TABLE OF CONTENTS

ARTICLES

A History of Railroad Abandonments

Steven R. Wild .......................... 1

Airlines in Turbulence: Strategies for Survival

Paul Stephen Dempsey .............. 15

Transport Sector Privatisation in the Russian Federation

Prof. Dr. Elmar Giemulla ...... 99
Dr. Heiko van Schyndel

1995 HAROLD A. SHERTZ WINNER

The Third Package of Liberalization in the European Air Transport Sector: Shying Away from Full Liberalization

Dennis A. Duchene ................. 119

BOOK NOTES

Administrative Law: Principles and Practice:
John H. Reese

L. Michael Brooks .................. 163

Collision Course: The Truth About Airline Safety:
Ralph Nader
Wesley J. Smith

Charles E. Harrison .......... 169

NB: Airport Ratesetting: The follow-up article to “More Than You Ever Wanted to Know About Airport Rate Setting” in Volume 22, Number 2 of the Journal cannot be published because the comment period for the expected legislation following the Northwest Airlines v. County of Kent, Michigan decision was extended. Look for this article in our fall issue.
UNIVERSITY OF DENVER COLLEGE OF LAW

ADMINISTRATIVE OFFICERS
Daniel L. Ritchie, M.A., M.B.A., Chancellor
William F. Zaranka, Ph.D., Provost, Dean of Faculty
James R. Griesemer, D.P.M., Vice Chancellor for Financial Affairs/Treasurer
Joseph Sanders, M.A., Vice Chancellor for Communication
Denis O. Lynch, B.A., J.D., LL.M., J.D.S., Dean, College of Law
Arthur Best, A.B., J.D., Associate Dean for Academic Affairs
Barbara N. Greenspan, B.A., M.S., J.D., Director, Westminster Law Library
Mary Roberts-Bailey, B.A., M.S.W., J.D., Assistant Dean for Student Affairs

FACULTY
David W. Barnes, A.B., M.A., Ph.D., J.D., Professor of Law
Arthur Best, A.B., J.D., Professor of Law and Associate Dean for Academic Affairs
Jerome Borison, B.S., J.D., LL.M., Associate Professor of Law
Burton F. Brody, B.S.C., J.D., LL.M., Professor of Law
J. Robert Brown, Jr., B.A., M.A., Ph.D., J.D., Associate Professor of Law
Penelope Bryan, B.S., J.D., M.A., Assistant Professor of Law
Federico Cheever, B.A., M.A., J.D., Assistant Professor of Law
Alan K. Chen, B.A., J.D., Assistant Professor of Law
Roberto L. Corrada, B.A., J.D., Assistant Professor of Law
Edward A. Dauer, A.B., LL.B., Dean Emeritus and Professor of Law
Paul Stephen Dempsey, A.B., J.D., LL.M., D.C.L., Professor of Law and Director, Transportation Law Program
Nancy S. Ehrenreich, B.A., J.D., LL.M., Assistant Professor of Law
Martha M. Ertman, A.B., J.D., Assistant Professor of Law
Cecelia M. Espinoza, B.A., J.D., Assistant Professor of Law
Barbara N. Greenspan, B.A., M.S., J.D., Associate Dean of Planning
Robert M. Hardaway, B.A., J.D., Professor of Law
Keith M. Harrison, B.A., J.D., Assistant Professor of Law
Jeffrey H. Hartje, B.A., J.D., Associate Professor of Law
Sheila K. Hyatt, B.A., J.D., Professor of Law
Francis W. Jamison, B.A., J.D., Professor of Law and Internship/Externship Coordinator
Jan G. Laitos, B.A., J.D., S.J.D., Professor of Law and Director, Natural Resources Program
Harry O. Lawson, B.A., M.S., Professor of Judicial Administration and Director, Master of Science in Legal Administration Program
Neil O. Littlefield, B.S., LL.B., LL.M., S.J.D., Professor of Law
Lucy A. Marsh, B.A., J.D., Professor of Law
Ved P. Nanda, B.A., M.A., LL.B., LL.M., Thompson G. Marsh Professor of Law and Director of the International Legal Studies Program
Julie A. Nice, B.S., B.S., J.D., Assistant Professor of Law
Stephen L. Pepper, A.B., J.D., Professor of Law
George W. Pring, B.A., J.D., Professor of Law
John H. Reese, B.B.A., LL.B., LL.M., S.J.D., Professor of Law
Paula R. Rhodes, B.A., J.D., Associate Professor of Law
Edward J. Roche, Jr., B.B.A., J.D., Professor of Law
Howard I. Rosenberg, B.A., LL.B., Professor of Law
Robert B. Smith, B.A., J.D., LL.M., Assistant Professor of Law
John T. Soma, B.A., M.A., J.D., Ph.D., Professor of Law
Joyce S. Sterling, B.A., M.A., Ph.D., Professor of Law
Celia R. Taylor, B.A., J.D., Assistant Professor of Law
Lawrence P. Tiffany, A.B., LL.B., S.J.D., Professor of Law
Mark A. Vogel, B.B.A., J.D., S.J.D., Associate Professor of Law and Director, Graduate Tax Program
Timothy B. Walker, A.B., M.A., J.D., Professor of Law
James L. Winokur, B.A., LL.B., Professor of Law
Robert B. Yegge, A.B., M.A., J.D., Dean Emeritus and Professor of Law
Edward H. Ziegler, Jr., B.A., J.D., LL.M., Professor of Law
PAUL STEPHEN DEMPSEY
AND THE TRANSPORTATION LAW PROGRAM

Paul Stephen Dempsey is Professor of Law and Director of the Transportation Law Program. He formerly served as an attorney with the Civil Aeronautics Board and the Interstate Commerce Commission in Washington, DC.

Professor Dempsey has written more than fifty law review and professional journal articles, scores of newspaper and news magazine editorials, and six books: AVIATION LAW & REGULATION (two volumes, Butterworth, 1993); AIRLINE DEREGULATION & LAISSEZ FAIRE MYTHOLOGY (Quorum Books, 1992); FLYING BLIND: THE FAILURE OF AIRLINE DEREGULATION (Economic Policy Institute, 1990); THE SOCIAL AND ECONOMIC CONSEQUENCES OF DEREGULATION (Quorum Books, 1989); LAW & FOREIGN POLICY IN INTERNATIONAL AVIATION (Transnational Publishers, 1987); and LAW & ECONOMIC REGULATION IN TRANSPORTATION (Quorum Books, 1986). Since 1979, he has been faculty editor of the Transportation Law Journal (TLJ).

Dempsey has been the host of KWGN-TV's weekly talk show, "Your Right To Say It" since 1986. He has appeared on the ABC Evening News with Peter Jennings, the MacNeil-Lehrer New Hour, ABC World Business Report, NBC Today, ABC Good Morning America, CNN Crossfire, National Public Radio, CBS Radio, NBC Mutual Radio, and other news broadcasting networks in the United States and abroad. His editorials have been published in numerous newspapers and news magazines, including Newsweek, the New York Times, and the Wall Street Journal.

Professor Dempsey is President of Americans for Sound Aviation Policy (ASAP). He has served as a consultant to U.S. and foreign airlines, railroads, motor carriers, transportation labor organizations, and telecommunications companies. He also serves on the board of directors of Frontier Airlines.
The University of Denver College of Law’s Transportation Law Program is rooted in the establishment of the Transportation Law Institute in 1967, a continuing legal education program for attorneys and practitioners. The College of Law began co-sponsoring the Institute with the Transportation Lawyers Association. In 1976, the Transportation Lawyers Association expanded its partnership with the College of Law by providing funding for a faculty position in transportation law. At the same time, the College of Law assumed responsibility for publishing the TLJ.

Since 1979, Professor Dempsey has directed the Transportation Law Program at the College of Law. Under Dempsey’s direction, the program has developed and is attracting an increasing number of students. Other faculty working in the program include Professor Robert Hardaway as well as part-time professors William Thoms, Professor of Law and Director of the Aviation Law Program at the University of North Dakota, and Scott Hamilton. Additionally, Professor Roberto Corrada includes aviation labor law issues in his employment law course. Alumni of the program include aviation professionals who return to school to earn their law degrees, students who become interested in transportation law through their work on the TLJ, and those who go on to work in various aspects of the transportation industry.

As with all programs, Transportation Law is a partnership—here between the University of Denver and the Transportation Lawyers Association, between full and part-time faculty, and between faculty and students. Professor Dempsey works in partnership with students both on the TLJ and through his classes.
# TABLE OF CONTENTS

## ARTICLES

- **Protective Programs in Mergers**: Generous Public Policy for a Favored Few  
  
  *Herbert R. Northrup*  
  
  175

- **Buy North America**: A Revision to FTA Buy America Requirements  
  
  *Lawrence Hughes*  
  
  207

- **Intermodal Transportation Planning for the Environment**: Social, Cultural and Economic Considerations for an Interdisciplinary Solution for Change  
  
  *David R. Fiore*  
  
  237

  *John M. Stafford*

- **Problems of Transnational Regulation**: A Case Study of Aircraft Noise Regulation in the European Community  
  
  *Jeffrey Goh*  
  
  277

## SYMPOSIUM ON THE GENERAL AVIATION REVITALIZATION ACT

- **A “Tail” of Liability Reform**: The General Aviation Revitalization Act of 1994 and the General Aviation Industry in the United States  
  
  *Timothy S. McAllister*  
  
  301

- **The Push for Statutes of Repose in General Aviation**  
  
  *Christopher C. McNatt, Jr.*  
  
  323

  *Steven L. England*
# TABLE OF CONTENTS

## ARTICLES:  *SYMPOSIUM ON INTERNATIONAL LAW*

Deregulation of Truck Equipment Cabotage: A Canada - United States Initiative  

*Dean Saul*  

Pages: 345

The International Transport Workers’ Federation Flag of Convenience Shipping Campaign: 1983-1995  

*Herbert R. Northrup*  
*Peter B. Scrase*  

Pages: 369

The Stagnation of Economic Regulation Under Public International Air Law: Examining Its Contribution to the Woeful State of the Airline Industry  

*Andras Vamos-Goldman*  

Pages: 425

Creating Uniform Worldwide Liability Standards for Sea Carriage of Goods under the Hague, Cogsa, Visby and Hamburg Conventions  

*Samuel Robert Mandelbaum*  

Pages: 471

## COMMENT

Congress Gives Intercity Busing a Free Pass: A Comment on *Jefferson Lines v. Oklahoma Tax Commission*  

*Thomas H. McConnell*  

Pages: 503
UNIVERSITY OF DENVER COLLEGE OF LAW

ADMINISTRATIVE OFFICERS
Daniel L. Ritchie, M.A., M.B.A., Chancellor
William F. Zaranka, Ph.D., Provost, Dean of Faculty
James R. Griesemer, D.P.M., Vice Chancellor for Financial Affairs/Treasurer
Joseph Sanders, M.A., Vice Chancellor for Communication
Dennis O. Lynch, B.A., J.D., LL.M., J.D.S., Dean, College of Law
Arthur Best, A.B., J.D., Associate Dean for Academic Affairs
Gary L. Alexander, B.A., M.L.L., J.D., Interim Director, Westminster Law Library
Mary Roberts-Bailey, B.A., M.S.W., J.D., Assistant Dean for Student Affairs

FACULTY
David W. Barnes, A.B., M.A., Ph.D., J.D., Professor of Law
Arthur Best, A.B., J.D., Professor of Law
Jerome Borison, B.S., J.D., LL.M., Associate Professor of Law
Burton F. Brody, B.S.C., J.D., LL.M., Professor of Law
J. Robert Brown, Jr., B.A., M.A., Ph.D., J.D., Associate Professor of Law
Penelope Bryan, B.S., J.D., M.A., Assistant Professor of Law
Federico Cheever, B.A., M.A., J.D., Assistant Professor of Law
Alan K. Chen, B.A., J.D., Assistant Professor of Law
Roberto L. Corrada, B.A., J.D., Assistant Professor of Law
Edward A. Daiuer, A.B., LL.B., Dean Emeritus and Professor of Law
Paul Stephen Dempsey, A.B.J., J.D., LL.M., D.C.L., Professor of Law and Director, Transportation Law Program
Nancy S. Ehrenreich, B.A., J.D., LL.M., Assistant Professor of Law
Martha M. Ertman, A.B., J.D., Assistant Professor of Law
Cecilia M. Espinoza, B.A., J.D., Assistant Professor of Law
Robert M. Hardaway, B.A., J.D., Professor of Law
Keith M. Harrison, B.A., J.D., Assistant Professor of Law
Jeffrey H. Hartie, B.A., J.D., Associate Professor of Law
Sheila K. Hyatt, B.A., J.D., Professor of Law and Associate Dean for Academic Affairs
Francis W. Jamison, B.A., J.D., Professor of Law and Internship/Externship Coordinator
Jan G. Laitsos, B.A., J.D., S.J.D., Professor of Law and Director, Natural Resources Program
Harry O. Lawson, B.A., M.S., Professor of Judicial Administration and Director, Master of Science in Legal Administration Program
Neil O. Littlefield, B.S., LL.B., LL.M., S.J.D., Professor of Law
Lucy A. Marsh, B.A., J.D., Professor of Law
Ved P. Nanda, B.A., M.A., LL.B., LL.M., Thompson G. Marsh Professor of Law and Director of the International Legal Studies Program
Julie A. Nice, B.S., B.S., J.D., Assistant Professor of Law
Stephen L. Pepper, A.B., J.D., Professor of Law
George W. Pring, B.A., J.D., Professor of Law
John H. Reese, B.B.A., LL.B., LL.M., S.J.D., Professor of Law
Paula R. Rhodes, B.A., J.D., Associate Professor of Law
Edward J. Roche, Jr., B.B.A., J.D., Professor of Law
Howard J. Rosenberg, B.A., LL.B., Professor of Law
Robert B. Smith, B.A., J.D., LL.M., Assistant Professor of Law
John T. Soma, B.A., M.A., J.D., Ph.D., Professor of Law
Joyce S. Sterling, B.A., M.A., Ph.D., Professor of Law
Celina R. Taylor, B.A., J.D., Assistant Professor of Law
Lawrence P. Tiffany, A.B., LL.B., S.J.D., Professor of Law
Mark A. Vogel, B.B.A., J.D., LL.M., Associate Professor of Law and Director, Graduate Tax Program
Timothy B. Walker, A.B., M.A., J.D., Professor of Law
James L. Winokur, B.A., LL.B., Professor of Law
Robert B. Yegge, A.B., M.A., J.D., Dean Emeritus and Professor of Law
Edward H. Ziegler, Jr., B.A., J.D., LL.M., Professor of Law
Articles

A History of Railroad Abandonments

Steven R. Wild, J.D.*

TABLE OF CONTENTS

I. Introduction ......................................................... 1
II. At Early Common Law ............................................ 2
III. Restrictions by Contract ......................................... 2
IV. Terms of the Railroad Charter ................................... 3
V. Acts of State Legislatures ......................................... 3
VI. Transportation Act of 1920 ....................................... 4
VII. Competition from Trucks ......................................... 6
VIII. The 4R Act ....................................................... 7
IX. The Carter Push ................................................... 8
X. Staggers Act of 1980 .............................................. 9
XI. Effects of Deregulation .......................................... 10
XII. Rail Corridors ..................................................... 10
XIII. Railbanking ....................................................... 11
XIV. Other Preservation Methods ..................................... 12
XV. Mining and Heavy Industry Needs ............................. 13
XVI. Conclusion ....................................................... 13

I. Introduction

Railroading is a speculative business and from the earliest days of construction, some routes have proven profitable, others unprofitable.

* Steven R. Wild holds a Bachelor of Arts in Philosophy and Political Science from Duke University. He received his Juris Doctorate in 1994 from Vanderbilt University School of Law. After graduation, Mr. Wild clerked for the Honorable James A. Pudlowski of the Missouri Court of Appeals. Currently, he is an Assistant St. Louis City Counselor.
Accordingly, railroads sought to cut their losses by abandoning unprofitable routes. By discontinuing service, eliminating maintenance, avoiding local property taxes, and recovering the salvage value of the rail, ties, and sidings, a company may save between $18,000 and $24,000 per mile per year.¹ Yet historically, railroads rarely had a free hand in abandoning routes. Over the years, shippers, local governments, and interested citizen groups challenged the route abandonments under a variety of state and federal laws. Those challenges were aimed at the disastrous effects abandonments often had on local businesses and on proposed alternate uses of the valuable corridors of railroad land. This article examines the economically important, but sparsely chronicled challenges to abandonments railroads have faced from the mid-nineteenth century to the present.

II. EARLY COMMON LAW

If the ancient common law been the only way to challenge abandonments, the railroads could have abandoned lines freely. The common law of railroads derived from the law of older modes of transport, such as maritime law and carriage transport law. As common carriers of goods and people railroads had a common law duty to serve all comers.² However, no duty existed at common law to serve all localities on or off of the route map. Therefore, at common law, no action existed for the incidental damages suffered by private parties from loss of service.³ Barring restrictions by contract, statute, or charter, railroads would be free to abandon or change routes at will.⁴

III. RESTRICTIONS BY CONTRACT

In many abandonment cases, state courts held railroads liable for breach of contract by focusing on the benefits which railroads derived from local interests when the rail was laid. To lure railroads to build near their towns, local interests frequently granted rights of way, made cash donations, purchased bonds and stocks, or extended public credit.⁵ Communities voted to sell government bonds, and farmers mortgaged land to

⁴. DAVID RORER, THE LAW OF RAILWAYS 274-75 (1884) (citing Gear v. Dubuque & Sioux City R.R. Co., 20 Iowa 523, 529 (1866), and Mississippi & Tenn. R.R. Co. v. Devaney, 42 Miss. 555, 593-98 (1869)).
pay for them.\textsuperscript{6} The outlays were substantial. While state and federal governments pledged about one-fifth of the cost of all railroad construction through 1870, local and municipal sources contributed at least another one-fifth.\textsuperscript{7}

In light of these substantial expenditures, some courts overlooked the prevailing formalities of contract law and found that promises to build roads and serve communities were binding in law or equity.\textsuperscript{8} Therefore, in some states, a railroad contemplating abandonment of an unprofitable line faced the prospect of lawsuits from local investors based on the new flexibility in the law of contract.

IV. Terms of the Railroad Charter

In many other cases, a railroad’s own charter limited its ability to abandon routes. Violating a charter provision was actionable in a state court. The terms of a railroad’s charter or articles of incorporation often included a description of the terminuses or bound the railroads to described routes. Most of the charters granted in the early 1800’s describe only the terminuses and a few intermediate points, while others defined only the terminuses, or vague “eligible points.”\textsuperscript{9} Therefore, in the early nineteenth century, railroads enjoyed wide discretion to locate or relocate their roads within the ambiguous terms of these charters.\textsuperscript{10} However, the terms of subsequent charters required more detailed route descriptions and frequently restricted abandonments.\textsuperscript{11} Thus, the charter restrictions, though sparse in early versions, later became a serious barrier to railroad abandonments.\textsuperscript{12}

V. Acts of State Legislatures

General legislation was another impediment to railroad abandonment. By the early 1900’s, over half of the states had enacted legislation governing route relocation.\textsuperscript{13} Many jurisdictions established their own

\begin{footnotesize}
\begin{enumerate}
\item William Z. Ripley, Railroads, Rates and Regulation 38 (1912).
\item Id. at 39.
\item Rorer, supra note 4, at 280. Compare the early case of The Utica & Schenectady R.R. Co. v. Brinkerhoff, 21 Wend. 139, 140 (N.Y. Sup. Ct. 1839), finding no binding contract due to a lack of mutuality and binding consideration, with the later Burlington, Cedar Rapids & Minn. Ry. Co. v. Palmer, 42 Iowa 222, 226-29 (1875), interpreting a written promissory note as a contract for service.
\item Meyer, supra note 5, at 75.
\item Rorer, supra note 4, at 278 (citing Southern Minn. R.R. Co. v. Stoddard, 6 Minn. 92, 96 (1861)).
\item 1 Isaiah L. Sharpman, The Interstate Commerce Commission 240 (1931).
\item Stewart Rapalje and William Mack, A Digest of Railway Decisions 2 (1895), (citing People ex rel. Walker v. Louisville & N. R.R. Co., 10 N.E. 657, 666 (Ill. 1887).
\item Meyer, supra note 5, at 126.
\end{enumerate}
\end{footnotesize}
railroad commissions to regulate abandonments.14 State statutory authority usually was a prerequisite to abandonment.15 The patchwork of regulations that resulted from the states’ attempts to control railroads was inefficient and confusing. Professor Balthasar H. Meyer described the situation in 1903 by noting that “railway legislation in the United States is full of inconsistencies and anomalies, spasmodic expressions of legislative impulses, and the futile attempts of administrative bunglers.”16

Collectively, the contractual obligations, charter limitations, and statutory rules presented more than an administrative headache for the railroads after the turn of the century. Maintaining unprofitable track was extremely expensive, and represented an expenditure that the railroads could ill afford. By the 1910’s the railroads showed weak profits and even weaker credit. While testifying before the Senate Committee on Interstate Commerce, Alfred P. Thom, General Counsel of the Association of Railway Executives, stated that economic “[c]onditions in this country have been going on, tendencies have originated and are in operation, forces have grown into controlling power, that have made the flow of capital into these enterprises [railroads] come to a standstill, and it [capital] is no longer available.”17

As a result of this capital crisis, railroads were unprepared to meet the increases in demand on track and equipment precipitated by World War I.18 For example, in 1917, the Southern Railway found that the prices of bonds it had intended to utilize for its entire improvement fund had fallen so low that they could not sell them or even market new ones.19

VI. TRANSPORTATION ACT OF 1920

Relief for the railroads came in the form of the Federal Transportation Act of 1920.20 Changes in railroad rate policies were the primary features of the Act, but it also contained, for the first time, a basis for

---

16. MEYER, supra note 5, at 7.
17. ASSOCIATION OF RAILWAY EXECUTIVES, REMEDIAL RAILROAD LEGISLATION 1919, 119 (Robert Binkerd ed., preliminary ed. 1919) (Alfred P. Thom, General Counsel of the Association of Railway Executives, testimony before Senate Committee on Interstate Commerce, January 16, 1919). See also ALBRO MARTIN, ENTERPRISE DENIED (1971) (the major theme of which is that capital undernourishment of the railroads by the ICC beginning in 1906 precipitated the collapse of railroad profitability after 1911).
18. SHARPMAN, supra note 11, at 172.
federal control over abandonments.21 Both features of the Act were designed to improve the financial health of railroads.22

The Act enabled railroads to abandon unprofitable lines "despite the protest of the local authorities" if it could show the Interstate Commerce Commission (ICC) that the line unduly burdened interstate commerce.23 Specifically, the law required the ICC to determine and foster "public convenience and necessity" by balancing the needs of interstate commerce against the needs of particular communities.24

These federal abandonment procedures facilitated many miles of track abandonment. By 1963, carriers had abandoned some 49,374 miles of the 252,588 miles of track existing in 1920.25 However, the degree to which the ICC itself hindered or helped this abandonment is questionable.26 Some commentators, looking at the 16:1 railroad victory to loss ratio before 1946 concluded that the ICC completely allied itself with railroad interests.27 Other commentators implied that the high approval ratio was only due to the railroads' unwillingness to litigate the difficult cases. Data show that those cases which the railroads lost involved greater mileage, and presumably greater opposition from local interests. If the latter group of commentators is correct, then the ICC really acted as a judicial brake upon possible abandonments which, though never brought, may have been permissible under the Transportation Act of 1920. The railroads were successful in only minor cases and continued to lose revenue on the longer routes. However, data showed that those cases which the railroads lost involved greater mileage, and presumably greater opposition from local interests.28 If the latter group of commentators was correct, then the ICC really acted as a judicial brake upon possible abandonments which, though never brought, may have been permissible under the Transportation Act of 1920. If the ICC acted as a judicial brake, then the railroads were successful in only the minor cases and continued to lose revenue on the longer routes.

For the railroads, the ICC opposition to larger abandonments was undoubtedly harmful. Presumably, this opposition saved the businesses

---

23. Sharfman, supra note 11, at 6.
27. See Charles R. Cherington, Regulation of Railroad Abandonments, 102 (1948).
of many local shippers. Railroads often provided the only access for their goods to move into the market rendering the local shippers captives of the railroad industry. The captive shipper problem appeared to be one of the chief concerns of Congress in formulating the "public convenience and necessity" standard. The post-1920 ICC policy was apparently moderate; it permitted many shorter abandonments to help railroad profitability, but evidently denied longer abandonments to protect the majority of captive shippers.

VII. COMPETITION FROM TRUCKS

With the development of truck transportation in the early 1930's, the captive shipper problem essentially evaporated. Although the motorized truck had proven useful during World War I, it did not significantly impact interstate commerce until the early 1930's. At that point, three important technological innovations came together: 1) the pneumatic tire to cushion freight, 2) the hydraulic brake to safely increase the weight of a load, 3) and the network of paved intercity highways to provide a route. With the extension of highways and reliable substitute service by truck, the ICC granted many more abandonment requests.

That change of events was far more bitter than sweet for the railroads. While the railroads enjoyed the favorable response of the ICC regarding abandonments of unprofitable lines, abandoning did not replace the revenues lost to truck competition. Trucks exhibited certain market advantages over railroads that still exist today. First, highways are directly subsidized by the government. Second, since truckers do not own the highways they do not pay property taxes on those millions of acres. Third, in medium and short hauls, trucks deliver goods more quickly and safely by avoiding depots and transfers. Fourth, although the motor carrier industry has been subject to some regulation, those regulations are far less costly than rail regulations. Finally, trucks enjoy a flexible route structure, whereas railroads must laboriously lay or abandon track to make fundamental route changes.

The speedy and customized service offered by trucks enabled the in-

31. Id. at 12-15.
33. Stone, supra note 26, at 68.
34. Often the railroads paid taxes at discriminatory rates, having little local political support in tax districting arrangements. Id. at 69.
35. Childs, supra note 30, at 20.
37. Stone, supra note 26, at 70.
dustry to devour the railroad industry's market share of freight revenue. In 1920 railroads had a virtual monopoly on the nation's freight revenue.\textsuperscript{38} By 1940, rails had only 75.42\% of all freight revenue, while motor carriers had captured 17.74\% of the market.\textsuperscript{39} During World War II, rails enjoyed a brief resurgence of business, due to the shortage of gasoline and rubber required by trucks.\textsuperscript{40} However, by 1970, rail freight revenue slumped to 40.62\% of the total and was still falling.\textsuperscript{41} Motor carriers captured the lion's share of this lost business with a total share of 53.26\%, while airways captured 2.61\%, and oil pipelines another 2.17\% of the revenue.\textsuperscript{42}

By 1973, the formerly great railroads of the Northeast were on the verge of bankruptcy.\textsuperscript{43} Fundamental shifts in the economy added to the railroad industry's woes. America produced less of the dense, bulky goods such as steel and coal, best suited to transport by rail,\textsuperscript{44} and more of the low density high value merchandise better handled by truck.\textsuperscript{45} The country also began to produce more goods from plants located in the suburbs, which are more easily accessed by truck.\textsuperscript{46}

VIII. The 4R Act

In February 1976, President Gerald Ford signed the Railroad Revitalization and Regulatory Reform Act (4R).\textsuperscript{47} The 4R provided funds for consolidation of the failing Northeastern railroads into Conrail.\textsuperscript{48} It also contained provisions affecting the abandonment process; the most notable provision imposed a time limit on the ICC's deliberation in abandonment cases.\textsuperscript{49} This was a major improvement, since the average length of time from filing to decision during the 1960's was 410 days.\textsuperscript{50} Reducing the length of time for administrative decisions was and still is paramount in abandonment considerations, because in such situations railroads might lose tens of thousands of dollars per mile per year.\textsuperscript{51} The 4R also

\textsuperscript{38} See Conant, supra note 26, at 43.
\textsuperscript{40} Stone, supra note 26, at 43.
\textsuperscript{41} AM. Trucking Ass'ns, supra note 39, at 35.
\textsuperscript{42} Id.
\textsuperscript{43} Stone, supra note 26, at 55.
\textsuperscript{44} Id. at 69.
\textsuperscript{45} W. Abdelwahab and M. Sargious, Modeling the Demand for Freight Transport, 1992 J. Transp. Econ. & Pol'y, 49, 63.
\textsuperscript{46} Stone, supra note 26, at 69.
\textsuperscript{48} Stone, supra note 26, at 76.
\textsuperscript{49} Id. at 97.
\textsuperscript{50} Id.
\textsuperscript{51} McFarland, supra note 1, at 356.
provided a new fast track for abandonments through a provision that
gave the ICC authority to exempt railroads from regulations.\textsuperscript{52} The 4R
held great promise for the railroads, and great disappointment for aban-
donment opponents. However, the ICC did not unlock the potential of
these deregulatory provisions until the Carter presidency.

IX. THE CARTER PUSH

James Earl Carter was an unexpected champion of railroad deregula-
tion. His anti-regulation stance hardly fit the big-government Democrat
stereotype. His native Georgia had no special love for railroads, having
enacted anti-rail provisions into its Constitution a century earlier.\textsuperscript{53}
However, President Carter entered office during a period of economic
recession with high inflation and viewed deregulation as a pro-consumer
move designed to bring down inflation.\textsuperscript{54} First, he successfully dereg-
ulated the airline and trucking industries, then advocated similar steps for
railroads.\textsuperscript{55}

Jimmy Carter had both the will and the means to effect substantial
changes in ICC policy. The ICC was traditionally a less political, more
independent, bipartisan agency,\textsuperscript{56} but in 1969, the President was given
the authority to appoint the ICC Chairman.\textsuperscript{57} Jimmy Carter radically
changed the composition of the ICC’s membership,\textsuperscript{58} and since the Com-
mission had such a pathetic reputation while supervising the collapse of
America’s rail system, no one protested.\textsuperscript{59}

The new ICC wasted no time in deregulating the railroad industry.
By 1980 the Commission had reinstated contract rates for coal, dereg-
ulated the movement of produce, expedited mergers, and freed up major
aspects of car service.\textsuperscript{60} It also took a major step in favor of railroad
abandonment by allowing an opportunity cost factor to figure into the
public interest evaluation.\textsuperscript{61} Traditional factors for determining whether
or not to approve an abandonment included only: the needs of the ship-
ners, the availability of substitute service, and the amount of losses on the

\textsuperscript{53} Ga. Const. art. IV, §4 (repealed 1933).
\textsuperscript{54} See President James Carter, Annual Message to the Congress (Jan. 25, 1979) in 1 PUB.
\textsc{Papers} 110, 113, 130-131 (1980).
\textsuperscript{55} Stone, supra note 26, at 104-106.
\textsuperscript{56} Ernest W. Williams, Richard D. Stone’s The Interstate Commerce Commission and the
\textsuperscript{57} Id. The President also had the authority to appoint other commission members.
\textsuperscript{58} By September 30, 1980 four of the top six ICC positions were held by Carter appoin-
tees. Stone, supra note 26, at 103.
\textsuperscript{59} Williams, supra note 56, at 72.
\textsuperscript{60} Stone, supra note 26, at 88-100.
line in relation to the financial stability of the carrier as a whole.\textsuperscript{62} By introducing opportunity costs as a new measure of the burden on railroads, it tilted the balance decidedly in the favor of the railroads. Under the old formula, any line showing a net trickle of profit did not qualify for abandonment. A similar line under the new formula might have qualified for abandonment if the railroad showed that the trickle of profit is insufficient with respect to the large capital investment in the line. In other words, the new formula permitted railroads to show that the level of the line's profits did not justify the capital tied up in the line and that the capital could be put to better use elsewhere to further the interest of national commerce. A successful railroad established that the ratio of profit to investment fell below a "reasonable rate of return."\textsuperscript{63}

X. \textbf{Staggers Act of 1980.}

It has been said that the Staggers Rail Act of 1980\textsuperscript{64} was merely a move by Congress to codify the \textit{de facto} deregulation established by the ICC in the late 1970's.\textsuperscript{65} Although this was in large part true, the Staggers Act had a somewhat mixed effect on the deregulation of railroad abandonments. In keeping with the ICC's deregulatory motif, the Staggers Act reduced the time limits on deadlines for filings to oppose abandonments and for the ICC to reach decisions in abandonment cases,\textsuperscript{66} and allowed the ICC to approve proposed abandonments without the lengthy investigation procedure.\textsuperscript{67}

The Staggers Act also provided a new weapon \textit{against} railroad abandonment: the forced-sale, or cram-down provision. Before 1980, 49 U.S.C. § 1a(6)(a) (1976) provided interested parties a chance to purchase or subsidize a line slated for abandonment. Yet, there was no requirement, and often no incentive, for the railroad to negotiate in good faith. Thus, the railroad was permitted to hold out for a last-minute above-market offer.\textsuperscript{68} The Staggers Act modified this provision by giving the ICC power to set the terms of sale or subsidy if the railroad could not reach agreement with a \textit{bona fide} offeror.\textsuperscript{69} The cram-down provision con-

---

\textsuperscript{62} \textbf{Cushman, supra} note 29, at 133-34.

\textsuperscript{63} The ICC publishes annual reasonable rates of return on capital to use in this formula. In 1991, the rate was 11.6%. \textbf{John K. Maser III, Rail Transportation, 59 Transp. Prac. J.} 434, 436 (1992).


\textsuperscript{65} \textbf{Stone, supra} note 26, at 113.


\textsuperscript{67} \textbf{Stone, supra} note 26, at 129.

\textsuperscript{68} See, \textit{e.g.}, Chicago \& N.W. Transp. Co. v. United States, 582 F.2d 1043 (7th Cir. 1978).

tained some safeguards for railroads. The terms could never be lower than the net liquidation value of the route because to do so could constitute an unconstitutional taking of property.70 Further, the purchaser could not abandon the route or sell the pieces (as the original owner might have wanted to do), but rather had to continue rail service for at least two years.71 Still, rail advocates were bitter about the cram-down provision, especially concerning forced subsidies, that required railroads to keep servicing unwanted customers on unwanted routes.72

XI. Effects of Deregulation

On the whole, railroads benefitted tremendously from ICC and Congressional efforts over the last two decades. From 1981 to 1987 railroads' average rate of return on investment rose from 2% to 7%.73 The availability of cheaper and easier abandonments was a significant factor in this profitability increase. Although absolute revenues continued to fall due to truck competition and other factors, relative rates of return climbed; railroads were able to reduce costs faster than revenues fell.74 Still, railroads remain a relatively unprofitable industry. A 1988 GAO study of twenty-one industries ranked railroads dead last in return on equity.75 Many commentators attribute at least part of the problem on the remaining administrative impediments to abandonments.76 There is more than just railroad profit at stake in the concern for efficient railroads. Rectifying inefficiencies in the nation's transport system saves the nation many times over in terms of business logistics costs. Better, cheaper, and faster rail service due to deregulation has already saved the nation some five billion dollars over the last decade.77

XII. Rail Corridors

If this were a simple question of economics, more deregulation of abandonments could hardly be questioned. However, other important considerations come into play when discussing abandonments. Aside from the immediate value of service to individual shippers along the

70. Also called "constitutional minimum value," Michel, supra note 66, at 250-51.
72. See generally WILLIAM R. BLACK, RAILROADS FOR RENT (1986).
74. Id. at 25.
77. DELANEY, supra note 73, at 19-26.
routes, the corridors themselves may be valuable for a variety of public purposes. The corridors are often well suited for other roads or highways, power lines, telecommunications, commuter operations, recreational trails, and possibly other unforeseen uses.  

After abandonment, a corridor is not likely to remain intact. The railroads hold the land under their tracks in a variety of legal property interest forms. These forms depend upon the terms of the original acquisition of land and prevailing state law. The railroad often owns land in fee simple absolute and may sell it after abandonment. However, other railroad corridors carry the possibility of reversion to the previous landowners because they are held in property interests akin to fee simple determinable or easements with possibilities of reverter. In such cases, abandoning the rails is usually the determinable event, at which point reversion takes place; therefore, an abandonment presents a distinct likelihood that the corridor of land will revert to multiple individual landowners, and forever cease to be a corridor.

It is imperative that parties wishing to conserve a corridor obtain ownership of the corridor prior to the railroad’s legal abandonment of the line and take care not to subsequently abandon the line themselves. What constitutes an abandonment remains a matter of state law and usually involves an objective measure of intent to abandon, such as removal of track. Therefore, the alternative uses themselves, since they are not railroad uses, could give rise to an abandonment. It is a complicated matter to purchase a line in tact and then use it for some purpose other than railroading, which is what many corridor conservationists seek to do.

XIII. Railbanking

The corridor reversion problem was addressed by Congress in Section 8(d) of the National Trails System Act. Added in 1983, this provision expressly provided that if an interested party purchases a corridor with a view to any public purpose, and if the railroad agrees to cooperate, no abandonment (and therefore no reversion) under state law takes place. Commonly called “railbanking,” the process keeps the land

---

79. *Id.* at 160-61.
81. MONTANGE, *supra* note 77, at 162.
85. *Id.*
under federal ICC jurisdiction, thereby staving off reversions under state law. It is also popularly known as the “rails to trails” program, since the interim public use is often a recreational hiking or biking trail.

XIV. Other Preservation Methods

Of course, other ways exist for preserving rail corridors. A group may petition the state for a special enactment of its eminent domain power; however, this is a lengthy and uncertain process ill suited to the task of fighting abandonments. A concerned party may also ask the railroad to discontinue service, instead of fully abandoning the line; this choice is undesirable from the railroads’ perspective because taxes on the railroad continue to accrue and the track cannot be removed and reused or sold.

Local preservation groups can and do operate corridors as short line railroads. It is surprising that such ventures ever work, considering that slating a line for abandonments requires that an experienced railroad could not find sufficient profit in the line. However, new lines which operate without expensive union labor and tailor their operations to local markets often succeed. Approximately one-third of the land disposed of by Class I railroads each year is purchased by smaller roads. The short line trend has become so popular that the ICC now disseminates a pamphlet entitled *So You Want to Start a Small Railroad*, which contains advice for newcomers. Page one admonishes the innocent upstarts that “[a]n attorney or ICC practitioner experienced in railroad matters and ICC regulations and requirements could prove most helpful.”

Challenging an abandonment directly is a costly and bold endeavor. Simple arguments of hardship rarely find favor with today’s Commission. Rather, one must be prepared to engage in a battle of statistics with the railroad, challenging, for example, its estimate of opportunity costs. One must also meet short, strict, filing deadlines, and

---

86. Montange, *supra* note 78, at 154-56.
87. The provision was sustained against constitutional attacks from abutting landowners. Preseault v. ICC, 494 U.S. 1 (1990).
90. Id.
93. Id.
hire experts to sort through data. As a result, only fifteen to twenty percent of corridors proposed for abandonment by railroads are ultimately conserved.

XV. MINING AND HEAVY INDUSTRY NEEDS

The captive shipper problem largely evaporated with the rise of the motor carrier. However, certain industries ship goods which are not effectively movable by truck; chiefly minerals, including coal and iron. Trucks are not a viable substitute service for these industries, and the captive shipper problem is formidable for them. Therefore, in 1984, the mining industry joined forces with the coal-dependent electric utility industry to create a lobby against wide-open deregulation. The Consumers United For Rail Equity (CURE) was formed to voice their opinion and to propose legislation restricting abandonments. It seems, however, that CURE's efforts are destined to fail year after year because of opposition from the great majority of industries who benefit from rail deregulation.

XVI. CONCLUSION

Railroad abandonments have been extremely important economically and have literally reshaped the map of the nation. An issue of this magnitude deserves close attention by railroads, government planners, and citizen groups. But surprisingly, the topic of abandonments has been largely ignored in academic publications; it was overshadowed by its cousin, rate regulation, despite the fact that the two went hand in hand through the early patchwork of state regulations, later federal regulation, the competition from motor carriers, and ultimately deregulation. The more recent public concern with rails to trails has pushed rail abandonments closer to the limelight and hopefully will produce much needed scholarship on the issue.

95. Montange, supra note 78, at 146-47.
96. Id. at 167.
97. Stone, supra note 26, at 170-71.
98. Id.
99. Id. at 169-74.
100. Id.
Airlines in Turbulence: Strategies for Survival

Paul Stephen Dempsey*

TABLE OF CONTENTS

I. Importance of the Airline Industry ....................... 16
II. The Contemporary State of the Airline Industry ........ 18
   A. Profit (Loss) .................................. 18
   B. Economic Characteristics of Commercial Aviation ... 21
   C. Demand ........................................ 26
   D. Price .......................................... 30
   E. Capacity ...................................... 31
   F. Airline Balance Sheets .......................... 32
III. Survival and Growth Strategies .......................... 34
   A. Operational Alternatives .......................... 35
      1. Route Strategies ................................ 35
      2. Fuel Efficient Fleet of Standardized Aircraft .... 40
      3. Low Debt ..................................... 42
      4. Conservative Growth ............................ 44
      5. Low Wages/Flexible Work Rules ................. 44
      6. Superior Service ............................... 46
      7. Auxiliary In-Flight Services .................... 47
      8. Auxiliary Non-Flight Services ................... 47

* Paul Stephen Dempsey is Professor of Law and Director of the Transportation Law Program at the University of Denver. He formerly served as an attorney with the Civil Aeronautics Board and the Interstate Commerce Commission in Washington, D.C.
I. IMPORTANCE OF THE AIRLINE INDUSTRY

The commercial airline industry carries 1.25 billion passengers and
22 million tons of cargo, about a quarter of the world's manufacturing exports based upon value. The industry produces 22 million jobs (3 million directly, 7 million indirectly, and 12 million induced), and accounts for one trillion dollars a year in economic production ($250 billion directly, $250 million indirectly, and $500 billion induced). If the industry were a nation, it would rank seventh in the world in economic production, just ahead of Canada.

Airlines are an essential component of the tour and travel industry, arguably the largest industry in the world. One source noted its tremendous economic importance:

[The tour and travel industry] generates more than $3.5 trillion of GNP. It employs 127 million people or one out of every 15 workers. It accounts for 12.9% of consumer spending and provides 7.2% of worldwide capital investment, more than $442 billion a year.

As an integral part of the infrastructure upon which economic growth is built — the veins and arteries of commerce, communications and national defense — a healthy transportation system offering reasonable prices and ubiquitous service to the public is vitally important to the health of the nation it serves. Progress and development in the transport sector often serve as catalysts for broader economic prosperity, both domestically and internationally.
II. THE CONTEMPORARY STATE OF THE AIRLINE INDUSTRY

A. PROFIT (LOSS)

Yet airlines have sustained enormous losses since deregulation and liberalization set in. From 1977 to 1992, the global air transport industry earned gross revenue of just over $2 trillion, while operating expenses were $1.96 trillion; operating profit was 2% of revenue, and net profit was a meager 0.6% of revenue. Worldwide, airlines have experienced a $15 billion shortfall over the last four years.

U.S. airlines were deregulated in 1978. Paradoxically, despite the fact that the industry has become very highly concentrated under deregulation, from January 1978 through December 1993, cumulative net losses for the major U.S. airlines totaled $9.3 billion. They lost $2.6 billion in 1992, and $2.1 billion in 1993, bringing the total losses to $12.8 billion since 1990. The U.S. airlines alone carry a debt burden of $35 billion, or more than eight times the industry's total accumulated profit from the beginning of commercial aviation in the 1920s, until 1988.

The capital needs of this industry are enormous. While the world's airlines spent $147 billion in the 1980s, the industry is projected to need $815 billion by the year 2000. Airbus, Boeing and Douglas predict the industry will need between $40 billion and $50 billion for new aircraft each year over the next decade.

Moreover, according to the International Civil Aviation Organization (ICAO), the world will need between $250 billion and $350 billion in

---
10. AIR TRANS. ASS'N, ANN. REP. (1994); Little Progress On Profits, AIRLINE BUS., 60 (Supp. 1994). Continental enjoyed an accounting profit of $2.6 billion largely attributable to write downs of debt with the emergence of the company from Chapter 11 bankruptcy. They are projected to break even, at best, in 1994. Julius Maldutis, supra note 4.
11. See Lisa Burgess, International Community Wants Action on Panel Report, COMMERCIAL AVIATION NEWS, Aug. 23, 1993, at 21. Actually, the amount of accumulated profit is overstated since it has not been adjusted for inflation. Despite the popular perception, in real dollars, the airline industry has not lost all the profit it ever made since the inception of commercial aviation.
Top Three Airlines' Market Share
(in revenue passenger miles)
(1979-1994)

Percent

Year 79 80 81 82 83 84 85 86 87 88 89 90 91 92 93 94
Market Share 40.5 38.5 38.8 39.9 38.6 36.5 40.3 42 44.6 47.7 47.1 47.1 56.1 58.6 58.9 58.3

Copyright © 1994
Paul Stephen Dempsey

*1st Nine Months
new airport infrastructure by the year 2010. Admittedly, some of that infrastructure will come from taxpayers, concessions, parking, and such. But the bulk of it must come from the airlines, directly or indirectly, in the form of landing and air traffic control fees, gate, counter and hanger leases, passenger facility charges, fuel and other taxes, and ground services fees.

The airline industry suffers from severe business risk in the form of high fixed costs, highly cyclical demand, and intensive competition; it suffers severe financial risk in the form of high debt-to-equity ratios, which increases the variability of earnings and the chances of insolvency. Because of the level and intensity of business and financial risk in the industry, one would expect that airlines, in order to attract adequate investment, should earn more than other industries. But in fact, airlines earn less.

Some blame the contemporary financial crisis in which airlines find themselves on the Persian Gulf conflict, the spike in fuel costs it produced, and recession. The Persian Gulf conflict and recession exacerbated, but did not create, inadequate profitability. The U.S. airline industry’s net profit margin averaged a modest 2.8% from 1955-77, then collapsed to 0.7% from 1978-88, deregulation’s first decade. Add in 1989-1993, and the average since deregulation drops to a negative 0.4%. It has been estimated that the world’s airlines need operating margins of 4% just to service debt, and 6% if they are to generate sufficient profit and pay for fleet modernization.

The essential question is, why has the industry been so anemic since promulgation of the Airline Deregulation Act of 1978?

**B. Economic Characteristics of Commercial Aviation**

When deregulated, airlines were believed to be potentially naturally competitive, without economies of scale, scope or density, or significant barriers to entry. Thus, deregulation was deemed likely to produce neither concentration nor destructive competition, despite the allegations

---


15. Despite the sharp decline in the industry’s profit margin since deregulation, capital continued to flow into the industry, with a proliferation of equipment leasing companies eager to purchase aircraft for airlines able to pay from robust cash flow, and from the glamour of the industry, which attracts new entrepreneurs. There are three businesses everyone seems to believe they can run — restaurants, ball clubs, and airlines.

U.S. Airline Industry
Net Profit Margin
(1955-1993)

Year 55 56 57 58 59 60 61 62 63 64 65 66 67 68 69 70 71 72 73 74 75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 91 92 93

Copyright © 1994
Paul Stephen Dempsey
of most airlines to the contrary. According to Alfred Kahn, deregulation's principal architect, aircraft were merely "marginal costs with wings." As 15 years of experience with deregulation have revealed, the airline industry is considerably more complicated than that. Airlines are labor intensive and fuel intensive. Unlike most service industries, airlines are also capital intensive.

The airline industry exhibits a relentless tendency both to produce excess capacity and to price its product below fully allocated costs. The demand of consumers for schedule frequency produces tremendous excess capacity with no shelf life, pushing costs up. The demand of consumers for low prices and a perception that air transportation is virtually a fungible commodity drives prices down to levels which, too often, fail to cover fully allocated costs.

Airlines inevitably produce excessive capacity. Whether regulated or deregulated, from the mid-1950s to present, U.S. airlines almost have never achieved an average annual load factor exceeding 67% (and in most years load factors substantially worse than that, and domestic load factors are worse still), meaning in effect, at least one-third of available inventory remains unsold.

On this point, economist Melvin Brenner notes:

The industry has always had excess capacity, even during boom times. Overcapacity results from:

a) The competitive importance of schedule frequency. Since schedule convenience is one of the most important differentiating characteristics of the airline product, all airlines strive for high scheduled frequency on every important route, and

b) the fact that airlines have very high fixed costs and are therefore incentivized to fly their aircraft as much as possible, even if incremental flying does not produce enough revenue to cover fully allocated costs. Whenever a flight covers variable costs and contributes to overhead, the individual carrier is better off flying rather than not flying. However, the cumulation of the many marginally-justified schedules creates over-capacity for the industry as a whole.

17. Dempsey & Goetz, supra note 6, at 179-87, 221-34.
18. Said Kahn, with characteristic irreverence, "I really don't know one plane from the other. To me they are just marginal costs with wings." Barbara Sturken Peterson & James Glab, Rapid Descent: Deregulation and the Shakeout in the Airlines 77 (1994).
19. Domestic load factors for U.S. carriers ranged between 60.5% and 62.6% between 1987 and 1993, while international load factors ranged between 65.6% and 67.0% during the same period. Julius Maldutis, Q. Global Aviation Rev. 2d Quarter 1994, 10-11. The Association of European Airlines reported load factors between 56.7% and 63.8% during the same period. Id. at 15.
Moreover, that capacity has no shelf life. Once a scheduled flight pulls back from the jetway, any empty seats are lost forever. Seeking to sell as much of that perishable inventory as possible, carriers offer the price of the lowest price provider in an effort to grasp an ascending and, too often, elusive break-even load factor and preserve market share. As another source noted, "In a high fixed cost, price sensitive, commodity type business such as this, excess capacity has a devastating effect because it motivates carriers to fill aircraft by cutting prices. Other carriers are forced to match, and fare wars erupt."\(^{21}\)

Excessive capacity coupled with perishable inventory leads to variable cost pricing. The incremental costs of adding a passenger to a scheduled flight are nil (e.g., a bag of peanuts, and a cup of Coca-Cola). But industry costs are disproportionately fixed, with fixed costs comprising between 80% and 90% of total costs. Airlines also suffer from the problem that most of their costs are joint costs, spread over an array of originating, destination and connecting passengers and freight moving throughout their networks. Thus, actual costs are obfuscated and difficult to ascribe to particular passengers.

In the long run, carriers must recover their fixed costs or face bankruptcy (as scores of airlines have learned). But the collectively irrational behavior exhibited by airlines before regulation in 1938 and after deregulation in 1978 causes cost and price to fail to achieve equilibrium at a level which covers fully allocated costs and allows an adequate profit. In the absence of government oversight, the inherent primordial economic characteristics of the airline industry propel it to engage in below cost pricing. This explains the fact that industry profitability declined sharply after deregulation.

One major U.S. airline described the phenomenon this way:

Airline seats are a perishable commodity whose costs include a very high proportion of fixed charges. As a result, there has always been a financial incentive for airlines to sell seats that would otherwise depart empty for any price that exceeds variable costs, i.e., expenses for passenger ticketing, baggage handling, food service and incremental fuel.

As simple and reasonable as this sounds, prices based on variable costs cannot, in the real world, be limited to seats that would otherwise depart empty. The highly competitive airline marketplace ensures that whatever price is set will be made available for a large percentage of all seats, including many that could have been sold at higher fares.

The problems associated with variable cost pricing become particularly acute when demand for air travel slackens. The lead time for new aircraft orders is two to three years, and airlines cannot quickly reduce their capacity without putting planes on the ground, a move that invariably means losing

business to their competitors and — because fixed costs continue — forces up average unit costs. Thus, in periods of reduced economic activity, there are many more empty seats, a circumstance that leads to heightened temptation on the part of airlines to fall into the variable cost pricing trap.22

Because industry costs are disproportionately fixed, selling seats at a loss often sacrifices less revenue than parking aircraft in the desert, because parked planes still generate costs but produce no revenue. Hence, excessive capacity (which the industry inevitably produces) too often remains aloft even when the highly cyclical demand curve turns downward.

C. DEMAND

Demand for air transport services has always been highly cyclical, with greater or lesser demand depending on time of day, day of week, and season, and depending upon broader market fluctuations, year to year. We know, for example, that discretionary, leisure traffic picks up in the Summer, thereby allowing the industry to enjoy higher load factors for the third quarter.

When the economy is growing and consumer confidence is strong, demand grows, improving airline load factors, and allowing carriers to raise yields and profitability. When the economy falls into recession, unemployment grows, and consumer confidence declines, individuals postpone discretionary travel, and airline load factors, yields and profitability suffers. One source notes the hyper-cyclical nature of airline performance on a macro-economic basis:

On the macro-economic level, we have a hyper-cyclical situation. Our lows are lower and longer — and our highs are lower and shorter — than the general economy.

During good economic times, new entrant airlines proliferate, skimming off enough passengers to damage the established airlines. Then when an economic downturn hits, the new-entrants declare bankruptcy and operate in Chapter 11 or go out of business altogether, but always manage to prevent the established airlines from making much of a profit.23

Traditionally, passenger traffic has grown at about 2.25 times the rate of GDP growth; thus, if the world economy grows by 2%, passenger demand should grow by 4.5%. World air travel growth averaged 7.4% a year during the boom 1983-89 period.24 But worldwide, traffic fell 4% in 1991, the first decline since records have been kept.25

Many experts predict that global passenger demand will average 5-

---

24. EVANS, supra note 7, at 48.
6% annually over the next two decades, although it will be spread unevenly, with intra- and inter-Asian markets growing at 8-9% annually, and North American, transatlantic, and European markets growing at only 4% annually. Some analysts predict that traffic will have to grow about 8% in order for the U.S. airline industry to achieve profitability, something it is not likely to do.

U.S. domestic traffic growth has been virtually flat since 1987, which is remarkable in light of the unrealistic and destructive price wars of the era, and the fact that recession did not begin to set in until 1989-90. This raises the frightening possibility that the domestic passenger market may have matured. One source notes, "the big US and European markets have not reached maturity yet, but the rate of growth has been falling ever since the double-digit growth of the 1960s."

Dr. Julius Maldutis advanced four reasons which may explain why U.S. domestic passenger growth is stagnant:

- Some in the academic community are beginning to raise the question, Is it a mature industry? In 1994, 255 million Americans flew, making 460 million trips. How many more times can you travel? That's one possible answer.
- The second possible answer is globalization. Every U.S. company buys, sells or competes in the global arena. Perhaps the business traveler to Cleveland didn't disappear but now is going to Copenhagen to buy the milling machine; namely, a diversion from domestic to international [travel].
- The third possibility: At the end of 1993, the United States had 15,000 video teleconferencing centers. In my company, every Monday morning, we have a general sales meeting that is televised to all our branch offices around the globe. IBM is demonstrating a PC that has a video camera, and now all IBM executives can be in a video teleconference via their computers. Or the

27. The Asia-Pacific region is growing fastest. In 1990, it accounted for about 31% of the world's total market, and 132 million passengers. By the year 2000, IATA estimates the region will account for 189 million passengers, or 39% of the world's total; by 2010, it will account for 375 million passengers, or 51% of the world's total. IATA predicts that the doubling of traffic in the region over the past six years will be repeated, with China, Malaysia, Thailand and Indonesia expected to be growing fastest. Asian-Pacific, Airline Bus., 1992, at 55. For Asian markets, the Orient Airlines Association predicts 7.5% traffic growth through the year 2000; IATA predicts between 7% and 8.6% growth through the year 2010; OECD predicts 8.5% traffic growth in the Asia/Pacific region during the next two decades; and McDonnell Douglas predicts 9.7% through the year 2010. See Has the Asian Bubble Burst? Airline Bus., Oct. 1993, at 7; and Air Traffic to the Year 2003, ICAO Rev., Oct. 1994. No matter who is making the predictions, all are tremendously optimistic for the Asian-Pacific passenger market. Seven of the ten most profitable airlines in the world in 1993 operate in this region. Airline Business 100 Data, Airline Bus., Supp. 1994, at 59. The year before, twelve of the twenty most profitable airlines were domiciled in the Asian-Pacific Region. Has the Asian Bubble Burst? Airline Bus., Oct. 1993, at 7.
29. Evans, supra note 7, at 53.
30. Maldutis, supra note 4.
31. Evans, supra note 7, at 52.
Airline Domestic Intercity Passenger-Miles
(1940-1993)

Billions Passenger-Miles

Year

Copyright c 1994
Paul Stephen Dempsey

Transportation Law Journal
chief executive of an engine manufacturer says that he has constructed two video teleconferencing centers and now has no employees who need to travel between East Hartford and the Florida plant. Thus, technology may be affecting intracorporate business travel.

- But the fourth reason is perhaps the most important reason of all in assessing what is happening to the airline industry. In the last four years 1.6 million Americans have been restructured. . . . One and a half million white-collar, middle-management frequent flyers have lost their jobs. To me, this is the fundamental cause of the airline industry's difficulty. The lack of growth is a function of the fact that corporate America is undergoing vast structural change, and this vast structural change is affecting the airline industry travel market.32

Many small businesses simply have been priced out of the passenger market by aggressive yield management, and no longer fly. With corporate downsizing constraining the white collar labor force and trimming travel budgets, and communications technologies improving robustly, business travel fell to 37% of traffic in 1992, and 48% in 1993.33 In the late 1980s, business traffic accounted for between 52% and 60% of domestic traffic and 75% of revenue.34 The shift of demand to the price-sensitive leisure market will relentlessly erode carrier yields.

This appears to be a global phenomenon, reflected in the reduction of the number of first and business class seats by, for example, KLM, British Airways, Japan Airlines, ANA, American Airlines and Northwest.35 If the sharp decline in business traffic is other than a short-term aberration, the airline industry is in very serious trouble.

Airlines have conditioned consumers to hold unrealistic expectations of what a ticket should cost, and to withhold discretionary spending until price wars erupt, as they eventually and inevitably do. All carriers fly essentially the same aircraft, and increasingly, most offer less service, and thus, relatively little service differentiation; hence most consumers view air travel (unlike hotel rooms) as a fungible commodity. As economist Robert Kuttner observed, airlines are

a highly capital-intensive industry with a standard product [which] cannot stand pure price competition — for all the profits would soon be competed away. Airlines dwell not in an Adam Smith world but in a world more reminiscent of economist Joseph Schumpeter's model in which 'efficiency' de-

34. EVANS, supra note 7, at 51.
pends more on technical advances than on price wars.\textsuperscript{36}

Foreign markets, while growing steadily, are increasingly protectionist and militant. Foreign governments view U.S. firms as dumping excess capacity abroad and endangering their national flag carriers. For example, while the U.S. may not care about Pan Am's survival, the government of France cares dearly about the survival of Air France. On grounds that U.S. airlines were providing excessive capacity in the market, France renounced the U.S.-France bilateral aviation agreement on May 4, 1992, and it expired one year later. Thailand renounced its bilateral for similar reasons.\textsuperscript{37} The Australian Department of Transport moved to restrict the number of fifth-freedom passengers Northwest could carry between Osaka and Sydney. Friction has also erupted in U.S.-Japanese aviation relations, a market dominated by Japanese passengers by a 6 to 1 margin, but where U.S.-flag carriers fly 60\%-70\% of the capacity.\textsuperscript{38}

Increased privatization and mergers will enhance the competitive prowess of foreign carriers. Many emerge from privatization with relatively clean balance sheets and route structures built by decades of paternalistic care. More than 40 foreign airlines have proposed or completed partial or full privatization.\textsuperscript{39}

\section*{D. Price}

Despite widespread allegations that deregulation resulted in billions of dollars in consumer savings, the truth is that prices were falling faster before deregulation than after it. Inflation adjusted yields declined 2.5\% annually from 1950 to 1978; they fell only 1.7\% a year after 1978.\textsuperscript{40} In the decade preceding 1978, fuel adjusted real yields fell 2.7\% annually; in the decade following promulgation of the Airline Deregulation Act of that year, fuel adjusted yields declined only 1.9\% a year.\textsuperscript{41}


\textsuperscript{37} For a discussion of conflict resolution under bilateral air transport agreements, see Paul S. Dempsey, \textit{Law & Foreign Policy in International Aviation} (1987).


\textsuperscript{39} Malduitis, \textit{supra} note 4.

\textsuperscript{40} Edmund Greenslet, World Airline Capital Requirements, Address Before the Chicago Convention 50th Anniversary Conference (Oct. 31, 1994).

\textsuperscript{41} Dempsey & Goetz, \textit{supra} note 6, at 243-63, 281-95. Moreover, a yield measure of pricing in the post-deregulation era overstates the consumer benefits because hubbing has made traveling more circuitous for most passengers — they fly more miles today to get from A to B through H. The linear route pre-deregulation systems were generally in a somewhat straight line. Plus, the yield number includes frequent flyer redemptions, which did not even exist before 1978. These factors make it even more remarkable that yields fell more slowly since deregulation than before it.
1995]  

Airlines in Turbulence  

Today, the airline industry prices in a highly schizophrenic way — we see evidence of monopoly, monopsony and variable cost based destructive competition side by side, as we would expect to see in any deregulated public utility. Ninety-three percent of passengers pay an average of only about 30% of the full fare.42 The full fare has risen to such prohibitive levels that only those who absolutely must will pay it (only 10% of passengers do).43 Inequitable distortions in the pricing system force tens of thousands of people who would fly at a reasonable price simply to stay home.

Pricing at concentrated, gate and slot constrained airports is monopolistic, as the U.S. General Accounting Office (GAO) has well documented.44 But not enough monopolies yet exist to cover the industry’s fixed costs and offset steep discounting in competitive markets. Moreover, the Fortune 500 exert monopsony power to play carriers off against each other for corporate discounts at the discretionary traveler level, without the restrictions, a level which often fails to cover fully allocated costs.

Computer reservations systems and computer software will enable increased decoding of the effort of yield managers to obfuscate the availability of the cheapest seats. Carriers will continue to follow each other down as price wars erupt to sell excessive inventory, because of the factors described above. As one observer noted, “fare wars are like city buses; if you miss one, there’ll be another in 15 minutes.”45

E. Capacity

While some excess capacity will disappear with the collapse of sev-

Prices were falling faster before deregulation than after because costs were not declining the way they were before. In fact, poor profitability led to more leasing, which increased 300% as a portion of operating expenses in the 1980s, while travel agent commissions increased 700% (again, as a percentage of carrier operating expenses). Interest payments ascended because of more debt. Equipment and labor utilization declined because of hubbing. The average size of larger and larger aircraft (with corresponding declining ASM costs) grew until the early 1980s, then plateaued, largely because carriers needed 737 and equivalent stage length and seat capacity aircraft to feed hubs. These changes (plus the lack of a breakthrough technological revolution the equivalent of jets at Boeing and Douglas in the past 15 years) help explain why the decline in yields slowed post-deregulation.

By perpetuating the myth that consumer benefits are enormous, the airlines postpone the day when our government can take any sensible measures to rescue the industry from its financial collapse. Id.

42. JULIUS MALDUTIS, AIRLINE UPDATE: IT’S ABOUT TIME! 9 (1994).
43. Maldutis, supra note 4.
45. Carl Quintanilla, Air-Fare War Is Proving to Be A Battle of Wits, WALL ST. J., June 14, 1994, at B-1.
eral major airlines and the downsizing of others, many used aircraft and skilled labor simply are recycled into the fleets of new entrants and growing carriers. For example, Delta sold a large number of DC-9s, only to see them re-emerge in Atlanta in the fleet of low-cost ValuJet.

Moreover, financing is available via the equipment manufacturers both for new entrants and carriers emerging from Chapter 11. While the leasing companies may have been disciplined from the profligate decade of the 1980s, public sources of capital, in the form of state and local contributions and guarantees, have become increasingly available — to TWA (from Missouri), Northwest (from Minnesota), United (from Indiana), and American (from North Carolina). Foreign airlines also continue to inject significant capital into U.S. firms to take advantage of the domestic feed they provide into their lucrative long-haul wide-bodied international networks (e.g., KLM-Northwest, British Airways-USAir, and Air Canada-Continental). For a growing number of airlines, labor has also become the lender of last resort (e.g., TWA, Northwest, and United). Moreover, further constriction of the industry is impeded by the bankruptcy laws (unlikely to be changed), and the antitrust laws (likely to be more vigorously enforced).

These factors ensure that neither enough marginal carriers nor significant excessive capacity will disappear soon, depriving the surviving carriers of traffic at adequate prices to cover their fully allocated costs plus a reasonable profit. All the while, the balance sheets of most established major network carriers will continue to deteriorate.

F. AIRLINE BALANCE SHEETS

Since deregulation, the balance sheets of U.S. airlines have been polluted with enormous debt, caused by grossly inadequate profitability and, at some airlines, leveraged buy-outs [LBOs].46 Total debt to capital ratios now exceed 65% at virtually all the major U.S. airlines, and would be worse still if long-term operating leases were capitalized. Wall Street has downgraded that debt to “junk” status, if only because it has no lower category. As Wall Street analyst Julius Maldutis aptly noted, if the airlines were savings and loan institutions, the government would put them into receivership and liquidate them.

Philip Baggaley of Standard & Poor's concluded that the prospectus for returning the major U.S. airlines to investment grade was grim:

The required operating margins are well above any historical performance and the required new equity actually exceeds the total market capitalization of these companies. Basically, the problem is that airlines are carrying a much heavier burden of debt and leases now than they were in the 1980's.

46. Dempsey & Goetz, supra note 6, at 11-40.
For example, AMR had about $6 billion of debt and leases in 1988, their operating margin high point. The total now is about $18 billion.\textsuperscript{47} 

Similarly, Felix Rohatyn of Lazard Freres estimated in 1993 that the U.S. airline industry would need to earn $15 billion annually each and every year through the year 2000 just to improve their balance sheets to a 50/50 debt/equity ratio.\textsuperscript{48} That is a level of profitability the airline industry has never attained.

At this writing, fuel costs and interest rates are relatively benign, but they will not always be. Nonetheless, even when the economy improves, debt service will consume much of potential operating profit. The recommendations of the U.S. National Commission to Ensure a Strong Competitive Airline Industry for meaningful tax reform will not likely be implemented by a Congress already fearful of its own debt burden.\textsuperscript{49} Carriers will continue to bid up travel agent commissions in an effort to buy traffic.\textsuperscript{50} The potential for spinning off short haul feeder routes and ancillary services (as United proposed in 1993) will be met with labor antagonism and a consequent deterioration of service.\textsuperscript{51} Some carriers have used Chapter 11 to trade debt for equity (e.g., Continental and TWA). Trading wage and work rule concessions for equity (as TWA, Northwest and United have done, and USAir and American would like to do) seems the primary opportunity for reducing costs.\textsuperscript{52} And in fact, the comparative lower cost advantage thereby given TWA, Northwest and United likely will cause American, Delta and USAir to follow suit or risk eventual extinction.

New equipment has been deferred (although this creates a problem for phasing out Stage Two aircraft), and more than 700 aircraft have been parked in the desert. It is doubtful that auxiliary services in the long term can be profitable if the core airline is weak, although American Airlines is moving forcefully in that direction. While hubbing enhances network and marketing efficiency, it sacrifices operational efficiency and squan-

\begin{footnotes}
\item 47. Baggaley, supra note 12.
\item 50. As a portion of total operating expenses, travel agent commissions rose 308% between 1980 and 1990. Paul S. Dempsey et al., 1 Aviation Law & Regulation § 2.19 (1993).
\item 51. As one commentator noted, "The only other option [to trading equity to labor for wage and work rule concessions] is slash-and-burn restructuring with labor war and significant disruptions of the national travel system." Joseph Conn, Expert: United Plan Sets Pattern for Others, Denver Post, Dec. 28, 1993, at 4C.
\item 52. In late 1993, United reached an agreement with its pilots and machinists whereby labor would take 52% of voting equity in exchange for $5.1 billion, partly in terms of wage and work rule concessions. In mid-1993, employees at Northwest surrendered billions of dollars in wage and work rule concessions for 37.5% of the airline. Earlier, TWA, emerging from bankruptcy, gave employees 45% of equity in the airline for significant concessions.
\end{footnotes}
ders productivity in equipment, fuel and labor utilization, and is being reevaluated at Continental and United Airlines.

Despite the conventional wisdom, deregulation has not resulted in increased industry productivity.\textsuperscript{53} In fact, hubbing, the dominant megatrend on the deregulation landscape, appears to have reduced efficiency and productivity in labor and equipment utilization, increased airport congestion, modestly increased travel circuity, and has been a catalyst for the purchase of smaller aircraft, ending the pre-deregulation trend toward larger and larger aircraft.\textsuperscript{54} As one source observed, "Overall in the ten years after 1983, despite deregulation and intensified competition, neither cabin crew nor flight crew productivity appear to have improved in North America."\textsuperscript{55}

Some contend that the success of Southwest is proof positive that good management will harness costs and resolve these problems without the need for governmental intervention. Southwest thrives on a comparative advantage that other airlines cannot achieve because of existing labor agreements and their tenacious commitment to hubbing, CRS, travel agents, and other costly overhead. The success of 4\% of the U.S. industry, predicated in part on artificial comparative advantages created by the labor laws, and the Wright Amendment (yields in the Southwest dominated Dallas-Houston market exceed 20 cents a mile),\textsuperscript{56} should not dictate national policy for the 96\% of the industry which is collapsing, and upon which most Americans must rely. If we could wave a magic wand and give all airlines Southwest's cost structure, the industry eventually would compete away its profit, for the reasons described above. This author told Southwest's Herb Kelleher that if every airline had his cost structure, they would still find a way not to make a profit. He did not disagree.

III. Survival and Growth Strategies

After more than a decade of deregulation, several survival strategies have emerged. Listed below are several.\textsuperscript{57} They are neither listed in order of importance, nor are they of equal value. But generally speaking,

\textsuperscript{53} "Any business that produces an ever smaller amount of physical product for each dollar of cost had better be able to raise its prices at will. Needless to say, this is not an option generally available to the airlines." \textit{ESG Aviation Services, 7 The Airline Monitor} 5 (Sept. 1994).

\textsuperscript{54} \textit{See Dempsey & Goetz, supra} note 6, at 317-18.

\textsuperscript{55} Rigas Doganix, Fariba Alamdari & Andrew Lobbenberg, \textit{Who is Lean & Mean?}, \textit{Airline Bus.}, Nov. 1994, at 22, 31.

\textsuperscript{56} \textit{Aviation Daily}, Sept. 23, 1994, at 493. In the Southwest dominated Chicago-Detroit market, yields are nearly 30 cents. \textit{Id}.

\textsuperscript{57} Not to take all the credit, several of these characteristics, or derivations of them, have been identified by other sources, including Airline Economics, Inc.
the more of them an airline possesses, the better its chances for survival in the ruthlessly Darwinist environment unleashed by deregulation and liberalization.

A. Operational Alternatives

1. Route Strategies

   a. STRATEGICALLY LOCATED HUB-AND-SPOKE NETWORKS — Before deregulation, while Atlanta (for Delta) and Pittsburgh (for Allegheny, now USAir), were moderately concentrated, no airline dominated more than 50% of the market (measured by gates, passengers, or takeoffs and landings) at any major airport in the United States. Today, dominant airlines control more than 60% of the market (sometimes more than 90%) at 17 major airports. The infrastructure of gates and landing slots at the major airports has been consumed by the megacarriers, leaving little room for significant new entry.\(^{58}\)

   One source notes:

   A product of deregulation, the hub system was initially a great success. It enabled more airlines to envelop huge geographical regions like giant spiderwebs, snare passing traffic and expand market share. By replacing linear routes, it multiplied customers flight options — and customers. American Airlines, for example, has 455 daily departures from Dallas/Fort Worth International Airport compared with 137 in pre-hub 1979. Hubs also integrated remote cities into a national and international route network.\(^{59}\)

   Strategically located hubs are designed to allow the carriers to blanket the nation with ubiquitous service. For example, United has hubs at Chicago, Denver, San Francisco, and Washington, D.C. (Dulles). American Airlines established hubs at Chicago, Dallas/Ft. Worth, Nashville, Raleigh/Durham, and San Juan. Delta has hubs at Atlanta, Dallas/Ft. Worth, Salt Lake City, and Cincinnati. America West hubs at Phoenix and Las Vegas.

   In contrast, TWA has a domestic hub only at St. Louis (and an international gateway at New York-Kennedy). Before its demise, Pan Am dominated no domestic airport. Among the airlines which have fallen into bankruptcy, only Continental had multiple strategically located hubs — at Houston, Denver, Cleveland and Newark (the latter it acquired from People Express on its death bed).\(^{60}\)

   What are the characteristics of an airport that make it an attractive

\(^{58}\) 88% of the gates at the nation's 66 largest airports are leased to airlines, and 85% of the leases are for exclusive use. Intelligence, Aviation Daily, Aug. 20, 1990, at 323.


\(^{60}\) Continental no longer maintains a hub in Denver.
venue for a hub? A prudent airlines seeks these attributes: (1) an interior point geographically situated for flow from several directions, particularly east to west, since that is the routing of most business traffic (the most lucrative share of the market); (2) a large population base to enhance high-yield origin and destination (O&D) traffic, preferably white collar (again, because business travelers pay more for air transportation); and (3) preferably, no nearby hubs or competing airports dominated by another airline.61

Hubbing is advantageous for a number of reasons. It allows enhanced marketing opportunities via the geometric proliferation of the number of possible city-pair markets which can be served. Thus, significant networking economies may be achieved via hubbing. Moreover, consumption of airport infrastructure can translate into higher yields. Yields at concentrated airports are more than 20% higher per mile for passengers who begin or end their trips there than at unconcentrated airports.62 Hubbing also results in a yield premium for connecting traffic, particularly in the large majority of city-pair markets not served nonstop. Some hub carriers have learned to focus on this high-yield connecting traffic, and avoid the local price wars.63

Airlines with more gates, takeoff and landing slots (at capacity constrained airports), and/or code sharing agreements charge significantly higher prices than those without, according to the GAO. In fact, flights at airports where majority-in-interest clauses reduce expansion opportunities result in 3% higher fares; flights at slot controlled airports result in 7% higher fares; and carriers with code-sharing arrangements charge 8% higher fares.64

In 1988, the eight largest airlines owned 96% of the landing and takeoff slots at the four slot-constrained airports (i.e., Chicago O'Hare, Washington National, and New York's Kennedy and LaGuardia). In 1985, before the U.S. Department of Transportation decreed these public resources could be bought and sold in the market, the eight largest airlines controlled only 70% of the slots.65 An airline which doubles the number of its gates enjoys a 3.5% increase in fares.66

These yield advantages are achieved because of a broader economic

---

63. Maurice Myers, Address Before the Salomon Brothers Transportation Conference (Nov. 17, 1994).
64. Dempsey et. al., supra note 61, at § 5.05.
66. Id. at 6.
principle, the "S Curve," which posits that the dominant carrier in terms of frequency and capacity in any market will enjoy a disproportionate share of the traffic in terms of higher load factors and higher yields.67

International carriers also employ their gateways as venues for sixth freedom connecting traffic. For example, KLM puts enough capacity on the North Atlantic to transport the entire population of the Netherlands to the United States in a single Summer. Most of the traffic is funnelled through its hub at Amsterdam Shiphol, from or to points beyond.

Several sources have criticized hubbing as inefficient for short-haul operations, because of the increase in delay and congestion, which has a debilitating effect on labor and aircraft productivity. They point to Southwest’s average of 20.4 minutes of ground time, compared to American’s 50.3 minutes.68 Southwest’s half hour less ground time translates into enhanced aircraft utilization, 22% higher than the industry norm.69 Moreover, the absence of banking flights into congested hub airports also results in more efficient use of ground personnel. The following chart provides comparisons of aircraft utilization of selected major carriers:

<table>
<thead>
<tr>
<th>Airline</th>
<th>Average Stage Length</th>
<th>Daily Aircraft Utilization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Southwest</td>
<td>380</td>
<td>10:55</td>
</tr>
<tr>
<td>America West</td>
<td>637</td>
<td>10:35</td>
</tr>
<tr>
<td>United</td>
<td>826</td>
<td>9:44</td>
</tr>
<tr>
<td>USAir</td>
<td>518</td>
<td>9:44</td>
</tr>
<tr>
<td>Delta</td>
<td>626</td>
<td>9:35</td>
</tr>
<tr>
<td>Continental</td>
<td>793</td>
<td>9:29</td>
</tr>
<tr>
<td>American</td>
<td>835</td>
<td>9:25</td>
</tr>
<tr>
<td>Northwest</td>
<td>705</td>
<td>9:08</td>
</tr>
<tr>
<td>TWA</td>
<td>695</td>
<td>9:01</td>
</tr>
</tbody>
</table>

Despite the growth and profitability of Southwest Airlines and its linear route clones, American Airlines’ Chairman Robert Crandall argues,

hubs will continue to be the most efficient way, in most markets, of providing the frequent time-of-day choices travelers like even more than they like nonstop service. In fact, intense competition between multiple carriers of-

67. Barbara Beyer, Address at the International Conference on Aviation & Airport Infrastructure, Denver, Colorado (Dec. 5-9, 1993).
68. SH&E, The Facts About American vs. Southwest 47 (unpublished study prepared on behalf of APA, Sept. 13, 1993). Southwest’s average stage length is 380 miles, compared to American’s 807. Id. at 49.
69. SH&E, supra note 68, at 48-49.
70. Mead Jennings, Staying At the Top, AIRLINE BUS., Mar. 1994, at 28, 31; see also SH&E, supra note 68, at 49.
faring very frequent service to many destinations via multiple hubs tends to make most nonstop service unfeasible.71

He continues:

One of our greatest strengths is a huge and well-integrated domestic and international route system centered around our six hubs. This hub-and-spoke system allows us to serve thousands of markets, thus generating a large network revenue benefit . . . .

While a hub-and-spoke system is admittedly more expensive to operate than a comparably-sized system of point-to-point routes, the system's incremental costs are more than offset by its enormous revenue benefits. For example, we estimate that there are fewer than 500 city pair markets in the United States big enough to adequately support point-to-point jet service. However, our hub-and-spoke system makes it possible for American to effectively serve over 10,000 markets — and realize a large revenue per available seat mile premium relative to point-to-point carriers.72

Nevertheless, hubbing sacrifices equipment and labor utilization and consumes more fuel than a linear route system in markets sufficiently dense to support nonstop service. Clearly also, the United States is over-hubbed by duplicative parallel route networks connecting virtually every conceivable city-pair market. To trim costs and reduce capacity, carriers have begun to down-size or close hubs, as United has done at Washington Dulles airport (while retaining it as an international gateway), American has done at San Jose and Raleigh-Durham, and Continental has done at Denver.

b. LINEAR ROUTE SYSTEMS — As noted above, the only profitable U.S. major airline, Southwest, embraces a point-to-point linear route system, which allows more productive equipment and labor utilization, and more efficient fuel consumption than does a hubbed operation. Southwest avoids congested airports, focusing instead on secondary airports in many markets, thereby allowing a quick turn around time (15 minutes is the goal).

Think of an aircraft as a $30 million to $180 million factory that produces consumer goods — in this case, seats. A factory that runs more hours per day produces more seats. Southwest's planes sit on the ground only 15-20 minutes. United's sit at its hub airports for 45-55 minutes, during which time they produce no product. Southwest also enjoys enhanced asset utilization by using its gates 10-12 times a day compared to United's six times a day.

A few of the megacarriers appear interested in following Southwest's lead, with Continental inaugurating CALite and United launching U-2, or

“United Express.” Nonetheless, one source predicts that hubs will continue to dominate air transportation:

While there is increasing demand for point-to-point services and carriers willing to offer them like Southwest, Continental Lite and a number of new entrants, the actual amount of traffic carried on the flights is only about 6 to 7 percent of the total traffic. Most city pairs are too small to justify point-to-point service so the maximum growth in traffic will probably never exceed 20 percent of the total traffic. Thus, at least 80 percent of all passengers are still expected to utilize hub services into the foreseeable future.73

c. REGIONAL FEEDERS AND FRANCHISEES — Many airlines rely on smaller feeder carriers to bring passengers from smaller communities to connect with their long-haul systems. As a rule, these regional carriers operate smaller turboprop or piston aircraft painted in megacarrier colors and logo, and do not pay union wages. Baggage is interlined, and code-sharing falsely suggests to the consumer that single-firm seamless service is being provided. Several of the major carriers have turned over short-haul traffic to these regional feeders.

d. INTERNATIONAL ROUTES — The global air transport market is growing, and many international markets are quite lucrative. Although traffic is temporarily down on the North Atlantic, airlines which serve the North Pacific and Latin American market enjoy the most attractive yields. Both Northwest and United earn a disproportionate share of their total income from international markets. Between 1987 and 1989, Northwest earned between 68% and 91% of its total operating profit from international markets, while United earned between 24% and 34%.74 Many industry analysts predict international markets will grow faster than domestic markets during this decade.

With the collapse of Pan Am and Eastern, and the bankruptcy of TWA, the larger domestic U.S. carriers have replaced them in major international markets. Thus, United Airlines purchased Pan Am’s transpacific, Latin American and Heathrow routes. American Airlines purchased Eastern’s Latin American routes (earlier acquired from Braniff), and TWA’s Heathrow authority. Delta bought Pan Am’s European routes (absent Heathrow).

Many of these markets enjoy higher yields because governments limit the number of carriers which may be designated to serve them. Many nations have rejected the U.S. policy of “open skies.”75

73. Beyer, supra note 67.
75. See Paul S. Dempsey, Law & Foreign Policy in International Aviation (1987).
2. Fuel Efficient Fleet of Standardized Aircraft

Fleet simplification allows a reduction in the inventory of spare parts, as well as maintenance and training costs, and thereby improves the cost, speed and efficiency of aircraft maintenance. Southwest flies only the Boeing 737. Flying a single aircraft type not only allows Southwest to enjoy enhanced worker productivity vis-a-vis its competitors, it also allows Southwest to realize lower maintenance costs, some 25% less than the industry average. 76

Until recently, United flew predominantly Boeing aircraft. In November 1993, United took delivery of its first Airbus A-320s, acquired under very favorable terms, including a walk away lease. Not long before, United boasted that buying planes from a single manufacturer, Boeing, promoted "commonality within the fleet which assures significant long-term operational efficiencies." 77

Newer aircraft have higher acquisition costs, but lower operational costs. Newer aircraft are more fuel efficient, allow enhanced labor productivity, and cost less to maintain. They are also more reliable.

But inadequate profitability in the 1980s caused the U.S. fleet to degenerate into the oldest in the developed world. Thirty-one percent of the U.S. fleet now exceeds the economic design goals originally set by the manufacturers. 78 Aircraft more than 20 years old now make up a quarter of the U.S. fleet. 79

Economics now determines when aircraft are retired. 80 Spending $3 million to husk kit a 25-year-old plane is more economically rational than spending $35 million on a new aircraft. 81 As one observer noted, "with the harrowing airline economics of the early-1990s, the trouble and expense of keeping old planes aloft comes down to a simple maxim: If it's broke, fix it." 82

The following chart reveals average fleet age for selected major airlines:

80. Id.
81. Id. at A15.
82. Id.
TWA's fleet is 18.3 years old on average, while America West's is a youthful 7.7. By the time Pan Am collapsed in December 1991, its fleet had grown to a geriatric 18 years. In contrast, British Airways' fleet is 8.0 years old, Swissair's is 7.3 years old, Qantas' is 5.9 years, and Singapore Airlines is but 4.9 years young.

Merged airlines have been forced to deal with the problems of consolidating huge fleets of aircraft of inconsistent types produced by several manufacturers, which increase the cost of maintenance and require multiple inventories of spare parts.

In the United States, deregulation led to an unprecedented number of mergers and acquisitions during its first decade. As a consequence, Continental, which consolidated Texas International, New York Air, People Express and Frontier under a single roof, experienced this problem of blending an eclectic collection of disparate aircraft fleets and corporate cultures, causing costs to soar and service to decline. Northwest flies the fleets of North Central, Southern and Hughes Airwest, which merged to form Republic, which Northwest acquired.

In contrast, airlines which grow from within (such as, for the most part, United) save maintenance cost and aircraft down time by incrementally growing with relatively standardized fleets. Nonetheless, American, Delta USAir, and Northwest each fly eight different aircraft types.

The U.S. Congress has mandated the retirement of Stage 2 aircraft by January 2, 1999. As of May 1990, the airlines with the highest percentage of aging Stage 2 aircraft were: Eastern (70%), Northwest (65%), Pan

---

85. DEMPSEY et. al., supra note 61, at § 2.01.
86. Julius Malduitis, British Airways Plc — The Crown Jewel, Aug. 23, 1993, at 5. British Airways is also pursuing a fleet modernization and simplification program. Id.
87. Otto Loepp, Address at the Salomon Bros. Transportation Conference (November 18, 1994); James Strong, Address at the Salomon Bros. Transportation Conference (November 18, 1994).
88. Kling, supra note 76.
Am (58%), USAir (55%), TWA (55%), Continental (52%), and Midway (85%). As noted above, deregulation also produced the hub-and-spoke phenomenon — the dominant megatrend on the deregulation landscape. Hubbing requires that airlines fly passengers more miles in smaller aircraft with more takeoffs and landings. Indeed, hubbing led many airlines to cancel orders for wide-body aircraft in the early 1980s, and either fly their existing jets or place orders for narrow-bodied planes. The average seat mile costs for a wide-bodied aircraft like a Boeing 747 are significantly lower than that of a narrow-bodied plane like a Boeing 737 or 727. Yet hubbing bleeds off the traffic that might otherwise support more long-distance nonstop wide-bodied service.

3. Low Debt

The operating losses engendered by deregulation created enormous debt. Despite reduced wages, airline operating expenses increased 94% during deregulation’s first six years. During deregulation’s first decade, the industry suffered a 74% decline in its profit margin to a mere 0.9% — until now, the worst financial period in the industry’s history. Deregulation also freed corporate raiders, like Frank Lorenzo (at Continental and Eastern), Carl Icahn (at TWA), and Alfred Checchi (at Northwest) to laden airlines with suffocating debt. As a percentage of total capitalization, Eastern’s debt climbed from 79% of total capitalization in 1980 to 473% in 1988, its last year before bankruptcy. TWA’s debt soared from 62% in 1980 to 115% in 1989. Continental’s rose from 62% in 1980 to 96% in 1989. Pan Am’s debt soared from 62% in 1980 to 273% in 1989. Congressman Byron Dorgan aptly noted, “I’m not so alarmed if they load up a lipstick company with debt and it fails. But if you do that to an airline, it’s a real blow to the public interest.”

Unfortunately, low debt has subjected some airlines to leveraged buy outs. Low debt suggests there are lots of assets owned which can be sold.

94. Id.
95. Id.
96. Id.
to pay off the debt assumed during the acquisition. For example, Northwest had one of the lowest percentages of aircraft leased (4%) in the industry prior to its leveraged buy-out. The Checchi group put up $40 million, while persuading KLM to put up $400 million (since written down to zero on KLM's books), while Northwest was saddled with more than $3 billion in debt. The LBO so loaded Northwest with debt that, in order to avoid Chapter 11, Northwest deferred aircraft deliveries, convinced banks to defer loan payments, and convinced labor to take deep wage cuts in exchange for stock. But by 1994, despite several profitable quarters, Northwest was still struggling to refinance $4 billion in debt, with a $1.7 billion note due in 1997.

In order to thwart potential LBOs, some airlines have sold aircraft and leased them back, a strategy which reduces the inventory of aircraft which could finance an LBO, but nonetheless increases the long-term costs of doing business, whether the debt shows up on the books of the airline or not.

The following chart reveals the total debt/total capitalization ratios and percentage of fleet leased for selected major airlines:

<table>
<thead>
<tr>
<th>Airline</th>
<th>Debt/Capitalization</th>
<th>Leased/Total Aircraft</th>
</tr>
</thead>
<tbody>
<tr>
<td>American</td>
<td>64.78%</td>
<td>47%</td>
</tr>
<tr>
<td>Continental</td>
<td>77.60%</td>
<td>86%</td>
</tr>
<tr>
<td>Delta</td>
<td>68.03%</td>
<td>47%</td>
</tr>
<tr>
<td>Northwest</td>
<td>156.37%</td>
<td>44%</td>
</tr>
<tr>
<td>Southwest</td>
<td>34.90%</td>
<td>51%</td>
</tr>
<tr>
<td>United</td>
<td>84.96%</td>
<td>55%</td>
</tr>
<tr>
<td>USAir</td>
<td>113.49%</td>
<td>47%</td>
</tr>
</tbody>
</table>

TWA leases 68% of its fleet, while America West leases 78% of its. In contrast, British Airways leases only one third of its fleet. Among major U.S. airlines, operating leases rose from 35% of total capital in 1987, to 55% in 1992. If the long-term operating leases were put on the airlines’ balance sheets, they would look considerably worse than

99. Dempsey et. al., supra note 61, at § 2.07.
101. Malduit, supra note 19.
103. Malduit, supra note 86, at 11.
they already do. Most of the airline industry has already had its debt downgraded to junk.

4. Conservative Growth

Few airline executives have been successful in restraining themselves from growing too rapidly. Sir Freddie Laker started Skytrain, made a bundle of money flying from London to New York, found himself on the cover of Time magazine, then bought one DC-10 after another until he found himself in bankruptcy. Donald Burr made a bundle of money flying low-cost low-frills service out of Newark, found himself on the cover of Time magazine, then bought Frontier Airlines, Britt, and PBA, until he too found himself in bankruptcy.

Southwest Airlines grew by two cities a year with one type of aircraft (the Boeing 737) flying a linear route system until 1993, when it announced the purchase of Morris Air, hubbed in Salt Lake City, for $128.5 million, and placed a $2.5 billion order for 63 Boeing 737X aircraft to be delivered between 1997 and 2000, the largest order in the 22 year-old carrier's history. Southwest entered seven new cities in 1994, increasing its available seat miles [ASM] 29% in the fourth quarter of that year. It remains to be seen whether this aggressive growth strategy will in the long run be successful, with the emergence of non-union low cost Southwest clones (e.g., Kiwi and Reno Air), as well as major carriers restructuring to compete in low-cost Southwest-type operations (e.g., CAL-lite and U-2).

5. Low Wages/Flexible Work Rules

Some airlines have broken unions and thereby reduced costs. Continental and TWA are prime examples. Although Continental has lower labor costs than any other major airline (its available seat-mile cost is 8.35 cents, among the lowest in the industry), not even that has kept it out of bankruptcy. Labor acrimony, enhanced by the tactics of its former chairman, Frank Lorenzo, cost it dearly in the 1980s.

The airline industry is a service industry. Happy employees can give

---


106. Herb Kelleher, Address to the Salomon Bros. Transportation Conference (November 18, 1994).

passengers a lovely trip, and lure them back for another, and another. Angry, embittered employees can do the opposite.

Other airlines convinced unions to settle for two-tier wage rates, with the "B" scale at entry grade. American, United, and Delta are examples. During the 1980s, more than half of the pilots and flight attendants at American, for example, were on the "B" scale. Some of the flight attendants at the two-tier airlines, earning between $950 and $1,220 a month,\textsuperscript{108} qualified for food stamps.

In most service industries, salaries account for a disproportionate share of operating costs. But low wages do not guarantee survival. People Express collapsed despite its rock bottom wages. Continental and Midway, also with relatively low wages, fell into bankruptcy (although Continental emerged from Chapter 11, for the second time, in 1993).\textsuperscript{109}

As a percentage of operating expenses, Delta has among the highest labor costs of any major airline.\textsuperscript{110} Yet Delta thrived under deregulation, at least prior to the bout of indigestion it suffered with the acquisition of Pan Am's transAtlantic routes.

In the United States, employment-at-will leaves industries free to lay off newly hired employees. Of course, the most recently hired employees are the poorest paid, meaning that layoffs increase average wages per employee.

Nonetheless, that flexibility cannot be achieved in Europe, where unions seize airports in protest (leading to the ouster of Air France Chairman Bernard Attali), or Japan, whose tradition guarantees employment for life. Nonetheless, some foreign airlines have achieved productivity improvements and modest wage concessions. For example, Lufthansa convinced its workers to accept a one year pay freeze and pilots to fly 75 hours per month (as opposed to the prior limit of 53 hours per month).\textsuperscript{111}

Because of the high value of the Yen, Japanese labor costs are exceptionally high. Japan Airlines has frozen new hiring and pay increases while out-sourcing labor from low wage nations like Thailand and Singapore, and relatively lower wage nations like Germany and the United Kingdom. For example, a Thai flight attendant is paid only about 10% of the salary of a Japanese flight attendant, but is well paid for comparable jobs in Thailand. So as to ensure that acrimony does not breed between


\textsuperscript{109} Continental has the lowest labor costs, as a percentage of operating expenses, of any major U.S. airline. AVIATION DAILY, Feb. 11, 1991, at 276.

\textsuperscript{110} Id.

cabin crew members on the same flight, the Thai attendants are given only five-year contracts.

Before its demise, Pan Am hired low-cost Yugoslavian flight attendants. United Airlines employs Taiwanese flight attendants.

Although carrier staffing levels are not always comparable, because of currency valuation, fleet compositions, stage lengths, social welfare benefits, and so on, the data are nonetheless quite interesting:

| Number of Employees Per 1,000 Revenue Passenger Kilometer at Selected Airlines (1993) |
|-----------------------------------------------|------------------|
| Air France                                    | 1.22             |
| Lufthansa                                     | 1.18             |
| British Airways                               | .76              |
| American Airlines                             | .74              |
| Delta Airlines                                | .66              |
| United Airlines                               | .60              |
| Singapore Airlines                            | .41              |
| Japan Airlines                                | .39              |
| All Nippon Airways                            | .39              |

These data explain why Air France attempted to lay off 4,000 employees in late 1993.

As a rule of thumb, most U.S. airlines have about 100 employees per aircraft. Southwest had close to 90. TWA reduced its number of employees to aircraft from 156 in 1993, to 116 in 1994.\(^{112}\)

6. **Superior Service**

Safety first, then punctuality, appear to be the primary objectives of air transport service for most airlines, although economic imperatives may sometimes conflict with these worthy goals.

In the United States, declining profitability under deregulation has caused a nearly universal degeneration of airline service, so consumers have been taught not to expect much. Consumer polls reveal Americans rate foreign airlines higher than U.S. airlines. When USAir consumed Piedmont, its loyal customers were most concerned with whether USAir would continue Piedmont’s practice of giving passengers the full can of Coca-Cola, rather than just a cup. That one example reflects how far consumer expectations have fallen.

The point is, today, it does not take much service to stand out as being better. Consumers can be, and too often are, turned off by late arrivals and departures, dirty planes, inedible food, and embittered em-

\(^{112}\) Jeffrey Erickson, Address to the Salomon Bros. Transportation Conference (November 16, 1994).
ployees. The three largest airlines — Delta, United and American — typically are rated higher than other domestic airlines in terms of service. One poll ranked them 17th, 19th and 20th, respectively, among the world's twenty best airlines.

TWA's service deteriorated horribly with the labor animosity created during Carl Icahn's ownership of the company, and his breaking the backs of the flight attendant's union with a strike in 1986. After Icahn, TWA sought to restore service and differentiate its product by offering enhanced leg room, removing 8% of its seats. It worked. J.D. Power & Associates named TWA the top domestic carrier for long flights.113

Nonetheless, for short flights, customers appear willing to forego service. Southwest offers rock bottom fares for short flights with no meals, and makes a profit doing it.

7. Auxiliary In-Flight Services

Movie theaters apparently merely break even on admissions vis-a-vis film rental, making their profit on soft drinks, pop corn and candy. Hotels also find revenue centers in restaurants, liquor, pay television, telephones, and room and valet services.

Airlines have slowly learned that the captive passenger strapped to his seat can be a source of income, offering alcohol, headsets and movies, duty free products, telephones, as well as catalog sales, for a price. The in-flight magazine and video entertainment also offer a source of advertising revenue. Only Laker Skytrain and People Express explored the possibility of selling food, although this seems a natural source of potential revenue, particularly if the food is good. In the future, individualized interactive video will allow carriers to generate revenue from passengers playing video games, scanning computer libraries, communicating with their offices, word processing, or, on international flights, gambling. We may also see some effort to convert the baggage compartment and the upper deck into sleeping berths on long-distance flights.

8. Auxiliary Non-Flight Services

American Airlines has turned to its various non-flight subsidiaries as profit centers, generating revenue from computer reservations systems, education, consulting, and such. The economies of scale associated with aircraft maintenance, ground handling and catering services have long been profit centers for airlines. Air freight is also a growing profit center for combination carriers.

9. Bundled Travel Services

The tour and travel industry is the largest in the world. Air transportation is one major piece of that industry. Hotels and automobile rentals are two of the other major pieces. On virtually all business or vacation trips, a passenger needs air transportation, a hotel, and, often, a rental car.

Several airlines have purchased hotels in the past (e.g., TWA owned Hilton International; Pan Am owned Intercontinental; Air France owned Meridien). United Airlines’ Richard Ferris blundered by trying to assemble a travel network of hotel chains and car rental chains under a single roof, called “Allegis.” Airline people seem not to know how to run hotel and car rental companies any better than hotel and car rental executives know how to run airlines. That was one mistake Ferris made. The other was his wholesale failure to integrate the companies from both a marketing and operational standpoint.

Suppose one airline had the foresight to bring travel under a single umbrella, offering integrated one-stop shopping, discounts with affiliated hotel and car rental companies, and seamless service. Newspaper advertisements would offer bundled air-hotel-automobile discounts.

Suppose a customer called an airline’s reservations agent to book a flight, and was asked,

“Will you also be needing a hotel or rental car? Since you booked your flight on our airline, we can give you a 20% discount at the following hotels, and another 20% discount at the following car rental agencies. Moreover, when you arrive at your destination, you can go straight to your hotel. We will collect your bags at the airport and deliver them later in the afternoon to your hotel room. Or if you prefer, we’ll put them into the trunk of your rental car.”

A passenger could enjoy one-stop shopping with the belief he was enjoying a discount on affiliated product lines, and be free of the enormous hassles of bags. He could take his golf clubs or skis, but be spared the burden of heavy lifting.

In the same way that business travelers become addicted to particular product lines because of frequent flyer mileage, business travelers might applaud a system which would permit them to go straight from their destination airport to their business meetings, allowing their bags to catch up with them later that afternoon at the hotel.

All airlines recognize that consumers detest handling bags. They provide as much in-cabin baggage space as possible. They ensure swift and efficient baggage transfer between themselves and their commuter and code-sharing affiliates. Yet remarkably, no scheduled airline offers
baggage transfer from their aircraft to hotels or automobile rental companies.

Integration would have to take place along marketing and operational lines. Joint advertising and joint discounts are easy. The operational dimension is the trickiest and most critical, because passengers also detest lost bags. So, monitoring would be essential, perhaps coupled with employee rewards for excellence.

But the economies of scope are manifest. Airlines already employ a platoon of baggage handling personnel at every airport. Computer technology would allow tagging at check-in of those bags going to specific hotels or car rental companies. The tags could be florescent orange, if necessary. Car rental companies already have reservations and operations personnel who could collect bags and put them into the trunks of cars. Hotels already have vans and porters to collect bags. The vans could be sent to meet each incoming flight, and the hotel concierge could guide the passengers to the van in the way tour groups are met.

Like most of the innovations airlines have inaugurated, if successful, it will be copied. Therefore, to get the jump on competitors, the first to embrace seamless travel service should identify those hotel chains and car rental companies which business travelers prefer most, and lock those up in an equity and marketing marriage, whereby they trade, say, a block of airline stock for an equally valued block of hotel and/or car rental stock. That would allow each to earn a profit on the other’s business, enjoying significant mutual synergistic marketing advantages.

Customers would get what they have always wanted. They could sit back and relax and leave the least pleasant parts of journeys to the airline, for which they would express their gratitude and loyalty in repeat business to increase load factors and core business. The affiliated hotels and car rental companies would also prosper, and the dividends earned on their stock should reflect it.

B. Marketing Alternatives

1. Frequent Flyer Programs

The widespread service permitted by multiple hubs allows airlines to enjoy economies of density, and better market their product to the most lucrative customer, the business traveler. For example, United Airlines serves all 50 states, not because each is profitable, but because it can hold itself out as satiating the ubiquitous geographic needs of business travelers.

Airlines offer to fill passengers’ business needs, luring them with rewards of free travel to exotic destinations; actually, airlines are encouraging business fraud. Suppose, for example, a distributor of copying paper
offered to sell a business executive paper at a price 25% higher than his competitors, but promised him two free first class airline tickets to Hawaii if he bought the distributor's paper all year long. Wouldn't the business executive be defrauding his company if he purchased the higher priced paper? Yet that is precisely the type of inducement that airlines offer business travelers addicted to their frequent flyer programs. Once addicted, many business travelers select (and bill their companies for) the higher priced flight on the airline satiating their desire for free travel. Indeed, 75% of travel agents report that their business customers chose to fly a particular airline more than half the time because of their membership in a frequent flyer program.\textsuperscript{114}

While stimulating traffic in the short term, the long-term costs of such programs is significant. The number of non-revenue passengers have been growing steadily, and now comprise 6% of all traffic.\textsuperscript{115} The cost of administering the programs is also significant. Carriers have responded in two ways. First, using yield management, they have severely constricted the availability of seats for frequent flyer mileage redemption. Second, they have unilaterally changed the award rules, generally increasing the number of miles needed for free travel.\textsuperscript{116}

2. Computer Reservations Systems

Eighty percent of flights are booked through travel agents, and 95% of agents use one of the airline-owned computer reservations systems.\textsuperscript{117} According to the GAO, an airline which owns its own computer reservations system stands between a 13-18% better chance of selling its product through its system than does a competitor.\textsuperscript{118} American Airlines pioneered them, with SABRE. United owns a majority interest in Galileo. Continental owns SYSTEM ONE, which it took from Eastern for a good deal less than its fair market value. TWA, Northwest and Delta share the combination of PARS and DATAS II (now named WORLDSPAN).

\textsuperscript{116} James S. Hirsch, Airlines Will Devalue Frequent-Flier Miles Next Year, Wall St. J., Apr. 25, 1994, at B1. Arguably, this is a patent breach of contract with passengers who were encouraged to buy air travel to earn miles under one set of rules, and subsequently be told that the airline has no intention of meeting its commitments.
\textsuperscript{117} General Accounting Office, Airline Competition: Higher Fares and Reduced Competition at Concentrated Airports 27 (1990). Airlines attempt to induce travel agents to book flights with them by offering commission overrides, which offer economic inducements for exceeding quotas. A poll of travel agents reveals that more than half of them "usually" or "sometimes" select a carrier in order to obtain override commissions. Id. at 29.
Computer reservations systems have created a sophisticated and expedient means of exchanging pricing proposals, and have facilitated implicit price fixing. They also produce extraordinary profits for their owners, far beyond the rents which could be exacted in a fully competitive market.

3. **Sophisticated Yield Management**

Airlines have learned that by watching passenger demand carefully, they can shrewdly manipulate the number of seats for which restricted discounts are offered on a regular basis, and fill seats with passengers paying the maximum price. That explains the phenomenon of tens of thousands (40,000 to 100,000) of rate changes each day.

Yield management has become a principal means of yield improvement, with some carriers segmenting markets in up to 25 categories. Successful yield management can increase revenue by between 2-5%, and for on-line connections within an airline’s hub, up to 7%.

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

C. **Cost Containment**

The non-union low-cost carriers are the driving force in the industry. Therefore, established major airlines have been compelled to focus on cost containment and reduction.

Some sources maintain that there are three ways to improve carrier profitability — “cutting costs, increasing sales (and market share), and improving yields.” To achieve the equivalent bottom line improvement, an airline would need to slash costs 10%, increase sales by 25%, and improve yields by 5%.

1. **Operational and Equipment Costs**

Some major airlines have studied the Southwest Airlines linear route model and have begun to emulate it. Continental inaugurated CALite,
initially serving 14 cities in the Southeast in a linear route operation. The USAir responded with “Project High Ground,” designed to increase aircraft utilization by significantly reducing ground time. The “quick turn” strategy (designed to emulate Southwest’s 15-minute ground turnaround) should improve productivity and lower operational costs.

Like Continental, United formed U-2, or “United Express,” as a low-wage, short-haul (less than 750 miles) airline within an airline, threatening that if labor failed to conclude an agreement allowing United to create it, the carrier would turn over short-haul domestic routes to low cost, non-union regional feeders. United estimates the agreement will allow it to reduce operating costs in short-haul markets by about 30%, close to Southwest’s approximately seven cents a mile.

Carriers have also responded to the decline in profitability by slashing new equipment purchases. American Airlines cut $5.6 billion in new aircraft. Northwest slashed $3.7 billion in aircraft orders, while United Airlines cut $3.6 billion in aircraft, and $5.5 billion in capital spending overall. Many U.S. firms are parking existing aircraft in the desert to reduce capacity.

This is a global trend. Even the Pacific Rim (among the few remaining bastions of serious traffic growth, governmental protectionism, and modest profitability), has seen its carriers defer or cancel scores of new aircraft. Thai Airlines will take delivery of only 18 of the 23 aircraft it ordered over the next five years. Philippine Airlines is negotiating delayed delivery of six Airbus 340s. Garuda Indonesian Airlines halted plans to purchase 48 wide-bodied Boeing and Airbus aircraft. Malaysian Airlines cut domestic flights, froze hiring, removed surplus aircraft and deferred new deliveries. Only Singapore Airlines (frequently the world’s most profitable carrier) has not announced cuts or delays in aircraft orders.

Some carriers have announced they will “hushkit” their aging aircraft (to stave federal noise requirements), rather than replace them. Thus, Northwest intends to hushkit 40 of its DC-9s whose average age is

126. Id. at A-6.
24 years, so as to be able to fly them another 15 years.\footnote{130}

Others have reduced seat pitch to "shoe horn" more passengers on board. A decade ago, USAir put 145 seats on its 727-200 aircraft; today, the same planes seat 163. United added five rows of seats to its DC-10-30s during the last decade, increasing the number of seats from 232 to almost 300.\footnote{131} TWA tried to differentiate its service by reducing the number of seats to add leg room, but it was costly. Taking four of the seats off a 141 seat MD-80 results in a $87,603 annual revenue loss.\footnote{132}

Generally speaking, and assuming market demand generates comparable load factors, there are enormous economies of scale and lower costs achievable for an airline flying relatively larger aircraft longer distances, vis-a-vis flying smaller aircraft shorter distances. In other words, the per passenger ASM costs ordinarily are lower for larger aircraft than smaller aircraft. And airlines enjoy a cost taper the longer the stage length of the flight.

Thus, Comair and Mesa Airlines, flying turboprop planes with an average stage length of between 150-200 miles, face an ASM cost of between 17-19 cents per mile, far above that of the major airlines.\footnote{133} This requires charging higher yields in short-haul markets, which is often achievable because of the dearth of competition.\footnote{134}

Fuel costs constitute a sizeable portion of operating costs, and are largely governed by events beyond the control of airline executives. The spike in fuel costs caused as a result of Saddam Hussein invading Kuwait added about $3.6 billion to the operating expenses of the world’s airlines between August 1990 and March 1991.\footnote{135} While fuel costs rose significantly during the Persian Gulf crisis, they were nonetheless lower in actual and real terms than they were a decade earlier. Between 1981 and 1984, the actual cost per gallon of aviation fuel ranged between $0.79 and $1.04 per gallon, while in real terms (adjusted for inflation) it ranged between $1.04 and $1.47.\footnote{136} In contrast, aviation fuel sold in 1990 for only $0.77 per gallon, and in 1991 for $0.67 per gallon.\footnote{137}

\footnote{132} Id.
\footnote{133} Larry Risley, Address to the Salomon Bros. Transportation Conference (November 17, 1994).
Jet Fuel Costs
(1977-1992)

Cost per Gallon in Cents

Year

2. Labor Costs

Some have blamed “bad management” for the industry’s woes, while others blame “greedy labor.” As one economist alleged:

It’s not the fault of deregulation, as some critics claim. The basic problem is that, despite a tumultuous 15 years of labor relations since deregulation, very little has really changed. Unions still hold the upper hand in bargaining power at major airlines, leading to high labor costs, low productivity and lots of red ink.\(^{138}\)

Many new non-union airlines enjoy significant comparative cost advantages vis-a-vis established carriers. Arguably, labor costs are among the most potentially controllable operating costs,\(^{139}\) leading troubled airlines to focus on wage and staffing reductions and productivity improvements via work rule changes. For example, Delta has announced an ambitious target of 7.5 cents per mile in three years, dubbed “Project Leadership 7.5,” which would slash its costs by 19%, much of it achieved by draconian (20%) cuts in its work force.\(^{140}\) Delta enjoys more flexibility to outsource work and cut jobs than many of its rivals because the company is not highly unionized, although such a radical change will radically alter the traditional Delta corporate culture of labor-management cooperation.\(^{141}\) Continental has already achieved unit costs of 7.56 cents a mile, although it suffers a problem on the pricing side of the equation.\(^{142}\)

Some carriers have taken strikes to attempt to coerce labor to surrender concessions in wages and work rules. Frank Lorenzo’s Continental took a strike in 1983, then his Eastern Airlines took a strike in 1989. Dick Feviss’ United Airlines took a pilots strike in 1985. Carl Icahn’s TWA took a flight attendant’s strike in 1986. Bob Crandall’s American took a flight attendant’s strike in 1993. In each case, the carrier paid a terrible price as embittered employees sabotaged service and thereby dissuaded high-yield business traffic.

The contemporary trend is for carriers to persuade labor to take wage and work rule concessions for equity. As a result, labor now owns 45% of TWA,\(^{143}\) 27% of Northwest, and 55% of United,\(^{144}\) while USAir

---

140. Bridget O’Brian, Delta Air to Pare Up to 15,000 Jobs, Or 20% of Staff, in Big Restructuring, WALL ST. J., Apr. 29, 1994, at A3.
141. Id.
has tried to do the same.\textsuperscript{145} The following chart reveals the exchanges of wage and work rule concessions at the major airlines:

<table>
<thead>
<tr>
<th>Airline</th>
<th>Value of Concessions</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northwest (1993)</td>
<td>$886 million over 3 years</td>
<td>33%</td>
</tr>
<tr>
<td>TWA (1993)</td>
<td>$600 million over 3 years</td>
<td>45%</td>
</tr>
<tr>
<td>United (1994)</td>
<td>$8 billion over 12 years</td>
<td>55%</td>
</tr>
</tbody>
</table>

As a consequence of union busting and union "partnering," most of the U.S. airline industry is now dominated by low-cost carriers.

American Airlines, which faces low-cost competitors on 40% of its routes, seeks $750 million in wage cuts and productivity gains from its unionized employees, and has restructured 16,000 non-union workers by


\textsuperscript{146} \textit{American Airlines, Corp., Second Quarter Report} 2:3 (1994).
offering early retirement to some, and contracting out services. In January 1993, low-cost rivals competed on 8% of American's routes; in January 1994, the figure was 25%.148 USAir management rejected an offer by pilots for $2.5 billion in concessions over five years in exchange for 25% of the airline's common stock and $700 million in new preferred stock.149

The following chart identifies labor costs, operating expenses, and operating revenues per available seat mile for selected carriers:

<table>
<thead>
<tr>
<th>Airline</th>
<th>Labor Costs</th>
<th>Operating Expenses</th>
<th>Operating Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>America West</td>
<td>3.37</td>
<td>7.14</td>
<td>6.84</td>
</tr>
<tr>
<td>American</td>
<td>3.79</td>
<td>9.39</td>
<td>9.09</td>
</tr>
<tr>
<td>Continental</td>
<td>8.26</td>
<td>9.00</td>
<td>8.51</td>
</tr>
<tr>
<td>Delta</td>
<td>2.48</td>
<td>6.95</td>
<td>7.82</td>
</tr>
<tr>
<td>Northwest</td>
<td>3.69</td>
<td>9.26</td>
<td>8.76</td>
</tr>
<tr>
<td>TWA</td>
<td>8.82</td>
<td>8.17</td>
<td></td>
</tr>
<tr>
<td>United</td>
<td>10.79</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Southwest's total costs are 24% less than the industry average, which is remarkable, given the relatively short stage length of its flights. By 1994, America West had lowered its ASM costs to 7.03 cents per mile,151 while Continental had lowered its costs to 7.56 cents per mile.152

151. Maurice Myers, Address to the Salomon Bros. Transportation Conference (Nov. 17, 1994).
These costs compare quite favorably with major foreign carriers:

<table>
<thead>
<tr>
<th>Operating Costs of Selected Foreign Airlines¹⁵³</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1993, in cents per available seat mile)</td>
</tr>
<tr>
<td>Japan Air Lines</td>
</tr>
<tr>
<td>British Airways</td>
</tr>
<tr>
<td>Air Canada</td>
</tr>
<tr>
<td>Qantas Airways</td>
</tr>
</tbody>
</table>

Labor costs typically range between 30-40% of total operating expenses for the European carriers. In 1990, labor expenses accounted for 33% at American Airlines and 21.7% at Singapore Airlines.¹⁵⁴ Asia-Pacific airlines are about 30% more productive than European airlines.¹⁵⁵ But one source noted, “The competitive advantage of low labor costs in the Asia-Pacific region, buttressed by higher yields, congestion and supportive regulators, is now being eroded by the inflationary pressures of economic growth and the differentials which that growth has generated.”¹⁵⁶ Another predicts, “The perennial profit-makers, like Singapore Airlines, Thai International and Cathay Pacific, will see their cost advantage over other world regions eroded as economic growth fosters inflation and living standards and wages spiral upwards.”¹⁵⁷

Some airlines have responded to the burden of wages and employee benefits by contracting out, or “out-sourcing” services. For example, Japan Airlines and All Nippon Airways, burdened with high labor expenses exacerbated by a strong Japanese Yen, have based aircraft abroad to serve regional routes with low cost local cabin crews.¹⁵⁸ United contracted out sky cap and janitorial services, and sold its flight kitchens to Dobbs, which gave it $120 million, allowing it to avoid a $71 million investment in upgrading and expanding kitchens, and to enjoy a $320 million savings over 7 years. The 5,200 employees may seek a job with Dobbs, albeit at significantly lower wages. American Airlines claims that if it had the same labor costs as Continental, it would have saved $1.7 billion in 1992; if its labor costs were as low as Southwest’s, it would have saved $1.1 billion that year.¹⁵⁹

¹⁵³ Philip Baggageley, Address Before the Chicago Convention 50th Anniversary Conference (Oct. 31, 1994).
¹⁵⁵ Id.
¹⁵⁶ Id.
¹⁵⁸ Cameron & Shearman, supra note 154, at 16.
3. **Marketing Costs**

Marketing costs increased 20% among the world’s airlines during the 1980s. Travel agent commissions have grown enormously, rising more than 308% as a percentage of U.S. airlines’ operating expenses during the 1980s. Before deregulation, travel agent commissions consumed 4.2% of airline operating expenses, or a total of $883 million; by 1993, commissions had grown to 11.3%, for a total of $7.5 billion. Northwest reported average commissions of 38% in the trans-Pacific market in 1991.

One source observed:

The lesson of deregulation — that carriers compete on fares rather than quality — has an inherent contradiction. The pressures to lower costs to compete on price run counter to the rise in marketing costs to retain and expand the customer base. This has generated a new school of thought, which says that cost-cutting cannot be a priority when the increasingly sophisticated marketing carries such an inflated price tag.

Some carriers, such as Delta and Southwest, have taken the “bull by the horns” and unilaterally rolled back travel agent commissions, and embraced ticketless travel. The downside risk was that travel agents might collectively retaliate by steering passengers to more generous carriers, although Northwest, American, United and USAir followed Delta’s lead promptly thereafter, negating the likelihood of business shifting.

Ticketless travel will put airlines on par with hotels, which take a credit card number over the telephone, and give customers an oral confirmation number, usually with no written supplementation. Travel agents will be forced to charge consumers directly for their services, and many marginal ticket agents will go belly up. Until consumers have direct access to CRSs, they will incur significant transaction costs in calling around to find which airline offers the most convenient flight at the lowest price.

**D. Global Marketing & Equity Alliances**

1. **Global Marketing Alliances**

Cabotage restrictions prohibit foreign airlines from plying the domestic trade. They may be avoided in various ways, including “sharing codes, making ‘blocked space’ arrangements for both passengers and

---

161. Dempsey et al., supra note 61, at § 2.19.
162. Babbitt, supra note 23, at 10, 12.
163. Cameron & Shearman, supra note 154, at 16.
164. Id.
cargo, obtaining an ownership interest in a U.S. carrier, making arrangements between U.S. and foreign carriers covering computer reservations systems, and setting up joint frequent flier and marketing programs."^{166}

Hence, several major international marketing alliances have emerged:

1. Code Sharing and Blocked Space Relationships
2. Computer Reservations Systems
3. Frequent Flyer Programs

a. Code-Sharing, Blocked Space, & Funnel Flights

Code-sharing has become an increasingly popular means of connecting airline networks in a way to enhance marketing opportunities and, it has been argued, provide a seamless product. For example, a passenger seeking to travel from Ithaca, N.Y., to Brasilia, Brazil, could fly on a series of United Airlines through flight numbers under a code-sharing relationship whereby TW Express would pick the passenger up in Ithaca and deliver him to New York Kennedy Airport, United would pick him up at Kennedy and fly him to Rio de Janeiro, and TransBrazil Airways would take him on to Brasilia.\(^{167}\) Only one passenger every other month takes such a journey, but they can do it all on under the United code-sharing umbrella.

"Blocked space" arrangements involve the leasing or reservation of a specific number of seats by one passenger airline for its passengers to be flown in aircraft operated by another airline. They allow airlines the advantage of offering on-line connections and the potential to draw greater traffic as a result of having one carrier listed in the computer reservations systems, on timetables, and in advertisements, rather than two connecting carriers. For example, Northwest might enter into a blocked space agreement with KLM whereby Northwest would sell up to a specified number of seats on the KLM Minneapolis-Amsterdam flight to Northwest's customers.

"Funnel flights" involve a single flight number and ticket coupon for change-of-gauge operations, whereby passengers are transferred from one aircraft to another.

"Code sharing" and "funnel flights" are two airline practices that have become more widespread in recent years, and more widely condemned in the press.\(^{168}\) As early as 1988, Thomas Plaskett, chairman of

---

168. Air Canada has a marketing alliance with United, which increased passenger connections between the two airlines by 171% in its first four months. David Carr, Canada's Airline Conundrum, AIRLINE BUS., May 1993, at 50. KLM has a code-sharing agreement with North-
Airlines in Turbulence

Pan Am, prophetically described "code sharing" as an "ominous trend" that could be injurious to consumers and to airline competition. In mid-1994, the Wall Street Journal observed, "a growing number of critics claim that network arrangements actually deceive consumers, narrow their choices and possibly raise ticket prices." Both of these practices are driven by the opportunities for consumer deception afforded by fraudulently manipulating the computer reservations systems.

Among the most powerful and ubiquitous computer systems in the world are those owned by the airlines. "They reduce the planet to microbits of electrons, allowing us to move about Mother Earth with ease, and book a flight, hotel room, or rental car anywhere we can imagine."

What a pity that this information stream is becoming so horribly polluted.

An extremely limited number of consumers have direct access to one of the major computer reservations systems — Sabre, Apollo, Worldspan, or System One. Instead, most consumers must rely on an intermediary in purchasing an airline ticket, usually a travel agent, to render accurate, complete and objective information regarding the schedule, price, availability and routing of specific flights. The travel agent, in turn, must rely on the integrity of the computer reservation system to which he or she is connected. The CRS must rely on the integrity of the information sup-

---

west, acquired as a result of a $400 million investment in the U.S. carrier, which because of Northwest’s anemic performance, has been written down on KLM’s books to zero. British Airways has a code-sharing agreement with USAir, acquired as a result of its $300 million investment in the carrier. United has entered into a code sharing relationship with Lufthansa.

Iberia signed a code-sharing and block sheet agreement with Carnival Airlines, effectively giving it one-stop service from Spain to New York, Chicago, Los Angeles, Houston and New Orleans through a Miami hub. David Cameron, *Iberia Turns Florida Keys, AIRLINE BUS.*, May 1993, at 10. Yet soon after creating it, Iberia announced it was retrenching, and considering eliminating the Miami hub. Carla Vitzthum, *Iberia Retrenches; Costs Cut After Years of Growth, WALL ST. J.*, Sept. 24, 1993, at B5D. Nonetheless, it plans to continue participation in the fast growing Latin American market, where it enjoys a 35% market share and equity interest in three local carriers. *Id.* Iberia owns 30% of Aerolinas Argentinas, 37.5% of Ladeco Chilean Airlines, and 45% of Viasa Venezuelan International Airways. Ian Veriche, *Iberia Airlines’ Shakeup Extends to South America, COMMERCIAL AVIATION NEWS, Sept. 13, 1993, at 11. Since 1992, Iberia has trimmed its work force by 5,000, to 24,000 employees. Vitzthum, *supra*, at B5D.

China Airlines has a code sharing relationship with TWA allowing through ticketing from Asia through the gateways of San Francisco and Los Angeles to New York. Qantas has a similar relationship with Canadian Airlines.


plied by the scores of participating domestic and international airlines.\textsuperscript{172}

The upstream polluter poisons the river for those who drink downstream. Corruption of the information provided by the carriers distorts the CRSs, which in turn, causes the travel agents to provide erroneous information to consumers, who are thereby deprived of choices they prefer, creating a dysfunctional market injuring not only consumers, but also competing airlines offering equivalent or superior service alternatives. DOT approval of "code sharing" and "funnel flights" legitimates such carrier corruption of flight information.\textsuperscript{173}

Even before price, most consumers choose an airline, first, based on scheduling convenience (i.e., which airline offers a flight on the date and time the consumer wants to travel to his or her selected destination).\textsuperscript{174} Once date and time are established, the consumer turns to convenience, usually with the following priorities:

1. **NONSTOP SERVICE.** Nonstop flights are preferred over flights with one or more stops (because flights which stop inevitably consume more origin-destination travel time);
2. **THROUGH-PLANE SERVICE.** Single plane service is preferred over connecting flights (because of the inconvenience and delay of changing planes, often at a crowded hub airport, coupled with the increased possibility of missed connections and lost baggage);
3. **ON-LINE CONNECTING SERVICE.** Single carrier connecting service is preferred over connecting carrier service (for all the reasons stated above, as well as the uncertainty of the quality of service on the connecting carrier, and the possibility of being transferred to inferior aircraft);
4. **INTERLINE SERVICE.** Connecting carrier service is preferred over non-interline connecting service (because interline agreements allow "seamless service" — through joint-line ticketing and baggage transfers); and
5. **NON-INTERLINE CONNECTING SERVICE.** Non-interline connecting carrier service is the least desirable of all (because absent an interline agreement between the carriers, passengers are forced independently to book their connections, with no joint rates or through ticketing, and must collect their own bags and transfer them between connecting aircraft).\textsuperscript{175}

\textsuperscript{172} Thomas Dickerson, _Travel Law_ § 2.05[6] (1993).
\textsuperscript{174} 20.3% of U.S. residents select a carrier based on schedule, while only 13.8% choose one based on price. _Aviation Daily_, Oct. 3, 1991, at 23; reprinted in Dempsey et al., _supra_ note 61, § 2.24.
\textsuperscript{175} See _EI Al Asks DOT to Resist Northwest's Call for Trade Sanctions_, 53 _Travel Weekly_ Mar. 3, 1994, at 6.
Yet the practices of “code sharing” and “funnel flights” obfuscate the service actually being provided, inducing consumers to purchase an inferior product from that which they prefer. “Funnel flights” deceive consumers into believing they are purchasing product #2 (through-plane service), when they are actually being sold product #3 (on-line connecting service). “Code sharing” deceives consumers into believing they are purchasing product #3 (on-line connecting service), when they are in fact being deceptively sold product #4 (interline service). By giving the appearance of an on-line connection, it appears to be a superior travel option. And although the DOT has promulgated rules requiring “code sharing” flights be listed with an asterisk and that passengers be so informed, at least a third of consumers are not told what airline they are actually flying.\textsuperscript{176}

Moreover, the computer reservations systems are programmed by their megacarrier owners to give a significant display preference to a domestic on-line connection over a domestic interline connection — in effect, superior shelf space.\textsuperscript{177} This is true even for a pseudo on-line connection, such as a code sharing arrangement with an independent airline. As one source noted, “Even with an asterisk, it beats being consigned to the third screen.”\textsuperscript{178}

By listing the same flight several times, “code sharing” and “funnel flights” consume the finite number of lines available on the computer reservations screen — valuable shelf space.\textsuperscript{179} Multiple listings of the same flight combinations squeeze out superior service offerings on each of the major CRs — Sabre, Apollo, Worldspan and System One. International code shares show up on the CRs once under the U.S. flag carrier’s code (e.g., Northwest’s, or NW), once under the foreign-flag carrier’s code (e.g., KLM, or KL), and once again as an asterisked interline trip in which the two connect, with all three sometimes consuming the entire first page of the CRS display screen.\textsuperscript{180} Funnel flights show up in the CRS as many as three separate times as well, shoving alternative

\textsuperscript{176} Mead Jennings, \textit{U.S. Tries to Clarify Codes}, \textit{Airline Bus.}, June 1994, at 12.


\textsuperscript{180} It would be the equivalent of Coca-Cola and Pepsi agreeing to sell a joint Pepsi-Coke mix, with Coca-Cola selling it as Coke2, Pepsi-Cola selling it as Pepsi2, and both selling it as Pepsi-Coke, consuming three times the super market shelf space of competing products, and squeezing some of those competitors off the shelf. Thus, even though many consumers might prefer pedigree “Big K” Cola to the cross-bred Pepsi-Coke combination, “Big K” may be nowhere to be found.
competitive offerings onto the second page of the CRS screen, where they collect computer dust.

Because of the pressure of time, most airline ticket sales are made by travel agents from the first page of the computer reservations screen — it is widely acknowledged that more than 70% of all flights are sold from the first page of the screen. By relegating competitive service offerings to inferior display on computer reservations systems (the second or third page of the CRS), these practices deceive consumers and damage competing airlines, even though their “interlining” options, or even “on-line” options, may be as good as, or in some respects superior to, the “code sharing” and “funnel flight” alternatives with which they compete.

Code-sharing raises not only consumer deception problems, it poses significant competition problems as well. Domestically, most megacarriers refuse to code-share or enter into joint fare relationships with independent jet carriers, instead insisting their code-share partners fly no jet equipment. Their refusal has relegated numerous small and medium sized communities across America to inferior turboprop or piston air service. Aside from the social consequences of the deterioration of rural air service, such discriminatory treatment by megacarriers in favor of affiliates and against independent carriers also raises serious antitrust concerns under the “essential facilities doctrine.”

“Funnel flights” raise similar concerns. This author was in the TWA international terminal at John F. Kennedy Airport in New York recently, and was astounded that, notwithstanding the laws of physics, the departure screens displayed two or three flights boarding simultaneously (at precisely the same gate and time) to various nonstop destinations across the Atlantic.

