)

Petitions for certiorari are of course governed by the rules applicable to the Supreme Court of the United States and counsel should refer to Chapter 133 of Title 28 which governs miscellaneous provisions for review by the Supreme Court. Particular attention is directed to two subparagraphs\(^{19}\) which specifically govern appeals from circuit courts and the timing thereof. The petition must be filed within 90 days of the entry of the circuit judgment or decree which time period may be extended by a justice for a period not exceeding 60 additional days. A stay of the circuit court order may be granted either by a circuit judge or a justice and conditioned as they desire. Another section of Title 28\(^{20}\) provides a method review by the Supreme Court can be accomplished before or after rendition of the circuit court judgment but from a review of the annotations thereunder it would appear that this section is invoked rarely.

The third remaining rule generally applicable to petitions of certiorari is Federal Rule of Appellate Procedure 41 which governs the timing of the issuance of the court’s mandate and provides that the timely filing of a petition for rehearing will stay the mandate. A stay of the mandate may also be obtained by a motion requesting such pending application to the Supreme Court for a writ of certiorari. This stay shall not exceed 30 days but if during that period the clerk of the circuit court receives from the clerk of the Supreme Court notice that a petition has been filed the stay, of course, will continue.

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19. 28 U.S.C.A., §2101(a) and (f).
PROFITABILITY AND RISK IN AIR TRANSPORT: A CASE FOR DEREGULATION

BY

RICHARD D. GRITTA*

Introduction:

A heated debate surrounds the issue of governmental regulation of transportation. Nowhere is the debate more intense than in air transport where the ten U.S. Domestic carriers have reported aggregate losses of $52.5 million for the first half of 1975. Regulators maintain that, while regulation has not been entirely successful, a reevaluation of the existing regulatory framework is all that is necessary. Opponents, on the other hand, argue that deregulation is the only course that can restore the industry's lost profitability.

The purpose of this article is to explore the controversy in air transportation in view of the CAB's goal to foster sound financial conditions in the industry. The intent is to prove that the current regulatory framework has not done so and must therefore be altered.

Criteria for Regulatory Effectiveness:

The acid test of regulatory effectiveness is twofold:

1. Regulation (apart from safety considerations, the FAA's function) must provide for efficient service to the public and insure reasonable fare levels,
2. Regulation must insure the financial health of the industry regulated. It must allow the industry and its firms to earn their fair rates of return. The latter implies that investors earn returns commensurate with risks and returns in other industries.

Many airline economists have attacked the CAB and its regulatory policies on the first criterion. Jordan, for example, has argued that

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1. Specifically, the carriers must earn returns sufficient to: (1) enable them to attract new capital at a reasonable cost, (2) enable them to maintain their credit standing and financial integrity, and (3) commensurate with returns being earned on investments in other industries facing corresponding risks. For a full discussion, see: Victor H. Brown, "The Direct Testimony of Victor H. Brown", Domestic Passenger Fare Investigation, (Washington, D.C.: Civil Aeronautics Board, August 1970), Docket 21866-8, Exhibit BE-T-1, 5.
current fare levels are much too high, a direct result of inefficient governmental regulation. Douglas and Miller have reached much the same conclusion. This author, however, is concerned with the second criterion, for even if the first is met, the failure to secure adequate returns to investors would result (and has resulted) in severe problems for the industry.

**Profitability and Risk in Air Transport:**

The methodology used in this paper is a comparative study of the returns to the ten carriers versus returns to other regulated groups (the Moody’s electric utilities, gas utilities, and telephone companies) and to various groups of non-regulated industrial firms (again, the Moody's groups). The rationale here is that the carriers must earn returns on a par with those earned by other firms equal in risk. The failure to do so will result in difficulty in financing new capital for the maintenance and growth of assets. The ultimate consequence will be, of course, the financial deterioration of the industry and the bankruptcy of some of its members.

Profitability can be measured in several ways. The key measure used most frequently by stockholders, however, is the rate of return on net worth (net profit after taxes/net worth). It indicates the stockholder's return on his investment base and is tied directly to stock prices. For the purposes of this paper, mean (average) returns for the

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3. The author selected these groups because they were the sample firms used by Brown in his inputs to the Fare Investigation on behalf of the CAB's Bureau of Economics. See: Brown, "The Direct Testimony of Victor H. Brown".

