Transportation Law Journal

Volume 18

1989-1990
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Federal Liability for Transporters of Hazardous Wastes

John R. Ruhl*

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I. INTRODUCTION

In the past 18 months, federal courts have published more than 120 opinions dealing with claims made under two federal environmental statutes that impose strict liability and potentially catastrophic penalties and clean-up costs.

The two statutes are of critical interest to persons who transport or arrange for the transportation of hazardous wastes. Penalties and clean-up costs are imposed for environmental damages resulting from activities that occurred even before the statutes were enacted—regardless of whether such activities were lawful when they occurred, and regardless of whether the environmental problems stem from intentional dumping or accidental spills. Most common law defenses, such as the exercise of due care, are inapplicable. Carriers and brokers can find themselves sharing equal liability with the generators of the waste and the owners of the damaged sites.

This article outlines the principal areas of potential liability under the two statutes, namely, the Resource Conservation Recovery Act ("RCRA")1 and the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("the Superfund Act")2. The article does not discuss potentially overlapping liability under certain other federal environmental statutes, international law, or state statutes. Nor does it cover in any detail the claims that may be asserted under common law theories.

II. LIABILITY UNDER THE RESOURCE CONSERVATION RECOVERY ACT ("RCRA")

A. BACKGROUND AND PURPOSE OF RCRA

In 1976, Congress enacted RCRA in an attempt to close the "last remaining loophole in environmental law," unregulated land disposal of hazardous and non-hazardous wastes.3 The Act creates a cradle-to-grave regulatory scheme to ensure that hazardous wastes are properly disposed of. Generators of waste are required to identify hazardous

wastes and use a manifest system to ensure that wastes are disposed of only in facilities possessing a permit. The Environmental Protection Agency ("EPA") is authorized to set standards applicable to transporters of hazardous waste, conduct inspections and collect samples, and exercise broad enforcement powers. RCRA also contains a citizen suit provision which empowers any person to commence a civil suit to stop violations of the Act.

B. POTENTIAL PENALTIES UNDER RCRA

Civil Penalties. The Act imposes civil penalties of up to $25,000 per day for violations. It authorizes not only the federal government, but also state, municipal and private plaintiffs to bring suits to enforce these penalties and obtain injunctions requiring cleanup of contaminated facilities. The prevailing party can recover its costs of litigation, including attorney fees and expert witness fees.

Criminal Penalties. Criminal penalties of up to $50,000 per day and up to two years imprisonment can be imposed on persons who knowingly commit or cause to be committed the following acts: transportation of hazardous waste to an unlicensed disposal facility, or without a proper manifest; omission or alteration of information on a hazardous waste manifest; transportation, disposal or other handling of used oil in violation of the provisions of the Act. Additional fines of up to $1,000,000 and imprisonment can be imposed for knowingly placing another person in imminent danger of death or serious bodily injury.

10. 42 U.S.C. §§ 6928(a)(3), (c), (g) (1982); see also 42 U.S.C. § 6973(b) (1982) (authorizing fines of up to $5,000 per day for willful refusal to comply with any EPA order).
C. DEFINITIONS UNDER RCRA

Terms used in the Act are broadly defined to include carriers and brokers, as well as their owners. For example:

*Person* is defined to include individuals, partnerships and corporations. Consequently, managers and principal owners of carriers and brokers have been found liable for civil penalties, damages and even criminal penalties. Consequently, managers and principal owners of carriers and brokers have been found liable for civil penalties, damages and even criminal penalties.

*Disposal* is defined to include the "discharge, . . . spilling, leaking, or placing of hazardous waste . . . onto any land or water." If a truck spills hazardous waste—even by accident—it constitutes a "disposal" and thus a violation under the Act. Moreover, liability arises from environmental damages caused by spilling and leaking that occurred before the effective date of the Act.

*Facility* is defined to include any "equipment, . . . storage container, motor vehicle, rolling stock . . . or . . . any site or area where a hazardous substance has been deposited, . . . or otherwise come to be located. . . ." A truck, trailer, or barge holding hazardous waste therefore can be considered to be a hazardous waste "facility."  

*Hazardous Waste* is broadly defined to include (1) numerous substances listed by EPA regulations; and (2) any substance which has certain toxic or other dangerous characteristics.

*Endangerment* (as used in both RCRA and the Superfund Act) is construed liberally to mean merely threatened or potential harm, without any requirement of proof of actual harm. Thus, a trucking company or other defendant can be penalized and assessed for past and future cleanup costs even if there has been no demonstrable damage to the

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environment.\textsuperscript{24}

Contribute (as used in the statutory phrase in 42 U.S.C. § 6973(a), "contributing to" disposal) is interpreted much more broadly than the verb "cause."\textsuperscript{25} That is, RCRA penalties apply not only to shippers and storage site owners; but also to persons who have "contributed" to any resulting endangerment, including past off-site carriers and brokers—even if such contributing acts occurred many years ago.\textsuperscript{26}

D. EMERGENCY PROVISION OF RCRA

Scope of Emergency Provision. RCRA’s emergency provision (42 U.S.C. § 6973(a)) is a codification of the common law of nuisance.\textsuperscript{27} It allows the federal government to sue in federal district court whenever the transportation or other handling of hazardous wastes "may present an imminent and substantial endangerment to health or the environment."\textsuperscript{28} Alternately, the EPA may "issue such orders as may be necessary to protect public health and the environment," backed by civil fines for failure to obey.\textsuperscript{29}

Elements of Proof. To recover against a defendant under the emergency provision, the federal government must establish that: (1) the conditions present an imminent and substantial endangerment; (2) the endangerment stems from the transportation, handling, storage, treatment, or disposal of any solid or hazardous waste; and (3) the defendant has contributed to such transportation, handling, storage, treatment, or disposal.\textsuperscript{30}

Liability Without Negligence. The statute imposes liability without fault or negligence and applies to present conditions resulting from past activities of past off-site operators, transporters and others who contributed to improper disposal.\textsuperscript{31}

\textsuperscript{24} Id. at 1398; see also Environmental Defense Fund, Inc. v. Lamphier, 714 F.2d 331, 338 (4th Cir. 1983) (open-ended injunction imposed by court under RCRA).


\textsuperscript{26} United States v. Northeastern Pharmaceutical and Chemical Co., 810 F.2d 726, 741 (6th Cir. 1986).


\textsuperscript{28} 42 U.S.C. § 6973(a) (1980) (although the statute is termed an "emergency" provision, it does not require an emergency to be applicable).

\textsuperscript{29} Id.


\textsuperscript{31} United States v. Northeastern Pharmaceutical and Chemical Co., 810 F.2d 726, (6th Cir. 1986) (statute used against non-negligent carriers even though the dumping practices were state-of-the-art at the time); United States v. Ottati & Goss, Inc., 630 F. Supp. 1361 (D.N.H. 1985).
Joint and Several Liability. The harm is presumed to be indivisible and the liability is therefore joint and several for all defendants, unless one of the defendants successfully shows that the damage should be apportioned among the defendants.\textsuperscript{32}

Liability for Past, Present and Future Cleanup Costs. Recoverable damages under RCRA include not only the costs incurred up to the time of trial, but also such future costs as it reasonably can be shown will be incurred after trial.\textsuperscript{33}

E. "Citizen Suit" Provision of RCRA

For carriers and brokers, perhaps the most dangerous liability provision of RCRA is the "citizen suit" provision in 42 U.S.C. § 6972. That section allows any person—including private citizens, municipalities and states—to bring an action under RCRA's emergency provision (§ 6973, discussed above) and to recover attorney fees and other costs if successful.\textsuperscript{34}

One recent article labeled § 6973 as the "real wildcard liability under RCRA" and hypothesized that:

Presumably, under this authority [§ 6972], any aggrieved individual could compel a non-negligent transporter to clean up a leaky abandoned dump to which it had brought wastes, even if the transporter's practices were acceptable at the time of disposal.\textsuperscript{35}

F. Additional Claims and Damages

Additional Theories of Liability. Plaintiffs suing under RCRA generally have brought additional claims under other state and federal environmental statutes,\textsuperscript{36} as well as claims under common law theories, such as pub-


\textsuperscript{33} Environmental Defense Fund, Inc. v. Lamphier, 714 F.2d 331, 338 (4th Cir. 1983) (open-ended injunction imposed upon defendant); United States v. Northeastern Pharmaceutical and Chemical Co., 810 F.2d 726, 741 (8th Cir. 1986) (held RCRA "imposes liability for the present and future conditions resulting from past acts").

\textsuperscript{34} 42 U.S.C. § 6972(a) (1982) provides, in part:

"Any person may commence a civil action on his own behalf . . . against any person . . . including any . . . past or present transporter . . . who has contributed or who is contributing to the past or present handling, storage, treatment, transportation, or disposal of any solid or hazardous waste which may present an imminent and substantial endangerment to health or the environment . . ."

(Emphasis added).

\textsuperscript{35} Miller & Gutter, Liability of Transporters of Hazardous Materials under RCRA and CERCLA, 32 FEDERAL BAR NEWS & JOURNAL 293 (Sept. 1985).

\textsuperscript{36} Claims often are filed under CERCLA.
lic nuisance; breach of warranty; intentional tort theories such as products liability, trespass, assault and battery and infliction of emotional distress; and various theories of negligence, including negligence per se.

Civil Damage Claims. Civil damages claimed by plaintiffs have included general compensatory damages and punitive damages, as well as special damages, such as medical costs, loss of property value, and loss of use of water sources.

G. CRIMINAL LIABILITY UNDER RCRA

Transportation to Non-Authorized Site. At least one federal court has convicted a carrier and a shipper (and their principal employees) under 42 U.S.C. § 6928(d)(1) for unlawfully transporting paint wastes and solvents to a non-authorized disposal site. The convictions were based on evidence that the defendants knew (1) what the waste was; and (2) that the disposal site had no permit. The court held that ignorance of the law was no defense.

The court acknowledged that in certain circumstances, a defendant might have a valid defense if he in good faith believed that the wastes were being disposed of properly. But the court rejected that defense based on the circumstantial evidence presented at trial.

Other Criminal Offenses. At least one other federal appeals court has upheld the criminal conviction of a management employee of a carrier for dumping of hazardous waste without an EPA permit and failure

40. Id.
41. Id.
43. 42 U.S.C. § 6928(d)(1) (1982) provides that any person who:
   Knowingly transports or causes to be transported any hazardous waste . . . to a facility which does not have a permit under [RCRA] . . . shall, upon conviction, be subject to a fine of not more than $50,000 for each day of violation, or imprisonment not to exceed two years . . . or both . . .
   (Emphasis added).
44. United States v. Hayes Int'l Corp., 786 F.2d 1499, 1504 (11th Cir. 1986).
45. In Hayes, 786 F.2d at 1503, the court stated:
   in a prosecution under 42 U.S.C. § 6928(d)(1) it would be no defense to claim no knowledge that the paint waste was a hazardous waste within the meaning of the regulations; nor would it be a defense to argue ignorance of the permit requirement.
46. Id. at 1506.
47. United States v. Greer, 850 F.2d 1447 (11th Cir. 1988).
48. Dumping without an EPA permit violates 42 U.S.C. § 6928(d)(2)(A) (1982), and carries a maximum penalty of $50,000 per day or two years' imprisonment, or both.
III. LIABILITY UNDER THE SUPERFUND ACT

A. BACKGROUND AND PURPOSE OF SUPERFUND ACT

History of Superfund Act. In 1980, Congress enacted the Superfund Act. The Superfund Act was enacted to fill gaps left by the Resource Conservation and Recovery Act of 1976 ("RCRA") in dealing with abandoned dump sites, in requiring notification of the existence of inactive sites, and in providing funds for state hazardous waste cleanup programs.

Liability Under Superfund Act. Liability under the Superfund Act is a very real threat to carriers and brokers. Liability extends to the actual or threatened release of a hazardous substance from a "facility" (which is defined to include "motor vehicles" and "storage containers"). Thus, the government can be expected to take action against transporters whenever it takes action against waste generators and site owners.

B. CHARACTERISTICS OF LIABILITY UNDER SUPERFUND ACT

Suits involving claims under the Superfund Act often include claims made under RCRA. Following is a summary of several similarities and differences with respect to the two statutes:

Scope of Relief Under Superfund Act. The Act is essentially a federal codification of the equitable principle of restitution. Like RCRA, the Act authorizes the EPA to seek injunctive relief, that is, an order directing the defendants to take action to remove the "imminent and substantial endangerment to the public health or welfare or the environment". The Act also authorizes the EPA to pay for cleanup from the Superfund and then sue the potentially responsible parties to recover its "response costs" incurred in cleaning up the sites.

Broad Investigative Power Vested in EPA. Like RCRA, the Superfund

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49. Failure to report dumping activities violates 42 U.S.C. § 9603(b)(3) (1982), and carries a maximum penalty of $10,000 or one year's imprisonment, or both.
Act authorizes the government to have reasonable access to private records of generators, transporters and site owners for purposes of information gathering.\textsuperscript{57}

\textit{Liability Without Negligence}. Like RCRA, the Superfund Act is imposed upon generators, carriers, brokers and facility owners without regard to whether they were negligent in handling wastes.\textsuperscript{58}

\textit{Joint and Several Liability}. Like RCRA, the Superfund Act imposes joint and several liability upon all parties involved, including successors to the original responsible parties,\textsuperscript{59} unless the parties can show a reasonable basis for apportioning the response costs among the defendants.\textsuperscript{60} It has been held that the Act allows crossclaims and third-party claims for contribution, but such claims may be virtually impossible to prove in most cases.\textsuperscript{61}

\textit{Liability for Owners and Principal Employees}. As with RCRA, liability under the Superfund Act extends beyond the corporate entity and attaches to the individuals who control a defendant’s business, including directors, major shareholders and the managers of the company.\textsuperscript{62}

\textit{Liability Without Proof of Causation}. The elements of proof for a Superfund Act claim do not require a plaintiff to trace the damage done to any specific defendant. It is sufficient that the defendant has dumped or handled hazardous waste on the site.\textsuperscript{63}

\textit{Injunctive Orders and Claims to Recover Response Costs}. As under RCRA, the EPA can seek injunctive relief, that is, an order directing the defendants to take action to remove the “imminent and substantial endangerment or else the EPA can incur so-called “response costs” of cleanup and then sue to recover its response costs.\textsuperscript{64} Recent amendments to the Act allow recovery of prejudgment interest on response

\begin{footnotesize}
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\item 57. 42 U.S.C. § 9604(e) (1982); see also United States v. Charles George Trucking Co., 642 F. Supp. 329 (D. Mass. 1986) (trucking company fined for failure to provide requested information to EPA); United States v. Liviola, 605 F. Supp. 96 (N.D. Ohio 1988) (civil penalties imposed on trucking company and other for failure to provide requested information to EPA).
\item 58. United States v. Monsanto, 858 F.2d 160, 167 (4th Cir. 1988).
\item 59. Smith Land & Improvement Corp. v. Celotex Corp., 851 F.2d 86, 92 (3rd Cir 1988).
\item 60. O'Neil v. Picillo, 682 F. Supp. 706, 724 (D. R.I. 1988); United States v. Monsanto, 858 F.2d 160, 172 (4th Cir. 1988); but see Allied Corp. v. Acme Solvents Reclaiming, Inc., 691 F. Supp. 1100, 1116-17 (N.D. Ill. 1988) (setting out factors “which might persuade a court to reject joint and several liability [even] where the harm is indivisible”).
\item 63. United States v. Monsanto, 858 F.2d 160 (4th Cir. 1988).
\item 64. 42 U.S.C. § 9607 (1982).
\end{itemize}
\end{footnotesize}
costs incurred.65

Retroactive Liability. Like RCRA, the Superfund Act’s response cost provisions apply retroactively to impose liability for response costs attributable to acts committed before the 1980 enactment of the Superfund Act.66

Future Liability. The court can compel responsible parties to remain subject to the court’s injunctive order and liable for future response costs for as long as necessary to abate the environment problem.67

Liability to Federal and Nonfederal Plaintiffs. Any person (including states, municipalities and private citizens) can sue to recover response costs of cleaning up a site contaminated by hazardous wastes.68 For example, local governments can turn to the Superfund Act as a means of shifting the costs of closing their landfills to industrial users of the landfills and their transporters. Likewise, water utilities, citizen groups and other nonfederal plaintiffs can bring environmental claims against carriers and others for contributing to pollution at landfills and other dumping sites.

Recovery of Treble Damages and Other Costs. The Act authorizes the EPA to sue for three times the actual response costs incurred where a defendant refuses to follow an EPA cleanup order.69 Although the Superfund Act’s operative provisions (42 U.S.C. §§ 9606 and 9607) do not specifically provide for the recovery of attorney fees, acts violating the Superfund Act generally also violate RCRA, and plaintiffs therefore can claim attorney fees under RCRA’s attorney fee provisions.70

C. INJUNCTIONS AND CLAIMS FOR RESPONSE COSTS UNDER SUPERFUND ACT

Injunctive Actions. Under the Act’s injunctive provision, 42 U.S.C. § 9606, the EPA is granted broad powers—including the power to issue orders and to enforce them in the federal court—to stop actual or threatened releases of hazardous wastes. Persons who refuse to comply with federal orders issued under Section 9606 can be fined up to $25,000

per day,71 (in addition to the potential liability for treble damages, as described above72). Courts also can issue open-ended injunctive orders which obligate defendants to cooperate in cleanup and monitoring activities until some indefinite future date.73

**Actions for Response Costs.** Under 42 U.S.C. § 9607(a), a plaintiff can sue to recover for "all costs of removal or remedial action" taken to alleviate damage to natural resources. The plaintiff must prove four things:

a. The defendants fall within one of four classes of potentially responsible persons described in the statute, namely:

1. current owners and operators of the hazardous waste facility;
2. past owners and operators of the hazardous waste facility;
3. those who arranged for disposal of hazardous waste at the facility; and
4. transporters of hazardous waste to the facility.

b. The defendants placed hazardous waste at the site (or other facility) that is similar to the kind of waste found at the site (or sites).

c. A "release" of that hazardous waste (or any hazardous waste) has occurred or threatens to occur at the facility.

d. The release or threatened release has caused the plaintiff to incur response costs.74

**No Tracing of Waste Required.** The plaintiff is not required to prove that any defendant's hazardous waste caused specific damage at the site; nor must the plaintiff match the waste found to each defendant as if it were matching fingerprints.75 The only required connection between the defendant and the site is that the defendant must have placed hazardous waste there and that similar hazardous waste must be found at the site.76

**D. DEFENSES AVAILABLE UNDER SUPERFUND ACT**

**Statutory Defenses.** Three limited statutory defenses are available under the Superfund Act. A carrier (or other defendant) can escape liability if it can show that the response costs were necessitated solely by: (1) an act of God; (2) an act of war; or (3) an act or omission of an unrelated third party.77

**Third-Party Defense.** To qualify for the third-party defense, a carrier

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(or other defendant) has the burden of proving that (1) the third party is not an employee of the defendant; (2) the third party’s actions or omissions did not occur pursuant to a "contractual relationship with the defendant, existing directly or indirectly;" and (3) the defendant:

(a) . . . exercised due care with respect to the hazardous substance concerned, taking into consideration the characteristics of such hazardous substance, in light of all relevant facts and circumstances, and (b) . . . took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions. 78

In short, the defendant must show that a totally unrelated third-party is the sole cause of the release. 79 Courts have been strict in reviewing the facts and circumstances under which defendants have claimed the third-party defense. 80

**Failure to Prove That Defendant Selected Disposal Site.** It may be possible to carve out a defense from the language of 42 U.S.C. § 9607(a)(4), which defines a liable transporter as "any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities or sites selected by such person." Reading this definition literally, a carrier or broker may be able to avoid liability if it can prove that it did not select the site to which the hazardous wastes were delivered. 81 (In this regard, it may be useful for carriers to insert a clause in their transportation contracts stating that the shipper, not the carrier, is responsible for choosing the disposal or treatment facility to which the wastes are to be delivered.)

**Lack of Intent to Dispose of Hazardous Material.** In at least one case, a defendant was able to avoid liability under the Superfund Act by proving that it was supplying the hazardous materials to another defendant as part of a sale of the materials, and that it had no intention of delivering the materials for the purpose of disposal. 82 Any carrier delivering hazardous materials in a similar situation may be able to raise a similar defense.

**Response Costs Inconsistent With "National Contingency Plan".** The Superfund Act allows recovery of response costs only insofar as they are consistent with so-called "National Contingency Plan." 83 In certain instances, it may be possible for a defendant to reduce or defeat another

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81. See United States v. South Carolina Recycling and Disposal, Inc., 21 E.R.C. 1577 (1984) (plaintiff must prove that transporter selected the facility to which wastes were delivered).
party's claim for reimbursement or contribution of response costs if that party's remedial actions were ill-conceived, negligently carried out, not cost-effective, or otherwise inconsistent with the National Contingency Plan.  

Other Possible Defenses. Courts have acknowledged that the Superfund Act is a codification of the equitable remedy of restitution and that equitable defenses therefore can be raised (although no cases have been found in which courts have allowed equitable defenses). In one case, a defendant unsuccessfully asserted equitable defenses of "waiver and release;" "estoppel;" and an alleged failure to consult with the defendant before and during the clean up process. In another case, a defendant unsuccessfully raised the defense of "unclean hands," alleging that the government's clean up of the hazardous waste was so negligently conducted as to have caused more damage than was cleaned up. Presumably, equitable defenses will be allowed in cases in which facts and circumstances justify them.

IV. CONCLUSION

The growing matrix of overlapping environmental statutes, regulations and caselaw is becoming so complex that no one can boast full knowledge of the field. Nor can anyone predict what the ultimate effect will be on the transportation industry.

All that can be said with certainty is that large numbers of claims under RCRA and the Superfund Act are being filed with regularity by government and private plaintiffs. Carriers and brokers are named as defendants in a good number of those cases. The potential penalties they face are severe.

Transportation practitioners therefore are well-advised to become as thoroughly familiar as possible with environmental laws and to make every effort to ensure that their companies are in compliance at federal, state, and local levels.

86. Id.
87. O'Neil v. Picillo, 682 F. Supp. 706, 726 (D.R.I. 1988) ("unclean hands" defense rejected on ground that "mere negligence" by state in cleaning up a site was insufficient to bar the state from recovering under the Superfund Act).
State Nuclear Transportation Routing Laws

STEVEN C. GOLDBERG*

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A. INTRODUCTION

The purpose of this paper is to summarize state nuclear transportation routing-related laws and their relationship to the relevant federal law. The compatibility of such laws with federal nuclear transportation law has been, or is being, addressed in several federal court and Department of Transportation (DOT) advisory opinions.

The discussion centers around nuclear transportation permit laws that contain routing-related provisions. Any formal state nuclear transportation route designations are also identified.

B. FEDERAL NUCLEAR TRANSPORTATION ROUTING LAWS

Nuclear materials transportation is primarily subject to federal regulation by DOT under the Hazardous Materials Transportation Act (HMTA)\(^1\) and the Nuclear Regulatory Commission (NRC) under the Atomic Energy Act (AEA).\(^2\) The HMTA authorizes DOT to promulgate regulations for the safe transport in commerce of hazardous materials, including radioactive materials. The HMTA, as discussed in more detail later in this article, expressly preempts inconsistent state and local laws.\(^3\) DOT hazardous materials transportation regulations are contained in 49 C.F.R. Parts 171-177. These regulations include requirements for radioactive materials packaging, marking, labeling, placarding, shipping papers, and highway

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3. See 49 U.S.C. § 1811(b) and discussion infra, at section D of this article.
routings. The AEA authorizes the NRC (then Atomic Energy Commission) to regulate and license the receipt, possession, use and transfer (including transportation) of source, by-product, and special nuclear material. NRC radioactive materials transportation regulations are contained in 10 C.F.R. Parts 71 and 73. These regulations include requirements for packaging and physical security.

As relevant to the present topic, DOT hazardous materials transportation regulations provide that any person who operates a motor vehicle containing highway route-controlled quantity (HRCQ) radioactive material\(^4\) must operate over preferred routes selected to reduce time in transit, except that an interstate system bypass or beltway around a city must be used when available.\(^5\) A preferred route is a state-designated route selected by a state routing agency in accordance with specified DOT routing guidelines,\(^6\) or the state equivalent, and an interstate highway for which an alternative route has not been designated by a state routing agency.\(^7\) State route designations must be preceded by substantive consultations with potentially affected states and localities.\(^8\) State designated routes must be provided to DOT to be effective.\(^9\) Deviations from preferred routes are permitted when necessary along routes selected in accordance with the standards for selection of non-HRCQ (low-level) radioactive materials routes.\(^10\) These standards are discussed below. Preferred route deviations are essentially allowed to the extent necessary to pick up and deliver HRCQ radioactive materials and under emergency conditions.\(^11\) NRC approval of spent fuel shipment routes is required.\(^12\)

Non-HRCQ placarded shipments of radioactive material (low-level radioactive material) must operate on routes that minimize radiological risk.\(^13\) In selecting routes, the carrier must consider available information on accident rates, transit time, and the time of day and day of the week during which the shipment will take place. This requirement does not apply when there is only one practicable highway route available or the motor vehicle is operated on a preferred highway.

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5. See 49 C.F.R. § 177.825(b) (1988).
7. See 49 C.F.R. §§ 171.8 and 177.825(b) (1988).
11. Id. The application of this preferred route deviation exception for HRCQ radioactive materials shipment pickup is addressed in a 1988 DOT enforcement case discussed infra. See text at note 70.
To the author’s best knowledge, only Arkansas, Colorado, Iowa, Kentucky, Nebraska, Tennessee, and Virginia have notified DOT of preferred alternative routes. A discussion of individual state routing-related laws follows.

C. STATE NUCLEAR TRANSPORTATION ROUTING LAWS

1. California. The California Vehicle Code authorizes the California Highway Patrol to adopt regulations specifying nuclear shipment routes. To the best of the author’s knowledge, such regulations have not been promulgated.

2. Colorado. The Colorado Nuclear Materials Transportation Act authorizes the State Highway Department to adopt regulations that designate highway routes for nuclear materials transportation. To the best of the author’s knowledge, such regulations have not been promulgated. This law also establishes a nuclear transportation permit system administered by the Colorado Public Utility Commission. The nuclear transportation permittee is required to give advance notification of each nuclear shipment, including a list of routes to be used.

3. Connecticut. The Connecticut Atomic Energy Act establishes a nuclear transportation permit system administered by the State Department of Transportation. The permit application must include the scheduled route. The Department is authorized to require a route change if deemed necessary to protect public health and safety. Implementing regulations provide that the scheduled routes of each permit applicant are expressly confined to limited access highways and the shortest practicable route to and from them. All routes must be expressly determined by the Department.

4. Delaware. According to Delaware Department of Public Safety policy, all shipments of high-level nuclear materials must travel over routes designated by the Commission on Hazardous Materials.

5. Florida. The Florida Radiation Protection Act authorizes the Department of Health and Rehabilitative Services to designate routes. To the best of the author’s knowledge, carrier route selection is permitted.

15. See COLO. REV. STAT. § 40-2-208 (1988). This statute is the subject of litigation and a DOT inconsistency ruling. See discussion, infra, text at notes 64 and 69.
17. See CONN. GEN. STAT. ANN. § 16a-106 (West 1988).
18. See CONN. AGENCIES REGS. § 19-409d-54.
21. See FLA. STAT. ANN. § 404.20(2)(c) and (3)(c) (West 1986).
6. Georgia. The Georgia Transportation of Hazardous Materials Act establishes a nuclear transportation permit system administered by the Georgia Public Service Commission (PSC). This law authorizes the Georgia PSC to require route changes as a condition of receipt of a nuclear transportation permit.

7. Idaho, Oregon, Washington, and Wyoming. These four states are parties to the Pacific States Agreement on Radioactive Materials Transportation Management. This law authorizes the establishment of an interstate committee to propose model regulatory standards and to coordinate decisions by party states regarding radioactive materials routing. The model standards must not conflict with federal requirements and would require a carrier to furnish route information. To the best of the author’s knowledge, implementing standards have not yet been issued.

8. Indiana. The Indiana Motor Carrier Act authorizes the Indiana Public Service Commission (PSC) to designate public highway routes over which motor carriers may operate and adopts certain specified provisions of DOT hazardous materials and motor carrier safety regulations, including 49 C.F.R. Part 177 which contains the DOT nuclear routing rule. To the best of the author’s knowledge, the Indiana PSC has not designated nuclear routes.


10. Louisiana. The Louisiana Nuclear Energy and Radiation Control Law authorizes the Department of Environmental Quality (DEQ) to promulgate routing regulations. DEQ regulations adopt DOT hazardous materials transportation regulations.

11. Maryland. The Maryland Department of Transportation prepared a 1981 routing plan for highway shipments of radioactive materials, including a risk analysis and comparison of interstate and state highways using DOT routing guidelines. The plan identifies preferred routes for Maryland nuclear shipments.


24. See IND. CODE ANN. § 8-2-7-1 et seq. (Burns 1988).


27. See Maryland Department of Transportation, Highway Routes for Shipment of Radioactive Materials—Corridor Comparison Study I-95 vs. 301 (1981).
12. *Michigan.* Pursuant to the Michigan Radiation Control Act\(^2\) and Michigan Fire Code\(^2\) the Michigan Department of Public Health and Michigan Department of State Police, respectively, have promulgated joint regulations requiring the prior approval of both agencies prior to the transport of radioactive materials in the state.\(^3\) The application for transport approval must identify the proposed routes, including a designation of alternative routes and the reasons for the selection of the proposed route. Approval to transport may include any conditions or limitations either Department determines is necessary. Implicitly, though not explicitly, this could extend to the specification of a different route than that proposed by the permit applicant.

13. *Minnesota.* A Minnesota radioactive waste management statute requires high-level nuclear waste shippers to identify proposed routes to the State Commission of Public Safety (Commission).\(^3\) The Commission is authorized to designate state preferred routes. To the best of the author’s knowledge, the Commission follows DOT routing regulations and has not designated any state alternative routes.

14. *Mississippi.* The Mississippi Radiation Protection Act authorizes the State Board of Health to promulgate regulations regarding the designation of nuclear materials transportation routes.\(^3\) The Board’s implementing regulations adopt applicable DOT and NRC nuclear transportation regulations. The regulations do not contain specific state route designations.

15. *Nevada.* The Nevada Hazardous Materials Act requires the Nevada Department of Transportation (Department) to develop a routing plan for shipments of controlled quantities of radioactive materials and high-level radioactive waste in Nevada.\(^3\) The Department is required to cooperate with DOT interstate regional transportation commissions, and states contiguous to Nevada, to develop plans for the interstate routing of shipments of HRCQ radioactive materials or high-level waste. The Department is authorized to adopt necessary regulations and to cooperate with federal, state and local governmental agencies that regulate other hazardous materials.\(^3\) To the best of the author’s knowledge, no routing regulations or plans have been developed yet.

16. *New Jersey.* A New Jersey nuclear waste transportation law

\(\text{\textsuperscript{11}}\) See Department of Public Health, Division of Radiological Health, regulations R325-5801 et seq. and Department of State Police, State Fire Safety Board, regulations R29.551 et seq. (both effective July 1982).
\(\text{\textsuperscript{14}}\) See Miss. Code Ann. § 45.14-1 (West 1988).
authorizes the Department of Environmental Protection and the Department of Transportation to establish criteria for selection of state designated high-level nuclear transportation routes in conformity with federal law and to meet state needs and to designate such routes in the future.\textsuperscript{35}

The New Jersey Radiation Protection Act separately establishes a state nuclear transportation permit (certificate of handling) system administered by the Department of Environmental Protection.\textsuperscript{36} This law requires the permit applicant to identify the proposed shipment route. The Department’s implementing regulations require that the proposed route utilize railways, roadways, or other transport modes deemed safe by the Department and State Police. It requires major highways to be used for road shipments except where the Department judges such routes would place a greater threat to the public health and safety than alternative routing or where secondary roads must be used for minimum distance for egress from the point of origin or ingress to the final destination. The applicant may not transport in any New Jersey county which has a population density exceeding 1,000 persons per square mile. If movement through a densely populated area is unavoidable, the following additional measures must be taken: the transit must be nonstop, primary roads must be used, an armed escort consisting of local police or trained guards must be provided by the shipper, and no spent fuel may be shipped through densely populated areas between 7:00 a.m. and 9:00 a.m. and 4:00 p.m. and 6:00 p.m.\textsuperscript{37}

17. \textit{New Mexico}. The New Mexico Radiation Protection Act authorizes the State Environmental Improvement Division (Division) to promulgate regulations for the highway transport of nuclear material, including routing.\textsuperscript{38} The Division’s implementing regulations require a license to transport nuclear waste on New Mexico highways. The license application must contain proposed transportation routes. In approving routes, the Division is required to consult with affected local subdivisions and the State Transportation Department. To promote the objective of safest possible transport, vehicles carrying nuclear waste are required, to the extent practicable, to travel by interstate highways, use routes that minimize travel time, avoid traveling through or near heavily populated areas, avoid tunnels, narrow streets and alleys, areas adjacent to large numbers of people, populated areas, and hazardous road conditions due to climatic or structural conditions.\textsuperscript{39} 

18. \textit{North Carolina}. The North Carolina Radiation Protection Act au-
uthorizes the Department of Human Resources (Department) to promulgate regulations regarding the designation of nuclear materials transportation routes in the state.\textsuperscript{40} The Department is authorized to adopt applicable federal rules and regulations governing nuclear materials transportation. To the best of the author's knowledge, the Department has adopted DOT routing regulations and not designated any state alternative routes.

19. \textit{Ohio}. The Ohio Atomic Energy Act requires nuclear materials shippers or carriers to provide advance notification to the state Disaster Services Agency (Agency) including the scheduled route.\textsuperscript{41} To the best of the author's knowledge, the Agency follows applicable DOT regulations and has not designated state alternative routes.

The Ohio Hazardous Materials Transportation Act separately requires advance shipment notification of hazardous materials determined by Ohio Public Utilities Commission regulation to present an extraordinary public health and safety risk.\textsuperscript{42} Such notification must be accompanied by an elaborate route selection assessment giving due consideration to a number of specified factors, including risk to public health and safety and the environment. Nuclear transportation subject to the prenotification requirements of the Ohio Atomic Energy Act is exempt.

20. \textit{Oregon}. An Oregon nuclear facilities statute establishes a nuclear transportation permit system.\textsuperscript{43} The permit application must include an identification of the proposed route.\textsuperscript{44} The State Energy Facility Siting Council (Council) is authorized to promulgate associated regulations regarding nuclear materials routing consistent with DOT and NRC rules.\textsuperscript{45}

The Council's implementing regulations, accordingly, require that spent nuclear fuel be routed in accordance with NRC regulations in 10 C.F.R. § 73.37 and HRCO radioactive material shipments in accordance with DOT regulations in 49 C.F.R. § 177.825. These materials are to be transported on interstate highways or railroads.\textsuperscript{46}

21. \textit{Pennsylvania}. The Pennsylvania Hazardous Materials Transportation Act authorizes the Department of Transportation (Department) to adopt regulations regarding hazardous (including radioactive) materials routing that do not conflict with federal regulations.\textsuperscript{47} The Department regulations adopt the DOT routing transportation regulations and do not

\textsuperscript{40} See N.C. GEN. STAT. ch. 104E (West 1988).
\textsuperscript{41} See OHIO REV. CODE ANN. § 4163.1 (Baldwin 1987).
\textsuperscript{42} See OHIO REV. CODE ANN. § 4905, et seq.
\textsuperscript{43} See OR. REV. STAT. § 469.300 et seq. (West 1989).
\textsuperscript{44} See OR. REV. STAT. § 469.605.
\textsuperscript{45} See OR. REV. STAT. § 469.607.
\textsuperscript{46} See 35 OR. ADMIN. R. Div. 60 Rule 4.
\textsuperscript{47} See PA. STAT. ANN. tit. 75, § 8301 et seq. (West 1989).
contain any additional state routing rules.\footnote{See 67 PA. CODE ch. 403 (effective May 1982).}

22. \textit{Rhode Island}. The Rhode Island public utilities and carriers law authorizes the Rhode Island Public Utilities Commission (PUC) to promulgate regulations regarding motor carrier safety.\footnote{See R.I., GEN. LAWS § 39-12-1 to 39-12-21 (West 1988).} Rhode Island PUC implementing regulations provide that shipments of large quantity radioactive material and specified placarded radioactive material require a permit from the PUC prior to traveling Rhode Island highways. The permit application must include a detailed description of the routes to be followed. It is not clear what, if any, authority the PUC has to require utilization of a different route than that specified by the carrier. The regulations prohibit transportation of radioactive material over the highways of the state during the hours of 7:00 a.m. to 9:00 a.m. and 4:00 p.m. to 6:00 p.m. Monday through Friday.

23. \textit{South Carolina}. The South Carolina Radioactive Waste Transportation and Disposal Act requires radioactive waste carriers to notify the Department of Health and Environmental Control (Department) of proposed routes.\footnote{See S.C. CODE ANN. § 13-7-110 to 13-7-200 (West 1988).} The Department is authorized to promulgate regulations regarding primary routes. Department regulation 61-83 invokes the DOT routing regulation and does not contain any additional state routing rules.

24. \textit{Tennessee}. Tennessee Public Service Commission regulations restrict operation of placarded shipments of hazardous (including radioactive material) on specified highways.\footnote{See Tenn. PSC reg. 1220-2-1-46.}

25. \textit{Texas}. The Texas radiation control statute authorizes the Texas Department of Health (Department) to adopt rules and guidelines providing for the transport and routing of radioactive materials in the state.\footnote{See Tex. REV. CIV. STAT. art. 4590f (Vernon, Supp. 1986).} To the best of the author’s knowledge, the Department follows applicable DOT regulations and has not promulgated its own.

26. \textit{Vermont}. A Vermont hazardous materials transportation statute authorizes the Agency of Transportation (Agency) to designate any highway as part of a preferred route for the transportation of fissile radioactive materials and DOT defined large quantity packages of radioactive material in order to cause the least risk to persons and property.\footnote{See VT. STAT. ANN. tit. 5, § 2001 to 2003 (West 1988).} The Agency is to confer with the municipality in question regarding the establishment of a preferred route within their jurisdiction. Agency implementing regulations adopt applicable DOT routing regulations.

27. \textit{Wyoming}. According to a 1985 policy letter from the former Wyoming Governor to the Wyoming Highway Patrol Director, radioactive...
materials shipment must utilize interstate highways only unless otherwise authorized by the Governor. 54

On the basis of the foregoing, the most prescriptive state routing provisions are in Connecticut (limited access highways and most direct route), Michigan (carrier route selection basis), New Jersey (major highways and avoid heavily populated areas and hazardous road conditions), and Rhode Island (time of day restriction). Other states variously follow DOT routing regulations, authorize interstate or interjurisdictional cooperation in route selection, or permit state review and approval of carrier-selected routes generally as part of the state nuclear transportation permit scheme.

D. DOT INCONSISTENCY RULINGS, DOT ENFORCEMENT DECISION AND FEDERAL COURT DECISIONS

1. DOT INCONSISTENCY RULINGS

The HMTA contains an express provision concerning federal pre-emption of state and local law. Specifically, § 112(a) preempts "any requirement of the state, or political subdivision thereof, which is inconsistent with any requirement" of the HMTA or implementing regulations. A state requirement is federally inconsistent if compliance with both the state and HMTA or implementing regulation is not possible ("dual compliance" test) and the state requirement is an obstacle to the accomplishment and execution of the HMTA and implementing regulations ("obstacle" test). 55 DOT is authorized to render advisory opinions on the federal consistency of state or local laws, termed inconsistency rulings.

DOT regulations contain a policy statement 56 which identifies the relationship between the DOT's routing regulation and state and local regulations. The policy statement essentially provides that any radioactive materials routing rule that is not identical to the DOT routing rule is federally inconsistent. The appendix also addresses the federal consistency of routing-related laws, such as those which might require filing route plans or which unnecessarily delay transportation.

The appendix defines the term "routing rule" as
[a]ny action which effectively redirects or otherwise significantly restricts or delays the movement by public highway of motor vehicles containing hazardous materials, and which applies because of the hazardous nature of the cargo. Permits, fees and similar requirements are included if they have such effect . . . Id. (emphasis added.)

54. See Letter from the Governor E. Herschler to Col. E. Ayers, Director, Wyoming Highway Patrol (March 28, 1985) (on file with author).
DOT has rendered a number of inconsistency rulings regarding state and local nuclear transportation permit and routing laws. DOT has stressed that since its rulings are rendered under the HMTA it considers only statutory preemption. It has noted that a federal court could find such laws preempted on constitutional preemption or interstate commerce grounds even if not statutorily preempted. DOT does not make such determinations.

The Michigan and Connecticut transportation permit laws summarized above were found to be federally inconsistent routing rules in IR-857 and IR-21,58 respectively. County transportation permit laws containing route restrictions in Maryland and New York also were found to constitute federally inconsistent routing rules in IR-1859 and IR-14,60 respectively. DOT noted that local routing restrictions are federally inconsistent unless identical to 49 C.F.R. § 177.825(a) (non-HRCQ radioactive material) or 49 C.F.R. § 177.825(b) (HRCQ radioactive material). The same result was reached regarding a Boston ordinance banning the transportation of radioactive materials on city streets unless there was no practical alternative and additional time-of-day restrictions in IR-3.61 DOT noted additionally in their rulings that only states, not counties or municipalities, were authorized to designate preferred routes for HRCQ shipments.

A New York bridge and port authority transportation permit regulation was found to constitute a federally inconsistent routing rule in IR-11.62 The same result was reached regarding a New York bridge and tunnel authority regulation banning radioactive materials shipments in IR-20.63

Finally, an inconsistency ruling application (IRA-44) is currently pending on the federal consistency of the Colorado Nuclear Transportation Act summarized above.64

In arriving at its decisions in the referenced cases, DOT variously found that the subject nuclear transportation permit and other routing law-related laws subjected nuclear shippers or carriers, otherwise in compliance with DOT regulations, to varied and inconsistent state or local requirements that had the potential to redirect or restrict nuclear shipments. These laws were found to pose an obstacle to the accomplishment of the HMTA objectives of creating a uniform, comprehensive federal regulatory program for radioactive materials transportation safety and preventing un-

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necessary delay in nuclear shipments. DOT found that the subject laws thus failed the "obstacle test" for determining federal consistency under HMTA regulations and were thereby preempted.

2. DOT ENFORCEMENT DECISIONS AND FEDERAL COURT DECISIONS

There have been no judicial decisions concerning nuclear transportation routing laws. There have been three decisions concerning state nuclear transportation permit laws with routing provisions. There has been one DOT administrative decision concerning nuclear transportation routing. These are described briefly here.

The case of Jersey Central Power and Light Co. v. New Jersey involved the validity of a state spent fuel alternative route designation under the HMTA. Under the New Jersey transportation permit law discussed earlier, a spent fuel shipper was required, as a permit condition, to use a route other than that proposed and approved by the NRC. The federal court in New Jersey found that this state route requirement was not a valid state route designation under the HMTA routing regulation since it did not follow the requisite regulatory procedure for such designations and was, therefore, federally inconsistent and preempted. The court enjoined the state from preventing the subject shipment and required it to grant the transportation permit.65 Although the Third Circuit Court of Appeals found the case moot on appeal, since the subject spent fuel shipment had concluded, dicta in its decision indicated it would have agreed with the lower court decision on the merits of the case.66

The rail-related provisions of the Ohio Hazardous Materials Transportation Act summarized above, which included requirements for carrier route assessments, were found preempted under the Federal Railroad Safety Act (FRSA) in the case of CSX Transportation v. Ohio Public Utilities Commission.67 The FRSA preempts any state law relating to a DOT-regulated area of railroad safety and permits additional state law only where necessary to address a local safety hazard, an exception the district court found absent in the present case. In deciding the case on FRSA preemption grounds, the court indicated that it did not need to address the plaintiff's additional claim that the Ohio law as further preempted by the HMTA and in violation of the commerce clause of the constitution because it imposed an undue burden on interstate commerce.68

65. See Jersey Central Power & Light Co. v. New Jersey, No. 84-4964 (D.N.J., filed Dec. 27, 1984.)
68. See 45 U.S.C. 421.
In the final court case, a federal court in Colorado granted a motion for summary judgment and adjudged the Colorado Nuclear Materials Transportation Act summarized above to be federally consistent and not preempted by the HMTA.\textsuperscript{69} This case was prompted by the DOE inconsistency ruling application noted earlier.

A 1988 contested DOT enforcement action contains perhaps the most thorough litigative analysis of the DOT nuclear routing regulation to date.\textsuperscript{70} The case involved the efficacy of a Nevada nuclear route designation in the context of overweight fuel shipments from Nevada to Idaho. The DOT staff proposed the imposition of a civil penalty on the subject carrier for not using a route identified for nuclear shipments in a 1982 letter from the Governor of Nevada to DOT. The route identified in the 1982 letter would have taken the shipments at issue through the city of Las Vegas. The Las Vegas route was initially authorized in a Nevada Department of Transportation overweight permit. In the face of objections from the city of Las Vegas, and following consultations between the shipper, carrier and the Governor’s office, the initial overweight permit was revoked and reissued authorizing use of a different route that circumvented Las Vegas which was also 100 miles further from the nearest interstate highway.

Following a hearing before a DOT administrative law judge (ALJ), the proposed penalty was dismissed on the grounds that the route identified in the 1982 letter was not a properly designated preferred state route under the DOT routing regulation in 49 C.F.R. § 177.825(b). Among other things, the ALJ found that the subject letter did not evidence any prior routing analysis, prior consultations with affected jurisdictions, or that the Governor was authorized to act as the state routing agency as each required by the DOT routing regulation.\textsuperscript{71} This case arose prior to the regulatory requirement in 49 C.F.R. § 177.825(b) that state designated routes must be provided to DOT to be effective.

The ALJ alternatively found that, even if the 1982 route designation was proper when made, such designation had been effectively revoked by subsequent events, including the consent of the Governor’s office to the route identified in the reissued overweight permit. In the absence of an effective state designated preferred route at the time of the subject shipments, the ALJ concluded that the carrier could have selected either the route identified in the 1982 letter or the longer route contained in the overweight permit as “pick up” route deviations from the nearest pre-


\textsuperscript{70} See In the Matter of Tri-State Motor Transit Company, No. 87-22-RMC (DOT, filed Sept. 9, 1988).

\textsuperscript{71} Id, slip op at 7-11.
ferred route under the DOT routing regulation. As noted earlier, 49 C.F.R. § 177.825(b) permits a deviation from a preferred route to the extent necessary to pick up or deliver HRCQ radioactive material in accordance with the same criteria governing the selection of routes for non-HRCQ radioactive shipments, namely, minimization of radiological risk. The ALJ found that the carrier could have reasonably selected the route actually utilized as minimizing radiological risk by avoiding Las Vegas in favor of a more remote route despite the fact that such route was a less direct access route to the nearest interstate highway. The DOT staff had argued unsuccessfully that only the most direct pickup route to the nearest preferred route could be used if the underlying regulatory objective of reducing transit time for HRCQ radioactive materials shipments was to be met. The ALJ noted that both routes in question were over 300 hundred miles from the nearest interstate highway and that, if a pickup route of 300 hundred miles is acceptable, one of 400 miles is equally acceptable. The ALJ found no language in the DOT routing regulation which imposed a mileage restriction on deviations from a preferred route for pickup or delivery purposes.

E. CONCLUSIONS

DOT hazardous materials transportation regulations provide a framework for the designation of nuclear transportation highway routes. There is no comparable regulation governing rail transportation. In accordance with this DOT routing regulation, a number of states have formally selected state routing agencies and designated alternative state routes for nuclear shipments. At the same time, a number of states have nuclear transportation permit laws that confer some route review or approval authority on the state permitting agency. These state permitting agencies may or may not be official state routing agencies, and any routes they might require as a permit condition may or may not be the state designated alternative routes if such routes exist in the state. This could create potential routing conflicts over authorized state routes as it did in the Jersey Central Power case. Whether, and to what extent, this has actually occurred in unlitigated cases is beyond the scope of this paper.

State nuclear transportation permit laws with routing provisions have generally been found by DOT, when challenged, to, in effect, constitute

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72. Id. at 20.
73. See discussion supra, text at note 10. On September 29, 1989, DOT issued a notice of proposed rulemaking to amend this regulation to require carriers to use the shortest distance pickup and delivery routes available to preferred routes. See 54 Fed. Reg. 40,272.
74. Tri-State, supra, slip op at 21-22.
75. Id. at 22.
76. Id.
nuclear routing laws in the guise of transportation permit laws with the potential to unduly delay or redirect nuclear shipments and their authorized selection of nuclear routes by non-routing agencies without adherence to the regulatory routing criteria in 49 C.F.R. § 177.825(b). The only judicial precedent on the issue, the Jersey Central Power case, and the Colorado case reached different conclusions. The CSX Transportation case did not reach the validity of the highway routing provision of the state nuclear transportation law at issue in that case since only the railroad-related provisions of that law were challenged and found impermissible on federal railroad law preemption grounds. As noted earlier, there is no present federal nuclear routing law or regulation for railroad shipments.

There are no judicial decisions concerning actual state nuclear routing laws or designations as distinct from permit laws with routing provisions. The Tri-State administrative case does. The Tri-State case indicates that, when formally challenged, purported state nuclear route designations must conform to the DOT regulatory requirements for such designation in order to be effective. The case also contains the only litigative interpretation of the bounds of the regulatory exception to the use of preferred routes allowed for shipment pickup. This case is significant in this latter regard since it provides that there is no mileage limit for a pickup route and that the longer of two alternative pickup routes may be acceptable if, on balance, it would minimize the transportation risk in a given situation. The decision in this case must also be understood in the context of the particular facts at hand, namely, that the shorter alternative pickup route went through the city of Las Vegas while the longer route did not. The extent to which a non-preferred route would qualify as a permissible pickup route, and which of several possible alternative pickups might be acceptable, must be determined on a case-by-case basis.

Parties undertaking nuclear materials shipments should become familiar, not only with formal state alternate route designations, if any, but also with state nuclear transportation permit laws with routing provisions. As ongoing federal programs for the permanent disposal of the nation's civilian and defense transuranic and high-level nuclear waste progress, the existence of potentially restrictive and conflicting state routing-related laws will be of particular significance.
Judicial Ordering of Intergovernmental Roles in Hazardous Materials Transportation

GARY M. BOWMAN*

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I. INTRODUCTION

During the past ten years, public attention has repeatedly focused on the transportation of hazardous materials. The tank car explosion at Waverly, Tennessee in February 1978 that killed fifteen people and destroyed two city blocks first dramatized the potential danger inherent in the transportation of many commodities.¹ The 1984 chemical plant disas-

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¹ STAFF OF SENATE COMM. ON COMMERCE, SCIENCE & TRANSP., 96TH CONG., 1ST SESS.,
ter at Bhopal, India and the 1986 railroad fire at Miamisburg, Ohio heightened anxiety about hazardous materials. Nevertheless, the transportation of hazardous materials is ubiquitous in the United States: over 250,000 hazardous materials shipments are made in the United States each day and thousands of hazardous materials incidents occur each year.

The governmental response to the threat of hazardous materials has been uniform across the country: schemes to regulate the handling and movement of dangerous commodities have been devised at the local, state, and federal levels. Critics of the hazardous material regulation regime in the United States have focused on this preference for regulatory standard-setting and, as a result, most proposals for regulatory reform in the area have advocated a greater reliance on tort liability to control carriers of hazardous material. Although no legislative action has been taken to explicitly balance standard-setting with tort liability, an inadvertent but fortuitous result of hazardous materials litigation in the past five years has been the assignment of intergovernmental roles in hazardous materials policymaking: a zone of regulatory standard-setting authority has been reserved for the federal government and a zone of control through tort remedies has been preserved for the states. The federal courts have assumed a unique role in the hazardous materials area, ordering intergovernmental responsibility in an area of substantive law and creating a national regulatory regime in the absence of legislative action.

II. THE FEDERAL REGULATORY PROGRAM

The federal government exerts a pervasive standard-setting control over hazardous materials shipments in the United States. Congress has delegated to the federal Secretary of Transportation sole authority to define what commodities are hazardous materials, strengthening and continuing a long tradition of federal activity in controlling transportation of dangerous materials.

The Interstate Commerce Commission (the "ICC") and other federal

5. See generally, BOWMAN, HAZARDOUS MATERIALS PROGRAMS IN THE FIFTY STATES (1988).
agencies had regulated dangerous commodities since 1866, but in 1966, authority to regulate the transportation of hazardous materials was transferred from the ICC, the Department of the Treasury, and the Civil Aeronautics Board to the newly formed Department of Transportation (the "DOT"). Within DOT, separate modal administrations were retained to preserve organizational continuity. Moreover, modal administration functions specified by the Act could not be delegated to other Department administrations by the Secretary of Transportation. Thus, although the Secretary had Cabinet-level responsibility for transportation safety standards (including hazardous materials), each modal administration was allowed to promulgate independent regulations.8

After a series of accidents involving the rail shipment of propane in 1969 and 1970, legislation was passed in 1970 imposing greater requirements on DOT to coordinate standards for carriers of hazardous materials. Under the Hazardous Materials Transportation Control Act of 1970,9 the Secretary was required to establish facilities and technical staff for evaluating hazards associated with hazardous materials; establish a central reporting system for hazardous material accidents; conduct a review of all aspects of hazardous material transportation and recommend appropriate steps to be taken immediately to provide greater control over shipments; and prepare an annual report for Congress on regulatory, enforcement, and exemption activities as well as accident and casualty statistics. However, DOT was unable to implement the statute because of a shortage of administrative and enforcement resources. Consequently, the provisions of the law were incorporated into the Hazardous Material Transportation Act of 1975.10

As a result of the National Transportation Safety Board's investigation of a Boeing 707 crash in 1973, which revealed a general lack of compliance with existing hazardous materials regulations due to fragmentation of the regulatory authorities, complexity of the regulations, lack of industry familiarity at the moving level with federal regulations, and inadequate government surveillance and enforcement,11 the Hazardous Materials Transportation Act (the "HMTA") was finally passed into law in 1975. The intent of the law was to improve regulatory and enforcement activities by providing the Secretary of Transportation with broad authority to enact

8. O.T.A., supra note 4, at 147.


10. O.T.A., supra note 4, at 147.

regulation applicable to all modes of transport. Specifically, the HMTA:

1. Expanded DOT’s potential jurisdiction to any traffic “affecting” interstate commerce.

2. Authorized the designation of hazardous materials, defined as materials or classes of materials in quantities and forms that the Secretary of Transportation determines may pose an unreasonable risk to health and safety or property.

3. Authorized DOT to issue regulations related to packing, repacking, handling, labeling, marking, placarding, and routing; expanded the regulated community to include those who manufacture, test, maintain, and recondition containers or packages used to transport hazardous materials.

4. Authorized the establishment of a registration program for shippers, carriers, and container manufacturers and reconditioners.

5. Codified DOT procedures for granting regulatory exemptions.

6. Provided the Secretary with the ability to conduct surveillance activities (e.g., hold hearings and conduct investigations), establish recordkeeping requirements, and conduct inspections. Provisions of the 1970 ACT were also included in this section of the HMTA, such as submission of an annual report to Congress.

7. Authorized the DOT to assess civil and criminal penalties for violations of the HMTA.

8. Defined the relationship between the federal regulations and those of the states and local governments, preempting non-federal rules found to be inconsistent with the federal program and establishing a procedure whereby DOT could waive preemption.

Shortly after the HMTA was enacted, the Secretary created the Materials Transportation Bureau (the “MTB”) within the Research and Special Programs Administration, which was designated the lead DOT agency for hazardous materials regulation. The Hazardous Materials Board was terminated and the responsibilities of the Office of Hazardous Materials were transferred to the newly formed MTB. MTB was delegated responsibility for issuing all hazardous materials transportation regulations except those governing bulk transport by water, which continues to be regulated by the Coast Guard.

Two other federal agencies, the U.S. Environmental Protection Agency and the Nuclear Regulatory Commission, establish transportation-related requirements for hazardous substances, hazardous wastes,
and radioactive materials. The Occupational Safety and Health Administration regulates workplace safety for employees of carriers of hazardous materials. The Interstate Commerce Commission requires carriers to publish rates and obtain operating certificates. The Department of Defense and the Department of Energy have also established some additional transportation requirements for their own shipments of radioactive material. In addition, hazardous materials sent by mail must comply with both DOT and U.S. Postal Service regulations.

The standard-setting function of the federal government in the hazardous materials area is essential. A nation-wide classification of materials that are hazardous when transported, the quantities of those substances that may be safely transported, and the characteristics of the containers in which the substances may be safely carried are examples of chemical and engineering standards that must be set if there is to be a minimum level of public safety in the area.

The standard-setting function should be performed at the federal level for two reasons. The most obvious reason is that most hazardous materials transported in the United States are shipped to states other than the state of their manufacture. Consequently, each state setting its own standards would create both a burden on interstate commerce and a dis-economy of scale in setting the standards causing each state to incur higher transaction and information costs. Therefore, one agent, the federal government, should set the standards to be applied nationwide.

A more subtle reason for nationwide standard-setting is avoiding what has been called "the tragedy of the commons." This phenomenon is recognized in the environmental area and occurs when the setting of environmental standards is delegated to local governments, who are concerned not only with public safety and environmental quality, but also with economic growth. Richard Stewart has reasoned that:

Given the mobility of industry and commerce, any individual state or community may rationally decline unilaterally to adopt high environmental standards that entail substantial costs for industry and obstacles to economic development for fear that the resulting environmental gains will be more than offset by movement of capital to other areas with lower standards. If each locality reasons in the same way, all will adopt lower standards of environmental quality than they would prefer if there were some binding mechanism that enabled them simultaneously to enact higher standards, thus eliminating the

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22. Id. at 151.
23. Id.
24. Id.
25. O.T.A., supra note 4, at 119.
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threatened loss of industry or development.\textsuperscript{28}

Thus, uniform national standards are enacted to reduce the transaction costs of interstate bargaining.\textsuperscript{29}

Nevertheless, there are problems inherent in a legal regime that includes only regulatory standards. A commonly recognized problem is that the process of setting standards, based on a calculation of minimum acceptable public safety if the standards are followed, necessarily excludes an analysis of the probability that the regulated firms will comply with the regulations.\textsuperscript{30} Thus, as the costs of optimal precautions increases,

[S]ome firms may find it cheaper to violate the regulations than to comply with them. Even assuming that required precautions improve the safety record of firms that comply, the improvement in safety achieved by complying firms will be offset by the reduction in the number of firms that comply. In the extreme case, increasing the costs of compliance actually may reduce overall safety.\textsuperscript{31}

The effectiveness of enforcement is a key variable in determining the extent to which the regulated firms ought to comply with the regulations; in the current era of fiscal decrementalism, it is likely that the enforcement of hazardous materials regulations will not be increased,\textsuperscript{32} even though there is now an extensive regulatory regime under the HMTA.\textsuperscript{33}

III. STATE HAZARDOUS MATERIALS PROGRAM

Despite the expansive federal activity in regulating hazardous materials and the problems with standard-setting that regulation entails, all of the states and many localities throughout the United States have enacted their own programs for regulating hazardous shipments in their jurisdiction.\textsuperscript{34} The proliferation of state and local programs is evidence of a widespread belief that the federal regime does not provide adequate protection to the citizens of local areas.\textsuperscript{35} Thus, the "tragedy of the commons" that characterizes state environmental policy-making does not generally characterize hazardous materials transportation regulation at the state level.

A 1988 survey of the fifty states' hazardous materials programs

\begin{footnotesize}
\begin{itemize}
\item 28. \textit{Id.} at 1212.
\item 29. Posner, \textit{supra} note 26, at 600.
\item 31. Comment, \textit{supra} note 6, at 365.
\item 32. The shortage of enforcement resources at the federal level is recognized as the most serious problem with the hazardous materials regulatory program. O.T.A., \textit{supra} note 4, at 206.
\item 33. \textit{Id.}
\item 34. \textit{See generally}, Bowman, \textit{supra} note 5.
\item 35. Marten, \textit{supra} note 6, at 354.
\end{itemize}
\end{footnotesize}
demonstrated the proliferation of state and local programs. The most striking conclusion of the study was that there is a great variety in the approaches that the states have taken in regulating hazardous materials transportation. No two states have done exactly the same thing, even when types of programs were broken down into broad categories as in Figure 1 above.\textsuperscript{36}

The most uniformity that has been achieved has been in the adoption of the federal hazardous materials regulations in twenty-six states, but no state has adopted the federal regulations without amendment or supplementation. Eighteen states currently have hazardous materials emergency response teams that are supported by the state government. Five more states are developing state-supported teams. Eighteen states have imposed fees on carriers of hazardous materials, but none of the states with fee programs use the revenues to directly fund the prevention and cleanup of hazardous materials incidents, although such schemes are common in the environmental area. The hazardous materials user fee programs are aimed at deterrence of incidents, rather than at compensation or abatement; but no state has conducted an evaluation of the effect of its fees on carriers or safety regulation compliance.\textsuperscript{37}

The most common theme expressed in the fifty state study was that the nature of hazardous materials transportation needs to be studied more before policy can be made to increase public safety. Twenty-seven states are studying hazardous materials policy. All of those twenty-seven states are studying new policy using state agency task forces, composed of representatives of various state agencies, to oversee the process.\textsuperscript{38}

The State of Virginia is illustrative of how states are attempting to develop a hazardous waste policy. Virginia has a variety of regulations that affect the transportation of hazardous materials and has adopted restrictive regulations for its bridges and tunnels. A State Task Force, appointed by Governor Charles Robb, studied the hazardous materials threat in Virginia throughout 1985 and 1986.\textsuperscript{39}

The only clear conclusion drawn by the task force was that the agencies of the Virginia government that are responsible for hazardous materials need data about the manufacturers, shippers, carriers, commodity

\textsuperscript{36} The categories are whether the state has appointed a single agent to coordinate hazardous materials policy throughout the state, whether the state collects incident data, whether the state has conducted a risk assessment, whether the state has adopted the state hazardous materials regulations, whether the state has adopted the federal regulations in 49 CFR § 171 \textit{et seq.}, whether the state imposes fees on hazardous materials carriers, and whether the state has a right to know law.

\textsuperscript{37} Bowman, \textit{supra} note 5, at IV-1-IV-4.

\textsuperscript{38} Id.

\textsuperscript{39} See generally, G. Bowman, \textsc{Hazardous Materials Transportation Regulation in Virginia} (1987).
flow, and accidents to help them draft regulations, plan for accident prevention and emergency response, and target enforcement efforts. In Virginia, as in all states, no state agency maintains a comprehensive database on fixed facilities that handle hazardous materials, the routes on which hazardous materials travel, or accidents in which hazardous materials are involved. A variety of federal hazardous material databases exists, but the data in the federal bases are too aggregated to be very useful in a particular state like Virginia.

The widely accepted method of gathering and examining data on hazardous materials flow is the use of risk assessment techniques. Risk assessment involves estimating the frequencies and consequences of undesirable events, then evaluating the associated risk in quantitative terms. The process of risk assessment organizes thought about risks, permitting the judgments of interdisciplinary teams of experts to be integrated in a systematic way. It also helps identify risks that might not have been thought of otherwise and it motivates improvements in data collection by pointing out database deficiencies. The results of risk assessment provide knowledge essential to informed decisionmaking.

Public concern is greatest about risks that are involuntary, uncontrolled, unfamiliar, immediate, manmade, and catastrophic. Hazardous materials transportation possesses many and sometimes all of those attributes. Risk assessment can help to address two fundamental questions, one quantitative and objective, and one qualitative and subjective: What is the level of risk? Further, what level of risk is acceptable to the parties concerned? The first question is readily addressed with adequate data and proper methodology, whereas the second question involves numerous judgments and often a great deal of discussion and negotiation. This is especially true when large numbers of people and several governmental jurisdictions are involved. Professional risk assessment places heavy emphasis on quantitative results. Where policy issues are involved, however, and involuntary risks exist, such as those associated with the transportation of hazardous materials, qualitative judgments are important.

In the technical detail of risk assessment models, the question of risk acceptability is complicated further by the fact that some of the concerned parties may have risk perceptions that differ from the actual risks. Risk

40. Id.
41. Id.
42. The standard work in this area is Rowe, Risk Assessment Processes for Hazardous Materials Transportation (Transportation Research Board Report, 1983).
44. Id.
45. Id.
equity, the appropriate distribution of risks among different members of society, is another complicating factor. Factors of perception, actual risk, and equity are important policy considerations in the initial stages of developing a state hazardous material program. The Virginia data in Figure 2 suggest that the problems of hazardous material incidents is so small the preemptive governmental intervention in the area may not be warranted.46

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Incidents</th>
<th>Injuries</th>
<th>Deaths</th>
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<tr>
<td>1982</td>
<td>NA</td>
<td>32</td>
<td>1</td>
</tr>
<tr>
<td>1983</td>
<td>177</td>
<td>52</td>
<td>0</td>
</tr>
<tr>
<td>1984</td>
<td>190</td>
<td>20</td>
<td>0</td>
</tr>
<tr>
<td>1985</td>
<td>255</td>
<td>44</td>
<td>0</td>
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Figure 2

Both actual accident experience and the accident forecasts demonstrate that the number of hazardous material accidents is not great. Every day, thousands of tons of hazardous material travel through Virginia without incident. Although the possibility of a catastrophic incident in Virginia exists, it has not yet occurred (the U.S. Department of Transportation estimates that the average hazardous material incident only involves $1100 in property damage) and the best available data indicates that a catastrophe will not occur while the current level of enforcement and emergency response resources are maintained.47

The most rigorous study of how hazardous materials incidents occur reached this conclusion.48 Hazardous materials incidents are random events: the frequency of accidents is not related to the total number of non-hazardous material accidents (which occur in relation to the number of cargo-miles), the causes of the accidents are random and not representative of the overall distribution of accident causes, the number of casualties in any one year does not appear to be related to the number of accidents, and each accident is unique in its characteristics.49 In short, each hazardous material accident is a freak occurrence, which is not an ideal target for prevention by government regulation.

The respondents to the 1987 survey of state hazardous materials programs illustrated the unsuitability of current state programs to reduce the risk of hazardous materials incidents.50 All of the respondents indicated that the goal of their state policies was, in economic terms, to mini-

46. Id. at 8.
47. Id.
49. Id. at 23.
50. Bowman, supra note 5, at IV-1.
mize the transfer costs (in public safety as well as dollars) from hazardous materials incidents to their states' populations. The design of state programs (such as the establishment of user fines and fees) is appropriate for forcing the generators and carriers of hazardous material, who create the hazard, to shoulder the costs of their activity. The level of user fees and fines, however, has not produced an optimal level of risk transfer, regardless of how that level is measured.\footnote{Id. at IV-2.}

The problem can be viewed in the following illustrations borrowed from welfare economics methodology.

---

**Figure 3**

The total benefit curve in Figure 3 illustrates that increasing the commitment of resources through direct expenditure by the government (in enforcement or in emergency response) or through indirect expenditure by the private sector (in fines and user fees) will yield increasing gains in public welfare, but only up to a point (at $X_1$). More expenditure, beyond $X_1$, will produce marginally less benefit in welfare.

If viewed in conjunction with the total benefit curve in Figure 3, the cost incurred in Figure 4 yields implications for the appropriate level of public expenditure. At $X_1$, the marginal cost curve reaches its minimum, meaning that every additional increment in public expenditure will result in less benefit that the previous increment of expenditure. This is consistent with the behavior of the total benefit curve in Figure 3. At $X_1$, the amount of total benefit begins gradually to decline, even with increased commit-
ment of resources. From a cost-benefit perspective, public expenditure to this point would be optimal.

At point X2, where the average total cost of the program and the marginal cost of the program are the same, another possible optimal point is reached. The additional gain in public welfare is equal to the additional cost of the program at X2. Beyond X2, increasing commitment of resources will buy more public welfare, but the cost of the increase in safety will be greater than the gain itself. Thus, X2 is probably the most appropriate target for hazardous materials policies, since the amount of safety not directly provided by the program beyond X2 (the shaded area in Figure 3) can be increased through targeting emergency response efforts not specifically concerned with hazardous materials, such as fire department preparedness.

An absolute degree of safety is achieved at X3. At this point, hazardous materials incidents can be entirely eliminated, but only at a very high public expenditure. For instance, a ban on hazardous material transportation would eliminate hazardous materials transportation accidents, but at an unacceptable cost.