This author attempted to reconstruct a bit of what he saw from TWA’s May 1, 1994, timetable. TWA appears to funnel at least the following flights through JFK in New York:

---

181. Continental Airlines is the notable exception, which has entered into a major code-sharing relationship with America West Airlines.
1995]  

Airlines in Turbulence  

<table>
<thead>
<tr>
<th>Destination</th>
<th>Flight Number</th>
<th>Origin</th>
</tr>
</thead>
<tbody>
<tr>
<td>Athens (via Paris)</td>
<td>800</td>
<td>New York</td>
</tr>
<tr>
<td>Athens</td>
<td>880</td>
<td>New York</td>
</tr>
<tr>
<td>Athens</td>
<td>880</td>
<td>San Antonio (via New Orleans)</td>
</tr>
<tr>
<td>Frankfurt</td>
<td>740</td>
<td>New York</td>
</tr>
<tr>
<td>Frankfurt</td>
<td>740</td>
<td>Seattle</td>
</tr>
<tr>
<td>Frankfurt</td>
<td>758</td>
<td>St. Louis</td>
</tr>
<tr>
<td>Frankfurt</td>
<td>742</td>
<td>Kansas City</td>
</tr>
<tr>
<td>Lisbon</td>
<td>900</td>
<td>New York</td>
</tr>
<tr>
<td>Lisbon</td>
<td>910</td>
<td>San Francisco</td>
</tr>
<tr>
<td>Lisbon</td>
<td>912</td>
<td>Kansas City</td>
</tr>
<tr>
<td>Madrid</td>
<td>904</td>
<td>New York</td>
</tr>
<tr>
<td>Madrid</td>
<td>914</td>
<td>Los Angeles</td>
</tr>
<tr>
<td>Madrid</td>
<td>905</td>
<td>Washington, DC (Nat'l Airport)</td>
</tr>
<tr>
<td>Milan</td>
<td>842</td>
<td>New York</td>
</tr>
<tr>
<td>Milan</td>
<td>842</td>
<td>San Francisco</td>
</tr>
<tr>
<td>Milan</td>
<td>850</td>
<td>Los Angeles</td>
</tr>
<tr>
<td>Rome</td>
<td>840</td>
<td>New York</td>
</tr>
<tr>
<td>Rome</td>
<td>886</td>
<td>San Francisco</td>
</tr>
<tr>
<td>Rome</td>
<td>844</td>
<td>St. Louis</td>
</tr>
<tr>
<td>Rome</td>
<td>854</td>
<td>Kansas City</td>
</tr>
</tbody>
</table>

There are probably more, and TWA is probably not the most egregious of the abusers. But it may be at least dismaying for a passenger in San Antonio, who is issued a single ticket coupon for flight 880 to Athens, Greece, to find himself not only stopping in New Orleans, but also changing planes in New York. Before funnel flights, he would have received two ticket coupons for two separate flights (designated by two separate flight numbers), one from San Antonio to New York, and the other from New York to Athens. For its part, TWA can pretend to offer single-plane service straight through from San Antonio to Athens. And if a passenger does end up connecting to flight 800 from New York to Athens, he will find himself stopping in Paris en route, perhaps changing aircraft again.

It may also be a bit surprising for a Seattle passenger on flight 740 bound for Frankfurt, to find himself in New York not only changing airline terminals and planes, but boarding at a gate with three other flights at precisely the same departure time on to the same wide-bodied aircraft bound for Frankfurt. For its part, TWA can hold itself out as providing single-plane service to Frankfurt from New York, Seattle, St. Louis, and Kansas City, when in fact, only the New York-Rome service is single-aircraft. Moreover, and perhaps more importantly, TWA fills valuable shelf space in the computer reservations systems with four separate flights and flight numbers to Rome, when in fact, it flies only a single jet

across the Atlantic to Rome. Again, that is not to say that TWA is the worst perpetrator of such practices. Even airlines which would prefer not to, find they must commit such practices to remain competitive with other airlines which engage in them.

Many consumers have traditionally assumed that a single ticket coupon with a single flight number means flying in a single aircraft (with or without stops), but without changing planes. For the overwhelming majority of flights, each change of plane carries a separate flight number and separate ticket coupon. Many consumers prefer not to have to get off the plane and sit and wait, and wait, and wait, at a crowded hub airport, while the airline gets another chance to lose their bags or cause the passenger to miss a connecting flight.

Only a very limited number of consumers enjoy direct access to the CRSs; the overwhelming majority do not. If they did have direct access to one of the computer reservations systems, they would not have to rely on a frazzled travel agent to peel through the several pages of the displays (now cluttered with multiple code sharing and funnel flight listings) to determine whether what fictitiously appears to be the single-plane service in fact connects with other aircraft, how long and where the connection transpires, to what kind of aircraft they will be transferred, and (in a code-sharing situation), the identity of the connecting carrier. More importantly, they could determine whether there was a real nonstop or single-plane alternative on another airline. But direct CRS access is probably years away from most consumers.

Not only do code sharing and funnel flights deceive consumers, they also injure competing airlines. In reviewing the impact code sharing had on small competing independent regional airlines, Professor Clinton Oster found "there seem to be few, if any, markets where an independent can maintain its market share in competition with the code-sharing partner of a major jet carrier." He further found that "when a code-sharing partner prevails in a market, service levels generally seem to drop." William Britt, founder of Britt Airways (at one time the nation's largest regional airline), complained that independent regional air carriers cannot survive when their competitors adopt the codes of the major airlines.

In fact, since the dawn of commercial aviation, all of the purported consumer advantages of "code sharing" have been available under traditional forms of carrier interlining — scheduling, ticketing and baggage

185. Id. See also Robert Moorman, Dilemma of Independent, Non-Aligned Regionals, Air Transport World, July 1988, at 89.
coordinated — all the essential elements of so-called “seamless service.”\textsuperscript{187} “Code sharing” merely advances interlining to the point of producing consumer deception, purporting to offer consumers something more than they are actually being sold. “Funnel flights” deceive consumers into believing they will not have to change planes, when in fact, they must. Many consumers are thereby denied the competitive alternative of a nonstop flight via a competing airline.

Moreover, interlining to a code share partner may lead to travel via a carrier or type of aircraft consumers would otherwise prefer to avoid. Domestically, a “code sharing” relationship typically funnels consumers into commuter affiliates flying small aircraft below the weather.\textsuperscript{188} Internationally, it can result in being funneled into a third-world airline flying old Soviet aircraft.\textsuperscript{189}

Among the parties which have pointed out the pernicious effects of “code sharing” and “funnel flights” to both the Civil Aeronautics Board and the U.S. Department of Transportation during the past decade have been the following:

American Airlines: The funnel flight “masquerade means that many passengers who will in fact be required to change planes are induced to purchase a product in the belief that they will not be required to do so. . . . It is surprising that a practice so deceptive on its face has been tolerated for so long.”\textsuperscript{190}

American Airlines: Code-sharing is an “unfair practice that deceives, misleads, and confuses consumers in violation of Section 411 of the Federal Aviation Act.”\textsuperscript{191}

American Airlines: “The purpose and effect of [code-sharing] is to clutter CRS display screens and relegate competitive travel alternatives to lower screen positions than those they would otherwise occupy.”\textsuperscript{192}

Association of Retail Travel Agents: The DOT should promulgate a rule prohibiting “screen padding.”\textsuperscript{193}

American Society of Travel Agents: “The effect of double or sometimes even triple listing the same flight option is to clutter CRS screens.”\textsuperscript{194}

\begin{footnotes}{\textsuperscript{187}} See Robert Moorman, \textit{supra} note 185, at 89.\end{footnotes}

\begin{footnotes}{\textsuperscript{188}} See Richard Newman, \textit{How Safe Are Small Planes?}, \textit{U.S. News & World Rep.}, Nov. 14, 1994, at 68.\end{footnotes}

\begin{footnotes}{\textsuperscript{189}} See Alex McWhirter, \textit{Codes of Misconduct}, \textit{Business Traveler}, Mar. 1994, at 16.\end{footnotes}

\begin{footnotes}{\textsuperscript{190}} DOT Docket 47546, 1991. This petition was supported by British Airways and Lufthansa. See also American Airlines petition in CAB Docket 41875, 1983.\end{footnotes}

\begin{footnotes}{\textsuperscript{191}} DOT Docket 49223, 1994.\end{footnotes}

\begin{footnotes}{\textsuperscript{192}} DOT Docket 49260, 1994.\end{footnotes}

\begin{footnotes}{\textsuperscript{193}} 57 Fed. Reg. 43780, 1992.\end{footnotes}

\begin{footnotes}{\textsuperscript{194}} DOT Docket 49260, 1994.\end{footnotes}
British Airways: “it is intrinsically deceptive for two carriers to share a designator code.”

European Civil Aviation Conference: Code-sharing is “screen padding” and “manipulation of flight categorization.”

Senator Wendell Ford: Code-sharing is “inherently dishonest,” and “a legal way of advertising one product, but then selling another.”

North American Airlines: “code-sharing relationships preclude smaller carriers from competing for important international feed traffic.”

Donald L. Pevsner: “all single-coupon ticketing for two or more flight sectors is inherently deceptive.”

TACA International: Funnel flights are deceptive and unfair methods of competition.

United Air Lines: “the sharing of designators is misleading and deceptive and should not be permitted.”

USAir: Multiple listing reduces “the proportion of competitive flights displayed.”

Notwithstanding these widespread concerns and despite the broad-based nature of the opposition, including formal petitions for rulemaking, the DOT has taken little meaningful action to protect the consuming public or injured competitors from these unfair and deceptive practices. Remarkably, the Clinton Administration’s DOT appears more inclined to support these practices than its predecessors, with its continued rhetorical praise of such practices.

According to the U.S. General Accounting Office, the DOT approved 39 international code-sharing arrangements between 1987 and February 1993. Between February 1993 and March 1994, the DOT approved 89 such agreements. Moreover, the international integration made possible by “code sharing” promises to reduce competition in international markets, transforming the airline industry into a small number of global megacarrier alliances.

196. Letter to DOT Ass't Sec. Jeffrey Shane (April 16, 1987).
197. Letter to DOT Secretary Pena (Nov. 3, 1993).
200. DOT Dockets 49512 and 49513, 1994. These petitions were supported by Aviateca and NICA.
Globalization is a euphemism for cartelization. We did not see meaningful competition between Continental and Eastern when Frank Lorenzo dragged them under a single roof. Nor will we see meaningful competition between Northwest and KLM now that they are commonly owned and blending marketing under a bilateral which confers unprecedented and wholly indefensible antitrust immunity, condoning unprecedented pooling — a bilateral air transport agreement concluded, by the way, only months after Northwest gave George Bush's committee to re-elect the President $100,000.00.

In summary, the fundamental problems of such marketing alliances as code-sharing and funnel flights are:

1. Their success relies upon their ability to flood the computer reservations system screens with duplicative information so as to deceive the consumer into purchasing a product that may be different than that he or she prefers;

2. Discriminatory alliances between airlines reduces or eliminates competition between them and diverts traffic from competitors, thereby leading to higher levels of concentration.

Two major international aviation organizations have provided leadership in this area. The U.N. International Civil Aviation Organization has finalized a CRS code of conduct which requires that: (1) "funnel flights" be treated as connections; (2) "code sharing" trips be listed as offline connections; (3) such combinations should not be listed more than once under different codes or flight numbers; and (4) displays should clearly indicate when a single flight number itinerary involves a change in aircraft, change in airport, or involves "code sharing." The European Civil Aviation Conference has adopted a CRS code of conduct requiring all "code sharing" or "funnel flight" trips specifically be designated as such, rather than on-line and direct flights, respectively.

---


205. European Aviation Group Expected to Adopt Code on Res Displays, Travel Weekly, Mar. 9, 1989, at 10; Nadine Goodwin, ECAC To Issue CRS Regulations, Travel Weekly, Apr. 21, 1988, at 1. All of this could be rectified very simply. All DOT need do is promulgate a common sense rule under section 411 of the Federal Aviation Act requiring that every separate flight have a separate flight number and separate ticket coupon, and that there be no multiple listing of flights in the computer reservations systems.

The U.S. Department of Transportation has a statutory responsibility to protect the public against unfair and deceptive competitive practices and unfair methods of competition. 49 U.S.C.A. § 41712 (West 1994). This responsibility makes it imperative that the DOT immediately inaugurate a rulemaking which, at minimum, should:

1. Eliminate all multiple-listing of flights in computer reservations systems; and
2. Require that all consumers be fully informed, orally by the travel agent, and in writing (preferably with the issuance of a separate ticket coupon for each flight in the itinerary), of the true
b. Computer Reservations Systems

Foreign alliances with U.S. airlines began in the 1980s with shared frequent flyer programs, then entered computer reservations systems, code-sharing, and finally turned to outright equity ownership. The following charts reveal the alliances of the two dominant European computer reservations systems, and a major Asian CRS.

<table>
<thead>
<tr>
<th>European Computer Reservations Systems Partners</th>
</tr>
</thead>
<tbody>
<tr>
<td>Galileo</td>
</tr>
<tr>
<td>United (38.0%)</td>
</tr>
<tr>
<td>British Airways (14.7%)</td>
</tr>
<tr>
<td>KLM (12.1%)</td>
</tr>
<tr>
<td>Swissair (13.2%)</td>
</tr>
<tr>
<td>Alitalia (8.7%)</td>
</tr>
<tr>
<td>USAir (11.0%)</td>
</tr>
<tr>
<td>Air Canada (1%)</td>
</tr>
<tr>
<td>Olympic (1%)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Asian Computer Reservations System Partners</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abacus</td>
</tr>
<tr>
<td>ANA</td>
</tr>
<tr>
<td>Cathay Pacific</td>
</tr>
<tr>
<td>Malaysia Airlines</td>
</tr>
<tr>
<td>Singapore Airlines</td>
</tr>
<tr>
<td>China Airlines</td>
</tr>
<tr>
<td>Royal Brunei</td>
</tr>
<tr>
<td>(and a small share of WORLDSPAN)</td>
</tr>
</tbody>
</table>

c. Frequent Flyer Programs

Several Asian frequent flyer alliances have emerged, including one between Korean Air Lines, China Airlines and Philippine Airlines. Cathay Pacific, Singapore Airlines, and Malaysia Airlines also announced plans to launch a joint Asia Frequent Flyer program. Ansett is affiliated with Singapore Airlines, All Nippon Airways, and United Airlines.

Identity of the actual carrier providing the service, the number of stops, changes of aircraft, and types of aircraft.

Continued inaction will cause a cancerous proliferation of such fraudulent practices as even more carriers (even those which philosophically oppose “code sharing” and “funnel flights”) clutter the CRSs with multiple flight listings of their own as a competitive defense mechanism, thereby causing inordinate traffic congestion on the Information Superhighway.

207. Id.
Some of the major U.S. airline frequent flyer relationships with foreign carriers are as follows:

- American Airlines
- Canadian Airlines International
- Cathay Pacific
- Qantas
- Singapore Airlines
- TWA
- Continental Airlines
- Aer Lingus
- Alitalia
- Austrian
- Cayman Airways
- Iberia
- KLM
- LanChile
- SAS
- Delta Air Lines
- Air New Zealand
- Japan Airlines
- KLM
- Lufthansa
- Singapore Airlines
- Swissair
- TWA
- Air India
- Air New Zealand
- Philippine Airlines
- United Air Lines
- Air France
- Alitalia
- British Midland
- Iberia
- KLM
- Lufthansa
- Sabena
- Swissair
- USAir
- Air France
- British Airways
- Finnair
- Lufthansa
- Philippine Airlines
- Swissair
2. Global Equity Alliances

a. U.S. Equity Alliances

Foreign airlines have exhibited a tenacious interest in penetrating the U.S. passenger market — the largest market in the world. In the last few years, KLM bought a huge piece of Northwest; SAS purchased a chunk of Continental; Singapore Airlines and Swissair each acquired a slice of Delta; and British Airways unsuccessfully sought a share of United Airlines, and subsequently purchased a large slice of USAir. The following chart depicts the substantial foreign airline interests in U.S. flag carriers:

<table>
<thead>
<tr>
<th>Foreign Airline</th>
<th>Percentage Ownership</th>
<th>U.S. Airline</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAS</td>
<td>18.4%</td>
<td>Continental*</td>
</tr>
<tr>
<td>Swissair</td>
<td>5 %</td>
<td>Delta</td>
</tr>
<tr>
<td>Singapore Airlines</td>
<td>5 %</td>
<td>Delta</td>
</tr>
<tr>
<td>Ansett Airlines</td>
<td>17 %</td>
<td>America West*</td>
</tr>
<tr>
<td>Japan Air Lines</td>
<td>20 %</td>
<td>Hawaiian Airlines*</td>
</tr>
<tr>
<td>KLM</td>
<td>49 %</td>
<td>Northwest*</td>
</tr>
<tr>
<td>British Air</td>
<td>15 %</td>
<td>United**</td>
</tr>
<tr>
<td>British Air</td>
<td>24.6%</td>
<td>USAir</td>
</tr>
<tr>
<td>Air Canada</td>
<td>27.5%</td>
<td>Continental</td>
</tr>
</tbody>
</table>

* investment written down to zero  
** proposed; later withdrawn

The equity interests by Scandinavian Airline System [SAS] in Continental Airline Holdings was inspired by the U.S. carrier’s 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.208 Swissair’s and Singapore Airlines’ interest in Delta appears to have been inspired by different reasons — the desire of Delta to have a friendly partners poised to fend off LBOs, and to align itself with two of the world’s carriers renowned for a high quality product.

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

As a practical matter, however, much of the foreign investment in U.S. airlines has been an economic failure. SAS wrote its investment in Continental down to zero. KLM has watched its investment in Northwest

deteriorate. Ansett must worry as America West languishes in bankruptcy. Japan Air Lines can hardly be enthused about the state of Hawaiian Airlines.

Not only are foreign airlines affiliating with U.S. carriers. Other international aviation alliances and acquisitions are emerging, including, as we shall see, British Airway's acquisition of British Caledonian, and Air France's purchase of UTA. The following, rather incomplete, chart reveals several of the major ownership interests of foreign airlines:

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

b. European Equity Alliances

One source predicts that the "European airline industry will consolidate into four, perhaps five, large systems to achieve economies of scale and to successfully compete against other global airline combines." Market Darwinism has led each airline to fear for its survival, and to extend its route network via alliances to insure it will be one of the remaining megacarriers in the next century.

(1) THE BRITISH AIR GROUP

    British Airways
    British Caledonian (absorbed)
    USAir (25%)  
    Qantas (25%)
    Air Russia (31%)
    Deutsch BA (49%)
    TAT (49%)
    Dan Air (100%)
    Brymon (40%)

Geographically, British Airways [BA] is the world's largest scheduled international passenger airline, serving 72 nations with a total of 155 destinations and transporting 28 million passengers.\textsuperscript{211} It was fully privatized in 1987. British Airways is the leading carrier in the U.S.-U.K. market, flying nearly 40% of the seats (up from 29% in 1985).\textsuperscript{212}

BA has been profitable each year for the last ten. Various sources have attributed its success, vis-a-vis its European cousins, to: (1) its protected position under the U.S.-U.K. bilateral; (2) its superior origin and destination market, resulting in better yields; (3) its superior route structure; (4) pre-privatization write off of the Concorde; (5) its greater flexibility as a privatized company; (6) its culture of cost-consciousness; (7) enhanced labor and asset utilization; and (8) targeted marketing.\textsuperscript{213}

British Airways has been on a major expansion program, buying equity in a host of regional carriers around the world. BA spent $300 million for 24.6% voting stock in USAir, and is implementing code sharing arrangements, to give it access to 65 U.S. destinations via ten U.S. gateways.\textsuperscript{214} In 1993, it spent $666 million for 25% of Qantas Airways (which absorbed Australian Airlines, and invested in Air New Zealand and Air Pacific).\textsuperscript{215} BA owns nearly half (and holds an option to buy the other half) of TAT, France’s largest independent airline, with 20% of the landing slots at Orly Airport, Paris’ principal domestic airport, and routes to 32 domestic and four international destinations.\textsuperscript{216} BA also acquired the assets of Dan-Air, based at London Gatwick Airport, and entered into a new franchising agreement with CityFlyer Express, both of which will operate under the British Airways name.\textsuperscript{217} In 1992, British Airways ac-

\textsuperscript{211} Maldutis, supra note 86, at 2.
\textsuperscript{212} Id. at 9.
\textsuperscript{214} Maldutis, supra note 86, at 3.
\textsuperscript{215} Id. at 3; Evans, supra note 7, at 48, 53.
\textsuperscript{216} Maldutis, supra note 86, at 3, 7.
\textsuperscript{217} Id. at 4.
quired nearly half of Delta Air, renamed Deutsche BA.\textsuperscript{218} In addition to
the carrier's regional routes, it has been given authority to fly from Berlin to
Munich, Stuttgart, Cologne, Dusseldorf, and Moscow.\textsuperscript{219} BA owns
nearly a third of Air Russia, which will begin service from Moscow in
1995 or 1996.\textsuperscript{220} As a Qantas executive observed, "You can expect us to
hunt as a pack."\textsuperscript{221}

BA has been described as having one of the best management teams
in the airline industry: "Management can be characterized as aggressive
and demanding. It will, however, be challenged to integrate its far flung
airline investments into a cohesive integrated operating entity."\textsuperscript{222} An-
other source observed, "The real test will be whether BA's internal cost
discipline, and its competitive edge, will be transposed onto its
partnerships."\textsuperscript{223}

But BA also inherited a route system from a paternalistic British
government intent on protecting a BOAC which unified a far flung Em-
pire. This included a dominant position at London's slot-constrained
Heathrow Airport, at which only two U.S. carriers have been permitted
entry. As Guy Kekwick observed, "The incumbents at Heathrow do en-
joy near-monopoly profits from their positions at what is the leading in-
ternational airport in Europe, if not the world."\textsuperscript{224}

(2) THE AIR FRANCE GROUP

Air France
UTA (absorbed)
Air Inter (wholly owned)
Sabena (partially owned)
CSA (partially owned)
Air Canada (marketing alliance)
Aeromexico (marketing alliance)
Vietnam Airlines (marketing alliance)
Servair (catering)

Air France merged with UTA and integrated domestic service
though Air Inter, allowing it to dominate the hub at Charles de Gaulle
Airport in Paris. It invested equity in Sabena (Air France and other pri-
ivate investors bought 37.5\%, blocking any rival at Brussels) and CSA

\textsuperscript{218} Evans, \textit{supra} note 7, at 48, 53.
\textsuperscript{219} Maldutis, \textit{supra} note 86, at 7.
\textsuperscript{220} \textit{Id.} at 7.
\textsuperscript{221} James Strong, \textit{Address to the Salomon Bros. Transportation Conference} (Nov. 17,
1994).
\textsuperscript{222} Maldutis, \textit{supra} note 86, at 17.
\textsuperscript{224} Erik Ipsen, \textit{British Airways Is Flying High, But Troubles Loom}, \textit{INTERNATIONAL HER-
(among the more promising east European carriers), and entered into marketing agreements with Air Canada, Aeromexico and Vietnam Airlines, thereby avoiding "the pitfall of equity involvement in heavily loss-making but well positioned carriers." Air France sold its Meridien Hotel group.

(3) THE ALCAZAR GROUP

In 1989, SAS, Swissair and Austrian Airlines created a loose confederation called European Quality Alliance. With KLM, they reached tentative agreements to form a single system, with KLM, SAS and Swissair each owning 30%, and Austrian Airlines owning 10%. The system would revolve around the hubs of Amsterdam, Copenhagen, Geneva, Zurich, Oslo,Stockholm and Vienna. In 1992, the four carriers had revenues of $16 billion (making it the world's largest airline in terms of total sales), but lost a combined $365 million. It was estimated a merger would save the carriers about $1.12 billion a year.

However, merger talks collapsed in late 1993, with Swissair preferring a U.S. partnership with Delta Airlines, and KLM preferring Northwest. KLM invested $400 million in Northwest in the mid-1980s. Swissair also owns 5% of Delta Air Lines, and Delta owns 5% of Swissair.

(4) LUFTHANSA

Lufthansa owns Condor, its charter arm, established Lufthansa Express, a low cost no-frills subsidiary, and Lufthansa CityLine, a regional operation, and purchased equity in Austrian based Lauda Air (26%) and Luxembourg based Luxair. Lauda Air's costs are just 14% of total revenue (compared with 30% for Austrian Airlines). Lauda has begun operating at London Gatwick Airport, serves Sydney, Melbourne, Hong Kong, and Bangkok, and operates code sharing services with Lufthansa into Los Angeles and Miami. In late 1993, Lufthansa concluded a code-sharing relationship with United.

226. Evans, supra note 7, at 48, 53.
229. Id. at A8.
231. Evans, supra note 7, at 48, 53; Gallacher, supra note 227, at 4.
c. North American Alliances

In Canada, carrier profitability has plummeted since the Mulrooney Administration imposed deregulation.\textsuperscript{234} PWA lost a record $748 million in 1992.\textsuperscript{235} Air Canada's long term debt-to-equity ratio rose to 9:1, and was expected to reach 25:1 by the end of 1993.\textsuperscript{236} Nationair, a Montreal based charter carrier went bankrupt.\textsuperscript{237}

Air Canada has purchased 27.5\% of Continental Airlines.\textsuperscript{238} AMR has an agreement with Canadian Airlines parent PWA to invest $195 million to buy 33\% of the carrier.\textsuperscript{239} AMR expects to earn $15 billion in services from the relationship over the next 20 years.\textsuperscript{240}

E. Raising Capital

In the 1960s, the world's airlines spent $20 billion on capital equipment, raising 40\% from internal cash flow and the rest from the capital market. In the 1970s, the industry spent $48 billion on capital equipment, raising 52\% from cash flow. In the 1980s, the industry spent $143 billion on capital equipment, raising 51\% from internal cash flow, much of the rest financed by leasing companies. From 1990 to 1993, capital spending totaled $127 billion, but cash flow covered only 17\% of that. It has been projected that cash flow will cover only 37\% of capital spending throughout this decade, while capital expenditures will double to $511 billion by the year 2003.\textsuperscript{241} Edmund Greenslet noted,

The really critical question is whether the airlines can, over time and on average, reverse the decline in net profit margins. . . . [I]n the end it will be capital, and the need for cash flow to support it, that is likely to be the primary driver of airline economic trends in the 1990s and beyond.\textsuperscript{242}

Other sources project the world's airlines will need about $815 billion by the end of the decade, compared with $147 in the last decade.\textsuperscript{243} However, enormous losses suffered under deregulation and liberalization have so polluted the balance sheets of many of the world's airlines that it will be difficult to finance investment out of earnings or raise new eq-

\textsuperscript{235} Canada's Airline Conundrum, \textit{Airline Bus.}, May 1, 1993, at 50, 53.
\textsuperscript{236} Id.
\textsuperscript{237} Id. at 50.
\textsuperscript{238} Id.
\textsuperscript{239} Id.
\textsuperscript{240} Id.
\textsuperscript{241} Edmund Greenslet, World Airline Capital Requirements Address to the Chicago Convention 50th Anniversary Conference (Oct. 31, 1994).
\textsuperscript{242} Id.
\textsuperscript{243} Maldutis, supra note 4; Ranking - Skies in 1992, \textit{Airline Bus.}, April 2, 1992, at 16.
Interest expenses at IATA carriers totaled $3.7 billion in 1992. Troubled carriers have a few alternatives to raise capital:

1. Asset Sales. Many airlines have cannibalized assets to stay aloft. Pan Am sold its Intercontinental Hotel chain, its Manhattan skyscraper, its transPacific and London Heathrow routes to raise operating capital. TWA sold its Hilton International Hotel chain, Century 21 real estate company, and Spartan Foods. Air France sold its 57% interest in Meridien Hotels. Airline assets are often worth more capitalized than operating.

2. Additional Investment From Existing Investors, Debt Holders, or Equipment Manufacturers. Northwest approached KLM, unsuccessfully, about injecting more capital into the U.S. carrier. The equipment manufacturers assisted Continental’s exit from bankruptcy by injecting capital and trading debt for equity.

3. New Investors. The airline industry still attracts the wealthy seeking a piece of a high-profile glamour industry. The defiance of gravity, the sweaty palms some passengers get on takeoff or landing, the magnificence of cutting edge technology, images of exotic destinations, the prestige of owning a franchise fewer in number than the National Football League, and the opportunity to become lord of a city whose hub it dominates have always attracted men with huge egos. Even rapidly descending Pan Am was able to tap the capital markets with new stock issuances in the 1980s, despite its red ink.

4. New Airline Partners. As noted above, several foreign airlines have gained feed from the world’s largest passenger and air freight market by buying equity in U.S. carriers. For example, British Air effectively turned USAir into a regional feeder airline, funnelling short-haul connecting traffic into its lucrative, long-haul, wide-bodied, transAtlantic system, to be fed throughout its beyond-Heathrow network.

5. Trading Labor Concessions for Equity. Wage and work rule concessions were traded for equity at Eastern Airlines in the 1980s, and at TWA, Northwest and United in the 1990s.

6. Government Assistance. From 1977 to 1992, governments gave $3 billion to state-owned airlines. Although the U.S. industry is privately owned, the U.S. National Commission to Ensure a Strong Competitive
Airline Industry recommended that several taxes be rolled back on U.S. airlines, and that the Strategic Petroleum Reserve be tapped to aid airlines when fuel costs rise significantly. Congress exempted aviation fuel from a new 4.3 cents a gallon gasoline tax until October 1996. The state of Minnesota agreed to sell $250 million in bonds on behalf of Northwest Airlines to finance construction of a maintenance facility in Duluth, and $100 million for an engine repair facility in Hibbing. The federal government also authorized the sale by airlines of billions of dollars of public assets in the form of landing slots and international routes. These are indirect forms of taxpayer subsidy.

This phenomenon proceeds robustly abroad, where most airlines enjoy significant governmental ownership, and a paternalistic relationship which forbids airline collapse. The following chart reveals governmental ownership in the major airlines of western Europe:

<table>
<thead>
<tr>
<th>Airline</th>
<th>Government Stake (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aer Lingus</td>
<td>100</td>
</tr>
<tr>
<td>Air France Group</td>
<td>99.38</td>
</tr>
<tr>
<td>Alitalia</td>
<td>84.9</td>
</tr>
<tr>
<td>Austrian Airlines</td>
<td>51.9</td>
</tr>
<tr>
<td>British Airways</td>
<td>0</td>
</tr>
<tr>
<td>Iberia</td>
<td>100</td>
</tr>
<tr>
<td>KLM</td>
<td>38.2</td>
</tr>
<tr>
<td>Lufthansa</td>
<td>59.16</td>
</tr>
<tr>
<td>Olympic Airways</td>
<td>100</td>
</tr>
<tr>
<td>Sabena</td>
<td>88</td>
</tr>
<tr>
<td>SAS Group</td>
<td>50</td>
</tr>
<tr>
<td>Swissair</td>
<td>20.4</td>
</tr>
<tr>
<td>TAP Air Portugal</td>
<td>100</td>
</tr>
</tbody>
</table>

In 1991, the Belgian government wrote off $250 million in debt for its flag carrier, Sabena. In 1992, Spain injected $922 million into Iberia. In 1993, the Portuguese government granted $230 million in aid to TAP Air Portugal. Air France and Olympic Airways also turned to their

---

governments for billions of dollars of subsidies. Nonetheless, governmental assistance is becoming more difficult under the EEC's state aid rules.

Recently privatized carriers enter the market with a significant comparative advantage — relatively clean balance sheets, and therefore have superior access to the capital markets. For example, the Philippine government wrote off $560 million of Philippine Airlines debt before its privatization in 1992. It was little problem for recently privatized British Airways to tap the capital markets to finance major equity investments in USAir and Qantas.

V. AIRPORT INFRASTRUCTURE IN THE 1990s

Airlines and airports are inextricably intertwined. Neither can survive without the other. Both join forces to provide seamless service to the passenger. Airports are the hearts that pump the circulatory system in which airline routes serve as veins and arteries. In a less metaphorical sense, airlines are the airports' most important customers. Airports are the essential venue for funneling passengers into the air transportation network.

With the growth in passenger and freight demand, major new airports are being built around the world:

<table>
<thead>
<tr>
<th>Airport/Opening Date</th>
<th>Projected Cost (US $billion)</th>
<th>Runways</th>
<th>Passengers (millions-1992)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Munich/1992</td>
<td>$7.1</td>
<td>2</td>
<td>13</td>
</tr>
<tr>
<td>Osaka (Kansai)/1994</td>
<td>$15</td>
<td>1 (3)</td>
<td>24</td>
</tr>
<tr>
<td>Denver (Int'l)/1995</td>
<td>$4.8</td>
<td>5 (12)</td>
<td>31</td>
</tr>
<tr>
<td>Macau/1995</td>
<td>$0.9</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Seoul (Yongjong)/1997</td>
<td>$4.4</td>
<td>2</td>
<td>21</td>
</tr>
<tr>
<td>Hong Kong (Chek Lap Kok)/1997</td>
<td>$12+</td>
<td>1 (2)</td>
<td>23</td>
</tr>
<tr>
<td>Kuala Lumpur (Sepang)/1998</td>
<td>$3.5</td>
<td>1 (2)</td>
<td></td>
</tr>
<tr>
<td>Bangkok (Nong Ngu Hao)/2000</td>
<td>$3.9</td>
<td>2 (4)</td>
<td>16</td>
</tr>
</tbody>
</table>

In addition, Athens, Greece, is planning a new airport at Spada to open in 1997, and Oslo, Norway, is planning a new airport at Gardermoen. Many other airports are undergoing expansion:

**MAJOR ASIAN AIRPORT EXPANSION IN THE 1990s**

<table>
<thead>
<tr>
<th>Airport</th>
<th>Expenditure</th>
<th>Passengers (millions-1992)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tokyo (Haneda)</td>
<td>$1.5 billion</td>
<td>43</td>
</tr>
<tr>
<td>Tokyo (Narita)</td>
<td>$0.7 billion</td>
<td>22</td>
</tr>
<tr>
<td>Bangkok (Don Muang)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beijing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shanghai</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wuhan</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liangjiang</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Guangzhou</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shenzhen</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hanoi</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ho Chi Minh City</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Danang</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Penang</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The 19th Century was Europe’s, the 20th America’s, and the 21st Century shall be Asia’s. Much of the new airport infrastructure investment will be in Asia over the next decade and a half. The Asia-Pacific region is the world’s fastest growing air transport market.259 Seven of the ten most profitable airlines in 1993 were Asian; five of the ten least profitable were U.S. carriers.

Over the next two decades, the world air transport market is projected to grow between 5% and 6% a year, although North America is anticipated to grow at only about 4% a year.

Projections of passenger growth in the Asia-Pacific market are astounding. The Orient Airline Association predicts 7.5% through the year 2000. The International Air Transport Association [IATA] predicts between 7% and 8.6% through 2010. The Organization for Economic Cooperation and Development [OECD] predicts inter-Asian traffic growth of between 8% and 9% over the next two decades. The U.N. International Civil Aviation Organization [ICAO] predicts between 9.3% and 10.8% between 1993 and 1995. McDonnell-Douglas predicts 9.7% through the year 2010. And the People’s Republic of China [PRC] is anticipated to enjoy traffic growth in the range of 13.6% and 14.7%.

IATA predicts that Asia-Pacific, which in 1990 accounted for 31% of the world’s total passengers (132 million), will by the year 2000 account for 39% (or 189 million), and by 2010 51% (or 375 million), thereby displacing North America as the world’s busiest commercial aviation market.

33%, and in 1993, 20%. This has placed enormous strains on the capital requirements of the commercial aviation sector, and caused serious safety and operational problems.

The PRC has concluded that its airlines and airports need capital and operational expertise, and has recently opened both to foreign investment. The CAAC will designate two of its airlines for foreign investment/operations, allowing foreign investment up to 35% and foreign voting rights up to 25%.260

Among the most intriguing opportunities which appear to be on the table is the possibility of setting up a joint venture to build an airport in China. Construction costs on mainland China are a fraction of what they are anywhere else in the world. It has been predicted that, by the end of this decade, the east coast region of China will have 22 new airports, and 10 of the region’s existing airports will have been upgraded and expanded.261

The capital requirements of new airport infrastructure development are enormous. Both IATA and ICAO concur in their projections that, worldwide, $250 billion will be spent for airports between now and the year 2010, of which $100 billion will be required for the Asia-Pacific region alone.262

Of course, the construction of additional airport capacity is of direct concern to the primary tenants, the airlines. From the airlines’ perspective, airport expansion has a positive, and a negative, component.

On the positive side of the ledger, demand driven expansion of capacity can reduce congestion and delay, leading to enhanced utilization of aircraft and labor, and reduced consumption of fuel. New infrastructure can enhance carrier efficiency and productivity in serving a growing customer base. The U.S. Federal Aviation Administration predicts that, absent infrastructure expansion, serious delays at more than 30 of the nation’s largest airports will cause $1.1 billion in additional airline costs by the year 2001.263

The growth in flights and passengers can create congestion on the land side (in terms of surface access), air side (in terms of runway, tarmac and air space), and in the terminal. Some of that can be resolved with better utilization of scarce resources, such as technological advances in

Airlines in Turbulence

1995]

Aircraft navigation, or peak period pricing. Ultimately, it can cause airports to expand terminals and add runways, and new airports to be built.

On the negative side of the ledger, while some airport infrastructure costs are borne by passengers, taxpayers, and concessionaires, and the sale and lease of real estate, most of the cost of new and expanded infrastructure must be borne by the airlines (in the form of landing fees, terminal fees, aircraft parking fees, gate and hangar rental, ground handling services, air traffic control charges and fuel taxes) and their passengers (in the form of passenger facility charges, parking and tolls).

From the perspective of the airports, user costs are a relatively modest portion of airline operating expenses — a mere 4.1% of total airline average annual operating costs since 1978. But from the airlines’ perspective, whose net profit margins in the U.S. ranged between 2-3% before deregulation, and collapsed to less than 1% since, even a modest economic burden is an onerous one.

During the 1980s, airline user charges constituted between 70% and 90% of airport revenue (although other sources insist that passenger carriers pay only about a quarter of airport costs, about the same as concessions). ICAO predicts an average 9% annual increase in airport landing and associated charges, and an average 12% annual increase in route facility charges, through the end of this decade. What is clear is that in recent years, airport and route charges imposed upon airlines have grown faster than most other operating expenses, and the ability of airline operating revenue to digest them.

And while airport capital equipment needs will total between $250 billion and $350 billion by the year 2010 (with much of that paid, directly or indirectly, by the airlines), airline capital needs worldwide (mostly for new aircraft) will, by some estimates, total $815 billion by the year 2000. Given the inadequate profitability of the airline industry since deregulation, these capital requirements will be difficult to achieve.

Economic recession dampens passenger demand, thereby relieving some pressure on the infrastructure, and squeezing airline profits, making it more difficult for carriers to bear the cost of airport development. It is said of airlines that they order aircraft in good times and take delivery in bad. Of airports, it can be said that construction is begun in good times, and completed in bad.

One short term alternative to raise capital for new airport infrastructure is to privatize them. While private developers usually bear a higher

---

266. Id.
267. Id.
cost of capital vis-a-vis the government, and lack the government’s eminent domain powers, private firms, driven by a profit motive, often produce a product (here, airport services) with fewer employees, and greater economy and efficiency. The privatized British Airports Authority has proven that real estate and concessions can be developed into a significantly enhanced revenue stream. Nonetheless, airports are a monopoly bottleneck, and unless regulated, have the ability to extort monopoly rents from their customers (primarily the airlines).

Sir Walter Raleigh observed that he who controls the seas, controls the trade. He who controls the trade controls the wealth. He who controls the wealth controls the world. These days, airways have replaced the oceans, and airports have replaced seaports in importance. Airlines are too numerous to be profitable in mature markets. But airports are the bottlenecks through which passengers and high-valued cargo must flow. Thus, it would be imprudent to privatize them without regulatory supervision of carrier charges.

Other alternatives to building new airport infrastructure includes enhancing use of existing facilities via better rationing (e.g., peak period landing fees, to move demand to less congested parts of the day), and improvements in navigational and aircraft technologies (e.g., larger and STOL aircraft).

VI. THE PROSPECTUS FOR GOVERNMENT REFORM

A. PUBLIC POLICY

To his credit, Alfred Kahn recently conceded that the economic theories upon which deregulation was predicated were wrong, the predictions of deregulation’s proponents were therefore wrong, and the industry may well exhibit a tendency to engage in destructive competition.268 While economic regulation was imperfectly administered and created some distortions (including excessive service competition), it nevertheless created an environment in which destructive competition was avoided. Profits were by no means robust (as noted above, the industry’s

268. Anthony Veloci, Jr., Kahn Tells Airlines: Sit Tight, Cut Costs, AV. Wk. & SPACE TECH., Aug. 16, 1993, at 40. When asked what he might have done differently if he could turn back the clock, Kahn said, “I would recognize the danger of excessively exuberant investment, over-capacity and destructive competition was greater than we evaluated it at the time.” Id. at 41. “I knew a lot about communications and not much about airlines. That was the main reason I tried to proceed very gradually with deregulation. I read studies by serious academic scholars of the industry, and it was clear to me they underestimated the benefits of airline deregulation, including the advantages of scale and the advantages of hub-and-spoke operations.” Id. at 44. For recent assessments of the theories upon which deregulation was predicated, see DEMPSEY & GOETZ, supra note 6; PAUL S. DEMPSEY, THE SOCIAL & ECONOMIC CONSEQUENCES OF Deregulation (1989).
average profit margin averaged 2.4% from 1960-77, below that of all manufacturers, which typically earn between 4-6%), but they were significantly better than they have been during the 15 years since deregulation (when they fell to a negative 0.4%). In the early-1970s, neither the infusion of tremendous wide bodied capacity, recession, nor the sharp and unprecedented rise in fuel costs precipitated by the Arab Oil Embargo of 1973 bankrupted a single airline.

The National Commission's report emphasized that, adjusted for inflation, airline ticket prices have fallen during the last 15 years. Of course, that could be said for any 15 year period since the inauguration of commercial aviation in the 1920s. Allegations of consumer savings resulting from deregulation have been grossly overstated. It is remarkable that deregulation's proponents find a solid correlation between falling prices and deregulation, but find no relationship whatsoever between deregulation and falling profits.

Again, regulation was imperfect. But some forget that under regulation, real consumer prices were falling, wages and productivity were rising, safety was improving, traffic was growing, concentration was declining, and profit, by no means robust, kept balance sheets respectable and equipment new. In the mid-1970s, regulatory reform was well on the way to curing many of the distortions in the system — enhanced pricing and entry flexibility allowed carriers to rationalize operations, tap the elasticities of demand to fill seats which otherwise would have flown empty, and enjoy respectable profitability. But full deregulation has unleashed the industry's inherent primordial tendency to engage in destructive competition.

B. Economic Theory

In an earlier section, we examined the economic characteristics of commercial aviation, and described its catastrophic economic results since deregulation. Here, we briefly examine economic theory as it pertains to the question of regulation and deregulation.

The phenomenon of destructive competition has long been recognized as an appropriate rationale for government regulation. In fact, destructive competition was a primary rationale for airline economic regulation in the 1930s. In the mid-1970s, Stephen Breyer (now a U.S.

270. Dempsey & Goetz, supra note 6, at 243-63, 281-95.
272. See 1 Dempsey et. al., supra note 50, § 1.03.
Supreme Court Justice) was an architect of Congressional airline deregulation as an aide to Senator Ted Kennedy. In reviewing the allegation that "competition would force the airlines to charge prices that covered only variable, but not fixed, costs," Justice Breyer concluded that there was no evidence that destructive competition did (prior to regulation) or would (subsequent to deregulation) occur.273

As Chairman of the Civil Aeronautics Board, Alfred Kahn also dismissed allegations that deregulation would lead the industry to engage in destructive competition. But by 1993, with the benefit of more than a decade of real world experience with deregulation, he appears to have changed his mind. When asked about whether his vision of deregulation in the late 1970s included the steep financial nose dive that resulted from it, Kahn said, "No. I talked about the possibility that there might be really destructive competition, but I tended to dismiss it. And that certainly has been one of the unpleasant surprises of deregulation."274

One need only revisit Alfred Kahn's 1972 treatise on economic regulation to find a definition of an industry which exhibits the tendency to engage in destructive competition. Wrote Kahn:

The major prerequisites [of destructive competition] are fixed or sunk costs that bulk large as a percentage of total cost; and long-sustained and recurrent periods of excess capacity. These two circumstances describe a condition in which marginal costs may for long periods of time be far below average costs. If in these circumstances the structure of the industry is un-concentrated — that is, its sellers are too small in relation to the total size of the market to perceive and to act on the basis of their joint interest in avoiding competition that drives price down to marginal cost — the possibility arises that the industry as a whole, or at least the majority of its firms, may find themselves operating at a loss for extended periods of time.275

Kahn described the post-deregulation airline industry almost perfectly.

Another individual who may have explained why airlines tend to engage in individually rational, but collectively irrational, behavior is Garrett Hardin, a student of population and environmental problems. In his powerful essay, "The Tragedy of the Commons", Hardin wrote:

Picture a pasture open to all. It is to be expected that each herdsman will try to keep as many cattle as possible on the commons. Such an arrangement

274. Veloci, supra note 268, at 41.
may work reasonably satisfactorily for centuries because tribal wars, poaching, and disease keep the numbers of both man and beast well below the carrying capacity of the land. Finally, however, comes the day of reckoning, that is, the day when the long-desired goal of social stability becomes a reality. At this point, the inherent logic of the commons remorselessly generates tragedy.

As a rational being, each herdsman seeks to maximize his gain. Explicitly or implicitly, more or less consciously, he asks, “What is the utility to me of adding one more animal to my herd?” This utility has one negative and one positive component.

(1) The positive component is a function of the increment of one animal. Since the herdsman receives all the proceeds from the sale of the additional animal, the positive utility is nearly +1.

(2) The negative component is a function of the additional overgrazing created by one more animal. Since, however, the effects of overgrazing are shared by all the herdsman, the negative utility for any particular decision-making herdsman is only a fraction of 1.

Adding together the component partial utilities, the rational herdsman concludes that the only sensible course for him to pursue is to add another animal to his herd. And another . . . . But this is the conclusion reached by each and every rational herdsman sharing a commons. Therein is the tragedy. Each man is locked into a system that compels him to increase his heard without limit — in a world that is limited. Ruin is the destination toward which all men rush, each pursuing his own best interest in a society that believes in freedoms of the commons. Freedoms in a commons brings ruin to all.276

Substitute airlines for herdsmen, aircraft for cattle, and the airways and airports for the commons and you can see how the airline industry propels itself toward destruction, particularly in a market in which consumers which value frequency.

Hardin points out that the tragedy of the commons can be avoided where private property rights exist. The problem is dividing the skies into parcels of property. In international markets, the bilateral air transport agreements effectively do that by limiting the number of entrants.

C. Politics

Despite the tens of thousands of employees who have lost their jobs, and investors, lenders and equipment manufacturers who have been stiffed, and a growing number of consumers disenchanted by inequitable pricing and deteriorating service, today the political will for reform is weak. It has become politically incorrect to challenge deregulation, or advocate increased government oversight. We live in an era where the

conventional wisdom is that government can do no good, and the market

can do no wrong.

In the mid-1980s, the industry and conservative "think-tanks" turned
on a tremendously effective propaganda machine which convinced much
of the public that airline deregulation was a phenomenal success, largely
because of grossly overstated estimations of consumer benefits. Remark-
ably, the industry refuses to turn off that propaganda machine. Airline
executives had a marvelous opportunity to request meaningful oversight
before the National Commission to Ensure a Strong Competitive Airline
Industry, but declined, insisting it focus instead largely on peripheral is-
issues, rather than on the central causes of the industry's collapse. This
stems from a distrust of government, a failure to understand that a model
other than classic price and entry regulation is possible, and frankly, a
dose of hubris.

To recommend a taxpayer bail out (i.e., tax relief) and selling off our
airlines to foreign citizens, as that Commission did, would seem a confes-
sion that aviation policy of the past 15 years has been a failure. But be-
cause several of its members were architects of deregulation, that
Commission was paralyzed from addressing the failure of deregulation.

D. INTERNATIONAL AVIATION

The U.S. Department of Transportation seems infatuated with the
notion that "open skies" (a/k/a exporting deregulation abroad) ought
ubiquitously to govern air transport. Some foreign governments view this
as naive, for they perceive deregulation as the catalyst for the financial
collapse of much of the U.S. airline industry (with good cause).

Consistent with this theological devotion to "open skies," DOT's ap-
proval of code-sharing (despite the manifest consumer deception and the
deleterious impact on independent regional airlines) appears motivated
by the desire to facilitate foreign ownership, a means of providing capital
to U.S. airlines financially ravaged by deregulation and LBOs — both
caused by a bankrupt U.S. aviation policy. The quid pro quo is code-
sharing (giving foreign airlines indirect access to rich domestic U.S. feed),
liberal bilateral rights of access (with direct non-stop access to interior
U.S points, and generous fifth-freedom rights), and in at least one in-
stance, antitrust immunity so that the two carriers (i.e., KLM/Northwest)
can agree both to merge marketing, cease competing, and remarkably,
pool traffic and revenue. Foreign investment is far more attractive to for-

277. Most sensible nations look at U.S. government transport ministers as hopelessly naïve,
and they are right. While the U.S. government may care little about the well being of Pan Am or
Eastern, the government of France cares dearly about the survival of Air France. Hence, renun-
ciation of bilateral is the response to a perception that U.S. carriers can make no money in their
deregulated domestic markets, and are dumping capacity in international markets.
Airlines in Turbulence

1995]

eign airlines if the foreign carrier can control the North American feed into their relatively lucrative wide-bodied long haul networks.

While propping up airlines collapsing because of the failure of U.S. domestic aviation policy, foreign ownership poses four potential problems: (1) given that the U.S. relies on the civilian commercial airline fleet for needed lift capacity in time of international conflict under the Craf program, it may have a deleterious effect on national security; (2) it eliminates competition in foreign markets; (3) it pollutes the integrity of bilateral air transport negotiations; and (4) it may potentially endanger domestic aircraft production.278

"Open skies" is more likely to get U.S. carriers unlimited access to Singapore Changhi or Amsterdam Shiphol than London Heathrow or Tokyo Narita, or a totally multilateral regime of free, unlimited entry abroad.279 Small countries, like Austria, Switzerland and Iceland, with little domestic passenger feed, are more than happy to trade access to a little for access to a lot.

U.S. aviation labor unions have declared war against lifting of the cabotage prohibition. They are fighting the wrong battle. Even if the United States gave away cabotage tomorrow and received nothing in return, little would change. The foreign airlines are not so foolish to invest billions of dollars setting up a route network in a nation where almost every airline suffers from chronic economic anemia. Moreover, the most desirable airport infrastructure in the United States has been consumed.

All we would likely see from elimination of cabotage would be the elimination of some closed door restrictions on foreign carrier flights that serve two points in the U.S. Thus, a European carrier with a through flight from Europe to Los Angeles via New York could pick up a few passengers in New York. The competitive impact would be but marginal, as is our competitive impact on fifth freedom flights in Europe. The trans-oceanic schedule does not allow much in terms of threatening competition.

279. Some U.S. airline executives define open skies to include a prohibition of code-sharing and state aid, and that it be pursued multilaterally or not at all. The qualifications are lost on most listeners.

One might recall that Graham Claytor, until recently the CEO of Amtrak, went up to Capitol Hill and repeatedly advocating "economic self-sufficiency" in the same breath as "for a capitalized Amtrak." Congress heard only the first phrase and ignored the second. Amtrak now runs 50 year old equipment made by a manufacturer which has been out of business for 15 years. It's maintenance yard has to make parts from scratch — there are no spare parts to buy. You can imagine what that does to maintenance costs and equipment down-time.

Many in the industry praise deregulation as magnificent and advocate that it should be pursued on a global scale. Any qualifications on what is meant by open skies are lost on the unsophisticated, and as we both lament, the unsophisticated dominate DOT.
Foreign carriers secure adequate access to the world's largest passenger market (the U.S.) via foreign control and code-sharing, risking only a few hundred million dollars if they decide to buy control. They invest dumb equity, expecting synergistic revenue on the feed the U.S. carriers provide into their wide-bodied long-haul networks. When Sir Colin Marshall dictates that USAir must shed itself of its London routes, and that the ALPA proposal for equity ownership is unsatisfactory, he de facto controls USAir, despite the unmistakable legislative prohibition.

As a rule, U.S. airlines enjoy their highest load factors, highest yields, and highest profits in the most heavily regulated international markets, and suffer their lowest load factors, lowest yields, and lowest profits in the "open skies" domestic markets. U.S. flag carriers perform best in the Latin America and Pacific markets, which are relatively tightly regulated. U.S. carriers transport only about 15% of the passengers in the open skies U.S.-Netherlands market, and about 20% in the open skies U.S.-Korea market.

Exporting "open skies" to the international arena will, in the long term, export the severe overcapacity we face domestically, created by overlapping hub and spoke networks, while profitability is eroded by new entrants. Open skies will result in that duplicative network capacity played out on a global scale, coupled with low-cost Laker Skytrains, Virgin Atlantics, and People Expresses emerging in a host of international markets.

In the short term, U.S. airlines might eat the lunch of some of the European and Japanese carriers (although airport capacity constraints in Europe will themselves deny U.S. carriers significant new entry). They enjoy a comparative labor cost advantage in both arenas.

But in the long-term, in an open skies environment, the Asian tigers might well eat the lunch of the U.S. flag carriers because of their comparative cost advantage, as well as their relatively higher service levels. Business travelers already rate Asian carriers as the best. This results from a cultural and attitudinal difference in the level and type of cabin service that U.S. airline management cannot expect to exact from U.S. cabin crews. For obvious reasons, employee-owned companies will have a difficult time hiring third world cabin and cockpit employees. All the major U.S. airlines will eventually succumb to employee ownership.

Code-sharing will deprive U.S. carriers of the comparative advantage of on-line domestic feed from the world's largest market — North America. But over the next two decades, Asia will become the largest passenger market. In an open skies regime, Asia inherits the earth, as it has in most major industrial sectors.

Regarding state-aid, the objection of the United States seems somewhat hypocritical. For example, the U.S. objects to the government of
France pouring billions of francs into Air France, and yet ATA repeatedly calls for rolling back taxes. Whether the government hands airlines the money, or takes less away, the net effect is the same.\textsuperscript{280} The 4.3\% per gallon exemption in aviation excise fuel taxes, coupled with low fuel costs, was an enormous factor in producing the modest profitable third and fourth quarters the industry just enjoyed.\textsuperscript{281}

Certainly, subsidized airlines need not make a profit in order to survive. Nor are they vigorous price competitors. Most subsidized and government-owned carriers are lethargic and inefficient. But, as we see at British Airways, paternalistic governments have established ubiquitous global route networks, and are willing to engage in subtle forms of protectionism (e.g., capacity restrictions at Heathrow).

Privatization of industry is a global phenomenon driven in part by ideology, and in part by the fiscal needs of governments having a more difficult time satiating the social welfare needs of their constituents. In most western industrialized nations, the aging population is growing and consuming more resources, while the number of taxpayers are declining. Flushing out capital from state owned industries offers politicians a band-aid, which postpones the higher taxes and lower benefits which must eventually come.

In the airline sector, the privatized airlines usually proceed through a downsizing of employment, a streamlining of operations, and perhaps most significantly, emerge triumphant with a clean balance sheet.

After 15 years of deregulation (a/k/a domestic open skies), the balance sheets of U.S. carriers have been polluted with enormous debt. If British Airways wants to raise $400 million on the capital markets to control USAir, no problem. If USAir entered the capital markets to find $400 million on its own, the junk interest rate would be prohibitive.

From a purely Machiavellian perspective, U.S. carriers are better off with sluggish governmentally owned and subsidized competitors than with more privatized British Airways.

With most major airlines suffering chronic economic malaise, some have bemoaned the absence of a U.S. aviation policy. With commendable dedication, Transportation Secretary Federico Pena has attempted to chart a new course in aviation policy.

Unfortunately, the path he chose suffers from two fundamental mis-

\textsuperscript{280} Moreover, the airline industry is sucking at the state and local teats in North Carolina, Minnesota, Indiana, Missouri and Colorado.

\textsuperscript{281} Samuel Buttrick of Kidder, Peabody, pointed out that 70\% of U.S. airline gains in the first half of 1994 were attributable to lower fuel prices. Julius Maldutis of Salomon Brothers observed that in spite of the $313 million profit the industry earned in the third quarter of 1994, they posted only a $68 million profit for the first nine months, and would likely lose $300 or more for the year; see also Babbitt, supra note 23, at 10.
understandings and misconceptions, and a generous dose of naivete. In the long term, the policies now being pursued by Mr. Pena may do serious harm to our airlines.

First, Mr. Pena has spent much time in recent months negotiating “open skies” bilateral agreements with nations the size of their postage stamps, offering them virtually unlimited access to the United States (the largest and richest source of passenger and freight traffic in the world) in exchange for . . . what? The opportunity for U.S. carriers to fly to any airport in countries like Luxembourg, Iceland, Switzerland, and Austria. While these are splendid nations, the air traffic opportunities they offer U.S. carriers are miniscule compared to the opportunities the vast U.S. passenger and cargo market offer their airlines.

Further, Mr. Pena has offered foreign carriers direct access to U.S. traffic via anticompetitive marketing and equity relationships with U.S. carriers, which feed traffic into the lucrative long-haul, wide-bodied foreign carrier networks.

Such a naive approach is inconsistent with Congressional policy as expressed in the International Air Transportation Competition Act of 1979, which provides that, in negotiating bilaterals, the Department of Transportation may allow “opportunities for carriers of foreign countries to increase their access to United States points if exchanged for benefits of similar magnitude for United States carriers . . . .” The opportunity for a U.S.-flag airline to fly to Luxembourg is hardly the equivalent of allowing a Luxembourg carrier to fly to New York, Chicago and Los Angeles.

Second, there is, has been, and continues to be a long standing priority given to the interests of the passenger carriers vis-a-vis the cargo carriers. Since World War II, the entire framework of bilateral air transport agreements negotiated between the United States and foreign nations has been predicated on a route structure designed to move people.

But the routings are vastly different. People prefer to move from A to B nonstop if they can. Most bilaterals focus on point-to-point passenger routings.

Although highly time sensitive, air freight is less particular about its routing. A circuitous movement from A to hub to B annoys cargo less than it does passengers. Freight can sit quietly on tarmacs, and needs little entertainment, food, or warmth. Cargo doesn’t mind overnight circuitry in the flight path. While a passenger would be loathe to fly from Dublin to New York via Frankfurt, freight does not seem to mind.

Consolidating freight from numerous origins allows aggregate load factors to take advantage of the economies of scale of larger aircraft. Thus, an A to B route structure (e.g., Dublin to New York) is antithetical to the efficiency of air cargo operations.
Moreover, the economies of scope in the movement of freight are profound. Thus, a U.S. cargo jet flying from Dublin to Frankfurt (where packages coming from all over Europe headed for the United States are consolidated) can easily accommodate another package or two to Rome, or Budapest, or Copenhagen. The additional costs are nil. The additional revenue goes straight to the bottom line.

Freight is also much less sensitive to price than about half of the passenger market, which consists of discretionary traffic. Freight must move to market. People do not have to fly to vacation destinations, and if the price is too dear, they stay home, or drive the kids to Wally World.

The all-cargo carriers do compete with the passenger combination airlines, which carry freight, along with bags, in the belly of their planes. But given their route structures, the passenger carriers are a somewhat poor competitor for the large cargo carriers, which are well integrated with surface carriers for a seamless movement from origin to destination.

Freight has always taken a back seat to passengers in U.S. bilateral negotiations. The international aviation system was designed primarily to accommodate bilateral passenger aviation needs.

The only way to responsibly pursue international aviation negotiations is pragmatically, with hard bargaining for meaningful rights of access for our airlines. The U.S. International Air Transportation Competition Act of 1979 calls for

the strengthening of the competitive position of United States air carriers to at least assure equality with foreign air carriers, including the attainment of opportunities for United States air carriers to maintain and increase their profitability, in foreign air transportation . . . [and] opportunities for carriers of foreign countries to increase their access to United States points if exchanged for benefits of similar magnitude for United States carriers or the traveling public with permanent linkage between rights granted and rights given away.282

That is what the law requires, and that is the way aviation negotiations should be conducted. Platitudes by DOT Secretaries and airline executives about open skies and the enormous consumer benefits of deregulation will only result in more U.S.-Netherlands type bilaterals (wholly inconsistent with the statutory goals quoted above, as well as U.S. antitrust policy), and postpones the day when we find a meaningful solution to the deterioration of the U.S. airline industry.

What, then, should drive U.S. international aviation policy?

First, pragmatism. Bilateral negotiations should be pursued pragmatically, rather than ideologically, as the law requires. We should bargain hard for access by U.S. carriers, and surrender only that for which

282. Dempsey et. al., supra note 50, § 10.18.
there is a roughly equivalent quid-pro-quo. Platitude about “open skies” coupled with signing new one-sided bilaterals with small nations with little traffic potentially erodes the long-term vitality of U.S. airlines.

Further, the U.S. Department of Transportation could do more to address the day-to-day operational barriers in foreign markets, including limited airport access, inadequate terminals and hangar space, restrictions and delays in processing cargo, restrictions on ground handling and currency remittances, and discriminatory charges, fees and taxes. Our DOT should aggressively defend the rights of U.S. airlines to compete abroad, with the threat of imposing sanctions on the airlines of nations which discriminate against U.S. carriers, and where necessary, the implementation of the threat.

Second, air cargo rights should be negotiated separately from passenger rights, and preferably on a multilateral basis, in which the U.S. sits down with all the major nations in a region and hammers out an agreement which creates a multidirectional distribution network geared to the way freight moves, allowing the carriers to take advantage of their inherent economies of scale and scope with a maximum of efficiency and productivity.

All that requires a fundamental re-thinking of U.S. aviation policy, embracing pragmatism and common sense over ideology. Transportation is the fundamental catalyst for shrinking the planet, allowing the economic system to fulfill its global destiny. Prudent government policy can much enhance both the free flow of commerce and the economic well being of the airlines of our nation.

In the final analysis, the U.S. Department of Transportation is entrusted with protecting the public interest. The public interest should be broadly defined, to include the interest of shippers, passengers, airlines, and their employees, lenders, creditors and investors. With that as its goal, a course correction along the lines succinctly described here would be in the best national interest.

E. The Future

Ultimately, unless the government provides the oversight necessary to enhance pricing stability and rationalize capacity, when all the dust settles, we will be left with fewer, but horribly injured, airlines. In the United States, several major airlines will gradually collapse into liquidation, but the process likely will be so slow and the few survivors so weak that a Penn Central or Amtrak-type solution will not be implausible. However, the federal government’s ability to provide a bail out will be circumscribed by its own excessive debt burden and a reluctance to re-

---

283. Gritta et. al., supra note 14.
peat the catastrophic bail out of the deregulated savings and loan industry. If the survivors are able to reap monopoly rents on a widespread basis, the public outcry will be for imposition of public utility type regulation. Alternatively, the free marketeers will call for surrender of cabotage to allow foreign entrants to discipline the few surviving U.S. carriers, and the cycle will begin anew.

Government is a highly imperfect institution, but we must reluctantly concede it is sometimes a necessary companion, particularly to correct for market failure in industries essential to the vitality of the nation as a whole. With more competitors, we can have less government; but with fewer competitors, we will need more government. Thus, injecting modest governmental oversight now to provide some measure of stability to pricing and allow a rationalization of capacity will stem the implosion of this important infrastructure industry, so vital to commerce, communications and national defense.

VII. THE AIRLINE INDUSTRY IN THE NEXT DECADE

Predicting the future is a fool's game. Nonetheless, current trends suggest several possible results by the turn of the Century:
1. Improved communications technologies will erode the business traffic base of airlines, leaving them gradually, but increasingly, more reliant on discretionary traffic, which is highly price sensitive.
2. Both the number and market share of Southwest-clone low-cost, low-priced, linear route carriers will grow, although these carriers ultimately will not account for more than a fifth of the total U.S. air passenger market. Such growth will plateau, for the number of city-pair markets which can support nonstop service is finite.
3. The United States will be served by many fewer than its current 17 interior hubs.
4. The surrender of wage and work rules by labor for equity at Northwest, TWA and United may give them a competitive cost advantage that the remaining major airlines will be forced to replicate. Labor will control or own significant equity in most of the major network U.S. carriers, which must restructure their costs if they are to grow, and survive. But workers will be disappointed if they expect to earn meaningful dividends from their airline stock portfolios.
5. Several major domestic network carriers will have collapsed or merged, leaving the industry more highly concentrated. This trend will be accelerated should fuel costs or interest rates rise significantly.
6. While the U.S. domestic market will not grow at the rates at which it

284. DEMPEY, supra note 271, at 1.
grew in the 1980s, international aviation will grow robustly, particularly in the Pacific Rim.

7. With mergers and bankruptcies, the number of major international carriers will shrink, each having strategic alliances with network carriers and pseudo-carriers on other continents.

8. The U.S. government will have to face up to its obligation to provide responsible oversight of this essential infrastructure industry to enable it to rationalize capacity and stabilize pricing. History is prologue. These words were said by a former President of the Air Transport Association:

Since air transport was launched into meteoric growth . . . of [the] private capital devoted to it . . . there remains today scarcely 50 percent. Since the beginning of air transport, a hundred scheduled lines have traversed the airways in a struggle to build this newest avenue of the sky. But today scarcely more than a score of those companies remain. The industry has been reduced to the very rock bottom of its financial resources . . .

There are only two ways whereby the necessary capital can be provided to this industry. One is the way toward which the governments of foreign lands increasingly tend — the way of mounting governmental subsidies, whereby public funds are poured without stint into air transport. The other way is the traditional American way, a way which invites the confidence of the investing public by providing a basic economic charter that promises the hope of stability and security, and orderly and intelligent growth under watchful governmental supervision.285

These words are as true today as when they were first spoken, only a few months before Congress passed the Civil Aeronautics Act of 1938, which for four decades allowed the U.S. airline industry to grow and prosper, and establish what was once universally acclaimed as the “world’s finest system of transportation.”

285. DEMPSEY et. al., supra note 50, § 1.03.
# Transport Sector Privatisation in the Russian Federation

Prof. Dr. Elmar Giemulla*
Dr. Heiko van Schyndel**
(Translation by Dorothee Müller and Christian Duggan)

## Table of Contents

<table>
<thead>
<tr>
<th>I. Introduction</th>
<th>100</th>
</tr>
</thead>
<tbody>
<tr>
<td>II. Framework of Legal Requirements for Privatisation</td>
<td>102</td>
</tr>
<tr>
<td>A. Steps in the Process of “The Privatisation of State and Municipal Enterprises of the RSFSR”</td>
<td>102</td>
</tr>
<tr>
<td>B. Application for Privatisation</td>
<td>102</td>
</tr>
<tr>
<td>C. The Right to Initiate Proceedings</td>
<td>102</td>
</tr>
<tr>
<td>D. Application Decision</td>
<td>102</td>
</tr>
<tr>
<td>E. Privatisation Commission</td>
<td>103</td>
</tr>
<tr>
<td>F. Privatisation Plan, Examination and Voting</td>
<td>103</td>
</tr>
<tr>
<td>G. Privatisation of the Undertaking</td>
<td>104</td>
</tr>
</tbody>
</table>

---

* Elmar Giemulla is a fully qualified German lawyer and an Attorney at Law, admitted to the Bar of New York. He is also an ABA-member. He is coauthor of a commentary on the Warsaw Convention, the Convention for the unification of certain rules relating to international transportation by air, which has recently published in English.

** Heiko van Schyndel is a German lawyer and an Advocat, a member of the Voronezh oblast Collegium of Advocats (Russian Federation).

The authors have been advising the Russian government and a number of Aeroflot's successor companies for over two years on the restructuring of the Aviation Administration and privatisation of Russian air carriers.
I. Introduction

The upheavals currently taking place in Russia are also reflected in its legal system. Considerable legal uncertainty has arisen since the demise of the Soviet Union and still exists. On the one hand, numerous economy-controlling regulations\(^1\) were passed by Russia in the process of

---

transition to a market economy. On the other hand, laws dating back to
Soviet times may still be applied. Section Two of the Resolution of the
Supreme Soviet of the RSFSR\textsuperscript{2} on the ratification of the Treaty for the
Foundation of the Commonwealth of Independent States stipulates that
in the territory of the RSFSR, until appropriate legislation is passed by
the RSFSR, the standards of the former USSR may continue to be ap-
plied to the extent that they are compatible with the constitution, the
legislation of the RSFSR and the Treaty.\textsuperscript{3} This provision raises more
questions than it answers.

Those in government are experiencing difficulties defining the direc-
tion of a self-contained legal framework due to a lack of agreement as to
what direction; consequently, those who are governed find it difficult to
take these regulations—some of which are only very short-lived seri-
ously. Additionally, any law presupposes a legal consciousness that un-
derlies and at the same time marks the law. Russia is still a long way
from the mutual influence and inter-permeation of law and legal con-
sciousness essential to the understanding and (non-forcible) application
of the law. In a society where the law was predicated on an identity of
public and private interests, the enforcement of private interests was
often only possible by circumventing the law. This has had a lasting im-
 pact on legal consciousness.

It is well known that economic activity, through custom and practice,
creates its own laws to a certain extent. Herein lies both opportunity and
danger: will the Russian sense of business develop in accordance with the
Western model of the honest businessman, whose customer relations are
marked by "good faith," or will business acumen be measured by how
cleverly and successfully one can "pull a fast one" over a business part-
ner? Both tendencies can currently be observed in Russia. It will be up to
the legislature to focus on one of these, to incorporate it in the legal
norms being created, and to permanently influence legal consciousness.

The legislature has undoubtedly already taken the first steps. As a
result, for the first time in an institutionalised context, two conditions en-
abling commercial activity developed: encouragement of business activity
in general and privatisation legislation organised on private law principles
for the protagonists of the market economy. One central element,

\textsuperscript{2} After the adoption of the "Law of Amendment of the Designation of the State RSFSR" of 21 December 1991; Vedomosti RSFSR, 1992, No. 2, art. 62, the former RSFSR bore the official title "Russian Federation - Russia." Since the adoption of the new constitution, "Russian Federation" and "Russia" are equally valid as official titles of the state.

\textsuperscript{3} Order of the Supreme Soviet of the RSFSR of 12 December 1991 "On the Ratification of the Treaty to Establish the Commonwealth of Independent States."
privatisation legislation in the transport sector, will be described below.⁴

II. FRAMEWORK OF LEGAL REQUIREMENTS FOR PRIVATISATION

A. STEPS IN THE PROCESS OF “THE PRIVATISATION OF STATE AND MUNICIPAL ENTERPRISES OF THE RSFSR”

The Privatisation Law (PrivL)⁵ provides that the privatisation of state and municipal enterprises proceeds either through the sale of the business by way of tender or by auction, through the sale of interests in the capital (i.e. shares) of the business, through the redemption of the assets of a business wholly or partially leased from the state. The privatisation process itself is made up of a series of six complex and, in practice often protracted, individual stages involving a large number of participants.

B. APPLICATION FOR PRIVATISATION

The privatisation of state and municipal enterprises may only be commenced by means of an application. The application must be submitted to the area office of the State Committee for the Administration of Russian State Property (Goscomimushtshchestvo, hereinafter “GCI”) or to the Committee for the Administration of Property of Federation Member-states, national or administrative area units.⁶

C. THE RIGHT TO INITIATE PROCEEDINGS

Article Thirteen, Section One of the PrivL directs that the right to initiate a privatisation application belongs to, but is not limited to, the GCI or its area offices; the manager of the business; the workers’ collective of the business, a production plant, production area or another division of the business; and central and local institutions of state power and the executive.⁷

D. APPLICATION DECISION

Privatisation applications are registered on the day of receipt with the appropriate committee.⁸ Within one month of registration of the privatisation application, the appropriate committee must decide whether

---

⁴ The laws and regulations forming the basis of this article have been made available to the authors in connection with their consulting activities. Many of these sources are not published or available; citations have been included where available.
⁵ Vedomosti RSFSR, 1991, No. 27, art. 927; Vedomosti RSFSR, 1992, No. 28, art. 1614.
⁶ Id. at art. 13, s. 1.
⁷ Id. at art. 13, s. 1 (first sentence).
⁸ Id. at art. 14, s. 1 (second sentence).
to permit privatisation or deny the application. Normally, written notification of the decision is required within three days. The Privatisation Commission may refuse an application only if Article Nine of the PrivL prohibits an applicant from purchasing an undertaking which is to be privatised; the undertaking is subject to a statutory restriction on privatisation; or the undertaking is included in the table of properties of the relevant privatisation programme not subject to privatisation.

E. PRIVATISATION COMMISSION

Following a decision favouring privatisation, a Privatisation Commission is formed to privatise the undertaking. The Privatisation Commission consists of numerous representatives from various state organisations.

F. PRIVATISATION PLAN, EXAMINATION AND VOTING

A privatisation plan is drawn up within a period of three months, but in exceptional circumstances the time limit may be extended for an additional three months. The privatisation plan for a business establishes, inter alia, the method and timetable for privatisation, the starting price of the business and the amount of share capital of the joint stock company. It may also include a plan for business reorganisation providing, inter alia, for the separation of departments into independent businesses or the sale of business assets.

The Privatisation Commission examines the plan of each business and submits it to the local people’s deputies or an authorised representative as well as to the workers’ collective of the business for the purpose of a vote. The vote must take place within one week of receipt of the privatisation plan or the plan is deemed to be approved. The approved privatisation plan is confirmed by the appropriate committee for property

---

9. Id.
10. Id. at art. 14, s. 2.
11. Id. at art. 14, s. 3.
12. Id. at art. 14, s. 4. These are, for example, the GCI, corresponding local property committees, and financial authorities. The people’s deputies responsible for the area in which the undertaking is located, the management, the workers’ collective of the undertaking, the State Committee of the Russian Federation for Competition Policy and Support for New Economic Structures have the right to send representatives to the privatisation commission. In addition, the Privatisation Commission may involve external advisors in its work (experts, specialised auditors, advisory and other organisations).
13. Id. at art. 14, s. 6.
14. Id.
15. Id.
16. The deadline for voting may be extended by two weeks.
administration.\textsuperscript{17}

If the workers' collective rejects a privatisation plan, the Privatisation Commission is obliged to present an alternative plan.\textsuperscript{18} When the collective also rejects the alternative plan, the appropriate local people's deputies or another authorised body tenders the final decision regarding plan revision and both the method and procedure for effecting privatisation.\textsuperscript{19} However, where the Russian Federation owns the business submitting a plan rejected by the local people's deputies, the Privatisation Commission must submit an alternative version of the plan. If the privatisation plan is again rejected, the final decision falls to the property committee.\textsuperscript{20}

G. PRIVATISATION OF THE UNDERTAKING

The PrivL provides for several privatisation methods. State and municipal enterprises may be sold and purchased by invitation to tender\textsuperscript{21} or by auction.\textsuperscript{22} Capital interests, or shares in open joint stock companies, may be sold in the undertaking.\textsuperscript{23} The last method described in the PrivL allows for the redemption of assets of businesses that are either wholly or partially leased from the state.\textsuperscript{24}

III. THE STATE PROGRAMME FOR THE PRIVATISATION OF STATE AND MUNICIPAL ENTERPRISES OF THE RUSSIAN FEDERATION

Although the 1991 Privatisation Law required an annual privatisation programme, only the Privatisation Programme for 1992\textsuperscript{25} had been produced by December 1993. Approval of the 1993 Programme was prevented by the power struggle between the legislature and Executive. At the end of 1993, by decree of President Boris Yeltsin, a new privatisation programme was passed,\textsuperscript{26} but this programme failed to indicate the year of applicability. However, the time limits set in the programme give rise to the presumption that a new programme will replace it in the second half of 1994.

\textsuperscript{17} Vedomosti RSFSR, 1991, No. 27, art. 14, s. 5; Vedomosti RSFSR, 1992, No. 28, art. 14, s. 5.
\textsuperscript{18} Id. at art. 14, s. 7.
\textsuperscript{19} Id.
\textsuperscript{20} Id. at art. 14, s. 8.
\textsuperscript{21} Id. at art. 20.
\textsuperscript{22} Id. at art. 21.
\textsuperscript{23} Id. at art. 22.
\textsuperscript{24} Id. at art. 15, s. 2.
\textsuperscript{25} Vedomosti RSFSR, 1992, No. 28, art. 1617.
\textsuperscript{26} Vedomosti RSFSR, 1994, No. 1, art. 2.
IV. The 1992 Privatisation Programme

According to its preamble, the 1992 Privatisation Programme was designed to form a stratum of private owners that encouraged the creation of a socially-geared market economy; provide for the social protection of the population and the development of a social infra-structure with income derived from privatisation; support the process of stabilising the financial situation in the Russian Federation; create a commercially competitive environment that supports demonopolisation; attract foreign investment; and create conditions and organisational structures that broaden the scope of privatisation in 1993 and 1994. To further and simplify these aims, the Programme categorised privatisation. It drew distinctions between properties and businesses where privatisation was prohibited; required a decision of the Russian Government or the governments of the Republics within the Federation (depending on the ownership situation); required a decision of the GCI, taking into account the views of the competent Minister; could only be accomplished in accord with the local privatisation programme; or was compulsory. The programme further provided that projects not within one of these categories could be privatised pursuant to local privatisation programmes or the appropriate privatisation application process.

V. The December 1993 Privatisation Programme

The aims of the December 1993 Privatisation Programme differed somewhat from those of the 1992 Programme. The 1993 Programme sought to bring together a broad sector of private owners to provide an economic basis for market relations. Further, the Programme aimed at involving the broadest possible sector of the population in the privatisation process by selling state and municipal property to be privatised, and by using privatisation cheques before, and money after, 1 July 1994. It looked to end the use of privatisation cheques and most “minor privatisation” projects, while accelerating the development of trade and services.

Fundamentally, the Programme was designed to end privatisation of large and medium-sized businesses in industry and construction through a structural reorganisation of the economy while increasing the efficiency of businesses in general and the economy as a whole. To accomplish this goal, the Programme called for the development of post-privatisation support for undertakings, the creation of a competitive environment, and development of capital markets. Attracting investment—including foreign investment—for production was also listed as a goal to be achieved by the Programme. Finally, the Programme included a provision for social protection of the population, covering private ownership rights (shareholders).
The December 1993 Programme also classified enterprises into different categories. The distinction was made between Federally-owned properties and enterprises, the privatisation of which was prohibited; Federally-owned properties and enterprises requiring a decision of the Russian Government before privatisation; Federally-owned properties and enterprises, the privatisation of which requires a decision of the GCI, taking into account the views of the competent Minister; properties and businesses in state (municipal) ownership, whose privatisation may only proceed in accordance with the local privatisation programme; and properties and businesses in federal or state (municipal) ownership subject to compulsory privatisation.

27. The most important privatisation prohibitions related primarily to the disposal of mineral and natural resources and airspace; nature reserves and the properties located within them; state finances, gold and diamond reserves; the central bank; military installations; establishments more than 50% financed by public monies; moveable and immovable property forming part of the historical and cultural heritage; nuclear power stations and undertakings engaged in the production of special radioactive materials; property, undertakings, systems and means of air navigation, airports of federal significance, meteorological centres; various environmental protection establishments; installations of the water industry; various infrastructural installations as well as supply and disposal installations; television and radio establishments; training centres for the ministries and authorities; undertakings which manufacture or process immuno-biological substances; civil defence installations; crematoria and cemeteries; and training centres for national teams.

28. The following institutions could only be disposed of on the basis of a decision of the government of the Russian Federation or a republic: Undertakings that are part of the weapons and munitions industry; institutions for civil defence and mobilisation purposes; institutions serving for storage of state reserves and mobilisation supplies; undertakings processing precious metals, precious stones, rare ores and radioactive elements; institutions of the energy industry; commercial banks (subject to a special privatisation process); undertakings and properties of railway transport; undertakings of federal significance in the maritime and air transport sector; post and telecommunications undertakings; news agencies; socio-cultural institutions in federal or republic ownership; and properties and undertakings in the gas industry of federal or interregional significance.

29. On the basis of a decision of the GCI, the following were to be privatised with the agreement of the appropriate Ministry: market-dominating undertakings (having a market share of more than 35%); undertakings having a capital base of more than one billion rubles as of 1 January 1992; undertakings in the ocean shipping and inland waterways sector; manufacturers and bottlers of alcoholic beverages; manufacturers of children's foods; undertakings and organisations serving passengers on ships and in railway stations; polygraphic undertakings and publishers; construction companies constructing strategically important and security-related projects; mechanical engineering undertakings in the nuclear power plant sector; and “Russian State Circus” companies and organisations.

30. Undertakings to be privatised through the GCI in accordance with the local privatisation programme included local transport services (excluding taxi services); public baths and laundrettes; waste disposal plants; pharmacies; properties and institutions with socio-cultural significance, if other categories do not apply; assets included in the financial statements of local authorities; children's camps; airports of regional and local significance; and significant local and regional sea ports.

31. Compulsory privatisation was applied to wholesale and retail traders; undertakings in the hotel and restaurant and service sectors; institutions in the construction and construction
VI. PRIVATISATION OPTIONS AND BENEFITS FOR EMPLOYEES OF BUSINESSES TO BE PRIVATISED

The workforces of businesses to be capitalised have a choice of three privatisation options. The first option allows all members of the workforce of the business to acquire either preferential (non-voting) shares constituting twenty-five percent of the share capital or ordinary shares up to ten percent of the share capital. The total non-voting preferential shares allocated to one employee may not exceed twenty times the statutory minimum wage fixed by legislation of the Russian Federation and is a one-time option without charge. Allocation of ordinary shares to one employee may not, however, exceed six times the statutory minimum wage fixed by legislation of the Russian Federation, with a discount of thirty percent of their nominal value. Payment of ordinary shares may be deferred by up to three years, subject to an immediate payment of not less than fifteen percent of the nominal value.

Officers of the management of the business being privatised (managers, their deputies, chief engineers, chief accountants) may acquire a right (or option), subject to contracts entered, to purchase ordinary shares at their nominal value. The total sum of the options for all named officers may constitute up to five percent of the capital.

The second option grants all members of the workforce of the business to be privatised the right to acquire ordinary (voting) shares of up to fifty-one percent of the share capital. In this case, shares are offered neither free of charge nor at a discount.

The final option allows businesses with a workforce of more than 200 employees and a basic fund with a balance sheet value of between one and fifty million rubles to give a group of the workforce the option to acquire twenty percent of the share capital in the form of voting shares in the business. The group must assume responsibility for compliance with

---

32. See paragraph 5.4 of the 1992 Privatisation Programme and paragraph 5.3 of the December 1993 Privatisation Programme.
33. Up to three months in the December 1993 Programme.
34. Fifty percent under the 1993 Programme.
35. These were expanded to include managers of independent units or branches in the 1993 Programme.
36. Amended to not exceed 2000 times the statutory minimum wage fixed by legislation of the Russian Federation in the 1993 Programme.
37. This restriction was dispensed with in the December 1993 Programme. To that extent, this option is now available to workforces of all undertakings with more than 200 employees.
the privatisation plan for the business, prevent the insolvency of the business and obtain the approval of the full assembly of the workforce to complete an appropriate contract between the group and the asset fund. This contract secures the obligations of the members of the group and establishes the extent to which their personal assets must be offered as security. The value of deposited assets may not be less than 200 times the statutory monthly minimum wage of the group membership. The asset fund transfers voting rights in respect of twenty percent of the voting shares for the term of the agreement, not to exceed one year.

VII. DEGREE NO. 721 OF THE PRESIDENT OF THE RUSSIAN FEDERATION OF 1 JULY 1992 “ON ORGANISATIONAL MEASURES FOR RESTRUCTURING STATE ENTERPRISES AND VOLUNTARY MERGERS OF STATE ENTERPRISES INTO JOINT STOCK COMPANIES”

President Yeltsin stated this decree was designed to create conditions to accelerate privatisation of state enterprises. For this purpose, a number of the privatisation regulations were modified to prescribe to businesses with a workforce of more than 1000 employees and a basic fund with a balance sheet value of more than fifty million rubles as of 1 January 1992. These undertakings were to become open joint stock companies.

In particular, the decree established several items. The GCI and local committees administering assets must initiate the restructuring of whole state enterprises (excluding the former State-owned farms, or Sovkhosy), or of the production and scientific parts of an enterprise whose status has not yet been brought into line with the legislation of the Russian Federation (hereinafter “firms”), as well as closed joint stock companies which are more than fifty percent state-owned. Firms whose privatisation was prohibited by the State Programme for the privatisation of state and municipal enterprises in the Russian Federation in 1992 are not included. All state-owned shares of joint stock companies founded in accordance with the decree in question may be sold or transferred only through privatisation. Founders of open joint stock companies formed in accordance with the present decree are the corresponding committees for the administration of assets. The articles of these joint stock companies must accord with the Model Articles of an open joint stock company. These must also be compulsorily applied in the case of privatisation of state enterprises.

38. Vedomosti RSFSR, 1992, No. 28, art. 1657. This decree passed largely unnoticed in the West, possibly due to its—for Russian conditions—utopian timetable. The provisions of the decree, however, currently still apply to businesses which could not be capitalised or privatised on time.
The restructuring of firms into joint stock companies in accordance with the regulation “On the Commercialisation of State Enterprises and Simultaneous Restructuring into Open Joint Stock Companies”\(^\text{39}\) added to the decree, must be carried out through the privatisation commissions created in each firm. Firms that participate in trans-departmental state organisations, corporations, associations and other voluntary business associations must establish the legal organisation of their association by 1 October 1992, by restructuring these as companies or joint stock companies, and at the same time establishing the extent of the founding firms' contributions to the capital fixed by the articles of association. State assets, previously allocated to such organisations by the state administration authorities, may be injected into the founding capital by the appropriate committee for administration of assets, provided the associations are restructured as open joint stock companies. A recommendation should be made to the Russian Fund of Federation Assets or the local asset funds, to transfer parcels of shares in their possession on a contractual basis, prior to their sale, on trust to such natural and legal persons recognised as purchasers under Article Nine of the law of the Russian Federation. State-owned parcels constituting more than fifty percent of the firm's capital can, with the consent of the workers' collective of the firm, be administered by a trust.

VIII. OTHER IMPORTANT REGULATIONS RELATING TO THE PRIVATISATION PROCESS

Other important general Russian laws for the conversion of state enterprises to private units, or at least to units organised under private law, are the December 1993 Russian Federation Constitution, RSFSR Law on Business and Entrepreneurial Activity, and the Joint Stock Companies Regulation.

\(^{39}\) This regulation outlined, *inter alia*, the process for each undertaking. A Privatisation Working Committee was formed for each undertaking. The committee submitted the privatisation plan to the GCI by 1 October 1992, together with documentation on the valuation of assets and draft articles of association (constitution) for approval. The GCI considered and confirmed the documentation within seven days, thereby passing a resolution for the incorporation of the joint stock company. Then, the GCI produced a copy of the approved privatisation plan, the application for registration and the articles of the joint stock company to the local Soviet by 1 November 1992 for registration of the company in the state register. Thus, a joint stock company became the legal successor to the restructured business. The first shareholders' meeting of the newly-formed company was to take place not later than twelve months after registration with the workers' collective passing a resolution as to the share distribution to the employees and other persons within 15 days of registration. The resulting resolution was submitted to the GCI. Further, this regulation established a model set of Articles (constitution) for the creation of future joint stock companies.
IX. THE CONSTITUTION OF THE RUSSIAN FEDERATION OF DECEMBER 1993

The present valid constitution, which came into force on 25 December 1993 after the referendum of 12 December 1993, established the general framework for economic activity. The constitution regulated the free movement of goods, services and finances, promotion of competition, and freedom of economic activity; right of ownership; freedom of association; and freedom of occupation. Thus, entrepreneurial activity is directly or indirectly influenced by the constitution.

X. RSFSR LAW “ON BUSINESSES AND ENTREPRENEURIAL ACTIVITY”

The second important law for converting to private business is “On Businesses and Entrepreneurial Activity” \(^{45}\) of 25 December 1990. It established the general legal, economic and social foundations for businesses engaged in activities with a view to making a profit. A business is a commercial entity created to produce goods, carry out work and provide services to meet the needs of society and make profits. A business carried out its activities independently, made decisions about past and future production, and projected profits.

XI. JOINT STOCK COMPANIES REGULATION (ORDER)

The third law of importance in privatising is the Joint Stock Companies Regulation.\(^{46}\) It is not a statute, but a regulation confirmed by the Council of Ministers of the RSFSR.\(^{47}\) The regulation applies with their...
registered office in the territory of the Russian Federation and it is only intended to apply to joint stock companies until the adoption of the Law of the RSFSR on Joint Stock Companies.

The Joint Stock Companies Regulation created a catalogue of rules applicable to both open and closed joint stock companies. Specific sections of a small number of regulations control variations between open and closed joint stock companies. Because the articles do not provide otherwise, shares of a closed joint stock company can be transferred only with the consent of the majority of shareholders.\(^48\)

The share capital of closed joint stock companies must be at least 10,000 rubles. By contrast, share capital of open companies requires at least 100,000 rubles.\(^49\) Both cash and non-cash capital contributions are possible. The shareholders' general meeting may, by simple majority, increase the share capital, or decrease it by reducing the nominal value of the shares or cancelling a portion of the shares.\(^50\)

XII. **Special Features of the Privatisation of Businesses in the Transport Sector, Particularly in the Aviation Sector of the Russian Federation**

A. **General Remarks**

Previously, the organisation of the Soviet Union's transport sector reflected the general structure of the state economy: the state was the only "business manager" in charge of what, in Western terms, were "businesses." Viewed this way, the entire Soviet Union was, in reality, a huge business of state structures. To the Western mind, there was a lack of definition of the requisite structural bodies for "administration" (in the sense of state administration), at least in the area of economic activity. The individual decisions of the state were for this reason not comparable to the term "administrative act." Rather, they were essentially managerial or commercial decisions. The classic administrative activity of issuing licenses was restricted to a form of registrations process—for example, for airports and aircraft in the aviation sector. "Licenses," in the Western sense of the word, were unnecessary because there was no assumption indicating that independent economic activity required regulation.

---

49. *Id.*, Sec. 37.
50. *Id.*, Sec. 39.
Therefore, the privatisation of a particular area of the economy was essentially nothing more than the privatisation of part of the state often requiring the establishment of the requisite administrative body.

B. GENERAL CONSIDERATIONS IN THE TRANSPORT SECTOR

The 1992 and 1993 Privatisation Programmes provided that the industries in the sectors of rail, aviation, ocean and inland shipping were among those to be capitalised and privatised only on the order of the GCI, taking into account the opinion of the respective ministry. The phrase “taking into account the opinion of the respective ministry” relates only to a duty to consult, and not the authority to veto by the respective ministry. Therefore, the Privatisation Programme also provides that “the decision about privatisation belongs to the GCI (alone).”

The 1993 Privatisation Programme provides that property, undertakings, systems and funds of flight security, of airports and of aviation businesses that guarantee a single system of flight security for lower and upper airspace, federal airports (Classes A, B, C and D under the usual airport classifications), meteorological centres and flight testing centres, and civil aviation teaching and training centres will not be privatised. However, regional and local airports can be privatised based on regional and local privatisation programmes.

Further, property and undertakings of the rail, ocean shipping and federal aviation sectors can be privatised now only on the order of the government of the Russian Federation. The non-federal ocean and inland shipping businesses are included, as before, among the property that may be capitalised and privatised only on the order of the GCI after considering the opinion of the relevant ministry.

The GCI has the power to issue standards regulating the process of privatisation within the area of its responsibility. In order to further develop and consolidate the regulations of the 1992 Privatisation Programme, the GCI issued an Order on 16 September 1992 “On the Specific Features of the Conversion of Aviation, Maritime, River, Automobile Transport and Roads Structural Enterprises into Joint Stock Companies and Their Privatisation.”

This order requires the commission on privatisation of these enterprises privatisation to present plans, property value estimates and charters of joint stock companies of enterprises (or their units) that contain units subject to military mobilisation or have a dominating position on

---

51. This amendment is obviously connected to public transport interests which have now moved strongly into the consciousness of those responsible for privatisation.
52. Vedomosti RSFSR, 1991, No. 27, art. 4, para. 2; Vedomosti RSFSR, 1992, No. 28, art. 4, para. 2.
the federal or local markets directly to the GCI. A copy is sent to the Ministry of Transport of the Russian Federation. The Ministry of Transport examines these documents within seven days, and submits a reasoned opinion of conclusions to the GCI.

Where certain enterprises as specified in the annexes to the Order are converted into unlimited liability joint stock companies, typical additional conditions\textsuperscript{53} reflecting features specific to the transport sector.\textsuperscript{54} It

\textsuperscript{53} These enterprises must meet air, sea, road and transport safety requirements in full; maintain and develop the respective safety systems (supporting the operation of transport safety systems in accordance with current branch standards, including maintenance of staff numbers, offices, transport vehicles and air traffic control equipment); meet in full the ecological safety requirements for transport vehicles, the technical methods of their storage, repair and technical operation; ensure that training, further training, and certification of personnel meets the respective qualification requirements of the mode of transport; maintain and develop the respective systems of training; insure transport vehicles and personnel in accordance with the requirements of the particular mode of transport; maintain core business activities; undertake transportation of cargo and passengers, and other work and services in accordance with the validity of the respective licenses and certificates (such as those for flight operators); undertake transport of cargo and passengers, and carry out work, services and production in accordance with the charters (or codes) of the respective forms of transport, the rules of cargo, luggage and passenger transport and other legal documents; ensure equal rights of access for carriers to infrastructure and terminal facilities owned or managed by the company; ensure integrated transportation and cargo transfer technology of sub-contractors, including at transport nodes and in multi-modal transport; apply prices and tariffs in accordance with the price lists valid in the Russian Federation for works and services which are subject to regulated and fixed prices and tariffs; observe current tariffs and regulations with respect to other types of transport; and make available existing transport systems (production capacities) for government requirements and in the interest of Russian consumers (passengers, consignors and consignees).

\textsuperscript{54} According to V. Jerimov, the Transport Minister of the Russian Federation, features specific to the transport sector are the setting of tougher standards in the system to ensure safety in the transport sector, in the actions of employees as well as in the guarantee of the operation of technical equipment. One of the biggest problems is that administrative employees in Russia are used to state ownership and are not able, in such a short time, to come to terms with the administration standards in a market economy. The risk of accidents in the transport sector and of consequent ecological damage is impossible to estimate because of the use of basic assets in a poor state of repair (a characteristic of Russian transport undertakings). Examples include aircraft, ocean-going and inland ships, as well as road vehicles.

Among features specific to air, sea, internal shipping and road transport undertakings are the fact that the majority have the status of "social transport providers" and are therefore involved in the provision of socially important functions in the manufacturing and social infrastructure which presupposes a special role of society and the state in their functional administration.

The special role of the "social transport provider" in regional transport is due to territorial factors such as the unusually low level of private car ownership in Russia which is 10-15 times lower than in industrially developed countries. The possibilities of economic regulation in Russia is especially restricted by the existence of "natural monopolies" in the absolute majority of transport undertakings.

An additional feature of the transport sector in Russia is its extraterritoriality. The proposed scheme of capitalisation of the inter-regional transport undertakings will bring about a conflict of local and federal interests, a noticeable reduction in the opportunities for the government to safeguard national transport needs, and obligations arising from international transport agreements. A closure of existing transport links, with huge losses for the national economy, is a
is mandatory these conditions be included in the charters of such companies.

Capitalisation of aviation, maritime and river ports as well as road construction and maintenance facilities are carried out subject to special conditions that reflect the strategic interests of the Russian Federation.\textsuperscript{55}

While joint stock companies fall under state ownership, the GCI appoints a representative, nominated by the Russian Transport Ministry, to sit on the Board of Directors of the companies.

Some specific aviation, maritime, river, road transport and road construction and maintenance enterprises and assets were not subject to privatisation in 1992. They are not included among the authorised assets and are excluded from the property lists of the enterprises.\textsuperscript{56}

C. Special Features of the Privatisation of the Air Transport Sector

The GCI and Transport Ministry jointly produced and put into force “Special Terms of Capitalisation and Privatisation of Airports” to define the obligation to account for the strategic interests of the Russian Federation in the privatisation of transport sector undertakings. These special terms provide, \textit{inter alia}, that airports will be privatised as independent concerns. In addition, they set out further requirements to be included in the constitutions of the airport companies.\textsuperscript{57}

\textsuperscript{55} To this end, for example, “Special Terms of Capitalisation and Privatisation of Seaports” and “Special Terms of Capitalisation and Privatisation of Airports” were jointly adopted by GCI and the Transport Ministry on 30 September 1992. These special terms, in the form of regulations, set out which special transportation features should be considered in drafting privatisation plans and compiling the constitutions of the companies.

\textsuperscript{56} These enterprises include, \textit{inter alia}, the nuclear-powered fleet, and special purpose fleet (nuclear-powered icebreaker fleet, nuclear-powered transport ships); floating and dry docks of 8.5 tonnes load and higher; general purpose roads and organisations responsible for their maintenance; fire-fighting units, their buildings and facilities; riverports, airports, transport junctions and other types of transport terminals land plots; road shoulder sections; and maritime and river enterprises basins and others.

\textsuperscript{57} The charter of an airport joint stock company established at this stage provides that the appointed representative of the GCI will perform the functions of the owner of state property at shareholders meetings and meetings of the Board of Directors of the joint stock company. The representative has the right to veto decisions to change the organisational and legal form of the company, and its charter. In addition, the representative can participate in the appointment of the Director General and has a permanent seat on the Board of Directors. The charter also
D. “Main Principles of Separating Independent Airports from the Air Transport Enterprises”\textsuperscript{58}

Duties of the enterprises are distributed. An airline is an integrated flight-technical and commercial facility designed to transport passengers, cargo and post by air. Using its own or leased aircraft fleet while making available and selling these respective services, the airline undertakes duties in the interests of the national economy. An airline must typically include the following structural units of the air transport enterprise: flight detachments, aviation technical base, flight attendant services, air communication agency, and parts of the personnel responsible for commercial, supply and other functions. An airline may rent or have in the airport interdependent systems for preparation of meals, passenger service, cargo and post processing, and may own or rent facilities, buildings and equipment necessary to carry out these activities. It may use its own personnel at registration counters, arrival and departures assistance for its flights and other interdependent systems and facilities. The relevant technological equipment of an airport is rented by the airline. (Other enterprise services, as a rule, are included in the airport structure.)

An airport is an integrated engineering and commercial facility, intended for the arrival and departure of aircraft and for serving air transport. To this end, it provides for use of the airfield and airport buildings, refuelling and storage facilities and maintenance of technical facilities such as heating, electricity, transportation and communications. It is responsible for the arrival and departure of aircraft and their technical and commercial servicing, passenger care, air traffic control within the airport vicinity, leasing of, and the granting of concessions for, facilities, buildings and equipment.

Assets of the two entities are also divided. Aircraft, aviation engines, spare parts and materials for them, facilities, buildings, structures, special transport and equipment, designated exclusively for operation of aircraft belonging to airlines are allotted to the airline. The remaining equipment is allotted to the airport. Assets on a clearing account, stocks, payments, debits and credits, loans, bank deposits and the authorised capital of joint stock companies are apportioned between the airline and the airport. Assets to pay salaries, to encourage employee activity and fund social requirements, are apportioned proportionately to the number of employees (basic salaries fund) and the remaining assets, intended for

\textsuperscript{58} This provision is set out as an annex to the special terms.
production modernisation, as well as various long-term investments are apportioned proportionately to the value of capital funds.

The airline is allotted the territories of a hangar and related structures and sites for servicing aircraft near the hangar, buildings occupied or used primarily by airline personnel, and adjoining areas with site-security procedures carried out. The remaining territory, used by the aviation enterprise, is included in the airport's land plot, accounting for the perspectives development. The airport provides land, buildings, equipment and services to the airlines on an equal access basis.

There are pre-requisites for the mandatory separation of independent airports from the air transport enterprises. The airport must be capable of taking in class 1 and 2 aircraft and handling over a half million people annually (as of 1991). The selection of all other airports as independent enterprises takes place prior to holding an auction based on the request of the aviation, airport or flight technical employees after a decision of GCI at the suggestion of the Ministry of Transport.

The special terms further provide that the following are not to form part of an airport's share capital: equipment, assets, property of the air traffic control centres; facilities and systems structures, flight radio-technical maintenance and communication (except internal airport communication and computers); Class A, B, C, D, and E airports serving federal needs; take-off, landing, taxi, side-by and terminal safety runways, aircraft parking sites and aprons; airport fences; radio and lighting equipment facilities; and ATC energy supply systems and airport communication systems. These facilities and structures (with the exception of air traffic control structures and facilities) shall be leased by established joint stock companies on a long-term basis of between ten and fifty years.

XIII. Conclusion

From a legal point of view, the privatisation of the transport sector of the Russian Federation is very complex. It involves laws and declarations of the Supreme Soviet as well as Executive Decrees, regulations of the

59. First class aircraft are characterised with a take-off weight of more than 75 tonnes (IL-96, IL-86, IL-76, TU-154); Second class aircraft have take-off weights between 30 and 75 tonnes (TU-134, AN-12, YAK-42).

60. Airports are privatised only by the way of their conversion into unlimited liability joint stock companies (see Article 12 of the RSFSR "On Businesses and Entrepreneurial Activity"). Airport employees are provided with benefits only in accordance with Variant One, specified in the State Programme of privatisation.

61. Several enterprises and units of the aviation industry are not subject to privatisation or capitalisation. For instance: systems and means of Air Traffic Control of airports and aviation enterprises, connected with the unified system of ATC of lower and higher air space; Independent Civil Aviation Unit (Moscow); and Meteorological centres and flight testing stations, including the meteorological centre of the "Sibavia" concern.
ministerial cabinet—the government of the Russian Federation, decisions and declarations of the State Committee for the Administration of Russian State Property, and of the Transport Ministry.

Among the unusual features of the Russian legal system, to a Western observer, is the fact that Decrees of the Executive can significantly modify the provisions of a statute.62

These modified outline conditions have been further amended in the transport sector, in view of the special significance of the sector in meeting the needs of public transport, so that the "actual" law is unsatisfactory if applied in isolation.

The substantive and procedural privatisation law in Russia only becomes clear to an outsider if he first familiarises himself with the individual sectors of the economy and the corresponding "exceptional rules." The transport sector illustrates this fact.

62. An example of this is, inter alia, Presidential Decree No. 721, see supra text accompanying note 38. The aim of this law was to speed up the lengthy and cumbersome privatisation process for large undertakings promulgated in the Privatisation Act.
1995 Harold A. Shertz Winner

The Third Package of Liberalization in the European Air Transport Sector: Shying Away from Full Liberalization

Dennis A. Duchene*

TABLE OF CONTENTS

I. Introduction .................................................. 121
II. Pre-Third Package Liberalization Efforts ................. 123
    A. The Treaty of Rome .................................... 123
    B. Liberalization Efforts by the Commission and the ECJ .............................................. 124
C. The First Package of Air Transport Liberalization .... 127
    1. Application of the Competition Rules .......... 128
    2. Group Exemptions to the Competition Rules .... 128
       a. The Airline Agreements Block Exemption Regulation ............................................. 129
       b. The Computer Reservation System (CRS) Block Exemption Regulation ..................... 129
       c. The Ground Handling Block Exemption Regulation ................................................. 130
    3. Air Fare Rules ........................................... 130

* J.D. 1995, University of San Diego School of Law.

119
4. Capacity Sharing and Market Access Rules ........ 130
5. Summary ........................................ 131
D. The Ahmed Saeed Case .............................. 131
E. The Second Package of Air Transport Liberalization ... 132
   1. Council Regulation 2342/90 on Air Fares ........ 133
      a. Air Fare Competition ...................... 133
      b. Flexibility Zones: Automatic Approval .... 133
      c. Double Disapproval ....................... 133
      d. Double Approval ........................... 134
      e. Investigation and Consultation/Arbitration .. 134
   2. Council Regulation 2343/90 on Market Access and
      Capacity Sharing ................................ 134
      a. Increased Market Access and Reciprocity .. 135
      b. Public Service Obligations and New Regional
         Routes ....................................... 135
      c. Multiple Designations Allowed ............. 135
      d. Fifth Freedom Rights ...................... 136
      e. Market Access Exceptions .................. 136
      f. Capacity Increases ......................... 136
   3. Commission Regulation 84/91: Fares, Capacity, and
      Slot Access Block Exemptions ................. 136
   4. Summary of Second Package ..................... 137

III. The Third Package Of Liberalization ................. 137
   A. The Licensing Regulation ...................... 138
      1. Community Ownership ...................... 138
      2. Demonstration of Financial Fitness ....... 139
      3. Aircraft Financing and Safety Standards ... 141
      4. Grandfather Clause and License Duration ... 142
   B. The Route Access Regulation .................. 142
      1. Full Freedom Community Traffic Rights and
         Cabotage Limitation ....................... 143
      2. Public Service Obligation .................. 143
      3. Domestic Exclusive Route Grandfather Rights and
         New Regional Route Protection .............. 144
      4. Traffic Distribution, Operational Rules, and Traffic
         Right Limitations ......................... 144
      5. Capacity Limitations ....................... 145
   C. The Air Fare Regulation ....................... 146
      1. Setting Air Fares and Filing Requirements .... 146
      2. Member State Disapproval .................. 147
      3. Commission Review ........................ 147
   D. The Airline Agreement Block Exemptions
      Regulation ..................................... 148
I. Introduction

The creation of a Single European Market for the air transport sector in the European Community (EC) is viewed by many as one of the most difficult challenges before the EC, and is indicative of the commitment of the member states to a Europe without frontiers.1 The liberalization of the EC air transport sector has made significant developments toward a free market approach within the last seven years. Compromise between a wide variety of diverse and conflicting interests2 has allowed the EC to move away from the old regime of air transport characterized by nationally subsidized carriers which engaged in restrictive and discriminatory practices.3 This inefficient and anti-competitive environment has now given way to a more competitive and lean marketplace from which passengers enjoy lower fares and a greater variety of services.4

The pace of these liberalization efforts has been tempered by the desire of the community to avoid the rather severe consequences which the U.S. had suffered as a result of its rapid deregulation approach in the

1. Liberalization Creates EC Single Airline Market, AV. WK. & SPACE TECH., Jan. 18, 1993 at 39 (discussing the Third Package, its potential impact on the EC air transport sector, and the remaining problems which need to be addressed in this sector).


late 1970’s. EC air transport liberalization has been gradually implemented through the adoption of three separate Packages of legislation over a period of five years, with the delivery of the First Package in 1987, the Second Package in 1990, and the Third Package in 1992 coinciding with the Single European Act’s general goal of achieving a Europe without frontiers. The Third and final package was expected to move the air transport sector towards a more fully liberated market by loosening up many of the constraints which inhibit European airline competition.

The Third Package, however, is a far cry from the full potential of liberalization in the EC air transport sector even when one considers the short time frame of implementation and the unique circumstances in Europe such as national subsidization of air carriers and high operating costs. The Third Package is disappointing in many respects, such as the significant discretion it leaves in the hands of the Member States, the numerous exceptions from the competition rules allowed to Member States, and the failure to address subsidies, full cabotage rights, and domestic transport policy. Although the EC embraces a gradual implementation of air transport liberalization, this latest package appears to be the product of a watered-down political compromise which balks at the prospect of moving towards the full liberalization potential of the air transport sector.

This paper will focus on the Third Package of liberalization regulations in the EC air transport sector, its potential effects and abuses, and the obstacles which remain to the development of free competition in the air transport sector. In particular, the focus will be on market access to routes and slots, air fares, and the anti-competitive practices which concern them. Although computer reservation systems and ground handling

5. Civil Aviation Memorandum No. 2, Progress Towards the Development of Community Air Transport Policy, COM(84)72 final [hereinafter Memorandum 2].


significantly affect the ability of an airline to effectively compete, these
issues will not be discussed in this paper. Part II provides a brief overview
of the major liberalization milestones prior to the Third Package,
from the Treaty of Rome to the Second Package. Part III examines the
regulations of the Third Package, its impact on the air transport sector,
and its shortcomings. Part IV discusses the various obstacles which re-
main to free competition in the EC air transport sector, and also suggests
some possible solutions to these problems. The Conclusion summarizes
by noting that the Third Package is generally a disappointment in its fail-
ure to fully move the EC air transport sector toward a free Single Euro-
pean Market and that future efforts are needed if the potential of full
liberalization is to be realized.

II. PRE-THIRD PACKAGE LIBERALIZATION EFFORTS

After World War II, nationally owned and operated air carriers,
known as flag carriers, comprised the overwhelming majority of the air-
line industry in Europe.10 European nations negotiated with each other
for route access and tariffs in a highly restrictive fashion through the use
of bilateral agreements, resulting in a complex network of such agree-
ments covering Western Europe.11 Despite the signing of the Treaty of
Rome in 1957,12 which was intended to promote the establishment of a
common market among member states, the air transport sector went vir-
ually unchanged until the late seventies and eighties when active efforts
of the Commission and the European Court of Justice (ECJ) eventually
led to the Council’s adoption of the First Package of liberalization in
1987.13 A brief overview of these early liberalization efforts and of the
First and Second Packages of liberalization is necessary for a more thor-
ough understanding of the Third Package and its implications for the EC
air transport industry.

A. THE TREATY OF ROME

The Treaty of Rome is effectively the basic constitution of the EC,
the central purpose of which is to create an economically efficient market
and to restrict anti-competitive behavior among Member States.14 Arti-
cle (3)(e) of the Treaty specifically provides for “the adoption of a com-
mon policy in the sphere of transport.”15 Title IV of the Treaty provides

11. Id.
    (1958) [hereinafter EEC Treaty or Treaty of Rome].
14. Treaty of Rome, supra note 12, art. 3.
15. Id. art. 3(e).
articles for the implementation of a common transport policy; however, the application of provisions under these articles to air transport was left to the discretion of the Council.\textsuperscript{16} Although the Council had the power under these articles to create a common air transport policy, it was not until 1983 that the Council acted on this power. This delay of some twenty-five years is due to the political nature of the Council which consists of representatives from each Member State and from the fact that the Member States' views on common air transport policy significantly differed.\textsuperscript{17}

Over time, the inaction of the Council became glaringly apparent and the question soon arose whether the general competition rules\textsuperscript{18} of the Treaty of Rome applied to the air transport sector regardless of the Council's failure to act towards a common air transport policy. Articles 85 and 86 of the Treaty prohibit anti-competitive activities within the EC and were included by the drafters to achieve efficient economic integration of the community.\textsuperscript{19} In 1962, the Council adopted Regulation 17\textsuperscript{20} which implemented articles 85 and 86 of the Treaty, however, the scope of the regulation excluded the air transport sector.\textsuperscript{21} Both the Commission and the ECJ actively expressed their view that the competition rules of articles 85 and 86 applied to the air transport sector.

\textbf{B. Liberalization Efforts by the Commission and the ECJ}

The Commission, which unlike the Council is a non-partisan body, believed that a common market should be achieved as soon as practically possible in keeping with the spirit of the Treaty of Rome. The Commission reasoned that the air transport sector was subject to the Treaty's gen-

\begin{itemize}
\item \textsuperscript{16} Id. art. 84(2). Article 84(2) reads: The Council, acting by means of a unanimous vote, may decide whether, to what extent and by what procedure appropriate provisions may be adopted for sea and air transport.
\item \textsuperscript{17} Ebbe and Wenglorz, supra note 7, at 502.
\item \textsuperscript{18} Treaty of Rome, supra note 12, art. 85, 86. Article 85(1) generally prohibits as incompatible with the common market agreements and concerted practices which may affect trade between Member States and have as their object or effect the prevention, restriction, or distortion of competition within the common market.
\item \textsuperscript{19} Labyrinth supra note 2, at 327.
\item \textsuperscript{20} Council Regulation 17/62, 1962 O.J. 204.
\end{itemize}
eral competition rules unless the Treaty otherwise provided, and that the Treaty did not otherwise provide that the air transport sector was exempt.\textsuperscript{22}

An active ECJ played the pivotal role in the eventual acceptance by the Council that the competition rules of the Treaty applied to the air transport industry. In a series of critical cases, the ECJ actively demonstrated its commitment to the creation a common market, even when this commitment was directly contrary to the meaning and intent of the articles of the Treaty.\textsuperscript{23} In the French Seamen's case, the Court held that the general rules of the Treaty, including competition rules, do apply to transport despite article 84(2) which provides that the Council is to decide whether and to what extent provisions are to apply to air transport.\textsuperscript{24}

In 1979, the Commission drafted a proposal to the Council stating their position that the competition rules of the Treaty of Rome applied to the air transport industry.\textsuperscript{25} This First Memorandum suggested that the Council regulate scheduled inter-regional air services. After modifications by the Council which effectively prohibited access for new airline services on established routes, the First Memorandum was not further acted on.

By 1983, the Parliament had grown tired of waiting for the Council to act on the Commission's proposals relating to a common air transport policy and brought suit against the Council before the ECJ for failing to act.\textsuperscript{26} In deciding this case, the Court not only allowed the admissibility of a suit for failure to act, but more importantly held that the Council had indeed failed in its duty to provide a common transport policy.\textsuperscript{27}

Meanwhile, in 1984 the Commission issued a Second Memorandum to the Council\textsuperscript{28} in which it proposed a more realistic, gradual approach to liberalization.\textsuperscript{29} The Commission suggested maintaining the bilateral

\textsuperscript{22} Argyris, supra note 21, at 8.
\textsuperscript{24} Labyrinth, supra note 2, at 335. Case 167/73, Commission of the European Communities v. France, 1974 E.C.R. 359.
\textsuperscript{27} Id. See also Labyrinth, supra note 2, at 337.
\textsuperscript{28} Memorandum 2, supra note 5.
\textsuperscript{29} The term 'liberalization' is used instead of 'deregulation' because of the general intent of the Commission to liberate the air transport sector gradually from its traditional national restraints rather than a complete and immediate U.S. style deregulation toward a free market.
agreement structure within the EC and providing unified regulations within this structure in order to liberate the air transport sector. The Commission also suggested that revenue sharing, restrictions on routes, and limits on air fares be eliminated from the current structure, and that block exemptions from the competition rules of article 85(1) be granted in these areas during a period of adjustment.30

It was not until the ECJ’s famous Nouvelles Frontieres case that the Court held articles 85 and 86 of the Treaty directly applicable to the air transport industry.31 The Court held that absent specific regulations governing air transport adopted by the Council under article 87 of the Treaty, articles 85 and 86 could be applied in particular instances by a competent authority of a Member State,32 or by a reasoned decision on the matter by the Commission.33 Either of these methods for enforcing articles 85 and 86 against an air carrier engaging in anti-competitive practices could result in a floodgate of litigation brought by aggrieved consumers and travel agents in the national courts of the Member States.34

In 1986, the Commission itself took direct action against ten EC airlines for anti-competitive practices by utilizing the Court’s holding in Nouvelles Frontieres.35 This action placed considerable pressure on the airlines concerned to enter into discussions with the Commission because of the potential for substantial exposure to law suits from passengers and travel agents.36 The airlines capitulated to the Commission’s threat of a reasoned decision and agreed to mild reforms concerning price fixing, revenue and capacity pooling agreements and slot allocation.37 These reforms, however, did not come close to approaching the level of liberalization that the Commission sought in its Second Memorandum to the Council.38 The Commission continued to hold the threat of a reasoned decision over the heads of the EC airlines in an effort to enforce their agreement, and this threat effectively applied pressure on the Council to adopt uniform regulations for the application of the Treaty’s competition rules to the air transport sector.39

and the severely negative U.S. style results which this method brings (i.e. bankruptcies, dominant mega-carriers, etc.).

30. Memorandum 2, supra note 5. See Labyrinth, supra note 2, at 342-349.
32. Treaty of Rome, supra note 12, art. 88.
33. Treaty of Rome, supra note 12, art. 89. See Labyrinth, supra note 2, at 339.
34. See Labyrinth, supra note 2, at 339.
35. Ebke and Wenglorz, supra note 7, at 509 (these airlines included Air France, Aer Lingus, Alitalia, British Airways, British Caledonian, KLM, Deutsche Lufthansa, Olympic, Sabena, and SAS); Argyris, supra note 19, at 10-11.
36. See Labyrinth, supra note 2, at 350; See also Kark, supra note 4, at 403.
37. See Labyrinth, supra note 2, at 351-352.
38. Id.
39. Argyris, supra note 21, at 11.
C. THE FIRST PACKAGE OF AIR TRANSPORT LIBERALIZATION

Although the recent holdings of the ECJ and the Commission’s threat of action against the EC airlines for anti-competitive behavior placed pressure on the Council to consider and implement the proposals of the Second Memorandum, the Council remained unable to reach a necessary consensus on the application of the competition rules to the air transport sector due to divergent interests and viewpoints of the individual Member States.\(^{40}\) In 1986, however, the very goals of the EC were significantly changed by the adoption of the Single European Act (SEA) which accelerated the date for achieving a Single European Market without frontiers to 1992.\(^{41}\) The SEA not only provided for the establishment of a Single European Market for air transport,\(^{42}\) but also changed the voting requirements for decisions concerning the establishment of a single market for air transport from unanimous voting to qualified majority voting.\(^{43}\) Free of the shackles of unanimous voting and still under pressure from the Commission and ECJ, the stage was set for the Council to take action towards the achievement of a unified market in the air transport sector.

Due to these factors and an increasingly competitive market in the EC, the Council finally adopted the First Package of liberalization in the air transport sector in December 1987.\(^{44}\) This package, provided for a transition to a more liberalized air transport regime in an attempt to meet the SEA deadline of 1992 for a unified internal market.\(^{45}\) The scope of this First Package extends only to flights between Member States and not to domestic flights within a Member State or to flights between a Member State and a non-EC country. Specifically, this package is comprised of: (1) application of the competition rules of the Treaty of Rome, articles 85 and 86, to the air transport sector,\(^{46}\) (2) application of the article 85(3) exemption provision to the air transport sector\(^{47}\) and the block exemptions adopted thereunder,\(^{48}\) (3) rules concerning scheduled air

---

40. See Labyrinth, supra note 2, at 351.
42. See Id. art. 13.
43. See supra note 41, art. 13. The political significance of this change in voting method was critical to breaking the deadlock in the Council which is comprised of a representative from each Member State. No longer can a single or minority group of Member States render the Council immobile to act on air transport legislation.
44. 1987 O.J. (L374) 1-25 (December 14, 1987 agreement on the first package of liberalization).
45. Id.
48. Commission Regulation 2671/88, 1988 O.J. (L 239) 9 (block exemptions for airline agreements concerning capacity, revenue pooling, air fares, and slot allocations); Commission
fares, and (4) rules concerning capacity sharing and market access. Each of these components of the First Package are briefly discussed below.

1. Application of the Competition Rules

Regulation 3975/87 provides detailed rules for the application of articles 85 and 86 to the air transport industry. The regulation allows exemptions from these rules for certain technical agreements between airlines which improve the operation and efficiency of the air carriers if they provide a benefit to consumers and do not have restrictive practices as their objective or effect. The regulation also gives the Commission the jurisdiction to hear complaints of article 85(1) and 86 violations by Member States or natural persons with a legitimate interest, and to levy fines against violating enterprises.

2. Group Exemptions to the Competition Rules

Regulation 3976/87 applies article 85(3) which provides for the establishment of group exemptions from the application of the competition rules of Regulation 3975/87. This regulation gives the Commission the power to exempt certain types of agreements in the air transport industry from the competition rules. These group exemptions may be subject to certain conditions which, if not met, may result in the revocation of the exemptions or in the imposition of a fine. The Commission immediately acted on its newly granted power and adopted three regulations creating block exemptions for airline agreements, computer reservation systems, and ground handling to allow for a transitional period in order to facilitate the development of competition.

Regulation 2672/88, 1988 O.J. (L 239) 13 (block exemptions for computer reservation systems);
Commission Regulation 2673/88, 1988 O.J. (L 239) 17 (block exemptions for ground handling services).

52. Council Regulation 3975/87, supra note 46; Labyrinth, supra note 2, at 361.
53. Council Regulation 3976/87, supra note 47, art. 2. (Agreements which may be exempted include capacity and revenue sharing, rates, slot allocations, computer reservation systems (CRS), and ground handling).
54. Id. art. 2(3).
55. Id. art. 7.
a. The Airline Agreements Block Exemption Regulation

Commission Regulation 2671/88, like the other two block exemption regulations, provided broad exemptions until January 1, 1991, thereby giving substantial protection to then existing airlines.\(^57\) Regulation 2671/88 grants exemptions for airline agreements concerning capacity sharing, revenue pooling, tariff (air fare) consultations, and slot allocations.\(^58\) Capacity limitation agreements must provide a satisfactory spread of service over the less busy periods, cannot result in anti-competitive market segmentation, and must allow the airlines involved the freedom to vary their capacity and schedules and to withdraw without penalty on short notice.\(^59\)

Revenue pooling agreements under 2671/88 require that the less favorably scheduled air carrier receive a transfer of revenue which cannot exceed 1 percent of the total revenue, and that the transfer be fixed prior to the offering of the service.\(^60\) Additionally, each carrier must be free to vary the capacity offered.\(^61\)

Tariff (air fare) consultations under Regulation 2671/88 must be voluntary and non-binding on the participants, and must be open to the observers from the Commission, Member States, and airlines on the routes concerned.\(^62\) The consultations must be limited to the definition and construction of airline tariffs only, and cannot discuss capacity limitations or travel agent compensation. The rates must not discriminate on the basis of nationality or residence of passengers and the airlines must be free to offer other rates.\(^63\)

Slot allocation agreements must, under 2671/88, be open for participation to all interested carriers and the slot allocation rules must be clearly defined and fairly applied, and must not base priority rules on the identity of an airline.\(^64\)

b. The Computer Reservation System (CRS) Block Exemption Regulation

Regulation 2672/88\(^65\) grants exemptions for CRS agreements, but provides for certain conditions to insure competition in an essentially oligopolistic CRS market. Subscribers, usually other airlines and travel

\(^{57}\) See, e.g., Commission Regulation 2671/88, supra note 48, art. 8; see also Ebke and Wenglorz, supra note 7, at 511.

\(^{58}\) Commission Regulation 2671/88, supra note 48.

\(^{59}\) Labyrinth, supra note 2, at 362; Argyris, supra note 21, at 25.

\(^{60}\) Argyris, supra note 21, at 26.

\(^{61}\) Id. at 26.

\(^{62}\) Labyrinth, supra note 2, at 362; Argyris, supra note 21, at 28.

\(^{63}\) Labyrinth, supra note 2, at 362; Argyris, supra note 21, at 28.

\(^{64}\) Labyrinth, supra note 2, at 363; Argyris, supra note 21, at 29.

\(^{65}\) Commission Regulation 2672/88, supra note 48.
agents, must be free to add, drop, or switch systems on short notice without penalty, and CRS vendors must not partition the market. Additionally, a CRS must neutrally display the flights of airlines seeking access to the system, and airline commissions paid to travel agents may not be based on the volume of bookings made in the system in which the airline has an economic interest.

c. The Ground Handling Block Exemption Regulation

Regulation 2673/88 grants exemptions for ground handling agreements on conditions that purchasers of such services are free to switch or add other suppliers on short notice, and that the rates for such services not be discriminatory based on the identity of any airline.

3. Air Fare Rules

Council Directive 87/601 provides rules for proper authorities of the Member States to approve of fares. Fares may be approved if they are reasonably related to the long term, fully allocated costs of the carrier and cannot be disapproved on the grounds that the proposed rate is lower than that offered by another carrier on that route. In addition, the directive establishes two pricing zones within which carriers may set their prices freely without government restriction.

4. Capacity Sharing and Market Access Rules

Council Decision 87/602 provides rules to liberalize market access and capacity sharing. Instead of the usual bilateral agreement capacity limitation on a given route of a 50:50 ratio, the Decision initially allows airlines to increase or decrease their capacity by 5 percent, and as of October 1, 1989, the Directive allows another 5 percent variation for up to a 60:40 ratio. Decision 87/602 also allows Member States to have the right of multiple designations, which allows the Member State to appoint more than one carrier to a given bilateral route if that route has a required minimum

66. See Banowsky, supra note 51, at 191-92.
67. Labyrinth, supra note 2, at 363.
69. Labyrinth, supra note 2, at 363; Argyris, supra note 21, at 31-32.
71. Id. at art. 3.
72. Labyrinth, supra note 2, at 359; Ebke and Wenglorz, supra note 7, at 511-12; Council Directive 87/601, supra note 49, at art. 5. The two zones established are: (1) the Discount Zone, which extends from 90% to 65% of the referenced fare, (a one way non-restricted more than fare), (2) the Deep Discount Zone, which runs from 65% down to 45% of the referenced fare.
74. Id. at art. 3; Ebke and Wenglorz, supra note 7, at 512.
number of passengers. The Decision also allows Community carriers to establish flights between major airports in their home country and regional airports in another Member State. 

Most importantly, Decision 87/602 allows Community carriers to engage in Fifth Freedom rights so long as the first or last airport of the flight route is within the home country of the carrier and so long as there is at least one regional airport involved.

5. Summary

Although the First Package was intended to be the first step in a process of liberalization of the air transport industry, the reforms had little overall effect on the development of competition, especially in the area of air fares. Given the broad scope of the block exemptions, this result should not be surprising as the existing airlines remained fairly protected from increased competition. On the other hand, the application of the competition rules to the air transport sector and the creation of limited Fifth Freedom rights demonstrated a willingness of the Member States to change.

D. The Ahmed Saeed Case

In 1989, the ECJ again took an activist position when it held in the Ahmed Saeed case that the competition rules of the Treaty of Rome directly applied to the air transport sector, and that the competition rules applied to all EC air transport flights, whether domestic, inter-EC, or between a Member State and a non-EC country, although the method of application will be different depending on the type of flight and the type of violation.

The Court held that article 85(1) could be applied to domestic flights and flights between a Member State and a non-EC country under articles 88 and 89 as laid out in Nouvelle Frontieres. Most importantly, the Court held that the abuse of dominant position provisions of article 86

---

75. Council Decision 87/602, supra note 50, at art. 5(2).
76. Id. art. 6(1).
77. Fifth Freedom rights are the rights of a Member State's carrier to pick up passengers in another Member State and transport them to/from a third Member State.
78. Council Decision 87/602, supra note 50, at art. 8(1). (the capacity of the Fifth Freedom flight service must not exceed 30% of the carrier's capacity on any given route).
79. Ebke and Wenglorz, supra note 7, at 513.
80. See Seatbelt, supra note 3, at 441.
82. See generally Ebke and Wenglorz, supra note 7, at 513-19.
also apply across the board to all types of flights, and that the Commission as well as member states could enforce article 86 directly, despite the lack of secondary Community law applying article 86 to domestic and EC-external flights.  

Lastly, the Court held that, in light of its rulings on the application of articles 85 and 86 to all types of flights, a Member State violates its obligations under articles 5 and 90(1) when it approves of air fares that are contrary to articles 85 or 86, as determined by the rules of Regulation 2671/88 and Directive 87/601 of the First Package.  

The import of this holding is that the Member States must apply the air fare approval system of the First Package in their bilateral agreements with non-EC countries, and that the Member States must also apply these approval procedures for all inter-EC and domestic flights unless new rules and/or exemptions are provided for air fares on these type of flights.  