4. If the carriers cannot earn adequate returns on net worth, then stock prices, reflecting investor apathy, will fall. The carriers will be forced increasingly into long-term debt finance to secure needed funds. The net result will be severe financial problems and possible liquidations in the industry. For a discussion of the causes and effects of the increased use of debt finance in the industry, see: Richard D. Gritta, "Debt Finance and Volatility in Rates of Return in Air Transport", *Transportation Law Journal*, VI (January 1974), 73. For a study employing a bankruptcy model, see: Richard D. Gritta, "Solvency and Financial Stress in Air Transportation", *Transportation Law Journal*, VI (July 1974), 139.
1964-1974 period are used. The study period thus encompasses a long enough time horizon to insure that several economic cycles are included.

Risk is often defined as the instability in rates of return over time and is measured by the standard deviation around the mean or average return and by the coefficient of variation. Greater risk is indicated by larger deviations around the average return and higher coefficients of variation.5

Table I presents data on the mean returns and risk measures for the ten carriers, plus data for 28 electric utilities, 7 gas utilities, and 3 telephone companies, as well as for 74 industrials and 14 sub-groups of industrial firms. Appendix A provides the same data for the individual firms used in the study.

The contrast between the carriers and the majority of the other groups is striking. No other regulated group has a mean return as low as that of the airlines or a risk measure anywhere near as high. The carriers' mean return of 10.8% is exceeded by that of the gas utilities (14.6%), the electric utilities (12.2%), and the telephone companies (11.4%), while the standard deviation and coefficient of variation for the carriers (9.2% and 1.47) are significantly higher than those of the gas utilities (2.2% and 0.15), electrics (1.3% and 0.11), and the telephone companies (1.3% and 0.11). This suggests that investors in these regulated industries have earned greater returns while exposing themselves to less risk!

Comparisons to the averages for the industrials (12.5% mean return, with a standard deviation and coefficient of variation of 2.9% and 0.34, respectively) and for all of the 14 sub-groups lead to much the same conclusion. This is especially true of the Chemical and Drug group (16.1%, 2.2%, and 0.14), the Metals and Mining group (16.0%, 2.2% and 0.14), and the Construction Equipment group (14.4%, 2.6%, 0.18), etc. Investors in these groups have earned considerably higher average returns on their investments than investors in air transport and have accepted less risk in the process. In only one case, the Steel group, has the mean return (8.5%) been much lower than that of the carriers. Relative risk, however, has also been considerably lower. (The standard deviation and coefficient of variation for the Steel

5. Risk is traditionally measured by financial analysts by the coefficient of variation (CV). The CV is the standard deviation divided by the mean. By dividing by the mean return, the CV corrects for size differentials in the levels of the returns themselves. See: J. Fred Weston, and Eugene F. Brigham, Managerial Finance, 4th ed., (New York, N.Y.: Holt, Rinehart, & Winston, 1975), 316 and 576.
### TABLE I