The interesting aspect of the states' hazardous materials safety programs is that most state officials, when queried about this aspect of their state's program, believe that their state's level of expenditure is somewhere to the right of X1. Thus, no state has achieved an optimal level of hazardous material safety, regardless of the criteria of safety used by the policymakers in the state.52

52. Id.
In fact, since hazardous materials accidents are random events, risk costs are equal to the expected severity of the accident.\textsuperscript{53} It is thus impossible to achieve the level of safety sought through the state regulatory programs.

At the state level, the imposition of a risk-distribution program through tort remedies is a more appropriate legal approach to controlling the risk of hazardous materials incidents than standard-setting regulation. A tort liability system, that applies sanctions after hazardous materials incidents occur, allows the risk and value of hazardous material transportation to be "priced," facilitating the most efficient allocation of transportation resources. As Professor Calabresi has pointed out:

\textit{The most desirable system of loss distribution under a strict resource-allocation theory is one in which the prices of goods accurately reflect their full cost to society. The theory therefore requires, first, that the cost of injuries should be borne by the activities which caused them, whether or not fault is involved, because, either way, the injury is a real cost of those activities. . . . Second, the theory requires that among the several parties engaged in an enterprise the loss should be placed on the party which is most likely to cause the burden to be reflected in the price of whatever the enterprise sells.}\textsuperscript{54}

This risk-distribution theory is very powerful in the hazardous materials context because the carrier is the logical party to bear the risk of the materials he carries, he is the party with the best information as to the nature of his cargo and the route over which the cargo will be carried. The result of the application of liability to carriers should be that carriers will obtain the optimal amounts of insurance to abate their risk of liability, passing the cost of the insurance along to shippers through increased carriage rates, and the shippers will increase the price of their goods to the public, spreading the risk of the hazardous transportation across society without the imposition of a standard-based regulatory system at the state level.\textsuperscript{55}

\section{Local Government Regulatory Programs}

Local governments have been the most outspoken critics of the federal regulatory regime. Many local officials believe that the federal program does not sufficiently adapt to the unique hazardous materials risks in specific local areas. As the City of Boston has written:

\begin{quote}
A major north-south interstate highway passes through the most densely
\end{quote}

\textsuperscript{53} Wolfe, supra note 48, at 1.
\textsuperscript{55} This concept is developed by Manten, supra note 6, at 371-374, but he focused only on strict liability as achieving risk-distribution results. A negligence system would also achieve the desired risk-distribution result if the fact-finders are effective at determining fault. See Posner, supra note 26, at 164; Shavell, Strict Liability versus Negligence, 9 J. LEGAL STUD. 1 (1980).
populate section of New England, that being downtown Boston. At present, no state or federal regulation restricts the use of this highway, in spite of requests by the City to both state and federal agencies. The City would prefer that a national or state plan would address this problem, but none exists. In the absence of such a state or national plan, the City has acted to reduce the dangers to people working and living within its boundaries.56

As a result, many localities have adopted their own ordinances restricting the movement of hazardous materials. The Boston ordinance is the most well-known local program. Its 1980 ordinance completely banned the transportation of hazardous materials through the city except when: (1) no practical alternative exists, or (2) Boston is the starting point or destination point of the shipment. Trucks which satisfied the exceptions were only allowed to operate during daylight hours or on special routes.57

The criticisms of state programs apply a fortiori to local regulatory schemes. Proliferation of state and local licensing, registration, and permit requirements, usually applicable to trucks, create economic externalities and can pose hardships for carriers. Aside from the impact of a requirement within the regulating state, transporters are concerned about the cumulative economic impact of these requirements and particularly about permits or licenses that must be obtained per vehicle or per trip. The latter usually increase transit time and increase the cost of carriage to shippers who are not located in the regulating locality.58

Notification requirements have been established by numerous local governments as a means for regulating hazardous waste transportation. A study conducted by Battelle Memorial Institute for DOT found that 136 localities had established laws requiring carriers to notify local officials when hazardous materials were going to be transported in the area.59 The Battelle study found that even when notification is made under these laws, local police authorities are too busy with other activities to monitor the movement of the hazardous materials shipments. Further, the proliferation of state and local notification requirements creates unsurmountable scheduling difficulties for carriers and require the hiring of large staffs by both carriers and local governments to monitor shipments.60

There is a consensus, however, that routing is an important tool for local governments to prevent or reduce the consequences of hazardous

57. Marten, supra note 6, at 355.
58. Bowman, supra note 30, at 33.
59. O.T.A., supra note 4, at 181.
60. Id.
material accidents. Increasing numbers of cities, counties, and townships across the country are adopting ordinances requiring hazardous materials carriers to use designate routes.\textsuperscript{61} Carefully made routing decisions restrict hazardous materials shipments to the safest routes, which are often interstate highways and beltways, providing a low cost prevention measure that local police can enforce without additional equipment or training. DOT has attempted to foster the adoption of routing programs at the local level.\textsuperscript{62}

Routing is an important adjunct to a regulatory program and a tort liability regime. Regulatory programs are promulgated with the assumption that they will be followed; the risk-distribution basis of tort remedies assumes that rational actors will buy the appropriate amounts of insurance. Since the deregulation of the trucking industry in the early-1980s, and the lowering of the regulatory barriers to entry in the industry, a class of carriers has emerged that challenge both regulation and tort.\textsuperscript{63} The independent truckers, who are usually impecunious and who often survive in an almost purely competitive market by not incurring the costs inherent in proper maintenance and insurance, cause most of the hazardous materials incidents in the United States.\textsuperscript{64} Thus, they are both the most risky class of carriers and the group least likely to be affected by either a regulatory or a liability-based system of hazardous materials transportation controls. Routing systems require that all hazardous materials shipments be conducted on routes with the least risk of damage in the event of an incident and provide an extra margin of public safety in relation to carriers who are not sensitive to other controls. To this extent, local routing controls are the safety net in the hazardous materials control regime.

V. Federal Court Ordering of Hazardous Materials Control Roles

Since there are different echelons of control required in the hazardous materials field, an efficient national system of hazardous materials regulation requires the delineation of clear roles for federal, state, and local governments in the area. This ordering within the federal system

\textsuperscript{61} Bowman, \textit{supra} note 39, at 33.

\textsuperscript{62} \textit{id.} To assist state and communities with the designation of routes for both radioactive and nonradioactive shipments of hazardous materials, the DOT published two guidance documents, the most important of which is the Peat-Marwick-Mitchell program in \textit{Guidelines for Applying Criteria to Designate Routes for Transporting Hazardous Materials}.

\textsuperscript{63} On the effect of deregulation in the trucking industry, see M. Derthick & P. Quirk, \textsc{The Politics of Deregulation} (1985).

\textsuperscript{64} Bowman, \textit{supra} note 39, at 29.
was not done by Congress when it passed the HMTA.\textsuperscript{65} As a result, the
task of ordering the intergovernmental relationship in the hazardous
materials area has increasingly been performed by the federal courts ap-
plying the Hazardous Materials Transportation Act.\textsuperscript{66}

The role of the federal courts in ordering intergovernmental relations
has traditionally been based on an assumption that the power of the
states was primary and that positive federal action merely overlay state
activity:

Federal law is generally interstitial in nature. It rarely occupies a legal field
completely, totally excluding all participation by the legal systems of the
states. This was plainly true in the beginning when the federal legislative
product (including the Constitution) was extremely small. It is significantly
ture today, despite the volume of Congressional enactments, and even within
areas where Congress has been very active. Federal legislation, on the
whole, has been conceived and drafted on an ad hoc basis to accomplish
limited objectives. It builds upon legal relationships established by the
states, altering or supplanting them only so far as necessary for the special
purpose. Congress acts, in short, against the background of the total corpus
juris of the states in much the way that a state legislature acts against
the background of the common law, assumed to govern unless changed by
legislation.\textsuperscript{67}

To the extent that the federal courts are only empowered to act in the
hazardous materials area under the Hazardous Materials Transportation
Act, the role of the federal courts is interstitial. In fact, the HMTA was
passed by Congress to accomplish an interstitial purpose: to close the
gaps between inconsistent regulation and "to preclude a multiplicity of
state and local regulations and the potential for varying as well as conflict-
ing regulations in the area of hazardous materials transportation."\textsuperscript{68}
However, the Act does not specifically delineate the zone of federal au-
thority in the hazardous material area: the Act delegated that responsibil-
ity to the Secretary of Transportation.\textsuperscript{69}

Since the passage of the HMTA, the DOT itself has acknowledged
that state and local action may be consistent with the Act if they do not
involve the seven elements of inconsistency delineated in the DOT's regu-
lations.\textsuperscript{70} However, nineteen inconsistency reviews\textsuperscript{71} have been under-

\textsuperscript{65} Hazardous Materials, 49 Fed. Reg. 46632, 46633 (Dep't Transp. 1984) (Inconsistency

\textsuperscript{66} National Tank Truck Carriers, Inc. v. Burks, 698 F.2d 559, 560 (1st Cir. 1983).

\textsuperscript{67} P. Bator, P. Mishkin, D. Shapiro & N. Wasshler, HART & WECHSLER'S THE FEDERAL

\textsuperscript{68} Jersey Cent. Power & Light Co. v. Township of Lacey, 772 F.2d 1103, 1113 (3d Cir.

\textsuperscript{69} 49 U.S.C. § 1802 (1982).

\textsuperscript{70} Hazardous Materials, supra note 65, 46633.

\textsuperscript{71} The HMTA authorizes the Secretary of Transportation to make inconsistency rulings as
taken by the DOT since the passage of the HMTA in 1974, and DOT has never determined that a challenged state or local program is consistent with the Act.\(^2\) So, although there may be a zone of permissible state and local activity in the field, the boundaries of that zone have not been identified by the executive branch. Thus, the interstitial gap that the federal courts have been forced to fill is expansive.

The restrictions on state and local activity have led to much litigation on the preemptive effect of the HMTA, with either a plaintiff state or local government arguing that the DOT's inconsistency ruling represented a over-restrictive reading of the HMTA or with a plaintiff carrier arguing that the HMTA prohibited a particular state or local regulation. From this procedural posture, the federal courts have been forced to identify zones of federal, state, and local authority and, thus, order intergovernmental roles in the hazardous materials area.

The federal courts have long resolved federalism questions through the preemption doctrine, which arises from the interaction between the supremacy clause of the United States Constitution and the Tenth Amendment's reservation of authority to the states to exercise all powers not delegated to the federal government. The doctrine stands for the principle that a valid exercise of the supreme federal power preempts or supersedes an incompatible state law.\(^3\)

Since most preemption issues arise under the commerce clause, the court's analysis in preemption cases is similar to commerce clause analysis,\(^4\) although most preemption cases are broader than a strict commerce clause controversy. In hazardous materials cases, the courts have applied preemption analysis.\(^5\)

The first question of a preemption analysis is whether Congress has validly established federal legislation in the hazardous material field pursuant to the powers delegated by the Constitution. It is clear that the power to regulate transportation comes from the commerce clause, the war powers clause, and the authority to promote the general welfare and to the effect of specific state and local regulations on the Act. 49 U.S.C. 1811. However, DOT has been reluctant to make inconsistency rulings because they "have the effect of contributing to an adversarial, confrontational relationship with regional entities and militate against the creation of a nationwide, consistent, hazardous materials transportation policy." U.S. DOT, 1982 ANNUAL REPORT ON HAZARDOUS MATERIALS TRANSPORTATION 40 (1983). As a result, there is believed to be concurrent primary jurisdiction vested in both DOT and the federal courts to review intergovernmental conflicts in this area. State of Rhode Island Rules and Regulations Governing the Transp. of Liquefied Natural Gas and Liquefied Propane Gas, 44 Fed. Reg. 75566, 75567 (Dep't Transp. 1979) (Inconsistency Ruling 2).

74. Id.
75. National Tank Truck Carriers, Inc. v. Burke, 608 F.2d 819 (1st Cir. 1979).
to protect the general public. Accordingly, the majority of commentators and courts have assumed valid congressional authority to regulate interstate transportation.\textsuperscript{76}

The second inquiry is whether Congress has expressly preempted state and local authority to regulate in a particular field. If compliance with both federal and state law is impossible because the laws are in conflict, no finding of congressional intent need be ascertained, and the state or local law is preempted. This principle has been acknowledged by the Supreme Court in modern times in \textit{Florida Lime \& Avocado Growers v. Paul}.\textsuperscript{77} In that case, the Court held that absent any direct conflict between federal and state law, a court must determine whether Congress has manifested an express intent to preempt state law in a given area. If Congress clearly intended to preempt the field, state law must give way to Congressional authority.\textsuperscript{78}

If no express intent is found, Congress may nevertheless have implicitly preempted state law when it creates a "scheme of regulation" in a particular field. In \textit{Rice v. Santa Fe Elevator Corp.},\textsuperscript{79} the Supreme Court said, "where the federal government, in the exercise of its superior authority in the field, has enacted a complete scheme of regulation . . . states cannot, inconsistently with the purpose of the Congress, conflict or . . . complement the federal law, or enforce additional or auxiliary regulations."\textsuperscript{80} The Court indicated that the goal in each case was to determine Congress' purpose in enacting the legislation:

Such a purpose may be evidenced in several ways. The scheme of federal regulation may be so pervasive as to make unreasonable the inference that Congress left no room for the States to supplement it. Or the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject. Likewise, the object sought to be obtained by the federal law and the character of obligations imposed by it may reveal the same purpose. Or the state policy may produce a result inconsistent with the objective of the federal statute.\textsuperscript{81}

Thus, the preemption doctrine consists of a set of unstructured principles which, as the Supreme Court admitted in \textit{Hines v. Davidowitz},\textsuperscript{82} provide no "rigid formula or rule which can be used as a universal pattern


\textsuperscript{77} 373 U.S. 132 (1963).

\textsuperscript{78} \textit{Id.} at 143.

\textsuperscript{79} 331 U.S. 218 (1943).

\textsuperscript{80} \textit{Id.} at 230.

\textsuperscript{81} \textit{Id.}

\textsuperscript{82} 312 U.S. 52 (1941).
to determine the meaning and purpose of every act of Congress." 83 The Court uses various terms in attempts to pinpoint how federal law preempts state or local law, but acknowledged, in Hines, that, "'[i]n the final analysis, there can be no one crystal clear distinctly marked formula.'" 84 However, the Court does assert that its "primary function is to determine whether . . . [state] law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" 85

The DOT's inconsistency rulings have taken a restrictive approach to state action under the HMTA. DOT inconsistency rulings are conducted under the dual compliance test first articulated by the U.S. Supreme Court in Ray v. Atlantic Richfield Co. 86

The first criterion [of inconsistency analysis] is the dual compliance or direct conflict test and concerns those State or local requirements that are incongruous with Federal requirements; that is, compliance with the State requirement causes the Federal requirement to be violated or vice versa. The second criterion is a sense subsumes the first and concerns those State or local laws that, regardless of conflict with a Federal requirement, stand as "an obstacle to the accomplishment and execution of the [HMTA] and the regulations issued under the [HMTA]." In determining whether a State or local requirement presents such an obstacle, it is necessary to look at the full purposes and objectives of Congress in enacting the HMTA and the manner and extent to which those purposes and objectives have been carried through MTB's regulatory program. 87

The DOT has applied this test to preclude all state and local hazardous materials control initiatives that have been scrutinized under the inconsistency ruling process. 88 In Inconsistency Ruling 2, which involved New York City's bridge and tunnel regulations, DOT made clear that it believes there is no state or local role in the area:

There are also certain areas where the need for national uniformity is so crucial and the scope of Federal regulation is so pervasive that it is difficult to envision any situation where State or local regulation would not present an obstacle to the accomplishment and execution of the HMTA and the Hazardous Materials Regulations. 89

A unique aspect of the law in this area is that despite legislative action in the form of the HMTA, which delegates authority in the hazardous

83. Id. at 67.
84. Id.
85. Id.
86. 435 U.S. 151 (1978).
87. IR-3, supra note 56, at 18919.
88. The dual-compliance test was specifically extended to the hazardous materials area in National Tank Carriers, Inc. v. City of New York, 677 F.2d 270 (2d Cir. 1982).
materials area to the executive branch DOT, and despite the clear holding of the DOT administrators that federal authority is plenary in the hazardous materials area, the federal judiciary has forged roles for the states and localities while protecting the plenary federal regulatory authority.

In most of the preemption litigation involving the HMTA, the courts have endorsed the executive branch position that the federal authority to set standards and promulgate regulations involving standards is exclusive. For instance, in City of New York v. DOT, the City of New York sued to enjoin the enforcement of DOT rules governing the shipment of radioactive material, eliminating the preemption of the City’s own regulations. At the District Court level, Judge Abraham Sofaer found that since it could be demonstrated that the DOT regulations promulgated under the HMTA did not “maximize” public safety, the federal regulations were not the appropriate controls to be applied in the City. Judge Sofaer looked to the comparative public safety impact of the two sets of rules rather than the intergovernmental impact. On appeal, the Second Circuit did not consider the relative effect of the two sets of regulations, but held that Congress passed the HMTA to create “a single federal authority” responsible “for overseeing the transportation of hazardous materials by all modes. This centralization was designed to achieve a comprehensive approach to reducing risk....” The judicial inquiry into public safety justifications for regulations was specifically rejected by the appeals court. They found that, “[s]uch a requirement would constitute a radical shift in regulatory policy with serious ramifications for the transportation industry. In the past, we have been extremely reluctant to hold Congress to have made such a basic change in regulatory procedure absent explicit statutory language or other clear manifestation of Congressional intent.”

The same deference to federal regulatory authority was demonstrated by the Third Circuit in Jersey Cent. Power & Light v. Township of Lacey in 1985. That case arose after the Nuclear Regulatory Commission ordered Jersey Central to remove 224 spent fuel assemblies from its West Valley nuclear demonstration project. The Township of Lacey enacted ordinances to ban the transportation of the radioactive material within its boundaries. Judge Higgenbotham’s opinion highlighted the clear intention of the federal courts to preclude state regulatory action in

92. 715 F.2d at 741.
93. Id.
94. 772 F.2d 1103 (3rd Cir. 1985), cert. denied, 475 U.S. 1013 (1986).
the area. He wrote that, "[t]he ultimate basis for DOT's Final Rule is that the public risks in transporting these materials by highways are too low to justify the unilateral imposition by local governments of bans and other severe restrictions on the highway mode of transportation." He concluded that, "the HMTA regulations preempt 'inconsistent' state and local regulations."

Recently, in *CSX Transp. Inc. v. P.U.C. of Ohio* U.S. District Judge James Graham of the District of Southern Ohio considered a suit filed by four railroads which claimed that the Ohio railroads which claimed that the Ohio railroad safety legislation passed in the wake of the 1986 Miamisburg incident was preempted by the HMTA and the Federal Railroad Safety Act. The Ohio laws set type, quantity, and container standards for the transportation of hazardous substances through Ohio by rail. The State of Ohio defended its regulations by claiming that since the rules related to hazardous materials, the state could regulate the railroads as long as the regulations were not inconsistent with the HMTA. Judge Graham rejected that argument. He wrote that:

There is no dichotomy ... between the FRSA and the HMTA, with the former limited to general railroad safety and the latter directed specifically toward the intermodal regulation of the transportation of hazardous materials. Indeed the regulation of the transportation of hazardous materials by rail is inextricably intertwined with the regulation of railroad equipment and operating procedures. The legislative history of the FRSA evidences a clear Congressional intent that rail safety regulations be nationally uniform and that all enforcement should be by federal authorities.

It is apparent from *CSX v. Ohio* that the states have little freedom to set standards for hazardous materials transportation, especially when the state standards impact on railroad safety.

However, in other recent major litigation under the HMTA, a federal court staked out an independent area of responsibility for the states. In *Borough of Ridgefield v. New York Susquehanna & W.R.R.*, several localities in New Jersey attempted to bring a civil suit in federal court to enforce the standards codified in the federal hazardous materials regulations. This was the first attempt to bring a private enforcement action under the HMTA. The Third Circuit noted that the defendant carriers

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95. Id. at 1113 (quoting 46 Fed. Reg. 5298, 5299 (codified at 49 C.F.R. pts. 171, 172, 173, 177)).
96. Id.
100. 701 F. Supp. at 612.
101. 810 F.2d 57 (3rd Cir. 1987).
102. Id. at 60.
were subject to the regulations, but the court held that damage suits for unsafe activity in the hazardous materials area are matters for state statutory and common law and must be pursued in state court. The court specifically recognized the federal ordering inherent in the hazardous materials area, stating that the "cooperative system of regulations allows municipalities to ensure a safe environment, while allowing oversight by the federal agency. In filing their complaint in district court, the Municipalities’ chose an unavailable route to ensure the safety of butane transportation by New York Susquehanna & Western." 103

The Borough of Ridgefield case extends the holding of S. Pac. Transp. Co. v. United States 104 that state liability systems are a second-tier or control in the hazardous materials area. In the well-known case Chavez v. S. Pac. Transp. Co., 105 which involved damages resulting from the explosion of eighteen box cars of bombs in a rail yard, the federal district court concluded that liability for the accident was to be assessed under California law. The transportation of hazardous materials is recognized to be an ultrahazardous activity, so the court applied the risk-distribution approach of California law, developed by Judge Traynor, 106 to hold the carrier strictly liable for the incident. Recognizing the traditional common carrier exception to the strict liability rule, 107 the Chavez court nevertheless reasoned that the exception does not apply in the hazardous materials area:

...there is no logical reason for creating a "public duty" exception when the rationale for subjecting the carrier to absolute liability is the carrier’s ability to distribute the loss to the public. Simply stated, the public pays for requiring the carrier to engage in the activity which is by nature dangerous to the public. Consequently, "the harsh impact of inevitable disasters is softened by spreading the cost among a greater population and over a longer time period." The person engaged in the hazardous enterprise is in the most suitable position to pass the cost to the public and the social and economic benefits which are ordinarily derived from imposing strict liability are

103. id. at 60.


107. RESTATEMENT (SECOND) OF TORTS § 519 states that the general rule that one who engages in ultrahazardous activity must bear absolute liability for damages resulting from that activity. However, Restatement § 521 codifies the rule of Aktieselskabet Ingrid v. Cent. R.R., 216 F. 72 (2d Cir. 1914), cert. denied 238 U.S. 615 (1915).
achieved.\textsuperscript{108}

The \textit{Chavez} approach has been adopted throughout the United States since 1978, although the question of whether enterprise liability should always be applied to hazardous materials carriers is still unsettled. Nevertheless, the federal courts have left that question, as part of a zone of responsibility for non-standard setting control of hazardous materials transportation, to the states.\textsuperscript{109}

The local governments have also been assigned a role in controlling hazardous materials shipments. In \textit{New Hampshire Motor Transp. Assoc. v. Flynn},\textsuperscript{110} the First Circuit examined New Hampshire regulations requiring permits and routing of hazardous materials highway shipments. The DOT had previously determined that the New Hampshire requirements were inconsistent with the HMTA because it believed that the rules were "inconsistent with an important federal objective" and could cause transportation delay.\textsuperscript{111} The DOT inconsistency ruling was affirmed by the District Court.\textsuperscript{112} In an approach both converse and complimentary to the Second Circuit's approach in \textit{City of New York v. DOT},\textsuperscript{113} where the appeals court did not look at the impact of challenged federal regulations before affirming them, the appeals court in \textit{Flynn} did look at the impact of the challenged state regulations before rejecting them. That analysis revealed that the permit and routing requirements did not create delays, since permits and routing were available at all times, and, as a result, the court ruled that the New Hampshire rules were not inconsistent with the federal regulatory scheme.\textsuperscript{114}

Dicta in other decisions involving routing requirements, including \textit{City of New York} and \textit{Jersey Central Power} indicate that the federal courts are willing to allow local routing requirements to coexist with the federal regulations as long as the routing requirements do not have the impact of burdening interstate commerce.\textsuperscript{115} The inquiry in routing cases focuses on the commerce clause rather than the HMTA, and the Supreme Court has often stated its deference to local regulation of highway transportation in Commerce Clause litigation. For instance, in \textit{Kassel v. Consol. Freightways}, Justice Powell wrote:

\begin{quote}
[A] state's power to regulate commerce is never greater than in matters tra-
\end{quote}

\begin{thebibliography}{9}
\bibitem{110} 751 F.2d 43 (1st Cir. 1984).
\bibitem{111} Id., supra note 89, at 75566.
\bibitem{112} 751 F.2d at 43 (1st Cir. 1984).
\bibitem{114} 751 F.2d at 51.
\bibitem{115} See Thompson, supra note 99, at 422-23.
\end{thebibliography}
ditionally of local concern. For example, regulations that touch upon safety—especially highway safety—are those that "the Court has been most reluctant to invalidate." ... Indeed, "if safety justifications are not illusory, the court will not second-guess legislative judgments about their importance in comparison with related burdens on interstate commerce." (citations omitted)\(^{116}\)

An interesting aspect of the federal case law in the hazardous materials area is that the jurisprudence, made on the basis of different facts and even in different circuits, has created a hazardous materials control regime that embraces each of the three aspects of optimal hazardous materials control: standard-setting, allocation of risk through tort liability, and routing. In establishing this system, the courts have also allocated responsibility for each area to a different level of the federal system: the national government is responsible for standard-setting and the promulgation of regulations, the states are responsible for distributing risk through their tort systems, and state and local governments are responsible for routing.

VI. CONCLUSION

In the period after Garcia v. San Antonio Metro. Transit Auth.,\(^ {117}\) it has been often noted that effective national management in many policy areas requires more than "a confectionery federalism. It needs one that is rooted in the realities—political, fiscal, administrative, programmatic, and procedural—of today's intergovernmental relations. Above all, it needs a judicial approach and theory that reflects a genuine sense of balance.\(^ {118}\)

Judge Posner has noted that federalism really only means an allocation of responsibilities among levels of government so that the diseconomies of scale associated with centralization and the externalities that are often associated with decentralization are balanced.\(^ {119}\) In the hazardous materials area, a balance, both between branches of the national government and among levels of the federal system, appears to have been achieved and, remarkably, the balance has been created by the judicial branch of the federal government—the branch considered least likely to create comprehensive programs.

\(^{117}\) 469 U.S. 528 (1985).
\(^{119}\) Posner, supra note 26, at 599-601.
Railroad Spinoffs, Labor Standoffs, and the P&LE

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I. INTRODUCTION

Labor protection has been and continues to be a major difference between employment in the transportation industry and other business sectors. Railroad employees adversely affected by their employers' mergers have enjoyed a degree of job protection unequaled in any other industry. Historically, the cost of this protection has been carried by the railroads as a cost of consolidation. However, when Congress created Conrail, some of this burden was shifted to the taxpayer.1

Labor protection was originally a voluntary provision worked out between management and labor.2 Railway labor protection was later imposed by the Interstate Commerce Commission (ICC) and still later by special statutes.3 Today, many of those statutory arrangements are being challenged as railroads aim to compete with other deregulated modes of transportation.

With the coming of partial deregulation of the transportation industry,4 support for labor protection has eroded in Congress and throughout the body politic. Observers of labor question why railroad employees enjoy more protection than, for example, displaced auto or steel workers. The reason for special treatment of railroaders and other transport em-

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1. See generally Thoms, Clear Track for Deregulation—American Railroads, 1970-1980, 12 Transp. L.J. 183 (1982). Amtrak and Conrail, both federally-sponsored systems, used subsidies payable through the Department of Transportation to provide employee protection for railroaders displaced by the creation of these systems. Thus, employee protection costs were born by taxpayers.
3. For a more detailed version of labor protection and its effect on the airline as well the railroad industry, see Thoms and Clapp, Labor Protection in the Transportation Industry, 64 N.D.L. Rev. 379 (1988).
4. See Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705 (1978), (amending 49 U.S.C., §§ 1301-1551 (1958)). This law phased out the Civil Aeronautics Board and allowed new entry and free exit from the airline business, ending the regulatory regime that was keyed to protection from competitors.
ployees is rooted in labor history. Today, however, labor protection does not command a political consensus. New legislation limits the scope and extent of labor protection in the new competitive transportation market.

Particularly important is the effect of labor agreements and labor protection provisions upon the creation of new short line railroads. Since 1980, almost 200 new short line railroads have been formed. The rise of short line railroads, operating over secondary lines spun off by Class I rail systems, brings questions of whether successor railroads are bound by labor protection requirements and may determine the viability of such carriers.

Although labor protection agreements have been found throughout the transportation industry, the focus of this article shall be limited to the relationship of rail labor protection and short line railroad development. The remainder of this article is organized in four sections. In the next section, the historical development of regulatory and legislative labor protection is presented. In section III, the results of an economic analysis which identifies the cost savings attributable to short line operation are provided. The recent Supreme Court decision in Pittsburgh & Lake Erie Railroad Company v. Railway Labor Executives' Association and related case law are considered in section IV. The final section provides a summary and conclusions.

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5. The reasons are related to the special position of rail labor brotherhoods as the "Kings of Labor" with a great deal more political power than industrial unions in the early twentieth century. The rationale for the labor protection decisions of the ICC was that the welfare of the employees in a public as well as a private interest. See Thoms and Clapp, supra note 3, at 380.


7. There is no clear definition of a "short line railroad". A definition proposed by the Association of American Railroads (AAR) is gaining acceptance. The AAR segments short lines into regional, local, and switching and terminal railroads. A regional railroad is defined to be a non-Class I, line-haul, freight railroad which operates at least 350 mile of road and/or earns at least 40 million dollars in revenue. A local railroad is defined to be a freight railroad which operates less than 350 miles of road and earns less than 40 million dollars. A switching and terminal railroad is a railroad that is not a line haul carrier. In this article, the term "short line" is broadly defined to include regional, local, and switching and terminal railroads. See also Thoms, How Long is a Short Line?, TRAINS, October 1986, p. 37.


9. As will be seen below, the ICC has been exempting short line sales from labor protection requirements since 1982. Railroad unions have supported H.R. 3332, which would extend labor protection provisions to all railroad sales and abandonments, including those to short lines which the ICC now exempts from requiring protective provisions. See Northrup, supra note 6, at 405.

II. REGULATORY AND LEGISLATIVE ACTIONS

A. THE ORIGIN OF RAIL LABOR PROTECTION AGREEMENTS

"Labor Protection" is a term of art referring to the mitigation of the effects of mergers by transportation companies upon their employees.\textsuperscript{11} Such labor protection may mandate that an employer continue a worker’s redundant job. At the very least, the employer must ensure that the employee’s economic status is not diminished by the merger or consolidation. This may involve payments for moving, retraining expenses, or cash payments.

Labor protection arrangements were first found in the railroad industry as an outgrowth of the short-lived nationalization of the rails during World War I.\textsuperscript{12} The Transportation Act of 1920\textsuperscript{13} called upon the ICC to create a plan for consolidation of the nation’s railroads into a limited number of systems.\textsuperscript{14} However, the ICC feared the effect on rail employees by closing switching yards. In addition, profitable railroads opposed the consolidation plans because of proposals to consolidate them with unprofitable railroads.\textsuperscript{15} Gradually, the Commission backed away from the Transportation Act’s consolidation mandate.\textsuperscript{16}

The first statute dealing specifically with labor protection conditions was the Emergency Railroad Transportation Act of 1933 (ERTA).\textsuperscript{17} ERTA froze rail employment at the May 1933 level for 3 years.\textsuperscript{18} Rather than providing the severance and displacement allowances found in today’s labor protection provisions, ERTA had the effect of postponing large-scale layoffs during the worst years of the depression.\textsuperscript{19}

In 1934, the ICC began to attach labor protection conditions to those

\begin{itemize}
  \item \textsuperscript{11} Braniff Master Executive Council v. Civil Aeronautics Bd., 693 F.2d 220, 222 (D.C. Cir. 1982). See generally 49 U.S.C.A. § 11347 (West Rev. 1986). The term "labor protection" is found in the statutes authorizing regulatory approval of mergers of carriers as one of the criteria of public interest.
  \item \textsuperscript{12} The railroads were nationalized for a brief period during World War I and operated as a consolidated system. They were returned to private ownership in 1920, but interest in economies spurred enthusiasm for rail mergers. See Ris, supra note 2, at 511.
  \item \textsuperscript{13} Transportation Act of 1920, Pub. L. No. 66-152, 41 Stat. 456, 481 (1921).
  \item \textsuperscript{14} id. The Ripley Plan, calling for consolidation of the nation's railroads into 19 systems, was never adopted. Consolidation of Railroads, 63 I.C.C. 455 (1921). A subsequent plan, calling for two major systems in the East and three major systems in the West, was adopted eight years later, but never came into force. See Consolidation of Railroads, 159 I.C.C. 522, 558, 567 (1929); see also Ris, supra note 2, at 513-14.
  \item \textsuperscript{15} See Keeler, RAILROADS, FREIGHT AND PUBLIC POLICY, 26 (1983).
  \item \textsuperscript{16} See Daggett, PRINCIPLES OF INLAND TRANSPORTATION, 584-606 (2d ed. 1934).
  \item \textsuperscript{17} Emergency Railroad Transportation Act of 1933, Pub. L. No. 73-68, 48 Stat. 211, 214 (1933) (codified as amended at 45 U.S.C. §§ 661-669 (1982)).
  \item \textsuperscript{18} id.
  \item \textsuperscript{19} Labor unions had pushed for this legislation to protect its members from unemployment; it was passed as an emergency measure. See Ris, supra note 2, at 519-520.
\end{itemize}
mergers it did approve.\textsuperscript{20} Faced with the reality of ICC conditions mandating labor protection and the expiration of ERTA, a conference of railroads and unions held in Washington in 1936 crafted the Washington Job Protection Agreement. This agreement became the basis for most modern labor protection conditions in railroad and airline consolidations. Obviously, the railroads would prefer having no labor protection conditions at all, since the burden of compensating the laid-off workers rests with the carriers. However, both the railroads and their unions preferred to work out their own agreement, rather than have one imposed upon them. The Washington Agreement provided for compensation for dismissed employees, allowances for those displaced from higher positions, moving expenses entailed in taking jobs in new locations, and retention of fringe benefits.\textsuperscript{21} Eighty-five percent of the nation’s railroads signed the Washington Agreement.\textsuperscript{22}

Labor and management, working together, could always establish labor protection provisions on their own. Until 1939, however, a question remained as to the ICC’s authority to impose labor protection conditions under its mandate, which required consideration of the public interest in mergers.\textsuperscript{23} In that year, the Supreme Court ruled, in \textit{United States v. Lowden},\textsuperscript{24} that the ICC could require labor protection along the lines of the Washington Agreement without specific statutory authority.\textsuperscript{25} This decision allowed the ICC to begin to impose conditions modeled upon the Washington Agreement.

\textbf{B. ICC MANDATED LABOR PROTECTION}

When Congress considered the Transportation Act of 1940,\textsuperscript{26} its major concerns were the depression and unemployment.\textsuperscript{27} Merger plans then before the ICC would possibly affect 200,000 to 400,000 railway

\begin{thebibliography}{9}
\bibitem{}See \textit{Chicago, R.I. \\& P. Ry. Trustees Lease}, 230 I.C.C. 181 (1938). \textit{See also} \textit{Ris, supra} note 2, at 516.
\bibitem{}\textit{Chicago, R.I. \\& P. Ry.}, 230 I.C.C. at 187. It was determined by the ICC that the “public interest” included railway workers as involved members of the public with a vital interest in the continuation of certain operations of the railroads.
\bibitem{}\textit{U.S. v. Lowden}, 308 U.S. 225 (1939). This case involved a railroad merger, wherein the ICC required labor protection provisions as a condition of the merger. Opponents of labor protection stated that the ICC had no statutory authority. The Court stated that requiring labor protection could be considered as part of the statutory merger criteria of “public convenience and necessity.” Congress later gave the ICC specific statutory authority.
\bibitem{}See \textit{Ris, supra} note 2, at 519-520. \textit{Ris states, inter alia,} that “[a]ny discussion of the legislative history behind the 1940 Act cannot overemphasize the importance of the Depression

jobs. Most of these jobs were held by men between the ages of 45 and 60, whose chances of reemployment were slim. In contrast, the railroads viewed mergers as an important means of reducing operating costs.\textsuperscript{28}

The Transportation Act of 1940 required that the Interstate Commerce Commission approve railroad mergers or consolidations.\textsuperscript{29} The Transportation Act of 1940 also established a statutory obligation on the ICC to provide labor protection in merger cases.\textsuperscript{30} The Interstate Commerce Act\textsuperscript{31} (title I of the Transportation Act of 1940) required a fair and equitable arrangement which would result in no employee being placed in a worse position for up to four years.\textsuperscript{32} The exact length of time depended upon the railroader's length of services with the merging carrier.\textsuperscript{33}

In a series of rail merger cases, the ICC mandated certain standards for employee protection. Because the leading such case arose from the 1952 consolidation of the passenger stations in New Orleans, these requirements became known as the "New Orleans conditions."\textsuperscript{34} The issue for the ICC in the New Orleans Union Passenger Terminal Case\textsuperscript{35} was what job protection should be afforded railroad workers affected by railroad mergers. The ICC determined that railroad workers should receive the labor protection provisions as set forth in the Washington Agreement.\textsuperscript{36}

The New Orleans conditions mandated that an employee furloughed as a result of a merger would receive a monthly dismissal allowance equal to his average monthly compensation before the merger. This compensation was to be paid over a four year protection period. Employees bumped to a lower-paying job would receive a monthly allowance to make up the difference between the old and the new wage. Other New Orleans conditions included reimbursement for moving costs and recovery for losses from the sale of homes.\textsuperscript{37}

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\textsuperscript{28} See generally KEELER, supra note 15, at 124-28.
\textsuperscript{29} 49 U.S.C. § 11343 (1980).
\textsuperscript{32} Id.
\textsuperscript{33} Id.
\textsuperscript{34} New Orleans Union Passenger Terminal Case, 282 I.C.C. 271 (1952). Construction of a consolidated rail terminal in New Orleans involved the abandonment of several older stations and a considerable amount of track. ICC treated this as a merger case and imposed labor protection on the participating railroads.
\textsuperscript{35} 282 I.C.C. 271 (1952).
\textsuperscript{36} Id. at 281.
\textsuperscript{37} Id. Such compensation was important, because when railroad division points are elimi-
Two limitations to the Washington Agreement conditions were made by the ICC in *New Orleans*. First, employee benefits were reduced to the extent that the employee received compensation from other employment or unemployment insurance.\(^{38}\) Second, employees adversely affected by a consolidation before May 17, 1952 (four years from the date of the ICC's order approving the merger) were to receive as a minimum the major protection afforded by the Oklahoma conditions.\(^{39}\)

The Oklahoma conditions differed from the Washington Agreement in two ways. First, employees received 100 percent protection under the Oklahoma conditions while under the Washington Agreement the level of payment was contingent upon years of service.\(^{40}\) Second, the Oklahoma conditions continued for four years from the date of the ICC's order while payments under the Washington Agreement went into effect from the date of the adverse effect and continued for a maximum of five years.\(^{41}\) If the total compensation received under the Oklahoma conditions was less than that under the Washington Agreement, the employee was to receive the compensation according to the Washington Agreement.\(^{42}\) Thus, the *New Orleans* conditions judicially enacted many of the labor protection provisions for railroaders affected by mergers.

From 1956 to 1971 there was a steady stream of merger applications before the ICC.\(^{43}\) With the ICC adopting a more lenient policy towards mergers, there were many reasons why long-time competitors decided to merge. Prominent among them were the economies of scale resulting from a larger system, the economics of running long freight trains over long distances in the diesel age, the elimination of duplicate facilities, and attempts to better meet truck competition.\(^{44}\)

Assuming that the ICC would require labor protection anyway, many of the post-1956 mergers included voluntary labor protection agreements arranged between the carriers and unions. This type of agreement was viewed by rail management as insurance for the withdrawal of labor's opposition to the merger before the ICC and the courts. In the Norfolk & Western, Penn Central, and Burlington Northern mergers,\(^{45}\) the carriers

\(^{38}\) *Id.* at 282.

\(^{39}\) *Id*.

\(^{40}\) *Id.* at 275.

\(^{41}\) *Id*.

\(^{42}\) *Id*.

\(^{43}\) KEELLER, supra note 15, at 36.

\(^{44}\) *Id.* at 124-128.

agreed to reduce jobs only by "attrition", meaning not replacing retirees or those who quit the railroad. In effect, this guaranteed some employees lifetime jobs.

C. STATUTORY LABOR PROTECTION

In addition to the labor protection provisions of the Interstate Commerce Act, Congress has mandated labor protection in several special statutes. These include the labor protection provisions attached to the creation of Amtrak and Conrail, and provisions attached to the Milwaukee Road and Rock Island reorganizations. As a result, the ICC has modified the job protection it provides in merger cases.

1. THE RAIL PASSENGER SERVICE ACT OF 1970

The Amtrak labor protection provisions were mandated by the Rail Passenger Service Act of 1970. This act established the National Railroad Passenger Corporation (Amtrak) to take over the operation of the nation's intercity passenger trains. The act also directed that railroads relieved of their passenger service must provide labor protection to their displaced passenger employees.

Based on the New Orleans Agreement, the act greatly expanded the labor protection provisions for displaced Amtrak employees. For example, the burden of proof was shifted from the worker to the railroad to prove that the assumption of passenger service by Amtrak was not the cause of the employee's displacement. The length of protection was

cases merged several large carriers in the East, the last merged several Western transcontinental lines into today's Burlington Northern system.

46. "Attrition" has also meant that the carriers would not lay off large numbers of employees. Usually, workers with more seniority bid into jobs. Thus, the senior trainman would then get the job of the departing railroad. See Dempsey and Thoms, Law and Economic Regulation in Transportation, 303 (1986).


48. Id.

49. Id. Rail passenger traffic declined as a result of air competition and the completion of the interstate highway system. Over twenty percent of the passenger trains were in dissolution proceedings before the ICC in 1970. Amtrak was created to avoid a national transportation crisis. See Thoms and Clapp, supra note 3, at 385.

50. 45 U.S.C. § 565(a) and (c) (1982).

51. See New Orleans Union Passenger Terminal Case, 282 I.C.C. 271 (1952); see supra notes 34-42 and accompanying text.

52. See New York Dock Ry. v. U.S., 609 F.2d 83, 89 (2d Cir. 1979), aff'd I.C.C. dec., see 354 I.C.C. 999 (1978), 360 I.C.C. 60 (1979); New Orleans Union Passenger Terminal Case, 282 I.C.C. 271, 282 (1952). In 1971, pursuant to the statutory authority of the Rail Passenger Service Act, the Secretary of Labor certified a labor protection agreement known as Appendix C-1, which shifts the burden from the employee to the employer to prove the factors of the employee's worsened position. New York Dock, 609 F.2d at 89, 45 U.S.C. § 565 (1982).
increased from four to six years, its base date being the time of employment displacement. A displaced worker was also given the option of receiving a lump-sum settlement in lieu of the monthly dismissal allowance. In addition, moving benefits were further expanded. In no case could the benefits be less than those provided by the Interstate Commerce Act.

The Rail Passenger Service Act labor protection was limited only to Amtrak's assumption of rail passenger service and private carrier's discontinuance of passenger trains. In later mergers and abandonments the ICC based labor protection on the Amtrak provisions and the New Orleans conditions. For example, in New York Dock Railway v. United States, labor protection provisions for the merger of two Class III terminal railroads in New York City were based on both the New Orleans conditions and the Rail Passenger Service Act. The Second Circuit expanded the Rail Passenger Service Act protective conditions to include the Appendix C-1 provisions. The Second Circuit, however, denied railroaders double recovery of pyramiding of benefits.

The labor protection provisions established by the Second Circuit have become known as the "New York Dock conditions." In general, they are significantly more protective of rail labor interests than any previously imposed set of conditions. The major difference is the New York Dock conditions include the upgrading of monthly compensation for displaced employees. The New York Dock conditions are now the standard protective conditions imposed by the ICC.

2. The Regional Rail Reorganization Act of 1973

The most extensive and controversial labor protection plan is found in subchapter V of the Regional Rail Reorganization Act of 1973 (3R Act).
Act), the Act which established Conrail. The 3R Act was enacted in response to the bankruptcies of seven eastern railroads. Subchapter V of the 3R Act authorized 250 million dollars for labor protection, reimbursing Conrail and its predecessor railroads for displacement allowances and job protection payments.

The 3R Act imposed labor protection at a level higher than the normal ICC standard; Subchapter V was designed to gain the support of labor for the creation of Conrail. All employees of Conrail and its predecessors were to receive the same labor protection that employees were awarded in the merger of the Penn Central and Erie Lackawanna railroads. All Conrail employees with five years seniority with the predecessor railroad received job protection until age 65. The job protection included a monthly displacement allowance equal to the average 1974 monthly salary (increased to reflect general wage hikes), a severance benefit of up to 20,000 dollars in lieu of continued employment, and certain fringe and relocation benefits.

The 3R Act appropriation for the labor protection was soon spent. An additional 235 million dollars was appropriated in the Staggers Rail Act of 1980. However, it was made clear that when that money was gone, Conrail would have to fund the labor protection costs from its own revenues.

3. **Railroad Bankruptcies and Labor Protection**

Labor protection benefits diminished with the reorganization of the Chicago, Milwaukee, St. Paul & Pacific Railroad and the liquidation of the Chicago, Rock Island & Pacific Railroad. Congress responded with two

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65. *id.*


73. After abandonment of over 2/3 of its system, the Milwaukee was sold to the Soo Line. The Rock Island was liquidated with its tracks either torn up or sold to other railroads. See Thoms and Clapp, *supra* note 3, at 389.
restructuring laws that included labor protection terms that were imposed at levels lower than the ICC standard.

The Milwaukee Railroad Restructuring Act\textsuperscript{74} provided former employees of the Milwaukee Road the option of receiving either eighty percent of straight-time salary for up to three years or a lump-sum payment not to exceed 25,000 dollars.\textsuperscript{75} The Rock Island Railroad Transition and Employee Assistance Act of 1980 (RITA)\textsuperscript{76} provided similar reduced benefits for the employees of the Rock Island.

The Rock Island labor protection provisions were further diminished by the bankruptcy court.\textsuperscript{77} The court refused to implement the labor protection provisions of RITA because it reasoned that such claims would become a senior claim against the estate of the Rock Island.\textsuperscript{78} Since the trustee is obligated to preserve the estate of the creditors, the court concluded that the imposition of labor protection provisions would amount to an unconstitutional taking of the estate.\textsuperscript{79}

4. \textit{The Northeast Rail Services Act of 1981}

With the advent of the Reagan administration and a Republican majority in the Senate, attitudes towards subsidies for Amtrak and Conrail and labor protection shifted.\textsuperscript{80} The Northeast Rail Services Act (NERSA),\textsuperscript{81} part of the Budget Reconciliation Act of 1981,\textsuperscript{82} resolved some of Conrail’s operational problems.\textsuperscript{83} The objective was to improve Conrail’s financial picture in anticipation of a future sale.\textsuperscript{84} In addition, Conrail was relieved of many of its labor protection costs.\textsuperscript{85}

NERSA directed the Secretary of Labor to devise a new labor protection provision that would provide termination allowances not to exceed

\begin{footnotesize}
\begin{enumerate}
\item Railway Labor Executives’ Ass’n v. Gibbons, 455 U.S. 457 (1982).
\item Id. at 463.
\item Id.
\item See Thoms and Clapp, supra note 3, at 390-91.
\item See Thoms and Clapp, supra note 3, at 391.
\item 45 U.S.C. §§ 1102(2), 1103 (1982) (NERSA transferred some of Conrail’s commuter service responsibilities in order to provide Conrail the opportunity to become profitable).
\end{enumerate}
\end{footnotesize}
25,000 dollars per employee. Employees were to be offered either a permanent position with Conrail or a separation allowance of up to 25,000 dollars. NERSA also specified how Conrail could eliminate certain fireman and brakeman positions. In addition, NERSA mandated the creation of a central hiring roster of former Conrail, Milwaukee Road, and Rock Island employees for preferential hiring by other railroads. Similar labor protection relief was also provided to Amtrak.

D. CONCLUSION

Government insistence on labor protection is a result of a long history of federal involvement in railroad labor policy, ICC policies encouraging rail consolidation, Congressional concern about unemployment, and politically assute rail unions. However, job protection for railroad employees has been curtailed in recent years. Congress appears to be less fearful of the political power of rail unions. Unfair though it may be, public sentiment appears to regard rail employees as holding sinecures—and public perceptions are often the basis for legislative policy.

It is clear that what Congress gives, Congress may take away. If a Congressional statute gave lifetime job protection to rail employees, Congress may later modify or eliminate such protection by statute as well. For example, the labor protection provisions of NERSA being limited in amount (25,000 dollars) and duration, are much less favorable than that of previous laws.

Further restrictions to labor protection have occurred with the ICC's decision not to require labor protection in short line sales. The economic rationale for short line sales introduces additional factors further complicating rail labor protection. Thus, before reviewing the legal issues revolving around labor protection and short line sales, the economic factors underlying the creation of short line railroads shall be considered.

87. Id.
88. Id. at § 797(a), (d) (1982).
89. Id. at § 797(c) (1982).
90. Id. at § 797(d) (1982).
92. Organized labor now contains less than seventeen percent of the work force. See Thomas and Clapp, supra note 3, at 390.
III. THE ECONOMICS OF SHORT LINE RAILROADS

A. THE DOWNSIZING OF THE CLASS I RAILROAD

The merger movement from the 1960s to the 1980s left the country with the largest Class I railroad systems in history. During the past decade, however, Class I railroads as an industry have been shrinking. Beginning in the late 1970s, Class I railroads aggressively reduced their systems through abandonment and short line sales.\(^94\) In 1978, Class I railroads owned 177,710 miles of road. By 1987, the miles of road owned by Class I carriers had fallen to 132,220 miles (a 25.6 percent decrease).\(^95\)

The passage of the 4-R Act\(^96\) and the Staggers Act\(^97\) greatly eased the abandonment process. For example, the Staggers Act imposed stringent time deadlines on the disposition of abandonment cases.\(^98\) Moreover, if the application was unopposed, the Act required the ICC to approve abandonment within 30 days.\(^99\) From 1978 to 1987, the ICC granted certificates of abandonment for 27,971 miles of road (Table 1).

Abandonment has been the traditional means of disposing of excess lines. More recently, Class I railroads have also been downsizing by selling lines to short line operators. From 1978 to 1988, 19,083 miles of road were sold to short lines (Table 1). In part, Class I's prefer the short line alternative because the property can be sold in its entirety without the associated salvage costs and the expense of selling land parcel by parcel.\(^100\)

There are two different strategies motivating the sale of profitable lines: divestment or establishing a low cost feeder line.\(^101\) Divestment was attempted by the Illinois Central Gulf (ICG). After having absorbed the parallel Gulf, Mobile & Ohio, the Illinois Central Gulf then either aban-

\(^{94}\) A few lines were also taken over by states, which then proceeded to find a designated operator to run them. Twenty-six states have set up rail authorities to purchase otherwise abandoned railroads. See Levine et al., STATISTICS OF REGIONAL AND LOCAL RAILROADS, 67, 77 (1988). Although New York and West Virginia have also operated railroads, most states have found designated operators for the service. See Dempsey and Thoms, supra note 46, at 277-281.

\(^{95}\) ASSOCIATION OF AMERICAN RAILROADS, RAILROAD FACTS 1988, 42 (1988).


\(^{99}\) Id.


\(^{101}\) Id.
TABLE 1. MILES OF ROAD ABANDONED, AND MILES OF SHORT LINE CREATED, 1978-1988

<table>
<thead>
<tr>
<th>Year</th>
<th>Miles of Road Abandoned</th>
<th>Short Lines Created</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>2,417</td>
<td>368</td>
</tr>
<tr>
<td>1979</td>
<td>2,873</td>
<td>284</td>
</tr>
<tr>
<td>1980</td>
<td>2,321</td>
<td>1,578</td>
</tr>
<tr>
<td>1981</td>
<td>1,352</td>
<td>587</td>
</tr>
<tr>
<td>1982</td>
<td>5,151</td>
<td>1,470</td>
</tr>
<tr>
<td>1983</td>
<td>2,454</td>
<td>341</td>
</tr>
<tr>
<td>1984</td>
<td>3,083</td>
<td>1,506</td>
</tr>
<tr>
<td>1985</td>
<td>2,343</td>
<td>2,620</td>
</tr>
<tr>
<td>1986</td>
<td>1,417</td>
<td>3,551</td>
</tr>
<tr>
<td>1987</td>
<td>1,703</td>
<td>6,674</td>
</tr>
<tr>
<td>1988</td>
<td>2,857</td>
<td>104</td>
</tr>
<tr>
<td>TOTAL</td>
<td>27,971</td>
<td>19,083</td>
</tr>
</tbody>
</table>


doned lines or turned them over to short lines.¹⁰² The ICG's goal was to streamline its system through short line sales to create a core system of lines between Chicago and New Orleans and make the system an attractive acquisition.¹⁰³

Other railroads are seeking to establish low-cost feeder systems. Feeder line sales are motivated by a desire to:

1) eliminate the burdens of ownership (high operating and maintenance costs, etc.), 2) recover some economic value from the line (sales price), and
3) preserve the benefits associated with ownership (access to traffic originated or terminated on the lines).¹⁰⁴

Whether the sale is motivated by divestment or as a feeder line, the question remains why can a short line railroad successfully operate failed Class I lines? One reason is local ownership and management.¹⁰⁵ Another is better service to community needs.¹⁰⁶ However, a major reason

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¹⁰². Since 1975, twenty regional and local railroads totaling 3995 miles of road have been spun-off by the Illinois Central Gulf. Levine et al., supra note 94, at 56.

¹⁰³. See Mielke, supra note 100, at 140. Apparently the divestment strategy was successful. In March 1989, the ICG was sold to the Prospect Group and its name changed to the Illinois Central Transportation Company (the "Main Line of Mid-America" is back to its original name, the name on the engine that Casey Jones rode to glory.)

¹⁰⁴. Id. at 141.

¹⁰⁵. See Ex Parte 392, I I.C.C. 2d at 813.

¹⁰⁶. Id. See also Dooley and Rodriguez, Rail Services Levels for Grain Shippers Under Class I and Short Line Ownership, 29 J. TRANSP. RES. FORUM, 86 (1988); see Interstate Commerce Commission, A Survey of Shipper Satisfaction with Service and Rates of Shortline and Regional Railroads, (1989).
for the rush to short lines railways is that operators see a chance to reduce operating costs—in particular labor costs.\(^{107}\)

Little research is available which addresses the effect that short lines have upon railroad operating costs. As part of the North Dakota Rail Services Planning Study, the costs of operating a set of light density branch lines under Class I ownership and as a short line railroad were estimated.\(^{108}\) After briefly reviewing the costing model, the results of the case study will be analyzed.

\section*{B. The Short Line Costing Model}

The costing method consisted of two principle steps. First, methodologies for estimating both Class I carrier costs on light density lines and short line railroad costs were developed and translated into computer models.\(^{109}\) Second, the models were applied to a network of light-density lines in North Dakota.\(^{110}\)

The model employs a systems approach or perspective. System costs and revenues were estimated for the rail network under two different scenarios. Under the first scenario, the network of lines was analyzed as a light density subsystem of the Burlington Northern’s (BN) network. In the second scenario, the same set of lines was analyzed as the short line component of a feeder system.

System costs were defined to consist of two basic components, on-line and off-line costs. On-line costs comprise the operating, capital, and opportunity costs associated with serving and maintaining the set of light-density lines, and on-line costs consist of both variable and fixed components. Off-line costs reflect the variable expense associated with moving the traffic generated from the light-density network over other parts of the Class I carrier’s network.

Under the BN scenario, on-line costs were calculated to reflect the train operating and work-rule environment, and fixed cost characteristics of a Class I carrier. Under the short line scenario, on-line costs were estimated to reflect the potential labor economies and scale of operation of a short line railroad. Under both scenarios, system costs are the sum of the on-line fixed and variable costs and the off-line variable costs.

System revenues are the revenues generated by the traffic originat-

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\(^{107}\) \textit{Ex Parte} 392, 1 I.C.C. 2d at 815. If labor protective conditions are imposed, the economic justification for the transfer of a line is diminished if not negated.


\(^{110}\) A network of lines similar to the light density lines subject of the analysis was sold by the Burlington Northern to the Red River Valley & Western in July 1987.
ing or terminating on the network of lines. System revenues were determined for each scenario by multiplying the Class I carrier's rates for each commodity, market, and service level by the volume of traffic. System revenues are compared to system costs under each alternative to determine the operating profit or loss.

The estimation of on-line costs for the BN consisted of a three-step process.\textsuperscript{111} First, a series of unit costs were calculated from the accounting and operating data contained in BN's 1986 R-1 report.\textsuperscript{112} Second, annual levels of activity or "service units" were estimated for the network of lines through the use of an operating model. Third, the annual service units were multiplied by the unit costs to yield on-line expenses. In each case, an expense item (e.g. locomotive fuel) was divided by an output measure (e.g. locomotive hours) to produce a unit cost (e.g., fuel per locomotive hour). In addition to the R-1 unit costs, a normalized maintenance of way and net liquidation value were calculated per mile of track. These unit costs reflect the light-density nature of the set of line segments and regional considerations such as the value of land.

In calculating the BN service units, the network of lines was organized into way train routes based on existing classification points and BN timetables. Discussions with short line management provided similar information for the short line. Mileages from each station to the classification yard, as well as round trip way train miles were estimated from timetables and distance tariffs. Two types of way train service were modeled, assigned or scheduled way train service and unassigned or on-demand service. Large multiple-car and trainload consignments were assumed to receive unassigned way train service. Single car and small multiple-car shipments were assumed to be spotted and pulled during assigned way train service. The frequency of scheduled way train service for each route was obtained from BN trainmasters.\textsuperscript{113}

The general methodology for developing short line operating costs was to adjust Class I operating costs on a unit cost basis to reflect the expected differences in labor costs and operating characteristics of a smaller, more flexible railroad. Information was provided by a survey of short line railroads and personal interviews with short line management, BN officials, and rail labor representatives.

\textsuperscript{111} The on-line unit costs used in this study closely follow the cost categories and definitions prescribed by the ICC in \textit{Ex Parte} No. 274 (Sub. No. 11), Abandonment Regulations-Costing, 3 I.C.C. 2d 340 (1987).

\textsuperscript{112} Most of the operating unit costs were calculated from BN's R-1 Annual Report to the I.C.C., using Schedule 755 (Operating Statistics), Schedule 415 (Equipment Expenses), and Schedule 410 (Railway Operating Expenses).

\textsuperscript{113} The frequency of service was assumed to be the same for both the Class I and short line operation. Further research indicates that the frequency of service increases with short line ownership. See Dooley and Rodriguez, supra note 106, at 91.
C. CASE STUDY RESULTS

Costs were estimated for nine components of rail operations. These are train crew, locomotive, freight car, transportation, maintenance of way, administrative, property taxes, opportunity cost on net liquidation value, and other costs.\textsuperscript{114} Cost components of the analysis were aggregated and compared for the BN and short line systems. Large differences in absolute and percentage terms were noted for several of the major cost categories. Results of the model are presented in Table 2.

**Table 2. Cost Comparison of Burlington Northern Railroad and Short Line Railroad by Component of Cost of Operation\textsuperscript{a}**

<table>
<thead>
<tr>
<th>Cost Component</th>
<th>Burlington Northern Railroad</th>
<th>Short Line Railroad</th>
<th>Percent Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Train Crew Costs\textsuperscript{b}</td>
<td>2,221,350</td>
<td>543,716</td>
<td>-75.5</td>
</tr>
<tr>
<td>Locomotive Costs\textsuperscript{c}</td>
<td>1,187,996</td>
<td>1,369,562</td>
<td>-15.3</td>
</tr>
<tr>
<td>Car Costs\textsuperscript{d}</td>
<td>1,087,633</td>
<td>993,906</td>
<td>-8.6</td>
</tr>
<tr>
<td>Transportation Costs\textsuperscript{e}</td>
<td>582,635</td>
<td>336,289</td>
<td>-42.3</td>
</tr>
<tr>
<td>Maintenance of Way Costs</td>
<td>2,338,000</td>
<td>1,990,640</td>
<td>-14.9</td>
</tr>
<tr>
<td>Administrative Costs</td>
<td>104,203</td>
<td>434,000</td>
<td>+316.5</td>
</tr>
<tr>
<td>Property Taxes</td>
<td>303,270</td>
<td>303,270</td>
<td>-</td>
</tr>
<tr>
<td>Opportunity Costs on</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Liquidation Value</td>
<td>2,337,905</td>
<td>1,479,687</td>
<td>-36.7</td>
</tr>
<tr>
<td>Other Costs</td>
<td>61,799</td>
<td>250,000\textsuperscript{f}</td>
<td>-</td>
</tr>
<tr>
<td>Total On-branch Costs</td>
<td>10,224,792</td>
<td>7,701,072</td>
<td>-24.7</td>
</tr>
<tr>
<td>Total Off-branch Costs</td>
<td>12,305,560</td>
<td>12,305,560</td>
<td>-</td>
</tr>
<tr>
<td>Total Revenue</td>
<td>22,741,824</td>
<td>22,741,824</td>
<td>-</td>
</tr>
</tbody>
</table>

\textsuperscript{a} Costs were estimated assuming a 15.8 percent cost of capital for freight cars, for locomotives, and fixed roadway expenses for the BN and a 10.0 percent cost of capital for the short line.
\textsuperscript{b} Includes wages, fringe benefits, alimony and crew night costs.
\textsuperscript{c} Includes locomotive repairs, depreciation/rentals/leases, return on investment, servicing, fuel, overhead, and machinery.
\textsuperscript{d} Includes car-day and car-mile costs.
\textsuperscript{e} Includes train inspection/lubrication, dispatching, crossing protection and signal/interlockers costs.
\textsuperscript{f} Includes opportunity cost on working capital and insurance costs.

The largest decrease in costs came from short line train crew savings. Cost reductions of 1.68 million dollars, or 75.5 percent, were realized as a result of crew size reductions and a lower wage rate. Maintenance of way costs were reduced by 350,000 dollars (15 percent), while transportation costs (other than crew costs) dropped by 250,000 dollars (42 percent). Administrative costs, however, increased sharply by

114. For a detailed discussion of the costs, see Tolliver, supra note 109.
over 300 percent. This higher overhead expense proportion makes intuitive sense because of the higher fixed cost nature of short line operations. The larger traffic base characteristic of the Class I carrier is simply not present on the short line network.

Total on-branch system costs for the short line operator were 2.5 million dollars less than for the Class I carrier, a reduction of 24.7 percent. Total off-branch costs and total revenues are identical for both systems. From a profitability perspective, the Class I carrier is barely able to recover total on-branch and off-branch costs at existing traffic levels and specified costs of capital. For the same traffic base, the short line operator earned a profit of 2.7 million dollars.\textsuperscript{115}

The model illustrates that major cost differences exist between short line and Class I operations in the areas of train crew wages, locomotive costs, and administration. Short lines have lower labor costs as a result of lower wage rates, fewer fringe benefits, less restrictive work rules, and smaller crew consists.\textsuperscript{116}

In summary, the economic analysis presents several important implications for policy makers. First, low rates of return on light density branch lines may lead Class I railroads to abandon lines if they are not sold. The sale of light-density lines to short line operators is an alternative to preserve branch line trackage. In turn, this will provide continued rail service to the shippers on these lines. Second, the development of short line railroads may enhance the economic viability of both Class I and short line operators. Because of lower operating costs, short line operators may be able to earn a higher return on investment than a Class I carrier would on the same light-density network. At the same time, the Class I carriers' earnings should be enhanced if marginally profitable rail line segments can be spun off. Third, the higher profitability of short line operators may mean that more dollars are available and allocated to maintaining the track, roadway, and structures.\textsuperscript{117} Thus, short line development may also serve to lessen or eliminate deferred maintenance on light-density lines.

\textsuperscript{115} An increase in the frequency of service most likely also increases the volume of traffic, and hence revenue. Thus, the revenue projection for the short line should considered to be a conservative estimate. See Dooley and Rodriguez, supra note 106, at 92.


\textsuperscript{117} However, a recent report concluded that deferred maintenance and delayed capital improvements are a problem for 57 percent of the short lines. See Fed. Railroad Admin., U.S. Dept. of Transp., Deferred Maintenance and Delayed Capital Improvements on Class II and Class III Railroads, 47 (1989).
IV. LABOR PROTECTION AND SHORT LINE RAILROADS

A. Ex Parte 392

Since 1985, the Commission has refused to impose labor protection on acquisition cases other than mergers or consolidations. The Staggers Rail Act gave the ICC the authority to exempt a railroad transaction from the requirements of the Act when ICC regulation is not necessary to carry out the policies of Congress. The fundamental purpose of the exemption process was to allow the ICC to grant exemptions from the act where deregulation would be consistent with the policies of Congress. Under Ex Parte 392, the ICC provided an abbreviated procedure for non-carriers to acquire railroads. In addition, labor protective provisions were not imposed in these cases.

The ICC’s decision in Ex Parte 392 led to an acceleration in the number of short line sales. Frustrated with the failure of years of nationwide labor-management bargaining to reduce labor costs, many of the nation’s Class I railroads turned to short line sales. Other railroads tried to lease rail lines to non-union subsidiaries or subsidiary lines which already had a labor contract more favorable to management. For example, Guilford Transportation attempted to lease the entire Boston & Maine, Maine Central, and Delaware & Hudson railroads to the Springfield Terminal, a former trolley line in New England.

In response, rail labor brought two general issues regarding labor protection in short line spinoffs before the courts. First, must a selling carrier bargain about labor protection in an Ex Parte 392 sale or alternatively are union agreements binding on the new carriers. Second, may a carrier enjoin a strike over labor protection in an Ex Parte 392 sale.

The question of labor protection in short line sales became murky due to conflicting decisions between federal courts of appeal. The Third Circuit held in Railway Labor Executives’ Association v. Pittsburgh & Lake Erie Railroad Company that rail unions must be included in the negoti-

118. See Ex Parte No. 392 (Sub-No. 1), Class Exemption for the Acquisition and Operation of Rail Lines Under 49 U.S.C. § 10901, 1 I.C.C. 2d 810 (1985), aff’d mem., 817 F.2d 145 (Table) (D.C. Cir. 1987).
120. See Ex Parte 392, 1 I.C.C. 2d at 811. See also H.R. Rept. 1430, 96th Cong., 2d sess. 105 (1980).
121. Id. at 811.
122. Id. at 814. “It is our established policy that the imposition of labor protective conditions on acquisitions and operations under 10901 could seriously jeopardize the economics of continued rail operations and result in the abandonment of the property with the attendant loss of both service and jobs on the line.” Id. at 813.
ations of line sales to new operations. This decision directly conflicted with later opinions in the Eighth and Seventh Circuits. The Eighth Circuit Court upheld the Burlington Northern's spinoff of lines to the Montana Rail Link. The Seventh Circuit followed the Eighth Circuit in allowing the Chicago & North Western's attempt to sell its Duck Creek lines. On June 21, 1989, the Supreme Court of the United States decided the matter as far as the Pittsburgh and Lake Erie sale was concerned. However, because of the special facts of that case, many of the issues concerning labor protection in short line sales remain unresolved.

B. THE P&LE CASE

Pittsburgh and Lake Erie (P&LE) was a steel-hauling short line railroad serving points in Ohio and western Pennsylvania. Once a part of the mighty New York Central System, the "Little Giant" went its own way as an independent line after the formation of Conrail. Part of its business was handling overhead traffic for the Baltimore & Ohio, bypassing B&O's own lines. The B&O began upgrading its own trackage and avoiding the P&LE route with its merger into the Chessie System.

As the fortunes of the steel industry declined, so did those of the P&LE. The railroad's owners found a willing buyer, P&LE Rail Co. (Railco), a subsidiary of Chicago & West Pullman Transportation Corporation. Railco, however, was unwilling to take on the burden of P&LE's labor contracts. While the railroad would remain, only 250 of P&LE's 750 employees would be offered jobs with Railco.

The Railway Labor Executives' Association (RLEA) claimed that this transaction was one affecting rates of pay, rules, and working conditions under the Railway Labor Act. The RLEA indicated its willingness to negotiate all aspects of the matter, including the decision to sell the railroad. The P&LE indicated a willingness to discuss the matter, but noted that bargaining was not required because this was a sales transac-

124. Id. at 423.
128. In the five years before the case, P&LE lost 60 million dollars. P&LE v. RLEA, 109 S. Ct. at 2584.
129. The RLEA is an organization made up of various labor unions representing railroad workers.
130. 45 U.S.C. § 156 (1988). Section 156 (Section 6 of the original act) requires that the party proposing to change rates of pay, rules, and working conditions post notices on the property proposing a bargaining session before such changes can be made.
tion governed by the Interstate Commerce Act. The company claimed that the Section 6 notices posted by the unions (proposing changes in wages, work rules, and working conditions) were invalid since this transaction was preempted by the ICC.