E. THE SECOND PACKAGE OF AIR TRANSPORT LIBERALIZATION  

In light of the moderate impact of the First Package on the air transport sector and the pressure to achieve a unified internal market in air transport by 1993, the Council agreed to act upon recent Commission proposals and adopted a Second Package of liberalization in June of 1990. This package consists of three Council Regulations, two of which effectively replace Directive 87/601 and Decision 87/602 of the First Package, and the third of which merely changes the effective dates in Council Regulation 3976/87 and will therefore not be discussed. Later, in December, 1990, the Commission adopted three Regulations which replace and/or modify the block exemption Regulations 2671/88, 2672/88, and 2673/88 of the First Package. Of these, only the new airline agreements block exemption will be discussed as the other two are merely modifications of the effective dates corresponding to the First Package block exemptions.  

84. See Ebke and Wenglorz, supra note 7, at 515-16; Strivens and Wieghtman, supra note 83, at 563-64.  
85. See Ebke and Wenglorz, supra note 7, at 516; Strivens and Wieghtman, supra note 83, at 564.  
86. See Ebke and Wenglorz, supra note 7, at 517; Strivens and Wieghtman, supra note 83, at 565.  
1. Council Regulation 2342/90 on Air Fares

Regulation 2342/90 replaced Council Directive 87/601 and brought significant liberalization changes to the rules for approval and the range of approvable air fares from those of the First Package. The regulation applied only to flights within the EC, and as a regulation it directly bound Member States, unlike a Directive. These significant changes are discussed below.

a. Air Fare Competition

The ability for Community air carriers to introduce lower fares on existing routes was extended in the Second Package to conditional Fifth Freedom rights under the condition that the Fifth Freedom air fares fall within the flexibility zones.

b. Flexibility Zones: Automatic Approval

Like the rules of the First Package, any proposed air fare falling within the flexibility zones is required to be approved by the Member State. The important difference is that an additional normal economy fare zone was added, the discount and deep discount zones were extended, and the flexibility zones now apply to third, fourth and fifth freedom air carriers. The new economy zone extends from 105 to 94 percent of the referenced air fare, the discount zone now extends from 94 to 80 percent of the reference air fare (as opposed to the old 90 to 65 percent), and the deep discount zone now includes any air fare within 79 to 30 percent of the referenced air fare (as opposed to the old 65 to 45 percent). Prerequisite travel restrictions for discount zone tickets that were allowed in the First Package have been significantly removed, however the discount zone is now 11 percent smaller in range.

c. Double Disapproval

When an air fare is above 105 percent of the referenced air fare the new double disapproval system applies. If both Member States concerned do not reject the fare within 30 days of application for approval, the fare shall be considered approved. This disapproval method will probably not be used frequently because it only applies to extremely high

89. Council Regulation 2342/90, supra note 87.
90. See Ebke and Wenglorz, supra note 7, at 517.
91. Council Regulation 2342/90, supra note 87, art. 3(6).
92. Id. art. 4(3).
93. Id.
94. Id.
95. Id. art. 4(4).
d. Double Approval

The double approval system applies to fares below the lowest flexibility zone since all other fares fall under either the flexibility zone automatic approval or the double disapproval methods. A proposed fare shall require approval by both interested states. If neither of the states has expressed disapproval within 21 days of the fare’s submission, the fare shall be considered approved. The practical difference between this method and the double disapproval method is that only one Member State may prevent the approval of the air fare in the double approval method.

e. Investigation and Consultation/Arbitration

Regulation 2342/90 obliges the Commission to investigate any air fare not within the flexibility zones upon the request of a Member State with a reasonable interest in the route in question. The Commission must decide within 14 days if the air fare is to remain in effect pending the decision, and must make a final decision within two months of the request as to whether the proposed fare is unjustifiably high, or is a form of dumping to the detriment of competition on that route. A Member State affected by the Commission’s decision may appeal to the Council within one month. When one Member State rejects an air fare below the flexibility zones under the double approval system, consultation and arbitration procedures are provided to resolve the dispute.

2. Council Regulation 2343/90 on Market Access and Capacity Sharing

Regulation 2343/90 replaced Council Decision 87/602 of the First Package and brought significant liberalization changes to market access and capacity growth. These changes are briefly reviewed below.

---

96. Id.
97. Id. art. 4(5).
98. Id.
99. Id. at art. 5(1).
100. Id. at art. 5(1),(2),(3).
101. Id. at art. 5(5). Note that the airlines themselves do not have the right to request a Commission review of an air fare or an appeal of a Commission decision to the Council. Only the Member States themselves have these rights which suggests that they will be used primarily for the protection of flag carriers.
102. Id. at art. 6.
a. Increased Market Access and Reciprocity

The new regulation grants air carriers third and fourth freedom rights to any airport in the Community, subject to reciprocity of the Member State of the air carrier concerned to allow airlines of another Member State third and fourth freedom routes on the same route. The reciprocity requirement may disadvantage a large air carrier's ability to gain access to routes to other Member States because of its inability to provide reciprocal slots at its airport for the other Member States. Correspondingly, the smaller air carriers at less busy airports may be advantaged in using their ability to grant reciprocal slots to gain access to slot tight airports in other Member States.

b. Public Service Obligations and New Regional Routes

The regulation provides that a Member State may impose a public service obligation on a Community air carrier operating within that State to provide a service to a regional airport which is necessary for the economic development of that region. The reciprocity requirement will not apply for a period of two years to a new route being serviced by air carriers of a Member State with aircraft of 80 seats or less, unless the requesting air carrier also intends to operate with aircraft of the same capacity. This provision has the effect of protecting small carriers on new regional routes from larger air carriers for at least two years.

c. Multiple Designations Allowed

The regulation requires Member States to accept multiple designations on a country-pair basis. In addition, Member States must accept multiple designations on a city-pair basis if minimum route capacity thresholds are met. This provision opens the door for routes which

104. Id. at art. 4, 5(1).
105. Id. at art. 5(2).
106. See Ebke and Wenglorz, supra note 7, at 523.
107. Id.
108. Council Regulation 2343/90, supra note 87, at art. 5(3).
109. Id. at art. 5(4).
110. See Council Regulation 2343/90, supra note 87, at art. 2(h). (A multiple designation on a country-pair basis is the designation by a Member State of more than one air carrier to operate scheduled air services between it and another Member State, and multiple designation on a city-pair basis is the same except that the scheduled services may be between an airport or airport system in the home Member State and an airport or airport system of another Member State. The city-pair basis simply provides for the selection of the airports of another Member State which multiple carriers may service.)
111. Id. at art. 6(1).
112. Id. at art. 6(2). (The route capacity threshold until Jan. 1, 1992 is either 140,000 passengers or more than 800 return flights per year, after which the threshold is lowered to 100,000 passengers or more than 600 return flights per year.)
have been traditionally limited to a single air carrier of another Member State to other air carriers of that State.

d. Fifth Freedom Rights

Fifth Freedom rights are granted by the regulation conditioned on the requirements that an airport in the servicing air carrier’s home State is one of the airports involved in the triangular service between the three concerned Member States and the Fifth Freedom service capacity does not exceed 50 percent of the capacity of the third or fourth freedom service involved.\textsuperscript{113}

e. Market Access Exceptions

The regulation provides for significant exceptions which a Member State may use to deny market access. The denial or limitation of access to routes in a Member State may be based on Community, national, regional, or local rules relating to safety, the protection of the environment, and the allocation of slots, or may be based on insufficient airport facilities or navigational aids to accommodate the service.\textsuperscript{114}

f. Capacity Increases

Community air carriers may now increase their capacity from the 60:40 ratio allowed under the First Package by 7.5 percent a season.\textsuperscript{115} The regulation abolishes capacity sharing limitations on services between regional airports\textsuperscript{116} and further states that provisions shall be adopted to abolish capacity sharing restrictions by Member States by 1992.\textsuperscript{117} A Member State may request the Commission to limit the capacity growth of an airline if this growth has led to serious financial damage for the air carriers licensed by that State.\textsuperscript{118}

3. Commission Regulation 84/91: Fares, Capacity, and Slot Access Block Exemptions

Regulation 84/91\textsuperscript{119} replaces the block exemption regulation 2671/88 of the First Package, and is essentially the same except for the addition of an exemption from article 85(3) of the Treaty of Rome for the allocation of slots. The exemption requires that the consultations on slot allocation are open to all interested air carriers and that the rules of priority are

\textsuperscript{113} Id. at art. 8(1).
\textsuperscript{114} Id. at art. 10(1).
\textsuperscript{115} Id. at art. 11(1).
\textsuperscript{116} Id. at art. 11(3).
\textsuperscript{117} Id. at art. 11(2).
\textsuperscript{118} Id. at art. 12(1).
\textsuperscript{119} Commission Regulation 84/91, supra note 88.
established without relation to carrier identity; however, these rules may take account of grandfather rights of an air carrier to previously used slots.\(^{120}\) In an attempt to assist new entrants,\(^{121}\) the exemption requires that they be given priority in the allocation of 50 percent of the newly created or unused slots. However, a new entrant may be limited to a maximum of four slots per day.\(^{122}\)

4. Summary of Second Package

The Second Package of liberalization considerably advanced the EC air transport system towards the goal of a more competitive market in the areas of air fare approval, route and slot access, and capacity growth. However, many obstacles remain to free competition, especially for new entrants. The discretion and exceptions to the rules provided for Member States, the limited Fifth Freedom rights, the lack of cabotage rights, and the restrictive slot allocation procedures continue to allow distortion of competition in the air transport sector. It should be remembered, however, that the second package was intended to be an interim step in the gradual process of liberalization which was to be finalized by the end of 1992 via the expected Third Package.\(^{123}\)

III. The Third Package Of Liberalization

In June of 1992, the Council adopted the Third Package\(^ {124}\) of air transport liberalization measures which became effective on January 1, 1993 in an attempt to meet the goal of a Single European Market by the end of 1992. This package consists of a Licensing Regulation, a new Route Access Regulation which replaces 2343/90 of the Second Package, and a new Air Fares and Rates Regulation which replaces 2342/90 of the Second Package.\(^ {125}\)

Of additional importance is the adoption in June 1993 of Commission Regulation 1617/93,\(^ {126}\) a block exemption for airline agreements concerning schedules, joint operations, tariffs and slot allocation. Regulation 1617/93 replaces block exemption Regulation 84/91 of the Second Pack-

---

120. Id. at art. 4(1).
121. See Id. at art. 4(1)(c). (A new entrant is defined as an air carrier with less than four slots on a given day and requesting more, or an air carrier holding not more than 30 percent of all slots on a day at an airport or airport system and requesting more for use on a route which no more than two other carriers are exercising third or fourth freedom rights.)
122. Id.
123. See Ebbe and Wenglorz, supra note 7, at 527.
124. Council Regulations No. 2407/92 on licensing of community air carriers, 1992 O.J. (L 240) 1, No. 2408/92 on access to intra-community air routes, 1992 O.J. (L 240) 8, and No. 2409/92 on fares and rates for air services, 1992 O.J. (L 240) 15.
125. Id.
age. Lastly and very importantly, the Council adopted Regulation 95/93 in January 1993 which provides common rules for the allocation of slots, an issue which has traditionally been a thorny problem in the EC air transport sector.\textsuperscript{127} These regulations will be treated as part of the Third Package for purposes of this paper. They are discussed below, in addition to the three basic Third Package regulations mentioned above: The Third Package regulations on Computer Reservation Systems and Ground Handling will not be discussed in this paper.

A. The Licensing Regulation

The Third Package introduces, for the first time in EC history, a common licensing scheme for community carriers.\textsuperscript{128} This Licensing Regulation provides common requirements for the issuance and withdrawal of operating licenses by Member States to air carriers established in the community.\textsuperscript{129} The regulation provides superior and exclusive rules for the granting of operating licenses, and air carriers meeting its requirements shall be granted an operating license by the concerned Member State.\textsuperscript{130} The general focus of the regulation’s requirements are on the financial fitness of the air carrier, both short and long term. Each of the significant requirements of the regulation will be discussed below.

1. Community Ownership

A Member State may not grant an operating license to an undertaking unless its principal place of business is located in that Member State and it main occupation is air transport.\textsuperscript{131} Community ownership requires not only majority ownership by Member States and/or nationals of Member States, but also requires that such Member States or nationals shall at all times, effectively control the undertaking.\textsuperscript{132} A grandfather provision provides that airlines with outside control that have previously been recognized as community carriers may continue to be considered as such as long as those in control of the carrier at the time of adoption of

\textsuperscript{127} Council Regulation 95/93 O.J. 1993 (L 14) 1.
\textsuperscript{128} Council Regulation No. 2407/92, supra note 124.
\textsuperscript{129} Id. at art. 1(1).
\textsuperscript{130} Id. at art. 3.
\textsuperscript{131} Id. at art. 4(1).
\textsuperscript{132} Id. at art. 4(2); Id. art. 2(g) provides:
‘Effective control’ means a relationship constituted by rights, contracts, or any other means which, either separately or jointly and having regard to the considerations of fact or law involved, confer the possibility of directly or indirectly exercising a decisive influence on an undertaking, in particular by:
(a) the right to use all or part of the assets of an undertaking;
(b) rights or contracts which confer a decisive influence on the composition, voting or decisions of the bodies of an undertaking or otherwise confer a decisive influence on the running of the business of the undertaking.
the Licensing Regulation remain in control. Some commentators have suggested that the effective control requirement is not clear and may be used as a tool by Member States to withdraw licenses. This standard will also tend to limit investments, mergers, and cooperative agreements between community carriers and non-EC airlines and therefore may put EC carriers at a disadvantage in a globally competitive market.

2. **Demonstration of Financial Fitness**

The financial fitness requirements are the most significant provisions of the Licensing Regulation. Air carriers applying for an operating license for the first time must, by a submitted business plan, demonstrate to the reasonable satisfaction of the competent authorities of the licensing Member State that it can meet its financial obligations for the next two years, and that it can meet its fixed and operational costs for the next three months without income. This requirement raises several concerns, the most obvious of which is the discretion placed in the authorities of the Member State via the reasonable satisfaction standard. This discretion may be easily abused to protect the Member State's national airlines, and even if not abused, it is difficult to believe that a carrier will be able to predict its future air fare revenues with any certainty considering the increasingly competitive market.

Existing license holders must notify their licensing authorities: in advance of any changes in new scheduled service or a non-scheduled service to a continent or world region not previously serviced, of changes in type

---

133. *Id.* at art. 4(3); Council Regulation 2343/90, *supra* note 87, Annex I (the airlines so recognized are Scandinavian Airlines System, Britannia Airways, and Monarch Airlines).
135. *Council Regulation No. 2407/92, supra* note 124, art. 5(1), (2); *id.* Annex:
   A. Information to be provided by a first time applicant from a financial fitness point of view.
   1. The most recent internal management accounts and, if available, audited accounts for the previous financial year.
   2. A projected balance sheet, including profit and loss account, for the following two years.
   3. The basis for projected expenditure and income figures on such items as fuel, fares and rates, salaries, maintenance, depreciation, exchange rate fluctuations, airport charges, insurance, etc. traffic/revenue forecasts.
   4. Details of the start-up costs incurred in the period from submission of application to commencement of operations and an explanation of how it is proposed to finance these costs.
   5. Details of existing and projected sources of finance.
   6. Details of shareholders, including nationality and type of shares to be held, and the Articles of Association. If part of a group of undertakings, information of the relationship between them.
   7. Projected cash-flow statements and liquidity plans for the first two years of operation.
   8. Details of the financing of aircraft purchase/leasing including, in the case of leasing, the terms and conditions of the contract.
or number of aircraft, of change in scale of activities, of intended mergers or acquisitions, and change of ownership of ten percent or more.\textsuperscript{136} If the licensing authority finds that these changes have a significant bearing on the air carrier's finances, it shall require the carrier to submit a revised business plan incorporating these changes and covering one year after the changes are to go into effect in order to determine if the carrier can then meet its existing and potential obligations. The authority shall then issue a decision based on the revised plan, within three months of its submission.\textsuperscript{137} What does this mean? Can an authority reject the change in business plan, and if so, even if done in good faith, is it wise to have a Member State second guessing the business strategy of every air carrier it licenses? This provision does not provide a clear standard by which the authority is to determine whether or not the carrier in question will be able to meet its obligations in the future, nor does it provide any indication of what action the authority is to take if they make this determination. Once again, the possibility for abuse of discretion by the Member State in order to protect its own airline is present.\textsuperscript{138}

The Regulation also allows the licensing authorities to suspend or revoke a carrier’s license if they believe that the carrier can no longer meet its obligations for a twelve month period due to financial problems. However, a temporary license may be granted pending financial restructuring of the carrier as long as safety is not at risk.\textsuperscript{139} If the carrier is under insolvency proceedings, the Member State is not allowed to let the carrier retain its operating license if the competent authority of the Member State is convinced that the carrier cannot be satisfactorily restructured within a reasonable time.\textsuperscript{140} This rule also raises the possibility of

\textsuperscript{136} Id. at art. 5(3).
\textsuperscript{137} Id. at art. 5(4); Id. Annex:

B. Information to be provided for assessment of the continuing financial fitness of existing license holders planning a change in their structures or in their activities with a significant bearing on their finances.

1. If necessary, the most recent internal management balance sheet and audited accounts for the previous financial year.

2. Precise details of all proposed changes e.g. change of type of service, proposed takeover or merger, modifications in share capital, changes in shareholders, etc.

3. A projected balance sheet, with a profit and loss account, for the current financial year, including all proposed changes in structure or activities with a significant bearing on finances.

4. Past and projected expenditure and income figures on such items as fuel, fares and rates, salaries, maintenance, depreciation, exchange rate fluctuations, airport charges, insurance, etc. traffic/revenue forecasts.

5. Cash flow statements and liquidity plans for the following year, including all proposed changes in structure or activities with a significant bearing on finances.

6. Details of the finances of aircraft purchase/leasing including, in the case of leasing, the terms and conditions of the contract.

\textsuperscript{138} See Crans, \textit{supra} note 8, at 219.

\textsuperscript{139} Council Regulation No. 2407/92, \textit{supra} note 124, art. 5(5).

\textsuperscript{140} Id. at art. 12.
abuse by the Member State, especially during recessionary periods. Smaller carriers encountering temporary difficulties may be unnecessarily grounded by authorities of a Member State if such action is beneficial to the Member State's flag carrier.\textsuperscript{141}

In addition, existing airlines must submit annual audited accounts and information relevant to their continuing financial fitness at the request of the licensing authority.\textsuperscript{142} These financial fitness criteria generally do not apply to small air carriers which operate aircraft of less than ten tons and/or less than twenty seats and whose net capital is at least 80,000 ECU. However, the financial fitness criteria will apply if the carrier operates scheduled services or has a turnover which exceeds 3 million ECU per year.\textsuperscript{143} It is not clear if this means that such small air carriers are exempt from the criteria only if they operate non-scheduled services.

The financial fitness criteria of this regulation may provide a useful tool to the Commission to ensure that start-up carriers have sufficient capital for the first few months, however, the ability to base a rational decision on projected earnings in a volatile market, the competence of the Member State's authorities to second guess business strategies, and the potential for abuse of the substantial discretion left to the Member States in order to protect their flag carriers significantly detracts from any benefit these criteria provide. A Member State’s decision refusing an operating license under these rules may be reviewed by the Commission upon referral by a concerned air carrier,\textsuperscript{144} but as long as the Member State acted within the discretion provided by the rules, it is doubtful that the Commission would overturn the decision.

3. Aircraft Financing and Safety Standards

As for the ownership of aircraft, the Licensing Regulation only requires that an air carrier have at least one aircraft at its disposal, either through ownership or lease agreement.\textsuperscript{145} Possession of a valid Air Oper-

\begin{itemize}
  \item \textsuperscript{141} See Crans, \textit{supra} note 8, at 219.
  \item \textsuperscript{142} Council Regulation No. 2407/92, \textit{supra} note 124, art. 5(6); \textit{id.} Annex:
    \begin{enumerate}
    \item Audited accounts not later than six months after the end of the relevant period and, if necessary, the most recent internal management balance sheet.
    \item A projected balance sheet, including profit and loss account, for the forthcoming year.
    \item Past and projected expenditure and income figures on such items as fuel, fares and rates, salaries, maintenance, depreciation, exchange rate fluctuations, airport charges, insurance, etc. traffic/revenue forecasts.
    \item Cash flow statements and liquidity plans for the following year.
    \end{enumerate}
  \item \textsuperscript{143} \textit{id.} art. 5(7).
  \item \textsuperscript{144} \textit{id.} art. 13(3).
  \item \textsuperscript{145} \textit{id.} art. 8(1).
\end{itemize}
ator's Certificate,146 issued in compliance with a Council Regulation on the matter, is a prerequisite to obtaining an operating license.147 For purposes of safety, the leasing of aircraft, with or without crew, to another air carrier shall be approved by the appropriate licensing authority and the conditions of the approval shall be made part of the lease.148 The aircraft used by the air carrier shall, at the option of the Member State, be registered in either the Member State's national register or within the Community.149 Registration of leased aircraft in the Member State shall not be required if doing so would require structural changes to the aircraft, and registration requirements may be waived in the event of a short-term lease to meet temporary needs of an air carrier.150

4. Grandfather Clause and License Duration

Article 16 of the Licensing Regulation provides that operating licenses in force at the time that the regulation goes into effect shall remain valid for one year, during which the carrier shall make arrangements to conform with the requirements of the regulation.151 The operating license, approved by a Member State, shall be valid as long as the air carrier meets the obligations of the Licensing Regulation, but Member States may impose an annual review for a new license and every five years thereafter.152 If an air carrier has not operated in six months, or has not commenced operations six months after the granting of its license, the Member State may require the carrier to resubmit the license for approval.153 Member States may also require a carrier to resubmit its operating license if there has been a change of ownership. If there has been a change in ownership, the license shall remain valid unless the licensing authority decides that safety is at risk.154

B. The Route Access Regulation

The Route Access Regulation155 is the centerpiece of the Third Package, and is the product of the Council's attempt to create freedom for community air carriers within the entire community, a goal consistent

146. Id. art. 2(d) (defining 'air operator's certificate' as a document by the competent authorities of a Member State affirming that the carrier has the ability to secure the safe operation of the aircraft for the activities specified in the certificate).
147. Id. art. 9.
148. Id. art. 10.
149. Id. art. 8(2)(a).
150. Id. art. 8(2)(b), 8(4).
151. Id. art. 16.
152. Id. art. 11(1).
153. Id. art. 11(2).
154. Id. art. 11(3).
with the concept of a Single European Market by 1992. Achieving this
goal in the air transport sector, however, is overly ambitious considering
the short time frame and the unique aspects of the air transport market in
the EC. As a result, full cabotage and domestic flights are excluded from
the application of these regulations until April 1, 1997. In addition there
are several escape mechanisms which allow Member States to avoid ap-
iplication of the rules in certain situations. The significant provisions of
the Route Access Regulation are discussed below.

1. Full Freedom Community Traffic Rights and Cabotage Limitation

The Route Access Regulation grants full third, fourth, and fifth free-
dom rights to community carriers for intra-community routes. Until
April 1, 1997, cabotage rights are granted on the conditions that they
must be an extension of a flight from/to the home state of the carrier, and
the capacity of the cabotage service does not exceed 50 percent of the
capacity of the service which the cabotage is an extension of. In addi-
tion, Member States may regulate access to domestic routes for air carri-
ers licensed by it until April 1, 1997.

2. Public Service Obligation

Similar to the Second Package, the Route Access Regulation allows
Member States to impose a public service obligation to peripheral or de-
velopment regions, or on thin routes to regional airports in order to pro-
vide sufficient air services. If no air carrier has commenced to
undertake service on a route under the public service obligation, a Mem-
ber State may grant one carrier, selected from submissions to tender, an
exclusive right to operate the route for up to three years. This exclu-
sive right to operate a public service route shall not apply when another
concerned Member State proposes satisfactory alternative means of ful-
filling the same public service obligation, or where other forms of trans-
port will provide adequate and uninterrupted service when the capacity
offered exceeds 30,000 seats per year. In most of Europe, adequate alter-
native transport would probably be rail service. The Commission
shall investigate, at the request of a Member State, or on its own, to de-
termine if the public service obligation is unduly restricting development
of the route.

156. Id. art. 3(1).
157. Id. art. 3(2).
158. Id. art. 3(4).
159. Id. art. 4(1).
160. Id. art. 4(1)(d).
161. Id. art. 4(1)(k), 4(2).
162. Id. art. 4(3).
3. **Domestic Exclusive Route Grandfather Rights and New Regional Route Protection**

Where domestic routes were operated under an exclusive concession by law or contract at the time of application of the Route Access Regulation, and where other forms of transportation are not equally adequate, such exclusive concession may continue until it expires or for three years, whichever comes first. In addition, a Member State may deny access for two years to other carriers to a regional route started by a carrier licensed by it if the aircraft has no more than 80 seats and the total capacity does not exceed 30,000 seats per year, unless the other carrier operates the route with not more than 80 seats available for sale per flight. The Commission may investigate such a situation to determine if development of the route is being unduly restricted.

4. **Traffic Distribution, Operational Rules, and Traffic Right Limitations**

Of all the provisions in the Route Access Regulation, those in Articles 8 and 9 are the most interesting in that they allow significant methods by which a Member State may place restrictions on route access. First, a Member State may regulate, without discrimination on grounds of nationality or identity of the aircraft carrier, the distribution of traffic between airports within an airport system. This may significantly impact the efficiency of operations for an air carrier operating at an airport system if the carrier is forced to operate at a more expensive or less desirable airport within the system. Second, traffic rights are subject to published community, national, regional, and local operational rules relating to safety, the environment, and the allocation of slots. The application of national, regional, and local rules in these areas allows discretion to the Member States which may be abused for the benefit of flag carriers or those airlines licensed in a particular Member State. The Commission may investigate the applications of these provisions at the request of a Member State or on its own initiative, and a Member State may refer the Commission’s decision to the Council. Why cannot an air carrier itself request investigation by the Commission or appeal the Commission’s decision? Air carriers competing with the Member State’s flag carrier may be prevented from avoiding a restrictive limitation under these provisions.

163. *Id.* at art. 5. *See* note 155
164. *Id.* at art. 6(1).
165. *Id.* at art. 6(2).
166. *Id.* at art. 8(1).
167. *Id.* at art. 8(2).
168. *Id.* at art. 8(3), B(4).
In addition, a Member State may place restrictions on, or even deny, the exercise of traffic rights when serious congestion or environmental problems exist, especially when other modes of transport can provide adequate service.\textsuperscript{169} Actions taken for these reasons shall be non-discriminatory, be valid for no more than three years, not unduly affect the objectives of this regulation, not unduly distort competition between air carriers, and not be more restrictive than necessary.\textsuperscript{170} Even with these safeguards, it seems highly probable that a Member State may be able to restrict or deny access to carriers for the benefit of its flag carrier, especially if sufficient rail services exist between the home state of the disfavored carrier and the Member State in question. The Commission, on its own or by request from a Member State, may investigate such restrictions and shall indicate if the restrictions may be implemented during the investigation period.\textsuperscript{171} Although a Member State may refer the Commission's decision to the Council,\textsuperscript{172} an air carrier itself may not.

Lastly, a Member State shall not authorize an air carrier to start a new service or increase a pre-existing service between one of its airports and that of another Member State if an air carrier of the other Member State has been denied similar growth at the airport in question because of slot allocation rules.\textsuperscript{173} This rule is to apply pending the implementation of a Council Regulation on common slot allocation rules.\textsuperscript{174} In this respect, airlines operating from congested airports are at a significant disadvantage to increase services to airports of other Member States if they are unable to reciprocate slots.

5. Capacity Limitations

Capacity limitation agreements between air carriers are effectively prohibited by the Route Access Regulation,\textsuperscript{175} however, a notable and questionable exception is provided. If the lack of capacity limitations has led to serious financial damage to air carriers licensed by a Member State. The State may request the Commission review the situation, and on the basis of many factors, including whether the opportunities of air carriers of that Member State to effectively compete are unduly affected, the Commission may decide to stabilize the capacity for scheduled air services to and from that state.\textsuperscript{176} Any Member State may refer the Commis-

\textsuperscript{169} Id. at art. 9(1).
\textsuperscript{170} Id. at art. 9(2).
\textsuperscript{171} Id. at art. 9(4).
\textsuperscript{172} Id. at art. 9(6).
\textsuperscript{173} Id. at art. 9(8).
\textsuperscript{174} Council Regulation 95/93, supra note 127.
\textsuperscript{175} Council Regulation No. 2408/92, supra note 124, art. 10(1).
\textsuperscript{176} Id. at art. 10(2).
sion's decision to the Council for review. The term 'unduly affected' is very ambiguous and does not provide a clear standard. Does this mean that if the air carriers of a Member State are inefficient and suffer loss because of competition that capacity restrictions may be re-introduced to the market? If competition is not allowed to force inefficient carriers to become lean and efficient or get out of the marketplace, then what will? Additionally, the inability of an air carrier itself to request review of the Commission's decision places it at the mercy of its licensing Member State. After all, what good are rights if one cannot be heard before they are taken away?

In summary, the Route Access Regulation brings the air transport sector much closer to the goal of an open market than any of the previous packages, but it also allows much discretion to Member States and has the potential for abusive and protectionist practices. In addition, access to full cabotage rights and domestic routes are left to be worked out in 1997.

C. THE AIR FARE REGULATION

The Air Fare Regulation\textsuperscript{178} includes one of the more interesting surprises of the Third Package in that the double disapproval and the double approval methods of the Second Package are completely done away. With the stated purpose of allowing air fares to be determined freely by market forces, the Council leaves the fares to be set by the air carriers.\textsuperscript{179} The Council recognized, however, that this freedom must be complemented with appropriate safeguards for the interests of consumers and industry, and therefore provided the Member States with the limited ability to reject air fares.

I. Setting Air Fares and Filing Requirements

The new regulation does not apply to non-community air carriers or to public service obligations. Only community air carriers (c.a.c.'s) may introduce new products or lower fares for existing, identical products.\textsuperscript{180} Charter fares and cargo fares are set by free agreement of the contracting parties,\textsuperscript{181} and all c.a.c.'s must inform the public of air fares and cargo rates.\textsuperscript{182} Member States may require that air carriers file new air fares with them not more than 24 hours before the fare takes effect.\textsuperscript{183}
April 1, 1997, a Member State may require that air fares on domestic routes, where no more than one carrier or a joint operation of two carriers licensed by that Member State operate, be filed more than one working day but no more than one month before the air fares come into effect.\footnote{184}  

2. *Member State Disapproval*

A concerned Member State may at any time withdraw a basic fare\footnote{185} which is excessively high to the disadvantage of users in relation to the long term fully allocated relevant costs of the air carrier, including a satisfactory return.\footnote{186} A Member State may also decide at any time to stop further fare decreases on a route or group of routes when market forces have led to sustained downward development of air fares deviating significantly from ordinary seasonal price fluctuations and resulting in widespread losses among all air carriers concerned when taking into account their long term fully allocated relevant costs.\footnote{187} A Member State deciding to act under these provisions must notify the Commission and all other Member States and air carriers involved. If after fourteen days, neither Member State or the Commission disagrees, the Member State deciding to take such action may implement it.\footnote{188} In the case of a disagreement, any Member State involved may require consultations within 14 days to review the situation,\footnote{189} but the regulation does not state what the effect of these consultations shall be, especially in the case where no agreement is reached.

3. *Commission Review*

The Commission may, at the request of an involved Member State, examine the decision of another Member State to withdraw an excessively high basic fare or stop further fare decreases.\footnote{190} Note that an interested air carrier may not itself request that a Member State's decision be examined by the Commission. The Commission may, however, upon a complaint by an interested air carrier, investigate whether certain air fares are either excessively high or result in sustained downward development of air fares under the provisions above.\footnote{191} Again, a Member State

---

\begin{itemize}
  \item \footnote{184}{Id. at art. 5(3).}
  \item \footnote{185}{Id. at art. 2(k). (defining a basic fare as “the lowest fully flexible fare, available on a one way and return basis, which is offered for sale at least to the same extent as that of any other fully flexible fare offered on the same air service”).}
  \item \footnote{186}{Id. at art. 6(1)(a).}
  \item \footnote{187}{Id. at art. 6(1)(b).}
  \item \footnote{188}{Id. at art. 6(2), (3).}
  \item \footnote{189}{Id. at art. 6(4).}
  \item \footnote{190}{Id. at art. 7(1).}
  \item \footnote{191}{Id. at art. 7(2).}
\end{itemize}
concerned, but not an air carrier, may refer the Commission's decision to
the Council for review.\textsuperscript{192} The bottom line of these review procedures is
that an air carrier may use the Commission review process offensively
against other carrier's fares, but may not use such review process de-
defensively to defend against either a Member State's action or a Commission
action against that air carrier's own fares. Unless another concerned
Member State decides to defend an air carrier from such action, the car-
rier is vulnerable to the discretion of a Member State and of the Commis-

\textbf{D. The Airline Agreement Block Exemptions Regulation}

The new block exemptions regulation for airline agreements super-
sedes Commission Regulation 84/91 of the Second Package and provides
exemptions from art. 85(1) of the Treaty of Rome for air carrier agree-
ments concerning the joint planning of schedules, joint operations, tariff
consultations, and slot allocations.\textsuperscript{194} The Second Package regulation's
exemption for agreements on joint planning and coordination of capacity
have been done away with in the new regulation.

The exemption for agreements on the joint planning of schedules re-
quires that such agreements must be intended to ensure the satisfactory
supply of air services and must facilitate interlining.\textsuperscript{195} The agreement
must not limit or share capacity, prevent any of the involved parties from
introducing additional services, prevent quick withdrawal of either party
from the agreement, or seek to influence the schedules of other air carri-
er on the referenced route.\textsuperscript{196}

The exemption for agreements on joint operations only applies if the
costs and revenues of the operating air carrier are shared, and there has
been no direct air service on that route during the previous year or the
capacity on the route of the joint operation does not exceed 30,000 seats
per year.\textsuperscript{197} In addition, the operating air service must not offer a capac-
ity, besides that of the joint operation, of more than 90,000 seats per year
at one of the airports involved in the joint operation, nor must the com-
munity revenues of the operating carrier exceed ECU 400 million per
year.\textsuperscript{198} Finally, the joint operation must not prevent the air carriers in-

\begin{itemize}
\item [192.] Id. at art. 7(8).
\item [193.] See Crans, supra note 8, at 223.
\item [194.] Commission Regulation 1617/93, supra note 126.
\item [195.] Id. at art. 2.
\item [196.] Id.
\item [197.] Id. at art. 3 (the capacity limitation is raised to 60,000 seats per year for routes longer
than 750 km. on which there is at most a twice daily direct air service).
\item [198.] Id. at art. 3(c), (d).
\end{itemize}
volved from operating additional air services with independent fares, capacity, and schedules, must not exceed three years and must allow either party to terminate the agreement with less than three months notice.200

Tariff consultations may be exempt only if they concern the technical construction and conditions of fares and rates charged, do not concern capacity, give rise to interlining, and if the tariffs are applied without discrimination.201 In addition, the consultations must be voluntary and open, must not be binding on the participants, and must not include agreements on agent's remuneration.202

Exemptions for slot allocation consultations apply only if the consultations are open to all concerned and the rules of priority are made without discrimination on the basis of carrier identity or nationality. They must also be made available to interested parties.203 Additionally, new entrants must be allocated up to 50 percent of new or otherwise unused slots upon request, and participants in such consultations shall have access to relevant slot allocation information.204

The Commission may withdraw the benefit of the block exemption under this regulation if it finds that an agreement has effects which are incompatible with either art. 85(3) or 86 of the Treaty of Rome.205 In particular, this will be the case where there is no effective price competition on a route which was the subject of tariff consultations, where an air service under joint operation is not exposed to competition by other air carriers or by other modes of adequate transportation, or where a new entrant cannot obtain sufficient slots to allow them to compete effectively with established carriers which results in the substantial impairment of competition on the routes concerned.206

E. The Slot Allocation Regulation

As referred to in the slot reciprocity requirement of the Route Access Regulation 2408/92,207 the Council eventually adopted a regulation on common rules for the allocation of slots at community airports.208 The allocation of slots at community airports has traditionally been a very sensitive issue and has provided great potential for abusive practices by Member States for the protection of their flag carriers. In adopting the

199. Id. at art. 3(f), (g).
200. Id. at art. 4.
201. Id. at art. 4(c)-(e).
202. Id. at art. 5.
203. Id. at art. 5(d), (e).
204. Id. at art. 6.
205. Id.
206. Council Regulation No. 2409/92, supra note 124, art. 9(8).
207. Council Regulation 95/93, supra note 127.
new slot allocation regulation, the Council recognized the necessity for non-discriminatory rules on slot allocation and also the need to provide for the introduction of new entrants into the market.\textsuperscript{208} Generally, the requirements of this new regulation only apply to congested community airports, and the regulation itself must be reviewed for continuation by July 1, 1997.

I. Conditions for Airport Coordination

The regulation provides that a Member State may, at its discretion, designate one of its airports as a coordinated\textsuperscript{209} airport for the purposes of allocating slots, if the coordination is done in a transparent, neutral, and non-discriminatory way.\textsuperscript{210} A Member State must, however, designate an airport as fully coordinated\textsuperscript{211} during periods of slot capacity shortages if, after a thorough capacity analysis with all interested parties, the capacity problems cannot be solved in the short term.\textsuperscript{212} A Member State must conduct a thorough capacity analysis when more than half of the carriers at the airport consider the capacity insufficient for operations at certain periods, when new entrants encounter serious problems in obtaining slots, or when a Member State considers it necessary.\textsuperscript{213} This rule provides new entrants with the ability to raise the slot allocation issue, but does not provide the same voice for existing carriers unless more than half of all carriers raise the issue. This effect could disadvantage smaller existing carriers at congested airports which are effectively dominated by flag carriers.

The Member State responsible for a coordinated or a fully coordinated airport shall ensure the appointment of a natural or legal person with sufficient knowledge of slot allocation methods as airport coordinator who shall monitor and coordinate slot allocation.\textsuperscript{214} Note that the responsibility of a Member State to appoint the coordinator may result in a nationally biased appointment. Fully coordinated airports are also required to have a coordination committee consisting of air carriers, airport authorities, and air traffic control representatives, which shall monitor

\begin{itemize}
\item \textsuperscript{208} \textit{Id.}
\item \textsuperscript{209} \textit{Id. at} art. 2(f) (A coordinated airport "shall mean an airport where a coordinator has been appointed to facilitate the operations of air carriers operating or intending to operate at that airport.")
\item \textsuperscript{210} \textit{Id. at} art. 3(2).
\item \textsuperscript{211} \textit{Id. at} art. 2(g) (A fully coordinated airport "shall mean a coordinated airport where, in order to land or take-off, during the periods for which it is fully coordinated, it is necessary for an air carrier to have a slot allocated by a coordinator.")
\item \textsuperscript{212} \textit{Id. at} art. 3(3).
\item \textsuperscript{213} \textit{Id.}
\item \textsuperscript{214} \textit{Id. at} art. 4.
\end{itemize}
slot allocation and advise the coordinator on the allocation of slots.\footnote{215} There is no indication that the coordinator must implement any of the suggestions of this committee, nor is there any clear provision providing a remedy for the committee in such a situation.

2. \textit{Process for Slot Allocation}

The slot allocation rules of the new regulation provide grandfather slot rights to carriers which have used slots in a previous equivalent scheduling period,\footnote{216} and scheduled services and programmed non-scheduled services shall have priority when all slot requests cannot be filled.\footnote{217} The coordinator shall also consider any additional priority rules established by the air carrier industry and any recommendations of the coordination committee.\footnote{218} The coordinator must also attempt to accommodate ad hoc slot requests for any type of aviation by using slots available from a pool of recently given up slots.\footnote{219}

Generally, an air carrier is free to exchange slots with another air carrier or change their use for different routes or services subject to confirmation by the coordinator that airport operations would not be prejudiced, that regional limitations of a Member State are respected, and that the change of slot use does not allow an air carrier to increase its frequency of service to the detriment of an air carrier from another Member State.\footnote{220} Slots allocated to new entrants\footnote{221} for intra-community use may not be freely exchanged by them or changed in type of use for a period of two seasons.\footnote{222} The grandfather rights and the ability to exchange slots appear to provide significant potential for abuse by large established carriers to lock up slots at congested airports.

Upon complaints concerning slot allocation, the coordination com-

\begin{footnotesize}
\begin{itemize}
  \item \footnote{215}{\textit{Id. at art. 5.}}
  \item \footnote{216}{\textit{Id. at art. 8(1)(a).}}
  \item \footnote{217}{\textit{Id. at art. 8(1)(b).}}
  \item \footnote{218}{\textit{Id. at art. 8(1)(c).}}
  \item \footnote{219}{\textit{Id. at art. 8(3).}}
  \item \footnote{220}{\textit{Id. at art. 8(4).}}
  \item \footnote{221}{\textit{Id. at 2(b) provides:}}
    
    'new entrant' shall mean:
    \begin{itemize}
      \item (i) an air carrier requesting slots at an airport on any day and holding or having been allocated fewer than four slots at that airport on that day, or,
      \item (ii) an air carrier requesting slots for a non-stop service between two Community airports where at most two other air carriers operate a direct service between these airports or airport systems on that day and holding or having been allocated fewer than four slots at that airport on that day for that non-stop service.
    \end{itemize}
    An air carrier holding more than 3\% of the total slots available on the day in question at a particular airport, or more than 2\% of the total slots available on the day in question at an airport system of which that airport forms a part, shall not be considered as a new entrant at that airport.
  \item \footnote{222}{\textit{Id. at art. 8(5).}}
\end{itemize}
\end{footnotesize}
mittee shall consider the matter and make proposals in attempt to resolve the problems. If the problems cannot be resolved, the concerned Member State may provide for mediation by an air carrier's representative organization, or other third party.\footnote{223} This mediation process is not clearly outlined, and does not provide for a result should the complaining parties not come to agreement.

Notwithstanding these slot allocation rules, a Member State may, under certain conditions, reserve certain slots at a fully coordinated airport for domestic, scheduled services on a peripheral or regional route which is considered vital to the economic development of the region under certain conditions,\footnote{224} or on public service obligation routes.\footnote{225} Note that this may often be used to the benefit of the Member State's flag carrier.

3. Slot Pools

A slot pool shall be set up at any airport where slot allocation takes place. That pool shall contain newly created slots, unused slots, and recently given up slots.\footnote{226} In addition, unused slots shall be placed into the pool unless they can be justified as provided for in the regulation. These include the grounding of an aircraft type, the closure of an airport or airspace used on that route, or other similarly exceptional cases.\footnote{227} Grandfather slot rights are limited in a similar manner. If slots allocated to an air carrier over a given period are not used at least 80 percent of the time, then the air carrier shall not be entitled to the same slots over the next equivalent period. Finally, those slots shall be placed in the slot pool.\footnote{228}

The regulation also requires that a coordination committee meeting

\footnote{223} Id. at art. 8(7), (8).
\footnote{224} Id. at art. 9(1)(a), providing conditions that:
  (i) the slots concerned are being used on that route at the time of entry into force of this Regulation;
  (ii) only one carrier is operating on the route;
  (iii) no other mode of transport can provide an adequate service;
  (iv) the reservation of slots shall end when a second carrier has established a domestic scheduled service on the route with the same number of frequencies as the first air carrier and operated it for at least a season. Id.
\footnote{225} Id. at art. 9(1)(b).
\footnote{226} Id. at art. 10(1).
\footnote{227} Id. at art. 10(2).
\footnote{228} Id. at art. 10(3)-(5). Justifiable reasons for less than 80 percent utilization of slots are limited to (1) unforeseeable and unavoidable cases outside the air carrier's control; (2) problems of a new scheduled service of no more than 80 seats on a route between a regional airport and the coordinated airport and where the capacity does not exceed 30,000 seats per year; (3) serious financial damage for a Community air carrier concerned resulting in a temporary operating license while under financial reorganization; (4) interruptions in charter services caused by tour operator cancellations provided that slot usage does not fall below 70 percent; or (5) intentional
shall be convened to examine possible remedies, if serious problems exist
for new entrants.\textsuperscript{229} However, the regulation does not provide for any
action these remedies. New entrants have priority rights to 50 percent of
the slots. However, this status is lost if a new entrant turns down an offer
of slots which are within two hours of the time requested.\textsuperscript{230} The loss of
new entrant status could be a fatal blow to a small carrier, and since the
regulation does not provide exceptions to this rule, it may operate harshly
or discriminatorily.

4. \textit{Safeguard Mechanism (Reciprocal Slot Limitation) and Third
Country Problems}

An air carrier shall not be allowed to freely exchange slots or change
the use of its slots in order to increase services on a route between a fully
coordinated airport and another Member State if a community air carrier
of another Member State, with equal or less frequency of services on that
route, has not been able to obtain the slots at that airport which are nec-
essary to increase its services on the route.\textsuperscript{231} In such a situation, the
Member State responsible for the fully coordinated airport shall attempt
to facilitate an agreement between the air carriers involved.\textsuperscript{232} A con-
cerned Member State may request that the Commission investigate the
possibility of applying this limitation, if such request is filed within two
months of the time that the coordinator has been informed of an air car-
rrier’s intention to exchange or change the use of its slots.\textsuperscript{233} Lastly, the
Commission shall negotiate any slot allocation difficulties encountered by
Community air carriers at the airports of non-EC third countries, the
remedy for which may be limitation of slots at EC airports for air carriers
of that third country.\textsuperscript{234}

IV. \textbf{REMAINING OBSTACLES AND POSSIBLE SOLUTIONS}

The Third Package is far from the liberating breakthrough it was ex-
pected to be, and many significant obstacles remain before a fully liberal-
ized EC air transport sector can be achieved. Although many of these
problems are inherent in the nature of national ownership of flag carriers,
many of them result from the regulations themselves or from their failure
to address such problems. The gradual implementation approach em-

\begin{flushright}
\footnotesize
\textsuperscript{229} Id. at art. 10(6).
\textsuperscript{230} Id. at art. 10(7), (8).
\textsuperscript{231} Id. at art. 11(1).
\textsuperscript{232} Id. at art. 11(2).
\textsuperscript{233} Id. at art. 11(3).
\textsuperscript{234} Id. at art. 12.
\end{flushright}
braced by the EC in the liberalization of this sector should not be used as an excuse to shy away from full liberalization. Where such efforts are feasible they should be embraced and implemented without delay unless there is justification that the effort would be catastrophic to existing airlines, and even then the desirability of protecting such non-competitive airlines should be fully examined.

A. REMAINING LICENSING AND START-UP OBSTACLES

The community ownership requirements of the Licensing Regulation provides Member States with the discretion to deny an air carrier a license if a non-EC party can exercise effective control of that carrier.\textsuperscript{235} The broad definition of effective control\textsuperscript{236} may prevent an air carrier from entering into joint ventures with third countries\textsuperscript{237} for fear of being accused of not having effective control and having its operating license pulled by a Member State. In today’s global transport market this could seriously undermine the ability of smaller EC carriers to form alliances in order to compete with the mega-carriers. The effective control concept should be clarified and restricted to require only majority ownership by EC Member States or persons.

Another drawback of the Licensing Regulation is its financial fitness criteria.\textsuperscript{238} Requiring a new entrant to demonstrate, to the reasonable satisfaction of the licensing Member State, that it can meet its financial obligations for the next two years, and that it can meet its fixed and operational costs for the next three months without income may prevent new entrants with marginal surplus capitalization from entering the market. The discretion of the Member State in this regard is unacceptable and specific accounting standards for determination of financial fitness should be defined if this rule is maintained. In addition, the rule should be restricted to a requirement of sufficient funds to operate for a limited time and should not be dependent on future projections, which often tend to be inaccurate and unreliable.

A related issue is the oversight by the licensing State of any changes in operation or ownership of an existing airline.\textsuperscript{239} A change in ownership is relevant to the continuation of a carrier’s license; however, second guessing an existing airline’s business strategies is ludicrous. Once an air carrier survives the initial new entrant period there is no legitimate reason for oversight other than to prevent anti-competitive practices. For a free market approach to work, carriers must be free to engage in

\textsuperscript{235} See text discussion supra part III.A.1.
\textsuperscript{236} See supra note 132 and accompanying text.
\textsuperscript{237} ‘Third Country’ is intended to mean a non-EC country.
\textsuperscript{238} See text discussion supra part III.A.2.
\textsuperscript{239} See supra note 137 and accompanying text.
whatever financial risk they desire, within the bounds of business law, even if this risk includes the possibility of bankruptcy. For the same reasons, the Member State is given discretion to revoke the license of a carrier which it determines cannot meet its obligations for the next year.\textsuperscript{240} This is completely unnecessary, unless, of course, safety is at risk.

In addition to the obstacles created by the Licensing Regulation, operating costs themselves are a significant obstacle to new entrants.\textsuperscript{241} The magnitude of such costs in the EC as compared to the United States is significantly higher due to airport and air traffic control fees, high labor costs and low labor productivity.\textsuperscript{242} While common regulation of airport and control fees may solve part of the problem, labor costs are a thorny national problem and are not likely to be easily solved at a community level in the near future.

### B. Remaining Access Obstacles

The limitation on cabotage rights of EC carriers until 1997 is the last remaining major obstacle to free access to all EC routes, and its removal should promise lower fares for all intra-EC flights.\textsuperscript{243} Full cabotage rights will be painful for smaller domestic operators who are unprepared for the new competitive atmosphere. With this in mind, there is no reason to allow Member States to limit cabotage rights when it injures airlines licensed by them. Although similar exceptions have been adopted in the past, one hopes that such an exception will not be adopted when full cabotage is implemented in 1997.

In a related issue, the exclusion of purely domestic flights from the application of the air transport regulations will be removed in 1997.\textsuperscript{244} The application of the common air transport rules to domestic flights is necessary to prevent discrimination against air carriers operating cabotage services and to promote lower fares on domestic routes.

The discretion allowed to Member States concerning their ability to restrict route access for airport system traffic distribution purposes and for the application of national and local safety and environmental rules presents the potential for significant abuse.\textsuperscript{245} The Member States also have the discretion to restrict route access when they determine that seri-

\textsuperscript{240} See supra note 139.

\textsuperscript{241} See Safeguards supra note 8 (congested airports and air space and the high costs of operating from European airports are likely to inhibit the start of new services).

\textsuperscript{242} See, e.g., Flying the Flag, THE ECONOMIST, supra note 10; Schmid, supra note 9.


\textsuperscript{244} See supra note 158 and accompanying text.

\textsuperscript{245} See discussion supra part III.B.4.
ous congestion or environmental problems exist.\textsuperscript{246} Abuse of these provisions is made all the more possible when only other Member States, and not air carriers, may refer the matter to the Commission for review.\textsuperscript{247} Action by a Member State under these provisions should either be pre-approved by the Commission or be subject to review upon the request of any air carrier.

C. REMAINING SLOT ALLOCATION OBSTACLES

The Slot Allocation Regulation brought liberalization to an area of the air transport sector traditionally controlled by the individual Member States and riddled with discriminatory practices. This regulation leaves the potential for abusive practices by Member States and significant issues are left unaddressed.\textsuperscript{248} For instance, a Member State is not required to fully coordinate an airport for slot allocation if less than 50 percent of the existing air carriers complain of slot shortages which could lead to the perpetuation of slot allocation practices detrimental to smaller established air carriers.\textsuperscript{249} This discretion would be removed if a concerned air carrier could request that a Member State consider full coordination, or that the Commission review the situation.

Other potential problems are presented by the ability of the Member State to appoint the airport coordinator, and the failure of the regulation to explain the impact of the coordination committee on the coordinator’s decisions.\textsuperscript{250} Also, the grandfather rights provision and the free exchange of slots may also continue to limit the allocation of slots to smaller established carriers and new entrants.\textsuperscript{251} Unfortunately, the regulation’s medi-

\textsuperscript{246} Id. But see Safeguards supra note 8 (A European official denies that such safeguards will be used as excuses for member states to protect their national carriers because of Commission oversight). This argument fails to recognize that Commission oversight is not always available to concerned air carriers.

\textsuperscript{247} See generally Safeguards supra note 8; Delayed, Again supra note 8 (Third Package safeguards could hobble competition).

\textsuperscript{248} See text discussion supra part III.E.

\textsuperscript{249} This would especially be the case where more than 50 percent of the air carriers at a given airport are dominant mega-carriers with the ability to hoard slots amongst themselves through grandfather rights and mutual slot exchange agreements. But cf Schmid, supra note 9 (stating that “smaller aircraft require a higher frequency and thus more allocation of slots,” and therefore smaller aircraft may be used deliberately to ‘stockpile slots’ in order to prevent or hinder market access for competitors).

\textsuperscript{250} European Airports Assert Their Rights in Battle Over Slots, THE WALL STREET JOURNAL, Jan. 7, 1993, at A1 (airports council members complain that airports still play no role in making the allocation rules and that community involvement and interest in lower fares would boost competition).

\textsuperscript{251} See Community Competition (II) supra note 6, at 280 (increasingly difficult for new entrants to obtain sufficient slots at congested EC airports).
ation process for resolving slot allocation disputes and new entrant problems does not provide guidelines for resolving these issues.

In addition, the exceptions provided to Member States allow for the reservation of slots on thin domestic regional routes which are exclusively serviced. It also allows the limitation of an air carrier’s ability to exchange slots or change their use in order to increase frequencies on a route, if another Member State’s air carrier cannot obtain slots at the fully coordinated airport for the same purpose. These exceptions may be used by a Member State to either protect its own air carriers or to limit the growth of an air carrier operating at one of its coordinated airports.

Various solutions are possible to resolve these problems, such as the removal of Member State discretion through Commission oversight and approval, and limiting or eliminating the exceptions to the allocation rules. The implementation of these solutions, however, would burden the Commission with the bureaurocratic responsibility for the oversight of the slot allocations at all congested EC airports. The best answer may be to follow the U.S. approach and let the air carriers treat slots as commodities. Some limits may be necessary to avoid market domination and discriminatory trading, but this method may provide new entrants and smaller carriers with the ability to expand when necessary.

D. REMAINING AIR FARE COMPETITION OBSTACLES

The Third Package leaves discretion to reject airfares that are excessively high to the disadvantage of users in relation to the long term fully allocated relevant costs of the air carrier, to the Member States. The bounds of this discretion are unclear. For instance, what standard is used to determine the disadvantage to users? Additionally, what is required for the long term costs to be moderate, and how are the fully allocated relevant costs of the carrier determined? Most importantly, what measure of satisfactory return is sufficient?

Similarly, a Member State may also stop further fare decreases on a route when market forces have led to sustained downward development of air fares, deviating significantly from ordinary seasonal price fluctuations and resulting in widespread losses among all air carriers. The same type of discretion arises here also, the most obvious of which is the determination of ‘significant deviation’ and ‘widespread losses’. This discretion may be exercised by a Member State to discriminate against air carriers competing with its flag carrier.

252. See Delayed, Again, supra note 8 (the best way to distribute slots is to sell them to the highest bidder); Flying the Flag, supra note 10 (a market-based allocation method with appropriate safeguards remains a tantalizing prospect for governments — especially as the money raised could be used to improve airports and air-traffic control).

253. See text discussion supra part III.C.2.
The review and/or appeal process of air fare decisions is another problem. Air carriers can only be heard by the Commission when they are complaining of other carrier's fares, but cannot be heard to appeal a Member State's action against its own fares. Similarly, an air carrier cannot refer a Commission decision on the matter to the Council. This lack of voice raises concerns that a more competitive carrier may be discriminated against by a Member State and be left without the ability to have the action reviewed.

The current rules may not only work to an air carrier's detriment, but may burden the Commission and Council with continual air fare disputes between Member States. A possible solution may be to return to a double-disapproval system. Whatever the solution, the discretion left to Member States must be restricted and clarified, and the concerned air carriers on the route in question must be given a voice in the matter.

E. MEGA-CARRIER DOMINATION AND PRIVATE SUBSIDIES

In addition to the problems with the Third Package of liberalization, market forces unleashed by liberalization itself can tend to result in negative effects if they are not carefully monitored. The liberalization of the air transport market in European Community has brought with it a re-structuring similar to that which the U.S. went through after deregulation, which resulted in a limited number of mega-carriers. Commentators suggest that ultimately only five large EC airlines will survive the liberalization efforts as a result of bankruptcies, consolidations, and mergers. Potential mergers, however, will be reviewed by the Commission, and in cases where substantial negative impact is likely the merger may be disapproved.

For existing smaller carriers and new entrants to survive, they will either have to form strong alliances, serve as feeders to the mega-carrier hubs of operation, or find a niche in the market. The advantages of strategic alliances include reducing costs and generating efficiency among smaller carriers, while increasing their collective economy of size.

---

254. See Safeguards supra note 8 (suggesting that the Third Package disapproval system is cumbersome and that the old double disapproval system was less cumbersome and more liberal).
255. See Seabelt supra note 3, at 444-45.
256. See Labyrinth supra note 2, at 371-73.
257. Examples of such mergers are the takeover of British Caledonian by British Airways and the merger of Air France, UTA, and Air Inter.
258. See generally Community Competition (I) supra note 6, at 68-70.
259. Like the cooperation between Lufthansa, Air France, and Iberia.
260. See generally Labyrinth supra note 2, at 371-73; Schmid, supra note 9, at 202-03.
261. See Schmid, supra note 9, at 202; see generally Community Competition (II) supra note 6, at 285-86.
will probably continue until a reasonable equilibrium is reached. Of course, these changes are welcome as long as they benefit consumers. The Commission should continue to vigilently review prospective mergers and other cooperative agreements for any signs of anti-competitive practices in the corresponding relevant markets.

The most thorny EC air transport issue is that of private subsidies, which has yet to be addressed by the Council. Subsidization of national air carriers has traditionally been at the core of the restrictive and protectionist practices characterizing the EC air transport sector. Of course, British Airways has been successfully privatized and Air France plans to go private in the near future. However, the majority of the large carriers are nationally owned. An interesting twist resulting from the liberalization is that many of the large subsidized national flag carriers have been acquiring and merging with other carriers to gain dominance and solidify their position in the market. The impact of this practice on the competing private carriers is grossly unfair and the use of subsidies to expand the market position of flag carriers should be greatly restricted.

Subsidies are essentially contrary to free competition and result in a distortion of the market to the detriment of competing carriers and consumers, either through higher prices or through taxes required to pay the subsidies. There are no easy answers to this politically sensitive issue. However, as free market forces continue to place pressure on national flag-carriers, their respective nations may become tired of supporting them. In a larger context, subsidized inefficient air carriers with their associated higher prices chase away world travel and tourism. This in turn, directly and indirectly sacrifices large numbers of jobs.\textsuperscript{262} The greater the competitive environment becomes, the more the inefficiency of the flag carrier becomes glaringly visible and the greater the drain on the national economy.\textsuperscript{263} As a result, the Council may eventually achieve the qualified majority necessary to adopt subsidy restrictions and privatization incentives.\textsuperscript{264} The abolishment of nationally subsidized air carriers may eventually result in the replacement of the old bilateral agreement structure of the EC air transport sector by a common multi-lateral system,\textsuperscript{265} and this would effectively open the skies within the EC.

\textsuperscript{262} See generally Flights of Fancy European Airlines, \textit{The Economist}, Feb. 5, 1994, at 69.
\textsuperscript{263} See \textit{Community Competition (II)} supra note 6, at 286.
\textsuperscript{264} See Flights of Fancy European Airlines, supra note 262 (recent Commission proposal to allow a one-time, last-time subsidy to national flag carriers); \textit{European Airlines; Winged}, \textit{The Economist}, Oct. 2, 1993, at 73 (suggesting that subsidies must end and that regulations must not be re-introduced, even in tough economic times).
\textsuperscript{265} See generally Seatbelt supra note 3, at 446-47.
V. CONCLUSION

While the EC has managed to achieve significant progress towards liberalization of the air transport sector, the Third Package leaves many serious obstacles in the path of the development of competition, especially for existing smaller air carriers and new entrants. These problems need to be addressed if a freely operating Single European Market is to be achieved in the air transport sector.

The EC will likely find that maintaining a pseudo free market approach will result in the creation of tension both between Member States and air carriers which may eventually lead to either the erosion and possible disintegration of the current market regime, or the re-regulation of the industry. In addition, the current regime will continue to limit the benefits that a strong free market could provide. As the weakest links in the chain, the national flag carriers, will continue to distort the true ability of private carriers, especially small and new ones, to compete. If the ability of new players to jump into the game and compete is any indicator of a free market, such distortion cannot be tolerated.

U.S. style deregulation is not necessary to resolve these remaining problems, and the fear of the negative effects of this approach should not smother efforts to address these remaining issues. If the gradual implementation approach is maintained, and if the EC fully applies the competition rules to the dominant mega-carriers, the restructuring effects of further liberalization efforts will not be as severe as those resulting from the U.S. deregulation effort. Although some existing carriers may go by the wayside, that in itself is not necessarily a bad result in a free marketplace. Those Member States which give up their flag carriers may find that the net economic effect is a positive one.

Future unified liberalization efforts are necessary to address the remaining issues concerning free competition in the EC air transport sector. Only in this way can there exist a liberalized market from which consumers fully benefit, and from which the EC Commission can be free of the constant balancing act between the flag carrier protectionism and

266. See generally Crans, supra note 8; Flying the Flag, supra note 10 (discussing post Third Package problems such as slot access, flag carrier subsidies, and high operating costs); Delayed, Again supra note 8; Safeguards supra note 8.


268. See Safeguards supra note 8; Schmid supra note 9, at 204, See Crans, supra note 8, at 223.

269. See Banowsky, supra note 51, at 203.

270. See generally Flying the Flag, supra note 10; Delayed, Again supra note 8.
the development of free competition necessary for smaller existing carriers and new entrants. Given the number of issues left to be resolved by 1997, perhaps the adoption of a Fourth Package of liberalization is appropriate.271

271. See supra note 243 (EC officials said there was an understanding that the industry will be fully liberalized by the end of the transition period in April 1997).
Book Notes


L. Michael Brooks*

Administrative law is among the most important legal fields for the transportation practitioner. By necessity, the representation of clients who participate in a regulated industry involves extensive interaction with administrative agencies. Some of these interactions may later involve the utilization of the judicial process; but for the bulk of administrative matters, the agency will be the final forum for asserting one’s client’s position. This fact makes administrative practice a uniquely challenging form of advocacy in the legal profession. It also makes administrative law a difficult subject to teach effectively in a law school setting.

In his new course book, Professor John H. Reese, of the University of Denver College of Law, attempts to alleviate the difficulties with teaching administrative law in a traditional law school curriculum. Using modern “adult learning theory” techniques, Professor Reese has developed a course book that appears capable of educating students about the unique nature of administrative law.

The text is properly called a “course book” rather than a casebook. While it contains substantial excerpts from over seventy-five major cases, a significant portion of the book is devoted to textual material. These materials suggest how students should analyze particular cases or statutory provisions. The text uses a variety of models designed to prepare

* Mr. Brooks is an Order of St. Ives graduate of the University of Denver College of Law (May, 1995). He received his undergraduate degree, Magna Cum Laude, from Regis University in 1992; B.A., History and Political Science. Mr. Brooks was an article editor on the Transportation Law Journal during the 1994-95 term. He will take the Colorado Bar Examination in July of 1995, after which he will begin a year-long judicial clerkship at the Colorado Court of Appeals.

Mr. Brooks worked as a research assistant to Professor Reese in the later stages of the course book’s development. He was one of several students assigned to survey state APAs for inclusion in the text. Through this experience Mr. Brooks was able to thoroughly familiarize himself with the pedagogical approach taken by Professor Reese in this text.

1. See Martin Steinmetz, et. al., The Transportation Law Education Study, 22 Transp. L.J. 133, 149-50 (1994) (noting that 42% of the transportation practitioners surveyed ranked administrative law as first or second most important substantive legal fields in their practice).
students to analyze administrative problems independently. This technique is useful in stimulating classroom learning. Simultaneously, it helps prepare students for the kind of analysis they must perform in practice when confronted with an administrative law issue.

The text is designed to track the federal Administrative Procedure Act [hereinafter “APA”] in substantially the same order as sections of the Act are codified in the U.S. Code. At the beginning of each section of the text, Professor Reese quotes relevant sections of the APA. These statutory excerpts are followed by cases or text designed to help the student understand the meaning of the sections, while flushing out statutory ambiguities. At the end of each section, Professor Reese cites the administrative procedure statutes of the ten most populous states in a brief survey format. While space constraints would preclude detailed analysis of state law provisions, Professor Reese’s general discussion of the differences between state APAs and the federal APA helps remind students that the models for analysis provided throughout the book apply to state administrative problems. These references to state APA materials provide a unique opportunity for instructors to compare and contrast the federal APA with other possible approaches to administrative law problems.

Professor Reese divided the book into fourteen chapters of varying length. The first chapter provides an introduction to the field of administrative law. The primary goal of this chapter seems to be showing that the approaches students have learned for examining other legal subjects may not be well suited to the learning of administrative law. The chapter identifies a range of primary sources of law in the field to show how limited a role the judicial system plays in administrative law. Professor Reese seeks to introduce students to agencies’ non-judicial authority by reference to a variety of Supreme Court cases involving separation of powers. Throughout this chapter, and indeed throughout the text, Professor Reese uses simple diagrams and other visual symbols to illustrate key points. In Chapter One, Professor Reese employs these primarily to show the separation and blending of various powers within an administrative agency.

Chapter Two provides a more detailed introduction to the APA. It also introduces and briefly describes the various public information and open meeting statutes that affect the administrative process. The Freedom of Information Act [hereinafter “FOIA”], controlling the release of agency documents to the public, is the most heavily litigated component of the APA. Because of its complexity and the broad range of issues litigated, it is among the more difficult administrative law topics to teach. Professor Reese does not attempt to provide a comprehensive treatment of FOIA. Rather, he outlines the essential ideas and refers students to
other sources for more in-depth coverage of FOIA. In his teachers’ manual, Professor Reese suggests that instructors supplement this section of the book with other materials as they see fit.

The third chapter is entitled “Agency Administration of its Legislative Program.” This chapter surveys the various alternatives an agency has in pursuing its mission, given that many administrative agencies have broad discretion in the means chosen to implement their programs. These include rulemaking and policy making through adjudication. The chapter examines the internal and external factors influencing agency choices of means. It includes a lengthy analysis of the circumstances in which a court may compel an agency to choose a particular mode for asserting its authority. Professor Reese ends this chapter by examining the constitutional ramifications of the agency’s choice of modes. Specifically, Professor Reese contrasts legislative-type acts with adjudicative acts in light of the requirements imposed by the Due Process Clauses of the Fifth and Fourteenth Amendments.

Chapters Four and Five examine the procedural requirements for rulemaking and adjudication, respectively, on the federal level. The analysis here emphasizes the statutory language of the APA, using cases to further flush out the meaning of particular sections of the APA. Chapter Four uses a full page flow chart to show the linkages between the various APA provisions dealing with rulemaking. Chapter Five contains a similar flow chart for agency adjudications. In both chapters, the difference between formal and informal proceedings is emphasized. Professor Reese takes great pains to explain how it is determined that formal procedures should be used to make a rule or adjudicate an agency dispute. In raising the issue formal procedures, Professor Reese sets the stage for the discussion of the rights of persons before agencies and the specific procedural requirements for formal proceedings. These topics make up a large part of the remaining chapters.

Chapters Six and Seven deal with procedural rights in administrative proceedings. Chapter Six focuses on the procedural rights bestowed by the APA and FOIA. Chapter Seven provides an extensive analysis of the due process and equal protection limitations on agency actions. Professor Reese’s analysis of due process case law is as comprehensive as that provided in any major constitutional law casebook in print. The case excerpts here are numerous and lengthy. The author uses textual notes between cases to explain how the cases fit together and how they can be used effectively to challenge administrative action. The examination of due process is largely confined to the analysis of two basic questions: whether due process protections apply in a particular situation, and if so, what process is due. All of the cases in this chapter are organized around these two issues.
Chapters Eight and Nine focus on the formal procedures used by agencies in some circumstances. These procedures were first introduced in the fourth and fifth chapters. Formal hearings under the APA are the subject of Chapter Eight. Chapter Nine serves to further analyze the decision process in formal proceedings. It deals with a variety of related matters that are not components of agency hearings but are nonetheless parts of formal agency decision making.

Chapter Ten is a kind of APA catchall. It provides a brief textual analysis of a variety of APA sections not already covered. Licensing, negotiated rulemaking, alternative dispute resolution, and regulatory flexibility are among the key topics here.

Chapters Eleven through Fourteen contain materials on judicial review of agency actions. Of these chapters, Twelve and Fourteen stand out. Chapter Twelve provides an extensive and scholarly analysis of the difficult subject of standing to seek judicial review of agency actions. Covering the same territory as many constitutional law or federal jurisdiction casebooks, this chapter includes a series of conceptual models which serve to explain and, to the extent possible, reconcile a confusing body of Supreme Court standing cases. The models provide a structure that allows students to identify possible standing problems in a given case and suggest possible methods for overcoming these difficulties. The models suggested by Professor Reese consist of the following: "pure" standing questions under Article III of the Constitution, standing arising under Article III and some form of agency organic legislation, standing arising by virtue of the interaction of a "relevant" statute and § 706 of the APA, prudential limitations on standing (i.e., generalized grievances, taxpayer standing, "zone of interest" analysis, third party standings etc.), and state created standing.

Chapter Fourteen discusses the scope of judicial review. At 129 pages, it is the longest chapter in the book. The extensive analysis provided in the chapter is well organized and thorough. However, the length of the judicial review chapter seems to betray the main emphasis of the course book, that administrative law teaching should seek to de-emphasize the role of the courts. Nevertheless, much of Professor Reese's most insightful analysis may be found in this chapter. Particularly his treatment of *Chevron, U.S.A. v. Natural Resources Defense Council, Inc.* which expanded the scope of judicial review of legal questions, is unique among administrative law casebooks. This same detailed analysis carries over into a later section dealing with review of agency factual findings.

Throughout the book, Professor Reese keeps well in mind that the intended audience is the law student and not other legal scholars. Thus,

---

he generally resists the temptation to use the book as a platform for raising academic arguments against other legal scholars. His references to secondary source materials are generally limited to cites to the Attorney General's manual on the APA and various comments by the Administrative Conference of the United States. This reserves more space for primary source material and explanations of the basic models for analysis of administrative materials. Professor Reese's *Administrative Law: Principles and Practice* should fill a void in current administrative law teaching and may ultimately assist the bar in preparing the next generation of attorneys to deal competently with administrative law problems in practice.
Collision Course: The Truth About Airline Safety, by Ralph Nader and Wesley J. Smith, TAB Books, 1994, $21.95

Charles E. Harrison*

Collision Course is not the only reading material one would want on a twelve hour non-stop to Paris. Nader and Smith’s account of the safety of air travel in the United States is a condemnatory assemblage of industry and governmental failures at safeguarding the flying public. The book is replete with tales of an inept bureaucracy beholden to the industry it oversees, and an avaricious corporate structure which places company profits ahead of safety concerns. Tragic anecdotes illustrating airline accidents permeate the book, and when digested leave the reader frightened and angry at the possibility these accidents could have been avoided.

While travel by air is admittedly safer than driving the nation’s highways, if the conclusions of Collision Course are to be believed, passenger aviation safety could be vastly improved. According to the book, aircraft impact survivability, midair collision avoidance, flight attendant training, airport security, pilot fatigue prevention, air traffic control, and more could be improved to save lives. It is through a combination of bureaucratic realities, as well as industry image and profitability concerns, that these dangerous issues are left unaddressed. Fortunately, Nader and Smith propose solutions to the problems they define. Unfortunately, the explanation of these problems occasionally leaves one with the impression that correcting them will be a difficult task.

The book is divided into seven sections: an introductory overview of air transportation safety issues, five chapters that detail specific areas of criticism, and a conclusionary chapter including recommendations regarding the industry and personal safety tips for the air traveler. Section one begins with a brief history of the industry and the organizations responsible for monitoring its safety record. Differing types of statistical data maintained on domestic airline safety are also addressed.

In section two, Nader and Smith begin their assault on the FAA. The Agency is condemned for a variety of problems, some of which the authors unhappily admit are endemic to many agencies in Washington,

* J.D. Univ. of Denver 1995, B.A. The American Univ., 1990. Mr. Harrison is a former Notes and Comments Editor of the Journal.

169
D.C. These problems include bureaucratic inefficiencies, the length of time necessary for the agency to implement safety regulations, and the familiar role with the industry it monitors.

Two criticisms of the Administration, though by no means the only ones, are particularly emphasized. First, the Administration is lambasted as “a reactive agency that usually refuses to mandate safety improvements until accidents take lives.”¹ The authors entitle this moribund attitude The Tombstone Imperative, and provide examples where they insist the FAA did not enact regulations until lives were lost.

Aircraft wing deicing is cited as a prime example of such mortally reactive thinking. Nader and Smith describe how from 1950 to 1992, deicing was left to the discretion of the pilot, regardless of weather conditions. Deicing regulations remained unchanged, despite numerous air accidents described as preventable if the aircraft had been mandatorily deiced.² According to the authors, it was only after the death of 37 passengers on a flight from Newark that the FAA instituted mandatory deicing procedures for large jets.³

Second, the Administration is disparaged for its relationship with the industry it oversees. Nader and Smith find the root of this problem in what they term the conflicting mandate of the FAA. This mandate charges the FAA with the economic promotion of the industry and the advancement of air travel safety. These two objectives, the authors assert, are often at odds and incompatible.

For example, any FAA safety regulation, under an Executive Order signed by Ronald Reagan, must undergo a cost/benefit analysis whereby the regulation may not be enacted if the financial cost to society of implementing the rule will be greater than the value of any lives saved by the rule. The FAA assesses a single human life the value of $1.5 million.⁴ In dollars, therefore, the cost of implementing a regulation may be assigned a greater value than that given to potential lost lives. In such a situation, the regulation may not be enacted. Nader and Smith assert the FAA does little to attempt to reconcile the conflict, and frequently sides with an industry that usually concludes safety regulations are too costly and would endanger corporate earnings.

Section three focuses on shortcomings in the air traffic control (ATC) system. The book describes failings the authors see as a direct consequence of the failed air traffic controller strike of 1981. Since that time ATC has been managed by fewer, and less well trained, controllers.

² Id. at 62-68.
³ Id. at 68.
⁴ Id. at 36.
Nader and Smith further describe problems with outdated, unreliable technology, and faulty software. The only cheerful note in the section is the authors' contention that the FAA’s Central Flow Control center, created in response to the emergency situation following the 1981 strike, has made domestic flying significantly safer.

Safety issues regarding equipment used in commercial aviation is section four's concern. In the first instance, the authors argue that the safety of the commercial fleet is decreasing due to it's age. Older aircraft require more frequent and expensive maintenance than newer planes. Nader and Smith charge this maintenance is prone to be neglected as a cost cutting measure when the financial viability of the airline is in question. Also, older aircraft are often 'grandfathered' from complying with certain FAA safety regulations, such as those requiring fireproof cabin materials and more impact resistant passenger seats. The authors argue these greying aircraft are inherently more dangerous than younger planes and that this condition is likely to continue.

The authors also take issue with the FAA and industry's reluctance to require child safety seats for infants, protective breathing devices for passengers (known as smoke hoods), easier access to emergency exits, bomb-resistant cargo containers, and flotation devices for every domestic flight. Their patent advocacy for these safety refinements and the chilling situations they describe as a demand for them are compelling. Smoke hoods, for example, are cited as an inexpensive device which could give passengers attempting to exit from a burning plane invaluable extra seconds to escape. These seconds would be inestimable as most deaths in a plane accident are not due to sudden impact, but are the result of asphyxiation.

Section five details security and safety issues at airports. Criticisms range from inadequate weapons screenings for airport and airline employees to the lack of bomb detection equipment for checked luggage. The section concludes with the authors' contention there is much room for improvement on disaster preparation, runway collision warning systems, and runway length.

The book's final substantive section is devoted to the human elements of airline safety and natural weather occurrences, such as wing ice and wind shear. The authors recommend increased training for most airline personnel, including the increased use of simulators for commuter airline pilots. They also would have the airlines foster an atmosphere to better prepare passengers for an emergency. Wisely, the authors acknowledge airlines would be loathe to further remind customers there is even the remotest possibility of an accident while on board.

In concluding their denunciation, Nader and Smith make a series of recommendations for both industry and the FAA. Though the implemen-
tation of some of their suggestions would prove impractical or forbiddingly expensive, several are laudatory and deserve consideration. First, they recommend a return to a regulated industry. The pair find much of the airlines financial woes stemming from deregulation, a condition they feel has led to a preoccupation with profits, at the expense of safety. The current straits of the aviation industry may be responsible for some reluctance towards increased expenditures on safety, however; it would probably take more than safety concerns to mark a return to the days of the Civil Aeronautics Board.

Second, eliminate the dual mandate of the FAA. Nader and Smith hold that the agency should solely be concerned with air safety and recommend that another governmental entity be responsible for promoting the industry. Third, repeal the cost/benefit rule. The authors argue for a standard which incorporates what a reasonable passenger would feel was a rational cost for the safety of a regulation, rather than the current cost/benefit analysis.

Their fourth recommendation would require commuter airlines to meet the same safety standards as major air carriers. Implementing the safety standards of larger aircraft on commuter craft would be extremely difficult and even the authors admit the price of some equipment is far more than what most commuter airlines could afford. Further, they recommend an end to what they charge is a deceptive marketing tactic called code sharing. In code sharing, commuter airlines, often owned by conglomerations or third parties, are permitted to use the name of the major carrier with which they share passengers. Under this rubric, many travelers believe the commuter they are flying is owned, managed, and maintained by a large commercial carrier, when in fact it is not.

Fifth, Nader and Smith advocate the expansion of the protection offered under the federal whistle-blower statute. Currently, federal protection only applies to government employees and not those in the private sector.

Finally, the two recommend air carriers be forced to compete based on their safety records. The concept sounds attractive to the consumer, and in comparison has become one of the automobile industry's favorite selling points. Unfortunately, due to the nature of airline crashes and their relative infrequency, many statistics that would numerically mark a carrier as unsafe would be unreliable as accurate indicators of a dangerous airline. Nader and Smith do not recommend a method for measuring safety and with the abundant variables such a measurement would have to rely on, it is possible no dependable method exists.

The book ends with a safety checklist air travelers should review prior to departure. The list has many pointers, many of them common sense recommendations with which frequent travelers are familiar. Other
suggestions, including purchasing one's own smoke hood, wearing non-flammable clothes when flying, and bringing an infant safety seat rather than carrying a child in your lap are not as obvious. Finally, the two recommend the concerned air traveler join a consumer group dedicated to monitoring airline safety. Interestingly, but not surprisingly, one of the recommended groups was founded by Ralph Nader.

In Collision Course, Nader and Smith courageously raise the banner of consumer safety in the face of the powers of air travel. The book's attitude, alternating between contempt and outrage, frantically seizes one's attention and emotions, perhaps ultimately too strongly. The book's alarmist tone, while successfully imparting the authors' urgency about the situation they perceive, is somewhat distracting from a serious topic which merits even-handed discussion. Nonetheless, diplomatic exchange on safety issues has never been a popular Nader tool and one would be startled to find a conciliatory outlook on anything associated with his name. Collision Course succeeds the authors' goal, the reader's hackles rise and powerful attention is focused on an area whose safety ultimately concerns everyone.

5. Id. at 330.
Articles

Railroad Labor Protective Programs in Mergers:
Generous Public Policy for a Favored Few

Herbert R. Northrup*

Table of Contents

I. Introduction ................................................. 176
II. Development of Railroad Protective Programs ........ 176
   A. The Washington Agreement of 1936 .................. 177
   B. Expansion of ICC-Imposed Labor Protection ........ 179
   C. The ICC's Current Conditions for LPPs .............. 179
   D. Lifetime Attrition Benefits ......................... 181
   E. Transfer of LPPs to Airlines and Urban Transit But
      Not to Trucking ...................................... 182
III. Lifetime Attrition Benefits—Costs and Beneficiaries ... 184
   A. The Conrail Experience .............................. 184
   B. The Burlington Northern and Other Carriers’
      Experience ........................................... 185
      1. Burlington Northern LPP Costs .................. 186
      2. The Age Groups Receiving Benefits ............... 188

* Professor Emeritus of Management, The Wharton School, University of Pennsylvania; formerly Professor of Industry; Director, Industrial Research Unit; Chairman, Labor Relations Counsel; and Chairman, Department of Industry. A.B., 1939, Duke University; A.M., 1941, and Ph.D. (Economics), 1942, Harvard University.
I. INTRODUCTION

By legislative or administrative regulation, railroad employees for nearly sixty years have enjoyed income and job protection in mergers, consolidations, and "abandonments" (facility closings) which are far more generous than those available to employees in industry generally. Prior to deregulation, this policy was extended to airlines by administrative action, but thereafter it has not been continued. In urban transit, the railroad system was adopted when the industry became almost entirely publicly owned, but few mergers have occurred. The rationale for protection in transit was to maintain existing collective bargaining relationship and contracts after the transfer to public ownership. The net effect has been to expand union penetration and control in the industry.1

This article first examines the history and provisions of railroad labor protective programs (LPPs), and their spread to airlines and urban transit. It then analyzes their costs, other economic impacts, the rationale for their existence, and the types of jobs which LPP recipients of benefits have performed. A final section proposes a different approach for handling such layoffs that is both less costly and more likely to return laid-off workers to productive employment.

II. DEVELOPMENT OF RAILROAD PROTECTIVE PROGRAMS

The success of the railroad unions in establishing the concept of LPPs came during the 1930s. From a high of two million during World War I, employment on the railroads had declined to about one-half that number as a result of the competition of trucks and automobiles and the impact of the Great Depression.2 Meanwhile, the industry, which had

---


2. Except for the World War II period, employment in the railroad industry has been on a
been faced with overcapacity for many years, was in dire need of consolidation and merger, a fact that had been "addressed as early as ... in the Transportation Act of 1920." With the severe downturn during the Great Depression, railroad unions feared that mergers and consolidations would be implemented that would result in substantial unemployment of their members. They, therefore, sought political protection against such action, and were very successful in this endeavor.

The Emergency Railroad Transportation Act of 1933 was passed to encourage, promote, or require action on the part of railroads to avoid unnecessary duplication of service and facilities and to promote financial reorganization ... section 7(b) was included in the act of 1933. This was the first legislation in this country (generally following an example of the British in 1921) to protect employees. The striking feature of ... [§ 7(b)] was to "freeze" into their jobs all railroad employees actively employed in May 1933, who might be affected by reason of action taken pursuant to authority contained in the Emergency Railroad Transportation Act of 1933 ... for a variety of reasons, not the least of which was this "job freeze," no significant consolidations took place under this legislation.

A. The Washington Agreement of 1936

The 1933 Act expired by its terms in 1936. At the behest of the railroad unions, legislation was introduced and strongly supported in Congress to continue protection almost as restrictive as that provided by § 7(b). Anxious to avoid such limitations, and prodded by President Franklin D. Roosevelt, the carriers entered into negotiations with the unions. After protracted bargaining, the so-called "Washington Agreement" resulted on May 21, 1936, between the then twenty-one national railroad unions and carriers representing eighty-five percent of the country's railroads. The agreement covered railway "coordination," which was defined as "joint action by two or more carriers whereby they unify, consolidate, merge or pool" their facilities or operations in whole or in

steady decline since the 1920 peak. It rose to 1.4 million during World War II, and then fell over the years to about 235,000 today. For data, see, TRANSPORTATION IN AMERICA (ENO Transportation Foundation, Inc., 12th ed. 1994), at 24.

3. Daniel J. Kozak, Labor Protection in the Railroad Industry, in Northrup & Miscimarra, supra note 1, at 501, citing The Transportation Act of 1920, Pub. L. No. 66-152, 41 Stat. 456 (1920). Dr. Kozak's study, based in part on his doctoral dissertation (University of Maryland, 1981), and on information supplied by several railroads on their experience in major mergers, is the most thorough and recent study of railroad LPPs now extant.


part.\textsuperscript{6}  

The Washington Agreement "set the tone for railroad labor protective arrangements for the next fifty years."\textsuperscript{7} Its principal provisions provided that employees deprived of employment as a result of coordination received either sixty percent of their prior earnings for as long as they had worked up to five years, or a lump sum severance. Those accepting the former also continued to receive such fringe benefits as free transportation, pension credits, and medical benefits. In addition, employees who were downgraded as a result of coordination received an allowance for up to five years to make up for the difference in earnings; and employees who were required to move to continue to work received transportation, moving expenses, and compensation for losses on the sale of homes. The five-year extent of benefits, unique at the time of adoption and rarely matched elsewhere since, was based upon a current estimate of the time when employees could expect to return to the railroad active work force.\textsuperscript{8}

\textbf{B. Expansion of ICC-Imposed Labor Protection}

Even before the Washington Agreement was negotiated, the Interstate Commerce Commission (ICC) was considering making some type of employee protection a condition of approving mergers and consolidations. In 1934 the Commission actually required some modest employee protection despite the absence of explicit statutory authority to do so.\textsuperscript{9} In 1938, the ICC declared that it had the authority to impose labor protection provisions pursuant to the public interest criterion. In the test case decided the next year, the Supreme Court ruled that the ICC's assumption of authority was appropriate for the maintenance of an adequate and efficient transportation system.\textsuperscript{10}

Despite the Washington Agreement and the ICC support, the railroad unions were concerned that LPPs would not be continued. The Washington Agreement was set to expire in 1941; the ICC policies were discretionary, not mandatory. For these reasons, the unions sought legislation. The Transportation Act of 1940\textsuperscript{11} added section 5(2)(f) to the In---

\textsuperscript{6} Id. at 145. \textit{See also}, Earl Latham, \textit{The Politics of Railroad Coordination} 1933-1936 (1959).

\textsuperscript{7} Kozak, \textit{supra} note 3, at 502.

\textsuperscript{8} Rehmus, \textit{supra} note 5, at 145.

\textsuperscript{9} St. Paul Bridge & Terminal Ry. Co. Control, 199 I.C.C. 588 (1934).

\textsuperscript{10} United States v. Lowden, 308 U.S. 225 (1939). According to Ris, the Court was particularly "concerned with the fact that government policy encouraging railroad consolidation was at least partially responsible for the damage suffered by the displaced and dismissed employees." \textit{See}, William K. Ris, Jr., \textit{Government Protection of Transportation Employees: Sound Policy or Costly Precedent?} 44 J. Air L. & COM. 509, 517-18 (1979).

interstate Commerce Act, making labor protection provisions mandatory whenever the ICC approved a merger or consolidation. Under § 5(2)(f) of the 1940 legislation:

The ICC . . . adopted specific protection criteria centering around displacement allowances for employees forced to hold lower paying positions, dismissal allowances for employees deprived of employment, preservation of fringe benefits, arbitration provisions [to settle disputes arising over interpretation of ICC directives], and moving and relocation benefits.12

The ICC also developed standard sets of conditions to meet particular transactions: "the Oklahoma Conditions in 1944 for joint purchase arrangements; the Burlington Conditions in 1944 for abandonments; and the New Orleans Conditions which clarified and enhanced the Oklahoma Conditions."13 These conditions included all the Washington Agreement-type benefits, with durations of four and five years.

C. THE ICC'S CURRENT CONDITIONS FOR LPPS

In 1976, Congress enacted the Railroad Revitalization and Regulatory Reform Act (4R Act),14 which further liberalized and made mandatory railroad LPPs. As a result, the Commission increased wage guarantees from 60 percent of income for five years, which was the Washington Job Protection Agreement model, to full income for six years. This liberalization followed in the Rail Passenger Service Act of 1970 which created the Amtrak system.15 "The Amtrak arrangements, in turn, were based on the labor protective arrangements initially developed through the Urban Mass Transportation Act of 1964."16

After the passage of the 4R Act, the ICC developed the standard six-year packages which are summarized in the Appendix: New York Dock17 conditions for mergers, consolidations, and acquisitions of control; Oregon Short Line18 conditions for abandonments; Mendocino Coast19 condi-

---

13. Id.
19. Mendocino Coast Ry. - Lease and Operate - California Western R.R., 354 I.C.C. 732
tions in lease transactions; and Norfolk and Western conditions for trackage rights transactions. To be eligible for such statutory benefits, employees must show that their worsened position has been caused by a "transaction" which is defined as a merger. Ordinary layoffs or downgradings, such as those caused by economic conditions, automation, or other developments are not covered. A transaction, however, may occur in any year after the merger is effectuated, and then the six-year period is tolled. For example, if after five years of merged operations, a carrier decides to consolidate two repair shops and this is found to be a covered transaction, anyone laid off is entitled to six years of protection effective the day on which the layoff occurs. Thus, LPP protection costs may continue for many years beyond the sixth anniversary of the merger.

Only for transactions covered by New York Dock and Oregon Short Line conditions did the ICC also require a collective bargaining implementing agreement before any merger-related changes could take place. This gives the unions tremendous bargaining power to extract conditions favorable to them because the potential economic benefits of the merger are being withheld from the carriers until an agreement is reached. Such a requirement is especially effective under the Railway Labor Act with the "interminable delays" inherent in its prescribed bargaining and government intervention requirements. Some relief is provided to carriers under New York Dock and Oregon Short Line because disputes over implementation agreements can be taken to arbitration which the ICC can accept, overturn, or return to the arbitrator for further consideration. Although this procedure can also be time consuming, it works faster on average than do the Railway Labor Act procedures. Nevertheless, the unions have been able to win expanded definitions of what is entailed by a "transaction" by holding up agreement, thus adding to costs.

All the above conditions provide that employees who are dismissed under covered conditions are made "whole" for up to six years, as are those who are downgraded. The former can receive instead lump sums of 90-360 days' pay based upon years of service, with smaller payments to persons with less than one year of service. The costs of such protection are substantial. For example, even though railroad passenger service had been reduced to a minimum by the time that Amtrak was created, and

21. This was derived from the Washington Agreement and the New Orleans conditions.
despite the fact that most passenger railroad employees also held seniority in freight service and, therefore, elected to take jobs in freight, bumping out the most junior employees, $52.5 million (unadjusted for inflation) was paid out in these benefits during 1971-77.24 Moreover, since the costs of these benefits to the newly established National Railroad Passenger Corporation (NRPC), the government entity established to own Amtrak, along with other debts, including obligations to workers employed at the time of Amtrak's takeover of passenger service were "ultimately to be absorbed by the government, the taxpayers were in effect guaranteeing the payment of employee protection [to such employees]."25

D. LIFETIME ATTRITION BENEFITS

In the 1960s and early 1970s, a much more liberal labor protection package became common in major rail mergers, including the merger of the Pennsylvania and New York Central railroads in 1968. Perceiving a risk that the political power of the railroad unions could derail their proposed merger, the Penn Central merger proponents agreed to "lifetime attrition protection"26 of the labor force as a means of gaining union support. This was both preceded and followed by a series of major mergers which provided (in most cases by agreement of the parties) the same extravagant protection that guaranteed lifetime attrition protection even for employees who were in their twenties and thirties.27 Moreover, when the Penn Central went bankrupt, such benefits were incorporated into law28 despite the prophetic warning of then Secretary of Transportation Claude S. Brinegar. He described the bill's LPP as "unprecedented provisions which do not assure the new system of labor costs that will permit it [Conrail] to survive, but which do impose an excessive burden on the taxpayer." Brinegar further warned that there would be an "adverse long-term impact" in maintaining the very conditions that "helped bring on the demise of the six major [eastern railroad] bankrupts."29 Then Sen-

24. Kozak, supra note 3, at 508.
25. Ris, supra note 10, at 521.
26. "Lifetime attrition protection" provides the individual workers covered by LPPs with, among other benefits, wage and benefit coverage throughout work life except in cases of retirement, resignation, or discharge for cause.
27. These mergers were those of the Virginian & the Norfolk & the Western (1959); Norfolk & Western and the Nickel Plate, and lease of the Wabash (1964); Chicago & North Western and Chicago Great Western (1967); the Baltimore & Ohio, the Western Maryland, and the Chesapeake & Ohio (1967); the Great Northern, the Northern Pacific, the Chicago, Burlington & Quincy, and the Spokane, Portland & Seattle into the Burlington Northern (1970); and the Illinois Central and the Gulf, Mobile & Ohio into the Illinois Central Gulf System (1972). See Kozak, supra note 3, at 511.
28. Reference is to the "3R Act" described infra note 40.
29. Quoted by Ris, supra note 10, at 539.
ator Beall summed up the unfairness involved:

While . . . it is essential that displaced workers be provided fair and equitable treatment, the labor protective provisions in the Senate bill are unwise from a public policy standpoint, overly generous in terms of their benefits, unprecedented, and discriminatory to other railroad employees, and to employees in other industries who lose jobs.

Thus, by any standards, the displacement benefits are generous and extraordinary. The generous benefits provided go far beyond protection available to employees of other industries, and beyond what we have heretofore provided other railroad employees.30

As discussed below, the costs of such benefits proved too great even for the United States Treasury, and were drastically modified in the early 1980s with severance pay substituted for salary continuance.

E. TRANSFER OF LPPS TO AIRLINES AND URBAN TRANSIT
   BUT NOT TRUCKING

Railroad-type LPPs spread to the airline and urban transit industries, but not to trucking, the industry employing the largest number of transportation employees. Despite the fact that the airline industry, in contrast to railroads, has been expanding almost since its inception, the now defunct Civil Aeronautics Board (CAB) followed the ICC and by administrative action provided LPPs for airline employees modeled upon the ICC policies. It ceased such requirements following the deregulation of the airline industry in 1978. Airline programs were limited to five-year durations, but because of the high wages in the industry and the scope of CAB protections, LPPs in air transport tended to inhibit mergers.31 After the CAB was abolished and the duty to approve mergers and related matters transferred to the Department of Transportation (DOT), no LPPs have been ordered.32

Additionally, an “Employee Protection Plan” (EPP) included in § 43(e)(2) and (d)(1) of the Airline Deregulation Act of 197833 provided a more modest protection for airline employees in mergers and related transactions, but was never fully implemented or financed by Congress. It was discontinued by its own terms in 1987, although litigation concern-

30. Quoted by Kozak, supra note 3, at 517.
31. Ris, supra note 10, at 526. See also, STANLEY B. ROSENFIELD, LABOR PROTECTIVE PROVISIONS IN AIRLINE Mergers (1981).
ing its coverage continues.\textsuperscript{34}

Section 13(c) of the Urban Mass Transportation Act of 1964 (UMTA)\textsuperscript{35} established railroad-type LPPs for mass transit, a chronically profitless industry, when the UMTA transferred municipal mass transit operations from private to public ownership. There are actually few mergers in urban transit, but the LPP requirements set forth in § 13(c), as administered by the U.S. Department of Labor, “have not so much prevented workers in the industry from being disadvantaged as they have fortified their privileges,”\textsuperscript{36} and thus have contributed to the losses almost universal among publicly-owned urban transit carriers.

In the trucking industry, efforts of the International Brotherhood of Teamsters (Teamsters) to win LPP benefits either for mergers or for deregulation,\textsuperscript{37} which resulted in a drastic reduction in union membership in that industry, have been unsuccessful.\textsuperscript{38} Even where trucking workers are employees of a trucking common carrier owned by a railroad, LPPs have been won only in two highly unusual cases.\textsuperscript{39}

As shown above, generous railroad LPPs were developed when the

\begin{flushright}
\begin{itemize}
\item[34.] For a summary of the EPP, see Herbert R. Northrup, \textit{The Failure of the Teamsters' Union to Win Railroad-Type Labor Protection for Mergers or Deregulation}, 22 \textit{Transp. L.J.} 365, 400 (1995).
\item[35.] \textit{See} note 16. Section 13(c) of the Urban Mass Transportation Act of 1964, Pub. L. No. 88-365, 78 Stat. 302 (1988) reads as follows:

It shall be a condition of any assistance under section 3 of this Act that fair and equitable arrangements are made, as determined by the Secretary of Labor, to protect the interests of employees affected by such assistance. Such protective arrangements shall include, without being limited to, such provisions as may be necessary for (1) the preservation of rights and benefits (including continuation of pension rights and benefits under existing collective agreements or otherwise; (2) the continuation of collective bargaining rights; (3) the protection of individual employees against a worsening of their positions with respect to their employment; (4) assurances of employment to employees of acquired mass transportation systems and priority of reemployment of employees terminated or laid off; and (5) paid training or retraining programs. Such arrangements shall include provisions protecting individual employees against a worsening of their positions with respect to their employment which shall in no event provide benefits less than those established pursuant to section 5(2)(f) of the [Interstate Commerce] Act of February 3, 1887 (24 Stat. 379), as amended. The contract for the granting of any such assistance shall specify the terms and conditions of the protective arrangement.

\item[36.] Rottenberg, \textit{supra} note 1, at 626.
\item[37.] Deregulation in trucking was accomplished as a result of the Motor Carrier Act of 1980, Pub. L. No. 96-296, 94 Stat. 793 (codified as amended in scattered sections of 49 and 5 U.S.C. (1988))).

\item[38.] \textit{See} Northrup, \textit{supra} note 34.

\item[39.] Employees of Penn Truck, then owned by what became Conrail, were included as “railroad employees” in the 3R Act, and in a case known as \textit{Cosby}, the Court of Appeals, Eighth Circuit, ordered that LPP benefits be granted to employees of Frisco Truck Lines, a subsidiary of the San Francisco and St. Louis Railway, after it was merged into the Burlington Northern. Other courts and the ICC have rejected the reasoning of the \textit{Cosby} court. \textit{See}, Cosby v. I.C.C., 741 F.2d 1077 (8th Cir. 1984). \textit{Contra} Missouri Pac. Truck Lines, Inc., v. United States, 3 Cl. Ct. 14 (1983); \textit{aff'd} 736 F.2d 706 (Fed. Cir. 1984); Kansas City S. Indus., Inc., et al. v. I.C.C., 902 F.2d
\end{itemize}
\end{flushright}
industry was heavily regulated, and influenced the development of such LPPs in two other regulated industries. Unlike the airline industry, however, as the railroads have gone through a period of deregulation, LPPs have continued to be instituted almost as a matter of course when covered transactions occur involving Class I railroads.

III. Lifetime Attrition Benefits — Costs and Beneficiaries

Lifetime attrition benefits are still being paid by several of the major railroads as a result of agreements made in 1959-1971. As one would expect, such agreements have proven to be very expensive. Additionally, a disproportionate amount of the funds paid have gone to relatively young employees, a majority of whom are in the clerical group. The experience of two carriers — Conrail and Burlington Northern — illustrate how such generous payments work in practice, and how they affect operations.

A. The Conrail Experience

The 1968 merger of the Pennsylvania and New York Central Railroads into the Penn Central Railroad was based upon the theory that the elimination of duplicate facilities and routes would return these two giants to profitability. The theory proved wrong for a number of reasons, not the least of which was that, prior to the merger, an accord with the unions had been reached on a lifetime attrition agreement. As a result, the merged labor force of what became the Penn Central totaled 102,000 in 1968, in part because it cost the company at least as much to lay off unneeded employees as to keep them employed. Two years later, Penn Central declared bankruptcy. Meanwhile, other northeastern railroads were also either bankrupt or about to cease operations.

To deal with this situation, Congress created the Consolidated Rail Corporation (Conrail) in the 1973 Regional Rail Reorganization (3R) Act. It was designed to take over not only the Penn Central, but also its subsidiaries and other northeastern railroads; to consolidate their essential rail properties; and to create a viable entity that could be sold as such to private investors. To solve the labor problem, Conrail was required to negotiate new agreements, a process that took four years under the Railway Labor Act while the uneconomic and overlapping existing agreements remained in effect, and the bloated labor force remained almost intact.

Meanwhile, unions were anxious to obtain federal subsidies for life-

423 (5th Cir. 1990); and Rives II v. I.C.C., 934 F.2d 1171 (10th Cir. 1991). A detailed analysis of this issue and the cases is found in Northrup, supra note 34, at 373.
time protection, while carriers were reluctant to inaugurate a “take away” struggle with the unions. They, therefore, agreed to continue this extremely generous protection. As a result, a twenty-page labor agreement which incorporated lifetime attrition protection became Title V of the 3R Act.41

From its inception, Title V was an economic disaster. The costs were greatly underestimated at $250 million. By January 1981, $319.1 million had already been paid in benefits.42 A report of the United States General Accounting Office found that, although $250 million had been budgeted on the assumption that the bulk of these dollars would be utilized for severance payments, more than that amount had been spent on lifetime attrition guarantees instead because the affected employees chose the latter benefits rather than severance pay.43

Congress tightened some of the benefits procedures in the Staggers Rail Act of 1980.44 Then, in the 1981 Northeast Rail Service Act (NERSA),45 Congress repealed Title V of the 3R Act, gave Conrail clear rights to lay off unneeded personnel, and set a $25,000 limit on severance pay for operating and $20,000 for nonoperating employees. Free to act, Conrail cut its employee count from 70,273 in 1981 to 35,500 in 1986 when the NERSA program ended.46 When Conrail was sold to the public in 1986, its work force stood at 33,437. It became profitable almost immediately and remained so even during the recession of the early 1990s. By improving operating procedures, installing better and more automated equipment, and disposing of unprofitable lines, Conrail had further reduced its employment to 24,833 by 1994.47

B. THE BURLINGTON NORTHERN AND OTHER CARRIER EXPERIENCES

The merger of the Chicago, Burlington & Quincy, the Great Northern, the Northern Pacific, and the Spokane and Portland and Seattle Railroads to form the Burlington Northern (BN or the Northern Lines merger), was not approved by the ICC in 1966, in part because the Commission did not believe that the then-standard New Orleans LPP conditions would be just and reasonable in light of the impact on employees. Only after the railroads agreed with the unions to provide lifetime attri-

41. For these developments, see Kozak, supra note 3, at 513; and Ris, supra note 10, at 521, 540.
42. Kozak, supra note 3, at 519.
47. Henry J. Holcomb, Conrail Says It will Lay Off 590 Workers, PHILADELPHIA INQUIRER (June 15, 1995), at C1.
tion conditions was the merger approved in 1967. BN’s experience and that of other carriers with such extraordinary payments for non-working employees shows just how costly these conditions are, and what age groups and employee classes are the principal beneficiaries thereof.

1. **Burlington Northern LPP Costs**

In the Northern Lines merger proceeding, the applicants projected that the attrition conditions would cost a total of $10 million. In fact, the actual costs have been many times more. Although some of the costs include *New York Dock*, as well lifetime attrition benefits, the bulk of the following costs involve the latter:

- From 1982 to 1987, BN paid more than $100 million in total labor protection costs (includes attrition and *New York Dock* payments) - Table 1;
- For clerical employees alone, from 1980 to mid-year 1988, BN paid more than $70 million in lifetime attrition payments;
- From 1988 to mid-May 1995, BN paid $42.8 million in total labor protection costs (includes attrition and *New York Dock* payments);
- For clerical employees alone, from 1988 to mid-May 1995, BN paid $22.7 million in lifetime attrition payments.49

The concentration of payments to clerical employees, who are represented by the Transportation Communications Union (TCU), (formerly the Brotherhood of Railway & Airline Clerks), is especially important, as is discussed below. These are railroad employees whose jobs are very similar to those in other industries. They are, therefore, employees whose talents and skills can be quite easily utilized by non-railroad businesses with only minimum training.


49. Data from Burlington Northern Railroad. These data do not include severance payments, which are additional. The data do include displacement (downgrading) costs, as well as dismissal (layoff) costs. Since, however, employees subject to displacement must accept the highest-rated position available under their seniority system in their craft or class or lose their LPP eligibility, displacement costs are not a significant part of the total costs. The *New York Dock* payments are largely the result of the BN’s 1980 merger with the much smaller St. Louis and San Francisco Railway. The 1982-87 data were supplied to this author by the Burlington, and passed on to Kozak for his study. *See Kozak, supra* note 2, at 530. Data for 1988-1995 were developed as evidence in the 1995 BN - Sante Fe merger proceedings before the ICC, and used in part in this author’s presentation. *See*, Rebuttal Verified Statement of Herbert R. Northrup, Burlington Northern, Inc. and Burlington Northern Railroad Company - Control and Merger - Sante Fe Pacific Corporation and The Atchison, Topeka and Sante Fe Railway Company, ICC, Finance Docket Nos. 32549, 32549 (Sub-No. 1), *et al.*, (June 9, 1995).
FIGURE 1
BURLINGTON NORTHERN RAILROAD
LABOR PROTECTION PROGRAM PAYOUT (1988-1995)

Total Payouts = $42,807,396
TCU Employees = $22,731,569
Non-TCU Employees = $20,075,727

Note: data for 1995 cover 5 months.
Source: Burlington Northern Railroad
TABLE 1
LABOR PROTECTIVE COSTS ($ MILLIONS)
BURLINGTON NORTHERN RAILROAD, 1982-1987

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1982</td>
<td>$12.3</td>
</tr>
<tr>
<td>1983</td>
<td>21.0</td>
</tr>
<tr>
<td>1984</td>
<td>18.8</td>
</tr>
<tr>
<td>1985</td>
<td>17.9</td>
</tr>
<tr>
<td>1986</td>
<td>16.0</td>
</tr>
<tr>
<td>1987</td>
<td>14.2</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$100.2</td>
</tr>
</tbody>
</table>

Note: Data include totals for lifetime attrition, New York Dock, and other LPPs.
Source: Burlington Northern Railroad Company.

2. The Age Groups Receiving Benefits

The data obtained for the Kozak study found that, sixteen years after the Northern Lines merger, LPP benefits went primarily to particular age groups, both for these lines and for other carriers. He reported that although no two of the LPP benefits in the data presented resulted in the same claimant distribution, they all fell into one of three modal groups: 50-65 years, 26-40 years, or both

It is . . . interesting . . . that such a large percentage of these expenditures are paid to younger workers, junior in seniority, who would appear to be able to find jobs when layoffs occur, and who may be paid these monies even while working in other jobs. Perhaps the rail unions push hard for these protective payments because it is one way of gaining the loyalty of the junior men who might otherwise more deeply resent the precipitous layoffs in the railroad industry . . . .

Figure 2 shows that by 1994, more than twenty-five years after the Northern Lines merger, the largest age group receiving lifetime attrition benefits were 392 non-working employees aged 56-60 years; another 255 were 61 years or older, but 336 were 51-55; and those 50 or younger included one clerical 26-30, 18 clericals 31-35, 55 clericals 36-40, and 125 clericals 41-45 years of age. No other class of employees was found in the 40 and under brackets. Here again, the data show that younger clericals were among the largest beneficiaries of lifetime attrition benefits.

The Wall Street Journal quoted one young recipient of another railroad's similar LPP:

"I worked maybe a month last year, but I still collected my pay check every

50. Kozak, supra note 3, at 531. This data represents a one month snapshot.
51. Data developed by Burlington Northern for the Santa Fe merger case.
Figure 2
Burlington Northern Railroad
Age Distribution of Claimants in Labor Protection Programs 1994

Source: Burlington Northern Railroad
week," says David Halterman, a former clerk for the Illinois Central Gulf Railroad. Mr. Halterman left a protected job for one that he said offered opportunity for advancement. Plus, he said that at 33, he is "a little young to be retired." 52

C. MERGER COSTS — VARIOUS RAILROADS, 1970s AND 1980s 53

Kozak provided LPP cost data for various railroads, including the BN, and also reviewed other available data covering the 1970s and 1980s. He reported "tremendously high protection costs":

Wilner . . . stated that protection benefits paid in 1985 by seven railroads, including severance payments to buy out protective obligations, amounted to about $338 million. 54 Protection costs . . . from 1971 to 1977 . . . under . . . [Amtrak] totaled $52.5 million. . . . The $250 million fund set aside for labor protection under the . . . [3R Act] of 1973 was supposed to last twenty-five years. It lasted forty-six months. Labor protection associated with . . . [Con- rail] cost the American taxpayers in excess of $630 million . . . between 1976 and 1986. Labor protection associated with the Milwaukee Road and Rock Island Railroad restructuring efforts cost the federal government [i.e., taxpayers] $92.6 million. . . . 55

For individual railroads, data supplied by an eastern railroad showed $70.6 million paid for LPP benefits, 1983-1987; and for a western railroad, $173.6 million, 1983-1986. 56

IV. ECONOMIC EFFECTS OF LIFETIME ATTRITION PROTECTION

No carrier in any other transportation industry, including those directly competitive to the railroads, is required to pay lifetime protection charges. Indeed, no railroad merger has been subjected to lifetime attrition conditions for over twenty years. 57 As a result, carriers, like BN, which are paying lifetime benefits compete with those, like Union Pacific, which are not. Such costs clearly must handicap competition by the paying carriers with railroads and motor carriers which are not so burdened. Attrition conditions are likewise a continuous drag on profits and

53. The data, as of 1986, provided by Burlington Northern, for the Northrup-Miscimarra book. Other carriers also supplied information. See supra note 3, at 527.
55. Kozak, supra note 3, at 528.
56. Id., at 529-30.
productivity. The cost to profits is, of course, clear. The funds spent to
pay employees for not working are direct deductions from profits. In eco-
nomic terms, they are rents paid to non-working employees by stockhold-
ers, a transfer from owners to the non-working employees, which may
reduce the propensity to invest in railroads and may likely depress stock
prices.

In terms of productivity, the existence of non-working but paid em-
ployees clouds the effective utilization of the work force in a number of
ways. It drains funds away from investment, first by reducing the moneys
available to invest in more productive and efficient equipment, opera-
tions, and technology. Second, it complicates decisions providing for
proper labor force utilization. What may be the most productive labor
utilization, or most productive investment in equipment, operations, and
technology to enhance labor productivity, may be thwarted because non-
working employees’ salaries must be considered in the cost-benefit cal-
culation. The addition of the non-working employees’ wages to a cost-ben-
efit calculation can result in maintaining a less efficient operation in order
to avoid increasing those receiving pay but performing no service. As a
result, employees are likely to be maintained on the rolls when they are
either performing no required service, or doing a job in a less efficient
and less productive manner than could be achieved if lifetime attrition
benefit costs did not skew the efficiency curve.

The whole purpose of a railroad merger is to help maintain and en-
hance effective and efficient transportation. Paying people for not work-
ning as long as they profess to be available for work does not contribute to
this goal; in fact, it does just the opposite. Making progress toward a
more efficient transportation network is a means for the railroads to con-
tribute public benefits. This requires doing more with less resources, in-
cluding labor as well as capital resources. By their very nature, lifetime
attrition benefits thwart this objective. Such benefit costs could result, for
example, in trucks obtaining business that might otherwise be won by
railroads if they were not burdened by these costs. The resulting higher
costs, as well as those for highway congestion, maintenance, and repair,
plus possible environmental degradation, are then borne by the public,
including the vast numbers of workers who have no such benefits.

As a result of lifetime attrition conditions, labor protection costs can
thus add substantially to the total costs of railroads and offset other eco-
nomic advantages of a merger. These advantages include eliminating du-
plicate facilities, centralizing functions, reducing overhead expenses and
increasing capital availability for investment in more efficient equipment.

There are other uneconomic and antisocial aspects of lifetime attri-
tion protection. The existence of the lifetime attrition requirements con-
tributes to a loss of skills on the part of the recipients. This is particularly
true for those needing computer and data processing skills, which include most of the clerical class. If one does not use those skills, they soon fade. Moreover, such skills are constantly being upgraded by technical advances, making it ever more difficult for employees not working to maintain competitive skills. The employees receiving these benefits are likely to suffer disemployment consequences — the longer they are receiving benefits, the less productive they are likely to become. Certainly, this is not good for the employer, the employee, or society.

For these and other public policy reasons, the ICC has rarely imposed lifetime attrition protection because:

the imposition of such conditions would not be consistent with the public interest. Conditions calculated to preserve unneeded jobs would unduly restrict the applicants in the establishment of most economical operations, would be wasteful, and would be in conflict with the objectives of national transportation policy under which we are required to promote economical and efficient service and to foster sound economical conditions in transportation and among the several carriers.\textsuperscript{58}

V. The Economics And Rationale For New York Dock Benefits

The ICC interprets the present provisions of the Interstate Commerce Act to require the imposition of New York Dock conditions as the standard labor protection for affected railroad employees when it approves a merger involving a Class I carrier. This has been done without any careful economic analysis to determine whether present conditions, or those inherent in the affected merger, can justify paying the covered employees their full salaries and benefits for six years for not working. It has also been done without any attempt to gain concessions from the railroad unions to eliminate remaining anti-productivity work rules. An examination of the economic effects of such payments, and the rationale for making them, does in fact raise serious questions about the propriety of treating railroad workers so generously under these circumstances.

A. Economic Impact of New York Dock Conditions

New York Dock conditions can have serious economic and social disadvantages and create disincentives similar to those that have been described for lifetime attrition benefits. New York Dock provides labor protection for up to six years instead of lifetime attrition benefits. Therefore, the costs to the carrier are much less over time. New York Dock costs are, nevertheless, a significant amount considering that it is pay for

\textsuperscript{58} Missouri Pac. R.R. Co. - Merger - The Texas & Pac. Ry. Co. and Chicago & E. Ill. R.R. Co., 348 I.C.C. 414 (1976). This opinion cites a number of previous cases to the same effect.
employees not working and, therefore, deterring, not contributing, to a carrier’s return on investment. For example, in three years, 1990-92, BN paid out $93,881.09 in New York Dock benefits to thirteen employees of the former relatively small St. Louis and San Francisco Railway, eight of whom were in the 41-60 age bracket. 59

New York Dock benefits potentially inhibit economical and efficient service for the critical years following a merger, when the economies of merger should be installed, by reducing profits, curtailing investment, offsetting the most efficient and productive utilization of the work force, and transferring funds from stockholders to non-working employees. This is exacerbated by the requirement that no merger-related change can be effectuated until implementing agreements with the unions are reached because it is likely to induce the carrier to give the most favorable rendering of New York Dock conditions in order to obtain an agreement. Just as the ICC has noted for lifetime attrition benefits, many times New York Dock can be, “not consistent with the public interest . . . preserve unneeded jobs . . . unduly restrict . . . the most economical operations . . . [and] conflict with the objectives of national transportation policy . . . to promote economical and efficient service. . . .” 60

An excellent example of how New York Dock benefits may inhibit sound railroad economic policies is found in Amtrak’s current situation. A careful analysis of its economic situation by the General Accounting Office (GAO) has found that Amtrak has never been able to make a profit on any of its passenger lines, and that it is steadily falling farther behind in this regard. Moreover, Congress, which has been heavily subsidizing passenger rail service, is demanding that these subsidies be reduced, if not eliminated. 61

One of the GAO’s recommendations is to amend § 405 of the Rail Passenger Service Act to modify LPP requirements. 62 Actually, this may be crucial to Amtrak’s future because eliminating its cross-country system could result in $5 billion in LPP payments which Amtrak certainly cannot pay. 63 Therefore, LPP payments could be the taxpayers’ obligation unless Congress amends the National Passenger Rail Service Act somehow to permit a solution similar to that established for Conrail.

LPP benefits, as already noted, are heavily directed to junior employees because senior employees mostly remain on the job. Such bene-

59. Data from the Burlington Northern Railroad.
62. Id. at 79.
fits have a deleterious effect by discouraging covered employees from proceeding with their working life. Such discouragement to seek jobs elsewhere must surely occur. Numerous studies have demonstrated that unemployment benefits which are considerably less generous than New York Dock ones tend to lengthen unemployment duration. Likewise, the higher the benefits paid under workers’ compensation, the longer is return to work likely to be postponed.

Similarly, New York Dock benefits encourage employees to postpone looking for new opportunities until their payments for not working are exhausted. By then, a 35-year-old worker is over 40, a 45-year one over 50, etc. Postponing career decisions is likely not only to lessen the ability of a person to obtain a job; it can also reduce a person’s capabilities and qualifications for work as jobs change, technology advances, and employer needs are altered by competitive, business, and technical developments.

The difficulties that even excellent employees have in returning successfully to work after being absent for long periods may be illustrated by the problems encountered by engineers and scientists who are off from work for a considerable time. Science today moves so rapidly that one year’s absence from work can be very difficult to make up. Of course, scientists and engineers are not involved here. Yet the field of computer and data processing skills, like science, moves forward rapidly and requires skills that must ever be upgraded. Absences of one to six years can, therefore, have a most deleterious impact on job qualifications of the clericals, the largest group who receive LPP benefits.

Consequently, putting people on six-year salary continuances for doing no work is not necessarily in their best interest, as well as being wasteful, inefficient, and uneconomic for the business. Moreover, an examination of the rationale developed for railroad LPPs demonstrates that the historical reasons advanced for their existence frequently do not withstand scrutiny in today’s labor market and economy.

B. THE RATIONALE FOR RAILROAD LABOR PROTECTIVE PROGRAMS

The traditional rationale advanced for awarding LPPs to railroad

---


66. One of the difficulties women have experienced in research and development laboratories is that extended absences for child birth and care can set back their careers for just this reason. See, Herbert R. Northrup, Professional Women in R&D Laboratories, 31 Res.-Tech. Mgmt. 44 (1988).
workers has been that these employees have unique skills that are not utilized in other industries. It is further maintained that when a railroad ceases operations, such as when a merger between competing railroads occurs, no other avenues of employment are available for the utilization of the displaced railway personnel. Moreover, since the railroads have suffered declining employment for over seventy-five years, opportunities for employment with other railroads outside the workers' domiciles are very slim. Even if job opportunities on other railroads existed, the displaced workers would be required to begin any new railroad employment at the lowest job in the craft or class because the rigid seniority system in the industry is carrier and carrier district specific. Thus, it is argued that when railroad workers are laid off permanently, or for long periods, ordinary unemployment compensation arrangements are insufficient for their needs. It is further contended that, since government regulates numerous phases of railroad industry behavior and operations, and has encouraged railroad consolidations, it should also regulate employee relations to ensure that employees are properly treated.

Historically, there are several reasons why the different treatment of railroad workers in nearly all aspects of labor and social legislation has occurred, in addition to this alleged uniqueness of work. First, the railroads by the latter part of the nineteenth century were the most significant means of transporting goods, materials, and people over long distances, and vital to the commerce of the country. Second, regulation of the railroads was found constitutional under the interstate commerce clause of the Constitution at an early date. Therefore railroads, unlike manufacturing industries, have long been subject to congressional regulation. Finally, at the turn of the century, the railroad operating crafts had gained power and influence and were able to affect political decisions. When government takeover of the railroads during World War I encouraged the unionization of the non-operating crafts, union power and influence were greatly enhanced. During the 1930s, railroad employment, even though cut by one-half since 1920, stood at one million, and the unions had members in every congressional district and were a key political force.

These historical foundations for LPPs no longer apply. The deregulated environment is one in which the railroads must compete. Consequently, LPPs that inhibit the carriers' ability to compete, and thereby retard job maintenance and creation, need to be reexamined.

Furthermore, if one examines the jobs of railroad workers, the alleged "uniqueness" appears to be confined largely to engineers and con-

---

67. For numbers relating to the employment decline in the railroad industry, see supra note 2.
ductors. Signalmen have training in electrical and electronic applications, which surely could be used in other industries. All clerks and office personnel could undoubtedly qualify with minimal training for jobs in other industries, and these employees are the main beneficiaries of LPP benefits. Skilled mechanics in the shops should have little difficulty obtaining positions in many metal industries. Most maintenance-of-way workers are laborers or equipment operators. The latter could easily be trained in road construction or other heavy equipment operation.

The absence of other jobs in the same industry and location is not unique to the railroads. Identical thinking and claims could be applied to numerous other industries, such as steel mills, which have experienced tremendous cutbacks, paper mills, and many plants located in one-industry towns. Moreover, given that the railroads emphasize careful selection of operating employees, it is difficult to believe that these employees, if laid off, would not qualify for jobs in other industries after some training.

Employees of other industries which are directly affected by government action and arguably play a more valuable or significant role in the economy have no benefits or privileges akin to LPPs. Engineers and scientists working for the aerospace industry have been, and continue to be, laid off by the thousands since the end of the cold war as the federal government decreases its defense expenditures. In 1989, aerospace employment stood at 1.3 million; by 1993, it was down to 966,000 and declining rapidly.68

This industry is likely to lose one-half its current employment by the turn of the century. One factor hurrying the decline is that the federal government appears to be encouraging the merger and consolidation of aerospace and other defense-related companies. Thus, Lockheed purchased the aircraft manufacturing divisions of General Dynamics and made other acquisitions; then, it merged with Martin Marietta, which had purchased the defense electronics and space divisions of General Electric. The Lockheed Martin Company expects to lay off 19,000 employees by the turn of the century, closing twelve plants and laboratories and twenty-six field offices.69

In 1993, approximately 146,000 aerospace employees were engineers and scientists, and another 50,000 technicians.70 Such employees receive no payments or protections similar to LPPS. Yet, these employees possess education and training that have contributed in no small manner to


69. Kenneth N. Gilpin, Lockheed to Eliminate 12,000 Jobs, N.Y. TIMES, (June 27, 1995), at D1, col. 5. Lockheed had already announced a lay off of 7,000, thus totaling 19,000 in all.

70. See supra note 68, at 144.
the defense and the maintenance of well-being of the country and fellow citizens, and could again be needed for this same service.

The arguments for LPPs in the railroad industry thus rest largely on grounds that are no longer defensible in terms of the “uniqueness” of the jobs, their location, or their significance to the country’s welfare in comparison with jobs in other industries. The payment of generous benefits for six years to railroad workers laid off because of mergers or consolidations results in special privileges to these workers not enjoyed by those elsewhere in the economy, significant costs and competitive disadvantages to carriers, and a financial burden to the public, which in the final analysis must pay the costs of more expensive transportation.

VI. THE SPECIAL FEATURES OF THE BURLINGTON-SANTE FE MERGER

The 1995 merger of the BN and Sante Fe (SF) railroads provided an opportunity for the ICC to reexamine its policy of automatically awarding New York Dock benefits in mergers. The facts of this case seemed unusually suitable for such a consideration because of the nature of the merger and of the employee population that was estimated to be adversely affected.

The Commission, however, did not feel that it had the authority to make such a change, but it did move to ease some restrictions. It dismissed the unions’ request for lifetime attrition benefits, stating that such benefits “are calculated to preserve unnecessary jobs, and unduly restrict a carrier’s ability to establish economical conditions.”71 Moreover, whereas prior decisions under the New York Dock contained a phrase protecting employees who were subject to a lifetime attrition arrangement by providing that the order “shall not be construed as depriving any employee of any rights or benefits or eliminating any obligations which any employee may have under any existing job security or other protective conditions of arrangements . . . .” Rather it decreed that such questions of whether an employee was covered by prior lifetime attrition or current New York Dock, or perhaps by any LPP was to be left to negotiations and arbitration.72 The Commission further stated:

71. Burlington Northern Inc., Decision No. 38, (1995), at 80. [Reference is to the duplicated copy; the decision will be printed in the ICC’s published volumes in due course.] The ICC is also unlikely not to order New York Dock benefits if, as expected, it approves the impending take-over of the Southern Pacific by the Union Pacific, but it may well loosen some of the restrictions as it has done in the Burlington case. For the Union Pacific case, see, Union Pac. Corp., Union Pac. R.R. & Missouri Pac. R.R. — Control and Merger — S. Pac. Rail Corp., S. Pac. Trans. Co., St. Louis Southwestern Ry., SPDSL Corp & Denver & Rio Grande Western R.R., I.C.C. Finance Docket No. 32760 (1995).
72. Id. at 81. Under the rules governing arbitration pursuant to an ICC order, the ICC
Though we do not think that the BN/Sante Fe should be given carte blanche to modify the provisions of applicable prior protective arrangements, we are not now prepared to say that prior protective arrangements can never be modified in negotiations or arbitration. . . . Some prior protective arrangements, by way of illustration, may not permit jobs to be mover; some such arrangements, by way of further illustration, may not require the employee to relocate; and it may be that some terms of some prior protective arrangements may need to be modified to allow BN/Sante Fe to carry out the control transaction we are approving in this transaction.73

To what extent this decision will lead to substantive changes remains unclear, although certainly it is a step toward loosening the rigidity of the LPP arrangements. Moreover, Congress could change the law, or possibly the ICC could alter its views and design an approach such as that proposed for this merger. It is believed that the following recommended approach would be more in keeping with the needs both of the employees and the carriers in the railroad industry, particularly where the situation approximates that in the BN-SF merger, since it is designed to return those laid off to productive employment.

The BN-SF merger is basically an end-to-end, not an overlapping merger, so that displacement is relatively small. Moreover, the merger proposal foresaw adding to the operating craft work force, not decreasing it.74 Thus, engineers, conductors or brakemen, whose skills are the most unique to the railroad industry of any group or class, stand to gain by this merger.

Layoffs in the shop crafts and maintenance-of-way groups are expected to average about 5 percent, which has been the normal attrition rate in these crafts. Therefore, it is likely that few, if any, layoffs will occur among these employees as a result of the merger.

The clerical force accounts for almost all employees who are expected to be adversely affected by the merger. Some 1,400 jobs are scheduled for abolishment in this category. Fortunately, this class of employees has the most transferable skills. Most are computer literate; their jobs, more than any others, are not unique to the railroad industry; and they are, therefore, the most able to obtain jobs elsewhere within a reasonable period of time.

---

73. Id. at 81-82.
74. In their presentation to the ICC in behalf of the merger, BN and SF provided a list of all personnel who would be either laid off (dismissed), transferred, or downgraded (displaced) as a result of the merger. That list is in the author’s possession.
VII. A Positive Policy For Labor Protection

Industry generally seems most always to be looking for well-motivated, trained employees, and especially clerical employees who are computer literate and able to handle jobs in clerical and data processing work. Such employees are the largest group laid off in railroad mergers and consolidations. It would seem, therefore, that what would be a fair policy for all parties — the employees, the carriers, and the public — is a program that provides proper recognition of the past services of laid-off personnel, aids them in their job search, is consistent with the economic needs of the carriers, and enhances competition in transportation services for the public good.

Such a positive policy and program of labor protection could consist of the following elements:

1. All employees whose jobs are abolished should receive mandatory severance pay based upon a minimum formula of one week's pay for each year worked up to a maximum of one year's salary. Those receiving severance pay shall be permanently severed from the company. Severance pay is the standard benefit, and the formula suggested is the standard one used by employers in other industries for permanent layoffs.75

New York Dock severance pay (separation allowance) is somewhat more liberal than this, as described in the Appendix, below. The New York Dock formula also gives the employee the opportunity to reject severance pay for displacement or dismissal allowances, as the great majority do. Even if the New York Dock provisions were adopted by the ICC or the Congress, severance should be made compulsory for those laid off so that they will commence looking for a new career without delay, and the carriers can immediately know and provide for the merger costs.