**PROFITABILITY AND RISK MEASURES: DOMESTIC CARRIERS VERSUS OTHER INDUSTRIES, 1964-1974**

<table>
<thead>
<tr>
<th></th>
<th>Mean¹ Return</th>
<th>Standard¹ Deviation</th>
<th>CV¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Airlines (10 Carriers)</td>
<td>10.8%</td>
<td>9.2%</td>
<td>1.47</td>
</tr>
<tr>
<td>Electric Utilities (28 firms)</td>
<td>12.2%</td>
<td>1.3%</td>
<td>0.11</td>
</tr>
<tr>
<td>Gas Utilities (7 firms)</td>
<td>14.6%</td>
<td>2.2%</td>
<td>0.15</td>
</tr>
<tr>
<td>Telephone Co. (3 firms)</td>
<td>11.4%</td>
<td>1.3%</td>
<td>0.11</td>
</tr>
<tr>
<td>Industrials (74 firms)</td>
<td>12.5%</td>
<td>3.0%</td>
<td>0.25</td>
</tr>
<tr>
<td><strong>Sub Groups:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cigarette, Tobacco (3)</td>
<td>16.5</td>
<td>3.2</td>
<td>0.20</td>
</tr>
<tr>
<td>Chemical &amp; Drug Cos. (14)</td>
<td>16.1</td>
<td>2.2</td>
<td>0.16</td>
</tr>
<tr>
<td>Metal Mining (3)</td>
<td>16.0</td>
<td>4.6</td>
<td>0.29</td>
</tr>
<tr>
<td>Construction Equipment (3)</td>
<td>14.4</td>
<td>2.6</td>
<td>0.18</td>
</tr>
<tr>
<td>Food Products (9)</td>
<td>14.4</td>
<td>2.0</td>
<td>0.15</td>
</tr>
<tr>
<td>Auto Manufacturers (3)</td>
<td>12.7</td>
<td>5.6</td>
<td>0.49</td>
</tr>
<tr>
<td>Business Machines (3)</td>
<td>12.7</td>
<td>2.3</td>
<td>0.23</td>
</tr>
<tr>
<td>Retail Stores (3)</td>
<td>11.9</td>
<td>1.9</td>
<td>0.16</td>
</tr>
<tr>
<td>Petroleum Refining (8)</td>
<td>11.1</td>
<td>2.4</td>
<td>0.23</td>
</tr>
<tr>
<td>Glass Products (3)</td>
<td>11.0</td>
<td>1.6</td>
<td>0.14</td>
</tr>
<tr>
<td>Food Stores (3)</td>
<td>10.8</td>
<td>2.2</td>
<td>0.23</td>
</tr>
<tr>
<td>Paper Products (5)</td>
<td>10.4</td>
<td>3.5</td>
<td>0.34</td>
</tr>
<tr>
<td>Aircraft Manufacturers (5)</td>
<td>10.4</td>
<td>4.6</td>
<td>0.46</td>
</tr>
<tr>
<td>Non-Ferrous Metals (3)</td>
<td>10.3</td>
<td>2.8</td>
<td>0.31</td>
</tr>
<tr>
<td>Steel (6)</td>
<td>8.5</td>
<td>2.9</td>
<td>0.34</td>
</tr>
</tbody>
</table>

¹ Defined as the average ratio of net profit after taxes to net worth (stockholders' equity) for the years, 1964-1974. The rates of return for each firm for each of the years, 1964-1974, were averaged to determine the mean return for each carrier or firm. The group mean return is the average of the individual company returns. The standard deviations and coefficients of variation (CV) were calculated in a similar manner. The standard deviation and CV for each firm in the group were averaged to obtain the group figure. Data on the individual firms is contained in Appendix A.

**SOURCE:** Computed from raw data contained in the Value Line Investment Survey. Following correction to appendix A.

In those four groups with average returns similar to the carriers, Paper Products (10.4%), Food Stores (10.8%), Aircraft Manufacturing (10.4%), and Non-Ferrous Metals (10.3%), investor risk exposure has also been considerably less, as can be seen from the exhibit.
The following is a breakdown for the individual carriers. It should be compared with the figures for the individual firms in Appendix A.

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<thead>
<tr>
<th>Carrier</th>
<th>Mean Return</th>
<th>Standard Deviation</th>
<th>CV</th>
</tr>
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<tbody>
<tr>
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<td>6.8%</td>
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<td>1.46</td>
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<tr>
<td>BRN</td>
<td>11.8%</td>
<td>7.1%</td>
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<tr>
<td>CAL</td>
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<td>9.4%</td>
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<tr>
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<td>19.8%</td>
<td>5.7%</td>
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<td>1.7%</td>
<td>11.4%</td>
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<tr>
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<td>6.8%</td>
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<tr>
<td>WAL</td>
<td>11.7%</td>
<td>11.3%</td>
<td>0.97</td>
</tr>
</tbody>
</table>

Source: Calculated from data contained in the *Value Line Investment Survey*.

Of particular interest are EAL and TWA, two of the largest carriers. Their mean returns are very poor and their risk measures extreme. The performances of AAL, UAL, WAL, and even of BRN and CAL, are mediocre at best, when contrasted to the vast majority of the individual firms in Appendix A. And while it is clear that not all the carriers (and their investors) have suffered equally, (DAL, NW, and NAL have returns greater than some of the firms in the sample), risk exposure for all the carriers has been great. When the last five year period is considered, the results are even more significant. The following data is for the period, 1970-1974.

6. Financial theory would, of course, suggest that the opposite be true.

7. It can be argued that DAL and NW have been especially blest with sound long-haul route structures in rapidly growing areas of the country and with less competition than that facing many of the other carriers. This has been the result of the historical development of the carriers and of CAB policies, rather than of superior airline management.
<table>
<thead>
<tr>
<th>Carrier</th>
<th>Mean Return</th>
<th>Standard Deviation</th>
<th>CV</th>
</tr>
</thead>
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<td>Industry</td>
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Source: Computed from data contained in Value Line Investment Survey.