On August 19, 1987, the RLEA sought to enjoin the P&LE from going forward with the sale of the line. On September 15, 1987, the unions went on strike. The district court denied the railroad’s request for an injunction ending the strike, on the grounds that the Norris-LaGuardia Act (NLGA) prohibited most injunctions in labor disputes.

Subsequently, on September 19, 1987, Railco filed a notice of exemption pursuant to Ex Parte 392, which exempted Railco from the ICC’s labor protection requirements. None of the unions had requested labor protection from the ICC. On October 8, the district court ruled that the ICC’s preemption of the issue negated the duty that P&LE had to bargain with the unions over the sale. In addition, the district court held “that the NLGA did not forbid the issuance of an injunction under such circumstances.”

The Third Circuit Court of Appeals reversed. The court did not share the belief that the Interstate Commerce Act and the Railway Labor Act were on a collision course. Specifically, the court held that the ICC’s intervention did not void the NLGA’s prohibition on labor injunctions.

On remand, the district court held that although the railroad did not have a duty to bargain with its employees over the decision to sell the property, it did have to confer with the unions over the sale’s effect on the employees. The court went on to rule that the status quo provision of the Railway Labor Act must be satisfied before the sale could be consummated despite ICC approval of the transaction. The court then granted

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132. 49 U.S.C. § 10901 (1989). This requires noncarriers (Chicago & West Pullman’s Railco subsidiary was not an operating railroad) to obtain ICC approval before buying an existing railroad.
134. Id. at 2590.
135. Norris-LaGuardia Act, Pub. L. No. 72-65, 47 Stat. 70 (1932) (as codified at 29 U.S.C. § 101 (1982)). This law limits the power of the federal courts to grant injunctions in labor-management disputes, unless Congress has specifically prescribed injunctive relief.
137. Id.
138. Id. The District Court for the Western District of Pennsylvania entered an injunction against the strike.
139. Id.
141. Id.
143. Id.
the unions' request to enjoin the sale and the Court of Appeals affirmed.\textsuperscript{144}

The Supreme Court reversed, and in doing so may have set a precedent for no labor protection in short line sales.\textsuperscript{145} The Court, through Mr. Justice White, spoke of the interaction of three statutes: the Interstate Commerce Act (ICA), the Railway Labor Act (RLA), and the Norris-LaGuardia Act (NLGA).\textsuperscript{146}

Without disregarding the RLA's duty to bargain or the NLGA's hostility to injunctions, the Court found that the RLA did not authorize an injunction against the proposed sale.\textsuperscript{147} Working to harmonize the various statutes, the Court's decision was grounded on several considerations.

The Court first noted that the RLA speaks of a "change in agreements."\textsuperscript{148} In this case, however, the sale did not of itself change a labor agreement. Moreover, the original agreement between P&LE and the unions did not contemplate any such sale. As such, the P&LE was under no obligation to serve Section 6 notices upon the unions.

Second, the Court rejected the RLEA's argument that the posting of Section 6 notices by the union required the railroad to preserve the status quo.\textsuperscript{149} The majority stated:

\[\text{[W]e are convinced that we should be guided by the admonition ... that the decision to close down a business entirely is so much a management decision that only an unmistakable expression of congressional intent will suffice to require the employer to postpone a sale of its assets pending the fulfillment of any duty it may have to bargain over the subject matter of union notices such as were served in this case. Absent statutory direction to the contrary, the decision of a railroad employer to go out of business and consequently to reduce to zero the number of available jobs is not a change in the conditions of employment forbidden by the status quo provision of § 156.}\]

\textsuperscript{150}

Finally, the Court's construction of the RLA noted the necessity of avoiding conflicts between the RLA and the ICA.\textsuperscript{151} The Court found that the ICC has plenary jurisdiction over rail transactions. Nothing in the Railway Labor Act deals specifically with an employer going out of the railroad business. Since the collective bargaining agreement is silent

\textsuperscript{144} Railway Labor Executives' Ass'n v. Pittsburgh & Lake Erie R.R., 845 F.2d 420 (3rd Cir. 1988).
\textsuperscript{146} Id. at 2588.
\textsuperscript{147} Id. at 2597.
\textsuperscript{148} Id. at 2592.
\textsuperscript{149} Id. at 2593-4.
\textsuperscript{150} Id. at 2595-6.
\textsuperscript{151} Id. at 2596.
concerning sale of the railroad, the unions cannot stop the sale by posting notices.

Although the railroad did not have to bargain with the union over its sale of the business, there does remain a limited duty to bargain over the effect of the sale upon employees. The Court did state, however, that obligation ceased when the sale was closed after the ICC’s Ex Parte 392 exemption became effective.\footnote{Id. at 2597.} The Court remanded the case to the Third Circuit as to whether or not the Court of Appeals should have lifted the injunction against the strike.

So \textit{P&LE v. RLEA}, which had the effect of halting short line spinoffs, was finally decided for management.\footnote{See Abbott, \textit{Short Line Sales To Go On Despite P&LE, Say Class Is, \textit{Traffic World}}, July 31, 1989, at 6. The Pittsburgh & Lake Erie currently has no plans to sell the lines. Management is negotiating with its labor unions to cut its payroll from 650 to less than 275 people.} However, the \textit{P&LE v. RLEA} holding is limited to the facts of a special situation and is not necessarily applicable to the spinoff of short line railways. There are at least five reasons that \textit{P&LE v. RLEA} may not resolve other cases involving labor protection in short line sales.

First, the P&LE was not a sale involving the spinoff of part of the railroad. The P&LE was being sold intact, as is. In contrast, most short line spinoffs involve the sale of light density branch lines by a Class I railroad to a friendly connecting company.

The fact that this was a proposal by the railroad to get out of the railroad business altogether was very important to the Court.\footnote{P&LE v. RLEA, 109 S. Ct. at 2594-6.} Footnote 17 suggests that a different result may be reached in a partial line sale.\footnote{Id. at 2595.} In footnote 17, the Court distinguished \textit{Railroad Telegraphers v. Chicago & N.W. R. Co.}\footnote{Railroad Telegraphers v. Chicago & N.W. Ry., 362 U.S. 330 (1960).} and the present case. The Court noted that "a railroad's proposal to abandon certain single-agent stations and hence abolish some jobs was a bargainable issue."\footnote{P&LE v. RLEA, 109 S. Ct. 2595.} It is arguable that \textit{Telegraphers} would control in the case of a partial line sale.

Second, P&LE was not maintaining any contractual or other relationship with the new company.\footnote{Id. at 2596.} The P&LE stockholders planned to take the proceeds from the sale and exit from the railroad business. In contrast, many of the spinoff short lines are closely affiliated with their parent Class I. It is not uncommon for short lines to rely on a Class I for their freight car supply or services such as tariff filings.

Third, the unions had not requested the ICC for labor protection pro-
visions (possibly believing the action to be futile under current policies of the ICC). 159 Though they are not required to ask for labor protection, they may so petition.

Fourth, there still is a limited and undefined duty to bargain with unions over the effect of a sale. 160 With a seller that is an ongoing railroad, the employees who worked the discarded lines can displace other employees on the seller’s network. Thus, the affect on other current employees may be enough to require full-scale bargaining when a railroad wishes to continue operating but spinoff an unprofitable branch line.

Finally, the unions’ Section 6 notices were served after the P&LE’s agreement with Railco had been settled. 161 P&LE v. RLEA does not address the case where a union serves a Section 6 notice anticipating a future sale. The Court stated:

We address the duty to bargain about the effects of the sale only in the context of the facts existing when the unions’ notices were served. We do not deal with a railroad employer’s duty to bargain in response to a union’s § 156 notice proposing labor protection provisions in the event that a sale, not yet contemplated, should take place. 162

In summary, P&LE v. RLEA probably will not be the last word on labor protection for railroad employees in short line situations. Thus, other than allowing the Little Giant to sell its lines, issues surrounding labor protection and short line sales remain unresolved. 163

C. RELATED ISSUES

Labor protection is not the only issue facing short line spinoffs. The crew consist issue, which has vexed the rails since 1959, is just now being addressed by the Class I carriers and unions. Crew consist may also be an issue when a new railroad takes over traffic formerly handled by a Class I carrier. Remember that labor contracts have no expiration date on the railroads. Thus, the question arises whether a short line railroad should be considered a successor employer to the original carrier.

Here we see a conflict between the philosophies of the ICA and the RLA. The ICA views public convenience and necessity as the prime consideration in continuing a service. 164 The RLA treats all matters involving employment as subject to the free bargaining of employers and employ-

159. id. at 2591.
160. id. at 2597.
161. id. at 2597.
162. id. at 2597 n.19.
163. See Abbott, Short Line Sales To Go On Despite P&LE, Say Class Is, TRAFFIC WORLD, July 31, 1989 at 6. (Class I railroads, prospective short line buyers, and bankers feel that P&LE v. RLEA is irrelevant. Future sales may involve negotiations with unions, labor protection payments, or other legal challenges).
164. Dempsey and Thoms, supra note 46, at 49.
ees. The ICC may grant a new carrier operating rights as a way of facilitating transportation. However, under the RLA, the National Mediation Board may view the transfer as a way for the railroad to evade the obligations of its collective bargaining agreement.

Particularly interesting are the cases in which directed-service orders are issued by the ICC. These orders are ad hoc notices permitting one carrier to operate over the lines of another. Directed service orders can be issued when a carrier has no cash and is unable to continue operations. This is what has happened with the Delaware & Hudson Railway. Its owner, Guilford Industries, had a policy of leasing its lines to subsidiary Springfield Terminal. The Springfield terminal had a sweetheart contract with its unions allowing small crews. When it was ruled that Guilford was evading its Railway Labor Act responsibilities, Guilford claimed a cashless position and filed for reorganization of the D&H. The ICC directed the New York, Susquehanna and Western to operate over the D&H lines, but with the smaller crews allowed by the NYS&W agreement, apparently with the grudging consent of the unions.

Both labor protection provisions from the ICC and labor agreements involving the carriers and their unions have had a chilling effect on short line sales. It may be that the crew consist issue has to be settled on a carrier-by-carrier basis (as it has been with airlines and motor carriers) rather than by the indirect route of involving subsidiaries, branchlines, and paper corporations.

For years, railroads and their unions have bargained on a national basis. This meant that prosperous and struggling railroads and their unions received the same labor agreement. Today, railroads have attempted to bargain on an individual basis and free themselves from the dead hand of national agreements. There will always be room for short line railroads because of local management, better service, and regional efficiencies. However, labor costs will be less of a factor if Class I railroads and their unions can come to acceptable agreements on their own.

165. Id. at 297.
167. RAILFAN & RAILROAD, Sept. 1988, at 30. The ICC has extended the directed service order over the D&H, without solving the question of whether the NYS&W agreement (which provides for reduced crews) or the old D&H agreement (which maintains larger crews) should prevail.
168. Pious, Rx for Regional Railroading, RAILWAY AGE, May 1988, at RR7. This seems to have been the fate of both the Guilford and the Burlington Northern schemes for turning over traffic to subsidiaries with less strict labor contracts.
V. SUMMARY AND CONCLUSIONS

In summary, the 1980s saw a major downsizing of mainline railroads. While there were extensive abandonments, many other lines that might have been abandoned were sold to new railroads.

The labor protection provisions of the New York Dock standard\(^{170}\) will continue to be applied in rail merger cases as the standards for mergers and consolidations have not been statutorily changed. However, job protection for railroad employees has been curtailed in recent years.

Further restrictions to labor protection have occurred with the ICC’s decision not to require labor protection in short line sales.

The economic analysis concluded that short line operation of Class I light density lines reduced operating costs by almost 25 percent. This was largely the result of short lines being able to operate with smaller crews and relaxed work rules.\(^{171}\) Thus, short line operators may be able to earn a higher return on investment than a Class I carrier would on the same light-density network. At the same time, the Class I carriers’ earnings should be enhanced if marginally profitable rail line segments can be spun off.

The ICC has the power to impose labor protection provisions in short line sales. However, it has chosen not to, in an attempt to avoid saddling any startup railroads with any additional costs.\(^{172}\) Currently, rail labor is lobbying Congress to extend the standard six-year labor protection arrangements to short lines. Such a bill would effectively legislate the New York Dock conditions in all short line takeovers. If such a bill is enacted, rail observers fear that short lines will find it difficult to obtain new operators and that capital investors will flee the industry.\(^{173}\) The Association of American Railroads’ public information spokesman, Frank Wilner, writes:

If rail labor is successful in extending this protection, the economics of regional and short line railroads will be jeopardized, additional rail abandon-

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170. As shown above, the New York Dock standards are the most recent protective conditions imposed by the ICC. They follow the Amtrak standards of 6 years labor protection from the date an employee was adversely affected by the merger. See Dempsey and Thoms, supra note 46, at 301-303.

171. This does not mean that the railroad is nonunion. Sometimes a short line has an existing union contract that is more favorable to management (for example, it provides for a reduced crew on trains) than the Class I railroad it replaces. That is how the Guilford Transportation combine leased its three railroads to tiny subsidiary Springfield Terminal. The Railway Labor Act protects the right of short line and mainline employees to choose whatever bargaining representative they desire to represent their interests. See TRAINS, Feb. 1988, at 3; TRAINS, Mar. 1988, at 10, 20-21; PASSENGER TRAIN JOURNAL, Feb. 1988, at 37.

172. See Phillips, Can they Teach the Elephant to Dance, TRAINS, March 1988, at 20. (Author speculates that railroad short lines are able to operate efficiently without traditional work rules and adherence to outmoded labor contracts would mean abandonment of a good part of the industry).

ments most likely will occur, less rail traffic will be available for feeding into trunk lines and more productive jobs will be lost.\textsuperscript{174}

In conclusion, many of the issues addressed in \textit{P&LE v. RLEA} remain unresolved because of the unique facts of that case. First, the Pittsburgh & Lake Erie was not a true short line spinoff, but rather the sale of an entire railroad. Second, the P&LE was not maintaining any contractual or other relationship with the new company. Third, the unions had not requested the ICC for labor protection provisions. Finally, the \textit{P&LE v. RLEA} case does not address the case where a union serves a Section 6 notice anticipating a future sale.

Class I railroad management, the unions, and prospective short line buyers hoped that \textit{P&LE v. RLEA} would resolve the uncertainties of labor protection in short line sales. However, much uncertainty remains as the factual differences of a partial line sale could lead to a different result. The resulting uncertainty has led the railroads and unions to negotiate the effects of future sales, which is ironic as this was the original intent of the Railway Labor Act.

Railroad Equipment Financing

Michael Downey Rice*

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I. INTRODUCTION

Equipment obligations — obligations secured by rolling stock — are a unique and important means of access to the capital markets for the railroad industry. Because of a history of investment safety dating back to the last century, and certain important legal factors, railroad equipment obligations are accepted by the investment community when other credit windows may be closed to railroad companies. The rating agencies cus-

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tomarily rate equipment obligations in one of the three highest grades, even when other debt securities of the railroad are deep in speculative territory.

In the recent decade of deregulation and railroad consolidation, an equipment surplus has reduced the need for outside financing. But now the slack has been taken out, and the major trunk line carriers and the new regional railroads are going to the institutional finance market to finance new equipment acquisitions and major rebuilding programs.

The legal framework for this renewed financial activity, secured financing and finance leasing, has changed substantially since the last review of railroad equipment financing in the legal literature. While the same issues are presented as in other types of secured financing and leasing, particularly aircraft financing, the resolution of these issues is not always the same, and there are some curious practices used in railroad equipment financing, some justified and some not, that deserve explanation.

I shall first explain some of the peculiar forms of railroad equipment financing. Railroad equipment financing uses forms that were developed in antiquity, and despite the unification of personal property security devices under the Uniform Commercial Code, these old forms remain fixed by statute and tradition.

A particular element of the legal strength of railroad equipment obligations is derived from federal recordation statutes in both the United States and Canada. I shall examine these statutes and their relationship to state and provincial personal property security law.

Equipment obligations of railroad companies enjoy an exemption from the registration requirements of the Securities Act of 1933, and are generally free of other federal and state securities regulation schemes. I shall also examine the dimensions of this exemption.

The unique history of railroad equipment obligations includes special treatment in railroad reorganization. Section 1168 of the Bankruptcy Code, a provision much beloved by institutional investors, sets forth this special treatment. I shall review some limitations of that statute. And finally, I've presented a few specific recommendations for putting together railroad equipment financing transactions.


II. RAILROAD EQUIPMENT OBLIGATIONS

A. THE TRADITIONAL FORMS

Forms of railroad equipment obligations predate the law of personal property security, as expressed in Article 9 of the Uniform Commercial Code and the predecessor conditional sales acts and chattel mortgage acts. Indeed, railroad equipment obligations were the first examples of personal property security devices, emerging in an era of legal hostility to such things, when the common law treated non-possessory interests in personal property as fraudulent.

The Philadelphia plan equipment trust was the first form of railroad obligation, appearing in the early part of the nineteenth century as a means of financing canal boats. The law at that time would not countenance mortgages of chattels, therefore in order to finance a canal boat, the canal company would lease the boat to a boatman, the boatman would pay regular rents for a stated period, and at the end of that period he could purchase the boat for a nominal amount. This arrangement was determined to be valid against third parties, and the new railroad industry in Pennsylvania adopted this bailment-lease to finance equipment acquisitions, the railroad company being the lessee and the financing party being the lessor.

The modern form, as it evolved a century later, retained the bailment-lease but added a form of trust indenture, under which a trustee acted as owner and lessor for the benefit of a group of financing parties. The financing parties received equipment trust certificates, issued by the trustee, as evidence of their interest in the transaction; the railroad-lessee usually endorsed its guaranty on these certificates. Certificates were issued in serial maturities, and were entitled to "dividends" at a fixed rate. The rents covered the principal maturities and dividends, and at the end of the lease term the railroad-lessee became the owner of the equipment.

Equipment trust certificates acquired a reputation for investment safety over the years, and institutional investors regularly purchased these securities for their fixed-income portfolios. They were sold by the railroads at competitive bidding, under the supervision of the Interstate Commerce Commission. The usual issue involved an advance "rent" to

9. Id. at 69; see also M. Rice, Railroad Equipment Obligations 111 (1978).
cover 20% of the purchase price of the equipment, and during a term of fifteen years rents were calculated to cover equal annual payments of principal and semiannual payments of "dividends" on the certificates.

Under modern notions of the distinction between a security interest and a lease, whether by reference to the Uniform Commercial Code,\(^{10}\) federal income tax considerations,\(^{11}\) or accounting principles,\(^{12}\) the lease in the Philadelphia plan is not a lease at all, but a disguised security interest. Even with this contrived structure, the railroad equipment trust has become enshrined in various statutes,\(^{13}\) and is probably here to stay. The form was adopted for aircraft financing in the post war boom of commercial aviation,\(^{14}\) and the equipment trust continues as a significant instrument of aircraft finance.

Because of an exemption from registration under the Securities Act of 1933,\(^ {15}\) railroad equipment trust certificates have no restrictions on distribution or resale and can thus be treated as publicly-offered securities. The private-placement counterpart has been the New York Plan "conditional sale."

A "conditional sale" is a device designed to accommodate the payment of the purchase price in installments, with the seller retaining an interest in the goods sold until satisfaction of the condition, full payment. The early appeal of the conditional sale was the retention of "title" in the seller. A railroad company usually was subject to a mortgage on the entire system, covering not only the land and right-of-way, but also the tracks, rolling stock, supplies, and all of the pieces that made up a functioning railroad. Such mortgages had after-acquired property clauses, so that new equipment coming into the hands of the road would become subject to the mortgage. A conditional sale, in which the vendor retained "title," was held by the Supreme Court to give the conditional vendor a claim superior to the lien of the mortgage.\(^{16}\) Thus comforted, investors

\(^{10}\) See, e.g., Coogan, Leases of Equipment and Some Other Unconventional Security Devices: An Analysis of U.C.C. Section 1-201 (37) and Article 9, 1973 DUKE L. J. 909.


\(^{16}\) Fosdick v. Schall, 99 U.S. 339 (1879); see G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 62 (1965).
were willing to advance funds against assignments of conditional sale obligations, and a major method of equipment financing emerged. Conditional sales were validated by specific state legislation in the period 1881-1913. But the principal impetus for their use as financing devices was a peculiar regulatory interpretation.

The Interstate Commerce Commission was given power to regulate the issuance of securities by rail carriers in the 1920 amendments to the Interstate Commerce Act, long before the broader regulatory mechanism of the Securities Act of 1933 and related statutes was put in place. The securities regulation scheme vested in the ICC involved an approval process, whereby securities could not be issued unless and until the Commission approved the same — quite different from the registration and disclosure mechanism of the '33 Act. As part of the approval process, the ICC would investigate how the proceeds of the issue of the securities were used and would pass on the offering price. Ordinarily, the ICC required that competitive bidding be used in the sale of the securities.

Thus, issuance of securities by railroad companies could be a cumbersome process. The definition of "security", however, in the Interstate Commerce Act was less broad than the definition in the '33 Act, and a loophole was soon found. In an early decision, the ICC took jurisdiction over the notes issued in an equipment financing, but not the conditional sale agreement that secured the notes. So railroad lawyers developed a form of financing that used a conditional sale, with the payment obligation contained therein, without accompanying notes. The Interstate Com-

17. K. DUNCAN, EQUIPMENT OBLIGATIONS 155 (1924). These "recording statutes" often made specific reference to railroad rolling stock and some were limited to such equipment. A few of these statutes remain on the books: CAL. PUB. UTIL. CODE, § 7578 (West 1965); VT. STAT. ANN. tlt. 30 § 1034 (1986). The recording statutes always required that the equipment be marked with the name of the owner or lessor; this established a tradition that is still observed, although a universal legend such as "Subject to a Security Interest Filed with the Interstate Commerce Commission" is usually used, to make it easier for the lads in the paint shop.

20. For a discussion of the differences between securities regulation under the Interstate Commerce Act and the Securities Act of 1933, see H.R. REP. No. 94-725, 94th Cong. 2d Sess. 64 (1975); see also 1 L. LOSS & J. SELIGMAN, SECURITIES REGULATION 166 (3d ed. 1989).
merce Commission confirmed that such conditional sale obligations were not “securities” as defined in the Interstate Commerce Act, and that it had no jurisdiction over their issuance. Thereupon, the railroads used conditional sale financing for those transactions that were best privately placed, without the structural confinement that went along with the approval process for the equipment trusts.

When conditional sale financing, without the benefits and blessings of ICC regulation, became a major element of railroad debt, the Commission attempted to change its mind, but was unsuccessful.

There was a certain symmetry in the federal securities regulation scheme, however; because conditional sale obligations were not regulated by the Interstate Commerce Commission, the exemption from registration afforded by section 3(a)(6) of the Securities Act (as originally written) did not apply, and such obligations came under the scope of the ‘33 Act. Accordingly, the railroads and financial institutions used the section 4(2) exemption from registration for “private placements” in arranging these transactions, and conditional sale transactions became a significant element of railroad capital formation in the institutional private placement market.

Conditional sale financing of railroad equipment followed a consistent structure. The railroad company would contract with the equipment vendor to pay the purchase price of the equipment in installments, usually equal annual installments for fifteen years, with interest on the unpaid balance paid semiannually. The vendor would retain “title” to the equipment until the debt was discharged (with the advent of the Uniform Commercial Code, the notion of “title” was replaced by a security interest). The parties supplying the financing would appoint an agent, and the agent would pay the invested funds to the equipment vendor, taking an assignment of the conditional sale indebtedness and the rights under the conditional sale agreement. Thus the vendor was paid immediately upon delivery of the equipment, and the financing parties stepped in its shoes to collect the conditional sale indebtedness. The financing parties did not receive notes or any similar instrument by the railroad, but were issued certificates by the agent, as evidence of participation in the indebtedness.

The railroad equipment financing triad is completed by lease financing. Railroad equipment lends itself to leasing: railroad companies are accustomed to using equipment owned by others, and because rolling stock has a relatively long life, a fifteen-year transaction, the traditional

term for a railroad equipment financing, would provide financing parties a
sicntificant residual value at the end of the term.

Full-payout finance leases had been used as early as 1949,\textsuperscript{27} perhaps inspired by real estate sale-leasebacks developed in that era.\textsuperscript{28} By the 1950's, leasing was recognized as a financing method for chattels as well as real property.\textsuperscript{29} When tax incentives for investment in equipment — the investment credit and accelerated methods of depreciation — were introduced in the early 1960's, leasing took on major importance as a method of providing some of the benefits of these tax incentives to transportation companies that often did not have the tax liability to use them effectively. Instead of the user purchasing the equipment, another corporation needing shelter for taxes would acquire the assets and lease them to the user. This leasing corporation would reduce its own tax liability with the depreciation deductions and investment credit, and pass a portion of the benefits on to the equipment user in the form of reduced rents. The need of airline companies to finance new fleets of turbojet aircraft led to the development of leveraged leasing, in which the owner-lessee borrows most of the purchase price.\textsuperscript{30} The railroad industry quickly adopted the structure, and many fortunes were made in brokering railroad equipment lease transactions.

Railroad leveraged lease transactions were shaped by the same forces that shaped straight debt financing. Because the prevailing railroad securities statute, section 20a of the Interstate Commerce Act, required ICC approval for a carrier to "assume any obligation or liability as lessee . . . in respect of the securities of any other person," it was felt in most legal quarters that the debt portion of a leveraged lease transaction should be in the form of a conditional sale agreement, not regarded by the Commission as a security, thus avoiding the need for ICC approval.\textsuperscript{31} And so they were, involving a somewhat cumbersome documentary structure: a conditional sale agreement from the vendor to the owner-lessee, a lease to the railroad company, and an assignment of the conditional sale indebtedness to an agent for the debt participants. Very often the equity participant or participants, the owner of the equipment, would

\begin{itemize}
\item[27.] D. Street, Railroad Equipment Financing 124 (1959).
\item[31.] This view was not universally held, and many leveraged lease transactions have been done with notes, with no apparent ill effect. No one seems to have been concerned that the lease itself would be regarded as a security.
\end{itemize}
use a trust as an ownership vehicle, involving another instrument and another party. And all of the financing parties and the railroad would usually join in a participation agreement of some sort, setting up closing conditions and picking up odds and ends of covenants and agreements. Much paper, much lawyering.

B. PRIVATE CAR LINES

Railroad equipment financing is not confined to equipment owned by or leased to railroads. Railroads also move commodities in "private cars," cars owned by others. Shippers often own rolling stock designed for the special needs of their commodities, and independent entities, called "private car lines," maintain fleets of equipment for short-term lease to railroad companies and shippers. These private cars are a major portion of the nation's fleet of railroad rolling stock, and the financing of this equipment is a major capital market.

The securities regulation aspects of railroad company equipment obligations do not apply to the obligations of private car lines. These lines are not regulated carriers, and are not covered by the scheme of railroad regulation embodied in the Interstate Commerce Act and the successor provisions of the Transportation Code. Nevertheless, the forms used for financing equipment by railroads have been adopted for financing private cars, not because the law requires it, but because tradition suggests it. Thus private car line equipment financiers often use the equipment trust as the security instrument, and they sometimes employ conditional sales.

The danger of this practice is that the investors may assume that the legal characteristics of these devices is independent of the nature of the obligor, and may disregard important differences in treatment under the securities laws, bankruptcy laws, and some other relevant areas of the law. The distinction between railroad companies, on one hand, and private car lines and other types of obligors, on the other hand, must always be kept in mind in reviewing and applying legal principles to equipment obligations.

III. PERFECTION OF SECURITY INTERESTS

Railroad equipment financing (and financiers) have the benefit of a comprehensive federal statute covering recordation of interests in such equipment. Because it pre-dates the Uniform Commercial Code, the operation of this statute does not depend on that feature of state law; yet the

draftsmen of the secured transactions article of the Uniform Commercial Code have accommodated the federal statute by treating it as the method of filing to perfect a security interest, in a singularly successful marriage of federal and state law.

The railroad equipment recording statute was first promulgated as section 20c of the Interstate Commerce Act.\textsuperscript{34} DeForrest Biblyou of the New York bar proposed the statute in 1951\textsuperscript{35} to remedy the problem of compliance with the conditional sales acts and railroad recording statutes of the various states.\textsuperscript{36} The interchange of equipment among the railroads of North America had made recording of interests in railroad rolling stock under state statutes both impractical and inadequate.\textsuperscript{37}

Section 20c was inspired by section 503 of the Civil Aeronautics Act,\textsuperscript{38} the provision for federal recodarion of interests in aircraft. The railroad statute created a system of central filing with the Interstate Commerce Commission, and referring to the forms of financing prevailing at the time — mortgages, leases, equipment trust agreements, and conditional sales agreements — decreed that once such instruments were recorded with the Commission, they would be "valid and enforceable against all person . . . ."\textsuperscript{39}

\begin{footnotes}
\item[36] See generally K. Duncan, Equipment Obligations 97, 155 (1924).
\item[39] Sec. 20c. Any mortgage, lease, equipment trust agreement, conditional sales agreement, or other instrument evidencing the mortgage, lease, conditional sale, or bailment of railroad cars, locomotives, or other rolling stock, used or intended for use in connection with interstate commerce, or any assignment of rights or interest under any such instrument, or any supplement or amendment (including any release, discharge, or satisfaction thereof, in whole or in part), may be filed with the Commission, provided such instrument, assignment, supplement or amendment is in writing, executed by the parties thereto, and acknowledged or verified in accordance with such requirements as the Commission shall prescribe; and any such instrument or other document, when so filed with the Commission, shall constitute notice to and shall be valid and enforceable against all persons including, without limitation, any purchaser from, or mortgagee, creditor, receiver, or trustee in bankruptcy of the mortgagor, buyer, lessee or bailee of the equipment covered thereby, from and after the time such instrument or other document is so filed with the Commission; and such instrument or other document need not be otherwise filed, deposited, registered or recorded under the provisions of any other law of the United States of America, or of any State (or political subdivision thereof), territory, district or possession thereof, respecting the filing, deposit, registration or recordation of such instruments or documents. The Commission shall establish and maintain a system for recordation of each such instrument or document filed pursuant to the provisions of this section, and shall cause to be marked or stamped thereon, a consecutive number, as well as the date and the hour of such recordation, and shall maintain, open to public inspection, an index of all such instruments or documents, including any assignment, amendment, release, discharge or satisfaction thereof, and shall record, in
\end{footnotes}
Section 20c served the railroad industry and the financial community faithfully for many years; its terms were so unequivocal that no court was asked to construe it.

The Interstate Commerce Act, as a whole, was regarded as a terrible mess, however, and in 1976 a joint project of the Law Revision Counsel of the House of Representatives, the Interstate Commerce Commission, and the Department of Transportation was commenced to revise the Interstate Commerce Act as part of a new transportation code. Section 20c sustained some damage in passing through this legislative gauntlet. Its two long sentences were chopped into nine shorter ones, as it was recodified as new section 11303 of Title 49, United States Code:

(a) A mortgage (other than a mortgage under the Ship Mortgage Act, 1920), lease, equipment trust agreement, conditional sales agreement, or other instrument evidencing the mortgage, lease, conditional sale, or bailment of railroad cars, locomotives, or other rolling stock or vessels, intended for a use related to interstate commerce may be filed with the Interstate Commerce Commission. An assignment of a right or interest under one of those instruments and an amendment to that instrument or assignment including a release, discharge, or satisfaction of any part of it may also be filed with the Commission. The instrument, assignment, or amendment must be in writing, executed by the parties to it, and acknowledged or verified under Commission regulations. When filed under this section, that document is notice to, and enforceable against, all persons. A document filed under this section does not have to be filed, deposited, registered, or recorded under another law of the United States, a State (or its political subdivisions), or territory or possession of the United States, related to filing, deposit, registration, or recordation of those documents. This section does not change the Ship Mortgage Act, 1920.

(b) The Commission shall maintain a system for recording each document filed under subsection (a) of this section and mark each of them with a consecutive number and the date and hour of their recordation. The Commission shall maintain and keep open for public inspection an index of documents filed under that subsection. That index shall include the name and address of the principal debtors, trustees, guarantors, and other parties to those documents and may include other facts that will assist in determining the rights of the parties to those transactions. 40

The drafters of the new code deserve credit for creating a crisper, more easily comprehended statute. But in the search for efficiency, a few missteps were made.

The first of the new, shorter sentences has a reference to "vessels."

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This is a result of combining old section 323, covering interests in vessels used by regulated carriers, with section 20c. They were originally written in similar terms, so that combining the two provisions seems quite sensible. Except that old section 323 was limited to vessels used by water carriers subject to regulation by the Interstate Commerce Commission, and new section 11303 speaks of "vessels, intended for a use related to interstate commerce . . . ." Quite different, and considerably broader, for only a minority of interstate marine commerce was handled by regulated carriers. This broad coverage had been specifically rejected by Congress in enacting the original section 323.

The new fourth sentence is the heart of the statute: "When filed under this section that document is notice to, and enforceable against, all persons." The succinct phrase "all persons" is regarded by the drafters of the new code as being more inclusive than the litany "all persons including, without limitation, any purchaser from, or mortgagee, creditor, receiver, or trustee in bankruptcy of, the mortgagor, buyer, lessee, or bailee of the equipment covered thereby." The question is, would a court reach the same conclusion? For the retention of the phrase "any purchaser from" would have made clear that the holder of an interest recorded under the new section 11303 would prevail over a buyer in the ordinary course of business. This is not the case under section 503 of the Federal Aviation Act relating to interests in aircraft, a statute which refers simply to "all persons." Courts consistently favor buyers in the ordinary course of business over holders of security interests recorded under that federal statute.

The deletion of the reference to "trustee in bankruptcy" is equally troublesome. Those are strong words, giving an equipment creditor rights in bankruptcy that it otherwise might not have. The deletion is especially perplexing when one considers section 337(a) of the law creating the new Bankruptcy Code, which was passed by Congress a few weeks after the revisions to the Interstate Commerce Act. This section would have amended the reference to bankruptcy in section 20c to speak of "a case under Title 11 of the United States Code," had it still been there to amend. This specific reference reinforces the notion that the drafters of the Bankruptcy Code were aware of this special language, and

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47. On November 6, 1978. The revisions to the Interstate Commerce Act were passed on October 17, 1938.
intended to preserve special rights for railroad equipment creditors (although this does seem inconsistent with elaborate bankruptcy code provisions for automatic stay and adequate protection).

There is some solace for equipment creditors in section 3 of the law amending the Interstate Commerce Act, which states that the new provisions "may not be construed as making a substantive change in the laws replaced," and in the legislative history that tells us that the objective of the revision was to restate the Interstate Commerce Act and related laws in comprehensive form, without substantive change.\textsuperscript{49} The Law Revision Counsel duly opined to Congress that he was satisfied that the new law restated existing law accurately without substantive change.\textsuperscript{50} (Perhaps that is close enough for government work). At least one court has ignored the revised law and looked to the original words of the Interstate Commerce Act to decide a close question.\textsuperscript{51}

In one respect, however, the drafters of the revised Interstate Commerce Act were true to their word: if they were tempted to make reference to the contemporary and more general term "security interest" instead of the references to antique forms, mortgages and conditional sales, they successfully resisted. For unlike section 503 of the Federal Aviation Act, covering interests in aircraft, and section 11304 of Title 49, Transportation, covering interests in equipment used by regulated motor carriers, section 11303 does not specifically cover the generic form of security interest so carefully constructed by Professor Gilmore and the other authors of the secured transactions article of the Uniform Commercial Code. And so to be safe, the creator of a railroad equipment obligation must cast the words in the form of a mortgage, lease, equipment trust agreement, or conditional sale agreement. It is possible, of course, that a generous court would give a broad interpretation to the statute in order to protect an interest under an Article 9 security agreement, and such an interpretation would be quite justified, but if a court has ever been generous to a secured party it has escaped attention.\textsuperscript{52}

These complaints notwithstanding, section 11303 of Title 49 is a very comprehensive and useful statute. It quite clearly covers leases, something that the filing provisions of Article 9 of the Uniform Commercial Code do not.\textsuperscript{53} It quite clearly covers assignments, eliminating a problem that

\textsuperscript{48} 92 Stat. 1337, 1446 (1978).
\textsuperscript{49} H. REP. No. 95-1395, 95th Cong., 2d Sess. 4 (1978).
\textsuperscript{50} Id.
\textsuperscript{52} See e.g., Clark, Secured Transactions, 43 Bus. Law. 1425 (1988).
\textsuperscript{53} The recently promulgated Article 2A-Leases of the Uniform Commercial Code does not provide for filing or recording leases of goods, except in the case of goods that may become fixtures. American Law institute, National Conference of Commissioners on Uniform State Laws, Article 2A. Leases, 1987 Official Text with Comments; See also Symposium, Article 2A of the...
has come up under the correlative aircraft provision, section 503 of the Federal Aviation Act.\textsuperscript{54} It is not limited in its coverage to regulated railroads, but includes railroad equipment owned or used by shippers and private car lines (even though the Interstate Commerce Commission originally thought that it did not).\textsuperscript{55} In the only reported court test, it received a passing grade.\textsuperscript{56}

The lack of judicial gloss is not a major problem. In the case of the parallel federal statute for interests in aircraft, section 503 of the Federal Aviation Act,\textsuperscript{57} it is now well settled that the interstices of the federal law are to be filled by reference to the applicable state law.\textsuperscript{58} And the draftsmen of the Uniform Commercial Code clearly had that in mind.\textsuperscript{59} The Code treats these federal statutes as recording statutes, providing a method of filing,\textsuperscript{60} and exempts from the application of Article 9 "a security interest subject to any statute of the United States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property . . . ."\textsuperscript{61} The words "to the extent" provide the federal-state interface, the Uniform Commercial Code picking up where the United States Code stops.\textsuperscript{62}

The recodification procedure at the Interstate Commerce Commission is covered by relatively uncomplicated regulations.\textsuperscript{63} The complete document is recorded with the Commission, and the document must be accompanied by a letter of transmittal in a certain form. This letter contains basic information regarding the names of the parties and the description of the equipment, similar to a Uniform Commercial Code financing state-

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61. \textit{Id.} at § 9-104.

62. The 1972 revisions to Article 9 of the Uniform Commercial Code have been adopted in 49 of the 50 states and the District of Columbia. The remaining state, Vermont, continues to use the 1962 version, which excludes from the coverage of Article 9 "an equipment trust covering railway rolling stock." U.C.C. § 9-104(e) (1962). \textit{Id.} § 9-104 comment 5; see also GILMORE, \textit{supra} note 3, at 430.

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ment, and provides guidance to the Commission staff for indexing the recorded documents.

The indexing system, however, is not altogether satisfactory. This system is patterned after the grantor-grantee index typically used for real estate records. Unlike the system of records of interests in aircraft maintained by the Federal Aviation Administration in Oklahoma City, there is no index by car number. Car numbers are assigned by individual railroads and private car lines, not by the ICC, and there is no system of registration by car number as there is at the FAA for aircraft "tail" numbers. A knowledge of railroad genealogy is necessary to track equipment through the many mergers, and railroad companies are not always fastidious about filing statements of new numbers when car numbers are changed to accommodate mergers or when the equipment is rebuilt. Thus a search of Interstate Commerce Commission records cannot be undertaken with a high level of confidence that every document recorded in respect of a given unit will be found.

Because of the these circumstances, in a refinancing of railroad rolling stock it is best for the new financing parties to take the interest in the equipment from the parties to the existing financing. An assignment of an existing lease or debt instrument, coupled with a renewal and amendment, may give the new financing parties the priority position of the original financing, whereas a release of the old interest and establishment of a new interest raises the question of intervening interests that may not have been found in a search. In the refinancing of a lease transaction, a useful technique is the conditional sale from the original owner-lessee to the new owner-lessee, with an assignment to the new debt financing parties, and an amendment of the existing lease. This provides a debt instrument in one of the forms required by section 11303.

A. Perfection in Canada

The rails of Canadian railroads are 4' 8 1/2" apart, just as in the United States, and the Canadian railroads participate in the equipment interchange system of the Association of American Railroads. Thus rail-

64. See 14 C.F.R. § 49 (1988).
66. This is not to say that it would work in all cases. Section 9-312 (7) of the Uniform Commercial Code gives future advances the same priority as the first advance under a particular security interest. But there is a question of the fairness to other creditors of permitting this priority when the original security agreement does not contemplate such advances, in circumstances where the agreement itself is recorded, not just a financing statement. If a court chooses to use real property transactions as an analogy, there is room for doubt. See G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW 883 (1985). Thus a refinancing party cannot depend on the effectiveness of acquiring the old priority position from the original financing party, but it is better to do it than not to.
road rolling stock, put into service and financed in the United States, may cross the border to Canada from time to time.

In most transactions, this is of little consequence. In a transaction covering 500 or 1000 units the cars will become scattered, and an occasional trip to Canada by some of those does not represent significant risk. However, some U.S. railroad companies have lines in or through Canada or significant equipment interchange with Canadian roads, increasing the proportions of the problem. Worth special attention are locomotive transactions with railroads on the northern border that have trackage in Canada, because each locomotive represents significant value.

Canada has a national recording statute, section 86 of the Railway Act of Canada:

(1) Any instrument or copy of an instrument evidencing the lease, sale, conditional sale, mortgage or bailment of rolling stock located, moving or running on or over the lines of track of a company, or the amendment, assignment or discharge thereof, that is executed by the party or parties thereto, may be deposited in the office of the Registrar General of Canada, within twenty-one days from the execution thereof, and no instrument so deposited need be otherwise deposited, registered or filed under any law respecting the deposit, registration or filing of instruments affecting real or personal property, and on the execution and deposit of any such instrument as aforesaid, the same is valid against all persons.67

Section 86 has the same reference to traditional forms and the same notion of validity against "all persons" as the American statute. A difference to be kept in mind is the twenty-one day limit — if the documents are not deposited on time, they must be re-executed and sent up to Ottawa again.

Historically, section 86 only covered equipment leased, conditionally sold, or bailed to a railway company, leaving interests in equipment of private car lines to provincial law. (The reference in the statute to "company" is limited to railway companies.)68 In 1982, section 86 was amended to its current form, ostensibly closing this gap. However, some Canadian counsel are not convinced that the national government has such authority; section 86 is only possible because of a provision in the Canadian constitution giving the national government jurisdiction over railway matters.69 And there is the question of the effectiveness of such deposit when rolling stock is on private tracks, on the property of a shipper or receiver.

Thus Canadian counsel should be consulted in all financings involving significant amounts of equipment on Canadian tracks. In some cir-

67. CAN. REV. STAT. ch. R-2, § 86.
cumstances counsel may advise filing under one or more of the provincial statutes, personal property security acts in Manitoba, Ontario, Saskatchewan, and the Yukon territory,70 and conditional sales acts in the remaining provinces71 (except Quebec72).

IV. FEDERAL REGULATION

Equipment obligations of railroad companies enjoy a special exemption from securities regulation, a curious situation that can only be understood through an examination of the history of railroad securities regulation.

The first federal foray into securities regulation involved railroad securities. Securities manipulation in the railroad industry is the stuff of legend.73 At the beginning of the twentieth century, the bloated capital structure of American railroads resulting from decades of stock watering was a problem of national proportions.74 Following the recommendation of a special presidential commission chaired by Arthur T. Hadley, President of Yale University,75 Congress, by section 439 of the Transportation Act of 1920,76 added securities regulation to the powers of the Interstate Commerce Commission over railroad carriers.

Thus when the Securities Act of 193377 was passed, regulation of railroad securities was already in the hands of the patriarch of the independent regulatory agencies. Accordingly, an exemption from registration of securities under the new law was afforded to the railroad industry by section 3(a)(6) of the '33 Act.78 That exemption spoke of securities subject to the approval of the Interstate Commerce Commission, so whatever was not covered by one act was covered by the other. Very neat. When motor carrier securities were brought under Interstate Commerce Commission regulation, the section 3(a)(6) exemption was enlarged to suit.79 Also very neat.

70. MAN. REV. STAT. ch. P-35 (1987); ONT. REV. STAT. ch. 375 (1980); SASK. STAT. ch. P-6.1 (1979-1980); YUK. ORD. ch. 20 (1980(2d)).
72. QUE. REV. STAT. art. 1980.
73. See, e.g., M. JOSEPHSON, THE ROBBER BARONS (1934).
74. See BONBRIGHT, RAILROAD CAPITALIZATION 13, 156 (1920).
76. Note 18, supra. For the history and purposes of this statute, see authorities cited at note 21, supra.
78. Id. 48 Stat. 76.
Then came the Northeast railroad apocalypse in the 1970’s. Shortly after the collapse of the Penn Central and the adjoining roads, a Congressional staff report concluded that regulation of railroad securities had not been adequate under the existing statutory scheme. Proposals were advanced to eliminate the section 3(a)(6) exemption from registration for carrier securities, so that there would be dual regulation by both the Securities and Exchange Commission to reinforce the regulation of the ICC. Hearings were held, testimony was taken, bills were proposed, and legislators were lobbied. A provision to eliminate the exemption from the ’33 Act was carried along with the legislative process leading to the Regional Rail Reorganization Act of 1973, but was deleted in the final version reported by the committee of conference. Eventually section 3(a)(6) of the ’33 Act was amended by section 308 of the Railroad Revitalization and Regulatory Reform Act of 1976.

The revised section 3(a)(6) preserved the exemption for motor carrier securities, but eliminated the exemption for railroad securities — almost. While railroad equity securities, mortgage bonds, and the like would no longer be exempt from the registration requirements of the ’33 Act, an exemption was continued for “any interest in a railroad equipment trust.” This was reasonable, because railroad equipment trusts had an excellent record of investment safety from the beginning of the century right through the current crisis, and the regulation of railroad equipment trusts by the Interstate Commerce Commission was quite satisfactory, at least for investors.

But the statute goes on to define an “interest in a railroad equipment trust” as “any interest in an equipment trust, lease, conditional sales contract, or other similar arrangement entered into, issued, assumed, guaranteed, or for the benefit of, a common carrier to finance the acquisition

82. H.R. 12128, 92d Cong.; H.R. 9810, 93d Cong.
84. H.R. 9142, § 911, 93d Cong.; H.R. 10979, § 201, 94th Cong.
88. Hearings, supra note 83, at 996.
of rolling stock, including motive power."

This expands the exemption to types of financing that the Interstate Commerce Commission had not been regulating — conditional sales and leases. The explanation for this loophole is that, at the time of passage, it was not regarded as such. When H.R. 10979, the bill that embodied this language, was reported out of committee, the Interstate Commerce Commission had concluded a proceeding expanding the scope of its securities regulation activities to cover conditional sale agreements and other types of non-negotiable obligations. So all types of equipment obligations of railroad companies (except some leases) that were exempted from the registration requirements of the '33 Act by the new section 3(a)(6) language came under the securities regulation jurisdiction of the Interstate Commerce Commission.

But the ICC's expanded jurisdiction over carrier obligations survived only briefly. The Association of American Railroads and motor carrier interests appealed the action of the ICC and prevailed. The court determined that the earlier, narrow construction of the term ""securities"" in the Interstate Commerce Act was correct, that conditional sale agreements and other noteless forms of financing were not subject to ICC jurisdiction, and that any expansion of this jurisdiction would require legislative action.

Legislative action to expand the jurisdiction of the Interstate Commerce Commission was not forthcoming. Deregulation was in fashion. In 1982, Commission jurisdiction over motor carrier securities was eliminated, and the section 3(a)(6) exemption from registration for motor carrier securities under the '33 Act was eliminated in the same statute. Thus motor carrier securities no longer have special treatment, and are regulated under the '33 Act as any other securities.

Conditional sale and lease obligations of railroad companies continued unregulated at the federal level.

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91. Date of report, December 12, 1975.
94. Id. at 966.
96. The current relevant language of section 3(a) of the Securities Act of 1933 is as follows:
   Sec. 3. (a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:
   (6) Any interest in a railroad equipment trust. For the purposes of this paragraph "any interest in railroad equipment trust" means any interest in an equipment trust.
The deregulation fever then infected the Interstate Commerce Commission. In 1985, citing "the congressional policy to relax regulatory oversight where feasible,"\textsuperscript{97} the Commission unilaterally abandoned most of its securities regulatory functions. In \textit{Ex Parte No. 397} the Commission amended its regulations to exempt from the operation of 49 U.S.C. § 11301 (the Commission's securities regulation statute) the issuance of securities by, \textit{inter alia}, Class II and III railroads and "any rail carrier, regardless of size, issuing equipment trust certificates."\textsuperscript{98} An exemption for other securities is available to a Class I railroad must file an annual notice of securities proposed to be issued in the succeeding two years.\textsuperscript{99}

In order to respond to concerns that state regulatory agencies would attempt to plug this loophole, the Commission expressed the view that the granting of an administrative exemption would not diminish the Commission's underlying statutory authority, and that any state regulatory jurisdiction is preempted by the Commission's exclusive statutory jurisdiction.\textsuperscript{100}

Thus equipment obligations of railroad companies are exempt from the registration requirements of the Securities Act of 1933, and are effectively exempt from the requirement for approval by the Interstate Commerce Commission. State "blue sky" laws ordinarily have an exemption for railroad equipment obligations, in deference to the federal regulatory scheme, and thus there is no state registration requirement either.

In constructing an equipment transaction, the language of the relevant statute must always be kept in mind. The section 3(a)(6) exemption from the registration requirements of the '33 Act speaks of transactions "to finance the acquisition of rolling stock, including motive power."\textsuperscript{101} Thus a refinancing of currently-owned equipment would not have the ben-

\textsuperscript{97} U.S.C. § 77c (1982).
\textsuperscript{99} \textit{id., see also} 49 C.F.R. § 1175 (1988).
\textsuperscript{100} 49 C.F.R. § 1175.2 (1988). A Class I railroad is one with annual operating revenues of $50,000,000 or more; 49 C.F.R. § 1201 (1987).
\textsuperscript{101} \textit{Ex Parte no. 397}, supra note 97, citing Schwabacher v. United States, 334 U.S. 182, 197 (1948), and Laird v. I.C., 691 F.2d 147, 152-53 (3d Cir. 1982), cert. denied, 461 U.S. 927 (1983). See 49 U.S.C. § 11301(b)(1). Section 402(a)(6) of the Uniform Securities Act, (the "blue sky" law in effect in twenty-one states), provides a specific exemption from state registration and filing provisions for securities "issued or guaranteed by any railroad . . . subject to the jurisdiction of the Interstate Commerce Commission." Other state blue sky laws have similar exemptions.
efit of the exemption. This language can cause problems with the usual rolling stock acquisition and financing practices of railroad companies. Railroad equipment is purchased and financed in large quantities, hundreds of cars at a time. But they cannot be manufactured and delivered all at once. An order is placed, the units are built, and then delivered to the railroad as they come out the factory door. The railroad pays cash, and then, when a sufficient number of units have been delivered to justify a financing, an equipment trust financing is arranged and the group of equipment is conveyed to the trustee. Often the timing of the financing is related to conditions in the money market. This practice is so common that railroad system mortgages usually have a provision to exclude from the lien of the mortgage rolling stock owned by the railroad for less than a year, so that such equipment trust financings can be arranged without obtaining a release from the mortgage trustee.

In order to keep from stretching the meaning of the words "to finance the acquisition of rolling stock" too far, the railroad company should ensure, by appropriate resolutions, that the connection between the acquisition of the equipment and the financing is established and maintained. Better yet, the financing should be arranged before equipment deliveries commence, or arrangements should be made with the manufacturer for delivery of the equipment under short-term "interim user agreements" or other lease arrangements, so that the manufacturer remains the owner until the financing is in place. This problem of the nexus between the acquisition and the financing also arises in connection with section 1168 of the bankruptcy code, a very important provision in railroad equipment financing which is addressed below.

But the most important limitation to keep in mind is that the section 3(a)(6) exemption only relates to obligations of common carriers. Equipment obligations of private car lines are subject to the '33 Act, which requires registration if another exemption, such as the section 4(2) "private placement" exemption, is not available.

While the section 3(a)(6) exemption provides relief from the requirement for a formal registration procedure and prospectus, it does not relieve the requirement for candor in offering materials. The remedies of section 12 of the '33 Act are available if any communication used in the offering "includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading. . . ." /id. And the prohibition against fraud in section 17 applies notwithstanding the exemption. Thus any offering circular or other materials prepared in con-

nection with an offering under the section 3(a)(6) exemption must be done with care and diligence.

A. LEGAL INVESTMENT LAWS

Railroad equipment obligations are often the subject of specific provisions in state laws regarding the investments permitted to savings banks, insurance companies, and fiduciaries — not in the nature of restrictions, but rather, special accommodations. At one time, particularly in the New England states, these legal investment laws were quite particular, describing the types of securities permitted and sometimes providing for a "legal list" to be kept by a state agency. Railroad equipment obligations were usually specifically mentioned in these statutes, and sometimes particular requirements for the terms of these obligations were set out.

There has been a recent trend towards liberalization of these laws, dropping the specific requirements for a more general standard or the "prudent man rule." But New York retains specific language, both for savings banks and insurance companies. The legal investment laws for insurance companies in New York are particularly important, because all insurance companies licensed to do business in the Empire State must comply therewith. Designing an equipment trust financing to comply with these provisions is not particularly difficult, but they must be kept in mind to avoid inadvertently limiting the market for the financing.

Some legal investment laws are pegged to ratings by recognized independent rating agencies, usually permitting investment in debt securities that are rated "investment grade," or in one of the three highest rating grades. (Both Moody's and Standard & Poor's characterize the four highest grades as "investment grade."). Rating agencies customarily have rated railroad equipment obligations having typical characteristics — 15-year maximum maturity, financing of not more than 80% of equipment cost, and the protection of section 1168 of the Bankruptcy Code — not lower than the third highest grade, even if the senior debt of the railroad is rated substantially lower.

B. SECTION 10 OF THE CLAYTON ACT

An often forgotten federal statute is section 10 of the Clayton Act, an antitrust law with criminal penalties. It prohibits transactions between

common carriers and other entities with common officers or directors, unless the transaction is done pursuant to competitive bidding under the regulations of the Interstate Commerce Commission. 108

Transactions between a railroad company and wholly-owned subsidiary are usually thought of as not raising the prospect of criminal prosecution, if the economic effect is a wash. 109 But the question of interlocking directorates with other parties can present a very real problem, and the question must be asked at the beginning of a transaction. Here again, the statute is limited to common carriers, and private car line transactions do not have this problem.

C. BANKRUPTCY

Secured transactions are subject to the automatic stay in bankruptcy proceedings, and payments on the obligation may be limited for a time to a measure of "adequate protection," instead of the payments specified in the contract. Thus in the eyes of institutional investors, a critical element of railroad equipment obligations is the special protection in bankruptcy afforded by section 1168 of the Bankruptcy Code:

(a) The right of a secured party with a purchase-money equipment security interest in, or of a lessor or conditional vendor of, whether as trustee or otherwise, rolling stock equipment or accessories used on such equipment, including superstructures and racks, that are subject to a purchase-money equipment security interest granted by, leased to, or conditionally sold to, the debtor to take possession of such equipment in compliance with the provisions of a purchase-money equipment security agreement, lease, or conditional sale contract, as the case may be, is not affected by section 362 or 363 of this title or by any power of the court to enjoin such taking of possession, unless—

(1) before 60 days after the date of the order for relief under this chapter, the trustee, subject to the court's approval, agrees to perform all obligations of the debtor that become due on or after such date under such security agreement, lease, or conditional sale contract, as the case may be; and

(2) any default, other than a default of a kind specified in section 365(b)(2) of this title, under such security agreement, lease, or conditional sale contract, as the case may be—

(A) that occurred before such date is cured before the expiration of such 60-day period; and

(B) that occurs after such date is cured before the later of—

(i) 30 days after the date of such default; and

(ii) the expiration of such 60-day period.

(b) The trustee and the secured party, lessor, or conditional vendor, as the case may be, whose right to take possession is protected under subsection

(a) of this section may agree, subject to the court's approval, to extend the 60-day period specified in subsection (a)(1) of this section.\textsuperscript{110}

The legal lore of this provision is closely related to the similar provision for aircraft, section 1110,\textsuperscript{111} which has been the subject of much learned comment, some very good,\textsuperscript{112} some not.\textsuperscript{113} To consider the effect of these provisions, we should get it right from the horse's mouth, the comments of the House of Judiciary Committee, the drafters of the Bankruptcy Code, on section 1110:

This section, to a large degree, preserves the protection given lessors and conditional vendors of aircraft to a certificated air carrier or of vessels to a certificated water carrier under section 116(5) and 116(6) of present chapter X. It is modified to conform with the consolidation of chapters X and XI and with the new Chapter 11 generally. It is also modified to give the trustee in a reorganization case an opportunity to continue in possession of the equipment in question by curing defaults and by making the required lease or purchase payments. This removes the absolute veto power over a reorganization that lessors and conditional vendors have under past law, while entitling them to protection of their investment.

The section overrides the automatic stay or any power of the court to enjoin taking of possession of certain leased, conditionally sold, or lien equipment, unless the trustee agrees to perform the debtor's obligations and cures all prior defaults (other than defaults under ipso facto or bankruptcy clauses) within 60 days after the order for relief. The trustee and the equipment financer are permitted to extend the 60-day period by agreement. During the first 60 days, the automatic stay will apply to prevent foreclosure unless the creditor gets relief from the stay.


\textsuperscript{111} The first part of 11 U.S.C. § 1110 is similar to 11 U.S.C. § 1168:

1110. Aircraft equipment and vessels

(a) The right of a secured party with a purchase-money equipment security interest in, or of a lessor or conditional vendor of, whether as trustee or otherwise, aircraft, aircraft engines, propellers, appliances, or spare parts, as defined in section 101 of the Federal Aviation Act of 1958 (49 U.S.C. 1301), or vessels of the United States, as defined in subsection B(4) of the Ship Mortgage Act, 1920 (46 U.S.C. 911(4)), that are subject to a purchase-money equipment security interest granted by, leased to, or conditionally sold to, a debtor that is an air carrier operating under a certificate of convenience and necessity issued by the Civil Aeronautics Board, or a water carrier that holds a certificate of public convenience and necessity or permit issued by the Interstate Commerce Commission, as the case may be, to take possession of such equipment in compliance with the provisions of a purchase-money equipment security agreement, lease, or conditional sale contract, as the case may be, is not affected by section 362 or 363 of this title or by any power of the court to enjoin such taking of possession unless ....

The remaining subparagraphs are identical to those of section 1168. 11 U.S.C. § 1110 (1982).


\textsuperscript{113} Goldman, Album and Ward, Repossessing the Spirit of St. Louis: Expanding the Protections of Sections 1110 and 1168 of the Bankruptcy Code, 41 BUS. LAW. 29 (1985).
The effect of this section will be the same if the debtor has granted the security interest to the financer or if the debtor is leasing equipment from a financer that has leveraged the lease and leased the equipment subject to a security interest of a third party.\(^{114}\)

The history of section 1168 goes back to the reorganization of the Chicago, Rock Island and Pacific Railway in the 1930's. The legal traditions of the time had given effect to the title-retention features of equipment trust and conditional sales agreements to protect equipment creditors in equity receiverships. Equipment obligations had been honored, for the most part, through various periods of economic distress in the industry,\(^{115}\) and equipment obligations had consequently been regarded as investment vehicles of very low risk. In the Rock Island proceeding, payments on equipment obligations were suspended, an extraordinary event. When the issue was litigated, the Supreme Court determined that secured creditors could be enjoined from recovering collateral if such recovery would delay or obstruct the reorganization.\(^{116}\) A revolting development, to be sure.

The courts having been found unsympathetic to equipment creditors, relief was sought in the legislature. As part of a rearrangement and simplification of section 77 of the Bankruptcy Act (section 77 covered railroad reorganizations) in 1935,\(^{117}\) Congress added a sentence to the end of section 77(j):

The title of any owner, whether as trustee or otherwise, to rolling-stock equipment leased or conditionally sold to the debtor, and any right of such owner to take possession of such property in compliance with the provisions of any such lease or conditional sale contract, shall not be affected by the provisions of this section.\(^{118}\)

It is clear from the legislative history of this provision that it was intended to preserve what was regarded as an existing right of equipment creditors, and that such right was crucial to the continued access of the railroads to the capital markets.\(^{119}\)

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\(^{114}\) H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 405 (1977). The comments on section 1168 (section 1166 of H.R. 8200) are brief, citing the parallel section 1110. Id. at 423. The two provisions are generally treated in the legislative history as involving the same issues. Id. at 238.

\(^{115}\) Street, supra note 27.


\(^{118}\) Id., 49 Stat. 922.

\(^{119}\) H.R. Doc. No. 89, 74th Cong., 1st Sess. (1935); Hearings before the committee on the Judiciary on H.R. 6249, 74th Cong., 1st Sess. 60 (1935) (statement of Coordinator's Counsel); id. at 79; S. REP. No. 1336, 74th Cong., 1st Sess. 5 (1935). A statement in the House Judiciary Committee report summarizes the views at the time:

Under the present provisions of section 77, there is doubt whether the trustee under the typical equipment-trust agreement is entitled to the possession of the property insured by the terms of the agreements, it having been urged in some of the pending cases that, under the provisions of section 77, the equipment-trust arrangement must
Access to capital was important in other transportation industries, too. Special protective provisions for equipment obligations of airline companies and water carriers were later added to the Chapter X reorganization provisions of the Bankruptcy Act. These followed the language of the last sentence of section 77(j), including the references to title retention devices—conditional sales and leases.\(^{120}\) When the bankruptcy laws were overhauled in the '70s,\(^ {121}\) the affected industries and the investment community made it perfectly clear to the drafters of the new law that such provisions were essential, and that financing of transportation equipment could not continue without them.\(^ {122}\)

\(^{120}\) Section 116(5) was added in 1957: Notwithstanding any other provisions of Chapter X, the title of any owner, whether as trustee or otherwise, to aircraft, aircraft engines, propellers, appliances, and spare parts (as any of such are defined in the Civil Aeronautics Act of 1938, as now in effect or hereafter amended) leased, subleased, or conditionally sold to any air carrier which is operating pursuant to a certificate of convenience and necessity issued by the Civil Aeronautics Board, and any right of such owner or of any other lessor to such air carrier to take possession of such property in compliance with the provisions of any such lease or conditional sale contract shall not be affected by the provisions of this chapter if the terms of such lease or conditional sale so provide.

\(^{121}\) Section 116(6) followed in 1968: Notwithstanding any other provisions of this chapter, the title of any owner, whether as trustee or otherwise, to vessels (as the term is defined in the Ship Mortgage Act, 1920, as now in effect or hereafter amended) leased, subleased, or conditionally sold to any water carrier which holds a certificate of public convenience and necessity or permit issued by the Interstate Commerce Commission, and any right of such owner of any other lessor to such water carrier to take possession of such property in compliance with the provisions of any such lease or conditional sale contract shall not be affected by the provisions of this chapter if the terms of such lease or conditional sale so provide.

\(^{122}\) The vigor of the lobbying effort is evidenced by this comment of the House Judiciary Committee: "Whether or not there was an initial need for these provisions, their existence has become largely addicting to the financing industry, and now the industry claims it would simply cease financing of the relevant equipment if the protections were removed." H.R. Rep. No. 95-595, supra note 114, at 239.
Thus it was the intention of the drafters of the Bankruptcy Code to preserve the traditional rights of equipment creditors to move against the collateral, but with modifications to accommodate the "joint interests of the equipment financiers and of the integrity of the bankruptcy laws and the reorganization process." Thus the provisions giving the bankruptcy trustee the right to retain possession of the equipment by agreeing within a certain period to perform the obligations under the financing agreement.

The drafters of section 1168 also wished to respond to changes in personal property security law since 1935. The conditional sale and the lease for security embodied in the equipment trust had been supplanted (but not replaced) by the unified, generic form of security interest under Article 9 of the Uniform Commercial Code. To avoid forcing equipment financing transactions into outmoded forms, reference was made in the new legislation to "security interests." The Bankruptcy Code provided its own definition for this term, but it is clear that it is founded on the Uniform Commercial Code creature.

In order to avoid the broad scope of the term "security interest," which would include general mortgages, the words of limitation "purchase money" were added, to include "only security interests that were granted to finance the acquisition of the covered equipment." These words have caused some anxiety in connection with sale-leasebacks of aircraft, because such financing seemed inconsistent with the legislative intent even though the reference to leases in the statute is not qualified by the term "purchase-money." The consensus of current comments, however, is that the statute means what it says, and such concerns are not justified.

The words "purchase-money" must also be considered in connection with the practice of railroad companies to accept delivery of equip-

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123. H.R. Rep. No. 95-595, supra note 114, at 239.
124. It has been the custom to provide for such rights of bankruptcy trustees in the default provisions of railroad equipment obligations, because reorganization of railroad companies is a not uncommon procedure, and it is thought better to have the equipment obligations ride through the organization (so long as payments were kept current) rather than to repossess and sell the collateral. This has not been the custom in aircraft equipment obligations, however. Aircraft equipment obligations always had ipso facto bankruptcy default clauses, declaring bankruptcy or insolvency an immediate event of default. They still do, even though such clauses are ineffective under the Bankruptcy Code. 11 U.S.C. §§ 363(1), 365(e); see H.R. Rep. No. 95-595, supra note 114, at 346, 348.
128. Id. at 240.
130. Sheneman, supra note 112; Gerstell and Hoff-Patinos, supra note 112.
ment and pay for it as it comes from the manufacturer, and later to subject a group of this equipment to an equipment trust financing. (This practice also relates to the section 3(a)(6) exemption from registration under the '33 Act, discussed above.) The references to lessor and lease in section 1168 should be interpreted broadly enough to encompass the nominal lessor and the bailment-lease embodied in the traditional Philadelphia plan equipment trust, if the court is sensitive to the traditions of equipment obligations and the legislative history of that section of the Bankruptcy Code. 131 Nevertheless, the parties to an equipment trust agreement should ensure that there is a very clear connection in the record between the acquisition of the equipment and the financing. The best course of action is the arrangement of the financing before the first unit of equipment is delivered, but failing that, interim financing in contemplation of the "permanent" financing should be satisfactory. At a minimum, the corporate resolution authorizing the purchase of the equipment should speak of the ultimate financing arrangements.

The purchase-money limitation also affects transactions to finance the rebuilding of railroad equipment. Rebuilding can range from fumigating the weevils to work of such magnitude that a unit will be given a new date by the Association of American Railroads for the purposes of car hire charges. 132 But it would take a great semantic stretch to treat rebuilding as acquisition, no matter what the content of new parts. Thus it cannot be assumed that a debt financing to cover the cost of rebuilding equipment already owned by a railroad company would be covered by section 1168.

What is a railroad to do? The purchase of rebuilt equipment does no violence to the language or intention of section 1168, so a railroad could trade in its hulks for others in the inventory of the rebuilder, have the rebuilding done to its order, and then purchase the rebuilt equipment and finance the purchase. If the railroad contemplates doing the rebuilding in its own shops, the hulks would have to be the property of someone else, that someone else would contract with the railroad for the rebuilding, and the railroad would acquire the rebuilt cars after rebuilding is complete. Because much of the proceeds of the financing goes back to the railroad to cover the costs of rebuilding, there might be doubt in some minds about meeting the purchase-money test. But here we can look to railroad tradition. Since the beginning of railroading, rolling stock has often been built in a railroad's own shops. During construction, the cars would be

131. It is clear from the legislative history of the last sentence of section 77(j) that the drafters thereof understood that the leases embodied in the contemporary equipment trust agreements, and referred to in the legislation, were bogus and "...in form and substance are generally in the nature of contracts of conditional sale." H.R. REP. No. 1283, 74th Cong., 1st Sess. 4 (1935).

132. Car hire charges, the amounts railroad companies pay one another for the use of rolling stock, are an inverse function of the age of the railroad car.
owned by an individual, usually a company employee. Upon completion of construction, an equipment trust financing would be arranged, and the individual would convey the equipment to the trustee. No one ever doubted that such a transaction would have the protection of the last sentence of section 77(j) of the Bankruptcy Act.

If a railroad proposes to do the rebuilding of its own hulls, or have its own hulls rebuilt on the outside, it may be asking too much of tradition and usage to assure the protection of section 1168 in a debt financing. A better approach would be a sale and leaseback, relying on the express words of the statute that protect lessors and leases. This should not offend even those who look askance at sale and leaseback transactions, for the proceeds of the financing are surely being used to increase the traffic capacity of the railroad. Which is what the drafters of that sentence had in mind in 1935.\textsuperscript{133}

V. AUTORACKS

A major factor in the economic performance of American railroads is the movement of automobiles to market. The necessary efficiency is achieved with special autorack cars — flat cars with two or three level racks, often with a metal skin, to carry new cars and small trucks.