2. Employees scheduled for layoff may be offered employment in other crafts or classes. If offered such positions, the employee must accept a position or forfeit protection benefits. Also, if the company accepts employee for possible employment, it shall agree to train them and place them in open jobs if they complete the training to the company's satisfaction. Most LPP arrangements now place certain limitations on offers of comparable employment, such as prohibitions against loss of benefits if an employee must change his residence and, therefore declines a job offer. Unions also challenge offers of comparable employment in ar-

bitration. This makes each offer subject to variable standards of comparability depending on the criteria chosen by different arbitrators.

3. Employees who are severed as a result of the transaction may during the first year thereafter apply for tuition reimbursement to take courses that are designed to improve their ability to secure new jobs or higher rated jobs either in the railroad in which they have worked or elsewhere. Tuition will be reimbursed by the carrier upon proof of satisfactory completion of the course with a passing grade. Such tuition reimbursement is very common among companies, and several railroads already have such programs.76

4. A dispute resolution procedure of negotiation and arbitration should be established to resolve selection or rearrangement of work force disputes without a requirement that any agreement be reached before the railroads make any merger-related changes.77

Such a program would provide immediate payment for those laid off. It might also encourage some senior personnel to accept severance pay and retire, or even be accompanied by a special bonus plan encouraging retirement, thereby making room for junior personnel to be retained. It would also give those laid off the funds to assist in reorienting their careers, looking for positions, and otherwise overcoming the loss of employment. It would invite laid-off employees to better their standing in the labor market through training and development. Finally, it would allow for disputes to be quickly and finally resolved without holding up the merger-related changes. It would be, therefore, in all ways a modern program, geared to today's labor market, and appropriate for railroad mergers, as well as for those in other industries where such programs are widely utilized.

VIII. Conclusion

Public policy in the United States has been very kind to railroad workers by treating them differently and more generously than workers in nearly all other industries. Special legislation provides railway employees and their unions with more favorable representation rights and collective bargaining, unemployment insurance and retirement benefits, and redress from injuries on the job than are available to workers generally.78

76. For short summaries of such programs, see Karen Matthes, Tuition Reimbursement: A Wise Investment When Managed Properly, 70 HR FOCUS 17 (Jan. 1993); and Gillian Flynn, Career Development Is a Company Attention-Getter, 73 PER. J. 22 (Oct. 1994).

77. This implementing agreement procedure is modeled on the one contained in Mendocino Coast and Norfolk and Western conditions, cited in notes 18 and 19, and in the original Amtrak LPPs.

78. Reference is to the Railway Labor Act for collective bargaining and representation, See supra note 22; The Railroad Retirement and Unemployment Insurance Act, and the Federal
Aided by such legislation, railroad employees are among the highest paid workers in the country. The provisions for LPPs are, therefore, only one aspect of a public policy which raises important questions of fairness and equity that need addressing.

In a perceptive work, Charles L. Schultze has noted that:

the specific forms of social intervention over the years have often had only a tenuous relation to the particular nature of the market failures to which they were addressed. Usually, when a problem has been singled out for public action, little attempt has been made to isolate the causes of market failure and deal with them in a way that preserves as many as possible of the elements of voluntary choice and private incentives. Rather, intervention typically substitutes a centralized command-and-control approach to decisionmaking over a far broader area than is necessary to deal with the market failure in question.

The institution of LPPs by federal regulation and legislation is a prime example of such government intervention. Instituted both to protect railroad workers against unemployment and to encourage railroad consolidation, LPPs have instead encouraged employees not to work and enhanced the costs of carriers, inhibiting their profitability and resulting ability to expand employment. Moreover, major recipients of LPP benefits are relatively young clerical employees who are very likely to be employed by other industries instead of receiving pay for not working. As a result, the careers of such recipients may be blunted, not advanced, by such social engineering.

There is also the problem of overcompensating those who suffer market losses, including unemployment, in one particular industry. As it has been pointed out, railroad LPPs are not only discriminatory, they also breed inefficiency which lessens the maximum utilization of resources. Because transportation affects the costs of all products we use, this is a cost for the entire economy.

Section 11347 (formerly § 5(2)(f) of the Interstate Commerce Act, as the ICC currently interprets it, requires that New York Dock conditions be imposed in mergers of Class I railroads. In the event that there is legislative change, or that the ICC alters its views and is supported by the courts, the proposals set forth herein would meet the spirit of a fair and


79. In 1993, employees of Class I railroads earned an average of $45,354 per year. This placed them 74th in a list of approximately 900 four-digit SIC groups of employees. Most of those earning more were in such industry classifications as investment advisers, security brokers and dealers, news syndicates, etc., although some industrial classifications, such as motor vehicles and petroleum refining also had higher annual earnings. (Data from U.S. Bureau of Labor Statistics, compiled by Association of American Railroads.)

equitable arrangement for the protection of employees. The change would also end the situation in which railroad employees receive benefits far and above those received by employees in other industries. The gains by such a change would surely exceed the losses, and would invigorate competition in transportation for the public good.

APPENDIX

SYNOPSIS OF ICC IMPOSED RAILROAD LABOR PROTECTION BENEFITS

The Interstate Commerce Commission imposes four sets of standard labor protection conditions for different transactions:

1) New York Dock — applies to mergers, consolidations and acquisitions of control;
2) Oregon Short Line — applies to abandonments;
3) Mendocino Coast — applies to leases; and
4) Norfolk and Western — applies to trackage rights.

Except for the notice and negotiation provisions for reading an “implementing agreement,” the substantive benefits of these four sets of conditions are identical. The following is a brief summary of the major provision of these protective conditions.

ELIGIBILITY FOR PROTECTION CRITERIA

A transaction, i.e., an ICC authorized action such as a merger, abandonment, lease or trackage rights arrangement, triggers eligibility for protective benefits.

In order to claim protection benefits, an employee must identify a transaction that may have led to a loss or diminution in earnings. The burden of proof is then on the railroad to show that causes other than a transaction affected an employee.

A displaced employee is an employee who is placed in a worse position with respect to his compensation and rules governing his working conditions as a result of a transaction. He still holds a job, albeit at a lower rate of pay, and is entitled to be made whole. A dismissed employee is an employee who is deprived of employment as a result of a transaction.

The protective period is the six-year period after an employee is adversely affected as the result of a transaction. Employees with less than six years of service are protected for a period equivalent to their actual years of service.

One area of almost constant dispute between the railroads and unions is over the issue of eligibility criteria. The union typically attempts to link employee furloughs with ICC transactions and the carriers try to demonstrate the opposite. A large body of arbitral precedent has been built up in recent years requiring the linkage between an adverse effect and an ICC transaction in order to make an employee eligible for protective benefits. Job reductions, per se, do not entitle employees to ICC imposed protection benefits. Collectively bargained labor protection agreements, on the other hand, typically have much looser eligibility criteria for qualifying for protection benefits.

Preservation of Collective Bargaining Agreements

Section 2 of each of the ICC protective conditions contains a provision preserving "rates of pay, rules, working conditions and all collective bargaining and other rights, privileges and benefits." The history of the language dates back to the Urban Mass Transportation Act of 1964. At the time, as private transit company operations were assumed by public transit authorities, the transit unions were concerned that their collective bargaining agreements would not be preserved through this transition. This preservation of agreement language subsequently was carried over into the Amtrak C-1 protective conditions as the C-1 conditions were based on the UMTA provisions. In turn, the "new" ICC protective provisions resulting from the Rail Revitalization and Regulatory Reform Act of 1976 amendments to the Interstate Commerce Act were based substantially on the 1971 Amtrak C-1 conditions. This preservation of agreement language then was carried over to the ICC protective conditions formulated in the late 1970's.

The rail unions have relied on this provision to argue that employees must carry along their collective bargaining agreements as they are transferred from one railroad to another in a merger, consolidation or lease transaction in lieu of working under the agreement of the railroad to which they are transferred. Although an initial group of arbitration awards in the early 1980's supported the unions' position, subsequent awards have ruled that agreements are not portable as work forces are consolidated.

Preservation of On-Property Protection Agreements

Many employees in the railroad industry come under the purview of collectively bargained protection agreements that are unrelated to an ICC authorized transaction. Often these agreements provide benefits for longer than a six-year period or contain looser eligibility criteria for qualifying for benefits (e.g., lifetime protection agreements guarantee income maintenance until an employee retires, resigns or is dismissed for cause). For employees covered by such protection agreements and who are also affected by an ICC authorized transaction, the ICC protection conditions
allow such employees to elect benefits under their on-property agreement in lieu of the ICC protection benefits.

**NOTICE, NEGOTIATIONS AND IMPLEMENTING AGREEMENTS**

Section 4 of each of the ICC protective conditions contains detailed procedures for serving notices, conducting negotiations, reaching implementing agreements, and submitting issues to arbitration if an implementing agreement is not reached. The *New York Dock* and *Oregon Short Line* conditions require a thirty day negotiation period after notices are served. If an agreement is not reached within this period, either party may submit the dispute to arbitration. However, the transaction cannot be implemented without an agreement or arbitration decision. Although this process is designed to be completed in 90 days, *New York Dock* transactions usually take a minimum of 180 days and often longer to move to finality where arbitration is involved.

*Mendocino Coast* and *Norfolk and Western* transactions, on the other hand, provide for a twenty day negotiation period after service of a notice. At the end of twenty days, the railroad is free to consummate the lease or trackage rights transaction notwithstanding the absence of an implementing agreement. If an agreement is not reached subsequently, the matter can be referred to arbitration.

The scope of arbitration under Section 4 of the ICC protective conditions is limited to the selection of forces issues. The parties attempt to agree on how work forces are intermingled in a consolidated operation. If an agreement is not reach, then the arbitrator determines the appropriate selection of forces.

**PROTECTIVE ALLOWANCES**

There are three types of protective allowances under ICC protective conditions. They are: (1) displacement allowances; (2) dismissal allowances; and (3) separation allowances. Displacement allowances are designed for employees who are forced to accept a lowerpaying position as a result of an ICC transaction. It is a make whole provision that provides for difference in pay between the old and new positions. Dismissal allowances are designed for employees who are deprived of employment as a result of a transaction. If employees cannot exercise their seniority to hold another position or are not offered comparable positions, the railroad must provide full income maintenance for six years, or in the case of employees with less than six years service, for a period of time equivalent to their actual years of service. Finally, separation allowances are available for employees who are deprived of employment. In lieu of electing protection for up to six years but being available for recall, employees can elect to resign and accept a lump sum severance allowance.

The displacement and dismissal allowances are based on a “test period” of the last twelve months in which the employee had railroad in-
come immediately preceding the month in which an employee was adversely affected by an ICC transaction. This figure is divided by twelve to produce a monthly guarantee. Separation allowances are based on an employee's daily rate of pay multiplied by 360 which produces a typical severance allowance of between sixteen and seventeen months of pay. Fringe benefits also are preserved for those employees collecting a dismissal or displacement allowance.

MOVING BENEFITS

Employees who are required to change their point of employment as the result of an ICC authorized transaction are entitled to moving and relocation benefits. Such benefits include actual relocation costs, traveling expenses of himself and members of his family, living expenses for himself and members of his family, his own actual wage loss not to exceed three days, and any loss on sale of his home. Because of the administrative costs and burden of monitoring these benefits, many railroads in recent years have agreed to pay a one time lump-sum relocation benefit in lieu of the aforementioned moving and relocation benefits.
Buy North America: A Revision to FTA Buy America Requirements

Lawrence Hughes*

TABLE OF CONTENTS

I. Introduction ................................................................. 208
II. Buy America Legislative History (Including NAFTA) ............. 208
   A. The 1933 Buy America Act ........................................... 208
   B. The Surface Transportation Assistance Act of 1978 .......... 213
      1. The Legislature Acts to Place Transit Under Buy America ........................................ 213
      2. UMTA Administers Buy America for the First Time ............................................. 216
   C. The Surface Transportation Assistance Act of 1982 ....... 217
      1. The Legislature Updates the 1978 Legislation .......... 217
      2. UMTA Revises Its Buy America Regulations .......... 218
   D. The Surface Transportation and Relocation Assistance Act of 1987 ........................................... 219
   E. The Intermodal Surface Transportation Efficiency Act of 1991 .............................................. 221
      1. Legislative Action ................................................. 221

* J.D. (expected 1997), The New York Law School; M.S. Transportation Planning and Engineering (1989), Polytechnic University; A.B. Applied Mathematics (1984), University of California, Berkeley. The author is a transportation planner with the New York City Department of Transportation, and has previously planned transportation services with the MTA New York City Transit Authority and the Santa Clara County Transportation Agency.

207
I. Introduction

This article follows the story of the “Buy America” transit industry protectionism program administered by the Federal Transit Administration (FTA). Buy America dates back to the Depression, an era of massive American unemployment. As the transit industry passed into the public sector in later years, the Buy America program was applied to the transit industry. The passage of the North American Free Trade Agreement (NAFTA) purported to cast aside protectionism in the United States, Canada, and Mexico; yet somehow, Buy America protectionism remained in the transit industry. The continued application of this type of provincial regulation to transit has been detrimental to the transit industry.

This article explains how Buy America is inconsistent with NAFTA. It calls for the elimination of Buy America and urges replacement with a “Buy North America” regulation.

II. Buy America Legislative History (including NAFTA)

A. The 1933 Buy America Act

The first Buy America requirements generally applicable to government procurements were enacted during the Depression. The purpose of Buy America was to require the federal government to spend taxpayers’ dollars only on goods produced in the United States. The Buy

1. The original 1933 legislation is popularly referred to as the “Buy American” Act. All subsequent legislation has been referred to as “Buy America.” This article will refer to both as “Buy America.”


3. See Buy American Act, supra note 2.
America requirements were added as a Senate amendment to a House appropriations bill\textsuperscript{4} for the treasury and post office departments.\textsuperscript{5}

**BUY AMERICA**

**CHRONOLOGY OF LEGISLATION**

<table>
<thead>
<tr>
<th>YEAR</th>
<th>ACT/LEGISLATION</th>
<th>KEY FEATURES</th>
</tr>
</thead>
<tbody>
<tr>
<td>1933</td>
<td>Buy American Act introduced</td>
<td>• applied to purchases by DOT for its own use</td>
</tr>
<tr>
<td>1965</td>
<td>UMTA Funding Program introduced</td>
<td></td>
</tr>
<tr>
<td>1978</td>
<td>Surface Transportation Assistance Act introduced with Buy America Clause</td>
<td>• preference for U.S. products</td>
</tr>
<tr>
<td>1982</td>
<td>Surface Transportation Assistance Act introduced</td>
<td>• Buy America applicable to contracts over $500,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• $500,000 exemption for applicability of Buy America removed. Four new exemption areas and waivers introduced.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• 50% domestic content</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• final assembly in U.S.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• 10% price differential waiver for rolling stock; 25% for all other projects.</td>
</tr>
<tr>
<td>1987</td>
<td>Surface Transportation and Uniform Relocation Assistance Act adopted</td>
<td>• domestic content increased to 55% Oct 1/89 and to 60% Oct 1/91</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• sub-components defined and content requirements specified</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• rolling stock price differential waiver increased from 10% to 25%.</td>
</tr>
<tr>
<td>1991</td>
<td>Intermodal Surface Transportation Efficiency Act</td>
<td>• same provisions as STURAA of 1987</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• “iron” added to list of materials covered</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• minor wording added re false labeling</td>
</tr>
</tbody>
</table>

*Source: Canadian Urban Transit Association*

Buy America requirements were added to the bill by Sen. Hiram W. Johnson (R-Cal.).\textsuperscript{6} Two parts of Sen. Johnson’s bill\textsuperscript{7} were the heart of the

\textsuperscript{4} H.R. 13,520, 72d Cong., 2d Sess. (1933) (enacted).

\textsuperscript{5} TREASURY AND POST OFFICE DEPARTMENTS APPROPRIATION BILL, Fiscal Year 1934, H.R. REP. NO. 1787, 72d Cong., 2d Sess. (1932); S. REP. NO. 1021, 72d Cong., 2d Sess. (1933).

\textsuperscript{6} On January 11, 1933, Sen. Johnson moved to suspend the standing rules of the Senate (Rule XVI, relating to the germaneness of amendments to appropriations bills) in order to propose adding Buy America provisions to the appropriations bill. 76 CONG. REC. 1572. Debate on the rules suspension continued on January 30, 1933. 76 CONG. REC. 2868 (1933). Sen. Thomas P. Gore (D-Okla.) opposed the rules suspension, as he did the entire Buy America provision, explaining it in this way to Sen. Johnson:
legislation.\textsuperscript{8} The second section of the bill required that only articles, materials, and supplies mined, produced, or manufactured in the United States could be used for public projects. The restriction would not apply for materials used outside the United States, if the materials would not be available in commercial quantities of satisfactory quality, or if the appropriate department head believed the requirement was inconsistent with the public interest or the cost was unreasonable.\textsuperscript{9}

Section three of the bill required all contractors for public construction projects in the United States to use only materials from the United States.\textsuperscript{10} If a department head found that a contractor failed to comply with this section, then that contractor would be ineligible for any further government contracts for a period of three years.\textsuperscript{11}

Debate on the amendment began on January 31, 1933.\textsuperscript{12} Sen. James J. Davis (R-Pa.) recited a long list of reasons to support the amendment.\textsuperscript{13} According to his argument, the bill would bring employment to Americans, reduce the influx of foreign competition, and prevent further decline in the earnings of American workers.\textsuperscript{14} A reduction in earnings would then lead to the destruction of the American standard of living.\textsuperscript{15} Permitting competitive products produced by cheap labor in foreign countries would destroy American markets, diminishing American earning and buying power, and keep American workers “in the breadlines.”\textsuperscript{16} The federal government, Sen. Davis argued, should not allow the dump-

\begin{flushright}
I may wish to offer amendments providing that no State shall buy anything that is not produced within the State, and that no county shall buy anything that is produced outside the county, and that no farmer shall be allowed to buy anything at all or sell anything that he grows on his farm, and also to offer a motion that the American eagle shall be displaced as the emblem of the Republic and a terrapin be substituted in its stead—a terrapin closed up in its shell and hermetically sealed. If trade is a curse let us stop it.
\end{flushright}

\textit{Id.}

7. Sen. Johnson gave a short explanation of the origins of his amendment. 76 \textsc{Cong. Rec.} 3175 (1933). Several manufacturers from California and Pennsylvania explained to him that there was an upcoming bid at Boulder Dam. They were concerned foreign bidders might undercut their bids by just a small amount (from one to five percent). If that were to happen, then roughly $6 million would be paid to a foreign country, which the manufacturers thought was outrageous.

8. 76 \textsc{Cong. Rec.} 2869 (1933).

9. \textit{Id.}

10. But the same exemptions listed in § 2 would also apply to contractors, \textit{i.e.}, the restriction would not apply for materials used outside the United States, if the materials would not be available in commercial quantities of satisfactory quality, or if the department head found such requirement to be inconsistent with the public interest, or the cost to be unreasonable.

11. \textit{Id.}

12. 76 \textsc{Cong. Rec.} 2985 (1933).

13. \textit{Id.}

14. \textit{Id.}

15. \textit{Id.}

16. \textit{Id.}
ing of foreign goods in American markets while Americans remain unemployed.\(^{17}\) Protection from cheap European and Asian labor of was necessary in order to maintain the American standard of living;\(^{18}\) no American would want to have the standard of living as low as Europeans or Asians.\(^{19}\) To Sen. Davis, the United States would be adopting those standards if Americans remained on welfare while foreigners were busy at work dumping cheap products on the United States\(^{20}\) Sen. Davis observed the purchase of foreign products by American government contractors while Americans remained unemployed and expressed the disappointment that not only was there is no legislation to bar these foreign products completely, but also that the federal government was using tax dollars to purchase these foreign goods while American workers were idle.\(^{21}\)

Although protectionism schemes could generate ill-will from adversely affected Europeans and Asians, Sen. Davis did not consider those consequences as compelling as the interests in keeping the good will of Americans.\(^{22}\) He claimed Buy America would protect American jobs and American industry, and if Buy America itself was insufficient (because Americans themselves did not buy American products for their own use), then tariffs would have to be to effectively prohibit foreigners from dumping their goods in the United States.\(^{23}\)

A response to Sen. Davis came soon. The debate over Buy America continued two days later when Sen. William H. King (D-Utah) outlined the reasons for not supporting it.\(^{24}\) He said the amendment would destroy American trade and commerce relations with other countries.\(^{25}\) At the time of the debate, the United States had excess agricultural and industrial products.\(^{26}\) Sen. King said pursuit of a closed market for foreign imports would likely cause other countries to refuse American exports.\(^{27}\) He noted that trade was reciprocal: if the United States did not buy from other countries, other countries would not buy from the United States.\(^{28}\)

\(^{17}\) Id.

\(^{18}\) Id.

\(^{19}\) Id.

\(^{20}\) Id.

\(^{21}\) Id.

\(^{22}\) Id.

\(^{23}\) Id. Sen. Davis went on to describe how foreigners price their goods competitively. Foreign governments overproduce at their factories as a matter of public policy. Although there may have been an insufficient market for their goods, those governments preferred to make up the loss on their factories than to pay for the welfare of the unemployed. Id.

\(^{24}\) 76 Cong. Rec. 3171-72 (1933).

\(^{25}\) 76 Cong. Rec. 3172 (1933).

\(^{26}\) Id.

\(^{27}\) Id.

\(^{28}\) Id. In addition, Sen. King said since Buy America was not germane to the appropria-
Other senators gave their reasons for supporting or not supporting Sen. Johnson’s amendment. After the Senate voted to allow the amendments, Sen. Johnson formally offered the Buy America appropriations bill amendment. Debate on the bill continued that day and the next. Sen. Johnson’s amendment passed on the night of February 3,

29. Sen. Park Trammell (D-Fla.) claimed there was no legislation of greater benefit than this amendment. He characterized American bureaucrats as not caring about American interests, purchasing foreign imports for no good reason. Sen. David A. Reed (R-Pa.) observed the Department of War had similar requirements for the purchase of domestic goods which worked well in keeping American dollars within the United States. at 3172-73.

Two days prior to the February 2, 1933 debate, Great Britain imposed an embargo against products from its colonies with less than 50% domestic content. All public construction orders in Great Britain, between 1920 and 1933, were included this clause.

Sen. Hiram Bingham (R-Conn.) said that the only response to this “Buy British” movement was to impose Buy America legislation.

30. Sen. Gore noted that in 1932, Japan purchased one-fifth of the United States cotton crop, one-third of the total cotton export, worth $60-70 million. In return, Japan sent electric light bulbs and rubber-soled shoes. He said it was short-sighted for the United States to close its doors to foreign trade since Americans would effectively be unable to export cotton.

Sen. John J. Blaine (R-Wis.) said the amendment would drive all the midwestern paper mills—half the paper mill industry—out of business because they used imported wood pulp from Canada (it was not economical to transport domestic wood pulp from the Pacific Northwest). He said there would be similar effects on furniture manufacturers.

Sen. Edward P. Costigan (D-Colo.) believed the amendment would be nothing more than an increase in tariffs at a time when more liberal trade relations should be established.

Sen. Bingham, however, said the other senators’ concerns were misplaced since only a small amount of paper was purchased by the federal government, and so the amendment would not damage the industry. There was also a provision that allowed foreign purchase where materials are not available in sufficient quantity or quality, or where it was impracticable or unreasonable. The amendment would not harm the cotton producers, for it only affected government purchases.

31.  76 CONG. REC. 3177 (1933).  32.  Id. at 3178.  33.  Id.  Sen. Gore commented again:

The enemies of trade have triumphed; the friends of trade have been routed. One of the lingering distinctions between the Democratic and Republican Parties has been this fundamental difference; the Democrats have believed that trade is a blessing, not a curse; the Republicans have believed that trade is a curse and not a blessing. Their doctrine has triumphed on this occasion. Such triumph will but protract this depression, will multiply and aggravate its evils.

76 CONG. REC. 3178 (1933). Sen. Arthur Robinson (R-Ind.) noted that the amendment was the start of a complete embargo against importation of foreign goods. Sen. Costigan added that the amendment failed to provide safeguards against monopolistic pricing.

34. The debate on February 3, 1933, focused mostly on the effects of raising trade barriers. Sen. Millard E. Tydings (D-Md.) noted that in 1929, the balance of trade was $1 billion in favor of the United States. In 1930, the balance of trade was $800
1933. The House accepted the Johnson amendment. The appropriations bill was enacted on March 3, 1933.

B. The Surface Transportation Assistance Act of 1978

1. Congress Acts to Place Transit Under Buy America

The applicability of Buy America regulations to transit procurements was a moot issue in the 1930s because, transit systems were controlled almost exclusively by private companies. Following World War II, the fortunes of the private transit operators changed drastically. The economics of the business were changing and transit was no longer profitable. At the end of World War II, publicly-operated transit systems were carrying 20% of the nation’s transit ridership. This number increased to 35% by 1955 and rose to almost 50% by 1960. In 1960, Congress began debating the issue of federal assistance for transit systems. These debates led to the passage of the Urban Mass Transit Act of 1964. This legislation established the Urban Mass Transit Administration (UMTA) to dole out federal assistance for up to 80% of the cost of transit equipment.

By the late 1960s and early 1970s, Congress began to notice the success of foreign transit equipment suppliers in the United States, particularly European and Japanese manufacturers, and how American
companies were having little success in their competitors’ markets. The concern of U.S. transit suppliers was high then, and continues to be high today. Congress desired to stop “unfair” foreign competition from coming into the United States, so it implemented the Buy America provision for transit. Like the 1933 act, the 1978 transit version of Buy America would also be established on the belief that American tax dollars should not be spent on goods from countries that neglect certain social goals (e.g., equal opportunity, environmental protection, and worker safety).

Aside from social goals, in considering the Federal-Aid Highway Act of 1978, the Senate Committee on Environment and Public Works noted there had been increasing concern in recent years over the economic impact of foreign imports. Other recent federal acts included requirements for the use of domestically produced goods, including both the Clean Water Act of 1967 and the Public Works Employment Act of 1977. Section 143 of the Federal-Aid Highway bill contained the Buy America provision, and required the use of domestic materials in federal-aid highway projects with a value greater than $1 million.

The House version of the bill was known as the Surface Transportation Assistance Act of 1978, and also included a Buy America provision. The House Committee on Public Works and Transportation considered a requirement similar to the Senate’s whereby the Buy America provision would only encompass projects of a minimum value (between $1 million and $5 million). However, the committee found such a limitation would exclude most highway construction projects from the requirement. Therefore, the House bill had no bottom limit on the

46. Id.
47. Id.
48. Id.
51. Id.
52. As with the 1933 Buy American provisions, exceptions would be available where the Secretary of Transportation found that the requirement would be inconsistent with the public interest, if the cost of rolling stock was unreasonable, if domestic supplies were not available or were not of satisfactory quality, or if the cost of using domestic materials would increase the cost of the project by more than 10%. As the bill was being considered during the nation’s second “energy crisis,” it was explicitly stated that the Buy America requirement did not apply to the purchase of petroleum-based products since “domestic supplies are clearly inadequate to meet national demand.” Id.
55. Id. Only 18% of all highway construction projects were valued at over $1 million (only 2.7% were valued at over $5 million). Id.
value of the covered project.

The House bill included the Buy America provision in recognition of the need to protect American manufacturers and suppliers from foreign competition. These foreign imports were often underpriced because of foreign government subsidies, cheap labor, and a strong American dollar, resulting in substantial losses to domestic companies, an increase in the American trade deficit, inflation, American unemployment, and a reduction in productivity.

But America did not completely address foreign underpricing: Rep. Robert W. Edgar (D-Pa.) explained that the then-current Buy America provisions (enacted in 1933) applied only to direct federal procurements, and not to grants-in-aid. Rep. Edgar's amendment would encompass grants-in-aid projects within the Buy America requirement.

He further explained that in recent years UMTA had been pursuing a deliberate policy to entice foreign railcar builders to the United States. This policy was pursued with the expectation of lowering railcar procurement costs through increased competition. However, no consideration was given to the effects on existing domestic railcar builders. Similar UMTA tactics had decreased the likelihood a Philadelphia order will go to a domestic manufacturer. Rep. Edgar said the provision would not preclude foreign bids, but would give work to Americans when the cost is reasonable.

By the time the House and Senate bills arrived at the conference committee, the only difference between the two bills was the Senate pro-

---

56. Id.
57. Id. The entrance and exit of foreign bus manufacturers can be traced to U.S. dollar exchange rates. Letter from Scott A. Mintier, President Transit Bus Division, Nova Bus Corporation (Apr. 6, 1995) (on file with author). Rep. Edgar introduced the Buy America section to the bill during the mark-up session. 124 CONG. REC. 32,311. As written, the requirement would apply only to projects authorized by this particular bill, as well as all ongoing highway and mass transit projects. Id.
58. Id.
59. Id.
60. Id.
61. Id. Rep. Edgar gave an example of the UMTA policy. The cities of Baltimore and Miami were in the process of procuring railcars for their new rapid transit systems; the procurement was being conducted jointly for identical cars in order to contain costs. In order to prolong the life of the cars, the two cities specified stainless steel cars. Two potential foreign manufacturers, Hawker-Siddley (Canada) and Société Franco-Belge (France), complained to UMTA that they only produced aluminum cars. Even though all the domestic railcar builders could build stainless steel cars, UMTA ruled in favor of the foreign manufacturers. Id. Nevertheless, a domestic manufacturer, Transit America (formerly, The Budd Company), built the cars. JANE'S URBAN TRANSPORT SYSTEMS 31 & 241 (Chris Bushell & Peter Stonham eds., 6th ed. 1987).
62. Id. In fact, the order did go to a Japanese manufacturer, Kawasaki. Id. at 307.
63. 124 CONG. REC. H. 32,311 1978. Rep. Edgar said the domestic preference given would simply offset the subsidies given by foreign governments to their manufacturers. Id.
vision to exempt projects under $1 million from the Buy America requirement. The two houses compromised, and projects with a value of less than $500,000 were exempted from Buy America requirements.

2. UMTA Administers Buy America for the First Time

On December 6, 1978, UMTA issued regulations implementing the Surface Transportation Assistance Act of 1978. The regulations implemented by UMTA did not apply to direct federal procurement but only to UMTA aid recipients.

The regulations adopted by UMTA encompassed all federally-assisted procurements in excess of $500,000; Buy America did not apply to the procurement of services. UMTA required that all federally-funded procurement bid specifications include a Buy America provision. The specification had to include a requirement of the successful bidder to complete a “Buy America Certificate” which certified compliance with the requirement (unless an appropriate waiver is granted). A false Buy America certification was a criminal act.

UMTA defined a “manufactured end product” as domestic if the cost of the domestic components was at least 50% of the total value of all components, and the final assembly of the components took place within the United States. Components were considered entirely domestic or entirely foreign.

65. Id. at the time, the cost of a typical bus was $70,000, and the cost of a typical railcar was $600,000. Canadian Urban Transit Association, Assessment of the Impact of Buy America Restrictions on the Canadian Transit Supply Sector 7 (1993) [hereinafter CUTA].
67. Id. at 49 C.F.R. § 660.11; federal procurements are covered by the 1933 Buy America Act.
68. Id. at § 660.11(a).
69. Id. at § 660.21(b).
70. Id. at § 660.21(b)-(c).
71. Id. at § 660.41(a). The successful bidder has the burden of proof if UMTA investigates its compliance with Buy America. If the bidder fails to prove its compliance, it will be required to substitute a sufficient quantity of domestic materials to comply with its original “Buy America Certificate,” but without change to any of its original contract terms. The failure to do this is actionable under the terms of the contract and state law. Refusal to comply with certification requirements may result in the bidder being barred from future contracts. Id. at §§ 660.42-660.44.
72. Id. at § 660.22(2). The transportation cost and applicable duties must be included in calculating component costs. Id. at § 660.22(c).
73. Id. at § 660.22(b). Foreign components for which a waiver is given will be treated as domestic. Id. If the origin of the component is unknown, it will be treated as foreign. Id. at § 660.22(b).
UMTA made four types of waivers available:\(^{74}\)
(1) Public interest;\(^{75}\)
(2) Unreasonable cost of rolling stock;\(^{76}\)
(3) Insufficient or unsatisfactory domestic availability of supplies;\(^{77}\)
and
(4) Domestic cost greater than 10% over foreign cost.\(^{78}\)
Operating assistance grants were automatically waived from Buy America requirements.\(^{79}\)

C. The Surface Transportation Assistance Act of 1982

1. The Legislature Updates the 1978 Legislation

In considering the Surface Transportation Assistance Act of 1982,\(^ {80}\) the House Committee on Public Works and Transportation believed that federal mass transit funds should not be spent in countries where the United States has a trade deficit, and proposed that no projects be funded where a significant portion (i.e., greater than 15%) of the bus or other rolling stock was a product of a country where the United States had such a trade deficit.\(^ {81}\) However, in conference, this provision for exclusion of products from trade-deficit countries was deleted.\(^ {82}\)

In its place, the Surface Transportation Assistance Act of 1982 made several changes in the Buy America provisions for mass transit.\(^ {83}\) The provisions eliminated the $500,000 threshold for the application of the Buy America requirements,\(^ {84}\) but added a requirement that all steel, cement,\(^ {85}\) and manufactured products used in UMTA-funded projects be produced in the United States.\(^ {86}\)

---

74. Id. at § 660.32.
75. For a public interest waiver, UMTA considers all appropriate factors, including cost, "red tape," and delay. Id. at § 660.32(a)(1) & (b).
76. For an unreasonable cost waiver, tax revenues likely to be paid by the domestic manufacturer back to the United States are used to make an appropriate price adjustment. Id. at § 660.32(a)(2).
77. For an insufficient or unavailable waiver, it is presumed to be the case if no responsive and responsible bidder replies. Id. at § 660.32(d).
78. For a 10% cost waiver, the bid of the lowest responsive and responsible foreign bidder is multiplied by 1.1 and compared to the lowest responsive and responsible domestic bidder. Id. at § 660.32(e).
79. Id. at § 660.33 (App. A(a)).
83. See Surface Transportation Assistance Act of 1982, § 165.
84. Id.
85. Later, cement was removed.
86. Id.
The exceptions to the requirements were also revised. The exception for the consideration of unreasonable cost, after taking into account tax revenues to be returned to the government by domestic manufacturers, was eliminated. The exception allowed when domestic material increased the cost of the project by more than 10% was retained for rolling stock, but increased to a 25% differential for all other projects. The Act codified UMTA’s definition of domestic rolling stock: American-made components must represent at least 50% of the total cost of the rolling stock, with final assembly in the United States. Lastly, the act allowed states to adopt more stringent Buy America requirements, although “buy state” or “buy local” requirements could not be imposed.

2. **UMTA Revises Its Buy America Regulations**

UMTA issued revised Buy America regulations consistent with the

---

87. See *Id.*
88. *Id.*
89. *Id.*
91. Surface Transportation Assistance Act of 1982 § 165(b). The act codified the definition through the use of an exception:

The provisions of . . . this section shall not apply where the Secretary finds . . . that (A) the cost of components which are produced in the United States is more than 50 per centum of the cost of all components of the vehicle or equipment described in this paragraph, and (B) final assembly of the vehicle or equipment described in this paragraph has taken place in the United States. . . .

*Id.*

92. *Id.* Any such act must be through the legislated law, and not merely administrative. *Id.*

In spite of the statute, many American locales impose “buy state” or “buy local” requirements. Letter from Al Cormier, Executive Vice President, Canadian Urban Transit Association, to all Provincial Premiers (June 14, 1994) (on file with author). The Canadian Urban Transit Association compiled a list of states with “buy state” or “buy local” requirements.

<table>
<thead>
<tr>
<th>State</th>
<th>Requirement Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arizona</td>
<td>5% preference for in-state suppliers.</td>
</tr>
<tr>
<td>Indiana</td>
<td>Buy Indiana policy, though not supported by state law, has been in effect for many years; state agencies are required to justify any award to an out-of-state firm.</td>
</tr>
<tr>
<td>Kansas</td>
<td>Tie bias preference to in-state firms.</td>
</tr>
<tr>
<td>Louisiana</td>
<td>Preference to steel rolled in-state.</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>All other factors equal, preference for Massachusetts products, then American products; also to goods from American labor-depressed areas. For commodities, Massachusetts preference if all other factors are equal; otherwise low bidder wins.</td>
</tr>
<tr>
<td>Michigan</td>
<td>Some legislation favoring Michigan companies has recently been considered, but not supported sufficiently to pass.</td>
</tr>
<tr>
<td>New Mexico</td>
<td>5% preference for New Mexico-based firms. Requires use of timber grown in state is the species required is available.</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>5% preference for Oklahoma supplies.</td>
</tr>
<tr>
<td>Utah</td>
<td>Reciprocal bias—e.g., a firm based in a state that favors its own companies by 5% will be at a 5% disadvantage when bidding on a Utah state contract.</td>
</tr>
<tr>
<td>Virginia</td>
<td>Preference on tie bids; reciprocal bias as in Utah.</td>
</tr>
</tbody>
</table>

*CUTA, supra* note 65, at 11.
Surface Transportation Assistance Act of 1982.\textsuperscript{93}

During the next few years, UMTA had several opportunities to apply the waivers allowed in the legislation. In one instance, UMTA allowed Canadian passenger vans to be purchased under a public interest waiver since there was only one American manufacturer of these types of vans.\textsuperscript{94}

The issuance of such a waiver, however, was discretionary, not compulsory.\textsuperscript{95}

D. THE SURFACE TRANSPORTATION AND RELOCATION ASSISTANCE ACT OF 1987

The House version of the 1982 transportation authorization bill\textsuperscript{96} was co-authored by Rep. Bud Shuster (R-Pa.),\textsuperscript{97} who desired that the American content requirement of mass transit projects be increased from 50% to 85%.\textsuperscript{98} However, he did recognize that a number of foreign manufacturers had come to the United States, and were manufacturing mass transit equipment using both American and foreign components.\textsuperscript{99} He noted that an increase to 85% would be unfair to these foreign companies which came and invested money in the United States.\textsuperscript{100} Some Congress-


\textsuperscript{94} Some grant recipients were reporting difficulties in the purchase of 15-passenger vans. Exemption From Buy America Requirements, 49 Fed. Reg. 4062 (1984). These vans were often used in programs designed for elderly and handicapped persons, as well as in rural transit programs. Only two companies manufactured these vans: Ford Motor Company and Chrysler Corporation. The vehicles manufactured by Chrysler did not qualify under Buy America since their final assembly was in Canada. However, 74% of the components of the vans, by cost, were produced in the United States.

Several states and Chrysler petitioned UMTA for a public interest waiver. Without a waiver, only Ford could have supplied these vans, and there would be no competition.


\textsuperscript{96} H.R. 2, 100th Cong., 1st Sess. (1987).

\textsuperscript{97} See 2 Cong. Index 28,339 H. 3702 (CCH 1981-1982).

\textsuperscript{98} In 1985, the Transport Workers Union of America noted that the American transit bus market had declined from 91% in 1978 to 60% in 1985, resulting in the loss of many American jobs to foreign producers. Transport Workers Union Protests Purchase of Foreign-Made Vehicles With Federal Funds, PR NEWSWIRE, Oct. 4, 1985. The union claimed the 50% American content requirement was "woefully inadequate," and called upon Congress to raise the domestic content requirement to 85%. \textit{Id.}


\textsuperscript{100} See \textit{Id.} Rep. Bruce Morrison (D-Conn.) expanded on Rep. Shuster's concerns. He cited Saab-Scania as a company that had established a plant in his state with the understanding that only a 50% domestic content requirement needed to be met. \textit{Id.} at 1710. The amount of capital investment required to meet an 85% content could not be justified by the American transit market size. This would have forced Saab out of the American market. \textit{Id.} at 1710-11. Other companies, including Bus Industries of America, Bombardier Corp., Knorr Brake Corp., and M.A.N. Truck & Bus Corp. would have been similarly affected. \textit{Id.} Rep. Willie Hefner (D-
men, however, repeated arguments used previously in support of Buy America provisions advocating the stronger provision requiring 85% American content.\textsuperscript{101}

The Senate, in its version of the bill, reestablished a $500,000 threshold for Buy America requirements.\textsuperscript{102} This threshold, it was held, would help to reduce the administrative burdens imposed on small projects, and lower their costs.\textsuperscript{103}

By the time the bills reached the conference committee, the house bill had both a proposal to increase domestic content from 50% to 85%, and to increase the project cost differential for rolling stock from 10% to 25%, thereby matching the differential used for all other purchases.\textsuperscript{104} The conference committee compromised on the domestic content, proposing that the 50% content be raised to 55% in two years, \textit{i.e.}, as of October 1, 1989, and from 55% to 60% two more years later on October 1, 1991.\textsuperscript{105} The committee also accepted the house provision for a uniform 25% price differential.\textsuperscript{106} Finally, the committee added a small provision that "subcomponents" were included with "components."\textsuperscript{107} The bill was enacted, amending section 165 of the Surface Transportation Assistance Act of 1982, essentially unchanged from the conference committee's proposal.\textsuperscript{108}

N.C.) explained that such an increase would close the doors on M.A.N., a bus manufacturer in his state, and put 600 people out of work. \textit{Id.}

The 85% American content requirement would have also been a heavy burden on Canadian transit suppliers. Canadian manufacturers building transit vehicles for Canadian markets typically included 55% Canadian content. C\textit{UTA}, \textit{supra} note 65, at 35. Approximately 40% of the content was American, consisting of major components, \textit{e.g.}, drive-train/motors, axles/trucks, air conditioning, etc. When building buses for American markets, at least 60% American content had to be included (typically, there was 65% American content). If the Buy America content requirement were to be raised from 60% to 65% or 70%, there would have been serious doubts as to whether any production could possibly have remained in Canada, and this could have resulted in the exit of all transit manufacturers from Canada. \textit{Id.}

\begin{itemize}
  \item \textsuperscript{101} Rep. Helen Bentley (R-Md.) stated that stronger Buy America provisions were necessary in order to keep taxpayer money in the United States. The Buy America provision would help to achieve a stronger American industrial base. \textit{Id.}
  \item \textsuperscript{102} See 133 Cong. Rec. 2035 (1987).
  \item \textsuperscript{103} \textit{Id.} Sen. Arlen Spector (R-Pa.) opposed this threshold because it would subvert what he saw to be a successful Buy America policy. \textit{Id.} However, the senator concentrated on the effects of the highway industry, not mass transit. \textit{Id.}
  \item \textsuperscript{104} See H.R. \textit{CONF. REP.} No. 27, 100th Cong., 1st Sess. (1987).
  \item \textsuperscript{105} \textit{Id.}
  \item \textsuperscript{106} \textit{Id.}
  \item \textsuperscript{107} \textit{Id.} This would mean that an American subcomponent shipped out of the country to be used as part of a foreign component will be considered "domestic." See \textit{Id.}
\end{itemize}
E. THE INTERMODAL SURFACE TRANSPORTATION EFFICIENCY ACT OF 1991

1. Legislative Action.

In 1991, the Congress again amended section 165 of the Surface Transportation Assistance Act of 1982. The amendments made were slight. In addition, the Urban Mass Transportation Administration’s name was changed to the Federal Transit Administration (FTA). Subsequently, Congress finally codified the Buy America requirements.

2. FTA Action.

In recognition of the excessive burden imposed by Buy America for “micro-purchases,” FTA used its authority to exempt FTA-funded purchases of less than $2,500, as of March 15, 1995. As of July 24, 1995 this waiver was then expanded to purchases of up to $100,000. The Executive Vice President of the American Public Transit Association, Jack R. Gilstrap, said that these waivers were established to reflect Congress’ intent to apply Buy America only to large purchases, such as buses and trains.

F. THE NORTH AMERICAN FREE TRADE AGREEMENT

The North American Free Trade Agreement (NAFTA) negotiations were based largely on the U.S.-Canada Free Trade Agreement (CFTA). Although the CFTA expanded on the General Agreement on Tariffs and Trade (GATT) provisions regarding government procurements exceeding $25,000, it did not eliminate Buy America. Federally-

110. Iron was added to the list of products covered by the requirement. See Id. A penalty was established for persons who falsely placed “Made in America” labels on goods that were not made in America; such person would become ineligible to receive any future contracts under the act. See Id.
113. See Buy America Requirements, 60 Fed. Reg. 37,930 (to be codified at 49 C.F.R. § 661).
116. Anita C. Jenke, U.S., Canada Firms Weather Free Trade, METALWORKING NEWS, May 21, 1990, at 1. As UMTA explained: Finally, it should be noted that the U.S.-Canada Free Trade Agreement does not exempt Canadian-made products from the UMTA Buy America requirements. Products manufactured in Canada are considered foreign goods, and are entitled to no special treatment under the UMTA Buy America provisions.

funded projects of provincial, state, or local governments remained unaffected.\footnote{117}

NAFTA was enacted into law in 1993, and became effective on January 1, 1994.\footnote{118} Several economic objectives were achieved with NAFTA. The agreement was to expand sales opportunities between American, Canadian, and Mexican companies exporting to each other.\footnote{119} Another goal of the agreement was to enhance North American international competitiveness by permitting companies to set up operations where it would be most profitable economically, without the distortions caused by trade or investment barriers,\footnote{120} and to send a strong and encouraging signal throughout the hemisphere regarding the U.S. commitment to freer trade and open markets.\footnote{121} Finally, NAFTA was to eliminate tariffs and quotas within North America.\footnote{122}

But, even with these goals of opening the North American market to free trade, the Buy America barriers to the free trade of transit equipment still exist.\footnote{123}

\begin{footnotes}
\footnote{117}{\textit{CUTA, supra} note 65, at 13.}
\footnote{119}{Bello, \textit{supra} note 115, at 589. Transit construction projects in Mexico have flourished with the passage of NAFTA. A consortium composed of Bombardier (a Canadian railcar builder) and three Mexican firms has won an 18-year franchise to build and operate a US $685 million, 27-kilometer light rail line in Mexico City, expected to be completed in 1997. Julian Wolinsky and N.A. Eames, \textit{57 Light Rail and Modern Tramway} 106 (1994). Bombardier has won a contract from the \textit{Sistema de Transportes Colectivos del Distrito Federal} worth $64 million (Canadian) to refurbish 234 Mexico City subway cars. Julian Wolinsky, \textit{56 Light Rail and Modern Tramway} 301 (1993). Thirty-two articulated cars from Bombardier will be operated on new line 2 of the Guadalajara light rail system—\textit{Sistema de Tren Electrico Urbano}. Steve J. Morgan, \textit{57 Light Rail and Modern Tramway} 79 (1994). The 25 original articulated cars in the Monterrey system from Concarril are being supplemented with an additional 23 units from Bombardier. \textit{North America’s Expanding Urban Rail Systems}, \textit{Railway Age}, Feb. 1994, at G22. There are also many opportunities for the construction of new rail lines in Mexico. Construction of line 3 of the Guadalajara light rail system will begin in March 1995. Steve J. Morgan, \textit{56 Light Rail and Modern Tramway} 301 (1993). Tunneling has started on line 2 of the Monterrey light rail system—\textit{Sistema de Transporte Colectivo Metrorrey}; revenue service is expected to start near the beginning of 1995. Steve J. Morgan, \textit{57 Light Rail and Modern Tramway} 79 (1994). Mexico City has the largest subway system in North America based on ridership—1.6 billion annually. The current system has 9 lines with 109 route-miles. The system is being expanded to include 21 lines with 196 route-miles. \textit{North America’s Expanding Urban Rail Systems, supra.}}
\footnote{120}{Bello, \textit{supra} note 115.}
\footnote{121}{\textit{Id.}}
\footnote{122}{\textit{Id.}}
\footnote{123}{Brian Cudahy, an FTA spokesman, said, “Our rules do not agree with general tariff rules, they are not the same as the North American auto compact or NAFTA. We require U.S. parts and assembly here if tax dollars are used to purchase the buses or railcars.” Michael Levy, \textit{Canada-Made Buses Marked “Made in USA”, Buffalo News}, Jan. 26, 1994.}\
\end{footnotes}
III. BUY AMERICA’S INCONSISTENCY WITH NAFTA

Government procurement is covered within NAFTA at chapter 10. The basic requirements of government procurement are specified in article 1003 ("National Treatment and Non-Discrimination"). The article requires that:

1. With respect to measures covered by this Chapter, each Party shall accord to goods of another Party, to the suppliers of such goods and to service suppliers of another Party, treatment no less favorable than the most favorable treatment that the Party accords to:
   (a) its own goods and suppliers; and
   (b) goods and suppliers of another Party.

2. With respect to measures covered by this Chapter, no Party may:
   (a) treat a locally established supplier less favorably than another locally established supplier on the basis of degree of foreign affiliation or ownership; or
   (b) discriminate against a locally established supplier on the basis that the goods or services offered by that supplier for the particular procurement are goods or services of another Party.

Article 1003, therefore, says that the general principle of chapter 10 of NAFTA is to establish a level playing field for government procurement throughout North America. That is, any goods which are produced within Canada or Mexico ought to be treated equally with American goods when being considered as part of a governmental procurement.

But, NAFTA has further provisions regarding governmental procurements. Article 1001 ("Scope and Coverage") relates important limitations of the scope of the agreement. The agreement only covers specified federal government entities and specified government enterprises. It says state and provincial government procurements are covered in accordance with Article 1024.

Turning to Article 1024 ("Further Negotiations"), NAFTA says that no later than December 21, 1998, the parties are to commence further negotiations. Prior to these negotiations, "the Parties shall endeavor to consult with their state and provincial governments with a view to obtaining commitments, on a voluntary and reciprocal basis, to include within this Chapter procurement by state and provincial government enti-

125. Id.
126. Id.
127. Id.
128. Id.
129. Id.
ties and enterprises.”

The exclusion of state and local government procurement in NAFTA is consistent with international trade rules. In most cases, the article is fair because state and local procurements are made by local communities, based on local values and local funding. The United States government does not control most state and local funding, and cannot enter into a trade agreement with other nations that would restrict state and local governments in their means of procurement.

Since FTA-funded transit procurements are made by state and local governments, Buy America rules have continued to be applied. However, the procurement of transit equipment by state and local governments is unlike the other state and local procurements for which Article 1024 was written. In the United States, the FTA assists transit systems with capital funding of 80% under the discretionary and formula capital programs. Only 20% of the cost is paid for by the state or local government.

The classification of transit equipment purchases as state and local government procurements is nothing more than a legal fiction and a sham; transit equipment purchases are constructively federal procurements. Since 1964 the federal government had been paying nearly the full cost of transit equipment. It was because of the federal government’s near full funding of transit equipment Congress felt the need to expand Buy America to transit procurement in 1978.

If transit procurement is indeed a state and local function, then the 1978 Buy America provisions are inappropriate. Both the 1933 Buy America debate and the 1978 Buy America debate focused on the need of the United States government to purchase its goods within the United States. If transit is really a state or local purchase, then it ought to be up to the state or local government to impose its values on its procedures as to whether to impose Buy America (or “buy state” or “buy local”) requirements or not.

But, as is more likely, if transit procurement is considered a federal purchase, then Buy America cannot coexist with NAFTA. Federal

---

130. *Id.* If, however, negotiations pursuant to Article IX:6(b) of the GATT on Government Procurement are completed prior to this date, then the parties shall immediately begin their consultations with their state and provincial governments. *Id.*

131. Under international-trade rules, when government grant money is doled out to various commissions or public authorities, conditions such as Buy America may be attached. Peter Hadekel, *North American Trade Deal Opens Up New Markets for Canadian Firms*, *The Gazette* (Montréal), Apr. 9, 1994, at C1.

132. *CUTA, supra* note 65, at 14. The Canadian Urban Transit Association notes that this is particularly unfair since there are no comparable “Buy Canada” rules in place. *Id.*

133. There is no federal funding of transit in Canada. *Id.* at 4.

134. *See supra* notes 43-44 and accompanying text.
procurements are clearly covered under Article 1001 of NAFTA.\footnote{North American Free Trade Agreement, supra note 124.} Therefore, Article 1003 applies: the United States may not treat Mexican and Canadian transit suppliers any less favorably than American transit suppliers.

The United States has taken a position which is inconsistent with Buy America and NAFTA. It has said transit procurement is a federal, not a state or local, function, so Buy America may be applied;\footnote{See supra part II.} and transit procurement is a state or local, not federal, function, so NAFTA does not apply.\footnote{See supra part III.}

Not only is the FTA position inconsistent, but it is unfair, economically damaging to the other NAFTA signatories, particularly Canada, and contrary to the spirit of NAFTA. It may prevent a transit agency from being able to purchase the best product available.\footnote{Buy America Laws Create Problems for U.S. and Canadian Transit, URBAN TRANSPORT NEWS, June 21, 1995.} With no Buy Canadian requirements, American manufacturers have expanded to the Canadian market.\footnote{Id. at 47.} This trend will continue under NAFTA.\footnote{Id.} Prior to NAFTA’s passage, FTA Administrator Gordon Linton said, “We can stay the way we are and go the way of the dinosaur, or we can really participate in the global market.”\footnote{Joe Dougherty, NAFTA Holds Promise for Mass Transit, Says Linton, PASSENGER TRANSPORT, Nov. 8, 1993, at 1.} Linton said President Clinton was in favor of NAFTA because it would allow U.S. manufacturers to expand to Canada and Mexico.\footnote{Id.} He added this could increase the American market by 30 to 35 percent which would more than make up for a shrinking American market.\footnote{Id.} Yet, Linton says the Buy America mandate will not change under NAFTA.\footnote{Id.} Thus, contrary to the spirit of NAFTA, Linton has taken an aggressive and predatory stance by advising American manufacturers to go expand and exploit the Canadian and Mexican markets, and to refuse manufacturers in those countries to sell to the United States.

The Canadian Minister of International Trade, Roy MacLaren, has taken the position that FTA’s Buy America provisions are contrary to the intent of NAFTA, and the United States is not acting in the expected spirit of cooperation. In a letter to the Canadian Urban Transit Association, MacLaren wrote,
In my letter . . . of February 18, 1994, I noted that these [Buy America] restrictions are contrary to the principles of free trade between Canada and the United States . . . [T]he United States was not willing, despite the efforts of other countries, to include government funded programs within the disciplines of either the North American Free Trade Agreement (NAFTA) or the General Agreement on Tariffs and Trade (GATT).

IV. BUY LOCAL LEGISLATION FAILS—A QUEBEC CASE STUDY

The Framers of the British North American Act in the 1860s granted the federal government exclusive jurisdiction over trade and commerce. According to section 121, goods from one province shall be admitted “free” into any other. Canadian courts have narrowly interpreted the jurisdiction of the federal government. As a result, provinces have been able to easily erect barriers, such as preferential procurement policies. This is not the case in the United States where the Supreme Court has a long tradition of striking down local laws and regulations which inhibit interstate commerce.

In Quebec, provincial funding supplies 60% for Quebec-built buses, but only 35% for others. The provincial subsidy applies to buses with at least 20% Quebec content. This 25% differential in funding is a de facto “Buy Quebec” requirement for the Quebec market. The only preference given by Quebec is for Quebec-built buses—buses from other provinces are given no preference over buses from other countries.

But protectionism through de facto “Buy Quebec” requirements has not worked. Quebec transit companies are very unhappy with price and quality of Quebec-only. There is only one bus manufacturer and one railcar manufacturer in the province.

145. Letter from Roy MacLaren, Minister of International Trade (Canada) to Al Cormier, Executive Vice President, Canadian Urban transit Association (May 11, 1994) (on file with author).
147. Id. However, the section does not mention services or non-tariff barriers. Id.
148. Id.
149. Id.
153. Ontario Bus Industries is the largest bus manufacturer in North America, with sales of $200 million. But, the company was shut out of the Quebec market. The Quebec transit operators bought their buses from Les Autobus MCI. Lorinc, supra note 146.
154. When Quebec bought articulated buses a few years ago, it went to a Belgian firm because no Quebec firm built them (even though Manitoba-based New Flyer did build them). Id.
155. The failure to address customer dissatisfaction with transit buses has not been limited to Quebec. Letter from Scott A. Mintier, supra note 57. This is evidenced by the number of fail-
Quebec had lured the Diesel Division, General Motors of Canada, Ltd. from London, Ontario to St-Eustache, Quebec, in 1977, using a promise of preferential subsidy to Quebec municipalities purchasing Quebec-built buses.\textsuperscript{156} The plant was purchased in 1987 by Les Autobus MCI.\textsuperscript{157} Unable to make sufficient profits, the Autobus MCI plant was closed at the end of 1992.\textsuperscript{158}

However pro-Quebec the province might have been for the purchase of home-built buses, the feelings were not shared by the transit operators themselves in Quebec.\textsuperscript{159} Transit officials in Montréal and other major cities in Quebec had spent millions of dollars fixing poorly built buses from Autobus MCI.\textsuperscript{160} Critics, including Claude Larose, president of the Quebec Urban Transit Association, and Guy Chartrand, president of Transport 2000, claim the buses are based on outdated technology and designs, and Autobus MCI had failed to invest in research and development.\textsuperscript{161} The Société de transport de la Communauté urbaine de Montréal (STCUM) was unhappy with its buses from Autobus MCI, and wanted competitive bidding.\textsuperscript{162} The Quebec Association of Transit Commissions, a province-wide buying group, had the same feelings.\textsuperscript{163}

After the Autobus MCI plant was closed, Ontario Bus Industries began negotiations with the STCUM for the sale of buses.\textsuperscript{164} Ontario Bus Industries had expected to bid on 390 new buses.\textsuperscript{165} But then, Autobus MCI was bought out. The Fonds de solidarité des travailleurs du Quebec (the Quebec Federation of Labor venture-capital fund) supplied $12.5 million cash to buy the Autobus MCI plant in partnership with Nova Quintech, a firetruck manufacturer.\textsuperscript{166} The Société de Développement Industriel (the province's industrial-development agency) supplied $2.9

\textsuperscript{156} Hadekel, \textit{supra} note 151.

\textsuperscript{157} Les Autobus MCI is a subsidiary of Greyhound Lines of Canada (not affiliated with Greyhound Lines in the United States), which in turn is controlled by the Dial Corp.

\textsuperscript{158} Hadekel, \textit{supra} note 151.

\textsuperscript{159} Ronald Lebel, \textit{Corrosion Plagues Buses}, \textit{The Gazette} (Montréal), Nov. 10, 1992, at CI.

\textsuperscript{160} \textit{Id}.

\textsuperscript{161} \textit{Id}.

\textsuperscript{162} Hadekel, \textit{supra} note 151.

\textsuperscript{163} \textit{Id}. Many customers from outside Quebec, however, have been satisfied with the same buses. Letter from Scott A. Mintier, \textit{supra} note 57; Letter from Raymond Déry c.a., Commerce Officer, Gouvernement du Quebec Ministère de l'Industrie, du Commerce et de la Technologie (Mar. 21, 1995) (on file with author).

\textsuperscript{164} \textit{Id}.

\textsuperscript{165} \textit{Id}.

\textsuperscript{166} \textit{Id}.
million in low-cost financing, and $5 million in loan guarantees.\textsuperscript{167} The company became known as Nova Bus.\textsuperscript{168}

Ontario Bus Industries had negotiated for the order of 390 buses in Quebec.\textsuperscript{169} Its price was $35,000 lower per bus than Nova Bus. Nova Bus later reduced this difference to $10,000 per bus, but still, with the difference in provincial funding, Nova Bus, with the highest price, won the contract.\textsuperscript{170} Until 1998, the Quebec government will be protecting Nova Bus by directing its municipalities to buy only from Nova Bus.\textsuperscript{171}

Nova Bus now has 100\% of the Quebec transit bus market, and 21\% of the Ontario market.\textsuperscript{172} Ontario Bus Industries has 40\% of the North American market, but no share of the Quebec market.\textsuperscript{173}

The protectionist provincial funding legislation in Quebec caused other provinces to reexamine their funding policies. Ontario Bus Industries tried to persuade Ontario to retaliate.\textsuperscript{174} Norman Larocque, vice president of operations at New Flyer, said, "It was very unfair because a company in Quebec that got preferential treatment was not disallowed from bidding in other provinces."\textsuperscript{175} He believes Autobus MCI subsidized bids outside of Quebec with the premium Quebec transit systems must pay to buy Autobus MCI buses.\textsuperscript{176}

Talks between Ontario and Quebec over Quebec trade barriers initially failed.\textsuperscript{177} Ontario Premier Bob Rae said,

So far, however, Quebec does not appear to feel much incentive to let go of its unfair practices. Perhaps an element of reciprocal treatment, in which Ontario simply mirrors back to Quebec some of the policies which Quebec has been using against Ontario . . . will prompt Quebec to undertake more productive negotiations. I will now take this matter up with my colleagues in Cabinet, and we will decide exactly what actions to take.\textsuperscript{178}

On September 27, 1993, Ontario announced that it would discourage municipalities in Ontario from buying buses made in Quebec.\textsuperscript{179} Such moves would likely widen the gaps further between Quebec and the rest

\begin{thebibliography}{9}
\bibitem{167} Id.
\bibitem{168} Bus Maker Wins Order, \textit{The Gazette} (Montréal), July 7, 1993 at D1.
\bibitem{169} Hadekel, \textit{supra} note 151.
\bibitem{170} Id.
\bibitem{171} \textit{Ontario-Quebec Government Talks}, \textit{supra} note 152.
\bibitem{172} \textit{Ontario Says Talks on Quebec Trade Barriers Fail}, Reuter Textline, Sept. 1, 1993, available in LEXIS, WORLD Library, TXTLNE File.
\bibitem{173} Id.
\bibitem{174} Lorinc, \textit{supra} note 146.
\bibitem{175} Id.
\bibitem{176} Id.
\bibitem{177} \textit{Ontario-Quebec Government Talks}, \textit{supra} note 152.
\bibitem{178} Id.
\bibitem{179} \textit{Ontario Should Have Held Its Fire}, \textit{The Gazette} (Montréal), Sept. 29, 1993, at B2.
\end{thebibliography}
of Canada.\textsuperscript{180} Meanwhile, Quebec complained that Ontario set up a barrier of its own by requiring low floor buses for easy accessibility.\textsuperscript{181} The Nova Bus plant did not manufacture these types of buses.\textsuperscript{182}

However, the environment in Quebec is changing. In December, 1993, Quebec and Ontario agreed to open their respective bus markets.\textsuperscript{183} Nova Bus has unveiled a new low floor bus, invested millions of dollars into research and development, made significant improvements to the design of its “Classic” bus model, and otherwise undertaken substantial efforts to produce competitive, quality products.\textsuperscript{184}

Thus, de facto Buy Quebec legislation caused resentment among the other manufacturers in Canada, while Quebec transit operators suffered with buses perceived to be of poor quality and high cost. Quebec, however, is now making strides to open its markets, while its manufacturing industry works to provide improved products. Maintenance of Buy America in the United States may cause the same types of disputes between American and Canadian manufacturers as had existed between Quebec and Ontario, thereby totally unraveling the spirit and intent of the NAFTA.

\section*{V. Times Have Changed}

\subsection*{A. Conditions Favoring Protectionism No Longer Exist}

The conditions considered in the passage of the original 1933 Buy America Act, or the Surface Transportation Assistance Act of 1978, no longer apply to transit procurements within North America in the 1990s.

The 1933 act was debated during the great depression, a time when public attention was focused sharply on the need to provide jobs to Americans. When the 1978 act was passed, the country was suffering from the worst economic climate since the depression.\textsuperscript{185} Although there continues to be a call for generating American jobs, the need for jobs today is in no way comparable to the conditions of the depression era.

Much was made during the passage of Buy America of the “cheap” imports from Europe and Asia. Today's American bus market is practically limited to manufacturers from the United States, Canada, and Mexico.\textsuperscript{186} Buses from Canada are virtually indistinguishable from American

\begin{itemize}
  \item \textsuperscript{180} Id.
  \item \textsuperscript{181} Hadekel, \textit{supra} note 151.
  \item \textsuperscript{182} Id. However, neither did Ontario Bus Industries manufacture these types of buses—it was just gearing up for production. \textit{Id.}
  \item \textsuperscript{183} Letter from Raymond Dery c.a., \textit{supra} note 163. As of January 1, 1998, both provinces will treat all Canadian-built buses equally. \textit{Id.}
  \item \textsuperscript{184} Letter from Scott A. Mintier, \textit{supra} note 57.
  \item \textsuperscript{185} Henke, \textit{supra} note 45.
  \item \textsuperscript{186} There is, however, strong international competition in railcar construction from western
\end{itemize}
buses, with Canada having a nearly identical standard of living to the United States. The largest and most respected Mexican manufacturer of buses uses American-made parts. Hence, contemporary concerns over cheap imports from Canadian and Mexican manufacturers are unfounded.

B. TRANSIT MANUFACTURING IS A SMALL INDUSTRY (AND GETTING SMALLER)

The transit equipment market is not that large. In the United States, expected transit bus orders in the immediate future will likely average 3,340 buses per year, while 500 buses per year are expected to be ordered in Canada. Meanwhile, there are five U.S. and Canadian manufacturers to serve this market. For railcars, there are likely to be 469 to 594 cars purchased per year in the United States, while in Canada, there is an expected market of 87 cars per year.

In years past, the United States had several reputable bus manufacturers, most notably General Motors and Grumman Flxible. Railcar builders included the Budd Company, Pullman-Standard, and St. Louis

European and Japanese manufacturers. Within North America, though, there are only two domestically-owned railcar manufacturers—one American, and one Canadian (there had also been a single Mexican manufacturer, but this company was recently absorbed by the Canadian company). Nevertheless, these manufacturers can hardly be accused of supplying cars from "cheap" labor.

187. Dina: Top Performance South of the Border, BUS RIDE, Jan. 1994, at 46. The Mexican intercity bus market is 44% Dina, 25% Mercedes, and 24% Mexicana de Autobuses; the remaining 7% is smaller body builders. Id.

188. CUTA, supra note 65, at 22.

189. The major bus manufacturers which remain in North America are as follows.

Mexico: Diesel Nacional ("Dina")—intercity buses only
Canada: New Flyer Industries
         Nova Bus
         Motor Coach Industries (intercity buses only)
         Prevost Car (intercity buses only)
U.S.: Flxible
      Gillig
      Neoplan USA
      Ikarus USA
      Stewart & Stevenson

Three other manufacturers, all European-based, have left the American market within the past ten years (M.A.N. Truck and Bus Corp., Volvo of America Corp., and Saab-Scania). Additionally, neither Ikarus USA nor Stewart & Stevenson have been particularly successful, and may close up shop. Id. at 17.

190. The major railcar builders are as follows:

Mexico: None
Canada: Bombardier
U.S.: Morrison Knudsen

Ten other foreign car builders are also in the United States. European builders include AEG Westinghouse, Ansaldo, Asea Brown Boveri, Breda, Matra, and Siemens-Duewag; Japanese builders include Kawasaki, Mitsubishi, Nippon Sharyo, and Sumitomo. Id. at 17.
Car Company. But by 1977 all the American railcar builders had gone out of business, and it was not until 1982 that there was again an American-owned railcar builder.\textsuperscript{191}

Today, American transit manufacturers are in poor shape, and consolidation is the rule. General Motors is out of the bus business. Its successor, Motor Coach Industries, has sold its intercity bus manufacturing business to Mexican interests.\textsuperscript{192} Grumman has spun off FlixBus, and FlixBus has since been trying overcome the poor reputation it acquired under Grumman’s ownership.\textsuperscript{193} Neither Budd nor Pullman-Standard remain, having been consolidated (along with Mexico’s Concarril) in Canada’s Bombardier. The only American railcar builder is a relative newcomer, Morrison Knudsen.

The transit market is small, and cannot support many manufacturers. In December 1991, Bombardier, a Canadian railcar manufacturer, purchased the other remaining Canadian railcar builder, UTDC.\textsuperscript{194} The following year, Bombardier agreed to pay $81 million for Concarril, the state-owned railcar builder in Mexico.\textsuperscript{195} Bombardier is the only other North America-owned railcar builder to compete with Morrison Knudsen.

Motor Coach Industries, successor to General Motors and once the dominant bus builder in the country, announced it was quitting the transit business, and selling its transit bus manufacturing subsidiary, Transportation Manufacturing Corp. (TMC).\textsuperscript{196} According to John R. Nasi, president and CEO of TMC, “It’s not a healthy market,” adding that significant operating losses were the reason for the sale.\textsuperscript{197} He cited low profits, proliferation of specifications by cities, and growing federal mandates such as the Clean Air Act Amendments of 1990.\textsuperscript{198}

TMC’s transit bus business is being purchased by Nova Bus.\textsuperscript{199} At

\textsuperscript{191} Id. at 9. Onerous contracts and subsequent losses put some railcar manufacturers out of business. Letter from Scott A. Mintier, supra note 57.

\textsuperscript{192} Motor Coach to Mexicans, N.Y. TIMES, Aug. 9, 1994.

\textsuperscript{193} At least fifteen American transit systems had removed Grumman FlixBus model 870 buses from service. News & Notes, MOTOR COACH AGE, Feb. 1985, at 20. The most notable withdrawal was the entire Grumman FlixBus fleet from the New York City Transit Authority in 1984. Id.

\textsuperscript{194} Ronald Lebel, Bombardier to Acquire Mexican Railcar Maker, THE GAZETTE (Montréal), Apr. 10, 1992, at D1.

\textsuperscript{195} Id.

\textsuperscript{196} Motor Coach Industries to Quit Transit Business, PASSENGER TRANSPORT, Nov. 15, 1993, at 1.

\textsuperscript{197} Mexican Firm Could Acquire MCI’s Transit Bus Business, PASSENGER TRANSPORT, Jan. 10, 1994, at 3.

\textsuperscript{198} Id.

\textsuperscript{199} NovaBUS Acquires TMC, PASSENGER TRANSPORT, Dec. 5, 1994, at 1.
the same time, Bombardier is acquiring a 25% interest in Nova Bus,\textsuperscript{200} thereby even further consolidating the industry.

In early December 1993, Dina,\textsuperscript{201} a Mexican bus manufacturer, announced its intention to purchase the intercity bus business of Motor Coach Industries in a deal worth $336.6 million.\textsuperscript{202} The acquisition of Motor Coach Industries by Dina was completed on August 8, 1994.\textsuperscript{203} Dina will now be the largest manufacturer of intercity buses in North America.\textsuperscript{204}

In February 1994, control of Ontario Bus Industries passed to the Province of Ontario.\textsuperscript{205} Although there had been discussions about a possible merger with Nova Bus,\textsuperscript{206} an interim agreement was reached for another Canadian company, GFI Control Systems, to manage Ontario Bus Industries.\textsuperscript{207} A year later, in April 1995, Western Star Truck Holdings Ltd., also a Canadian company, agreed to purchase Ontario Bus Industries from the Ontario Government for $39 million (Cdn.).\textsuperscript{208}

Flexbile has initiated discussions with Mexicana de Autobuses of Mexico City for a strategic alliance between the two companies for the manufacturing of intercity and articulated transit buses.\textsuperscript{209}

---

\textsuperscript{200} Id.


\textsuperscript{202} Id. Because Motor Coach Industries has operations in Canada, this was one of the first three-country companies formed since NAFTA was signed. \textit{Id}. However, it is expected Dina will continue to operate manufacturing plants in both Mexico and the United States. Craig Lentzsch, Motor Coach Industries' executive vice president, said, "The Mexican company makes a quality product for their market; we make a quality product for our market. I believe that our plans would be to continue to do just that." \textit{MCI Buyout}, \textit{Bus World}, Spring 1994, at 3.

\textsuperscript{203} \textit{Motor Coach To Mexicans}, \textit{N.Y. Times}, Aug. 9, 1994.

\textsuperscript{204} Id.

\textsuperscript{205} Ian Macdonald, \textit{Bad Times at OBI}, \textit{Transfer Points}, Aug. 1994, at 8.

\textsuperscript{206} Id.

\textsuperscript{207} \textit{GFI Takes Over Management of Ontario Bus Industries}, \textit{Passenger Transport}, Nov. 21, 1994, at 2. GFI is a joint venture between Devtek Corp. and Stewart & Stevenson, the latter having also manufactured a small number of buses in the United States.


C. **Inclusion of Canadian and Mexican Firms Necessary to Maintain Competition**

Only through the inclusion of all three NAFTA countries will there be sufficient competition to ensure quality products at competitive prices. Maintaining barriers against Canadian and Mexican products will simply cost Americans more money without providing any net gains.\(^{210}\)

Proponents of free trade argue, notwithstanding short-term dislocations, growth generated in both the United States and Canada will make the North American economy a more formidable counter-balance to the unified European market.\(^{211}\) "[T]he reduction of barriers on both sides of the border will spur economic integration that should make US firms more competitive globally."\(^{212}\)

Inclusion of Canadian buses regularly in American transit procurements will not represent a major change. Canadian and American transit equipment is virtually indistinguishable (using shared common designs and company origins) on account of nearly identical operating conditions.\(^{213}\) Canadian bus designs and some railcar designs were developed by American companies, and produced in Canada under license or by a Canadian subsidiary.\(^{214}\)

Most intercity buses are not purchased with FTA funds, and so Buy America rules do not apply. Hence, this market is an indicator of what the transit bus industry might be like without Buy America. The marketplace for intercity buses has evolved such that the United States and Canada together comprise a single market.\(^{215}\) Only two of the major intercity bus manufacturers produce their buses entirely within the United

\(^{210}\) These effects are already evident in Canada. In Quebec, the 390-bus order from Nova Bus will cost the province $58 million in subsidies over the next three years. Hadekel, *supra* note 151. This amount could have been nearly halved by buying from Ontario. *Id.*

\(^{211}\) Barriers mainly create [an] arbitrary redistribution of income among provincial residents. . . . If B.C. Ferry Corporation pays too much for its equipment, B.C. shipbuilders benefit but B.C. ferry riders—or taxpayers, since ferry rides are subsidized—lose. This is a zero-sum game. . . . The province as a whole just cannot win, though appreciative shipbuilders may become strong supporters of the government that butters their bread.

Politicians’ response to this argument is that if provinces are to develop modern economies, there are certain crucial industries that must for a time be encouraged, even if consumers or taxpayers suffer as a result. The trouble is, these infant industries seldom grow up.


\(^{214}\) *CUTA, supra* note 65, at 18.

States.\textsuperscript{216}

Presently, the Canadian share of the American transit bus market is nearly 50\%.\textsuperscript{217} Canadian manufacturers are able to sell in the United States only because they have a separate facility in the United States for final assembly, and include at least 60\% American content.\textsuperscript{218} The maintenance of these separate facilities results in inefficiencies and higher costs.\textsuperscript{219}

Ontario Bus Industries, for example, maintained a 570-employee plant in New York State in order to comply with Buy America.\textsuperscript{220} This plant completed half-assembled buses from the main 670-employee plant in Mississauga, Ontario.\textsuperscript{221}

\section*{VI. Conclusions}

The Canadian market alone cannot support three transit bus manufacturers, nor a single railcar manufacturer.\textsuperscript{222} Advancement of the industry through research and development is limited.\textsuperscript{223} With Buy America regulations, Canadian companies are unable to make decisions on a commercial basis.\textsuperscript{224}

\begin{flushleft}
\textsuperscript{216} Id.
\textsuperscript{217} Id. at 23.
\textsuperscript{218} Id. The Canadian bus manufacturers have established final assembly plants in the northern United States: Nova Bus at Schenectady, N.Y., New Flyer at Grand Forks, N.D., and Ontario Bus Industries at Oriskany, N.Y. Id. Bombardier has a final assembly plant in Barre, Vt. Id.
\textsuperscript{219} “Buy America restrictions attached to federal funding are trade-restrictive and result in inefficiencies and higher costs.” Letter from Roy MacLaren to Al Cormier, supra note 145.
\textsuperscript{220} Lorinc, supra note 146.
\textsuperscript{221} Id. Additionally, the maintenance of two separate manufacturing facilities so close to each other (but in separate countries) leads to temptation to skirt the formalities of the separate facilities, tempting manufacturing companies to “cheat” in order to remain competitive. A customs officer at the Peace Bridge (Buffalo) observed a driver switch a “Made in Canada” plate for a “Made in U.S.A.” plate on a new bus. Michael Levy, Canada-Made Buses Marked “Made in USA”, BUFFALO NEWS, Jan. 26, 1994. The company, Ontario Bus Industries, has already been fined $400,000. Id. It may pay another $500,000 in fines, and its president, Donald K. Sheardown, may also be personally fined $100,000 and sentenced to one year in prison. Id. Sheardown had sworn out false certificates, as required by 49 C.F.R. § 661.12. BIA Pleads Guilty, BUS WORLD, Spring 1994, at 3. The U.S. Justice Department said that Sheardown had knowingly signed the false certificates. Id.
\textsuperscript{222} CUTA, supra note 65, at 42.
\textsuperscript{223} The Buy America rules effectively restrict or limit the capability of the Canadian transit industry, with or without government assistance, to invest in R & D for new products because of the limited access to the U.S. market, particularly with respect to the manufacture of components and sub-components. At the same time, these restrictions impact on the American transit industry by limiting them from the benefit of joint product development, free access to the larger Canada-U.S. market competition and rationalization of an excess-capacity and inefficient manufacturing industry.
\textsuperscript{224} Letter from Al Cormier to all Provincial Premiers, supra note 92.
\end{flushleft}
Protectionism has not worked.\textsuperscript{225} The Surface Transportation Assistance Act of 1978 provided the greatest inflation-adjusted level of funding for transit ever.\textsuperscript{226} The influx of dollars and regulation merely postponed the inevitable failure of the Buy America rules.\textsuperscript{227} Today, according to data collected by Booz, Allen and Hamilton, the U.S. railcar manufacturers have a lower market share than before the first 1978 Buy America regulation.\textsuperscript{228} The same is true with bus manufacturers, though not to nearly the same degree as with railcar manufacturers.\textsuperscript{229} All but two of the American bus manufacturers and the American railcar manufacturer are on shaky financial ground.\textsuperscript{230}

Buy America provisions for American content and final assembly should be changed to nothing less than "Buy North America." The American and Canadian transit markets are interdependent, and have historically developed together.\textsuperscript{231} The reasons for the imposition of Buy America requirements have to do with Europe and Japan, not Canada or Mexico.\textsuperscript{232} Development of a common transit market between the United States, Canada, and Mexico is consistent with NAFTA and Buy America principles.\textsuperscript{233} Free access by Americans to Canadian markets while Canadians are restricted from American markets is viewed by the industry as unfair and inconsistent with CFTA and NAFTA principles.\textsuperscript{234}

\textsuperscript{225} Henke, supra note 45.
\textsuperscript{226} Id.
\textsuperscript{227} Id.
\textsuperscript{228} Id.
\textsuperscript{229} Id.
\textsuperscript{230} Id.
\textsuperscript{231} CFTA, supra note 65, at 49.
\textsuperscript{232} Id.
\textsuperscript{233} Id.
\textsuperscript{234} Id.; Letter from Raymond Dery c.a., supra note 163. The Canadian Urban Transit Association (CUTA) has pushed for an exemption to Buy America. Canadians Want Buy America Removed as a Trade Barrier, Urbana Transport News, May 12, 1994. CUTA says the requirements are inconsistent with NAFTA. Id. At a minimum, CUTA would like the restoration of a threshold of at least $1 million. Id. U.S. trade officials have indicated that a $25,000 minimum might be considered. Id.
Intermodal Transportation Planning for the Environment: Social, Cultural, and Economic Considerations for an Interdisciplinary Solution for Change

[T]he future of air quality and transportation are intertwined . . . when we plan for transportation we have to plan for air quality; and when we plan for air quality we have to look at how our transportation plans are being put together.1

David R. Fiore*
John M. Stafford**

† © The copyright to this article and all graphs and charts is held by the authors. Reproduction is prohibited without the written consent from both authors.

1. Larry Kallenberger, Deputy Director of the Department of Local Affairs, Denver, Colorado, quoted in Government Profile 2, October, 1989.

* David R. Fiore is the Director of Properties and Concessions for Budget Rent a Car Systems, Inc. He is accountable for both domestic and international endeavors in his area for the corporation. Prior to joining Budget, Mr. Fiore worked for ten years as an airport administrator for various airports including San Francisco International Airport, Fort Wayne International Airport, and a major reliever airport to O'Hare International Airport. Former Editor-in-Chief of the Transportation Law Journal; J.D. from the University of Denver College of Law (recipient of a Student Leadership Award and two Scholastic Excellence Awards); B.S. in Airport/Aviation Management from Southern Illinois University; International legal studies in Moscow, Russia and Budapest, Hungary through Loyal University College of Law; Commercial Pilot with Instrument and multi-engine ratings; Certified Member of the American Association of Airport Executives. The views expressed in this article are personal and in no way imply that they are the position of the Budget Rent a Car Corporation.

** Mr. Stafford is presently a Juris Doctorate candidate at the University of Denver College of Law (May 1996). He has interned for Region VIII of EPA and was an Honors Program summer law clerk for the United States Department of Justice, Environment and Natural Resources Division. He is also General Editor of the D.U. Law Review. Prior to law school, he
<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I.</td>
<td>Introduction</td>
<td>239</td>
</tr>
<tr>
<td>II.</td>
<td>Background</td>
<td>239</td>
</tr>
<tr>
<td></td>
<td>A. History</td>
<td>239</td>
</tr>
<tr>
<td></td>
<td>B. The Problem</td>
<td>240</td>
</tr>
<tr>
<td></td>
<td>C. The Issues</td>
<td>245</td>
</tr>
<tr>
<td>III.</td>
<td>Legislative Overview</td>
<td>248</td>
</tr>
<tr>
<td></td>
<td>A. General</td>
<td>248</td>
</tr>
<tr>
<td></td>
<td>B. Funding Overview</td>
<td>249</td>
</tr>
<tr>
<td></td>
<td>C. Clean Air Act Amendments of 1990</td>
<td>253</td>
</tr>
<tr>
<td></td>
<td>1. Non-attainment Areas</td>
<td>253</td>
</tr>
<tr>
<td></td>
<td>2. Conformity</td>
<td>255</td>
</tr>
<tr>
<td></td>
<td>3. Transportation Control Measures (TCMs)</td>
<td>256</td>
</tr>
<tr>
<td></td>
<td>D. Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA)</td>
<td>258</td>
</tr>
<tr>
<td></td>
<td>E. Title 23, Highways</td>
<td>260</td>
</tr>
<tr>
<td></td>
<td>1. Surface Transportation Program (STP)</td>
<td>260</td>
</tr>
<tr>
<td></td>
<td>2. Congestion Mitigation and Air Quality Improvement Program (CMAQ)</td>
<td>260</td>
</tr>
<tr>
<td></td>
<td>3. Complimentary Provisions</td>
<td>261</td>
</tr>
<tr>
<td></td>
<td>4. Intelligent Vehicle Highway Systems (IVHS)</td>
<td>261</td>
</tr>
<tr>
<td></td>
<td>5. Future Planning</td>
<td>263</td>
</tr>
<tr>
<td></td>
<td>a. Statewide Planning</td>
<td>263</td>
</tr>
<tr>
<td></td>
<td>b. Metropolitan Planning</td>
<td>264</td>
</tr>
<tr>
<td></td>
<td>F. Title 42, Public Health and Welfare</td>
<td>265</td>
</tr>
<tr>
<td></td>
<td>1. State and Local Incentive Program</td>
<td>265</td>
</tr>
<tr>
<td></td>
<td>G. Title 49, Transportation</td>
<td>266</td>
</tr>
<tr>
<td></td>
<td>1. Airports</td>
<td>266</td>
</tr>
<tr>
<td></td>
<td>2. Rail Terminals</td>
<td>267</td>
</tr>
<tr>
<td></td>
<td>3. Rail As An Alternative</td>
<td>268</td>
</tr>
<tr>
<td></td>
<td>a. Background</td>
<td>268</td>
</tr>
<tr>
<td></td>
<td>b. High Speed Rail</td>
<td>268</td>
</tr>
<tr>
<td>IV.</td>
<td>Analysis</td>
<td>270</td>
</tr>
<tr>
<td></td>
<td>A. General</td>
<td>270</td>
</tr>
<tr>
<td></td>
<td>B. State and Local Matching Fund Requirement</td>
<td>271</td>
</tr>
<tr>
<td></td>
<td>C. Banking/State Intermodal Trust Fund</td>
<td>271</td>
</tr>
<tr>
<td></td>
<td>D. FAHP Fund Allocation Dictates vs. Block Grants</td>
<td>272</td>
</tr>
<tr>
<td></td>
<td>E. Tolls</td>
<td>274</td>
</tr>
<tr>
<td>V.</td>
<td>Conclusion and Recommendations</td>
<td>275</td>
</tr>
</tbody>
</table>
I. Introduction

Today, society generally recognizes the complex interrelationships between transportation and air quality. The highly technical Clean Air Act amendments of 1990 (CAAA)\(^2\) and the labyrinth of the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA),\(^3\) enacted to provide the funding for the requirements imposed by the CAAA, evidence the complexity of the recognized interrelationships.

National and state dual interests in economic development and the environment drive the funding process of intermodal transportation projects. The highway bills of the 1950s provide for the national economic interests in interstate commerce and interstate travel. The more recent CAAA and ISTE A address a new national interest in the environment. Congress introduced CAAA and ISTE A to provide sufficient flexibility to address the states’ concurrent dual interests.

The incentives provided by the combination of the CAAA and ISTE A provide a significant step in the right direction toward establishing an intermodal system capable of addressing the nation’s transportation needs while simultaneously improving the air quality. In their present form, however, they will not achieve either goal.

The existing statutory scheme imposes limitations on the methods of planning and the available funding mechanisms. Relatively modest changes in the law can remove these limitations and will allow the statutory scheme to do what Congress intended it to do, and can simultaneously protect the environmental and economic interests of our nation. This paper analyzes the existing statutory schemes of the federal CAAA and ISTE A and recommends changes that, we believe, are realistic and instrumental to advance the intent of the framers.

II. Background

A. History

The federal government’s role relative to the nation’s transportation system is, as it should be, to protect the national interests. In the 1950s, the national interests included national security and defense, interstate commerce, and interstate travel. The 1990 enactment of the Clean Air Act amendments, and its predecessors, mandated significant action to remedy air quality problems. In essence, this mandate elevated the protection of the environment to the status of a new national interest. To

---

adequately address this new national interest, at a time when projections indicate a significant trend toward increasing vehicle miles traveled,4 requires more than the traditional approach to transportation issues. Intermodal transportation systems are generally regarded as being an integral part of the air quality solution.

B. The Problem

Despite the most sophisticated air pollution controls in the world, the EPA has identified 101 locations in the United States, in which some 112 million people reside, that do not meet the National Ambient Air Quality Standards (NAAQS) for ozone.5 In addition, over 29 million Americans now live in 44 identified areas that exceed NAAQS for carbon monoxide.6 The source of almost half the ozone and nearly all of the carbon monoxide (CO) air pollution is the 157 million motor vehicles (122 million cars and 35 million light-duty trucks) operated in the United States.7

Government projections expect the population of the United States to increase by over 30 million people within the next 20 years, mostly in existing metropolitan areas.8 This change in population will increase the number of vehicles (mobile sources of pollution) on the road, and thus, aggregate traffic congestion. Increased congestion, in turn, will result in longer traffic delays, and longer periods of operation for pollution emitting-vehicles.

Figure 1 illustrates the interplay between tail-pipe emissions per vehicle mile traveled (VMT) and the number of VMT as projected to the year 2015.9

Despite projected additional reductions in tail-pipe emissions, the projected increase in VMT will result in increased automobile related emissions. This offsetting relationship becomes increasingly significant as the reductions in per-vehicle emissions approach their technical limit. Once the per-vehicle emissions have been reduced to their projected asymptotic limit of approximately one gram per mile, the total amount of emissions will be a function solely of the number of VMT.

Congress addressed both the emission and VMT problems in the CAAA.10 Efforts to reduce emissions focused primarily on enforcing the

---

4. See infra text accompanying note 8.
6. Id.
7. Id. at 2.
8. ISTE A § 6009(a)(2).
9. Automobiles and Ozone, USEPA Office of Mobile Sources, p. 3.
10. See supra note 2 and accompanying text.
Figure 1

VMT vs. Per Vehicle Emissions

[Graph showing VMT vs. per vehicle emissions over time with two lines: one for vehicle miles traveled and another for average per-vehicle emissions.]
stringent technical standards for tail-pipe emissions, while the efforts to reduce VMTs centered on the expanded transportation control measures (TCMs) set out in § 108(f)(1)(A).\textsuperscript{11} Technology based provisions experience less opposition than the more “cultural” changes imposed by the TCMs designed to reduce VMT.\textsuperscript{12} While much of the resentment to TCMs arose from the projected inconvenience, other commentators have observed an economic distinction between TCMs and the more technical provisions, such as “reformulated fuels, inspection and maintenance programs, vapor recovery, and stationary source controls.”\textsuperscript{13} “In a purely cost-effective sense, TCMs cost tens of thousands of dollars per ton of emissions reduction.”\textsuperscript{14} The more technical provisions targeting the reduction in tail-pipe emissions “are much more cost effective.”\textsuperscript{15}

If one presumes that for mandated changes to be effective and long lasting, the voting public must be convinced that the burden imposed by the federal mandate is not only needed and cost-effective, but also the least intrusive means by which the desired result may be obtained, then Figure 2 presents an interesting problem. Figure 2 represents the same data presented in Figure 1, but expressed as a product of emissions per vehicle times the total projected VMT for each represented year. The graphed value, therefore, represents the total mass of emissions from vehicles. Until the asymptotic limit in the reduction of per-vehicle emissions is reached in the year 2005, Figure 2 suggests that the most critical factor in overall pollutants is the level of per-vehicle emissions, not the number of VMT.\textsuperscript{16} Technological controls do produce a significant drop in overall emissions despite the dramatic rise in VMT over the same interval of time.

During this period (present to 2005), significant political and popular opposition may confront any attempts to impose the significant costs and hardships that accompany the more expensive, culture altering TCMs. After the year 2005, however, Figure 2 suggests that the gross emissions will again begin to rise. Unlike the rise observed in the 1960s, however,

\begin{itemize}
\item\textsuperscript{12} The use of the term “cultural changes” in association with transportation control measures refers to the general goal of these measures to get people out of their single occupancy vehicles. TCMs encourage higher occupancy vehicle travel either in car pools or some form of mass transit.
\item\textsuperscript{13} Theodore C. Taub et al., TDMS, APFOS, CIPS, CDDS, ICED TEA and Other Terrestrial, C851 AII-ABA 627, 684.
\item\textsuperscript{14} Id. (quoting Kris Wisniewski, transportation planner in the Statewide Planning and Policy Section of MDOT.)
\item\textsuperscript{15} Id.
\item\textsuperscript{16} This relationship applies to those criteria pollutants, such as ozone and carbon monoxide, that result primarily from tail-pipe emissions. This relationship may not be valid for other criteria pollutants, such as particulates, that have other significant sources such as road sand.
\end{itemize}
Figure 2

GRAMS OF POLLUTANTS Emitted
(grams/mile X vehicle miles traveled)
we may not be able to stem that rise by dramatically reducing per-vehicle emissions. When we reach this projected juncture in ten years, we will have two options: either reduce the VMT or find ways to further reduce the per-vehicle emissions below the approximate 1.0 gram per mile per vehicle illustrated in Figure 1.

In reality, we are facing that problem today because, with either option, the answer cannot be achieved by simply flipping a switch. The solution for reducing VMT requires the planning, design, construction, and implementation of major alternative transportation systems, realizing the delay in time before such systems become effective. In this sense, Figure 2 suggests that we are susceptible to being the victims of our prior success. In other words, the absence of an immediately critical problem lulls the public attitude into complacency regarding air quality problems, yet the crisis is inevitable and the solutions are costly and time consuming to implement.  

The alternative to reducing VMT is to further reduce tail-pipe emissions. To some, efforts to reduce tail-pipe emissions below the projected 1.0 gram per vehicle per mile may seem futile. Several potentially viable techniques, however, are presently being studied. The concept of a “zero tail-pipe emission vehicle” (ZEV) generally involves either an electric vehicle or an “ultra-light hybrid” vehicle. Relying on such technological solutions to mobile source air pollution problems, however, may have significant practical and cultural problems. The practical problems involve the risk that the actual construction of such a vehicle will not achieve the anticipated results. In fact, the developer of the ultra-light hybrid vehicle acknowledges the non-trivial task involved in “putting them together with system optimization and excellent software.”

17. For example, the fate of Denver’s previously approved expansion of their light-rail system is embroiled in a political dispute. This dispute follows Denver’s first year in more than twenty without a single violation of the federal air pollution standards. Al Knight, Denver Should Celebrate its First Clean-Air Year, DENVER POST, Jan. 8, 1995, at E1. This trend of improving air quality, and the “Republicans promise to reverse the current tendency to spend huge amounts of money avoiding what appear to be minor environmental risks,” Id. at E5, illustrate the type and magnitude of opposition that should be anticipated for any type of TCM.

18. A vehicle with some tail-pipe emissions may be considered a ZEM if its emissions are less than the powerplant emission required to refuel an equivalent battery car. Interview: Amory Lovins Predicts Radical Auto Changes, GREENWIRE, Nov. 14, 1994.

19. “Ultra-light hybrid” vehicle refers to the vehicle being developed by Amory Lovins of the Rocky Mountain Institute. It is constructed with the ultra-light advanced-composite materials used in military aircraft and powered by electrically driven wheels. The electricity to drive the wheels is generated on-board by burning fuel on an as needed basis. Mr. Lovins claims these vehicles are capable of traveling coast to coast on a single tank of fuel while emitting 100 to 1000 times fewer pollutants than today’s cars. Electric Vehicles: “Supercar” Could Transform Auto Industry, GREENWIRE, July 22, 1994.

the emphasis Americans place on safety today, general acceptance of such a vehicle may also encounter cultural barriers regarding the survivability of a crash in an ultra-light hybrid or electric vehicle. The "composite materials" used to construct such vehicles "absorb less force during collisions, transferring more to passengers."21 Contrary to the developer's contention, "[t]here is still a lot of work to do to ensure that the passengers survive."22 Significant product liability issues could stall the commercial development of these vehicles well past the 2005 juncture23 when such emission-reducing vehicles are projected to be needed.

Despite these potential barriers, in 1990 the California Air Resources Board mandated that two percent of new vehicles offered in California be ZEV; the percentage increases to five percent by the year 2001, and to ten percent by 2003.24

As with any new technology, the cost to the individual consumer for a ZEV will likely be high. Comparatively, public work projects including mass transportation, such as airports and high-speed rail, may be paid for through funding sources established by Congress that disperse the cost through a wider citizen/user base.

Several components of our "American culture" compound this bleak outlook for the air pollution problems related to mobile sources. First, unlike our European and Asian counterparts, Americans travel primarily in single occupancy vehicles. Second, the rise in popularity of suburban housing has created a shift in population away from higher density urban centers. With increasing numbers of American workers living further from their place of employment and in geographically dispersed areas, the result has been an increase in VMT associated with single occupancy vehicle commuters. Serving the typical American worker with an efficient mass-transit system also becomes more difficult (and less practical) due to this geographic dispersion.

C. The Issues

Under the CAAA, an intermodal transportation project must be consistent with the state implementation plan (SIP) and demonstrate progress toward attainment of the National Ambient Air Quality Standards (NAAQS). As a result, state and municipal planning organizations (MPOs)25 throughout the country are asking the following questions: 1)

22. Id.
23. See Figure 2.
25. A MPO is an organization "designated as being responsible, together with the State, for conducting the continuing, cooperative, and comprehensive planning process under 23 U.S.C.
can the limited capacity of the existing transportation systems be relieved by alternative forms of transportation; 2) does high-speed rail, light-rail, or any other mode of transportation provide an alternative that will reduce the VMT; and 3) are there other, more cost-effective forms or alternative mechanisms to achieve the economic and environmental goals?

The answers to these questions reside in the process of considering the various transportation control measures (TCM) provided for in the CAAA, as opposed to the more technical provisions aimed at reducing the level of tail-pipe emissions. The TCMs contained in the CAAA have a consistent goal of reducing VMT by getting people out of single occupancy vehicles. Accomplishing this reduction in VMT requires more of a cultural change in personal driving habits. Although one commentator suggested that legislative efforts to reduce urban sprawl and the resulting reduction in VMT constitutes “social engineering,” logic requires that all possible alternatives be considered.

Cultural changes are not always susceptible to the “technology forcing” methods Congress imposes on the more technical provisions. When mandating changes in personal driving habits, the legislature should consider an analogy to what constitutes a successful negotiation. To achieve lasting results, a negotiation must result in a mutually beneficial solution. In order for legislatively mandated cultural changes to be long lasting, they must recognize the extent to which such mandates will be tolerated by the American public. Ignoring cultural realities is likely to result in a political backlash, the ousting of the responsible incumbents, a reversal in policy goals, and the wasting of resources already committed to the abandoned policy objectives. Denver’s Mayor Webb recently

26. CAA, supra note 11.
28. TCMs imposed by EPA, when California refused to submit a SIP for Los Angeles, that included a surcharge of $3.00 per day on parking, exclusive bus and carpool lanes, pre-construction review of new facilities with more than a certain number of parking spaces, and a gasoline rationing plan to reduce the amount of gasoline used in Los Angeles by over 80% were short lived due to strong popular and political opposition. X John P. C. Fogarty, Law of Environmental Protection (ALI), § 11.08[3] at 221-23 (ed. 1994).
29. For example, some commentators suggest that the answer to air quality programs is to reduce urban sprawl in favor of high density residential housing projects that are easier and less costly to service with mass-transit programs. Taub et al., supra note 13, at 638 (Moving towards compact land use patterns, eliminating further sprawl and emphasizing transportation management systems will be necessary if the Clean Air Act amendments are enforced). The reality of today’s housing growth, however, indicate that the areas of fastest growth are in the large planned communities developed by developers in the suburbs. To legislatively deny the public this type of housing option is likely to be very unpopular with that subset of the population responsible for the greatest percentage of home buying. It is hard to imagine that this
Figure 3

Household-based Motor Vehicle Travel for Selected Purposes

coined the term “transportation whiplash” in response to a threatened reversal of previously approved transportation plans. 30

We suggest that the best solutions integrating intermodal transportation programs with the air quality goals of the CAAA do not attempt to change the established cultural trends that create urban sprawl, but rather work within the established framework to find creative solutions that are mutually beneficial. 31 It may not be possible to get people to use alternative modes of transportation all of the time. Figure 3 illustrates the relative number of household vehicle miles traveled for selected categories. 32 The two highest-categories are “commuting to work” and “social & recreational” travel. The two lowest categories are “shopping” and “family & personal business”. To be most effective, efforts to encourage people to get out of their single occupancy vehicle and into some form of mass transit should logically target the commuting and social and recreational traffic. For practical reasons, people may be more receptive to commuting to work by rail or bus than going to shopping centers by such modes. By focusing on reducing commuting miles, policy makers may more realistically weigh the costs against the benefits of alternative modes of transportation.

III. LEGISLATIVE OVERVIEW

A. GENERAL

Although the CAAA is vitally important, it did not provide significant funding to carry out these programs and projects. That’s where the ISTEA comes in. 33

Meeting both the environmental and economic development needs of our society is the primary goal in developing an intermodal transportation policy. One factor in accomplishing this goal is efficiency. “Efficiency” means something quite different to those who seek to promote

---

subset of home buyers, and the politically powerful developers, would not utilize the electoral process to fight any legislation prohibiting suburban development projects.


31. Even the technically based provisions of the CAAA are susceptible to the same type of grass roots rebellion if they impose too great a burden on the general public. For example, the Governor of Maine suspended the new enhanced I/M provisions only two months after being enacted due to poor acceptance and demands by the public for abolition of the program.


economic development and those who seek to further environmental protections.

A common definition of transportation efficiency is to move people and goods in the fastest and most convenient manner from point A to point B. Accomplishing this minimizes both the amount of fuel consumed and the time spent traveling. Reducing the quantity of fuel consumption saves money and simultaneously reduces the volume of emissions released to the atmosphere. Minimizing the time spent traveling allows the time saved to be used in more personal, or profitable, endeavors.

The transportation objectives of those seeking to spark economic growth are to: 1) provide efficient modes of transportation; and 2) minimize the financial imposition on developers and companies contemplating establishing business ties with a community. The transportation objective of those who seek to protect the environment is to accommodate the projected increase in population and vehicle miles traveled while reducing overall emission levels. The result of these differing objectives is apparent in the various legislation regarding transportation and environmental issues.

The focus of legislation incorporating intermodal transportation issues, found in various U.S.C. Titles, varies depending on the nature of the underlying legislation. For example, transportation legislation in Title 49, while acknowledging environmental issues, focuses primarily on the economic considerations. Highway legislation in Title 23 is more responsive to the environmental issues. Environmental legislation regarding mobile pollution sources such as the CAAA deals primarily with two issues: 1) reducing tailpipe emissions; and 2) reducing VMT. This section summarizes and synthesizes the most significant of these acts. Part B provides an overview of the funding process, Part C discusses components of the CAAA, and Part D discusses the funding mechanisms available under ISTEA to meet the requirements mandated by the CAAA.

B. FUNDING OVERVIEW

The CAAA established new mandates for states to comply with certain well-defined air quality standards. Congress attempted to establish the funding mechanism and achieve the requirements of the CAAA through the enactment of ISTEA. Figure 4 illustrates the complexity of ISTEA's funding mechanisms as they relate to the CAAA.

Although ISTEA was designed to establish flexible funding for the states, it is not as flexible as its framers intended. To illustrate the inflexible nature of ISTEA, note that one of the major components of ISTEA, the Surface Transportation Program (STP), dictates how the majority of
federal money is spent. The STP leaves only thirty percent of the federal funds to the states' discretion.\textsuperscript{34}

ISTEA was built around the preexisting twenty year-old Federal Aid Highway Program (FAHP). Under the FAHP, states must match federal monies with a local or state share of funds. Most of the federal programs require levels of state and local financial participation ranging from ten to fifty percent.\textsuperscript{35} Taxes collected on motor fuel constitute the primary source of revenue under the FAHP.\textsuperscript{36} Americans have accepted the appropriation of "user" related taxes to fund highway projects. ISTE A attempts a major shift in this national paradigm by incorporating air quality considerations into our nation's transportation program.\textsuperscript{37}

Before ISTE A, funds collected from motor vehicle users paid directly for the nation's infrastructure. This made sense because virtually all of the fuel tax payers used the highway system. Today, however, ISTE A mandates that those funds be used to support the creation of a national intermodal transportation system. People not intending to use the intermodal systems may object to their fuel tax dollars being spent on it. Proponents of the intermodal system, however, are likely to argue that even nonusers benefit from intermodal projects through relieved congestion and improved air quality.

Some intermodal projects eligible for ISTE A funding are highly capital intensive. Due to of these high capital costs, states often cannot meet the law's local matching share requirements. To meet the matching share, under the current FAHP structure, states must consider sources of revenue, such as unpopular taxes, that may inhibit economic development and otherwise place them at an economic disadvantage to their neighboring states.

Another impediment to the implementation of programs under ISTE A is the federal prohibition against new tolls on the interstate highway system.\textsuperscript{38} The reasoning for this prohibition is to ensure the free movement of interstate commerce. Many of our nation's interstates, however, bisect major metropolitan areas. These bisecting segments of the interstate system often are sources of metropolitan area air quality problems.

\begin{itemize}
\item \textsuperscript{34} A Summary, \textit{Intermodal Surface Transportation Efficiency Act of 1991}, U.S. Dep't of Transp., Publication No. FHWA-PL-92-008.
\item \textsuperscript{35} \textit{Id.} at 42. Federal Lands programs are the exception, requiring no state or local matching funds.
\item \textsuperscript{36} In FY 1991, the Federal Highway Trust Fund net receipts for motor fuel constituted more than eighty-eight percent of all revenue sources. \textit{Our Nation's Highways, Selected Facts and Figures}, U.S. Dep't of Transp., Publication No. FHWA-PL-92-004 at p. 28. States similarly depend largely on motor fuel receipts for state and federal highway projects that have matching shares requirements.
\item \textsuperscript{37} \textit{See supra} part II. A.
\item \textsuperscript{38} 23 U.S.C.A. §§ 129, 301 (1994). \textit{See also} ISTE A, \textit{supra} note 3, at §1012.
\end{itemize}
resulting from commuter traffic congestion. As a result, the prohibition of tolls designed to encourage "free movement" actually results in traffic congestion because it denies state government a significant source of revenue to fund needed transportation system improvements. One solution is to provide an alternative means of commuting, for example rail, along these corridors; tolls would provide a revenue source to meet the financial needs of alternative modes of transportation.

Although the federal government disallows tolling of interstate highways, it has relaxed its restrictions on the use of toll financing in the FAHP for non-interstate highways. The highway administrator, T.D. Larson, stated:

The President's Executive Order on Privatization of Infrastructure provides the basis for additional Federal support for State and local government efforts toward forging new relationships with the private sector. Provisions of the ISTEA together with new technology make toll financing and public/private partnerships an attractive option by which States can capitalize on private sector resources, such as new capital sources and user charge options.

The only looming limitation here is the continued prohibition on tolling interstate highway segments, regardless of whether they bisect major metropolitan areas. To date, a number of states have taken advantage of public/private toll partnerships. To take advantage of this funding mechanism, however, a state must enact the statutory framework to authorize a state agency to contract with private companies to fund, plan, build, and/or operate private toll facilities. The DOT suggests that the key items to be addressed in such legislation include:

1. how public and private funds are combined;

40. Id. at i. This publication explains in greater detail other relaxations in federal toll policy.
41. Id. at 6, 10. A summary of these projects include:
   (1) The North Atlanta Parkway. A 6.5-mile, six-lane limited access toll highway built with federal, state, local, and private sources;
   (2) The Florida Turnpike. Over 340 miles of highway including some local projects taken over by the state and toll authorities (some include multi-county authorities);
   (3) The Toll Road Corporation of Virginia. A 17-mile limited-access highway connecting the existing Washington Dulles International Airport Toll Road to Leesburg, Virginia. State and local governments granted a company a franchise to build, own, and operate the facility for 30 years, after which the State takes over. The project is financed primarily by private debt to be repaid from toll collection;
   (4) California Demonstration Projects. Total projects' worth is $2.5 billion, which will be privately planned, funded, financed, built, and operated;
   (5) San Jose Lagoon Bridge. The Puerto Rico Highway Authority contracted the bridge out as a public/private partnership.
2. the form of procurement;
3. use of state authority regarding rights-of-way;
4. toll or rate-of-return regulation; and
5. limitation of liability.\textsuperscript{42}

Projects including public and private partnerships are not unprece-
dented. The Public Utilities Regulatory Policy Act of 1978 created a
means for independent power producers to participate in the utility mar-
et. The Act induced the construction of a significant number of new
generation facilities, which, like transportation facilities, are capi-
tal intensive.

The benefits of private involvement, other than the obvious alterna-
tive source of capital, is the enhanced efficiency and speed. Private de-
velopers who are keen to improve their return on investment (ROI) will
seek efficient cost-cutting approaches. The allocation of risk is spread to
the private sector which may be more willing to take calculated risks that
are restrained in the public process. Private developers competing with
free roads will strive to offer better service and facilities; privately funded
roads may be some of the first highways to apply Intelligent Vehicle
Highway System (IVHS) technology.

Another restraint on the states' ability to generate their matching
share is inherent in the nature of the funding mechanisms under ISTEA.
The funding mechanisms for major intermodal projects presently do not
allow states to "bank" the federal money allocated to their intermodal
system. If the federal money is not spent within a period ranging from
one to four years, the money disappears.\textsuperscript{43}

C. Clean Air Act Amendments of 1990

\textit{With enactment of the Clean Air Act Amendments of 1990 (CAAA),
transportation planners have been challenged \ldots to maintain the Nation's
mobility while enhancing our air quality.}\textsuperscript{44}

The CAAA constitute a set of significantly stricter and more en-
forceable standards designed to bring the nation's air quality into compli-
ance with the National Ambient Air Quality Standards (NAAQS). To
better understand how, when, and where the CAAA affects transpor-
tation programs and planning, a brief review of what constitutes a non-
attainment area is in order.

\textsuperscript{42} \textit{Id.} at 9.
\textsuperscript{43} \textit{A Summary, supra note 34, at 42.}
\textsuperscript{44} \textit{Transportation Programs and Provisions of the Clean Air Act Amendments of 1990, U.S.
Dep't of Transp. Publication No. FHWA-PD-92-023 HEP-41/10/92 (40M) QE at 1.}
1. Non-attainment Areas

Following the 1977 amendments to the 1970 Clean Air Act, an area may be classified as either attainment, non-attainment, or unclassifiable\(^45\) with regard to the criteria pollutants for which NAAQS have been promulgated.\(^46\) Because motor vehicles account for almost half the ozone and nearly all the carbon monoxide (CO) air pollution in the United States,\(^47\) they are the two most important pollutants in terms of their impact on transportation issues. One of the significant changes in the 1990 amendments is the breakdown of the non-attainment areas based on the degree of ozone or carbon monoxide pollution.

Following the 1990 amendments, each ozone nonattainment area is further classified as either marginal, moderate, serious, severe, or extreme depending on the measured concentration of ozone.\(^48\) For CO nonattainment areas, the classification consists of two primary categories: moderate and severe.\(^49\) EPA recognized that the areas with regularly higher levels of ozone or CO would be more difficult and take longer to bring into compliance with the NAAQS. EPA, therefore, implemented a staggered set of deadlines that the SIP must meet in attaining the NAAQS.\(^50\)

In theory, the longer time the CAAA allows nonattainment areas

\(^{45}\) An “unclassifiable” area is one that cannot be classified on the basis of available information as meeting or not meeting the national primary or secondary ambient air quality standards for that pollutant. Unclassified areas are subject to the applicable attainment area requirements. CAA § 107(d), 42 U.S.C. § 7407(d) (Supp. V 1993).

\(^{46}\) The six criteria pollutants are ozone, carbon monoxide, sulfur dioxide, nitrogen oxides, lead, and particulate matter.

\(^{47}\) See supra text accompanying note 7.

\(^{48}\) Currently, the only “extreme” ozone nonattainment area is Los Angeles.

\(^{49}\) CAA § 186(a)(1), 42 U.S.C. § 7512(a)(1) (Supp. V 1993). These CO areas have until December 31, 1995 (5 years), and December 31, 2000 (10 years), respectively to meet attainment standards. Id.


In addition, serious CO nonattainment areas, Id., and the City of Denver, Colorado, Id., at § 7512a(a)(2)(B), must submit, by November 15, 1992, a plan that identifies and adopts specific and enforceable TCM to offset any growth in VMT.

Serious CO nonattainment areas must also provide provisions requiring employers to reduce work-related vehicle trips and miles traveled by employees. Id. at § 7512a(b)(2).

50. Under these staggered guidelines, an area classified as “marginal” for ozone must be in compliance by November 15, 1993 (3 years following enactment of the revisions); “moderate” by November 15, 1996 (6 years); “serious” by November 15, 1999 (9 years); “severe” by November 15, 2003 (15 years), or by November 15, 2007 under special circumstances; and for the “extreme” ozone non-attainment area by November 15, 2010 (20 years). Id. at § 7511(a)(1). Under special
with more serious pollution to address their problems, should be an incentive to implement long-term solutions rather than quick-fix short-term solutions. However, some evidence indicates that some nonattainment areas may use this structure to delay dealing with their air pollution problems. For example, Denver upgraded to a more serious nonattainment status, not because the technical data warranted such a change, but merely because Denver wanted the increased time to comply with the CAAA.

2. Conformity

The conformity provisions of the CAAA requires any transportation plan or program in a nonattainment area funded, developed, or approved under Title 23 or the Federal Transit Act\(^{51}\) to conform to the SIP.\(^{52}\) The definition of conformity to an implementation plan is conformity to the plan’s purpose of reducing or eliminating the number and severity of violations of the NAAQS. Also, to be in conformity, a new transportation plan must not create any new violations of any standard in any area, increase the severity or frequency of existing violations, or delay attainment of any standard, required interim emission reduction, or other milestones in any area.\(^{53}\)

The conformity provisions are significant to transportation issues because they prevent any federal agency from approving, accepting, or funding any transportation plan, program, or project until such plan, pro-

\(^{51}\) 49 U.S.C.A. app. 1601 et seq.

\(^{52}\) CAA § 176(c); 42 U.S.C. § 7506(c) (Supp. V 1993).

\(^{53}\) Id.
gram, or project has been found to conform to the applicable SIP. In particular, no transportation plan or transportation improvement program may be adopted or found to be in conformity by a metropolitan planning organization (MPO) until a final determination that emissions from such plans or programs are consistent with estimates of motor vehicles and necessary emissions reductions contained in the applicable implementation plan.

Transportation improvement programs must also provide for the timely implementation of TCMs consistent with schedules in the applicable SIP. Transportation projects can be adopted, approved or found to be in conformity by a MPO only if: 1) the project comes from a conforming plan or program; 2) the design and scope of the project has not changed significantly since the determination that the originating plan and project was in conformity; and 3) at the time of the conformity determination, the design and scope of the program was adequate to determine emissions. If a project does not meet these three criteria, it will be deemed to be in conformity only if it is demonstrated that the projected emissions from the project, together with the projected emissions for the conforming transportation plans and programs within the nonattainment area, do not cause emissions to exceed reductions schedules and projections in the applicable SIP. The reapproval requirement is good in theory from an environmental standpoint; however, it restricts a state's ability to use funds that may later become available without significant efforts to document compliance with the SIP.

3. Transportation Control Measures (TCMs)

EPA's data depicted in Figure 1 illustrates the competing trends toward cleaner vehicles, on the one hand, and the ever-increasing VMT on the other. Based on this data, Congress recognized the need to find additional methods to reduce air pollution from mobile sources to combat the increase in projected VMT. CAAA § 108(f)(1)(A) lists 16 TCMs intended to decrease the public's reliance on the automobile and to use the automobile more efficiently. The CAAA of 1990 requires a graduated

54. Id.
55. As designated under Title 23 or the Federal Transit Act, 49 U.S.C.A. app. § 1601.
57. Id.
58. Id.
59. Id.
(f) Information regarding processes, procedures, and methods to reduce or control pollutants in transportation; reduction of mobile source related pollutants; reduction of impact on public health
(1) The Administrator shall publish and make available to appropriate Federal, State,
and cumulative implementation of TCMs in states with serious, severe, and extreme ozone nonattainment areas, and for moderate and serious CO nonattainment areas. The implementation of TCMs is cumulative in that each successive ozone and CO nonattainment category incor-

and local environmental and transportation agencies not later than one year after No-

vember 15, 1990, and from time to time thereafter—

(A) information prepared, as appropriate, in consultation with the Secretary of Trans-

portation, and after providing public notice and opportunity for comment, regarding

the formulation and emission reduction potential of transportation control measures

related to criteria pollutants and their precursors, including, but not limited to—

(i) programs for improved public transit;

(ii) restriction of certain roads or lanes to, or construction of such roads or lanes for use

by, passenger buses or high occupancy [FN1] vehicles;

(iii) employer-based transportation management plans, including incentives;

(iv) trip-reduction ordinances;

(v) traffic flow improvement programs that achieve emission reductions;

(vi) fringe and transportation corridor parking facilities serving multiple occupancy ve-

hicle programs or transit service;

(vii) programs to limit or restrict vehicle use in downtown areas or other areas of emis-

sion concentration particularly during periods of peak use;

(viii) programs for the provision of all forms of high-occupancy, shared- ride services;

(ix) programs to limit portions of road surfaces or certain sections of the metropolitan

area to the use of non-motorized vehicles or pedestrian use, both as to time and place;

(x) programs for secure bicycle storage facilities and other facilities, including bicycle

lanes, for the convenience and protection of bicyclists, in both public and private areas;

(xi) programs to control extended idling of vehicles;

(xii) programs to reduce motor vehicle emissions, consistent with subchapter II of this

chapter, which are caused by extreme cold start conditions;

(xiii) employer-sponsored programs to permit flexible work schedules;

(xiv) programs and ordinances to facilitate non-automobile travel, provision and utili-

zation of mass transit, and to generally reduce the need for single-occupant vehicle travel,

as part of transportation planning and development efforts of a locality, including

programs and ordinances applicable to new shopping centers, special events, and

other centers of vehicle activity;

(xv) programs for new construction and major reconstructions of paths, tracks or areas

solely for the use by pedestrian or other non-motorized means of transportation when

economically feasible and in the public interest. For purposes of this clause, the Ad-

ministrator shall also consult with the Secretary of the Interior; and

(xvi) program to encourage the voluntary removal from use and the marketplace of

pre-1980 model year light duty vehicles and pre-1980 model light duty trucks.


63. In serious ozone nonattainment areas, states must submit a demonstration by Novem-

ber 15, 1996 (6 years after implementation) as to whether the current aggregate vehicle mileage, aggregate vehicle emissions, congestion levels, and other relevant parameters are consistent with the area's demonstration of attainment. 42 U.S.C. § 7511a(c)(5)(A) (Supp. V 1993). If the demonstration exceeds the levels projected in the area's attainment demonstration, the state must submit, within 18 months, a revision of the applicable SIP that includes a TCM provision consisting of measures from, but not limited to, the list of 16 TCMs in §108(f). Id. at § 7408(f). In considering such TCM, states are to avoid increasing or merely relocating emissions and congestion rather than reducing them, and should also ensure adequate access to downtown and other commercial and residential areas. Id. at § 7511a(c)(5)(A).

Severe ozone nonattainment areas, while subject to all the TCM provisions applicable to serious nonattainment areas, must comply with two additional TCM provisions by November 15, 1992 (2 years after enactment). First, states must identify and adopt specific enforceable TCM to
porates the requirements of the lesser category plus additional requirements.

D. INTERMODAL SURFACE TRANSPORTATION EFFICIENCY ACT OF 1991 (ISTEA)

[T]o develop a National Intermodal Transportation System that is economically efficient, environmentally sound, provides the foundation for the Nation to compete in the global economy and will move people and goods in an energy efficient manner.65

Following the enactment of the CAAA, Congress passed the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA).66 The Act outlined the formula to create a National Intermodal Transportation System. It stated that such system shall consist “of all forms of transportation in a unified, interconnected manner, including the transportation systems of the future, to reduce energy consumption and air pollution while promoting economic development and supporting the nation’s pre-

offset any growth in emissions from growth in VMT or number of vehicle trips. Id. at § 7511a(d)(1)(A). Second, states must require employers in the nonattainment area to implement programs to reduce work-related vehicle trips and miles traveled by employees. At a minimum, these plans must require employers of 100 or more persons to increase average passenger occupancy per vehicle in commuting from home to work during peak travel periods by at least twenty-five percent. Id. at § 7511a(d)(1)(B).

Extreme ozone nonattainment areas are subject to all the TCM provisions applicable to severe ozone nonattainment areas. Id. at § 7511a(e). In addition, extreme areas are authorized, although not required, to establish TCM measures to reduce the use of high-polluting vehicles or heavy-duty vehicles during heavy traffic hours. Id. at § 7511a(e)(4).

64. For moderate CO nonattainment areas with a design classification of 12.7 ppm at the time of classification, states are required to revise their SIP by November 15, 1992 (2 years after enactment), to include a forecast of VMT in the nonattainment area for each year before the year in which the plan projects attainment of the NAAQS for CO. 42 U.S.C. § 7512a(a)(2)(A) (Supp. V 1993). The revision must also provide for annual updates to the VMT forecast and provide reports on the accuracy of previous estimates. Id.

A special rule, applicable only to Denver, requires the state of Colorado to submit a revision that includes TCM analogous to the provisions for severe ozone nonattainment areas as defined in § 182(d)(1)(A) except that the revision’s purpose is to reduce CO emissions rather than VOC emissions. 42 U.S.C. § 7512a(a)(2)(B) (Supp. V 1993). This special provision requires the identification and adoption of specific enforceable TCM to offset any growth in emissions from growth in VMT or number of vehicle trips in the nonattainment area. See 42 U.S.C. § 7511a(d)(1)(A) (Supp. V 1993).

In serious CO nonattainment areas, the special rule for Denver (a moderate nonattainment area) becomes generally applicable. 42 U.S.C. § 7512a(b)(2) (Supp. V 1993). In addition, serious CO nonattainment areas are required to submit a comprehensive, accurate, current inventory of actual emissions from all sources, as described in § 172(c)(3). 42 U.S.C. § 7512a(b)(2) (Supp. V 1993).

66. ISTE A, supra note 3.
eminent position in international commerce."\textsuperscript{67}

Two purposes stated in the opening premise "economic development" and "reducing energy consumption and air pollution," are especially worth noting. The transportation system includes rail, motor vehicle, and air. Legislation governing rail and air transportation focuses on economic development, while the motor vehicle legislation focuses on the environmental issues.

The major components of ISTEA were codified in a variety of statutes. The components can be found in Title 23, Highways; Title 42, The Public Health and Welfare\textsuperscript{68} and Title 29, Transportation. A National Intermodal Transportation System (NITS) policy\textsuperscript{69} was adopted in 1994. In addition to the general premise of ISTEA stated above, the policy states that, when appropriate, the NITS should be funded by the Highway Trust Fund.\textsuperscript{70} This is significant since the primary revenue source of the Highway Trust Fund are taxes paid at the gasoline pumps by consumers. Targeting vehicle users as the major source of funding appears to be consistent with EPA's findings that motor vehicles are the largest single source of ozone and carbon monoxide air pollution.\textsuperscript{71} The Office of Intermodalism, established under the Secretary of Transportation, monitors the progress of the NITS objectives and coordinates research and development.\textsuperscript{72}

As stated above, most of the federal programs discussed in subsections E, F, and G, infra, require levels of state and local financial participation ranging from ten to fifty percent.\textsuperscript{73} Some projects under ISTEA are capital intensive requiring large local or state matching shares. States may be discouraged from imposing taxes to generate matching shares due to the likely resultant economic development disadvantage relative to its neighboring states. Federal regulations prevent tolling of interstate high-

\textsuperscript{67} Id. The Secretary of Transportation is required to report annually to Congress about the progress of various transportation programs. The requirements include: (1) Highway pavement of Federal-aid highways; (2) Bridges on and off Federal-aid highways; (3) Highway safety; (4) Traffic congestion; (5) Public transportation facilities and equipment; and (6) Intermodal transportation facilities and systems. 23 U.S.C.A. § 303 (1994). The report shall include information compiled by the states on issues including traffic-monitoring statistics and intermodal advancements. Id. The intermodal requirements established under this section require, in part, that each state must integrate all of its transportation systems by including methods of achieving optimum yield from such systems, methods for increasing productivity in the state, and methods for increasing the use of advanced technologies.

\textsuperscript{68} 42 U.S.C.A. § 13235 (1994), provides local incentives for encouraging the use of alternative fuels.


\textsuperscript{70} Id. at § 5501(b)(8).

\textsuperscript{71} See supra note 5 and accompanying text.


\textsuperscript{73} See supra note 3 and accompanying text.
ways that would otherwise be a potential source for the states' matching share.\textsuperscript{74}

Recent developments have challenged the structure of the DOT. Section Es through G, infra, outline the various components and funding sources that comprise the present structure of the ISTEA legislation.\textsuperscript{75}

E. Title 23, Highways

1. Surface Transportation Program (STP)

The surface transportation program\textsuperscript{76} provides funding for a wide range of transportation alternatives in the spirit of ISTEA.\textsuperscript{77} It provides up to eighty percent federal funding for new construction or reconstruction projects to accommodate other modes of transportation. It precludes, however, projects related to local or rural roads unless they are carpool, bicycle transportation, pedestrian walkway, or safety improvement-related projects.

Projects approved under the Federal Transit Act, including intracity or intercity bus terminals and facilities,\textsuperscript{78} may also be funded under the STP. With exception to clauses (xii) and (xvi), all of the TCMS listed in the Clean Air Act\textsuperscript{79} are permitted under this highway program.\textsuperscript{80} Additionally, it allows funds to be used for surface transportation “planning” programs and transportation enhancement activities.\textsuperscript{81}

2. Congestion Mitigation and Air Quality Improvement Program (CMAQ)

The Congestion Mitigation and Air Quality Improvement Program (CMAQ)\textsuperscript{82} channels highway funds to projects likely to contribute to the attainment of a NAAQS, whether through reductions in VMT, fuel consumption, or “through other factors.”\textsuperscript{83} Projects may be eligible under this program if they are included in a state implementation plan (SIP)

\textsuperscript{74} 23 U.S.C.A. §§ 129, 301 (1994). \textit{See also} ISTEA, supra note 3, at § 1012.
\textsuperscript{75} Following the Republican takeover in Congress, efforts to restructure the DOT have reemerged; now there is an emphasis on block grants which will help resolve the issue of unfunded federal mandates.
\textsuperscript{76} 23 U.S.C.A. § 133 (1994). Funding for projects listed under this section is provided pursuant to 23 U.S.C.A. § 104(b)(3) (1994).
\textsuperscript{77} ISTEA, supra note 3, at §1007.
\textsuperscript{78} 23 U.S.C.A. § 133(b) (1994).
\textsuperscript{80} \textit{See supra} note 12.
approved pursuant to the CAA that will have “air quality benefits.”84 States without nonattainment areas located within their borders can seek financial assistance instead under the surface transportation program (STP).85


Two sections of the highway bill provide complimentary provisions to the STP and the CMAQ.86 Section 146 provides funding for projects that promote carpool and van pool opportunities.87 The other, Section 142, encourages the development, improvement, and use of public mass transportation systems that operate motor vehicles, mainly buses, on federal highways.88 Additionally, the interstate maintenance program89 precludes the expansion of capacity of any interstate highway or bridge that are not high-occupancy vehicle or auxiliary lanes. States are required to establish the occupancy requirements of vehicles operating in high-occupancy vehicle lanes.90 Such requirements shall be no fewer than two occupants, and motorcycles and bicycles shall not be considered single occupant vehicles.91

4. Intelligent Vehicle Highway Systems (IVHS)

The Intelligent Vehicle Highway Systems Act of 1991,92 thought by some to be the “best near-term technology for improving surface transportation,”93 seeks to improve traffic flow. Intelligent vehicle highway systems (IVHS) means the development or application of electronics, communications, or information processing94 used singly or in combination to improve the efficiency and safety of surface transportation systems.95 IVHS plans for a satellite-based system capable of detecting areas of traffic congestion and relaying alternative route information to

84. Id.
85. See supra note 9.
86. Funding for all projects under this paragraph is pursuant to 23 U.S.C.A. § 104(b) (1994).
87. Id. at § 146.
88. Id. at § 142.
89. Id. at § 119.
90. Id. at § 102. This recognizes the phenomena experienced in California where added lane capacity actually attracted more traffic rather than reducing congestion.
91. Id.
94. IVHS § 6059; 23 U.S.C.A. 307 (1994). Such developments or applications include advanced traffic management systems, commercial vehicle operations, advanced traveler information systems, commercial and advanced vehicle control systems, advanced public transportation systems, satellite vehicle tracking systems, and advanced vehicle communications systems.
95. Id.
individual vehicle for purposes of rerouting. The Act established eight goals that, in sum, strive to reduce the societal, economic, and environmental costs associated with traffic congestion.96

Section 307, the primary means for funding IVHS, is a research and planning tool. Eligible transportation planning entities97 may apply for IVHS planning grants98 or operational testing projects99 that contribute to the goals and objectives of the Act. The allocation of funding set aside for the IVHS programs reflects Congress' recognition that IVHS technology is the "best near-term" solution to highway congestion. Fifty percent of the available funds under this section must be made available for the development and implementation of IVHS under a scheme that designates priority corridors.100 Unless a transportation entity is responsible for planning for an area with at least 1.5 times the national average of vehicle miles traveled, it is unlikely that it will be able to secure funding under this section.101

One author suggests that it will be difficult to coordinate the regulation of the IVHS since more than 22,000 cities and counties in the United States potentially have regulatory power over the system within their ju-

96. IVHS § 6052(b), Goals; 23 U.S.C.A. § 307 provides that the goals of the program shall include:

(1) the widespread implementation of IVHS to enhance the capacity, efficiency, and safety of the Federal-aid highway system and to serve as an alternative to additional physical capacity of the Federal-aid highway system;
(2) the enhancement, through more efficient use of the Federal-aid highway system, of the efforts of the several States to attain air quality goals established pursuant to the Clean Air Act;
(3) the enhancement of safe and efficient operation of the Nation's highway systems with a particular emphasis on aspects of systems that will increase safety and identification of aspects of the system that may degrade safety;
(4) the development and promotion of IVHS and an IVHS industry in the United States, using authority provided under this section of Title 23;
(5) the reduction of societal, economic, and environmental costs associated with traffic congestion;
(6) the enhancement of United States industrial and economic competitiveness and productivity by improving the free flow of people and commerce and by establishing a significant United States presence in an emerging field of technology;
(7) the development of technology base for IVHS and the establishment of the capacity to perform demonstration experiments, using existing national laboratory capabilities where appropriate; and
(8) the facilitation of the transfer of transportation technology from national laboratories to the private sector.
97. IVHS § 6055(c).
98. Id. at § 6055(b).
99. Id. at § 6055(d).
100. Id. at § 6056. IVHS § 6058 authorizes the appropriation of $71 million for fiscal year 1992 and $86 million for each of fiscal years 1993 through 1997 for the "corridors program." An additional $23 million for 1992 and $27 million for each of fiscal years 1993 through 1997 was authorized for other IVHS activities. The Federal share is payable at the rate of 80 percent in the same manner as other funds apportioned under Title 23.
101. Id. at § 6056(b)(1).
risdictional boundaries. He suggests that a model state statute should be established to clarify the role that local governments, as regulators of IVHS services, should play and that rules should be created for local governments that choose to provide IVHS services in lieu of the private sector. Additionally, he suggests that a statutory regime that creates a level playing field for different emerging technologies should be created.