Seven of the carriers have experienced a sharp deterioration in their average rates of return and overall risk levels have risen during the last five years. This is particularly true for two of the strongest carriers, NW and NAL, whose mean returns have fallen to 7.7% and 8.7%, respectively. AAL, EAL, and TWA had negative returns, while the returns for CAL and UAL declined by well over 50%.

While some might argue that the economic times have been hard in 1973 and 1974, there can be no doubt that the future for most of the carriers is anything but bright. And it is very debatable whether even a strong economic recovery can completely solve the industry’s problems.

**Conclusions:**

This article has demonstrated that the airlines have not earned returns commensurate with risk. Investors, in fact, historically could have earned higher returns by investing in other regulated groups or industrial firms while subjecting themselves to considerably less risk. This has been the causal variable behind the depressed level of airline stock prices and a direct contributor to the increasingly dangerous use of long-term debt finance that now burdens the industry.8

Given the above data, (and that generated by Jordon, Douglas and


Miller, and others), one can only conclude therefore that the existing regulatory framework in air transport has not been fair and efficient. The carriers have not earned sufficient profits and the public has not benefited from lower air fares. Neither criterion noted above has been met. Two questions therefore remain: What are the root causes behind the current situation? And along what lines must regulatory change proceed?

The causes of the financial crisis appear to lie in the CAB’s misplaced competitive emphasis. Fruhan has observed that the Board controls most of the key variable affecting airline profitability, leaving the carriers only one crucial variable—scheduling. In increasing new route awards and creating excessive competition in many markets, the CAB hoped to drive air fares down and traffic up. Instead, however, in an effort to dominate market shares, the carriers have been pressured into sharply increasing flight frequencies. The inevitable result has been disaster: over capacity in many city-pairs, seat-wars, and falling profits. The fight for competitive advantage, as it has been labelled by Fruhan, has involved significant financial costs (duplicative advertising expenditures, redundant capacity, and the inefficient allocation of resources, as well as environmental costs), and it is a struggle in which few have emerged victorious.

The ultimate solution to the problem, this author believes, lies in a return to the free market mechanism; that is, in moving toward a deregulated industry with free entry and exit from markets, freedom of price competition, etc. The advocates of continued regulation have not proven their case. Numerous regulatory changes in the past have done little to improve the financial condition of the carriers. The industry has continued to deteriorate and the costs of mis-regulation have been continually passed on to the public. Too often, CAB practices have proven to be more a protector of the inefficient carriers

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10. There seems to be a substantial premium in terms of market penetration in providing greater than the pro-rata share of flight frequencies in a given city-pair. Evidence suggests that if a carrier in a two carrier market provides 55% of the flight frequencies in that market, it will attract 60-65% of the market share; hence, the suicidal drive to increase the number of flights in a given market. For a complete discussion, see: Wesley G. Kaldahl, “The Direct Testimony of Wesley G. Kaldahl”, Domestic Passenger Fare Investigation, (Washington, D.C.: Civil Aeronautics Board, August 1970), Docket 21866-Phase 7, EA-T-1, 7-18.

than a force for constructive action. This trend must be reversed. The free market system can operate to correct the abuses permitted by the restrictive barriers to true competition now present. In this manner, deregulation can provide for the more efficient allocation of resources within the industry and guarantee its long-term prosperity.¹²

¹². Any solution to the problem of the industry will be quite complex, however. The danger of rash, ill-timed actions (especially given the current economic situation) cannot be minimized. Any move toward deregulation must therefore proceed slowly. For a summary of the opposing viewpoints and for an experimental plan for deregulation see the CAB Staff Proposal: "Evaluation of Economic Behavior and Other Consequences of Civil Aviation System Operating with Limited or No Regulatory Constraints", The Federal Register, Vol. 40, No. 131, Tuesday, July 8, 1975.
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<td>CV</td>
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**AUTO MANUFACTURERS** (3 Firms)

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<th>Standard Deviation</th>
<th>CV</th>
</tr>
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<td>6.6</td>
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**BUSINESS MACHINES** (3 Firms)

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<td>IBM</td>
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<td>National Cash Register</td>
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**RETAIL STORES** (3 Firms)