While an autorack car may have the look of a single unit, such a car is actually two separate things, mechanically and legally — the flat car and the autorack placed on it. Autoracks are like buildings, in that they are attached to the surface that they stand on and depend on it for support — but that surface usually belongs to someone else, and it moves.

Autoracks represent considerable investment — more than the flat cars on which they are erected — so they are often the subject of a financing. Sometimes alone, more often with other equipment types, never with those flat cars. Such a financing involves some special considerations.

Section 1168 of the Bankruptcy Code specifically covers autoracks, speaking of "rolling stock equipment or accessories used on such equipment, including superstructures and racks. . . ."

Section 11303 of the Transportation Code, the federal law provision for the recordation of interests in railroad equipment with the Interstate Commerce Commission, does not. This statute speaks only of "railroad cars, locomotives, or other rolling stock. . . ."

That is not terrible. Autoracks are certainly mobile goods, and the filing of a financing statement describing that collateral in the state where the debtor (and the lessee, in a lease transaction) has its chief executive

\textsuperscript{133} Supra note 119.
office will perfect a security interest in the racks in every state (including Louisiana, after January 1, 1990). Because a railroad company would fit the definition of a "transmitting utility," continuation statements need not be filed to continue the effectiveness of the financing statements after five years. But, \textit{nota bene}, private car lines and equity participants are not transmitting utilities, and continuation statements must be filed every five years to maintain the perfect status of a security interest against such entities.

The federal statute in Canada covering interests in railroad equipment, section 86 of the Railway Act, speaks only of rolling stock, so like the American statute, it is of no use for autorack financing. The filing provisions of provincial law would have to be used.

Also limited to rolling stock is the exemption from the registration requirements of the Securities Act of 1933, expressed in section 3(a)(6) thereof.

\section{VI. RECOMMENDATIONS}

The arrangement and documentation of a railroad equipment financing should proceed just as any other secured transaction covered by Article 9 of the Uniform Commercial Code, or any other lease by reference to contract and personal property lease law (and Article 2A of the Uniform Commercial Code when, if, and as it is adopted). But there are these points to keep in mind.

1. Railroad equipment obligations, whether leases or secured transactions, and assignments thereof, must be recorded with the Interstate Commerce Commission pursuant to 49 U.S.C. § 11303, and the regulations at 49 C.F.R. § 1177. That statute does not accommodate generic Article 9 security interests, and a conditional sale, chattel mortgage, or equipment trust must be used as a debt instrument. The statute is not limited to obligations of common carrier railroads, and all obligations relating to railroad rolling stock, regardless of the user or owner, must be recorded under the statute.

2. In many other respects, the equipment obligations of railroad companies and the railroad equipment obligations of other entities are governed by different statutes. The distinction between these two separate families of obligations should be observed in analysis, drafting, and implementation of a transaction.

3. Obligations of railroad carriers used to acquire rolling stock and locomotives are exempt from the registration under the Securities Act of 1933, need not be approved by the Interstate Commerce Commission under 11 U.S.C. § 11301, and are exempt from the registration and filing provisions of state blue-sky laws. The custom of placing these obliga-
tions only with institutional investors should be continued so as not to betray the confidence of Congress in the integrity of these obligations and the issuance thereof. An offering circular should be prepared and used in the same circumstances that a prospectus would be used for issues registered under the '33 Act keeping in mind the civil liabilities for untrue statements and omissions of material facts set forth in section 12 and the prohibition against fraud of set forth in section 17 of that Act.

4. Railroad equipment obligations of private car lines, shippers, and other entities not regarded as railroad companies are not exempt from the registration requirements of the '33 Act, and if an exemption from registration under section 4(2) of that act is not available, such obligations must be registered.

5. The requirements of the legal investment laws, particularly those for the state of New York, should be observed.

6. The possibility of interlocks between officers and directors of the parties to a financing involving a railroad company should be searched out at the beginning of a transaction, to avoid conflict with the restrictions of section 10 of the Clayton Act.

7. Equipment obligations issued by railroad companies should have a clear connection between the acquisition of the equipment and the financing, if the benefits of section 1168 of the Bankruptcy Code are to be available to the financing parties.

8. Section 1168 of the Bankruptcy Act does not apply to entities other than railroad companies, and such obligations will be subject to the usual rules for automatic stay and adequate protection of secured transactions or the rules for unexpired leases under the Bankruptcy Code.

9. Transactions to finance the rebuilding of equipment must be carefully constructed to obtain the protection of section 1168 of the Bankruptcy Code. The structure of a transaction should be established before rebuilding commences.
Administrative Bulls in the Delicate China Shop of Motor Carrier Operations — Revisited

JAMES C. HARDMAN*

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I. INTRODUCTION

In 1966, an extensive analysis of the actions of the National Labor Relations Board\(^1\) in determining whether certain personnel engaged by motor carriers in their operations\(^2\) were employees or independent contractors in the context of the National Labor Relations Act\(^3\) was undertaken.

The title "Administrative Bulls in the Delicate China Shop of Motor Carrier Operations" was chosen because research and reflections led to the belief that the NLRB was charging into the industry's operations in such a manner as to cause considerable confusion, concern, and in some instances havoc.

The recent decision in North American Van Lines, Inc. v. National Labor Relations Board\(^4\) indicates that the "China Shop" is still being visited by the NLRB. Of more concern in the industry today, however, are the recent activities of the Internal Revenue Service\(^5\) as they address the same issues in the context of employment taxes.\(^6\)

While many in the industry believe this activity to be new, it is more appropriate to characterize it as reinvigorated.\(^7\) The issue of "employee" v. "independent contractor" has a long and controversial history and there are numerous decisions and/or rulings by courts\(^8\) and the

\(\text{\footnotesize\(^1\)}\) Hereinafter, "NLRB".

\(\text{\footnotesize\(^2\)}\) The personnel situation studied was that of "owner-operators" who for purposes of that article and this paper can be defined as a driver who controls or owns and drives a tractor or a tractor-trailer unit which is leased to the motor carrier and who provides incidental service thereto. Singer and Hardman, Administrative "Bulls" in The Delicate China Shop of Motor Carrier Operations, 17 Lab L. J. 584 (1966).


\(\text{\footnotesize\(^4\)}\) 869 F.2d 596 (D.C. Cir. 1989).

\(\text{\footnotesize\(^5\)}\) Hereinafter, "IRS".

\(\text{\footnotesize\(^6\)}\) The issue also arises in other areas of the law, including employee fringe benefits, unemployment compensation, workers' compensation, wage and hour laws, immigration law, and civil rights. In respect to the last area, see Dowd, The Test of Employee Status: Economic Realities in Title 7, 26 WM & MARY L. REV. 75 (1984).

\(\text{\footnotesize\(^7\)}\) See, I.R.S. News Release IR-88-45 announcing the intent to focus on this issue.

\(\text{\footnotesize\(^8\)}\) See, the discussion in United States V. Webb, 397 U.S. 179 (1969).
IRS\textsuperscript{9} which deal specifically with the relationship within the motor carrier industry.

Many excellent papers have recently been written on the substantive aspects of the legal problem,\textsuperscript{10} and legal counsel specializing in motor carrier and tax law have been making an effort to acquaint the motor carrier industry with the issues involved.\textsuperscript{11}

It is essential that this type of preventive law be undertaken as the decision of the IRS to reinvigorate its program of auditing individual companies can lead to adverse findings which can have serious consequences.

II. CONSEQUENCES OF MISCLASSIFICATION

A. STATUTORY LIABILITY

If an employee has been erroneously classified as an "independent contractor" the carrier-employer will generally be liable for the full amount of FICA\textsuperscript{12} (both employee’s and employer’s share), FUTA,\textsuperscript{13} and income tax withholding.\textsuperscript{14}

Liability can be high as the IRS can go back three years when seeking such taxes and can assess penalties and interest in determining the total tax liability.\textsuperscript{15}

It has been reported that one major motor carrier was faced with a potential tax liability of $15 million in back taxes. Other carriers have faced more than $1 million in back tax liability. A handy gauge of potential liability is between $25,000 and $50,000 per driver.\textsuperscript{16}


\textsuperscript{10} See for example, Clark, Independent Contractor-Employee, What Are They — Why?, a paper delivered at the 1989 Conference Professional Program, Transportation Lawyers Association; and Moore, Definition of "Employee" — Common Law Rules, a paper delivered to the 1988 Safety Council Meeting of the Interstate Truckload Carrier Conference of the American Trucking Association.

\textsuperscript{11} The present paper, for example, is adapted from a speech the author presented to the 1989 Safety Council Meeting of the Interstate Truckload Carrier Conference of the American Trucking Associations.


\textsuperscript{13} "FUTA" refers to taxes due under the Federal Unemployment Tax Act, 26 U.S.C. § 3301 (1989).


\textsuperscript{16} See, Schultz, IRS Crackdown on Carrier Focuses on Owner-Operators, TRAFFIC WORLD Jan. 21, 1989, at 34.
B. RELIEF PROVISIONS

1. SAFE HARBOR PROVISION

There are, however, certain relief provisions which minimize the extent of exposure a motor carrier may face. Under Section 530 of the Revenue Act of 1978, a safe harbor exits for purposes of FICA, FUTA, and income tax withholding.

An individual may be treated as an independent contractor if these three requirements are met:

1. The individual has been treated consistently as a non-employee;
2. The taxpayer has a reasonable basis for not treating the individual as an employee; and,
3. The taxpayer must not have treated any individuals holding substantially similar positions as employees for purposes of employment taxes for any period after December 31, 1978.

2. ERRONEOUS CLASSIFICATION RELIEF

The Tax Equity and Fiscal Responsibility Act of 1982 also contains a relief provision for the erroneous classification of individuals as independent contractors.

The Act attempts to see that the tax assessment in a misclassification case is closer to the amount of lost revenue to the Treasury after considering the average tax paid by misclassified workers.

To accomplish this purpose, set percentages are applied to determine the employer’s liability for income tax withholding and the employee’s share of FICA. No relief is provided for FUTA and the employer’s share of FICA nor if the liability is due to the intentional disregard of the requirement to withhold and deposit the taxes.

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19. This standard is to be liberally construed in favor of the taxpayer. Ridgewell’s, Inc. v. United States, 81-2 U.S.T.C. ¶ 9583 (Cl.Cl. 1981) and Rev. Proc. 85-18, 1985-1 C.B. 518. Generally a reasonable basis exists if reliance is based on (1) judicial or administrative precedent including a private IRS letter ruling; (2) a previous audit upholding the classification; or (3) long standing industry practices. The American Institute of Family Relations v. United States, 44 AFTR2d ¶ 79-5042 (D.C. Cir. 1979).
3. ABATEMENT OF TAX LIABILITY

There are also two provisions for potential abatement of an employer’s liability due to a misclassification. Section 3402(d) provides that an employer may offset any income tax paid by the individual against the income tax which should have been withheld and deposited.\(^{25}\)

Section 6521(a) provides that if the employer paid self-employment tax and the employee is barred from recovering the tax paid, the employer may offset the employee’s share of FICA otherwise due the amount paid by the employee.\(^{26}\)

The abatement procedures, however, do not apply if Section 3509\(^{27}\) applies.\(^{28}\)

III. COMPLEXITY OF SUBSTANTIVE LAW ISSUES

The issue of “independent contractor” v. “employee” is not one of minor complexity nor are there any “quick fixes”. The principle of law can be boiled down to a simple and brief statement. The difficulty arises in applying it to specific factual situations.

An employee may simply be defined as an individual who performs services for another who has the right to control and direct the individual as to the results desired as well as the details and means by which the results should be accomplished.\(^{29}\) An independent contractor, on the other hand, is an individual who performs services under an oral or written agreement to benefit another party and to achieve a specified result, but who is not subject to the control or direction of the other party in respect to the details or means by which the result is achieved.\(^{30}\)

These definitions appear simple enough until one starts to ask questions such as “What does the right to control mean?” and “What type of directions are we concerned with?”. The answers to these and other questions are not simple.

Legislators, courts, and administrative agencies have grappled with the distinction between “independent contractor” and “employee” since the early days of administrative regulations.


\(^{29}\) The definition of an “employee” for federal employment regulation is set forth in IRS Regulations, 26 C.F.R. § 31.3121(d)-1(c) (1988).

\(^{30}\) In IRS Regulations, 26 C.F.R. § 31.3121(d)-1(c) (1988), an independent contractor is differentiated from an employee. In United States v. Webb, 397 U.S. 179, 194 (1969), the Court cautioned the Regulations merely provided a summary or initial guide to the issue and were not intended to displace the common law rules.
A. The Common Law Test

The original Social Security Act,\textsuperscript{31} when adopted in 1935, defined employees by merely specifying that the term included an "officer of a corporation."\textsuperscript{32} Thus, it was thought that the term "employee" was to be given its usual common law meaning.\textsuperscript{33}

Various courts, however, in recognizing that the legislation addressed social problems or areas attempted to broaden the coverage to include any individuals who as a matter of economic reality were dependent upon the business to which they rendered service.\textsuperscript{34}

The administrative agency also attempted to broaden the scope of coverage until it was stopped by the so-called Gearhart Resolution.\textsuperscript{35} The present Federal Employment Tax Regulations,\textsuperscript{36} as a result, now embrace the common law test.

B. The IRS Regulations

Under the Regulations:\textsuperscript{37}

1. Each individual is an employee if under the usual common law rules the relationship between him and the person for whom he performs service is the legal relationship of employer and employee.

2. The relationship generally exists when the person for whom the services are performed has the right to control and direct the individual performing the service not only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished.

The Regulations refer to some specific factors to consider such as the right to discharge and the furnishing of tools and a place of work.\textsuperscript{38} As the Supreme Court cautioned in \textit{United States v. Webb}, however, the Regulations are a brief sketch or summary of relevant factors and were not intended to displace the common law rules themselves.\textsuperscript{39}

\begin{itemize}
\item 31. 49 Stat. 620 (1935).
\item 32. 49 Stat. 620, 647 (1935).
\item 33. See, United States v. Webb, 397 U.S. 179 (1969) for a full discussion of the common law rules and the definition of "employee".
\item 34. See, United States v. Silk, 331 U.S. 704 (1947) and Bartles v. Birmingham, 332 U.S. 126 (1947).
\item 37. See, 26 C.F.R. § 31.3121(d)-1(c) (1988).
\item 38. Id.
\item 39. Webb, 397 U.S. 179 at 194.
\end{itemize}
1. **Right of Control**

   If the right of control of the matter or means of performing the work is in the person or entity for whom the service is performed, the relationship almost certainly will be found to be an employment relationship. Under the common law this criterion definitely carries more weight than all the others.\(^{40}\)

   In the context of motor carrier operations, this factor would be evidenced in part by the necessity to comply with operations manuals, to follow certain routes, requiring reports, requiring services to be performed personally, the establishment of set hours of work, and “forced” dispatch.\(^{41}\)

   While the control necessitated by federal regulations such as the Leasing Rules and Regulations\(^{42}\) and the Safety Regulations\(^{43}\) has generally not caused difficulties in the area of federal employment taxes,\(^{44}\) the questions which motor carriers still face evolve around the imposition of service requirements by customers.

   The motor carrier industry is highly competitive and in particular segments of it, pickups and deliveries are not only scheduled in terms of the day, the portion of the day involved, *i.e.*, a.m. or p.m., but in terms of a specific hour or portion of it. Missing a scheduled delivery, for example, can subject the carrier to damages for any production downtime incurred by a receiver who does not carry an inventory.

   Thus, it is difficult to conduct a business where the individual driving the vehicle has the unfettered right to accept or reject a load which is under customer imposed time restraints and the driver is the only individual with the present ability to handle the load.

   Similarly, shippers want to be able to trace their loads while in transit. Carriers must know the position of the vehicles to plan ahead in terms of:

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\(^{40}\) See, Hoosier Improvement Co. v. United States, 350 F.2d 640 (7th Cir. 1965) and Barrett v. Phinney, 278 F.Supp. 65 (S.D. Tex. 1968) (Workers Compensation.)

\(^{41}\) See, Rev. Rul. 70-441, 1970 C.B. 210 and Rev. Rul. 69-349, 1969-1 C.B.261. “Forced” dispatch is the practice of requiring a driver to haul a specific load as opposed to giving the driver a choice between loads to be hauled.


\(^{43}\) See, for example, Hours of Service of Drivers, 49 C.F.R. Pt. 395 (1988).

\(^{44}\) Difficulties, however, exist in other areas of the law as courts have not consistently treated governmental regulations in the employee-independent contractor equation. Compare Local 77 v. NLRB, 603 F.2d 862 (D.C. Cir. 1979) (government regulation constitutes supervision by state and not alleged employer) and Transport Motor Express v. Smith, 262 Ind. 41, 311 N.E.2d 424 (1974) (inconsistent to have control required by ICC Regulations and to assert worker is an independent Contractor).
accepting loads, to be available when the equipment unloads, or to be assured that the load in transit has not been hijacked or diverted.

Yet the requirement that a driver handle a load in the circumstances above and/or make daily or periodic reports have traditionally been construed to evidence control.

The smart carrier will recognize that it must meet the competitive realities of the marketplace or the issue of "employee" or "independent contractor" will be a moot one. Agencies and courts must do likewise.

If "control" is necessitated because of customer demands, and assuming the individual independent contractor is willing to contract to provide certain reports or to handle certain "required" loads, it appears that these factors should not bear on the "employment issue" any more so than government imposed regulations.

2. INDEPENDENT BUSINESS

A second factor in the common law test of "employment" is whether the independent contractor is actually operating a viable trade or business.

This involves such questions as whether there is an investment of a substantial sum in equipment or tools, whether the individual bears a risk of loss attributable to the operation, whether the business serves multiple accounts, and whether the business engages employees or helpers in conducting operations.

In terms of motor carrier operations, the IRS probably considers the most significant question to be whether the person has a significant investment in equipment and facilities used in performing services for another.45

Individuals who own and furnish trucks they own have no problem meeting this criterion. A relatively new phenomena, however, has been occurring in the motor carrier industry, i.e., carrier assisted equipment acquisitions.

The rising cost of tractors46 has made it difficult for some individuals to acquire new equipment which is basically required to survive economically. This problem is compounded by the fact that little credit is available to independent contractors because so many have traditionally been poor businesspersons, the success of the business is so dependent upon the individual,47 and the assets are constantly moving making it difficult to

45. R.L. Moore, Technical Assistant to the Assistant Chief counsel of Employee Benefits and Exempt Organizations, Internal Revenue Service, stated that in his opinion this was probably the most significant factor for the motor carrier industry. Moore, supra, Note 10, at 16-17.
46. A new over-the-road tractor will cost from $75,000 to $125,000.
47. Many independent contractors will not allow any other person to drive his or her vehicle.
foreclose, inspect, or otherwise feel "secure".48

Carriers, on the other hand, can secure lower prices because of mass purchasing, may have better knowledge of the credit worthiness of the individuals.49 have an incentive to modernize the fleet,50 an can feel more secure as they will know if the vehicle is, in fact, being used in potentially profitable operations and generally where it is if repossession is necessary.51

A dilemma, however, may exist. The IRS may not feel that the individual's investment is real or adequate.52 The mere fact that a carrier may finance the equipment, however, should not lead to this conclusion. The real issue is whether the relationship created, whether a conditional sale, a lease-purchase option, or even a true lease, is, in fact, a bona-fide one.

If the carrier is making a reasonable return on its investment, charging commercially reasonable rates of interest and/or lease payments, and, in practice, operating this aspect of its business in a manner similar to an independent dealer or finance company, the independent contractor relationship should not be in jeopardy.

This issue was raised in North American Van Lines, Inc. v. National Labor Relations Board. While the agency gave considerable weight to it in deciding the individuals were employees,53 the Court found that while the practice, as well as some other supportive efforts, had the potential to lead to "control", the facts did not lead to this conclusion nor support the inference of control. The Court noted that financing was done at competitive rates and that the finance contracts were frequently sold to third

Thus, if an illness occurs, the vehicle may sit idle and few have adequate insurance to cover such business contingencies. See Hardman, Owner-Operator — Do You Have Insurance To Survive a Business Interruption? TRANSPORTATION TOPICS, 2814, p. 36 (July 10, 1989).

48. A tractor may be operated in any of the 48 contiguous states or Canada and be away from its home base for extended periods of time. A financier has little opportunity to inspect it and to know if it is still operable and operating.

49. As part of the driver certification process, the carrier is obligated to secure information on past driving records, past employment, health information, and references. See generally, Qualifications of Drivers, 49 C.F.R. Pt. 391. This information all bears on the issue of credit worthiness.

50. Generally, newer tractors have fewer breakdowns and are available to haul more loads. Normally, the vehicles are more fuel efficient and thus the operator can make a greater net profit in his or her operations and is more satisfied with the contractual relationship.

51. A carrier will know if the equipment has no pickup or delivery scheduled and for business purposes will investigate immediately. An independent financier will not be put on notice until a scheduled payment is missed and may have little information to start a search for the equipment thereafter.

52. See, Moore, supra, note 10 at pp.17-18.

Another criterion in determining whether an independent business exists is whether the individual has control over the factors which will determine whether he or she can make a profit or loss.

In terms of revenue, it is clear that an employee may have the opportunity for higher income based on a piecework or commission basis. Therefore, the test should be a two pronged approach, i.e., the ability to determine to a significant extent how much revenue or income will be deprived, and how much the individual’s ingenuity, initiative, and judgment will control costs affording the opportunity for a profit or a resultant loss.

Factors to be considered include whether the individual; (1) has the prerogative to hire and direct helpers or assistants, (2) is responsible for his or her own expenses on the road and determining what expenses will be incurred, (3) has the right to determine what loads will be handled, or how many loads will be hauled, (4) has the right to determine what maintenance will be done on equipment and by whom, and other similar factors.

The issue of serving multiple accounts is also a criterion which arises and is a difficult one motor carriers must face since it is frequently said that a continuing singular relationship indicates that an employer-employee relationship exists.

Yet, motor carriers are faced with market conditions in which a shortage of independent contractors exist. Considerable time and money is spent in advertising and searching for independent contractors. Thus, motor carriers have a substantial interest in establishing an environment in which independent contractors can succeed financially and enjoy contractual relationships with carriers on a continuing basis.

Compounding the problem is the fact that governmental regulations basically preclude “contract hopping”. In North American Van Lines Inc., for example, one of the factors discussed was the carrier’s restriction on “trip leasing”. The Court rightfully found that some of the limits im-

54. 869 F.2d 596 at 604.
55. Moore considers this the second most significant factor. Moore, supra, note 4, at pp. 19-20.
56. Dart Transit Company, one of the largest, if not the largest, motor carrier utilizing independent contractors has approximately 15 employees who devote either full or part time efforts to independent contractor relations including recruiting. There are numerous publications which exist only to carry advertisements of carriers for independent contractors and employee drivers. See, for example, “Pro Trucker”, a monthly magazine published by Ramp Enterprises, P.O. Box 549, Roswell, GA 30077-0549.
57. North American Van Lines, Inc., 869 F.2d 596 at 604, “Trip” leasing is a procedure whereby a motor carrier with operating authority from the Interstate Commerce Commission can sublease the equipment and operator of that equipment to another similarly authorized motor
posed resulted from government regulations.\textsuperscript{58}

The real issue is not whether the individual under contract with a particular carrier can serve multiple accounts with the same vehicle or vehicles under lease, but whether he or she may expand the business and use other equipment in the service of other carriers. If no prohibition exists in respect to the latter alternative, it should be an indication of an independent contractor relationship.

3. \textit{Integration}

Closely related to the issue of an "independent business" is the question of whether the motor carrier is so dependent upon the services of the individual under contract that the individual is necessarily subject to control establishing "employment".

In \textit{Morish v. United States},\textsuperscript{59} the Court of Claims found such integration to exist where the plaintiff carrier had a direct financial interest in the diligence and competency of drivers in that the success of his business depended on the driver's success in getting towing jobs and in handling such jobs in a proper manner.

This test, however, is essentially the reverse of the economic reality test used more extensively in other areas of the law\textsuperscript{60} and which led to the Gearhart Resolution.\textsuperscript{61}

In any business situation, two or more entities which work on a common cause are going to have an integration of interest. If each individual to a business arrangement does a good job, any businessman will argue that the chances of each profiting are maximized.

If it does not work out that way, obviously either party can terminate

\textsuperscript{58} The Interstate Commerce Commission precludes an independent contractor from providing services to any other party while under lease to an authorized motor carrier, 49 C.F.R. § 1057.12(c)(1) (1988) except if the carrier is a household goods carrier. In such instance, the independent contractor and the motor carrier may agree that the contract applies only during the time equipment is operated by or for the authorized carrier lessee. 49 C.F.R. § 1057.12(c)(3) (1988).

\textsuperscript{59} 555 F.2d 794 (Cl. Ct. 1977).

\textsuperscript{60} See, for example, Secretary of Labor, U.S. Dep’t of Labor v. Lauritzen, 835 F.2d 1529 (7th Cir. 1987) (FLSA Action).

the relationship after the contract work in question and seek out new joint ventures or opportunities.

While the relationship exists both parties obviously want to induce the other party to do his or her best or as the court stated in *North American Van Lines, Inc.* "...to persuade, convince, and jaw bone drivers into hauling more loads..." This cannot be equated to control creating an employment situation.

As noted in *North American Van Lines, Inc.*, a motor carrier can control an individual’s overall performance as opposed to control over the means and manners of performing the task involved without creating an employment relationship.63

4. *RIGHT OF DISCHARGE*

The right of discharge is also frequently considered an important factor in determining the employment issue.

Allegedly the ever present threat of dismissal would cause an individual to obey instructions and accept control.64

Thus, it is frequently cautioned that an agreement attempting to create an independent contractor relationship should be for a specific term, have restraints upon termination, and impose liabilities for termination without cause.65

One question which must be raised in the present context of motor carrier operations, however, is whether the carrier’s right to terminate a contract "at will" constitutes any real threat since the independent contractor has so many alternative contract opportunities.

The problems a carrier faces with a "long term" contract is that it is basically non-enforceable,66 the probability of recovering damages for a breach are virtually null,67 and severe legal or business consequences could arise if the independent contractor could continue to operate during a "notice of cancellation" period.68

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63. *Id.* at 601.
64. See, Moore, supra, note 10 at pp.20-21.
65. See, Clarke, supra, note 10 at pp.7-8.
66. In the motor carrier industry, a "long term" contract was considered one for 30 days or more because the Interstate Commerce Commission in the past required vehicle lease to be for a minimum 30 day period.
67. If an independent contractor breaches the contract, he or she is so mobile it is difficult to trace their presence or, if so, to convince any court that their service is so unique as to require specific performance. It would also be difficult to establish damages or that such damages would be significant enough to justify the cost of litigation.
68. Few independent contractors have any assets which are attachable to satisfy a judgment and because of their mobility, it would frequently be difficult to discover such assets.
69. A discontent independent contractor desiring to terminate the contract could hurt the
The business realities are such that carriers and independent contractors at the present time essentially think of each load as a distinct contract job. The written contract, which sets forth detailed terms and conditions, is thought of as a master agreement which governs the individual agreements to tender and transport a load. Thus, the parties essentially feel that when a trip is completed, either may make the decision whether the relationship should continue.

The above concept is really not inconsistent with an independent contractor relationship assuming it is understood and agreed to by the parties. At the same time, however, it must be recognized that it may be a difficult one for the IRS to accept.

While the above discussion does not touch upon all factors which might be considered in any particular factual situation, the more significant factors have been addressed. It can be seen that they are difficult to apply unless one understands the motor carrier business.

IV. PRESENT IRS APPROACH TO RESOLVING ISSUE

A. THE TWENTY QUESTION TEST

The IRS trains its auditors and its revenue agents to utilize the "Twenty Common Law Factors" compiled by the Social Security Administration in determining whether the requisite control and employment exists. While these factors are helpful in making the determination, one who studies the factors will obviously recognize that some are ambiguous and overlapping and they can be misleading when applied to a particular factual situation. When you finish the "twenty questions", you will also see that in most, if not all instances, factors exist which point to both status and that a judgment factor of significant degree is frequently warranted after all criteria are considered.

These problems are the ones which are of greatest concern to trucking executives. Contrary to what many believe, the IRS has a legitimate reason to be concerned with the issue and, when appropriate to utilize the audit system as a means of carrying out the legitimate mandate it has

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71. If tax collection is the predicate of the IRS' reinvigorated audit program, it appears that a carrier which issues and files IRS Form 1099 MISC, 26 U.S.C. 6041A should not be the target of an audit solely related to the issue of employee versus independent contractor. The IRS' remedy for the collection of taxes, if not paid, should lie with the recipient of income. Except for the withholding requirement, the use of IRS Form 1099 MISC is essentially the same as filing W-2 or W-4 forms covering employees in terms of disclosing or identifying tax liability to the IRS.
to collect taxes. There are obvious abuses in industry generally as well as within the trucking segment of it.\footnote{22}

The major concern is that the IRS is attempting to use criteria which, because of their general applicability, may, in fact, hinder a fair and effective audit from being achieved.

IRS auditors generally have been young, aggressive, and well meaning individuals, but who lack private work experience and any degree of knowledge about the various industries they audit. Yet, a basic understanding of the industry being audited may be the key to a meaningful and correct audit.

\textbf{B. IMPROVING THE EFFECTIVENESS OF AUDITS THROUGH SPECIFIC INDUSTRY CRITERIA}

Recognizing that the problem of inexperienced auditors is one which is probably insoluble, it would behoove the IRS to attempt to establish criteria based on specific industries which would give more guidance to its auditors and at the same time to the industries involved.

The job is not a monumental one. In fact, much of the work has already been done by some state agencies.\footnote{73} In Minnesota, the Department of Labor and Industry has done an excellent job in setting forth guideline criteria for different industries under the Workers' Compensation Act.\footnote{74}

The criteria for "Truck Owner/Drivers" reads as follows:\footnote{75}

\textbf{Subpart 1. DEFINITION.} A truck owner-driver is any individual, partnership, or corporation (hereinafter referred to as "individual") who owns or holds a vehicle as defined in Subpart 2 under a bona fide lease and who leases that vehicle together with driver services to an entity which holds itself out to and does transport freight as a for-hire or private motor carrier.

\textbf{Subpart 2. INDEPENDENT CONTRACTOR.} In the trucking industry, an owner-operator of a vehicle that is leased and registered as a truck, tractor, or truck-tractor by a governmental motor vehicle regulator agency is an in-

\footnote{22} It is reported that 98\% of the taxes due on traditional businesses which file W-2 and W-4 forms are collected whereas only 15\% of taxes are collected from the "underground economy" which includes independent contractors in the trucking industry. Schult, \textit{IRS Crackdown on Carrier Focuses on Owner-Operators}, TRAFFIC WORLD Jan. 23, 1989 at 24. Similarly, surprising figures exist in other segments of society. In New York, nearly 10\% of the 15,745 partners in law firms had not filed state income tax returns for at least one of three years. Only 0.5\% of low level employees in the same firms had not done so. \textit{Tax Briefing,} INSIGHT ON THE NEWS, Vol. 5, No. 16, April 17, 1989, at 45.

\footnote{73} The agencies dealing with unemployment compensation in Minnesota and Wisconsin, for example, have promulgated criteria applicable to specific industries. See Department of Economic Security, Employee Taxes, MINN. R. 3315 (1987) and Relationship of Carrier and Contractor Operators, WIS. ADMIN. CODE, § ILHR 105 (1985-1986).

\footnote{74} Independent Contractor, MINN. R. 5224 (1989).

\footnote{75} Independent Contractor, MINN. R. 5224.0290.
dependent contractor, not an employee, while performing services in the operation of his or her truck, if each of the following factors are substantially present.

A. The individual owns the equipment or holds it under a bona fide lease arrangement.

B. The individual is responsible for the maintenance of the equipment.

C. The individual bears the principal burden of the operating costs, including fuel, repairs, supplies, vehicle insurance, and personal expenses while on the road.

D. The individual is responsible for supplying the necessary personal services to operate the equipment.

E. The individual's compensation is based on factors related to the work performed including a percentage of any schedule of rates or lawfully published tariff and not on the basis of hours or time expended.

F. The individual generally determines the details and means of performing the services, in conformance with regulatory requirements, operating procedures of the carrier, and specifications of the shipper.

G. The individual enters into a contract that specifies the relationship to be that of an independent contractor and not that of an employee.

Subpart 3. EMPLOYEE. An owner operator of a vehicle as defined in Subpart 2 is an employee, not an independent contractor, while performing services in the operation of the individual's truck, if all of the following criteria are substantially met.

A. The individual is paid compensation for his or her personal services:

   (1) Based solely on wage by the hour or a similar time unit that is not related to a specific job or freight movement.

   (2) on a premium basis for services performed in excess of a specified amount of time; and

   (3) from which FICA and income tax is withheld.

B. The individual is treated as an employee by the firm with respect to fringe benefits offered to employees by the firm.

C. The individual usually works defined hours.

D. The employer requires that the individual must perform the work personally and cannot change drivers.

E. The individual has no choice in the acceptance or rejection of a load.

F. The individual and firm have no written contract; or, if there is a written contract, it does not specify the individual's relationship with the firm as being that of independent contractor.

While no set of criteria can define a person's status definitively, it would give industry personnel a greater comfort level if an audit had the direction given by the Minnesota criteria as opposed to the more generalized twenty question test.

One with experience in governmental affairs knows that it is improba-
ble that the IRS will, in fact, modify its practices and procedures because of its workload and the press of matters pending before it or that if it agreed to do so, that it would occur promptly.

V. IMPLEMENTING A PREVENTATIVE LAW PROGRAM

A. PREAUDIT PRINCIPLES

Legal counsel, therefore, should prepare their clients for a “twenty question” audit and recommend that any preventative law program be based on the following principles:

1. The Commitment of Top Management Must be Secured. Top management must make the commitment that if the company is to utilize independent contractors, it must accept the status with its disadvantages as well as its advantages. If it wants to have certain controls or be able to give certain directions which are inconsistent with the independent contractor status, it must and should recognize this. Further, it must make its commitment to use independent contractors and the maintenance of such status known to managers and employees. A written policy is an asset, if not a necessity.76

2. The Commitment of Line Management Must be Secured. The line managers who deal with the independent contractors must not only understand the company policy, but be committed to its implementation.

3. The Company Community Must be Educated. All persons, from top management to the lowest level employee must know the basic concepts of an independent contractor relationship and why certain individuals are within that status and how that status affects their dealings.

4. The Independent Contractor Should be Educated. Individuals who have assumed the status as an independent contractor must understand what or what not he or she can expect from the company and why various procedures are followed.

5. An Internal Auditor Should be Appointed. One individual should

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76. The policy of Dart Transit Company, a for-hire motor carrier based in St. Paul, Minnesota, reads as follows:

Dart Transit Company has a basic belief in the entrepreneurial spirit and feels that its use of independent contractors in the conduct of its business is consistent with that belief.

By adoption of the independent contractor system, Dart intends to create opportunities for individuals to operate their own businesses.

Dart respects the independent contractor and is committed to dealing with them in a fair and equitable manner.

Dart shall seek to assist the independent contractor in achieving economic success and to provide a working relationship which will prove mutually rewarding.

We still subscribe to this policy.

We not only desire to create by contract an independent contractor relationship based on sound, fundamental principles, but we are willing to work diligently to preserve such a meaningful relationship in practice.
be appointed who has the primary responsibility to see that company policy is implemented, to oversee the educational functions, to review forms, procedures, etc., and to monitor day-to-day operations. This individual should be the liaison person with legal counsel.

Over a period of time, employees of the motor carrier will or should inherently deal with independent contractors in a proper context. ’’Driver’’ will become ’’contractor’’, ’’pay’’ will become ’’contract payment’’, ’’discharge’’ will become ’’decertification’’ or ’’contract termination’’. These verbal expressions will reflect substantive changes in attitudes and dealings and not a superficiality and the motor carrier client will be well on the way to creating, maintaining, and confirming an independent contractor status.

B. AUDIT PRINCIPLES AND PROCEDURES

If an audit comes, the motor carrier should be prepared. But there are some additional steps which should be considered:

1. An official spokesperson for the company should be designated. This should be a knowledgeable, articulate individual, probably the internal auditor assisted by legal counsel. Other members of the carrier’s staff and employees should be instructed to refer inquiries to the designatee and not to answer questions unless requested or authorized to by the company designatee.

2. Be prepared. Legal counsel should advise the client what questions it can anticipate will be asked and what documents should be available. The ”twenty questions” should be answered and copies of the written answers should be available for reference. When certain things are done in the carriers operation because of government regulations, etc. copies and citations to such regulations should be available.77 Samples of shipper instituted instructions should also be accumulated and be available78 if such instructions affect the direction and control imposed on the independent contractor.

3. Accumulate relevant documents. Counsel should assure that a sample set of the forms and documents used in conjunction with independent contractors are accumulated and available if an audit occurs.

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78. These instructions and/or requirements may appear in written contracts between a motor carrier and the shipper. They may also appear on bill of lading, shipping memo, dispatch records, etc. Typical instructions would include scheduled pickups and deliveries of freight, calls for delivery appointments, etc.
It would also be sage to review the documents for possible revision if they are inconsistent with the client's practice or use inappropriate terminology.

4. Be prepared to explain procedures. Have procedures manuals and/or descriptions of the functions performed by each department which deals with independent contractors available and also have available a knowledgeable, experienced manager and/or employee from each department who can attest to the day-to-day operations of the department. The opportunity should also be taken to audit the practices and recommendations should be made to the client regarding any changes which appear to be warranted from a legal standpoint.

5. Make the client aware of it's rights. Make sure the client understands it should try to accommodate each reasonable request of the auditor, but not to give him or her carte blanche access to records or personnel. If legal counsel is not present during the initial audit, arrangements should be made to ensure that legal counsel is available for consultation as to the rights and powers of the auditor. 79

6. Request an informal review. Legal counsel should request a meeting with the auditor prior to his or her making or filing any written official report so that if a misunderstanding has occurred there is an opportunity to clarify it or present additional evidence.

VI. AFTERMATH OF AN IRS AUDIT

While the issue hopefully will be resolved correctly at the audit level, the client should be made aware of his/her rights to appeal an adverse ruling. 80 In some instances, it may mean correcting an error, settling an obligation to the government, and starting afresh. Basically a ruling only covers a particular factual situation on a particular day. For this reason, it is also important to warn a client that a favorable finding does not mean that it does not have to maintain the program which led to such ruling. Although the odds may widen, there can always be another audit.

VII. CONCLUSION

The use of independent contractors in motor carrier operations has had a long history and despite the hurdles which have been created, they will be used for a long time in the future. Legal counsel, therefore, must warn "China Shop" operators to look out for the "Bulls".


Robber Barons in the Cockpit: The Airline Industry in Turbulent Skies*

PAUL STEPHEN DEMPSEY**

I. INTRODUCTION

During 1989, three of the four largest airlines in the United States became targets for leveraged buyouts (LBOs): Northwest, United and American. As of this writing, only the former has been successfully concluded. The failure of the United LBO sent the Dow Jones Industrials skidding 190 points on Friday, October 13, 1989—the twelfth most serious collapse in Wall Street history.

Two reasons account for the sudden surge of interest in airline acquisitions. First, after more than 150 bankruptcies and 50 mergers, the industry has become an oligopoly. Eight megacarriers dominate 94% of the domestic passenger market. With fortress hubs and shared monopolies, ticket prices are ascending into heaven. Now that airlines are becoming money machines, they have become targets for leveraged buyouts.

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* Copyright © 1990 by Paul Stephen Dempsey. The author would like to thank Theodore P. Harris, of Airline Industry Resources, McLean, Va., for providing several insights essential to this article. This article was also published in Volume 2 of the DePaul Business Law Journal.

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Second, the glamor of the industry has always attracted men with huge egos. In the old days, it was buccaneers like Howard Hughes, Eddie Rickenbacker and Juan Trippe. These days it is Marvin Davis, Donald Trump, and Peter Ueberroth. Owning an airline is more prestigious than owning an NFL franchise, for there are fewer of them. Owning an airline also means becoming emperor of several fiefdoms, for the fortress hubs are a stranglehold over the cities they serve and the regions they dominate.

For example, in buying Northwest for $3.7 billion, Alfred Checchi became king of Minneapolis, Detroit and Memphis—Northwest’s hubs. If Marvin Davis’ $6.2 billion bid for United had been successful, he would have been lord of Chicago (O’Hare is the world’s busiest airport), Denver, San Francisco and Washington—United’s hubs.

Prior LBOs reveal that corporate raiders leverage airlines to the teeth to pay for their acquisitions. In the mid-1980s, Frank Lorenzo gobbled up Continental and Eastern, while Carl Icahn grabbed TWA and Ozark. Both added millions in indebtedness to these once proud airlines, while stripping them of assets. Before Eastern fell into bankruptcy, it carried $2.5 billion in long-term debt; its debt service was a crushing $575 million. TWA carries $2.4 billion in debt and lease obligations, and has a negative net worth of $30 million. Checchi may load Northwest with more than $3 billion in debt. United will carry more than $6 billion, no matter who buys it. This article will introduce the reader to several of the major actors in the Monopoly game, their enormous egos and their ruthless game plan.

Foreign airlines are gobbling up significant shares of U.S. airlines. Already Northwest, Delta, Texas Air, America West and Hawaiian Airlines have significant foreign equity. Not only does debt pose significant problems for the long-term viability of airlines, foreign ownership adds national security concerns. This article will examine the motivations behind airline LBOs and the policy reasons why they are not in the public interest.

Criticism of LBOs centers on the impact massive amounts of debt will have on the ability of airlines to make new aircraft purchases or maintain existing aircraft properly, expand operations, maintain competition, and withstand the vicissitudes of the market cycle. A deep and prolonged recession will likely cause a new round of bankruptcies and consolidations among debt ridden airlines which will leave the industry even more concentrated than it is today. Finally, foreign ownership of U.S. airlines raises competition and national security concerns. We begin with a look at deregulation.
II. DEREGULATION

The Airline Deregulation Act of 1978 was designed to create a more competitive environment in commercial aviation. But as deregulation has matured, we have an industry more highly concentrated than at any point in its history, and a horizon devoid of new competitors. Deregulation has proceeded through four stages:

A. PRICE WARS

In the beginning, deregulation sent fares tumbling, as new entrepreneurs such as People Express and Air Florida emerged to rival the megacarriers. Although the new entrants never accounted for more than five percent of the domestic passenger market, with lower costs they drove prices down, and consumers enjoyed a bonanza of low fares. But industry profitability soon plummeted to the worst losses in the history of domestic aviation. These losses were exacerbated in the early 1980s by the worst recession since the Great Depression. During the first decade of deregulation, the industry as a whole made enough money to buy two Boeing 747s.

Two economic characteristics of airlines lead to destructive competition when carriers compete head to head. First, airlines sell a product which is instantly perishable. Once a scheduled flight closes its door and pulls away from the jetway, any empty seats are lost forever. They cannot be warehoused and sold another day, as can manufactured goods. It is as if a grocer was selling groceries which had the spoilage properties of open jars of unrefrigerated mayonnaise. He would be forced to have a fire sale every afternoon, for any unsold inventory would have to be discarded.

Second, the short term marginal costs of production are nil. Adding another passenger to an empty seat costs the airline another cardboard meal and a few drops of fuel. Thus adding nearly any bottom is profitable in the short term. Head to head competition between carriers usually results in destructive competition, for carriers price at the margin and fail to cover long-term and fixed costs.

The hemorrhaging of dollars led management to slash wages, trim maintenance, reduce service, and defer new aircraft purchases. It also led to a massive shakeout of smaller firms. During the first decade of deregulation, more than 150 carriers collapsed into bankruptcy.5

B. CONSOLIDATIONS

In order to stave off bankruptcy, carriers began to reconfigure their operations. The entry and exit freedom produced by deregulation enabled them to establish hub and spoke operations. Four hubs (i.e., Atlanta Hartsfield, Chicago O'hare, Dallas/Ft. Worth International, and Denver Stapleton) became duopolies, while all the rest became monopolies, with a single airline controlling more than 60% of the takeoffs and landings, gates, and passengers.6

A rash of mergers also produced greater concentration. During the first decade of deregulation, there were more than 50 mergers, acquisitions and consolidations, the major ones concluded in 1986 and 1987, when the Reagan Administration’s Transportation department embraced an exceptionally permissive antitrust policy.7 Indeed, the Department of Transportation approved each of the 21 mergers submitted to it.8 The following chart graphically depicts the pedigree and the market share of the nation’s largest airlines:

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6. Id.
### Chart I — Major Air Carrier Mergers, Acquisitions, Purchases and Consolidations Since Proclamation of the Airline Deregulation Act of 1978

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<th>Airline</th>
<th>1989</th>
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<th>1987</th>
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<td>American</td>
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<td>16.9</td>
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<td>Pan Am (transpacific routes)</td>
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<td>Texas International</td>
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<td>Hughes Airwest</td>
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<td>Allegheny</td>
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The eight largest airlines today dominate nearly 94% of the domestic passenger industry and almost all hubs. Not only are passenger airlines highly concentrated; mergers in the all cargo industry have reduced it to a duopoly. Federal Express acquired Flying Tigers, which itself consumed Seaboard when deregulation was young. Consolidated Freightways, one of the nation’s largest trucking companies, acquired Emery Air Freight, which itself earlier consumed Purolator.

C. PROFITABILITY

With such tremendous concentration, carriers have been able to raise ticket prices significantly. In 1989, the General Accounting Office reported that prices were 27% higher in monopoly or duopoly hubs than at competitive airports.\(^9\)

The oligopoly which has emerged from deregulation has grown increasingly profitable. The two years ending June 30, 1989, was the most profitable period for airlines in history.\(^10\) One source noted, "after a decade of turbulence, [the industry] is entering a new period of prosperity: a period where tight airport space and increasing demand for air travel will produce the steady cash flow necessary for a smooth buyout."\(^11\) Contestability theory, which provided much of the intellectual foundation for deregulation, has not been sustained by the empirical evidence.\(^12\) Hence, significant new entry now appears unlikely.

\(^9\) **GENERAL ACCOUNTING OFFICE, AIR FARES AND SERVICE AT CONCENTRATED AIRPORTS** (1989).


Operating earnings of the major airlines, which account for more than 90% of the U.S. industry's traffic, rose by 10% in the second half of 1987 compared with the same year earlier period. For 1988, industry revenues grew 11% and operating earnings by 28%. Traffic, revenue passenger miles, increased a modest 5% for the year. However the 5% unit growth was accomplished amidst a 7% advance in the average fare, or yield per passenger mile . . . .

The first half of 1989, the period during which the trend toward recapitalization of the airline industry became evident, saw the continuation of record revenues and earnings in the airline industry. Boosted by late 1988 fare restructurings, and a still strong economic environment, the average fare rose 11% in the first quarter of the year, compared with the year before, and second quarter yields were up 6%. The average yield in the month of March alone rose 17%, year to year. Despite softening traffic trends, particularly in domestic markets, industry revenue growth in the first half of this year was 8%.

**Id.** at 14-15.

\(^11\) **Ellis, United's Buyers May Be Wearing Rose-Colored Goggles, Bus. WEEK, Oct. 16, 1989,** at 36.

\(^12\) **Dempsey, The Empirical Results of Deregulation: A Decade Later and the Band Played On, 17 TRANSP. L.J. 31 (1988).**
D. LEVERAGED BUY-OUTS

With unprecedented profitability, and the innate glamor of the industry, three of the nation’s four largest airlines became targets for LBOs in 1989. Denver oil king Marvin Davis launched a $2.7 billion bid for Northwest Airlines. Northwest ultimately fell victim to a $3.7 billion bid by Alfred Checchi.\textsuperscript{13} Davis enjoyed a $30 million profit on the Northwest raid, then turned around and put a siege on United. That raid was preempted by a management/pilot bid for United led by CEO Stephen Wolf for $300 a share, or nearly $7 billion. In October 1989, Donald Trump, former suitor of United,\textsuperscript{14} and purchaser of the Eastern Air Lines New York-Washington-Boston shuttle,\textsuperscript{15} launched a $7.54 billion bid for American Airlines.\textsuperscript{16}

One source summarized the principal reasons motivating airline LBOs:

1) The belief that the significant earnings and earnings potential demonstrated during the last two years, and the concurrent strong level of cash flow generation is sustainable. Inherent in this tenet is the expectation that the degree of cyclical and even seasonality airline earnings and cash flow have historically demonstrated will be absent or lessened in the future.

2) The realization of premium values for used aircraft, facilities as well as new aircraft delivery positions, which has increased the liquidity (and enhanced the equity capital) of many carriers. Included in the strong market for airline assets is premium values being accorded gates, slots, real estate and other tangible and intangible assets.

3) The availability of capital, both equity and debt, due in part to the renewed interest in airline lending by commercial banks and the current favorable interest rate environment. Included in this tenet is the tremendous increase in leasing capital, which has provided, and is expected to continue to provide more than half the capital expenditures in the 1990s.\textsuperscript{17}

As of this writing, financing for the $7 billion management/labor bid for United has collapsed, Donald Trump has withdrawn his $7.5 billion bid for American, bids for Delta and USAir are rumored, and Congress is considering legislation that would make airline acquisitions more difficult.

Some LBOs can be justified on grounds that they rid companies of

\textsuperscript{13} Hughes & Smith, Failed Bid for NWA Leaves Marvin Davis Richer and Still Ready, Wall St. J., June 21, 1989, at 1.


\textsuperscript{15} The Trump Shuttle operates 21 aircraft between three cities. In contrast American Airlines has 480 planes. An Ego As Big as American, NEWSWEEK, Oct. 16, 1989, at 56. Another source reports that American has 683 aircraft. Here Comes Donald, Duck!, TIME, Oct. 16, 1989, at 52.


\textsuperscript{17} See supra note 10, at 14.
ineffective management and improve productivity, profitability, and performance by paring unrelated assets and squeezing labor. But American, United, Delta and USAir are generally viewed as among the best managed and most efficient companies in the business. Let us examine America's two largest megacarriers, the assault by corporate raiders upon them, and the entrepreneurs who battle for control of the nation's aviation system.

1. AMERICAN AIRLINES AND CEO ROBERT CRANDALL

American Airlines has been the most vocal opponent of LBOs, describing Trump's bid as "ill considered and reckless", and insisting that "excessive levels of debt in the airline industry are not in the public interest." As AMR Chairman Robert Crandall said, "The disadvantages of excessive leverage, and its effects are heightened by the continuing volatility of airline earnings." American called for congressional protection against LBOs, a plea to which, as we shall see below, Congress appears to be responding.

Robert Crandall is Chairman and President of American Airlines. Although initially a critic of deregulation, he moved quickly to capitalize on its opportunities for growth. His aggressive policies of reinvesting earnings, growing from within, establishing new hubs from scratch (i.e., Nashville, Raleigh-Durham and San Jose) and thereby outflanking the dominant southeast hub of Atlanta, aggressively managing yield, inventing frequent flyer programs, and getting out early with a computer reservations system have made American Airlines the largest airline in the United States in terms of revenue passenger miles.

The man has a Vitalis look, with his oily hair combed straight back. He is a chain smoker and an avid jogger—two packs and four miles a day, respectively. One commentator notes that, "His tough stance on union wages, his bare-knuckled price-cutting and his proclivity for salty phrases have all contributed to Robert L. Crandall's public image as a hard-nosed street fighter." Above all, Crandall is a fierce competitor. As one acquaintance noted, "He doesn't want anybody to beat him . . . He's in business to put his competition out of business." Crandall views the deregulated environment as one in which he can wage "legal-

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22. 'I'm Going to Run This Joint', N.Y. Times, Dec. 8, 1985, at 8F.
ized warfare in the industry."\textsuperscript{24}

After a series of price wars which left both American and Braniff bleeding in their Dallas hub,\textsuperscript{25} Crandall sought to fix prices with Braniff's President, Howard Putnam. Putnam recorded the conversation and turned the tapes over to the Justice Department.\textsuperscript{26} But nothing was to save Putnam from demise. Braniff entered bankruptcy in 1982.\textsuperscript{27} After scaling down significantly, selling off its Latin American routes to Eastern and many of its aircraft, the new Braniff emerged from reorganization under the control of the Pritzker family of Chicago (who control the Hyatt hotel chain), and reassumed its Dallas/Ft. Worth operations. But head to head competition with the two megacarriers which dominated Dallas—American and Delta—proved infeasible. With a generous loan from

\begin{flushleft}
\textsuperscript{24} S. Davis, Delta Air Lines: Debunking the Myth 166 (1988).
\textsuperscript{26} Crandall and Putnam had the following conversation on February 1, 1982:
\quad CRANDALL: I think it's dumb as hell for Christ's sake, all right, to sit here and pound the shit of each other and neither one of us making a fucking dime.
\quad PUTNAM: Well—
\quad CRANDALL: I mean, you know, goddamn, what the fuck is the point of it?
\quad PUTNAM: Nobody asked American to serve Harlingen. Nobody asked American to serve Kansas City, and there were low fares in there, you, know, before. So—
\quad CRANDALL: You better believe it, Howard. But you, you, you know, the complex is here—ain't gonna change a goddamn thing, all right. We can, we can both live here and there ain't no room for Delta. But there's, ah, no reason that I can see, all right, to put both companies out of business.
\quad PUTNAM: But if you're going to overlay every route of American's on top of over, on top of every route that Braniff has— I can't just sit here and allow you to bury us without giving our best effort.
\quad CRANDALL: Oh sure, but Eastern and Delta do the same thing in Atlanta and have for years.
\quad PUTNAM: Do you have a suggestion for me?
\quad CRANDALL: Yes. I have a suggestion for you. Raise your goddamned fares 20 percent. I'll raise mine the next morning.
\quad PUTNAM: Robert, we . . .
\quad CRANDALL: You'll make more money and I will too.
\quad PUTNAM: We can't talk about pricing.
\quad CRANDALL: Oh, bullshit, Howard. We can talk about any goddamned thing we want to talk about.
\end{flushleft}

Complaint of U.S. Dept of Justice in United States v. American Airlines, Inc., 759 F.2d 1241 (1985), 1 Trade Cases p. 66, 605 (N.D. Tex). Crandall was a bit red faced when he learned that Putnam had taped the conversation, and turned the tape over to the Justice Department. No doubt, Crandall screamed the last words indelibly recorded on the tape in the black box by most pilots immediately before they crash. "Oh, shit!" Price fixing is, after all, a per se violation of the Sherman Act, one which could throw Crandall in prison. Most convicted wealthy white collar criminals actually end up in Club Fed as did Ivan Boesky, working on their muscles and tens in minimum security institutions. It is, nonetheless, an embarrassing way to spend your time. The Justice Department was less ambitious. It initially sought a court order prohibiting Crandall from working in any responsible airline position for two years, and prohibiting American Airlines from discussing pricing for a decade. P. Dempsey & W. Thoms, Law & Economic Regulation in Transportation 214 (1986). Ultimately, the Reagan Administration settled for less still—a consent decree in 1986 in which Crandall neither admitted nor denied guilt. Brown III, supra.

\textsuperscript{27} Karr, Airline Deregulation After Braniff's Fall, Wall St. J., June 14, 1982, at 20.
American to buy new aircraft, Braniff abandoned Dallas, and moved its hub to Kansas City.

Southwest Airlines dominates tiny Dallas Love Field, while American dominates Dallas/Ft. Worth International Airport. Southwest's Chairman Kelleher once joked to Crandall that their relationship was analogous to that of tiny Finland compared with mighty Russia. "There's only one difference," Crandall retorted with a Siberian stare, "I ain't reducing troops." 28

Crandall has adopted an extremely aggressive approach to capitalizing on the opportunities afforded by airline deregulation. American had adopted the philosophy of, in its words, "competitive anger." As Crandall put it, "We like to be successful. When we're not, we're angry with ourselves, our colleagues and the world at large." 29 He has repeatedly insisted, "My friends call me Mr. Crandall. My enemies call me Fang." 30

Destroying the competition means more to Crandall than running them out of town. It includes assaulting their character. In 1987, Crandall bought 15,000 copies of a scathing article about Texas Air's Frank Lorenzo which appeared in Texas Monthly to distribute at employee meetings. 31 For his part, Lorenzo describes Crandall as "hypocritical" and "afraid of competition"—the pot calling the kettle black, so to speak. 32

But Crandall didn't like it when the shoe was on the other foot. In response to a book about Braniff in which Crandall was portrayed unfavorably, he bought 25,000 copies to take them out of circulation, then paid the publisher $150,000 to discard existing inventory and print a reworded edition. 33

Crandall's aggressive character also manifests itself strongly in his internal domination of American. He has a fiery temper. Richard Murray, a former American Airlines executive, recalls being fired at several meetings, only to be rehired before adjournment. Once, Crandall became so angry at a competitor that he flew into a rage, and accidentally pulled some blinds off a window and onto his head. When aides rushed to help, he responded, "To hell with my head. What are we going to do about this problem?" 34

Crandall loves detail. He likes to immerse himself in the numbers. Crandall was once spotted humped over paperwork three inches high on

29. Loeffelholz, Competitive Anger, FINANCIAL WORLD, at 28.
30. Id. at 33.
32. See Easterbrook, supra note 88.
33. Id.
34. Brown III, supra note 23.
an American flight on Christmas morning.\textsuperscript{35} He brags that he cut $40,000 in operating expenses by removing olives from American's dinner salads.\textsuperscript{36} When Crandall took over as chief operating officer in 1980, he reduced the number of guards at an American facility from three to one. The lone guard was replaced, first, with a part-time guard, and then with a guard dog. Finally, Crandall inquired whether it might be possible to replace the dog with loudspeaker system broadcasting a tape recording of barking dogs.\textsuperscript{37}

Crandall's tight fisted managerial style, entrepreneurial bravado and marketing acumen made American the largest airline in the free world, second in number of aircraft only to the Soviet Union's Aeroflot. Under Crandall, American's revenue passenger miles had grown steadily since 1981; its market share increased steadily since 1980; it has turned a profit every year since 1983; and its debt to equity ratio was superior to that of the Dow Jones airlines since 1985.\textsuperscript{38} That such a lean, mean flying machine as American would be assaulted in a leveraged buy-out left most analysts stunned in disbelief in October 1989 when Donald Trump made a bid of $120 a share, or $7.54 billion.\textsuperscript{39} It was like a minnow swallowing a whale. Trump purchased the Eastern shuttle which flies 21 aircraft between three cities; American has 480 aircraft.\textsuperscript{40} In 1988 American earned $476.8 million on revenue of $8.8 billion.\textsuperscript{41} Trump's acquisition would have added $6.5 billion in debt to American.\textsuperscript{42} Perhaps Trump's ego got the best of him. As one source noted:

Mr. Trump, a billionaire with a towering ego who made his fortune with glitzy skyscrapers and casinos, entered the airline business last Spring by buying Texas Air Corp.'s Eastern shuttle for $365 million and renaming it the Trump shuttle. He owns New York City's famed Plaza Hotel, plus buildings named Trump Tower, Trump Parc, and Trump Palace.\textsuperscript{43}

He promised, however, not to rename American Airlines "Trump Airlines." But after the stock market collapse of Friday, October 13, 1989, Donald Trump withdrew his bid for American.

\begin{thebibliography}{9}
\bibitem{35} American Aims for the Sky, supra note 28, at 58.
\bibitem{36} Id. at 55.
\bibitem{37} Loeffelhoz, supra note 21 at 30. God help us if he is shaving the margin of safety so finely.
\bibitem{39} Supra note 16, at 1, col. 6.
\bibitem{40} An Ego As Big As American, NEWSWEEK, Oct. 16, 1989 at 56.
\bibitem{42} Id., at col. 2.
\bibitem{43} Id., at col. 1.
\end{thebibliography}
2. **UNITED AIRLINES AND CEOS RICHARD FERRIS AND STEPHEN WOLF**

Stephen Wolf is presently chief executive officer of United. But much of its corporate culture was shaped by his predecessor, Richard Ferris. Ferris was one of the major actors in the quest for deregulation. As United’s chief (from 1976 until 1987), Ferris led the carrier to break ranks with the rest of the industry and promote deregulation.

As the nation’s largest carrier, United believed that the deregulated skies would be friendly to it. United worked long and hard behind the scenes to persuade Congress and the Carter Administration to pass the Airline Deregulation Act of 1978. "If the truth be known," said a former Untied executive, "Monte Lazarus [a lieutenant of Ferris] wrote the Airline Deregulation Act." Ironically, Lazarus, a former assistant to CAB Chairman Secore Brown, was known as the consummate Washington bureaucrat even after joining United.

Under regulation, United had been hindered from growing. In 1938, United enjoyed about 22% of the domestic passenger market; by the mid-1970s, its share had declined slightly, to 20%. Under regulation, the CAB had favored the smaller airlines in awarding new routes. Ferris believed that United would have few opportunities for expansion under a benevolent CAB. Deregulation would be the means for United to grow.

Once deregulated, United pulled out of many of its thin markets, abandoning a large number of small and medium-size cities, and concentrated on dense, long-haul routes. But it soon found that it needed regional feed into its hubs to fill the long-haul capacity, and reversed course. Today, it serves at least one airport in each state so that it can boast, "We serve all 50 states."

Working from a stand up desk, Ferris was known to be a tough, hot tempered competitor. Take his role in the demise of Frontier. In the mid-1980s, Denver’s Stapleton Airport was the only airport in the country used as a hub by three airlines. As a consequence, Denver consumers enjoyed some of the lowest air fares in the country. But for the three airlines—United, Continental and Frontier—the results were disastrous. Profitability in the market plummeted.

So in 1985, United purchased 30 of Frontier’s jets for $360 million. Later that year, Donald Burr’s People Express bought the rest of Frontier for $307 million. People’s “no frills” fares were matched by United and Continental, and an economic blood bath resulted. Between September 1, 1985, and July 31, 1986, Frontier alone lost $47 million. It was a loss that parent People Express could not long withstand.

44. S. Davis, *supra* note 24, at 12.
In July 1986, United agreed to take Frontier off Burr's hands for $146 million, with the condition that United reach an agreement with Frontier's unions satisfactory to United. United met with the pilots, but not the four other Frontier unions. After several weeks during which additional Frontier assets were transferred to United, United announced that the labor negotiations were at an impasse.\footnote{Amended Complaint of Frontier Airlines, In re Frontier Airlines Inc., 74 BR 973 (BANKR. D. Colo 1987) Reorganization, (Case No. 860B-802IE).} Burr had little choice but to put Frontier into bankruptcy in late August, 1986. And then there were but two in Denver. Prices and profitability began to climb.

Ferris began his reign at United with good rapport with labor, frequently visiting the cockpits, and taking the time to earn a pilot's license.\footnote{Rising UAL Turmoil, supra note 45.} But a 29-day strike by United's pilots in 1985 began a seething relationship with labor that caused Ferris to begin flying private jets, avoiding his own company's planes. At a dinner in 1986, Ferris was overhead boasting to American's CEO Robert Crandall that United would one day have some of the lowest labor costs in the industry.\footnote{Id.}

Ferris came to head United through the ranks of its Westin Hotel chain, which may explain his obsession with creating a vertically integrated travel conglomerate. Already owning Westin, United went on a binge under Ferris in which airline profits were spent on developing a computer reservations system (Apollo), and buying a rental car company (Hertz), and yet another hotel chain (Hilton International, formerly owned by TWA). In 1986, the combined company flew 50 million passengers, controlled about one-third of the car rental business, and owned 150 hotels. To reflect its scattered emphasis, United dropped the UAL label and renamed the holding company Allegis, a bastardization of the words "allegiance" and "aegis".

Not only was the name bad, but the combination made United ripe for a hostile takeover, for its dismembered parts were worth more than its barely unified whole. While the idea of a unified full-service travel empire was not a bad one (selling a customer an airline ticket, hotel room and rental car as a package intuitively seemed an attractive marketing concept), it never really got off the ground before the vultures began to circle.

In 1987, Donald Trump, who owned 5% of the company, urged Ferris to break up the conglomerate and sell its parts separately.\footnote{Id.} The pilots, angry with Ferris for different reasons, began to put together their own $2.3 billion bid for the company.\footnote{Cohen & Kilman, Talk of a Possible Takeover of UAL Inc. Is in the Air, Wall St. J., Apr. 9, 1987, at 6, col. 1.} And other suitors were waiting in
the wings, including the Coniston Partners. As one analyst noted, "If the pilots wanted to stir up a hornet's nest, it looks like they have."51

Ferris was a fiery tempered executive who attacked problems by moving on the offensive promptly.52 In addition to the usual poison pills and golden parachutes, he concluded a unique financial arrangement with Boeing that gave it some usual powers over the business operations.53 When that wasn't enough, he proposed to saddle the company with a $3 billion recapitalization to thwart the takeover attempts, distributing the proceeds as a $60 a share dividend.54

Shareholder resistance and difficulty in financing it led the Board of Directors to balk. Ferris resigned red faced in June 1987. He was succeeded for a short term by Frank Olson, chairman of the Hertz unit.55

Although the company spent $7.3 million on the name change (to which Wall Street gave a thumbs down), United abandoned the Allegis title in 1987.56 United also sold off the hotel and car-rental businesses, took on $3 billion in debt, and paid shareholders a hefty dividend. Olson was subsequently replaced by Stephen Wolf, a former chairman of Flying Tigers.

In early August 1989, Denver oil king Marvin Davis offered $240 a share, or $5.4 billion, for United, later raising his bid to $275.57 Management responded with a $300 a share, or $6.75 billion buy-out of its own involving the pilots. British Airways was also a partner, putting up $750 million, or about 78% of the equity.58 Management was to have owned 10%, British Airways 15%, and the pilots 75%.59 To pay for its share, the pilots would take pay cuts of up to 10%, less overtime pay, and fewer vacation days.60 The debt would have created interest payments of $600 million to $700 million annually.61 The machinists union criticized the deal as unrealistic, saying, "[p]lacing billions of dollars of additional debt on the carrier . . . would seriously jeopardize the carrier's operation, safety

51. Id. at col. 2.
52. Rising UAL Turmoil, supra note 45.
54. Id.
55. Id. at 1, col. 6; Id. at 22, col. 5.
56. B. NASH & A. ZULLO, supra note 31.
58. Id. at col. 3.
and future existence."62

The financing fell through on Friday, October 13, 1989, sending the Dow Jones Industrial average tumbling 190 points.63 Oddly, the stock market panic was motivated, at least in part, about anxiety over junk bonds. But the United financing had none, and that was an issue about which the Japanese banks objected.64

Shortly thereafter, Marvin Davis withdrew his bid, and British Airways backed out of the management/pilot buy out.65 Under the deal which collapsed, United CEO Stephen Wolf was to have earned $76.7 million and new UAL stock options.66 Management would have then spent $15 million for a one percent stake, and been given nine percent more in stock options.67 Everyone’s eyes became filled with dollar signs. The Board of Directors voted lifetime first-class passes for themselves and their spouses, and $20,000 a year for life.68 The investment bankers would get $59 million and lawyers $45 million.69 United’s 25,000 machinists and 25,000 noncontract employees criticized Wolf’s greed in pursuing an LBO which would enrich him while forcing pay cuts and benefit reductions on labor, and called for his resignation.70

III. DEBT—ON BALANCE SHEET AND OFF

Today, four of the nation’s largest airlines have a negative net worth—a debt to equity ratio in excess of 100%. They are Continental, Eastern, Pan Am and TWA. As of this writing, Eastern is in Chapter 11 bankruptcy, Pan Am is regularly rumored near collapse, and TWA are actively seeking merger partners of outside investors, and Continental is reportedly on the block to be sold.71 Three of these companies are owned by two corporate raiders—Frank Lorenzo’s Texas Air controls Continental and Eastern, while Carl Icahn owns TWA. Continental also

69. Storch & Jouzaitis, supra note 67, at 6, col. 2.
70. After Buyout Diet, supra note 66.
entered bankruptcy in 1983. We will examine how these men have stripped these companies of assets below.