Although the free flow of ideas relative to emerging technologies may be warranted during the research and development stages of IVHS, allowing multiple divergent technologies would not be in the national interest. The federal government has a legitimate interest in establishing a consistent national standard to ensure uniformity among the states.

5. Future Planning

Both the state and metropolitan area levels have primary responsibility for planning. The roles of each level of planning are discussed below.

a. Statewide Planning

Statewide planning must consider all modes of transportation and shall coordinate metropolitan area plans to ensure connectivity within transportation systems. Additionally, the state must carry out its responsibilities for the development of the transportation portions of the State implementation plan as required by the CAAA. The planning process must consider a minimum of twenty listed items. It must evaluate the overall social, economic, energy, and environmental effects of the deci-

103. Id. at 249.
104. Id.
106. Id. at § 135(b)-(d).
107. Id. at § 135(c) lists:
   (1) The results of the management systems required pursuant to subsection (b).
   (2) Any Federal, State, or local energy use goals, objectives, programs, or requirements.
   (3) Strategies for incorporating bicycle transportation facilities and pedestrian walkways in projects where appropriate throughout the State.
   (4) International border crossings and access to ports, airports, intermodal transportation facilities, major freight distribution routes, national parks, recreation and scenic areas, monuments and historic sites, and military installations.
   (5) The transportation needs of nonmetropolitan areas through a process that includes consultation with local elected officials with jurisdiction over transportation.
   (6) Any metropolitan area plan developed pursuant to section 134.
   (7) Connectivity between metropolitan areas within the State and with metropolitan areas in other States.
   (8) Recreational travel and tourism.
   (9) Any State plan developed pursuant to the Federal Water Pollution Control Act.
sions made in the planning process. After evaluating this lengthy list of subjective criteria, the state must develop a Transportation Improvement Program (TIP). The TIP must be consistent with metropolitan area planning and must be in conformance with the state implementation plan pursuant to the CAAA for areas of nonattainment. The TIP must not include projects unless “funding can reasonably be anticipated.” Finding the funds for capital-intensive projects such as high-speed rail presents a dilemma within the constraints imposed by existing law.

b. Metropolitan Planning

Metropolitan planning organizations (MPOs) have the responsibility to develop transportation plans, in cooperation with the state, for urbanized areas of the state. The MPO provisions state that:

It is in the national interest to encourage and promote the development of transportation systems embracing various modes of transportation in a manner which will efficiently maximize mobility of people and goods within and through urbanized areas and minimize transportation-related fuel consumption and air pollution.

Here too the planning process requires MPOs to consider all modes of

(10) Transportation system management and investment strategies designed to make the most efficient use of existing transportation facilities.
(11) The overall social, economic, energy, and environmental effects of transportation decisions.
(12) Methods to reduce traffic congestion and to prevent traffic congestion from developing in areas where it does not yet occur, including methods which reduce motor vehicle travel, particularly single-occupant motor vehicle travel.
(13) Methods to expand and enhance transit services and to increase the use of such services.
(14) The effect of transportation decisions on land use and land development, including the need for consistency between transportation decision making and the provisions of all applicable short-range and long-range land use and development plans.
(15) The transportation needs identified through use of the management systems required by section 303 of this title.
(16) Where appropriate, the use of innovative mechanisms for financing projects, including value capture pricing, tolls, and congestion pricing.
(17) Preservation of rights-of-way for construction of future transportation projects, including identification of unused rights-of-way which may be needed for future transportation corridors, and identify those corridors for which action is most needed to prevent destruction or loss.
(18) Long-range needs of the State transportation system.
(19) Methods to enhance the efficient movement of commercial motor vehicles.
(20) The use of life-cycle costs in the design and engineering of bridges, tunnels, or pavement.

108. Id. at § 135(f). Funding for § 135 is provided pursuant to 23 U.S.C.A. § 307(c)(1) (1994).
109. See supra part III. C.2.
110. Id.
111. Id.
113. Id.
transportation. The membership composition of MPOs must include local elected officials and all transportation agencies within the metropolitan area.\textsuperscript{114} Metropolitan area boundaries must include existing urbanized areas and the contiguous areas expected to become urbanized within the 20-year forecast period.\textsuperscript{115} CAAA designated nonattainment areas must be included, at a minimum, in the MPO boundaries. Provisions for multistate areas are made under this section.\textsuperscript{116}

In developing transportation plans and programs pursuant to this section, MPOs must consider a list of fifteen factors. The majority of factors mirror those listed under the statewide planning considerations above.\textsuperscript{117} The most significant added requirement is that MPOs must include the effects of all transportation projects to be undertaken within the metropolitan area, without regard to whether such projects are publicly funded.\textsuperscript{118} This stretches MPO authority to indirect sources which may include private real property (e.g. parking lots) or roads (in subdivisions, etc.) that may attract mobile sources of pollution.\textsuperscript{119}

In developing long-range plans, MPOs must identify all transportation facilities, giving emphasis to those that serve national and regional transportation functions. In formulating the plan, they must consider all factors listed in subsection (f) of § 134 as such factors relate to a 20-year forecast period.\textsuperscript{120} Overcoming congestion-related problems will require that planners to look into the future. The "consideration" of the 20-year plan, however, is loosely enforced. Unlike the statewide planning requirements, MPOs must indicate public and private financial resources together with its recommendations for innovative financing techniques.\textsuperscript{121} Additionally, MPO plans must be in coordination with the SIP, and MPOs must ensure that their plans are in compliance with the state TIP. In fact, the TIP must reflect transportation plans for the metropolitan planning area.\textsuperscript{122}

F. TITLE 42, PUBLIC HEALTH AND WELFARE

1. State and Local Incentive Program

The goal of the State and Local Incentive Program is to introduce

\begin{itemize}
  \item \textsuperscript{114} Id. at § 134(b).
  \item \textsuperscript{115} Id. at § 134(c).
  \item \textsuperscript{116} Id. at § 134(d).
  \item \textsuperscript{117} See supra note 105.
  \item \textsuperscript{118} 23 U.S.C.A. § 134(f)(6) (1994).
  \item \textsuperscript{119} 42 U.S.C.A. § 7410(a)(5)(C) (Supp. V 1993).
  \item \textsuperscript{120} 23 U.S.C.A. § 134(g)(2) (1994).
  \item \textsuperscript{121} Id. at § 134(g)(2)(B). Innovative financing techniques may include value capture tolls and congestion pricing.
  \item \textsuperscript{122} Id.
\end{itemize}
“substantial numbers” of alternative-fueled vehicles in such states by the year 2000. The governor of each state may submit a state plan that incorporates provisions to attain this goal, and the plan should include the estimated cost of implementation. The program suggests a number of ways that a state can coordinate with other entities to achieve the objectives of the program. States with approved plans may apply for federal assistance in the form of technical assistance, including model state laws, or grants for the purpose of assisting with the implementation of the plan.

When determining the amount of financial assistance that a state may receive, the following three factors are considered: (1) the energy-related and environmental-related impacts, on a life cycle basis, of the introduction and use of alternative-fueled vehicles included in the plan compared to conventional motor vehicles; (2) the number of alternative fueled vehicles likely to be introduced by the year 2000 as a result of successful implementation of the plan; and (3) such other factors as the Secretary (of Energy) considers appropriate.

Typically, government fleets are better suited for the transition into alternative fuels than the general public. Government fleet operators can provide on-site storage of alternative fuels unlike consumer-dependant gas station operators who may not be able to justify the cost of on site alternative fuel storage. Additionally, government fleet operators may be better equipped to use electrically driven motor vehicles since the distance traveled by most government vehicles is within short geographic areas.

G. Title 49, Transportation

1. Airports

The general policy statement governing airport development and improvement encourages the development of transportation systems that use various modes of transportation. This intermodal development should serve both states and local communities “efficiently and effectively,” and should protect and enhance natural resources and the quality of the environment. In recognition of the National Transportation Policy, § 47101 states that an intermodal system must transport passengers and property in an “efficient” manner.

124. Id.
125. Id.
126. Id. at § 13235(b)(2).
128. Id.
129. Id.
pears to be based on economic grounds, with environmental issues being secondary. The provision states that the future economic direction the United States depends on its "ability to confront," among other items, energy vulnerability and air pollution. Section 47101 also states "[a]ll forms of transportation, including aviation and other transportation systems of the future, will be full partners in the effort to reduce energy consumption and air pollution." Again, however, this environmental partnership attaches to the statement "while promoting economic development."

Section 47101 goes on to state that "intermodality and flexibility are paramount in the process of developing an [intermodal transportation] system that will obtain the optimum yield of United States resources." To achieve this "optimum use of State resources," Section 47101 requires the Secretary of Transportation to cooperate with state and local officials and they shall "consult" with the Department of the Interior and the Environmental Protection Agency. The transportation plans and programs shall be developed with other transportation planning.

---

130. Id. at § 47101(b).
131. Id. at § 47101(b)(4).
132. Id.
133. Id. at § 47101(b)(5) defines Intermodal Transportation System as: [one that] consists of transportation hubs that connect different forms of appropriate transportation and provides users with the most efficient means of transportation and with access to commercial centers, business locations, population centers, and the vast rural areas of the United States, as well as providing links to other forms of transportation and to intercity connections. Note the use of the term 'appropriate transportation.' Unlike the environmental laws that focus on the reduction of pollution, the term 'appropriate transportation' seems to suggest that efficiency is defined in more than one way, here, taking into account social or cultural choice. Additionally, Congress added an alternative means of transportation to the number of solutions; heliports. Id. at § 47101(e)(2). This may be in response to an earlier report prepared by the Committee on Public Works and Transportation stating '[it] is supportive of government and industry efforts to develop tilt rotor aircraft technology for civil purposes' to free up scarce airport capacity in metropolitan areas. House Rep. 102-503, Airport and Airway Safety, Capacity, and Intermodal Transportation Act of 1992.
135. Other planning, although not stated, should include State Transportation Improvement Plan and MPO planning efforts. Congress noted earlier that in some metropolitan areas, airports have found it difficult to participate fully in the MPO planning process. It stated that "[it] expects[s] airports to be full and effective participants in the MPO process" and that it will monitor the situation, and if necessary, take appropriate further action. House Rep. 102-503, Airport and Airway Safety, Capacity, and Intermodal Transportation Act of 1992. Existing legislation does not note whether this problem persists, however, airport operators should insure that they are aware of all MPO planning initiatives and assert their right to participate in the MPO planning process.
2. Rail Terminals

In the spirit of ISTEA, § 5563 allows for financial assistance to convert rail passenger terminals to intermodal transportation terminals.\textsuperscript{136} Appropriate modes of transportation included under § 5563 include: (1) motorbus transportation; (2) mass transit (rail or rubber tire); and (3) airline ticket offices and passenger terminals providing direct transportation to area airports.\textsuperscript{137} This section of Title 49 does not state specifically that its intent is to provide an efficient transportation system and, thus, a cleaner environment, although it is inferred. At a minimum, it is a cooperative provision which will help achieve the goal of creating an intermodal transportation system. This provides an opportunity, for instance, for airlines to take advantage of additional consumer ticketing locations (an economic opportunity) and for transportation planners to link to systems together for efficiency purposes (an environmental opportunity).

3. Rail As An Alternative

a. Background

Despite heavy early use of rail transportation in the United States, railroad companies were eventually forced to compete with highways and airports that were publicly funded. Increased competition prompted "a change in corporate strategy; the focus shifted from passenger to freight service."\textsuperscript{138} As a result, financing dwindled for customer service oriented improvements, "leaving much of the passenger rail facilities in disrepair."\textsuperscript{139} The government thus influenced the direction American culture by making automobile and air travel more attractive. Transporting people and goods by rail may be accomplished through the use of various technologies. A few of these technologies include traditional rail service, light intercity rail service, and high-speed ground transportation service (high-speed rail). Traditional rail service by the 1930s provided regularly scheduled intercity service at speeds of 100 miles per hour.\textsuperscript{140} Today, however, fewer trains can travel at these speeds because of deteriorating track conditions. Light rail generally provides a means to move people from points within metropolitan areas at slower speeds. High speed rail includes steel on wheel and magnetic levitation systems reaching speeds

\textsuperscript{137} Id.
\textsuperscript{139} Id. \textit{See also}, JOSEPH VRANICH, \textit{SUPERTRAINS — SOLUTIONS TO AMERICA'S TRANSPORTATION GRIDLOCK} 14, at 227 (1991).
\textsuperscript{140} Id.
above 125 miles per hour. Of the three, high speed rail has received the most attention by Congress.

b. High Speed Rail

In the 1990s, American travelers returning from Europe and Japan seem ready to shift the American culture, and get people out of their cars by introducing the alternative of high-speed ground transportation systems.\textsuperscript{141} The Legislature responded. The High Speed Rail Development Act (HSRDA) of 1993\textsuperscript{142} amended the Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act).\textsuperscript{143} It is worth noting that the 4R Act, which merely precluded the extinction of the railroads, was not revised until this cultural prompting occurred nearly twenty years later. While the HSRDA recognizes the importance of high-speed rail, it restricts continued federal subsidies for operation and expenses.\textsuperscript{144} Implementation for high speed rail is placed at the state and local level. A new Title X was added to the 4R Act creating a National High Speed Rail Assistance Program to aid state, local, and private sector efforts to improve intercity mobility through development of high speed rail in appropriate intercity corridors.\textsuperscript{145}

To be eligible for funding, a rail corridor “must serve two or more major metropolitan areas\textsuperscript{146} where the Secretary determines high speed rail offers the potential for cost effective intercity public transportation.”\textsuperscript{147} A state must petition the Secretary to obtain such a designation, demonstrating that it meets the criteria pertaining to effective planning, cost-effectiveness, environmental considerations, and broad-based financial support.\textsuperscript{148} The “broad-based financial support” provision requires a state to consider private sources of investment. This may prove problematic due to long delays in project startups which can diminish the potential return on investment.\textsuperscript{149} The public agency responsible for the

\textsuperscript{141} Krumm, supra note 138, citing: \textit{TRANSPORTATION RESEARCH BOARD, NATIONAL RESEARCH COUNCIL, IN PURSUIT OF SPEED: OPTIONS FOR INTERCITY PASSENGER TRANSPORT, SPECIAL REPORT 233, Ch. 3, (1991).}


\textsuperscript{144} Supra note 63.

\textsuperscript{145} See Krumm, supra note 138, at 317; see also supra note 74 at § 1.

\textsuperscript{146} Today six corridors are designated, including: (1) Chicago-Milwaukee-St. Louis-Detroit; (2) Washington, D.C.-Richmond-Raleigh-Charlotte; (3) Miami-Orlando-Tampa; (4) San Diego-Los Angeles-Sacramento; (5) Eugene-Portland-Seattle -Vancouver; and (6) New York-Albany-Buffalo. It is worth noting that these corridors are intercity long-haul routes. 49 U.S.C.A. §309 (1994) requires that potential short-haul markets for HSGT systems should also be examined.

\textsuperscript{147} See Krumm, supra note 138, at 317; see also supra note 3, at § 1001.

\textsuperscript{148} See Krumm, supra note 138, at 317-18.

\textsuperscript{149} Id. at 323.
development of these corridors must develop a master plan.\(^{150}\) The Secretary may fund up to eighty percent of the eligible costs, providing that the state and local governments fund the other twenty percent.\(^{151}\)

Congress ultimately charged the Secretary of Transportation with leading an interagency\(^{152}\) research and development effort of high-speed ground transportation (HSGT) technologies in order to develop the implementation of magnetic levitation and high-speed steel wheel on rail transportation systems as alternatives to existing transportation systems.\(^{153}\) Section 309 is facilitated primarily by provisions for demonstration projects and research and development agreements. Demonstration projects of advancements in HSGT may submit such proposals to be incorporated into any revenue service HSGT project or system under construction or in operation at the time the application is made.\(^{154}\) Thus, the proposed technological advancement must be incorporated into one of the designated corridor projects.

Alternatively, to become eligible, a state may seek designated corridor status together with its application for technological advancement funding. Research and development agreements may be entered into by the Secretary for the purpose of conducting research to overcome technical and other barriers to the development and construction of practicable HSGT systems and to help advance the basic generic technologies needed for these systems.\(^{155}\) By June 1, 1995, the Secretary must submit a report to congress as to the commercial feasibility of constructing one or more HSGT systems in the United States. The study must include: (1) an economic and financial analysis;\(^{156}\) (2) a technical assessment; and (3) recommendations for model legislation for state and local governments to facilitate construction of HSGT systems. Financing and model legislation for state and local governments must be considered together, and such legislation must be coordinated with the federal programs to ensure that adequate capital will be secured to facilitate HSGT projects.

\(^{150}\) See ISTEA, supra note 3, at § 1002.

\(^{151}\) Id.

\(^{152}\) Other agencies include: the Secretaries of Commerce, Energy, and Defense; the Administrator of the Environmental Protection Agency; the Assistant Secretary of the Army for Public Works; and the heads of other “interested” agencies. 49 U.S.C.A. § 309(a) (1994).


\(^{154}\) Id. at § 309(b)(2)(B)(i).

\(^{155}\) Id. at § 309(c).

\(^{156}\) The economic and financial analysis includes twelve issues that must be considered. 49 U.S.C.A. § 309(d)(2) (1994). Such considerations in summary are the examination of potential short and long-haul HSGT markets; extent of relief to traffic congestion and to other modes of transportation; availability of rights-of-way; recommendations for funding mechanisms, tax incentives, etc.; recommendations for the roles appropriate for local, state, and regional governments to facilitate construction of HSGT; among other items.
IV. Analysis

A. General

As previously discussed, ISTEA is not the flexible funding mechanism the government intended it to be. The sources of the inflexibility include the magnitude of the state-matching share, the inability of states to bank and leverage federal funds (for long terms), the dictates on how FAHP funds must be allocated, and the restrictions on placing tolls on existing interstate highways to generate a state’s matching share.

The consequence of this inflexibility is far greater than one may think. ISTEA’s internal provisions significantly restrict the state’s ability to fund the capital intensive intermodal projects. For instance, if a state imposes a general tax to meet this local obligation, it may depress economic development by discouraging businesses from relocating to these states because of this added tax burden. Thus, local and state planners under the current funding mechanisms are likely to shy away from capital intensive environmental/transportation projects. Also, if a project cannot be funded, MPOs and states are precluded from incorporating such projects into their 20-year plans. The President’s Executive Order on Privatization of Infrastructure, creating public/private partnerships, is a positive step toward finding creative ways to finance intermodal projects. The only change that we would suggest here is to lift the federal prohibition on states that prevents them from establishing tolls, particularly on congested segments of interstate highways.

B. State and Local Matching Fund Requirement

To receive federal funds for intermodal transportation projects, states must usually contribute a local matching share. The historic rationale for this requirement is that such a matching share demonstrates local support or commitment to the project. Unfortunately, however, most intermodal transportation projects are so capital intensive that even the states’ matching share is often prohibitively expensive.

C. Banking/State Intermodal Trust Fund

As discussed in the funding section above, the funding mechanisms of ISTEA and the FAHP preclude states from “banking” the federal money allocated to them. If the federal money is not spent within a certain time, a state runs the risk of losing the money. The state, therefore, has the incentive to allocate the money to short-term projects; intermodal projects that require large sums of money are thus left without a funding source if they cannot be built within the time and resource limitations of

157. See supra text accompanying note 133.
the state. If states were allowed to bank federal funds, creating their own intermodal trust funds, they would be able to plan for capital intensive projects that require long-term financial planning. This type of relaxation to the FAHP would provide the states with funds that can reasonably be anticipated, and it would empower MPOs and states to incorporate these projects in their 20-year plans.

D. FAHP Fund Allocation Dictates vs. Block Grants

The federal government controls how all but thirty percent of federally allocated dollars are spent. This defeats the intent that ISTEA provide a flexible source of funding for intermodal projects. One method of overcoming this federal funding dictation is to create a block grant program. The arguments for and against block grants are very predictable. States typically argue that they are capable of addressing their needs more efficiently if they are freed of the heavy bureaucracy imposed by the federal oversight of federal allocations. The federal government, on the other hand, is typically concerned that states lack the resources to adequately plan for the efficient use of the federal money. The federal government is also concerned that the states will preferentially spend the federal money on state interests and will not adequately address the national interests.

The following analysis explores possible solutions that satisfy both the state and federal interests. The federal government has a legitimate concern that states spend federal money efficiently to protect the more historic national interests in security and defense, interstate commerce, and interstate travel. These interests are presently provided for by the maintenance of the national highway system and interstate highway system funded under ISTEA.

There is a fundamental difference in the characteristics of the historic national interests and the new national interest in air quality. The characteristics of the historic national interests are more uniform with one another. This uniformity stems from the ability to address all three historic interests by simply maintaining the national and interstate highway systems. In contrast, the new national interest in air quality varies in both its character and in the optimal approach to protecting that interest. For example, City A, with a congestion problem that results in an ozone nonattainment area, may be best served by an intermodal transportation project utilizing an intelligent vehicle system designed to remedy the congestion problem. This same intermodal project will do little, however, to address City B’s particulate nonattainment area caused by excessive vehi-

---

158. See supra text accompanying note 111.
159. See supra note 32.
cle miles traveled. City B would be better served by a program that increases mass transit facilities to reduce the number of vehicle miles traveled. In this regard, states have a legitimate interest in having the autonomy and truly flexible funding sources available to implement intermodal projects that are customized to address their local needs.

Some of the solutions to the new national interest in air quality, however, require a more uniform and consistent national standard in their application. The programs in this category are those that need national uniformity to be effective or to protect the more historic national interests. Examples of this type of project include the alternative fuel vehicle and intelligent vehicle programs. Having a multitude of mutually incompatible alternative fuel vehicles could easily inhibit interstate travel and interstate commerce if all varieties of alternative fuels were not readily available throughout the United States. Likewise, an intelligent vehicle program that utilizes satellites and transponders on individual's vehicles, to identify congested areas and interactively reroute vehicles to alleviate the congestion, would be worthless if all vehicles were not required to utilize a compatible technology.

Not all the high-tech solutions necessarily fall into this category, however. For example, the ultra-light hybrid vehicles, touted as zero tail-pipe emission vehicles, could use standard fuel when the on-board generation of the electricity is needed. If a standard fuel is used, there would be no impediment to the historic national interests and the federal government should not object if multiple divergent technologies develop in this area. If block grants would facilitate the more efficient development of this type of high-tech solution to the protection of the new national interest in air quality, the federal government should encourage the competition.

Obviously, the solution to this problem contains elements of both types of projects: 1) those that should remain under strict federal oversight, such as certain types of intelligent vehicle design and alternative fuel development; and 2) those that do not need the high level of federal oversight and which might actually prosper under the block grant approach. Given this observation, the answer to the optimal funding mechanism may actually be a hybrid approach. The remaining issue then becomes: How should such a hybrid funding mechanism be designed? Based on the above discussion, a logical approach to designing a hybrid funding mechanism would be to build it out of three component parts.

The first part would fund those transportation projects that clearly fall within the historic national interests, including conventional maintenance and improvement of the existing national highway and interstate highway systems. These types of national and interstate highway maintenance projects would continue to be administered under the strict federal
oversight in place today. States with interstate highway segments that are in satisfactory condition, however, can certify to this effect, thereby allowing these funds to be used for other intermodal projects.

The second component would fund only those projects that address the new national interest in air quality and require uniformity on the national level to be effective. This represents a significant change in the process. Rather than direct federal supervision of each intermodal transportation project, the federal government would establish a set of regulatory national performance standards for those projects that require uniformity on the national level. In essence, the federal government would be building a set of national standards for an arsenal of intermodal “tools” to be placed on a federal “tool bench.” States, in designing their customized intermodal transportation system, could pick and choose from an array of tools on the federal tool bench, provided each such component was in conformity with the national set of performance standards for that particular tool. This approach retains, for the federal government, those aspects of control that are essential to the efficient use of federal funds, but leaves states free to control the macro design of their optimal intermodal transportation system. With the checks and balances provided by the national performance standards, the funds for these projects could be allocated to the states in block grants without the loss of federal oversight. Federal oversight would remain a component of the system through the municipal planning organizations (MPO), transportation improvement plans (TIP), and the state implementation plan (SIP).160

The third component of the hybrid funding approach would fund all other projects addressing the new national interest in air quality. Funding under this component would extend to other intermodal transportation projects that are neither essential to the protection of the historic national interests, nor in need of the uniformity provided by national performance standards. Therefore, projects in this third component would be conducive to block grant funding. Figure 5161 summarizes the relationship between the type of project and the degree of federal oversight.

<table>
<thead>
<tr>
<th>FEDERAL OVERSIGHT</th>
<th>Maintenance and Improvement of National and Interstate Highway System</th>
</tr>
</thead>
<tbody>
<tr>
<td>BLOCK GRANTS</td>
<td>Intermodal Projects Requiring National Uniformity Via National Performance Standards</td>
</tr>
<tr>
<td></td>
<td>All Other Intermodal Projects</td>
</tr>
</tbody>
</table>

160. See supra text accompanying notes 62-68.

E. Tolls

Under present law, states may not impose tolls on existing interstate highways. These restrict the state's ability to generate their matching share. Many interstate highway segments experience significant congestion problems, particularly where they intersect major metropolitan areas. Tolls collected on these portions of the interstate during the most congested times would encourage drivers to seek alternative routes, thus easing the congestion problem. The tolls would simultaneously provide a funding source for alternative intermodal transportation projects that would further reduce congestion and, depending on the type of project, potentially reduce the number of vehicle miles travelled.

Rather than taxing all motor vehicle users, it makes sense to establish a user tax or a toll along these congested corridors to pay for the high capital costs associated with alternative modes of transportation. By affording an alternative means of transportation, the interstate system may be relieved of congestion. From a cultural standpoint, policy makers will not force vehicle owners to use this alternative means. Instead, they create an incentive, through the implementation of a national policy, that supports intermodal transportation. Vehicle owners may still drive, however, they must pay a toll for making this choice.

A modified version of allowing tolls on segments of the interstate highway system may include congestion pricing schemes. Congestion pricing may include tolling commuters during peak-hour travel only or at a higher rate than during non-peak-travel periods.

V. Conclusion and Recommendations

The key to an efficient and effective intermodal transportation system is in the ability to fund all such projects. States must be provided with a flexible means to fund capital intensive projects that compliment both the environmental and economic development objectives of ISTEA and the CAAA. In their present form, the combination of the CAAA and ISTEA provide a potentially synergistic mechanism allowing state or local governments to plan for and fund intermodal projects. Several relatively minor problems, however, prevent the full potential of these two statutes from being realized. Based on our analysis, we suggest that the following legislative changes are capable of removing these roadblocks:

1. Remove the state matching share requirement.\footnote{See supra text accompanying part IV.B.}
2. Allow states to bank federal funds in a state intermodal trust fund for a duration consistent with MPO and state 20-year transportation plans.\footnote{See supra text accompanying part IV.C.}
3. Implement a hybrid allocation/block grant program consistent with the
national interests and the need for uniformity.\textsuperscript{164}

4. Allow states to implement tolls on congested segments of existing inter-state highways in accordance with MPO and state 20-year transportation plans.\textsuperscript{165}

Once the funding mechanisms become as flexible as the framers of ISTEA envisioned, numerous intermodal transportation projects will become viable tools for states to incorporate into their long-term plan. Long-term planning promotes efficiency. The efficiency created promotes better air quality and more convenient, cost-effective modes of transportation.

\textsuperscript{164} See supra text accompanying part IV.D.

\textsuperscript{165} See supra text accompanying Part IV.E.
Problems of Transnational Regulation: A Case Study of Aircraft Noise Regulation in the European Community

Jeffrey Goh*

TABLE OF CONTENTS

I. Introduction: Growth of Air Transport ......................... 278
II. The Emergence of Aircraft Noise .......................... 280
III. International Standards: Annex 16 ....................... 283
IV. The Role of the EC .............................................. 285
   A. European Law on Aircraft Noise: The Directives ...... 287
      1. First Directive ............................................ 287
      2. Second Directive ........................................... 288
      3. Third Directive ............................................ 288
      4. Fourth Directive .......................................... 289
   B. An Overview .................................................. 291
V. Implementation and Enforcement ............................... 292
   A. Compliance by Member States: Article 169 ............. 292
   B. Compliance by Member States: Individual Action and Damages ........................................... 294
   C. Protection Against Aircraft Noise under the European Convention of Human Rights .................... 296
VI. Conclusions ....................................................... 298

277
I. INTRODUCTION: GROWTH OF AIR TRANSPORT

The civil aviation sector represents one of the most significant progressions of this century. From its uncertain beginning at the dawn of this century, air transportation has come a long way. Ready accessibility to air transport services has meant that the world is perceived as being much smaller and that air transport is substantially more convenient. American and European entrepreneurs embarked on an undertaking designed to revolutionise the provision of transport services. Its use has increased dramatically and in such a proportion that today it is a common mode of travel.

Remarkable growth and development in the range of air transport services and technology earned the sector a distinctive international character. However, in the initial stages of its development, air transportation focused primarily on domestic services. The emergence in subsequent years of international services reflected not only their importance within the industry, but also that these new services were a crucial source of revenue for survival. Perhaps as a consequence of those pioneering years, the most outstanding feature of the industry was its international character; outstanding largely because it included not just the air industry but allowed “every part of the world [to be reached] within a few hours of every other and, in doing so . . . brought about a revolution in world trade, in business contacts, and in methods of diplomacy.”

The growing demand for international air transport services meant the level of such activities had to increase, resulting in a need to coordinate the provision of those services and their cognate activities. Only after the Second World War was the pressing need for such an action recognised. With the wide availability of surplus aircraft in addition to increased flying and navigational experience providing fertile ground for commercial exploitation, services inevitably multiplied many times over. Aircraft and personnel were quickly adapted for commercial purposes. Concern for this immense growth and the accompanying implications produced the impetus to drive the countries providing international services to search for a means to ensure an orderly development.

The culmination of the search was a 1944 Chicago meeting convened at the instigation of the governments of the United States and the United

* Lecturer in Law, University of Sheffield, United Kingdom.

My thanks go to the European Commission and the Department of Transport for their assistance, and to the University of Sheffield for generous funding.


2. For an excellent account of air transport history, see Davies, supra note 1. See also Bin Cheng, The Law of International Air Transport (1977)(regarding developments leading up to the formation of an international framework).
Problems of Transnational Regulation

1995]

Kingdom to discuss various concerns arising from international air transport activities. This meeting, the Convention on International Civil Aviation of 1944 (Chicago Convention), set out the general principles of international civil aviation and established a framework of international co-ordination, co-operation and regulation of services. At that point, although safety was the primary concern (and still is today), other issues demanded attention. Therefore, the Chicago Convention addressed several non-agenda items including the technical aspects of air transportation affecting the environment such as engine-fuel emission or noise generated by aircraft engines.

These rapid developments, however, have not progressed without severe consequences and difficulties. Perhaps one of the most serious consequences to emerge has been environmental disturbances. The International Civil Aviation Organization (ICAO) explicitly recognized this aspect and made a statement to that effect.

The ability to travel safely, comfortably and quickly across vast distances has given human beings greater access to distant places and a heightened awareness of their own cultural and social diversity. However, it must be recognized that, like many other human activities, civil aviation can sometimes have adverse environmental consequences.

Particularly problematic for the environment is the noise disturbance caused by aircraft movements and related activities. The disturbance can be considerable, a fortiori, in an area where the air traffic is dense. Although that disturbance may be great, the other prices that have been paid should not be minimized or considered insignificant.

This article focuses specifically on air transport and the environment; more precisely, aircraft noise and the difficulties associated with the European Community (EC) regulatory framework. There are two objectives here: first, to trace the developments that brought aircraft noise concerns to the forefront and; second, to briefly examine both the legal

---


4. The Convention also created the International Civil Aviation Organization (ICAO) to pursue the objectives of the Convention. For a further discussion on the ICAO, review Professor Bin Cheng's excellent text, supra note 2.

5. The Convention today has 16 Annexes: Personnel Licensing; Rules of the Air; Meteorological Service for International Air Navigation; Aeronautical Charts; Units of Measurement to be used in Air and Ground Operations; Operation of Aircraft; Aircraft Nationality and Registration Marks; Airworthiness of Aircraft; Facilitation; Aeronautical Telecommunications; Air Traffic Services; Search and Rescue; Aircraft Accident Investigation; Aerodromes; Aeronautical Information Services; Environmental Protection; Security against Acts of Unlawful Interference; Safe Transport of Dangerous Goods by Air.

framework for international air transport and the relationship of EC laws with the laws the EC Member States. The latter objective garners a measure of importance to the extent that Member States failing or refusing to incorporate provisions of an international treaty or convention will have little or no choice as to the applicability of those provisions if they were adopted by the EC en bloc. The third section considers aircraft noise measures and some of the difficulties encountered by the EC both in relation to the implementation by Member States and their "extra-Community" effect in respect to non-Community countries and air carriers. Finally, some concluding remarks are made in an attempt to shed some light on the future of aircraft noise regulation within the EC. 7

II. THE EMERGENCE OF AIRCRAFT NOISE

Perhaps in the days when travelling by air was less common, one associated aircraft noise with progress and prestige. But, as travelling increased, so did the frequency of flights. Air space congestion resulted from denser air traffic. Consequently, further infrastructural facilities such as accessible airports were needed. However, consequences necessarily accompanied the developments. Community standards and patterns of living in the vicinity of airports were affected. The elasticity of tolerance in respect of these consequences to a large extent depended upon whether they were direct or indirect as much as whether the standard of living changes were for better or worse. Protestations against rapid developments in air transport have already been manifested in various ways. Examples include disobedience against the construction of the Japanese Tokyo-Narita Airport in 1971 and the protracted inquiries in the case of London-Stanstead Airport. Current plans at the United Kingdom's (UK) Manchester Airport to build a second run-way have divided opinions of the local community and aroused strong concerns.

It is axiomatic in the language of the environment to refer to chemical or gaseous pollution. Ironically, this is a narrow and misleading conception. It is often taken for granted that environmental protection is the exercise of conserving nature and natural resources, thereby seeking to prevent damage to them. While this is largely true, it is simply an ecologically-based environmental concern. Issues relating to the environment, however, are capable of having a considerably wider scope than the traditional conception. Noise or vibration is a specific form of environmental disturbance, but the "target" of the disturbance or pollution, while possibly ecological to an extent, reflects sociological concerns.

Noise, whether from road drilling or loudspeakers, affects the toler-

---
7. The article does not seek to present a picture in which regulatory problems across national boundaries in other areas of air transport do not exist.
ance level of human beings, as does vibration. It may be argued that protection from excessive aircraft noise may constitute a species of the "third generation of human rights."\(^8\) Noise from aircraft engines affecting the human population can be conveniently reduced to three kinds: community noise, passenger noise, and ground noise. Community noise is the aircraft noise affecting residents in the vicinity of airports or those communities falling under the flight path. The distinction must be drawn between residents or communities existing in a particular locality prior to the arrival of air transport activities and those moving as a result of those activities. This distinction is crucial if proof of a right is a condition. By contrast, both passenger noise (noise affecting passengers whilst airborne) and ground noise (noise affecting the maintenance crew and personnel at airports) are preceded by their very own existence. Accepting this premise, noise or vibrational disturbances must constitute a form of environmental pollution.

Further, within the notions of ecological and sociological pollution, a sub-category of biological pollution is conceivable. Biological effects from ecological pollution may arise in situations where drinking water is contaminated leading to poor health or fatalities. Biological effects of sociological pollution may evidence themselves in the form of deafness from excessive noise or even heart failure from extreme vibration or drilling.

In spite of a regulatory framework for international air transport, neither the issue of environment nor specifically aircraft noise were items of pressing concern. The lack of action was scarcely realised until it became a critical problem. The first recorded attempt to tackle the issue occurred in 1966. The UK International Noise Conference was organised jointly by the government and aircraft manufacturers. In spite of its domestic dimension, the Conference resulted in the "Special Meeting on Aircraft Noise in the Vicinity of Aerodromes" in 1969 held under the auspices of the ICAO. The provisions of Annex 16 to the Chicago Convention,\(^9\) then entitled Aircraft Noise, owe their existence to that meeting.\(^10\) The prevailing view maintained if the regulation of and standard-

---

8. A third-generation human right is generally recognised as the right beyond those included in the Universal Declaration of Human Rights of 1948, the 1966 Covenant on Civil and Political Rights and the Covenant on Economic and Social Rights of 1966. This is the subject of a current analysis by the author and on which comments are welcome. For now, see W. Paul Gormley, Human Rights and Environment: The Need for International Co-operation (1976).


10. Annex 16 was retitled Environmental Protection: International Standards and Recommended Practices in 1981 to reflect the expanded scope that now includes Volume II dealing with gaseous emissions from aircraft engines.
setting for aircraft noise was to be effective, a coordinated effort conducted through an international body was indispensable - to the extent the international characteristic of civil aviation had undoubtedly become inherent. Both meetings were therefore significant in building the foundations for an international effort dealing with the problem of aircraft noise.

The process of controlling aircraft noise as a form of environmental pollution creates both complex and difficult problems just by virtue of the polycentric nature of the decisions. Addressing the problems does not simply call for a straightforward decision of whether the noise ought to be ceased or whether the claims of the affected parties should be rejected, but involves a delicate balancing of difficult questions and the sometimes conflicting interests of the community and aircraft engine manufacturers. Since aircraft noise is generated at different points and its effect varies according to the specifics of the particular situation, controlling aircraft noise by legislation does not always provide the most appropriate option. A number of different forms of control may need to be adopted, their suitability being dependent on the ways and extent parties are affected or the source of the noise in question.

There are many methods of aircraft noise regulation. Planning control, a common approach, determines the level of protestation to the development of a new airport through inquiries and consultations. Local control of developments toward the parameters of an airport is also frequently employed to deal with the inconvenience of aircraft noise. Providing subsidies for insulating houses and buildings affords an ex post remedy. This remedy has been utilized in two major UK airports. Still another approach purchases properties blighted by aircraft noise, allowing owners of the affected properties to move elsewhere; a move not otherwise possible given the deflated value of their properties. It is often part of the environmental protection programme of airport authorities and proprietors to set aside a generous amount of their income towards the costs of the latter two schemes. Private law remedies in tort represent a further form of control which has been considered elsewhere. Perhaps the more effective form of control is the regulatory process of certification. The process involves a licensing system which imposes conditions or circumstances designating a particular level of acceptable aircraft noise. The conditions may circumscribe the hours aircraft with a certain type of engine may operate - in essence curfew control. How-

13. In respect to the United Kingdom, the Civil Aviation Act, 1982 sec. 78(3) (Eng.), vests
ever, the major portion of the certification process concerns the aircraft engine types, and therefore the noise that they produce. Conditions or circumstances imposed through the certification process emanate from standards laid down at the international, European and national levels.

The ICAO promulgates international standards in accordance with Volume I of Annex 16 to the Chicago Convention. The ICAO standards have had a major influence on global aircraft noise emission standards. Due to the rapid expansion of air transportation there has been a call for greater regulatory intervention by the EC institutions. As part of the wider Community programme to harmonise standards on the environment, four Council Directives have been adopted by the Council of Ministers to regulate noise from aircraft engines. More recently, the Council indicated its intention to formulate a common position on aircraft noise for a presentation at the next meeting of the Committee of Aerial Environment Protection of the ICAO in December 1995. Focus on the national regulatory arrangements by the national regulatory agency responsible for implementing domestic legislation that gives effect to international standards or EC rules is the next step in the analysis. Although the separate nature of each institution and the rules they enact may be argued in the abstract at great length, in practice the substance of their work and the rules they produce regarding aircraft noise are very similar.

III. International Standards: Annex 16

The premise from which to begin understanding the system of international air transport flows from the fundamental principle of airspace and territorial sovereignty as provided for by Article 1 of the Chicago Convention. Each contracting State recognises that every State has complete and exclusive sovereignty over the airspace above its territory. The significance of this provision is the recognition that it attaches to the sovereign status of States and, subject to technical exceptions, no aircraft may fly into the space and territory of another State. This has been the

---

14. A fact which should not invoke much surprise since Convention signatories probably signed onto to these standards prior to the convention.


16. Aircraft noise is not dealt with solely by governmental organizations. In fact, several non-governmental organizations have begun to emerge to respond to the issue: the European Environmental Bureau, the Airfields Environment Federation, the Aircraft Noise Monitoring Advisory Committee and others.
single most responsible provision that has resulted in the vast number of bilateral air service agreements and nationalistic practices between countries.

Annex 16 to the Chicago Convention, which incorporates aircraft noise and fuel emissions, was adopted in 1971 following the recommendations of the 1969 “Special Meeting on Aircraft Noise in the Vicinity of Aerodromes.” That meeting also resulted in the establishment of the Committee on Aircraft Noise to “assist ICAO in the development of noise certification requirements for different classes of aircraft.” Following the decision to expand the scope of Annex 16 in 1981 to include gaseous emissions from aircraft engines, the ICAO is now assisted by a body with a wider term of reference known as the Committee on Aviation Environmental Protection which is responsible for reviewing and proposing noise standards. It is also useful to note the close co-operation between the environmental institutions of the International Air Transport Association (IATA), a non-governmental organisation, and the ICAO. Recently, the role of IATA in environmental matters has increased considerably. Its environmental policies in relation to aircraft noise (and gaseous emissions) are promoted through its Environmental Task Force, although aircraft noise is dealt with specifically by the Aircraft Noise and Emissions Task Force.

The plan of the ICAO regarding aircraft noise includes the following: establishing procedures for describing and measuring aircraft noise; assessing human tolerance to aircraft noise; aircraft noise certification; formulating criteria for establishing noise abatement procedures that address ground run-up of aircraft; and land-use control. Apparently, the ICAO considers the most effective method of regulation the certification process for different classes of aircraft and aircraft engines by permitting or prohibiting their use. The mechanics of this regulatory process involve the phasing-out of certain aircraft and their engines. In particular, it attempts to reduce, and eventually remove, the use of what is known as Chapter Two (2) aircraft. Chapter 2 of Volume I of Annex 16 applies to those aircraft designs certified before 1977. Chapter 3, with comparatively more stringent standards, applies to aircraft certified after 1977. The overall process of removing noisier aircraft from the skies is, however, expected to be accomplished not only by phased replacement with

newer and quieter aircraft or modifications to existing noisier aircraft, but also by the adoption of standard noise abatement operating procedures, or perhaps by a combination of these measures.

The regulation of aircraft noise is a process involving a plethora of considerations from land-planning policies to the use of preferential runways. Since the changes in regulation are closely related to technological advancement, inevitably a regulatory process of this nature also affects the future production of aircraft. Further, there is no doubt that aircraft engine manufacturers safeguard their commercial interests by paying quite a bit of attention to noise certification standards. The standards adopted by the ICAO reflect the improvements in the manufacture of aircraft engines while evaluating the effectiveness of newly developed materials, i.e. sound absorbing materials designed to reduce the noise levels of existing aircraft engines. However, promulgating noise standards demands that a similar degree of importance be attached to the "technical and operational constraints which noise abatement can induce upon aircraft performance."19

Although doubts about the role of the ICAO in coordinating uniform standards for quieter skies ought not be entertained, the persuasive nature of standards and recommended practices in Annex 16 weakens the international regulatory framework not only as to aircraft noise, but also as to other air transport issues. The standards need to be reinforced by legally binding measures. Unless facilitated by the relevant constitutional framework or a high degree of willingness exists to incorporate them into domestic law, failure to utilize the standards carries no real sanction. The inadequacy of leaving the responsibility solely to an international institution is evident. To that end, however, the effectiveness of ICAO standards and recommended practices is greatly reinforced in two ways. First, the EC adopting those standards in the form of Community legislation binds Member States and to an interesting extent, non-EC countries. Second, enacted national measures incorporate those standards and recommended practices into domestic law. Thus, the difficulty stemming from the legal weakness of ICAO measures pales into insignificance.

IV. THE ROLE OF THE EUROPEAN COMMUNITY

To examine the role of the EC on matters relating to the environment generally requires a very detailed and lengthy discussion which is beyond the scope of this article. For its limited worth, the policy reasons underlying the actions taken or proposed relating to aircraft noise will be outlined. From this, it is hoped that the role of the EC in regulating aircraft noise, as part of its environmental protection programme, will grad-

19. ICAO, supra note 17.
ually emerge so that the basis upon which the subsequent legislation on aircraft noise is enacted can be better understood. Reference to the programmes of action of the EC is important because very little policy information can be extracted in the founding treaty. Indeed, the word “environment” is not mentioned in the Treaty of Rome\textsuperscript{20} which means no legal base for Community actions on the environment exists. Consequently, the approach to the development of environmental policies must be cautious. However, this need for caution has since been avoided by the enactment of the Single European Act of 1986.

In 1973, the first EC programme of action on the environment was adopted. \textit{Inter alia}, it noted that “[a] global environmental policy is only possible on the basis of new, more efficient forms of international cooperation which take into account both world ecological correlations and the interdependence of the economies of the world.”\textsuperscript{21} It also specifically recognised noise as a source of harm to individuals and their environment.\textsuperscript{22} Four subsequent action programmes have been formulated and together they set out a number of leading principles relating to the environment.\textsuperscript{23}

(i) prevention and protection of nature and natural resources from significant damage;
(ii) priority consideration, so that environmental issues can be addressed as early as possible in the decision-making process;
(iii) liability at source, so that polluter will pay; respect and mutuality, whereby activities of one Member State should not damage the environment of another and that negotiations must have proper regard to relations with developing nations;
(iv) internationalisation of the Community’s role by joint efforts and cooperation; division of responsibility between the Community and individual Member States according to the types of pollution; and
(v) education, in order to promote greater awareness of environmental importance.

These general principles regarding the need for coordination on environmental issues and noise as an environmental problem combined with specific acknowledgement of aircraft noise as a sufficiently serious source of such noise led to the enactment, in December 1979, of the first of four directives that utilised ICAO standards limiting aircraft noise emissions.

\textsuperscript{20} Treaty Establishing the European Economic Community (Treaty of Rome), March 25, 1957, 298 U.N.T.S. 3. The initial signatory countries were: Belgium, France, the Federal Republic of Germany, Italy, Luxembourg and the Netherlands.
\textsuperscript{21} 1973 O.J. (C 112) 1, at 7.
\textsuperscript{22} \textit{id.} at 8.
\textsuperscript{23} 1977 O.J. (C 139) 1; 1983 O.J. (C 46) 1; 1987 O.J. (C 70) 3; COM(92) 23 (18.03.1992).
A. **European Law on Aircraft Noise: The Directives**

European legislation with regard to air transport has been a comparatively recent development due to the diverse political and economic factors which presented particular difficulties in this area. Today, the increasing role of the EC in air transport has expanded from economic and safety regulation to environmental regulation including noise emission standards. In this regard, four European directives resulted in a duty being placed on Member States to ensure that subsonic aircraft of a civil nature registered in Member States comply with certain requirements stated in Volume 1 of Annex 16. The directives, on the other hand, do grant certain exemptions. What follows is a cursory look at the important provisions of the directives, some of which will be necessarily technical but unavoidable in order to set the agenda for a subsequent analysis of the difficulties raised by some of the provisions.

1. **First Directive**

Council Directive 80/51 was adopted in 1979 and aims to limit noise emissions from subsonic aircraft. Subject to certain exemptions, it expressly prohibits Member States from certifying an aircraft registered in their territory unless that aircraft complies with certain requirements stated in Annex 16, and in particular those specified in Chapters 2 and 3. In addition, it requires that all civil propeller-driven aircraft with a maximum certified take-off weight under 5700 kilograms and all civil subsonic jet aircraft not falling within Annex 16 to be successfully registered and comply with standards at least equivalent to those in Chapter 2 of Annex 16 to the Convention. Certain exemptions are allowed if propeller-driven planes are only flown in the territory of Member States or in the territory of Member States that have given consent. Further, limited exemptions are noted in Article 4 including a discretion for Member States to allow "aircraft of historic interest" to be registered without complying with the stated standards.

The Directive also set a deadline to phase out by December 31, 1986 all civil subsonic jet aircraft with a take-off weight exceeding twenty tons unless they attained standards at least equal to those contained in Chapter 2 of the Annex.

---

24. For instance, no legislation on air transport competition within the EC was introduced until 30 years after the Treaty of Rome was concluded in 1957; see Jeffrey Goh, *Regulating the Skies of Europe: Air Transport Competition* 27 EUR. TRANSP. L. 295 (1992).

25. A Directive is defined in Article 189 of the Treaty of Rome as "binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of forms and methods." See *supra* note 20.

2. *Second Directive*

The second directive, namely Council Directive 83/206,\(^{27}\) amended the 1979 Directive in the light of amendments made to Annex 16 by the ICAO which came into force in November, 1981. This directive specifically stated that Member States should not allow civil subsonic jet aircraft registered outside the EC to land in their territory after January 1, 1988 unless those aircraft also complied with the noise emission standards as set out in Chapter 2. Chapter 2 provisions, although subject to certain temporary exemptions which had to expire by December 31, 1989 and which accounted for "economic" and "technical impossibility," represented a significant increase in the levels of control to be exercised by Member States regarding aircraft noise and aircraft not registered within the EC. The 1979 Directive had merely indicated that Member States should "endeavour" to ensure non-EC registered aircraft complied with international standards. In this respect it is obvious that the imposition of Community obligations on Member States indirectly obligates non-EC countries to also comply with EC and hence international standards. To ignore compliance would lead to the withdrawal of permission to land within the Community. This is significant given the different questions raised as to sovereignty and control of non-EC airlines. The question of unfair international trade also dominates since older aircraft are commonly purchased or leased for use by the airlines of third world or developing nations. Nevertheless, in practice, few problems arise since international noise standards are formulated as a result of wide-ranging agreement among ICAO signatories and EC measures generally mirror those adopted by the ICAO. At any rate, such EC measures are a product of political compromise between Member States which dealt with their existing obligations under their non-EC air service agreements. Be that as it may, not every airline flying into the Community is a signatory to the Chicago Convention nor will every decision by the EC always reflect the unanimous agreement of every Member State.

In air transport, since 1986, Article 84(2) of the Treaty of Rome has provided that decisions may be made by majority vote. In such cases, the regulatory problems beyond national frontiers are most acute.

3. *Third Directive*

The third Council Directive, adopted in 1989, represented yet a further step in the progression to more stringent controls.\(^{28}\) In language mirroring that first used in the 1979 Directive, the preamble notes the need for "aircraft noise [to be] further reduced, taking into account envi-


\(^{28}\) 89/629/EEC 1989 O.J. (L 363) 27.
ronmental factors, technical feasibility and economic consequences." It also notes the need for increased investment in "the latest and quietest aeroplanes available" and states in Article 2 that Member States may not allow registered civil subsonic jet aircraft to fly in their country or in the other countries of the EC unless they comply with noise standards at least as high as those required by Chapter 3 of Annex 16 after November 1, 1990. In effect, all aircraft registered within the EC after November 1, 1990 must comply with the standards set according to their particular classification stipulated in Chapter 3, whether they will be used for air services within or without the EC. The application of standards in Chapter 3 represents a stronger level of control than was previously applicable under the Chapter 2 regime.

Certain exemptions inevitably had to be provided, the most important of which is found in Article 5. This Article enables Member States to grant exemptions for aircraft both leased from non-EC countries on a short term basis and to operators who can show that their pursuits would otherwise be "adversely affected to an unreasonable extent." The difficulty is establishing the extent to which the airline concerned has been affected. No parameters define the meaning of "unreasonable extent." These exemptions reflect the potential hardship which may be suffered by certain airlines, particularly small commercial carriers, if the standards introduced are not phased in as part of long-term plans. However, Article 5 exemptions must expire on December 31, 1995 when it is expected that the extent of the adverse or unreasonable affect on airlines will be marginal.

4. Fourth Directive

The 1989 Directive was a first step along a path to ensure that all aircraft comply with the standards in Chapter 3 of Annex 16 to the Convention. Further measures were subsequently adopted in 1990 by the ICAO laying down the grounds for the eventual prohibition of all aircraft that merely complied with Chapter 2 standards. These measures are now contained in the most recent EC directive, Council Directive 92/14. The aim of this Fourth Directive is to "phase out Chapter 2 aircraft which are regarded as unacceptably noisy, over a number of years." Article 2 stipulates all aircraft, whether EC registered or not, with a maximum take-off weight of or exceeding thirty-four tons and the potential to accommodate more than nineteen passengers (excluding crew) must not operate in a Member State's territory after April 1, 1995 unless they meet either

29. Id.
Chapter 3 standards or those in Chapter 2, provided the certificate regulating the ability of such aircraft to fly was given less than twenty-five years ago.\textsuperscript{32} In simpler terms, aircraft which were certified before 1970 will be prohibited from flying in the EC. From April 1, 2002, however, the Directive requires via Article 2(2) that all aircraft comply with Chapter 3 standards; an effective end to the exemption contained in the proviso.

As in the previous directives, certain exemptions can be granted; several are worthy of further consideration since they raise not merely EC, but extra-Community, implications. These include aircraft from developing nations and other aircraft. Aircraft belonging to airlines from developing nations, listed in the Annex to the Directive, are exempt from Articles 2(1)(a) and 2(1)(b).\textsuperscript{33} Such aircraft must however: 1) comply with Chapter 2 standards; 2) have "operated into Community airports in a twelve (12) month reference period between 1986 and 1990 selected in conjunction with the States concerned;" and 3) have been registered in those developing countries referred to in the Directive Annex within the reference period and continue to be "operated by natural or legal persons established in those countries."\textsuperscript{34} In practice, developing nations in the Annex can choose, in consultation with a Member State, a twelve month period between 1986 and 1990 regarding the use of this exemption. The developing nation in question presumably would wish to adopt a reference year during which as many of its airlines' aircraft as possible fell within the terms of the exemption and whose individual airworthiness certificates were issued more than twenty-five years before the time the exemption is applied for, since Article 2(1)(a) and (b) do not apply to such aircraft. It is the aircraft which airworthiness certificates were granted more than twenty-five years ago that will benefit from these provisions, provided of course they comply with the other terms of the exemption. But this exemption does not override the provisions in Article 2(2) and therefore, airlines, despite being referred to in the Annex, will not be allowed to operate unless they comply with standards in Chapter 3 from April 1, 2002 forward.

The exemption acknowledges that the adaptation of aircraft places an economic burden on all airlines, particularly on airlines from developing nations. Affordability in most instances dictates that purchases or leases of aircraft should be restricted to older and hence noisier aircraft. If forced to comply with the general time scale, such airlines may cease to

\textsuperscript{32} Articles 2(1)(a) and 2(1)(b).

\textsuperscript{33} Examples of airlines of developing nations listed in the Annex are: (i) Air Algerie (Algeria); (ii) Egypt Air (Egypt); (iii) Royal Air Maroc (Morocco); and (iv) Air Zimbabwe (Zimbabwe).

\textsuperscript{34} Article 3(a) and (b).
operate at a time when their operations are regarded as vital to the economy of their countries of origin. The existence of this exemption also underlines the fact that the Directive not only has implications for airlines within the EC but also for extraterritorial airlines. The enforcement of the Directive within the EC will force non-EC states to comply with EC as well as international standards, unless an exemption application is successful. The crucial aspect in this regard is the principle of mutuality in air transport relations between individual Member States and non-EC countries which are governed by the system of bilateral agreements. Since national interests still pervade the EC, there is every incentive on the part of individual Member States to maintain existing agreements to the fullest extent permitted by EC law. If the air traffic rights of the foreign carrier are withdrawn for reason of non-compliance with EC noise Directives, the bilateral system enables the foreign government to similarly withdraw existing reciprocal air traffic rights of an EC carrier; the consequence of this exchange are too obvious to require further exploration for present purposes.

Additionally, Article 4 allows for exemptions to the twenty-five year term specified in Article 2(1)(b) for all aircraft for a period not exceeding three years, if the airline in question is placed in a position where "the pursuit of its operations would otherwise be adversely affected to an unreasonable extent." It is suggested that this exemption is a recognition of the technical difficulties involved in making the appropriate changes to aircraft and the need for certain airlines to adapt over a more relaxed time period as part of a long term investment strategy or risk going out of business. This, it is submitted, is an important provision on a point already raised relating to the obligations that may be imposed indirectly on non-EC countries because it limits potential objections that these countries may raise.

B. An Overview

The approach of adopting and implementing the ICAO standards by the EC has been a consistent characteristic of the Directives. If one understands the EC legislation on aircraft noise, there must be an appreciation of the categorisations of aircraft formulated by the ICAO, specifically those of Chapters 2 and 3 of Annex 16. The aim of the four EC Directives ensures compliance of aircraft registered in Member States with international standards. A duty is placed on Member States to enact legislation limiting the issuance of noise certificates to those in compliance with the specified standards. The Directives are progressive in the sense that each subsequent directive imposes higher standards of noise control and aims at ensuring compliance with a view toward bringing about the gradual phasing out of aircraft that fall below the higher noise
level and internationally accepted requirements. If an aircraft fails to comply with noise level standards, it will not be granted a certificate by a Member State. As a result, it will not be able to land, take-off or fly over the territory of Member States. Airlines are therefore required to ensure their aircraft comply with standards laid down in the Directives.

Other common themes can also be identified from the four Directives, particularly regarding compliance with the applicable standards required within reasonable time scales and exemptions granted by Member States in certain special circumstances.

V. IMPLEMENTATION AND ENFORCEMENT

It is vital to the Community's aim of uniform provision regarding aircraft noise standards that Member States comply with their obligations and, on the whole, most have fulfilled such duties.\textsuperscript{35} Failure to comply with those obligations, however, is potentially liable to two forms of enforcement action.

A. COMPLIANCE BY MEMBER STATES: ARTICLE 169

Article 169 of the Treaty of Rome provides a mechanism by which the Commission can take action against a Member State if it considers such State to have failed to fulfil its Treaty obligations.\textsuperscript{36} Since these aircraft noise measures are "directives," they clearly place Member States under an obligation to implement "as to the result to be achieved" and lack of compliance in this regard could render a Member State subject to an action under Article 169. The \textit{locus standi} for an Article 169 action is conferred only on the Commission although it is common for individuals to prevail on the Commission to initiate an Article 169 action. If the Commission considers a Member State to have not fulfilled its obligations, the Commission, after providing the State concerned with the opportunity to submit its own point of view, will deliver a reasoned opinion. A failure to comply with the terms of the reasoned opinion may result in the matter being brought before the European Court of Justice (ECJ). At this stage, interim measures can be sought by the Commission and granted by the ECJ pursuant to Article 186.\textsuperscript{37}


\textsuperscript{36} Article 169 provides that:

[i]f the Commission considers that a Member State has failed to fulfill an obligation under this Treaty, it shall deliver a reasoned opinion on the matter after giving the State concerned the opportunity to submit its observations. If the State concerned does not comply with the opinion within the period laid down by the Commission the latter may bring the matter before the Court of Justice.

\textsuperscript{37} Article 186 states "[t]he Court of Justice may in any cases before it prescribe any necessary interim measures."
Effective as it may seem, the Article 169 procedure is not without its limitations. First, and in particular, the decision to initiate Article 169 proceedings is discretionary although mandamus could be sought against the Commission for failure to perform a duty under the Treaty. Further, and notwithstanding that a reasoned opinion has been issued, the Commission may decide not to commence legal proceedings for a variety of reasons. Most relevant in this context is the political complexion of air transport within the EC. The protectionist tendencies of Member States in respect to this sector often will be a consideration of relative importance despite the purported role of the Commission as "the guardian of the Treaty." In practice, therefore, it is common to detect an aura of informality in seeking such compliance. The Commission often allows a reasonable period for the implementation of the Directives after considering various items including the legislative time-table of Member States, the availability of relevant personnel at a particular time and so on. In the case of the 1992 Directive, for instance, Article 10 states that Member States were under a duty to "bring into force the laws, regulations and administrative provisions necessary to comply with this Directive before July 1, 1992." However, it was agreed that the period for national implementation would be extended to July 1, 1993 to allow Member States more time to incorporate the Directive into their national law since the Directive was greatly delayed in coming into force. Any infraction would not have attracted proceedings by the Commission.

A second limitation relates to the technical nature of aircraft noise standards. Often members of the public find it difficult to decide whether an infringement took place. Hence, the limited possibilities and strength of individual representation to the Commission for an Article 169 action sink into greater oblivion. While the absence of prima facie evidence does not bar the Commission's consideration of a matter, given that proceedings under this Article can take up to a year to conclude, it is generally true an enforcement action requires, as a pre-condition, cogent evidence. The difficulty with monitoring compliance to a large extent is mitigated by the regulatory approach adopted under EC law. What exists is no more than a broad framework stipulating the standards. National authorities often play a more prominent role since, commonly, national legislation incorporates the Directives to vest the regulatory function of aircraft noise monitoring on the appropriate authorities. Furthermore, this fits with the principle of dividing responsibility between the EC and Member States according to the type of environmental problem and according to the level at which the problem can be dealt with most

appropriately.\textsuperscript{39}

B. COMPLIANCE BY MEMBER STATES: INDIVIDUAL ACTION AND DAMAGES

A more effective way for an individual to enforce EC rights is to rely on the “direct effectiveness” of EC legislation enabling an individual to seek enforcement of rights arising from that legislation in national courts. This judicially-created concept was first delivered in a landmark decision by the ECJ in 1962.\textsuperscript{40} It is, however, subject to a number of conditions:

(i) The legislation in question must be clear and unambiguous in its intention to confer rights on individuals.
(ii) There must be an unconditional conferral of the right.
(iii) The measure must not be dependent on any further action being taken by the Member State.\textsuperscript{41}

It is possible that none of the four Directives are likely to fulfil such requirements particularly since the Directives allow Member States to grant exemptions in certain situations, thereby rendering some provisions conditional. Additionally, the Directives are regulatory and one would be hard-pressed to search for any unconditional conferment of a right. Regardless, the Directives require implementation by Member States and authority exists suggesting that such a condition would be fulfilled if the implementation date has lapsed.\textsuperscript{42}

Since the significant case of \textit{Francovich v. Italian State},\textsuperscript{43} however, it is submitted that even if the four directives in question are not directly effective, an individual suffering some loss as a result of the Member State’s failure to fulfil its obligations with regard to noise standards in the EC may well be in a position to make the Member State liable for damages. The principle enunciated by \textit{Francovich} enables an individual to seek compensation in respect of the failure by the Member State to fulfil its Treaty obligation of implementing Community legislation, provided that the following can be established:

(i) The individual must prove that the legislation in question seeks to es-

\textsuperscript{39} Supra note 20.
\textsuperscript{40} Case 26/62, Van Gend en Loos v. Nederlandse Administratie der Belastingen, 1963 E.C.R. 1. \textit{See also} Case 41/74, Van Duyn v. Home Office, 1974 E.C.R. 1337, 1 C.M.L.R. 1 (1974). Note further that the direct effect concept applies to Directives only in respect to “vertical” bodies, that is, “organisations or bodies which were subject to the authority or control of the State or had special powers beyond those which result from the normal rules applicable to relations between individuals.” Case 188/89, Foster v. British Gas p.l.c., 3 C.M.L.R. 833, 856-857 (1990).
\textsuperscript{41} Case 25/62, Van Gend en Loose v. Nederlandse Administratie der Belastingen.
\textsuperscript{43} Cases 6/90 and 9/90, 1992 I.R.L.R. 84.
establish individual rights. Thus, for instance, this condition might be satisfied if a member of the public living in close proximity to an airport or under the flight path could demonstrate that the Directives in question aimed at establishing rights for such individuals since they are arguably the primary beneficiary of the tightening of aircraft noise standards - the sociological concept of environmental pollution.44

(ii) The detail of such rights must be apparent from the legislation. Whether the right must be explicit or implied is not clear. Both may be acceptable approaches based on the jurisprudence of the ECJ. If it can be successfully demonstrated that the aircraft noise legislation seeks to provide a better environment, then compliance with certain standards prior to airworthiness certification may be translated to a right of the individual against adverse sociological pollution. An individual’s right to enjoy an environment where certain noise standards are not breached must be implied from the Directives.

(iii) There must be a causal link between the infringement by the Member State with regard to implementation (or lack of it) and the damage incurred by the individual. This is essentially a factual requirement, though clearly the notion of damage implies a predetermined or preexisting right. A causal link may exist if, for instance, the individual’s loss from a subsequent decrease in the value of any property owned where such decrease was caused by noise levels exceeding those laid down in the EC legislation, might have directly resulted from the failure of the Member State to implement the EC noise standards.

An Article 169 action may not be required to establish infringement on the part of a Member State where such State clearly failed to implement the Directives on noise standards. Where no legislation in that State imposes standards at least equivalent to those required by EC legislation, the State clearly fails to meet its Treaty obligations when the relevant compliance date in the Directive has passed. In such a case, the Francovich principle allows an individual to seek compensation in national courts without requiring a recourse to the Article 169 procedure.

However, the consequences of the Francovich case remain unclear. The ECJ indicated that the legal liability of the State would be based on that State’s own national law.45 Therefore, what types of loss would be recoverable are undefined. The decision does encourage Member States to fulfil their implementation obligations with regard not only to legislation that is directly effective but also to legislation with indirect effects.

44. Id. The point has already been made relating to the entitlement to a reasonably clean and healthy environment as a human right, though the tri-partite correlation between aircraft noise, the environment and human rights in the legislation still needs to be elaborated.
45. Supra note 43.
C. Protection Against Aircraft Noise under the European Convention of Human Rights

In a separate but highly relevant European development, an individual may also challenge the interference of aircraft noise as an invasion of a person's right to privacy and enjoyment of property rights under the European Convention on Human Rights (ECHR Convention). In 1987, an application was submitted by two residents in the vicinity of London's Heathrow Airport to the European Commission of Human Rights (ECHR Commission) claiming that the noise levels at the airport violated their rights as provided for by the ECHR Convention in Articles 6(1), 8, 13, and Article 1 of Protocol 1 to the Convention. The ECHR Commission rejected the applicants' claims under Articles 6(1), 8, and Article 1 of Protocol 1 as manifestly ill-founded and therefore refused admissibility of their cases. The ECHR Commission appeared to have been driven by the consideration that the interference with their private lives and property rights was necessary in a democratic society for the economic well-being of the country. Additionally, the Commission has been influenced by the fact that the Airport had taken some significant measures, i.e. the purchase of properties affected and the restrictions on air traffic during the night, to deal with the noise resulting from expansion. The crucial question was whether the Government had exceeded its margin for development when balanced against the interests of particular individuals. To resolve the question, the ECHR Commission had to invoke the principle of proportionality. On the issue of effective national remedy as required by Article 13, the ECHR Commission held there had been no violation in respect of Article 6(1) or Article 1 of Protocol 1. The Commission also found that the first applicant's complaint relating to the lack of an effective remedy under Article 8, that is, interference with property rights, did not reveal any violation. The rationale for this decision derived from the fact that the first applicant resided in an area designated as low aircraft noise nuisance (35 Noise and Number Index - NNI Contour) with half a million other residents.

The position was, however, slightly different with respect to the second applicant whose property was located within the 60 NNI Contour, an area designated as affected with a greater noise level. Although his substantive claim under Article 8 was eventually rejected on balance of necessity, it was nevertheless an "arguable claim for the purposes of Article

46. The European Convention on Human Rights is a separate regime from the European Community. It was established under the auspices of the Council of Europe.


1995] Problems of Transnational Regulation 297

13 of the Convention."^49 Given the arguable character of the claim, it was then necessary for the ECHR Commission to determine whether the applicant had an effective remedy. It concluded by majority decision, after reviewing the remedies obtainable in the UK, that "none of these remedies could provide adequate redress" for the second applicant's claim under Article 8 of the Convention.^50

When the case appeared before the European Court of Human Rights (ECHR Court), the court concluded that since the ECHR Commission ruled the complaints under Articles 6(1) and 8 inadmissible, there was no jurisdiction to entertain the complaints.^51 As to the Article 13 claims, the ECHR Court agreed with the ECHR Commission that the first applicant had not been deprived of an effective remedy since the UK enjoys a wide margin of appreciation in adopting specific forms of measures. For the second applicant, however, the ECHR Court took a different view from the ECHR Commission and reached a conclusion similar to the one reached for the first applicant. No violation of Article 13 was found in the case of either applicant.

Although almost all the complaints were rejected by the ECHR Commission, and eventually by the ECHR Court, the significance of this case lies in the principle it has created, that is, the possibility of enforcing property rights affected by aircraft noise as an inherent human right. Powell and Rayner was the first instance when the issue of aircraft noise specifically was raised as a possible human right in the European context, although prior to this case, the relationship between the environment and human rights had been mooted with limited success.^52 Furthermore, while provisions of the Convention or decisions of the ECHR Commission or Court may not be legally binding in some member countries, particularly the UK, there has been recognised the gradual infiltration of the principles entrenched in the Convention into the system of European Community Law by the ECJ. In a number of cases, the ECJ has made rulings in the light of provisions within the Convention. Thus, for instance, in Johnston v. Chief Constable of Royal Ulster Constabulary, the ECJ held that the "principles on which that Convention is based must be taken into consideration in Community law," and the Equal Treatment Directive accordingly ensured that all persons concerned under it had a right to obtain an effective remedy in a competent court against measures contrary to the Directive; a right explicitly recognised by the

50. Id.
The foregoing discussion centered on the implementation of the Directives by Member States and the enforcement procedures for failing to do so. Where the default is on the part of the airline operator for failing to comply with the requirements laid down, enforcement is carried out by national authorities as envisaged by the Directives themselves. Non-compliance based on the EC measures will result in the withdrawal of permission to land within the Community, while non-compliance based on national legislation may lead to financial penalties and withdrawal of an operating license.

VI. Conclusions

Despite a slow start, aircraft noise has moved in a meteoric way to become one of the most important issues in air transportation. International, regional and national efforts exemplify the seriousness with which this matter has been embraced. The effectiveness of an international regulatory system is significantly reinforced by EC legislation where Member States (and also to the extent discussed, non-EC countries) are concerned and by national measures of signatories to the Chicago Convention. The consequences of the continuing importance being placed on controlling aircraft noise, whether through international rules or Community and national legal standards, have been the enactment of a multitude of measures of a varying nature.

The basis for EC legislation on the control and limitation of aircraft noise is two-fold. First, the four Directives were introduced against the backdrop of the international standards adopted by the ICAO. Most, if not all, of the requirements in these Directives mirror those provided for by Annex 16 of the Chicago Convention. Second, these Directives arose from the wider environmental protection programme of the EC. The coincidence in terms of emphasis represents an extended implementational process on the control of aircraft noise since Member States are legally bound by EC legislation. Quite apart from the difference in the status of international rules and EC legislation in Member States, the stricter deadlines set by the EC are yet another difference in spite of the coincidence in the introduction of EC aircraft noise measures.

Perhaps it is safe to hypothesise that in the absence of any international rules, the transport and environmental policies of the EC neverthe-

less will be taken with all seriousness to prepare for the ultimate European union. Yet, at the same time, the rigour with which the EC measures are to be implemented cannot be oblivious to the international effects the process creates. The shift from the second Directive to the fourth Directive in terms of granting exemptions to developing countries is a useful illustration in this regard. For the system of international air transport to function effectively and efficiently, measures such as these must not ignore the implications and difficulties transcending national boundaries. International air transport is still characterised by contracts and agreements requiring respect for the obligations and rights of the others. Inevitably, discretion had to be written into the fourth Directive to safeguard the interests of airlines that could be adversely affected by implementation of the EC aircraft noise measures.

These latter points are indicative of the political overtones in matters related to air transport. However much the virtues of environmental protection against aircraft noise may be extolled, at the end of the day they must be weighed against economic factors such as the pursuit of “environmental friendliness” to ensure that no undue burden is imposed on aircraft operators or airport proprietors. The need for global competitiveness prohibits such an imposition. A recent report by the Committee of Wise Men, when asked to inquire into the competitiveness of the European air transport industry, summarised succinctly the need for this delicate balancing exercise, garnished with an implicit reference to the idea of sovereignty that has characterised so much the system of international air transport. The Committee report stated:

The introduction of separate, more stringent European noise standards would result in increased costs to European airlines and put them at a unilateral economic disadvantage against their global competitors. Moreover, the benefits, because of the noise . . . inequalities of the world’s airline fleets, would be only marginal at Europe’s busiest airports which must continue to accept aircraft from all over the world.54

These observations are largely premised on the inevitable fact that no possibility exists for aircraft noise to be eliminated completely. But a great deal could be done to minimise its disturbance, whether by effective planning controls to prevent inward developments toward an airport or by encouraging improvements in technology for the production of quieter aircraft engines. No doubt, as air transport technology improves, higher standards would be achieved, and indeed expected. Quieter aircraft and aircraft engines would be produced as a matter of logical progression. The investment in and the usage of these, however, will need to be complemented by a legal framework to ensure that airline operators continue

54. COMITÉ DES SAGES, EXPANDING HORIZONS 40 (1994).
to recognise the need for environmentally acceptable standards of aircraft noise. The marketplace is no suitable substitute. But, at the same time, the polycentric nature of regulatory decisions in air transport require proper regard for potential adverse effects at the intra-territorial level as well as the extra-territorial level. Above all else though, the flame signifying its importance, whether as an environmental concern per se or as a species of human rights, must be kept burning to ensure continuous efforts for advancements in air transportation while at the same time bettering the quality of life. The deeper the recognition of this important need, the less complicated the resulting regulatory issues that transcend national frontiers.
Symposium on the General Aviation Revitalization Act

A "Tail" of Liability Reform: General Aviation Revitalization Act of 1994 & The General Aviation Industry in the United States

Timothy S. McAllister*

TABLE OF CONTENTS

I. Introduction ......................................................... 302
II. General Aviation Industry .......................................... 303
    A. Industry And Its Actors .................................. 303
    B. Industry Growth .......................................... 304
    C. Industry "Crash" .......................................... 305
    D. Industry Post-"Crash" Adjustments .................. 307
III. Call for Tort Reform ............................................... 308
IV. The General Aviation Revitalization Act of 1994 ........... 310
    A. GARA Scope .............................................. 310
    B. Congressional Purpose ................................. 312
    C. GARA and FA Act "Savings Clause" .............. 313

* Timothy Simon McAllister graduated from the University of Pennsylvania in 1991 with a B.A. in International Relations. Mr. McAllister is a staff member with the Transportation Law Journal and expects to graduate in May 1996. When not studying law, Mr. McAllister may be found flying his sailplane in Northern Colorado.
I. INTRODUCTION

After an eight year legislative battle,1 a modest effort at reforming the U. S. aviation products liability system was signed into law by President Clinton on August 17, 1994.2 The General Aviation Revitalization Act of 19943 (GARA) amends the Federal Aviation Act of 1958,4 purportedly in order to offer general aviation "some measure of relief from the onslaught of product liability litigation."5 In the words of President Clinton, GARA accommodates the need to revitalize our general aviation industry, while preserving the legal rights of passengers and pilots. . . . This limited measure is intended to give manufacturers of general aviation aircraft and related component parts some protection from lawsuits alleging defective design or manufacture. . . . This act will allow manufacturers to supply new basic aircraft for flight training, business use, and recreational flying. . . . This is a job-creating and job-restoring measure that will bring good jobs and economic growth back to this industry.6

This paper addresses the implications of GARA for the general aviation manufacturing industry in the United States. In particular it examines GARA's scope and purpose in light of the current state of the

3. Id.
general aviation industry. It also analyzes the possible effects of GARA’s interaction with Federal preemption of State products liability laws in aviation cases. The article discusses general aviation’s prospects under GARA’s attempt at reform. The article, in conclusion, looks at the destructive intersection of tort liability, industrial competitiveness and manufacturer viability with preservation of litigants’ access to the courts for product liability suits.

II. GENERAL AVIATION INDUSTRY

A. INDUSTRY AND ITS ACTORS

General aviation encompasses a broad range of activities which do not fall under the rubric of the Federal Aviation Administration’s Federal Aviation Regulation Parts 121 and 135 for scheduled and non-scheduled airline operations. As such, general aviation includes the construction, maintenance, and flight operations of corporate jets, 1944 Boeing Stearmans, home-built sailplanes, and helicopters (to name a few). The general aviation industry is composed of actors as varied as the “Big Three” airframe manufacturers, small airframe, kit-plane, and component parts manufacturers, Fixed Base Operators (FBOs), private flight instructors, mechanics, and pilots. Though not generally recognized as a vital sector of the American economy and transportation infrastructure, the general aviation industry is a “prestige industry” whose benefits are not insubstantial. General aviation’s fortunes are viewed as one indicator of the vibrancy of American industry in the global marketplace. As with any “flagship” industry, a sharp decline in its fortunes raises questions of why and what can be done. During the 1980’s and 90’s, general aviation dramatically illustrated how developments in tort law in-

14. General Aviation contributes more than $38 billion to the U.S. economy and provides over 530,000 jobs. It supports more than 212,000 general aviation aircraft and 703,000 pilots. Furthermore, the country depends on general aviation “... to obtain medical treatment for the sick and injured, to protect our crops, to haul freight and Fortune 500 presidents, [and to train virtually all commercial airline pilots] ... without it, Alaska would shut down... General Aviation is an essential part of this [nation's] vital infrastructure. It's a national resource, a national asset, ...” Symposium, Second Annual FAA General Aviation Forecast Conference Proceedings, March 12-13, 1992, FAA-APO 92-3 at 15. (Keynote Address) [hereinafter Symposium].
terfaced with economic development — to play a large role in forcing an industry to its knees.

B. Industry Growth

General aviation and the industries it spawned find their roots in the two World Wars. Following World War I, the U.S. government disposed of thousands of surplus “Jenny’s” at bargain basement prices. A vibrant general aviation community was born. During the 1920’s and 30’s, thousands of locally-built, single-engine planes flew in “barnstorming” acts around the country and spread a vision of the future of aviation from the big city to the smallest town. At the same time, the federal government entered the field of prescribing legal rules, regulations governing the airways and aircraft. In this pre-World War II period, the government recognized the need for support in the development of an aviation infrastructure.

The technology of aerial warfare drove much of the American effort to defeat the Axis Powers in World War II. From this effort blossomed the principal pieces of 1960’s and 70’s general aviation. A plethora of trained pilots, aircraft mechanics, aero-engineers commanded a rapidly maturing airspace and airport infrastructure. A general “belief” grew in the present and future benefits of air transportation and recreation.

The post-war 1950’s were a time of innovation and entrepreneurial spirit in the field of general aviation aircraft manufacturing. Alongside the world-class commercial products of Boeing, Douglas, and Lockheed, a multitude of single- and multi-engine light piston aircraft were emerging from backyard garages, small-town factories, and major manufacturers’ plants. The skies were filled with surplus World War II training aircraft, as well as new designs from manufacturers like Cessna, Piper, Beech, Stinson, and Luscombe. Small town airports flourished and surplus military airfields were transferred to civilian use. A burgeoning support industry drew on the talents of ex-army air corps personnel. These human resources propelled further growth in maintenance shops, fuel services, sales and support, and training of the next generation of pilots.

The 1960’s and 70’s saw exponential growth in the number of pilots flying and the number of aircraft produced. This was due in large part to the endeavors of the “Big Three” of Cessna, Piper, and Beech. Consolation of the general aviation manufacturing industry had taken place in

16. In addressing the future of general aviation in 1992, acting Administrator of FAA, Mr. Barry Harris Lambert, stated “[s]olo flight has been a part of America’s heritage for almost nine decades. I can’t imagine what this country would be without it.” Supra note 14, at 15.
17. Boeing 377 and 707, Douglas DC-7 and DC-8, and Lockheed Constellation.
the late 1950's, and the “Big Three” were now in a position to offer a comprehensive product line. They also had the infrastructure necessary to support sales and training. Their aggressive marketing of general aviation and the resultant explosion in sales of general aviation aircraft reached its peak in the late 1970's. This spawned sharp growth in the support industries such as FBO's, mechanics, and support personnel.

By 1978-79, there were twenty-nine manufacturers of general aviation aircraft, including the “Big Three.” These manufacturers produced over 14,000 light piston general aviation aircraft, and realized revenue of $2.2 billion. This revenue achieved a consistent balance of trade surplus with foreign countries. These sales in turn supported 11,000 FBO's and upwards of 560,000 jobs.

C. INDUSTRY “CRASH”

The tremendous growth of general aviation came to a halt in the early 1980's, when it entered a period of stagnation and decline. By the early 1990's the general aviation industry was decimated as demand for its products and services ebbed. A number of structural factors are helpful in explaining the declining fortunes of general aviation.

A close look at these factors shows that general aviation had become a luxury, less and less accessible to the average person from the late

---

19. Id. at 8.
20. An average of 13,000 piston aircraft over the 1965-1982 period. Id.
23. 1993 House Hearings, supra note 18 at 25.(testimony of Mr. Edward W. Stimpson, President, General Aviation Manufacturers Association (GAMA)).
24. Symposium, supra note 14, at 15. (keynote address by Mr. Barry Harris Lambert, Acting Administrator, Federal Aviation Administration).
25. Among the structural factors making general aviation less attractive to current and prospective pilots and aircraft owners, and mitigating against an expanding market for new build general aviation aircraft:
   - number and types of aircraft produced in the 1970's (130,000+)
   - the durability and quality of the aircraft produced (average age of 28 years in 1994, projected to grow to 34 years by 2000)
   - decline in real disposable income and increased costs (fuel, financing, pilot training)
   - surge in commercial airline traffic following enactment of the Airlines Deregulation Act of 1978
   - Congressional repeal of the investment tax credit (ITC) and flight training funds under the GI Bill
   - Congressional imposition of the luxury tax [subsequently repealed. Author.]
   - growth of the amateur-built “kit” industry
   - relatively inexpensive cost of used aircraft
   - urbanization and airspace access (closing general aviation airfields and restricting access to general aviation).
1970's onward. Despite attempts to bolster its flagging fortunes, economic and demographic challenges proved too much for general aviation industries. For the average American, profitability and affordability evaporated for operation and ownership of general aviation aircraft. Therefore, production stalled. Construction of light piston-engine aircraft by major, established manufacturers during the 1980's virtually ceased.

By 1993, only nine manufacturers of light pistons produced approximately 500 light piston aircraft. In that year, Piper was still in the process of emerging from Chapter 11 bankruptcy protection and produced 2% of their 1978 total production; Beech was producing 18% of their 1978 total production; and Cessna was producing no light piston general aviation aircraft. As the business of the "Big Three" dropped precipitously, so did the fortunes of their enormous network of suppliers and support providers. Component part manufacturers and general aviation support services suffered an equally sharp contraction. FBO's declined from a high of 11,000 to less than 4,900. The number of people beginning pilot training (pilot starts) dropped to their lowest levels since the early 1960's.

Marking the beginning of this "crash" was a sharp rise in the costs of insuring and defending against product liability actions relating to defective design and manufacture. Aircraft builders had to deal with each aircraft's "liability tail," those real or imagined design or manufacture defects for which a company would be responsible. The costs associated with a products liability tail 10, 20, 30 and 40 years long rose dramatically. In fact, it became the number one concern of all general aviation manufacturers. The "crash" was also marked by a growing number of

29. 1993 saw 78,000 student pilot starts as opposed to 135,000 at the high point in the early 1960's. Id. at 54.
30. See Restatement (Second) of Torts § 402A and Comments.
31. By 1980, Piper had a liability "tail" of 135,000+ active light piston aircraft and untold thousands of inactive and damaged aircraft that could be returned to serviceable condition at any time. Id. at 29.
32. For example:
- General aviation manufacturers paid $24 million in awards, settlements, and defense costs in 1977. By 1987, this figure had reached $200 million+.
- Between 1987 and 1992 . . . the industry paid claims and out-of-pocket expenses for product liability defense totaling about $250 million a year.
- [In 1987] Beechcraft Aircraft Corp. estimated that it cost $80,000 per aircraft to offset exposure for product liability (or 30% of the cost of the average Beech product). The Beechcraft study analyzed 203 claims filed against the company between 1983 and 1986 and discovered that:
  - the average cost to win, lose, or draw was $530,000
  - the average value of plaintiff's claims per accident was $9.86 million, despite . . .
frivolous legal actions aimed at general aviation manufacturers. By the mid 1980's, the industry came to the conclusion that it was necessary to focus on limiting its tremendous exposure to products liability actions. To their minds, this became important if the production of light piston aircraft for general aviation use was to revive in this country.

D. Industry Post-"Crash" Adjustments

Despite the view of the "Big Three" and various industry trade organizations such as the General Aviation Manufacturers Association (GAMA), all has not been gloom and doom in the industry. In 1992, sales of light piston aircraft kits were at an all-time high. Innovative kit manufacturers proliferated, filling the void left by the "Big Three." Registration and certification of a multitude of modern, "state-of-the-art" experimental home-built aircraft skyrocketed. This overshadows Piper Aircraft's stumbling attempts to emerge from the ashes of bankruptcy in 1993 and the industry's 20% growth in export billings. The GAMA production statistics for light piston aircraft do not include kit manufacturers products and sales, nor up to 33% of production aircraft delivered and exported by the United States. Interestingly, the GAMA research

118 accidents attributable to pilot/operator error.
22 accidents attributable to improper maintenance.
21 accidents attributable to weather.
1 accident attributable to air traffic control (ATC).
1 accident attributable to other causes.
63 accidents attributable to undetermined causes.
0 accidents attributable to manufacturing defect.

Id. at 4-5. (Beechcraft Study quoted by Congressman James M. Inhofe).
- Piper chose to self-insure after the mid-1980's, but its last insured yearly premiums were in excess of $40 million versus $100 million in sales. Id. at 29. (testimony of Charles M. Suma, President and CEO, Piper Aircraft Corp.).
- Cessna has not produced a single light piston aircraft since 1986, yet it continues to be sued for nearly every accident involving a Cessna product regardless of cause. The company has been forced to spend an average of $20-25 million each year in litigation costs since 1986. Interestingly, this figure almost exactly equals Cessna's yearly expenditures on R&D over the period 1965-1982. Id. at 27. (testimony of Russell W. Meyer, Jr., Chairman and CEO, Cessna Aircraft Co.).

33. Characterized as "frivolous" lawsuits or "automatic inclusion" by the general aviation industry, manufacturers of aircraft and component parts saw themselves increasingly joined as defendants whenever a light piston aircraft was involved in an accident. One particularly egregious incident involved Unison Industries, Inc. (a maker of piston engine magnetos and ignitions) being joined in the crash of a Cessna 206 off Oahu, Hawaii. After spending $10-15,000 in mounting a defense, Unison discovered that its product was not even on the aircraft. In the words of Unison president Frederick B. Sontag, "[h]ow would you like to be sued for being in a bar fight and you weren't even in the bar?" This, after Unison was sued 35 times between 1983-93; none of the cases ever went to trial. Id. at 48.

34. 3,318 kits were sold in 1992. 1993 Senate Report, supra note 22, at 6.

35. In 1990, 1,115 were certificated by FAA and in 1989, 1,326 were certificated by FAA. Id.

36. Id. at 2.

37. Id. at 2.
figured prominently in Congressional hearings on GARA and portray the industry in imminent threat of destruction.

Despite the precipitous decline in deliveries and exports of light piston general aviation aircraft during the 1980's, the 1990's saw a rebound. Production of these aircraft by non-traditional sources swelled to around 3,500 light pistons a year. All sectors of the general aviation industry felt this rebound. Demand for component parts and support services grew, paralleling the slow to moderate growth returning to general aviation. While not comparable to the go-go years of the late 1960's and 1970's, the general aviation industry and community in the 1990's began to show signs of successful adjustment. The industry began to recognize society's changing economics and demographics which themselves signaled an end to limitless growth in the field of general aviation.

III. A Call For Tort Reform

Beginning in the late 1970's, strident calls came from industry, as well as private citizens, for State and the Federal legislatures to enact tort liability reform in order to address a perceived crisis in the legal system. In particular, many manufacturers and providers of services faced an escalation of costs associated with defending against increasing numbers of often frivolous legal actions directed at their products. This forced increases in the price of their goods and services, and in turn, drove many consumer items off the market or out of reach. Consumers often turned to imports to satisfy their demand.

In no field of law did this crisis have a more profound and devastating effect than aviation products liability.\textsuperscript{38} From being the unqualified world leader in the field of general aviation (from the number of aircraft produced, to the number of pilots certified), the United States general aviation manufacturing industry became a gutted hulk.\textsuperscript{39} Members of the general aviation industry and pilot community became major players in an increasingly vociferous lobby favoring reform of the current tort sys-

\textsuperscript{38} State "notice pending" (whereby a plaintiff need only insert 10-15 key words in the complaint in order to join a defendant) and the inherent difficulty in determining fault in general aviation aircraft accidents (because of lack of direct evidence and jury ignorance and distrust of aviation technology and FAA regulation) are often cited as the primary reasons general aviation manufacturers find themselves increasingly in court and forced to expend money defending such "automatic inclusions." 1993 \textit{House Hearings}, \textit{supra} note 18 at 8, 49, and 19.

\textsuperscript{39} Whereas there were 29 U.S. manufacturers and 15 foreign manufacturers marketing general aviation aircraft in 1980, 1992 saw only 9 U.S. manufacturers and 29 foreign manufacturers marketing general aviation aircraft. 1993 \textit{House Hearings}, \textit{supra} note 18, at 8. Furthermore, prior to 1981, general aviation and consistently achieved a balance of trade surplus; by 1992, the United States had a balance of trade deficit of +$800 million, this despite the fact that U.S. registered light piston aircraft were being exported at an accelerating rate due to their low cost and high quality. 1993 \textit{Senate Report}, \textit{supra} note 22, at 2.
tem, particularly aviation product liability. These efforts at reform were focused at the Federal level, where it was believed that the overarching Federal authority over aviation safety offered the best chance of achieving uniformity of legislation.  

Countering the calls for reform of the products liability system was an equally strident group, led by the American Trial Lawyers Association (ATLA).  

ATLA, in general, proposes that the tort system as a whole, and products liability in particular, must meet changing societal needs and notions of safety in society. For a society that too often in the past had its safety sacrificed to economic growth and industrial prosperity, the extension of stricter standards of care into the field of products liability appeared to offer needed legal redress.

The ATLA membership opposed any tort reform favoring general aviation manufacturers for a number of reasons. Among these were: the iniquity of broad tort immunity being offered to a particular industry;  

the laxity of FAA certification standards and the certification process;  

---

40. Congressman Glickman, co-sponsor of GARA in the House of Representatives (H.R. 3087), stated, “[w]e have an industry that is Federally regulated from birth to death. There is no State involvement in the regulation of aviation from licensing of pilots to moving through airspace. It is a Federal issue. And therefore, there is a very strong case to be made that liability laws ought to be federalized or made uniform because you have an industry that is totally regulated from the Federal side of the picture.” 1993 House Hearings, supra note 18, at 7.  

41. Symposium, supra note 14, at 62. (remarks of Brian E. Barents, President and CEO, Learjet Corporation).

42. Why should an industry that was enjoying great profitability, be granted tort immunity for up to 50 years of economic activity? The extent of the profitability of the “Big Three” as of 1992 was impressive: Cessna was sold to Textron for $100 million. Beech recorded its highest revenues ever. Cessna and Beech both transitioned into production of corporate jets and multi-engine turbine aircraft. These aircraft are more profitable than single- or multi-engine light piston aircraft by a factor of ten. In light of this, ATLA argued that any reduction in liability would not assure production of light piston aircraft by the “Big Three.” ATLA also argued limited liability would take away pilot and passenger rights to compensation. Furthermore, the fact that general aviation is viewed as an “inhernently dangerous activity” mitigates against any lessening of the standard of care applied to general aviation products. 1993 House Hearings, supra note 18, at 69-70, and 73. (testimony of Mr. Katzman, ATLA member).

43. FAA certification standards with respect to such safety issues as the installation of shoulder harnesses, seat slips, and “crashworthiness” do not bring the number of defective products to an acceptable level. A number of examples are germane. The following are aircraft types with chronic defects that have gone for long periods without any FAA mandated corrective action program being administered:

- Cessna 411 with lack of rudder authority during single engine operations.
- Cessna 210 with bladder fuel tanks that trap water.
- Mooney Turbo 210 with vapor lock.
- V-Tail Beech Bonanzas with a basic design flaw due to lack of aeronautical knowledge during the 1950's.
- Lear 23 crashes (over 50% of the aircraft built have crashed).
- Piper Malibu with an unprecedented number of crashed due possibly to a defective autopilot.

Id. at 70.
and manufacturer collusion in the National Transportation Safety Board (NTSB) accident investigations.\footnote{45} ATLA may have shrewdly concluded that reform efforts had weakened from consistent and dedicated opposition to legal reform over the past eight years. ATLA chose not to attend any of the hearings of GARA in an official capacity during 1993 or 1994. This absence, in part, allowed GARA to be enacted into law. It delivered an ominous message, though, to industry: “GARA satisfies ATLA.”

\section*{IV. The General Aviation Revitalization Act of 1994}

\subsection*{A. GARA Scope}

GARA\footnote{46} amended the FA Act to provide an eighteen-year Federal

\begin{quote}
44. FAA regulations provide for the certification of production aircraft under a Delegated Option Authority (DOA) whereby the manufacturer “switches hats” and acts as the FAA oversight authority with regard to granting an aircraft its type certificate. \textit{Id.} at 71.

45. \textit{Id.} at 71.

46. 49 U.S.C. § 40101. (1994). GARA provides that:

Sec. 2. Time Limitations on civil actions against aircraft manufacturers.

(a) \textit{In General.} — Except as provided in subsection (b), no civil action for damages for death or injury to persons or damage to property arising out of an accident involving a general aviation aircraft may be brought against the manufacturer of the aircraft or the manufacturer of any new component, system, subassembly, or other part of the aircraft, in its capacity as a manufacturer if the accident occurred:

(1) after the applicable limitation period beginning on

(A) the date of delivery of the aircraft to its first purchaser or lessee, if delivered directly from the manufacturer; or

(B) the date of first delivery of the aircraft to a person engaged in the business of selling or leasing such aircraft; or

(2) with respect to any new component, system, subassembly, or other part which replaced another component, system, subassembly, or other part originally in, or which was added to, the aircraft, and which is alleged to have caused such death, injury, or damage, after the applicable limitation period beginning on the date of completion of the replacement or addition . . .

(b) \textit{Exceptions} — Subsection (a) does not apply:

(1) if the claimant pleads with specificity the facts necessary to prove, and proves, that the manufacturer with respect to a type certificate or airworthiness certificate for, or obligations with respect to continuing airworthiness of, an aircraft or a component, system, or subassembly, or other part of an aircraft knowingly misrepresented to the Federal Aviation Administration, or concealed or withheld from the Federal Aviation Administration, required information that is material and relevant to the performance or maintenance or operation of such aircraft, or the component, system, or subassembly, or other part, that is customarily related to the harm which the claimant allegedly suffered;

(2) if the person for whose injury or death the claim is being made is a passenger for the purposes of receiving treatment for medical or other emergency;

(3) if the person for whose injury or death the claim is being made was not aboard the aircraft at the time of the accident; or

(4) to an action brought under a written warranty enforceable under law but for the operation of this Act.

(c) \textit{General Aviation Aircraft Defined} — For the purpose of this Act, the term “general aviation aircraft” means any aircraft for which a type certificate or an airworthiness certificate has been issued by the Administrator of the Federal Aviation Administration, which, at the time such certificate was originally issued, had a maximum seating capacity of fewer than 20 passengers, and which was not, at the time of the
statute of repose on civil actions for death or injury, or damage to property, relating to general aviation aircraft and their component parts. General aviation aircraft are broadly defined under GARA as all aircraft (unpowered, single-engine, or multi-engine; piston, turbine or jet; and fixed or rotary-winged) holding a valid FAA type or airworthiness certificate, carrying fewer than twenty people, and not engaged in passenger carrying operations at the time of the accident.\textsuperscript{47} Not surprisingly, GARA provides four major exceptions. The eighteen-year statute of repose does not apply to cases in which: (1) the manufacturer misrepresents certain safety information to the FAA, (2) the claimant was a passenger for purposes of receiving medical or emergency treatment, (3) the claimant was not aboard the aircraft, and (4) actions are brought under manufacturer’s written warranties.\textsuperscript{48}

These exceptions notwithstanding, the 1994 House Committee on the Judiciary report on the Bill makes clear that GARA’s goal is to cut off the product liability tail for general aviation manufacturers of aircraft and component parts after eighteen years.\textsuperscript{49} On the other hand, the Bill preserves all civil actions against all other elements of the general avia-

\textsuperscript{47} Id. § 40101(2)(c).

\textsuperscript{48} Id. § 40101 2(b)(1)-(4).

\textsuperscript{49} “Once a general aviation aircraft or component part crosses the specified age threshold, and unless one of the specified exceptions applies, the possibility of any act or omission on the part of its manufacturer in its capacity as a manufacturer - including any defect in the aircraft or component part ceases to be material or admissible in any civil action...” H.R. Rep. No. 103-525, 103d Cong., 2d Sess., pt. 2, at 6-7 (1994)[hereinafter 1994 House Report II].
tion industry. Additionally, and most importantly, GARA affirmatively preserves a role for State law. State law governs the adjudication of aviation products liability cases involving claims for defective design or manufacture. The House Committee on the Judiciary was very careful to emphasize that it was voting the bill out of the committee as "a very limited Federal preemption of State law" which should be viewed as a "narrow and considered response to the 'perceived' liability crisis in the general aviation industry. . . . [R]ather than seeking to revise substantially a number of substantive and procedural matters relating to State tort law, [it] is limited to creating a statute of repose."52

B. CONGRESSIONAL PURPOSE

The clear beneficiaries of this bill are general aviation airframe manufacturers with a liability tail of over eighteen years in piston aircraft. Congressional intent clearly reflects the views of industry testimony which characterized passage of the bill as a win-win proposition that protects both the interests of the industry and prospective claimants.53 The purpose of GARA is two-fold. First, it seeks to provide the opportunity to restart large scale production of light piston general aviation aircraft in order to create jobs and exports.54 Second, GARA avoids fundamental

50. "...[V]ictims would ... continue to be free to bring suits against pilots, mechanics, base operators, and other responsible parties where there is negligence or other misconduct is the proximate cause of the accident." Id. at 7.

51. "... [I]n cases where the statute of repose has not expired, state law will continue to govern fully, unfettered by Federal interference." Id.

52. Id. at 4, 6.

53. Any reduction in an injured plaintiff's ability to bring suit against general aviation manufacturers would be far outweighed by the "boom" in manufacturing expected to come from the liability climate in the wake of passage of any statute of repose. Conversely, it was alleged that even if the industry did not rebound, the effect on an injured plaintiff's ability to bring legal action was negligible. Passage of the statute of repose was a measured response that took into account manufacturer's need. The effect on prospective claimant need for legal resort was likened to taking a sick family dog to a veterinarian/taxidermist. "[Whether the dog dies or is cured] . . . either way you get your dog back." 1993 House Hearings, supra note 18, at 60. (testimony of Monte Mitchell, President, Aircraft Electronics Association).

54. A sampling of 1993 House hearing testimony reveals the purported benefits of this legislation from industry's point of view:

- Stevens Aviation Written Comment:
  Premised on the production of 6,000 new light piston a year, at an average cost of $125,000 for the next five years, passage of this bill would create an additional $2 billion in revenue and 12,800 jobs in the general aviation industry. Id. at 112.

- Testimony of Monte Mitchell, President, Aircraft Electronics Association:
  ...[A] statute of repose will be the major stimulus for the United States general aviation industry needs to reopen production lines . . . . This will create tens of thousands of new, stable, high-paying, private sector, manufacturing, engineering, and related support jobs. Not only will it help our industry, it will help the overall economy and help the local grocery store and barber shop as well as expand the local, State, and Federal tax revenues through payroll sales and related taxes. Id. at 59.
reform of the tort system. It does not preempt state law.55 Facially, GARA's eighteen-year statute of repose accomplishes both purposes. More importantly, GARA implicitly appears to have come down firmly on the side of preserving the present tort system. The implications for the viability of light piston aircraft production, let alone the mass production of these aircraft, are not positive.

C. GARA AND FA ACT "SAVINGS CLAUSE"

The Federal Aviation Act of 1958 vests "plenary authority to make and enforce safety regulation governing the design and operation of civil aircraft" in the Secretary of Transportation.56 Under § 1421, the Secretary is authorized to promulgate "minimum standards governing the design, . . . and performance of aircraft, . . . as may be required in the interest of safety."57 The Secretary has done this through the FAA in the form of comprehensive Federal Aviation Regulations (FARs).58 As the FA Act and FARs indicate, the federal government exercises broad controls over the field of aircraft design and safety such that the regulation of each of these has traditionally been a matter of federal concern.59

Federal concern notwithstanding, the unamended FA Act left considerable power to the state. It did so by containing a broad general remedies "savings clause"60 which provided: "[n]othing in this chapter shall in any way abridge or alter the remedies now existing at common law or by statute, but the provisions of this chapter are in addition to such remedies." However, the FA Act was subsequently amended in the summer of 199461 to grant: "a remedy under this part in addition to any other reme-

---

55. Testimony of Charles B. Suma, President and CEO, Piper Aircraft Corp.: New jobs in excess of 25,000 manufacturing . . . positions could easily be created within five years of the passage. Typically, these manufacturing-based jobs have an economic factor of one to four . . . Id. at 30-31.

56. Testimony of Mr. Russel Meyer:
If we do not get this legislation [the production of piston aircraft] is all academic. [Cessna is] not going to go back into the production of single engine aircraft. [Cessna] will stay building jets and turbine aircraft . . . [However, in the event S. 1458 were adopted, Cessna would re-enter the business of manufacturing single-piston aircraft] the day this legislation is enacted.


55. When asked to comment on the scope of the proposed legislation, Mr. Phil Boyer, President, Aircraft Owners and Pilots Association, stated: "as for this being looked at as any major form of tort reform. It is not." 1993 House Hearings, supra note 18, at 55.


58. Haynes, supra note 8, at 34.

59. Id.


dies provided by law."\textsuperscript{62} This amendment is consistent with the legislative intent of the FA Act that state tort remedies and the law governing these remedies, as they apply to legal claims arising out of aircraft accidents, are not preempted by Federal statute. The meaning of this savings clause with respect to Congressional intent to preempt state common law in the regulation of aviation has been the source of important litigation that greatly affects general aviation’s present and prospective liability exposure.

D. \textbf{GARA AND FEDERAL PREEMPTION OF STATE PRODUCT LIABILITY LAW}

There has been a great deal of litigation surrounding scope of the 1978 Airline Deregulation Act (ADA) amending the FA Act to provide for Federal preemption of State regulation of airline "rates, routes, or service."\textsuperscript{63} The primary question at issue is whether \textsection 1305(a)(1) only preempts state laws that relate to rates, routes, and services of air carriers, or additionally preempts state products liability actions relating to aircraft design or manufacture.\textsuperscript{64} There is some division among the courts on this issue. The U.S. Supreme Court has not issued a decision on point, but in \textit{Ray v. Atlantic Richfield Co.},\textsuperscript{65} the Court found state tort law preempted because of the dominant role that the federal government held and the dominant federal interest in effectuating a uniform system of safety regulations in that area.\textsuperscript{66} The court in \textit{Ray} stated that in certain areas analogous to aircraft safety, Congress intended to exclusively regulate without specifically stating so.\textsuperscript{67}

Lower courts have spoken on the question of federal preemption under \textsection 1305(a)(1). The Tenth Circuit in \textit{Cleveland v. Piper Aircraft, Inc.},\textsuperscript{68} and the District Court of Kansas in \textit{Sunbird Air Service v. Beech Aircraft Corp.},\textsuperscript{69} have allowed state tort law to operate because they believe Congress intended to preserve existing common law remedies under the ADA. These courts interpret Congressional refusal to remove the savings clause as an indication that state aviation product liability actions were not preempted.\textsuperscript{70}

Defining the scope of federal interest in exclusively regulating air-

\begin{enumerate}
\item 49 U.S.C. \textsection 40120(c), (1994).
\item Haynes, \textit{supra} note 8, at 34.
\item \textit{Id.} at 163.
\item \textit{Id.}
\item \textit{Cleveland v. Piper Aircraft, Inc.}, 985 F. 2d 1438 (10th Cir. 1993).
\item \textit{Piper Aircraft}, 985 F.2d 1438; \textit{Sunbird}, 789 F. Supp. 360.
\end{enumerate}
A "Tail" of Liability Reform

craft safety involves making a determination as to whether the FAA's statutory scheme in regulations preclude State common law remedies. In Sunbird, the court held that the regulations promulgated by the FAA were merely minimum safety standards which did not preclude a finding of negligence under state tort law.\(^{71}\) According to this case, the Federal government has not evinced a dominant federal interest in exclusively regulating aircraft safety. But these decisions are not consistent if Congress, by its various amendments of the FA Act, intends to preempt state tort law as it relates claims of defective aircraft design or manufacture.

Congress has the power to preempt State products liability law under the Supremacy Clause of Article VI of the United States Constitution.\(^{72}\) Under the test set out in the case of Cipollone v. Liggett Group, Inc.,\(^{73}\) state law is preempted by Federal law under the Supremacy clause where:

(1) Congress, in a federal statute, explicitly states an intent to preempt state law; (2) in the absence of an express preemption, there is outright or actual conflict between federal and state law, thus, making compliance with both federal and state law in effect impossible; or (3) federal law so thoroughly occupies a legislative field as to make reasonable the inference that Congress left no room for the states to supplement federal law.\(^{74}\)

Arguably, GARA § 2(d) resolves this question by definitely addressing the statute of repose's relationship to other laws and the issue of the scope of Federal preemption of State law in the area of products liability actions.\(^{75}\) GARA § 2(d) provides: "[t]his section supersedes any state law to the extent that such law permits a civil action described in subsection (a) to be brought after the applicable limitation period for such civil action established by subsection (a)."\(^{76}\) Congress gave the various courts a definitive expression of federal legislative intent. It did so by failing to address federal preemption of state tort actions for aircraft accidents and by specifically preserving any and all state law not superseded. GARA § 2(d), in company with preservation of the 49 U.S.C. § 40120(c) general "savings clause," may be read as clarifying the scope and strengthening the role of state tort law applicability to aviation products liability actions.

According to the federal preemption test in Cipolone, the legislative intent behind GARA makes clear that state common law governs all actions for damages. State products liability standards specifically govern product liability actions for aircraft design or manufacturing defects up

---

\(^{71}\) 789 F. Supp. at 362-62.


\(^{74}\) Id. at 2617.


until the period of repose commences. Rather than preempt state common law in the field of aviation accident litigation, GARA amends the FA Act such that the holdings in Piper and Sunbird have been positively affirmed. The holdings now have effect beyond their earlier jurisdictions and are binding on all future court decisions. They may now be regarded as the law of aviation product liability until the eighteenth year of the product’s life.

V. GARA Effects

A close reading of GARA shows its critical effects on the aviation industry, the pilot-consumer, and the general public. GARA may drastically reduce the prospects for new light piston aircraft production while doing nothing to address the underlying reasons for liability exposure and the high costs of defending against product liability actions.

A. GARA Effect on Industry Liability

1. “Big Three”

GARA explicitly offers only two affirmative reductions in the cost of products liability exposure for manufacturers of light piston aircraft. GARA allows established manufacturers to calculate a product’s liability tail for insurance purposes. Further, it relieves the “Big Three” and any other general aviation manufacturers of any products liability exposure for products built before August 17, 1976.77 This offers the prospect of money being freed for research and development (R&D) investment in new and old piston-engine, general aviation aircraft. It promises the restart of production of these designs by established manufacturers.

An important qualification to GARA’s affirmative aspects concerns insurance. Assistance to the industry depends on the willingness of insurers to write coverage for a product’s first eighteen years. This is no mean feat in light of the propensity of aviation accident victims to litigate whenever possible.

Further, there are powerful incentives for the “Big Three” to focus production on turbine and jet aircraft: profitability and marketability. Single-engine aircraft are not as profitable or as marketable. This discourages investment of any savings from reduced liability exposure in general aviation R&D. Established manufacturers’ willingness to rise to the challenge of engaging in large scale production to replace aging general aviation fleets is questionable.78 More likely, these manufacturers

77. Due to consolidation of the general aviation industry, there are only a few corporate entities in existence that will benefit from this.

78. Notwithstanding Cessna’s commitment to build 2,000+ light piston aircraft per year at a new production facility it is constructing in Independence, Kansas. It remains to be seen
may use the reduced liability savings to pad more profitable ventures.

2. **Small Manufacturers**

GARA does nothing to address the probability of products liability action within the eighteen-year period of the statute of repose. Although most aviation product design and manufacturing defects are discovered in the first seven years of a product's life,\(^\text{79}\) liability exposure for "automatic inclusion" actions\(^\text{80}\) are affirmatively preserved for another eleven years. For start-up manufacturers and suppliers re-entering the market, eighteen years of liability exposure must be factored into financial plans and could be prohibitive.

Start-up manufacturers of aircraft and component parts will likely find themselves unable to accumulate the necessary capital to enter the market. This should be true because insurers are unwilling to enter the market unless there is a proven track record of safe operations. The prospect of existing levels of exorbitant premiums and terms new manufacturers enter or re-enter the market is daunting. Ironically, small manufacturers of production and kit-planes are at the cutting edge of aircraft and production technology. They are also virtually immune to the frivolous lawsuit.\(^\text{81}\) This insulation from automatic inclusion in a lawsuit may be logically attributed to a number of factors. These include the manufacturers' small size, lack of capital, assumption of risk by the kit-builder and very detailed waivers of liability.

GARA artificially makes "Big Three" 1970's product lines freshly competitive in a market better suited to innovation and small production runs. The threat of "Big Three" production of proven product lines may force small manufacturers to leave the market or abort start-up, with no assurance the "Big Three" will re-start large-scale production or ensure the marketability of light piston general aviation aircraft.

3. **Component Parts Manufacturers**

GARA does nothing, for the most part, to insulate the manufacturers of engines and component parts from the present excessive liability exposure. First, the parts they manufacture are replaced in less than

---

\(^{79}\) *House Hearings*, supra note 18, at 10.

\(^{80}\) "Automatic Inclusion" action refers to a generally held belief in the industry that if the opportunity to sue is there, a product liability suit is sure to be filed (i.e. opportunity leads to action).

\(^{81}\) *Symposium*, supra note 14, at 183. (Statement of Fred George, Technical Editor, *Flying Magazine*).
eighteen years. Second, changing FARs often require manufacturers to redesign their products before either the part’s normal lifespan or eighteen years. These manufacturers will face continual liability exposure. GARA is particularly vague regarding the liability of piston engine manufacturers. Engines generally go through two to three rebuilds in a typical 6,000 hour life-span. Each remanufacture will trigger a new eighteen year statute of repose period. Engine manufacturers and rebuilders will be subject to continuous liability. As engine production is capital intensive, manufacturers appear to possess great wealth. They become the new "deep pocket" and a tempting target for the "automatic inclusion" action. Whether the few piston engine manufacturers are willing and/or able to accept this shifted liability exposure may determine the fate of light piston aircraft in the wake of GARA.

4. Other Industry Actors

GARA does nothing to insulate the aviation service industry from liability exposure to the "automatic inclusion" action. This sets the stage for maintenance shops being included in an increasing number of such suits. Plaintiffs will seek to join as many defendants as possible in a lawsuit, in the hope of obtaining complete financial relief. With fewer "deep pocket" manufacturers available as defendants, plaintiffs will resort to collecting a larger pool of smaller defendants. As most maintenance shops are small and poorly capitalized, this vital piece of general aviation infrastructure is exposed to much more potential liability under GARA for general aviation accidents than it was before GARA.

B. GARA Effect on Consumer Safety

In Congressional report after report, the stated intention of reform legislation is to remove the general aviation industry’s liability tail. In turn, industry players could restart production of new light piston aircraft and their components. Manufacturers will use litigation savings to invest in R&D. They would incorporate the latest innovations in comfort and safety into their product lines. More new aircraft would inevitably lead to a reduction in the average age of the general aviation fleet, the safety of such aircraft would increase. Public access to general aviation would be preserved and enhanced. Finally, the public perception of general aviation as being modern and safe would be improved. This was the theory, at least, behind GARA.

The primary backers of GARA, apart from the major players in the industry, were general aviation pilots. This group was represented by the Aircraft Owners and Pilots Association (AOPA). AOPA traded away their members’ legal rights against manufacturers of defectively designed
products older than eighteen years in return for vague promises of a new golden age of general aviation. The hope was that if manufacturers were relieved of the specter of product liability exposure, they would produce new models of cheap, reliable, and state-of-the-art aircraft. Pilots, the ultimate consumers of general aviation products, would trade legal rights which they were not likely to exercise for the choices and safety new aircraft production would offer.

There are very few indicators that new choices will happen anytime soon. General aviation aircraft technology has matured to a level where advances in speed, reliability, and economics are unlikely to occur. In fact, the only real room for significant improvement in aircraft design is in the field of crashworthiness. Yet, in this particular market, there is a maxim that safety does not sell. Furthermore, the general public has no ability to perceive the improved safety technologies. This is the root of manufacturers’ litigation costs.

The “Big Three” have no incentive to make massive expenditures for new, state-of-the-art product lines. Rather, the reverse is true. If the “Big Three” do resume production of light piston aircraft, the likelihood is that they will merely produce twenty-plus year-old designs. These designs neither advance protections for pilot-consumers, nor convince the general public that these aircraft are any safer.

GARA allows the “Big Three” to restart production of old aircraft designs with a proven market demand. The “Big Three” have little reason to invest scarce resources in light piston R&D. This will not change with the advent of superior technology and “crashworthiness” of the products of the small airframe manufacturers. GARA simply frees up funds previously used in litigation defense for R&D in turbine and jet aircraft. There is no requirement that established light piston manufacturers re-start production of these aircraft. GARA drastically improves the “Big Three’s” competitiveness vis à vis small manufacturers of production and light piston kit aircraft. This is unfortunate. Small manufacturers are the only innovators in the industry, and their continued success and viability are put in jeopardy by GARA.

Another perverse effect of the statute of repose is that manufacturers are free of any product liability once their product’s longevity exceeds

---

82. They would be deceased or take the enlightened attitude that they were at fault in cases where they were only maimed!

83. Take for example the Beech Malibu and the Aerospatiale Tobago, two aircraft whose design is separated by about 20 years. The Tobago offers little improvement and arguable inferiorities. Symposium, supra note 14, at 183. (Statement by Fred George, Technical Editor, Flying Magazine).

84. It may said as a general rule that the general public views flying in light aircraft as “crazy” and “unnatural.” The effect of any under the hood modifications to light piston designs is unlikely to change this attitude.
eighteen years.\textsuperscript{85} This begs the question: what incentive is there for manufacturers of light aircraft to engineer their products to be safe after the statute of repose expires? Currently, American design and workmanship on general aviation aircraft have produced aircraft whose primary structures may conceivably be serviceable for more than a hundred years. But in light of the \textit{Sunbird} holding that FAA regulations are merely a set of minimum design standards, manufacturers may choose to design their aircraft for an eighteen-year life. Pilots who fly eighteen-plus year old aircraft are cut free of any legal redress — even for crashes of aircraft designed to less stringent standards. AOPA and the pilots it represents may have traded their long-term safety and access to legal redress for industry negligence. The AOPA and its members may have pursued a false illusion of thousands of cheap, light pistons rolling off the production lines.

C. GARA Effect on Public Safety

GARA strengthens the role of state common law product liability standards. It does so by going beyond FAA aircraft certification standards and forces general aviation manufacturers to comply with society’s evolving sense of risk. While this is a clear negative for the general aviation industry’s liability exposure, it may be a positive for the community at large.

GARA affirms the fact that the FAA FARs are merely minimum standards.\textsuperscript{86} Case holdings found them so years ago. Certification minimums do not attempt to offer society state-of-the-art protection, despite FAA claims to the contrary. Moreover, it may be said that the FARs are not meant to be the standard by which legal liability is judged, especially since the FAA prescribed varying levels of technical requirements for pilot, aircraft, and maintenance certification.\textsuperscript{87}

Despite FAA claims to ensure state-of-the-art safety to the pilots of general aviation aircraft, their passengers and society in general, it may be said that the FARs are being weakened at the altar of industry revival. The adoption of a relaxed certification process for home-builts is a prime example. Already, kit-builts are considerably less safe than production aircraft. This may be also due to relaxed competition in the vacuum left by the “Big Three.” If the FAA is applying increasingly flexible (read:

\textsuperscript{85} Currently, manufacturers must correct defectively designed products interminably. Manufacturers point to FAR Part 21.3 for this proposition. Under FAR Part 21.3, manufacturers must report product defects to the FAA. Additionally, manufacturers point to 14 C.F.R. 145.63 which requires maintenance personnel to report product defects to the FAA. \textit{1993 House Hearings, supra} note 18 at 40.

\textsuperscript{86} Id. at 362-63.

\textsuperscript{87} \textit{See} 14 C.F.R. §§ 91, 121, 135 (1995).
lax) certification standards, will engine and component parts manufacturers be willing to shift to the riskier home-built market? The risk of accidents or increased liability exposure does not encourage the revival of light aircraft manufacturing.

VI. SUMMARY AND CONCLUSIONS

Far from signaling a rebirth of the general aviation industry in the United States, GARA places the general aviation industry in a more precarious position. GARA does not address the reasons the general aviation industry is the target of the often frivolous “automatic inclusion” action. GARA does not address the high costs of defending against these actions. Finally, GARA does not address a multitude of non-legal factors making the general aviation industry unprofitable and inviable.

The general aviation industry would be well-served by a broad effort to change the public perceptions that make it the target of unfounded and costly litigation. The reduction of general aviation to the role of airshow performance reinforces a growing public perception that small aircraft flying is crazy, dangerous, and an inevitable prelude to an aluminum hailstorm. General aviation’s re-direction toward large, sophisticated and expensive turbine and jet aircraft emphasizes profitability at the expense of utility. Limited public access portrays general aviation as the haunt of wealthy doctors, lawyers, and corporations. So long as the public perception regards general aviation as inherently unsafe and the preserve of the deep-pocket defendant, there will be incentive to bring suit based on the most minute chance of getting to the jury (and even more infinitesimal chance of winning). Liberal, modern-day civil procedure, which requires only the sketchiest facts to be pled,88 and “automatic inclusion”89 allow frivolous legal claims to reach the courtroom. Once at trial, public perceptions lead to placing the highest possible liability standards on the industry. Ultimately, the question of what is a defective general aviation product goes to a jury (with all the attendant risks to the innocent defendant).

GARA delays an accounting of the ills of the general aviation industry. It leaves untouched the sources of general aviation industry liability exposure in a misplaced reliance on economic forces. GARA cannot revive the industry. It places irrational competitive pressure on the most successful sectors of the industry: small production and kit manufacturers. These sectors of the industry are least likely to survive increased litigation costs. Large manufacturers will plow their savings into already vibrant turbine and jet products. Prospects for innovations in light piston aircraft

89. See supra note 81 and accompanying text.
technology will decrease. The likelihood of elderly aircraft soldiering on will increase. Pilot-consumers and the general public will be at more risk than ever before.

GARA may encourage manufacturers of airframes, both large and small, to contemplate an entry or re-entry into the general aviation market. But such decisions will take place in the shadow of lingering uncertainty. Eschewing this uncertainty, many entrepreneurs will sit on the tarmac — their “tails” clipped.
The Push for Statutes of Repose in General Aviation

Christopher C. McNatt, Jr.*
Steven L. England**

TABLE OF CONTENTS

I. Introduction ................................................................. 324
II. Costs to General Aviation Manufacturers Stemming from the Liability Explosion ..................................................... 324
III. The Push for Statutes of Repose ........................................ 325
    A. Reasons Behind the Push .......................................... 325
    B. Leaders of the Movement ......................................... 326
IV. State by State Analysis of Statutes of Repose at the Time of GARA's Enactment ...................................................... 327
V. What Type of Statute of Repose is "Best" for the General Aviation Industry? ......................................................... 342
VI. Conclusion .................................................................. 343

* Mr. McNatt received his B.A. from the University of California, San Diego, 1988, and his J.D. from the University of Denver College of Law, 1994. He currently practices law with the firm of Seider & Reynolds in Los Angeles, California. Mr. McNatt wishes to extend his appreciation to Professor Paul Dempsey for his helpful suggestions and comments, and he would like to thank TRANSPORTATION LAW JOURNAL General Editor Steven L. England for his assistance in preparation of this article.

** Mr. England, General Editor of the TRANSPORTATION LAW JOURNAL, is a third year law student at the University of Denver College of Law, graduating in May 1996. He graduated from the University of Colorado in 1992, with a B.S. in Business Finance. Steven is also the Chief Justice of the Phi Alpha Delta law fraternity at the University of Denver College of Law.
I. Introduction

On August 17, 1994, President Clinton signed into law the General Aviation Revitalization Act of 1994 (hereinafter GARA).\(^1\) GARA was passed primarily to salvage the American general aviation industry which had been decimated by spiraling litigation costs. Those costs were incurred in defending products liability actions that stemmed from crashes involving an aging fleet of small privately piloted aircraft. Throughout Congressional debate on GARA, sponsors cited the loss of thousands of jobs resulting from liability costs incurred by general aviation manufacturers.

GARA provides an eighteen-year statute of repose on general aviation aircraft and their component parts. Plaintiffs may avoid the time bar if they prove by clear and convincing evidence that the manufacturer misrepresented, or concealed from the FAA, information relevant to the maintenance or operation of the aircraft. It is a “rolling” statute in regard to modifications or replaced parts.

GARA was not only passed to provide a stimulus to the faltering general aviation industry, but also to provide national uniformity in products liability actions against general aviation manufacturers. This article explores the push to create a uniform statute of repose in general aviation addressing specific state laws which parties were often forced to contend with actions stemming from general aviation accidents.

II. Costs to General Aviation Manufacturers Stemming from the Liability Explosion

General aviation manufacturers have provided the citizens of the United States with access to the ever expanding network of airports in this country. General aviation is the life-line of many small communities. Over 5000 communities rely solely on general aviation for their access to the nation's airways.\(^2\) However, “[f]rom 1978 to 1992, American general aviation manufacturers spent as much to defend product liability suits as they had spent for the prior 30 years in developing new aircraft.”\(^3\)

In the 1980's liability costs for general aviation manufacturers soared. In the period from 1983 to 1986 the legal department of Beech Aircraft Company kept track of suits involving their aircraft and found that the average cost of defending the 203 suits which arose in that time period exceeded $500,000.\(^4\)

By the early 1990's what had been a very prosperous industry in the

---

late 1970's neared non-existence. In 1978, 17,000 piston-engine aircraft were produced; by 1993 the number had decreased to 555. The total production of aircraft fell from 18,000 in 1978 to 900 in 1992.

Employment in industries that rely on general aviation suffered a loss of 100,000 jobs. In the general aviation manufacturing industry, the number of manufacturing employees fell from 6000 in 1978 to 1000 in 1992.

As of 1994, "the average piston-engine airplane [was] over 28 years old and . . . one-third of the fleet [was] over 33 years old. . . ." Federal legislators realized that it was time to provide federal protection to the general aviation industry. Congress was assured that if a uniform statute of repose was signed into law, Cessna Aircraft would create 25,000 jobs over the ensuing five years. With members of the Senate and the House rallying to the call of job creation, GARA was passed and signed into law.

III. The Push for Statutes of Repose

American industry has long fought for laws limiting liability exposure. In response to what has been viewed by many as a liability explosion, the leaders of America's manufacturing concerns convinced at least twenty-four state legislatures that industry should not be indefinitely liable for what they produced.

A. Reasons Behind the Push

Often, those injured or killed in general aviation accidents have high future earning capacity. They are commonly professionals or business executives with the financial means to participate in the expensive pursuit of private flight and the very expensive pursuit of litigation upon injury. As a result there are higher jury awards stemming from general aviation cases as opposed to those accidents involving products of other industries.

The costs of defending these suits is added to the price of every new aircraft manufactured. For example, Beech Aircraft adds approximately $70,000 to the cost of each new aircraft to cover its litigation costs. By 1994, the litigation costs of American manufacturers were 20 to 50 times

9. 140 Cong. Rec. S2991, S2993, supra note 5.
higher than their foreign competitors. As a whole, litigation costs for American general aviation manufacturers increased from $24 million in 1976 to $210 million in 1986. Through increasing products liability costs, sales of aircraft produced by American general aviation manufacturers fell from 17,000 units in 1979 to 900 in 1992. That figure represents a decrease in sales of over 90 percent. What was once a leading American industry with a $340 million trade surplus in 1978 became a foreign dominated market with an $800 million trade deficit in 1992. Once a thriving American industry, general aviation shrank into insignificance as an employer. According to the General Aviation Manufacturers Association industry, unemployment figures exceeded 70% in 1992.