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<tbody>
<tr>
<td>Macy, R.H. &amp; Co.</td>
<td>10.2</td>
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<tr>
<td>May Dept. Stores</td>
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**PETROLEUM REFINING** (8 Firms)

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<tr>
<td>Atlantic Richfield</td>
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<td>Standard Oil of Cal.</td>
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<td>Standard Oil of Ohio</td>
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**GLASS PRODUCTS** (3 Firms)

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<tbody>
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<td>Owens-Illinois, Inc.</td>
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<td>Category</td>
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<tr>
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<td><strong>FOOD STORES (3 Firms)</strong></td>
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<td>American Stores</td>
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<td>Crown Zellerbach</td>
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<td>International Paper</td>
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<td>Kimberly-Clark</td>
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<td>Union Camp Corp.</td>
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<td><strong>AIRCRAFT MANUFACTURERS (5 Firms)</strong></td>
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<td>Phelps Dodge Corp.</td>
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<td>0.17</td>
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<tr>
<td><strong>STEEL (6 Firms)</strong></td>
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<td>Inland Steel</td>
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<td>National Steel</td>
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<td>8.5</td>
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*Coefficient of variation

SOURCE: Computed from raw data contained in the Value Line Investment Survey.
COMMENT: GOVERNMENTAL UNDERMINING OF THE COMMON CARRIER SYSTEM—A CONFLICT IN PHYSICAL DISTRIBUTION

BY JAMES C. JOHNSON*

INTRODUCTION

This paper deals with controversy. Section 203(b)(5) of the Interstate Commerce Act\(^1\) states that motor vehicles controlled and operated by a cooperative association as defined in the Agricultural Marketing Act\(^2\) shall be relieved of economic regulation.\(^3\)

Recent legislative and judicial events that have transpired during the last decade regarding the interpretation of this section of the ICA have raised numerous questions as to whether the strength of the common carrier system is being undermined.

THE PHILOSOPHY OF THE AGRICULTURAL MARKETING ACT OF 1929

The AMA is germane to this discussion because it is specifically referred to in Section 203(b)(5) of the ICA. To fully understand the meaning of Section 203(b)(5) of the ICA\(^4\) it is necessary to look briefly at the content and philosophy of the AMA. The first paragraph of the AMA declares the policy of Congress in this area to be:\(^5\)

\[
\ldots \text{to promote the effective merchandising of agricultural commodities in interstate and foreign commerce so that the industry of agriculture will be placed on a basis of economic equality with other industries, and to that end to protect, control, and stabilize the currents of interstate and foreign commerce in the marketing of agricultural commodities and their food products, (2) by preventing inefficient and wasteful methods of distribution, (3) by encouraging the organization of producers into effective associations or corporations under their own control for greater unity of effort in marketing . . .}
\]

*Associate Professor of Marketing and Transportation, The University of Tulsa
1. 49 U.S.C. 303(b)(5). Hereafter referred to as the "ICA".
2. 12 U.S.C. 1141. Hereafter referred to as the "AMA".
3. See footnote 1.
4. Ibid.
As the above policy statement points out, Congressional intent was to encourage cooperatives among farmers and in fact to protect them if necessary.

Section 1141j of the AMA defines the term "cooperative association" as follows:

Any association in which farmers act together in processing, preparing for market, handling, and/or marketing the farm products of persons so engaged, and also means any association in which farmers act together in purchasing, testing, grading, processing, distributing, and/or furnishing farm supplies and/or farm business services: Provided, however, That such associations are operated for the mutual benefit of the members thereof . . . and in any case to the following: Third. That the association shall not deal in farm products, farm supplies, and farm business services with or for nonmembers in an amount greater in value than the total amount of such business transacted by it with or for members. All business transacted by any cooperative association for or on behalf of the United States or any agency or instrumentality thereof shall be disregarded in determining the volume of member and nonmember business transacted by such association.

In summary, a careful reading of the AMA brings out two basic points, i.e., (1) cooperative associations are to be encouraged and that they will be protected if necessary and (2) that they will have the right to haul products for nonmembers of the cooperative, as long as these revenues are less than 50% of the total revenues for the cooperative.

The AMA states rather clearly that the hauling for nonmembers would be only in farm related products. However, this point, which appeared so patently clear when it was written in 1929, has become the focal point for a very controversial issue during the last decade.