With Northwest having been saddled with $3.3 billion to pay for the Checchi acquisition (quadrupling its long-term debt),72 with the two largest carriers (i.e., American and United) under siege, and with two more (i.e., Delta and USAir) rumored as targets, the industry looks like it will be burdened with excessive debt. That will make it difficult for the industry to weather recessions, expand operations, modernize fleets, and maintain older equipment.73 Such economic difficulties enhance public concerns over airline safety. The following chart depicts the huge amounts of debt with which the nation’s airlines have been burdened by virtue of gluttonous acquisitions, mergers and buy-outs in recent years:

<table>
<thead>
<tr>
<th>Date Completed</th>
<th>Acquirer (Acquired)</th>
<th>Value (in Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aug. 86</td>
<td>NWA (Republic)</td>
<td>$884</td>
</tr>
<tr>
<td>Sept. 86</td>
<td>TWA (Ozark)</td>
<td>250</td>
</tr>
<tr>
<td>Sept. 86</td>
<td>Texas Air (Eastern)</td>
<td>676</td>
</tr>
<tr>
<td>Dec. 86</td>
<td>Texas Air (People Express)</td>
<td>112</td>
</tr>
<tr>
<td>Mar. 87</td>
<td>AMR (Air Cal)</td>
<td>225</td>
</tr>
<tr>
<td>Apr. 87</td>
<td>Delta (Western)</td>
<td>860</td>
</tr>
<tr>
<td>May 87</td>
<td>USAir (Pacific Southwest)</td>
<td>400</td>
</tr>
<tr>
<td>Oct. 87</td>
<td>USAir (Piedmont)</td>
<td>1,590</td>
</tr>
<tr>
<td>Nov. 88</td>
<td>Carl Icahn (TWA) privatization</td>
<td>N.A.</td>
</tr>
<tr>
<td>May 89</td>
<td>Trump (Eastern Shuttle)</td>
<td>365</td>
</tr>
<tr>
<td>July 89</td>
<td>Checchi Group (NWA) buy out</td>
<td>3,650</td>
</tr>
<tr>
<td>Withdrawn</td>
<td>Management/Labor (UAL) buy out</td>
<td>6,790</td>
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<tr>
<td>Withdrawn</td>
<td>Trump (AMR)</td>
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</table>

N.A. = not applicable


By reducing competition, the acquisition or merger by one airline of another enhances the survivors’ profitability. But the acquisition by corporate raiders produce no such benefits.

Not only are LBOs burying airlines in debt, new aircraft acquisitions are as well. Media attention has focused on the geriatric jets—the peeling skin and the exploding doors (known in the industry as Kahndoors, after

the father of deregulation, Alfred Kahn). The Fear of Flying has prompted airlines to order huge new fleets of aircraft. The conventional wisdom also identifies mass as a key ingredient of survival. So fleets grow.

The airline industry now has more than $130 million in orders or options for 2,500 new aircraft. In contrast, the foreign debt of Brazil, which is the highest of all Latin American nations, is a paltry $114 billion.\textsuperscript{74} The industry as a whole had operating cash of less than $5 billion in 1988, which was a very good year.\textsuperscript{75} The industry’s capital expenditures between 1991 and 1994 are estimated to be $15 billion per year.\textsuperscript{76}

In 1989, United placed a record $15.7 billion order for 370 Boeing 737s and 757s (180 firm orders, and 190 on option). American has 259 aircraft on order and 302 on option, totaling $14.5 billion.\textsuperscript{77} In late 1988, Delta placed options or orders for 215 jets, including 40 giant MD-11s, and expanded that with a $10 billion order in November 1989 for up to 260 aircraft (firm orders for 50 new MD-90’s and 50 B-737-300’s, and options for 110 MD-90’s and 50 B-737’s).\textsuperscript{78} Texas Air placed an order for 100 jets in early 1989—50 firm and 50 on option—and then a second order on behalf of Continental in November 1989 for 40 Airbus medium and long range jets—20 firm and 20 on order.\textsuperscript{79} Even debt-saddled Northwest signed a $5.2 billion contract with Boeing for 80 757s (half of which are options) and 10 747-400s (four of which are options).\textsuperscript{80} Northwest had placed a $3.2 billion order for 50 Airbus A320s in 1986.\textsuperscript{81}

In part, airlines may be trading in aircraft options. Their huge orders enable them to enjoy volume discounts from the manufacturers. Before delivery, should they need the cash more than they need the planes, they can sell their delivery positions, as financially strapped Pan Am did in 1988 when it sold deliveries of 50 Airbus A320s to Braniff for $115 million. (Braniff overreached and consequently found itself in bankruptcy for the second time this decade). But aircraft futures only bring a profit during a bull market for planes, an environment which only exists when growth in passenger demand exceeds existing capacity. While that is the

\textsuperscript{74} Brady strategy: Rest in Peace, Wall St. J., Jan. 22, 1990, at 1, col. 1.5.
\textsuperscript{76} Id., (statement of Timothy Pettee, first vice president, Merrill Lynch Capital Mkt.), at 5.
\textsuperscript{78} Waldman & Wartzman, Delta Air Sets Orders, Options for $10 Billion, Wall St. J., Nov. 15, 1989, at A3.
\textsuperscript{79} Manges, Texas Air’s Continental Unit Set to Buy Up to 40 Airbus Jetliners for $4.5 Billion, Wall. St. J., Nov. 17, 1989, at A3.
\textsuperscript{81} NWA Orders 90 New Jets, MSP AIRPORT NEWS, Oct. 19, 1989, at 1, 11.
present market, it may not be the market in the mid-1990s when most of these planes will roll off the assembly lines at Boeing, McDonnell-Douglas and Airbus.

Adding new jets will mercifully reduce the age of the nation’s fleet. That will be a welcome blessing for the margin of safety. But it saddles the industry with even more debt.

What’s worse, unlike the days before deregulation when airlines actually owned most of their aircraft, today they lease them. For example, American Airlines owns only about a third of its 476 aircraft outright.\(^{82}\) Even solid carriers like Delta have sold large numbers of aircraft only to lease them back. That increases debt, but decreases value. Potential and successful LBOs will accelerate this trend.

Lease obligations usually don’t show up on balance sheets as debt, but like accumulated frequent flyer mileage, they should. Including it reveals that the industry’s debt to equity ratio today is significantly worse than it was in the mid-1980s, although the industry’s performance has dramatically improved since then. For example, Delta’s on balance sheet debt as a percentage of total capital is only 31%; but adding the debt equivalent of aircraft leases (about $3 billion to on balance sheet debt of $1.2 billion) increases the debt to equity ratio to 61%.\(^{83}\)

Leasing has become an increasingly popular means of retiring debt assumed in LBOs, or for LBO targets, as a means of reducing the availability of assets which could be liquidated, thereby making them less attractive targets. The increased operating costs of leasing and the loss of residual aircraft values upon their retirement from the U.S. system (many ageing Boeing 747s today sell for more than their purchase price when new) are partially offset by flexibility and the sharing of risk that leases offer. Leasing companies are stimulated by the underlying margins in the interest rate environment and the tax advantages of a leasing portfolio.\(^{84}\)

Whether purchased outright or leased, new aircraft not only impose tremendous debt, but they also flood the market with capacity. For example, American Airlines may have a fleet of more than 800 aircraft by the late 1990s. If we learned nothing else from deregulation, we should have learned that excess capacity causes prices to spiral downward, and leaves the airlines hemorrhaging red ink. A soft economy may dissuade the airlines from retiring the geriatric jets.

So now the wild cards—fuel prices, aerial terrorism or recession. The former will raise industry costs, as they did in the 1970s and 1980s (a

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84. *Statement of Timothy Pettee*, supra note 76, at 19.
10 cent per gallon increase will shave $1.3 billion from the industry's operating earnings, which were $2.3 billion in 1968); the latter two will curtail demand. If recession rears its ugly head, watch out.

Few industries are as susceptible to downward turns in the economy as are airlines. Recessions prompt travelers to cancel their vacations, and businessmen to tighten their belts. Passenger demand plummets.

As noted above, the seats airlines sell are in the nature of an instantly perishable commodity, and short term marginal costs (another meal and a few more drops of fuel) are nil. So during slack demand periods, ticket prices spiral downward. Undoubtedly, falling prices will cause Alfred Kahn to babble on about how thankful we should be that he deregulated the airlines. But carrier profitability will crumble.

Couple a prolonged recession with excess capacity and high debt service and we will see another round of bankruptcies and mergers like the one we endured in the early 1980s. When the dust settles, the industry will be even more concentrated than it is now. As the economy improves, the surviving megacarriers will raise prices more ruthlessly.

IV. CORPORATE PIRATES AND ROBBER BARONS

The airline industry has always attracted men with huge egos. Millionaires like Howard Hughes and flying aces like Eddie Rickenbacker found the allure of the heavens irresistible. These were men who built and pioneered the industry and nurtured its technological development. They came from a class of pilots and engineers who appreciated the beauty and necessity of flight, and were awed by its technology. They were buccaneers, explorers, and brash entrepreneurs. But unlike their contemporary counterparts, they saw aviation as strongly grounded in the public interest.

What attracts the likes of Marvin Davis, Carl Icahn, Frank Lorenzo, Jay Pritzker, Donald Trump, and Peter Uberroth to an industry like airlines? Is it the glamor of flight, the defiance of gravity, the sweaty palms many passengers still get on takeoff and landing, the allure of exotic destinations, or the raw sex appeal of the industry? Yes, partly that.

Owning an airline is a terribly prestigious endeavor, more prestigious today than owning an NFL franchise, for there are far fewer airline clubs playing in the league for domination of the heavens and America's largest cities. Only the very elite can afford entry into the exclusive and dwindling club of airline entrepreneurs.

And so it attracts men with very large egos, as it always has. From the earliest days of deregulation, the prevailing wisdom has been that af-

85. See supra note 75, (statement of John F. Peterpaull, vice president, Int'l. Assoc. of Machinists & Aerospace Workers).
ter the dust settles, only a small handful of gargantuan carriers will dominate the industry. Each Chief Executive Officer recognized that the pile of airline corpses would be high, but each believed he would rise to the top of the heap. Much chest beating and bravado was exhibited by CEOs under deregulation, even as their firms went bankrupt or as they were gobbled up by larger airlines.

But a different breed of entrepreneurs is now attracted to the airline industry, for reasons beyond fascination with aviation. Now that the dust is settling on the first decade of deregulation, we see an industry devoid of serious competition, and a small number of very large megacarriers sharing effective monopolies, raising prices and improving profitability. Dollars and status, the stuff of American free enterprise, lures the modern generation of corporate pirates. It is not just power and prestige that make today’s corporate raiders salivate. It is raw greed as well—the allure of megabucks. For government no longer protects the public’s right to decent service at a fair price.

A century after the railroad robber barons appeared, the same thirst for wealth and power has motivated a new generation of robber barons to dominate airlines and use this industry’s tremendous market power to pillage the nation. The primordial desire to dominate the nation’s transportation industry, it seems, is nearly as old as the invention of the wheel.

But the original airline entrepreneurs were more honest businessmen, devoted to aviation and its role in serving the needs of a great nation. These men built the great service oriented airline companies and ran them from the 1930s until the 1960s: William (Bill) Patterson of United; Cyrus (C.R.) Smith of American; Edward V. (Cap’n Eddie) Rickenbacker of Eastern; Juan Trippe of Pan American; Howard Hughes of TWA; and C.E. Woolman of Delta. These men were “giants among a bank of intuitive executives who counted few pygmies in their numbers.”

The new generation of airline entrepreneurs are giants too. But under deregulation, their devotion to the public interest, or even a sense of business ethics, is an anathema to their lust for wealth. A senior executive of Boeing predicted that “The only guys who’ll survive [under deregulation] are those who eat raw meat.”

Under the stewardship of Frank Lorenzo and Carl Icahn, the once proud Continental, Eastern and TWA have been stripped of assets, have little cash, aging fleets, a sliding reputation and declining market shares. Let us introduce you to two of the most ruthless airline Robber Barons, the

86. See supra note 4, at 6-12.
88. S. Davis, supra note 24, at 10.
ones who have stripped these companies of assets, and thereby raised Congressional concern about further LBOs:

A. FRANCISCO ANTHONY LORENZO OF TEXAS AIR

Frank Lorenzo, the Darth Vader of the airline industry, feared by his competitors and despised by labor, is among the greatest Robber Barons of all time. In a decade of bold acquisitions, adept financial maneuverings, mergers, bankruptcies, union busting, asset stripping, and old-fashioned wheeling and dealing, his Texas Air empire amassed some nine different airlines, becoming, for a short while, the largest airline company in the nation. Only the Soviet Union’s Aeroflot flew more aircraft. As the Wall Street Journal observed, “Mr. Lorenzo is widely viewed as a master at acquiring airlines and a genius at high finance. No one questions his vision in creating the nation's largest and lowest-cost airline-holding company from a rag-tag assemblage of operations . . . ”

An avid jogger, his skin is pulled taut around his icy reptilian eyes and slim frame. The son of Spanish-born immigrants who ran a beauty parlor in Queens, N.Y., young Frank grew up in the flight path of LaGuardia Airport. Lorenzo was given the nickname Frankie Smooth Talk while a student at Columbia University. At Columbia, Lorenzo resigned a dorm council position after he and several other students allegedly attempted to rig a student election. While he has a reputation of being pleasant and charming in personal encounters, an Eastern pilot noted, “He shakes your hand and smiles, and then as you start to walk away, he slaps you.”

Lorenzo worked and borrowed his way through Harvard Business School, ironically as a card-carrying Teamster driving a Coca-Cola truck. After graduating, Lorenzo became a financial analyst for TWA, and then Eastern.

In 1969, Lorenzo and a classmate, Robert Carney, created Jet Capitol Corporation. Jet Capitol became an advisor to nearly bankrupt Texas International Airlines (called Trans-Texas prior to 1968). Lorenzo and

90. See Easterbrook, Lorenzo Braves the Air Wars, N.Y. Times, Nov. 29, 1989, § 6 (magazine) at 17.
93. The New Master of the Skies, supra note 91, at 72.
94. See R.E.G. DAVIES, supra note 87, at 416.
Carney acquired Texas International in 1972 by helping to refinance it. Lorenzo became President and Chief Executive Officer at the age of 32. Lorenzo's headquarters have been in Houston ever since, although curiously, neither Texas Air nor its many subsidiaries are listed on the directory of the skyscraper he occupies.

Lorenzo initially opposed deregulation, arguing that small firms like his would be gobbled up or driven under by the big boys. But once deregulation became a fait accompli, Lorenzo jumped aboard with some enthusiasm, offering discount "Peanuts fares" to fill his planes, passing out peanuts to customers on them. Texas International billboards showed flying peanuts grinning from ear to ear. Somehow it all seemed appropriate. Jimmy Carter, the former peanut farmer from Plains, Ga., was President, and it was he who blindly championed deregulation.

The more savvy analysts and industry executives predicted that when the dust of deregulation finally settled, the industry would be dominated by a handful of megacarriers, perhaps no more than four or five huge firms. Neither Jimmy Carter nor his CAB Chairman, economist Alfred Kahn, could afford to agree with so dire a prediction, for that would mean that deregulation would be an imprudent experiment. But most of the industry's elite knew better. No one understood it more clearly than Frank Lorenzo.

And no one enjoyed the Monopoly game better than Lorenzo. As a former associate said, "Frank's into making money and doing deals. He's the classic entrepreneur. Every morning when he wakes up he's got a better one than the one he had the day before." He has a reputation of successfully executing complex transactions that put him on top of the heap. As one commentator noted, "In his 16-year campaign to build his vision of an airline for the future, he has taken no prisoners, using adroit maneuvers, leveraged buyouts and tough negotiating to conquer one airline after another." But after the Eastern bankruptcy, another observer pointed out that while his strength lies in making deals, his inability to manage people may be his undoing: "I see Lorenzo as a deal-maker, a guy who has never been noted for having a very clear strategy for how to build the human organization and is now reaping the [results of] that lack of vision."

In 1979, Lorenzo began a hostile takeover attempt of National Air-

96. Christensen, supra note 92, at 1.
97. Thurow, supra note 95, at 1 col. 1.
98. Christensen, supra note 92, at 1.
lines, a company three times the size of Texas International.\footnote{100} National was a carrier with a route structure radiating north and west from Florida, and east to London. At $26.00 a share, National offered a stable of used aircraft at a premium price. After Lorenzo began his raid, a number of other airlines jumped in, including Pan American, Eastern and Air Florida. Pan Am, which wanted National for the domestic feed it might supply for its international routes, ultimately concluded a non-hostile "white knight" acquisition for $55.00 a share, or a total of $400 million, and swallowed National. National would give Pan Am an almost fatal bout of indigestion, but Frankie Smooth Talk walked away from the arbitrage with a cool $46 million as loser's consolation.\footnote{101}

The money was not to sit in his icy hands for long. He invited Edwin Smart, TWA's Chairman, to breakfast at the Hotel Carlyle in New York and offered to buy TWA, then ten times the size of tiny Texas International. An insulted Smart left abruptly without eating.\footnote{102}

Rebuffed by TWA, Lorenzo soon began a hostile acquisition of Continental Airlines, whose stock was selling at less than the book value of the aircraft it owned. Continental had tried mergers with Western Airlines, but had not been able to conclude them. In a desperate move to avoid Lorenzo's assault, Alvin Feldman, Continental's dynamic and talented CEO, tried desperately to arrange an employee buy-out (ESOP). But it was too little, too late. Lorenzo had 51% of Continental for $100 million.\footnote{103} Feldman was found shot to death in his office—a reported suicide.\footnote{104}

Lorenzo also believed that just being big was not enough. He felt that the key to long-term success in the deregulated airline industry was to be a large low-cost carrier, one with a computer reservations system. He began his assault on labor by letting contracts with Texas International pilots drag on for a year and a half before settling them, refusing to negotiate, appealing over the heads of the union chiefs to labor.\footnote{105}

After acquiring Continental, Lorenzo established a non-union subsidiary, New York Air, to fly in the northeastern United States. The threat of transferring aircraft out of unionized Texas International and Continental into non-union New York Air gave him additional leverage in reducing wages and revising work rules with the unions.

Although deregulation meant that Washington's role would be reduced, it still was important, particularly in approving mergers and in ac-
quiring international routes. So Lorenzo began recruiting the Washington airline establishment. He lured Alfred Kahn, who had been the misguided Chairman of the CAB at the time the Airline Deregulation Act was enacted, and his two principal deputies, Michael Levine (CAB Director of Pricing and Domestic Aviation) and Phil Bakes (CAB General Counsel), to the Texas Air Empire. Levine would head New York Air while Kahn would sit on its Board of Directors. As Lorenzo's henchman, Bakes would eventually come to lead Eastern into bankruptcy, much as he helped lead the CAB to its shallow grave. Bakes had served on Teddy Kennedy's Senate Judiciary Committee staff when deregulation was on the table, and since has recruited many Kennedy deputies and prominent Democratic staffers as Texas Air lawyers and lobbyists, as impressive array as had ever been seen on Capitol Hill.  

Lorenzo also picked up the head of the transportation section of the Antitrust Division of the U.S. Department of Justice, Elliot Seiden. As father confessor of the industry's antitrust sins, perhaps more than any government official, Seiden was privy to the darkest secrets of Lorenzo's competition and indeed, Lorenzo himself. With friends in high places, Lorenzo could proceed without the government breathing down his neck. In recent years, Texas Air has spent more money on Political Action Committees than any other airline. It has been estimated that Texas Air spends at least $2 million on lobbying and public relations alone. 

In September of 1983, Lorenzo made his most infamous move. After two years of wrangling over wages with the machinists union, and six weeks after their strike, Lorenzo led Continental into Chapter 11 reorganization bankruptcy proceedings. Three days thereafter, he tore up all his labor agreements, including those of the non-striking pilots, fired all of Continental's 12,000 employees, and unilaterally cut wages between 40 and 60%. 

Labor felt betrayed. At no time during negotiations with pilots had management ever suggested cutting wages below the average for large established trunk line carriers. Continental was hardly near liquidation, with several hundred million dollars in ready cash. The pilots and flight attendants began their strike in October. 

It was a bitter strike. At one point a scab pilot, sleeping in his home in Evergreen, Colorado, was wakened abruptly at about 3:00 in the morning by the sound of crashing glass. Someone had thrown an elk head

108. Abramson & Sarasohn, supra note 106, at 12.
through his plate glass window into his living room. At about the same
time, Lorenzo flew into Denver's Stapleton Airport aboard a Continental
jet, whose pilot missed the runway, landing it on the parallel taxiway.

The unions ended their strike in 1985. But by then, their backs had
been broken. Lorenzo had earned the reputation of being a union
buster.\footnote{110}

Lorenzo's reputation as a union-buster was to cost him other acquisi-
tions, including runs at Frontier and TWA in 1985. At TWA, the pilots sur-
rendered millions of dollars in wage and work rule concessions to Carl
Icahn so that he would acquire it instead of the dreaded Lorenzo.

General Tire and Rubber, which owned Frontier, sold half of its air-
craft to United in 1985, and then the rest of the company to People Ex-
press. People was headed by the flamboyant and unorthodox Donald
Burr. Burr had been a former Lorenzo deputy at Texas Air and indeed,
was the best man at Lorenzo's 1972 wedding.

People Express had a difficult time digesting Frontier and Burr's
other smaller acquisitions, Britt and PBA. Chronic service problems led
consumers to dub it "People's Distress." In 1986, People concluded an
agreement to sell Denver-based Frontier to United. The deal fell through,
ostensibly because United could not reach an agreement satisfactory to it
with Frontier's unions. This left Burr holding a leaking bag. He was
forced to put Frontier into bankruptcy to stem the hemorrhaging of dollars,
then amounting to $10 million a month.\footnote{111}

In late 1986, Lorenzo swept in with an offer to buy People Express
and its Frontier, Britt and PBA subsidiaries for $298 million, less than the
$307 million that People had paid just for Frontier the year before.\footnote{112}
After the offer had been accepted, as People Express' position became in-
creasingly untenable, Lorenzo tendered an even lower counter-offer to
Burr on a take it or leave it basis. Burr had no choice but to accept. He
rejoined the Texas Air empire, but soon left, his tail between his legs.
Lorenzo folded all the airlines—New York Air, People Express, and Frontier
into Continental in a messy overnight transition on February 1,
1988.\footnote{113}

Also in 1986, Lorenzo made his boldest purchase of all—Eastern Air
Lines, for $615 million.\footnote{114} Eastern had cash of $463 million, more than

\footnotesize
\begin{itemize}
  \item \footnote{110}{O'Brien, A Look at Troubled Eastern's Options, Wall St. J., Mar. 8, 1989, at B1, col. 3.}
  \item \footnote{111}{Cohen & Koten, People Express Delays Filing on Frontier Air, Wall St. J., Aug. 26, 1986, at 3, col. 1.}
  \item \footnote{112}{Dempsey, Antitrust Law & Policy in Transportation: Monopoly is the Name of the Game, 21 Ga. L. Rev. 505, 540-41 (1987).}
  \item \footnote{113}{Hamilton, supra note 100, at H7.}
  \item \footnote{114}{O'Brien & Dahl, Uberroth Group Plans to Acquire Eastern from Texas Air Under $464 Million Pact, Wall St. J., Apr. 7, 1989, at A3, col. 1.}
\end{itemize}
Lorenzo's outlay. 115 Lorenzo had Eastern borrow about $300 million to finance his purchase of it. 116

Eastern had been managed, badly, by former astronaut Frank Borman. Eastern lost about a billion dollars during the first decade of deregulation. Borman had tried to trim costs by rolling back wages, concessions he exchanged with labor for 25% of Eastern's stock, and labor presence on the Board of Directors. While the other unions had taken salary cuts of about 28%, the Machinists Union, headed by Charlie Bryan, a feisty and contentious Irishman, would stand for none. One Eastern executive described Bryan as "an 800-pound gorilla." 117 The presence of Bryan on Eastern's Board made life for Borman a living hell. 118

Borman criticized labor for failing to see the "big picture." To that, one labor leader responded, "I know why we can't see the big picture. We can't see the big picture because it's written across the far side of the moon. And [former astronaut] Borman is the only one who's seen the far side of the moon."

Eastern's serious financial problems led Borman to three options: "Fix it, sell it, or tank it." 119 He concluded that he couldn't fix it and didn't want to tank it, so he sold it ... to the monster Lorenzo. But, it seems, what he really did was to tank the unions, with a vengeance.

Borman was gone, but the unions were no happier. The battle between Lorenzo and Eastern's unions began almost from day one. There is one episode the unions love to tell:

It is March 1986, and Lorenzo is locked in ferocious battle with the unions over the future of Eastern Air Lines. The negotiations have been punctuated by loud noises and nasty words. Insults have been exchanged. Then Charlie Bryan, head of the Eastern machinists union and Lorenzo's chief antagonist, undergoes an epiphany. He extends an olive branch, sending Lorenzo a telegram suggesting that they meet and calmly discuss their differences with an eye toward working together. Lorenzo's reply is swift and clear: "I do not talk to union leaders." 120

After acquiring Eastern, Lorenzo prepared for the siege. He had barbed wire stretched along the top of fences around its Miami headquarters. He had closed circuit cameras mounted in hangars to monitor mechanics. He also had manhole covers in the base welded shut. 121

115. Ennis, supra note 102, at 32.
116. Nelson, Lorenzo Has His Cake and Sells It Too, Denver Post, Mar. 29, 1988, at 6B.
117. Stockton, Tearing Apart Eastern Airlines, N.Y. Times Nov. 6, 1988, § 6 (magazine) at 36, 39.
118. See Borman, Showdown In Miami, BUS. MONTH, Sept. 1988, 39.
121. Christensen, supra note 92.
renzo wanted major wage concessions from the machinists, and the machinists weren’t about to surrender them without a fight.

As Lorenzo began to turn up the heat, the unions began their own assault on the man they love to hate, Lorenzo, "the devil incarnate, a hard-headed, hard-hearted wheeler-dealer intent on destroying their unions, their airline and their lives."122 They would paint him as the Great Satan, the “antichrist.”

Lorenzo’s Texas Air corporate structure is complicated, and intentionally so. Lorenzo owns 52% of Jet Capital Corp. With 1% of Texas Air’s equity, Jet Capital enjoys 34% voting control of Texas Air and the right to elect seven of Texas Air’s directors through a special class of stock.123 Texas Air, in turn, has more than 20 subsidiaries.124 In the 1920s, financial pyramiding of a similar nature gave birth to federal public utility regulation.

Shortly after acquiring Eastern, Lorenzo looted it of some of its more valuable assets. He began by stripping Eastern of its computer reservations system (System One), for a paltry $100 million at a time when Eastern’s bankers estimated its worth between $200 million and $320 million, and it was generating $255 million a year in cash.125 To finance it, Texas Air gave Eastern a 25-year note at 6.5% interest.126 Eastern, of course, is now without a computer reservations system, and must buy services from System One, for which it pays $130 million a year to Texas Air.127

Lorenzo controls a fuel brokerage firm from which Continental and Eastern must buy all their fuel, at a 1% commission, or about $30 million a year.128 Eastern was forced to buy a $25 million unsecured note from People Express, bringing Texas Air a $4 million profit.129 Thus, Texas Air upstreams cash to the parent in the form of management and service fees charged the subsidiaries, Continental and Eastern.

Lorenzo transferred eleven of Eastern’s gates at Newark to Continental, another Texas Air subsidiary, for an $11 million promissory note paying 10% interest. In contrast, Piedmont paid $25 million to Eastern for eight gates and related facilities at Charlotte.130 Lorenzo also transferred the lucrative Miami-to-London route and 20 aircraft to Continental.131

122. Id.
123. Petzinger & Thomas, House of Mirrors: Lorenzo’s Texas Air Keeps Collecting Fees From Airline Units That Have Continuing Losses, Wall St. J., Apr. 7, 1988, at 1, col. 6.
124. Ennis, supra note 102, at 33.
125. Petzinger, supra note 123.
126. Id.
127. Nelson, supra note 116; Petzinger, supra note 123.
128. Nelson, Lorenzo’s Empire Under Scrutiny, Denver Post, Apr. 18, 1988, at 6B.
130. Petzinger, supra note 123.
131. Castro, supra note 119, at 53.
Eastern also paid Continental $30 million to train 400 pilots to keep Eastern flying in event of a strike.\textsuperscript{132}

Lorenzo closed Eastern's Kansas City hub, and laid off about 25% of the work force. He also proposed to transfer the lucrative Boston-New York-Washington shuttle to a Texas Air subsidiary for $225 million, a transaction for which Jet Capitol arranged a juicy $1.25 million fee for itself for advising Texas Air.\textsuperscript{133} The shuttle was responsible for one-third of Eastern's profits. Its transfer was abated only when blocked by court order.\textsuperscript{134}

Lorenzo leveraged Eastern heavily with debt, mortgaging its unencumbered assets. In 1988, its annual debt service burden was a staggering $575 million.\textsuperscript{135} Before Eastern's bankruptcy, its long term debt was estimated to be $2.5 billion.\textsuperscript{136} Although secured by equipment, the debt has interest rates as high as 17.25%—radically higher than the 10% note accepted by Eastern from Continental for 11 gates, and the 6.5% note accepted by Eastern from Texas Air for the System One computer reservations system.\textsuperscript{137} But Eastern's creditors can reach Texas Air for only about 10% of the debt, for Lorenzo has carefully shielded the parent from it.\textsuperscript{138} As one source noted:

Mr. Lorenzo has built one of the most leveraged major corporations in the nation while insulating Texas Air—and himself—for most of the cost and much of the risk. ... Mr. Lorenzo presides over some of the nation's sickest airlines. ... All are losing money at some of the fastest rates in aviation history and rank as the industry's biggest debtors. As a group, the Texas Air companies have piled up $5.4 billion in debt. Last year they had to pay $623 million simply to service the long-term part of that debt—an interest bill higher than the annual revenue of each of nearly 100 companies at the bottom of the Fortune 500.\textsuperscript{139}

The unions, which owned 25% of Eastern's stock, complained that Lorenzo was draining off its assets for his own benefit.\textsuperscript{140} In one law suit, the pilot's union alleged that Lorenzo intended to "loot Eastern for the

\textsuperscript{133} Thomas, Texas Air Drops Plan to Transfer Eastern Shuttle, Wall St. J., July 5, 1988, at 4, col. 2. Petzinger, supra note 121.
\textsuperscript{134} Ennis, supra note 100, at 33; EAL Recalls Shuttle Plan to Clear Contempt Ruling, TRAVEL WEEKLY, Apr. 14, 1988, at 5.
\textsuperscript{136} Id.
\textsuperscript{138} O'Brien, supra note 135.
\textsuperscript{139} See supra note 83, at 9-10.
\textsuperscript{140} Nelson, supra note 128.
benefit of Texas Air." \(^{141}\) An Eastern pilot noted, "I think it’s clear to even the most casual observer that they’re engaged in union-busting by spinning off the airline’s most valuable assets." \(^{142}\) When asked whether he intended to bust Eastern’s unions so that he could enjoy a comparable cost structure to Continental, Lorenzo insisted, "That’s utter bullshit." \(^{143}\)

Before Eastern’s bankruptcy, a Texas Air spokesman promised, "Frank [Lorenzo] and [Eastern President] Phil Bakes have absolutely no plans for a Chapter 11 filing at Eastern." \(^{144}\) In response to inquiries by reporters as to whether Eastern would be placed in bankruptcy, Bakes himself said, "We’ve ruled that out. Bankruptcy never has been an option." \(^{145}\) No doubt, these false assurances were designed to calm nervous passengers booking flights and buying tickets.

Hatred for Lorenzo galvanized the unions. As an Eastern pilot said, "As long as money is flowing up into a tornado called ‘Jet Capital’, I see no reason why I or any other employee should feed this whirlwind with money out of our pockets." \(^{146}\) When the machinists struck, the pilots honored their picket lines, and Eastern was shut down. Despite the earlier assurances, Lorenzo quickly flew Eastern into Chapter 11 bankruptcy, further dismembering its assets. But unlike the Continental bankruptcy, Lorenzo could not tear up the union contracts at Eastern. Partly in response to Lorenzo’s use of bankruptcy in 1983 to shed Continental of its union contracts, Congress had amended the Bankruptcy Code in 1984 to make such an action impossible without permission of the bankruptcy judge.

Offers were made for Eastern by TWA raider Carl Icahn and former National Baseball League Commissioner Peter Ueberroth. Both were rejected by Lorenzo. Eastern was dismembered by selling the shuttle to Donald Trump, its Latin American routes to American Airlines, and its Philadelphia gates and Canadian routes to Midway Airlines, along with scores of aircraft.

Eastern employees burned Lorenzo in effigy. As one commentator note, "among many of them, a sense of betrayal runs deep. And the lightning rod for their anger is Frank Lorenzo, the steel-willed chairman of

\(^{141}\) Petzinger, supra note 123, at 24.

\(^{142}\) Knox, Lorenzo, Eastern’s Unions Square Off, Rocky Mountain News, Feb. 21, 1988, at 72.

\(^{143}\) Lorenzo, Being Frank, AIRLINE BUS., Jan. 1989, at 18, 21.

\(^{144}\) Knox, supra note 142.


\(^{146}\) Stockton, Tearing Apart Eastern Airlines, N.Y. Times, Nov. 6, 1988, § 6 (magazine) at 36, 39.
Texas Air Corp.”147

A recent editorial summed up the mark Lorenzo has made on the airline industry:

The trouble with Lorenzo is that his only genuine successes have been in creating an empire of misfits which has accumulated debts of over $5 billion, in attracting undiluted hatred from his workforce, in bringing on an unprecedented investigation by the DOT into his fitness to manage an airline, and in his blatant efforts in asset-stripping.148 Lorenzo’s self image is more positive. Said he, “I’m not a guy associated with a lot of ego.”149 If not that, he is associated with lots of other things.

B. CARL ICAHN OF TWA

Unlike many of the other Robber Barons, Carl Icahn is not a builder of great airlines. He is a corporate raider, a financial pirate, pure and simple, whose interest in companies focuses on what they can produce at the bottom line, in nice crisp dollars. A TWA union head summarized the difference between Icahn and Lorenzo: “Mr. Lorenzo wants to own the largest airline in the world. Mr. Icahn wants to be the richest man in the world.”150

As noted above, an attempted takeover of Trans World Airlines by Frank Lorenzo led its unions to give major wage and work rule concessions to Carl Icahn, who acquired TWA in 1986, paying $440 million for 22 million shares.151 He soon took it private, and moved its headquarters out of Rockefeller Center in Manhattan to Mt. Kisco, N.Y., near his home.152 The Mt. Kisco facilities are adorned with gilded chandeliers hanging from its high ceilings, and with oil paintings of dueling cavalymen, Napoleon with his marshalls, and ferocious sea battles hanging from its walls.153 The thrill of battle consumes Icahn. So too does the glamour of the airline industry. Few airline barons so relish the lights, the glitz, and the television camera focused on Icahn’s smiling face.

In 1986, TWA concluded a $224 million agreement to acquire Ozark Airlines, which shared TWA’s St. Louis hub. The merger gave the consolidated firm 76% of the gates at Lambert International Airport, and 86% of

149. Stockton, supra note 146, at 86.
152. Id.
passenger enplanements.\textsuperscript{154} This enabled TWA to raise ticket prices, which it promptly did.\textsuperscript{155}

In 1987, Icahn made a $1.6 billion bid for USAir at a time USAir was attempting to acquire Piedmont. USAir rejected the bid, but there was speculation on Wall Street that what Icahn really wanted was to force USAir to buy TWA.\textsuperscript{156} As one analyst noted, "He’s gone everywhere trying to sell TWA. There aren’t any takers."\textsuperscript{157} Others speculated that Icahn wanted to "green mail" USAir into buying back his 14.8% stock interest at a premium.\textsuperscript{158}

In 1987, the Securities and Exchange Commission began an investigation of Icahn’s activities as part of a wider probe of insider-trading created by the Ivan Boesky scandal. In particular, the SEC was looking at Icahn’s proposed bid for Phillips Petroleum in 1985, and his stake in Gulf & Western.\textsuperscript{159}

Icahn has leveraged TWA to the teeth, doubling its long-term debt, in order to raise cash for other acquisitions, including USX Corp. and Texaco. TWA’s $2.5 billion debt and lease obligations crushes the airline’s earnings with annual interest charges of $375 million.\textsuperscript{160} TWA has a negative net worth of $30 million.\textsuperscript{161} The company has a 15-1 debt to equity ratio.\textsuperscript{162} In 1988, the Consumer Federation of America became so concerned about these manipulations that it alleged, "After running up huge amounts of debt, the Icahn-led group now proposes to take all its money (and then some) out of TWA, leave the company with absolutely no equity, and leave the airline on the brink of bankruptcy."\textsuperscript{163} Ironically Carl Icahn recently noted, "There is no question that leverage during the past year has gotten out of hand—it was almost a feeding frenzy."\textsuperscript{164}

TWA flies the oldest fleet of aircraft in the industry. Icahn’s failure to reinvest TWA’s capital in the airline led the pilot’s union to argue that Icahn had betrayed them upon TWA’s acquisition, when he assured them that he would not dismember the airline. But until the Spring of 1989, TWA

\textsuperscript{154} Dempsey, supra note 8, at 511-12.
\textsuperscript{155} GENERAL ACCOUNTING OFFICE, AIRLINE COMPETITION: FARE AND SERVICE CHANGES AT ST. LOUIS SINCE THE TWA-OZARK MERGER (1988).
\textsuperscript{157} Id.
\textsuperscript{159} Id.
\textsuperscript{160} Vogel, supra note 153, at 87.
\textsuperscript{161} Power, Raiders May Not Make the Best Airline Pilots, BUS. WEEK, May 15, 1989, at 35.
\textsuperscript{162} See supra note 75, (statement of Bill Hoffman, treasurer of the Indep. Fed’n. of Flight Attendants)
\textsuperscript{164} Vogel, supra note 153, at 87.
had placed no orders for new aircraft. TWA President Joseph Corr resigned when he became convinced that Icahn would not buy the planes the airline needed. Subsequently, the hulking, blunt talking Corr became Continental's CEO.\(^{165}\) To stem the criticism, TWA ordered a few Airbus A-330 widebodies. But there was some speculation that they might be sold off before their scheduled delivery in 1994. Former TWA executives claim that the company also needs another 50 to 100 narrow bodied aircraft to replace aging aircraft.\(^{166}\) Any order for the Boeing or McDonnell-Douglas aircraft TWA desperately needs would also not see delivery until 1994.

Nonetheless, to fatten his war chest for future raids, Icahn proceeded to leverage TWA further still. With long-term debt of $2.5 billion, TWA's aircraft and engines were already pledged to existing lenders. In June 1989, he announced a $300 million high interest junk bond offering secured on TWA's spare parts such as light bulbs, gaskets, and landing slots.\(^{167}\)

Ironically, Icahn acquired TWA with generous concessions from the pilots, who were intent on avoiding the union-busting Lorenzo's hostile acquisition. But soon after climbing in TWA's cockpit, Icahn was to crush a union himself—the flight attendants, who struck in 1986. He had trained an army of scabs to pass out the dinner trays and pour drinks. (Actually, flight attendants are on board because the FAA requires their presence to protect passenger safety). But soon, he had a union on its knees, anxious to return to work at sharply reduced wages and benefits, and stiffer work rules. Icahn, the union buster.

Icahn is not without his dirty linen. He so slashed costs that TWA reduced the frequency with which it washed its blankets, with malodorous results.\(^{168}\) Something is rotten at TWA.

V. FOREIGN OWNERSHIP: THE GLOBALIZATION OF AVIATION

Not only is the debt caused by LBOs of serious public concern, so too is the rapidly growing phenomenon of foreign ownership. Foreign alliances with U.S. airlines began around the frequent flyer programs created by the U.S. carriers.\(^{169}\) The second wave occurred when foreign airlines affiliated with U.S. carriers' computer reservations systems. For example, the two dominant European systems have the following alliances:

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166. Vogel, supra note 153, at 87.
168. Vogel, supra note 153, at 87.
169. See supra note 76, at 3.
CHART III — EUROPEAN COMPUTER RESERVATIONS SYSTEMS PARTNERS

<table>
<thead>
<tr>
<th>Covia</th>
<th>Amadeus</th>
</tr>
</thead>
<tbody>
<tr>
<td>United</td>
<td>Texas Air</td>
</tr>
<tr>
<td>British Airways</td>
<td>Air France</td>
</tr>
<tr>
<td>KLM</td>
<td>Lufthansa</td>
</tr>
<tr>
<td>Swissair</td>
<td>Iberia</td>
</tr>
<tr>
<td>Alitalia</td>
<td>SAS</td>
</tr>
</tbody>
</table>

The most recent round of foreign interest in U.S. airlines has involved direct ownership in them. The following chart depicts the substantial foreign airline interests in U.S. flag carriers:

CHART IV — FOREIGN AIRLINE OWNERSHIP OF U.S. AIRLINES

<table>
<thead>
<tr>
<th>Foreign Airline</th>
<th>Percentage Ownership</th>
<th>U.S. Airline</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAS</td>
<td>9.9%</td>
<td>Texas Air</td>
</tr>
<tr>
<td>Swissair</td>
<td>5%</td>
<td>Delta</td>
</tr>
<tr>
<td>Air Singapore</td>
<td>5%</td>
<td>Delta</td>
</tr>
<tr>
<td>Ansett Airlines</td>
<td>20%</td>
<td>America West</td>
</tr>
<tr>
<td>Japan Air Lines</td>
<td>20%</td>
<td>Hawaiian Airlines</td>
</tr>
<tr>
<td>KLM</td>
<td>25%</td>
<td>Northwest</td>
</tr>
<tr>
<td>British Air</td>
<td>15%*</td>
<td>United</td>
</tr>
</tbody>
</table>

* proposed; later withdrawn

The equity interests by Scandanavian Airline System [SAS] in Texas Air and by Australia's Ansett Airlines in America West were inspired by the Americas carriers' need for a substantial infusion of new capital. From SAS's perspective, the Texas Air alliance gave it new feed into its transatlantic routes; SAS moved its international hub from New York Kennedy Airport to Newark, where Texas Air's Continental and Eastern could provide domestic feed. It is reported to be negotiating for 24.9% of Continental, which Lorenzo has placed on the block. Swissair's and Air Singapore's interest in Delta appears to have been inspired by different reasons—the desire by Delta to have a friendly partners poised to fend off LBOs.

But most are motivated by foreign airlines' interests in creating operating and market alliances. Thus, they invest "dumb equity", accepting sub-optimal returns because they will receive synergistic revenue on combined interline operations that they would not otherwise enjoy. For-

eign airlines want some control to assure U.S. feed, and thus are willing to give a raider a very favorable rate to finance the deal.

Not only are foreign airlines affiliating with U.S. carriers. Other international aviation alliances are emerging, including British Airway’s acquisition of British Caledonian, the British Airways/KLM proposed 20% stake in Belgium’s Sabena Airlines, the SAS interest in Aerolinas Argentinas, and the purchase of 35% of Air New Zealand by a consortium consisting of Qantas, Japan Air Lines and American Airlines.\textsuperscript{172}

International airline alliances have been stimulated by the prospect for liberalizing European transport in 1992.\textsuperscript{173} The conventional wisdom is that, when the dust settles from U.S. deregulation and international aviation liberalization, only a handful of global megacarriers will dominate air transport. Wanting to be among the survivors motivated the contemporary surge in international combinations and alliances. Tremendous commercial synergy is perceived in international aviation partnerships. Moreover, with the Europe’s aviation infrastructure even more saturated than America’s, opportunities for growth are largely limited to acquiring or affiliating with existing airlines.

Several public policy concerns arise over foreign ownership of U.S. airlines. The first surrounds national security. America depends upon its Civil Reserve Air Fleet [CRAF] for airlift capacity in time of war. Foreign ownership may jeopardize access to it. The second surrounds the integrity of bilateral air transport negotiations between the United States and foreign governments. International routes are traded by nations on a bilateral basis, usually with candid input from their carriers.\textsuperscript{174} Multiple allegiances may well jeopardize the integrity of that process. Third, these alliances may significantly reduce competition in international aviation. How strongly will United and British Airways compete in the U.S.-U.K. market, for example, if the two carriers have common ownership?

In 1989, Secretary of Transportation Samuel Skinner became very concerned about the Checchi group acquisition of Northwest Airlines, not only because the LBO would increase Northwest’s debt fourfold, but also because of the $400 million equity participation by KLM Royal Dutch Airlines, which would give it about 57% of total equity.\textsuperscript{175} As Skinner said,

While KLM’s voting share technically fell within the statute’s numerical limits [which requires that the airline’s President and two-thirds of its Board

\textsuperscript{172} Going Steady, ECONOMIST, July 22, 1989, at 39.
\textsuperscript{174} See generally, P. DEMPSEY, LAW & FOREIGN POLICY IN INTERNATIONAL AVIATION (1987).
\textsuperscript{175} See supra note 75, (statement of Samuel Skinner, United States Secretary of Transportation) at 4.
and other managing officers by U.S. citizens, and that not less than 75% of voting interest be owned and controlled by U.S. citizens[,] we concluded that KLM's ownership of 57 percent of NWA Inc.'s total equity, together with the existence of other links between the carriers and KLM's position as a competitor, could create the potential for the exercise of influence and control over the carrier's decisions. This would be inconsistent with the law.\textsuperscript{176}

In September 1989, Skinner convinced Checchi and Northwest to agree, \textit{inter alia}, to limit KLM's equity to 25%, and to limit KLM's representation on Northwest's Board of Directors to "matters relevant to KLM's pecuniary interest." The KLM board members must recuse themselves when the board is dealing with certain matters, such as bilateral negotiations and competitive issues.\textsuperscript{177} Thus, Skinner appears to interpret the section 101(16) of the Federal Aviation Act as limiting foreign equity interest to 25%. Nonetheless, foreign participation in Northwest's total debt and equity capitalization will still exceed 60%.\textsuperscript{178} Foreign financing is being provided not only by KLM, but also by Japanese banks and the Australian Elders IXL group, a brewer.\textsuperscript{179} Had the management/pilot deal for United not fallen through, British Airways was prepared to supply $570 million, or 78% of the total $965 million equity.\textsuperscript{180}

\section*{VI. PROPOSED LEGISLATION}

Prior to promulgation of the Airline Deregulation Act of 1978, the Civil Aeronautics Board had jurisdiction under section 408 of the Federal Aviation Act of 1958 to approve (or disapprove) any merger or acquisition of an airline by any person in "any phase of aeronautics." The 1978 Deregulation legislation changed the triggering mechanism to require approval only by a "person substantially engaged in the business of aeronautics."\textsuperscript{181} Thus, a corporate raider not already owning an airline or aircraft manufacturing enterprise would not need CAB approval to acquire an airline. The 1978 bill also sunset the Civil Aeronautics Board on January 1, 1985, when its remaining responsibilities were transferred to the U.S. Department of Transportation.

During the reign of Transportation Secretary Elizabeth Dole and Undersecretary Matt Scocozza, the DOT approved each and every one of the 21 mergers submitted to it. This led Congress to strip the DOT of

\textsuperscript{176} id. at 5.  
\textsuperscript{177} id. at 6.  
\textsuperscript{178} id. at 8.  
\textsuperscript{179} Dallos, \textit{U.S. Conducts 'Fitness' Exam of Northwest Airlines; Debt Cited}, L.A. Times, Sept. 5, 1989, at 1, col. 4.  
jurisdiction over mergers, transferring such power to the U.S. Department of Justice on January 1, 1989. As a consequence, an air carrier need not seek advance DOT approval of any ownership change. However, DOT continues to hold jurisdiction under section 401 of the Federal Aviation Act to scrutinize the fitness of airlines (which includes safety and compliance fitness), and under section 101(16) to review foreign ownership (which cannot exceed 25% of the U.S. flag carrier). The present DOT Secretary, Samuel Skinner, appears prepared to exercise the agency’s fitness jurisdiction if need be. Said he, "I will not allow excessive debt in the airline industry to jeopardize the public interest, especially in the area of safety."^182

In October 1989, the Senate Commerce Committee approved a bill which would prevent any person from acquiring more than 25% of an airline unless it is approved by the Secretary of Commerce.^^183 That same month, the House Public Works and Transportation Committee passed a bill which would give the Secretary of Transportation authority to disapprove ownership of more than 15% of an airline if it would so weaken the carrier as to injure its ability to compete, to jeopardize safety, or to give control to a foreign interest.^^184 In the findings sections of the bill, it is recognized that

(3) An air carrier in seriously weakened financial circumstances may take actions designed to—
   (A) reduce maintenance expenditures;
   (B) avoid or reduce commitments to modernize its fleet; or
   (C) avoid or reduce commitments to ground improvements at airport facilities; in order to meet its financial obligations.

(4) Air carriers with excessive debt burdens may pose an increased risk to air carrier safety and reliability.

(5) The public interest requires a review of acquisitions of control of air carriers which significantly increase air carrier indebtedness to assure that the public interest in air carrier safety and service is adequately protected.^^185

This bill is a step in the right direction. Other pending legislation is targeted at LBOs more generally. As one source noted:

While LBOs will surely be tested during an economic turndown, the problems are emerging despite a surging stock market and a stable economy. LBOs are going bust like never before. In the past five years, corporate debt has risen by $840 billion dollars while equity has fallen by $300

billion. Corporate interest payments account for 26 percent of cash flow, which is higher than the percent that prevailed in the past two recessions. [C]orporations in cyclical industries (like airlines) accounted for 50 percent of the LBOs since 1982.

The consequences to the government are also staggering. The movement from equity to debt will permanently reduce corporate tax collections by tens of billions of dollars. The government is subsidizing the de-capitalization of U.S. industry.

In the first half of 1989, $3.2 billion dollars in junk bond defaults occurred, more than double the pace of a year ago.186

A pending bill would eliminate the tax deductability of junk bonds used to finance LBOs.187 This would jeopardize many of them, although the Northwest and proposed United acquisitions did not employ junk bonds, using bank debt exclusively.188

VII. CONCLUSION

Recently, the Wall Street Journal asked Americans to identify the industries in which they have most, or least, confidence. The largest number by far, 43%, said they had no confidence in the airline industry. The disapproval rating for the industries which followed—insurance (27%), banking (23%), oil and gas (22%), and stockbrokers (22%)—was not nearly as high as that for airlines.189

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

Several empirical studies suggest that the grand experiment in deregulation needs some stiff course correction. Leveraged buy-outs and foreign ownership are but two of the serious problems which have emerged. He is a short list of the major problems of airline deregulation:

Concentration. With more than 150 bankruptcies and 50 mergers, deregulation has produced unprecedented concentration in aviation. The eight largest airlines now control 94% of the domestic passenger market, and dominate the nation’s busiest airports. A recent GAO study reveals that pricing at hub monopolies and duopolies is 27% higher than at competitive airports. The megacarriers also control the computer reservations systems, the frequent flyer programs, and queues for aircraft rolling

186. See supra note 84, at 6-7 [citations omitted].
off the assembly lines at Boeing, McDonnell-Douglas and Airbus. Prices appear to be rising everywhere.\textsuperscript{190}

\textit{Pricing}. The Bureau of Labor Statistics reports that the average cost of flying has tripled since the airlines were deregulated in 1978, while the cost of everything else has only doubled.\textsuperscript{191} Carriers extract monopoly rents from the markets they dominate. Not only are prices rising, they are highly distorted and volatile (there are 40,000 rate changes every day).

Curious pricing policies have emerged. A passenger flying from Atlanta to Denver often pays more than one flying the same airline from Atlanta to Denver via Chicago, even though the carrier’s fuel and labor costs are higher on the more circuitous routing. A passenger flying from Washington to Detroit can pay more than the one seated beside him flying from Washington to Cleveland via Detroit.\textsuperscript{192}

Something is fundamentally wrong with a market in which pricing can so often bear an inverse relationship to costs. This is hardly the textbook model of perfect competition we were promised by the pro-deregulation economists.\textsuperscript{193}

\textit{Consumer Abuses}. From false and misleading (including “bait and switch”) advertising, to deliberate overbooking, unrealistic scheduling, demand based flight cancellations, travel agent commission overrides, and onerous lost luggage rules, the industry appears to be dominated by the philosophy of P.T. Barnum—“there’s a sucker born every minute. The archaic common law doctrine of caveat emptor has emerged to shield the airline industry from liability.\textsuperscript{194}

\textit{Leveraged Buy-Outs}. Recent raids on three of the four largest airlines—American, United and Northwest—promise to load them with enormous debt. Another four of the nation’s giants—Continental, Eastern, Pan Am and TWA—have a negative net worth (a debt to equity ratio in excess of 100%). Corporate pirates like Frank Lorenzo and Carl Icahn have already stripped these once proud airlines bare. Debt service will force carriers to raise ticket prices and trim service (and perhaps the margin of safety) even more.\textsuperscript{195} If the economy turns soft, debt could bankrupt a few highly leveraged airlines, leading to even less competition than we now have. As Representative Byron Dorgan (D-N.D) said, “I’m not so alarmed if they load up a lipstick company with debt and it fails. But if you

\textsuperscript{190} P. Dempsey, supra note 4, at 129-93.
\textsuperscript{191} Who Wins the Air Wars?, NEWSWEEK. Sept. 18, 1989, at 41.
\textsuperscript{193} P. Dempsey, supra note 4, at 95-104.
\textsuperscript{194} Id., at 105-113.
do that to an airline, it's a real blow to the public interest."196

Foreign Ownership. Foreign ownership has invaded several U.S. airlines, including Texas Air, Delta, Northwest, and America West, and promises to snare United as well. Some deregulation ideologues, like Alfred Kahn, insist that Congress should repeal U.S. cabotage laws, allowing foreign airlines to provide domestic service. They have forgotten that most of the technological breakthroughs in aviation were inspired by its military applications—the ability of aircraft to deliver bombs and troops. How many Pearl Harbors would there have been if Japan Air Lines and Lufthansa had been the dominant U.S. airlines in the 1930s?

American's lack of confidence in the airline industry may well reflect more than public disenchantment with a few lost bags and late arrivals. It may also suggest that Americans have misgivings about deregulation.

Sooner or later, we will reregulate the airlines. The bills now before Congress to provide governmental scrutiny over airline acquisitions are a few steps in the right direction. It would be better if government jumped in sooner, rather than later—better to halt widespread failures in an industry so important to the nation's commerce, communications and national defense, and preserve what little competition remains.

Concentrations of wealth and power served as the catalyst for regulation with the promulgation of the Interstate Commerce Act of 1887, and three years later, the Sherman Antitrust Act. A nation which does not learn from its history is doomed to repeat it.

There are more important interests than the greed of a small and exclusive club of corporate robber barons. America needs a safe and dependable transportation network, providing its citizens a decent level of service at a fair price. Responsible government oversight of this important infrastructure industry is essential to restore its position as a servant of the public interest.

The airline industry is vitally important to the nation's commerce, communications and national defense. We need a strong, viable domestic transport system providing good and safe service at a reasonable price. That can only be provided with responsible government oversight.

That is not to say that we need to return to the rigid regulatory regime of the early 1970s. It is to say that deregulation has gone too far, and that the nation is ill served by laissez faire.197 It is time to roll back deregulation.

196. Smith, supra note 41, at A3.
Financing High Speed Rail
Meeting the Transportation Challenge
of the '90s

ABELARDO L. VALDEZ*

As cars and airplanes increasingly clog our decaying highways and graying skies it is clear that this nation urgently needs a solution to its growing transportation problems. The improvement and expansion of current passenger transportation systems is destined to be forever too little, too late. Population growth and development are occurring too quickly to keep up with their demands. Any expansion of our highways and skyways, however, means a corresponding increase in pollution and congestion thereby diminishing the quality of life for those who are the intended beneficiaries of such improvements. We need to exploit a new transport system, one whose progenitors have been with us for over 150 years but that is at the cutting edge of technology, namely high speed rail travel.

Travel by rail has had a long and glorious history in this country, help-

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The author wishes to gratefully acknowledge Craig L. Wiener, an associate with Laxalt, Washington, Perito & Dubuc, for his invaluable assistance.
ing to link the wide expanse between the east and west coasts. High speed rail can help to usher in a new Golden Age of train travel and alleviate many of our growing transportation problems. In order to adopt high speed rail in the future, planners and developers should look across the seas and bring the efficient, safe and convenient train travel of other countries back to our nation's shores.

High speed rail offers numerous advantages. The train can travel at speeds of up to 300 miles per hour. It can travel from city center to city center in many cases faster than an airplane or automobile, and it operates on efficient, low-polluting electricity, not ozone-depleting and smog-creating hydrocarbons. Thus high speed rail can meet tomorrow's growing transportation needs today with few of the problems associated with current systems.

However, high speed rail infrastructure, including acquisition of expensive rights of way, is costly. It requires a long-term commitment of capital and resources with no immediate financial payback. A spokesperson for General Electric Co.'s Transportation Systems Business Operation succinctly stated the problem surrounding high speed rail in this country: "The hangup isn't technology or equipment. Clearly, we have the technology to build equipment that will travel at [high] speeds. It's the financing, the economics of it and getting things in place." To overcome this obstacle, various creative financing solutions have been developed to insure an adequate supply of working capital. High speed rail projects currently in various stages of development rely on numerous combinations of public and private financing options. This Article will explore these financing options, both as they have been proposed and how they otherwise could be utilized for maximum efficacy.

I. THE CASE FOR HIGH SPEED RAIL

Some high speed rail systems can make efficient use of existing rights-of-way and transportation corridors. British high speed trains travel on improved railbeds that are shared with other rail services while the French TGV trains use existing rights-of-way when traveling in and around urban areas. A high speed rail system utilizing tilt trains, such as the TALGO Pendular from Spain, that has a passive tilt system, or the Bombardier LRC from Canada, that has an active tilt system, can use existing tracks after relatively modest railbed improvements have been made. This greatly reduces the cost of constructing and operating a high speed rail system. Given the lack of available funding for high speed rail in the

2. Thompson, High-speed Rail, 89 TECH. REV., Apr. 1986, at 32A.
Financing High Speed Rail

United States, tilt trains may be the most appropriate technology for high speed rail particularly in the Northeast Corridor.\(^3\)

In some cases, proposed magnetic levitation ("maglev") trains can be built along or above existing interstate highways and city streets thus avoiding the need to acquire additional and most likely expensive rights-of-way.\(^4\) The use of existing rights-of-way also helps to minimize any adverse environmental impacts of high speed rail systems.\(^5\) Moreover, there are additional environmental advantages of high speed rail. High speed rail systems consume much less energy than other forms of transportation\(^6\) and air pollution is much less than that caused by automobiles.\(^7\)

High speed rail also helps the environment by reducing airline traffic,

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3. See Boston Globe, Feb. 20, 1989, at 41 (city ed.). Tilt trains can lean into curves by as much as ten degrees. This allows them to go quickly around sharp curves without flinging passengers from side to side. The Canadian Bombardier cars use a system of sensors and hydraulic motors to bank each car as it enters a curve. The TALGO Pendular cars, marketed by the RENFE-TALGO Group, a joint venture between the Spanish National Railway Co. (RENFE) and Patentes Talgo S.A. (TALGO), use a series of springs that suspend the car from above and allow the base of each car to swing outward as it rounds a curve. See id. Trains with tilting trailers can run through curves thirty percent faster than conventional trains and unlike many high speed trains they do not require a straight dedicated track. Rosen, High Time for U.S. High Speed Rail, MECHANICAL ENGINEERING, Feb. 1989, at 34.

At the request of the Coalition of Northeastern Governors (CONEG), Amtrak tested both the Bombardier LRC and the TALGO Pendular along the Northeast Corridor in April of 1988. See Amtrak Evaluation of Tilt and Turbo Train Technologies, Vol. 1 (Jan. 1989). The tests demonstrated that passenger trains could be operated safely and comfortably at higher than usual levels of tilt. See id. at 4; Report of the CONEG High Speed Rail Task Force, at 3 (Apr. 6, 1989). The performance of the LRC and the TALGO Pendular was similar with the TALGO Pendular superior in all aspects except on long, smooth curves. The TALGO Pendular was superior on the short curves which prevail in the Northeast Corridor. Amtrak Evaluation, at 5.


5. See Interstate Right-of-Way Hearings, supra note 4, at 86 (statement of David H. Rush, Commissioner, Florida High Speed Rail Transportation Commission and Chairman, Florida High Technology and Industry Council). Use of high speed rail also reduces the need for additional road construction thus leading to fewer problems with runoff and destruction of vital wetlands. Id.

6. Amtrak’s Metroliner and Japan’s Shinkansen ("bullet train") consumer about one-sixth the energy of narrow body aircraft and France’s TGV consumes about one-half the fuel of an automobile per passenger-mile. The TGV consumes as much energy at 170 miles per hour as the Metroliner does at 120 miles per hour. Rosen, supra note 3, at 34; Thompson, supra note 2, at 32. Maglev is particularly energy efficient, consuming only one-fifth the energy per passenger-mile of an automobile and one-tenth that of a 727. Interstate Right-of-Way Hearings, supra note 4, at 87 (statement of David H. Rush).

7. Thompson, supra note 2, at 32.
thereby alleviating the need for additional flights and airport expansion.\textsuperscript{8} For instance, after the TGV line between Paris and Lyon opened, air traffic between the two cities dropped by fifty percent.\textsuperscript{9} Presently, ten times as many travelers between Paris and Lyon travel by train rather than by airplane.\textsuperscript{10}

High speed rail is also more reliable than either airplanes or automobiles. It can run effectively in all but the most severe weather conditions unlike automobiles and airplanes.\textsuperscript{11} As for safety, high speed rail systems have a much better passenger safety record than either air or automobile travel.\textsuperscript{12}

The French TGV is perhaps the most proven and successful of the high speed rail systems in use today. When it opened in 1981, the TGV Paris-Lyon line cut rail travel time between the two cities from three and one-half hours to two hours.\textsuperscript{13} The two billion dollar investment in the Paris-Lyon line is expected to be paid off in ten years from startup rather than the expected fifteen years.\textsuperscript{14} In 1988, seventeen million passengers traveled on the Paris-Lyon line earning the railroad 100 million dollars on revenues of 681 million dollars.\textsuperscript{15}

Although not as well known or technologically advanced as the TGV, the TALGO Pendular has proved highly successful in the Madrid-Paris run. In tests their equipment proved itself capable of traveling between New York and Boston in two hours and forty-five minutes.\textsuperscript{16} This represents a two hour savings in travel time over present Amtrak service while utilizing existing trackage with some improvements.

High speed rail also brings with it secondary economic benefits. Increased employment is accompanied by increases in spending and tax revenue.\textsuperscript{17} Additional benefits come from increased development associ-
ated with high speed rail projects.\textsuperscript{18}

II. FINANCING OPTIONS

The question of financing looms large as a potential stumbling block to the implementation of a high speed rail system. Financing a high speed rail system involves an enormous commitment that the states, without the help of the federal government, might find prohibitive. However, at the outset, it should be recognized that the federal government is not prepared to participate in the direct funding of high speed rail projects.\textsuperscript{19} This is due in part to the fact that most high speed rail systems would operate in only one or two states with virtually all of their benefits being realized at the local or state level.\textsuperscript{20} Coupled with the reality of the current federal budget deficit, there is little likelihood that there will be any movement toward federal grants-in-aid or subsidies for high speed rail in the near future.\textsuperscript{21}

The financing costs associated with a high speed rail system, primarily capitalized interest and debt service, comprise the major costs of such a project.\textsuperscript{22} Thus, the total costs of a capital financing program for a high speed rail system may be so large that any single entity would be unable to take on the task alone.\textsuperscript{23} The cost of high speed rail is imposing. All projects now under consideration carry with them multi-billion dollar price

\textsuperscript{18} The largest new shopping center in France is located in Lyon at the terminus of the Paris-Lyon TGV line. \textit{Tax Exempt Bond Hearings, supra} note 12, at 5 (statement of Sen. Bob Graham).

\textsuperscript{19} See, \textit{e.g.}, Rosen, \textit{supra} note 3; L.A. Times, June 1, 1987, pt. 1, at 3, col. 1; Thompson, \textit{supra} note 2.

\textsuperscript{20} See Thompson, \textit{supra} note 2.

\textsuperscript{21} The current federal funding situation has been described as follows: Beginning with the Carter administration and extending through the Reagan administration, the federal government has progressively reduced revenue sharing grants and loans for construction and maintenance of state and local infrastructure .... The drastic cut in federal grant and loan programs for the basic network of transportation, water, sewer, drainage and park facilities is primarily responsible for the creation of public-private partnerships and joint development as a sophisticated means of financing public-sector development in urban areas.


\textsuperscript{22} \textit{Tax Exempt Bond Hearings, supra} note 12, at 15 (statement of Harriett L. Stanley, Vice President, Public Finance Department, Prudential-Bache Capital Funding).

\textsuperscript{23} Estimated costs for high speed rail projects under consideration:
- Florida's project (Miami, Orlando and Tampa)—$2 billion;
- Southern California to Las Vegas—$2-$3 billion;
- Texas' project (Ft. Worth, Dallas, Houston, San Antonio and Austin)—$4.3 billion;
- Ohio's project (Cleveland, Cincinnati and Columbus)—$2 billion.

\textit{Chicago Tribune}, Apr. 30, 1989, at C5, col. 1 (final ed.). However, at $15-19 million per mile, high speed rail is still less expensive than urban expressways which costs more than $40 million/mile. \textit{Id.}
Furthermore, the lack of any United States experience with high speed rail combined with the long delay between project startup and return on investment will make it difficult to attract investment capital, absent any additional incentives. In order to overcome these potential pitfalls, promoters of high speed rail must make creative use of the financial tools at their disposal. The use of tax exempt industrial bonds, exploitation of development rights, and use of existing rights-of-way all need to be fully explored. Through these and other financing mechanisms, solutions can be devised and high speed rail projects can begin to jump off the drawing board and into reality.

A. **TAX EXEMPT INDUSTRIAL REVENUE BONDS TO FINANCE HIGH SPEED RAIL FACILITIES**

1. **INTRODUCTION**

A major component of establishing a high speed rail system is the capital financing cost. As with other large scale projects requiring massive initial investment, long construction periods mean that several years may pass before an investor receives a return on his investment. While a 1984 feasibility study done in the Tampa-Orlando-Miami corridor, financed by the Federal Rail Administration, found that a high speed rail system could generate enough revenue to eventually recover 100% of its operating costs and up to 40% of its capital costs, such recovery could take years. Furthermore, as previously noted any project may be too large and the cost too high for any single entity, public or private, to adequately finance it.

Tax-exempt bond financing may remedy this situation. Traditionally, tax-exempt bonds have been a means for states and municipalities to shift to private corporations part of their burden of providing traditional services by assisting private corporations with financing their projects. The government entity sells an issue of industrial development bonds (IDB’s) and then loans the proceeds to the private corporation. Because the interest on the IDB’s is tax-exempt, the purchaser of the bonds

24. *Id.* It is estimated that a high speed rail financing program would carry with it costs ranging from three to ten billion dollars and that the magnitude of these capital requirements would cause the financial markets to raise interest rates in order to maintain market stability. *Id.* at 76-77.

25. See *id.* at 77. Nine to twenty years may pass before investors receive any repayment of capital or return on their investment. *Id.*

26. Tax-Exempt Bond Hearings, supra note 12, at 50 (Statement of David Blumberg, Chairman, Florida High Speed Rail Transportation Commission).

achieves a greater after tax return on the investment as compared to taxable bonds. The governmental entity can thus offer the bonds at a reduced interest rate and the savings are passed on to the private entity through lower interest rates. These savings act as an incentive to engage in the desired development project. The private corporation uses the proceeds to construct the facility and ownership remains in the private entity. Under Florida's bond law, "[T]he debt service on the bonds is paid from the revenues of the project and secured by [both] the project", and any other guarantees given by the private corporation. Tax-exempt bonds can relieve governments of the burden of subsidizing public transportation projects through large appropriations. They attract investors by minimizing investment costs. The use of tax-exempt facility bonds creates an opportunity for a state to develop and operate a high speed rail project by working in conjunction with the private sector.

Tax-exempt financing has often been used for large scale transportation projects. For example, in early 1988 the newly created Metropolitan Washington Airport Authority (MWAA) issued its first $125 million in tax-exempt revenue bonds for the purpose of financing the maintenance and improvement of Washington National and Dulles International airports. The proceeds of the bonds will be used for a variety of projects. Tax-exempt bonds have also been used to improve and reconstruct bridges, acquire, construct, and maintain public buildings, and construct and operate mass transit facilities.

2. Recent Legislation

In the high speed rail area, the federal government has recently enacted legislation providing for tax-exempt financing for certain high speed rail facilities. The provision amends section 142 of the Internal Revenue

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28. Id.
29. Id.
30. Id.
31. Id.
32. Tax-exempt status for industrial development bonds is a form of subsidy and would mean a loss of revenue to the government. Compared however, to alternative transportation expenditures by the federal government such as direct running, it is a relatively modest federal participation. Tax-Exempt Bond Hearings, supra note 12, at 7 (statement of Sen. Graham (Florida)).
33. Tax-Exempt Bond Hearings, supra note 12, at 31 (testimony of Sen. Graham (Florida)).
34. At Dulles International Airport, plans include a new international arrivals terminal, a taxiway extension and an expansion of the baggage claim area. At National Airport there are plans to construct a two-level taxi holding area and a temporary parking area. Henderson, Bond Sale Set for Renovating National, Dulles, Washington Post, Mar. 23, 1988, at B6.
Code of 1986 by authorizing the issuance of tax-exempt bonds by states for high speed intercity rail transportation projects. Previously, such facility bonds were available only to finance transportation projects involving airports, docks, wharves, mass commuting and sewage facilities.