B. LEADERS OF THE MOVEMENT

The General Aviation Manufacturers Association and the CEO’s of America’s largest general aviation manufacturers were the primary promoters of statutes of repose favoring the general aviation manufacturing industry. Much of the general aviation industry is concentrated in Kansas. As a result of this concentration, members of the Kansas Congressional delegation were the primary sponsors of legislation aimed at preserving and reviving the general aviation industry.

GARA gained wide spread support; supporters included: the International Association of Machinists, the Aircraft Owners and Pilots Association (AOPA), the Experimental Aircraft Association, Helicopter Association International, the National Air Transportation Association and the National Business Aircraft Association. Following the passage of S. 1458, the bill which eventually became GARA, AOPA sent its 325,000 members a letter urging each member to contact his or her Congressional Representative to express support for the companion bill, H.R.

18. Representative Dan Glickman (D-Kan.) and Senator Nancy Kassebaum (R-Kan.) were the primary sponsors of the General Aviation Revitalization Act of 1994.
3087. The heads of many of the nation’s general aviation manufacturers reacted positively to the passage of S. 1458. Chuck Suma, president of Piper observed that the legislation “... will have a very positive impact on the future of general aviation,” while Robert Crowley, chairman of American General, stated that “[p]roduct liability is the largest cost of a single-engine aircraft. This bill gives us hope for the future.” Jacques Esculier, chief-executive of Mooney remarked that “[t]he limitation of product liability should give a new impulse to our industry.”

Proposed statutes of repose often were challenged by the American Trial Lawyers Association (ATLA) and federal efforts to impose statutes of repose were successfully derailed by ATLA since 1986. Other opponents included consumer groups such as Citizen Action and Public Citizen which deemed statutes of repose “patently unfair and draconian,” and believed victims injured by defective products should not be barred by Congress from the courthouse.

IV. STATE BY STATE ANALYSIS OF STATUTES OF REPOSE AT THE TIME OF GARA’S ENACTMENT

GARA preempts any State law to the extent the law permits a civil GARA action to be brought eighteen (18) years after the point the aircraft was placed in the market or the subject component part was added to or replaced. Most states do not have statutes of repose. However, when GARA was signed, sixteen states had statutes of repose that ran for either the “useful safe life” of the product or from five to twelve years. Before passage of GARA, only North Dakota had enacted a statute of repose specific to the general aviation manufacturing industry; the North Dakota statute has never been applied. Prior to passage of GARA eight states repealed or declared unconstitutional their statutes of re-

23. Senate Passes, 91-8, a Bill Setting 18-year Statute of Repose; Legislation on Product Liability for Light Aircraft Manufacturers, 12 Commuter-Regional Airline News No. 11 at 1 (March 21, 1994).
25. The applicable statute of repose is cited in the footnote appended to each subheading.
pose.\textsuperscript{28} When GARA became law, two states considered legislation aimed at protecting the general aviation industry.\textsuperscript{29}

Additionally at the time GARA became law, twenty-five states did not provide for nor had provided for a products liability action statute of repose, nor did they have any pending legislation in this area.\textsuperscript{30} The following analysis of state law discusses the laws in force as well as those declared unconstitutional and sheds light on why it was important for Congress to step in to provide uniformity in the area of general aviation accidents.

\textbf{Alabama}\textsuperscript{31}

Alabama's ten-year statute of repose began to run at the time the product was first used by a consumer who was not a distributor or another manufacturer and who had purchased the product to incorporate the product in question into one of its own products.

In 1992 this provision was declared unconstitutional. In \textit{Lankford v. Sullivan, Long \& Hagerty},\textsuperscript{32} the Alabama Supreme Court ruled that the statute of repose violated Article I, § 13, of the Alabama Constitution providing that for each injury a remedy by due process of law must exist. The plaintiffs in \textit{Lankford} sought recovery for injuries incurred when an elevator in which they were riding collapsed and fell. The trial court granted the manufacturer-defendant's summary judgment motion in accordance with statute of repose. The Alabama Supreme Court found that the legislature's determination that the growth in products liability litigation was a "social evil" was unreasonable.\textsuperscript{33}

The finding of unreasonableness in \textit{Lankford} was based on numerous law review articles, foremost among them was an article by Professor Francis McGovern.\textsuperscript{34} Professor McGovern asserts that statutes of repose may reduce recoveries by some plaintiffs, but that insurance premiums

\begin{flushleft}

\textsuperscript{29} These states were: Alaska, California, Delaware, Hawaii, Iowa, Louisiana, Maine, Maryland, Massachusetts, Mississippi, Missouri, Montana, Nevada, New Jersey, New Mexico, New York, Ohio, Oklahoma, Pennsylvania, South Carolina, Vermont, Virginia, West Virginia, Wisconsin, and Wyoming. In addition there was also no protection in the District of Columbia, Puerto Rico and the Virgin Islands.

\textsuperscript{30} \textit{Ala. Code} § 6-5-502 (1993).

\textsuperscript{31} 416 So. 2d 996 (Ala. 1992).

\textsuperscript{32} Id. at 1001.

\end{flushleft}
for the defendant will remain unaffected.\textsuperscript{35} In support of its finding, the court further cited a study by the Insurance Services Office which found “that only 2.7 percent of products involved in products liability actions were purchased more than six years prior to the injury-causing event.”\textsuperscript{36} Among those products with long life spans were aircraft and tractors. In conclusion, the court determined that the statute of repose was “arbitrary on its face” and could not be upheld.\textsuperscript{37}

\textbf{Arizona}\textsuperscript{38}

The Arizona legislature approved a twelve-year statute of repose which began to run as the product was first sold for use or consumption. The statute governed only strict products liability actions; it did not apply to actions based on ordinary negligence of the manufacturer or seller or breach of an express warranty provided by the manufacturer or seller.

The constitutionality of the Arizona statute was challenged in an action arising out of a 1988 crash involving a 1969 Beech aircraft.\textsuperscript{39} The Federal District Court in \textit{Carr} found the statute constitutional by holding that it did not violate either the equal protection or the due process clause of the fourteenth amendment. Using the rational basis test, the court found that “the Arizona legislature ‘could have reasonably determined that, by protecting manufacturers from liability for products sold 12 years before an injury, the perceived crisis of rising products liability insurance rates would be alleviated and new product development would be promoted.’”\textsuperscript{40} The court also clearly stated that there was no due process violation affiliated with statutes of repose “which do nothing more than preclude the assertion of one possible theory of recovery at trial.”\textsuperscript{41}

However, the statute of repose was declared unconstitutional in a 1993 Arizona Supreme Court decision involving an injury to a person working on an escalator.\textsuperscript{42} The \textit{Hazine} court avoided the discussion of due process and equal protection and instead based its declaration of unconstitutionality on a provision of the Arizona Constitution prohibiting, laws abrogating a plaintiff’s right to recovery.\textsuperscript{43} The court determined that the plaintiff had a constitutional right to sue based on strict liability; therefore, the statute of repose was declared unconstitutional.

Prior to that declaration the statute of repose was successfully used

\textsuperscript{35} \textit{Id.} at 595.
\textsuperscript{36} 416 So. 2d at 1002.
\textsuperscript{37} \textit{Id.} at 1004.
\textsuperscript{38} ARIZ. REV. STAT. ANN. § 12-551 (1992).
\textsuperscript{40} \textit{Id.} at 1334 (citing Bryant v. Continental Conveyor & Equip. Co., 751 P.2d 509, 513 (Ariz. 1988)).
\textsuperscript{41} \textit{Id.} at 1335.
\textsuperscript{42} \textit{Hazine v. Montgomery Elevator Co.}, 861 P.2d 625 (Ariz. 1993).
\textsuperscript{43} \textit{Id.} at 627 (The court focused its discussion on ARIZ. CONST. art. 18, § 6.).
by the Cessna Aircraft Corporation. Cessna avoided a claim of strict products liability where a plaintiff claimed modifications such as repair directives, inserts to an owner’s manual and a placard on procedures for restarting a stalled engine, were sufficient to extend the window of availability for a strict products liability action.\textsuperscript{44}

\textbf{Arkansas}\textsuperscript{45}

Arkansas law allows the manufacturer to present evidence of fault on the part of a consumer injured by a product when that consumer knew or should have known that the product had exceeded its “anticipated life.” Since the plaintiff is not absolutely barred by the running of time, this is not a true statute of repose.

\textbf{Colorado}\textsuperscript{46}

Colorado has a seven-year statute of repose that runs from the first time the product is used for its intended purpose by someone not engaged in the business of manufacturing, selling or leasing of the product. The statute does not apply to injuries arising from hidden defects, prolonged exposure to hazardous material, intentional misrepresentation or fraudulent concealment of a material fact concerning the product that proximate causes the injury. Additionally, if the manufacturer issues an express warranty that extends beyond seven years, that warranty provision overrides the statute.

The precursor to the current statute of repose, a ten-year provision, was challenged in \textit{Anderson v. The M.W. Kellogg Co.}\textsuperscript{47} The plaintiff in \textit{Anderson} brought an action based on negligence, strict liability, misrepresentation and breach of warranty against the successor of the corporation that had constructed the conveyor belt on which the plaintiff lost his arm. The trial court granted the defendant’s motion for summary judgment based on the fact that the injury occurred in November of 1982, over twenty years after the construction of the conveyor belt. The Colorado Supreme Court affirmed the trial court’s decision relying on both the clear language of the statutes the fact that no material issues of fact were in question.\textsuperscript{48} However, the court went on to find the products liability statute of repose constitutional.\textsuperscript{49} Using the rational basis test, the court determined that the “classifications enumerated as the four exceptions to the statute of repose bear a reasonable relationship to the legislative objectives of protecting the rights of certain types of injured plaintiffs while limiting the liability exposure of manufacturers and vendors of

\textsuperscript{47} 766 P.2d 637 (Colo. 1988).
\textsuperscript{48} Id. at 640-41.
\textsuperscript{49} Id. at 641-45.
equipment.”[^50] These enumerated exceptions are also elements of the current statute.[^51] “The repose provisions also serve to eliminate tenuous claims involving older products or equipment for which evidence of defective conditions may be difficult to produce.”[^52] The court concluded that the statute of repose does not violate the principle of equal protection.

While GARA was winding its way through Congress, Colorado legislators were grappling with another repose bill designed to grant immunity to general aviation manufacturers and parts suppliers manufacturing their products in Colorado.[^53] The bill, Colorado Aviation Manufacturers Act, went beyond the typical statute of repose in that it “[p]rohibit[ed] any lawsuit against an aircraft or aircraft components manufacturer for any product defect.”[^54] According to its drafters, the bill was designed to attract general aviation manufacturers to Colorado to support the development of Denver International Airport.[^55] However, the bill was not passed because it provided manufacturers with few economic incentives[^56] and it had serious constitutional flaws. The bill gave special treatment, immunity, to aircraft and aircraft components manufacturers, based on assumption of risk by those involved in an aircraft accident.[^57] If passed, the statute probably would have violated the fourteenth amendment guarantee of equal protection; it left those injured in aircraft accidents without any remedy for their injuries unless the manufacturer engaged in misrepresentation or fraud.[^58]

**Connecticut**[^59]

In Connecticut, parties are subject to a ten-year statute of repose. Once the manufacturer relinquishes control of the product, the statute of repose begins to run. The statute does not apply where the manufacturer intentionally misrepresented a product or fraudulently concealed information about the product. Further, express warranties providing longer periods of coverage may be used to override the time bar.

In an action arising out of an injury to a man struck by a filler cap

[^50]: Id. at 645.
[^51]: These exceptions are (1) hidden defects, (2) prolonged exposure to hazardous material, (3) intentional misrepresentation of a material fact and (4) fraudulent concealment of a material fact.
[^52]: Anderson, 776 P.2d at 645.
[^54]: Id. at “Bill Summary”.
[^55]: Id. at § 13-21-602(1)(G)&(I).
[^56]: Under generally accepted choice-of-law principles, the law of the site of the accident applies in general aviation accidents. Therefore, the strict liability limits of the statute would only help Colorado manufacturers if the accident occurred in Colorado.
[^57]: Supra, n. 53 at § 13-21-604(2)(A).
[^58]: Id. at § 13-21-610.
that blew off of a compression tank, the Supreme Court of Connecticut determined that the statute of repose was constitutional. The compression tank was purchased by the plaintiff's employer on May 18, 1971; the injury occurred on May 23, 1978; the action was filed May 21, 1981, ten years and three days after the manufacturer relinquished control of the product. The trial court dismissed the plaintiff's action in accordance with the ten-year statute of repose. On appeal the plaintiff claimed the statute violated the open courts and equal protection provisions of the Connecticut Constitution as well as the equal protection clause of the fourteenth amendment of the United States Constitution. Finding no constitutional violation, the court cited an earlier decision, "[t]he classification made by the legislature in passing General Statutes § 52-577a is reasonable, not arbitrary, and rests upon a difference having a fair and substantial relation to the object of the legislation." 

**FLORIDA**

At one time, Florida had a twelve-year statute of repose. This statute was declared unconstitutional in a 1980 Florida Supreme Court decision. In Battilla, Justice McDonald argued, in dissent, that there was a rational and legitimate basis in the legislature's "determination that perpetual liability places an undue burden on manufacturers." Justice McDonald's argument was cited five years later when the Florida Supreme Court retreated from its declaration of unconstitutionality of the statute of repose. The revival of the statute was short-lived; the Florida legislature abrogated the statute of repose for products liability actions in 1986.

Following the Battilla decision, but prior to the temporary revival of the statute of repose in Pullam, a 1983 crash involving 1972 Cessna occurred in Florida. The action was not brought until 1985, which was beyond the twelve-year limit of the statute of repose. The trial court granted Cessna's motion for summary judgment based on the statute of

---

61. CONN. CONST. § 10.
62. CONN. CONST. § 20.
63. 542 A.2d at 726 (citing Daily v. New Britain Machine Co., 512 A.2d 893, (Conn. 1986)).
64. Fla. Stat. ch. 95.031 (1982) (Amended by 1986 Fla. Laws ch. 86-272, to eliminate the statute of repose as it applies to products liability actions. The revised version of the statute is at Fla. Stat. ch. 95.031 (Supp. 1995)).
66. Id. at 875 (J. McDonald dissenting).
68. 1986 Fla. Laws ch. 86-272; see also, Shaw v. General Motors Corp., 518 So. 2d 900 (Fla. 1987).
repose. However, on appeal, Cessna lost because the court ruled that the *Pulliam* revival of the statute of repose was not retroactive.

**Georgia**

Georgia has a ten-year statute of repose that begins to run on the date of first sale for use or consumption of the product. The statute does not apply to actions of the manufacturer who manifests a willful, reckless, or wanton disregard for life or property.

**Idaho**

In Idaho actions are barred if an injury arises after the “useful safe life” of the product. The manufacturer must prove by a preponderance of the evidence that the “useful life” had terminated. A presumption arises that the product exceeded its “useful safe life” if the claim is made more than ten years after the time of delivery of the product. The plaintiff who presents clear and convincing evidence that the product has not exceeded its “useful safe life” may defeat the presumption. The ten-year period does not apply to situations where the manufacturer intentionally misrepresented a fact about the product or fraudulently concealed information about the product, if such misrepresentation or concealment is a substantial cause of the plaintiff’s injuries. An express warranty exceeding ten years overrides the time barring provisions of the statute.

Under the rational basis test, the statute is considered constitutional. It also has been found to not violate the “open courts” provision of the Idaho Constitution.

**Illinois**

The Illinois statute of repose precludes actions in which the injury occurs twelve years from the date of first sale, lease or delivery of possession by a seller or ten years from the date of first sale, lease or delivery or possession to its initial user, consumer, or other non-seller, whichever expires earlier. The statute is considered “rolling” if the manufacturer alters or modifies to the product after its initial sale, lease or delivery of possession and those modifications or alterations are the cause of the injury. The claim will not be time barred unless the applicable time limit has run since the modification or alteration. Providing replacement parts with the same formula or design as the original part does not allow for “rolling” of the time bar in actions based on defective design. Express warranties that exceed the time bars override the statute.

---

71. *Idaho Code* §§ 6-1403-6-1303 (1990) (Brackets due to mistake in codification in which two Acts were assigned chapter 13. The Compiler of Idaho Code has therefore designated The Idaho Product Liability Reform Act as chapter 14.).
73. *Id.*
INDIANA

Indiana has a ten-year statute of repose running with delivery of the product to its initial user or consumer. If injury occurs between eight and ten years following delivery to the initial user or consumer, the plaintiff has two years to bring his action.

The Supreme Court of Indiana,76 the Tenth Circuit Court of Appeals77 and the Seventh Circuit Court of Appeals78 have analyzed the Indiana statute of repose in aviation cases. In Dague, in ruling on questions certified from the United States Court of Appeals for the Seventh Circuit, the court found the Indiana products liability statute of repose constitutional. Dague involved the crash of a Piper Pawnee aircraft which the decedent of the plaintiff was piloting. The aircraft was manufactured in 1965 and placed in the stream of commerce on March 26, 1965. The pilot died on September 5, 1978, from injuries he sustained from the crash on July 7 of the same year in Indiana. The federal district court granted Piper's motion for summary judgment based on the statute of repose. Upon appeal, the federal appellate court certified questions regarding the constitutionality of the statute to the Indiana Supreme Court.

The Dague court determined that it was "[t]he clear intention of the legislature . . . to limit the time within which product liability actions [could] be brought."79 The court did not agree with the plaintiff's assertion that the statute was meant to provide for a two-year statute of limitations to bring a products liability action with no regard for the time the product entered the stream of commerce. The court instead found that the statute clearly set forth a ten-year period in which the injury must occur and that only if the injury occurs between eight and ten years after the product was placed in the stream of commerce would the ten-year period be extended by the two-year period.80 Therefore, clearly barred the plaintiff's action the court ruled that the statute. Additionally, the court found that the Indiana Products Liability Act did not violate the "open courts" provision81 or the "one-subject" requirement82 of the Indi-

75. IND. CODE ANN. § 33-1-1.5-5 (Burns 1992).
77. Alexander v. Beech Aircraft Corp., 952 F.2d 1215 (10th Cir. 1991). Alexander was originally filed in the Federal District Court for the District of Kansas because the defendant's primary place of business was in Kansas.
78. Schamel v. Textron-Lycoming, 1 F.3d 655 (7th Cir. 1993).
80. Id.
81. IND. CONST. art I, § 12 ("All courts shall be open; and every man, for injury done to him in his person, property, or reputation, shall have remedy by due course of law.").
82. IND. CONST. art. IV, § 19 ("An act, except an act for the codification, rearrangement of laws, shall be confined to one subject and matters properly connected therewith.").
ana Constitution.

*Alexander* involved the crash of model A23A Beechcraft Musketeer. The aircraft was manufactured in 1967; the accident occurred in 1984. The aircraft crashed in Indiana after running out of fuel. The United States Court of Appeals for the Tenth Circuit affirmed the district court’s dismissal of the action based on Indiana’s statute of repose. In their appeal, the plaintiffs asserted that the Beech Pilot/Operator Manual, dated 1979, was a replacement part that led to the accident because it may have created misconceptions regarding the amount of available fuel. The court held that the plaintiffs failed to present sufficient evidence indicating that the manual was a replacement part and that inadequacies in the manual were more appropriately pled as part of a failure to warn action. The court additionally ruled that the statute of repose does not deny due process or equal protection and therefore is not violative of the Fourteenth Amendment of the United States Constitution.\(^{83}\)

The Seventh Circuit case of *Schamel*\(^ {84}\) involved the 1988 crash of a 1959 Piper Comanche powered by a Textron-Lycoming engine. The plaintiff alleged that the connecting rods used in the engine caused the crash. In affirming the district court’s grant of summary judgment favoring Textron-Lycoming, the appellate court found that the last date the connecting rods were available from the defendant’s distributors was in 1974 sixteen years prior to the accident. The court went on to state that the plaintiff’s contention that the part could have stayed on the shelves of a Textron-Lycoming distributor until 1979 was unsupported by evidence. The defendant did not have the burden of rebutting every possible factual scenario.\(^ {85}\)

*Kansas*\(^ {86}\)

In Kansas, products liability actions are barred if injury arises after the “useful safe life” of the product. It is the responsibility of the manufacturer to establish “useful safe life” by a preponderance of the evidence. If the claim arises more than ten years after the time of delivery of the product, the presumption is that the product exceeded its “useful safe life.” This presumption may be rebutted by the plaintiff who presents clear and convincing evidence that the product has not exceeded its “useful safe life.” The ten-year period does not apply when the manufacturer intentionally misrepresented a fact about the product or fraudulently concealed information about the product, if such misrepresentation or concealment substantially caused the plaintiff’s injuries. An express

---

83. *Alexander*, 952 F.2d at 1225.
84. *Schamel*, 1 F.3d at 655.
85. *Id.* at 657-58.
warranty for a time exceeding ten years overrides the time barring provisions of the statute.

The Kansas courts apply the doctrine of *lex loci delicti*.\textsuperscript{87} In other words, the law where the wrong and injury occurs governs in tort actions brought in Kansas courts. Although Kansas is the center of general aviation manufacturing in the United States, the Kansas statute of repose has not been applied to any reported aviation cases.

The “useful safe life” language has been used to avoid summary judgment because it raises a question of fact.\textsuperscript{88} The *Miller* court refused to grant a defendant/manufacturer’s motion for summary judgment in a products liability action that arose from an accident which according to the defendant occurred at least thirteen years after the manufacture of the product in question. The plaintiff presented allegations indicating that the product in question had a “useful safe life” of thirty years. This language may benefit plaintiffs in their attempts to hold manufacturers liable for injuries stemming from products which the manufacturer at some point stated would last for a certain period of years longer than period which raises a presumption that the “useful safe life” expired.

**Kentucky**\textsuperscript{89}

The Kentucky statute of repose provides a rebuttable presumption favoring the manufacturer if the injury occurs more than five years after the date of sale to the first consumer or more than eight years after the date of manufacture.

**Michigan**\textsuperscript{90}

In Michigan products liability cases, if the product which is the alleged cause of the injury has been in use for ten years the plaintiff must prove his prima facia case in a products liability action without the benefit of any presumption. For example, in the typical strict products liability action, negligence need not be shown by the plaintiff; in Michigan, once the ten-year period has run the plaintiff likely will have to prove negligence of the defendant in a products liability action. Therefore, the statute does not act as an absolute bar to recovery for plaintiffs who have suffered injuries from use of a product over ten years old. The statute merely places a heavier burden on those plaintiffs injured by products in use for over ten years.

**Minnesota**\textsuperscript{91}

The statute of repose in Minnesota allows for a defense in a products

\textsuperscript{87} Alexander, 952 F.2d at 1223.
\textsuperscript{91} Minn. Stat. § 604.03 (1988).
liability action that the product had exceeded its ordinary "useful life." "Useful life" is determined by analysis of a number of factors including the "useful life" stated by the manufacturer in its manuals furnished with the product.

The Minnesota Supreme Court has found that the choice of the language, "useful life," by the Minnesota Legislature has presented many problems for litigants. In Hodder, the court undertook an in-depth analysis of the "useful life defense" and concluded that "useful life" is more useful to determine comparative liability of the parties than to determine if an action is barred. The court raised many questions regarding the language and insisted that the language was ambiguous; but, the legislature has yet to respond to the court's holdings.

Nebraska

In Nebraska, a products liability action must be commenced within ten years of the date of sale or lease for use or consumption. The running of this statute has been interpreted to commence when the product is relinquished for use or consumption. The product may be placed into the stream of commerce upon conveyance to a distributor, but until that distributor sells the product to an end-user, the ten-year period does not begin to run. This interpretation has important implications for those products inventoried for lengthy periods of time.

New Hampshire

The New Hampshire statute of repose has been declared unconstitutional, but remains on the books. The statute of repose provides for a twelve-year period from the time the manufacturer parts with possession and control or sells the product. For those defendants who are under a legal duty to inspect, maintain, repair, modify, alter or improve the product this time period is "rolling." Additionally, the time period is extended six years (but is not shortened to less than twelve years) beyond the date at which the defendant's legal duty as imposed by the government to alter, repair, recall, inspect or issue a warning or instructions about the product is incurred. The twelve-year period does not apply to situations in which the manufacturer has fraudulently misrepresented, concealed or failed to disclose a fact about the product. An express war-

---

93. Id. at 832.
97. Heath v. Sears, Roebuck & Co., 464 A.2d 288 (N.H. 1983) (The statute violates the New Hampshire Constitution by treating classes of plaintiffs differently, in that those injured in products liability actions are subject to time limitations different than the time limitation which applies to plaintiffs who bring personal injury actions which are not based on products liability.).
ranty for a time greater than twelve years will override the time barring provisions of the statute.

**North Carolina** 98

North Carolina does not have a statute of repose for strict products liability actions, however, it does have a six-year statute of limitations for defective products actions. That limit has been interpreted to operate as a statute of repose. The statute requires that a plaintiff injured by a defective product bring his action within six years of the date of initial purchase for use or consumption.

In a recent case involving the crash of Cessna 152, the North Carolina Court of Appeals held actions based on allegations of defective products must be brought within six years of the date of initial purchase for use or consumption. 99 The aircraft sold initially by Cessna in 1978, crashed in 1989, precluding any action based on claims that the aircraft or its components were defective. However, Cessna issued the plaintiff an Information Manual at an undetermined date that which allegedly omitted important information regarding carburetor icing which was a possible cause of the 1989 crash. The court determined that the manual itself was the defective product; since the date of delivery to the plaintiff was not indicated by either the plaintiff or the defendant, in the pleadings, the dismissal of the plaintiff's defective product action was unwarranted. 100

**North Dakota** 101

At one time, North Dakota had a ten-year statute of repose which began to run from the date of initial purchase for use or consumption. The statute ran up to eleven years from the date of manufacture. This statute was found to violate of the equal protection provision 102 of the North Dakota Constitution. 103

The entire products liability statute was repealed in 1993 and replaced by a new products liability statute excluding a statute of repose. 104 However, in 1995 the North Dakota legislature did pass a “useful safe life” statute of repose for general aviation manufactures but the statute has yet to be applied. 105

---

100. Id. at 483.
103. Hanson v. Williams County, 389 N.W.2d 319 (N.D. 1986).
104. 1993 N.D. Laws ch. 324, §§ 4, 5.
OREGON

Oregon has an eight-year statute of repose which begins to run on the date the product is first purchased for use or consumption.

The statute applies only to those "acts or omissions taking place before or at the time that the [manufacturer] places a product in the stream of commerce." In *Erickson*, the Oregon Supreme Court undertook an in-depth analysis of the statute of repose for products liability actions. Much of the court's opinion focused on the legislative history of the statute; it tended to show that the statute was a compromise between business and consumer interests. The court found that the end result of the legislative hearings was a limitation on those actions stemming from the acts or omissions of the manufacturer prior to placing the product in the stream of commerce. A different statute, a ten-year statute of limitations for negligence actions, was the statute the court looked to in order to determine that injuries stemming from the acts of a manufacturer after a product had been placed in the stream of commerce could be barred.

*Erickson* involved the crash of a logging helicopter caused by the failure of a compressor disk in one of the helicopter's engines. The crash occurred ten years after the helicopter had been placed on the market; therefore, the plaintiff's action would have been barred by the statute of repose. However, the manufacturer provided the plaintiff with incorrect information concerning the "useful safe life" of the compressor disk four years before the accident. Over the manufacturer's protests, the court determined that the act was governed by the ten-year statute of limitations for negligence actions rather than the eight-year statute of repose for products liability actions. The plaintiff prevailed.

RHODE ISLAND

The Rhode Island legislature enacted a ten-year statute of repose which began to run on the date the product was first purchased for use or consumption. However, the time bar was declared unconstitutional in *Kennedy v. Cumberland Engineering Co.* In *Kennedy* the Rhode Island Supreme Court agreed with its peers in Florida and New Hampshire by deciding that the statute of repose unconstitutionally barred a class of product liability plaintiffs from getting their day in court.

108. The manufacturer provided the plaintiff with a maintenance chart indicating that the compressor disk had a "useful safe life" of 6000 hours. In fact, it had a "useful safe life" of 4000 hours and at the time of the accident, had been in use for 4300 hours.
111. *Battilla v. Allis Chalmers Mfg.*, 392 So. 2d 874 (Fla. 1980).
South Dakota

Until 1985, South Dakota had a relatively short statute of repose. The six year statute began to run with delivery of the product. This provision was repealed in 1985.

Tennessee

In Tennessee, an action must be brought within ten years of the date the product is first purchased for use or consumption, or within one year of the expiration of the “anticipated life” of the product, which ever is shorter.

This statute of repose was addressed by the United States Court of Appeals for the Fourth Circuit in a case involving the crash of a 1972 Cessna. The aircraft was manufactured in Kansas in 1972. It crashed on January 17, 1985 in Tennessee while in route from Ohio to South Carolina, killing its sole occupant. Among the claims asserted by the plaintiff were negligence and strict liability. The appellate court affirmed the district court’s order dismissing the plaintiff’s tort actions based on the Tennessee statute of repose. The court found that the Tennessee statute applied because South Carolina courts applied the rule of lex loci delicti and the Tennessee statute of repose did not contravene South Carolina public policy.

In a recent Tennessee Court of Appeals decision involving the crash in Kentucky of an aircraft powered by an Avco engine, it was determined that under Tennessee law the principle of “most significant relationship” governed the choice of law to be made by the courts. The appellate court, affirmed the trial court’s application of the Tennessee statute of repose and determined that the stipulated facts clearly showed that the most significant contacts of the parties were in Tennessee. The plaintiffs were all Tennessee residents, the engine had recently been overhauled in Tennessee and the trip had started in Tennessee. The sole tie to Kentucky was the fact that the accident had occurred there, which was insufficient in light of the fact that Tennessee did not apply the doctrine of lex loci delicti. Additionally, the Pennsylvania contacts as the primary place of business of the defendant and the state in which the engine was manufactured were not significant enough to require the court to apply

117. Id. at 87-89. “[I]t is neither against good morals or natural justice or prejudicial to the general interests of the citizens of South Carolina.” Id. at 89.
119. The engine had been manufactured in 1959 and the accident occurred in 1987.
Pennsylvania law. The court therefore affirmed the dismissal of the plaintiffs' suits.

TExAS

At the time GARA became law, Texas had no statute of repose for products liability actions in place. However, there was legislation pending in the Texas Legislature specifically aimed at protecting of the general aviation industry.\textsuperscript{120} The legislation "relat[ed] to the time in which a products liability action against a seller of general aviation aircraft must be commenced."\textsuperscript{121} It provided for a twenty-five-year statute of repose.\textsuperscript{122} Under the proposed legislation, time began to run from "the date the aircraft [is] delivered to its first purchaser or lessee in [Texas] who [is] not engaged in the business of selling or leasing general aviation aircraft."\textsuperscript{123} This legislation was not enacted and would have conflicted with GARA's 18 year statute of repose.

UtAH\textsuperscript{124}

Utah's statute of repose was a six-year statute which ran from the date of initial purchase for use or consumption, but could be extended to ten years from the date of manufacture. The statute was declared unconstitutional in a 1985 Utah Supreme Court decision.\textsuperscript{125}

In Berry, the court found that the statute of repose violated the open courts provision\textsuperscript{126} and the right to recovery for wrongful death provision\textsuperscript{127} of the Utah Constitution. Berry involved the crash of a twenty-three year old Beech airplane that resulted in the death of the pilot.\textsuperscript{128}

Washington\textsuperscript{129}

In Washington, the product seller will not be liable in a products liability action if it can show by a preponderance of the evidence that the product exceeded its "useful safe life." If twelve years passed from the time of delivery, a rebuttable presumption that the product had exceeded its "useful safe life" at the time of the accident exists. The statute does not apply to situations where the manufacturer intentionally misrepresented facts or concealed information about the product, if such action

\begin{itemize}
  \item \textsuperscript{120} H.B. 1343, 73d Leg., 1st Sess. (1993).
  \item \textsuperscript{121} Id.
  \item \textsuperscript{122} Id. at (B).
  \item \textsuperscript{123} Id.
  \item \textsuperscript{125} Berry v. Beech Aircraft Corp., 717 P.2d 670 (Utah 1985).
  \item \textsuperscript{126} UTAH CONST. art. I, § 11.
  \item \textsuperscript{127} UTAH CONST. art. XVI, § 5.
  \item \textsuperscript{128} The facts concerning the accident were not set forth in the opinion and the decision of the lower court was not published.
  \item \textsuperscript{129} WASH. REV. CODE 7.72.060 (1992).
\end{itemize}
was a proximate cause of the plaintiff's harm. Express warranties exceeding the useful safe life of the product override the statutory time bar.

V. What Type of Statute of Repose is "Best" for the General Aviation Industry?

GARA has provided general aviation manufacturers with the benefit of an outside boundary to limit the time they may be subject to products liability and negligence actions. Statutes of repose will continue to be discussed in state legislatures, since there is no prohibition under GARA for shorter state statutes of repose. At the outset, it can undeniably be asserted that from the individual plaintiff's perspective that the "best" statute of repose is none at all. But, from the manufacturers' perspective, what would be best for the industry as a whole?

The basic difference between the existing statutes of repose is that some run for a given period of years, while others run for the "useful safe life" of the product. Courts have indicated that the "useful safe life" formulation presents many questions of fact and is very indeterminate. On the other hand, the period of years methodology, provides clearer guidance. It is in a manufacturer's best interest, to have the statute run for a period of years, as provided under GARA, because it could then more accurately predict long term liability costs and save litigation costs.

If a period of years is the "best" methodology to follow, the next issue which must be addressed is the most appropriate term of years. A period which is too short may not only be unconstitutional, it may also make the purchase of general aircraft unattractive. To prevent judicial voidance of the statute it must not unreasonably limit access to the courts. Although some state courts have voided statutes providing for ten- or twelve-year repose, many other state courts have not. Attraction of new buyers must also be considered since a potential consumer will not purchase an aircraft if the consumer knows that he or she may not be compensated for injuries arising out of use of the aircraft after only a few years of use.

Another factor to consider is whether the statute should be "rolling." Under a "rolling" statute of repose any product modifications restart the running of the statute as it applies to the subject modification. From the manufacturer's perspective a "rolling" statute is not likely to be attractive, because it does not provide a clear date at which liability will be avoided. From a social policy perspective the courts would prefer a "rolling" statute since it would allow aircraft owners to add updated component parts to their aircraft with the assurance that the parts are likely reliable.

One item which has been claimed by some plaintiffs to be a compo-
The Push for Statutes of Repose in General Aviation

VI. Conclusion

GARA's federal preemption provision provides general aviation manufacturers with the uniformity needed to formulate long range plans and increase employment. There will be challenges to GARA's federal preemption of state tort law, but GARA will likely withstand any such challenges as it would be subject merely to a rational basis test. However, state statutes of repose will continue to be important in general aviation accidents. Those statutes based on the "useful safe life" of the product will continue to provide interesting factual battles.

Manufacturing interests will continue their lobbying of state legislatures in an attempt to secure shorter statutes of repose, or at least "useful safe life" statutes, as GARA merely provides an outside time limit. In lobbying state legislatures, general aviation manufacturers will have the support of many other industries, because states have avoided industry specific statutes of repose and have chosen to adopt broad products liability statutes of repose which apply to all industries.

Along the way consumer action groups will sustain their equally strong lobbying efforts. These efforts, although very strong, may not be enough to counter-balance legislators' concerns over a weak economy, the disappearance of industries and the loss of jobs.

Since GARA has been in effect only fifteen months, its economic benefits have yet to be fully demonstrated. Although GARA has provided the benefit of uniformity for general aviation manufacturers, state legislative efforts should continue as GARA merely provides an outside time limit within which the states must now operate.
Articles

Deregulation Of Truck Equipment Cabotage: A
Canada-United States Initiative

Dean Saul*

TABLE OF CONTENTS

I. Economic Deregulation ........................................ 346
II. United States-Canada Cabotage Regulations ............... 347
   A. Incidental Move ........................................... 348
   B. Repositioning Move ....................................... 349
III. Comparative Analysis of the Canada and United States
    Customs Regulations Proposals ............................. 350
    A. Preamble and General Statement of the Intent of the
       Regulation ............................................... 351
    B. “Foreign-based” defined ................................. 352
    C. “International Commercial Transportation” (Canada)
       and “International Traffic” (United States) ........... 353

* Mr. Saul is an international trade and transportation lawyer at the Toronto office of Gowlings, Strathy & Henderson. He has acted as counsel to the Government of Mexico on transportation issues arising in the NAFTA; and has worked with both the ATA and CTA in the presentation of proposals for cabotage deregulation in Canada and the United States. In addition, he has worked for both industry and Canadian Governments on issues relating to regulation of truck, bus, rail, and air transportation and on matters relating to tariff regulations and customs issues arising in NAFTA cross-border traffic.

345
D. “Domestic Transportation” and “Local Traffic” as defined and permitted ........................................ 355
E. The Definition of Included Ancillary Equipment ........ 356
F. Limits on Equipment Cabotage .............................. 358
G. The Definition of Included Commercial Motor Vehicles ......................................................... 359

IV. Canadian Trucking Association Proposal ............... 360
A. International Commercial Transportation ............... 360
   1. Legislation ........................................... 360
   2. Regulations ......................................... 361
      a. Short Title ....................................... 361
      b. Interpretation .................................... 361
   3. Ancillary Equipment .................................. 361
   4. International Commercial Transportation ........... 361
   5. Terms and Conditions ................................ 362
   6. Incidental Domestic Transportation .................. 363
   7. Domestic Transportation .............................. 363
B. Guidelines and General Information ....................... 363
   1. Time Limits ......................................... 364
   2. Enforcement and Control ............................. 364
   3. Immigration Requirements ........................... 365

V. American Trucking Association’s Proposal ............... 365
A. United States Codes of Federal Regulations .............. 365
   1. Definitions ......................................... 365
   2. Admission Without Entry or Payment of Duty ........ 366
   3. Deposit or Registration by Vehicle not on Regular Trip ..................................................... 366
   4. Use in Local Traffic .................................. 366
   5. Minimum Movement ................................... 367
   6. Penalty for Improper Use ............................. 367
B. Section 123.16 Entry of Returning Commercial Motor Vehicles in International Traffic ............... 367
   1. Admission Without Entry or Payment of Duty ........ 367
   2. Use in Local Traffic .................................. 367

I. Economic Deregulation

Over the past 16 years, both the United States and Canada have moved from systems of stringent economic regulation for the truck transportation industry to effective total deregulation within and between each of the two countries.

On January 1st, 1988, the Motor Vehicle Transport Act of Canada terminated the public necessity and convenience test as the standard for economic regulation of the truck transportation industry operating be-
between Canada’s ten provinces, as well as between all points in Canada and the Canadian-United States border. The new Federal legislation established a reverse onus test for entry control to Canada’s extraprovincial trucking industry; however, as in the United States, the reverse onus test proved a slippery slope into effective deregulation.

On January 1st, 1993, long after the establishment of de facto deregulation, the reverse onus test in the Motor Vehicle Transport Act was sunsetted. From that date forward, all extraprovincial licensing in Canada has been based upon a fitness test only. Economic regulation for truck transportation within most provinces has also come to an end. Under the terms of the Canada Agreement on Internal Trade, all intraprovincial truck transportation economic regulation is to cease effective January 1st, 1998.

Deregulation of the United States truck transportation industry began administratively under the Interstate Commerce Commission in the late 1970s. By the mid 1980s, legislative deregulation caught up with de facto deregulation, and interstate and foreign commerce truck transportation in the United States was virtually wide open. The passage of TIRRA in 1995 and the sunsetting of the Interstate Commerce Commission in January, 1996 has brought about full deregulation of the truck transportation industry operating in the United States, whether in intrastate, interstate or foreign commerce. Subject to road tax, immigration, customs and other administrative requirements, the United States and Canadian truck transportation industries are relatively free to provide services between and within the two countries.

While this paper does not deal with immigration issues, it should be noted that NAFTA regulations currently in place in Canada and the United States prohibit Canadian drivers from participating in cabotage in the United States, and prohibit U.S. drivers from participating in cabotage in Canada. The proposed changes for customs regulations in both countries will not affect existing immigration regulations.

II. United States-Canada Cabotage Regulations

Customs regulations currently in place in Canada and the United States as they relate to the movement of commercial motor vehicles between the two countries were enacted during a period of relatively strict economic regulation. At that time, very few U.S.-based vehicles operated into Canada, and very few Canadian vehicles operated into the United States. Accordingly, restrictions placed upon the use of foreign-based equipment within each of the two countries were of nominal consequence. The constant growth of trade between Canada and the United States, much of it moving by truck, together with deregulation, has cre-
ated a situation wherein freedom of movement for the Canada-U.S. truck transportation industry of the 1990s is now impeded by the restrictive customs regulations of the 1960s.

Both Canadian and United States customs tariff regulations allow the relatively easy movement of commercial motor vehicles across the border between Canada and the United States, provided the equipment is engaged in international commercial transportation. There are, however, significant restrictions as to what that equipment can do while in each host country. In general terms, each of the two regulations prohibit cabotage and each provide for limited "interstate" or domestic transportation operations within very restrictive guidelines.

For the North American truck transportation industry, cabotage may be best described as the use of a commercial motor vehicle for the movement of goods between two points within a country in which that equipment is not based. A Canadian motor vehicle would be engaged in cabotage in the United States if it moved goods locally between Detroit and St. Louis; conversely, a U.S.-based commercial motor vehicle would be engaged in cabotage in Canada in moving goods domestically between Toronto and Montreal.

Canadian NAFTA tariff regulations as described in Canada Customs Memorandum D3-5-8, and as interpreted by Canada Customs, permit two forms of equipment cabotage.

A. INCIDENTAL MOVE:

A U.S.-based commercial motor vehicle entering Canada with a partial load carried in international commercial transportation is permitted to pick up goods in Canada and discharge those goods in Canada, provided however, that the pick up and delivery of those goods within Canada are intermediate to, and occur before the delivery of the import load that was on the vehicle when it entered Canada. Similarly, after picking up a partial export load, the U.S. vehicle is permitted to pick up and discharge goods within Canada, provided the pick-up and discharge of those goods takes place in a direct line between the pick-up point of the partial export load and the exit point of the vehicle from Canada. This type of cabotage was originally designed to allow a Canadian carrier to more efficiently use a U.S. trailer during the era of trailer interchange for cross-border operations. Generally speaking, the permitted incidental move is of very limited benefit to truckload operators; and recognizing the extent to which U.S. less-than-truckload carriers have moved into the Canadian marketplace, the incidental move now has very limited use for the LTL operator as well.
B. Repositioning Move:

Canada Customs' interpretation of the tariff regulation, and its own administrative practice set out in Canada Customs Memorandum N-560, permits a U.S. vehicle which has entered Canada with an import load, and has a pre-arranged export load available for movement from Canada back to the United States, to move goods domestically between two points within Canada. That domestic move is permitted, provided that the pick-up point and the delivery point for the domestic move are intermediate to and in a relatively direct line between the delivery point of the import load and the pick point of the pre-arranged export load. Any deviation from the direct route or any pick-up or discharge of goods beyond the import delivery point and the export pick-up point is regarded as a contravention of the tariff regulation. That strict interpretation of the tariff regulation and the Canada Customs Memorandum substantially diminishes the operator's ability to reduce empty miles through the use of a repositioning move. While the Canada Customs strict interpretation is currently being disputed in legal proceedings, that interpretation is nonetheless used for the purpose of this article.

To the extent that the current U.S. Customs regulation permits cabotage, it is somewhat more restrictive than the existing Canadian regulation. The U.S. regulation permits a Canadian vehicle to carry merchandise between points in the United States while it is in use on a regularly-scheduled international trip, and in circumstances where the local carriage is directly incidental to the international schedule. This type of repositioning move would ordinarily be most valuable to a truckload carrier; but as most truckload international operations are not regularly scheduled, this type of permitted cabotage is infrequently available to most Canadian truckload operators. The type of less-than-truckload operation conducted by Canadian-based vehicles moving into and out of the United States is such that this particular repositioning move is of nominal value only to most operators.

Another form of cabotage permitted in the United States allows a Canadian-based truck trailer to carry merchandise between points in the United States on its departure from the United States back to Canada. The use of that trailer locally, however, is prohibited unless the local move is made in a relatively direct line between the point at which the trailer made its inbound delivery, and the proximate Canada-U.S. border point through which the trailer originally entered the United States. This type of cabotage, which was originally designed to allow greater utilization of rail equipment which had been loaded into the United States and was returning empty into Canada, offers limited benefit to the Canadian truck operator.
Recognizing the drive towards competitiveness fostered by deregulation, as well as the commercial imperative of reducing empty miles in all truck transportation operations, the current customs regulations in Canada and the United States fall short of promoting the achievement of these ends.

III. COMPARATIVE ANALYSIS OF THE CANADA AND UNITED STATES CUSTOMS REGULATIONS PROPOSALS

The Canadian Trucking Association (CTA) and the American Trucking Associations (ATA) are currently co-sponsoring a proposal designed to significantly liberalize Customs Regulations as they relate to the movement of commercial motor vehicles between the United States and Canada as well as within each of the countries. At the present time, commercial motor vehicles which are based in either Canada or the United States are permitted to operate into and out of each of the countries in international transportation service, without a formal customs entry or the payment of duty otherwise applicable to that class of equipment.

Commercial motor vehicles operating in this form of international transportation may be required to exit the host country within a limited and fixed time period; and in both jurisdictions, current Customs Regulations severely restrict the use of foreign-based equipment in domestic transportation services (cabotage).

In July of 1994, the Board of Directors of the CTA initiated a proposal for liberalization of Customs Regulations, and delivered the same to a special subcommittee of the ATA. Each of the two Associations canvassed affected members, and began the exchange of further proposals designed to lead to a much greater latitude in cabotage operations in the two countries. A task force was created to deal with the several proposals, and a task force meeting was held in Ottawa, Canada on November 29, 1994. That meeting involved Association executives, industry leaders, and Canadian governmental officials. From early December 1994 until mid-August 1995, a series of proposals were exchanged between the CTA and the ATA; and from time to time there has been informal comment on these several proposals from Customs officials in both Canada and the United States. At the date of this article, final proposals for each of the Canadian and U.S. regulations have been filed with Canada Customs and the United States Customs Services respectively; and each is designed to be, to the greatest extent possible, a mirror image of the other. In other words, the proposals for new latitude in equipment cabotage are designed to be reciprocal for U.S.-based equipment operating in Canada and Canadian-based equipment operating in the United States.
This analysis is designed to review the two proposals comparatively, so as to allow the reader the opportunity of fully assessing the extent of reciprocity that is contained in these two draft regulations.

Each of the draft regulations are designed to deal with only a limited range of the commercial motor vehicles or conveyances otherwise covered by the existing Canadian and U.S. Regulations. For that reason, there are aspects of each Regulation which will not be changed inasmuch as the Regulations will continue to deal, in the future, as in the past with types of transportation equipment and/or service not Intended to be covered by the liberalization.

To the extent that each of the regulations remain unchanged for certain classes of commercial equipment or conveyances, those aspects of the regulations are excluded from this analysis.

A. Preamble and General Statement of the Intent of the Regulation

Each of the draft regulations contains a preamble or opening which identifies the subject matter to be dealt with in the regulation. The Canadian preamble, adopted from the current regulation, deals with the duty-free importation into Canada of foreign-based conveyances engaged in international commercial transportation of passengers or goods. The included foreign-based conveyances are identified by an appropriate Customs tariff reference. The Canadian version is drafted very expansively so that it continues to include conveyances (commercial motor vehicles railway equipment, containers, aircraft and motor vessels) and includes such conveyances, whether foreign-based in the United States or Mexico.

The United States preamble is more restrictive than the Canadian preamble in that it deals with the admission to the United States of foreign-based trucks, buses and taxicabs, without formal entry or payment of duty, when such equipment is engaged in international traffic.

While the scope of application of each draft regulation is somewhat different for the purposes of the new regulation as it is directed to defined commercial motor vehicles, the stated intent in each regulation is effectively a mirror-image of the other, and consequently they can be regarded as reciprocal.
international commercial transportation of passengers or goods may be imported into Canada, without payment of duties.

**Legislation**

Tariff item 9801.00.00 reads:

Foreign-based conveyances of heading No. 86.09 or of Chapters 87, 88 and 89, other than cargo containers less than 6.1 metres in length or having an internal capacity less than 14 cubic metres, engaged in the international commercial transportation or passengers or goods, under such regulations for each mode of conveyance provided for in this heading as the Governor in Council may prescribe.

- Most-Favoured-Nation Tariff: Free
- General Preferential Tariff: Free
- United States Tariff: Free

**Regulations**

**Regulations Respecting Vehicles, Aircraft or Vessels Engaged in the International Commercial Transportation of Passengers or Goods**

Short Title

1. These regulations may be cited as the International Transportation (Tariff Item 9801.00.00) Regulations.

**B. “Foreign-based” Defined**

The current United States regulation contains a definition of “foreign-based trucks . . .” and that definition is carried forward into the U.S. draft regulation. For the purposes of the U.S. draft regulation, foreign-based means “trucks . . . however owned, which have their principal base of operations in a foreign country . . . .” The current Canadian regulation contains no definition of a “foreign-based conveyance.”

Pursuant to the implementation of the NAFTA, Canada created a new regulation known as the NAFTA Temporary Admission of Conveyances or Containers. That Regulation applies only to conveyances which are based in the United States or Mexico, and the regulation contains a
definition of the term “based in the United States or Mexico.” That definition from the NAFTA regulation has been adapted for the purposes of defining “foreign-based” in this Canadian draft regulation. The proposed Canadian definition of “foreign-based” is more specific than the U.S. definition, and provides that a foreign-based conveyance or container will include one that has its ordinary base of operations or source of control outside Canada. In addition, a foreign-based conveyance includes one that is registered and licensed outside Canada.

These two definitions of “foreign-based” are not identical; but they are clearly comparable and are intended to be reciprocal. Nonetheless, the different language used in each case warrants further examination in order to ensure that, for all practical purposes, Canadian “foreign-based” and United States “foreign-based” are effectively equivalent.

2. In these regulations, and for the purposes of tariff item No. 9801.00.00 “foreign-based” means,
(a) in respect of a conveyance or container, that the conveyance or container
(i) is owner or leased by a person whose domicile or corporate domicile is outside Canada,
(ii) in the normal course of operation, leaves from and returns to a point outside Canada, and
(iii) is controlled from outside Canada; and
(b) in respect of conveyance, that conveyance is registered and licensed outside Canada.

C. “INTERNATIONAL COMMERCIAL TRANSPORTATION” (CANADA) AND “INTERNATIONAL TRAFFIC” (UNITED STATES)

Each of the draft Canadian and U.S. regulations represents a departure from the current regulations of each country. The current U.S. regulation refers to “international traffic” and effectively defines trucks engaged in international traffic as “arriving with merchandise destined to points in the United States, or arriving empty or loaded for the purposes of taking out merchandise . . . .” The current Canadian definition of “international commercial transportation” is equally narrow, although it suf-
fers from obvious ambiguity. Currently, “international commercial transportation” in the Canadian regulation means any:

transportation which results in or is intended to result in the carriage of goods . . . for hire or reward (a) from outside Canada to a place inside Canada; (b) from inside Canada to a place outside Canada; or (c) from a place outside Canada in transit through Canada to another place outside Canada.

The intent of both draft regulations is to redefine international traffic and international commercial transportation to include (a) the participation of a commercial motor vehicle in the whole or any part of transportation which results in the movement of goods from a point in one country to a point in the other country; (b) a cross-border movement of the commercial motor vehicle, empty, for the purposes of repositioning or maintenance; and (c) the inclusion in the definition of “international” of what would otherwise be “local traffic” or “domestic transportation” where the domestic use of the vehicle is either preceded or followed by the operation of the vehicle either into or out of the country. This inclusion of a domestic move in the “international” definition is proposed by Canada and is intended to better define the very narrow limits within which a foreign driver could operate in a host country in the event that the two countries agreed upon an amendment to immigration regulations designed to allow the trucking industry in both countries some small additional flexibility in their international operations.

It should be noted that the use of the Canadian phrase “international commercial transportation” and the use of the U.S. phrase “international traffic” are intended to have the same meaning.

Beyond that, the language used in these two draft sections is very similar and is regarded as effectively reciprocal.

5. For the purposes of Section 6(3) or Section 8, “international commercial transportation” means:

(i) any transportation or part thereof which results in, or is intended to result in the transportation of goods for hire or reward:
(a) from outside Canada to a place inside Canada;
(b) from inside Canada to a place outside Canada; or
(c) from a place outside Canada in transit through Canada to another place outside Canada;
(ii) any domestic transportation of

UNITED STATES
Any such vehicle shall be considered to be engaged in international traffic if it is:
(a) a commercial motor vehicle arriving with merchandise or passengers destined to points in the United States, or arriving empty or loaded for the purpose of taking out merchandise or passengers from the United States;
(b) And shall include:
(i) the delivery or pick-up of any merchandise which originated in or is destined for a foreign country;
(ii) any local transportation of merchandise where such transportation
goods where such transportation is preceded or followed by the use of the vehicle in cross-border transportation either into or out of Canada; and (iii) any arrival in or departure from Canada of the vehicle for the purposes of repositioning or maintenance.

It is proposed that “for hire or reward” be deleted; or alternatively there be added the following words:

“any transportation of persons or goods by or on behalf of an enterprise engaged in an activity of financial return, where the persons or goods are conveyed...”

D. “DOMESTIC TRANSPORTATION” AND “LOCAL TRAFFIC” AS DEFINED AND PERMITTED

Current Canadian regulation and administrative practice allows for the very limited use of a foreign-based conveyance for domestic transportation in Canada. While there is much confusion and some dispute as to what constitutes “domestic transportation,” we will take domestic transportation to mean the use of a conveyance to move merchandise between two points in Canada, regardless of whether the goods are in fact moving in international transportation. Within that context, the current Canadian regulation is interpreted by Canada Customs and administered to permit a narrowly defined repositioning move which is geographically restricted by the destination of an inbound international move and the origin of a subsequent outbound international move. In addition, there is very limited use that can be made of a foreign-based conveyance in conjunction with the international inbound or outbound movement of less-than-truckload shipments.

The current U.S. regulation is even more restrictive, allowing a foreign-based vehicle to carry merchandise between points in the United States, while the vehicle is in use on a regularly scheduled trip and only where the local traffic is directly incidental to the international schedule. In addition, a foreign-based truck-trailer may be used to carry merchandise between points in the United States on its departure for a foreign country, and only within the very limited conditions which are prescribed for the U.S. domestic use of foreign railroad equipment.

For the purposes of this comparative assessment the use of the Canadian phrase “domestic transportation” and the use of the U.S. phrase “local traffic” are intended to have the same meaning.

Effectively, as the U.S. and Canadian truck transportation services
operate today between the two countries, the two regulations, where strictly interpreted by Customs officials, allow extremely limited use of foreign-based equipment in a host country.

The two draft regulations, differently worded, effectively allow full use of foreign-based vehicles for domestic transportation in each of the two countries. The Canadian proposal contains certain restrictions on the definition of "domestic transportation" which are subject to further review, and which may be found to be irrelevant and warrant deletion.

The U.S. draft regulation includes the authority to transport merchandise domestically, and to fully reposition foreign-based vehicles locally in the United States. The draft Canadian regulation includes authority to use foreign-based vehicles in the domestic transportation of goods within Canada. There is no reference to equipment repositioning because the use of the term "goods" in the current Canadian regulation includes transportation equipment itself.

Each of the two draft regulations contain a statement to the effect that the right to use foreign-based vehicles in local transportation is premised upon the condition that the country in which such vehicles are based accords reciprocal treatment for vehicles based in the host country.

Once again, while the language of the two draft regulations differs somewhat, the language in the two regulations is similar and these sections are effectively reciprocal.

E. THE DEFINITION OF INCLUDED ANCILLARY EQUIPMENT

The current Canadian regulation includes a definition of ancillary equipment, and that definition has been expanded in the draft regulation to include in the definition of ancillary equipment any equipment which enhances the safe or efficient operation of the vehicle. This is intended to include all bogeys, convertors, or connecting devices ordinarily used by the truck transportation industry in the operation of the variety of tractor-trailer equipment now in operation in both Canada and the United States.

The current U.S. regulation makes no reference to ancillary equipment whatsoever. Accordingly, the U.S. draft regulation now includes, for local use in the United States, commercial motor vehicles and ancillary equipment. The definition of ancillary equipment is set out in the draft U.S. regulation. It is intended that "ancillary equipment" will have an identical meaning in each of the two draft regulations.

<table>
<thead>
<tr>
<th>CANADA</th>
<th>UNITED STATES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ancillary Equipment</td>
<td>(d) Use in local traffic: Foreign-based commercial motor vehicles admitted under this section shall not engage in</td>
</tr>
<tr>
<td>3. In these regulations, a reference to a vehicle, an aircraft or a vessel includes a</td>
<td></td>
</tr>
</tbody>
</table>

reference to any ancillary equipment necessary to ensure the safety, security, containment and preservation of passengers or goods transported by the vehicle aircraft or vessel, or necessary to enhance the safe or efficient operation of the vehicle, aircraft or vessel. Ancillary equipment, when engaged in transportation as provided for herein, may be imported pursuant to Tariff Item No. 9801.00.00 without customs documentation.

Domestic Transportation
8. Every foreign-based vehicle or container as described in Schedule “A” hereto that is engaged in the international commercial transportation of goods may, within the period of time prescribed in paragraph 6(3), engage in the domestic transportation of goods in Canada, without restriction, provided the country in which such vehicle is based accords Canadian-based vehicles or containers reciprocal treatment.
9. “Domestic transportation” means the transportation of goods which have an ultimate origin and destination within Canada.

local traffic in the United States unless the vehicle comes within one of the following exceptions:
(1) Commercial motor vehicles and ancillary equipment may transport merchandise, reposition vehicles, and be repositioned in local or international traffic in the United States, provided the country in which such vehicles are based accords United States-based vehicles reciprocal treatment; or
(2) Other foreign-based commercial vehicles may transport merchandise or passengers in local traffic in the United States.

(a) Definitions. For the purposes of this part the following definitions apply:
(1) “Ancillary equipment” means any equipment which enhances the safety, security containment, handling and preservation or merchandise carried in commercial motor vehicles.
(d) Use in local traffic: Foreign-based commercial vehicles admitted under this section shall not engage in local traffic in the United States unless the vehicle comes within one of the following exceptions:
(1) Commercial motor vehicles and ancillary equipment may transport merchandise, reposition vehicles, and be repositioned in local or international traffic in the United States, provided the country in which such vehicles are based accords United States-based vehicles reciprocal treatment; or
(2) Other foreign-based commercial vehicles may transport merchandise or passengers in local traffic in the United States, while in use on a regularly scheduled trip if such carriage is directly incidental to the international schedule.

§ 123.16 Entry of returning commercial motor vehicles in international traffic.
(b) Use in local traffic. Commercial motor vehicles, in use in international traffic, which may include incidental
local traffic in a foreign country or in this country, shall be admitted under this section. However, such vehicles taken abroad for use in local traffic in a foreign country, otherwise than in the course of a regularly scheduled trip in international traffic shall be considered to have been exported and must be regularly entered on return except those vehicles operating in local traffic in a foreign country under rules or regulations applicable to foreign-based vehicles in that country which are reciprocal to the treatment received by foreign-based vehicles under section 123.14 shall on their return to the United States be admitted without formal entry or the payment of duty.

(d) Definitions. For the purposes of this part, the following definitions apply:

(2) "Commercial Motor Vehicle" means any vehicle, bus, taxi, machine, tractor, trailer, semitrailer, container, chassis, including dollies and other connecting devices propelled or drawn by mechanical power and used on the highways in the transportation of merchandise, or any combination thereof.

F. LIMITS ON EQUIPMENT CABOTAGE

The current Canadian regulation requires that a foreign-based commercial motor vehicle imported into Canada under the regulation be exported from Canada within thirty days of its original entry. The current U.S. regulation makes no reference to a time frame within which a foreign-based vehicle which enters the United States must be removed from the United States. Recognizing that the two industries are satisfied to allow full equipment cabotage as between Canada and the United States, it is proposed in the two draft regulations that the defined foreign-based vehicle must exit the host country within one year after its initial arrival in the country. During the course of the one-year period after arrival in the host country, the defined vehicle may be used freely in domestic transportation within the host country. Each exit of the vehicle from the host country terminates that period of permitted domestic use; and each re-entry of the vehicle into the host country renews the authority to use that vehicle in domestic traffic for another one-year period.

The two draft regulations are intended to allow a vehicle to remain
in the host country in limited circumstances for a period beyond the one-year limit. The defined circumstances of overstaying the one-year limit are virtually identical in the two draft regulations. While neither regulation speaks to the issue, the two industries are agreed that the violation which arises from a vehicle overstaying the one-year limit should be a violation which begins at the expiry of the one-year limit, and not go back to the date of original entry of the foreign-based vehicle into the host country.

**CANADA**

(3) Every foreign-based vehicle described in Schedule “A” hereto, imported under Tariff number 9801.00.00 that is engaged in the international commercial transportation of merchandise shall, subject to subsection (4) be exported from Canada within (1) one year of its date of arrival into Canada and shall operate with the proper vehicle license issued by the appropriate provincial and/or Federal licensing authority.

(4) The period of one year referred to in subsection (3) may be extended for an additional period not exceeding thirty (30) days on the authority of a Canada Customs Officer, where the Officer is satisfied that good cause for such extension is shown.

**UNITED STATES**

(e) Minimum movement: A foreign-based commercial vehicle operating pursuant to paragraph (d)(1) of this section may remain in the United States, provided the vehicle exits the United States within 365 days of its date of arrival in the United States, however, if good cause is shown, the Port Director may authorize one thirty (30)-day extension of this period.

G. **The Definition of Included Commercial Motor Vehicles**

For the purposes of expanded equipment cabotage within the two countries, it became necessary to define those vehicles which would be included in this liberalized program. A draft of the vehicles to be included in the Canadian Regulation (Canadian Schedule “A”) used Canadian tariff definitions of commercial motor vehicles for the purposes of developing an included list. The list of commercial motor vehicles to be included in the U.S. regulation is drawn from definitions included in the U.S. Federal Motor Vehicle Safety Regulation, 49 CFR Part 390. In addition to definitions taken from that U.S. legislation, the U.S. definition includes “ancillary equipment,” previously referred to. The two definitions are attached. These definitions require close examination to ensure that they will in fact cover the same types of commercial motor vehicle equipment.
It should be noted that the Canadian proposed Regulation includes "containers."

Containers are dealt with in the United States under a wholly separate regulation; and it is intended that the "containers" regulation be amended in a fashion which will be complementary to the proposed amendment for "vehicles."

In any event, the Canadian inclusion of "containers" is given on a reciprocal basis and will be available for U.S. containers in Canada when it becomes available for Canadian containers in the United States.

Definitions:

(a) Definitions

(1) "Ancillary Equipment" means any equipment which enhances the safety, security containment, handling and preservation of merchandise carried in commercial motor vehicles.

(2) "Commercial Motor Vehicle" means any vehicle, bus, taxicabs, machine, tractor, trailer, semitrailer container, chassis, including dollies and other connecting devices propelled or drawn by mechanical power and used on the highways in the transportation of merchandise, or any combination thereof.

(4) "Tractor" a means a self-propelled motor vehicle designed and/or used primarily for drawing other vehicles.

(5) "Trailer" means a non-power, cargo carrying, unit which is designed for use in combination with a truck tractor including a chassis on which another merchandise carrying unit is place.

(6) "Truck" means any self-propelled motor vehicle designed and/or used for the transportation of merchandise including a tractor-trailer combination.

IV. CANADIAN TRUCKING ASSOCIATION PROPOSAL

A. INTERNATIONAL COMMERCIAL TRANSPORTATION

This memorandum outlines and explains the conditions under which foreign-based conveyances engaged in the international commercial transportation of passengers or goods may be imported into Canada, without payment of duties.

1. Legislation

Tariff item 9801.00.00 reads:

Foreign-based conveyances of heading No. 86.09 or of Chapters 87, 88 and 89, other than cargo containers less than 6.1 metres in length or having an internal capacity less than 14 cubic metres, engaged in the international commercial transportation of passengers or goods, under such regulations for each mode of conveyance provided for in this heading as the Governor in Council may prescribe . . . .
2. Regulations Respecting Vehicles, Aircraft or Vessels Engaged in the International Commercial Transportation of Passengers or Goods

a. Short Title

These Regulations may be cited as the International Commercial Transportation (Tariff Item 9801.00.00) Regulations.

b. Interpretation

In these Regulations “foreign-based” means:

(a) in respect of a conveyance or container, that the conveyance or container,
   (i) is owned or leased by a person whose domicile or corporate domicile is outside Canada,
   (ii) in the normal course of operation, leaves from and returns to a point outside Canada, and
   (iii) is controlled from outside Canada, and

(b) in respect of a conveyance, that conveyance is registered and licensed outside Canada.

3. Ancillary Equipment

In these regulations, a reference to a vehicle, an aircraft or a vessel includes a reference to any ancillary equipment necessary to ensure the safety, security, containment and preservation of passengers or goods transported by the vehicle, aircraft or vessel, or necessary to enhance the safe or efficient operation of the vehicle, aircraft or vessel. Ancillary equipment, when engaged in transportation as provided for herein, may be imported pursuant to Tariff Item No. 9801.00.00 without customs documentation.

4. International Commercial Transportation

For the purposes of Section 6(l), “international commercial transportation” means any transportation which results in, or is intended to result in, the transportation of goods or passengers for hire or reward:

(a) from outside Canada to a place inside Canada;
(b) from inside Canada to a place outside Canada; or
(c) from a place outside Canada in transit through Canada to another place outside Canada.

For the purposes of Section 6(3) or Section 8, “international commercial transportation” means:
(i) any transportation or part thereof which results in, or is intended to result in the transportation of goods for hire or reward:

(a) from outside Canada to a place inside Canada;
(b) from inside Canada to a place outside Canada, or
(c) from a place outside Canada in transit through Canada to another place outside Canada;

(ii) any domestic transportation of goods where such transportation is preceded or followed by the use of the vehicle in cross-border transportation either into or out of Canada;

(iii) any arrival in or departure from Canada of the vehicle for the purposes of repositioning or maintenance.

5. Terms and Conditions

(1) Save and except as provided in subsection (3), every vehicle, aircraft or vessel imported under tariff item 9801.00.00 of Schedule 1 to the Customs Tariff that is engaged in the international commercial transportation of passengers or goods shall, subject to subsection (2), be exported from Canada within 30 days of its date of arrival into Canada and shall

(a) in the case of a vehicle, operate with the proper vehicle license issued by the appropriate provincial licensing authority;
(b) in the case of an aircraft, comply with the requirements of the Aeronautics Act and any regulations made thereunder; and
(c) in the case of a vessel, comply with the requirements of the Canada Shipping Act and the Coastwise and Foreign Shipping (Customs) Regulations.

(2) The period of 30 days referred to in subsection (1) may be extended for an additional period not exceeding 24 months from the date of arrival into Canada where, at the expiration of that 30 day period, the departure of the vehicle, aircraft or vessel from Canada is delayed owing to

(a) the equipping, reconditioning, reconstructing, refurbishing or repair in Canada of the vehicle, aircraft or vessel;
(b) a major equipment breakdown of the vehicle, aircraft or vessel;
(c) adverse weather conditions;
(d) the detention of the vehicle, aircraft or vessel under the authority of any court order, or under any Act of Parliament or of the Legislature of a province or any regulation made thereunder, or
(e) a delay in the delivery of goods for loading for export on the vehicle, aircraft or vessel.

(3) Every foreign-based vehicle described in Schedule “A” hereto, imported under Tariff number 9801.00.00 that is engaged in the international commercial transportation of goods shall, subject to subsection (4) be exported from Canada within (1) one year of its date of arrival into Canada and shall operate with the proper vehicle license issued by the appropriate provincial and/or Federal licensing authority.

(4) The period of one year referred to in subsection (3) may be extended
for an additional period not exceeding thirty (30) days on the authority of
a Canada Customs Officer, where the Officer is satisfied that good cause
for such extension is shown.

6. **Incidental Domestic Transportation**

A vehicle imported under Tariff Item 9801.00.00 of Schedule 1 to the Cus-
tom Tariff may engage in the transportation of passengers or goods from
one point in Canada to another point in Canada only if such transporta-
tion is incidental to the international commercial transportation of the
passengers or goods and

(a) in the case of a vehicle entering Canada empty or without a substantial
payload, the point to point transportation is not made prior to the time of
loading at the first scheduled point in Canada of passengers departing Can-
da or of loading goods for exportation;
(b) the point to point transportation is not over territory outside the territo-
rial limits of Canada;
(c) the vehicle has not entered Canada for the purpose of an in transit move-
ment through Canada to a point outside Canada.

7. **Domestic Transportation**

Every foreign-based vehicle or container as described in Schedule “A”
hereto that is engaged in the international commercial transportation of
goods may, within the period of time prescribed in paragraph 6(3), en-
gege in the domestic transportation of goods in Canada, without restric-
tion, provided the country in which such vehicle or container is based
accords Canadian-based vehicles or containers reciprocal treatment.
“Domestic transportation” means the transportation of goods which have
an ultimate origin and destination within Canada.

**B. GUIDELINES AND GENERAL INFORMATION**

Tariff item No. 9801.00.00 and Regulations pursuant thereto apply
solely to foreign-based conveyances described therein which are tempo-
rarily imported into Canada for use in the international commercial
transportation of goods or passengers. No formal Customs accounting is
required. Vehicles, aircraft and vessels arriving in or departing from Can-
da may be required to report at the request of a Customs Officer, for the
purpose of examination.

Foreign conveyances classified under tariff item No. 9801.00.00 when
transporting passengers or goods which have not been cleared or checked
by Customs must also comply with the requirements stipulated in Cus-
toms Memoranda D3-2-2, Air Cargo; D3-4-2, I-Highway Cargo; D3-5-2,
Marine Cargo, and D3-6-6, Rail Cargo, relative to cargo control
procedures.

Paragraph 4(l)(a) of the Regulations requires that domestic trans-
portation pursuant to Sections 5 or 6 must conform with carrying rights granted by the appropriate provincial or federal licensing authorities.

1. **Time Limits**

Under normal circumstances vehicles, aircraft and vessels entitled to importation under tariff item No. 9801.00.00 shall be exported from Canada within the time limit fixed in the Regulation. This period may be extended by a Customs Officer where the officer is satisfied that, after the expiration of the permit period, the departure of the conveyance is delayed for reasons specified in subsection 6(2) or subsection 6(4) of the Regulations. In such instances a form E 50B, Vehicle Permit, shall be issued for the conveyance for a specified period of time sufficient to accommodate stated contingencies and provide for compliance by exportation. Conveyances reported under the post audit system do not require approval from Customs for extension of the time limit nor is a form E 50B required for each instance. However, such equipment may only remain in Canada beyond the time limit fixed by regulation, where it is in compliance with the conditions set out in subsection 6(2) or subsection 6(4) of the Regulations. Verification of circumstances where post audit equipment is in Canada beyond the permitted limit will be conducted as part of audits.

2. **Enforcement and Control**

Complaints of alleged violation of incidental domestic transportation privileges shall be directed to:

Department of National Revenue, Customs and Excise
Licensing Division
Ottawa, Ontario, K1A OLS

for investigation and appropriate action.

Carriers importing vehicles into Canada pursuant to tariff item No. 9801.00.00 may be subject to periodic audit of internal records relative to the movement and use of such equipment in Canada by Transport and Traffic Audit, Investigations Division, Ottawa, Ontario.

At the discretion of the Customs Officer concerned, forms E 50B may be issued for monitoring purposes.

Where it is established that misuse or diversion of conveyances imported under this tariff item has occurred, sanctions will be directed at the person who diverted the conveyance. These sanctions could take the form of duties in accordance with subsections 88(l) or 89(l) of the Customs Act, or seizure action under subsection 110(2) of the Act, or ascertained forfeiture under paragraph 124(l)(b) of the Act.
3. Immigration Requirements

Employment and Immigration Canada should be contacted concerning immigration requirements when conveyances will be operated in Canada by persons who are not Canadian citizens or permanent residents of Canada.

Services Provided By The Department Are Available In Both Official Languages. This Article Is Issued Under The Authority Of The Deputy Minister of National Revenue Customs And Excise.

V. American Trucking Association's Proposal

A. United States Codes of Federal Regulations § 123.14
Entry of Foreign-based Trucks, Buses, and Taxicabs in International Traffic

1. Definitions
(a) Definitions. For purposes of this part, the following definitions apply:
(1) “Ancillary equipment” means any equipment which enhances the safety, security containment, handling and preservation of merchandise carried in commercial motor vehicles.
(2) “Commercial Motor Vehicle” means any vehicle, bus, taxicabs, machine, tractor, trailer, semitrailer, container, chassis, including dollies and other connecting devices propelled or drawn by mechanical power and used on the highways in the transportation of merchandise, or any combination thereof.
(3) “International Traffic” means:
A. A commercial motor vehicle arriving with merchandise or passengers destined to points in the United States, or arriving empty or loaded for the purpose of taking out merchandise or passengers from the United States;
B. And shall include:
(i) the delivery or pick-up of any merchandise which originated in or is destined for a foreign country;
(ii) any local transportation of merchandise where such transportation is immediately preceded or followed by the use of the vehicle in cross-border transportation either into or out of the United States; or
(iii) any entry or exit of the vehicle to or from the United States for the purpose of repositioning or maintenance.

provided, however, that this paragraph shall only apply to vehicles based in a foreign country that applies a similar definition of “International Traffic” to vehicles based in the United States.
(4) “Local traffic” shall mean, except as provided in paragraph 3 of
this section, the transportation of merchandise or passengers between points in the United States, or between points in a foreign country.

(5) "Tractor" means a self-propelled motor vehicle designed and/or used primarily for drawing other vehicles.

(6) "Trailer" means a non-power, cargo carrying, unit which is designed for use in combination with a truck tractor including a chassis on which another merchandise carrying unit is placed.

(7) "Truck" means any self-propelled motor vehicle designed and/or used for the transportation of merchandise including a tractor-trailer combination.

2. Admission Without Entry or Payment of Duty

(b) Admission without entry or payment of duty. Commercial motor vehicles, however owned, which have their principal base of operations in a foreign country and are engaged in international traffic may be admitted without formal entry or the payment of duty. Such vehicles shall not engage in local traffic except as provided in paragraph (d) of this section. United States-based vehicles operating in local traffic in a foreign country under rules or regulation in that country which are reciprocal to the treatment received by vehicles based in that country under this section shall also be admitted back into this country without formal entry or the payment of duty.

3. Deposit or Registration by Vehicle not on Regular Trip

(c) Deposit or registration by vehicle not on regular trip. In any case in which a foreign-based commercial vehicle admitted under this section is not in use on a regularly scheduled trip, (except as provided in paragraph (d)). The district director may require that the registration card for the vehicle be deposited pending the return of the vehicle for departure to the country from which it arrived, or the district director may take other appropriate measures to assure the proper use and departure of the vehicle.

4. Use in Local Traffic

(d) Use in local traffic. Foreign-based commercial vehicles admitted under this section shall not engage in local traffic in the United States unless the vehicle comes within one of the following exception:

   (1) Commercial motor vehicles and ancillary equipment may transport merchandise, reposition vehicles, and be repositioned in local or international traffic in the United States, provided the country in which such vehicles are based accords United States-based vehicles reciprocal treatment; or

   (2) Other foreign-based commercial vehicles may transport merchandise or passengers in local traffic in the United States, while in
use on a regularly scheduled trip if such carriage is directly incidental to the international schedule;

5. Minimum Movement

(e) Minimum movement: A foreign-based commercial vehicle operating pursuant to paragraph (d)(1) of this section may remain in the United States, provided the vehicle exits the United States within 365 days of its date of arrival in the United States, however, if good cause is shown the Port Director may authorize one 30-day extension of this period.

6. Penalty for Improper Use

(f) Penalty for improper use. The use of any commercial vehicle referred to in this section in violation of this section may result in liabilities being incurred under section 592, Tariff Act of 1930, as amended (19 U.S.C. 1592).

B. Section 123.16 Entry of Returning Commercial Motor Vehicles in International Traffic

1. Admission Without Entry or Payment of Duty

(a) Admission without entry or payment of duty. Commercial motor vehicles, whether of foreign or domestic origin taking out merchandise or passengers for hire or leaving empty for the purpose of bringing back merchandise or passengers for hire shall on their return to the United States be admitted without formal entry or the payment of duty upon their identity being established by State registration cards.

2. Use in Local Traffic

(b) Use in local traffic. Commercial motor vehicles in use in international traffic, which may include incidental local traffic in a foreign country or in this country, shall be admitted under this section. However, such vehicles taken abroad for use in local traffic in a foreign country, otherwise than in the course of a regularly scheduled trip in international traffic shall be considered to have been exported and must be regularly entered on return, except those vehicles operating in local traffic in a foreign country under rules or regulations applicable to foreign-based vehicles in that country which are reciprocal to the treatment received by foreign-based vehicles under section 123.14 shall on their return to the United States be admitted without formal entry or the payment of duty.
The International Transport Workers’ Federation
Flag of Convenience Shipping Campaign:
1983-1995

Herbert R. Northrup*
Peter B. Scrase**

Table of Contents

I. Introduction .......................................................... 370
II. A Summary of the ITF’s FOC Campaign ......................... 371
   A. Development and Rationale of FOC Campaign ............. 371
   B. The FOC Campaign in Practice ............................. 374
   C. The ITF Agreement and Blue Certificate Issuance ....... 378
   D. Substandard and “Best in the World” FOC Shipowners ... 381
   E. ITF Worldwide Wage Minima v. ILO Minima ............... 384
   F. ITF Policy and National Country Flag Shipping .......... 385
   G. Dependency and International, or “Second” Registers. 387

* Professor Emeritus of Management; formerly, Director, Industrial Research Unit; Chairman, Labor Relations Council; and Chairman, Department of Industry, The Wharton School, University of Pennsylvania. A.B., Duke University, 1939; A.M., 1941, Ph.D. (Economics), 1942, Harvard University.

Roger E. McElrath developed the charts and tables, and contributed to the writing of Part III of this article.
III. The Finances of the ITF .............................................. 389
   A. Financial Structure ........................................... 390
   B. The Welfare Fund ............................................ 393
   C. The Seafarers' Trust ......................................... 396
   D. The ITF's New Proactive Use of the Trust .................. 399
IV. Double Bookkeeping and Litigation in the United States ....... 401
   A. United States Law and Double Bookkeeping ................. 403
   B. The Early Cases ............................................... 404
   C. The Washington-Oregon Trilogy .............................. 405
   D. The San Francisco Case ...................................... 408
   E. The Maldives Cases ........................................... 409
   F. Double Bookkeeping - - Concluding Comment ............... 410
V. Developments in European Litigation .............................. 410
   A. The Issues to be Addressed ................................ 412
   B. Injunction or Restitution? ................................. 413
       1. Universe Sentinel ......................................... 414
       2. Saudi Independence ..................................... 415
       3. Evia Luck ................................................. 415
       4. Nervion .................................................. 417
       5. JSS Britannia ........................................... 418
       6. Estoril .................................................. 419
   C. European Law and Lex Britannia ............................. 419
VI. Conclusion ................................................................ 420

I. INTRODUCTION

In the introduction of the earlier study of this subject, it was stated:

The International Transport Workers' Federation (ITF) is unique among the International Trade Union Secretariats (ITs) in several ways. Unlike the other ITs, the ITF directly represents employees, sometimes with their consent, and often without authorization; it signs agreements with individual companies; it has even negotiated an agreement with its counterpart, the International Shipping Federation [ISF]; by virtue of the strategic location of many of its affiliates, it has been able to exert enormous economic power through boycotts in order to gain its objectives; and as a result of this power, it has accumulated considerable financial reserves.
Since the publication of that book, the ITF has been involved in significant litigation, especially in Europe and the United States, its finances have substantially increased, and it has most recently begun to alter some of its policies. It continues, however, to attempt to strengthen its campaign against Flag of Convenience ("FOC") shipping, that is, ships which bear the flags of countries other than those of the beneficial owners.

The ITF affiliates national unions in all branches of transportation. In December 1993, it had 398 affiliated unions in 105 countries who had 4.3 million members. Of these, only 680,000, or 16 percent, were members of seamen's unions. Yet the ITF’s principal power and the bulk of its considerable wealth are derived from the maritime industry.

This article updates the earlier book by examining ITF policies and practices in the maritime industry since 1983. Special attention is given to ITF finances which are derived from the FOC campaign, to the "double bookkeeping" controversies and litigation in the United States, and to litigation resulting from ITF-associated boycotts, or threats thereof, in Europe. A review and update of the continuing ITF-FOC campaign provides the setting for these recent developments.

II. A SUMMARY OF THE ITF’S FOC CAMPAIGN

The ITF-FOC campaign is handled today very much as described in the ITF-FOC Book, but there are some new developments. Basically, it is an attempt to overcome by direct action the market effect of lower costs, and thereby to prevent the loss of registries and jobs by developed countries and their seamen to Third World countries and their seamen.

A. DEVELOPMENT AND RATIONALE OF FOC CAMPAIGN

Registering ships in countries other than those of the beneficial owners has been traced back to the 1920s and was growing more common prior to World War II. It has expanded greatly since World War II, and as shown in Figure 1, is still an expanding phenomenon. In December 1994, FOC ships, which are overwhelmingly staffed by crews from Third World countries, comprised 43 percent of the world gross registered tonnage ("GRT"). For 1994, the ITF general secretary stated that FOC ships

---


4. Id. at 77.

5. See ITF-FOC Book, supra note 2, at Chapter II, (detailing the ITF’s history, organization, structure, and government).

6. Id. at Chapters III and IV.

7. The general secretary is the chief administrative officer of the ITF, as in all ITTs. The
were in the majority. The leading countries in which the beneficial owners who utilize FOC shipping are headquartered are Greece, the United States, and Japan.

**Figure 1. Growth of FOC Shipping**

![Growth of FOC Shipping](chart.png)

Note: 1994 is an estimate. The countries for which data are not available represent less than 1 percent of FOC tonnage.
Sources: Lloyd’s Register, World Fleet Statistics, various years; ITF, Report on Activities, 1990-91-92-93 (1994, Table 1).

FOC shipping was once dominated by the flags of Panama, Liberia, and Honduras. Today, Honduras is no longer a major factor, but Panama and Liberia are not only the largest FOC ship registries, but as shown in Table 1, the largest registries in the world, accounting for more than one-fourth of the world’s gross tonnage. Many other countries in Asia, the South Pacific, as well as Bermuda and other developing nations now invite ship registry as a source of government revenue and employment of their citizens.

The listing of FOC countries is subject to varying definitions and interpretations, vice-presidents, and executive boards are chosen from the officers of affiliated national unions, and serve on a part-time basis. The general secretary in the ITF, and in many other ITTs that can afford more than a one-person permanent officer, is assisted by several assistant general secretaries. This form of union governance is based upon the typical European national union model. See, *ITF-FOC Book*, supra note 2, at 6.


9. *Id.*
Table 1
FLEET REGISTRATION AND GROSS TONNAGE IN 1994
(Twenty Largest Fleet Registers)

<table>
<thead>
<tr>
<th>Ships</th>
<th>Gross Tonnage</th>
<th>%G.T.</th>
<th>Ships</th>
<th>Gross Tonnage</th>
<th>%G.T.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Panama</td>
<td>5,799</td>
<td>64,170,219</td>
<td>13.5</td>
<td>United States</td>
<td>5,270</td>
</tr>
<tr>
<td>Liberia</td>
<td>1,621</td>
<td>57,647,708</td>
<td>12.1</td>
<td>Singapore</td>
<td>1,239</td>
</tr>
<tr>
<td>Greece</td>
<td>1,923</td>
<td>30,161,758</td>
<td>6.3</td>
<td>Philippines</td>
<td>1,518</td>
</tr>
<tr>
<td>Cyprus</td>
<td>1,619</td>
<td>23,292,956</td>
<td>4.9</td>
<td>Hong Kong</td>
<td>358</td>
</tr>
<tr>
<td>Bahamas</td>
<td>1,159</td>
<td>22,915,349</td>
<td>4.8</td>
<td>South Korea</td>
<td>2,121</td>
</tr>
<tr>
<td>Japan</td>
<td>9,706</td>
<td>22,101,606</td>
<td>4.6</td>
<td>Italy</td>
<td>1,434</td>
</tr>
<tr>
<td>Norway (NIS)</td>
<td>749</td>
<td>19,976,489</td>
<td>4.2</td>
<td>India</td>
<td>881</td>
</tr>
<tr>
<td>Russia</td>
<td>5,285</td>
<td>16,503,871</td>
<td>3.5</td>
<td>Taiwan</td>
<td>642</td>
</tr>
<tr>
<td>China</td>
<td>2,701</td>
<td>15,826,688</td>
<td>3.3</td>
<td>Germany</td>
<td>1,200</td>
</tr>
<tr>
<td>Malta</td>
<td>1,086</td>
<td>15,453,370</td>
<td>3.2</td>
<td>Turkey</td>
<td>1,000</td>
</tr>
</tbody>
</table>


Interpretations. For example, a shipowner in a developed country may agree to a bareboat charter to a Philippine organization, which then transfers the ship to the Philippine flag and employs a Philippine crew under Philippine conditions. The ITF may claim that this is an FOC ship. Philippine authorities, however, strongly disagree, noting that the Philippines is far in the lead as the world's largest supplier of seamen, that this country encourages the training and employment of its citizens on all ships, including FOC-registered ones, as a means of expanding employment and accumulating foreign currency, but that the bareboat chartered ship is a Philippine one operated completely by a Philippine organization.

To stem the loss of employment and share of the shipping market, some European countries have established "international" or "second" registers. These registers employ seamen at reduced rates, often utilizing Third World personnel for ordinary seamen and national personnel for officers. The most successful second register is that of Norway, in 1994 as

---

10. Under a bareboat charter the shipowner, for an agreed consideration, turns over all operations of the ship including crewing to a second party. This type of charter may, or may not, involve a flag transfer.

11. The Philippines has about 350,000 seamen who have been accredited to work on ships. Often, many are unemployed, but as in most Third World countries, competition for the jobs is great because the wages are among the highest in the land for blue collar work. The laws of this country provide that 80 percent of the seaman's base rate (the statutory allotment) is sent monthly in U.S. dollars to the agent, who then monthly remits that amount in pesos to the bank account of the seaman. Otherwise, the allotment could not be used by the family for support during the often ten months in which the seaman is gone. The exchange also provides the Philippines with badly needed U.S. dollars (hard currency). Dr. Northrup's interview with Crescencio M. Siddayao, Dept. Administrator, Philippines Dept. of Labor & Employment (on file with author).
shown in Table 1, the seventh largest in the world. As discussed in section II.G, below, the ITF has designated some second registers as FOCs, but not the two most successful ones.

Also discussed in section II.G, below, is the status of dependency registers such as Kerguelan for France, and the Isle of Man and Hong Kong for the United Kingdom. The last named, as set forth in Table 1, is the fourteenth largest register, and has existed for many years.

The driving forces generating the expansion of the FOC fleet are two major costs: taxes and labor. The former are much lower in FOC-flag registries; the latter are significantly so, particularly when costs of manning requirements, work rules, and fringe benefits are added to wage costs. FOC shipping thus involves the transfer not only of the registries but also of the jobs in developed countries to underdeveloped ones. Since the ITF, like most ITCs, was founded by European socialist-oriented unions, and has been dominated by them since its inception, it is not surprising that the organization’s FOC campaign quickly evolved into one to “regain” the lost jobs — i.e., transfer them back from Third World seamen to those in developed nations. As the ITF’s general secretary stated in a 1994 address, this remains the official goal of the campaign:

The ITF is, and has always been an organization led by its members. The majority of those members come from the traditional maritime countries [32 percent from Western Europe in December 1993]12 - the shipowning countries, and the Flag of Convenience Campaign . . . has been and still is led primarily by the desire of those unions to defend and maintain their jobs.13

Policies for the FOC campaign are established by the ITF’s Fair Practice Committee (“FPC”) which was originally manned almost exclusively by delegates from unions in developed countries. After several incidents came close to causing a rupture with unions in Asia, particularly India and Singapore, the FPC was enlarged to include representation from these and other countries.14

B. THE FOC CAMPAIGN IN PRACTICE

The FOC campaign follows a standard procedure in most ports, as diagrammed in Figure 2.

---

Figure 2. A Summary of the ITF-FOC Campaign

1. **Shipowner Approaches ITF**
   - Shipowner registers under FOC and wishes to have an ITF agreement.
   - ITF consults unions in country of beneficial ownership to see whether they wish to sign an agreement for the ship. If not, ITF consults unions in other relevant countries (e.g., labor supply).
   - With approval of beneficial ownership country, ITF-affiliated unions may sign an ITF approved national agreement, or the ITF agreement.

2. **Crew Member Complaints to ITF**
   - Crew member complaint visits ship.
   - ITF inspector visits ship at first possible port.
   - Union notifies shipowners via master of ITF policy and requests him to sign an ITF agreement.
   - Where necessary and subject to local conditions, action may take place to support union demand, such as crew strike, dockers' boycott.

3. **Local Union Inspector Visits Ship**
   - POC?
     - Refer to union in flag country.
     - Refer to ITF list of FOC countries.
   - Blue certificate
     - Inspector checks wages, conditions, etc. against existing agreement.
   - Problem?
     - No action taken.

4. **ITF Affiliate Takes Legal and/or Industrial Action to Secure Compliance with Agreement, Back Pay, etc.**
   - ITF affiliate takes legal and/or industrial action.
   - Report to ITF headquarters.

5. **ITF Asks for and Receives from Shipowner:**
   - A signed copy of the ITF special agreement or approved national agreement.
   - A copy of each crew member's individual contract of employment including the current ITF wage scale and, if necessary, endorsed by the authorities of the labor supplying country.
   - A copy of the ship's articles including ITF rate of pay and a special clause preventing seafarers being forced to renounce their claims to outstanding wages.
   - A current crew list; and
   - A contribution to the Seafarers International Assistance Welfare and Protection Fund for each seafarer ($230 annually per person) plus any agreed upon "back pay."

**ITF Issues Blue Certificate**
After determining that a given ship may be an FOC-flag one, ITF inspectors, who are members of ITF-affiliated unions and have been trained and are compensated by the ITF to perform this function, board a ship in port and request to see the wage and manning schedule and the ITF's "blue certificate," which is given to ships that are in compliance with ITF standards. It states: "It is hereby certified that the [name of ship] is covered by agreements acceptable to the International Transport Workers' Federation. This certificate is valid to [date]," provided it is signed by an ITF official "for [the] general secretary."

If no blue certificate is produced, if the wage schedule is otherwise unsatisfactory to the inspector, and if the shipowner declines to sign an agreement which is dictated by the ITF, an attempt is made to have longshoremen, other dock workers, or tugboat operators boycott handling the ship, or otherwise to prevent it from leaving port. The terms of the ITF-dicted agreement include wage rates unilaterally established by the ITF as equal to wages on the European average standard, described in section II.C, below. Additionally, the ITF demands "back pay," which is sometimes negotiable, but which is unilaterally determined by the ITF representative as the amount "owed" to the crew based upon voyage or voyages present and past; and dues to the ITF welfare fund of US$230 per crew member per year, plus back dues charged. With a ship complement of twenty-two, the dues, exclusive of back pay, amount to US$5,060 per year. This is often dwarfed by back pay which can mean a wage increase exceeding US$500 per crew member per month for a crew of twenty-two. On a nine-month voyage, this amounts to approximately US$100,000.

If the shipowner agrees to these demands and signs the ITF-dicted agreement, the blue certificate is provided by the ITF. The owner then avoids the high costs of having the ship literally held captive in a port, and thereby being unable to deliver or to take on cargo as required by shippers, or to meet cargo commitments in other ports.

In 1994, the ITF reported that as of December 1993, 2,358 FOC ships were under "acceptable" agreements, and that during this year, "around 355 were boycotted or faced with the immediate threat of boycott action." During 1993, the ITF collected US$8,940,213.68 from 315 ships in "arrears of wages and other cash benefits obtained for and paid to crew members" as a result of the FOC campaign. Table 2 shows for four years the number of ships under "acceptable" contracts, the "arrears of

15. See, e.g., FOC Inspectors Hold Worldwide Seminar, ITF News, Sept. 1990, at 8. This is one of many articles on inspector training found in the ITF News over the years. Additionally, the ITF's general secretary has announced an expansion of the number and duties of inspectors. See ITF Report 1990-1993, supra note 3, at 94.
wages and other cash benefits obtained for and paid to crew members,”
and the number of ships involved in these collections. These substantial
collections and ships involved followed a period in the late 1980s during
which “the number of ships covered by ITF acceptable collective agree-
ments fell significantly . . .” from a high of 2,200 ships in 1982 to 1,565 in
1989.\footnote{17}

\begin{table}
\centering
\caption{Ships Covered by ITF “Acceptable” Agreements, “Arrears” Wages and Welfare Funds Collected, and No. of Boycotts Ships 1990-1993}
\begin{tabular}{|c|c|c|c|}
\hline
Year & Ships with ITF Agreements & “Arrears” Pay Funds Collected & No. Boycotted Ships Involved \\
\hline
1990 & 1,533 & US$13,202,971.77 & 263 \\
1991 & 2,078 & 6,444,666.68 & 222 \\
1992 & 2,862 & 13,413,482.52 & 363 \\
1993 & 2,358 & 8,940,213.68 & 315 \\
\hline
\end{tabular}
\end{table}


In order to engineer these boycotts, the ITF requires the cooperation
of local or national maritime, tugboat, or longshore and other dock work-
ers’ unions, national laws which permit boycotts of this nature, and a crew
of inspectors. The countries where historically and currently boycotts
have enjoyed the most freedom from legal restraints are Australia, Fin-
land, and Sweden.\footnote{18} to a somewhat lesser extent, Norway, and more re-
cently, British Columbia, Canada.\footnote{19} Even in countries in which such
boycotts can be enjoined by the courts, however, delays can be very ex-
pensive while a shipowner seeks legal redress. As a result, some ship-
owners find that it is less expensive to agree to the ITF terms than to seek
court action. Charterers and terminal operators increasingly require that

\footnote{17} Id. at 93; and ITF Report on Activities, 1986-89, at 88 [hereinafter ITF Report 1986-
89]. A thorough examination of ITF fund collections and finances is found in Part III, infra.

\footnote{18} See, ITF-FOC Book, supra note 2, at 56-70, and 89-94.

\footnote{19} See, ITF Report, 1990-93, supra note 3, at 96. The International Longshoremen’s and
Warehousemen’s Union (“ILWU”), the dominant longshore union on the U.S. and Canada West
Coast and Hawaii, affiliated with the AFL-CIO in 1993 after long years of being independent
and supporting the communist international organizations. Since then, it has also affiliated with
the ITF and supported ITF activities, including boycotts which are legal in British Columbia.
U.S. West Coast maritime attorneys have advised the authors that no such boycotts have oc-
curred or been threatened in U. S. ports there, undoubtedly because of much more stringent
anti-boycott legislation in U.S. than in British Columbia. Some reports to Dr. Northrup question
this, claiming that such stoppages have occurred, but are not contested by shipowners who wish
“to avoid further trouble”.

ships obtain blue certificates in order to avoid any threat of boycotts. In some cases, companies which actively resist ITF demands permit their chartering departments to insist that independent operators obtain blue certificates. These facts are important sources of the ITF’s wealth, analyzed in section III, below.

C. The ITF Agreement and Blue Certificate Issuance

The ITF agreement requires wages at the level unilaterally established by it as equal to wages on the European average standard; since 1994 that has been US$856 per month for an able-bodied (“AB”) seaman. To this, overtime, fringe benefits, and other costs are added, bringing the actual “consolidated earnings” to US$1,804 per month.20 Moreover, the ITF standard agreement also includes Manning requirements and wage rates and conditions for all other classifications, which further increase costs.21

As a compromise with its affiliated seamen’s unions from Third World countries, particularly those in Asia which had threatened to leave the ITF over its unique attempts to establish unilaterally a common international wage,22 the concept of “total crew costs” (“TCC”) was developed. This concept provides for a minimum total cost for AB seamen, now set at US$1,100 per month, which is, of course, considerably less than the standard ITF rate, and which the ITF has vowed to raise as soon as possible to the standard rate. Not surprisingly, the ITF general secretary reported that “[a]lthough the number of ships covered by ITF Standard Agreements has fallen significantly, there has been a marked increase in the number of Total Crew Cost . . . agreements signed.”23

The widespread use of TCC agreements would on its face seem to mean that the attempt of the ITF to establish an uniform worldwide wage has in practice been abandoned to a major extent. Yet, this may well not be correct. According the secretary of the ISF:

Initially, ITF accepted that virtually any cost to employers could be added to the list [that went into deriving the cost of a TCC wage], as well major items such as basic wage, overtime, leave, etc., but over the years they have gradually and successfully restricted the elements they will accept. The situation now is that there are so many ITF restrictions — that TCC contracts are

---

20. This “benchmark” rate was frozen at $821 per month from 1983 until it was raised in 1993, effective Jan. 1, 1994. See, ITF Increases Wages for Flag of Convenience Crews, ITF News, May-June 1993, at 1.


22. See ITF-FOC Book, supra note 2, at 96-105 (describing the tension between Asian seafarers’ and ITF-affiliated unions).

23. ITF Report 1990-93, supra note 3, at 77.
becoming very standard, for example, each rank/rating, category must receive a precise ratio of wages related to the ABs rate; e.g., Master must be 3.061 and trainees 0.75 the wage costs multiplied by the manning of the ship must amount to 61% of the costs under the Standard Agreement and social costs must be less than 10% of the total, etc. Far from abandoning attempts to enforce a worldwide uniform wage, ITF are closer to achieving it than before.24

The ISF secretary has also found that the ITF is now making efforts to standardize TCC contracts so that one document will be applicable to all nationalities. They “have produced such a document and have persuaded a number of employers to adopt it,” including the German Shipowners’ Association for GIS, that country’s second register,25 as discussed in section II,G below.

This drive by the ITF to standardize and upgrade TCC agreements has produced a shipowner reaction. In 1993 an organization of maritime employers was reorganized under the name of the International Maritime Employers’ Committee (“IMEC”) to oppose the ITF policy of “picking off” individual employers by establishing negotiating committees covering employers in particular countries. This was done for the Philippines and India in 1994, and more recently has been attempted in Poland. The claim is that through this mechanism a better deal for shipowners and charterers was effectuated in the former two countries.26

To obtain a blue certificate when TCC is utilized by the ship, the ITF also requires a collective bargaining agreement from the crews’ home country where the affiliated union has recommended the issuance of the certificate subject to the approval of the ITF national headquarters, and the incorporation of regulations specified above. Since the ITF’s 1983 (Madrid) congress, approval of the ITF-affiliated unions which represent seamen in the country of the ship’s beneficial ownership is also necessary unless this right is not asserted within four weeks of a blue certificate request.27 This last requirement, originally known as the “Madrid Policy,” and modified by the “Geneva Policy” at the 1994 convention, resulted from numerous charges that blue certificates were provided despite substandard conditions, particularly by the Korean Seamen’s Union (“KSU”), which as of March 1983 had issued 712 blue certificates, an “astounding 41 percent of the total” then extant.28

25. Letter from David Dearsley, Secretary, International Shipping Federation, to Dr. Northrup (Nov. 20, 1995) [hereinafter Dearsley Nov. 20, 1995].
26. Id.
27. See, ITF Guidelines for Affiliates Signing TCCs (Jan. 1994), for detailed requirements for approval of TCC agreements.
28. See, ITF-FOC Book, supra note 2, at 132.
For a considerable time, the Madrid Policy does not appear to have been widely enforced despite a 1990 declaration by the Fair Practices Committee that "[t]he ITF and its affiliates must continue to adhere to it." In the United States, the National Maritime Union ("NMU") attempted to assume this role by establishing a satellite, the International Maritime Union, to carry out this function, but the ITF refused to sanction it, probably because it gave no role to the larger Seafarers International Union ("SIU").

After the 1994 Geneva Policy was agreed upon, however, the NMU and the SIU formed a joint organization, the Union of International Seamen ("UIS"), which has an address in Panama and a legal residence in the Caiman islands and, therefore, is presumably outside the jurisdiction of U.S. labor legislation. By thus establishing headquarters abroad presumably to escape domestic labor legislation, which is what the SIU and the NMU repeatedly have charged beneficial shipowners do, the UIS became what might be termed a "Flag of Convenience Union (FOCU)."

The UIS has asserted jurisdiction over whether a TCC agreement covering a ship, whose beneficial owners are American, and who also operates U.S. flag ships with NMU or SIU members, may be approved by the ITF. Correspondence provided to the authors indicated that this organization demands approximately $6,500 per ship for such approval. This apparently is over and above the $5,060 payable directly to the ITF. There is no indication that either the seamen or the shipowners receive any service for this charge other than assurance of obtaining a blue certificate.

Similar policies are practiced elsewhere. Court records in the double bookkeeping cases discussed in section IV, below, indicate that the Japanese unions played a similar role in the contracts with Filipino crewmen and the Greek unions with Maldives Islands crews. Others such as the Dutch, the Norwegians, as well as the Japanese, use the beneficial ownership power apparently to maintain a presence at the bargaining table and to attract welfare or other funds that have declined with declining memberships.

29. ITF Report, 1990-93, supra note 3, at 149.

30. The correspondence, dated in the summer of 1994, is from Robert Parise, UIS President, whose residence is in Florida, and is apparently directed to a shipowner whose name is blacked out, with copies to the then general secretary of the National Union of Seafarers of India, an official of a Philippine ship officers' union, and a gentleman in Manila. It includes a contract which states the payments required for a blue certificate. These payments are set at US$16 per year per man charged to the company, and an additional $.70 per man per day for UIS membership fees. The agreement also "permits" the Filipino union to represent the crew, who are apparently from that country.

According to the ITF general secretary:

the Geneva Policy . . . [provides that] unions in beneficial ownership countries have the negotiating rights on their ships. They have the right (implicit rather than explicit) to levy union dues or other charges in respect of the seafarers on board those vessels, both national or non-national. There is currently no ITF policy governing such arrangements, which are quite common in other countries too. Our main concern in such a situation is that the seafarers concerned receive proper trade union services and this is also something which is currently under active review. As an aside I must add, however, that the sums of money referred to are a tiny fraction of the saving achieved by shipowners in substituting foreign for US seafarers and no-one would be happier than the US unions if US owners were to hire their own countrymen.32

The difficulty with this explanation is, first, that the ITF has no authority to grant “negotiating rights” to any union, or to grant a union the “right . . . to levy union dues or other charges in respect to seafarers.” Rather, such matters are a function of national law and policy. Second, at least in the United States, the collectors of the monies, who have located themselves in foreign territory presumably to avoid U.S. law and policy, can apparently present no evidence that the monies paid provide anything to the seamen, but rather merely levy a tax against the shipowner.

It would appear, therefore, that the Geneva Policy is a method of attempting to shore up the depleting resources of developed country maritime unions, all of which are suffering financially from declining memberships. Unfortunately, the policy also appears open at least to financial mismanagement. Given the large amounts of monies involved in ITF boycott activities, as discussed below in section III, it is perhaps not surprising that questionable activity relating to the ITF-FOC campaign has been widely rumored in the past, as well as having been found in cases involving Australian, British, and Swedish unions, and more recently, the Russian unions.33 Meanwhile, the ISF secretary has “written formally [to the UIS] to enquire by what right they are making their demands.”34

D. **Substandard and “Best in the World” FOC Shipowners**

There is no doubt that some FOC ships, and some national flag ships as well, are substandard in terms of safety, working conditions, and wages.35 For seafarers on such ships, the ITF has played an important

---

32. Letter from David Cockcroft, ITF general secretary, to Dr. Northrup (April 5, 1995).
33. See, *ITF-FOC Book, supra* note 2, at 93 (Australia), 104 (Britain), and 105 (Sweden). Corruption in Russia is, of course, both widespread and widely publicized. There have been repeated reports of this among shipowners to whom we have talked.
35. A virtual catalogue of such ships is found in Paul K. Chapman, *Trouble on Board*
and humanitarian role. It has called the attention of the world to their conditions, demanded that their standards be improved before they can leave port, literally provided rescue, relief, and sustenance to those thus disadvantaged, and successfully pleaded their case before national and international governmental bodies.

There is also no doubt that, contrary to some ITF claims and literature, FOC ships cannot be characterized as providing either all bad or all good wages and conditions. Thus, a former general secretary of the ITF stated:

Among extremes associated with Flags of Convenience, making generalization hazardous, is that some owners are among the best employers in the world, e.g., the U.S. oil companies, while others are certainly the worst.36

The ITF's official booklet in regard to the FOC campaign likewise distinguishes the "good" from the "bad" with the former including only those who sign an ITF agreement:

Not all shipowners operating FOC vessels are as bad as the worst contingent who scrim on wages and safety measures, save on food and clothing for crew, and budget by not manning their ships properly.

The ITF has a good relationship with many companies . . . who take their responsibilities seriously. These are shipowners who have seen the sense of signing an ITF Agreement, and who have then strictly complied with it. In our experience, their ships are relatively safe, and on-board conditions are generally good . . . .37

The Liberian FOC fleet in large part is comprised of U.S. oil and bulk-carrier ships. In his book, a catalogue of alleged abuses involving FOC ships, Chapman states:

There is at least one well-organized and effective international ship registry, that of Liberia. Liberia has demonstrated that an international registry can function efficiently and humanely. In recent years, whenever the Center for Seafarers' Rights [a division of the Seaman's Church Institute] has contacted the Liberian ship registry on behalf of an individual seafarer or an entire crew, the international registry office, located in Reston, Virginia, has investigated the complaint . . . . [and sought to ameliorate the situation.] If the Center for Seafarers' Rights . . . complained directly to the shipowner, the response might not have been so decisive. But the Liberian registry could bring the weight of its authority to bear on the problem and there was a positive outcome.38

Despite these statements, FOC ships owned by U.S. oil companies and other Liberian-registered ships have been boycotted on numerous occasions regardless of the ship's condition, safety record, or the terms of employment merely because they did not carry a blue certificate.\(^{39}\) Moreover, in an address to the 1994 ISF Manpower Conference, the newly elected ITF general secretary has apparently hardened ITF policy:

The ITF is growing stronger while many of its affiliates are growing weaker . . . . Indeed, like the growth in the number of ITF approved collective agreements, it is in many ways a sign of failure. A failure to achieve the central political objective of the Flag of Convenience campaign — drive ships back to their genuine national flag and to the regulations laws and conditions of the shipowners' country. A failure so far to defeat the Flag of Convenience system.

Yet this remains our central political aim and we have no intention of abandoning it. We shall continue to concentrate our attack not [on] the individual shipowner who is obliged to make use of the flag of convenience because his competitors are doing so too, but on the system itself. Although we are aware that safety records vary from flag to flag, there really is no "good" FOC. In the end, any open register which really took its responsibilities seriously and acted as a flag state should act would lose its market to other, less scrupulous, countries. It is the FOC system itself which has caused such a marked deterioration in safety standards and the growth of the short term quick buck mentality . . . .

We have no desire to interfere with the collective bargaining arrangements applying to genuine national flag vessels. Subject to the standards laid down by the ILO, [International Labor Organization], national owners and national unions can exercise all the flexibility they like on national flag ships. When, however, a vessel moves to an FOC, then it becomes a matter for the ITF as a whole, acting collectively on behalf of all our affiliates. When we intervene to secure ITF standards on such a vessel, our ultimate objective is not just to sign an agreement, still less is it to secure a financial contribution to ITF funds. Our ultimate goal is to discourage the owner from re-flagging the vessel.\(^{40}\)

When asked to comment about the apparent contradiction between the booklet and the speech, the general secretary wrote:

The FOC brochure states the basic principle of ITF policy, which is that the FOC system is bad and that all FOCs are therefore bad things. This is true in the end simply because no FOC can exercise real control over "its" ships

\(^{39}\) See, ITF-FOC Book, supra note 2, at Chapter III. Such boycotts continue from time to time where national law does not outlaw them. See, e.g., the case of the Phillips Arkansas, a Liberian flag ship, noted in Frederick W. Wentker, Jr., Double Bookkeeping and ITF Activities - Double Wage Penalty Claims in the US, 21 Int’l Bus. Law. (1993), at 426.

\(^{40}\) David Cockcroft, Address to the ISF Manpower Conference, Taking the Moral High Ground: Priorities in Labour Standards - The ITF View (London 1994), at 7 [hereinafter ISF Address].
This doesn’t mean, however, that statistically there are not registers which have a higher ratio of well managed ships than others. It is no secret that the Liberian registry is at the top end of the scale... because it has always been the flag of preference for US tanker operators... rather than any intrinsically “better” behaviour on the part of the Liberian registry.41

The fact remains that all FOC ships by far are not substandard. The ITF’s failure to recognize this in practice is the result of its focus on raising the costs of all FOC-flag ships so that vessels flying developed country flags can better compete rather than necessarily on removing dangerous or substandard shipping from the world fleet.

E. ITF Worldwide Wage Minima v. ILO Minima

Although the ITF general secretary refers to “the standards laid down by the ILO,” there is a major difference between the wage standards promoted by the ITF, and those recommended by the ILO. The ILO recommendations are established by its Joint Maritime Commission (“JMC”), a bipartite committee established under ILO governing policies. The JMC has a government-appointed chairperson but is composed solely of representatives of employers and workers from major ship-owning and labor supplying countries in the maritime industry. The ITF secretariat has regularly served as secretary of the workers group and vice-chairman of the Commission; the ISF provides the same service for the employers’ group.

The ILO Commission has recommended increases in the AB seamen’s rate three times during the 1990s, the last effective January 1, 1995, at US$385 per month.42 This was a joint recommendation of employer and worker representatives in which the ITF participated. Yet the ITF has set a worldwide standard wage of more than twice the ILO standard.

The ILO wage is established as a reasonable minimum that some underdeveloped countries, in many of which seafarers’ jobs are among the highest paid, can meet without destabilizing national wage levels. Others, however, such as India, find this rate burdensome, and have objected to each increase in the ILO rate.

The ITF standard rate, on the other hand, appears dedicated to reducing, and eventually eliminating, the cost advantages of utilizing FOC flags and crews, thereby assisting in its objective of “regaining” the jobs for the seamen from developed world countries. Indeed, the ITF has made it plain that “one of the main objectives of the... [FOC] campaign

41. Cockroft, supra note 32.
had been to defeat the free play of market forces which sought to supply crews at the lowest rates the market would bear.”\textsuperscript{43} Actually, of course, the ITF has been compelled by economic forces and the needs of the Third World seamen and countries to settle in most cases for the lower TCC rates, and thus to put off any potential to “regain” the lost jobs by use of a much higher standard rate. The increasingly regular reinterpretation of the TCC rates, which have moved them closer to the standard rate, is, however, designed to nullify the TCC rate advantage, and therefore, to make it more difficult for Third World countries to compete.

The ITF has actually recognized the ILO minima by stating that wage rates and working conditions set for “bona fide national flag vessels must not fall below the ILO recommended minimum wages for an AB (recommendation 109) as interpreted by the ITF and other conditions laid down as recommended in the relevant ILO instruments.” The ISF, however, disagrees with a number of the ITF’s interpretations of the ILO standard, which again all have the effect of raising the costs.\textsuperscript{44}

F. ITF Policy and National Country Flag Shipping

Prior to the fall of communism, the ITF did not challenge the flag ships of the Soviet Union and its satellites on the grounds that they were not FOC shipping. Yet it was generally conceded that such countries’ shipping had inferior conditions and lower wages than did most FOC ships. Now that communism has been discarded, some newly formed unions in these countries have affiliated with the ITF. In June 1994, they comprised 16 percent of the ITF affiliated membership.\textsuperscript{45}

The ITF is concerned that these countries will become very low wage FOC havens. Already some seamen therefrom have been recruited by FOC flags, and some Russian ships have been flagged out to lower wage paying ex-communist country registries,\textsuperscript{46} and others have been flagged out for quite different reasons. According to the ISF secretary:


\textsuperscript{44} ITF Policy on Minimum Conditions of Service and Negotiating Rights on Merchant Ships, (Geneva Policy, 1994). The disagreements between the ITF and the ISF interpretations of the ILO wage resolution concern the definition of the standard number of days per week and per month. This affects the overtime calculation, and the number of leave days in a month. See, Letter from David Dearsley, ISF secretary, to A. Selanders, assistant secretary, ITF, (Mar. 15, 1995).

\textsuperscript{45} ITF Report, 1990-93, supra note 3, at 38.

\textsuperscript{46} It has been reported, e.g., that Russian crewmen have been utilized on Greek-owned Adriatic tankers, and that Russian ships have been flagged out to the Ukraine. See, ITF Seeks Talks with Adriatic Tankers; and Russian Crews Fight Use of Ukrainians, TRADE WINDS, Dec. 30, 1994, at 5. See also, Russian Crews for Export, ITF NEWS, July 1989, at 9; and Craig Mellow, Russia: Making Cash from Chaos, 131 FORTUNE, Apr. 17, 1995, at 148, 150 (which notes that one Russian entrepreneur founded an agency “to provide Russian sailors for Greek ships,” and an-
Many ships owned in former communist countries have been flagged-out to open registers [FOCs] but the reasons and the consequences are complicated. The need to attract foreign currency for fleet renewal and the demands by Western banks for the assets to be registered in countries with known and safe laws dealing with mortgages, etc., is probably the major reason. But the consequences have been bizarre as in many cases Russian crews who are members of Russian ITF affiliated unions, employed by Russian companies on Russian-owned ships flying, say, the Maltese flag, have to be paid ITF rates of pay. This puts them in the mega-star pay bracket by Russian standards and has resulted in many companies having to employ armed guards to protect crews from the local mafia on their return home.47

The 1995 increase in the ITF standard and TCC wage minima has apparently upset Asian countries who fear that this might reduce employment for their seamen because of the new competition from ex-communist countries.48 This has added to the long series of disagreements between Asian ITF affiliates and the ITF secretariat.49

The underlying causes of this problem have been the ITF’s unilateral willingness to declare a national union illegitimate, to boycott the ship, and to enroll the seamen involved who were not members of a union that was legitimate in the ITF’s opinion into its Special Seafarers’ Department (“SSD”). This then requires shipowners desiring a blue certificate to pay to the ITF entrance (initiation) fees of US$23 and annual dues of US$46 per seafarer in addition to the other charges noted in Figure 2 and related text, above, and to forward these monies to the ITF secretariat.50 No other ITS has such provisions for individual memberships. In the United States, of course, this procedure without a recognized showing of assent by the bargaining unit employees would raise questions of legality pursuant to National Labor Relations Act (“NLRA”), as amended.51

As workers in Third World countries have organized their own unions, such ITF action has diminished. In 1988, the SSD was consolidated with the Seafarers’ Department as its membership declined, falling from its 1988 membership peak of 9,834 to 6,344 the following year.52

According to the ITF general secretary, the SSD has been so overwhelmed by a heavy workload since the fall of communism and the large number of calls for its assistance that it does not have accurate current

---

48. A meeting of the ITF’s Asian/Pacific Seafarers, as described in the ITF News, Mar. 1990, at 7, gives hints of this. Conversations with shipping officials have confirmed this situation, and the ITF general secretary refers to it in his Maritime Ministry Address, supra note 8, at 3.
49. See, ITF-FOC Book, supra note 2, at 41, 54, 96, and 140.
50. ITF Standard Collective Agreement, supra note 21, at 11.
52. ITF Report, 1986-89, supra note 17, at 86 and 139.
SSD membership data. He also states that in areas, such as China, where free unionism does not exist, and in other countries where either a union's constitution or national legislation proscribe admittance of non-domiciled seamen, SSD membership is required, but that generally, ITF's "policy is that whenever possible seafarers should belong to an appropriate ITF affiliated union." 53 Nevertheless, he has noted that the ITF will continue to make judgments about whether it will act on its own initiative despite the existence of national unions if it sees the need:

Let me make it quite clear . . . the ITF and its affiliates are prepared to take action against any sub-standard ship whatever its flag if its physical condition or operational standards put seafarers' lives at risk. . . . 54

G. Dependency and International, or "Second" Registers

For many years, dependency territory registers, such as Hong Kong for Great Britain, and more recently, also Isle of Man, and for France, Kerguelen, have existed, utilizing Third World crews and often officers from the ruling country, or for Britain, or another Commonwealth nation.

Job losses by the developed country ship registers have during the last decade induced a number of European countries led by Norway to establish international, or "second registers" which permit much lower than union or country scale wages and the use of non-domiciled seamen, but usually provide benefits, such as medical protection and pension credits, as well as good and safe working conditions. 55 Such registers are designed to prevent re-flagging to FOC registers by reducing costs to levels that are reasonably competitive to the FOC level.

The rise of the second registers has been contentious within the ITF. The ITF leadership and some national unions are opposed to second registers, and national legislation that permits their operation. Thus, the German unions recently requested that the ITF designate GIS, the German second register, as an FOC flag, and forced the German owners to accept the ITF TCC contract for GIS which establishes higher than competitive rates and is designed not only to protect jobs and wage rates for the German officers on board, but also to comply with the ITF standard TCC contract applicable to all nationalities. 56

As a result of national government policy, ITF affiliates, with those in Norway and Denmark being the most successful, have negotiated agreements covering second registry ships. As Table 1 showed, Norway's

53. Cockroft, supra note 32.
54. ISF Address, supra note 40, at 8.
55. Telephone interview, cruise ship company official which flags some of its ships with NIS, the Norwegian second register.
second register was the seventh largest in the world in 1994: Denmark's was No. 24. Unlike the situation in Germany, the Norwegian and Danish unions have opposed pressure from the ITF and some of its affiliates to designate their second registers as FOC flags. They point out that their countries have adopted laws governing these registers, and that their existence, and in Norway, legislation, gives them some control of the terms and conditions of employment, which is far superior for them than to have the shipowners in their countries "flag out" to one or more of the existing FOC registers.

The record demonstrates the wisdom of the policies of the Norwegian and Danish unions. In 1980, the Norwegian regular register embraced 22 million gross tons of shipping. By 1987 when NIS was instituted, the regular register was down to 5.4 gross tons. In 1994, the regular register stood at 2.4 gross tons while NIS was up to 19.9. In 1985 the Norwegian fleet was manned almost exclusively by Norwegians; in 1994, 26,800 seafarers were employed, of whom only 6,800 were natives. It would also appear that some former Norwegian registers which flagged out have returned under NIS.

In Denmark, the data show that DIS has stabilized the national fleet. The regular register declined from 5.4 gross tons in 1980 to 0.5 in 1994 while DIS grew from 4.0 in 1989, its first year, to 5.1 in 1994.57

Other second or international registers have been created or utilized by owners. Luxembourg has become the (perhaps temporary) home for the Belgium owned fleet and as a flag state Belgium has ceased to exist. . . . Others, however, have had less success, for example the Canary Islands register and Madeira have been reformed for Spanish, Portuguese and other owners albeit so far with little impact.58

The ITF has adopted policies which demand the right for unions in the second register country to bargain for non-domiciled seamen wages and conditions on these registers.59 The wishes of the non-domiciled seamen are apparently not consulted. Where such bargaining occurs, the ITF policies apply "considerations" involving ship safety, union negotiating rights, maintenance of social security, and tax relief to seafarers and shipowners. It further provides that no ITF affiliates "shall sign agreements for second register vessels which fall below the ITF benchmark and the ITF standards, as amended from time to time." If a union affiliate in a second register country so requests, or if it decides where "circumstances so dictate," the FPC "reserves the right to declare any second

57. Id.
58. Id.
59. See, ITF FAIR PRACTICES COMMITTEE, RESOLUTION ON SECOND REGISTERS, (London, June 14-16, 1995), for the official ITF policy on such registers.
register an FOC, as it has done in regard to the German one. Thus far, however, the ITF has had very limited success in controlling second register employment policies in no small part because of the fundamental disagreements among affiliates as indicated by the German case on the one hand, and those of Norway and Denmark on the other. The Norwegian and Danish unions attempt to escape ITF censure by negotiating for the Third World crews and meeting somewhat closely ITF standards. They also are probably themselves mollified by some funding for these efforts.

These second registers, plus the almost extinction of the once dominant United States fleet, demonstrate the difficulties of developed countries attempting to compete in the maritime industry without various subsidies or restrictive legislation. The future for any ITF-led "regaining" of this work appears dim indeed.

III. The Finances of the ITF

There is no other ITS for which an analysis of its finances is more instructive in understanding its operating principles and priorities than the ITF. Unlike other union federations, the ITF does not receive the bulk of its income from member affiliates' dues, but rather from employers in the shipping industry. Moreover, as already noted, only 16 percent of the workers represented by ITF affiliates are employees of the shipping industry. Yet the preponderance of the ITF's financial resources derive from its Seafarers Department and the "taxes" imposed on shipowners as part of the FOC campaign. The sizable revenues flowing from this campaign combined with the inability (or unwillingness) of the ITF to disburse its resources among its affiliated national unions has made the ITF by far the wealthiest international trade secretariat. By 1994, the ITF had accumulated assets exceeding the equivalent of $100 million with negligible debt. A conservative investment portfolio would yield at least $5 million annually in interest income alone.

---

60. Id.
62. The last two major U.S. flag carriers, Sealand and American President, are seeking FOC status for at least some of their vessels, leaving the coastwise territory only for the U.S. flag, and this because the eighteenth century Jones Act permits only U.S. flag ships to handle U.S. port-to-port traffic. Other countries have similar legislation.
63. Most international trade secretariats have a difficult time balancing their operating budgets which are dependent largely on affiliated union dues. Except for the International Metal Workers Federation ("IMF"), whose affiliates include some of the largest unions in the free world, the typical ITS has little accumulated financial resources.
A. Financial Structure

Prior to 1984, the ITF included in its Report on Activities detailed data concerning its finances. The data for those years have been published previously. Beginning in 1984, financial data were omitted from these reports and other published ITF documents, but the ITF, as a union federation, has been required to report such information to the British Government on Form AR21, "Annual Return for a Trade Union," pursuant to the Trade Union and Labour Relations Act 1974. As of January 1996, the latest ITF Form AR21 report available from the British Government relates to 1994-95.

In 1981, the ITF established the Seafarers' Trust ("Trust"), a registered trust, in order to avoid paying corporation taxes on the Welfare Fund's investment income, and to distribute grants to seafarer affiliates and other friendly organizations. The Trust receives the Welfare Fund's investment income by covenant to charity as well as other donations therefrom. It is required to submit financial reports to the United Kingdom Charity Commission. The data presented are taken from the Welfare Fund and Trust reports to these British government agencies, plus two annual reports issued by the Trust in 1994 and 1995.

Although the ITF receives substantial income, its financial structure is relatively easy to comprehend. For accounting purposes, revenues and expenditures are recorded in two principal funds: the General Fund and the ITF Seafarers' International Assistance, Welfare, and Protection Fund ("Welfare Fund"), which was established to allocate grants and assistance to seamen.

The General Fund, which ostensibly supports the main operating costs of the ITF regardless of the industry involved, is financed primarily by revenue from affiliate dues. It is tasked with funding administration, i.e., salaries, rent, office equipment and supplies, travel, conferences, general overhead, and grants and donations, and regional education programs not specifically pertaining to the FOC program or other seafarer matters.

Since the late 1970s, however, the General Fund has provided a decreasing proportion of the ITF's total funding. Instead, the Welfare Fund, the overwhelming source of revenue for which is derived from the FOC campaign to compel contributions from shipowners, has been the dominant financial vehicle for the ITF. This is not altogether surprising. Given that the Welfare Fund is supposed to support only those activities relating to seafarers, the sharply rising expenditures on the FOC campaign in recent years naturally caused the Welfare Fund's share of the

---

64. See, ITF-FOC Book, supra note 2, at 135.
65. See Table 3.
ITF's spending to climb. Nevertheless, the Welfare Fund has been burdened with an increasing share of non-FOC campaign expenses; in 1984 the Welfare Fund was charged with 30 percent of non-FOC expenditures but by 1991-92 this had reached 54 percent. Subsequently, it has fallen to 48 percent in 1993-94 and 47 percent in 1994-95.66

Moreover, this does not tell the whole story. The Welfare Fund built and owned one of the two buildings formerly occupied by the ITF's staff, and no doubt also financed the new building and its refurbishing into which the ITF moved in October 1995 to consolidate the location of its London personnel.67 Numerous expenses and overhead can be charged to the Welfare Fund as if they pertained only to seafarers, but actually cover other activities as well. There is no question that the Welfare Fund has greatly enhanced the ability of the ITF to operate on a much greater scale than was possible before the inauguration of the FOC campaign.

Table 3 summarizes the most important aspects of the ITF's finances by consolidating the two Funds and the Seafarers' Trust through 1994-95, and by listing only those revenue and expense items which are of material importance. Over the past decade, the ITF's total income did not grow appreciably — even though that of the General Fund more than doubled — while its expenses tripled from £3 million to nearly £9.5 million. Fastest growing among expenditures were those relating to the FOC campaign and to general administration, the most significant of the latter being staff salaries.

Figure 3 points out the critical role of the Welfare Fund in financing the ITF's expansive spending during the 1980s. Without the Welfare Fund and the Seafarers' Trust, which receives its income from the Welfare Fund, the ITF would be a very modest organization, financially; this is shown by the fact that the General Fund's income did not account for more than 19 percent of the ITF's total income in any of the years from 1984 through 1994-95. Thus, the maritime activities of the ITF, and in particular those relating to the FOC campaign, provide the brunt of the ITF's financing for all its activities regardless of the industry involved.

The Welfare Fund has been so lucrative that the ITF's vastly increased expenditures have not resulted in a reduction in the ITF's total asset base. From 1984 to 1994-95, the ITF's assets rose from £37 million to £75 million (the latter amount being equivalent to more than US$100 million). In fact, greatly increased revenues flowing into the Welfare

66. Some portion of non-FOC campaign expenditures are of course related to the ITF's maritime activities, but it is not possible to determine the breakdown. There is no doubt, however, that income from the FOC campaign contributes substantially to funding ITF expenditures unrelated to seafarers.