CACHE VALLEY DAIRY ASSOCIATION: INVESTIGATION OF OPERATIONS

In Cache Valley Dairy Association Investigation of Operations, Division 1 of the Commission stated specifically that the backhaul.

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transportation services that cooperative associations are involved in must be limited to hauling farm related goods to be eligible for the exemption from regulation provided by Section 203(b)(5) of the ICA. 8

Although it was found that Cache Valley Dairy Association was a bona fide cooperative association within the meaning of the AMA, the Commission found that "... it was never intended that a bona fide cooperative association under the marketing act might indiscriminately engage in the transportation of nonfarm commodities for nonmembers and use Section 203(b)(5) as a shield against our regulations pertinent to for-hire transportation of otherwise nonexempt commodities." 9

It was also noted that if the Commission would allow the "co-ops" vehicles to haul nonexempt goods for nonmembers, the Commission would be in the awkward position of having this traffic not subject to the third part of Section 1141j of the AMA 10 while at the same time, the "co-ops" hauling farm-related products for nonmembers would be controlled by the restriction in Section 1141j. The effect of this is that the valuation amount of business would be restricted when hauling farm products for nonmembers, but would be unrestricted if the traffic was nonfarm related.

Because of the above, the Commission concluded that: 11

Thus, in considering the overall intent of the statute, we believe that the limitation of the third part of section 1141j implies an affirmative corollary; namely, that an association's dealings with nonmembers shall be limited to farm products, farm supplies, and farm business services.

The decision makes it clear that the Congressional intent of the AMA was not to sanction "co-ops" to engage in for-hire transportation in open competition with rail and motor common carriers.

Although the Association's revenue in the cases for nonmembers was only 2% of its total revenues the Commission rejected the percentage of revenues theory as not a valid test. This appeared to be a valid position for although only 2% of the Association's revenue was derived from nonmember traffic during a representative period, 35% of the tonnage hauled by the Association involved nonfarm items for nonmembers. 12 This constituted a considerable quantity of freight

8. 96 M.C.C. at 622.
9. 96 M.C.C. at 620.
10. 96 M.C.C. at 620-621.
11. 96 M.C.C. at 621.
12. 96 M.C.C. at 621.
that should have been carried by regulated common carriers.

As noted by the Commission there is little or no relationship between revenues and tonnage hauled. In fact, the revenue of the nonfarm goods on backhauls can always be kept at less than 50% by merely lowering the rate to be charged.

Thus the decision of the Commission turned on the issue of whether the backhaul transportation by the Association of nonfarm-related commodities for nonmembers was a service, functionally related or unrelated to the Association's farming activities.

NORTHWEST AGRICULTURAL COOPERATIVE CASE

In I.C.C. v. Northwest Agricultural Cooperative Association, Inc., the District Court concurred with the Commission's finding in Cache Valley. In a decision written by Chief Judge Solomon, it is stated:

The difficulty with the defendant's position is that it sanctions for-hire transportation in open competition with regulated common carriers without subjecting the Association's fleet to regulation. Though Congress intended to exempt agricultural cooperatives from regulation under the Act in the transportation of their goods to market and their necessary supplies and services on return, I do not read the statute as granting these associations an exemption to enter the general transportation business. Undoubtedly the Association's practice affords economies to its members, but these are economies not intended to be conferred by the Act.

On appeal, the Court of Appeals, reversing the District Court, held that an agricultural "co-op" whose primary activity was hauling for members did not lose its status as a cooperative association and therefore was not subject to the economic regulation of the Commission as long as its transportation of nonfarm products for nonmembers was incidental and necessary to the "co-op's" farm-related transportation both in character and amount.

In its decision, the Court of Appeals specifically noted that the AMA did not state, nor did it imply, that a "co-op" could not deal

13. 96 M.C.C. at 621-622.
14. 96 M.C.C. at 622.
15. 234 F. Supp. 4961 (D Oreg. 1964)
at all in nonfarm products for nonmembers. Furthermore, it was noted that the AMA specifically stated that its intention was to protect and encourage agricultural cooperatives and therefore the AMA should be liberally construed to effect that purpose. Therefore, the Court of Appeals found that Northwest did not lose its identity of a cooperative when it engaged in activities other than its primary one, as long as the other activities were incidental to the primary one and necessary to its effective performance.