In order to qualify for the high speed rail facility exemption, the train must be reasonable expected to operate at speeds in excess of 150 miles per hour between stations while carrying passengers and baggage. In addition, high speed rail facility bonds differ from other facility bonds in three ways. First, the facilities financed with the proceeds of such bonds need not be government owned. The government entity, therefore, need not pledge its full faith and credit behind the bonds. This allows the state to, "... shift a portion of the responsibility for providing basic services to private entities, which in turn will recover their costs from the users of the facilities." Thus, the public and private sector enter into a financing partnership which promotes overall cost effectiveness. Second, only twenty-five percent of each bond issue must receive an allocation from state private activity bond value limitation. If the facility is located in two or more states, this requirement must be met on a state by state basis for the financing of the facilities located within each state. The rationale behind providing the state with partial relief from its private activity volume limitation is that the cost of a high speed rail project would quickly exhaust the entire volume of a state's bond activity. Moreover, as with other large transportation facilities, a substantial number of persons who are non-residents of the state in which the facility is located will use and enjoy its benefits. Finally, any proceeds of an issue not spent within three years of the date of issue must be used to redeem outstanding bonds.

Tax-exempt bonds alone, however, are not a total solution to the

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37. Ide & Ubell, infra note 2, at 703; see infra notes 49-54 and accompanying text.
38. Tax-Exempt Bond Hearings, supra note 12, at 82 (statement of Richard A. Davenport, representing the Florida High Speed Rail Corporation).
39. H.R. Rep. No. 1104, supra note 35 at 5265. In general, the amount of tax-exempt private activity bonds that may be issued annually by any state (including local governments within the state) is limited to the greater of (1) $50 for every individual who is a resident of the State or (2) $150 million. Bonds subject to this limitation include most private activity bonds for which tax-exempt status is permitted. Congress has exempted airports, docks and wharves from the state volume limitation. Tax-Exempt Bond Hearings, supra note 12, at 38-39 (description of S. 1245 by the Joint Committee on Taxation).
41. See generally Tax Exempt Bond Hearings, supra note 12, at 38-39.
42. Tax-Exempt Bond Hearings, id. at 39 (description of S. 1245 by the Joint Committee on Taxation).
problem of high speed rail financing. These bonds can only cover the initial construction and interest costs. There will still be a period of time after capitalized interest has been depleted and before fare box and ancillary enterprise revenues are sufficient to cover operating costs.\textsuperscript{44} Other financing techniques need to be used to cover this gap.

3. \textit{Current Status}

Presently, Florida is in the forefront of implementing a high speed rail system through the use of tax-exempt bonds. The Florida High Speed Rail Transportation Commission (FHSRTC) is authorized to issue tax-exempt bonds to finance high speed rail.\textsuperscript{45} The Florida High Speed Rail Corporation (FHSRC), a consortium of equipment suppliers, contractors, consultants, and professional service firms, is now the sole applicant to finance, design, build, and operate a high speed rail system linking Tampa, Orlando, and Miami.\textsuperscript{46} On December 4, 1989, FHSRC paid a $650,000 "Certification Component Fee" to FHSRTC which will be used to cover the cost of reviewing technical and financial information to be submitted by FHSRC.\textsuperscript{47} The franchise for the project is expected to be formally awarded in 1991.\textsuperscript{48} Moreover, Maglev Transit Inc., a Japanese-German consortium has applied to build and operate an approximately $500 million magnetic levitation rail system through private financing to demonstrate the feasibility and benefits of high speed rail. The fourteen mile line will travel from Orlando International Airport to a currently undeveloped area near Disney World and Sea World.\textsuperscript{49}

Other front runners contemplating the use of tax-exempt bonds to help finance high speed rail systems include the California-Nevada Super Speed Grand Transportation Commission for a high speed rail system operating between Las Vegas, Nevada and a point in Southern California. The Texas Turnpike Authority is also considering a 620 mile system linking Fort Worth, Dallas, Houston, San Antonio and Austin. And the Pennsylvania High Speed Intercity Rail Passenger Commission is looking at the feasibility of a 225 mile rail line between Harrisburg and Pittsburgh.\textsuperscript{50}

\textsuperscript{44} \textit{See Tax Exempt Bond Hearings, supra note 12, at 78 (statement of Harriet L. Stanley referring to the hole in time after depletion of capitalized interest and before enterprise revenues are sufficient to support the system.).}

\textsuperscript{45} \textit{Fla. Stat. § 341.329 para. 1 (1987.).}

\textsuperscript{46} \textit{Business Wire, December 4, 1989.}

\textsuperscript{47} \textit{Id.}

\textsuperscript{48} \textit{Id.}

\textsuperscript{49} \textit{Washington Post, Feb. 20, 1990, at A8. If the high speed rail line proves successful, FHSRTC plans to use tax-exempt bond financing to build a 300 mile line running from Tampa to Miami through Orlando. Chicago Tribune, Apr. 30, 1989, at C5.}

\textsuperscript{50} \textit{Wiedrich, \textit{High Speed Trains: Next Stop the U.S.}, Chicago Tribune, Apr. 30, 1989, at C5.}
B. PUBLIC-PRIVATE PARTNERSHIP FINANCING OF HIGH SPEED RAIL FACILITIES

A public-private partnership, or a joint development project, is basically "a pairing of public and private resources to achieve a project or a product that will benefit both sectors." Such cooperation helps to ensure the success of development projects that might otherwise not succeed.

In a joint public-private development project, value capture techniques can be used to generate new revenues that in turn will defray the costs of providing a public infrastructure and services. Value capture takes advantage of the rising private property values which accompany the development of a transportation corridor. The public sector recaptures part of this added value either from the sale or lease of property and property rights acquired by the public entity or alternatively through an equity interest in the joint development project. Additional revenues can come from the leasing of land and air rights, contributions of property or capital costs from the developer, connection fees, and station concession fees.

Joint development can benefit equally both the public and private sector. The public sector gets to share its costs, have improvements added to its transportation facility, expand job opportunities, and recapture value added to the facility and surrounding property. The private sector has its land acquisition and site preparation costs reduced, shares risks and expenses with a public agency, and can take advantage of tax depre-

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52. Usually, the development would not take place without this public-private cooperation; because the developer requires the improved accessibility and expanded market created by the transit improvement, and the transit agency needs the financial resources and entrepreneurial skills of the private sector. Also, joint development projects often require contractual agreements between the developer and a public agency and close planning and cooperation among several public agencies. Id.
54. Id. at 171-72; The local property and sales tax bases increase as a result of the increased development accompanying creation of transit stations. Id. at 186; see Comment, New Financing Strategy for Rapid Transit: Model Legislation Authorizing the Use of Benefit Assessments to Fund the Los Angeles Metro Rail, 35 UCLA L. Rev. 519, 533-34 (1988).
55. Freilich & Chinn, supra note 52, at 186.
56. See generally id. at 187 n.113.
57. Id. at 186.
ciation and credit allowances unavailable to the public sector.\textsuperscript{58}

1. \textit{RAILBED FINANCING}

Construction of dedicated track for the high speed rail system is a virtual necessity.\textsuperscript{59} Even improvement of existing track will be expensive. The federal government has already spent $2.19 billion to upgrade the Washington-New York track on Amtrak's Northeast Corridor,\textsuperscript{60} with improvements on the New York-Boston portion still to be started. High speed rail presents an equally expensive problem.\textsuperscript{61} In order to finance the costs associated with land acquisition and construction of a high speed railbed, use must be made of both joint development techniques and tax-exempt bonds. The public sector will need to provide assistance for land acquisition through a combination of methods including the dedication of publicly owned property, the acquisition of lands through the expenditure of public funds, and the exercise of eminent domain power.\textsuperscript{62} Once the land has been acquired the entity responsible for the construction of the high speed rail system can issue tax-exempt bonds to raise the capital needed for construction of the railbed.\textsuperscript{63} Construction of rail facilities in and around rail stations also can be financed partially through the use of value capture techniques.\textsuperscript{64}

2. \textit{STATIONS}

Financing the construction of high speed rail passenger stations can be easily accomplished using existing joint development financing techniques. States could allow the municipalities where the stations are located to institute benefit assessment districts and issue franchises to interested vendors.\textsuperscript{65} Additional value created by the development can be recaptured in part by the entity building the station and used to offset its costs.

\begin{footnotesize}
\begin{enumerate}
\item[58.] \textit{Id.}
\item[59.] A high speed rail system comparable to the French TGV or the Japanese Shinkansen trains requires dedicated, i.e., single-purpose track. Maintaining the necessary tolerances would be difficult and expensive on conventional track continually worn by freight traffic. Many are therefore skeptical that upgrading Amtrak corridors will produce a world-class high speed rail system. \textit{See} Rosen, \textit{supra} note 3. "If an advanced Shinkansen or TGV were forced to share with freight trains most of the existing track in the United States, neither type of train could perform anywhere near its potential." \textit{Davis, High-Speed Trains: New Life for the Iron Horse?}, \textit{HIGH TECH.}, Sept., 1984, at 28.
\item[60.] \textit{See} Thompson, \textit{supra} note 2, at 38; \textit{see also} Chicago Tribune, \textit{supra} note 4; Rosen, \textit{supra} note 3.
\item[61.] \textit{See generally} Rosen, \textit{supra} note 3; Davis, \textit{supra} note 58.
\item[62.] \textit{See} Freilich & Chinn, \textit{supra} note 52, at 185.
\item[63.] \textit{See supra} notes 26-43 and accompanying text.
\item[64.] \textit{See generally} Freilich & Chinn, \textit{supra} note 52; Comment, \textit{supra} note 50.
\item[65.] \textit{See generally} \textit{JOINT DEVELOPMENT HANDBOOK}, \textit{supra} note 50.
\end{enumerate}
\end{footnotesize}
3. **ROLLING STOCK FINANCING**

Acquisition of rolling stock, the rail cars themselves, presents another financial consideration. The Technical and Miscellaneous Revenue Act of 1988 specifically prohibits the financing of rolling stock with bond proceeds. In a 1985 study, the Michigan Department of Transportation estimated that rolling stock for a system similar to the Japanese Shinkansen and the French TGV would cost $126 million. In perspective it should be noted that rolling stock comprises only about twenty percent of the capital costs of a high speed rail system.

There are a number of possible methods for financing the rolling stock itself. One method would share profit from services offered in the rail cars. Vendors providing services in the cars would pay franchise fees up front and these fees would be used to cover the cost of the high speed cars. Another method would tap into the vendors of high speed rail technology, who might be willing to give favorable terms in return for the chance to showcase their products. The makers of high speed rolling stock would donate their product in return for the benefits of the free publicity and advertising which would result once the system is successful. These methods may be workable but, as of yet, no private producer of high speed rolling stock has endorsed or advocated either of these proposals.

A lease-purchase or sale-leaseback transaction may also be used to finance the acquisition of rolling stock for a high speed rail system. In a sale-leaseback transaction, the high speed rail company would sell its rail cars to another party and then lease them back. This approach has numerous advantages for the high speed rail company.

First, the seller-lessee can deduct the entire rental payment as an ordinary and necessary expense which it would not be able to do in a conventional financing plan. Second, the rail company will not have to tie up its cash by an outright purchase of the rail cars and will thus have a greater amount of working capital. By not having to purchase the cars outright the rail company will be protected against tying up its cash in

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68. See Thompson, supra note 2.
70. See Rosen, supra note 3.
equipment that may one day become technologically obsolete.\textsuperscript{73} 

The buyer-lessee, as the owner of the rail cars, can take a deduction for their depreciation and also can receive a relatively high rate of return for what is essentially a passive investment.\textsuperscript{74}

\textbf{C. PRIVATE FINANCING OF HIGHSPEED RAIL FACILITIES}

The lack of available public funds for high speed rail and the inherent difficulties in making use of what funding is available lead some to the conclusion that private financing techniques should be used either for the initial capitalization of high speed rail projects or to cover their total costs. Methods of private financing include private placements, syndicated tax benefits, and public offerings. Private financing, however, is the least viable option available to developers of high speed rail systems due to the tremendous amounts of capital involved and the high risk perceived on the part of private investors. It is therefore unlikely that any high speed rail project would be financed on a totally private basis.

\textbf{1. PRIVATE PLACEMENTS}

Beyond the recognition that high speed rail will require the coupling of the private and public sectors, however, very little has been developed as to how such cooperation would come about. Various methods have been advanced regarding initial capitalization through private financing techniques. One such example is demonstrated by American High Speed Rail Corp.'s (a Los Angeles-based consortium that tried to build a high speed rail link between Los Angeles and San Diego) August, 1985 offering of a $50 million private placement.

Private placements are less highly regulated than public stock offerings. They are not registered offerings, and the company issuing the private placement does not provide a prospectus but investors instead can obtain an offering memorandum. Private placements generally have a limited appeal. There is less information available, they are less liquid than public offerings, and few individual investors can afford the $1 million minimum purchase limit likely to be set.\textsuperscript{75}

Private offerings entail numerous difficulties (American High Speed Rail Corp.'s $3.1 billion high speed rail proposal was scrapped in November of 1985 because attempts to raise private capital for the venture had failed)\textsuperscript{76} but are likely to be used again because they provide a mecha-

\begin{itemize}
  \item \textsuperscript{73} See Sponseller, Lease Financing: Sale and Leaseback Options, PUB. UTIL. FORT., Mar. 19, 1987, at 40, 40.
  \item \textsuperscript{74} See Maller supra note 70, at 296, 300.
  \item \textsuperscript{75} See Companies in the News, Financial World, Jan. 8, 1985, at 71.
  \item \textsuperscript{76} See West Coast Bullet Train Suffers a Fatal Wound, Metalworking News, Jan. 18, 1985, at 13.
\end{itemize}
nism for the initial capitalization of companies before they attempt to go public.\textsuperscript{77}

2. **SYNDICATED TAX BENEFITS**

Another financing technique that has been discussed is a syndicated tax benefit which essentially involves the selling of shares as partnership interests.\textsuperscript{78} One immediate advantage of syndicated tax benefits, as compared to private offerings, is that they may be made available in units of $25,000.\textsuperscript{79}

Syndicated tax benefits are a form of tax credit financing. They allow investors to buy a portion of a company’s tax load and transfer it for their personal use. The credits can be subtracted directly from investors’ personal tax loads. They are sold to raise funds at the outset of a project. Investors receive benefit only when the project is complete.\textsuperscript{80}

Even with its advantages, syndicated tax benefits, like private offerings, include prohibitive side effects. It is doubtful whether the lure of such benefits could raise sufficient funds to cover the costs of a high speed rail system.\textsuperscript{81}

3. **PUBLIC OFFERINGS**

Finally, there is the possibility for the wholly private funding of high speed rail through a public offering. One example of the private financing of a large public project is that of the Channel Tunnel. In March of 1986, the governments of France and the United Kingdom awarded to a ten company Anglo-French consortium a 55-year right to build and operate a tunnel under the English Channel. The consortium founded Eurotunnel, and as of October 1988, had raised $10.2 billion to complete the project.\textsuperscript{82}

Eurotunnel received $8.5 billion through a credit agreement underwritten by 198 private banks.\textsuperscript{83} It then launched a $1.3 billion equity offer-

\begin{itemize}
  \item \textsuperscript{77} See Companies in the News, supra note 74, at 71.
  \item \textsuperscript{78} See id.
  \item \textsuperscript{79} Id.
  \item \textsuperscript{80} Id.
  \item \textsuperscript{81} Tax credit financing has never been used for anything on the scale needed to help finance a high speed line. The largest tax credit sale raised perhaps $40 million, whereas a rail line might raise $200 million this way. Tax credits could raise only 20% of the money needed. And although tax credit shares are negotiable, they cannot be traded freely like securities, thus limiting their appeal. Id.
  \item \textsuperscript{82} See Morais, Public Good Through Private Enterprise, FORBES, Oct. 3, 1988, at 58. Eurotunnel plans to construct a 31-mile twin rail tunnel between terminals near Folkestone in the U.K. and Calais in France. Id.
  \item \textsuperscript{83} Id.
\end{itemize}
ing in order to raise additional capital required by the financing banks.\textsuperscript{84} Eighty percent of the offering was purchased by the public thus assuring the availability of the loan funds.\textsuperscript{85} Investors were lured by the forty percent compounded annual return Eurotunnel projects they will receive if they hold their shares until 1995.\textsuperscript{86}

Eurotunnel has recently faced some difficulties, which probably will not jeopardize the eventual completion of the project but could affect the project’s final cost.\textsuperscript{87} The project has fallen behind schedule and the cost of the rolling stock to be used to shuttle passengers and freight through the tunnel is more than double the original estimate.\textsuperscript{88} As a result Eurotunnel was forced to request more capital from the financing banks, that had already pledged at least $183 million a year for 12 years.\textsuperscript{89} While the project’s completion is not in doubt, and it is virtually guaranteed to enhance inter-European trade (especially after the economic unification of Europe in 1992), a windfall for investors is not completely assured.\textsuperscript{90} Reliance on such public offerings can be risky to investors who may be less willing to invest in a project with the perceived risk of high speed rail.

\section*{III. Conclusion}

The responsibility of furthering high speed rail is now firmly in control of state and local governments. Although states might provide funds to offset construction costs, it is more likely that they will provide indirect assistance—low-interest financing, free use of existing rights-of-way, aids to property acquisition, and tax abatements.\textsuperscript{91} The use of tax-exempt bonds will go a long way toward assisting the states in financing high speed rail projects, but does little to alleviate the perception of risk that private investors attach to high speed rail. Private investors need to be convinced that high speed rail has a viable future in this country.\textsuperscript{92}

\textsuperscript{84} N.Y. Times, Nov. 17, 1987, at D1, col. 6.
\textsuperscript{85} Morais, supra note 81, at 59.
\textsuperscript{86} N.Y. Times, Nov. 15, 1987, § 3, at 1, col. 2.
\textsuperscript{87} See Fears of Overruns in Chunnel Costs Erode Confidence, J. of Commerce, Aug. 9, 1989, at 1, col. 3.
\textsuperscript{88} See id.
\textsuperscript{89} See Morais, supra note 81, at 62.
\textsuperscript{90} See id.
\textsuperscript{91} See Thompson, supra note 2, at 8.
\textsuperscript{92} As one author has put it:

High-speed rail will become viable only when the public sector and private investors find a way to value indirect benefits high enough to make the sum of all benefits, public and private, direct and indirect, equal the costs, which will certainly exceed $5 million per mile and may be more than that. The returns from operating income alone are not likely to justify such large costs to any private investor.

Thompson, supra note 2, at 70.
One way to demonstrate to such investors and the public the benefits of high speed rail would be to introduce high speed technology into American transportation corridors through the upgrade of existing track and equipment. The proposed use of high speed tilt trains on the Boston-New York Corridor is a model project. This would be a limited accomplishment in terms of advancing high speed rail because high speed trains would still have to share the rails with heavy freight trains, which already bear much of the blame for putting the track in its current condition, but would at least be a first step on the way to a full implementation of high speed rail technology.

Thus the problem of financing high speed rail comes full circle. As previously discussed, the federal government is not willing to fully subsidize any high speed rail project. The role of the federal government, at this time and in the foreseeable future, is likely to be one confined to advice, facilitation, clearance, and, on a selective basis, providing a part of the financing. Federal and state governments even though unable to provide all of the funds to construct a high speed rail system can help to foster a political atmosphere encouraging and aiding its development. Creation of such a cooperative spirit will encourage private investors to aim capital toward high speed rail giving high speed rail the chance to demonstrate its true potential.

93. See Rosen, supra note 3.
94. See Davis, supra note 58.
95. See generally Thompson, supra note 2.
Motor Carrier Deregulation: A Decade of Legal and Economic Conflict

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I. INTRODUCTION

For decades prior to World War I, Europe and the Near East flourished in a strongly regulated political environment. They lived in the delicately balanced world of empire. Nations were interrelated through real as well as symbolic marriages of trade and royalty. Although their regulated existence was not trouble free, the players knew the rules. Minor states understood their position as economic and political balance weights which the major powers used to maintain their status and power. The major powers accepted the need for peaceful coexistence and alliance.

Between 1914 and 1918 this intricate structure was destroyed. The regulatory patterns were no longer in place. The players, both old and new, had to learn a new set of steps. Subsequently, Europe experienced economic depression, political and social dislocation, and ultimately another cathartic military experience which can be argued completed the unfinished work of deregulation left by World War I.

Not unlike the Europe of 1914, the motor carrier industry in the United States prior to July 1, 1980, existed in a highly regulated environment characterized by intricate rules and ritualized protection. The passage of the Motor Carrier Act of 1980¹ shattered the peace and forced all participants, large and small, to learn a new unchoreographed dance.

The consequences of this deregulation are still being assessed. This article examines four selected legal/economic issues which are offered as representative of the friction between established statutory and case law and the current public policy of deregulation and its economic conse-

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quences. The four chosen areas reviewed are: 1) freight undercharges and the "filed tariff doctrine;" 2) pension funds, ERISA/MPPAA and deregulation; 3) federal preemption and the States' power to regulate motor carriers; and, 4) selected antitrust issues.  

II. "UNDERCHARGES" AND THE FILED TARIFF DOCTRINE

Just as marketers of products are aware of the restrictions placed upon their pricing methods by the Robinson-Patman Act, motor carriers and the shippers that use them have long recognized pricing regulations applicable to this service industry. One of these regulations, fixed in the Interstate Commerce Act, places pricing limitations on motor carriers to ensure that they do not favor one customer over another. To promote compliance, the courts announced the "filed tariff doctrine." In 1915, Justice Brandeis explained the doctrine as follows:

The rate of a carrier duly filed is the only lawful charge. Deviation from it is not permitted upon any pretext. Shippers and travellers are charged with notice of it, and they as well as the carrier must abide by it. Ignorance or misquotation of rates is not an excuse for paying or charging either less or more than the rate filed. The rule is undeniably strict, and it may work hardship in some cases, but it embodies the policy which has been adopted by Congress in regulation of interstate commerce in order to prevent unjust discrimination.

The intent of the filed tariff doctrine was the prevention of large suppliers and shippers from negotiating "under the table" tariffs which were lower than filed tariffs, thereby undercutting competition from the smaller suppliers who also had to use the highways of interstate commerce to get their goods to market. The filed tariff doctrine, however, not only protects the shipper against the carrier overcharging, it also safeguards the carrier by permitting any carrier who has charged a lower rate than the tariff filed with the Interstate Commerce Commission [ICC] to sue the shipper to recover the undercharge.

This is not a "soft" rule. Since codified and interpreted, the courts

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2. Other areas could have been chosen. However, the authors selected these four particular issues and representative cases because of their timeliness and systemic effects upon the total industry, including carriers, shippers, regulators and the courts.


have been scrupulous in its application. Recently, the doctrine has been given additional bite. In 1982, with motor carrier deregulation in place and its concomitant undercharge problems emerging, the Supreme Court ruled that carriers have "... not only the right but also the duty to recover proper charges for services performed."6 This right to recover the undercharge is not subject to the common law contract defenses of estoppel or mistake.7 Courts have consistently refused to enforce contracts between carriers and shippers which reduce the amount legally payable or release the shipper from liability to pay the required charges.8

Prior to deregulation, the filing of interstate tariffs with the ICC was a routine process except in those few cases where a shipper protested the rate as being too high. A collectively set tariff was filed with the Commission by a Motor Carrier Rate Bureau on behalf of a number of motor carriers subscribing to the tariff, or a carrier filed its own with the ICC, and that was that; unless challenged, a rare event, the tariff went into effect.

Following deregulation, thousands of motor carriers issued their own tariffs, often tailored to the needs of a particular shipper customer or group of customers. This outcome was one of the primary objectives of deregulation, namely, the achievement of real price competition in the motor carrier industry. Even under deregulation, however, motor common carriers holding ICC certificates are required to file their interstate tariffs with the Commission. Such filing makes a tariff effective. Failure to file a tariff results in the carrier being required to charge the previously filed tariff rates despite what was contracted for by the parties. Given the rate wars resulting from deregulation, and the pricing concessions made by many motor carriers desperate to generate cash flow, it was inevitable that many new tariffs—including many not filed with the ICC—would reflect lower rates than earlier tariffs.9

It should also be noted that in addition to unlawful rates charged under unfilled tariffs, there are other moss-covered and not uncommon unlawful industry practices that result in undercharges. These include (1) simply granting a discount off the filed rate (either directly or, for example, as a kickback disguised as a claim payment), (2) not charging for

8. See, e.g., Western Transportation, 682 F.2d 1227.
9. It is conservatively estimated that there are currently $30 million in undercharge claims facing shippers. An interesting article aimed at the practitioner outlines a shipper’s defense approach to an undercharge claim. Undercharges Addressed by Logistics Managers, 30 TRANSPI. & DISTR. 40 (August 1989).
the full weight of the shipment, and (3) deliberate misdescription of the freight to produce a lower—and unlawful—rate. All three are hard to catch and even harder to prove. And, all three involve collusion between the carrier and the shipper, collusion whose evidence tends to vanish in the mists of time. Few bankruptcy trustees will ever see money for creditors from these sources.

The deregulation rate wars produced two results relevant to the undercharge issue. First, they were the primary cause of several thousand motor carrier bankruptcies in the 1980's, thus turning loose a horde of bankruptcy trustees looking for assets. Second, the evidence is clear that in rate war situations, an earlier (filed) tariff is likely to be supplanted by a subsequent (unfiled) tariff containing lower rates. This meant that if the filed tariff doctrine remained in force, hefty payments were due from unwary shippers who had dealt with now bankrupt carriers.

Practically, a review of the federal case law reveals that these undercharges fall into the following patterns: (1) when the carrier miscalculates the amount due under the filed tariff rate applied to the shipper; or (2) when the carrier, inadvertently or by design, fails to file the tariff containing a lower rate with the ICC as required by statute. The latter omission, as previously stated, is extremely dangerous to the shipper because if the tariff applied is not properly and timely filed with the ICC, the filed tariff doctrine requires that the applicable tariff used to calculate any undercharges must be the last tariff properly filed by the carrier.

In the early 1980's, just subsequent to the formal deregulation of the motor carrier industry, the Seventh Circuit faced the task of enforcing the filed tariff doctrine in the new deregulated environment. Shippers and carriers watched as the Western Transportation Company, a bankrupt trucker, initiated the attack. This carrier, while marshalling its assets to satisfy its creditors, discovered a series of executed shipping contracts wherein it had failed to charge the shippers the correct filed tariff rates at the time of shipment—a case falling within the first pattern of cases noted above. Consequently, Western filed a series of lawsuits using the filed tariff doctrine as the vehicle for its complaint and seeking payment for the undercharged freight transported.\(^\text{10}\)

In *Western Transportation Company v. Wilson and Company, Inc.*\(^\text{11}\) the carrier had agreed with the shipper to transport meat under a tariff applicable "... only when the shipment is loaded into or onto the truck by the shipper and unloaded therefrom by the consignee."\(^\text{12}\) The facts ac-
cepted by the court reflected that the shipper complied with this requirement. Unfortunately for the shipper, however, this filed tariff also required that the bills of lading contain a notation that the consignor and consignee were to load and unload the shipment. Western discovered that several shipments failed to have the required notation on the bills of lading and properly sued the shipper, as required by the filed tariff doctrine and the fiduciary duty owed by Western to its creditors, for the difference between what it charged under this tariff and what it would have charged under the different tariff that would have been applicable.

The trial court adopted the shipper's argument that the notation requirement rendered the filed tariff ambiguous. The filed tariff doctrine was, therefore, not applicable and the document was subject to the rules of interpretation and reformation like any other contract. After taking evidence as to the intention of the parties, the lower court concluded that the tariff was drafted with the intent to have the shipper pay the contracted lower rate and dismissed Western's complaint.

While sympathizing with the defendant/shipper that the filed tariff doctrine is "... a harsh rule"\textsuperscript{13} and admitting that Western's recovery of these undercharges would result in unjust enrichment by compensating the carrier for services it did not provide to the shipper, the 7th Circuit reversed the trial court and strictly applied the filed tariff doctrine. The Court disputed the trial court's finding of ambiguity in the filed tariff, reasoning that if "the duty to load and unload and the duty to say you will load and unload were contradictory, the tariff—construed, as every document must be construed, as a whole—would be ambiguous. They are not, and it is not."\textsuperscript{14}

Recognizing its own rule announced in \textit{National Van Lines, Inc. v. U.S.},\textsuperscript{15} that "... a tariff should be interpreted to avoid unjust, absurd, or improbable results ..." and that "... the practical application of tariffs by interested persons should also be considered in determining the meaning of the tariffs ...,"\textsuperscript{16} the Court held that those announced principles only applied if the tariff is ambiguous. If the tariff is found to be unambiguous, as in the present case, the parties are bound to its terms and the common law aids to contract construction are irrelevant. Interpretation, the Court reasoned, is permitted only when the tariff is ambiguous, so that a literal reading is impossible.

This Court, despite strictly applying the filed tariff doctrine, bridled against the inflexible standard that motor carriers are forbidden to receive different compensation from the rate fixed in an unambiguous applicable

\textsuperscript{13} \textit{Id.} at 1229.
\textsuperscript{14} \textit{Id.} at 1230.
\textsuperscript{15} 355 F.2d 326 (7th Cir. 1966).
\textsuperscript{16} \textit{Id.} at 332-33.
filed tariff, especially in light of the new deregulated environment. Its discomfort was manifested by the Court outlining in its opinion a method for the defendant to circumvent its decision. The Court instructed the defendant to use a method this shipper had successfully used in the past and which proved to be a frequently used technique during the 1980's. It told the shipper to request a stay from the trial court and apply to the ICC to have the offensive tariff notation provision declared unreasonable, a right reserved to the ICC under statute. The ICC had done this in the past and, apparently, was viewed as a friendlier forum in the newly deregulated environment.\footnote{See, Iowa Beef Processors, Inc. v. Western Transportation Company, I.C.C. Docket No. 32521F (Sept. 14, 1981). Interestingly, in this case, the Commission also found the tariff to be unambiguous but ruled it unreasonable.} This declaration by the ICC, if made, would preclude the carrier's collection of the undercharges.\footnote{In a case decided on August 7, 1989, Carriers Traffic Service, Inc. v. Boise Cascade Corp., 881 F.2d 475, (7th Cir. 1989), the Court upheld several lower court rulings which affirmed the ICC's decisions disallowing undercharges in shipper "load and count notation" cases (same as Western). The Court, however, made it clear that the decision was to be construed narrowly and did not upset the precedent set by Western because the case before the bar was based upon a traditional court review of agency action (i.e. reasonableness of agency action) rather than an initial court determination of the reasonableness of the tariff rates as was the case in Western.} Clearly, however, this Circuit Court and the party litigants found the filed tariff doctrine still alive and dangerous.

In early 1989, the Fifth Circuit dealt with the second prototypical undercharge claim under the filed tariff doctrine: a failure to file with the ICC the tariff rate contracted for with the shipper as required by statute. In the Matter of Caravan Refrigerated Cargo, Inc.,\footnote{The Court instructed that under 49 U.S.C. Sec. 10704(a) (Supp. 1989), a tariff provision is required to be reasonable. If not, it violates the statute and the I.C.C., under 49 U.S.C. Sec. 11701 (Supp. 1989), can compel compliance, i.e. vitiate the offensive clause.} the Court reviewed what it described as an "archetypal negotiated rate case."\footnote{864 F.2d 388 (5th Cir. 1989), reh'g denied en banc, 869 F.2d 1487 (5th Cir. 1989).} A shipper had a long-standing agreement with Caravan, a refrigerated transport carrier, that Caravan would "meet or beat" any motor carrier rate quoted by a competing carrier. During their relationship, the shipper and Caravan negotiated rates to assure competitiveness. Caravan billed the shipper for the contracted rates and the shipper paid. The rates charged, however, were not the same rates which Caravan had filed with the ICC. The rates properly filed with the Commission were higher than the contracted rates. The shipper contended that it was unaware of the variance and relied upon Caravan's rate quotations. Caravan filed for bankruptcy and its trustee filed an action to recover the difference between the negotiated rates and the filed tariff rates.

Unlike the defendant in Western Transportation, this shipper at-
tempted to have the case referred to the ICC for a determination of the reasonableness of the filed rates, arguing the "primary jurisdiction doctrine." The district court refused to refer the case to the ICC and, further, did not accept the shipper’s argument, filed in opposition to Caravan’s motion for summary judgment, that if the matter was not referred to the ICC for determination the trial court should rule that the tariff rate was unreasonable.

In another strong reaffirmation of the filed tariff doctrine, the Fifth Circuit deftly disposed of the shipper’s arguments for referral. While recognizing the primary jurisdiction doctrine, the Court agreed with the District Court that the facts of this case did not raise any "... technical or complex issues ... that require the expert administration of the Commission ..." The Court so ruled because the shipper’s "unreasonableness" argument was bottomed solely on the charge that having to pay the filed rate because Caravan "... failed to get its paperwork done" would be unfair. Accordingly, the Court reasoned that under the facts and arguments presented the filed tariff doctrine gave clear guidance and there was no need for referral.

Second, the Court refused to accept the shipper’s contention that the Motor Carrier Act of 1980 abrogated the filed tariff doctrine. The Court reasoned that despite the intent of the Act (i.e., economic deregulation of the motor carrier industry) Congress had examined the area thoroughly when the legislation was being enacted and did nothing to eliminate or

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21. See, City of New Orleans v. Southern Scrap Material Co., 704 F.2d 755, 758 (5th Cir. 1983) and ICC v. Atlantic Coast Line Ry., 383 U.S. 576, 579 (1966) wherein the doctrine that "... a district court trying a case under the Interstate Commerce Act must, if presented with such an issue, stay its proceedings and refer the case to the Commission" was presented. Further, the 5th Circuit had previously ruled that when the reasonableness of the rate is at issue, "... there must be a preliminary resort to the Commission." Southern Pacific Transportation Co. v. City of San Antonio, 748 F.2d 266, 272 (5th Cir. 1984) (quoting Great Northern Ry. v. Merchants Elevator Co., 259 U.S. 285, 291 (1922)).

22. The primary jurisdiction doctrine is applicable whenever the enforcement of a claim subject to a specific regulatory scheme requires resolution of issues that are "... within the special competence of an administrative body." United States v. Western Pacific R.R., 352 U.S. 59, 63 (1956). This doctrine has its origins in the famous case of Texas & Pacific R.R. Co. v. Abilene Cotton Oil Co., 204 U.S. 426 (1907), where the Supreme Court adopted the view that shippers seeking reparation predicated upon the unreasonableness of the established rate must primarily invoke redress through the ICC. It has come to mean that the ICC has jurisdiction over matters of fact and administrative matters, however, if words are used in their ordinary sense, introduction of evidence is unnecessary and the courts need not refer the matter to the ICC. See, Farley Transp. Co., Inc. v. Santa Fe Trail Transp. Co., 778 F.2d 1365 (9th Cir. 1985) where the Court also refused to refer a tariff question to the ICC; and Puerto Rico Maritime Shipping Authority v. Valley Freight Systems, Inc., 856 F.2d 546 (3rd Cir. 1988) where the filed tariff doctrine was enforced and the Court did not refer.

24. Id. at 390.
limit this long-standing doctrine. The Congress, the Court reasoned, by its inaction apparently intended to leave the filed tariff doctrine intact.\textsuperscript{25}

Further, in an apparent blow to the persuasiveness of ICC opinions before the Circuit Court, the 5th Circuit refused to apply the Commission’s advisory opinion allowing equitable defenses in disputes regarding reasonableness of rates.\textsuperscript{26} Although the ICC might soften and permit an erosion of the filed tariff doctrine, the 5th Circuit would have none of it. If the doctrine was to be nullified, the Court sent the message that it would have to be Congress that would have to do it.

Finally, the Court distinguished a recent 11th Circuit opinion, \textit{Seaboard System R.R. v. U.S.},\textsuperscript{27} which had recognized the Commission’s authority to find that misquotation of rates constitutes unreasonable practice under the statute. The Court explained that in \textit{Seaboard} the Commission had determined that the tariff sought to be enforced was not “...plain to the ordinary user.”\textsuperscript{28} Since the shipper in this case had not claimed nor offered any evidence that rates filed by Caravan were not plain to the ordinary user, the \textit{Seaboard} precedent was inapplicable and there was, therefore, no discord between the circuits.

In mid-July, 1989 the Eighth Circuit fired a salvo on behalf of the shippers in a ruling diametrically opposed to that made by the Fifth Circuit in Caravan. In \textit{Maislin Industries v. Primary Steel, Inc.},\textsuperscript{29} the Eighth Circuit faced the issue of whether the filed tariff doctrine obligated Primary Steel, Inc. to payMaislin Industries an amount greater than that which the parties negotiated. The district court had affirmed a ruling of the Interstate Commerce Commission finding it unreasonable under 49 U.S.C. Sec. 10701(a) for Maislin to recover tariff charges higher than those agreed to by the parties. On appeal, Maislin challenged the district court’s referral of the issue to the ICC and its subsequent affirmation of the ICC decision.

First, the Circuit Court upheld the district court’s reliance on the primary jurisdiction doctrine in referring the questions of whether Maislin’s freight rates and charges were unreasonable and whether Maislin’s practice of assessing and rebilling Primary Steel for tariff rates higher than

\begin{footnotesize}
\begin{itemize}
\item [26] \textit{Id.} at 391 citing National Industrial Transportation League—Petition to Institute Rulemaking on Negotiated Motor Common Carrier Rates, Ex Parte No. MC-177, 3 I.C.C.2d 99 (1986).
\item [27] 794 F.2d 635 (11th Cir. 1986). \textit{Seaboard} held that “finding a carrier practice unreasonable is the kind of determination that lies in the primary jurisdiction of the Commission.” \textit{Id.} at 638.
\item [28] \textit{Id.} at 637.
\item [29] 879 F.2d 400 (8th Cir. 1989).
\end{itemize}
\end{footnotesize}
those originally negotiated by the parties constituted an unreasonable practice in violation of 49 U.S.C. Sec. 10701(a) to the ICC.

Upon receiving the referral, the ICC relied upon its earlier decision in National Industrial Transportation League—Petition to Institute Rulemaking on Negotiated Motor Common Carrier Rates,30 and held that it could inquire into whether the imposition of undercharges would be an unreasonable practice under 49 U.S.C. Sec. 10701(a). The ICC then found that Maislin had quoted a rate other than a tariff rate to Primary Steel, that an agreement had been reached between the parties, and that Primary Steel had, in fact, reasonably relied on the rate quotation. The ICC concluded that Maislin would commit an unreasonable practice in requiring Primary Steel to pay undercharges for the difference between the negotiated rates and the tariff rates. The district court left the ICC's findings intact and the Eighth Circuit, unlike the Fifth, agreed.

Further and of greatest significance, the Circuit Court ruled that the district court properly rejected the applicability of the filed tariff doctrine because of the ICC policy change announced in Negotiated Rates.31 Negotiated Rates permits the ICC, upon a court's request, to determine whether collection of undercharges would constitute an unreasonable practice under 49 U.S.C. Sec. 10701. The district court observed that the ICC had not abolished the requirement that mandates carriers to charge the tariff rate. Rather, the ICC changed its policy on enforcing the "unreasonable practice" provision of section 10701(a), by allowing the consideration of equitable defenses. The district court held that nothing prohibits the ICC from changing its policy and that this change in policy was justified and consistent with its practices under the Interstate Commerce Act. Again, the Circuit Court agreed. The split between the Eighth and Fifth Circuits was irreparable.

It is offered that the reported federal circuit court cases since 1980 reflect that the filed tariff doctrine has collided head on with the observable result of motor carrier deregulation: the shakeout of several thousand motor carriers since 1980, many of them bankrupt. The review of these federal circuit court decisions reveals that although the courts have taken cognizance of the impact of deregulation, there is disagreement among the circuits as to whether to soften the long-standing and "harsh" filed tariff doctrine. The classic conflict between the Eighth and Fifth Circuits appears inevitably headed for the Supreme Court.

With respect to the role of the Interstate Commerce Commission, the reviewed cases suggest that absent a proven need for Commission expertise, federal court referral to the ICC of issues involving undercharges,

30. Supra note 26.
31. Id.
at least in the Fifth Circuit, will not be automatic.\textsuperscript{32} The federal courts recognize that the ICC has jurisdiction to declare a tariff unreasonable. However, several court decisions reflect a position that referral for this determination need not be made if the alleged offending provision(s) of the tariff are unambiguous and the court is comfortable with interpreting the provision in light of the applicable statute and in accordance with the normal judicial interpretive process. Again, what will come in the future as the Supreme Court rules on these issues is unclear.

Recently, the Commission, on a referred case from a Tennessee state circuit court, ruled that a negotiated rate agreed upon by both parties would be enforced notwithstanding a different filed tariff rate and declared the filed tariff rate unreasonable solely by virtue of its inconsistency with the negotiated rate.\textsuperscript{33} This decision further evidences the continuation of the aggressive strategy pursued by the ICC throughout the 1980's of declaring filed tariff rates unreasonable in light of different negotiated rates, thereby eroding the efficacy of the filed tariff doctrine before the ICC. This course of action appears to be the Commission's method of implementing what it perceives to be the Congress' intent with respect to deregulation of rates without actually legislatively abrogating the doctrine.\textsuperscript{34} Its success will be assessed when the Supreme Court speaks.

In requiem, the fond hopes of thousands of shippers that undercharges caused by carrier carelessness, neglect or malevolence with respect to filing tariffs in the hurly-burly of the modern deregulated environment, and without any significant element of tariff ambiguity, would be found by the federal courts to be justifiable exceptions to the filed tariff doctrine, have yet to be totally realized. The moral for shippers with respect to the undercharge issue is, simply, be sure your carrier has filed its tariffs with the ICC. If the carrier has failed to file, race to the ICC and argue that the filed tariff is unreasonable in light of the negotiated tariff rate

\textsuperscript{32} Recently, however, it has been reported that a U.S. Bankruptcy Court in St. Paul, Minnesota, ruled that 29 undercharge cases involving Murphy Motor Freight, Inc. should be referred to the ICC for a ruling on the reasonableness of the rates involved. Schultz, 219 TRAFFIC WORLD 14 (August 28, 1989).

\textsuperscript{33} Sunshine Mills Inc. v. Rebel Motor Freight Inc., MCC 30140 (July 31, 1989). In another Tennessee case referred to the ICC regarding Rebel Motor Freight Inc., the Commission again held that it would be an unreasonable practice for shippers to pay additional undercharges in negotiated rate cases. Ideal Chemical and Supply Co. v. Rebel Motor Freight Inc., MCC 30139 (Aug. 21, 1989). See also B&B Beverage Co. v. Eazor Special Services, Inc., MCC 30137 (Aug. 21, 1989).

\textsuperscript{34} It has been reported that Rep. Glenn Anderson (D. Calif.) has stated his intent to introduce legislation which will require all undercharge cases be considered by the ICC before they can be sent to bankruptcy court. This solution is allegedly being pursued because it appears unclear whether judicial action will produce uniform results. Schultz, 219 TRAFFIC WORLD 14 (Aug. 28, 1989).
and then pray that the Supreme Court agrees with Eighth Circuit's decision inMaislin.

III. PENSION FUNDS, ERISA/MPPAA AND Deregulation

One of the announced public policy goals of motor carrier deregulation was to encourage or even force weak carriers—presumably the more poorly managed ones—to exit the industry. This would lead, the deregulators argued, to a "lean and mean" motor carrier industry with lower prices and less excess capacity. Unfortunately, this admirable economic policy has been short-circuited by the statutory rules enforcing another overriding public policy: the government's interest in assuring its citizens that they will collect their pensions.

A complete statement and analysis of the legislative and case law history of the United States pension rules cannot be made within the scope of this, or perhaps, any article. A short recapitulation, however, is necessary to understand the terrain encountered by the motor carrier industry as it struggled with deregulation subsequent to 1980.

In 1974, Congress passed the Employee Retirement Investment Security Act [ERISA]. This legislation, enacted as a comprehensive federal regulation of pension plans, addressed four key areas of need: (a) the lack of adequate vesting provisions in many existing plans; (b) the inadequacy of the funding cycle used by many plans; (c) the lack of comprehensive regulation of the duties and responsibilities of plan trustees including disclosure to employee/participants; and, (d) the loss of employee benefits which resulted from plan terminations.

Arguably, the provision of ERISA which has had the most serious impact upon the motor carrier industry is the termination insurance program [Title IV] which protects the loss of employee benefits from plan terminations. This program is operated by the Pension Benefit Guaranty

35. 29 U.S.C. Sec. 1001 et seq.
36. Before ERISA, for example, employees with long careers within a company could lose their pension benefits if their employment was terminated before retirement. Title I of ERISA established minimum vesting standards to ensure that after a certain period of time an employee's pension rights would not be conditioned upon their remaining with the company. Peick v. Pension Benefit Guaranty Corporation, 724 F.2d 1247, 1251 (7th Cir. 1983), cert. denied, 467 U.S. 1259 (1984), citing 29 U.S.C. Sec. 1053(a) (1976). In Peick, a case involving the Teamster's Pension Fund, the 7th Circuit upheld the constitutionality of the MPPAA.
37. ERISA required minimum funding through amendments to the Internal Revenue Code. 724 F.2d at 1251.
38. ERISA imposes fiduciary duties upon plan trustees and requires the disclosure of greater information to the employee/participants. Id. at 1251.
39. In response to this growing problem, ERISA [Title IV] established a system of termination insurance to protect the employee's rights when a plan failed or terminated with insufficient funds. Id. at 1251.
Corporation [PBGC], a governmental entity.\textsuperscript{40}

Upon enactment of ERISA, the PBGC insured all nonforfeitable benefits that had been earned by employees in single employer plans. Any single employer that wanted to terminate its plan had to notify the PBGC. If the plan lacked sufficient assets to pay its nonforfeitable benefits, the PBGC assumed the obligation. Any monies expended by PBGC were recoverable from the terminating employer. This indemnification provision, however, allowed the PBGC to recover no more than thirty per cent of the employer's net worth.\textsuperscript{41}

Multiemployer plans were handled differently. These enormous, often union-sponsored, pension plans to which almost all major motor carriers contributed on behalf of their employees under collective bargaining agreements, were not unqualifiedly insured. Congress decided to wait and set 1978 as the target for implementing unqualified insurance on these plans. According to ERISA, from 1974 to 1978, employers withdrawing from these on-going multiemployer plans incurred a contingent liability. Their liability was contingent upon the plan terminating within five years after their withdrawal, and upon the PBGC's deciding to insure, if necessary, the plan's benefits. If the plan continued for five years after their withdrawal or PBGC decided not to insure or did not incur any liability, the withdrawing employer was freed of responsibility. ERISA did not, in general, require a withdrawing employer to provide PBGC any security for this potential liability.\textsuperscript{42}

In response to concerns voiced by experts and its own members regarding the financial viability of multiemployer pension plans under the rules set forth in ERISA and after extensive hearings and review, Congress enacted the Multiemployer Pension Plan Amendments Act [MPPAA] in 1980.\textsuperscript{43} The MPPAA made several important changes to ERISA. Critical to our discussion was the change in the rules controlling an employer's withdrawal from on-going multiemployer pension plans. No longer were employers only subject to a contingent liability. Under MPPAA, an employer who withdraws, totally or partially from a plan, must immediately begin to pay a fixed and certain debt owed to the plan. The amounts due for partial or complete withdrawals are calculated by differ-

\textsuperscript{40} Id. at 1251 citing 29 U.S.C. 1306 (1976). The PBGC receives no direct federal appropriations but rather relies on premium payments from participants in the system.

\textsuperscript{41} 724 F.2d at 1251-52, citing 29 U.S.C. Sec. 1341(a)(b) and (c), Sec. 1341(b)(2).

\textsuperscript{42} An exception was recognized for "substantial" employers—those that had contributed at least ten percent of all contributions received by the plan over a period of time. These employers were required to escrow an amount equal to their termination liability or post a bond. 724 F.2d at 1252, citing 29 U.S.C. Sec. 1301(a)(2), 1363(b), 1363(c)(1), 1363(c)(2).

\textsuperscript{43} 29 U.S.C. Sec. 1381 et seq.
ent formulas. In essence, MPPAA requires any motor carrier who withdraws from a multiemployer pension plan, for any reason, to pay a withdrawal penalty. For a substantial number of carriers, the calculated penalty for withdrawal is sizable, frequently exceeding the carrier's net worth. Although constitutionally attacked on several grounds, MPPAA was upheld.

Recognizing the trucking industry's unique position in the multiemployer plan area, Congress created, within the MPPAA, an exemption on the industry's behalf. This "'truckign exemption,"' allegedly, softened the statutory definition of complete withdrawal and, therefore, permitted the industry greater flexibility in withdrawing from on-going plans. The one catch is that for the exemption to apply, the plan must be one in which:

... substantially all [emphasis added] of the contributions required under the plan are made by employers primarily engaged in the long and short haul trucking industry, the household moving industry, or the public warehousing industry.

It is within this definitional nether world that one motor carrier fought for its life. In Central States Pension Fund v. Belmont Trucking Co., a case of first impression, the motor carrier argued, in part, that the MPPAA trucking exemption applied in their case because the plan they exited was

44. The details of "withdrawal liability" computations are very complex. See, 724 F.2d at 1255-56 for a thorough discussion of its intricacies.
46. See, e.g., Peick v. Pension Benefit Guaranty Corp., supra note 36; Republic Industries, Inc. v. Teamsters Joint Council No. 83 of Virginia Pension Fund, 718 F.2d 628 (4th Cir. 1983), cert. denied, 467 U.S. 1259 (1984). Parenthetically, the retroactive application provisions of MPPAA were statutorily amended by the Deficit Reduction Act of 1984, 98 Stat. 494, 899 (1984), thereby relieving any employer from withdrawal liability if it had withdrawn from the plan or had executed a binding agreement to withdraw from the plan prior to the effective date of MPPAA in 1980. Few carriers were effected.
47. Under 29 U.S.C. Sec. 1383(a) a complete withdrawal occurs when an employer "'(1) permanently ceases to have an obligation to contribute under the plan, or (2) permanently ceases all covered operations under the plan."' The trucking industry exemption alters this definition by mandating that a complete withdrawal occurs only if:

A) an employer permanently ceases to have an obligation to contribute under the plan or permanently ceases all covered operations under the plan, and
B) either—
   (i) the corporation [PBGC] determines that the plan has suffered substantial damage to its contribution base as a result of such cessation, or
   (ii) the employer fails to furnish a bond issued by a corporate surety that is an acceptable surety . . . , or an amount held in escrow by a bank or similar financial institution satisfactory to the plan, in an amount equal to 50 percent of the withdrawal liability of the employer.
more than 60% made up by the required carrier entities. Accordingly, Bellmont contended it was exempted from complete withdrawal charges. The District Court disagreed with Bellmont's analysis of the exemption and its definitional requirements. It held that the trucking industry exemption to withdrawal liability was not available to a motor carrier where only 60% of the contributions to the plan the carrier was seeking to exit came from employers primarily engaged in the required business classifications. The District Court construed the phrase "substantially all" to mean at least 85%, a figure discussed in the legislative history of MPPAA but not included in the statute. Accordingly, the motor carrier was assessed full withdrawal liability with the District Court further admonishing the carrier that it had misconceived the purpose of withdrawal liability. The 7th Circuit affirmed. Apparently, this purported safe haven denied sanctuary.

Other tactics have been taken by motor carriers in attempts to maneuver around the stringent requirements of ERISA and MPPAA. In a case decided earlier this year, the employer/carrier had an unlikely accomplice in its attempt—Teamster's Local 50. In *Central States Pension Fund v. Gerber Truck Service, Inc.*, Gerber, a non-union motor carrier, and the Teamsters' local agreed that if the carrier/employer signed the Teamsters' national collective bargaining agreement, the union would only require Gerber to make pension payments on behalf of three union employees which had come into Gerber's employ as a result of Gerber's merger with a now-defunct union carrier. The union agreed to this side deal in order to save three jobs for their members, two of which were close to retirement age. Gerber agreed, apparently out of kindness.

Although the facts in this case were somewhat compelling, the Court had no difficulty ruling in favor of the pension funds and against the carrier. The 7th Circuit held that once the carrier signed the collective bargaining agreement, it was bound to all its terms regardless of its separate understanding with the local, this separate agreement having no binding authority over the pension funds. Accordingly, the carrier was obligated to fund pension benefits for all covered employees, union and non-union

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51. 788 F.2d 428 (7th Cir. 1986).
52. See, e.g., *T.I.M.E.—DC v. Management-Labor Welfare & Pension Funds*, 756 F.2d 939 (2nd Cir. 1985) [carrier transferred employees to a different locale and became liable to make contributions on their behalf to a new pension plan were not released from making withdrawal payments due old pension fund]; *Byrnes v. DeBolt Transfer, Inc.*, 741 F.2d 620 (3rd Cir. 1984) [carrier not permitted to require 1,000 hours of work in twelve month period as threshold for ERISA coverage]. *See generally*, *T.I.M.E.—DC, Inc. v. N.Y. State Teamsters Conference Pension & Retirement Fund*, 580 F. Supp. 621 (N.D.N.Y. 1984).
53. 870 F.2d 1148 (7th Cir. 1989).
alike, in compliance with the collective bargaining agreement. The agree-
ments between the carrier and the local, the Court ruled, did not foreclose
the applicability of ERISA.\textsuperscript{54} This opinion certainly gives support to the
old saying that "no good deed ever goes unpunished."

It is offered that in an industry where unionization and multiemployer
pension plans were the rule prior to deregulation, the pension funding
regulations found in ERISA and MPPAA trapped and froze in place at
least three hundred (300) weak motor carriers. The problem faced by
these carriers is that they cannot be sold, merged, acquired or voluntarily
liquidated unless their employee pension fund liabilities are funded.
Given free entry to the industry by competitors, only a handful of these
carriers are candidates for acquisition by other carriers financially strong
enough to assume their pension obligations.

Not surprisingly, as the statistics attest,\textsuperscript{55} these carriers, faced with
the unflinching public policy represented by ERISA/MPPAA, have run
their assets into the ground and, ultimately, have gone or will soon go
bankrupt, thereby leaving creditors, employees and pension funds with-
out recourse. In the interim, they continue to limp along, an embarras-
sment to the deregulators, an extreme hazard to the multiemployer
pension system and its employee/participants, and a danger to the public
who share the roads with their ever increasingly unsafe equipment and
economic impediments to the stronger more competitive carriers.

Without question, the "ERISA/MPPAA problem" is one of the most
painful aspects of deregulation. The problem, however, is finite. Uti-
litimately, the affected carriers will die. Meanwhile, they will continue twisting and turning, ever so slowly, in the wind.

\section*{IV. Federal Preemption, State Powers and Deregulation}

The last decade has seen the deregulation of interstate transportation
as well as increased Congressional incursion into the States' regulation of
intrastate transportation.\textsuperscript{56} The airline, railroad and bus transportation in-
dustries all were touched by Congress' preemption activity.\textsuperscript{57} Unlike the
other major pieces of deregulation legislation, however, the Motor Carrier
Act of 1980 permitted the States to retain jurisdiction over intrastate trans-

\textsuperscript{54} Id. at 1149.


\textsuperscript{56} An outstanding survey of federal preemption of intrastate jurisdiction over transportation is contained in "Symposium: Intrastate Regulation," 14 TRANSP. L.J. 179-247 (1986).

\textsuperscript{57} See generally, the Airline Deregulation Act of 1978, the Staggers Rail Act of 1980 and the Bus Regulatory Reform Act of 1982.
portation, a policy that has strong roots in both case and statutory law. What Congress left alone, however, the ICC has not.

Only five states have elected to deregulate their motor carrier industries since the passage of the Motor Carrier Act of 1980. In fact, since the mid-1980's, the States' deregulatory ardor has faded as evidence builds to prove that deregulation has not been all that it was promised to be. Notwithstanding the States' reluctance to deregulate, the ICC, pursuing its objective to implement what it perceives to be Congress' mandate to fully deregulate the motor carrier industry, has undertaken a strategy which has, at its core, the emasculation of the States' authority to regulate intrastate transportation in any meaningful manner. Unlike the slow corrosive policy pursued in the undercharge/filed tariff doctrine issue discussed above, the ICC has gone on the direct attack against the States in this area, arguing that the case law and statutory authority clearly supports their position of preemption. In cases decided early in 1989, the 8th and 5th Circuits ruled on the ICC's recent offensive against the States' power to regulate intrastate transportation.

Middlewest Motor Freight Bureau v. ICC presented the issues neatly. Matlack, Inc. is a motor carrier operating under an ICC certificate to transport general commodities under contracts with manufacturers and distributors of chemicals and related products. Chemtech Industries, Inc. maintains facilities at Kansas City, St. Louis and Springfield, Missouri. It was Chemtech's practice to receive products from out-of-state origins

58. 49 U.S.C. Sec. 10521(b) (1980) expressly reserves to the States the regulation of common carriers' intrastate rates, even if these rates affect interstate commerce.

59. For example, since Cooley v. Board of Wardens of Port of Philadelphia, 12 How. 299 (1851), rules or regulations which are grounded on the state's police power over safety and are purely local in nature and do not unduly burden interstate commerce, are permitted even though they may in some manner regulate interstate trade. For an interesting recent treatment, see Specialized Carriers & Rigging Assoc. v. Comm. of Virginia, 795 F.2d 1152 (4th Cir. 1986). Further, although the ICC has jurisdiction under 49 U.S.C. 10521(a)(1)(A) over "... transportation by motor carrier... to the extent that passengers, property, or both, are transported by motor carrier between a place in a State and a place in another State" as well as regulatory authority over motor carrier transportation of property "... between a place in a State and another place in the same State through another State" 49 U.S.C. Sec. 10521(a)(1)(B), its authority to regulate interstate commerce does not, with some exceptions, "... affect the power of a State to regulate intrastate transportation provided by a motor carrier." 49 U.S.C. Sec. 10521(b)(1).


61. An excellent study and discussion of intrastate deregulation, its problems and future, is found in Dempsey, supra note 55.

62. The Southern Motor Carrier Rate Conference (SMCRC) case, infra note 100, in which the practice of collective intrastate ratemaking was challenged by the Department of Justice will be treated in the following section discussing antitrust issues. Although this case raises issues of federal supremacy, its thrust is antitrust.

63. 867 F.2d 458 (8th Cir. 1989).
and convert large inbound quantities into smaller outbound quantities at its Missouri locations. Shipments were then made to customers throughout Missouri, with seventy to eighty percent subject to supply contracts consummated in advance of the products being shipped to Missouri. Missouri claimed the movements within Missouri were intrastate transportation requiring state approval and issued citations to the carrier. The carrier filed for a declaratory order with the Commission to determine whether its ICC certificate covered these shipments as part of a continuous interstate transportation service. The ICC decided they were protected, preempting the state action and the appeal was filed.64

The Court was presented with two arguments by the petitioners: (1) that the ICC lacked jurisdiction to decide whether the transportation was interstate or intrastate; and (2) assuming jurisdiction, the ICC’s decision was arbitrary, capricious, an abuse of discretion and unsupported by substantial evidence on the record as a whole.

The Court quickly dealt with the issue of jurisdiction. It decided the issue as follows:

The question is whether the transportation from the distribution point in Missouri to customers in Missouri is part of a continuous interstate operation originating outside of Missouri and is thus covered by the ICC certificate, or whether the second leg of transportation is separate and wholly intrastate. We hold the issue is clearly within the ICC’s jurisdiction in interpreting whether its certificate covers the transportation.65

To resolve the second issue, the Court, relying upon the accepted legal principle that it must honor the agency’s interpretation of its statute so long as that interpretation is a reasonable one,66 reviewed the ICC’s application of the well established test set out in Texas & N.O.R.R. v. Sabine Tram Co.67 The Sabine test states that the determination of whether transportation between two points within a State is part of a larger interstate transportation service depends on the essential character of the shipment,68 a critical element of which is the “original and persisting in-

64. Id. at 459.
65. Id. at 460. As authority, the Court relied upon Service Storage & Transfer Co. v. Virginia, 359 U.S. 171 (1959), wherein the Supreme Court held that the ICC has primary jurisdiction to interpret federal motor carrier licenses and that an interpretation of the certificate should first be litigated before the ICC. The Court further cited Jones Motor Co. v. Pennsylvania Public Utilities Commission, 361 U.S. 11 (1959) and Merchants Fast Motor Lines, Inc. v. ICC, 528 F.2d 1042 (5th Cir. 1976).
66. See Chevron U.S.A., Inc. v. Natural Resources Defense, 467 U.S. 837 (1984) wherein the standard for review is set out and further states that where Congressional intent is absent the Court should “... not simply impose its own construction on the statute” but rather should determine whether the agency’s construction is reasonable.
67. 227 U.S. 111 (1913).
68. Id. at 122.
tention of the shippers.'

The ICC had determined in its decision that the shipped chemicals had not "come to rest" in St. Louis and were, therefore, not subject to State control. The Commission founded its opinion on evidence that the shipper's activity in Missouri did not interrupt the continuity of the original movement in interstate commerce because: (1) the shipments moved from outside of Missouri to the St. Louis distribution terminal and from there to their ultimate destination within 30 days; (2) since almost all of the shipments involved supply contracts entered into prior to shipment, Chemtech knew the final destination from the moment the shipment left its origin; and, (3) no manufacturing or processing took place at St. Louis. Accordingly, the ICC found that the evidence supported the finding that the shipper's intent was to ship to customers and that any movements from St. Louis to other points in Missouri were still interstate commerce.

The Court agreed. It dismissed the petitioners argument that the facts of this case were governed by Atlantic Coast Line R.R. v. Standard Oil Co. The ICC had distinguished this case arguing that in Atlantic the Supreme Court found no intent at the time of initial movement that the product be shipped beyond the storage facilities. The Court accepted the ICC's findings as reasonable that Chemtech intended that its product continue movement through St. Louis for delivery to known customers.

Based on these findings, the Court affirmed the actions of the ICC. The Commission had beaten back the first challenge to its broadening of the definition of interstate transportation.

One month later, the 5th Circuit was asked, in Texas v. United States, to rule on basically the same issue: whether the ICC had jurisdiction to preclude a state court enforcement action regarding shipments that the ICC had determined to be interstate, rather than intrastate, in nature. Again, the ICC argued in favor of an expansive definition of interstate transportation.

This case involved a classic "hub and spoke" distribution system operated by E&B Carpet Mills. E&B shipped carpet from Georgia to its warehouse in Arlington, Texas. E&B then wanted to ship these goods from Arlington to its customers located within Texas at the lower interstate rates. The Texas intrastate carriers objected. Prior to this action being

70. 275 U.S. 257 (1927).
71. 867 F.2d at 461.
72. 866 F.2d 1546 (5th Cir. 1989), reh. denied en banc 874 F.2d 812 (5th Cir. 1989).
73. Cases involving "hub and spoke" distribution systems have been litigated for the last half century. See, e.g., Atlantic Coast R.R. v. Standard Oil of Kentucky, 275 U.S. 257 (1927); Public Service Commission v. Wykoff, 344 U.S. 237 (1952).
filed, Armstrong World Industries, E&B’s parent, went to the ICC and, not surprisingly considering the ICC’s posture, obtained a declaratory judgment construing these shipments to be interstate in character.\textsuperscript{74} Texas initiated state court proceedings against E&B and filed this action to have the Circuit Court “... mitigate on jurisdictional grounds any preclusive effect that the ICC ruling might otherwise have, or to have the ICC order reversed or vacated despite the absence of any jurisdictional infirmity.”\textsuperscript{75}

Although the parties disputed both the applicable standard of review and whether E&B had the requisite “fixed and persisting intent” to convert the Arlington-to-customer trips into interstate commerce, the Court determined that the legal rules governing this issue were clear. It found that the Commission had been reasonable in its determination of the shipper’s “fixed and persisting intent.” The Court, following the ICC’s lead, gave great weight to two factors. First was whether the shipper made use of a transit privilege, such as the storage-in-transit provision in the carrier’s tariff, designating the shipment as a unified, interstate journey. The second factor was whether the shipper commingled interstate and intrastate goods at the hub.\textsuperscript{76}

The 5th Circuit analyzed the case in almost the identical manner as the 8th Circuit in \textit{Middlewest}. At the end of a comprehensive opinion, the Court succinctly concluded as follows:

\begin{quotation}
Whether commerce is interstate, and subject to ICC regulation, or intrastate, and subject to Texas regulation, depends on the “fixed and persisting intent” of the shipper. A carrier or shipper involved in a ... hub-and-spoke distribution system may be uncertain about the characterization of a certain movement, or a state may subject a carrier to regulatory proceedings with regard to transportation that the carrier believes to be interstate. If so, the shipper or carrier ... may ask the ICC to determine the character of the contested transportation ... The ICC has primary jurisdiction to decide that question. If the ICC does so, the resulting order is final and reviewable. Upon review, we will defer to the ICC’s judgment unless it is arbitrary or capricious. ... In this case, the ICC has applied the “fixed and persistent intent” rule reasonably in deciding that when the shipper involved transports goods across state lines to a hub warehouse pursuant to a storage in-transit privilege, the later hub-to-customer transport was still interstate in character, even though it did not again cross state lines.\textsuperscript{77}
\end{quotation}

The ICC, however, did not receive a clean sweep. In a powerful dissent, Judge Higginbotham argued forcefully against what he perceived to be the ICC “... simply expand[ing] its jurisdiction in order to undo the

\textsuperscript{74} 866 F.2d at 1548.
\textsuperscript{75} Id.
\textsuperscript{76} A shipper’s control over a hub warehouse does not cancel the effect of the transit privilege as long as the shipper has no opportunity to commingle local and interstate freight. Id. at 1563 citing the ICC.
\textsuperscript{77} 866 F.2d at 1561.
effects of state regulation when it disagrees with state policy." 

Judge Higginbotham contended that the majority ended its inquiry into the ICC's decision too quickly. He asserted that it was the Court's duty to "... determine not only whether the ICC has advanced a general theory that is reasonable, but also whether the specific interpretation relied upon in this case is likewise reasonable." 

Reviewing the facts, the Judge found that according to the ICC, all of the carpet shipped to the Arlington hub, and later transported to Texas destinations, moved pursuant to the transit privilege. However, it was not clear that the Arlington-to-customer trips were interstate in character under the second prong of the ICC's test, which "... requires that the shipper not commingle interstate and intrastate commerce at the hub warehouse." 

Judge Higginbotham maintained that the facts demonstrated that Armstrong's "fixed and persisting" intent to ship its carpet in interstate commerce beyond the Arlington warehouse dissolved for the majority of the carpet sent to the warehouse because the carpet, which Armstrong at some point intended to transport in intrastate commerce, was commingled with the carpet which was alleged to continue in interstate commerce. 

Further, the Judge stated that he could not accept "... the ICC's apparent distinction between an intent that expires and an intent that persists but is thwarted." He argued:

The ICC cites no cases to justify this distinction. It makes no sense in light of existing case law. It contradicts the ICC's general theory of the law. Would Armstrong's intent also be "thwarted" if an unexpected buyer—for example, a supplier, who operates his own fleet of trucks and so needs no transportation services, left without adequate stock after a labor strike at another carpet company—offered to purchase carpet at the warehouse at a price higher than other Armstrong customers would pay? The absence of a competitive buyer interested in Armstrong's "delivered rate" program would be a "circumstance beyond Armstrong's control." The ICC's test effectively eliminates the requirement that a shipper's intent be "fixed and persisting." 

Accordingly, Judge Higginbotham contended that the dissolution or thwarting of Armstrong's intent at the warehouse distinguished this case from *Midwest* and made these shipments intrastate in character. He argued that since the Eighth Circuit did not mention any local sales at the warehouse, any shipments via intrastate carrier, or any concept of

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78. *Id.* at 1569.
79. *Id.* at 1566.
80. *Id.*
81. *Id.* at 1566-67.
82. *Id.* at 1567.
83. *Id.*
"thwarted intent," the ICC's reasonable general interpretation was sufficient to decide that fact pattern but not this case.