67. See, ITF News, November 1995 at 2, for a picture of the new ITF headquarters and its address.
## Table 3

### Ten Year Financial Summary of the ITF

(Pounds Sterling)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INCOME</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General Fund</td>
<td>11,896,930</td>
<td>13,935,480</td>
<td>11,439,814</td>
<td>12,463,554</td>
<td>13,087,879</td>
<td>14,908,503</td>
<td>14,346,306</td>
<td>16,651,988</td>
<td>13,028,184</td>
<td>16,641,148</td>
</tr>
<tr>
<td>Subscriptions</td>
<td>1,200,964</td>
<td>1,328,801</td>
<td>1,231,298</td>
<td>1,422,981</td>
<td>1,463,128</td>
<td>2,206,663</td>
<td>1,852,081</td>
<td>2,370,817</td>
<td>2,534,025</td>
<td>2,877,870</td>
</tr>
<tr>
<td>Welfare Fund</td>
<td>899,672</td>
<td>1,004,593</td>
<td>1,058,668</td>
<td>1,164,482</td>
<td>1,229,220</td>
<td>2,032,725</td>
<td>1,593,203</td>
<td>1,872,203</td>
<td>2,166,263</td>
<td>2,382,231</td>
</tr>
<tr>
<td>Shipowners' Contrib.</td>
<td>10,695,966</td>
<td>12,606,679</td>
<td>10,208,516</td>
<td>11,040,573</td>
<td>11,624,751</td>
<td>12,701,840</td>
<td>12,494,225</td>
<td>14,281,171</td>
<td>10,494,159</td>
<td>13,763,278</td>
</tr>
<tr>
<td>Investment Income</td>
<td>7,619,630</td>
<td>6,017,460</td>
<td>5,470,948</td>
<td>5,669,961</td>
<td>5,876,553</td>
<td>7,413,136</td>
<td>7,167,506</td>
<td>8,273,128</td>
<td>8,118,128</td>
<td>10,544,313</td>
</tr>
<tr>
<td><strong>EXPENSES</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Administrative</strong></td>
<td>2,113,863</td>
<td>1,999,278</td>
<td>1,871,093</td>
<td>2,168,235</td>
<td>2,721,095</td>
<td>3,255,699</td>
<td>3,046,518</td>
<td>1,964,200</td>
<td>1,263,390</td>
<td>1,330,129</td>
</tr>
<tr>
<td><strong>FOC Campaign</strong></td>
<td>3,414,839</td>
<td>3,837,110</td>
<td>3,328,973</td>
<td>5,389,343</td>
<td>5,735,142</td>
<td>7,819,613</td>
<td>8,327,061</td>
<td>9,218,456</td>
<td>8,979,058</td>
<td>9,579,568</td>
</tr>
<tr>
<td><strong>Legal</strong></td>
<td>1,087,329</td>
<td>1,658,165</td>
<td>1,587,507</td>
<td>1,874,904</td>
<td>2,255,650</td>
<td>2,969,659</td>
<td>2,509,840</td>
<td>3,045,514</td>
<td>3,544,595</td>
<td>4,855,940</td>
</tr>
<tr>
<td><strong>Inspectors Fees</strong></td>
<td>1,771,298</td>
<td>1,662,765</td>
<td>1,165,701</td>
<td>2,851,831</td>
<td>2,950,597</td>
<td>4,373,595</td>
<td>5,488,125</td>
<td>5,750,271</td>
<td>4,752,568</td>
<td>4,723,628</td>
</tr>
<tr>
<td><strong>Travel</strong></td>
<td>601,554</td>
<td>929,056</td>
<td>524,804</td>
<td>836,316</td>
<td>1,288,883</td>
<td>1,733,579</td>
<td>1,787,510</td>
<td>1,708,514</td>
<td>1,221,375</td>
<td>1,180,582</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td>748,586</td>
<td>511,030</td>
<td>431,618</td>
<td>1,694,047</td>
<td>1,391,838</td>
<td>2,255,796</td>
<td>3,310,456</td>
<td>3,720,415</td>
<td>3,080,797</td>
<td>3,050,236</td>
</tr>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General Fund</td>
<td>43,125,459</td>
<td>51,427,479</td>
<td>55,538,272</td>
<td>55,449,624</td>
<td>58,252,804</td>
<td>63,297,813</td>
<td>67,053,094</td>
<td>74,287,679</td>
<td>73,020,978</td>
<td>74,671,498</td>
</tr>
<tr>
<td>Seafarers' Trust</td>
<td>15,233,761</td>
<td>16,398,145</td>
<td>21,205,193</td>
<td>27,200,618</td>
<td>29,126,371</td>
<td>34,803,106</td>
<td>38,533,459</td>
<td>41,986,258</td>
<td>39,189,000</td>
<td>36,688,000</td>
</tr>
<tr>
<td><strong>DEBITS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Backpay to be Distributed</td>
<td>1,833,111</td>
<td>1,094,402</td>
<td>1,511,293</td>
<td>1,816,135</td>
<td>2,225,605</td>
<td>2,023,889</td>
<td>2,851,986</td>
<td>3,755,011</td>
<td>3,148,371</td>
<td>3,282,208</td>
</tr>
<tr>
<td>Interest Due on Backpay</td>
<td>1,094,000</td>
<td>1,186,500</td>
<td>1,338,500</td>
<td>1,510,500</td>
<td>1,797,500</td>
<td>2,148,500</td>
<td>1,500,000</td>
<td>1,700,000</td>
<td>1,700,000</td>
<td>1,700,000</td>
</tr>
<tr>
<td>Total Assets in U.S. Dollars</td>
<td>$55,360,024</td>
<td>$75,406,861</td>
<td>$90,748,810</td>
<td>$98,777,960</td>
<td>$95,517,123</td>
<td>$112,967,607</td>
<td>$118,643,745</td>
<td>$131,154,897</td>
<td>$109,677,509</td>
<td>$114,366,853</td>
</tr>
</tbody>
</table>

**Notes:**
Figure 3. The Financial Importance of the Welfare Fund (Total ITF Expenditures as Charged to Each Fund)


Fund resulted in the decision to establish the Seafarers' Trust in 1981. The evolution of the ITF's assets and financial power, which are unmatched by any other ITS, is shown in Figure 4. The General Fund represents a very small percentage of the ITF's assets, whereas the Seafarers' Trust has grown considerably since the mid-1980s and now accounts for 50 percent.

B. The Welfare Fund

In 1965, the Welfare Fund was established as a distinct financial entity with the purpose of providing assistance and welfare disbursements to seamen. A small percentage of its revenue accrues from subscription payments made by members of the ITF's Seafarers' Department and by those seaman who are covered by ITF agreements but who do not belong to any union or to a union affiliated with the ITF.

The data in Table 3 also shows that the Welfare Fund benefits from interest collected on back pay won for seamen on FOC ships — US$5 million in fiscal 1994-95 remained undistributed. These funds are distributed to seamen, but it often requires time to find them or obtain their addresses because of the mobility in the industry and the problems of locating personnel in Third World countries where the infrastructure is
Figure 4. The ITF's Financial Power
(Total Assets)


weak. Some are never found despite energetic efforts by the ITF administrators to locate them. The ITF benefits by being able to use the “float” which, as Table 3 shows, has been a sizable amount each year.

Because the Welfare Fund’s revenues underwrite much of the ITF’s total expenditures on all of its programs and as such have permitted the ITF to operate on a much greater scale than was possible before the inauguration of the FOC campaign, it logically follows that shipowners in effect provide the resources that allow the ITF to pursue its objectives, including the extraction of further contributions. For example, from 1984 through 1989, and again in 1994-95, shipowners’ welfare contributions exceeded by a good measure the entire expense budget of the ITF covering all transport sectors under the ITF’s umbrella. As already noted, revenue figures alone do not tell the whole story of the critical nature of the Welfare Fund as a financing vehicle. Besides financing ITF’s headquarters, for which the ITF pays rent, the Welfare Fund undoubtedly provides other financing, such as for ITF’s sophisticated office equipment.

Spending by the Welfare Fund over the past decade has been dominated by expenditures for administration of the FOC campaign, outlays to the Seafarers’ Trust through the Covenant to Charity and other donations, and to a much lesser extent by welfare grants to seaman — supposedly the Fund’s principal mission. In 1989, for instance, the Welfare Fund
allocated welfare grants and assistance to seaman totalling less than 1 percent of that year's income; this rose to nearly 5.5 percent in 1994-95, still quite small.

Although the Welfare Fund has in recent years significantly increased its spending on welfare grants and donations to the Seafarers' Trust, the Welfare Fund still accrued surpluses and possesses huge financial reserves. At the end of fiscal year 1994-95, the Welfare Fund's assets were £36 million, which generated investment income that exceeded the General Fund's income from affiliate subscriptions or dues in 1990-91, 1991-92, and 1992-93.

The sharp increase in administrative expenses starting in the late 1980s is related to the escalating costs of the FOC campaign. In particular, legal charges have exploded as a result of court challenges to the ITF's attempt to force payments from shipowners. In 1984, legal and professional fees totaled £727,039, but by 1989 they amounted to £1.3 million, and in 1992-93 to £1.7 million, and stood at £1.2 million in 1994-95. Rising even faster than legal costs have been expenditures on inspectors' fees, which have jumped from £592,329 in 1984 to over £3 million in 1994-95, a result in part of a substantial expansion of the number of inspectors employed in recent years. One factor driving this increase, in addition to the hope that it will result in greater shipowner acceptance of blue certificates, may be increased reliance on such fees and on shipowners' welfare contributions for financial support by unions in western countries as their memberships continue to decline. Lending credence to this view is the fact that the level of "contributions" made by shipowners has changed relatively little over the past decade — from £7.4 million in 1984 to £10.5 million in 1994-95, — implying that either the contributions have become far more difficult to collect, thus requiring a greater number of more highly trained inspectors, or that reimbursements for inspections are being utilized to offset in part declining memberships in developed country maritime unions as the proportion of the world fleet that are FOC ships or second registers continues to increase.

The expansion of payments by the ITF to affiliates from the Welfare Fund seems certain to enhance the power of the ITF vis-a-vis its affiliates. If an affiliate desires to be a beneficiary of such funding, it surely enhances its standing by supporting the policies of the current administration. This is not unusual in the intra-politics of organizations. Given the declining nature of national maritime unions in developed countries and the financial power of the ITF, such a development in the hands of a strong general secretary is even more likely.
C. The Seafarers' Trust

The Seafarers' Trust has operated for most of its existence as a mechanism to minimize taxes on the FOC campaign's revenue and to issue grants. ITF personnel comprise the Trust's board of trustees and officials. Following an initial input of £4 million in 1981, the Trust has been "donated," under a Deed of Covenant, the investment income realized by the assets of the Welfare Fund since 1983. The Welfare Fund has also periodically made donations to the Trust, in addition to those associated with the Covenant, as a means of sheltering even more FOC revenue from taxation.

Figure 5 tracks the evolution of the Trust's assets since 1984. The Covenant donations have accounted for the majority of the Trust's income, although in the late 1980s the non-Covenant donations were likewise very large. Over this ten-year period, the Trust received in excess of £61 million in income. Tax-reducing donations from the Welfare Fund were in excess of £45 million. As shown in the financial summary of the ITF provided in Table 3, above, the total assets of the Trust rose from £7.7 million in 1984 to almost £37 million (or nearly $56 million) in 1994.

**Figure 5. Seafarers' Trust**  
(Welfare Grants Relative to Income)

![Graph showing the evolution of the Trust's assets since 1984](image)


Given that the Trust is a registered charity, one would expect that its expenditure accounts would reflect this fact by showing significant outlays on charitable activities. According to the Trust's first annual report, issued for 1993-94:

The Trust's principal objects are providing, or assisting in providing, for the
social welfare of seafarers of all nations and assisting them and their dependents in conditions of sickness, hardship and distress.68

What is most notable about the Trust is the apparent lack of accord between its stated objectives — i.e., those for which it has been granted beneficial tax status — and those it has pursued for most of its existence, particularly the lack of significant charitable outlays until recently, relative to its income and total assets.

As shown in Figure 5, except for its two latest fiscal years, the amount of welfare grants dispersed annually fell considerably short of the Trust's income and, to a far greater extent, its total assets. In only six years of the Trust's entire existence have welfare grants risen above 50 percent of its income and in only two years have welfare grant expenditures been sufficient to reduce the Trust's assets. Consequently, the Trust accumulated an ever-growing trove of riches; a cynic would believe this to be the reason that the ITF never issued an annual report for the Trust prior to 1993-94, when it could show substantial outlays on welfare grants. As of 1994-95, the total income received by the Trust since its creation in 1981 had reached £82.7 million; expenditures on welfare grants amounted to £44.7 million at the end of its fiscal year 1994-95, and combined with administrative expenses, totaled £46.1 million. The Trust's assets at the end of fiscal 1994-95, therefore, measured £36.6 million, which for the first time fell below the entirety of welfare grants issued by the Trust since its founding.

In terms of geographic distribution, the nature of the Trust's welfare grants is as noteworthy as their relative magnitude. The great bulk of the welfare grants have historically been issued for union-sponsored activities in developed countries. For example, only 9 percent of the funds transferred to the Trust in 1981 were expended. Twenty-eight of the thirty-two grants made by May 7, 1982, were to union projects in developed countries.69 Twelve years later in fiscal year 1992-93, about 80 percent of welfare grants were destined for countries belonging to the Organization for Economic Cooperation and Development ("OECD"),70 and in other years the distribution was doubtless also heavily skewed toward wealthy western nations, Australia and Japan.

One possible explanation, as stated in the ITF's first ever annual report of the Trust is "a lack of knowledge on the part of some agencies [in Third World countries] of the Trust's existence and also the degree to

69. See, ITF-FOC Book, supra note 2, at 140-41.
70. The ITF Seafarers' Trust, supra note 67, at 8. OECD is the international organization of the wealthier developed countries.
which they were prepared to seek alternative sources of finance."71 Perhaps at least equally significant, however, is the fact that all of the Trust’s trustees have been, and continue to be, members of the ITF executive board or of its staff, all are citizens of developed countries, and it is administered by an organization located in Europe and dominated by European unions. The apportionment of the Trust’s grants has predictably elicited complaints from developing country organizations,72 and has led the Trust to commence a new strategy for allocating a higher percentage of grants to them.

The new Trust policy for targeting grants is based upon a formula that considers the number of seafarers originating in and working in a region and the amount of trade conducting in a region by seaborne means.73 This reallocation of Trust grants has resulted in a decline of disbursements to developed countries from approximately 80 percent of the total in 1993-93 to about 64 percent in 1994-95.74

A substantial part of the increases in funding for Third World countries was provided to the “Asian Tigers” — Hong Kong, South Korea, Singapore, and Taiwan — none of which can realistically be considered as underdeveloped, but are Asian. These countries combined received less than 10 percent of the 1994-95 Trust grants as compared with 3 percent the previous year. This may reflect a temporary situation, or a healthy degree of prudence by the ITF in recognition that many developing countries cannot productively absorb large inflows of funds or equipment.

On a regional basis, grants for European groups were reduced from 69 to 30, and from £3.5 million to £2.2 million between 1993-94 and 1994-95. On the other hand, those in the Asia-Pacific region declined slightly in numbers, but increased somewhat in amounts from £2.1 million to £2.3 million. Of this total, Australia received £530,044 in 1994-95, about one-half of its 1993-94 total, but still 23.2 percent of the regional total as compared with the 1993-94 ratio of 52.4 percent. On the other hand, Japan received £534,827 in 1994-95, 23.4 percent of the regional total, as compared with £160,210, 7.7 percent of the regional total, in 1993-94. Other major grants in 1994-95 went to Taiwan (£470,150, 20.5 percent of the total regional grants), Thailand with the largest Third World country grant (£400,000, 17.5 percent of the regional total), and Samoa (£114,403, 5 percent of the regional total). There were no other six-figure grants.

71. Id. at 9.
72. The ITF estimates that at least 60 percent of seafarers are now from Asian countries, and when adding in those from other developing areas, the total number of seafarers from non-western countries probably surpasses 80 percent.
73. ITF SEAFARERS’ TRUST, ANNUAL REPORT, 1994-95, at 9.
74. All data relating to this issue are from the 1993-94 and 1994-95 ITF SEAFARERS’ TRUST ANNUAL REPORTS.
Thus, the increase in distribution of Trust grants for the Asia-Pacific region saw only two underdeveloped countries, Thailand and Samoa, gain major grants while Australia and Japan, two OECD countries, received 46.6 percent of the grant money, and another 20.5 percent went to Taiwan, a fast-rising “tiger”. It is unfair to base criticisms on one or two years of an attempt to reorient the Trust grant policy, but it is fair to note that there must be considerable more change if the grants are to make a substantial contribution to the countries which supply the largest number of the world’s seafarers.

D. The ITF’s New Proactive Use of the Trust

Soon after assuming the post of ITF general secretary in 1993, David Cockroft was quoted publicly that the Trust was poorly administered:

Administration has been almost non-existent . . . . Trust meetings have tended to take place three times a year at lunchtime in between other meetings. This has got to become more systematic and we have already had a full-day meeting . . . to look at it and there are more to come.75

True to his word, Cockroft has appointed an administrator for the fund, issued its first two annual reports, and as already discussed, considerably increased its donations, and moved to alter the concentration of grants to developed countries particularly by increasing those to welfare projects in Asia from which the majority of present day seamen are recruited.

The new Trust administration has also declared that “[d]eveloping a proactive approach to the future activities of the Trust is one of our main priorities.”76 Being more “proactive” includes instigating grants on its own motion instead of just waiting for affiliated unions to propose them, and altering the geographic grant distribution by permitting grants in underdeveloped areas where the ITF has no affiliates. It is also clearly in line with what appears to be Cockroft’s determination to utilize grants to increase the ITF’s visibility, to enhance its public image, and to further its FOC campaign.

Thus, the ITF scored a public relations coup by donating $1 million to endow a chair at the World Maritime University, located in Malo, Sweden, and agreeing “to provide initial funding for the establishment of an independent international institution dedicated to research into the whole range of seafarers’ occupational safety and health problems,” located in Wales.77 The Trust has also agreed to provide a grant of £270,000 per year for three years to the International Committee on Seafarers’

75. ITF Admits Controversial Fund is Badly Administered, TRADEWINDS, Aug. 6, 1993, at 9.
76. ITF SEAFARERS’ TRUST, ANNUAL REPORT, supra note 67, at 13.
77. ISF Address, supra, note 35, at 6.
Welfare ("ICSW") in order to establish a full-time secretariat, located in London.\textsuperscript{78} Since these organizations are all headquartered in Europe, they will not alter the past geographical distribution of grants, but there has also been a grant of £500,000 to a Thailand project.

Interestingly, in view of the new emphasis on health and safety is the fact that in the past only 0.6 percent of the Trust grants were related to health and medical matters, which is a smaller share than that given for sports and entertainment. Moreover, it remains to be seen whether these new organizational grants will duplicate activities of the ILO, and whether the result will be to emphasize items under the health and safety banner which will support ITF policies on hours, crew Manning, time off, and other collective bargaining issues.

The Cockcroft administration does not plan to alter the concentration of recipient organizations which have received Trust grants in the past. The majority of the nearly 700 grants since 1981 have gone to "established seafarers' welfare bodies such as those sponsored by various churches."\textsuperscript{79} There is good reason for this besides the fact that numerous churches do provide missions, rest areas, and other welfare services to seamen in ports throughout the world. In recent years, for example, one such church body, the Seamen's Church Institute, New York, dedicated itself, in the words of its then director, to "the problems of exploitation of seamen aboard ship."\textsuperscript{80} In this work, it has cooperated and assisted the ITF, as discussed in Part IV, infra. Cockcroft has noted in regard to church representatives:

We [the ITF and the church] provide complementary and not competing service to seafarers. Not only can you deal with the many complex problems which are beyond our competence, but you can also . . . "boldly go" where ITF inspectors would normally get thrown off the ship.\textsuperscript{81}

It would appear, therefore, that proactive changes in the Trust will alter some patterns of grant donations but maintain others. The key variable determining grant action will henceforth undoubtedly be the effect on ITF policies, practices, and aspirations, particularly in regard to the FOC campaign.

\textsuperscript{78} ICSW is a coordinating body involving ISF, ITF and various organizations providing port welfare, such as religious-sponsored missions. Ake Selander, for many years an ITF assistant general secretary with responsibility for the FOC campaign, is scheduled to become the secretariat for ICSW on his retirement from ITF early in 1966.

\textsuperscript{79} ITF Seafarers' Trust, Annual Report, supra note 67, at Foreword.

\textsuperscript{80} Richard F. Shepard, Ahoy, Mates, the Institute Back at the Seaport, N.Y. Times, May 6, 1991, at B3.

\textsuperscript{81} Maritime Ministry Address, supra note 8, at 3.
IV. **Double Bookkeeping And Litigation In The United States**

To avoid ITF boycotts, to step aside from controversy, and to adhere to requirements of charterers who insist that ships avoid boycotts, shipowners predominately from the Far East for many years signed ITF-approved agreements, paid into the ITF Welfare Fund, but also signed separate agreements with their national unions where they exist, or otherwise paid wages at a much lower rate than either the ITF standard or approved TCC scales dictated by the ITF. This was historically relatively easy to do prior to the recently enforced Madrid and Geneva policies because ITF's affiliated unions approved the issuance by the ITF in London of blue certificates to vessels which had signed the ITF agreements.

It is preposterous to believe that the Far Eastern unions or seamen were unaware of the double bookkeeping involved. In interviews with shipowner and ship operator personnel, maritime union officials, and government officials in Japan, Thailand, Singapore, and Hong Kong in 1983, double bookkeeping was talked about freely as clearly prevalent in all countries visited except Singapore, and parties interviewed declared that it was common in the Philippines, Taiwan, and South Korea as well. They all regarded it as necessary to operate, particularly in the Australian trade.  

Additionally, in Third World countries except Singapore, the wages actually paid seamen at the country rate are among the highest that could be earned as blue collar workers.

Double bookkeeping by Western standards is clearly unacceptable; certainly these authors do not support its use. The Asian view, however, looked at it differently. Those who have utilized double bookkeeping point to the circumstances created by the ITF attempt — the only effort of its kind — to establish a worldwide wage standard despite the vast differences in living conditions, living costs, and job opportunities in various areas of the world, and particularly the differences in these standards between developed and Third World countries. They combined these considerations with the view that double bookkeeping is a practical solution to a practical problem of being able to operate ships and to avoid

---

82. *ITF-FOC Book, supra* note 2, at 106 (summarizing these interviews, together with other information concerning double bookkeeping).

83. This has been attested to one of the authors by American companies who utilize particularly Filipino seamen, as well as by authorities in the Philippines, both in person in 1983, and by telephone and fax ten years later. The large number of applicants attempting to enroll in training schools in the Philippines, and the resultant oversupply of applicants and trained seafarers there attest to this situation. Wage data for such countries are found in the *Yearbook of Labour Statistics* published by the ILO, but even though these data are the most reliable available for underdeveloped countries, they lack rigor and are usually quite out of date. Wentker, *supra* note 39, at n. 4: “Currently [1993] a Filipino AB earns about US $700 a month base, overtime and vacation. The average wage for a labourer in the Philippines is about US $100-125 per month.”
controversies that probably could not be won. From their point of view, therefore, double bookkeeping became an understandable and reasonable solution to a problem.

It was usually not meant to cheat seamen, whose union officials, and probably most of the seamen themselves, must always have been aware of the double bookkeeping. In the Philippines, for example, manning agents licensed by the government, who are by law the only source of seafarer hiring, recruited seamen with the understanding that double bookkeeping was involved. It was explained to seamen that double bookkeeping was a method to maintain their jobs in economies in which jobs are very scarce. Some Filipino seamen prior to a voyage received a bonus and bonuses each month while on voyage for participating in the ruse. Moreover, they surely knew that if they complained about double bookkeeping, they could find it difficult in the future to gain these coveted jobs for which the supply generally exceeded the demand.

The seamen were paid the country or market wage throughout their terms of employment and signed receipts for those wages. Seamen also signed receipts for payment on the basis of the ITF wage schedule. The ITF wage schedule was often written into the ship's articles and two sets of books were kept: one reflecting the actual wage schedule, the other the ITF one.

The ITF had, of course, been aware of double bookkeeping for many years, but found it very difficult to obtain evidence or otherwise to curtail its practice. As its Report on Activities stated to the 1986 congress:

Manning agents circulate owners with details of their own special "guarantees" regarding the evasion of ITF standards once the ITF Blue Certificate has been obtained, thereby cheating both the crews and the charterers who insist on f-c-c ships being in possession of the Blue Certificate as a way of ensuring employment standards that are acceptable to ITF affiliates. The increasing sophistication of the "double accounts," coupled with what can only be described as terrorization of crews, presents ITF inspectors with tremendous problems in carrying out routine checks on compliance with ITF agreements.84

All this was altered insofar as trade through United States ports is concerned when the ITF teamed up with a resourceful attorney and the Seamen's Church Institute. As some Chinese shipowners predicted would happen a decade earlier, the seamen who blew the whistle were largely Filipino.85

84. See, ITF Report, supra note 3, at 117.
85. See, ITF-FOC Book, supra note 2, at 106.
A. United States Law and Double Bookkeeping

The attempts of the ITF and its affiliates to boycott FOC ships in United States ports were, after what appeared to be a successful start, drastically curtailed by a series of U.S. Supreme Court rulings during the 1960s and early 1970s. Directing its "attention . . . to the well-established rule of international law that the law of the flag ordinarily governs the internal affairs of a ship," and absent a clear affirmative direction from Congress otherwise, the Court ruled that there was no basis for the exercise of National Labor Relations Board jurisdiction over FOC ships.\textsuperscript{86} It then ruled that since picketing of foreign flag ships by American seamen was not an act protected by U.S. labor legislation, state courts could enjoin such action.\textsuperscript{87} ITF actions against FOC ships in American ports were thereafter largely halted until the double bookkeeping controversy erupted in late 1989.

United States law, however, has provided special protection to aspects of seafarers' wages and working conditions almost from the inception of the Republic. The Seamen's Wage Act\textsuperscript{88} dates from 1790; it was amended in 1872, 1898, and 1915. Key sections of this legislation are as follows:\textsuperscript{89}

(a) A seaman's entitlement to wages and provisions begins when the seaman begins work or when specified in the agreement required by §10302 of this title (46 U.S.C. § 10302) for the seaman to begin work or be present on board, whichever is earlier.

(b) After the beginning of the voyage, a seaman is entitled to receive from the master, on demand, one-half of the balance of wages earned and unpaid at each port at which the vessel loads or delivers cargo during the voyage. A demand may not be made before the expiration of 5 days from the beginning of the voyage, not more than once in 5 days, and not more than once in the same port on the same entry. If a master does not comply with this subsection, the seaman is released from the agreement and is entitled to payment of all wages earned. Notwithstanding a release signed by the seaman under §10312 of this title, a court having jurisdiction may set aside for good cause

\textsuperscript{86} McCulloch v. Sociedad Nacional de Marineros de Honduras, 372 U.S. 10 (1963). This case and related ones are fully discussed in the \textit{ITF-FOC Book, supra} note 2, at 50.


\textsuperscript{88} 46 U.S.C. § 10313 (1988). We are indebted to Frederick W. Wentker, Jr., Lillick & Charles, San Francisco; Craig C. Murphy and Robert I. Sanders, Wood, Tatum, Wonacott, & Landis, Portland, OR, for assistance in analyzing this legislation and the related court decisions; to Richard J. Dodson, Dodson & Vidrine, Baton Rouge, LA, and to Charles F. Lozes and David B. Lawton, Terriberry, Carroll & Yancey, New Orleans, LA, for providing further information about the cases; and to the late Paul N. Wonacott and Kathleen A. McKeon, also of the Wood, Tatum firm for use of their summary of the statute.

\textsuperscript{89} Other sections of the Act that have been brought up in the course of the litigation include §§ 10314 and 10315, which prohibit or limit advances and allotments of wages. 46 U.S.C. §§ 10314, 10315 (1988).
shown, a release and take action that justice requires. This subsection does not apply to a fishing or whaling vessel or a yacht.

(f) At the end of a voyage, the master shall pay each seaman within 24 hours after the cargo has been discharged or within 4 days after the seaman is discharged, whichever is earlier. When a seaman is discharged and final payment of wages is delayed for the period permitted by this subsection, the seaman is entitled at the time of discharge to one-third of the wages due the seaman.

(g) When payment is not made as provided under subsection (f) . . . without sufficient cause, the master or owner shall pay to the seaman 2 days’ wages for each day payment is delayed.

(i) This section applies to a seaman on a foreign vessel when in a harbor of the United States. The courts are available to the seaman for the enforcement of this section.

The double bookkeeping cases involved whether this law could be interpreted in an expansive manner, and whether damages for fraud, emotional distress, and other alleged injuries could be obtained where double bookkeeping was found. Initially, all these questions were won by the plaintiffs, with resultant large damage awards. Despite an initial victory on the west coast, however, the results were quite modest in terms of financial awards. Nevertheless, settlements and litigation have probably ended double bookkeeping on ships that enter American ports.

B. THE EARLY CASES

According to Richard J. Dodson, the attorney who handled these cases for the plaintiff seamen,90 about ten cases against double bookkeeping were brought. The earliest involved a 1988 case brought against a Hong Kong ship, the _M/V Palvia_, registered in Liberia, arrested in New Orleans, and placed under a large pre-trial bond by the Parish of St. James Louisiana District Court. Settlement was achieved for $451,080, and then $263,494 more when the company did not abide by a seamen’s protective order in the settlement agreement.91

The 1989 case that first brought the perils of double bookkeeping in American ports to the maritime world’s attention involved the _M/V Fareast Trader_ in the port of Galveston, Texas. Like most of the cases, this was brought to Dodson’s attention by John Sansone, a member of the International Longshoremen’s Association (“ILA”), then an ITF inspector in the Gulf of Mexico area, who in turn was alerted by a port religious

---

90. Interview with Mr. Richard J. Dodson, in Baton Rouge, LA, (March 22, 1995).
91. Tomas C. Urdas v. Pauley Inc. and Eckoxa Co., Ltd., 23rd Judicial District Court, Parish of St. James, State of Louisiana (1988). The second case was adjudicated in Hong Kong: See also, Dodson interview, _supra_ note 89; and _Multi Million Dollar Damages for Crew Cheated of ITF Wages_, ITF News, Sept. 1990, at 7.
The shipowners, headquartered in Hong Kong with a Filipino crew, compounded their problems by dispatching agents who threatened the crew. Dodson had provided the crew with tape recorders, his usual practice, and this became part of the evidence. The background of double bookkeeping and ITF policies was apparently also unknown to the defense. The shipowners settled on a very lavish interpretation of the Wage Act, plus damages, for a total of $1,174,000.93

The ITF was ecstatic with this result. Since its loss of the secondary boycott cases in the courts in the 1960s and 1970s, it had been seeking a legal approach to attack FOC shipping in United States ports. Because the United States has the second largest beneficial ownership of FOC registry ships, the successful attack on double bookkeeping in the Fareast Trader case appeared to be an answer. The ITF News announced:

Historic Victory for FOC Campaign . . . . The ITF’s campaign against flag of convenience shipping has received a major boost with a record-breaking US court settlement of $1,174,000 for 24 crew members from the Panamanian flag Fareast Trader . . . . it also represents a significant breakthrough in the use of US law . . . . An entirely new legal front in the FOC campaign has now been successfully established. . . .94

A second large award was made in the Japanese-owned, Panama flag ship, Pioneer Leader, case in Jacksonville, Florida. The shipowner settled for $1,030,000 on wage claims of only $188,000. In all such cases, the ability of Dodson to obtain a huge protective order, such as $7,100,000 in the Pioneer Leader case, almost insured the result. Shipowners’ inability to raise bond money for such amounts literally forced them to settle on Dodson’s terms.95

C. THE WASHINGTON-OREGON TRILOGY

Four key cases were brought on double bookkeeping charges in west coast cases involving Japanese-owned ships; three with Filipino crews and one with a Korean crew reached the courts in the same general period, 1989-90. The first to be decided, and one of a trilogy that the Court of

92. Sansone is now coordinator of ITF North America inspectors, headquartered in the AFL-CIO building in Washington, D.C. Dodson received nearly all his double bookkeeping cases (and many others) via either Sansone or directly from a religious group.


Appeals, Ninth Circuit, combined into one decision, involved the Pine Forest, a Vanuatu flag ship, arrested in Tacoma, Washington. The owners tendered $267,586 as back wages under the ITF standard agreement to thirteen crew members who left the ship there, hoping to settle the case. The seafarers nevertheless sued.

The result was Dodson's greatest, but a short-lived victory. The U.S. District court, Western District, Washington, awarded the seafarers $32,657,536, plus attorneys' fees. This included the whole panoply of the Dodson charges: statutory penalties, loss of future income, emotional stress, and punitive damages, not only for those that left the ship in Seattle, but for eight discharged overseas as well.

When defendants sought to appeal and wished to stay execution, the Court set supersedeas bond at $59,000,000. The defendant appealed to the Ninth Circuit, which reversed as to the bond because the lower court erred when it failed to allow for payment of back wages which would stop the running of penalties, and remanded the case to the District court "for the limited purpose of setting a new bond." 96 The case was then appealed to the Ninth Circuit on its merits.

The second case involved the Southern Aster. All the seamen in this case were discharged overseas. The U.S. District Court, District of Oregon, dismissed the statutory claims on the grounds that seafarers discharged in foreign ports from foreign-owned and -flagged ships were not covered by the statute, and dismissed their tort claims on grounds of forum non conveniens. As a condition of the dismissal, the shipowners agreed to submit to the jurisdiction of a Korean court. 97

Rounding out this trilogy was the case involving the M/V Fir Grove, a sister ship to the Pine Forest, but arrested in Oregon, not Washington and, therefore, heard by the same court as was the Southern Aster, with results quite different from that reached by the Washington court. The shipowners paid back wages according to the ITF standard agreement, and the ship was released upon payment of a bond. Subsequently the seamen were discharged in Oregon.

In a series of decisions, the court granted summary judgment against plaintiffs' fraud claims; 98 applied conflict of law analysis to find Philippine law should apply to pendent tort claims; 99 and denied plaintiffs' demand for a jury trial. 100 In its final decision, this court held that the ITF standard wage rates were the shipowners' obligation because they were exe-

99. Id. at 1024.
cuted in the shipping articles, rather than the lower wages promised before the voyage. In arriving at its decision, the court ruled that worthless sea water carried as ballast was not "cargo" within the meaning of the Act, and that "end of voyage" as used in the Act was not each trip or port stop, but rather the voyage was completed when the seamen were discharged even though they had not completed their contractual obligations.

As in Southern Aster, this court concluded that foreign seamen discharged in a foreign port are not covered by the Act. It, therefore, denied the attempt of former seamen of the Fir Grove in this category to intervene in the case. It rejected the expansive reading of the Act that because the withholding of wages was part of an ongoing scheme during the entire course of the voyage, conduct integral to that scheme occurred in the United States, thus satisfying the Act's jurisdictional requirement.

This Court also rejected the seamen's attempt to invoke penalties for the Act's half-wages-upon-demand penalty clause because the seamen did not notify the ship's masters of their claims. Signing wage receipts as part of the double bookkeeping arrangements was not found to be a substitute for notification. The claims of substantial tort damages under various theories, fraud claims, and misrepresentations of wage schedules, and emotional distress were all dismissed as unproved. Blacklisting charges because the cause of discharge was written in the seamen's books were likewise denied. The Court did, however, award attorneys' fees for seamen discharged in the United States.101

On appeal, the consolidated opinion of the Ninth Circuit in these three cases was well-grounded in the origin of the disputes. After pointing out that each case required the resolution of whether the Wage Act's projections extend to foreign crews discharged from foreign ships in foreign ports, the Court stated:

Although Congress likely could have extended the Wage Act this far, we conclude that it did not. The structure, history and more important, the plain language of the Act all point to this result. Congress must speak clearly to overcome the strong presumption against extraterritorial application of United States law, and this it has not done.102

Then, after stating that the dispute over whether ITF or lower wages should apply, the court noted that it understood the underlying issue of the double bookkeeping disputes:

Underlying the men's claims is an ongoing dispute between shipowners and the International Transport Workers' Federation, an umbrella labor organi-

zation of affiliated seafarers' unions. The unions seek to maintain worldwide wage rates that far exceed what seafarers from underdeveloped countries demand.\textsuperscript{103}

After summarizing the history and issues involved in the three cases, the Ninth Circuit affirmed the dismissal of the Southern Aster case and the key points of Fir Grove, and reversed those of Pine Forest; the U.S. Supreme Court denied certiorari.

The Washington-Oregon trilogy would appear to have ended controversies about the meaning of the Wage Act and related claims. The Ninth Circuit's opinion determined that seafarers had the burden of proving that they were underpaid, but that the wage rates set forth in the shipping articles were the rates that must be paid; that the foreign seamen discharged in any American port were covered by the Act, but those discharged in foreign ports were not; that ballast is not cargo, and that a voyage was not just the leg of one trip, but rather included all trips until the seafarers were discharged; that the half wage provision requires an effective demand by seafarers to the ship's master of their claims; and that none of the evidence adduced supported awards for substantial tort damages, fraud, emotional distress, or blacklisting. Nevertheless, a key case in San Francisco that had been pending was also appealed to the Ninth Circuit.

D. The San Francisco Case

This case, involving the M/S Kiso, a general cargo vessel owned by a Liberian company which was controlled by a Japanese company utilizing a Filipino crew, was being litigated even before Fir Grove, and was the first litigation to place the double bookkeeping matter in the context of the ITF campaign against FOC shipping. In summary judgment, the District Court, Northern District of California, ruled against making the case a class action suit covering all victims of double bookkeeping or all seamen who served on the M/S Kiso or other vessels owned by the same company; then ruled that the ITF agreement contained in the ship's articles defined the employment relationship; that "end of voyage" is established at the final port of destination and was not determined by the discharge of cargo at intermediate points; that seamen discharged in foreign ports are not covered by the Act; and that claims for wages required a full hearing.\textsuperscript{104}

The plaintiffs then claimed that certain fringe benefits were not paid. These claims were dismissed.\textsuperscript{105} Following trial, the District Court ruled

\begin{flushleft}
\textsuperscript{103} Id.
\textsuperscript{105} Mateo v. M/S Kiso, 1993 A.M.C. 2278 (N.D. Cal. 1993).
\end{flushleft}
against the seafarers on the remaining in rem claims for unpaid wages and statutory penalty wages. The trial court agreed that wages due were in fact paid, including vacation pay, in a timely manner, or if not timely, were paid appropriately because any delays were attributable to the seamen’s failure to request payment.\textsuperscript{106} On appeal, the Ninth Circuit affirmed these decisions.\textsuperscript{107}

E. The Maldives Cases

These cases involving Cyprus-flag ships, manned largely by Maldivian seamen and Greek officers, and owned by Forum Maritime, a Greek company, were brought in local courts in Louisiana by Dodson in the fall of 1992, on behalf of some Maldivian seamen. These cases may not have been strictly double bookkeeping ones although there were similar claims at least initially.

The Maldivian plaintiffs were FOC seamen who claimed that they were not receiving the pay they were entitled to under their contracts because of double bookkeeping. There were also allegations of blacklisting of the seamen and anti-union activities by the authorities in the Maldives.\ldots\textsuperscript{108}

Testimony\ldots indicated Forum paid the money claimed, in part directly to the seamen, and in part through a crewing agency which then made the payments in the Maldives. This procedure was allegedly in conformance with the law of the Maldives. The crew allege[d] that not all the money reached the intended final payees and there were several months of delays in some instances\ldots

[Later]\ldots seamen filed\ldots suit in state court for alleged torts only, seeking damages for blacklisting, distress allegedly caused by coercion and intimidation, [but]\ldots not specifically\ldots wage claims. Forum\ldots removed the cases to federal court under the Foreign Sovereign Immunities Act.\textsuperscript{108}

Dodson brought five cases in state court, and was able to arrest the ships and have bonds set at very high amounts for allegations involving relatively small claims — $3 and $4 million in two cases involving claims in thousands, or even hundreds. When the cases were remanded to federal court, these bonds were reduced to $300,000 or less.\textsuperscript{109} With pressure thus materially reduced for the defendants, the five cases were

\begin{itemize}
\item \textsuperscript{106} Mateo v. M/S Kiso, 1993 U.S.D. Lexis 3004 (N.D. Cal., Mar. 1, 1993).
\item \textsuperscript{107} Mateo v. M/S Kiso, 41 F.3d 1283 (9th Cir. 1994). The seamen chose not to seek further review by the United States Supreme Court.
\item \textsuperscript{108} Wemker, supra note 39, at 431.
\item \textsuperscript{109} In response to an “invitation to assign reasons” from the Court of Appeals, Fifth Circuit, to which Dodson had appealed after the district court had materially reduced the amount of bonds, U.S. District Court Judge Peter Beer wrote:
\begin{quote}
I firmly believe that this U.S. District Court and others similarly situated are being subjected to an unwitting participation in attempts to manipulate exorbitant settlements of questionable wage claims by the serious and often incredibly expensive method of stopping a voyage and holding a vessel in arrest through the use of exorbi-
\end{quote}
\end{itemize}
settled for payments of $5,000 or less for approximately a dozen seamen, plus $293,000 attorney’s expenses for Dodson, which included maintaining ten Maldivian seamen in motels for over one year. These ships with Maldivian seamen have returned to the Port of New Orleans on voyages since then without interference.¹¹⁰

F. DOUBLE BOOKKEEPING — CONCLUDING COMMENT

The double bookkeeping cases were largely a blip, if a significant one, in the ITF’s attempt to enhance its power in American ports. Thanks largely to Dodson, with assistance from the ITF and the port church groups, it is most unlikely that shipowners or charterers will permit such practices to be utilized for ships which enter American ports. The cases discussed herein, however, have not provided a method whereby the ITF can circumvent the United States laws governing boycotts, and thereby attack FOC shipping. Moreover, except for calling attention to the methods and prevalence of double bookkeeping, these cases do not affect double bookkeeping in ports of other countries. It may well be that in ports outside of North America and probably certain European countries, double bookkeeping is as prevalent as it undoubtedly was before Dodson commenced his successful campaign to eliminate it in the United States.

V. DEVELOPMENTS IN EUROPEAN LITIGATION

As the ITF boycott campaign grew in strength, it was inevitable that in Europe with its many countries there would be not merely isolated legal proceedings, but continuous chains and groups of proceedings in different jurisdictions to clarify the boundaries between the conflicting interests which the law seeks to protect. On the one hand, there is the right of unions and workers to secure satisfactory working conditions, but on the other hand there is the right of shipowners to trade their vessels internationally without being detained by extra-legal action in countries which have no connection with the owner, the crew or the union. To the ITF, the countries where boycotts were permitted were oases of justice in a hostile exploitive world, and to the shipowner they were areas of un-

¹¹⁰ Tant and exaggerated claims of a nature in all respects identical to those which are put forward here.

There is, in my opinion, no reasonably demonstrated basis for these exorbitant claims. Indeed, the amount of the bond I set is more than responsive to that of the claim that common sense dictates is viable.


¹¹⁰ This summary of the Maldivian cases has been materially assisted by interviews with Attorney Dodson, Mar. 22, 1995, and with Charles F. Lozes and David B. Lawton, attorneys for Forum Maritime and the Maldives Islands government, New Orleans, Mar. 23, 1995.
warranted intervention and lawlessness which vessels entered at their peril.

A shipowner confronted for the first time with a boycott could reasonably expect a demand by the ITF for the vessel to change its flag from a flag of convenience back to its national flag. This is after all the declared policy of the ITF. However, there are no reported cases of any such demand ever having been made, although there have been situations where owners have changed the flag and sometimes the crew, and the ITF intervention has ceased. The question of whether such a demand would be lawful seems never to have been asked, let alone answered, but if it were, the answer might be that even the jurisdictions most favorable to the ITF, which would be prepared to tolerate a boycott to obtain ITF wages, would not tolerate a boycott to force a change of flag. While this may well be the answer, it is surprising that the point has never been tested, bearing in mind the comments concerning British labor law of Lord Diplock in the *Nawala* case.111

If a demand on an employer by the union is about terms and conditions of employment, the fact that it appears to the court to be unreasonable because compliance with it is so difficult as to be commercially impractical, or will bankrupt the employer or drive him out of business, does not prevent its being a dispute connected with terms and conditions of employment . . . . Even if the predominant object were to bring down the fabric of the present economic system by raising wages to unrealistic levels, or to drive Asian seamen from the seas except when they serve in ships beneficially owned by nationals of their own countries, this would not, in my view, make it any less a dispute connected with terms and conditions of employment and thus a trade dispute, if the actual demand that is resisted by the employer is as to the terms and conditions on which his workers are to be employed.112

It would seem that at least a respectable argument could have been made by the ITF that the flag of the vessel was one of the terms and conditions of employment, which it required to be changed, and thus the ITF would have been entitled to the protection given to trade unions acting in a trade dispute in the United Kingdom. Such an argument, however, which would have given the highest credibility to the ITF in its

---

111. NWL Ltd. v. Woods, NWL Ltd. v. Nelson and others, 1 W.L.R. 1294 (1980). This case in 1979 concerned a threatened boycott at an English port of a Hong Kong flag vessel with Chinese crew and suspected beneficial ownership not in Hong Kong. The crew was entirely satisfied with its terms and conditions and actually opposed the intervention of the ITF. The question in issue was whether in such a situation the unilateral action of the ITF justified the plea of trade union immunity. Lord Diplock made it clear that the law was widely framed, and that any demand about terms and conditions of employment, however unreasonable, would attract immunity. See, *ITF-FOC Book*, supra note 2, at 69, 85.

112. Id. at 8.
campaign, has never been mounted in any boycott proceedings in Europe or elsewhere.

Given that the ITF’s declared policy is to oppose all FOC vessels and yet not to insist on the return to national flag under threat of boycott, the only other way to enforce the policy is to make the rates of pay so punitive that the shipowner will sooner or later return to the national flag or be defeated in a competitive market by owners remaining with their national flags.

It was inevitable that shipowners faced with very substantial demands which would undermine their competitiveness would turn to their lawyers to see what redress was available. In common with most other situations where legal redress is sought, the choice was between stopping the hostile activity by injunction or treating it as duress and seeking to recover damages and/or restitution afterwards. The legal developments in Europe during the past twenty years have centered on these two major remedies.

A. THE ISSUES TO BE ADDRESSED

Before it could be stated with any certainty whether ITF or crew action in any jurisdiction was permitted, a number of major issues had to be resolved, all of which were unlikely to be encompassed in any one case:

Is the law equally effective to prevent a strike or boycott in advance as it is to enable recovery in restitution or damages afterwards?
Does the concept of economic duress exist in a trade dispute context?
Can a union effect a lawful boycott on its own without the authority of the crew?
Can there be a lawful boycott, which is secondary industrial action in support of a primary dispute, where the crew members are not themselves on strike?
Can the ITF or its local affiliate make lawful demands against a vessel where there is a valid foreign collective bargaining agreement with a bona fide foreign trade union?
Is it lawful for the ITF to demand payment to its own Welfare Fund as one of the terms for permitting the release of a vessel from boycott?
If a vessel is subject to boycott, should the legality of the boycott be decided by the law of that jurisdiction or by some other system of law, i.e., the law of the flag or the country where the crew was recruited?
Does a different system of law apply to a claim in restitution than to a claim in tort?

All the above issues had to be decided by test cases in different jurisdictions. Most of these points have now been resolved, with the result that shipowners, crew, and the ITF know where they stand on the legality of any primary or secondary action in any particular jurisdiction. There
remains, however, a diminishing group of cases on more exotic and rarified legal points, and also a number of developing cases in jurisdictions in which the law has been changed by statute where there is a need for further litigation to identify its new meaning. This has in particular occurred in the United Kingdom under the conservative Thatcher government between 1979 and 1990, which ended by making all secondary boycotts unlawful, and in Sweden by the Lex Britannia enacted by a socialist government which restored the ITF’s liberty to boycott even vessels covered by bona fide foreign collective bargaining agreements.

Although labor law can be substantially different in different jurisdictions because it is often more closely related to politics than commerce, there were nevertheless definite trends in the litigation between shipowners and the ITF in different jurisdictions. The Scandinavian countries mainly held out with a slant towards labor, but the balance tipped away from the ITF in the remainder of Europe. In particular, there was a trend toward decisions which outlawed ITF intervention where a secondary boycott was mounted although in fact no primary dispute between the shipowner and the crew existed. A number of other European countries still permit secondary boycotts in some circumstances where there is a clearly identified primary dispute.

B. INJUNCTION OR RESTITUTION?

Twenty years ago, the first reaction of an attorney consulted by a shipowner asking whether an injunction could be obtained to forbid a boycott would be to consider the matter according to his own local domestic law. The port was after all within his own country’s jurisdiction. The shipowner invariably felt dissatisfaction and stated that on board a ship the law of the flag should prevail, an argument which had appealed to the U.S. Supreme Court in its early rulings in the 1960s and early 1970s.113 From the point of view of United Kingdom law, and indeed civil law on the continent of Europe, this was not an argument which at that time appeared likely to prevail over the effect of the local domestic law as applied in its own jurisdiction, albeit against a visiting foreign vessel.

As shipowners found themselves advised by their lawyers that there was no redress to prevent a boycott because such boycott was permitted by the local law, the question was asked whether there was an alternative remedy of claiming damages and/or restitution for what had been paid, after the duress of the boycott had been lifted and the vessel had sailed from the port. This alternative remedy had the added advantage of not delaying the ship while the issue was being tested in Court.

113. See, ITF-FOC Book, supra note 2, at 50.
1. *Universe Sentinel*

The first case to test whether a restitutionary claim could succeed against the ITF was the English case of the *Universe Sentinel*.\(^{114}\)

At the time of the proceedings in the early 1980s in this case, the United Kingdom law of economic duress was in its infancy. However, this case, which reached the House of Lords (the U.K. Supreme Court), drew on dicta in earlier decisions and held that economic duress could indeed be relied on to avoid contracts entered into in a situation where resistance to the demands would have caused harsh economic loss. As a result, restitution of sums paid under duress could succeed. The judgment related only to the payment to the Welfare Fund because the shipowners conceded that in the light of the *Nawala* case, in which judgment was handed down during the currency of the *Universe Sentinel* proceedings, they could not claim back in restitution that which the ITF could not have been prevented from demanding under threat of boycott in the first place. The issue was whether the demand was connected with terms and conditions of employment. By three judges to two it was held that the Welfare Fund payment was not so connected and was therefore refundable.

Later in the 1980s the same issue was tried in the Norwegian Appeal Court in the case of the *Dorthe Oldendorff*\(^{115}\) with precisely the same result. Three judges held that the Welfare Fund was not adequately connected with terms and conditions of employment, and the minority of two judges stated the contrary.

The proper or applicable law of the agreement entered into as a result of the boycott of the *Universe Sentinel* at Milford Haven, Wales, was never considered and was not in issue, but possibly from the success of this case the point began to germinate throughout the 1980s, leading to the important decisions of the *Saudi Independence*\(^{116}\) in the Netherlands,

---

114. Universe Tankships Inc., of Monrovia v. Int'l Transport Workers Federation, and others. App. Cas. 366 (H.L. 1983). The *Universe Sentinel* flew the Liberian flag, but was beneficially owned in the United States and had a mixed crew, including Indonesians. The vessel was detained by ITF boycott at the Welsh port of Milford Haven, with the ITF demanding full ITF worldwide conditions. The detention of the vessel would have had serious economic consequences involving more than one ship, due to the conditions in a fleet mortgage. The owners felt that they had no choice but to pay, but were determined to claim the money back again. Therefore as soon as the vessel sailed after signing up on ITF terms and making the necessary payments, notice of avoidance of the agreements was given and a Writ issued for restitution of all the money paid including back pay.


followed by the *Evia Luck*\(^{117}\) in the United Kingdom, and the *Nervion*\(^{118}\) and the *JSS Britannia*\(^{119}\) in Sweden.

2. **Saudi Independence**

The case of the *Saudi Independence*, which went to the Dutch Supreme Court, was the first case in Europe to grapple with the conflict between domestic law pertaining to the legality of strikes and the chosen foreign law in a contract of employment. The *Saudi Independence* sailed under the flag of Saudi Arabia, and employed a Filipino crew under Filipino employment contracts, which were stated to be subject to the law of the Philippines. The crew had a number of grievances and sought the assistance of the ITF while the vessel was at a Dutch port. The ITF advised the crew to strike. The owners commenced proceedings against both the ITF and the crew, seeking an injunction restraining the strike.

The court accepted the argument that the question of whether the crew was permitted to strike should be decided in accordance with the law of the employment contracts. It was held that under Filipino law the strike was unlawful and therefore the injunction was granted. The decision was upheld both in the Dutch Court of Appeal and the Dutch Supreme Court.

The ITF argued that irrespective of whether the action of the crew should be decided in accordance with Filipino law, the legality of the action taken by the ITF should be decided under Dutch law where the act of promoting the strike occurred. The Dutch Supreme court, however, confirmed the Appeal Court decision, that even if Dutch law should apply to the ITF's conduct, such conduct would be unlawful under Dutch law because it was inducing a strike which was unlawful under the applicable foreign law, that of the Philippines.

3. **Evia Luck**

In the mid-1980s after the United Kingdom legislation to limit secondary industrial action, shipowners believed that they were more likely to be successful in litigation in the United Kingdom and conversely the ITF believed that it would be more successful in Scandinavia. In the result, for unexpected reasons, both were proved wrong.

The *Evia Luck* was subject to boycott in Sweden and the boycott was lifted in exchange for the owners signing up on ITF terms subject to pay-


\(^{119}\) *JSS Britannia* (AD 120/89), Swedish Labour Court, No. 120, 1988.
ing back to the ITF’s account in London and signing agreements which were stated to be subject to English law. The owners then took the novel step of suing the ITF in London (where its headquarters is located) rather than in Sweden where the boycott had occurred. The ITF responded, seeking a stay on grounds of forum non conveniens. Judge Hirst in the Commercial Court in London, however, ruled in February 1986, that the ITF’s application failed and that the case could continue in London.

The action proceeded as a claim for damages and restitution in the Commercial Court in London. The damages claim was ultimately abandoned, but the restitution claim was pursued to the House of Lords. The issue was straightforward. Both parties agreed that the claim was subject to the English law of restitution. The ITF, however, argued that the legitimacy of the duress applied should be tested in accordance with the domestic law of the place where the boycott happened, i.e., Sweden. The owners argued that given that the parties had made the agreements entered into under threat of boycott subject to English law, it should apply to all aspects of the claim, including the test of the legitimacy of the boycott.

At first instance the owners failed as the respected Commercial Judge Phillips, stated that he considered the owners’ case to be “ludicrous.” However, in the Court of Appeal, two judges out of three considered that the ITF, having chosen English law, could not complain at English law being applied to the whole situation, including the test of the legitimacy of duress. The ITF then appealed further to the House of Lords, where it again lost with four judges finding for the owners and one for the ITF.

The owners abandoned their claim for damages in tort under the English double actionability rule in Boys v. Chaplin,120 which says that to succeed in an English Court for a notionally tortious act committed abroad, it is necessary to show not only that the act in question is tortious under English law, but that the claim could also be actionable in the foreign country where the act was committed. During the proceedings it became quite clear that under Swedish domestic law, the boycott was lawful. Faced with this the owners abandoned their claim for damages.

Another interesting point which emerged was that although the claim would have failed under Swedish domestic law, had the case been brought in a Swedish Court, the Swedish Court would probably have applied English law as the applicable law and owners would therefore have won. This had become apparent from the Swedish case of the Nervion, which had by then been heard at first instance. Thus, although owners eventually won in the United Kingdom, it appears that they would have

won in any event in Sweden, to which country the ITF had unsuccessfully tried to have the case remitted! It is well established under English law that when considering foreign law, only the foreign domestic law is applied and not its private international law rules. Therefore, it was of no concern to the English Court that the claims would in fact have succeeded in Sweden under its private international law rules even though it would have failed under Swedish domestic law.

4. **Nervion**

In the early 1980s, shipowners feared to go to the Northern Scandinavian countries, Norway, Sweden, and Finland. The law appeared to be very heavily weighted in favor of unions and employees against employers. However, the labor movement received a sudden and unexpected shock by the decision in the *Nervion*.

The *Nervion* had been subject to boycott in a Swedish port and had been signed up on ITF terms. Owners did not, however, pay the crew in accordance with the ITF employment contracts and the crew, supported by the ITF, decided to pursue a claim for ITF wages. This it did not by industrial action, but by the simple expedient of making a maritime claim against the ship for outstanding wages. In order to obtain security for its claim by arresting the vessel, the crew had to sue in the Commercial Court rather than the Labor Court.

For the first time, the Swedish Commercial Court grappled with the question of what law should be applied to test the validity of contracts entered into as a result of industrial action. In the absence of any express stipulation, it ruled in favor of the law of the flag, which was Panama. In accordance with Panamanian law, such contracts were voidable by reason of duress, even though this would not have been the case under Swedish domestic law.

Owners, therefore, won their claim in restitution, and this was subsequently affirmed by the Swedish Supreme Court. It is interesting to contemplate what might have been the outcome had the case gone first to the Labor Court from which there is no appeal to the Swedish Supreme Court.

The cases of the *Evia Luck*, where the chosen system of law was followed, and the *Nervion*, where no system of law was chosen, left open the question of what should happen where the ITF insisted under threat of boycott on choosing a system of law favorable only to the ITF but not to the shipowner. Could such a “choice” of law be disregarded in favor of the system of law with which the contract would otherwise have been most closely connected? This interesting question started to be litigated in the unreported case of the *Annabella Two* in the Commercial Court in
London, but it was never taken to a conclusion, possibly because it would no longer have been a useful test case. This was because during the proceedings the English common law rules on the choice of “proper” law were superseded by the “applicable” law under the Rome Convention, as enacted in the United Kingdom by the Contracts (Applicable Law) Act 1990.

Article 8 of the Rome Convention says that the material validity of a contract should be decided in accordance with the law which would apply if the contract were valid. This does not leave scope to argue that such law should be ignored, although under Article 8, Rule 2, it could be argued that the question of consent should be decided in accordance with the law of the plaintiff's residence. Also, there is a provision under Article 16 that the Convention does not apply if it would be contrary to the public policy of the forum. These points remain to be argued in some future case in the United Kingdom or any other country which has adopted the Rome Convention.

Not surprisingly, after the *Evia Luck* and the *Nervion* decisions, the ITF inserted a specific Swedish choice of law clause into agreements entered into under boycott in Sweden. This tactic was unsuccessful in the Swedish Court in the case of *Phillips Arkansas* where the ship was subject to boycott at a Swedish port and the court affirmed that the agreements were effectively avoided under Liberian law, being the law of the flag. To date, however, the effectiveness of the choice of Swedish law has not been challenged in the United Kingdom courts, beyond the tentative proceedings in the *Annabella Two* case. Such proceedings in the English courts would have particular significance because there is always jurisdiction over the ITF in English courts as its headquarters is in London.

The ITF might have thought that it would have no further difficulties under Swedish law. This was not to be. It suffered an even greater shock from the *JSS Britannia* case.

5. JSS Britannia

The *JSS Britannia*, which was registered in Cyprus, called at Gothenburg and was subject to boycott by the Swedish Seafarers Union and the ITF, which unions requested an ITF agreement. The owners stood their ground, arguing that there was already a valid collective bargaining agreement ("CBA") with the crew's trade union in the Philippines. The court held that industrial action by a union against an employer who al-

---

121. The Rome Convention is the name given to the agreement by European Community members as to the law applicable to contractual obligations open for signature in Rome, June 19, 1980, which harmonized the private international law rules for member countries of the European Community, now the European Union.

ready had a subsisting CBA with a bona fide foreign union was unlawful. An injunction was therefore granted to restrain the boycott, and the vessel sailed without further intervention.

Shipowners’ joy at the success of the *JSS Britannia* case was short lived. The then Labor government of Sweden, as one of its last acts in office before losing power to a conservative Government, amended Swedish labor law in such a way that although intervention with a Swedish CBA would remain unlawful, it would be permitted where the CBA was with a foreign trade union. This amendment to the Swedish Co-determination Act is now colloquially known as the “Lex Britannia.” Although the incoming Conservative government had said that it would reverse Lex Britannia, it never did so before being replaced again by a Labor government. Thus, Lex Britannia remains the law, the effect of which was made clear in the *Estoril* case.\textsuperscript{123}

6. *Estoril*

The Lex Britannia came into force on July 1, 1991, and in January 1993 the French-owned Kerguelen flag *Estoril* was subject to boycott at the Swedish port of Wallhann. The Portuguese crew had a valid CBA under a union which was federated to the ITF. Nevertheless, the ITF caused the vessel to be subject to boycott in support of a demand for ITF wages. The matter was heard by the Swedish Labor Court which held that in view of the Lex Britannia the union intervention was not unlawful and that a request for an injunction should therefore be refused.

C. EUROPEAN LAW AND LEX BRITANNIA

At the time of the hearing of the *Estoril*, Sweden had not yet become a member of the European Union, and so the question was never put to the test as to whether the Lex Britannia is contrary to the terms of the Treaty of Rome\textsuperscript{124} and European Maritime Law.

Since the entry of Sweden to the European Union on January 1, 1995, however, numerous academic and practicing lawyers in Sweden and elsewhere have voiced the opinion that Lex Britannia is contrary to various provisions of Community law, in particular Article 6 on discrimination on grounds of nationality, Article 59 on the provision of services, and Article 65 which indicates that as long as restrictions exist, it must be done without distinction on grounds of nationality, echoing the funda-

\textsuperscript{123} *Estoril* (AD Interim Decision 28/93), Swedish Labor Court No. 28, 1993.

\textsuperscript{124} The Treaty of Rome is the name given to the treaty made in 1957 between the founding members of what became the European Union, and subsequent amendments and accessions thereto. It is essentially the constitution of the European Union, and is loosely referred to as meaning the entire body of European Law.
mental prohibition of discrimination based on nationality contained in Article 6. There is also possible violation of Article 61 of the Treaty in relation to the provision of maritime transport between member states. It thus would appear to be only a matter of time before the validity of Lex Britannia is challenged either in the Swedish Courts or in the European Court.

VI. Conclusion

In the balance of the world, ITF activities continue. Australia remains a key sector of ITF strength. Antitrust legislation, which once served as redress for shipowners, has been amended by the Labor government there, and new labor legislation does not appear to block ITF boycott pressures. The Waterside (longshore) Workers' union, a strong ITF supporter, and the long-time communist-led Seamen's Union have merged, adding to the ITF's control. Petroleum companies, which once defied the ITF in Australian ports, now either contract out their voyages to independent charterers holding a blue certificate, or send in their own tankers flying flags from a country flag ship which has the certificate. Whether some Asian or other flagged ships still engage in double bookkeeping to escape the ITF pressure in Australian ports, as they certainly did in the 1980s, is not known.

Japan has seen its once strong Seamen's union, for many years the only Japanese union that engaged in nationwide collective bargaining, decline in numbers and strength precipitously as Japan has become the third largest country of beneficial owners of FOC ships. As do the log carriers in the United States trade, many if not most of these ships continue to use Japanese officers with their Philippine or other Third World crews. There have been a few boycotts and resulting litigation in this country of peaceful labor relations, but generally the traditional quiet atmosphere prevails.

The uneasy relationship between the Asian underdeveloped countries and the ITF has been relatively calm in recent years, but tensions could rise in the future. Under David Cockroft's leadership, the ITF has been attempting to expand its Asian presence and to improve its relationships there. The Trust Fund is, as noted in this study, slated for a key role in this. On the other hand, the Asian countries have already been concerned about the 1995 increases in the ITF's unilaterally determined

---

126. See ITF-FOC Book, supra note 2, at 94; and Wentker, supra note 39, at 429, for background and update.
127. See ITF-FOC Book, supra note 2 at 96; and Wentker, supra note 39, at 428.
standard and TCC wage rates in part because of Eastern European country competition. This unease will surely be aggravated because the ITF's Fair Practice Committee at its June 1995 meeting announced that these rates will be raised 9 percent beginning January 1, 1998. The new rates will be set at $934 per month for the standard rate and $1,200 for the TCC one.\textsuperscript{128}

The ITF campaign against FOC shipping has ebbed and flowed in its intensity over the years. Now under Cockcroft, the campaign is being increased. A new blacklist which will target whole fleets and their owners, managers, and related manning agents is being effectuated. Apparently, the object is to induce boycotts against any ship with particular owners or managers regardless of conditions on the particular ship if the ITF finds conditions on the shipowners' fleet is general objectionable.\textsuperscript{129} How this will play out remains to be seen other than it appears certain to invite considerable litigation, most of which has not been going well for the ITF in recent years both in the United States and in Europe. The real question is whether the new blacklist policy will be used against operators of genuinely poor condition "rust buckets," or whether it will be a further attack on FOC shipping regardless of shipboard conditions.

The ITF has the advantage of fighting a campaign as a single body, with a single policy, and with almost unlimited funds to carry it out. Owners, on the other hand, are not united. Although there have been a few isolated occasions of cooperation by owners in providing funds for key litigations, such occasions have been rare. Shipowning organizations have always shown interest at the prospect of cases being successfully fought by FOC owners against the ITF, but when it comes to assisting in the funding of such cases, their interest has waned. Whether the incipient IMEC can alter this short-term outlook, remains to be seen. It is, however, a step toward improved defense for the shipowners.

The major cases to be determined in Europe relate to the conflict between Swedish law and the provisions of the Rome Convention on Applicable Law within the European Community, and the extent to which claims for restitution can be successful where the chosen system of law allegedly put there under duress can be attacked. Being headquartered in London, the ITF is always subject to the jurisdiction of English courts unless or until it removes its headquarters to another country. In restitution cases, the question of validity under the Rome Convention must also be considered in any new case.

In the United States, the law is quite clear. The boycott question was

\begin{itemize}
\item \textsuperscript{128} ITF Rates Increased, ITF News (Aug./Sept. 1995), at 10.
\item \textsuperscript{129} Id. See also, James Brewer, ITF Warns It May Widen Blacklisting, Lloyd's List, Jan. 3, 1995, at 4 (copy of ITF's blacklist statement on file with authors).
\end{itemize}
well settled in the 1960s and 1970s. The much more recent double bookkeeping cases have determined the reach of the statutes pertaining to this issue. A shipowner that in the future engages in double bookkeeping in United States ports is clearly and deservedly subject to substantial penalties.

As the ITF works hard to tighten its restrictions against FOC shipping, it increases its power vis-a-vis its affiliated unions in the developed world. These unions continue to weaken because of loss of membership and income. The ITF can do little, if anything, about the membership of affiliates in the developed world because there seems no hope that FOC shipping will be driven from the seas. The ITF’s failure to recognize second registers as a superior answer to flagging out for declining developed country registers seems guaranteed to enhance the number and percentage of FOC shipping in the world fleet regardless of what anti-FOC policies the ITF adopts.

The ITF can, and does, aid developed country seamen union finances. To do this, the ITF uses patronage e.g., the appointment of union officials as port inspectors; it promulgates rules that such unions, as well as the ITF, can “tax” FOC shipowners by what may well be questionable methods, such as now being done by the American unions; and it provides grants from the Trust or the Welfare Fund. The net effect is a further increased dependency on the part of the affiliates, and an increase in power to the growing ITF bureaucracy and its general secretary.

An interesting paradox inherent in the ITF campaign against FOC shipping was called to attention in the 1983 ITF-FOC Book:

Finally, the ITF is an organization that has vowed to eliminate all FOC ships from commerce. It has failed to do so, but has grown wealthy in the process. It now faces an interesting dilemma. In the unlikely event that it would succeed in its avowed purpose, the ITF would eliminate the source of its wealth.\textsuperscript{130}

To put the matter another way, the ITF needs to continue to lose its war against ITF shipping in order to maintain its income and its power. Moreover, maritime unions in many countries are increasingly dependent upon the ITF’s power and wealth, and probably could not survive without assistance through this income stream.

The expansion of FOC shipping since 1983 has, therefore, resulted in enhanced wealth for the ITF. The Cockcroft administration is utilizing this wealth to expand the ITF’s bureaucracy and activities to further an enlarged effort against FOC shipping. If history is any guide, FOC shipping will continue to increase its market share because developed country

\textsuperscript{130} See, ITF-FOC Book, supra note 2, at 151.
seamen and their unions have priced themselves out of most markets. Meanwhile, most shipowners are unlikely to join forces against the ITF tactics, but instead will acquire blue certificates as a cheaper alternative, (which it usually is in the short run). Consequently, the ITF will grow ever more wealthy as it continues its efforts against FOC shipping’s ever-increasing market share.
The Stagnation of Economic Regulation Under Public International Air Law: Examining Its Contribution to the Woeful State of the Airline Industry

Andras Vamos-Goldman*

TABLE OF CONTENTS

Introduction ......................................................... 426

I. The Issue of Access Under Public International Air Law  429
   A. The Chicago Convention ................................. 431
   B. The System of Bilateral Agreements ..................... 434
   C. The General Agreement on Trade in Services .......... 436
   D. Treaties of Friendship, Commerce and Navigation .... 438

II. The Legal Regime and Its Contribution to the Problems of the International Commercial Aviation Industry ............ 439
   A. The Importance of International Commercial Aviation ........................................... 439
   B. The Crisis in International Civil Aviation ............... 440
   C. The Contribution of International Law to this Problem ........................................ 443

III. Possible Solutions Under Consideration .................... 446
   A. Defining the Vested Interests and Their Needs ........ 446

* B.A. Dalhousie University, 1979; L.L.B. Dalhousie University School of Law, 1982; L.L.M. in International and Comparative Law, Georgetown University, 1995; First Secretary and Executive Assistant to the Ambassador, Canadian Embassy, Washington, D.C.
INTRODUCTION

Many of us take international commercial aviation for granted. In the industrialized world, we are accustomed to the convenience of flying to almost any destination in the world, virtually at a moment’s notice. If planned far enough in advance, many of us can even afford it from time to time. The ability to go almost anywhere, at anytime, and with a reasonable assurance of arriving there within twenty-four hours has literally become a vital tool of international trade. When the convenience of dispersing freight and mail around the globe with similar ease and dispatch is added to the equation, our reliance on international commercial aviation becomes even more apparent.

It is human nature to take note of a problem only when it is too late to take remedial action. It is high time for the international community to seriously consider the warning signals coming from the airline and aerospace industries and realize that not everything is right with their world.\(^1\) This is especially good advice today, because the recent momentum in international trade liberalization is built on the supposition that world markets will continue to expand.\(^2\) Without a fast, reliable and affordable system of global transportation, which only commercial aviation can provide, that growth is far from assured.

\(^1\) See Timothy K. Smith, Why Air Travel Doesn’t Work, FORTUNE, Apr. 3, 1995 at 42; see also Editorial Board, Five-Year Outlook, AV. Wk. & SPACE TECH., Mar. 13, 1995, at 42 (presenting the annual review by the magazine’s editorial board of the longer term prospects for aerospace/defence markets). (Several articles concentrate on the state of the commercial aircraft/air transport sectors).

\(^2\) The fact that exponential growth in international trade will be required to keep the consumption based economies of the western industrialized countries operating is evidenced by the proliferation of trade liberalization initiatives in the last two years e.g., the successful conclusion of the Uruguay Round of Trade Negotiations, the coming into force of the North America Free Trade Agreement, the decision to pursue a hemisphere-wide Free Trade Agreement of the Americas by the year 2005 at last year’s Miami Summit, and the similar decision by the leaders of the Asia Pacific Economic Cooperation countries for a free-trade zone in the Pacific-Rim by the year 2020.
This paper is not intended to be a solution to the economic woes of the airline industry. Its scope is limited to reviewing economic regulation of scheduled international aviation services under public international air law. While most of the factors affecting the health and prospects of this industry result from the unique economics of commercial aviation, there is a correlation between the regulation of international aviation services and the state of the industry. Decisions regarding who will fly where, how often, and for what kind of renumeration, form the most important legal issues affecting international air transportation. With this focus, this paper explores the extent to which the present system contributes to the industry's problems. It concludes with a discussion of current measures used to counteract over-regulation and suggests a modest, practicable approach which would build on the existing legal framework using recent advances in international trade law.

Economic regulation under public international air law primarily refers to the states' right to control access to the airspace over their territories by aircraft on commercial service. This is done through the allocation of international routes, capacity, tariffs, and related rights, such as servicing and marketing which are ancillary to viable commercial access. Due to the historically strict application of these rights, it has also come to include restrictions as to who can own and control airlines. The rules that have developed over the last half century are a veritable jungle of confusing, sometimes contradictory regional and bilateral agreements. It consists primarily of the Convention on International Civil Aviation (Chicago Convention); an almost incomprehensible web of over four

3. See Smith, supra note 1, at 45 (discussing how "empty core" theory in economics predicts that the airline industry, with high fixed costs, low marginal costs and a highly perishable product will never be able to settle down to a stable level of profitability); see also Paul Stephen Dempsey (hereinafter Dempsey), The Prospects For Survival and Growth in Commercial Aviation, 29 Annals Air & Space L., pt. II at 163 (1994) (analyzing airline economics in-depth). Mr. Dempsey is no less pessimistic than Mr. Smith, but he attributes the industries problems to the lack of proper regulation, rather than fundamental economic theory.

4. See Bin Cheng, The Law of International Air Transport (The London Institute of World Affairs 1962); see also Convention on International Civil Aviation, Dec. 7, 1944, 61 Stat. 1180-82, 15 U.N.T.S. 295-301 (Hereinafter Chicago Convention) (defining the legal basis for economic regulation under public international air law without the institutional provisions which establish the International Civil Aviation Organization in the combination of Articles 1, 5, 6 and 7).

5. See Jacques Naveau, International Air Transport in a Changing World, pt. III, ch.2 at 89 (1989) (showing how the unilateral granting of traffic rights by states is carried out in the bilateral system regulating access for international aviation services).

6. See Thomas D. Grant, Foreign Takeovers of United States Airlines: Free Trade Process, Problems, and Progress, 31 Harv. J. on Legis. 63 (1994) (reflecting the view of most authors in this area, that airline economics and the restrictions on access imposed by public international air law are forcing carriers into closer cooperative arrangements, where they run into domestic limitations on foreign ownership and control).

7. See supra note 4.
thousand bilateral aviation agreements; numerous Treaties of Friendship, Commerce and Navigation (FCN); and most recently, the General Agreement on Trade in Services (GATS).

To complicate matters further, there are now three distinct international bureaucracies on a global scale involved in economic regulation of international air travel: the International Civil Aviation Organization (ICAO); the International Air Transport Association (IATA); and most recently, the World Trade Organization (WTO) in its capacity as the GATS Secretariat. There are also several organizations of regional scope, not to mention the numerous trade and industry associations representing special interests most dependent on the airline industry. When states are added to this picture, not just as owners of the rights of access, but also frequently as owners of airlines, it is not surprising that a question arises as to the legal framework's culpability for the industry's economic state.

This paper consists of four Parts. Part I briefly reviews the historical development of public international air law. While the focus is on the regulation of access, the issues of national security, technological development and international relations are also considered as factors that

8. See infra Agreement to Amend the Air Transport Agreement, as amended, and the Protocol Relating to the U.S.-Neth. Air Transport Agreement of 1957, as amended, October 14, 1992, T.I.A.S. No. 11976 (exemplifying the complexity created by the thousands of bilateral air transport agreements in existence, all being on deposit with the Legal Department of the International Civil Aviation Organization (ICAO), in Montreal).


11. See supra note 4 (creating the International Civil Aviation Organization (ICAO) in Pt.II). While intended to promote international air navigation and foster the development of international air transport, ICAO has been described as having "wide quasi-legislative and executive powers in the technical and regulatory field, [but] only consultative and advisory functions in the economic sphere." See also Michael Milde, The Chicago Convention - After Forty Years, 9 Annals Air & Space L. 119, 122 (1984).

12. See supra note 5, Pt.II, ch.2 at 59 (describing the founding, objectives, functions, development and links to the Chicago Convention and ICAO of the International Air Transport Association). Through the system of bilateral air agreements, often involving governments which also own airlines, IATA has been drawn further into the regulatory web than is usual for industry associations which have the legal status of a private law cooperative association.


14. See supra note 5, Pt.II, ch.3 at 67 (listing and describing the most prominent regional organizations).

15. See World-Wide Air Transport Conference on International Air Transport Regulation: Present and Future, Montreal, 23 November - 6 December 1994, Report Folder, AT Conf/4-WP/95 (containing interventions by numerous industry associations; e.g. Airports Council International; International Federation of Airline Pilots' Associations; International Transport Workers' Federation).
have helped shape today’s picture. This holistic view highlights how far international law in this area lags behind the needs of today’s economic, technological, and national security realities. Part II evaluates the extent to which the international legal regime is responsible for the current woes suffered by the industry. This entails an overview of the economic state of the international aviation industry, highlighting the influence that the regulation of access under current public international air law has on this situation. Part III examines the needs of the various stake-holders, and the devices that international organizations, countries and airlines use to circumvent the shortcomings of the present legal regime. In Part IV, this paper suggests that the possibility of changing the current regime is not likely. It is more fruitful, therefore, to focus on how the diverging approaches can successfully cohabit. In doing so, this paper sketches the parameters of an international legal regime that would permit and encourage a greater level of economic activity, and that can accommodate states in various stages of economic development.

I. THE ISSUE OF ACCESS UNDER PUBLIC INTERNATIONAL AIR LAW

From a purely legal point of view, it is difficult to understand why air law did not follow the long-standing precedent provided by the law of the sea. After all, starting with Hugo Grotius, the purpose of the freedom of the seas was to facilitate commercial access between states.16 This basic right has been reinforced in numerous treaties of “Friendship, Commerce and Navigation” (FCN).17 Following the 1982 United Nations Convention on the Law of the Sea, this right is now also conventional international law.18

In order to understand why public international air law developed differently to be subjected to absolute state sovereignty, it is important to note the prevailing historical and political circumstances that influenced its definition. The first concentrated attempt at international codification dates back to 1910, when the nation-state was becoming the paramount force in international relations.19 The two successful attempts at codifica-
tion on a global scale occurred in 1919 and 1944.20

The one reason most often given for governments' close control over access to national airspace was to protect fledgling airline industries.21 Yet, what must immediately strike any reader about the 1919 and 1944 dates is that international aviation law was codified contemporaneously with the two greatest man-made catastrophes endured by humanity in this century. The devastation that military airplanes caused in these conflicts is a matter of record. It is no wonder that national security considerations played as great of a role as economic protectionism, in making absolute state sovereignty the basic legal premise of public international air law. Nor has it since been significantly unfettered by multilateral obligations.22 Partially for this reason, the laws governing the use of airspace have tended to develop distinctly from those of other forms of transportation.23 This leads to the question of whether aviation law should be regarded as sui generis, or also subject to laws governing other means of conveyance, or indeed other services.24

The answer is probably that some parts of public international air law, relating to the needs of safety, navigation and maintenance are so unique that the law has evolved to become sui generis by necessity. Other aspects, especially the purely commercial ones, are not distinct enough from other transportation services to be sui generis. Yet they have remained privileged only because they have been tied to the other aspects of international air transportation in international law.

International aviation law's economic components are, however, coming under increasing pressure to be subject to the same disciplines that govern other transportation services. This pressure is a result of changes in the original two reasons that shaped public international air law. First, commercial aviation is highly evolved, and has become so distinct from military aviation that national security reasons no longer justify strict economic control of airspace.25 Second, the trend in the world to-

---


21. This is consistent with both the protectionist trade practices of the day, and the Convention for the Unification of Certain Rules Relating to International Carriage by Air (Warsaw Convention), Oct. 12, 1929, ICAO Doc. 7838, 9201.

22. See Cheng, supra note 4 (containing numerous provisions on safety, maintenance, navigation etc., which states do have to adhere to under the Chicago Convention in respect to regulating their airspace). When it comes to economic regulation, perhaps the only limitation is found in Article 5, which gives non-scheduled flights the right of overflight and non-revenue stops without obtaining prior permission.

23. See Diedricks-Verschoor, supra note 19, at 3.

24. Id.

25. With the exception of claims such as made by the former Soviet Union that KAL007
Economic Regulation Under Public International Air Law

Day is toward more liberalized trade, and industries that have long enjoyed domestic protection are increasingly forced to compete in the marketplace. The following short review of economic regulation under public international air law shows how the law has failed to keep up with these trends.

A. The Chicago Convention

The Chicago Convention still constitutes the basis of public international air law today. In the arena of economic regulation, the document reflects the economic and political positions of the two leading delegations at the conference, the United States and the United Kingdom. The United States, envisioning a sizeable fleet of commercial aircraft at the end of World War II advocated complete freedom of competition. The United Kingdom on the other hand, with far-flung possessions but without a fleet to match that of the United States, wanted an international organization to apportion and manage international air routes, frequencies, and tariffs.

What emerged was a compromise. Beyond restating the absolute sovereignty principle in Article 1, there was no agreement on a multilateral granting of rights associated with access—the so-called freedoms of the air. These varied rights were developed mainly because of the tech-

was used for “spying,” there is a real separation today between military and civilian/commercial air traffic, which was not the case in either 1919 or 1944. This, coupled with technological advances in detection and monitoring, means that national security considerations need no longer dictate the necessity of economic regulation. Excluded from this consideration is general aviation traffic, which under Article 5 of the Chicago Convention has access, but which is increasingly responsible for threats such as the transportation of narcotic substances.

26. See supra note 10 (including, for the first time, the liberalization of trade in services and such long-protected items as textiles). The movement towards a more rules-based international trading system is also evidenced by the proliferation of regional trade initiatives, including more and more commodities and sectors.

27. There have been no amendments to this Convention, nor has it been superseded by any other agreement. The thousands of bilateral air agreements are based on the rights defined in the Chicago Convention.


29. See id. at 6.

30. See Cheng, supra note 4, at 9-17 (describing in detail the definitions of the freedoms of the air). These include:

First freedom: right of overflight;
Second freedom: right to make technical, non-revenue stop;
Third freedom: right to carry traffic from home state to granting state;
Fourth freedom: right to carry traffic from grantor state to home state;
Fifth freedom: right to carry traffic from the granting state to a third state (also known as beyond-right);
Sixth freedom: applies to the carriage of traffic between two foreign countries via the home state of the carrier. As such, it is really third and fourth freedoms, with different granting states, thus making its status as true right suspect;
nological limitations of the day. With aircraft of limited size, range and dependability, airlines needed to make frequent stops. Whenever possible, stops had to be justified on economic grounds. Thus, separate rights had to be negotiated for a variety of circumstances. They were included in separate agreements, of which only the first two rights, dealing with overflight and technical, non-revenue stops, received widespread, though by no means universal acceptance. Yet access to the true, commercial rights of delivering and picking up passengers, mail and freight were left to states to negotiate on a bilateral basis.

Three other aspects of this Convention, which negatively affect access by scheduled international carriers, should be mentioned. First, in continuing to maintain absolute state sovereignty over access, developing countries and commentators place considerable emphasis on a so-called underlying principle giving all states the right to participate in international air transportation on the basis of equality. In spite of its insubstantial founding in law, this “principle” continues to be used to support the need for state control over access as the only way to ensure that all states will have an equal opportunity to participate in international aviation.

Seventh freedom: right of a carrier operating entirely outside its home state to discharge or take on traffic for third state;
Eight freedom: right to carry traffic between two points within the territory of the grantor state (cubage).


33. See Chicago Convention on International Civil Aviation, Dec. 7, 1944, 61 Stat. 1180, 15 U.N.T.S. 295; this argument appears more to be founded in oft-repeated rhetoric, which in time takes on the appearance of legitimacy, than in legal fact. The preamble, which is traditionally used to support this view states: “international air transport services may be established on the basis of equality of opportunity, and operated soundly and economically.” Thus, the placement of this concept in the preamble makes it only a guiding, not mandatory principle. Furthermore, the language clearly gives economic interests the same weight as that afforded to equality of opportunity.

The only other place where this is found is in Article 44, which outlines the aims and objectives of ICAO. In particular, Article 44(f) states: “that every contracting State has a fair opportunity to operate international airlines.” This is not a guarantee either, only direction to ICAO to create “fair opportunity”. Furthermore, under subsections (d) and (e) respectively, ICAO is mandated to:

“Meet the needs of the world for . . . efficient and economical air transport.”
“Prevent economic waste caused by unreasonable competition.”

Again, the language gives economic considerations at least as much, if not more weight. Perhaps the only effect of this reference in Article 44(f) was to empower developing countries with a peg to hang their political hats on, and tied ICAO’s hand in being involved in economic regulation of civil air services in a meaningful way.

34. Supra note 15 (containing references to numerous documents submitted mainly by de-
1996] Economic Regulation Under Public International Air Law 433

Second, the restrictions on access apply primarily to scheduled traffic, however, there are very few restrictions on non-scheduled (mainly charter) flights. This aspect is partially responsible for the proliferation of charter service around the world. Finally, a system of flag state registration ensures that "flag of convenience" does not become the problem in international aviation that it has become in maritime law. Yet this provision presents another barrier to more liberal access because it restricts aircraft registered in one state to fly only those routes negotiated by its country of registration.

While it may appear that the Chicago Convention is singularly designed to make access to a country's airspace a convertible currency, it must be pointed out that this is just one part of the Convention. Yes, the compromise defining economic regulation has turned out to be ineffective because of its lack of balance. Complete state sovereignty over commercial access is not moderated by a basic set of trade rules. Only such a balance of rights and obligations could encourage multilateral cooperation to adapt to the inevitable changes arising from human development's increasing pace. Its lack is the source of our present dilemma: how can airlines adjust to today's vastly changed technical, economic, political and trade climate while encumbered by absolute state sovereignty? Yet the Chicago Convention continues to be a success in other areas essential to international aviation. Standards on safety, licensing, navigation and maintenance, just to name the most obvious, have helped make aviation the safest form of transportation in the world.

The Chicago Convention is also the source of the principal international organization involved in the ongoing development of public inter-

35. See Cheng, supra note 4, ch. 5 at 173 (outlining the differences between the Chicago Convention's treatment of non-scheduled international air service in Article 5, as opposed to the subjection scheduled service to absolute granting state authorization in Article 6).

36. ARNOLD KEAN, INTERCHANGE OF AIRCRAFT: ESSAYS IN AIR LAW, at 111 (1982) (outlining the obstacles found in the provisions of the Chicago Convention (see Articles 12, 17 and 30-32 inclusive) that prevent "flag of convenience" operations in commercial aviation). As airlines strive to cut costs and form close relationships with one another, they increasingly rely on each others' resources. While strict registration rules ensure a minimum uniformity in non-economic standards, they also make exchange of equipment difficult, denying airlines the opportunity to maximize resources.

37. See id. at 115 (describing how some national aviation authorities, e.g. those of the United Kingdom, have been able to facilitate the interchange of aircraft, on a limited basis, which are registered in one country but provide service in another).

38. See Air Travel Still Safest, Av. Wk. & SPACE TECH., Jan. 2, 1995 at 30 (depicting airline travel as being approximately 30 times safer than travelling by automobile). The number of people killed in the United States in aviation related accidents averages about 100 per year, while 19,000 are murdered, 36,000 die in automobile accidents and about 5,000 are killed in boating related mishaps.
national air law. ICAO's charter, found in Part II, outlines the organization's aims and objectives, and makes several, clear references to economic regulation.\textsuperscript{39} Yet, ICAO has been unsuccessful in this area, in contrast to its great success in the regulation of technical matters.\textsuperscript{40} This lack of success is partially due to the conflicting way in which the ICAO mandate is defined in Article 44. ICAO cannot promote every contracting state's desire to operate international airlines, and simultaneously promote a system of efficient and economical air transport.\textsuperscript{41} This dichotomy, along with the one-party, one-vote system, has made it possible for protectionist interests to effectively exclude ICAO from the economic regulation of international commercial aviation.

B. THE SYSTEM OF BILATERAL AGREEMENTS

There is nothing in the Chicago Convention that expressly establishes bilateral agreements as the way to determine the right of commercial air access from one country to another. The fact that bilateral agreements have become the vehicle for economic regulation under public international air law, is due to the unwillingness of countries to become parties to the International Air Transport Agreement (IATA). This agreement, which annexed to the Chicago Convention, envisioned a multilateral approach.\textsuperscript{42} The ultimate result is that countries, with absolute control over the right to grant access to scheduled airline service, are able to use these rights as commodities in negotiating bilateral deals with other countries. Those countries, not signatories to the International Air Services Transport Agreement (IASTA), are even using overflight and technical stop rights in this way.\textsuperscript{43}

As one can imagine, this huge number of bilateral agreements are widely varied in content. While in the first thirty years after the Chicago Convention, the so-called Bermuda I model (negotiated in 1946 between the United States and Great Britain) was widely used; the last twenty years have seen a proliferation in the scope and content of these agree-

\textsuperscript{39} See supra note 4, pt.II, ch. 7 to 23, arts. 44 to 66.
\textsuperscript{40} See Milde, supra note 11, at 122.
\textsuperscript{41} See Chicago Convention, supra note 33 (discussing the ICAO's conflicting mandate between providing a fair opportunity for parties to operate international airlines and meet the needs of economical air transport). Unlike some scholars who argue that ICAO's mandate in economic regulation is inadequate, this author believes that a close examination of Article 44 of the Chicago Convention shows a clear preponderance of economically oriented aims and objectives. The Organization's inability to play a role in the economic regulation of public international air law is more a result of absolute state discretion and control over the decision making in ICAO.
\textsuperscript{42} See IATA, supra note 32.
\textsuperscript{43} See IASTA, supra note 31.
ments. It is not possible to analyze the more than four thousand bilateral air agreements, nor is it necessary for the purposes of this study. It is, however, useful to review the evolution of their basic components. This will assist in the later assessment of possible multilateral approaches.

The three most basic building blocks of any air bilateral agreement are specific understandings on capacity, fares, and routes. These form the inter-related aspects of the exchange of access rights. Capacity reflects the volume of traffic borne by the designated carriers of each country. Under Bermuda I, each carrier was relatively free to determine its production on any given route, so long as the capacity bore a close relationship to public demand. Under Bermuda II in 1977, this freedom was curtailed and governments agreed to exchange the operating programmes of their airlines six months in advance of each season. Today, capacity clauses vary greatly, from restrictive Bermuda II models to wide-open provisions, such as the clauses under the U.S.-Netherlands "open-skies" type agreement.

Fares, or tariffs, determine the charges that can be levied on each route for each class of service. For the first thirty-plus years after the Chicago convention, these were broadly determined by airlines working within IATA, the industry association representing the vast majority of the world's scheduled airlines through its Tariff Conference. In the 1970s, airlines became reluctant to abide by the tariffs, due mainly to the increased competition of expanding charter operations and the mushrooming capacity from the introduction of wide-body aircraft.

These developments were contemporaneous with a growing concern in a soon-to-be-deregulated United States over the anti-trust implications

44. See e.g., Naveau, supra note 5 pt. I, ch. 2 (describing the Bermuda I Agreement); and pt. IV, ch. 5 (outlining the factors that led to Bermuda II and the proliferation in the nature of bilateral air agreements).
45. See Cheng, supra note 4, at 229 (describing the building blocks of bilateral air agreements).
46. See Naveau, supra note 5, at 37-40 (describing how the capacity clause worked under the Bermuda I Agreement).
47. See Naveau, supra note 5, at 137.
48. See Daniel C. Hedlund, Toward Open Skies: Liberalizing Trade in International Airline Services, Minn. J. of Global Trade, Summer 1994 at 259 (allowing such open capacity as to enable Northwest Airlines, under the USA-Netherlands "open-skies" Agreement, to put enough capacity on its flights to Amsterdam to carry the entire population of Holland during one summer season). It is interesting to compare the considerations in this, and the Bermuda I Agreement, as both are only limited by traffic demands.
49. See Naveau, supra note 5, at 59 (discussing the way in which IATA, through its Tariff Conference, played a significant regulatory role up to the late 1970's).
50. See Anthony L. Veloci Jr., U.S. Airline Profitability May be Short-Lived, Av. Wk. & Space Tech., Mar. 13, 1995, at 45 (including a historical description and chart of the various boom and bust cycles experienced by the airline industry; what caused them and how the airlines reacted).
of how international air fares were determined. IATA's control over setting international fares was broken, and tariffs are now determined in the bilateral agreements. Under some of the most liberal agreements, there is a "double-disapproval" process allowing the airlines to set fares, which can only be revised with the agreement of both states.

Routes, which are the points in each country which may be served by scheduled international air service, are typically included in annexes to bilateral air agreements. From the earliest days of bilateral, routes to the territory of a party and the rights beyond that point ("beyond-rights") have been the subject of specific negotiations. Only recently, with some bilateral agreements moving in the direction of the United States "open-skies" concept, has the issue of routes been left for the airlines to determine. Even in these cases, there is great divergence among the recent, more liberal agreements.

C. THE GENERAL AGREEMENT ON TRADE IN SERVICES (GATS)

It is instructive to contrast the system of bilateral agreements determining the rights of access for international air service with the most recent development in global trade liberalization in this area. The divergence between the two concepts reflects the fact that five decades of trade policy development lie between them. Bilateral air agreements, by their very nature, are preferential and regulate trade through quotas. These agreements harken back to the days before GATT and make no attempt to meet any of today's international trade standards. Yet, as discussed previously, when it comes to the granting of economic rights,

51. See Naveau, supra note 5, at 162 (describing how the United States' Civil Aeronautics Board (CAB), disbanded with deregulation, issued Order 76-6-78, directing IATA to "show-cause" why tariff arrangements agreed to at the Tariff Conference were in the "public interest" and thus should be "immunized from the application of anti-trust laws").

52. See Naveau, supra note 5, at 62; See also supra note 15 (containing several references to interventions by IATA in the proceedings of the Conference). The IATA continues to play several other crucial roles. For example, it has a clearing-house operation for settling accounts among airlines and it provides advocacy on behalf of international civil aviation with governments.


54. See Naveau, supra note 5, at 43.

55. Id.

56. See Naveau, supra note 5 (describing the provisions of the 1992 U.S.-Neth. bilateral air agreement on routes as allowing the airlines of each party access to "a point or points in the other country without limitation"). Contrast this with the recently signed Can.-U.S. agreement, which while also liberal, does contain limitations as to the routes in Canada that may be served by United states airlines, albeit the restrictions are temporary. There are also no beyond-rights in the latter agreement.


58. See William C. Yue, Trade in Services under GATS and NAFTA, Chair Ginger Lew,
the argument that public international air law is *sui generis* and, therefore entitled to its own set of rules, is under increasing doubt.

The most persuasive argument for holding international civil aviation to the same standard as other services is the inclusion of a General Agreement On Trade In Services (GATS) under the successfully completed Uruguay Round of trade negotiations.\(^5\)

Currently, air transport services are included only to the extent of so-called "soft-rights," such as maintenance, marketing and computer reservation systems.\(^6\) However, the fact that services are now part of a global trade agreement indicates that for the first time in history there are international legal standards pertaining to trade in services.\(^7\) If current trends continue in liberalizing more and more sectors, it is inevitable that pressure will mount also to include the so-called "hard-rights" (capacity, tariffs and routes) into GATS. In fact, GATS already contains two provisions that will speed up this process. First, exemptions to the application of GATS to "soft-rights" are strictly time limited. Second, future negotiations on expanding GATS are built into the agreement and are to begin not more than five years after its coming into force.\(^8\)

GATS is not without controversy. While an in-depth analysis is outside the purview of this paper, it is useful to examine how its major components would effect the issue of access in public international air law. GATS is divided into two parts: 1) general obligations and disciplines and 2) specific commitments. Notably, the former contains most-favoured-nation treatment (MFN); a transparency requirement; reasonable, objective and impartial domestic regulation; and inclusion of GATS under the World Trade Organization's (WTO) Dispute Settlement Understanding (DSU).\(^9\) The latter includes undertakings as to national

---

June 24, 1994, at 1 (outlining in detail the currently prevailing international trade standards in the services area, as evidenced by the most recent agreements: GATS and NAFTA).


6. *See* GATS, *supra* note 10, at 307 (containing the scope of application of GATS to air services in Article 1).

7. *See Yue,* *supra* note 58 (noting that while GATS has a limited application for international air services, in NAFTA air transport services are expressly covered in bilateral negotiations).

8. *See John Gunther,* *Multilateralism in International Air Transport - The Concept and the Quest,* 29 *Annals Air & Space Law,* 259, 270 (1994) (characterizing these provisions as the tools with which trade in this area will be liberalized, through the need for continuous and frequent negotiation). *Contra* Ruwantissa I.R. Abeyrante, *The Economic Relevance of the Chicago Convention - A Retrospective Study,* 29 *Annals Air & Space Law* 3, 27 (1994) (hereinafter Abeyrante) (citing the provision on periodic review as evidence of "lack of confidence" in GATS being able to regulate aviation services). It is only possible to fathom the latter author's comments if they are read in the context of the article, which advocates the continued governance of economic regulation of international aviation services by ICAO. It is not surprising to discover that the said author is a member of ICAO's secretariat.

treatment (NT) and market access in specific sectors. Unlike the general obligations, the latter would apply only in cases where specific commitments are negotiated between countries.64

While GATS will be revisited in part IV of this paper, it is apparent that there are a number of reasons why current bilateral air agreements are not compatible with either the general or specific obligations of GATS. In the broadest sense, as GATS is eventually intended to apply to all services, the widest possible disparity exists between the completely protected international civil aviation services and most other services.65 This point is important because keeping up with the development of international law is one of the arguments that will be cited in this paper as an incentive for countries to depart from the present legal regime.

The issue of MFN, as it relates to trade in services, developed a separate controversy of its own, with potential to affect aviation services. One school of thought argues that MFN is an inappropriate mechanism to liberalize trade in services.66 Designed for trade in goods, where it helped master a system of tariffs, it is feared that the imposition of MFN for services will deprive countries of the best tool to gain market access, that is, the threat of withholding market access on a bilateral basis.67 A greater concern, however, for the liberalization of all aviation services is that “hard-rights” are not yet included in GATS, and the MFN obligation will undoubtedly make many countries wary of extending their most liberal bilateral air arrangements to all comers.

D. Treaties of Friendship, Commerce and Navigation (FCN)

There is yet another element in the patchwork of public international air law regulating economic access. For many countries, the backbone of their commercial relations with one another is the FCN Treaty. The standard United States FCN Treaty, in Article VII, provides national treatment to both parties' commercial activities of any sort carried out within the territory of the other party.68 While the right to limit the extent of this provision to, inter alia, air transport is expressly provided, the same Article just as expressly accords MFN treatment to nationals of the other party “in any event.”69

64. See Yue, supra note 58.
65. See Yue, supra note 58, at 198 (leading to yet another strong argument for the future inclusion of “hard” aviation rights in GATS, since in an inclusive agreement with exceptions it is always easier to remove the exception than to extend the scope of the agreement).
66. See Warren L. Dean and Constantine G. Papavizas, Veering Off Course, LEGAL TIMES, Mar. 20, 1995, 6, 10 (reflecting an argument that is widely heard among practitioners of trade law).
67. Id.
68. See supra note 9, art. VII at 12, art. XIX at 36.
69. Id. The provisions of FCN Treaties often contrast to those of Treaties Concerning the
There appears to be a contradiction between these provisions of the FCN Treaties in force with numerous countries, and the provisions of bilateral air agreements with the same countries, which provide access on a preferential basis. It would be interesting to see what would happen if a country with which the United States had an FCN treaty, but which only had very restrictive bilateral air agreements of its own, sought more liberal air access to the United States based on its FCN Treaty’s MFN obligation. Its offer to give the United States MFN treatment would, in this scenario, not be very appealing. Would the United States have a choice?  

II. THE LEGAL REGIME AND ITS CONTRIBUTION TO THE PROBLEMS OF THE INTERNATIONAL COMMERCIAL AVIATION INDUSTRY

Does the lack of an up-to-date international regime for economic regulation of international aviation services contribute to the difficulties of the industry? Before looking at this question, it is useful to answer two others: first, why does it matter; and second, what is the state of the industry?

A. THE IMPORTANCE OF INTERNATIONAL COMMERCIAL AVIATION

As alluded to in the introduction, without the maintenance of a fast, reliable and affordable system of global transportation, it will be impossible to sustain the expansion of international commerce. At the geopolitical level, it is this continued expansion upon which the future peace and prosperity of mankind is staked. Yet, the strength of neo-isolationist and protectionist forces, even in the most liberal economies, are never far from the surface. At the very height of the present upsurge in global trade liberalization, it took just one key developing country to fall victim to a financial crisis and have both financial markets and law-makers around the world running to retrench. The long term benefits of the Uruguay Round and the NAFTA were enthusiastically opposed by so

Encouragement and Reciprocal Protection of Investment (BITs). In the latter, aviation services are expressly excluded from MFN treatment, leading to the question of whether FCNs aren’t an anomaly.

70. Interview with Julie Oettinger, U.S. Department of State, Legal Advisor’s Office, (Mar. 1995). The United States could always rely on the fact that bilateral aviation agreements are more specific, and probably later in time than FCNs.

71. The negative reaction of a large minority of United States lawmakers to the United States becoming parties to the NAFTA and Uruguay Round Trade Agreements is a prime example. Others include the position of many European Union countries on agriculture, and that of Japan of eliminating its numerous non-tariff barriers. In fact, protectionism is still the most prevalent characteristic of international trade.

72. One needs only to recall the Congressional reaction to the attempts by the Clinton Administration to assemble a financial assistance package for Mexico.
many for the sake of short term protection and political credit. This clearly underlines the fragility of continued trade expansion.\textsuperscript{73}

If Mexico’s financial difficulties can affect world markets to such an extent, then a crisis in the international commercial aviation industry, with its tremendous impact on global economic development, would be far more devastating and long-lasting. To give just one example, though arguably the biggest, airlines are essential components of the world’s largest industry: tour and travel.\textsuperscript{74} Accounting for more than 12.9\% of global consumer spending, 7.2\% of worldwide capital investment, generating more than $3.5 trillion of combined Gross National Product (GNP), and employing over 127 million people (one out of every fifteen workers), this industry is almost completely dependant on the veins and arteries provided by commercial aviation.\textsuperscript{75}

Commercial aviation is also a fairly substantial industry in its own right. In the United States alone, it directly and indirectly employs twenty-one million people, and accounts for $750 billion of economic production yearly.\textsuperscript{76} If this industry were a country, it would account for about 4\% of the world’s economic output, making it the seventh largest economic power, just ahead of Canada.\textsuperscript{77} Therefore, its financial health has broader implications than just the service it provides to other economic enterprises, or indeed to continued trade expansion. In the case of Mexico, a financial crisis in the civil aviation industry would have global repercussions, but multiplied many-fold.

B. The Crisis in International Civil Aviation

If one looks only at the numbers, a crisis in commercial aviation may not appear to be that far away. The economic performance of the world’s airlines, especially over the last two decades, can only be described as abysmal. This industry has never been highly profitable at any time in its history.\textsuperscript{78} From 1977 to 1992, the global air transport industry

\textsuperscript{73} It should not be forgotten that up to the very day of the vote in the House of Representatives, there was no certainty that the NAFTA bill would pass. Nor the image of Ross Perot with his “great sucking sound” resonating throughout the U.S. political landscape. Or indeed, that the tirades in the Senate, that the WTO will mean a loss of U.S. sovereignty almost scuttled the Uruguay Round legislation. The truth is, that the commitment to trade liberalization in Congress, with a very few exceptions, is only as strong as the parochial interests of the individual lawmaker, and his or her prospects for reelection.

\textsuperscript{74} See Dempsey, supra note 3, at 163.

\textsuperscript{75} Id.

\textsuperscript{76} Id.

\textsuperscript{77} Id.

\textsuperscript{78} Id. at 165 (citing 2.8\% as the best profit margin United States airlines achieved, and that was from 1955-77). It is estimated that the world’s airlines need operating margins of 4\% to service their debt, and at least 6\% in order to generate enough profit to pay for fleet moderniza-

earned a net profit of 0.6% of revenue, on gross revenues of over $2 trillion.\textsuperscript{79} Over the first four years of this decade, losses ranged from $6.7 billion in 1991, to an expected loss of around $1.5 billion for 1994.\textsuperscript{80} These less than stellar statistics were achieved in spite of the fact that passenger traffic traditionally has grown at about 2.25 times the rate of Gross Domestic Product (GDP) growth.\textsuperscript{81} It is argued that the 1990 Gulf War, with the resulting increase in fuel prices and contemporaneous global economic recession, caused this recent downturn. While probably true since at least the United State’s industry has made a modest comeback in 1995, this still does not fully explain how international civil aviation can lose more money in a four year period than it made in all of its history and continue to survive unscathed.\textsuperscript{82}

That is not even the whole story. Airlines today carry enormous debt burdens. The U.S. industry’s debt alone in 1994 was in excess of $35 billion, which represents more than eight times the industry’s total accumulated profit from the inception of commercial aviation.\textsuperscript{83} At the same time, its capital needs are astronomical. Although the world’s airlines spent $147 billion in the 1980s on capital assets, their projected requirements to the year 2000 are around $815 billion.\textsuperscript{84} This does not include infrastructure spending for upgraded airport facilities.\textsuperscript{85}

While it is not within the purview of this paper to delve into the pure economic reasons for this woeful state of affairs, some fundamentals must be discussed. The airline industry is capital, labor and fuel intensive. It is exposed to severe business risks due to high fixed costs, the cyclicality of demand, and intense competition.\textsuperscript{86} It is acutely sensitive to the slightest political disturbance affecting international affairs. Its product is an extremely perishable seat or space in the cargo hold which disappears the moment the plane leaves the gate. Because of all this, and the requirements of the various legal regimes it must conform to, the airline industry prices its product in a schizophrenic fashion by attempting to fill to capac-

\textsuperscript{79} Id. at 164.  
\textsuperscript{80} Id. (noting that United States airlines alone have a cumulative net loss of $7.7 billion since deregulation of the U.S. domestic industry in 1978). In 1994, the U.S. industry made a profit for the first time since 1989. It was approximately $200 million, but this came about only because the industry was exempted for two years from the 4.3 cent fuel tax included in the 1993 budget.  
\textsuperscript{81} Id. at 168.  
\textsuperscript{82} Id. at 165.  
\textsuperscript{83} Id. at 164.  
\textsuperscript{84} Id.  
\textsuperscript{85} Id. (citing ICAO forecasts that “the world will require between $250 and $350 billion in new airport infrastructure spending by the year 2010”).  
\textsuperscript{86} Supra Dempsey, note 3, at 165.
ity, undercut competition and charge as much as possible, all at the same time. If an airline is further burdened by government involvement, then it must also conform to the needs of non-business goals, such as “showing the flag” or “full employment.” The net result is that for most airlines, average annual load factors even at the best of times never quite reach 70%, while 90% of passengers can end up paying only 30% of the full fare. 87

These challenges have to be overcome by airlines, a majority of which have to cope with balance sheets burdened with the enormous debt discussed earlier. For most United States airlines, debt-to-capital ratios already exceed 65%. 88 Yet with Stage-3 noise regulations looming in 1999 and 2000 for airlines flying to the USA and to Europe respectively, and with increasingly aging fleets, airlines are faced with the necessity to replace, re-engine or at least hush-kit large numbers of aircraft. 89 The capital for this will have to come from a combination of banks, leasing companies, aircraft and engine manufacturers; and in the cases of airlines with government equity participation, the taxpayer.

There is little question that this capital will be made available and in most cases further deteriorate the financial positions of airlines. This is partially due to the already large commitment made by suppliers of capital and the vested interest that lessors, airframe and propulsion manufacturers have in fuelling demand for their products. In addition, in many countries, the national airline, like a large bank, is considered too big and important to fail. This is not the case in the United States, where there is sufficient depth in the industry for carriers to fail without leaving gaps in service. Others would quickly pick up the pieces, especially the more lucrative international routes. 90 Virtually everywhere else however, there is just one airline, often a national carrier, engaged in international service.

Most governments up to now have not allowed such airlines to fail. In the historically reinforced belief that money will eventually come from somewhere, these airlines have continued to push the envelope of financial instability. 91 Yet there are trends that point toward an end to the “soft-life.” These include: the already discussed relentless drive toward trade liberalization; the widespread realization by more and more gov-

87. Id. at 165, 170.
88. Id. at 171. See also Anthony L. Velocci, supra note 50 at 45. (noting that airlines have one of the most damaged balance-sheet structures in the U.S. economy). Another commentator describes airline debt issues as junk bonds only because there is no lower category.
89. See Velocci, supra note 50, at 46.
90. Witness, for example, the scramble over Pan American’s North Atlantic routes, or Eastern’s Latin American and Caribbean routes. Their demise has not lessened service to these areas.
91. See Velocci, supra note 50, at 45.
Governments that they are reaching the limit of taxation acceptable to their populations; and the fact that governments must face their debt burdens and the need to free up revenue for this purpose through expenditure reduction. It is only a matter of time before government backing of commercial aviation succumbs to these trends, forcing hereto dependent airlines to face fiscal realities on their own.

C. The Contribution of International Law to this Problem

Whether airlines’ economic performance is affected by the way access is regulated today under public international air law depends on the extent to which this legal regime contains the necessary elements required to create an economically favourable regulatory environment. These basic elements include: elasticity (giving commerce some scope of action, but not to the extent where it damages either the industry or the consumer); predictability (enabling realistic planning as regulation is based on standard, transparent rules); and flexibility (having the ability to change the rules if they prove to be unworkable or become outdated). The current system of bilateral, based on absolute national sovereignty with little recognition of trade practices that have become the norm in other industries, does not fit this bill.

As discussed earlier, this is mainly because the Chicago Convention followed its absolutist predecessors and failed to strike a balance between the protectionist and security concerns of the day and the needs of international commerce and communication. In fact, the system of bilateral air agreements that have developed can be criticized as being the worst of all worlds: neither providing a predictable regulatory framework or possessing the elasticity and flexibility of the open market. Only with the conclusion of the Uruguay Round and the coming of GATS, has the door to the multilateral economic regulation of international aviation services been pushed ajar. Yet, with GATS only applicable to “soft-rights,” with an exemption available to parties, and with the vital obligations of national treatment and right of establishment not being generally binding, this development cannot be considered more than a toe-hold.92

The international community’s realization that the legal framework governing economic access was inadequate to meet the needs of the marketplace dates back to the 1960s.93 By that time, a number of factors had

---

92. See Abeyratne, supra note 62, at 27 (down playing the effects of GATS on the regulation of international commercial air services at the present time). The argument is valid, as far as it goes, but shows a lack of imagination, or perhaps faith in the inevitable progress of international law. Soft-rights refers to: aircraft repair and maintenance; the selling and marketing of air transport services; and computer reservation system services.

93. supra Naveau, note 5, pt. IV, ch. 3, at 116 (describing the emergence of disruptive factors in international commercial aviation, starting in the early 1960s).
emerged which put the Chicago structure into question. These included: technological developments like the coming of the jet age; the resulting excess in capacity and the consequent growth of charter operations (themselves caused, inter alia, by the strict regulation of scheduled traffic) which led to reduced fares and profits; the multiplication of scheduled airlines as former colonies gained independence and exercised their "right" of equal participation in international commercial aviation; and the numerous changes in the world economy. In fact, the industry has gone through a series of seven boom-bust cycles between 1960 and the present, with some or all of the above factors contributing to these wild fluctuations.

There have also been attempts by the international community to address the situation. Going back as far as the mid-1970s, ICAO began what has become a series of World-Wide Air Transport Conferences, designed to resolve the various crises multilaterally, with perhaps even a hope of improving upon the Chicago regime. The world, however, had become accustomed to the bilateral system. With the exception of the Carter administration, which experimented with the deregulation of the domestic airline industry, until recently few others have been interested in reform.

Because of the ongoing debate in the United States since deregulation, there is a vast array of literature available on how and to what extent air transport services ought to be regulated. Apart from the respective merits of more or less regulation, there does not appear to be a dispute on what benefits each system offers. More regulation lessens the chances of destructive competition, and provides a degree of certainty about the rules. In an industry which is prone to indiscriminate competition and where fleet planning is at least a two-to-five year proposition, these are vital requirements. Less regulation opened up the United States domestic market, reduced many fares and increased some services. It did not, however, do away with the evils of overcapacity and destructive competition, which eventually reduced the number of airlines serving

94. Id. at 117.
95. See Veloci, supra note 50, at 45.
96. P.P.C. Haanappel, Multilateralism and Economic Bloc Forming in International Air Transport, 29 Annals Air & Space L., pt. 1, 279, 302-05 (describing ICAOs efforts at reforming the legal regime).
97. Adam L. Schless, Open Skies: Loosening the Protectionist Grip of International Civil Aviation, 8 Emory Int'l L. Rev. 435, 443 (1994) (outlining the role of the United States in efforts to liberalize the international legal regime governing aviation services).
98. Supra Dempsey, note 3, at 209-11 (comparing the effects of the previously regulated U.S. environment with the post-deregulation situation).
the market to far fewer than during the preceding period of regulation.\textsuperscript{100}

Taken in these terms, the current international regime of individual, highly detailed, bilateral agreements can only be described as one of the strictest regulations. Yet, because these agreements do not adhere to any international trade rules, they lack the benefits regulation usually offers, having neither a defined structure nor real predictability.\textsuperscript{101} At the same time, as rigid as this system of bilateral is, it has not stopped destructive competition in some of the most lucrative markets.\textsuperscript{102} Thus, it resembles a less regulated system without the elasticity of the free market\textsuperscript{103} appears to be the worst of all worlds.

Not only does the present bilateral system fail to provide the benefits of either regulation or deregulation, but it is difficult to see how it can be improved in its current form. It is, for example, impossible to apply the trade liberalizing provisions of GATS to a system of bilateral agreements. Each bilateral, after all, is a preferential trade agreement with restrictions and quotas that would make any trade policy expert cringe. Nor has it proven possible thus far to change this system within the Chicago Convention framework. While most believe that formal amendment of the convention would probably not be necessary, there continues to be an unwillingness on the part of the international community for change.\textsuperscript{104} ICAO has called four international conferences since 1975, all without tangible results.\textsuperscript{105} For now, it appears that too many states have too great an interest in the present system to concede that the time for change has arrived.

Thus, there is, in addition to the lack of predictability and elasticity in the present international legal regime, a lack of flexibility in adapting to changes when the need arises. Yet, the need has certainly arisen, as the

\begin{enumerate}
\item[100.] Supra Dempsey, note 3, at 209-10 (highlighting the negative impact of deregulation on the domestic aviation industry).
\item[101.] The sheer numbers of bilateral air agreements add to the uncertainty. Any number of these agreements are under negotiation at any given time. It is also costly to monitor government regulators at home and every other country.
\item[102.] See Naveau, supra note 5, at 125 (showing how the cost of an airline ticket linking North America and Europe dropped from over 200 hours of work in 1957 to around 40 hours in 1978, even before the deep discount fares were introduced. At the same time, airline profits fell from 10% to 2%).
\item[103.] To further complicate matters, bilateral air agreements are negotiated by governments which often have an equity interest in their national airline. As in any negotiation, the result is usually a compromise, and ends up restricting the various rights of access. Thus, in most cases, bilateral air agreements are not elastic enough for the industry to benefit from the freedom of an open market.
\item[104.] Cf. Werner Guldinman, The Chicago Convention Revisited: Possible Improvements After 50 Years, 29 Annals Air & Space L. 347, 349 (describing how the difficulty of amending the Chicago Convention hampers legal regulation, rather than fostering it).
\item[105.] Supra Velocci, note 50, at 45.
\end{enumerate}
state of the international commercial aviation industry demonstrates. What is not certain, however, is how much the industry itself realizes this need. The rhetoric that comes from even the most liberal, market oriented airlines continues to demand the kind of protection that only bilateral agreements can provide, regarding their markets at home and abroad.

III. Possible Solutions Under Consideration

What do the various vested interests, especially the airlines, want? Is it possible to meet these requirements? If so, can they be met under a system of bilateral air agreements? If not, is there a way of adapting the present legal regime to make it elastic, predictable and flexible enough to help the industry, while keeping the changes within the boundaries of what is politically possible?

A. Defining The Vested Interests And Their Needs

A basic list of direct vested interests involved in international aviation consists of ten players. These are:

1. Consumer (both business/leisure travellers and industry which relies on air cargo).
2. Travel, tourism and related leisure industries.
3. Independent airlines in scheduled international service.
4. Government owned or controlled airlines.
5. Governments not involved in airline ownership.
6. Governments with equity participation in airlines.
7. Commercial aircraft, engine, avionics and other subcontract manufacturers.
8. Aircraft leasing and financial institutions.
9. Airport communities with or with possible international service.
10. International civil aviation and trade bureaucracies.

Suppose each vested interest is presented with the information in the previous section, and then asked what constitutes their bottom-line interests in international commercial aviation. A common-sense analysis of their requirements would likely indicate the following:

The consumer is primarily interested in low fares and secondarily in frequency and convenience (including comfort) of service. Primarily the business traveller also looks for incentives by way of bonuses, such as frequent-flyer miles. The travel, tourism and related industries' main interest is to get as many people travelling and thus using their facilities as much as possible, which also means affordable fares with convenient and frequent service.

Independent airlines are, however, schizophrenic. They want maximum freedom to set routes, tariffs, capacity and associated services. At
the same time, they insist on the protection of regulatory benefits, especially (but not exclusively) from foreign government owned or controlled airlines.

The interests of government owned or controlled airlines are more closely tied to broad governmental policies. These include concerns other than commercial aviation, such as job creation and domestic production. Functioning in a less market-oriented environment, they rely much more on the protection of regulation to gain favourable access.

Governments with a commitment to liberalizing aviation services want to see the industry run primarily by market forces, based on predictable trade rules. Yet, even these governments recognize the need for some involvement to prevent destructive competition or to “level the playing field,” especially when dealing with subsidized competition.

Governments with equity interests in airlines have a dilemma: do they work for the benefit of the airline or the body politic? A coherent policy is almost impossible, because these two interests do not often coincide. A prime example of this dilemma is the choice between liberalizing a route to gain frequency and lower price at the risk of subjecting the national carrier to competition from more efficient airlines.

Manufacturers are primarily interested in selling more of their products. Market conditions that maximize public demand for aviation services without destructive competition offer the best such climate.

Lessor and financial institutions are concerned about the state of indebtedness of the industry. While especially the former benefit from a situation where airlines do not have quite enough capital or credit to purchase aircraft outright, both are likely to prefer more predictability and profitability than presently exists in this industry.

Airport communities are after increased service, sometimes offering incentives to get it. Only those centres which are already congested would seek extra benefits from apportioning access.

The various international bureaucracies, by their very nature are interested in gathering or keeping or gathering as much of the economic regulation of international aviation under their auspices as possible.

While the above synopsis is not based on empirical study, the author believes that it is a common-sense analysis of the primary needs of the principal stake-holders in the international air transport industry. It reveals that only countries with equity interest in their national carriers and their airlines stand to benefit from the present, tightly controlled system of bilateral agreements. By contrast, almost all other participants would stand to gain from the greater flexibility offered by trade liberalization tempered by adherence to the evolving norms of international trade law.
At the same time, none of the stake-holders would benefit from a totally deregulated environment, even if such a thing were possible. It would appear, therefore, that some regulation is necessary and would be insisted to prevent destructive competition, while ensuring as level a playing field as possible. Such a system would also create a more predictable environment. This would permit longer-term planning by airlines, enabling them better to match resources to the needs of the market and thus lowering their costs. Benefits would flow to the other vested interests through increased demand caused by lower fares, more predictable service and steadier demand for equipment.

Yet any radical, near-term change is unlikely. While many solid reasons for this pessimism will be explored in the following pages, the foremost is the control of the international decision-making apparatus by governments with national airlines and which owe their continued survival to the present bilateral system. In spite of this, there are efforts that continue to circumvent the present regime’s shortcomings at all levels, and just as many suggestions on how a more workable system could evolve.

B. The Multilateral Institutions

In spite of the partial application of GATS to aviation services, the multilateral institution which still claims sovereignty over the economic regulation of international commercial aviation is ICAO. As noted earlier, since the mid-1970s, ICAO attempted four times to spark interest among the international community to undertake a review of this system, but to no avail. The most recent and most serious of these attempts was the 1994 World-Wide Air Transport Conference on International Air Transport Regulation: Present and Future. Thus, this effort is most useful to focus on. Preparation for this conference began in 1992 with a Colloquium and the establishment of a Group of Experts on Future Regulatory Arrangements (GEFRA) which was to prepare a report for the ICAO Secretariat on possible regulatory changes. These preparatory efforts were doomed from the outset because the inquiry’s terms of reference were limited only to parameters that could be broadly accepted by the ICAO membership. Thus, changes in the regulatory structure were

---

107. See Vijay Poonoosamy, Developing Countries in the Wake of Aeropolitical Changes, 29 ANNALS AIR & SPACE L., pt. II, 589, 598 (1994) (providing that the mandate of GEFRA was to “examine future regulatory arrangements for international air transport”).
108. See id. at 599-600 (outlining the topics of GEFRA’s focus, within its mandate as:
(1) the objectives states would have to agree to new arrangements;
(2) the equitable delineation of market access;
(3) broadened criteria for airline use of such access;
explored only to the extent that they remained compatible with the notions of absolute state sovereignty, equitable delineation of market access, and the requirement of formal designation of national carriers.\footnote{109}

The various Working Papers prepared by the ICAO Secretariat, based on the GEFRA study for the 1994 Conference were, nevertheless, innovative. The suggestions for new regulatory arrangements were premised on the main objectives of “participation,” or meaningful involvement on a reliable and sustained basis, and “adaptation” or compatibility with a dynamic world environment.\footnote{110} There were also three lesser objectives of “enhancement” of quantity and quality of service; “simplification” of regulatory arrangements; and “flexibility” to meet changing requirements.\footnote{111} A package of interrelated new regulatory arrangements were introduced, predicated on mutual, unrestricted basic market access and progressive liberalization through foreign investment in national air carriers.\footnote{112} A safety-net was also suggested in case of unforeseen contingencies, somewhat akin to the emergency measures available under GATT.\footnote{113}

Some of these modest and sensible proposals are worth examining in greater detail even if their inability to garner the support of the international community underlines the control that current vested interests possess. Unrestricted market access was limited only to service touching the

\footnote{4. the safeguards required to ensure fair competition;}
\footnote{5. potential impediments, such as subsidies and physical (not legal) constraints on access;}
\footnote{6. relationship with broader regulatory environment;}
\footnote{7. the treatment of “soft-rights”};

\footnote{109. See id. at 600 (listing the assumptions within which GEFRA had to work as: (1) regulation would continue within the framework of the Chicago Convention, which would not need to be amended to accommodate the proposed new regulatory arrangements; (2) basic objectives for entering into new arrangements have to be broadly shared among states; (3) states are to continue to exercise sovereignty over airspace and access to transport market; (4) states are to continue to enter into agreements with each other to exchange market access; (5) each party to an air agreement is to continue to designate carrier(s) to use the market access; (6) access is to be granted, with denial possible only for agreed upon reasons.)}

\footnote{110. See id. at 603-04.}

\footnote{111. See id. at 601. It is interesting to note the contradictory nature of these objectives. “Participation” and “adaptation” may be mutually exclusive, when international air services are viewed in a broad, dynamic world environment. For example, the participation of some carriers and countries in international air transport may clash with modern trade law principles.}

\footnote{112. See World-Wide Transport Conference, supra note 15 (containing a summary of the Secretariat’s suggestions, as well as the responses of states, interested organizations and the outcome of discussions).}

\footnote{113. Id. (referring to Agenda Item 2.2.3.2).}
territories of both parties, with the remaining freedoms continuing as options for bilateral negotiations.\textsuperscript{114} The safety net was made available for "rapid and significant" decline in one party's market share, and like in GATT, would be available for only a finite period and renewable only once.\textsuperscript{115} The system contemplated several ways in which market access could be liberalized progressively. These included individual bilateral air agreements, starting with separate functional blocks such as cargo or non-scheduled services through the reduction or elimination of restrictions on foreign ownership of national carriers, or through a right of establishment.\textsuperscript{116} While there were no concrete proposals for how either of the latter two would work, there was a very useful expansion of what could constitute a "designated carrier" eligible to access another's market.\textsuperscript{117}

In this author's opinion, a vital component of any future system of economic regulation is a mechanism to ensure that destructive competition does not negate the advantages of liberalization. The ICAO Conference Working Papers contained a proposal for a "Code of Conduct," obliging parties to refrain from destructive practices involving prices, capacity dumping, predation, discrimination, high pricing or capacity insufficiency.\textsuperscript{118} There were also proposals concerning competition laws and subsidies. Regarding the former, the mere suggestion by the Secretariat for "appropriate safeguards" was met with a call by most participants for continued exemption or immunization from national anti-competition laws for multilateral airline activities, especially tariff coordination.\textsuperscript{119} Concerning the latter, the proposals to take "transparent and effective" measures so that state aids or subsidies do not adversely impact on competition were met by arguments from many states that these were required for "meaningful participation in the international air transport system."\textsuperscript{120}

\textsuperscript{114} Id. (referring to Agenda Item 2.2.3.1).
\textsuperscript{115} Id. (referring to Agenda Item 2.2.3.2).
\textsuperscript{116} Id. (referring to Agenda Item 2.2.3.3).
\textsuperscript{117} Id. (referring to Agenda Item 2.3.3.1). This included not just those carriers that are owned or controlled by nationals of the designating state, but also those with their headquarters or principal place of business located in that state.
\textsuperscript{118} Id. (referring to Agenda Item 2.2.4.1). The usefulness of "Codes of Conduct" have often been debated. While the question of enforceability is very valid, in the present circumstance, with the level of opposition to almost any change, such a device would be a good first step.
\textsuperscript{119} Id. (referring to Agenda Item 2.6.3.1). In the discussion, some states also raised the problem that greater liberalization would lead to increased use of competition laws in an attempt to ensure fairness. Because of the international nature of the subject matter, this would lead to the extraterritorial application of such laws, with the resultant conflict and controversy among states. Thus, competition policy has to be developed in step with any regulatory changes in the current regime, in order to minimize the negative effects of possible overreaction, while still allowing states to ensure a competitive environment.
\textsuperscript{120} Id. (referring to Agenda Item 2.5.3.2).
Despite the tentative, mostly non-binding nature of most of these proposals, no concrete agreement emerged from this Conference. In fact, the countries and interests supporting changes to the existing system were in the minority. The group of developing countries, those European states with considerable government involvement in their airlines, and surprisingly even Japan consistently backed the status quo.\footnote{Id. (containing summaries of interventions from participating countries and organizations). Each Agenda Item is also accompanied by a summary of the discussion, indicating the flow of opinions.} While a great deal of expectation preceded the conference, it appears that there was insufficient realization of the potential magnitude of the problem facing the industry to generate the political will required for multilateral action at ICAO.