This “incidental and necessary” test was an outgrowth of *I.C.C. v. Jamestown Farmers Union* where it was stated:

... if such activities are merely incidental to, and necessary for the effectuation of the cooperative’s principal activities as embraced within the Act, the status of the cooperative remains unimpaired.

In applying the “incidental and necessary” test, the Court of Appeals in the *Northwest* case noted that the cooperative’s hauling was incidental because it was limited to otherwise empty trucks returning from hauling member farm products to the market and because the nonfarm revenue was very small compared to the total revenue of the cooperative. Likewise, the backhaul of nonmember traffic was necessary because it would not be economically feasible to operate the vehicles empty on the backhaul and without this traffic the “co-op” costs would be higher than common carriers and against the policy of the AMA.

The prime argument of the Commission in the *Northwest* case was that nonfarm hauling for nonmembers may not be counted at all in computing the 50% limit because the limitation applies only to “farm” business for nonmembers. The Court, rejecting this argument noted that a cooperative will only retain its exemption as long as its essential character is that of a cooperative. In other words, the Court said that a cooperative would not be of this character if its nonfarm hauling exceeded that which was incidental and necessary to its farm-related hauling.

If the Court of Appeals’ approach prevails, it is difficult to imagine a situation where the nonfarm business could approach 50% of the

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18. 350 F2d at 257.
19. 350 F2d at 257.
20. 57 F. Supp. 749 (D. Mn. 1944) affd., 151 F2d 403 (8th Cir. 1945).
21. 57 F. Supp. at 753.
22. 350 F2d at 255.
23. 350 F2d at 256.
total and still remain incidental and necessary to the farm-related business.

The Court in *Northwest* also found the cooperative was *not* engaged in the general trucking business:

Its trucking operation, viewed as a whole, is a farm service performed jointly by Northwest's members "for themselves." The return hauls enjoined are "connected with farm operations," for they are incidental and necessary to the effective performance of Northwest's farm-related operations. This return haul transportation therefore did not deprive Northwest of its essential character as a 'cooperative association' under the *Agricultural Marketing Act*. Since it retained this character it retained its right to exemption under Section 203(b)(5) of the *Interstate Commerce Act*.

**I.C.C.'s FIRST REACTION TO COURT's DECISION**

The Commission, through its Chairman, immediately recognized the gravity of the Court's decision and stated:

There goes business which regulated carriers have to be authorized to haul. If that isn't simply legalizing what the transportation industry, the Congress and the Commission has long fought as a type of 'gray area' operation, I don't know what it is.

It was also charged that the Court did not realize that its decision, in effect, had legalized a very dangerous threat to all regulated transportation and to the National Transportation Policy and was not justified because agricultural cooperatives were losing money.

The position of the Commission, as expressed by the Chairman, was based on two prime considerations, *i.e.*, (1) every common and contract carrier has the problem of backhauls and the judicial decision would only compound the problem by taking away traffic that rightfully belongs to for-hire carriers, and (2) if the Court's decision was based on valid reasoning, it would appear that private carriers should have the same privilege of hauling nonexempt commodities when it has problems of empty backhauls.

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24. 350 F2d at 257.
27. *Ibid.*.
It was also noted that the Commission would press with increased vigor to amend Section 203(b)(5) of the ICA to overcome the existing judicial interpretation.\textsuperscript{28}

**D.O.D. POLICY STATEMENTS CONCERNING “CO-OPS”**

The Department of Defense\textsuperscript{29} shortly after the *Northwest* decision stated its position relative to the use of cooperatives:\textsuperscript{30}

Farm cooperative trucks will be used when they can meet military requirements of safety and reliability and when their use would result in the lowest overall cost to the government.

Prior to the Northwest decision, cooperative vehicles were only used by the D.O.D. when there was no other form of for-hire transport available.

The old cliche that “there is nothing like a war to unite the political parties of a country towards a common goal” became true of the transportation industry after the *Northwest* decision. Immediately after the D.O.D. policy statement, various segments of the regulated transportation industry sent the Secretary of Defense a joint communiqué urging “that the D.O.D. proposal be accepted only in the remote event that common carrier service is not available.\textsuperscript{31}

The regulated segment of the industry pointed out that the regulated common carriers were a definite part of the logistical arsenal of the United States in a time of national emergency. On the other hand, the “co-op” trucks were engaged in transportation completely exempt from all economic regulation and they had absolutely no obligation to provide general transportation service on a nondiscriminatory basis to the general public. The “co-op” trucks could legally pick and choose traffic and receive just enough compensation to cover the cost of the otherwise empty backhaul. Furthermore, it was pointed out that the cooperatives can and will set rates that are just low enough to divert traffic from the regulated carriers and that utilizing cooperatives on such a basis was false economizing which would compromise the strength of the United States defense posture.\textsuperscript{32}

The transportation industry’s position was supported by the

\textsuperscript{28} Id.