Finally, Judge Higginbotham eloquently presented the following argument for reversal of the ICC's ruling:

If Texas is wrongfully regulating transportation, by exceeding its jurisdiction or by violating constitutional rights, the subjects of that regulation have a remedy before the ICC or in the federal courts. No such wrongful regulation has even been alleged in this case. On the other hand, if Texas is simply regulating intrastate commerce in a manner not approved by the ICC, the ICC lacks the power to expand its jurisdiction to interfere with Texas' regulation. Any contrary interpretation of the Motor Carrier Act would contravene the clear intent of Congress. Congress did not give the ICC a regulatory power as broad as Congress' own power under the commerce clause. Instead, Congress explicitly preserved the power of states to regulate goods in intrastate commerce . . . . If Texas were to harass carriers after the ICC declared the proposed program to the interstate, that harassment would presumably be unlawful. But again, no unlawful harassment has been alleged here. Armstrong complains only that Texas exercises its power too vigorously. The statutory division of power enacted by Congress permits and even invites the states to govern vigorously. 84

On the question of federal supremacy with respect to motor carriers since deregulation, it is offered that the courts have approved a significant extension of federal (ICC) power. In the Missouri case, the court's decision was a retail extension of the ICC's power to extend the reach of its interstate rate authority into territory previously reserved to the States. In the Texas case, the court approved a wholesale extension, albeit by a 2-1 decision in which Judge Higginbotham's ringing dissent is arguably more logical and reasonable than the views of the majority.

It appears that the courts follow the lead of the ICC when a case at issue leads to the lower rates contemplated by the Motor Carrier Act of 1980. Lower rates in the motor carrier marketplace are what Congress wants, and both the ICC and the courts seem to be disposed to push reason to the brink in order to grant that wish.

V. ANTITRUST ISSUES: PREDATORY PRICING AND COLLECTIVE REMAKING

Since the Act to Regulate Commerce of 1887, Congress has pursued a public economic policy in favor of competitive enterprise. The antitrust laws 85 reflected a congressional theory that competition was more likely to exist in an economic structure characterized by many competing firms

84. Id. at 1567-68.
than in concentrated industries dominated by a few large firms. Accordingly, the antitrust laws were designed to control the exercise of private economic power by preventing monopoly and protecting competition.

Recently, however, these long accepted antitrust concepts have been under attack by commentators and courts advocating the use of modern micro-economic theory in antitrust enforcement. These new approaches to antitrust analysis, commonly referred to as "Chicago School" theories, view economic efficiency, rather than the traditional prevention of industrial concentration, as the primary goal of antitrust enforcement. It can be argued, that the Chicago School economic theories have provided the intellectual framework for many of the antitrust enforcement policies implemented by both the ICC and the Department of Justice in the 1980's.

Against this contemporary antitrust backdrop, place the motor carrier industry in 1980. Historically, the industry had been immunized, as a matter of public policy, from certain antitrust violations. Problems found in other industries, such as predatory pricing, for example, were relatively unheard of because of regulation. Motor carriers were protected from violations resulting from collective ratemaking by the Reed-Bulwinkle Act of 1948. All this changed in 1980. The Motor Carrier Act of 1980 sharply curtailed this protection and these exemptions. The Act, the legislative mandate for deregulation of the industry, significantly reduced regulatory restrictions on entry, gave motor carriers greater pricing flexibility and set limitations on collective ratemaking activities. Motor carriers were rudely shoved into the modern world of competitive pricing, antitrust law and micro-economic theory.

86. As Judge Learned Hand stated in United States v. Aluminum Company of America, Inc., 148 F.2d 416 (2nd Cir. 1945):

Many people believe that possession of an unchallenged economic power deadens initiative, discourages thrift, and depresses energy; that immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress; that the spur of constant stress is necessary to counteract an inevitable disposition to let well enough alone.


88. 62 Stat. 473; the current version of the exemption is codified at 49 U.S.C. Sec. 10706(b)(2).

89. Under the exemption, as amended, the ratemaking conferences must disclose the names of their members [49 U.S.C. Sec. 10706(b)(3)(A)]; the organization must limit discussion and voting to allowed subjects and parties [Sec. 10706(b)(3)(B)(i)]; "... the organization may not file a protest or complaint with the Commission against any tariff item published by or for the account of any motor carrier ..." [Sec. 10706(b)(3)(B)(ii)]; the organization may not permit one of its employees or any employee committee to docket or act upon any proposal effecting a change in any tariff item ..." [Sec. 10706(b)(3)(B)(iii)]; "... upon request, the organization must divulge to any person the name of the proponent of a rule or rate docketed with it, must admit any person to any meeting at which rates or rules will be discussed or voted upon, and must divulge to any person the vote cast by any member carrier on any proposal before the organiza-
Deregulation resulted in a startling increase in competition within the industry. Thousands of new motor common carriers entered the business. Pricing became more competitive, freight prices dropped and numerous discount arrangements never before used in the industry became common. Hundreds of firms went bankrupt in this rigorous new environment.

Soon after 1980, several carriers, who had suffered acute adverse effects from deregulation, sought protection from the Commission. They bitterly complained to the ICC that the industry was experiencing serious antitrust violations. These carriers alleged that the major motor carriers were using illegal predatory and destructive rate cutting thereby causing these smaller carriers' financial collapse. The ICC was unmoved by their reasoning. After hearing the carriers' arguments, the Commission, adhering to the basic principles of deregulation theory, held:

There is little likelihood of this type of strategy in the motor carrier industry. For such a strategy to succeed, sufficient entry barriers must be present to prevent competitors from reentering the market once the predator attempts to raise its price to monopolistic levels. However, as regulatory barriers are reduced, predation by motor carriers becomes uneconomic, since entry costs are so low that a predator could never long enjoy its monopoly price.90

Notwithstanding the ICC's expressed position, many carriers continued to protest. In 1983, the Commission again requested and received comprehensive public comment in reference to claims that discounting and competitive pricing occurring in the business were predatory and constituted attempts by the major motor carriers to monopolize the industry. These further hearings did not change the Commission's opinion. The ICC again ruled that the empirical evidence demonstrated that the new competitive environment benefitted the public, that this type of price competition was exactly what Congress desired when it passed the Motor Carrier Act of 1980, and that the pricing activity occurring in the marketplace did not constitute illegal predatory tactics under the antitrust laws of the United States.91

The ICC, buttressed by testimony from both the Department of Justice and the Federal Trade Commission, concluded that its original assessment was correct. It determined that the motor carrier industry did not have the structural characteristics necessary to make predatory pric-
ing a viable strategy because since ". . . the motor carrier industry has few non-regulatory barriers to entry a predation strategy—should it ever be attempted—is unlikely to harm either competition or shippers, as no monopoly can result." Market efficiency, apparently, was in and the well established public antitrust policy against economic concentration was out. The message was clear: there was to be neither sympathy nor relief at the ICC for the motor carriers struggling with deregulation.

The ICC’s position came as no surprise. Many observers of the motor carrier industry, including many economists, have characterized the industry as being atomistic in character, having no significant operating economies of scale, having a large number of competitors (under conditions of free entry), having very low financial barriers to entry, using (relatively) low technology as to both equipment and labor skills required, and being one of the beneficiaries of the huge public capital investment that has been made to create the nation’s highway network.

The characteristics just mentioned do properly describe the truckload (TL) segment of the industry. However, the less-than-truckload (LTL) carriers are quite another story. The LTL for-hire carrier segment of the industry is not atomistic in any sense of the word. A small and still shrinking group of increasingly large firms dominates this traffic nationally. LTL operations do have significant operating economies of scale. The established large national LTL carriers are the beneficiaries of an almost insurmountable financial barrier to entry: their large and widespread terminal networks. And, the LTL carriers do employ increasingly sophisticated information processing technology. The only significant similarities between the TL and LTL segments of the industry are that they both operate trucks, carry freight and use the highway network.

Surprisingly, many who favored deregulation of the motor carrier industry gave short shrift to the economic and operating differences between TL and LTL carriers. In particular, little attention was given to the very significant differences between TL and LTL carriers with respect to barriers to entry and economies of scale. These major differences were certainly no secret; they have long been taught by any competent instructor in every basic course in transportation. That such significant differences could be ignored, or not understood, by some who proffered testimony favoring deregulation in Congressional and state legislative committee hearings, as well as the ICC’s hearings on predatory pricing, is startling.

92. Id. at 47,175.
94. Id.
95. Id.
Although many motor carriers perished and others remained angry in the aftermath of the ICC’s neglect, one carrier wants to get even. In 1987, Lifschultz Fast Freight, Inc., an LTL motor common carrier headquartered in New York City and with a majority of its freight business located on the east coast, bypassed the ICC and filed an independent private action in U.S. District Court alleging that Consolidated Freightways Corp., Yellow Freight System, Inc. and Roadway Express, Inc., commonly referred to as the “Big 3” in the LTL business, had engaged in predatory pricing with the intent to drive Lifschultz out of business in violation of the Sherman and Clayton Acts.96

The success of this action, currently in an extensive discovery phase, hinges on several factors: (1) whether it can be proven that the “Big 3” truly have the economic power and concentration to do what Lifschultz alleges; (2) whether Lifschultz can prove that the “Big 3” maintain high freight prices in the western United States, where they supposedly enjoy a significant competitive advantage, and then use these alleged “excess profits” to finance their charging below cost freight rates in the eastern United States where they face many smaller and, according to Lifschultz, more efficient competitors; and (3) whether this pricing technique, if proved, violates the antitrust laws or is merely an acceptable manifestation of the deregulated competition sought by Congress.

Motor carriers await the outcome of Lifschultz with anxiety. Will the courts stop the industry’s apparent inexorable movement toward interstate LTL oligopoly by enforcing the original precepts of antitrust policy against economic concentration or side with the voices of deregulation who argue in favor of this “new-wave” antitrust enforcement policy based upon efficiency? The answer is several years away.

On another deregulatory tack and paralleling the ICC’s activity regarding predatory pricing, the Department of Justice filed an action in 1982 against two motor carrier rate bureaus97 alleging that the rate bu-

96. Lifschultz Fast Freight, Inc. v. Consolidated Freightways Corporation of Delaware, Yellow Freight System, Inc., and Roadway Express, Inc., Civil Action No. 87-477-17, U.S. District Court, South Carolina, Greenville Division. It is alleged that the “Big 3” charge higher prices in the West and predatory low prices in the East in order to drive out the competitors in the East and, therefore, monopolize the industry. In its argument, Lifschultz advances the well-known and, arguably strict, Areeda and Turner standard for evaluating allegations of predatory pricing: Recognizing that marginal cost data are typically unavailable, we conclude that:
(a) A price at or above reasonably anticipated average variable cost should be conclusively presumed lawful.
(b) A price below reasonably anticipated average variable cost should be conclusively presumed unlawful.
97. Rate bureaus are regional organizations composed of motor common carriers. They provide a forum for their member motor carriers to discuss rate proposals; publish tariffs and
reaus’ collective ratemaking98 violated the federal antitrust laws.99 This attack, if successful, would have completed the gutting of the motor carrier industry’s collective ratemaking antitrust exemption which was begun by the Motor Carrier Act of 1980. This critical issue was decided by the Supreme Court in 1985 in the now well reviewed case of Southern Motor Carriers Rate Conference, Inc. v. United States.100

The Southern Motor Carriers Rate Conference [SMCRC] and North Carolina Motor Carriers Association [NCMCA] are rate bureaus composed of motor common carriers operating in North Carolina, Georgia, Tennessee, and Mississippi. As part of their activities, they submit, on behalf of their members, joint rate proposals to the Public Service Commission in each State. This collective ratemaking was authorized, but not compelled, by the respective States.101 The United States contended that the collective ratemaking violated the federal antitrust laws and filed an action to enjoin it. SMCRC and NCMCA maintained that their conduct was immune from the federal antitrust laws by virtue of the “state action” doctrine announced in Parker v. Brown.102

The Fifth Circuit, relying primarily upon Goldfarb v. Virginia State Bar,103 agreed with the Department of Justice. In its opinion, the Court reasoned that the Supreme Court’s announced Midcal104 test to determine enforceability of the Parker doctrine was inapplicable in suits involving private parties and even if, arguendo, the test applied, the rate bureaus argument would fail because the Midcal test requires that the private action not merely be authorized but compelled by the State. The rate bureaus appealed.

98. The rate bureaus were accused of colluding to keep freight prices high despite the public policy of deregulation.
99. The United States alleged that the two rate bureaus violated Sec. 1 of the Sherman Act by conspiring with their members to fix rates for the intrastate transportation of general commodities. 471 U.S. 48, 53 (1985).
101. For example, Congress has recognized the advantages of collective ratemaking and, accordingly, under the Interstate Commerce Act, motor common carriers are permitted, but not compelled, to engage in collective interstate ratemaking. 49 U.S.C. §§ 10706(b)(2) and 10706(d)(2)(C).
102. 317 U.S. 341 (1943). Simply, the Parker doctrine holds that the Sherman Act was not intended to prohibit the States from imposing restraints on competition.
103. 421 U.S. 773 (1975) held that a State Bar, acting alone, could not immunize its anticompetitive conduct from the federal antitrust laws.
104. This test, announced in California Retail Dealers Association v. Midcal Aluminum, Inc., 445 U.S. 97 (1980), has two prongs: (1) the challenged restraint must be one clearly articulated and affirmatively expressed as a state policy, and (2) the State must supervise actively any private anticompetitive conduct.
The Supreme Court disagreed with the Department of Justice's and the Fifth Circuit's restricted view of the Midcal test. Justice Powell, writing for the majority, stated that Midcal should not be given a narrow reading but rather:

... the two-pronged test set forth in Midcal should be used to determine whether the private rate bureaus' collective ratemaking activities are protected from the federal antitrust laws. The success of an antitrust action should depend upon the nature of the activity challenged, rather than on the identity of the defendant.105

Accordingly, the Court held that the "private v. state official" argument was not dispositive and that the Midcal test should be used to determine whether the private rate bureaus' collective ratemaking activities were protected under the federal antitrust laws.

Applying the Midcal test, the Court found that the facts demonstrated that the actions of the rate bureaus could be attributed to the required "clearly articulated state policy," within the meaning of the Midcal test's first prong, even in the absence of compulsion,106 because North Carolina, Georgia, and Tennessee statutes expressly permitted collective ratemaking. Finally, because the Government had conceded that there was adequate state supervision of the parties' activities, the Court held that both prongs of the Midcal test were satisfied and that the rate bureaus' collective ratemaking activities, "... although not compelled by the States, are immune from antitrust liability under the doctrine of Parker v. Brown."107 The motor carrier industry had successfully dodged another one of the deregulators' bullets.

VI. POSTSCRIPT AND A LOOK FORWARD

The authors have examined four areas of legal and economic effects of deregulation on the motor carrier community: undercharges and the "filed tariff doctrine," ERISA/MPPAA and deregulation, federal supremacy and the antitrust issues of predatory pricing and collective ratemaking.

The undercharge issue is a consequence of the severe price competition in the post-deregulation Darwinian motor carrier marketplace. It illustrates, painfully for many shippers, the rule that one cannot contract in violation of the law, however pure one's intent might be. Appeals to the

106. The Court held that:
The federal antitrust laws do not forbid the States to adopt policies that permit, but do not compel, anticompetitive conduct by regulated private parties. As long as the State clearly articulates its intent to adopt a permissive policy, the first prong of the Midcal test is satisfied.
471 U.S. at 60.
107. id. at 66.
ICC (and its primary jurisdiction over the reasonableness of tariffs) have given some shippers relief, but others have felt the court-applied sting of the filed tariff doctrine. Ultimately, the Supreme Court will sort out the conflict. The undercharge problem was not anticipated even though all concerned predicted that many motor carrier bankruptcies would occur as a result of deregulation.

The ERISA/MPPAA issue is a classic case of conflict between two clearly enunciated public policies enacted into law: the Congressional mandate that workers are to receive their pensions versus the Congressional wish to have weak (presumably inefficient) motor carriers exit the industry. The conflict is direct and hard-nosed. There is no room for evasion or equivocation, and mandate has triumphed over wish. The result, as one would expect, is messy. Carriers that should exit the industry, that want to exit the industry, that others would like to see exit the industry, cannot exit the industry. Instead, their assets must waste away (assets that might have paid some percentage of pensions due). As many of our parents, about to administer a spanking to us, were wont to say, "this hurts me more than it does you." We didn't believe it then, and we wouldn't believe it now. ERISA/MPPAA has a noble purpose, and it will have many noble results, but few in the motor carrier industry would believe it.

The incursion of ICC rate jurisdiction ever deeper into heretofore forbidden state territory reflects two legal trends. The first is the gradual overall extension of federal supremacy which was so sharply accelerated in the 1930's and continues to this day. The second is the direct result of ICC—and court—interpretation of Congressional intent as expressed in the Motor Carrier Act of 1980 and the hearings and debate leading to passage of that legislation. The authors suspect that both the ICC's and the court's decisions in the Missouri and Texas cases reflect the philosophy of deregulation favoring low(er) rates rather than the facts in each case, particularly the Texas decision. The authors agree with Judge Higginbotham's well-reasoned dissent, "... [the ICC] is simply extending its jurisdiction in order to undo the effects of state regulation when it [the ICC] disagrees with state policy." The Supreme Court is yet to be heard from on this issue, and the authors hesitate to speculate on what its decision might be.

Finally, there are the antitrust questions. The ICC says the competitive structure of the motor carrier industry makes price-fixing conspiracy among motor carriers unfeasible. Now comes Lifschultz alleging that the "Big 3" have done just that, and that they have the clout to do so. If this

108. Texas v. United States, supra note 78.
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case ever gets to trial it will air the issue. The authors do not speculate on the outcome.

However, the SMCRC antitrust case has been decided by the Supreme Court. The Antitrust Division of the Department of Justice has historically held a very jaundiced view of relief or immunity from antitrust law, whether federally granted or a result of state action. The Department of Justice fought hard, winning its case in the lower courts, but ultimately succumbed to the Supreme Court’s opinion that the States still have some rights.

Clearly, deregulation of the motor carrier industry has had a number of interrelated legal and economic conflicts and effects. Some, such as the extension of federal supremacy and the emergence of antitrust issues, were expected. Others should have been anticipated, such as ERISA/MPPAA, but were not. And others were unexpected, or at least unanticipated, such as the undercharge problem. Not surprisingly, the motor carrier deregulation knots tied by Congress must be untied by the courts.
The Duty to Bargain and Rejection of Collective Agreements Under Section 1113 by a Bankrupt Airline: Trying to Reconcile R.L.A. with Bankruptcy Code

ATHANASSIOS PAPAIOANNOU*

In March of 1989, Eastern Airlines, a major carrier with a rich history in air transportation, filed for bankruptcy¹ and sent a shock wave to all those involved in industrial relations in this country. Many realized that this bankruptcy, along with the three union-strike that had started a few days before the filing, was just the beginning of a labor fight which would largely affect labor relations across the nation.²

This bankruptcy, however was simply the culmination of a trend that has characterized airlines for the last decade. Since 1978, when the airline industry was deregulated by Congress,³ a wave of bankruptcies has hit and directly, or indirectly affected virtually all air carriers. The stormy competition generated by the deregulation of 1978, the entry of new non-

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union air carriers with significantly lower labor costs, and the subsequent rate-war that resulted\(^4\) created many financial problems for the major carriers. At the beginning, some of the financial problems could be attributed to the recession and the fuel crisis of the early 80s, but the industry's financial condition in 1985 and 1986\(^5\) show that the crisis was deeper and more persistent than initially thought.\(^6\)

As a result, more than 120 airlines have gone into bankruptcy since 1978.\(^7\) Most of them were small, regional carriers of limited importance to overall labor relations in the airline industry, however, some of them involved airlines employing thousands of employees and did have a tremendous impact on the airline labor scene. For example, Air Florida which went bankrupt in July, 1984, was the eighteenth largest certificated air carrier in the U.S.\(^8\) Braniff Airlines which filed for bankruptcy reorganization in May, 1982, employed 9,000 employees\(^9\) and was among the largest air carriers.\(^10\) When Continental Airlines petitioned for reorganization in September, 1983, it employed 12,000 employees and was heavily unionized.\(^11\) Another recent example is the Eastern Airlines bankruptcy. Eastern was once ranked at the top of the carriers, and its bankruptcy is just another sign of the extent of the problem. It is difficult to exaggerate the impact of bankruptcy upon employment relations. Following Continental's bankruptcy filing, three of its major unions started a strike (A.L.P.A., I.A.M., U.F.A.)\(^12\) which would become the industry's longest and perhaps fiercest strike, at least since deregulation.\(^13\) The strike


\(\text{\textsuperscript{5}}\) See Brenner, Airline Deregulation—A Case Study in Public Policy Failure, 16 TRANSP. L.J. 179, 202 (1988) (with the exception of 1984, the airline industry has suffered continued losses from 1978 through 1986); see also Katz, The American Experience Under the Airline Deregulation Act of 1978—An Airline Perspective, 6 HOFSTRA LAB. L.J. 87, 96 (1988) (in four of the ten years between 1978 and 1987, the entire industry posted a net loss and in 1987 the profit margin was a low 1.1%).

\(\text{\textsuperscript{6}}\) See, Profits Fall, Revenues Up at UAL, N.Y. Times, Oct. 27, 1989, at D4, col. 4 (describing the latest economic problems of United and U.S. Air, two of this nation's strongest carriers).

\(\text{\textsuperscript{7}}\) Carnevale, Presidential Air to End Pact Feb. 6 as Feeder for Continental at Dulles, Wall St. J., Jan. 11, 1988, at 8, col. 1.

\(\text{\textsuperscript{8}}\) In re Air Florida Sys., Inc., 48 Bankr. 440, 441 (Bankr. S.D. Fla. 1985).


\(\text{\textsuperscript{10}}\) Salupkas, Bankruptcy Petition by Braniff, N.Y. Times, Sept. 29, 1989, at D1, col. 6 (Braniff has filed for bankruptcy a second time) [hereinafter Braniff Second Bankruptcy].


\(\text{\textsuperscript{12}}\) In fact, I.A.M. had started the strike even before the airline filed bankruptcy.

\(\text{\textsuperscript{13}}\) Pilots End Two-Year Strike at Continental, Accept Terms Awarded By Bankruptcy Court,
ended with the defeat of the unions\textsuperscript{14} with only 20\% of the carrier’s employees remaining unionized as of December 31, 1987\textsuperscript{15} and with the company denying A.L.P.A. and I.A.M. their representation status.\textsuperscript{16} As for Braniff, the consequences were of no lesser importance. When it resumed operations on March 1984, its work force amounted to only 2,250 as opposed to its former work-force of 9,000 persons; pay-scales and other benefits had been significantly reduced.\textsuperscript{17} As for Eastern’s bankruptcy it’s too early to make any final assessment of its impact upon the future size of the carrier but one thing is sure; after the bankruptcy, Eastern Airlines will never return to its pre-filing status.\textsuperscript{18}

The impact of bankruptcy is not, however, limited to the cases where it actually occurs. It also has a significant influence upon labor relations when management threatens the unions that it will resort to bankruptcy.\textsuperscript{19} Given the financial difficulties that many carriers have faced since 1978, such threats,\textsuperscript{20} regardless of their sincerity do seem realistic and do affect labor relations.\textsuperscript{21}

The effects on labor law itself are no less important. In such a context the traditional concept of the duty to bargain takes a totally different form. However broadly one defines the scope of this duty, and it has been defined broadly under Railway Labor Act (R.L.A.),\textsuperscript{22} this obligation may be rendered a nullity if the employer can circumvent it by filing

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\textsuperscript{14} Id.
\textsuperscript{16} Id.
\textsuperscript{17} Braniff Bankruptcy, supra note 9. See also, Braniff Second Bankruptcy, supra note 10 (Braniff’s second bankruptcy filing in one decade in September 1989 forced it to lay-off more than half of its remaining 4,791 workers).
\textsuperscript{19} See Cappelli, An Economist’s Perspective in CLEARED FOR TAKEOFF 51 (McKelvey ed. 1988) (noting the impressive effect of the threat of bankruptcy on labor concessions) [hereinafter Economist].
\textsuperscript{21} But see Capelli, Competitive Pressures and Labor Relations in the Airline Industry, 24 INDUS. REL. 316, 325 (1985) (arguing that “it is not the simple threat of bankruptcy that determines the extent of concessions,” referring to the willingness of unions to make concessions to management) [hereinafter competitive pressures].
\textsuperscript{22} See, McDonald, Airline Management Prerogative in the Deregulation Era, 52 J. Air L. & Com. 869, 870 (1987): the courts historically have construed an air ( . . ) carrier’s management prerogative to change the nature or direction of its business as more narrowly constrained than...
bankruptcy, thus exploring the opportunity according to bankruptcy law to reject the agreement that has been reached through long and often hard negotiations. Moreover, the filing of a bankruptcy reorganization petition, creates certain situations where collective bargaining is required, and the traditional concepts of collective bargaining need to be adjusted to the needs of bankruptcy.

An airline bankruptcy gives rise to complex legal issues. Given the effect of bankruptcies on such an important sector of our economy and labor relations, it is very important to try to provide some answers to these problems. These problems not only involve the difficult legal questions that an attempt to reconcile bankruptcy with labor laws create in general, they also have to do with the fact that airlines are covered in their labor relations by the R.L.A. as will be discussed later, a statute which has a different structure from the National Labor Relations Act (N.L.R.A.).

Unfortunately, all the principal guidelines that exist today in the field of collective bargaining and agreements in the context of a bankruptcy reorganization, namely the Bidisco decision of the Supreme Court and section 1113 which was added to the Bankruptcy Code by Congress in 1984 (both which will be discussed later) are concerned with the N.L.R.A. Nevertheless, Congress has extended the coverage of the 1984 amendments to the airline industry without addressing the difficult problems which would be created by the imposition of N.L.R.A. oriented bankruptcy provisions on an industry where a different labor law applies, namely the R.L.A.

In this article we intend to basically reconcile the remedy of rejection of a labor agreement provided by section 1113 with the R.L.A. First the applicable bankruptcy provisions will be discussed. Then we will examine the right of an employer who is in a bankruptcy reorganization process to reject his collective labor agreements. The third part of this article will examine the difficult legal problems that the right to reject an agreement by a bankrupt company, covered by R.L.A., creates as far as that of an employer governed by the NLRA, especially where such changes have resulted in loss of employment or other prejudice to the carrier’s employees.

23. See infra note 125 and accompanying text.
24. See, e.g., Haggard & Pulliam, Conflicts Between Labor Legislation and Bankruptcy Law 129 (1987): “The presence of such a threat (of the liquidation of the company) suggests that the NLRA duty to bargain over major operational changes, to the extent that it exists at all, should be abrogated when the employer is in Chapter 11 reorganization. Legitimate interests of the employees and unions would be better served through bankruptcy law itself.”
25. See infra note 146 and accompanying text.
26. See infra note 128 and accompanying text.
27. See infra Note 123 and accompanying text.
28. See infra note 46 and accompanying text.
29. See infra discussion at A. at p. 223.
30. See infra discussion at B. at p. 225.
the duty to bargain is concerned.31 Our discussion will distinguish between the problems arising before the court’s decision whether to reject an agreement,32 and those presented after the court has issued its decision.33 Finally, we will discuss the competing interests to be balanced in a bankruptcy reorganization when collective bargaining and agreements are threatened by the needs and pressures of reorganization.34 Based on this balancing, we will conclude that the best approach for a court which is called to reconcile bankruptcy law and the R.L.A. will be the one that will encourage dialogue between the parties, of course, within the time limits that a bankruptcy always exercises upon both management and labor.

A. Rejection of Collective Agreements in Airlines: R.L.A. or Bankruptcy Code?

Bankruptcy law is currently governed by the Bankruptcy Code of 1978,35 which was amended in 198436 to provide for the particular procedures for rejection of a collective agreement. In section 1167, the Bankruptcy Code states that:

[N]otwithstanding section 365 of this title, neither the court nor the trustee may change the wages or working conditions of employees of the debtor established by a collective bargaining agreement that is subject to the Railway Labor Act (45 U.S.C. 151 et. seq.) except in accordance with section 6 of such Act.37

The R.L.A. which was passed in 1926 initially covered only railway labor relations.38 However, the R.L.A. was amended in 1936 to include the airlines.39 The question was then whether bankruptcy labor proceedings in the airlines are covered by R.L.A. or by the Bankruptcy Code?

Despite the explicit language of section 1167, which did not distinguish between airlines and railroads, bankruptcy courts have ruled that airlines' bankruptcies are covered by the Code and not by the R.L.A. as to the rejection of the collective agreements. One court40 gave emphasis to the fact that section 1167 appears in Subchapter IV of Chapter 11 which

31. See infra discussion at C. at p. 238.
32. See infra discussion at C.2. at p. 240.
33. See infra discussion at C.3. at p. 243.
34. See infra note 19 and accompanying text.
37. It is this section of the R.L.A. that provides for the procedures through which collective bargaining must take place under the R.L.A.
explicitly states that it covers only railroad employees. Another court relied on the past history of section 1167 which derives from section 77(n) of the Bankruptcy Act of 1898. The latter provided that "[N]o judge or trustee acting under this Title shall change the wages or working conditions of railroad employees except in the manner prescribed in sections 151 to 163 of [R.L.A.]." For the court, the change of the language from "railroad employees" to "collective bargaining agreement that is subject to the Railway Labor Act" was not indicative of a change in the Congressional intent on this issue. These arguments were never challenged on an appellate level, and are not completely persuasive. The explicit language of section 1167 cannot be ignored just because of the position of the section in a particular chapter of the Code. As to the Congressional intent, the similarity of the treatment of labor relations in the airlines and the railroads rendered the adoption of the literal interpretation of section 1167 even more convincing.

With the passage, however, of the 1984 amendments the issue was finally clarified. Thus, in section 1113, concerning the rejection of collective bargaining agreements, a provision was inserted which excludes from its coverage, only Title I of the R.L.A., which applies to railroads and not to the air carriers who are covered by Section II.

Given the later development, as well as the traditional insistence of the bankruptcy courts to subject airlines to the bankruptcy law of rejecting collective agreements, there is no doubt that in the future section 1113 along with the R.L.A. will govern this area of labor relations. The extent to which section 1113 will replace the R.L.A. is an unsettled problem which will be discussed later in this article. Before this, however, it will be necessary to discuss the right to reject a collective agreement and

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41. Section 103(g) provides that "Subchapter IV . . . applies only in a case . . . concerning a railroad."
43. This section was embodied in the Bankruptcy Act by Pub. L. No. 420, Ch. 204, 47 Stat. 1467, 1481 (1933).
46. 11 U.S.C. § 1113(a) (1985 Supp. III). "The debtor in possession, or the trustee if one has been appointed under the provisions of this chapter, other than a trustee . . . covered by Title I of the Railway Labor Act, may assume or reject a collective bargaining agreement only in accordance with the provisions of this section."
47. For one exception to this, see In re Overseas National Airways, Inc., 238 F. Supp. 359 (E.D.N.Y. 1965) which found that the R.L.A. alone is applicable in airline bankruptcies.
48. See infra discussion at C.2. at p. 240.
how it has developed in the last fifteen years in the courts, in Congress, and mainly in industries covered by the N.L.R.A.

B. The Labor Provisions of Bankruptcy Law in General

Chapter 11 of the Bankruptcy Code refers to the reorganization of companies as an alternative to liquidation. One of the main weapons that this chapter offers to companies which resort to reorganization procedures is the ability to reject the contracts that they deem burdensome to the reorganization efforts.49 The code provides in pertinent part: "... the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor."50

Executory contracts were defined by Congress as "contract[s] on which performance remains due to the same extent on both sides."51 From the language used, it becomes obvious that Congress did not make any particular reference to collective bargaining agreements. Up until the 1984 amendments to the Code, there was no specific provision for the labor agreements. By the time, however, that the Supreme Court considered the Bildisco case,52 it had already become settled law that section 365(a) included collective bargaining agreements.53

Thus, given that an employer engaged in bankruptcy reorganization may reject a collective agreement with his unions, a tension is immediately created between bankruptcy and labor law.54 The N.L.R.A. provides that an employer may change a collective agreement only upon its

49. See George, Collective Bargaining in Chapter 11 and Beyond, 95 YALE L.J. 300, 309 (1985) ("The ability to reject burdensome or unprofitable contracts is obviously one of the most significant privileges granted the debtor by the Bankruptcy Code.") See also White, The Bildisco Case and the Congressional Response, 30 WAYNE L. REV. 1169, 1170 (1984) ("[P]ractically, it would be impossible for many corporations to undergo a successful reorganization if made to carry every onerous executory contract.") Merrick, The Bankruptcy Dynamics of Collective Bargaining Agreements, 19 J. MARSHAL L. REV. 301, 326 (1986).


51. S. REP. NO. 989, 95th Cong., 2d Sess. 58 (1978). See also Countryman, Executory Contracts in Bankruptcy: Part I, 57 MINN. L. REV. 439, 460 (1973), defining executory contracts as ones "under which the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other."


53. But see the reference made to them by West, Life After Bildisco: Section 1113 and the Duty to Bargain in Good Faith, 47 OHIO ST. L.J. 65, 78-9 (1986). Cf. THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 111-13 (1986) arguing that collective labor agreements, being specifically enforceable, should be treated differently from those of unsecured creditors. The problem which in theory is a very interesting one, in practice has been resolved by Congress which in 1984 provided for the procedure of rejecting these agreements, thus accepting that they are subject to rejection.

54. George, supra note 49, at 309.
expiration\textsuperscript{55} and only after giving sixty days notice to the union which is party to this contract.\textsuperscript{56} Furthermore, before implementing these changes, an employer has to bargain to impasse with the union.\textsuperscript{57}

Tension between the provisions of labor and bankruptcy law is not easy to resolve nor is it easy to accommodate the differing purposes of these laws. The interest in maintaining harmonious relations between labor and management by promoting collective bargaining and holding the parties bound to their contractual obligations may in many cases conflict with the goal of preserving the viability of a financially troubled company. The courts, at least until the 1984 amendments, have been generally willing to give precedence to bankruptcy law and undermine the policies carried out by labor law.\textsuperscript{58}

Before examining the landmark Bildisco case which crystallized case law on the issue prior to the 1984 Act, we should take a brief look at two cases decided in 1975 under the old Bankruptcy Act which had a provision similar to section 365(a) concerning the rejection of executory contracts.\textsuperscript{59} These cases are very interesting to the extent that they represented two different approaches to the problem of rejecting collective bargaining agreements.

The first case was \textit{Shopmen's Local Union No. 455 v. Kevin Steel Products},\textsuperscript{60} in which the Second Circuit rejected the unions' argument that collective agreements are excluded from the rejectionable contracts provision of section 313(1). The court reasoned that a debtor-in-possession "is not the same entity as the pre-bankruptcy company."\textsuperscript{61} Applying the successorship doctrine,\textsuperscript{62} the court said that "[u]ntil the debtor here assumes the old agreement or makes a new one, it is not a 'party' under section 8(d) (of N.L.R.A.) to any labor agreement with the union and is


\textsuperscript{57} 29 U.S.C. § 159(a) (1982). The problem is similar under the R.L.A.

\textsuperscript{58} \textit{See} White, \textit{supra} note 49, at 1184-85 estimating that during the 1975-84 period management had obtained judicial approval of collective agreements' rejection in 22 out of 33 cases.

\textsuperscript{59} "[U]pon the filing of a petition . . . the court may . . . permit the rejection of the executory contracts of the debtor, upon notice to the parties to such contracts and to such other parties in interest as the court may designate." \textit{The Bankruptcy Act of 1898, Sec. 313(1)}.

\textsuperscript{60} \textit{Shopmen's Local Union No. 455 v. Kevin Steel Products}, 519 F.2d 698 (2d Cir. 1975).

\textsuperscript{61} \textit{Id.} at 704.

simply not subject to the termination restrictions of the section."\textsuperscript{63} Citing the then existing section 77(n)\textsuperscript{64} which excluded railroad employees from the Act's coverage as far as rejection of collective agreements are concerned, the court said that "Congress knew how to remove labor agreements from the scope of a general power to reject executory contracts."\textsuperscript{65} By not extending such an exception to N.L.R.A. contracts, it was the court's opinion that Congress wanted to permit their rejection in bankruptcy.

The court also opined that it is unlikely that permitting an employer to reject collective agreements would encourage him to file for bankruptcy to avoid his labor obligations. "The adverse consequences of bankruptcy are far too harsh for that," said the court.\textsuperscript{66}

The second and more controversial issue encountered by the court in \textit{Kevin Steel} was the standard to be applied for permitting rejection of labor agreements. The Second Circuit stated that:

[T]he decision to allow rejection should not be based solely on whether it will improve the financial status of the debtor. Such a narrow approach totally ignores the policies of the Labor Act and makes no attempt to accommodate them . . . A bankruptcy court should permit rejection of a collective bargaining agreement only after thorough scrutiny, and a careful balancing of the equities on both sides.\textsuperscript{67}

A few weeks later, the same court was called on to decide another case, in a R.L.A. context this time. In \textit{Brothers of Ry. Clerks v. REA Express},\textsuperscript{68} the court ignored the explicit provisions of section 77(n), and found that railroad labor relations are also subject to section 313(1) which provides for the rejection of executory contracts.\textsuperscript{69} As two commentators have said, "the appellate court wanted to permit rejection at any cost"\textsuperscript{70} and it thus tried to draw a doubtful analogy between section 6 of R.L.A.\textsuperscript{71} and section 8(d) of the N.L.R.A.\textsuperscript{72}

\textsuperscript{63} Shopmen's Local Union No. 455 v. Kevin Steel Products, 519 F.2d 698, 704 (2d Cir. 1975).
\textsuperscript{64} \textit{Id.}
\textsuperscript{65} \textit{Id.}
\textsuperscript{66} \textit{Id. at 706.}
\textsuperscript{67} \textit{Id. at 707.}
\textsuperscript{68} Brothers of Ry. Clerks v. REA Express, 523 F.2d 164 (2d Cir. 1975).
\textsuperscript{69} \textit{Id. at 169. But see} In re Michigan Interstate Ry. Co., 34 Bankr. 220 (Bankr. E.D. Mich. 1983): "[A]lthough the Court realizes that the debtor railroad's financial problems made it increasingly difficult to uphold its part of collective bargaining agreements, however, neither financial problems nor bankruptcy relieves the Railway of its contractual obligations."
\textsuperscript{70} \textit{Haggar & Pulliam, Conflicts Between Labor Legislation and Bankruptcy Law} 129 (1987).
\textsuperscript{71} \textit{See supra} note 37. \textit{For a more analytical discussion of the R.L.A., see infra} discussion at C.1. at p. 238.
\textsuperscript{72} \textit{See supra} notes 39, 40 and accompanying text.
In any case, the REA court proceeded to rule that R.L.A. railroads' contracts are subject to rejection under bankruptcy laws.\textsuperscript{73} Possibly realizing that it had gone too far,\textsuperscript{74} the Second Circuit tried to balance things to some extent. Thus it imposed a strict standard for the rejection of the agreement, a standard that was much stricter than the one it had imposed just a few weeks earlier in 

Kevin Steel. The court said in particular that:

in view of the serious effects which rejection has on the carrier's employees,

it should be authorized only where it clearly appears to be the lesser of two evils and that, unless the agreement is rejected, the carrier will collapse and the employees will no longer have their jobs.\textsuperscript{75}

Thus, two different standards were formulated by the same Circuit in the rejection of collective bargaining agreements by a bankrupt employer. The 

Kevin Steel standard essentially means that an agreement will be rejected if this will help the success of the reorganization. Under the REA standard, rejection will be granted only if it is a 

sine qua non condition for the survival of the company.\textsuperscript{76}

The rising number of bankruptcies that was the consequence of the early 80s recession, as well the controversial issues that the conflict between bankruptcy and labor law purposes creates, inevitably led the Supreme Court to grant certiorari in the 

Bildisco case. The issues that the Supreme Court was called upon to decide were whether the REA or 

Kevin Steel standard for rejection was the appropriate one and second, an issue that up until 

Bildisco had not yet been raised:\textsuperscript{77} whether an employer may unilaterally change terms of a collective bargaining agreement before the bankruptcy court authorizes rejection of the agreement.\textsuperscript{78}

Bildisco was a partnership which in April, 1980, filed a voluntary petition for bankruptcy reorganization under Chapter 11 of the Bankruptcy Code. Before and after filing, Bildisco had violated some of its contractual obligations with the employees and unilaterally altered the terms of the then existing collective agreement. The union charged the employers with unfair labor practices and the N.L.R.B. ruled in favor of the union.\textsuperscript{79} Meanwhile, on December 1980 Bildisco petitioned the bankruptcy court

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\textsuperscript{73} See Brothers of Ry. Clerks v. REA Express, 523 F.2d 164, 170 (2d Cir. 1975).
\textsuperscript{74} See, e.g., HAGGARD & PULLIAM, CONFLICTS BETWEEN LABOR LEGISLATION AND BANKRUPTCY LAW 129 (1987).
\textsuperscript{75} Brothers of Ry. Clerks, 523 F.2d at 172.
\textsuperscript{76} The Supreme Court read the REA standard as requiring the debtor to show "that its reorganization will fail unless rejection is permitted." N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513, 524 (1984).
\textsuperscript{77} Cf. White, supra note 49, at 1200, ("By authorizing a right unilaterally to reject a collective bargaining agreement, the Supreme Court gave management something that many management lawyers never expected to receive. It freed them not just from the clutches of the N.L.R.B., but also from the requirements of getting a bankruptcy judge's approval.").
\textsuperscript{79} Id. at 517.
\end{flushright}
to authorize rejection of the agreement, a request that was granted.\textsuperscript{80} The union appealed the court’s decision and Bildisco appealed the Board’s ruling. The Court of Appeals consolidated the two appeals and later ruled against the Board and in favor of the employers.\textsuperscript{81} The Supreme Court granted certiorari to Bildisco in 1984.

Since no party disputed that collective bargaining agreements are subject to rejection, the Supreme Court proceeded to deal with the appropriate standard for rejection of collective bargaining agreements. A unanimous Court first emphasized that:

[B]ecause of the special nature of a collective bargaining contract, and the consequent ‘law of the shop’ which it creates, . . . a somewhat stricter standard [than the one used for rejecting ordinary contracts, namely the business judgment standard] should govern the decision of the Bankruptcy Court to allow rejection of a collective agreement.\textsuperscript{82}

It then dismissed the strict REA standard that we have already seen. A unanimous Supreme Court found that the REA standard is “fundamentally at odds with the policies of flexibility and equity built into Chapter 11 of the Bankruptcy Code.”\textsuperscript{83} It reasoned that the burden of satisfying such a standard would “‘present difficulties to the debtor in possession that will interfere with the reorganization process.’”\textsuperscript{84} Thus, the Court found preferable a test adopted in \textit{Re Brada Miller Freight System, Inc.},\textsuperscript{85} which was essentially the same as the test found in \textit{Kevin Steel}. According to this test, rejection must be authorized “if the debtor can show that collective bargaining agreement burdens the estate, and that after careful scrutiny, the equities balance in favor of rejecting the labor contract.”\textsuperscript{86} Among the factors to be considered by a bankruptcy court in balancing the equities, the Court mentioned “the likelihood and consequences of liquidation for the debtor absent rejection, the reduced value of the creditors’ claims that would follow from affirmance and the hardship that would impose on them, and the impact of rejection on the employees.”\textsuperscript{87}

The Court also said that in order for the rejection to be granted, it must be shown by the employer that “‘reasonable efforts to negotiate a voluntary modification have been made and are not likely to produce a prompt and satisfactory solution.’”\textsuperscript{88} It reasoned that “‘national labor policies of avoiding labor strife and encouraging collective bargaining . . .

\textsuperscript{80} Id. at 518.
\textsuperscript{81} See, e.g., 682 F.2d 42 (3d Cir. 1982).
\textsuperscript{82} Bildisco, 465 U.S. at 524.
\textsuperscript{83} Id. at 525.
\textsuperscript{84} Id.
\textsuperscript{85} In re Brada Miller Freight System, Inc., 702 F.2d 390 (11th Cir. 1983).
\textsuperscript{86} Bildisco, 465 U.S. at 526.
\textsuperscript{87} Id. at 527.
\textsuperscript{88} Id. at 526.
generally require that employers and unions reach their own agreements as terms and conditions of employment free from governmental interference.” But a unanimous Supreme Court was very quick to limit what it had just said by stating that reasonable efforts to reach an agreement and not bargaining to impasse are enough to satisfy the bargaining requirement. Thus, the Supreme Court rejected the idea that bargaining to impasse should be required in a bankruptcy situation before rejection of the agreement is possible.

The second issue divided the Justices. A majority of five justices found that the employer does not commit an unfair labor practice by “[u]nilaterally rejecting or modifying a collective bargaining agreement before formal rejection by the Bankruptcy Court action.”

The majority opinion, written by Justice Rhenquist, first rejected the new entity theory previously applied by several courts including the two cases of the Second Circuit previously discussed. Rehnquist opined that “[i]t is sensible to view the debtor in possession as the same ‘entity’ which existed before the filing of the bankruptcy petition, but empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have employed absent the bankruptcy filing.”

This finding however did not prevent the majority from ruling that the employer could unilaterally change the terms of employment before the bankruptcy court’s approval. The Court first reasoned that “reorganization may succeed only if new creditors infuse the ailing firm with additional capital” and that such “beneficial recapitalization could be jeopardized if the debtor-in-possession were saddled automatically with the debtor’s prior collective bargaining agreement.”

Justice Rhenquist also reasoned that if the employer is estopped from unilaterally changing the conditions of employment, he would receive very little, if any, benefit from the rejection of the collective agreement.

Another argument used by the majority in justifying unilateral alteration of the working conditions was the following: since the filing of bankruptcy renders all contracts, including collective agreements, unenforceable, unless specifically assumed by the debtor with the Court’s...
approval, the employer cannot be required to adhere to the terms of an agreement that is unenforceable.97

Finally, Justice Rehnquist rejected the union's claim that prior to modification of the terms of the contract, bargaining to impasse should be required. He reasoned that "imposing such a requirement as a condition precedent to rejection of the labor contract will simply divert the Bankruptcy Court from its customary area of expertise into a field in which it presumably has little or none."98 The employer, however, "is obligated to bargain collectively with the employees' certified representative over the terms of a new contract pending rejection of the existing contract or following formal approval of rejection by the Bankruptcy Court."99

The minority disagreed with Justice Rehnquist on the second issue, accusing the majority that it "has completely ignored important policies that underlie the N.L.R.A., as well as [the other] parts of its [own] opinion."100 Writing for the minority, Justice Brennan said:

[An examination of the policies and provisions of both statutes [i.e. N.L.R.A. and Bankruptcy Code] inexorably leads to the conclusion that Congress did not intend the filing of a bankruptcy petition to affect the applicability of section 8(d) [of N.L.R.A.] and that, as a result, a debtor in possession commits an unfair labor practice when he unilaterally alters the terms of an existing collective bargaining agreement after a bankruptcy petition has been filed but prior to rejection of that agreement.101

In rejecting the non-enforceability argument of the majority, Justice Brennan said that "it is simply incorrect to suggest that the collective bargaining agreement does not retain sufficient vitality after a bankruptcy petition has been filed to be reasonably termed 'in effect' within the meaning of the statute."102 For the minority, saying a contract is unenforceable is one thing; to say that it has no consequence at all is quite another, and it is wrong.103

Justice Brennan also emphasized that the majority's holding would

97. Id. at 532.
98. Id. at 533.
99. Id. at 534. This part of the decision is not clear at all. The Court seems to suggest that bargaining for rejection and bargaining for the terms of the new collective agreement are two different things and this is correct. However, given the laxity of the standard for controlling the employer's behavior in this bargaining it is doubtful whether this requirement would prove anything more than an illusion. For a severe criticism of the bargaining requirements of Bildisco which seem to be quite inadequate, as well as of the confusion by which the decision is characterized, see George, supra note 49.
101. Id. at 541.
102. Id. at 545. Justice Brennan refers to the N.L.R.A., where the requirements for altering a collective agreement presuppose a contract "in effect."
103. Id. at 545. ("Although enforcement of the contract is suspended during the interim period, the contract clearly has other characteristics that render it 'in effect' during the interim period" and giving several examples of these effects)
contribute to labor unrest. After rejection of the agreement, the unions are free to strike, something detrimental for the prospects of reorganization. For the dissent, "the need to prevent 'economic warfare' resulting from unilateral changes in terms and conditions of employment is as great after a bankruptcy petition has been filed as it is prior to that time."  

104 In a footnote, the dissent cited the Continental Airlines case 105 and said that "[r]ecent events make it clear that the fear of labor unrest resulting from postfiling unilateral modifications is not merely a hypothetical possibility." 106

Finally, the dissent opined that prohibiting the employer from unilaterally altering the terms of an agreement prior to court approval will make the employer think more and bargain with the unions to reach a mutually acceptable new contract. 107 The unions of the bankrupt employer will also have strong incentives to reach an agreement because they know that the threat of the company’s liquidation is hanging over them and their members. 108

Not surprisingly, Bildisco gave rise to stormy reactions from the unions. 109 The decision was a blow to the unions interests not only because of the second part of the opinion where the Supreme Court was divided, but also because of the general philosophy of this decision which, "signals a subtle yet disturbing erosion of national labor policy." 110 Moreover, "the fact that the Court so readily accepted the management position by a 9-0 decision may cause union negotiators to predict a ready acceptance of that position in the future and may thus weaken their bargaining position." 111 What becomes obvious from this decision is that the Supreme Court is ready to sacrifice policies enhanced by labor law adjudication for the survival needs of the company. In theory this may seem inevitable if employees are to save their jobs. In practice, however, this approach neglects the possibility for abuses by the employer and it also severely undermines the positive effect that collective bargaining may have on the very survival of a company. 112

These problems in the Supreme Court’s approach, which will be discussed at the end of this article as well as the more general implications upon the future development of the Court’s approach to collective bar-

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104. Id. at 548.
105. Id. at 549.
106. Id.
107. Id. at 552.
108. Id.
109. See West, supra note 53, at 104; HAGGARD & PULLIAM, supra note 24.
110. George, supra note 49, at 303.
111. White, supra note 49, at 1202.
112. See George, supra note 49, at 344-45.
gaining, were immediately realized by the unions. The unions, already concerned with the results of bankruptcy upon their interests even before Bildisco, reacted by intensely lobbying members of Congress. The very day that the Supreme Court delivered its decision in Bildisco, Representative Rodino introduced to the House a bill to "clarify the circumstances under which collective bargaining agreements may be rejected." The bill actually endorsed the REA standard for rejection of the collective agreements. A few weeks later, the House of Representatives passed a different bill again introduced by Rodino, modeled along the lines of the initial bill.

That Bill provided in section 1113(d)(1)(A) that before applying for rejection of the collective bargaining agreements, the employers would have to "meet and confer in good faith with the authorized representative of the employees who are subject to a collective bargaining agreement." It also provided that the proposed modifications to the agreement must be necessary "for successful financial reorganization of the debtor and preservation of the jobs covered by such agreement." The standard for judicial rejection, according to section 1113(g)(2), was that "absent rejection of such agreement, the jobs covered by such agreement will be lost and any financial reorganization of the debtor will fail." It finally stated that "no provision of this title shall be construed to permit the trustee unilaterally to terminate or alter any of the wages, hours, terms and conditions established by a collective bargaining agreement."

The Senate however, was deadlocked between two proposed bills. The one advanced by conservative Senator Thurmond adopted the proposals of the National Bankruptcy Conference and while endorsing Bildisco's standard for rejection of the collective agreements, the only change was that it obliged the employer to wait for thirty days after the

113. See White, supra note 49, at 1202, ("The dramatic impact of Bildisco, however, and the one I suspect that truly called for the outraged response from union spokesmen, is the symbolic one. Here all nine members of the Court rejected the union position on the standard to be applied").


117. Id. at § 1113(d)(1)(A).

118. Id. at § 1113(d)(1)(B)(2)(A).

119. Id. at § 1113(g)(2).


filing of petition for rejection before implementing the changes. 122

The second bill, 123 introduced one day later by Democratic Senator Packwood was similar to H 5174 passed by the House. It imposed a thirty day period as a deadline for the court to rule on the petition for rejection, extendable for fifteen more days if the court so decides. It also differed from Rodino's bill in that it required that the proposals of the employer take into account "the best estimate of the sacrifices expected to be made by all classes of creditors and other affected parties to the reorganization." 124

The debate on the floor of the Senate was heated. What made things even more complex was that Congress was simultaneously trying to pass a bill which would bring changes in the status of bankruptcy judges, in accordance with the Supreme Court's 1982 ruling that held the judicial provisions of the Bankruptcy Code unconstitutional. 125

Under such conditions, with much political maneuvering and lobbying by various interest groups, the two Houses finally passed the Bankruptcy Amendments and Federal Judgeship Act of 1984. 126 The amendment concerning rejection of collective bargaining agreements was very close to the one proposed by Senator Packwood. Senator Thurmond and his supporters in the Senate were very eager to pass other amendments to the Act but they were forced to compromise in order to get their views through on the other issues. 127

Thus, section 1113 was added to the Bankruptcy Code by the 1984 Act. It provided that prior to applying for rejection of a collective bargaining agreement, a bankrupt employer will have to make a proposal to

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123.  H.R. 5174, 98th Cong. 2nd Sess. § 1113(b)(1)(A).
125.  In Northern Pipeline Construction Co. v. Marathon Pipeline Co., 458 U.S. 50 (1982) the Supreme Court held that it was constitutionally required to provide bankruptcy judges' length of term and salary guarantees, something which the Code failed to do. The Supreme Court however, postponed the application of its decision twice in order to give Congress time to amend the Code.

127.  130 Cong. Rec. S 6186 (daily ed. May 22, 1984) (see, e.g. Senator Dole's statement if the Packwood Amendment should be adopted, that is the end of the bill. And if it is not adopted, it is probably the end of the bill. Some of us want to get down to other areas in addition to this very important provision with reference to the Bildisco case.

union. The proposal, "based on the most complete and reliable information available at the time of such proposal" will provide "for those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor..." 128 The proposal must treat "all the creditors, the debtor and all of the affected parties... fairly and equitably." 129

It is also provided that after the proposal and before the petition to the court for rejection, the employer will "meet at reasonable times, with the authorized representative to confer in good faith in attempting to reach mutually satisfactory modifications of such agreement." 130

The court will approve the petition for rejection if: (1) the employer or trustee has fulfilled his above listed bargaining obligations; (2) the union has refused to accept the above proposal "without good cause" and; (3) "the balance of equities clearly favors rejection of such agreement." 131

The section further provides that a hearing will be held within fourteen days after the filing of the petition, a deadline that may be extended for another seven days if the court so decides. 132 The court will issue its ruling within thirty days from the first day of the hearings, otherwise, the employer is free to "terminate or alter any provision of the collective bargaining agreement pending the ruling of the court on such application." 133

Finally, while the employer is going through the procedures of section 1113 which have previously been discussed, he may ask for interim relief if he can show that this is a sine qua non to avoid liquidation:

If during a period when the collective bargaining agreement continues in effect, and if essential to the continuation of the debtor's business, or in order to avoid irreparable damage to the estate, the court, after notice and a hearing, may authorize the trustee to implement interim changes in the terms, conditions, wages, benefits, or work rules provided by a collective bargaining agreement. 134

129. Id.
130. Id. at § 1113(b)(2).
131. Id. at § 1113(c).
132. Id. at § 1113(d)(1) (1978).
133. Id. at § 1113(d)(2) (1978).
134. Id. at § 1113(e). The language of this provision allows the interpretation that an application for interim relief may be made even if the employer has not sought to reject the agreement through 11 U.S.C. § 1113 (1978). See, West, supra note 53, at 144-145.

However, both the legislative history of this provision—130 CONG. REC. § 8899, H7496 (daily ed. June 29, 1984) (statements of Reps. Hughes and Morrison)—and the character of the relief as temporary, indicate that an application for interim relief must be accompanied by § 1113 procedures. It does not matter whether the petition for interim relief will be submitted before or after the initiation of § 1113 proceedings, as long as at some time the employer begins bargain-
Thus, the present statutory law governing rejection of the collective bargaining agreements was formulated. Just to give an overall view of how the rejection process operates now, it will helpful to mention the nine steps that a bankruptcy court has used to determine whether or not to reject an agreement:

1. The debtor in possession must take a proposal to the union to modify the collective bargaining agreement.
2. The proposal must be based on the most complete and reliable information available at the time of the proposal.
3. The proposed modifications must be necessary to permit the reorganization of the debtor.
4. The proposal must assure that all creditors, the debtor and all of the affected parties are treated fairly and equitably.
5. The debtor must provide to the union such relevant information as is necessary to evaluate the proposal.
6. Between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor must meet at reasonable times with the union.
7. At the meetings the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement.
8. The Union must have refused to accept the proposal without good cause.
9. The balance of the equities must clearly favor rejection of the collective bargaining agreement.\textsuperscript{135}

Even a cursory reading of these nine steps reveals that interpretation problems are indeed enormous. The language is quite obscure and all of the terms are subject to varying interpretations.\textsuperscript{136} As a commentator said, the law "will make the trial judge's decision more discretionary and speculative; it will introduce greater guesswork into the lives of those who must advise management and unions about their rights."\textsuperscript{137} As expected, litigation quickly arose out of the interpretation of these provisions.

The author does not intend to go into detail regarding this litigation with the union under § 1113. It was the desire of Congress to promote collective bargaining when bankrupt employers want to reject and change existing agreements. An interpretation that would totally dissociate interim relief from the process of § 1113 would allow the employer to avoid the bargaining required by § 1113 by simply applying for interim relief.

\textsuperscript{135} In re American Provision Co., 44 Bankr. 907, 909 (Bankr. D. Minn. 1984).

\textsuperscript{136} Cosetti & Kirshenbaum, Rejecting Collective Bargaining Agreements Under Section 1113 of the Bankruptcy Code—Judicial Precision or Economic? 26 Duq. L. Rev. 181, 183 (1987), ("Because it (§ 1113) is a compromise, it is loaded with terms of compromise ... Given the ambiguity of the statute, and the tension inherent in situations where the debtor must seek rejection of its collective bargaining agreement, the potential for frequent, complex litigation seems great.").

\textsuperscript{137} White, supra note 49 at 1197.
since it is beyond the scope of this article. It suffices to say that one of the main controversies that is evolving in the courts concerns the new standard of rejection. Two Circuits have already taken differing approaches. While the Third Circuit said that for a collective agreement to be rejected, the rejection must virtually be a sine qua non for the success of the reorganization of the company, the Second Circuit ruled that it suffices to show that the rejection will facilitate the reorganization. In their reasoning, the courts looked at the legislative history of the 1984 amendments but reached completely different conclusions. They even resorted to linguistic arguments as to the meaning of "necessary" and "essential" to justify their divergent rulings.

This conflict alone demonstrates how legalistic arguments are useless if one does not have a clear-cut view of the needs and the interests involved in a conflict between labor and bankruptcy law. If Bildisco serves to demonstrate anything, it is mainly that the answer to a complex legal problem will often be arrived at by resorting to one's convictions about economic and social problems involved in a labor dispute with a bankrupt company. It is these problems which will be discussed at the end of this article. First, however, we will examine the particular legal problems created by the application of section 1113 to an industry governed by the R.L.A.

As to the overall impact that the new legislation will have upon the courts and their approach towards the problem of labor relations in bankruptcy situations, it is still too early to draw any definite conclusions. Some early estimates show that the bankruptcy courts are less willing to approve rejection of the agreements now, but it remains to be seen whether this reflects a permanent change in the courts' approach.

C. Reconciling Section 1113 and R.L.A.

Even though there are some, (albeit weak) indications about how the courts will interpret the 1984 Amendments, there is no hint as to how the courts will deal with the application of these amendments to the airline industry, since the R.L.A. and not the N.L.R.A. applies. Reconciling section 1113 and the R.L.A. will prove to be a very difficult task for the courts,

140. The standard is very similar to that adopted in REA, supra note 68.
141. Truck Drivers Local 807 v. Carey Transportation, Inc., 816 F.2d 83 (2d Cir. 1987).
142. This standard is virtually the same with that adopted in Bildisco, supra note 52.
143. Wheeling v. United Steelworkers, 791 F.2d at 1088.
and, since there has been no attempt by any bankrupt air carrier to reject existing collective agreements under section 1113 there are no precedents.\textsuperscript{145} It is these delicate problems which will be examined in this section. In order to do this a brief review of the relevant provisions of the R.L.A. is necessary. It should be emphasized that the R.L.A. is a statute which is largely unknown outside the airline and the railroad industries which it covers.\textsuperscript{146}

**THE R.L.A. PROVISIONS**

The R.L.A. was the product of an agreement between railroad employers and unions reached in 1926 and subsequently passed by Congress that same year with few changes.\textsuperscript{147} In 1936, it was amended to cover the airlines.\textsuperscript{148} The new law was the first comprehensive labor legislation covering an entire industry in this country and the first one to impose a duty to bargain between the two parties in labor relations, something which would be followed ten years later by the N.L.R.A.\textsuperscript{149} Among the stated purposes of this act was the maintenance of an undisturbed transportation system.\textsuperscript{150} This was to be achieved by settlement

\textsuperscript{145} Continental, Air Braniff and Air Florida filed for bankruptcy before the enactment of the 1984 Amendments.

As for the Frontier Airlines, its bankruptcy in 1986 did create labor problems but they were soon settled with the purchase of the carrier by Texas Air. Unions agreed with the purchaser to waive most of their claims against the bankrupt carrier in exchange for rehiring the employees of Frontier by the subsidiaries of Texas Air. See, Frontier Unions, Employees Waive Claims, Become Eligible for Jobs at Continental, Daily Lab. Rep. (BNA) No. 203, at A-6 (Oct. 21, 1986).

More recent and certainly more important was the case of Eastern's bankruptcy. In June 1988 the bankrupt company filed a § 1113 petition for rejection of its collective agreement with the pilots union which had expired but was still in effect as negotiations under R.L.A. were in process for its renewal. See, Eastern Seeks Court Okay for Cuts in Pilots' Contract, Daily Lab. Rep. (BNA) No. 120, at A-16 (June 23, 1989). Negotiations under the § 1113 started between the two parties but they were fruitless and there was a strong possibility that the court would reject management's petition for rejection. Thus, Eastern withdrew its application. See, Eastern Airlines Withdraws Request for Court Approval to Change ALPA Contract, Daily Lab. Rep. (BNA) No. 143, at A-16 (July 27, 1989).


\textsuperscript{147} LECHT, supra note 124 and accompanying text.

\textsuperscript{148} See, supra note 39 and accompanying text.


of all labor disputes which might arise between management and unions.\textsuperscript{151}

The Act obliges both parties to "exert every reasonable effort to make and maintain agreements concerning rates of pay, rules, and working conditions, and to settle all disputes."\textsuperscript{152}

The R.L.A. also distinguishes between two kinds of disputes. First, there are "major disputes" created by one of the parties' attempt to change the "rates of pay, rules, and working conditions;" and second, there are "minor disputes" which are those disputes arising out of grievances or from the interpretation or application of existing agreements.\textsuperscript{153}

The major disputes are settled by a complex procedure described in the R.L.A. The party desiring to make a change in a collective agreement serves a thirty day advance notice of its intention to the other party.\textsuperscript{154} Bargaining then takes place between the parties regarding the proposed change, and if it fails, then either party may invoke the mediation services of the National Mediation Board (N.M.B.).\textsuperscript{155} The N.M.B. is the administrative agency whose main authority is to mediate between labor and management in the airline and railroad industries.\textsuperscript{156} The N.M.B. has absolute discretion to prolong its mediation efforts for as long as it deems fit\textsuperscript{157} and during this time no party may implement its intended changes, nor to resort to economic action.\textsuperscript{158}

When N.M.B. determines that its efforts have failed, then it may advise the two parties to accept arbitration. If they refuse, there is a period of thirty days after which each party may implement its decisions and economic war may begin.\textsuperscript{159}

Having seen the relevant provisions of the R.L.A. we can now understand what basic change section 1113 brings in a case of bankruptcy. Absent section 1113, an air carrier who would like to, among other things, reduce the wages of his employees which were set by a collective agreement, would have to wait until the expiration of the collective agreement.\textsuperscript{160} Only then could he undergo all these lengthy procedures in

\begin{footnotes}
\item[153.] The terms "major" and "minor" are not actually mentioned in the statute but were judicially created. \textit{See, e.g.}, Elgin v. Burley, 325 U.S. 711, 723 (1945).
\item[154.] 45 U.S.C. § 156 (1982).
\item[156.] The other main authority of the N.M.B. is to conduct union certification elections. 45 U.S.C. § 152 (Ninth) (1982).
\item[157.] \textit{International Ass'n of Machinists v. N.M.B.}, 425 F.2d 527 (D.C. Cir. 1970).
\item[159.] 45 U.S.C. § 155 (1982).
\item[160.] This would be required if the collective agreement is of a fixed term which is the case in virtually all labor agreements in the airline industry. The R.L.A. does not contain any article like
\end{footnotes}
order to unilaterally impose the lower rates of payment, if no agreement is reached with the unions. However, with the introduction of the right to reject an agreement in the case of bankruptcy, the employer is relieved of these obligations, and he simply has to follow the expedited procedures of section 1113.

But from this point on the problems begin. For the purpose of a more systematic analysis the problems can be divided into those referring to the process leading to the rejection of the collective agreement, and to the ones that occur after the decision of the court on the petition on rejection. We will examine them separately.

2. **BARGAINING BEFORE THE COURT'S DECISION ON THE PETITION FOR REJECTION**

The first problem which may arise in the context of an airline bankruptcy also has to do with the unique structure of the R.L.A. In the usual cases of labor disputes involving solvent airlines, many controversies arise over the distinction between major and minor disputes. While major disputes are lengthy and the employer is prevented from implementing his decision until the exhaustion of these procedures, this is not the case with minor disputes. In minor disputes, which mainly concern interpretations of a collective agreement, the dispute is resolved by arbitration and the employer does not have to wait for the outcome of this process in order to implement his decision.\(^{16}\) By contrast, the union cannot go on strike in a minor dispute.\(^{162}\) Not surprisingly, airlines and railroads, which are covered by the R.L.A., usually try to convince the courts that a decision which they have made does not change the collective agreement and thus does not create a major dispute. Instead, they claim their dispute with the unions is just a matter of contractual interpretation and therefore, is a minor dispute.\(^{163}\)

It is, therefore, possible that a bankrupt carrier might argue in the bankruptcy court that certain decisions they have made are in conformity with the existing collective agreements and that they were not rejecting the agreement. Thus any objections of the unions should be submitted to

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N.L.R.A.'s § 8(d), which prohibits mid-term modification of a collective agreement. See Perritt, Aspects of Labor Law Affecting Labor-Management Cooperation in the Railroad and Airline Industries, 16 Pepperdine L. Rev. 501, 529 (1989). However, a mid-term modification of a fixed term contract under R.L.A. means that the employer is violating his contractual obligation and therefore he would be subject to the jurisdiction of the arbitration board.


arbitration and in the meantime the employer may proceed with his decision. It is not the author's intention to examine the difference between major and minor disputes. This delicate decision has given rise to vast litigation and the Supreme Court has taken differing approaches to the issue.\footnote{164} A discussion of this distinction would itself require a separate article. The problem to be answered at this point, however, is what court should resolve the controversy over whether a managerial decision creates a major or a minor dispute: the bankruptcy courts or the traditional courts?

The author believes that a bankruptcy court is not the right place for such a delicate legal problem to be resolved. The distinction between major and minor disputes is at the core of R.L.A. litigation and only courts which have previous experience with this issue should hear cases relating to it. There are no bankruptcy considerations which should be taken into account by a court in dealing with this distinction and the resolution of this problem is purely a matter of labor law.\footnote{165}

The next problem which has to be answered is what type of bargaining must take place under section 1113 before the rejection of the agreement. The phraseology used by Congress strongly resembles that used in the N.L.R.A.\footnote{166} The question thus is whether the N.L.R.A.'s requirement of bargaining to impasse applies also in bankruptcy or whether reasonable efforts without reaching an impasse will suffice as stated in the 
\textit{Bildisco} case.

This is a difficult question because legislative intent is not buttressed with a committee report and the statements made by the Congressmen are contradictory.\footnote{167}


\footnote{165} \textit{Cf. In re Goodman, 873 F.2d 598 (2nd Cir. 1989).} In that case, the Second Circuit ruled in a successorship case of a bankrupt employer that it was the N.L.R.B. and not the bankruptcy courts which has jurisdiction to resolve the issue of successorship. In its reasoning the court said that "there is no reason for the Bankruptcy Court to decide the successorship issue, because no bankruptcy issue hinges on the successorship determination." \textit{id.} at 603.

\footnote{166} 29 U.S.C. 156(d) (1982 Ed.). This point is also made by West, \textit{supra} note 53, at 123.