\textsuperscript{29} Hereafter referred to as D.O.D.


\textsuperscript{31} Id.

\textsuperscript{32} Id.
United States Chamber of Commerce. Its President issued the following statement:33

For the good of the nation's regulated transportation system and in the best interests of all those who depend upon it for service, I urge that you take no action which would lead to the continuation or growth of unregulated for-hire carriage by agricultural cooperative organizations.

CONGRESSIONAL REACTION TO THE CONTROVERSY

A number of bills subsequently were introduced into Congress to restrict the growth of "co-op" nonfarm, nonmember tonnage.34 Section 203(b)(5) was ultimately amended35 as a result of the enacted amendments. The new law provided that fifteen percent of the cooperative's total annual tonnage could be transported for nonmembers who are also nonfarmers. Also a maximum of 50% of the cooperative's total annual tonnage can involve carriage for farmer nonmembers. For purposes of computing the cooperative's total annual tonnage, any transportation service provided for an agency of the United States Government was to be included in the annual tonnage figure.36

RECENT "CO-OP" CONTROVERSIES

After the legislative amendments, it was merely a matter of time until cooperatives sought common carrier status. The first cooperative applicant was successful in its endeavor in American Farm Lines Cooperative Common Carrier Application.37

CONCLUSION

Section 203(b)(5) of the ICA38 was enacted by floor amendment and there was little time to consider all the possible ramifications of the

33. Id.
37. 114 M.C.C. 30 (1971).
38. 49 U.S.C. 303(b)(5).
exact words that were chosen. The Section adapted the provisions of the AMA and at the time seemed crystal clear in meaning. Although the AMA stated that “co-ops” could not earn more than half of their revenues from nonmember hauling of farm-related goods, it did not explicitly state that “co-ops” could not haul nonfarm-related goods for nonmembers. It was obviously assumed they would not. Because of the haste in which Section 203(b)(5) of the ICA was enacted, there appeared no reason to state explicitly what was obviously implied.

All was copacetic until the Northwest decision when the Court appeared to err. Specifically, the decision was diametrically opposed to the implied National Transportation Policy. Although, the preamble to the ICA does not specifically state the importance of common carriers, the implication is clear. In addition, various transportation messages of recent Presidents state unambiguously that the common carrier organization is the backbone of our transportation system. Therefore, any action that will weaken the common carrier system should be vigorously opposed by both the Courts and the Commission.

However, the Court of Appeals in Northwest ignored this portion of the National Transportation Policy and allowed a type of carriage that could only have unfavorable results on the common carrier system. Furthermore, the Department of Defense then added to the problem by stating that it would use “co-op” vehicles to haul their freight. This is really ironic, for the D.O.D. more than any other government agency should know the value of having a strong common carrier system during a time of national emergency.

The author finds the D.O.D. policy of shipping military freight on “co-op” vehicles lamentable. Consider the Doyle Report’s comment about the Government as a purchaser of unregulated transportation:

The indispensable nature of regulated for-hire carriers as the backbone of our transportation system has been emphasized elsewhere in this report. To the extent Government diverts traffic from regulated to unregulated for-hire carriers it is negating its own promotional and regulatory objectives which are established in the national interest. Such action on the part of


a Government agency is far less reasonable than similar action on the part of a private shipper who, so long as his actions are within the law, can be excused for seeking thus to minimize his costs. It is not the individual responsibility of a shipper single-handedly to assure a healthy transportation system—it is a responsibility of Government.

The 1968 "15/50" amendment was a political expedient which was totally devoid of logic concerning the preservation and strengthening of the common carrier system. There are approximately 9,300 agricultural cooperatives which in the aggregate have the potential and the ability to substantially weaken the common carrier system. The cooperatives' legalized traffic diversion is slowly but surely sapping the strength of the common carrier system today.

The present situation is deplorable and it is strongly urged that Congress repeal the "15/50" rule so that cooperatives will be precluded from transporting any nonfarm-related products for nonmembers.

41. See footnote 35.