\footnote{167} Compare Senator Moynihan's statement that "[t]his provision . . . embodies the basic principles of collective bargaining established by Congress in National Labor Relations Act," 130 Cong. Rec. S6900 (daily ed. June 29, 1984) with Senator Hatch's statement: "this process will involve good faith negotiations between the parties. This was the requirement articulated by the Supreme Court in the \textit{Bildisco} case. The Conference once again preserved the spirit of that court holding by requiring good faith efforts to confer . . .," 130 Cong. Rec. S8692 (daily ed. June 29, 1984).
In the case of the airlines, the problem takes a different form since the extensive case law under the N.L.R.A. regarding the duty to bargain to impasse, are the normal cases, not bankruptcies, and do not exist under the R.L.A. Under the latter, the courts have traditionally abstained from dealing with such problems, and have deferred to the judgement of the N.M.B. In any case, the N.M.B. does not have the authority to impose any sanctions; its power is rather indirect: if it finds that one party does not bargain in good faith it prolongs the mediation process so that additional pressure is exerted upon this party. Consequently, no concept of bargaining to impasse has been developed in the airline industry. Are we going to introduce it in the case of bankruptcies through section 1113?

The answer must be negative because the introduction of concepts which are alien to both parties, and especially when this is done in the emergency atmosphere that a bankruptcy usually creates, can cause great uncertainty. It is preferable if the court makes a thorough investigation of the negotiations and finds whether the employer really bargained with an intention to reach an agreement. If this examination is done in the proper manner by the court, it will not be necessary to get confused with the "bargaining to impasse" concept. After all, these issues are mainly determined on a factual basis rather than in terms of legal standards. If the bankruptcy judge is negatively influenced by the behavior of the employer, he will rule against him regardless of the legal standard and vice versa. The primary problem for the unions does not lie in the standard by which the courts will evaluate the employer's behavior in the negotiations, but rather on the courts' easy acceptance of the employers' argument that the financial problems of the company require the rejection of the agreement.

168. To be sure, the Supreme Court has ruled in Chicago & N.W. Ry. Co. v. United Transportation Union, 402 U.S. 570 (1971) that the obligation "to exert every reasonable effort" to reach an agreement—which is the R.L.A.'s equivalent of N.L.R.A.'s duty to bargain in good faith—is legally enforceable. The decision however did not have any substantial impact since the issue whether the two parties bargained in good faith under the auspices of N.M.B. is not raised in litigation.

169. See Detroit & Toledo S.L.R. Co. v. United Transportation Union, 396 U.S. 142, 150 (1969) (saying that prolonging mediation process and the status quo obligations of the Act "frequently make it worthwhile for the moving party (here the employer) to compromise with the interests of the other side and thus reach an agreement without interruption to commerce.")

170. Of course, the creation of such a problem presupposes that the courts will adopt the bargaining-to-impasse standard of rejection for bankrupt N.L.R.A. companies—something which is yet unknown.

171. In fact, West, supra note 53, at 89, argues that even under the N.L.R.A. there is no significant difference between the factors that are traditionally considered by the courts and the N.L.R.A. to determine a "good faith" bargaining and those that should be weighed according to Bildisco's "reasonable efforts" standard.


3. **THE DUTY TO BARGAIN AFTER THE COURT'S DECISION**

The discussion thus far has been about the collective bargaining which takes place before the rejection of the agreement. It is unclear however what happens after that decision, when section 1113 ceases to apply and the R.L.A. again comes into play.

Before getting to this point, we should make clear that now, the R.L.A. comes again to life. The special and exceptional procedures that section 1113 has provided for the rejection of the agreements have been exhausted. Since Congress did not widen the bankruptcy exception to cover the post-rejection situation, labor law, and in this case the R.L.A., comes into play.\(^{174}\) Under this perspective, if the court denies rejection of the labor contract, things are clear. The collective agreement continues in existence and binds the employer until its expiration.\(^{175}\) Upon expiration, the employer will have to invoke the normal R.L.A. procedures for major disputes in order to renew the agreement, or if negotiations and mediation fail, to unilaterally implement his new terms. Of course, nothing will prevent him from reapplying for rejection of the agreement, before the latter expires, if he can persuade the court with new evidence that rejection is necessary according to section 1113.\(^{176}\)

The problem occurs in the situation where the court has granted rejection of the labor agreement. What happens next? Is the employer free to initiate his own terms and conditions of employment? Does rejection of the agreement also means its automatic modification according to the employer's wishes? Unfortunately Congress has not dealt with this problem and the answer will have to be given by the courts. Some courts in N.L.R.A. cases seem to have indirectly and without any discussion accepted the idea that the employer is free after the rejection to impose his own terms and conditions of employment.\(^{177}\) This approach however seems not to perceive the legal situation that is created after the rejection of the agreement.

When the collective bargaining agreement is rejected there is no change in the duty of the employer to bargain with his certified union. As a commentator accurately said, "[W]hen a collective bargaining agree-

\(^{174}\) See also West, supra note 53, at 157-8.

\(^{175}\) Take for example the case of the Eastern bankruptcy. Eastern's attempt to reject the collective agreement through management resumed the normal negotiations with A.L.P.A. under the procedures of the R.L.A. in order to renew the existing collective agreement. ALPA Talks With Eastern Airlines Enter New Phrase Under Mediation Board, Daily Lab. Rep. (BNA) No. 175, at A-6, (Sept. 12, 1989).

\(^{176}\) See West, supra note 53, at 151.

\(^{177}\) See, e.g., In re Salt Creek Freighways, 47 Bankr. 835 (Bankr. D. Wyo. 1985); In re Allied Delivery Sys., 49 Bankr. 700 (Bankr. N.D. Oh. 1985). See also West, supra note 53, at 154-55.
ment is rejected . . . the parties' underlying relationship remains unchanged. The employees continue as employees, the union continues as their representative, and the employer remains obligated to deal with that agent; only the contractual structure of the relationship has been removed."\(^{178}\) In the airline context therefore, a duty to bargain arises under the R.L.A.

While it is difficult for anyone to deny that the employer has a duty to bargain with the union even after rejection of the agreement,\(^ {179} \) the critical question is whether the employer will be required to retain the existing actual working conditions during the negotiations. The situation is similar to the case when collective bargaining in a solvent corporation takes place after the expiration of a collective agreement. Justice Brennan rightfully pointed out in *Bildisco* that "it has widely been held that an employer generally may not make unilateral changes in matters that are mandatory subjects of bargaining even after a collective agreement has expired,"\(^ {180} \) and argued that even if the agreement is unenforceable because of the bankruptcy, the employer cannot alter actual working conditions pending negotiations.\(^ {181} \)

The same can be said about R.L.A. cases. The status quo requirements during the negotiations are the cornerstone of the R.L.A.'s approach to collective bargaining, as has already been discussed.\(^ {182} \) It is indeed impossible to conceive how the process of the R.L.A. would work without these provisions which provide the appropriate climate for the collective negotiations and the mediation efforts to effectively take place.\(^ {183} \)

Retaining the status quo during negotiations is even more important under the R.L.A. than under the N.L.R.A. Under the R.L.A. there is no administrative agency like the N.L.R.B. with an authority to impose sanctions when one of the two parties does not bargain in good faith.\(^ {184} \) The courts, as we have already said, do not usually inquire into the good faith

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179. Even the Supreme Court said in *Bildisco* that the employer is "obligated to bargain collectively with the employees' certified representative over the terms of a new contract pending rejection of the existing contract or following approval of rejection by the Bankruptcy Court." 465 U.S. at 534 (emphasis added).


182. *See Toledo*, 396 U.S. at 150 (1969) (characterizing the status quo requirements of the R.L.A. as "central to its design.")

183. *Id.*

of the parties under the R.L.A.\textsuperscript{185} Thus, the only pressures upon the employer to seriously bargain are the prolonged mediation procedures of the R.L.A. and the status quo obligations that accompany them.\textsuperscript{186} If these requirements are abolished, collective bargaining after the rejection of an agreement will be rendered meaningless.

Thus, consistent with the requirements of the R.L.A. it should be held that when the employer starts the negotiations with the union after rejection of the agreement, the employer will have to retain the existing working conditions. These will be either the ones existing at the time that the employer sought rejection of the agreement, or the conditions imposed by interim relief, in case the employer has successfully petitioned the court to grant him such a remedy.\textsuperscript{187}

It might be questioned, however, and the Supreme Court has done so in \textit{Bildisco},\textsuperscript{188} that if bargaining over the new terms is required after rejection, what is the benefit for the employer from the rejection of the agreement? The answer is that there is a benefit and it is large: the employer, by being allowed to reject the agreement before the end of its term, now has the opportunity to press the unions for concessions and, if they do not concede, to unilaterally implement his own terms after exhausting the procedures of the R.L.A. for major disputes.\textsuperscript{189}

Another question raised regarding post-rejection collective bargaining is that since there has been bargaining before the rejection, what is the need for new bargaining, especially if impasse has been reached? This point neglects the difference in the situations under which the bargaining takes place. Before rejection, the union always has the hope that the agreement will not be rejected by the court at least to the extent that the employer wants. After the judicial authorization of the rejection, however, the union confronts a new situation; it knows that unless an agreement is reached, the employer will ultimately be able to impose his own terms. Moreover, under the R.L.A., in the airline industry, the N.M.B.'s\textsuperscript{190} mediation services will now be offered, giving another dimension to the collective bargaining taking place after the rejection.

One should not overlook the fact that this mediation process is a pro-

\textsuperscript{185} See \textit{supra} note 165.

\textsuperscript{186} See \textit{supra} note 169 and accompanying text.

\textsuperscript{187} See \textit{West, supra} note 53, at 153-54 (arguing that granting of interim relief creates a "new status quo").

\textsuperscript{188} \textit{Bildisco}, 465 U.S. at 529.

\textsuperscript{189} For this argument see also \textit{George, supra} note 49, at 331.

\textsuperscript{190} One question is whether the N.M.B. will play any role in the bargaining before the rejection. I think that this will require the consent of both parties, who of course are always free, if they both agree, to invoke the services of any mediator. If however, one party does not consent the N.M.B. will not be allowed to intervene since § 1113 excludes any other procedure when rejection of the agreement is at stake.
longed one\(^{191}\) which will be dangerous to the process of reorganization. We should not forget, however, that the employer is offered the remedy of an interim relief. Thus, if any delay is really detrimental for the survival of the company, the employer has a remedy to deal with it.\(^{192}\)

Further than that, it can reasonably be hoped however, that the N.M.B. will take into account the special needs of the bankruptcy situation and conclude its efforts in a short time.\(^{193}\) It will also have to take into account the negotiations that took place before the rejection as an indication, but no more than that, of what the chances are for reaching an agreement. In any case, if this process proves in practice to be too long for bankruptcy needs, then some legislative action might be required to impose time limits upon the post-rejection bargaining and mediation under the R.L.A.

Until then, it is conceivable that in cases where the mediation process is unreasonably prolonged by the N.M.B., the bankruptcy court may intervene and order a termination of the mediation or, more accurately, a release of the employer from his status quo obligations. It does not escape attention that under R.L.A. case-law the courts cannot intervene in the mediation process and that the N.M.B. has absolute discretion to prolong the mediation.\(^{194}\) However, this was a judicial interpretation of the law and one may assume that the exceptional circumstances of a bankruptcy would allow the bankruptcy courts to interfere with the N.M.B.'s efforts after an agreement has been rejected. After all, it was exactly on these exceptional circumstances that the Supreme Court based its decision in *Bildisco*, even if this required the Court to disregard some fundamental principles of this country's labor policy.\(^{195}\) One wonders why the

\(^{191}\) See Burgoon, *Mediation Under the Railway Labor Act*, in *R.L.A. AT FIFTY*, supra note 146, at 79 (estimating that the average time of mediation is 7-8 months.) It is my belief that during the eighties, the average length of mediation has increased.

\(^{192}\) See West, supra note 53, at 157-58.

\(^{193}\) Many critics of the N.M.B. would counter that in certain cases, like Eastern Airlines’s recent negotiations with I.A.M., the N.M.B. prolonged the mediation for over a year and did not take into account the financial troubles of the company which thus worsened. Cf. e.g. Katz, *supra* note 5, at 90 (accusing N.M.B. of being biased in favor of the unions).

The problem however might lie not in any Board’s mistake but in the lack of good faith on the part of one of the two parties and the belief of the Board that the two parties had not made every reasonable effort to reach an agreement as R.L.A. requires. *Cf. Mediation Board Chairman Defends Delays in Pursuit of Airline Industry Settlements*, Daily Lab. Rep. (BNA) No. 73, April 16, 1984, p. A-8. In the case of bankruptcy however, N.M.B. will have to take in account that the court has already approved the need for the rejection of the agreement and has thus accepted the employer’s arguments. It will be hard therefore for N.M.B. to dispute the arguments that management is making in the negotiations and thus prolong the mediation process.

\(^{194}\) International Ass’n of Machinists v. N.M.B., 425 F.2d 527 (D.C. 1970). See *supra* note 121 and accompanying text.

\(^{195}\) See George, *supra* note 49, at 336 (talking about “a disheartening erosion of the very foundation of the National Labor Relation Act—the duty to bargain.”)
Supreme Court would not tolerate a judicial innovation of much lesser magnitude, such as the one proposed here.

Whether this approach will be adopted by the courts and ultimately by the Supreme Court is unknown. No case has yet arisen concerning the duty to bargain in bankruptcy after the enactment of section 1113.\textsuperscript{196} Furthermore, as has already been said, no bankruptcy of a major air carrier has yet been decided under the 1984 Act.\textsuperscript{197} Thus, the difficult task of accommodating section 1113 and the duty to bargain under the R.L.A. has not been addressed by the courts. The \textit{Bildisco} case, however, indicates that economic considerations and ideological approaches to the labor-management relations rather than legal principles will play an important role in the outcome of the cases.\textsuperscript{198} Therefore, it will be necessary to supply the solutions that have been proposed so far, with the necessary economic and social justification in order to make them convincing. This is the focus of the next part of this article.

\textbf{D. Policy Considerations in Bankruptcy-Labor Law Dilemmas}

It should be emphasized that the most important issue for a court facing the conflict of labor and bankruptcy laws is that it should not view the collective agreement as just another debt burdening the bankrupt company. Nor should the court treat the employees and the unions as another debtor.\textsuperscript{199} The employees have more at stake in the survival of the company than the other creditors.\textsuperscript{200} Furthermore, the collective agreement that may arise after the section 1113 procedures and the resultant collective bargaining—especially in the airline industry which is a labor intensive one—and has the potential of becoming the salvation plan of the company. A collective bargaining agreement is not only about wages and other benefits; it also concerns productivity rules, work-rules etc., the importance of which, to the airlines, cannot be underemphasized. If these issues are successfully dealt with under the section 1113 procedures, then bargaining will not only result in alleviating some of the financial burdens of the company but they can also become de

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\item \textsuperscript{196} In some N.L.R.A. cases however, bankruptcy courts seem to have implied that no bargaining is required after bankruptcy. See, \textit{e.g.}, in \textit{re} Salt Creek Freightways, 47 Bankr. 835 (Bankr. D. Wyo. 1985), and in \textit{re} Allied Delivery Sys., 49 Bankr. 700 (Bankr. N.D. Oh. 1985).
\item \textsuperscript{197} See supra note 145.
\item \textsuperscript{198} Cf. While, supra note 49, at 1202 (noting about other authors writing on bankruptcy-labor law conflicts that "the conclusions [they] arrived at were not reached primarily by legal analysis but from \textit{a priori} judgments.")
\item \textsuperscript{199} See Cosetti, Kirshenbaum, supra note 136, at 222; Merrick, supra note 49, at 331-32 (1986).
\item \textsuperscript{200} Cf. Merrick, supra note 49, at 328: "Different standards are applied with respect to rejection, not because the contract is different from the other contracts, but because the parties are different from other parties."
\end{enumerate}
\end{footnotesize}
labor reorganization plan of the bankrupt company. As one commentator said, "[R]ejection of the contract may decide technical matters related to claims on liquidation. It will be a waste of time [however] if it does not result in a new economic bargain." When the stakes are so high, the court must make sure that even the last chance of a productive dialogue has been exhausted.

It must always be kept in mind that a sense of community of interests is a prerequisite for a successful effort of a company to return to a healthy financial situation. Of course, no imposition of legal obligations alone, will create such relations. But serious collective bargaining, encouraged by law, will increase the flow of information between management and the union. Better informed parties are less likely to behave in a way that will destroy the company. Especially when viewed from the union’s side, increased information might convince it that management demands are justified and they are the only chance for the company’s very survival. A major problem in bankruptcies is that unions and the employees, even if they realize the extent of the financial problems of the company, do not believe that the proposed concessions by the employer are either necessary or effective. Collective bargaining will reduce the risk of such suspicion when the latter is unjustified.

By this latter reference to suspicion we come to another important aspect of the problem: any right we give to one or the other party may be detrimental to the process of reorganization if it is abused by its owner. Airlines have been characterized, since 1978, by hostile labor relations

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201. Cosetti, Kirshenbaum, supra note 136, at 226.
202. Id. "Nor should the courts allow the judicial process to be used as a substitute for bargaining."
203. The relative success of Continental’s reorganization, despite confrontational labor relations, should not be used as evidence justifying judicial tolerance towards an extensive use of bankruptcy rights against labor by a bankrupt employer. The issue is not whether this particular use of bankruptcy procedures has enabled Continental to continue its operations. It is rather whether a more restricted use of bankruptcy laws would have provided the same result. Undermining unionism and creating a war-like climate in labor relations of a particular company is too high a price to be paid if it can be avoided through stricter requirements for rejection of collective agreements. This point becomes even more important if one takes in account that Continental’s reorganization is still far from being successful. See, Needed Fast at Continental: Profits, N.Y. Times March 28, 1989, p. D-1, col. 3.
204. Merrick, supra note 49, at 346, "No employer-union relationship will become a cooperative venture simply by stating it should be so, but it is the Supreme Court’s obligation to promote that result:"
205. Cf. Simkin, Fidandis, MEDIATION AND THE DYNAMICS OF COLLECTIVE BARGAINING 141 (1986): "Many strikes are caused by ineptness. The knowledgeable persons on both sides of the table know about where the settlement area is, with or without a strike." (emphasis added)
206. See Merrick, supra note 49, at 362: "The sphere of uncertainty for a union always will be what are the probabilities that the business will succeed if concessions are made, and if they are not made."
between a management anxious about fierce competition from non-union low cost carriers vis-a-vis labor heavily unionized and weary about the erosion of the benefits that it had enjoyed during the regulation era.\textsuperscript{207} In such a setting, the fear of abuse is a realistic one.

To be sure, an employer has a lot of incentives against filing for bankruptcy. Losing a substantial part of its managerial freedom or being replaced by a trustee in bankruptcy and seeing the good will of its company being seriously injured, are a few examples.\textsuperscript{208}

This should not lead us to underestimate the danger of abuses of bankruptcy from the part of the employer.\textsuperscript{209} The increase in the number of holding companies, controlling more than one airline or even controlling companies in different kinds of industry, diminishes the incentives that an employer has against filing for bankruptcy reorganization.\textsuperscript{210} For example, when Eastern filed for bankruptcy, Texas Air, owner of Eastern, actually made that decision, and had less to lose than the employer (Eastern Airlines). The road of bankruptcy reorganization is becoming more and more an alternative for large and/or diversified companies; an alternative which is certainly a painful one but which sometimes seems better than the selling of the troubled company. Again Eastern Airlines proves this point.\textsuperscript{211} And as a matter of principle, there is no reason for the law to make the bankruptcy reorganization alternative seem to the employer more or equally preferable to the selling of the company.\textsuperscript{212}

The problem with using bankruptcy to attack unions is not whether an employer will choose to go bankrupt for this reason. Rather, the problem is whether the employer will use the opportunity created by the bankruptcy that he has filed for legitimate business reasons, in order to avoid his labor law obligations to an extent unjustified by the needs of reorganiz-

\textsuperscript{207} See generally, Cassell, Spencer, AIRLINE LABOR RELATIONS UNDER DEREGULATION: FROM OLIGOPOLY TO COMPETITION AND RETURN? (1986); Katz, supra note 5; Cappelli, Competitive Pressures, supra note 21.

\textsuperscript{208} White, supra note 49, at 1186-87. Cf. Cossetti, Kirshenbaum, supra note 136, at 183 "[T]he fear by organized labor that employers would rush to bankruptcy courts to rid themselves of unions has not materialized."

\textsuperscript{209} But see White, supra note 49, at 1186.

\textsuperscript{210} Cf. Comment, An Economic and Legal Analysis of Union Representation on Corporate Boards of Directors, 138 U. PA. L. Rev. 892, 929-30 (1982) (investors insure themselves from losses by diversifying their investments.)


\textsuperscript{212} It seems a bit ironic that the Supreme Court has justified its approach to the successorship doctrine by the need of a failing company to avoid bankruptcy and be sold to a new owner. See Burns Int'l Sec. Svcs., Inc. v. N.L.R.B., 406 U.S. 272, 288 (1972) (noting that "saddling such an employer (a successor) with the terms and conditions contained in the old collective-bargaining contract may . . . inhibit and discourage the transfer of capital.")

The irony is that in Bldisco the court gave the employer incentives to prefer bankruptcy reorganization to the selling of the company.
zation. This danger is highlighted in an industry like the airlines where management seems not to have a very high opinion about the concept of unionism.

The fear that prolonged collective bargaining may harmfully delay the process of reorganization is a legitimate one. There is also the problem that a union may act in a strategic way with the purpose of retaining whatever gains it can from the existing agreement, even if this endangers the process of reorganization.\textsuperscript{213} It is also possible that a union that represents employees in more than one company, and this is the case with almost all unions in the airlines, may sacrifice the interests of the employees of that particular company, in order to promote the interests of the union as a whole, for example, by giving signs of toughness towards management on a national level.\textsuperscript{214} In practice, however, this possibility is very small in the context of the American labor movement with its highly decentralized structure and the great independence that each branch of a certain union has from the other branches and the central administration of that union. Anyone who is familiar with the fights between branches of the same unions in different companies during mergers, so as to protect the interests of the employees of their own company, must realize that the fear expressed above is a very distant one.\textsuperscript{215}

On the contrary, counteractive strategic behavior is more probable on the part of management. Seeing an opportunity to crash the union and be permanently relieved from its pressure, management will be tempted to use the exigency of bankruptcy as an excuse for its union busting tactics and it will be hard to prove in the courts an anti-union animus.\textsuperscript{216} Even worse, when a company is merely one part of the business of a larger company\textsuperscript{217} management may sacrifice the interests of the particular company in order to gain an advantage over unions in the rest of its

\textsuperscript{213} This fear has been apparent in the recent major labor cases decided by the Supreme Court, First National Maintenance Corp. v. N.L.R.B., 452 U.S. 666, 681 (1981), and Bildisco.

\textsuperscript{214} For such an interpretation of unions’ motives, see Classic Struggle—Eastern’s Strike Tests Ability of Big Labor to Re-Establish Itself, Wall St. J., March 6, 1989, at 1-1, col. 1.

\textsuperscript{215} For the decentralized organization of most unions in the airlines, see Cappelli, Economist, supra note 19, at 55.

\textsuperscript{216} This remark becomes even more relevant after the unfortunate decision of the D.C. Circuit in A.L.P.A. v. Eastern, 863 F.2d 891, 902 (D.C. Cir. 1988) to introduce into the R.I.A. the Wright doctrine. See Wright Line, 251 N.L.R.B. 1083 (1980), enforced in N.L.R.B. v. Wright Line, 662 F.2d 899 (1981), cert. denied, 455 U.S. 989 (1982). Thus, in Eastern the Court held that an anti-union behavior during collective bargaining is not unlawful if there are other legitimate business reasons which would make the employer behave in the same way even in the absence of anti-union animus. For a criticism of this approach, see Judge’s Mikva’s dissent from the Circuit’s decision to refuse en banc rehearing of the case. A.L.P.A. v. Eastern Air Lines, Inc., 863 F.2d 891, 915 (D.C. Cir. 1988).

\textsuperscript{217} So far Delta has purchased Western, T.W.A. owns Ozark, Northwest has acquired Republic, and Texas Air has four airlines. See Brenner, supra note 5, at 187.
Furthermore, it should be noted that the usual deference of the courts to the employers' business judgment in solvent companies, is not justified, at least to the same extent, in the case of bankruptcy. After all, a bankruptcy, to some extent, means a failure of management and there is every reason for a court to be hesitant to accept the solutions proposed by a bankrupt employer for reorganization. The appointment of a trustee is a measure to be taken only in extreme cases. The reasoning for this approach is well established: the managers of the company "know the persons involved, the industry, the competition, and the business data. They are involved on a daily, rather than an intermittent, basis in managing the company." If these considerations are strong enough to cause us to overlook some degree of failure that management might have shown before the bankruptcy, they do not preclude us from enforcing those institutions which might assist management in the execution of its duties after the bankruptcy filing. When labor costs are the main issue in a given bankruptcy, the increase of dialogue with the unions is a good alternative. It is also of less severity than the appointment of a trustee or even an examiner. This alternative has the potential of leading to better solutions other than ones that can be unilaterally offered by a manage-

218. Just to give an example, we should remind the reader that when Eastern filed for bankruptcy in March 1989, the N.M.B. was considering an application by Eastern's unions to hold that Eastern and Continental are one bargaining unit and thus, Eastern's unions should also represent Continental's non-union employees. The application had many chances of success and it is not difficult to understand the negative impact that such a decision would have upon Texas Air's—the parent company of Eastern and Continental—management. See Texas Air Faces Test in Bargaining Ruling, N.Y. Times, Dec. 12, 1988 D-25, col. 5. After the filing of the bankruptcy, the possibility of such a ruling becomes quite remote and this is a shortfall that Texas Air gained for Continental because of Eastern's bankruptcy.

219. See George, supra note 49, at 343: "The Court has traditionally refused to second-guess the reasonableness of an employer's bargaining demands."

220. To be sure, there are many external factors for a company's failure. The very fact however that in the airline industry some particular companies actually went bankrupt and others made profits means that there are always important substantive factors for the failure of an airline.

221. See, e.g. In re Hotel Associates, Inc., 3 Bankr. 343, 345 (1980) ("resort to the appointment of a trustee may be an extraordinary remedy and an additional financial burden to a hard pressed debtor seeking relief under Chapter 11.") See also E. WARREN & J. WESTBROOK, THE LAW OF DEBTORS AND CREDITORS 435 (1986).


223. There will of course be cases where the unions will share some of the responsibility for the company's failure. See, e.g., Perritt, Jr., supra note 157, at 523 (1989) (describing the railroad unions' stubbornness in face of Penn Central's management's demand for modifications in labor agreements so as to prevent financial collapse). But the blame for a failure is usually commensurate with the degree of authority one has over conduct of a company. Thus, the management will often have the lion's share of responsibility for the bankruptcy.
ment whose ability has been questioned by filing bankruptcy.\textsuperscript{224}

Another point which is not usually raised in the debate about labor law problems in bankrupt companies is the following: there are two ways of controlling the employer's behavior in order to prevent abuses—the courts, or collective bargaining. The first can have limited effectiveness since it is rare for a judge not to defer to the employer's judgment when the former faces the troubling financial situation of the bankrupt company.\textsuperscript{225} Thus, collective bargaining is the only available method and, therefore, must be encouraged. Dialogue and dissemination of information restricts to a certain degree, the possibilities for abuses.\textsuperscript{226} Moreover, these negotiations are often the only way through which a court may get some idea of whether the claims made by the employer about the burden that a collective agreement imposes upon him are really made in good faith. Finally, in a bankruptcy situation the employees usually have the greatest pressure upon them.\textsuperscript{227} In an era of high capital volatility and increasingly diversified capital holding, management has less to lose. As for the unions, their main weapon (strike), loses much of its strength in a bankruptcy situation. The unions are often caught in a no-win situation: the strike is either going to fail because of their members' unwillingness to participate based upon the fear that the company may thus collapse or "succeed" in terms of participation in which case the company may end up in a financial disaster.

All things being equal, the balance of economic power in bankruptcy weighs against the employees. To give them the right of collective bargaining is not only a matter of fairness; it is a necessary, even if not sufficient, step towards prevention of abuses of bankruptcy that may be detrimental to the long term stability of labor relations in this country.

\textsuperscript{224} Cf. Countryman, Is the National Labor Policy Headed for Bankruptcy? 1984 ANN. SURV. BANK. L. 159, 162-63 ("Another factor that might have something to do with the profit and loss statement is never mentioned by management: managerial inefficiency. . . .").

\textsuperscript{225} See White, supra note 49, at 1181 (arguing that whatever test is applied for the rejection of the labor contract will be "merely a cynical facade used to obscure the true standard, namely, that the business judgement test prevails."). See also Note, supra note 17, at 386 ("if a company is in financial trouble and labor costs represent a significant portion of a company's problems, bankruptcy courts will continue to approve reorganization petitions that reject labor contracts.").

\textsuperscript{226} See Note, Rejection of Collective Bankruptcy Agreements Under the Bankruptcy Amendments of 1984, 71 VA. L. REV. 983, 1008 (1985) ("Because of the employees' stake in a successful reorganization, a union refusal to accept proposed modifications should alert the bankruptcy court to possible overreaching on the part of the debtor.").

\textsuperscript{227} See White, supra note 53, at 1189; Note, supra note 20, at 385 ("[N]o longer can the unions demand, 'if we don't get what we want, we'll take a walk . . .'. That walk may now be nothing more than a one-way trip."). Cf. also West, supra note 53, at 99.

But see the Wheeling-Pittsburgh strike in a bankruptcy situation where the company finally retreated from its positions. See Note, supra note 141, at 517.
CONCLUSION

This article has traced the problems which are created by the power a bankrupt airline has under section 1113 of the Bankruptcy Code. Also examined was the development of the right to reject an agreement in traditional N.L.R.A. cases. Then, an attempt was made to identify the problems which are created in the particular context of the R.L.A. and to suggest the appropriate solutions. As it was impossible to list and discuss all the potential problems that may be created, since there is no relevant experience as of yet, we developed at the end the general philosophy under which such problems must be addressed by the courts in the future. The emphasis was on the benefits that bargaining creates for bankruptcy reorganization and the potential for abuses that each party has in such a process. The major conclusion was that the courts should encourage dialogue between the two parties, the employer and the union, while at the same time making sure that the collective bargaining process does not become an interminable process to the detriment of the reorganization process.
Stopping By the Bus Terminal on a Dark and Stormy Night: The U.S. Bus Industry Seven Years After Deregulation

JEREMY KAHN*

I. INTRODUCTION

The industry we thought we knew,
With Trailways red and Greyhound blue,
But stopping to look, it's all quite clear,
There're some things old, but much that's new.

For much of the history of the bus industry, excitement and innovation were perhaps as likely as Snoopy sitting atop his dog house and writing the great American novel. Rather, the industry had a homey, don't rock the boat culture more indicative of a Robert Frost classic. Times have changed. The bus industry now has seven years experience following the Interstate Commerce Commission's administration of the Bus Regulatory Reform Act of 1982, and whether caused by or merely

1. This paper is a slight modification of a paper entitled "U.S. Bus Industry Seven Years After Deregulation; Its Governing Law; Its Structure; The Issues it Faces," presented to the Canadian Transport Lawyers Association Convention in Toronto, Ontario on November 18, 1989.


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coincidentally following the Bus Act, the industry is vastly different at the outset of the decade of the 1990's than it was at the outset of the 1980's.

The bus industry in the United States today provides essential transportation in different markets and for different classes of passengers. Buses provide the only public transportation to and from thousands of smaller communities. Buses provide essential daily transportation in more populated, urban regions of the country.

The bus industry in the U.S. has traditionally been regulated by the ICC in a manner similar to that of the trucking industry, although the regulatory approach to both industries diverged slightly as a result of the deregulatory legislation of the early 1980's.

This article is intended to provide an overview of current legal issues affecting the intercity bus industry. The article focuses on the current state of federal regulation, with the caveat that states continue to exercise reasonable power in regulating bus transportation within their borders.

To a limited extent, the article also addresses the structure of the industry and some of the current issues with which it is faced.

The bus industry in the United States has a long and proud history. Though there have been highs and lows, and although it appears the cycles will continue, all knowledgeable observers seem to agree that the bus industry as a whole will continue to play an important part in the continuing transportation picture within the United States. The industry's importance and character are such that it is reasonably expected that the federal government will continue to regulate it to some degree, however the winds of regulation or deregulation may blow.

II. THE REGULATORY FRAMEWORK

Government regulation of the bus industry in the United States has been the object of some careful thought, individual attention, and slight modification over recent years. At least at the federal level, there is now in place a highly deregulatory system, with vestiges of traditional eco-

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3. As perhaps an illustration of the dynamic nature of today's bus industry, as this paper is being completed, Greyhound Lines, the nation's only nationwide carrier, is in the midst of a major labor dispute. This is discussed within the context of this paper at the text corresponding to note 4, infra.


5. Other important aspects of the industry include urban transit systems and school buses. Urban systems are generally under the guidance of the Urban Mass Transit Administration (hereinafter UMTA), while school business, regulated to some extent at the state and local level, are regulated at the federal level in terms of safety and operations by the National Highway Traffic Safety Administration. To the extent this regulation affects the intercity bus industry, it will be mentioned later in this article.
nomic regulation in certain sensitive areas.\textsuperscript{6}

The bus industry was among the last of the transportation modes to be deregulated, following the airlines in 1978 and trucks and railroads in 1980. Thus, Congress had an opportunity to learn at least a bit from its experience in deregulating other transportation modes when bringing bus regulation into the "modern" deregulatory age.

The key legislation which defines bus regulation in the United States is the Bus Regulatory Reform Act of 1982. This Act, like the other deregulatory acts before it, was based on the premise that traditional regulation had been unduly burdensome. Congress expressed its desire to increase the flexibility of the regulatory scheme under which the bus industry operated.\textsuperscript{7}

Under the Bus Act, entry was to be eased for new carriers and expansion of existing routes was to be eased for existing carriers. Depending upon the nature of the new proposal, it might be only "very easy" to obtain some new authorities or "very, very, very easy"—to obtain others.\textsuperscript{8}

For those carriers engaged in charter and tour service, (which today probably constitutes the largest number of intercity bus companies) certificates were to be granted to any applicant which could demonstrate its "fitness" (defined as nothing more and nothing less than the ability to obtain requisite insurance coverage), without regard to traditional factors of public convenience and necessity, including any expressed public need for the service and any effect of the proposed service on existing

\textsuperscript{6} Regulation of the industry at the state, and occasionally regional or local levels, remains subject to state and local laws. Standards and practices differ widely from state to state. For the most part, this article addresses federal regulation only.

\textsuperscript{7} The "Congressional findings" included in the Bus Act are illustrative of the Congressional desire for regulatory flexibility in the various deregulatory acts affecting the different modes. The Congressional findings for BRRA include the following:

\textsuperscript{8} Historically the existing Federal and State regulatory structure has tended in certain circumstances to inhibit market entry, carrier growth, maximum utilization of equipment and energy resources, . . . ; that State regulation of the motor bus industry has, in certain circumstances, unreasonably burdened interstate commerce; that overly protective regulation has resulted in operating inefficiencies and diminished price and service competition in the motor bus industry; that the objectives contained in the national transportation policy can best be achieved through greater competition and reduced regulation; [and] that in order to reduce the uncertainty felt by the Nation's motor bus industry and those persons and communities that rely on its services, the Interstate Commerce Commission should be given explicit direction for reduced regulation of the motor bus industry and should do everything within its power to promote competition in the motor bus industry.\textsuperscript{\textregistered} BRRA § 3; Note following 49 U.S.C. § 10101.

\textsuperscript{9} It is presumptuous to cite one's own work, but the writer's article, The Bus Regulatory Reform Act of 1982 and Federal Preemption of Intrastate Regulation of the Intercity Bus Industry, 14 Transp. L.J. (1986), is one of the most exhaustive analyses of those provisions of the 1982 Bus Act which apply to the bus industry.
carriers. 9 More recently, the ICC has turned to at least some consideration of safety as an element of fitness. 10 The Commission now requires each applicant to certify its U.S. Department of Transportation safety rating. If an applicant for passenger authority holds a "conditional" or "unsatisfactory" rating, its application will be rejected. 11

For those carriers engaged in regular scheduled service, Congress retained a modicum of a traditional public need test. An applicant was first required to meet the fitness standard (i.e., show it could purchase insurance). Then, abandoning the traditional concept that the applicant must demonstrate a public need for the proposed service, the Bus Act assumes that need and imposes a burden upon objecting carriers to demonstrate that the transportation proposed "is not consistent with the


10. Ex Parte No. 55 (Sub No. 71), Notice of Policy and Final Rule Governing Submission and Evaluation of Safety Fitness Evidence in Motor Carrier Licensing Proceedings, 53 Fed. Reg. 49323 (Dec. 7, 1988). It might be noted in passing that the Bus Act required the Commission to consider both safety fitness and proof of insurance, 49 U.S.C. § 10922(c)(6), but until the end of 1988, the ICC essentially ignored its responsibility for ensuring safety.

11. One rare instance of the ICC taking a close look at passenger carrier safety involved its decision in Long Island Airports Limousine Corp., Extension—New York—New Jersey Service, MC-143668 (Sub No. 4), served September 16, 1987. That application, considered prior to the Commission’s policy statement in Ex Parte No. 55 (Sub No. 71), was the subject of an in-depth procedure solely on the issue of applicant’s safety fitness. The Commission relied upon a “conditional” DOT safety rating and “evidence [which] overwhelmingly shows a disregard for safety and flaunting [sic] of State law.” (p. 5) In a later decision involving the same proceeding, served June 14, 1988, the Commission, basing its decision on the award of a satisfactory DOT safety rating to the carrier, awarded operating authority. Commissioner Simmons in a strong dissent observed that the applicant continued to disregard state and federal regulations “not only in the safety area but in others as well.” He added, “in these circumstances, the most recent U.S. DOT safety audit should be given limited weight. Our responsibility to protect bus passengers from unsafe operators requires a much more meaningful analysis of safety records than that made by the majority . . . .” (p. 2) This call for greater scrutiny of safety has seemingly fallen on deaf ears as judged by the dearth of other Commission decisions in this area.

In fairness, it is true that there was an occasional ICC safety decision, but these were based solely upon DOT safety ratings, a presage of the Ex Parte No. 55 (Sub No. 71) policy finally adopted. For example, in Hammond Yellow Coach Lines, Division of Hammond Yellow & Checker Cab, Inc., Extension—Regular Routes, MC-139440 (Sub No. 5), served February 29, 1988, the Commission denied a passenger application on the basis of safety fitness. By a later decision served April 21, 1988, the Commission looked at a recently obtained “satisfactory” safety rating from the DOT and concluded without further discussion that the award of the satisfactory safety rating “establishes that applicant is now in conformance with applicable safety rules and regulations.” (p. 1)

For an even stronger statement by Commissioner Simmons, see his “comments” in American-Italian Tours, Inc., Extension—Three More Routes, MC-168048 (Sub No. 4), served January 16, 1986, in which he observed, “When presented with facts such as those brought out in this proceeding, the Commission has an independent obligation, quite apart from any reliance on DOT procedures, to ensure that carriers operating under authority granted by us continue to possess the requisite safety fitness. This is particularly so with respect to passenger carriage.” (Id. at 6-7).
public interest." 12 For the first time, Congress actually defined those concepts which the Commission should address in making this public interest "determination." These included (1) the National Transportation Policy as expressed in the Interstate Commerce Act, (2) the value of competition to the traveling public, (3) the effect of the new authority on motor passenger service to small communities, and (4) if approval of the new application would impair the ability of existing carriers to provide "a substantial portion" of its "regular route passenger service which [the] carrier provides over its entire regular route system." The fourth consideration, which included vestiges of traditional regulation, was tempered with the further statutory statement that diversion of revenue in and of itself is insufficient to support a finding of impairment. 13

Although the terminology of the Bus Act seems to imply that the Commission would maintain a meaningful role in continuing to regulate the interstate bus industry, in fact, the Bus Act has been interpreted by the Commission as meriting the approval of virtually each and every application for new operating authority. In the vernacular, it might be said that the ICC's entry policy is one of awarding requested operating authority to any applicant which can walk or chew gum at the same time. 14

In the handful of known decisions denying a new application for operating authority, the Commission acted either upon unique questions of the applicant's fitness or questions concerning the bona fide nature of the application. To the knowledge of this writer, no application for expanded motor carrier authority following the enactment of the Bus Act has been denied on the success of an objector showing that the proposed service is not consistent with the public interest. 15

As a matter of academic interest, with respect to rates, it may be noted that the Bus Act included a "zone of rate freedom" under which regular route rates could be modified without threat of Commission suspension, 16 and the Act provided specifically that rates relating to charter

15. One genre of such cases were those involving applications for charter and special operations authority by publicly funded transit authorities. With one exception [Manchester Transit Transit Authority Common Carrier Application, MC-164973, served December 12, 1984, aff'd, American Bus Association v. ICC, No. 85-1270, Memorandum Decision, D.C. Cir., March 31, 1986], applications by publicly funded transit authorities for expanded authority were uniformly denied. See Southeastern Pennsylvania Transportation Authority, d/b/a/ SEPTA, Extension—Special Operations, MC-29850 (Sub No. 9), served February 26, 1986, and decisions cited therein. This controversy was effectively eliminated by the 1987 amendment dealing with the award of operating authority to publicly funded carriers. See note 31, infra.
and special transportation could not be investigated and suspended at all. 17 Such provisions are of academic interest only, since, to this writer’s knowledge, interstate passenger rate matters have not been before the ICC (except where intrastate rates are involved, infra) since the enactment of the Bus Act.

There remain two areas of some interest and controversy in connection with intercity bus operations, one focusing on regular scheduled service and the second on charter service.

One of the conceptual underpinnings of the Bus Act was Congress’ recognition that intrastate bus service remained highly regulated by the states. Modifications of state operating authority were often hard to come by. Rate increases were often well nigh impossible to come by. The marked difference between the harsh regulatory philosophy of the states and the lenient philosophy of the ICC (even prior to the Bus Act), had led carriers free of traditional ICC regulation seeking to offer new and different services (or at least modifications of old services) being dragged back down to earth under continuing state regulatory burdens.

Although the concept of carriers providing regular scheduled service at a loss as a quid pro quo for their conduct of more profitable charter service had long been abandoned—in practice if not necessarily in stated federal policy—many states required carriers to continue to operate intrastate services at unreasonably low rates and despite low ridership. Carriers found it expensive, time consuming, and difficult to abandon unprofitable routes.

State regulatory requirements would result in the anomaly, for example, of an interstate carrier operating a scheduled service from New York City, through Buffalo, New York and into Cleveland, charging an interstate fare between New York City and Buffalo (the trip within New York State would be interstate if, for example, the passenger originated in Washington, D.C. and transferred at New York City for continuance to Buffalo) of perhaps $25 with the same intrastate rate between the same two points, as regulated by the New York Department of Transportation, of approximately one-half as much.

After several years of viewing deregulatory legislation affecting other modes, Congress (or more accurately, the bus industry lobbying Congress), recognized that if there was to be increased competition as the Bus Act sought to promote, then carriers would necessarily enter and leave the market. It was therefore necessary to permit carriers far greater flexibility than they had enjoyed in the past to deal with the newly competitive bus market.

Thus, Congress, employing its power under the U.S. Constitution to

17. Bus Act, § 11; codified as 49 U.S.C. § 10708(g).
regulate interstate commerce,\textsuperscript{18} decreed that it would preempt a substantial portion of state regulation of interstate bus carriers that were also engaged (or even arguably engaged) in intrastate service. Congress included in the Bus Act a provision which would allow the ICC—a federal agency—to issue intrastate operating authority over the intrastate portion of the same route a carrier served in interstate service.\textsuperscript{19} This allowed then current interstate carriers effectively to remove "closed door" restrictions in their certificates (the inability to pick up and drop off passengers within a particular state, or a portion of a particular state, which they served in connection with an unrestricted interstate route), by following the expedited, liberally construed procedure in the Bus Act.

Yet, the Bus Act went further. Obviously, under the ease of entry standards included in the Act, it would be far easier for carriers in almost every state to obtain intrastate authority from the ICC than to obtain it from the more regulatory minded state commissions. The Bus Act therefore included a provision allowing the ICC to award intrastate authority over those portions of new interstate routes within a single state.\textsuperscript{20} This law created a situation in which some carriers would go to great lengths and employ vivid imaginations in order to describe a service as interstate rather than intrastate. By doing so, they might obtain both interstate and intrastate authority from the liberal minded ICC, rather than face the more rigorous requirements of the individual states.

As one might imagine, carrier imaginations (and the imaginations of their attorneys), occasionally ran wild, and situations arose around the country in which carriers were obtaining purely local operating authority through a tenuous claim that the proposed service was interstate in nature when, in truth, the carrier was only offering limited, local service. In 1987, Congress, reacting to the complaints of New York City,\textsuperscript{21} and other states

\begin{footnotesize}
18. U.S. Constitution, Article I, Section 8.
21. An early application proceeding in which the New York City Transit Authority voiced the objection of New York was Subscribe-A-Ride, Inc., Common Carrier Application, MC-188184, served April 8, 1986. That application involved a request to provide a scheduled regular route commuter service which would conceivably include potential transportation wholly within New York City. That application was approved, with the ICC's observation, "Any carrier initiating an intrastate operation that does not include interstate service pursuant to such a certificate may be subject to a complaint and Commission enforcement procedures."

This argument was expressed in another way in a proceeding involving a petition for declaratory order to determine the propriety of certain local New York City operations. In Erin Tours, Inc.—Intrastate Operations—Petition for Declaratory Order, MC-C-10956, served March 23, 1988, the ICC considered this issue. In its decision in the same case served August 2, 1988, it found that the carrier was performing wholly intrastate operations, and that such operations could not be conducted under an ICC awarded certificate (p. 2). The Erin case relied upon a new law enacted to deal with this precise issue. See note 22, infra. Another case involving New
\end{footnotesize}
and localities, amended the law, imposing a condition on intrastate/interstate certificates which allows a carrier to provide intrastate service under an ICC certificate on only those routes over which it is actually conducting interstate service. The interstate service must be actual and substantial, although the interstate and intrastate services need neither be identical nor provided in the same vehicle.\textsuperscript{22}

The award by the ICC of intrastate regular route authority is a particularly contentious issue, since, in practice, the ICC and its liberal regulatory philosophy frequently ride roughshod over the local regulatory interest of the state. In this writer's experience, at most, states reluctantly accept federal intrusion in this area; at worst, they make efforts—both subtle and not so subtle—to reassert their own jurisdiction, regardless of what the ICC may say or do.\textsuperscript{23}

Within the framework of this issue, the number of disputes have seemingly been reduced as states reluctantly accept the ICC's power. There remain occasional proceedings involving claims of local transportation, frequently directed to the conduct of local airport service.\textsuperscript{24}

York's continued assertion of its power vis-a-vis the ICC is New York City Transit Authority v. ICC, 834 F.2d 302 (2nd Cir. 1988).


23. At least in concept, many of the issues raised in these cases are those also raised in the recent slew of intrastate/interstate cases involving property transportation, including Armstrong World Industries—Transportation Within Texas, 2 I.C.C.2d 63 (1986), aff'd State of Texas v. U.S., 866 F.2d 1546 (5th Cir. 1989), and its progeny. A bus case involving the primary jurisdiction of the ICC to interpret its own certificates is Holland Industries, Inc. v. Missouri, 763 S.W.2d 666 (Mo. 1989).

24. The leading case is Funbus Systems, Inc.—Intrastate Operations—Petition for Declaratory Order, MC-C-10917, with corresponding court review in Funbus Systems, Inc. v. California P.U.C., 801 F.2d 1120 (9th Cir. 1986). The ICC's decision on remand in MC-C-10917, served January 6, 1988, provides a detailed analysis of the issue. Other leading cases include Gray Line Tours Co. of Southern Nevada v. Interstate Tours and Limousines, Inc., et al., MC-C-10907 (Sept. 11, 1986), with corresponding court review in Gray Line Tours Company of Southern Nevada v. ICC, 824 F.2d 811 (9th Cir. 1987). Another decision which looks to the substantial nature of a carrier's interstate operations is Airporter of Colorado, Inc. v. ICC, 866 F.2d 1238 (10th Cir. 1989).

More recent ICC decisions include Erin Tours, Inc., supra, note 21, [dealing with local transportation in the New York City area], and O'Hare Wisconsin Limousine Service, Inc., intrastate Operations—Petition for Declaratory Order, MC-C-10980, served March 24, 1988, [dealing with airport operations]. Another purely local decision is that in American Coach Lines, Inc., Petition for Declaratory Order, MC-C-30038, served September 14, 1988, which dealt with seeming overlapping jurisdiction between the ICC and the Washington Metropolitan Area Transit Commission, a unique regulatory agency created by an interstate compact to deal with local, interstate passenger transportation in the Washington, D.C. area. The latest such decision is that in San Juan Air Services, Inc., d/b/a Shuttle Express—Petition for Declaratory Order, MC-C-30091, served November 15, 1988, aff'd, Evergreen Trails v. ICC, No. 89-1024, D.C. Cir., Memorandum Order filed January 11, 1990, which deals with another element of the interstate-intrastate dispute in the context of the "incidental to air" exemption in 49 U.S.C. § 10526(a)(8)(A).
To say that this issue is one of the areas of greatest contention in bus
regulation is not to say that there are a plethora of such cases involving
the issue, but rather to say that in the bus licensing area, there are no
other active issues.

There is a second, somewhat related area of interest arising from
provisions of the Bus Act. In two areas other than licensing, Congress
explicitly provided for ICC preemption of state regulation in terms of rates
and in terms of exit. The ICC was given the power to preempt the states
after first giving the states an opportunity to act.

Under the law, in terms of raising intrastate fares or seeking for-
mally to abandon a particular intrastate route (both involving intrastate
service on a route over which the carrier also provides interstate service),
the Bus Act provided that if a state does not grant the requested relief
within a fixed time, the carrier can appeal to the ICC. In every known
instance (with the exception of a handful in which procedural consider-
ations precluded a decision on the merits), the ICC has granted relief to
carriers which have pursued either of these courses of action.

25. Bus Act, § 17; codified as 49 U.S.C. § 11501(e). A leading case is Commissioner of
New York DOT v. ICC, 750 F.2d 163 (2nd Cir. 1984), cert. denied 105 S. Ct. 1929. Another case
is State of Texas v. U.S., 761 F.2d 211 (5th Cir. 1985). A more recent case is Alabama Public
Service Commission v. ICC, 839 F.2d 815 (D.C. Cir. 1988). That this issue has become less
significant is reflected in the ICC Annual Report for fiscal year 1988, which reports that only two
such petitions seeking rate relief for intrastate rates were filed during that year (p. 82).

26. Bus Act, § 16; codified as 49 U.S.C. § 10935. The major court case dealing with this
ICC decisions which provide an extensive discussion of the issues under this section of the law
and include citation to numerous ICC proceedings are Petition of Greyhound Lines, Inc. for Re-
view of a Decision of the New York State Department of Transportation Pursuant to 49 U.S.C.
10935, MC-1515 (Sub No. 378) served August 23, 1985; Petition of Trailways Tennessee Lines,
Inc. for Review of a Decision of the Alabama Public Service Commission Pursuant to 49 U.S.C.
10935, MC-55312 (Sub No. 27), served January 2, 1986; and Petition of Greyhound Lines, Inc.
for Review of a Decision of the Public Utilities Commission of Ohio Pursuant to 49 U.S.C. 10935,
MC-1515 (Sub No. 390), served July 15, 1986.

27. In the rate area, the recalcitrant and seemingly undaunted states are Connecticut and
Massachusetts, which seem merely to sit on proposed fare increases without action. Among
recent decisions, that in The Arrow Line, Inc., Petition for Review—Connecticut Intrastate Fares,
MC-C-30119, served September 15, 1988, includes citations to a number of earlier ICC deci-
sions in this area. The Commission’s decision in Petition of Peter Pan Bus Lines, Inc. for Re-
view of a Decision of the Massachusetts Department of Public Utilities Pursuant to 49 U.S.C. 11501(e),
served July 11, 1988, is of interest primarily in its definition of the calculation of the 120 day
period in which a state must act to trigger the appeal provisions of the Bus Act. The Commission
in its July 11, 1988 Peter Pan decision withheld granting relief on the basis of its calculation of the
120 day period, but relief was subsequently granted by a decision served August 23, 1988.

The one known decision in which the ICC did approve a request under 49 U.S.C. § 10935
was Petition of Trailways Lines, Inc. to Discontinue Bus Transportation in the State of California
Pursuant to 49 U.S.C. 10935, MC-109780 (Sub No. 111), served February 23, 1987. That peti-
tion was not approved, because it appeared that Trailways did not substantially comply with
California requirements in submitting its initial petition to discontinue service to that state agency.
In the early days of the Bus Act, there was some dispute over how these provisions should be employed. It is now clear, seven years after the Act, that the ICC will grant relief to a petitioning motor carrier in every imaginable circumstance.

Perhaps the most interesting remaining comment on this issue is one concerning federalism. Under the scheme of things in the United States, the federal government can set forth in a statute a basis for relief from burdensome state regulation and express its sense that the states ought to adhere to (or at least move their policies much closer to) the federal philosophy.\textsuperscript{28} Without regard to that statement, some states have obviously decided they won’t be bothered and will do things their own way.

By way of example, Massachusetts maintains its traditional policy of simply suspending (i.e. postponing without any consideration on the merits) for a period of one year any intrastate rate increase. Thus, carriers with Massachusetts intrastate routes find themselves returning again and again and again to the ICC appealing the failure of the Massachusetts Commission to come into line with the federal standards and at least act within a reasonable period on intrastate rate increases.

What is perhaps most galling for the carrier is that although ICC procedures permit the state to participate in the appeal to the ICC to justify its action, Massachusetts, as an example, ignores that ICC proceeding as well, recognizing that by its failing to act, it establishes a situation in which the ICC will ultimately act to approve intrastate rates, thus allowing the Massachusetts regulatory agency—presumably—to tell its constituency that it has not been “guilty” of permitting a carrier to charge higher rates.\textsuperscript{29}

The situation with respect to formal requests to abandon intrastate service is similar, with the exception that in the real world, carriers frequently simply stop running routes rather than seek formal approval to

\textsuperscript{28} Included in § 17 of the Bus Act is a “Sense of Congress” statement to this effect, stating, “It is the sense of Congress that each State should revise its standards and procedures (including timing requirements) for rates, rules, and practices applicable to intrastate transportation provided by motor common carriers of passengers to conform such standards and procedures to the standards and procedures for rates, rules, and practices applicable to interstate transportation provided by motor carriers of passengers not later than 2 years after the effective date of the Bus Act.” This is not codified, but appears as a note following 49 U.S.C. § 11501.

\textsuperscript{29} For example, not long after Peter Pan petitioned the ICC to allow it to increase its Massachusetts intrastate rates, Petition of Peter Pan, MC-C-30104, note 27 supra, it was required to return again to the DPU to increase other intrastate rates. Peter Pan Bus Lines, Inc.—Petition for Review—Massachusetts Intrastate Rates, MC-C-30171, served December 19, 1989. In neither of these cases did Massachusetts make any presentation. Instead, it chose not to act at all on the carrier’s request.
discontinue their activities, regardless of whether that is technically in compliance with the law.

Another area of some interest with respect to remaining ICC award of authority is that in the charter field. Carriers with a subsidy from the Urban Mass Transportation Administration ("UMTA") for the purchase or operation of buses to perform local transit services also seek in some instances authority from the ICC to perform interstate charter services.\(^{30}\)

The Bus Act itself included, for the first time, a distinction between private companies and those who are "a recipient of governmental financial assistance for the purchase or operation of buses." In applications where such "recipients" sought to provide charter service, they were to be included as carriers subject to the "public interest" test, rather than those who would "automatically" be awarded charter authority under the "fitness only" test which applies to other charter applicants.\(^{31}\)

The dispute in this area, although spilling over to the ICC, is more one within the confines of UMTA itself. That agency in 1987 issued its own "charter rules," which generally prohibit the operation by carriers who receive UMTA funding of their own charter service in competition with private operators.\(^{32}\)

This issue is a significant one, not so much for the decisions of the ICC dealing with the rare instances in which it arises—or even the decisions of UMTA in determining what is permissible under its rules—but instead as an example of government grappling with the concept of cross-subsidization, in which a government subsidized carrier is competing with private carriers in an arena in which the government subsidy was not arguably intended to apply.

This area is, understandably, an emotional one for carriers who see themselves competing with their own tax dollars, and one with significant political overtones. It is also one of the few bus-related issues which remains a "hot topic" in the current regulatory environment.

Another area of activity has been spawned by the Greyhound-Trailways merger.\(^{33}\) As a result of the merger, there were created many duplicative regular route operations in an economic environment which many in the industry believed would not support two carriers. A number of in-

\(^{30}\) See Southeastern Pennsylvania, supra note 15, and cases cited therein.

\(^{31}\) Bus Act, § 6; codified as 49 U.S.C. § 10922(c)(1)(B)(i). This current law applies to private recipients of public funding. Public recipients of public funding have other requirements at 49 U.S.C. § 10922(c)(1). This section of the law was simpler when first enacted as § 6 of the Bus Act. Additional, current restrictions on recipients of public funds were included in a 1987 amendment.


\(^{33}\) See text at note 44, infra.
dependent carriers entered into pooling arrangements with Greyhound Lines to pool traffic over these duplicative routes as permitted by 49 U.S.C. § 11342(a). For the most part, these applications were unopposed and routinely approved.\(^{34}\)

In one known instance, an existing carrier with at least a peripheral concern in the competitive aspects of the pooling arrangement filed a protest. The affected labor union also voiced its objection. Nonetheless, the Commission readily found that the anti-competitive concerns were either misplaced in this proceeding or simply unfounded and approved this application as well.\(^{35}\)

A final legal development within the bus industry is one borrowed from the trucking industry, namely a response to the uncertainty created by the filed rate doctrine. Increasingly, charter carriers have filed applications with the Interstate Commerce Commission for authority to serve any user of charter services, not just named users, presumably following the lead of the unrestricted contract permits issued in the property field.\(^{36}\) These applications are routinely approved and the applicant then returns to the ICC with a specific petition for exemption from tariff filing requirements for its newly authorized contract operations, which is also routinely approved.\(^{37}\)

This appears to be a traditional exercise of "going through the regu-

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36. Where property applications are concerned, carriers can request authority to serve an entire class of shippers as a contract carrier under 49 U.S.C. § 10923. Motor Contract Carriers of Property—Proposal to Allow Issuance of Permits Authorizing Industry-Wide Service, 133 M.C.C. 298 (1983). This seems to have been followed in practice by passenger carriers on a case by case basis. Applications for such authority are ubiquitous. Two recent such applications include Application of Mealey Transportation, Inc., MC-227670, ICC Register February 23, 1990, p. 27; Application of Orville B. Scott, MC-227451, ICC Register February 27, 1990, p. 15.

37. Practice for property carriers and passenger carriers differs. In Exemption of Motor Contract Carriers from Tariff Filing Requirements, 133 M.C.C. 150 (1983), aff'd, Central and Southern Motor Freight Tariff Association v. U.S., 757 F.2d 301 (D.C. Cir. 1985), the ICC granted a blanket exemption to all motor contract carriers of property from tariff filing requirements. That decision did not apply the blanket exemption to passenger carriers, but did invite passenger carriers to file individual petitions for exemption. 133 M.C.C. at 152-53. Many have acted on that invitation.

Within the pertinent provisions requiring the filing of tariffs, the ICC is authorized to grant motor contract carriers relief from its tariff filing requirements upon request, when the relief is found to be consistent with the public interest and the National Transportation Policy. 49 U.S.C. § 10702(b); 49 U.S.C. § 10761(b); 49 U.S.C. § 10762(f). The award of such approval is granted routinely. Recent instances of such awards are Airlines Acquisition Co., Inc., d/b/a/ Airlines Transportation Company—Exemption from Tariff Filing Requirements, No. 40370, ICC Register
latory motions" to obtain perhaps a modicum of additional protection. To this writer's knowledge, no claim similar to a property carrier undercharge claim has been made upon a passenger carrier, but by obtaining unrestricted contract authority and an exemption from tariff filing requirements, the passenger carriers achieve additional—if appreciated only in the minds of attorneys—protection.

III. THE STRUCTURE OF THE INTERCITY BUS INDUSTRY

Traditionally, the bus industry in the United States was synonymous with the names "Greyhound" and "Trailways," both in the mind of the public and in the minds of members of the bus community themselves.

In 1987, Greyhound Lines entered into an agreement to purchase most of the operations conducted under the Trailways name, and, after a heated battle at the ICC to obtain the agency's approval of the transfer, the transaction was ultimately approved. Only a handful of existing carriers even bothered to raise their anti-competitive concerns at the ICC during the agency's consideration of the merger. The Commission's response was that any such anti-competitive concerns were speculative only, and if anti-competitive abuses should arise at some future time, carriers could return to the ICC and make those concerns known again.

As for government policy, the merger was supported in the first instance under the "failing firm" doctrine of anti-trust law. It was shown that Trailways was in such severe financial position and there were no other potential purchasers, so the purchase by Greyhound was the only way to save the foundering Trailways.

On a long term basis, the ICC determined that the "relevant market" in which competition should be judged was the intercity passenger market, rather than the bus market. Thus, to the extent that Greyhound may have monopoly-like power in a particular market vis-a-vis other bus carri-

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38. This merger involved the "new" Greyhound Lines of Dallas, Texas and its Greyhound operations within the United States and Trailways, Inc., a major member of the National Trailways Bus System. The "old" Greyhound Corporation of Phoenix, Arizona is no longer in the intercity bus business in the U.S., but continues to own Greyhound of Canada.


40. GLI Acquisition Co.—Purchase—Trailways Lines, Inc., MC-F-18505-TA, served July 2, 1987 (pp. 4-6).
ers, its lack of market power vis-a-vis other modes of intercity passenger transportation suggested to the ICC that there would be no anti-competitive effects worthy of ICC consideration.\textsuperscript{41}

With the merger completed, an analysis of the structure of the industry, therefore, must begin with the new Greyhound-Trailways combination, with its extraordinary market presence, power, and resources.

A recent ICC list of the results of the ten largest passenger carriers is illustrative.\textsuperscript{42} More than 85\% of the operating revenues of the ten largest carriers are those of the combined Greyhound/Trailways organization. Of the nine "other" large carriers, seven operate almost exclusively in the heavily populated New England states; of these, several carriers are primarily suburban, commuter carriers and one operates primarily airport limousine service.

It is also noted that the revenues of the ten largest carriers constitute 85\% of the total revenues of all Class I ICC passenger carriers.

One can thus readily conclude that as the industry is now structured, there is Greyhound/Trailways; there are a small number of independent carriers generating significant revenues; and the remainder of the industry pales in comparison.\textsuperscript{43} Having said that there is extraordinary concentration in the industry, one must also recognize that there are innumerable independent, smaller carriers, primarily engaged in charter and tour services, which operate from every major city and minor town throughout the United States. Many of these are financially sound in their own way, having understood the importance of engaging in operations within the limits of their financial, managerial, and market capabilities. As a whole, they are an important segment of the industry. Individually, their size and power are insignificant.

As this article is completed, the very structure of the industry has been called into question by the nationwide strike by the Amalgamated Transit Union against Greyhound, which has seriously disrupted the operation of the intercity bus system.\textsuperscript{44} The seeming acrimony surrounding this dispute and the apparent hard-line approach by Greyhound in dealing with its union at least raises the question of the future viability of Greyhound as a nationwide carrier, at least insofar as the traditional view of that carrier is concerned.

\textsuperscript{41} GLJ Acquisition Co., \textit{supra} note 39, pp. 6-10, Fed. Carr. Rep. (CCH) at ¶ 37470.02-.03.


\textsuperscript{43} The severe concentration in the bus industry has been acknowledged for many years. \textit{The Intercity Bus Industry}, Office of Transportation Analysis, Interstate Commerce Commission, January, 1984, pp. 11, \textit{et. seq.}

At this moment, no one can predict the ultimate effect of this labor dispute on the maintenance of the Greyhound system, but given the ease of entry provisions of the law and the willingness of at least some operators to act decisively under the freedoms embraced in the Bus Act, change in the system is at least possible if not necessarily predictable.

IV. CURRENT ISSUES CONFRONTING THE BUS INDUSTRY

In considering the dynamics of the bus industry, one must recognize not only the regulatory system in which the industry operates, but also some of the significant issues with which it is faced.

The bus industry has its share of significant issues, but within the focus of this article, one must say that most of these are issues which are not directly related to the regulatory scheme.45

Although meaningful figures are not readily available, it is safe to say that with the exception of a handful of intercity carriers engaged in regular route transportation (be it true intercity transportation or even long distance commuter service within major metropolitan areas), charter and tour revenues provide a significant—if not the most significant—proportion of most carrier revenues. Deregulation of charter and tour operations on the federal level (and, generally on the state level to varying degrees) has resulted in overcapacity, leading to severe price competition, resulting in a diminution of overall carrier profits. This, coupled with ever increasing costs of operation, including the staggering cost of the newest intercity motorcoaches, increased cost of labor, including benefits, and other operating costs, including fuel and taxes, has resulted in mere economic survival being a major issue for many smaller charter and tour carriers within the industry.

Regardless of the number of efficient management programs which are instituted, regardless of the modernization of maintenance facilities and customer service facilities, and regardless of computerization of record keeping and billing, many carriers are faced with a close-to-being-unbearable squeeze on their profits.

In an earlier day, the federal investment tax credit provided an impetus for many bus carriers to invest their earnings in improved and expanded fleets of equipment. The elimination of that credit several years ago has substantially lessened the former ease and attraction of investment by existing carriers in their fleets.

Many carriers are today operating aging fleets of equipment, with models costing the then significant amount of $155,000 now replaceable only with comparable models which cost twice as much.

45. The assertions in this portion of this article are those of the author alone, based upon his observations of the industry.
In many instances, only new entrants, highly leveraged, and barely able to make lease payments on these expensive coaches, enter the charter market and provide fierce price competition, anxious only in the short run to meet their lease payment obligations, thereby further exasperating this problem.

Thus, one major problem of many existing charter and tour carriers (and these make up most of the industry) is merely to remain in business.

In this context, traditional regulatory concerns in general are of little significance, except in those rare, purely local situations in which a new entrant seeks to take on an existing carrier in providing a particular, specialized service. In such circumstances, the significance of regulation is merely to provide an entertaining legal argument upon which to advance the goal of keeping a new entrant out of a market which an existing carrier now rules.

A second issue—one of perhaps more interest to industry observers than industry participants—is the result of seven years of Bus Act experience on the availability of adequate service to the public. The bus industry has historically been viewed as one providing essential public services, and comments regarding the industry have frequently examined the effect of the flexibility inherent in the Bus Act upon the essential mission of the industry to provide service to small communities and those unable to take advantage of other modes of intercity transportation. Observations concerning this issue are in large part anecdotal. Further, as the ICC's decision approving the Greyhound-Trailways merger makes clear, one's conclusions are ultimately shaped by one's assumptions of the relevant market.

As of this date, it is reasonable to assume that at least one result of the current Greyhound strike will be a reassessment of the costs of providing service to smaller communities and perhaps some effect upon the level of service to such communities.

A final significant issue is the pending Americans with Disabilities Act, which, if it first appeared, would require all new intercity buses at some future date to be equipped with wheelchair lifts and space for wheelchair coaches. Many in the industry expect that this may have a catastrophic financial effect on carriers, by resulting in yet another significant increase in the cost of new motor carrier equipment, while at the same time resulting in diminished passenger capacity. The latest Wash-

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ington rumors suggest the legislation will be modified before enactment to lessen its impact upon the bus industry, but until the legislation is enacted, one can only speculate.

All in all, when one speaks of issues confronting the bus industry, one generally speaks of business issues—as opposed to regulatory issues—and for those regulatory issues which do take on some significance, the debate is purely local, rather than industry-wide. The business issues are those of almost any business; few are unique to transportation.

V. CONCLUSION

Within the United States, the intercity bus industry remains regulated by the Interstate Commerce Commission. Nonetheless, the enactment of the 1982 Bus Act and the generally deregulatory bent of the ICC has resulted in a system of regulation which is in almost every case a nuisance at most and often to be virtually ignored.

Surely, every bus operator must be aware of and comply with appropriate regulations, and surely every operator must be aware of the peculiar state and local regulations which exist in particular markets, but for the most part, the bus industry in the United States operates under the free market, business driven environment in which other transportation modes operate. In that event, knowledge and understanding of the industry is of equal—if not more—importance than knowledge of transportation law. Yet, if one were to attribute to any transportation mode the characteristics evoked by the phrase "miles to go before I sleep," it would be the intercity bus industry. It is one which, despite today's importance or unimportance of regulatory requirements, continues to provide essential day in and day out services to many thousands of communities which are otherwise unserved by public transportation.48 They are so essential that one can reasonably assume there will always be a continuing interplay between regulators and the marketplace to fashion the industry to meet the industry's unique role in the transportation system.