Still, there is hope on the multilateral front. For the last fifty years ICAO has been the sole multilateral guardian of all air transport services. On January 1, 1995, it was joined by a potential rival in the form of GATS. As discussed earlier, GATS only applies to the “soft-rights” of air transport. Nevertheless, there has been considerable speculation as to the potential for applying even these basic trade policy rules to aviation services’ “hard-rights.” It was impossible for this issue not to surface at the 1994 ICAO Conference, as some believe that GATS could serve as a multilateral alternative to the current regulatory arrangement.\footnote{Id. (referring to Agenda Item 2.6 Trade Agreements and Arrangements). For example, IATA noted that GATS could be extended.} However, this suggestion was not raised seriously. Instead, lip-service was paid to cooperation between the two agencies at the Conference, and in the final text, ICAO was urged to exert leadership in the area of economic regulation.\footnote{Id. (referring to Agenda Item 2.6). The discussion reveals some concern that ICAO was not exerting an “active and effective role in developing future regulatory arrangements in the economic area.” It was also realized that there would be increasing pressure to include more air transport services in GATS.}

The irony is that ICAO was trying to do just that at the 1994 Conference, but ran into the brick wall of multilateral decision-making. This was not lost on potential reformers and there were questions whether economic regulation of international aviation services is not better housed with GATS.\footnote{Id. (including Secretariat Working Paper WP/13 at Agenda Item 2.6.16).} Yet this is not the only hurdle that would have to be overcome, if ICAO was to relinquish sole control of economic regulation. For example, GATS, a multilateral agreement, would have to apply to the entirety of aviation services. According to Article 6 of the Chicago Convention, however, the permission of the grantor state is required for aviation services to be operated in that state. Thus, GATS could only be made applicable if the bilateral system were abandoned in favor of a mul-
C. THE REGIONAL OPTION

Multilateralism means general international participation while plurilateralism contains the added notion of countries joining with various degrees of commitment. Both theories have been suggested as alternatives to the current system of air bilateral agreements. A plurilateral agreement is considered more possible, as it offers participation without taking on full obligations at the outset by every party. It provides for a period of adjustment. Yet in looking at the future of the regulatory process, the ICAO Conference found that there is too great a disparity in economic and competitive situations for any form of global, multilateral agreement at the present time.\textsuperscript{125} It was somewhat more optimistic on the prospects of liberalized agreements on regional and sub-regional basis.\textsuperscript{126}

There is a longstanding philosophical debate among practitioners and academics working in the field of international law on whether regionalism is a useful step on the road to accomplish global agreement. Some argue that the formation of blocks leads to the continuation of bilateralism only between bigger players. This potential problem seems to have been mostly avoided up to now in the area of international trade, primarily because global and regional agreements have been progressing relatively contemporaneously.\textsuperscript{127} Yet in spite of the speculation in relation to international aviation, there seems to be little regulatory cooperation in the industry on a regional basis.\textsuperscript{128}

The one outstanding exception to this is the European Union (E.U.).

\textsuperscript{125} Id. (referring to Agenda Item 3.4.1(b) on Future Regulatory Process and Structure).

\textsuperscript{126} Id. at 3.4.1(c)

\textsuperscript{127} This is a reference to the continuing development of the GATT structure through the various "Rounds", while trade liberalization was also progressing regionally in Europe, North America, and planned expansion in both the Americas and the Pacific Rim.

\textsuperscript{128} There are the exceptions that prove the rule. The European Union (E.U.), with its customs union, is now entering an era of regional cooperation, as will be demonstrated. Historically, there have been a few regional alliances which have tried to combine to strengthen the effectiveness of their international aviation services. Of those still in existence, Scandinavian Airlines Systems (SAS) and Air Afrique are the most well known. The reason that there are, and have been so few such alliances, is because in addition to overcoming their domestic hurdles, the Chicago Convention is also an obstacle. While Article 77 expressly permits joint operations, these have to performed in conformity with all the other rules in the Convention. This same article permits cooperation among airlines, which will also be looked at in this paper. But these must be distinguished from a group of countries providing economic access to one another other than on a bilateral basis. Only the E.U. fits that format. Even NAFTA specifically excludes aviation services.
although to even count it seems somewhat unfair since it holds a unique and distinct advantage due to its status as a customs union. Originally, air and sea transport, (unlike road and rail which were without significant external implications to Europe) were not explicitly placed under Commission competence.\footnote{See supra note 48, at 287.} Yet, since the 1970s, the European Community (now Union) Commission (the “Commission”), and the Council of Ministers (the “Council”) have been looking at liberalizing this industry without success.\footnote{See Jeffrey Platt, \textit{European Community Cabotage}, 22 Transp. L. J. 61, 70 (1994).} A step towards liberalization occurred when the European Court of Justice, in the \textit{Nouvelles Frontieres} decision\footnote{Cases 209-213/84, Ministere Public v. Lucas Asjes, 32 E.C.R. 1425, 3 C.M.L.R. 173 (1986).}, recognized that the anti-competitive behaviour of European airlines can be policed by the Commission, not under competence over aviation, but under competition rules.\footnote{Id. at 288.} The Council finally exercised jurisdiction in the aviation field by adopting a liberalization package in 1987, and a second in 1990, which relaxed regulation on market access, capacity sharing, and fares.\footnote{Id. at 290.}

It was the third such package in 1993 which established a framework for an internal market. It included: freedom of establishment, allowing nationals of member states to establish and own up to 49% of airlines in other member states; removed capacity restrictions; and created traffic rights for all E.U. airlines on substantially all E.U. routes.\footnote{See supra note 48, at 288.} Further, by 1997, the 49% limit will be removed and E.U. airlines will be permitted to engage in cabotage—the right to fly a domestic route in another E.U. country.\footnote{Id. at 289.} There are also plans to extend these policies to the European Free Trade Association (EFTA).\footnote{Id. at 290.}

The E.U. has not stopped there. The 1994 report of the \textit{Comite des Sages}, or “Wise Men” to the Commission on the future of air transport in Europe, also addressed the deeper issues of nationality, subsidies and external aviation policy.\footnote{See Report by the Comite des Sages for Air Transport to the European Commission, \textit{Expanding Horizons}, on file with the Delegation of the European Commission, Washington, D.C. \textcopyright 1994.} While being critical of the European airline industry for still being “oriented towards outdated national boundaries,” it
also recognized a long-argued uniqueness associated with commercial aviation which requires national pride to be considered along with economic rationality. The "Wise Men" reluctantly gave in to a "last time, one time" injection of state aid for heavily indebted, inefficient European carriers, and called for a Community approach to external aviation by 1995.

These last two points are especially important. First, the unprofitability of most European airlines are due to factors associated with government control. More money alone will not make these airlines profitable without the structural efficiency needed to take advantage of the new opportunities offered by liberalized commercial aviation in Europe. Second, the question of whether external aviation policy falls under Community competence is still before the European Court of Justice.

In spite of this, there is a real fight brewing between the Commission and the Council caused by the policy of the United States to offer liberal bilateral agreements to the smaller E.U. and EFTA countries, thus hoping to "divide and conquer" the bigger ones. This second point emphasizes that externally even Europe, the one example of regional cooperation, has not taken on the vestiges of a regional entity.

D. INITIATIVES BY STATES

There are a few initiatives at the national level to liberalize the present system. They come from countries that have either deregulated their domestic airline industries or from those that are moving away from government equity ownership and control. These countries were in the minority at the 1994 ICAO Conference in pushing for regulatory reform and were not able to achieve change at the multilateral level. Some of their initiatives vis-a-vis one another have, however, led to useful innovation on a bilateral level.

The United States has been a pioneer in this area. Being mostly

D.C. (containing a full range of recommendations for achieving a Single Aviation Market in the E.U.).

138. See id. at 5.
139. See id. at 21. It is interesting to note that since the "one time - last time" recommendation, some European airlines have received government "bailouts". These include Air France, Olympic, and Iberia. Even more interestingly, some of these, like Iberia, are already back again, for yet more assistance. Air France have not yet asked again, but will eventually have to.
140. See supra note 130, at 63.
141. See Hedlund, supra note 48, at 292. While this is covered later in the paper, it is noteworthy that the United States had, at one time, wanted to negotiate a "bilateral" air agreement with the E.U., hoping that the progressive voices of the U.K. and the Netherlands will soften the resistance of the more protectionist countries like France, Spain, Italy and even Germany. The fact that the United States has changed tactics, and is choosing to "divide and conquer," even when the Commission is now, belatedly, arguing for a unified external air policy suggests that the protectionists continue to be in the driver's seat in the E.U.
alone in the pursuit of a more liberal international regime, its attitude has been important because it is the largest, most important, aviation market in the world.\textsuperscript{142} The United States had deregulated its domestic airline industry in 1978 with mixed results. While generally lowering fares and increasing service in some sectors, deregulation has also caused cutthroat competition, a gradual concentration in the industry, and ended, reduced or diminished service to many smaller destinations.\textsuperscript{143} Even a consolidation of service through the "hub-and-spoke" system has failed to make most U.S. airlines profitable on domestic service.\textsuperscript{144} It is probably fair to say that the U.S. example has contributed somewhat to the reluctance with which other countries view complete deregulation of their domestic air services. It has also not helped sell this U.S.-style deregulation for international aviation services. Yet, with what appears to be a single-minded initiative of trade liberalization pursued by most of the Administrations over the last two decades, the United States has become a virtual \textit{Don Quixote} in its attempts at improving access to international markets.\textsuperscript{145} Unlike Cervantes' hero, the United States has lately "made some windmills yield."

It must be pointed out that the various U.S. airlines were only behind the government to the extent of their immediate, individual interests. For example, in any initiative, be it expanded access or an opportunity for foreign investment in the U.S. industry, the airlines variously supported or opposed the initiative depending on their individual bottom lines.\textsuperscript{146} This has significantly contributed to the lacklustre result that almost two decades of work and the lure of greater access to the U.S. market has been able to produce.

The United States first began to work towards more "open" bilateral agreements by prohibiting government intervention on fares, except by mutual agreement.\textsuperscript{147} The first such agreement was the Protocol Relating

\textsuperscript{142} See \textit{The World of Civil Aviation 1993-1996}, International Civil Aviation Organization, Circular 250-AT/102 (containing statistical data on global aviation services).

\textsuperscript{143} See Dempsey, \textit{supra} note 3, at 209.

\textsuperscript{144} Id. at 174.


\textsuperscript{146} There are a myriad of examples of excessively heavy legal and political pressure exerted on the Administrations by airlines in protection of their interests on specific issues, without much regard to any consistency with positions take on previous occasions. As mentioned earlier, a number of airlines opposed the KLM-Northwest, British Airways-USAir deals, while in bilateral air negotiations airlines with privileged positions do not want to liberalize access. One good example is the United States-Japan bilateral, where neither Northwest nor United, with lucrative beyond-rights, has any interest in allowing other players to have a piece of the pie.

\textsuperscript{147} See Hedlund, \textit{supra} note 48, at 269. In more recent agreements, such as with Canada, the system employed is known as "double-disapproval," with airlines being free to set their own fares unless both parties agreed to object.
to the United States-Netherlands Air Transport Agreement of 1978.\textsuperscript{148} \textit{Inter alia}, it contained: almost unrestricted capacity (except that it had to bear a close relationship to the needs of the public); fares were to be set by the airlines with government intervention limited to the prevention of predatory or discriminatory practices; and protection of the airlines from monopoly power and unfair competition due to government support. This arrangement was further liberalized by the United States-Netherlands Open Skies Agreement of 1992 by giving the right to each party to designate as many airlines as it wished to unlimited route rights; allowing no restrictions on destinations, capacity or frequency; and granting liberal side arrangements including dispute settlement.\textsuperscript{149}

This was the first of a slowly growing number of bilateral air agreements predicated on the United States' concept of "open skies."\textsuperscript{150} The Netherlands agreement to liberalize aviation services along the U.S. model was a strong factor in the U.S. Government's agreement to allow KLM to hold 49\% of Northwest Airlines' equity (though not voting rights), in spite of the standard 25\% rule.\textsuperscript{151} This flexibility was not because any U.S. airline had any interest in the Dutch domestic market, or that extraordinary beyond-rights possibilities existed. Rather, it was because the United States wanted to encourage other bilateral partners to liberalize international access.\textsuperscript{152} While perhaps not to the same extent, the United States has since negotiated a few other liberal bilateral agreements. It is pursuing similar agreements with a number of small Euro-

\textsuperscript{148} Id.
\textsuperscript{149} Id. at 270.
\textsuperscript{150} See U.S. \textit{International Aviation Policy Statement}, November 1, 1994, U.S. Department of Transportation, Docket 49844 (containing United States' concept of "open skies"). Although "open skies" has been subject to several interpretations, and has gone through some modifications, the basic elements remain intact. These include:
(1) open entry on all routes;
(2) unrestricted capacity and frequency on all routes;
(3) unrestricted route and traffic rights (including no restrictions on intermediate and beyond points, change of gauge, routing flexibility, coterminality and fifth freedom traffic);
(4) double disapproval pricing in Third and Fourth Freedom markets;
(5) liberal charter arrangements;
(6) liberal cargo regime;
(7) conversion and remittance arrangements;
(8) open code-sharing opportunities;
(9) self-handling provisions;
(10) procompetitive provisions on commercial opportunities (e.g. intermodal rights);
(11) non-discriminatory operation of and access to computer reservation systems.
\textsuperscript{151} See Hedlund, supra note 48, at 274.
\textsuperscript{152} The best example of this that a planned $700 million investment in USAir by British Airways was disallowed by U.S. authorities, partially due to the protests of other airlines, but mainly because the United Kingdom would not negotiate to liberalize its air bilateral with the United States.
E. What Airlines Are Doing

The link between more liberal access and relaxed ownership requirements highlights the crux of this issue for airlines. Liberalization of the basic elements of access: capacity, routes and tariffs, along with their ancillary “soft-rights” provides a way to, but not necessarily into the target market. There are also a myriad of legitimate reasons why seeking “captive” rights in the target country may be the least effective way to gain such access. These include the legal and regulatory problems of taking an aircraft and crew, subject to one system of safety, labour, health, taxation and other laws and standards in one country, and also trying to operate them in another. Not to mention the virulent opposition of airlines involved in domestic service in that country.

Airlines have demonstrated their belief that the best available way of entering another market is through equity participation in carriers already operating there. Yet this option is usually quite limited, with strict nationality requirements for both ownership and control in place in most

153. See James Ott, U.S. Targets Europe for Free Trade Pacts, A.V. WK. & SPACE TECH., November 7, 1994 at 34 (commenting on United States discussions with several European countries, including Sweden, Denmark, Norway, Finland, Belgium, Luxembourg, Switzerland and Austria, with a view to expanding those agreements that are already liberal, or liberalizing traditional bilateral air transport agreements).

154. See Of Airlines and Airwaves, The Economist, March 18, 1995 (describing efforts by E.U. Transportation Commissioner Neil Kinnock to halt discussions by Austria, Belgium, Denmark, Finland, Sweden, and Luxembourg with the United States on international aviation services). The fear is that due to Europe's compactness, by gaining access to the smaller but still well located centres, the U.S. carriers will still have access to "Europe" and lucrative beyond rights. They can fly to Brussels, Vienna and Amsterdam, and bypass Frankfurt, Paris and Rome for the discretionary and Fifth Freedom traffic.

countries. Still, there is a growing recognition that the airline industry, like others, needs the injection of capital that in this increasingly interde- pendent global marketplace only foreign investment can offer. The lack of foreign investment opportunities has undoubtedly been a factor in retarding the development of the industry. It is ironic that those who expect this industry to carry the expansion of international trade do not recognize the need to deal with the limitations of its current compartmentalization.

Precisely because of these limitations, the last decade has seen an explosion of imaginative, cooperative activity among many of the world’s leading airlines. They were almost forced into these measures to meet the growing globalization of trade, including that of capital markets, because the restrictions placed on the industry, inter alia, by the stagnant legal regime regulating access, had closed other avenues. Airlines involved in scheduled international service have developed several levels of interaction. At one end of this scale are joint frequent-flyer programs and selective code-sharing arrangements. These are primarily used to encourage the customers of one airline to take the flights of another when there is a choice in the marketplace. With the restriction on cabotage, this is currently one of the most practical ways in which international carriers which do not desire closer cooperation can feed traffic to one another.

One step beyond this is a code-sharing relationship, or its first cousin, the blocked-space arrangement. In the former, airlines jointly list their flights throughout some or all of their networks, almost making it appear to the travelling public as if there was one carrier providing seamless service. In the latter, airlines actually buy blocks of space on each others’ flights and market them as their own. While to be valid, these provisions have to conform to the terms of bilateral air agreements, they can be seen as attempts to compensate for the lack of flexibility in these agreements which prevent airlines from freely setting routes, capacity and tariffs.

Alliances are also formed in the area of “soft-rights.” While airlines have performed ground-handling and maintenance functions for one-an-

156. See Cheng, supra note 4, at 67 (detailing United States law and regulation governing foreign ownership and control of United States airlines). In a nutshell, these stand at 25% maximum, though there are exceptions, as seen in the KLM-Northwest case. As mentioned earlier, under the Third Aviation Directive, ownership and control rules have been relaxed within the E.U., to give a maximum of 49% to nationals from other E.U. countries.

157. See Dempsey, supra note 3, at 196.

158. Id.

159. See James T. McKenna, Code-Sharing Creates Hurdle in Pilot Talks, Av. Wk. & Space Tech., April 24, 1995 (outlining some of the difficulties one airline, American, is having integrating this concept with its labour relations).
other for some time, it is in the marketing area that most of the recent innovation has taken place. The most important of these is an airline's decision as to which computer reservation system to market its services on. 160

At the other end of the scale are the equity alliances, which most often also involve at least some of the above methods of joint operation. As participation is the only sure way to ensure the penetration of a market, and as cabotage is not, and will not likely be an alternative, airlines are more and more drawn to the limited equity participation currently available. 161 Even with the severe restrictions on foreign ownership and control, this allows a certain amount of cross-fertilization of investment and ideas, in return for which the investor airline gets a tenuous foothold. If many airlines' fortunes continue along the present downward trend, the relaxation of nationality requirements for ownership or control will become an increasingly attractive alternative to bankruptcy or more state aid.

IV. THE ART OF THE POSSIBLE

With the legal issues being only one factor affecting airlines' fortunes, and with the many ways stakeholders are already getting around the shortcomings of the system, it may well be asked why is there a need for change. After all, there are optimistic forecasts for the growth in demand for international commercial aviation. 162 Many airline executives believe that they have turned the corner on achieving a stable industry through severe cost cutting. 163 Even the airlines themselves seem to be of two minds when it comes to liberalizing access or keeping the protection of the bilateral system. Countries, too, are divided between those few who want to see aviation services governed by modern trade law concepts, and the majority who still see aviation as primarily a source of national pride and job creation.

Yet, there are other signs which indicate that modernization of this aspect of public international air law is past due. For one, there is the enormous debt burden carried by the world's airlines, which will eventually have to be paid by the public, one way or the other. As most airlines

160. See Dempsey, supra note 3, at 191.
161. See generally Dempsey, supra note 3 (detailing the extent of U.S., European and global equity alliances).
163. Edward H. Phillips, Lower Costs Key to Airlines' Survival, Av. Wk. & Space Tech., Mar. 13, 1995 at 66 (outlining the mostly successful steps, primarily U.S. airlines are taking to reduce and keep down their operating costs).
make a large proportion of their profit on their international service, its liberalization would mean that more of this debt would be paid by those actually using the service. 164 For another, there are other stake-holders involved in international commercial aviation, whose interests are not governed by narrow and often outdated considerations of airlines and governments. 165 Neither of these mean that international air service is close to collapse, nor that improving international economic regulation alone is the answer. Rather, the inefficiency of the present regulatory system creates waste that the industry can ill afford, and offers false succour to those trying to avoid the momentum towards trade governed by the rule of law, not the rule of individual interest.

It has been shown that multilateral attempts at updating the international legal framework have met with repeated failure due largely to the control of the decision-making process by those states protecting their “right” to participate in international commercial aviation. Nor does regionalism seem to offer a solution, since the only slowly emerging model is found within the world’s only significant customs union. This is not surprising, as Europe is also the only area where geographic proximity goes hand in hand with advanced economic and technological development, elements which appear to be needed in combination for successful regional cooperation. Finally, in spite of the efforts of the United States to offer open access to the most lucrative aviation market in the world, there have been very few significant takers to liberalize international aviation services on a bilateral basis.

A. Reshuffling Existing Norms to Overcome Stagnation

Considerable ink has been spread in the pursuit of ideas as possible solutions to the current impasse. As often as not, even more ink was used to dispell them as either ineffective or unworkable. At the bottom of most of these ideas lies a concern that, unless there is a multilateral solution (however unlikely the prospect), the various regional or bilateral possibilities will result in the air transport world having to function under a system of “cohabitation.” 166 This could easily create have and have-not countries, regions and airlines, mirroring the unfortunate North-South divide that is the legacy of post-industrial decolonization. As it appears inevitable that divergent approaches are already resulting in divergent opportunities for stakeholders in different parts of the world, it is necessary to focus on making the cohabitation of these varied solutions work.

164. See Dempsey, supra note 3, at 165.
165. See supra discussion text pt. III, sec. A for an analysis of the needs of other stakeholders.
166. See supra note 96, at 315.
This is more urgent, and may also be more achievable, than any quest for the "holy grail" that modernizes international air services. Thus, the proposal in the next paragraphs draws together the diverging strands of economic regulation, anchors it to existing international legal structures (old and new), and suggests that this combination will offer a marginal improvement over the present system. It may also have a chance of acceptance by the international community.

It is first necessary to recite the "givens" based on the previous analysis. It is given that the Chicago Convention and the subsequently evolved system of bilateral air agreements is now solidly rooted in international law and practice. Regrettably, it is further given that this system has neither the elasticity of operation, overall predictability, or flexibility to adapt to changing circumstances to provide an ideal economic climate for international commercial aviation. Thus, it is given that these shortcomings contribute to the difficulties experienced by the international aviation industry. It is also given that developments in international trade law have bypassed this system, which is still based on pre Breton-Woods economic notions. Finally, it is given that wholesale improvements are out of the question because of the unique nature of the industry, the insistence on participation in international commercial aviation by most countries, the schizophrenia of the airlines, and the difficulties involved in changing the system due to the problems inherent in multilateral decision-making.

While it is conceded that it is not possible to amend the Chicago Convention or do away with the system of bilateral, the regime somehow has to be made more elastic, predictable and flexible. It must also begin to catch up to international trade law, within the parameters permitted by the uniqueness of the industry and the special role it plays in the lives of nations. In the absence of any hope for a multilateral agreement, it has been suggested that the best way to make gradual changes while preserving the status quo for those attached to it as long as possible is by multilateralizing the current system of bilateral air agreements. At first blush this already appears to be accomplished. The bilateral are, after all, based on the Chicago Convention, and are all registered with ICAO (See Appendix A). However, neither the Convention nor the Organization

---

167. *Id.* There are any number of commentators and practitioners who believe in the "multilateralization" of bilateral air agreements. There is more of a disparity on how and if this can be accomplished. Some of the obstacles include the catalyst that would start the process, the incentive that would draw countries together, and the process by which a change in the system can be made, without actually changing the system. Yet, precedents do exist. For example, the device used to enable the coming into force of the 1982 United Nations Law of the Sea Convention was a combination of a General Assembly Resolution urging parties to become parties on the basis of "an understanding" circumvented the political impossibility of amending the Convention.
exerts any regulatory uniformity on this body of laws.¹⁶⁸ Thus, in order to ensure the cohabitation of the varying liberalized aviation relationships around the world, bilateral air agreements must become anchored to "something more" than the few provisions of the Chicago Convention that merely play at economic regulation. At the same time, this "anchor" must be something that is already part of international law in order to stand any chance of acceptance by the international community.

Two questions arise immediately. First, what improvement does the mere multilateralization of bilateral agreements offer? Second, what constitutes the "something more," that must be added to the Chicago Convention to form the basis of this agreement?

In response to the first, the reader is asked to picture the thousands of bilateral aviation agreements, with varying levels of obligations flowing between the parties. While there is nothing to prevent countries from giving better treatment to some than to others, each country usually has a certain general level of openness or protection that it finds comfortable.¹⁶⁹ If the various bilaterals were displayed on a chart of concentric circles, with each circle representing a different degree of openness or protection, each country would find its aviation agreements on this chart grouped in an area which reflects its comfort level vis-a-vis liberalization of access (See illustration under Appendix B).

The reader is asked to think of this series of concentric circles as forming the basis of a framework agreement that each country wishing to become a party, joins. This agreement would also include a grandfathering proviso that no country's commitments need exceed those with which it is currently comfortable, until it chooses to liberalize. Thus at the outset, there would be no alteration to any country's rights or obligations vis-a-vis its present level of protection/liberalization. The only change would be that instead of the bilateral residing in the vaults of ICAO's legal department, they would become annexes to (and be consistent with) the terms of the underlying framework agreement. In other words, a plurilateral agreement would emerge, with parties having varying degrees of reciprocal obligations to one another.

So far this would be no more than the multilateralization of the existing bilateral system. Yet already it has one advantage over the present

---

¹⁶⁸ See supra note 96, at 302. As discussed earlier, while the Chicago Convention places economic regulation in the hands of ICAO, the organization has proven ineffective in carrying out this mandate.

¹⁶⁹ While this is obviously a generalization, countries are subject to trends. For example, the United States has almost consistently pushed for liberal bilateral agreements for the last two decades. The E.U. countries are now ad idem, at least on how they behave towards one another. Developing countries for the most part tend to protect their flag carriers, and use access rights as a source of hard currency.
regime. It offers uniformity of future development. And while there is little chance of modernizing a disparate system of bilateral agreements, there is at least some hope for future evolution if they are anchored to a common basis. This may be a small improvement, but it is an important point. This may be the only avenue for developing countries, faced with isolation should industrialized states strike liberal deals among themselves, to join a global system.

The second question refers to the "something more" to form the basis of the framework agreement, upon which the bilateral would be "anchored." To be worthwhile, such advancement should: increase opportunities for access to and into markets; generate greater uniformity and predictability in the regulation of such access; and raise the flexibility of the system to make it more adaptable to changing circumstances. Yet to be acceptable, it cannot disturb the pillars upon which the present system is built. Neither the Chicago Convention or the role of governments can be altered. The Convention is unalterable because the amendment process is difficult and would likely meet with international disapproval. Governments would resist passing economic regulation to an international bureaucracy, especially in a field where they have held on to it as tightly as in international aviation services.

Given these narrow parameters in which to manoeuvre, a framework, plurilateral agreement would have to continue to include, but also supplement, the Chicago Convention. In the view of this author, this supplement should be a modified GATS. This appears to be the most plausible way to ensure that the framework agreement is both anchored to existing rules of international law and is well placed to keep up with future developments in this area. The modifications should start with expanding GATS' Air Transport Services Annex to include both "soft" and "hard" rights. Additionally, where the Chicago Convention and GATS are not compatible, the changes to be discussed in the following paragraphs would be necessary. A framework agreement would emerge within which all parties would be free to negotiate bilateral agreements, so long as they adhered to both the rules of the Chicago Convention and an aviation-specific GATS. There would be no requirement to grant more liberal access. However, when any access is granted, it has to be done in conformity with the rules of the framework agreement (see illustration under Appendix C).

This approach has the advantage of allowing aviation services to catch up to the present level of development in the international trade law. In addition, most of GATS' provisions are directly beneficial for the progressive liberalization of economic regulation. These include transparency, rights on payments and transfers, objectivity in domestic regulation, and a modern dispute settlement mechanism. At the same time,
GATS retains the exceptions for public safety and national security. This combination produces the greatest available elasticity and predictability.\textsuperscript{170} The fact that “national treatment” is only applicable if specific commitments are made by the parties actually suits the proposed framework agreement because it makes it more saleable.\textsuperscript{171} The provisions for limitations on the period states can exempt themselves, and the commitment to future negotiations to begin no later than five years, ensures continued flexibility.\textsuperscript{172}

Yet as alluded to earlier, GATS in its present form may not be consistent with the Chicago Convention, nor is it entirely helpful to the liberalization of aviation services. Some modifications are proposed to end up with a workable and acceptable framework agreement that could perhaps be called the General Agreement on Aviation Services (GATAS). The first, and possibly biggest change that must be made is the modification of MFN to work on a reciprocal basis. This is because the MFN concept may well be contrary to the provisions of Article 6 of the Chicago Convention, requiring the permission of the grantor state for all scheduled commercial air traffic.\textsuperscript{173} Since “GATAS” is to be based on both the Chicago Convention and a modified GATS, it must be consistent with both. It has already been pointed out that formally amending the Chicago Convention is not practicable. More importantly, MFN in an aviation context would actually deter countries from liberalizing their policies on access, because once more liberal access was offered to one country, it would have to be offered to all. If, on the other hand, this provision were made reciprocal, a country would only need to extend rights on an MFN basis to another, if that country also extends MFN rights to it.\textsuperscript{174} This at least would not be an automatic deterrent to gradual liberalization.

The second change involves the provisions on “market access” and “national treatment.” They are to be found in the “Specific Commitments” portion of GATS, and are thus already not mandatory in nature.

\textsuperscript{170} See GATS, supra note 10, pt. II at 286.
\textsuperscript{171} Id. pt. III at 298.
\textsuperscript{172} Id. pt. IV at 298.
\textsuperscript{173} See generally Abeyrante, supra note 62. (With MFN, if the grantor state gave certain access rights to one state, it would automatically have to extend the same rights to all other states, which may not correspond to Article 6 which states “... without the special permission or other authorization ...”) It may be that “other authorization” could be stretched to include a grant under MFN, but given the energy with which access rights are guarded by states, it is not an argument that is likely to meet with a lot of sympathy.
\textsuperscript{174} There is a debate among some practitioners whether MFN is, by its very nature, a right with only a universal application, or whether it is capable of having qualities such as reciprocity. For the present circumstances this debate is largely academic. If MFN is only universal, then it is inappropriate for the liberalization of aviation services, and the reciprocal right of extending the best “deal” a country gives on access to any other country willing to do the same can be called something else. After all, a rose by any other name will still smell as sweet.
Yet it should be made clear that these provisions would also have to operate on a reciprocal basis. While not imposing a blanket requirement, and thus not scaring away potential parties, this would encourage a gradual liberalization based on market opportunities. Regarding “market access” specifically, some further modifications may be required in the provision on foreign ownership and control.\textsuperscript{175} This would ensure that the present provision against limitations on foreign involvement are tempered (at least temporarily) in order to encourage the gradual relaxation of these requirements. The reason for this need is that cabotage is not a likely option in the near term anywhere but among E.U. states. The only realistic form of market access, therefore, is equity participation in another country’s airline(s). This must be fostered to provide the needed cross-fertilization of capital and ideas.

There is another suggestion that will make “GATAS” more successful. This is the incorporation of a “Code of Conduct,” that each party to “GATAS” would be encouraged to adopt. The ICAO Secretariat draft for the 1994 Conference, discussed earlier, could serve as a useful model.\textsuperscript{176} It is admitted that it would be impossible to make its adoption mandatory by the parties’ designated carriers. Still, such a code would take an admittedly tentative, but positive, first step away from practices that have resulted in destructive competition. More importantly, its incorporation could embolden those states, fearful of such business practices, to join the proposed agreement. Yet another reason for its inclusion relates to the fact that increased liberalization will inevitably lead to the use of competition laws to protect domestic industries in the name of promoting fair competition. If history is a guide, the extraterritorial effects of such laws are bound to cause problems. A Code of Conduct, along with the WTO dispute resolution mechanism that comes with GATS, should go a long way towards minimizing, if not solving this problem efficiently if it arises.

The bureaucratic structure for a future “GATAS” is almost as important as its contents. As we have seen, the international administration of economic regulation under public international air law presently lies with ICAO. It is recognized that as successful as ICAO has been in all other aviation matters, it has not had similar accomplishments in the area of economic regulation. This paper has speculated that this is at least partially due to ICAO’s structure. While there are calls for ICAO to give up this function in favour, some suggest, of the WTO, others quite correctly point out that in the present international climate, this is not a realistic

\textsuperscript{175} See supra note 10, pt. III, art. XVI, 2(f) at 297.

\textsuperscript{176} See supra note 15, Agenda Item 2.2.4.1, WP/10.
Rathet than seeing an eventual “turf-fight” between these two organizations, this author would rather propose that an initiative for a “GATAS” type agreement come from both ICAO and the WTO. After all, “GATAS” would have its origins in both the Chicago Convention and GATS. It is further suggested that once negotiated, GATAS be jointly administered by both bureaucracies.

The difficulty of getting two international bureaucracies to cooperate long enough to launch such a venture, let alone jointly administer it, is not lost on this author. Yet, in the absence of creating a new international bureaucracy, it is inconceivable that either ICAO would relinquish its role under the Chicago Convention or that the WTO would do the same for GATS. Furthermore, some precedents do exist for cooperation among international organizations, with overlapping mandates, in bringing forth multilateral conventions. Should this or a similar idea ever see the light of day, the fact that it deals with economic regulation means that time will inevitably push major considerations towards GATS and the WTO, necessarily diminishing ICAO’s role.

Conclusion

It is not the intent of this paper to suggest that we are in danger of losing international commercial aviation. Its conclusions do not even point to the problems of economic access under public international air law as being the principal reason for the poor financial health of the airline industry. Yet it is hoped that it demonstrates that strict bilateralism, born more from national security than economic considerations over the last five decades, has retarded the development of the industry. Perhaps more importantly, it does not offer the legal climate which could help facilitate the development the airline industry needs today. As the end of the twentieth century approaches, trade laws governing international aviation services lag behind those of its sister service industries.

The allure of commercial aviation is like the magnetism of show business. There will always be people with money to invest in this industry, whether profitable or not. We have all heard the joke about how one makes a small fortune in the aviation business: It is by starting out with a

177. Abeyranse, supra note 62, at 28.
large one. It should not be forgotten, however, that if this industry continues to be unprofitable, someone will eventually have to pay the enormous debt burden it has built up. Therefore, it is incumbent upon today's decision-makers to look at all ways in which the industry can be helped. This includes making enough useful, achievable changes to the legal regime that has kept international aviation compartmentalized and underdeveloped, to ensure that the different approaches in play today are able to cohabit in harmony and have the ability to evolve together. While the world is not ready for a wholesale overhaul of the current regime, the modest changes suggested in the preceding paragraphs may be possible with only a little political will—before we all end up footing the bill.
- This diagram represents the current state of affairs, wherein thousands of bilateral aviation agreements exist independently bounded only by the provisions of the Chicago Convention.

- As the Chicago Convention stands for absolute state sovereignty in economic regulation, any adherence to international legal norms is purely illusory.
- Each circle represents an increasing level of liberalization. Thus, if the centre point is absolute control of economic regulation by a state even to the extent of not being a party to the “two-freedoms” agreement, the widest circle would represent a United States style “open skies” agreement.

- With the thousands of aviation bilaterals in existence, there would be as many circles as there were levels of “openess”.

-
APPENDIX C

"Modified" GATS
"GATAS"

Chicago Convention

- This diagram shows how bilateral aviation agreements would be "anchored" to underlying rules.

- The innovation in this proposal is that in addition to the provisions of the Chicago Convention, states negotiating bilateral air agreements would also have to adhere to GATS, with the modifications proposed in the text.
Creating Uniform Worldwide Liability Standards for Sea Carriage of Goods Under the Hague, COGSA, Visby and Hamburg Conventions

Samuel Robert Mandelbaum, Esq. *

**Table of Contents**

- Introduction .......................................................... 472
- I. Historic Background of Cargo Damage Law ................. 473
  - A. Developments Through the 19th Century ................. 473
  - B. The Harter Act Of 1893 .................................. 475
  - C. The Hague Rules ............................................ 477
  - D. COGSA ....................................................... 478
  - E. Visby Amendments of 1968 ............................... 480
  - F. The SDR Protocol of 1979 ............................... 481
  - G. Hamburg Rules of 1978 .................................. 482
  - H. The Great Switch ......................................... 484
  - I. The Current State of U.S. Law ........................... 485
- II. Comparison of the Hague, Visby and Hamburg Regimes ... 485
  - A. Scope of Application .................................... 485

* Samuel Robert Mandelbaum, a partner with Anderson & Orcutt, P.A., Tampa, Florida and Adjunct Law Professor of International Business Transactions at Stetson University College of Law, received an LL.M. Degree in International Trade from Georgetown University Law Center in May 1995. The author would like to thank Georgetown University law professors Allan I. Mendelsohn and Warren L. Dean, Jr. for their assistance in development of this article. The author would also like to thank his wife, Erica G. Mandelbaum, for her patience and support.
Introduction

Maritime legal principles relating to carriage of goods by sea are of ancient origin. Traditionally, the relationship between merchant and shipowner was that of a common adventure, each sharing in the risks and dangers. Due to the whims of nature, poorly trained masters and crew, enemy attacks, poor communications and inadequate navigational aids, there were many risks involved with an ocean voyage which perpetually threatened both the carriers' and the shippers' interests. Generally the shipowner was required to furnish a seaworthy vessel and a competent crew, but the shipowner and merchant would suffer together any loss due

1. ABA, Section of International Law, Reports to the House of Delegates, 22 Int’l. LAW. 247 (1988) [hereinafter ABA Reports].
2. Id.
3. Id.
to the perils and dangers of the sea.\(^5\) It was then considered reasonable that the risks should be shared more or less equally.\(^6\)

Notwithstanding, substantial economic conflicts have developed in recent centuries between shipowner interests\(^7\) and cargo owning interests\(^8\) over allocation of risk in international shipping for loss, damage and delay of sea-borne cargo.\(^9\) This conflict presents the following problems: (1) who bears the risk and how should the risk be allocated between ship-owning and cargo-owning interests? (2) should the shipowner be liable for loss or damage occurring while the goods are in his possession? and (3) should governments intervene to regulate such commercial transactions, or should they leave it to the parties to apportion their respective liabilities by contract?\(^{10}\)

I. **Historic Background of Cargo Damage Law**

A. **Developments Through the 19th Century**

In the sixth century, after the founding of Rome, the sea carrier was essentially made by Roman edict an insurer of the goods it carried. In their view, the sea carrier’s duty was to preserve good faith, insure the safety of the goods to be delivered and prevent fraud and robbery. It was the reasoning of Roman law that the carrier should be held liable for all loss and damage because it could best take precautions against such loss. The shipper, on the other hand, might not know how his goods had been abstracted or damaged, nor whether there was anyone whom he could hold responsible. Furthermore, if there had been culpa on the part of the carrier, it could be easily concealed. Based on this reasoning, the Romans sought to protect shippers by placing the entire the risk upon carriers. Over time, however, exceptions to carrier’s liability for loss were admitted for shipwreck and piracy.\(^{11}\)

By the 16th century, there was a growing feeling within the European commercial community that the owner and master of a ship should be excused for non-delivery of damage to cargo due to perils of the sea,

---

5. *ABA Reports, supra* note 1, at 249.
6. *Verhaar, supra* note 4, at 44.
8. “Cargo-owning interests” include the shipper/seller, buyer/consignee and cargo insurers. Sweeney, *supra* note 7, at 512.
10. See Thompson, *supra* note 9, at 168.
pirates and unusually bad weather.\textsuperscript{12} These circumstances were recognized as defenses by the year 1570, available to the shipowner or master who could establish the truth of his contentions.\textsuperscript{13} For loss or damage due to any fault or negligence of the master or crew, the master was held liable. Bills of lading during that time period typically reflected what the mercantile law implied (\textit{i.e.} The Law Merchant).\textsuperscript{14} The rule of The Law Merchant was that the carrier was liable unless he could prove that the loss of damage occurred through some inevitable mischance, which no amount of care or prudence on his part could have prevented, and was in fact unattended by culpa or negligence.\textsuperscript{15}

During the early 19th century, cargo owners using marine carriers to ship their goods continued to enjoy special protection under a strict liability system.\textsuperscript{16} In both common law and civil law countries:

\begin{quote}
the carrier was held strictly liable for cargo damage or loss that occurred in the course of the conveyance unless it could prove (1) that its negligence had not contributed to the loss and (2) that one of the four excepted causes (act of God, act of public enemies, shipper's fault, or inherent vice of the goods) was responsible for the loss.\textsuperscript{17}
\end{quote}

In other words, if one of the four exceptions applied, the carrier was liable only if it had been at fault, but in all other cases it was liable without fault. This extensive no-fault liability, in an era when such liability was rare, led many to describe the carrier as an 'insurer' of goods.\textsuperscript{18}

In deference to freedom of contract, the shipper and carrier could agree to a different risk allocation — including one in which the carrier assumed virtually no liability — even for its own negligence.\textsuperscript{19}

To avoid the role as quasi-insurers of cargo damage and loss, and to reduce or eliminate their responsibilities while in transit, carriers began to use exculpatory clauses in the bill of lading by the late 19th century.\textsuperscript{20}

\begin{flushleft}
\textsuperscript{12} Id. at 88, 51.
\textsuperscript{13} Id. at 51.
\textsuperscript{14} Id. at 88, 51.
\textsuperscript{15} Id. at 99-100.
\textsuperscript{16} Michael F. Sturley, \textit{Basic Cargo Damage Law: Historic Background}, 2A BENEDICT ON ADMIRALTY, 2-1 to 2-3 (MB, 1995) [hereinafter Basic Cargo Damage].
\textsuperscript{18} Basic Cargo, supra note 17, at 2-1 to 2-2; see also ARNOLD A. KNAUTH, \textit{The American Law on Ocean Bills of Lading} 116 (4th ed., 1953).
\textsuperscript{19} Carriage of Goods, supra note 17, at 3.
\textsuperscript{20} Basic Cargo Damage, supra note 16, at 2-2; The exculpatory clauses typically included losses and damage from "thieves; heat, leakage, and breakage; contact with other goods; perils of the seas; jettison; damage by seawater; frost; decay; collision; strikes; benefit of insurance; liberty to deviate; sweat and rain; rust; prolongation of the voyage; nonresponsibility for marks or numbers; removal of the goods from the carrier's custody immediately upon discharge; limitation of value; time for notice of claims; and time for suit." Benjamin W. Yancey, \textit{The Carriage of
Creating Uniform Worldwide Liability Standards

The bills of lading became so lengthy, and the parties' respective rights and liabilities so difficult to ascertain, that even bankers [were] in doubt as to their security when discounting drafts drawn against bills of lading, cargo underwriters [did not know] the risks which they covered when insuring goods, . . . and carriers and shippers [were] in constant litigation.21

All of these exemptive clauses were generally deemed valid if reasonable, and the courts in those days as to reasonableness were rather stringent in the carrier's favor.22

If the carrier could establish that the loss resulted from one of the perils excepted in the bill of lading, then the cargo owner had the burden of proving that the carrier caused or contributed to the loss through his negligence, in which event the carrier was liable.23 That burden of proof was a very real defensive weapon for carriers in the days before effective discovery procedures were developed, and often proved an impossible burden for cargo shippers to bear.24

The British and American courts differed in their views on enforceability of broad exclusions on bills of lading. British courts regularly enforced even the most far-reaching exculpatory clauses in bills of lading. They viewed the carrier's strict liability as a default rule which should be applied only in the absence of an agreement to the contrary.25 American courts gave more restrictive treatment to freedom of contract. The U.S. federal courts permitted carriers to limit their liability under some circumstances, but did not allow carriers to contract away liability for their own negligence.26

B. THE HARTER ACT OF 1893

While the international community was accomplishing little toward the unification of the law in the late 19th century, several countries enacted legislation governing exoneration clauses in bills of lading.27 The operation of short limitation periods and oppressive exemptive clauses provoked a movement in the late 19th century that resulted in passage of the Harter Act Of 1893.28 The U.S. Act represented a compromise be-

---

21. Id. at 2-3 to 2-4.
22. Yancey, supra note 20, at 1240.
23. Id. at 1240.
24. Id. at 1240.
26. Id.
27. Carriage of Goods, supra note 17, at 5.
between the conflicting carrier and shipper interests.\textsuperscript{29}

The Harter Act imposed certain of the old common law obligations on the carrier, and made it illegal to diminish these specific obligations in an ocean bill of lading.\textsuperscript{30} As violative of public policy, the Act voided any bill of lading seeking to relieve the carrier from negligence in proper loading, stowage, custody, care or proper delivery of the goods,\textsuperscript{31} and also voided any clause purporting to reduce the obligation of the owner to exercise due diligence in providing a seaworthy vessel.\textsuperscript{32} However, if the carrier exercised due diligence in furnishing a seaworthy vessel in all respects, then the owner was exempt from liability for damage or loss resulting from faults or errors in navigation or in the management of the vessel.\textsuperscript{33} Since communications were often difficult or impossible, and because they could not control their ships after departure, shipowners were not held liable for the negligence or fault of captain and crew in their navigation and management of the vessel after it had left port.\textsuperscript{34} Nor was such shipowner liable for perils of the sea, acts of God, acts of public enemies, inherent defects of the goods carried, seizure under legal process, acts or omissions of the cargo owners, and saving or attempting to save life or property at sea.\textsuperscript{35}

Though an important step in the development of U.S. law of maritime carriage, the Harter Act ultimately proved disappointing.\textsuperscript{36} The Act did not provide shippers an effective solution to the problem of burdensome exculpatory clauses in bills of lading, nor did it establish any positive rules of law.\textsuperscript{37} It failed to alter the validity of the very short limitations periods, low valuation clauses, or stringent notice of claims clauses.\textsuperscript{38}

Following passage of the Harter Act, about 30 years of instability ensued during which American law differed significantly from that in most other parts of the world.\textsuperscript{39} Over time, a movement for uniformity developed, prompting the Comite Maritime International (CMI) to draft

\begin{itemize}
\item \textsuperscript{29} \textit{Basic Cargo Damage}, supra note 16, at 2-5; \textit{see also} In re Ballard Shipping, 823 F. Supp. 68, 71 n. 2 (D.R.I. 1993).
\item \textsuperscript{30} \textit{Basic Cargo Damage}, supra note 16, at 2-5.
\item \textsuperscript{31} 46 U.S.C. app. § 190 (1976).
\item \textsuperscript{32} 46 U.S.C. app. § 191; \textit{see also} Yancey, \textit{supra} note 20, at 1241.
\item \textsuperscript{33} 46 U.S.C. app. § 192.
\item \textsuperscript{34} \textit{Cargo Liability and the Carriage of Goods by Sea Act (COGSA): Oversight Hearing before the Subcomm. on Merchant Marine of the House Comm. on Merchant Marine and Fisheries, 102d Cong., 2d Sess. 21 (1992) (Statement of Roger Wigen of 3M Corporation on June 24, 1992)} [hereinafter \textit{Oversight Hearing}].
\item \textsuperscript{35} 46 U.S.C. app. § 192; \textit{see also} \textit{Basic Cargo Damage}, supra note 16, at 2-5.
\item \textsuperscript{36} Yancey, \textit{supra} note 19, at 1241.
\item \textsuperscript{37} \textit{Basic Cargo Damage}, supra note 16, at 2-5.
\item \textsuperscript{38} Yancey, \textit{supra} note 19, at 1241.
\item \textsuperscript{39} \textit{ABA Reports}, \textit{supra} note 1, at 248.
\end{itemize}
a set of rules at a 1921 conference at the Hague, based primarily upon Harter Act theory.\textsuperscript{40}

C. The Hague Rules

In 1924, the International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, commonly known as the Hague Rules, was adopted by 26 participating nations. The Hague Rules were welcomed by most shippers, although they were adopted against the wishes of shipowners who opposed the increase in carrier liability under this new convention.\textsuperscript{41} Today, there are about 77 contracting parties to Hague, including a large number of developing countries.\textsuperscript{42}

The Hague Rules set out the bases for shipowner liability for cargo loss and damage. They preclude contractual exemptions from liability for shipowners; provide 17 specified defenses to carriers, including the controversial nautical fault defense; and establish a limit of $500 liability per package or customary freight unit.\textsuperscript{43}

Although there was major American involvement in the final stages of drafting the Hague Rules, the United States was slow to ratify or enact a statute based upon it.\textsuperscript{44} Apparently due to the United States' failure to ratify the convention, other countries had hesitated to adopt the Hague Rules.\textsuperscript{45} There was even a movement by British shipowners in the early 1930's to repeal United Kingdom law ratifying the Hague Rules, on the basis that the rest of the world had been unwilling to join the international uniformity effort.\textsuperscript{46}

The United States implemented the Hague Rules domestically with the enactment of the Carriage of Goods by Sea Act in 1936 (COGSA),\textsuperscript{47} and ratified the international convention in 1937.\textsuperscript{48} With the U.S. adoption of the Hague Rules, the remaining major maritime powers joined the new regime quickly. Within two years of the U.S. ratification, most of the European shipping nations followed suit, and by the beginning of World War II, the overwhelming majority of the world's shipping had adopted the Hague Rules.\textsuperscript{49}

\textsuperscript{40} Id.
\textsuperscript{42} Id.
\textsuperscript{43} See ABA Reports, supra note 1, at 248.
\textsuperscript{44} Basic Cargo Damage, supra note 16, at 2-18.
\textsuperscript{45} Id. at 2-19.
\textsuperscript{46} Id. at 2-20.
\textsuperscript{47} 46 U.S.C. app. §§ 1300-1314.
\textsuperscript{49} Basic Cargo Damage, supra note 16, at 2-20.
D. COGSA

Derived from the Hague Rules, COGSA governs the use of bills of lading and the relations of cargo and ship.\textsuperscript{50} COGSA applies during the period of time between the loading of the goods and the time they are discharged from the ship: i.e. tackle to tackle.\textsuperscript{51}

COGSA represents some significant changes from the prior liability scheme. Its provisions are as follows:

(1) COGSA requires an ocean common carrier operating between U.S. and foreign ports to exercise due diligence to make its ship seaworthy, to make the holds fit and safe for carriage and preservation of the goods carried, and to load, handle, stow, carry, keep, care for and discharge the goods properly and carefully.\textsuperscript{52} For liability to arise, however, it must be shown that the want of due diligence to make the ship seaworthy was the \textit{proximate cause} of the cargo loss or damage.\textsuperscript{53}

(2) A carrier will not be liable for any uncontrollable loss or damage falling under any one of the 17 defenses,\textsuperscript{54} which include:

(a) acts, neglect or default of the master or servants of the ship in navigating and managing the ship (the nautical fault defense);
(b) fire — unless caused by the fault of the carrier;
(c) perils of the sea;
(d) acts of God, war, or public enemies;
(e) intervention of law;
(f) acts or omissions of shippers;
(g) strikes, riots, or civil commotion;
(h) attempts to save life or property at sea (this includes damage caused by deviation to save life or property at sea);
(i) inherent vice of the goods or shrinkage, where the damage is caused by the characteristics of the goods (e.g., a liquid that evaporates);
(j) insufficient packing or marking by the shipper;
(k) a latent defect in the goods or damage caused by a defect in the goods, not the negligence of the carrier; and
(l) any other cause arising without the actual fault of the carrier or its agents (although the burden is on the carrier to prove freedom from fault).

(3) A $500 per package or customary freight unit limitation, unless the value of goods is declared on the bill of lading.\textsuperscript{55} The carrier is barred

\textsuperscript{50} Yancey, supra note 20, at 1244.
\textsuperscript{51} Id.; see also 46 U.S.C. § 1301.
\textsuperscript{52} 46 U.S.C. §§ 1303(1)(a), 1304(1).
\textsuperscript{53} See Yancey, supra note 19, at 1244. COGSA effectively reversed the rule previously set forth in May v. Hamburg-Amerikanische, 290 U.S. 333 (1933), in which the Supreme Court held that there need not be a causal connection between the lack of due diligence, unseaworthiness and damage for liability to be imposed on the carrier.
\textsuperscript{54} 46 U.S.C. § 1304; see also House Staff Report, supra note 48, at 3.
\textsuperscript{55} 46 U.S.C. app. § 1304(5).
from using a lower limitations amount.\textsuperscript{56}

(4) What constitutes a package under COGSA has created some problems for the courts, especially in light of the now-common use of the shipping container.\textsuperscript{57} Jurisdictions are split on whether a container should be considered a package for purposes of the $500 limitation.\textsuperscript{58}

(5) The Act extends the time to provide notice of claim and file suit against the carrier. Notice of the loss should be provided to the carrier before or upon removal of the goods, or within three days after removal if the loss is not apparent.\textsuperscript{59} Claimants have up to one year to file suit following delivery.\textsuperscript{60} Lesser time limits are prohibited under COGSA.\textsuperscript{61}

(6) COGSA does not apply to cargo carried on deck, where the bill of lading states that the cargo will be carried on deck.\textsuperscript{62}

(7) Under COGSA, unexplained losses, those for which there is no clear evidence which of two causes was responsible for the damage, are far more likely to fall on the carrier.\textsuperscript{63}

COGSA's principal goal was to unify the law governing bills of lading world-wide. It was intended to do more than simply allocate risks between carriers and shippers, but to do so on a uniform, predictable basis that would allow carriers, shippers, consignees, bankers and insurers to know their respective rights and responsibilities with certainty — and to do so without examining long and complicated bills of lading.\textsuperscript{64}

Despite the United States' adoption of the Hague Rules through COGSA in the late 1930s, which was subsequently ratified by almost all of the world's nations, several problem areas remained with the Hague scheme, causing uneasiness for both shippers and carriers.\textsuperscript{65} These problems included the confused state of American law on the limitation of $500 per package or per customary freight unit; the inadequacy of the $500 package limitation; questions as to what constituted a package in view of the newly-developed container trade; concerns about the rigid

\textsuperscript{56} 46 U.S.C. app. § 1303(8).
\textsuperscript{58} \textit{See House Staff Report, supra} note 48, at 4. Cf. Inter-American v. Consolidated Caribbean Transport, 313 F. Supp. 1334 (S.D. Fla. 1970) ($500 "per package" limitation applied to each of a number of cartons of shrimp loaded into a trailer); Standard Electrics v. Hamburg SudAmerica, 375 F.2d 943 (2nd Cir. 1967) (each pallet containing cartons of expensive electrical parts constituted a "package").
\textsuperscript{59} 46 U.S.C. app. § 1303(6).
\textsuperscript{60} 46 U.S.C. app. § 1303(6).
\textsuperscript{61} 46 U.S.C. app. § 1303(8).
\textsuperscript{62} \textit{See House Staff Report, supra} note 48, at 4.
\textsuperscript{63} \textit{Basic Cargo Damage, supra} note 16, at 2-22.
\textsuperscript{64} \textit{Id}.
\textsuperscript{65} Yancey, \textit{supra} note 20, at 1246.
non-delegability of the duty to use due diligence to make seaworthy; and the contractual extension of the carriers defenses to other parties to the transaction such as stevedores.66

E. VISBY AMENDMENTS OF 1968

Decades later, in response to the increased use of containerization in ocean transportation and international dissatisfaction with the per-package limitation, a diplomatic conference, convened in Brussels in 1968, adopted a Protocol amending certain provisions of the Hague Rules.67 That conference resulted in a 1968 Amendment to the Hague Rules, designated as the Hague-Visby Amendments (also Visby).68 Under Visby, most of the original Hague Rules survived, thus preserving the majority of the case law decided over the years under that regime.69 Both Hague and Visby retain the same basic rule as to the carrier’s duty of care, that the carrier must exercise due diligence . . . to make the ship seaworthy, and see that the ship is properly manned, equipped and supplied.70

The Amendments modified Hague in several respects. First, it increased the per-package limitation to $663, or alternatively, $2 per kilogram of lost or damaged goods, whichever is higher. Second, the Amendment clarified the definition of package to be the number of packages or units enumerated in the bill of lading as packed in such article of transport.71 Third, it denied the carrier the right to limit its liability for intentionally caused damage, or recklessly caused damage where the carrier had knowledge that damage would result.72 Certain other minor revisions were included in the 1968 Amendment to render it more consistent with American law, such as making inadmissible any contradictions of the recitals of conditions as set forth in the bill of lading when the bill has been transferred to a party in good faith, and approving the practice of granting extensions of the one year time limitation.73 The Amendment also defines the carrier as including the owner or the charterer who enters into a contract of carriage with a shipper.74

Within only months after the 1968 Visby Convention at which the Hague-Visby Amendment was promulgated, shippers were uniformly

66. Id.
67. ABA Reports, supra note 1, at 248. See also House Staff Report, supra note 48, at 4.
70. Id.
71. Id.
72. See House Staff Report, supra note 68, at 4.
73. Hague-Visby Amendment, supra note 68, at 1. See also Yancey, supra note 20, at 1248-49.
pleased with the results and enthusiastic about prompt ratification by the United States.\textsuperscript{75} Joseph Baettnner, on behalf of the Singer Company, summed up the views of most U.S. shippers by expressing support for Hague-Visby as a solution equitable to both shipowner and shipper interests.\textsuperscript{76} Similarly, speaking at that time on behalf of the Commerce and Industry Association of New York (a shipper's organization), Joseph A. Sinclair wrote to then Secretary of State Dean Rusk that his members were very pleased with Hague-Visby and hoped that the State Department will make every effort to obtain Congressional action during the present session having the assurance that ratification of the Hague-Visby Convention will be widely supported by major U.S. exporters.\textsuperscript{77}

In contrast, the carriers vigorously opposed ratification of Hague-Visby following the 1968 convention. Ralph E. Casey, then President of the American Merchant Marine Institute (AMMI), representing most U.S. flag steamship lines, pronounced that any the prospects for ratification were doomed.\textsuperscript{78} In his letter to Secretary Rusk dated May 22, 1968, Mr. Casey expressed the strong opposition of the AMMI to U.S. implementation of the Hague-Visby Protocol of 1968. On behalf of shipowners' interests, Mr. Casey criticized the weight liability limitation as excessive, the mixed limitation concept without a ceiling, and the container clause as especially disturbing.\textsuperscript{79} Benjamin Yancey, formerly the President of the U.S. Maritime Lawyers Association (MLA), similarly expressed his sharp disagreement with Hague-Visby.\textsuperscript{80}

In the face of such determined opposition from significant portions of the maritime industry, the Executive Branch decided not to go forward with ratification.\textsuperscript{81} The unwillingness of Congress to act in the absence of an industry consensus has long been recognized.\textsuperscript{82} It is for this sole reason, it has been commented, that the Visby Amendments were not ratified by the United States between 1968 and 1978.\textsuperscript{83}

F. THE SDR PROTOCOL OF 1979

In 1979, the Hague-Visby Rules were further amended to account for


\textsuperscript{76} Id.

\textsuperscript{77} Id.

\textsuperscript{78} Id.

\textsuperscript{79} Id. at 41-45.

\textsuperscript{80} Id. at 45-49.

\textsuperscript{81} Id. at 51.


\textsuperscript{83} Mendelsohn, supra note 75, at 30, 51-52.
currency exchange imbalances. The SDR Protocol of 1979 revised the previously-existing Poincare gold standard for liability limitations to a system using a Special Drawing Right (SDR) in an amount calculated by the International Monetary Fund.

The liability limitation was increased in the SDR Protocol to 667 SDRs per package or customary shipping unit, or 2 SDRs per kilo. During 1992, the SDR fluctuated around US $1.28.

As is the situation with the 1968 Hague-Visby Amendment, the United States has never adopted the SDR Protocol. Notwithstanding, as of 1992, 31 nations have adopted or were adopting the SDR Protocol and Hague-Visby Amendment.

G. Hamburg Rules of 1978

In 1978, the United Nations Commission on International Trade Law (UNCITRAL) held a conference in Hamburg, Germany, in response to a demand for revision of the Hague-Visby Rules. In promulgating the Hamburg Rules at that conference, UNCITRAL dealt with all of these problems in terms of “economic warfare” between cargo and carrier, and between ‘traditional maritime nations’ and the “developing world.”

The construct of the Hamburg Rules is significantly different from previous international cargo liability conventions, and as found by the U.S. Department of Transportation, would provide for an increase in carrier liability. The major features and changes of the Hamburg Rules are as follows:

1. Elimination of the nautical and managerial fault defenses;
2. Reduction of the 17 defenses of COGSA, down to three defenses:
   a. that the carrier took all reasonable measures to avoid the damage;
   b. that the loss, damage or delay was caused by fire;
   c. that the loss, damage or delay was due to efforts of the carrier to

84. See House Staff Report 6-23-92, supra at page 30.
87. Id.
88. See House Staff Report, supra note 48, at 30.
90. See House Staff Report, supra note 48, at 30; Yancey, supra note 20, at 1249-50.
91. Yancey, supra note 20, at 1249-50.
92. House Staff Report, supra note 48, at 31.
93. See Oversight Hearing, supra note 34, at 125 (Background Paper by the U.S. Department of Transportation).
save life or property at sea;\textsuperscript{94}

(3) The $500 per package limitation first appearing in the Hague Rules in 1924 and adopted by COGSA 12 years later, would be increased to 835 SDR's (Special Drawing Rights) per package, or approximately $1,169 per package or customary shipping unit;

(4) Shippers would be given an option of claiming damages based on the weight of the cargo rather than the value of the package (maximum recovery of 2.5 SDR's per kilo, approximately $1.59 per lb. or $1169 per package, whichever is higher);

(5) The term “per package” would be defined as the packaging units described in the bill of lading, thus curtailing shipowners’ attempts to limit their liability to $500 for an entire container on the grounds that it is the package when no other packaging was described on the bill of lading;

(6) Carriers would be liable for delays, but only up to two and a half times the amount of freight charges;

(7) On-deck cargo would be covered by liability rules for the first time;

(8) Cargo moving without a bill of lading would be covered for the first time;

(9) The burden of proof would shift to shipowners to prove they took all measures that could reasonably be required to avoid the occurrence and its consequences, thus eliminating negligence of the master or crew as a defense;\textsuperscript{95}

(10) Notice of loss or damage would be permitted to be given not later than one working day after delivery to the consignee (rather than before removal from the port);

(11) Notice of concealed loss or damage would have to be given within 15 days, in lieu of 3 days;

(12) Suits or arbitration could be instituted within 2 years from delivery rather than one year at present;

(13) Cargo owners would be relieved of General Average contributions if the ship owner’s negligent navigation or mismanagement of the ship caused the catastrophe which resulted in the claim for general damage.\textsuperscript{96}

The United States has not ratified the Hamburg Rules, which went into force on November 1, 1992 after 20 other nations had ratified it.\textsuperscript{97} To

\textsuperscript{94} Id.

\textsuperscript{95} Under COGSA, the carrier only has the burden of proving seaworthiness at the time of the voyage; then the burden shifts to the shipper to prove the carrier’s negligence.

\textsuperscript{96} See Oversight Hearing, supra note 34, at 100-01 (Testimony on Behalf of the Transportation Claims and Prevention Council, Inc., on Oversight on Cargo Liability).

\textsuperscript{97} DOT Paper, supra note 93, at 124-25.
date only 22 states have adopted the Hamburg Rules, of which seven are land-locked states having no ports, and all 22 states, as a group, represent only a very small portion of U.S. trade. These 22 nations are not major shipping powers, and are concerned mostly with protection for their imports and exports.

H. The Great Switch

During the mid-1970’s, a dramatic reversal of positions took place between carrier and shipper interests in the United States. Partly out of concern for the evolving Hamburg Rules, the shipowners and MLA changed their views on Hague-Visby, viewing Visby as a positive contribution to international maritime law. Shippers on the other hand, abandoned their previously strong support for Hague-Visby, and quickly embraced the unfolding Hamburg Rules. Though the sides flip-flopped completely, the controversy continues to be very intense.

Now, shipowners and cargo underwriters support Visby but not Hamburg, while shippers largely support Hamburg but not Visby. Consequently the United States suggested a compromise colloquially known as the trigger approach; the U.S. Government’s approach was to transmit a package arrangement to the Senate, requesting its advice and consent to the ratification of both Visby and Hamburg in stages.

This trigger approach was first proposed in 1978, in expectation that the Hamburg Rules would be ratified at a later date. In 1988, the U.S. Department of Transportation had sought to achieve a compromise by developing a trigger mechanism, under which the United States would ratify the Visby Protocol immediately with the commitment to adopt the Hamburg Rules once a significant number countries trading with the U.S. had enacted Hamburg. To date, virtually all of the commercial inter-


100. House Staff Report, supra note 48, at 30.

101. Mendelsohn, supra note 75, at 52.

102. Id.

103. Id. at 53.

104. ABA Reports, supra note 1, at 250.

105. Id.


ests have rejected this trigger approach.\textsuperscript{108}

The sad truth is that carriers, their insurers and the cargo insurers will not yield an inch on the Hague-Visby system, and shippers are adamantly opposed to Visby unless it surely leads to Hamburg — a classic stalemate which has produced governmental inaction until the maritime industry can solve its own problems.\textsuperscript{109}

\section{The Current State of U.S. Law}

Although the United States government has signed both the Hague-Visby Amendments and the Hamburg Rules, neither has been ratified by the United States Congress.\textsuperscript{110} Thus, COGSA of 1936 essentially remains the controlling law of the United States governing risk allocation.

By 1993, it was estimated there were 78 countries that adhered to either Hague and/or Visby, covering 63.9 percent of U.S. trade.\textsuperscript{111} Of that group, in early 1993 there were 32 nations that acceded to Visby.\textsuperscript{112} As the United States has not yet adopted or ratified the Hague-Visby Amendments to date, the COGSA 1936 provisions remain substantially unchanged.\textsuperscript{113} Accordingly, the United States today has a law that is different on its face from the laws of most of its major trading partners and different in application from the law of any other country.\textsuperscript{114}

Most bills of lading currently reflect Hague-Visby, as carriers reluctantly adjust to changes that containerization brought by raising liability limits.\textsuperscript{115} Interestingly, the U.S. courts have been applying Hague-Visby under choice of law rules.\textsuperscript{116}

\section{Comparison of the Hague, Visby and Hamburg Regimes}

\subsection{Scope of Application}

The Hague Rules apply only to bills of lading issued in a contracting state. The Hague-Visby Rules apply to bills of lading covering the carriage of goods between different states, so long as the bill of lading is issued in a contracting state, the carriage begins in a contracting state, or

\begin{thebibliography}{99}
\bibitem{108} Id.
\bibitem{109} See Sweeney, supra note 7, at 535.
\bibitem{110} ABA Reports, supra note 1, at 250.
\bibitem{111} See Oversight Hearing, supra note 34, at 8 (Statement of George F. Chandler, III, of the Maritime Law Association).
\bibitem{112} See Oversight Hearing, supra note 34, at 58.
\bibitem{113} Basic Cargo Damage, supra note 16, at 2-23.
\bibitem{114} Id.
\bibitem{115} Verhaar, supra note 4, at 44.
\end{thebibliography}
the parties have agreed to the application of the Convention. The Hague and the Visby Rules are inapplicable when a document other than a bill of lading is used in connection with the carriage.\textsuperscript{117} For example, COGSA, Hague and Hague-Visby do not apply when electronic data interchange EDI is used.\textsuperscript{118}

The Hamburg Rules apply to all contracts of carriage by sea between different states if the port of loading, the port of discharge or the place where the bill of lading or other transport document was issued is located in a contracting state. Hamburg may apply even when a contract for transport other than a bill of lading is utilized.\textsuperscript{119}

Carriers take the position there is no problem with [EDI] use under the Hague Rules and no reason to think the Hamburg Rules will facilitate them.\textsuperscript{120} In contrast, shippers maintain that COGSA requires a paper bill of lading, which creates a competitive disadvantage when compared to the inexpensive efficiency of an EDI.\textsuperscript{121}

B. DEFINITION OF CARRIER

COGSA, Hague and Hague-Visby only apply to the contracting carrier, but do not apply to the liability of the actual non-contracting carrier who has not issued a bill of lading to the consignor.\textsuperscript{122}

In contrast, the Hamburg Rules governs liability of both the contractual carrier and actual carrier. Essentially, Hamburg makes the contractual carrier liable for the whole carriage, including those portions performed by the actual carrier, and also enables the shipper to hold the actual carrier liable.\textsuperscript{123}

C. PERIOD OF CARRIER RESPONSIBILITY

COGSA, Hague and Hague-Visby provide for liability only from the time that the goods are loaded onto the ship up until they are discharged from the ship.\textsuperscript{124} Hamburg covers the goods from the moment the carrier takes the goods in charge at the port of loading, until the carrier actually


\textsuperscript{118} Oversight Hearing, supra note 34, at 125 para. 2. See also COGSA, 49 U.S.C. app. § 1301(b).

\textsuperscript{119} Status of the Hague Rules, supra note 98, at 2 para. 11.

\textsuperscript{120} Oversight Hearing, supra note 34, at 247 [hereinafter American Flag Position Paper].

\textsuperscript{121} Oversight Hearing, supra note 34, at 77 (Position of National Industrial Transportation League).

\textsuperscript{122} Status of the Hague Rules, supra note 98, at 5 para. 23. See also Oversight Hearing, supra note 34, at 125 para. 1.

\textsuperscript{123} Id.

\textsuperscript{124} COGSA, 46 U.S.C. app. § 1301(e); Status of the Hague Rules, supra note 117, at 3 para. 14; Oversight Hearing, supra note 34, at 125 para. 1.
delivers the goods at the port of discharge. Thus, the Hamburg liability regime extends beyond the actual carriage, even before loading and after unloading.\textsuperscript{125}

According to carriers, the Harter Act of 1893 also provides coverage during custody, so that the shipper has better protection under existing American law than he would under the Hamburg Rules.\textsuperscript{126} Shippers contend that only the Hamburg Rules provide for door-to-door liability coverage.\textsuperscript{127}

D. 17 DEFENSES, NAUTICAL FAULT AND BURDEN OF PROOF

Under COGSA, Hague and Visby, carriers have the burden to prove their vessel is seaworthy and the exercise of due diligence. However, the carrier has 17 defenses from liability. The most controversial is the nautical fault defense, which exempts a carrier from liability when the loss or damage arose from a negligent act in the navigation or management of the ship.\textsuperscript{128}

The Hamburg Rules reduce the 17 defenses down to three, and no longer exonerate the carrier from negligence for nautical fault.\textsuperscript{129} Carriers maintain that the Hague-Visby approach is appropriate, noting that most of the 17 defenses are implicitly retained anyway in the Hamburg regime, other than the nautical fault defense.\textsuperscript{130} However, carriers feel the lack of specificity of multiple defenses into the three generalized defenses of Hamburg is a giant step backward in legal process; they view Hamburg as only creating vagueness and inconsistency in the law on their available defenses.\textsuperscript{131}

Shippers, in contrast, see the change in Hamburg on these defenses as a positive move, as more properly placing the risks of loss upon the carrier where it is negligent.\textsuperscript{132} In any event, shippers contend, the Hamburg Rules do not really abolish the entire list of carrier defenses, but rather effectively leave all defenses intact except for nautical fault.\textsuperscript{133}

\begin{thebibliography}{9}
\bibitem{125} Status of the Hamburg Rules, supra note 117, at 2 para. 13.
\bibitem{126} See American Flag Position Paper, supra note 120, at 244.
\bibitem{127} See Oversight Hearing, supra note 34, at 21 (Statement of Roger Wigen of 3M Corporation).
\bibitem{128} COGSA, 46 U.S.C. app. §§ 1303-1304; Status of the Hamburg Rules, supra note 117, at 2 para. 15; Oversight Hearing, supra note 34, at 126 para. 5.
\bibitem{129} Status of the Hamburg Rules, supra note 117, at 2 para. 15; Oversight Hearing, supra note 34, at 125.
\bibitem{130} American Flag Position Paper, supra note 120, at 234.
\bibitem{131} Id. at 233-235.
\bibitem{132} Oversight Hearing, supra note 34 at 68 (Shipper Comments on Papers Submitted by APL and International Chamber of Shipping in Opposition to the Hamburg Rules) [hereinafter Shipper Comments].
\bibitem{133} Id.
\end{thebibliography}
Carriers view the exemption of nautical fault as an important device for risk distribution among insurers in major casualties.\textsuperscript{134} It works to spread loss among numerous underwriters, with little effect on the world's cargo premiums. In any event, carriers maintain, the defense of nautical fault is unimportant in the vast, routine majority of claims, and potentially important in major casualties, such as collisions, strandings or fires.\textsuperscript{135}

In contrast, shippers see no justification for the nautical fault defense.\textsuperscript{136} Shippers contend that given today's advanced telecommunications, which allow shipowners to maintain constant verbal and visual contact their vessels, the historic rationale of the ship owner's inability to control its vessel at sea no longer exists.\textsuperscript{137} Shippers maintain that the nautical fault defense has only served to aid carriers in evading any liability for their wrongs. It is an embarrassment to exonerate a carrier based upon a showing of negligence, and unfair to make the shipper pay for established nautical or managerial negligence on the part of the carrier and/or its management and agents.\textsuperscript{138}

Carriers contend that under Hamburg, the burden there is not really any shifting of the burden of proof, other than as a result of vague draftsmanship of the ship owner's defense. It may be said, carriers argue, to have cast a heavier onus upon the carrier only because of the burden of resolving that "vagueness."\textsuperscript{139}

Shippers feel that existing cargo liability laws unfairly place major risks of loss on cargo owners, and that Hamburg properly shifts that risk.\textsuperscript{140}

E. Package Limitation and Increased Limits of Liability

As already noted, COGSA and Hague limit the carrier's liability to $500 per package. The 1979 Protocol to Hague-Visby raised the limit to 667.67 SDRs or 2 SDRs per kilogram of goods, whichever is higher. The Visby Amendment allows a shipper an opportunity to limit the carrier's liability to the equivalent of one package, when a large container is packed with multiple packages of valuable goods.\textsuperscript{141} Under Hamburg, the liability limits have been increased to 835 SDRs (about $1,000) per

\textsuperscript{134} American Flag Position Paper, supra note 120, at 236-237.
\textsuperscript{135} Id.
\textsuperscript{136} Shippers Comments, supra note 132, at 68-69.
\textsuperscript{137} See Oversight Hearing, supra note 34, at 21-22 (Statement of Roger Wigen of 3M Corporation).
\textsuperscript{138} Id.
\textsuperscript{139} American Flag Ship Position Paper, supra note 120 at 239.
\textsuperscript{140} Oversight Hearing, supra note 34, at 101 (Augello Testimony) [hereinafter Agello].
\textsuperscript{141} Oversight Hearing, supra note 34, at 126-127; Status of the Hamburg Rules, supra note 117, at 4 para. 17-18.
package or 2.5 SDRs per kilogram.\textsuperscript{142} Carriers maintain all costs in the end fall back upon the shippers of cargo, who have to pay their own insurance premiums and ultimately, through freight rates, the carrier's premiums and liabilities.\textsuperscript{143} Even though increased recovery limits might be a gain for individual shippers, it would not be a gain for shippers as a class.\textsuperscript{144} Regarding the per-package definition, as well as the effect of containerization, carriers contend that the state of the law in the United States has become substantially settled in litigation.\textsuperscript{145}

Shippers believe that higher liability limits should result in a substantial reduction in their cargo insurance premiums.\textsuperscript{146} According to shippers, the shifting of risks to shipowners who have direct control over the degree of protection to cargo in transit is equitable.\textsuperscript{147} A specific provision defining what is a package is necessary, shippers urge, in view of the containerization age.\textsuperscript{148}

\section*{F. Delay Damages}

Neither COGSA, Hague nor Hague-Visby cover carrier damage for delay of goods.\textsuperscript{149} However, Hamburg provides for delay damages up to two-and-a-half times the freight payable for the goods delayed.\textsuperscript{150} Carriers argue that damages for unreasonable delay are nonetheless recoverable under present law, and that Hamburg merely limits damages for delay.\textsuperscript{151} Shippers disagree, contending that Hamburg properly allows for two-and-a-half times the freight charges.\textsuperscript{152}

\section*{G. Deck Cargo}

Under Hague, the carrier is not liable for cargo carried or stacked on deck under a bill of lading stating that the cargo is to be carried in that manner.\textsuperscript{153} The Hamburg Rules, on the other hand, take into account modern transport techniques involving stowage of containers on deck and

\begin{footnotesize}
\begin{enumerate}
\item\footnote{142}{Status of the Hamburg Rules, supra note 117, at 4 para. 16; Oversight Hearing, supra note 34, at 127.}
\item\footnote{143}{American Flag Ship Position Paper, supra note 120, at 230.}
\item\footnote{144}{Id.}
\item\footnote{145}{Id. at 240.}
\item\footnote{146}{Augello, supra note 140, at 100-101.}
\item\footnote{147}{Id.}
\item\footnote{148}{American Flag Ship Position Paper, supra note 120, at 239-40.}
\item\footnote{149}{Status of the Hamburg Rules, supra note 117, at 4 para. 21; Oversight Hearing, supra note 34, at 127.}
\item\footnote{150}{Id.}
\item\footnote{151}{American Flag Ship Position Paper, supra note 120, at 246.}
\item\footnote{152}{Status of the Hamburg Rules, supra note 117, at 4 para. 21.}
\item\footnote{153}{Id. at 4 para. 19; Oversight Hearing, supra note 34, at 126.}
\end{enumerate}
\end{footnotesize}
provide appropriate rules for deck cargo.\textsuperscript{154}

**H. Uniformity of Law and Increased Litigation**

Carriers state that the Hamburg Rules are inconsistent, unclear and confusing, and replacing the Hague Rules will create another half century of litigation to interpret the new treaty.\textsuperscript{155}

To the contrary, shippers maintain that the Hamburg Rules will result in less litigation due to removal of the nautical fault defenses, the introduction of the presumed fault standard, and increased time limits.\textsuperscript{156} Extensive litigation is not required, shippers argue, to determine what the Hamburg standards of liability means.\textsuperscript{157} Comparing the Hamburg standards to those of the Warsaw Convention, shippers comment that no oppressive litigation or claims payments have been reported.\textsuperscript{158}

**I. Economic Implications of the Regimes**

Carriers maintain that adoption of the Hamburg Rules would necessarily lead to higher costs both in the short term and the long run.\textsuperscript{159} In contrast, shippers argue that Hamburg \textit{must} result in lower costs for them since it eliminates double insurance on the same risk.\textsuperscript{160} But after five years of futile searching for reliable data, both sides abandoned the effort to resolve the economic argument, recognizing that neither economic proposition is provable to its opposition.\textsuperscript{161}

**J. The Ongoing Stalemate**

As the conflict was summarized in 1992 by Professor Joseph Sweeney of Fordham University Law School:

Because theoretical positions for or against the alternative solutions are wedded to economic self-interest, we have reached the point where organized shippers (something hardly possible before changes in the antitrust law in 1984) and organized carriers (carriers have always been very effectively organized) are glaring at each other and saying \textit{NEVER}. The voice of the insurance industry is also not heard as the voice of experience but rather the voice of self interest as P&I clubs — responsive to their shipowner members’

\textsuperscript{154} \textit{Status of the Hamburg Rules, supra} note 117, at 4 para. 20; \textit{Oversight Hearing, supra} note 34, at 126.

\textsuperscript{155} \textit{American Flag Ship Position Paper, supra} note 120 at 235.

\textsuperscript{156} \textit{Shipper Comments, supra} note 132, at 69.

\textsuperscript{157} \textit{Id.}

\textsuperscript{158} \textit{Id.}


\textsuperscript{160} \textit{See Sweeney, supra} note 7, at 531.

\textsuperscript{161} \textit{Id.}
III. Proposals for World Uniformity

At this time, most of the United States’ trading partners have adopted the Hague-Visby Amendments.\textsuperscript{163} These include such commercial allies as Australia, Canada, Japan, Belgium, China, Denmark, France, Germany, Hong Kong, Italy, Netherlands, Norway, Spain, Sweden, Switzerland and the United Kingdom, an estimated 63.9 percent of U.S. trade.\textsuperscript{164}

The 22 nations adhering to the Hamburg Rules to date are generally developing nations with an import-export focus, estimated at less than 2 percent of U.S. trade.\textsuperscript{165} Ship owning interests often raise the criticism that the Hamburg Rules have only been adopted by a minuscule portion of the world’s foreign trade, with no major commercial power adopting the rules.\textsuperscript{166} However, as commented by Professor Sturley, the U.S. adoption of the Hamburg Rules would undoubtedly be a major factor in their gaining widespread international acceptance.\textsuperscript{167}

Some U.S. trading partners have compromised with variations of the trigger approach, ratifying Hague-Visby immediately and adopting Hamburg at a later time. However, most recent enactments of Hague-Visby by other countries have included custom-tailoring in the domestic legislation.\textsuperscript{168} Some states have adopted, and others are about to adopt, laws that combine elements of the Hague and Hamburg approaches. Those laws, unfortunately, are far from uniform in combining the two regimes.\textsuperscript{169}

A. Australian Carriage of Goods by Sea Act 1991

For example, Australia enacted its Carriage of Goods by Sea Act in 1991 under which the Visby Amendments with the SDR Protocols were ratified immediately, with automatic adoption of the Hamburg Rules in

\begin{itemize}
\item \textsuperscript{163} \textit{Basic Cargo Damage}, supra note 16, at 2-23.
\item \textsuperscript{164} \textit{Oversight Hearing}, supra note 34, at 42-44.
\item \textsuperscript{165} \textit{Id.} at 40.
\item \textsuperscript{166} \textit{E.g., Oversight Hearing, supra note 34, at 55 (Statement of American Institute of Marine Underwriters, June 24, 1992)}.
\item \textsuperscript{167} \textit{Basic Cargo Damage}, supra note 16, at 2-24 n. 9.
\item \textsuperscript{168} Chandler Memorandum, supra note 99, at 2.
\item \textsuperscript{169} \textit{See Status of the Hamburg Rules, supra note 117, at 2.}
\end{itemize}
three years. In its bill the Australian Parliament pointed out that Visby and SDR Protocol do not alter the inherent balance of liability between shipper and carrier.

The Australian Parliament commented that under Hamburg carrier liability is extended to reflect the different categories of cargo now carried, new technology and loading methods, and other practical problems incurred by shippers such as losses incurred through delays in delivery. The deferred implementation of the Hamburg Rules is necessary, the Australian Parliament stated, as they had not yet come into force internationally and do not provide a viable alternative marine cargo liability regime at this time.

B. CANADIAN CARRIAGE OF GOODS BY WATER ACT 1993

In 1993 Canada enacted its Carriage of Goods by Water Act, implementing the 1968 Visby Amendments and the 1979 Special Drawing Rights Protocol immediately. The law also includes provisions for future adoption of the 1978 Hamburg Rules. The Act will require the Minister of Transport to conduct a review within five years to determine whether the Hague Visby Rules should be replaced by the Hamburg Rules. Thus the Act allows Canada to implement new liability rules as Canada’s trading partners adopt these conventions. The Minister called it a staged approach with respect to the two international conventions. Canada naturally would like to move in concert with the United States, because the United States is Canada’s second largest trading partner in terms of waterborne trade.

C. KOREAN CARRIAGE OF GOODS LAW

Korea also took liberties with the Hague-Visby Amendment. Article 789 of the Korean Carriage of Goods Law for Maritime Commerce contains 11 defenses available to a carrier. Significantly, the Korean version of Visby has specifically eliminated the nautical fault and fire defenses. The Korean law does not allow a shipowner to limit his liability

170. 1991 AUSL. ACTS 160 (October 31, 1991). As of this writing, Australia has not yet implemented the Hamburg Rules.
171. 492. See Oversight Hearing, supra note 34, at 170 (Explanatory Memorandum to Australian Carriage of Goods By Sea Bill).
172. Id. at 171.
173. Id.
175. Oversight Hearing, supra note 34, at 128.
177. See Korean Commercial Code, Ch. IV, § 1, at Art. 787-89.
178. Id.
for delay in the carriage of sea cargo.\textsuperscript{179}

D. THE SCANDINAVIAN MARITIME CODES

Thus far the most radical departure has occurred in the Scandinavian countries who have incorporated much of the Hamburg Rules in their version of Hague-Visby.\textsuperscript{180} Even the Scandinavian countries, "with their long history of supporting international uniformity in this field, have adopted legislation . . . that strikes a compromise between Hague-Visby and the Hamburg Rules."\textsuperscript{181}

Finland, Norway, Sweden and Denmark believe that the Hamburg Rules look to the future, and are implementing as much of the Hamburg Rules in the new legislation as is allowed by Hague-Visby.\textsuperscript{182} The legislation is expected to give rise to many conflicts and much uncertainty in the industry when coming into force.\textsuperscript{183} The major changes in the new Scandinavian codes include the following, as aptly summarized by Christopher Lowe and Ulrik Andersen:

In the new codes, the so called tackle-to-tackle principle the Hague-Visby rules is abandoned. The carrier will no longer be allowed to exclude liability for damage to or loss of the goods occurring, at the loading port, before the goods pass the ship's rail or, at the unloading port, after passing of the rail. The carrier will be liable for as long as it is in charge of the goods at the port of loading, during the carriage and at the port of discharge. In other words, the Scandinavian countries have adopted the compulsory period of responsibility of the Hamburg Rules, which cannot be contracted out of.

The Scandinavian countries also give up the catalogue of defenses available to the carrier in the Hague-Visby Rules. Instead, the carrier must prove that its servants and agents took all measures that could reasonably be required to avoid the damage in order for the carrier to avoid liability for damage to the goods whilst they were in its charge. This rule has also been picked from the Hamburg Rules, but unlike the Hamburg Rules, the Scandinavian countries will continue to keep the carrier's defenses in respect of fire and navigational mismanagement of the ship.

The stricter provisions in the Hamburg Rules relating to carriage of live animals and deck cargoes have also found favour in Scandinavia. According to the new Codes, the carrier can no longer exclude liability for damage to or loss of live animals.

\textsuperscript{179} Id. at Art. 746.
\textsuperscript{180} Chandler Memorandum, supra note 99, at 2.
\textsuperscript{181} See Basic Cargo Damage, supra note 16, at 2-26 n. 19.
\textsuperscript{182} See Scandinavian Codes, Ch. 13, On Carriage of General Cargo. See also Christopher Lowe & Ulrik Andersen, Scandinavia: The Scandinavian Compromise — Maritime Codes, Lloyds List (1994) [hereinafter The Scandinavian Compromise].
\textsuperscript{183} Id.
Similarly, the carrier will no longer be allowed to exclude liability for loss of or damage to deck cargo, and cargo may only be carried on deck under very special circumstances. If the carrier carries a cargo on deck in breach of an express agreement with the shipper to carry it below deck, the carrier will lose his right to limit its liability.

The new Codes maintain the limitation amounts of the Hague-Visby Rules for damage to or loss of goods. The carrier may limit his liability to 2 SDR per kg of the goods or to 667.67 SDR per package, whichever is the higher amount.

The Scandinavian Codes also adopt the jurisdiction and arbitration provisions of the Hamburg Rules, ensuring a plaintiff that it can always commence proceedings in a minimum number of places: where the defendant has its principal place of business; where the transport agreement was entered into; or, where the goods were taken over or delivered by the carrier.184

E. THE CHINESE MARITIME CODE

China has also enacted legislation, which combines the characteristics of both Hague-Visby and Hamburg.185 In an attempt to follow those principles recognized internationally in the shipping world in its 1993 Maritime Code, China tailored carriers' main responsibilities based primarily upon the Hague-Visby Rules, while also adopting significant qualities of Hamburg.186 The pertinent provisions of the new Chinese act are as follows:

1. The law adopts the Hamburg definitions of carrier, to include both contracting carrier and the actual carrier.187

2. Modified from the Hamburg Rules, the carrier has responsibility over goods in containers from the time of receiving the goods at port, until the goods are delivered at the port of discharge. With non-container goods, the carrier is responsible from the time of loading until the time of unloading, derived from Hague-Visby.188

3. The carrier is liable to the shipper for delay as per Hamburg, but damages are limited to the (actual) freight payable for the goods delayed.189 There is no 2 1/2 times enhancement factor as in the Hamburg Rules;

184. Id.
188. Id. at Art. 46.
189. Id. at Art. 50, 57.
(4) Following the SDR Protocol of Hague-Visby, the carriers' liability for loss or damage to goods is 666.67 SDRs, or 2 units of account per kilogram, whichever is higher.190

(5) Twelve (12) defenses to carrier liability are maintained in the new Chinese code, derived from the 17 exceptions of the Hague Rules. Notwithstanding, as provided in the Hamburg Rules, the carrier shall bear the burden of proof for these defenses.191

(6) The carrier is liable for loss or damage to deck cargo, unless the shipper had contractually agreed to deck carriage beforehand. This provision is derived from Article 9 of Hamburg.192

F. MLA-PROPOSED U.S.CARRIAGE OF GOODS BY SEA ACT OF 1995

A recent attempt for industry consensus in the United States has been made by the Maritime Lawyers Association. In February 1995 the MLA proposed a draft bill titled the Carriage of Goods by Sea Act of 1995.193

The proposal appears to be an attempted harmonization of Hague-Visby and Hamburg, although primarily based on Hague-Visby. A problem with the MLA proposal of this sort is that for unilateral action to take place the United States would probably have to denounce the Hague-Visby Rules, a step which is viewed as not conducive to international uniformity.194

The MLA proposed bill is modeled from the form of the existing 1936 COGSA statute. Key features and revisions to COGSA are as follows:

(1) The nautical fault defense of 46 U.S.C. § 1304(2) has essentially been eliminated, as a carrier would be liable where the cargo claimant presents proof of negligence in the navigation or management of the ship. Section 4(2)(a) of the proposal provides:

(2) The carrier and their ships shall not be responsible for loss or damage arising or resulting from —

(a) Act of the master, mariner, pilot, or the servants of the ocean carrier in the navigation or in the management of the ship, unless the

190. Id. at Art. 56.
191. Id. at Art. 51.
192. Id. at Art. 53.
193. See Carriage of Goods by Sea Act §§ 1 to 16, 46 U.S.C. app. §§ 1300 to 1315 (Proposed Official Draft, Mar. Law. Assoc. 1995) [hereinafter Proposed Changes to COGSA]. The M.L.A. proposal consists of two appendices; the first is the proposed Act, the second is a copy of the Proposed Act striking out material to be deleted from the existing Act, and underlining new language. Further references to this material are to page numbers in the second appendix.
194. Cf. Sweeney, supra note 7, at 534.
person claiming for such loss is able to prove negligence in the navigation or management of the ship; (emphasis added)

(2) The fire defense is limited, as a carrier is liable if the cargo claimant proves the fire was caused by actual fault or privity of the carrier;\textsuperscript{195}

(3) The balance of the 17 defenses are restricted to circumstances only where loss was not caused by the actual fault and privity of the carrier and/or its agents, the burden of proof for the defense falling on the carrier;\textsuperscript{196}

(4) The carrier is proportionately liable for loss or damage shown to be caused by its agents;\textsuperscript{197}

(5) Absent any proof of cause of loss or damage, the carrier is liable for one-half of the loss or damage;\textsuperscript{198}

(6) A carrier is liable for loss or damage from any unreasonable deviation in saving or attempting to save life or property at sea. If deviation is reasonable, the exemption remains;\textsuperscript{199}

(7) Limitation of damages to 666.67 SDRs per package or two SDRs per kilogram, whichever is higher. These limits do not apply if a greater value was previously declared on a contract of carriage;\textsuperscript{200}

(8) Contracts of carriage include both negotiable and non-negotiable bills of lading, whether printed or EDI;\textsuperscript{201}

(9) The definition of carrier would encompass both shipowner and charterer, as well as the contracting carrier and performing carrier;\textsuperscript{202}

(10) Carriers would be liable from time of receipt to time of delivery of goods;\textsuperscript{203}

(11) The definition of goods does not exclude cargo by which the contract of carriage is carried on deck;\textsuperscript{204}

(12) Notice of damage or loss can be tendered to the carrier until delivery of the goods to the person entitled to receipt, or if not apparent, within three days thereafter;\textsuperscript{205}

(13) Inclusion of a three-month period for a carrier to bring an indemnification or contribution claim against another party; and allowing

\textsuperscript{195} Proposed changes to COGSA, supra note 193, at 14 (if adopted, this provision will be codified at 46 U.S.C. app. § 1304(2)(b)).

\textsuperscript{196} Id. at 13-17 (if adopted, this provision will be codified at 46 U.S.C. app. § 1304).

\textsuperscript{197} Id. at 15-16 (if adopted, this provision will be codified at 46 U.S.C. app. § 1304(2)).

\textsuperscript{198} Id. at 13-17 (if adopted, this provision will be codified at 46 U.S.C. app. § 1304).

\textsuperscript{199} Id. at 16 (if adopted, this provision will be codified at 46 U.S.C. app. § 1304(4)).

\textsuperscript{200} Id. at 16-17 (if adopted, this provision will be codified at 46 U.S.C. app. § 1304(5)).

\textsuperscript{201} Id. at 2 (if adopted, this provision will be codified at 46 U.S.C. app. § 1301(b)).

\textsuperscript{202} Id. at 1-2 (if adopted, this provision will be codified at 46 U.S.C. app. § 1301(a)).

\textsuperscript{203} Id. at 2 (if adopted, this provision will be codified at 46 U.S.C. app. § 1301(e)).

\textsuperscript{204} Id. at 2 (if adopted, this provision will be codified at 46 U.S.C. app. § 1301(c)).

\textsuperscript{205} Id. at 12 (if adopted, this provision will be codified at 46 U.S.C. app. § 1303(6)).
Creating Uniform Worldwide Liability Standards

one year to file an arbitration claim following delivery.\textsuperscript{206}

(14) Invalidating any prior covenants providing a choice of foreign forum for litigation if goods originated or passed through the United States.\textsuperscript{207}

(15) There is no liability for delay in delivery of goods.

The MLA proposal attempts to strike a compromise between carrier and shipper interests. To date, there has been no formal action taken on the MLA’s proposal.

IV. \textbf{What Should the United States Pursue for a New Legal Regime?}

Though having served shipping and international trade well for years, the Hague/COGSA regime is now substantially outdated.\textsuperscript{208} It was designed for marine transportation as existing before the late 1920s, and is unsuitable for entry into the 21st century.\textsuperscript{209} The original drafters of the Hague Rules could not have possibly anticipated the electronic data revolution, advanced satellite telecommunications, the containerization age, the elimination or reduction of most tariffs on trade, the world’s emergence into a global economy with GATT and NAFTA, or the proliferation in international ocean transport of goods.

The importance of the ocean shipping industry to the United States cannot be understated.

The United States is the world’s largest trading nation. In 1990, U.S. exports were valued at $393.6 billion, and U.S. imports at $495.3 billion. Hence, U.S. international trade amounted to $888.9 billion during 1990. These goods were transported into or out of the United States by surface, air, or ocean transportation modes. Ocean transportation, which consists of cargo carried by liner vessels, non-liner vessels (tramps) and tankers, totaled $445.2 billion in 1990.\textsuperscript{210}

The implementation of GATT and NAFTA in 1994-95 is expected to result in a dramatic increase of international ocean shipping for the United States. These multilateral trade pacts essentially eliminate most tariffs and many restrictions in international commerce.\textsuperscript{211}

With the passage of NAFTA and GATT, the important role ports

\begin{footnotes}
\item[206.] \textit{Id.} at 12 (if adopted, this provision will be codified at 46 U.S.C. app. § 1303(6)(d)).
\item[207.] \textit{Id.} at 13 (if adopted, this provision will be codified at 46 U.S.C. app. § 1303(8)(b)).
\item[208.] \textit{Oversight Hearing, supra} note 34, at 127.
\item[209.] \textit{Id.}
\item[210.] Andrew H. Card, Jr., U.S. Secretary of Transportation, \textit{Report to the President and Congress of the Advisory Commission on Conferences in Ocean Shipping}, (Washington, D.C., April 10, 1992) at 17. [hereinafter Card Report].
\item[211.] \textit{Senate Approves GATT Trade Bill 76-24, Clearing Way for WTO Early Next Year} 11 BNA \textsc{Int'l Trade Rep.} 1874 (1994); \textit{House, Senate Conferees Complete Work on GATT Bill}, 11
\end{footnotes}
and marine transportation play in the economic well-being of the United States will only grow.

Foreign trade is an increasingly important part of the U.S. economy, currently accounting for over 20 percent of our Gross Domestic Product. U.S. exports and imports are projected to increase in value from $454 billion in 1990 to $1.6 trillion in 2010, while the volume of cargo is projected to increase from 875 million metric tons to 1.5 billion in 2010.212

Various international shipping lines are now experiencing substantial increases in cargo volume and net profits from ocean shipping, which is attributed to the finalization of GATT and NAFTA.213 Capitalizing on the 1994-95 agreements liberalizing world trade (i.e. GATT and NAFTA), which are expected to increase trade at U.S. ports by significantly reducing or eliminating tariffs, major U.S. port cities such as Baltimore, Seattle and Tacoma already report significant expansion of international cargo trade ranging from three percent to 16 percent.214

The United States can no longer proceed under an outmoded risk allocation system. Shipper and carrier interests, by necessity, must be prepared to make compromises for this purpose. With the significant growth of international ocean shipping as discussed above, an increase of cargo claims and litigation will be determined within an ancient system that is no longer prepared to efficiently, fairly and effectively resolve these disputes.

Due to strongly opposing sentiments of carrier and shipper interests, it is questionable whether the U.S. Congress will ever have the impetus to enact either the Hague-Visby or Hamburg regime. Notwithstanding, all shipping interests agree that COGSA has long been outmoded, and that devising a new legal regime is essential.

What type of liability scheme would be fair, realistic and serve the better long-term interests of American society? In this regard, there is no reason why the United States is constrained to rigidly adopt either Hague-Visby or Hamburg in toto, without exploring combinations, compromises and other alternatives. If substantive variations of these rules are contemplated, it may be necessary for the United States to denounce the particular compact being revised.215 In addressing these issues, vari-

215. C.f. Sweeney, supra note 7, at 534.
ous policy factors should be considered.

A. WORLD UNIFORMITY

It serves the international trade community of coming decades to promote a new legal regime upon the framework of the Hague-Visby Amendment with its SDR Protocol. As most of the industrialized world and trading nations have gravitated towards Hague-Visby, there are strong considerations for proceeding in that direction. However, the Hamburg Rules have some attractive attributes as well. Enactments of other countries, as discussed above, attempt an equitable balancing of interests between carriers and shippers.

B. STRONG U.S. FLAG FLEET

National merchant fleets not only contribute to the prestige of countries that sponsor them, they are often viewed as essential to protecting national security and guaranteeing unimpeded access to international markets on reasonable terms. Extensive government intervention in the support of national fleets, is said to be the most distinguishing feature of the ocean shipping industry.216 "A basic goal of the [U.S.] Shipping Act of 1984 is to preserve and encourage the development of an economically sound and efficient United States-flag liner fleet capable of meeting national security needs."217

An important factor that must necessarily be considered is the survival of the "U.S. flag fleet which has experienced a marked decrease in the number of American-flagged carriers since 1984. Regrettably, this trend is continuing."218

In response to 1992 reports that two of our largest liner companies would leave the U.S. flag and possibly change their corporate status by 1995, U.S. Representative Robert W. Davis noted that the liners' decision would be "based on many factors — but principally centers around their need to be competitive in the world market."219 He stressed the importance of a "continued and significant presence of a U.S. flag, U.S. owned and U.S. crewed liner operation."220 Even the shippers, Congressman Davis maintained, the polar opposite of carriers, "would rue the day when there are no U.S. carriers 'at the table.'"221 To prevent the loss of our U.S. flag fleet, he suggested that we revisit regulatory and economic approaches, to maintain the delicate balance between the carriers and

217. Id. at 170 (statement of U.S. Representative Walter B. Jones).
218. Id. at 175 (statement of U.S. Representative William J. Hughes).
219. Id. at 173-74 (statement of Representative Robert W. Davis).
220. Id.
221. Id.
shippers.222

On this note, a strict Hamburg regime, expected to “provide for an increase in carrier liability,”223 might not be a source of encouragement for a U.S. flag fleet. It is perhaps better, considering the important national interest of the United States of maintaining a U.S. flag fleet, to pursue a more balanced approach to risk allocation.

C. COMPROMISE ON THE “NAUTICAL FAULT” DEFENSE

Undoubtedly one of the major sources of controversy between shippers and carriers is the nautical fault defense, effectively exonerating shipowners from the negligence of their captains and crew in the navigation and management of the ship. The nautical fault defense is said to be at odds with traditional American tort concepts, as well as the liability laws governing the trucking and railroad companies.

As was testified in 1992 before the House Subcommittee on Merchant Marine by Roger Wigen, on behalf of the National Industrial Transportation League (a shipper's organization):

The world has changed a great deal since the Hague Rules were adopted in 1924. Wooden ships have given way to highly automated steel ships. Marconi’s wireless has been replaced with satellite communications. Gangs of longshoremen lifting loads of breakbulk cargo have yielded to lines of intermodal containers hoisted aboard ships by cranes. Formerly isolated national economics now compete fiercely in global commerce.

However, the laws governing international maritime cargo liability have failed to keep pace. They seem to be tied to a philosophy which believes a carrier has no liability for cargo once a seaworthy ship leaves port, even if the captain or crew are guilty of negligence. These laws accept the premise that once at sea, the carrier has no control over its vessel, captain, and crew. While this may have been true in the first third of this century, it certainly is not true today. Telecommunication advances allow maritime liner companies to have as much control over its vessel and crew as do trucking and railroad companies.224

The nautical fault defense might be revised, as its historic rationale has been virtually eliminated. The ship owner’s lack of control over his vessel, captain and crew while out at sea has become a diminishing problem, due to satellite telecommunications and other advanced technologies which enable the shipowner to continuously monitor and control the operation of his vessels through regular verbal, visual and radar communications.

As there may be certain situations in which the historic rationale for

222. Id.
223. Oversight Hearing, supra note 34, at 31.
224. Id. at 21-22 (statement of Roger Wigen).
the nautical fault defense would still be applicable, a fair and logical compromise might be reached on this issue by creating a qualified nautical fault defense. Circumstances may still exist where the shipowner is unable to exercise reasonable control over his vessel, captain, and crew, or where the shipowner is unaware of facts and circumstances leading to the negligence of his captain and crew in their operation and management of the vessel. For example, evidence showing an unexpected technical break in communications preventing conveyance of a ship owner's directions to his captain or crew, or a ship owner's lack of knowledge of their negligent propensities due to concealment, might suffice to establish the defense.

Thus, rather than maintain a complete exemption, a qualified nautical fault defense would be equitable to both sides to the debate, and still retain its traditional rationale. The shipowner should have the burden of presenting evidence to establish his lack of control or lack of knowledge of facts under these circumstances.

D. AN EFFECTIVE & ECONOMICAL LOSS COMPENSATION SYSTEM

The better interests of a commercial society may be advanced with a strong first-party claims resolution system, primarily reliant on cargo damage coverage. Once damage to freight is shown to be a covered loss, a shipper's own cargo insurer will routinely investigate and evaluate the claim, promptly compensating the shipper. It can be expected to be a relatively quick process. A cargo insurer can always pursue contribution, indemnification and/or subrogation against any other responsible parties, including the carrier. Hague-Visby seems to allocate the greater risk of loss upon the shipper, essentially furthering a strong first-party indemnity system. In contrast, the Hamburg Rules create a new regime of third party rights and remedies against the carrier, shifting somewhat to a third-party recovery process.

Despite the shift of risk in the Hamburg Rules favoring shippers, it is always the shipper that ultimately pays for the loss.225 Even if the Hamburg Rules are adopted in the United States, the need for cargo damage insurance for the shipper would not be eliminated.

Cargo insurance, unlike shipowners' protection and indemnity insur-

225. See William Warren, Red Hot Issue or Red Herring? Legal Liability and Cost of Cargo Insurance, 34 Am. SHIPPER 40 (1992) (where a maritime attorney expressed a view not long ago that "the whole issue is a red herring, because no matter who buys coverage, shippers end up paying the premium. Increasing liability may be shrewd public relations [for the carrier], but it is an essentially meaningless gesture . . . because increased premiums will eventually be passed along to the shipper." According to that maritime attorney, the party in the best position to purchase cargo insurance is the shipper, because only the shipper has certain knowledge of what is being shipped. Thus, it might be that shippers and carriers really have little in substance to argue about anyway).
V. Conclusion

The United States is the world's largest trading nation, with international trading approaching $1 trillion annually. The importance of ocean transportation to U.S. foreign trade is great, as approximately half of that trade consists of cargo carried by liner vessels.

The emergence of the United States into the global economy of the 21st century with GATT and NAFTA underscores the need for an effective and uniform risk allocation system for cargo loss, damage and delay. The United States should consider adoption of a Hague-Visby regime incorporating aspects of Hamburg, fairly balancing the interests of carriers and shippers.

Comment


Thomas H. McConnell*

Table of Contents

I. Introduction .................................................. 503
II. Summary of Jefferson Lines v. Oklahoma Tax Commission ................................................. 504
   A. Critical Summary .......................................... 510
   B. Implications ................................................ 511
III. The Averted Financial Impact .................... 511
IV. The Congressional Response ....................... 515
V. Conclusion .................................................... 518

I. Introduction

In April of 1995, the U.S. Supreme Court decided Jefferson Lines v. Oklahoma Tax Commission.1 In a 7-2 decision, the Court held that a state could impose a sales tax on the full fare price of bus tickets sold for

* J.D./M.B.A. (expected 1997), University of Denver; B.A. Economics (1992), Miami University. The author wishes to thank Darrel Mullins, the Notes and Comments Editor, for his assistance in preparation of this Comment.
interstate travel, as long as the trip began within the taxing state. In so doing, the Court distinguished the 1948 decision of Central Greyhound Lines v. Mealey which generally had been interpreted to mean that such taxes violated the dormant Commerce Clause of the U.S. Constitution.

While Oklahoma was the only state at the time of the decision that had attempted to impose such a sales tax on interstate commerce, the decision opened the possibility of a wave of similar new state taxes. As a result of the potentially onerous nature of such new taxes on a financially unsettled intercity busing industry, the American Bus Association (ABA) immediately pressured Congress for legislative protection. On December 29, 1995, President Clinton signed the Interstate Commerce Commission Termination Act. This legislation provided the protection the ABA sought. This Comment will begin with a review of the Jefferson Lines decision. It will then discuss the financial health of the interstate busing industry and the likely effect such new taxes might have had. It will conclude with a look at the new legislation and its likely interpretation.

II. Summary of Jefferson Lines v. Oklahoma Tax Commission

Jefferson Lines v. Oklahoma Tax Commission arose as a result of Jefferson Lines' failure to collect an Oklahoma tax on bus tickets sold within Oklahoma for interstate travel originating there. Jefferson Lines violated the following Oklahoma statutory provision: "[T]here is hereby levied upon all sales . . . an excise tax of four percent of the gross receipts . . . of each sale of the following: . . . (C) Transportation for hire to persons by common carriers, including . . . motor transportation companies . . . and other means of transportation for hire." After Jefferson Lines filed for Chapter 11 bankruptcy protection on October 27, 1989, the Oklahoma Tax Commission conducted an audit of Jefferson Lines. Sales

2. Id. at 1334. Oklahoma Tax Comm'n, v. Greyhound Lines, Inc., 50 F.3d 317 (5th Cir. 1995) involved the identical issue and the holding of Jefferson Lines controlled that decision. Id. Note that Greyhound Lines also involved an interstate busing company which filed for Chapter 11 bankruptcy protection. Id.
7. Telephone Interview with Susan Perry, Vice-President, American Bus Association (January 16, 1995).
9. Telephone Interview with Susan Perry, supra note 7.
11. Id. at 1334 (fn. 1) (citing Oklahoma Statute Title 68, § 1354(1)).
tax returns revealed a deficiency of $46,659\textsuperscript{13} for which the Oklahoma Tax Commission subsequently filed a proof of claim.\textsuperscript{14} Jefferson Lines objected to the claims and the U.S. Bankruptcy Court\textsuperscript{15} agreed that the tax imposed an undue burden on interstate commerce and presented the danger of multiple taxation in violation of the dormant Commerce Clause.\textsuperscript{16} The District Court for Minnesota\textsuperscript{17} and the Eighth Circuit Court of Appeals\textsuperscript{18} affirmed the Bankruptcy Court's ruling, the latter holding that the tax was not fairly apportioned as required by the decision in Central Greyhound Lines, Inc. v. Mealey.\textsuperscript{19} The U.S. Supreme Court reversed holding that the tax on the sale of transportation services was consistent with the Commerce Clause. Justice Souter authored the majority opinion. Justice Scalia, joined by Justice Thomas, concurred in the judgment. Justice Breyer was joined by Justice O'Connor in the dissent.

The Jefferson Lines majority opinion began with a discussion of broad policy issues. It noted that the dormant Commerce Clause "prohibit(s) certain state taxation even when Congress has failed to legislate on the subject."\textsuperscript{20}

We have understood this construction to serve the Commerce Clause's purpose of preventing a State from retreating into economic isolation or jeopardizing the welfare of the nation as a whole as it would do if it were free to place impermissible burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear. The provision thus reflects a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.\textsuperscript{21}

The Court, in demonstrating the consistency of the opinion in the instant case with prior precedents, proceeded to set out in detail the 1938 decision of Western Live Stock v. Bureau of Revenue.\textsuperscript{22} Western Live Stock involved a gross receipts tax on revenues received from "out-of-state advertisers."\textsuperscript{23} The Jefferson Lines court stated that the Western

\textsuperscript{13} Brief for Petitioner at 5, Jefferson Lines, 115 S. Ct. 1331 (No. 93-1677).
\textsuperscript{14} Jefferson Lines, supra note 1, at 1335.
\textsuperscript{16} Jefferson Lines, supra note 1, at 1335.
\textsuperscript{18} 15 F.3d 90 (8th Cir. 1994).
\textsuperscript{19} Id. at 1335 (citing Central Greyhound v. Mealey, 334 U.S. 653 (1948)).
\textsuperscript{20} Jefferson Lines, supra note 1, at 1335 (citations omitted).
\textsuperscript{21} Id. at 1336.
\textsuperscript{22} 303 U.S. 250 (1938).
\textsuperscript{23} Jefferson Lines, supra note 1, at 1336.
Live Stock court had no constitutional qualms with a tax on interstate commerce.24 The difficult question, however, was whether the tax could reach the full amount of revenues generated through interstate commerce or whether only a portion of these revenues could be taxed by New Mexico (leaving another portion for the other state(s) involved in the transactions). In other words, was apportionment of the tax required.25 The decision in Western Live Stock determined no apportionment was necessary because the value derived from interstate commerce could not be taxed elsewhere. Finally, the Court in Jefferson Lines quoted Western Livestock's statement that "it was not the purpose of the Commerce Clause to relieve those engaged in interstate commerce from their just share of the state tax burden."26

The Court also noted that Western Livestock marked the point at which the "old formalism" proscribing all taxation on interstate commerce "began to give way."27 The Court went on to explain that its 1977 Supreme Court decision in Complete Auto Transit Inc. v. Brady28 inaugurated the beginning of the current approach to taxation of interstate commerce.29

Complete Auto set forth the test which the majority applied in Jefferson Lines. The test includes four separate prongs. The first prong asks whether the activity taxed has a substantial nexus with the taxing State.30 The second prong determines whether the tax is fairly apportioned so that "each State taxes only its fair share of an interstate transaction."31 The third prong assures the tax does not discriminate against interstate commerce for the benefit of intrastate commerce.32 The fourth prong determines whether the tax is "fairly related to the services provided by the [taxing] state."33

The Court proceeded to apply the Complete Auto test to the Jefferson Lines case. The Court held the first prong of the test, the substantial nexus test, easily satisfied. Following McGoldrick v. Berwind-White Coal Mining Co.34 and Goldberg v. Sweet35 the court found that the sale of

24. Id.
25. Id. at 1337.
26. Id. (citing Western Livestock, 303 U.S. at 254).
27. Jefferson Lines, supra note 1, at 1336.
29. Id.
30. Id. (quoting Complete Auto, 430 U.S. at 279).
31. Id. at 1338 (citing Goldberg v. Sweet, 488 U.S. 252 (1989)).
32. Id. at 1344-1345 (citations omitted).
33. Id. at 1337 (quoting Complete Auto, 430 U.S. at 279).
34. 309 U.S. 33 (1940)
tangible goods and services as recognized by *Goldberg* provides "a sufficient nexus to the State in which the sale is consummated to be treated as a local transaction taxable by that State." 36

The second prong of the *Complete Auto* test guards against multiple taxation. 37 Two subtests, internal and external consistency, are employed. 38 "Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear." 39 "External consistency . . . looks . . . to the economic justification for the State's claim upon the value taxed." 40 The Court found the Oklahoma tax met the internal consistency subtest because if every state were to impose an identical tax, "that is, a tax on ticket sales within the State for travel originating there, no sale would be subject to more than one State's tax." 41

The Court then addressed the external consistency subtest. After citing to several cases (including *Central Greyhound v. Mealey* 42 relied upon by the lower courts 43) which required apportionment of income tax revenue between different states, the Court stated:

In reviewing sales taxes for fair share, however, we have had to set a different course. A sale of goods is most readily viewed as a discrete event facilitated by the laws and amenities of the place of sale, and the transaction itself does not readily reveal the extent to which completed or anticipated interstate activity affects the value on which a buyer is taxed. We have therefore consistently approved taxation of sales without any division of the tax base among different States, and have instead held such taxes properly measurable by the gross charge for the purchase, regardless of any activity outside the taxing jurisdiction that might have preceded the sale or might occur in the future. 44

The Court noted that it remains permissible for a good to be taxed more than once while in the stream of commerce. A sales tax could be imposed on the buyer and an income tax could be imposed on the seller. 45 Nonetheless, "because the taxable event of the consummated sale of goods has been found to be properly treated as unique, an internally consistent, conventional sales tax has long been held to be exter-

---

37. Id.
38. Id.
39. Id.
40. Id.
41. Id.
42. Id. at 1339 (citing *Central Greyhound v. Mealey, supra* note 3, at 1266).
44. *Jefferson Lines, supra* note 1, at 1339.
45. Id. at 1339-1340.
nally consistent as well."

The Court noted that the entire gross receipts from services performed wholly within the taxing state may be taxed. It further explained that if services are performed partially in other states, then a gross receipts or income tax must be apportioned. Here, however, cases dealing with gross receipts did not apply because the Oklahoma tax was not a gross receipts tax, but was instead a sales tax. Unlike a gross receipts tax, the possibility of multiple taxation does not exist with sales taxes. A sales tax falls on the buyer of the services, who is no more subject to double taxation on the sale of these services than the buyer of goods would be. The taxable event comprises agreement, payment, and delivery of some of the services in the taxing State; no other State can claim to be the site of the same combination.

The Court equated the delivery of goods with "the combined events of payment for a ticket and its delivery for present commencement of a trip." The Jefferson Lines Court continued by rebutting the argument that, although the identical tax could not be levied by other states, a similar tax could be levied which would amount to multiple taxation. A gross receipts tax imposed by a neighboring state, or a "use tax" levied by other states of passage for that portion of the trip within that state in conjunction with the Oklahoma tax would not constitute multiple taxation. The Court concluded the discussion of the external consistency test by stating that simply because apportionment was feasible it was not required.

The Court next addressed the third prong of Complete Auto's test "requir[ing] the tax must not discriminate against interstate commerce, and must be fairly related to the services provided by the state." The Court reasoned that the tax did not discriminate against interstate activity because both interstate and intrastate bus trips were taxed equally. Jefferson Lines argued the tax was identical to that invalidated in American Trucking Association v. Scheiner. There, Pennsylvania imposed a flat tax on all trucks traveling in and through the state. The Court dis-

46. Id. at 1340.
47. Id. at 1340-1341.
48. Id. at 1341.
49. Id.
50. Id. at 1341-1343.
51. Id. at 1343-1344.
52. Id. at 1346 (citations omitted).
53. Id. at 1345.
agreed with Jefferson Lines, reasoning that Scheiner was not on point because the Oklahoma tax was a sales tax whereas the Pennsylvania tax was a use tax.\textsuperscript{56}

Lastly, the Court addressed the fourth prong of the Complete Auto test requiring that there be “a fair relation between a tax and the benefits conferred upon the taxpayer by the State.”\textsuperscript{57} This test does not require a “detailed accounting of the services provided to the taxpayer on account of the activity being taxed, nor, indeed, is a State limited to offsetting the public costs created by the taxed activity,” said the Court.\textsuperscript{58} Tax revenues can be used for other indirectly beneficial governmental purposes.\textsuperscript{59} The tax must only be reasonably related to the taxpayer’s presence or activities in the state.\textsuperscript{60} By virtue of the tax being imposed on a sale occurring wholly within the state of Oklahoma and measured by the amount of the sale, this prong is satisfied.\textsuperscript{61}

Justice Scalia concurred. He and Justice Thomas agreed with the Court’s holding for the reason that the “sales tax does not facially discriminate against interstate commerce.”\textsuperscript{62} Justice Scalia went on to call for the abolition of the “eminently unhelpful, so-called ‘four-part test’ of Complete Auto.”\textsuperscript{63} Justice Scalia further stated that the dormant Commerce Clause does not appear in the Constitution and only Congress possesses the power to immunize interstate commerce from nondiscriminatory state action.\textsuperscript{64}

Justice Breyer dissented. He viewed the Oklahoma tax as identical to the one held unconstitutional in Central Greyhound.\textsuperscript{65} Justice Breyer noted that the tax in Jefferson Lines

‘imposes an ‘excise tax’ of 4% on ‘the gross receipts or gross proceeds of each sale’ made in Oklahoma’ . . . [whereas] . . . ‘[t]he [Central Greyhound tax] imposed a 2% tax on the ‘receipts received . . . by reason of any sale . . . made’ [within the state].’ Oklahoma imposes its tax on the total value of trips of which a large portion may take place in other States. [Central Greyhound] imposed its tax on the total value of trips of which a large portion took place in other States. New York made no effort to apportion the tax to reflect the comparative cost or value of the in-state and out-of-state portions of the trips. Neither does Oklahoma. Where, then, can one find a critical

\textsuperscript{56} Id. at 1344.
\textsuperscript{57} Id. at 1345.
\textsuperscript{58} Id.
\textsuperscript{59} Id. at 1346.
\textsuperscript{60} Id.
\textsuperscript{61} Id.
\textsuperscript{62} Id.
\textsuperscript{63} Id.
\textsuperscript{64} Id.
\textsuperscript{65} Id. at 1346-1347 (dissenting opinion).
The dissent also characterized as form over substance the majority's distinction based on the payor of the tax. "The upshot is that, as a practical matter, in respect to both taxes, the State will calculate the tax bill by multiplying the rate times the gross receipts from sales; the bus company will pay the tax bill; and, the company will pass the tax along to the consumer."67

Justice Breyer found further fault with the Oklahoma tax because it attempted to tax more than the portion of revenue from interstate commerce "which reasonably reflects the in-state component."68

A. Critical Summary

Jefferson Lines validates sales taxes on the full price of interstate services. At its foundation, the decision distinguishes a sales tax from an income or gross receipts tax. The decision makes clear that income or gross receipts taxes must be apportioned, while sales taxes do not. State legislatures should realize that a tax on interstate commerce which reaches the full amount of the purchase price must be imposed on the buyer of the goods, not the seller.

Justice Breyer criticized the distinction between a sales tax and a gross receipts or income tax as an arbitrary line in the sand. He recognized the practical value of such a line in that it provides a simple rule for taxes imposed on the buyer of goods. However, he stated that "I would reaffirm the Central Greyhound principle, even if doing so requires different treatment for the inherently interstate service of interstate transportation, and denies the possibility of having a single, formal constitutional rule for all self-described 'sales taxes'."69

Despite the dissent's view, any holding to the contrary would be difficult to reconcile with Goldberg v. Sweet70 which involved a telecommunications excise tax "on the gross charge of interstate telecommunications (1) originated or terminated in Illinois, . . . and (2) charged to an Illinois service address, regardless of where a the telephone call is billed or paid."71 The case mirrors Jefferson Lines as the Goldberg tax "has many of the characteristics of a sales tax . . . ."72 Analytically, the cases differ only in the administrative feasibility of apportioning a tax on the basis of

---

66. Id. at 1347 (citations omitted).
67. Id.
68. Id. at 1349 (citing Goldberg, supra note 35, 488 U.S. at 262).
69. Id. at 1349.
70. Goldberg, supra note 35, 488 U.S. at 252.
71. Id. at 256.
72. Id. at 262.
the use of state infrastructure. It is virtually impossible to do so with the electronic impulses which comprise a long-distance telephone call, however, it is rather easy to track the route of a bus. The Jefferson Lines majority opinion makes clear that the feasibility of apportionment does not weigh on the outcome.

B. Implications

The implications of this case appear quite broad. “Beyond transportation services, [the] ruling could encourage state governments to explore ways to tax professional services such as advertising, accounting and legal representation.” Author Christopher C. Faille argues in a recent article that Jefferson Lines “foreshadows a gradual movement toward a view long associated with Justice Scalia, that the commerce clause imposes no restraints on the taxing powers of the several states beyond such limits as Congress specifically enacts; in other words, that there is no ‘dormant’ meaning to this clause at all.” He terms this trend “devolution” and states that it will come “at the expense of the unity and productivity of the continental marketplace.”

III. The Averted Financial Impact

The need for shielding the intercity busing industry from a wave of new sales taxes on interstate bus tickets is not overstated. The interstate bus industry has faced difficult times for many years. Greyhound, by far the largest carrier accounting for over 75% of the revenues generated by the nation’s 21 largest bus companies, is no exception. Therefore, for the sake of brevity and simplicity, this analysis will focus primarily on Greyhound.

In 1987 Greyhound, the largest national busing concern, bought out financially strapped Trailways rescuing it from bankruptcy. However, less than three years later, Greyhound itself filed for bankruptcy, leaving the U.S. without any “economically viable nationwide bus company.”

73. Id. at 254-255.
74. Jefferson Lines, supra note 1, at 1343-1344.
77. Id. at 36.
80. Henke, supra note 78, at 19.
81. Id.
Greyhound emerged from bankruptcy in 1991 with a highly leveraged financial structure. The following years continued to be difficult as Greyhound recorded net income after taxes of just $7,497,000 in 1993 and recorded a net loss of $77,421,000 in 1994. Among other recent troubles: dissident bond-holders filed an involuntary petition for Chapter 11 bankruptcy in December 1994 and recently, Greyhound financially restructured.

The nine largest regional carriers, including Greyhound, account for about 90% of the total intercity bus company revenues and have also faced lean times. These regional carriers split just $17,764,000 in after tax profits in 1993 and 1994 combined. For the first half of 1995, the nine largest regional carriers posted profits of just $1,252,000.

Industry financial ratios, which give further insight into the financial health of the industry, indicate slim profit margins for the busing industry as well. For 1992-93, the before tax profit margin for all intercity and rural bus transportation companies was just 2.6%. For the 1993-94 period, this ratio climbed slightly to 3.2%.

Given these slim margins, any new tax arguably would be passed along to consumers in order for a company to stay afloat. However, while the balance sheet might demand it, the economic realities would not allow it. Susan Perry of the American Bus Association (ABA) states that any new tax would be “one more threat to the bus industry and one more tax or fee that could not be passed on to customers, particularly if it had snowballed and other states had passed the tax.” Charlie Zelle, President of Jefferson Partners (the successor company to Jefferson Lines), echoes this thought and adds that new taxes would have to be absorbed by the bus companies through reduced ticket prices. Additional evidence supports these statements and indicates the inability of bus passengers to absorb any additional costs. The “intercity, regular-route passenger is almost twice as likely to be poor as an average person in the population.” Craig Lentzsch, Greyhound’s Chief Executive Of-

84. Id. at 8032.
85. 95 I.C.C.2d 47 (Apr. 17, 1995).
86. 95 I.C.C.2d 135 (Dec. 6, 1995).
88. Telephone Interview with Susan Perry, supra note 7.
89. Telephone Interview with Charlie Zelle, President, Jefferson Partners (February 1, 1996).
90. Henke, supra note 78, at 27.
ficer, confirms that bus passengers are extremely price sensitive.\(^\text{91}\)

Higher prices could also cause bus passengers to turn to competing forms of transportation such as automobiles, discount airlines, and, in some markets, Amtrak.\(^\text{92}\) Moody’s Transportation Manual states:

Recent trends in the travel market include a consistent increase in discounted airline pricing and the emergence of low-fare regional airlines. These regional airlines now compete in intermediate-haul markets (400 to 700) miles that formerly had little, if any, low-cost airline travel available. In response, the . . . bus industry generally has reduced prices in these markets in an attempt to compete. *Price is the primary method of meeting airline competition.*\(^\text{93}\)

Out-of-pocket costs of driving are generally less than the cost of bus travel. While pricing is a primary method of meeting this competition, the bus industry is somewhat “protected from the incremental economics of auto travel since many of its customers travel alone. The lack of multiple, reliable cars within a family, and fear of driving alone for long distances, serves to offset the economic advantage of multi-person travel in a single car.”\(^\text{94}\) Hence, the threat of an additional tax deterring bus travel might not be realized if other factors besides price contribute significantly to the traveller’s choice of transportation. Nevertheless, a general consensus exists among managers and analysts that bus passengers are extremely price sensitive.\(^\text{95}\)

Because new taxes could not be passed along to bus passengers, new state sales taxes would negatively impact the bottom line of intercity bus companies.\(^\text{96}\) In 1990, twenty-three billion intercity bus passenger miles were logged. Revenues totalled over $750 million dollars for the intercity busing industry in 1994.\(^\text{97}\) The Oklahoma Tax Commission estimated that the tax had generated about $400,000 a year in revenue for the state and Utah estimated that such a tax would raise about $150,000 in revenue annually.\(^\text{98}\)

Other than the potential fiscal impact, additional taxes could exacerbate the overall decline in the number of intercity bus routes and the

---


93. *Id.* (emphasis added).

94. *Id.*

95. See e.g. Moody’s Transportation Manual, *supra* note 83, at 1355; Telephone Interview with Susan Perry, *supra* note 7; Telephone Interview with Charlie Zelle, *supra* note 89; *Greyhound Making a Turnaround Company’s 3Q Profit Presages Profitable ’96, supra* note 91, at B7.

96. Telephone Interview with Charlie Zelle, *supra* note 89.

97. Anderson, *supra* note 74, at 64.

number of bus industry jobs. Since 1972, the number of towns with regular route intercity bus service has declined from over 14,000 to just 5,000.99 One author notes that “since bus service provides a crucial link for many rural communities, the demise of the long-distance, scheduled-route bus industry is an especially unfortunate trend.”100 The reduction in routes has been accompanied by a reduction in employment. In 1960, the industry employed 41,000 people while in 1990 this number shrunk to 20,000 people.101

Despite the beleaguered state of the intercity bus industry, recent news from Greyhound reveals that, in fact, prosperous times may be just around the corner. Recently, Greyhound modified its pricing strategy by “scrapping discount promotions and replacing them with everyday low prices. Greyhound’s core customers are last-minute buyers - 70 percent buy their tickets within three hours of departure . . . . To have deep discounts only for advance purchases meant those core customers couldn’t afford to ride Greyhound.”102 Consequently, after posting a loss of $30,175,000 in the first half of 1995,103 the first quarterly profit in over two years was recorded during the third quarter with net income of $15.3 million.104 Greyhound forecast a profit of $16.7 million for 1996 and while this number may not be reached “executives are confident that the company will be profitable.”105 Despite these encouraging numbers, at least one analyst warns that “Greyhound is in a tough business, and a turnaround is not easy - especially after the company’s . . . troubles in the early 1990s.”106

The financially turbulent intercity busing industry would have difficultyshouldering an additional sales tax burden. Charlie Zelle, President of Jefferson Lines, states that the passage of new sales taxes “probably would have led to cutbacks. [New taxes] would have eroded profitability and would have made some runs unaffordable.”107 Mr. Zelle adds that “communities would lose service, jobs would be lost, and the viability of scheduled service intercity bus transportation would be threatened.”108 These cutbacks could impact the poorest segments of the population through higher prices, reduced routes, and fewer jobs. From this perspec-

99. Henke, supra note 78, at 27.
100. Anderson, supra note 79, at 139.
101. Id. at 64.
103. 95 I.C.C.2d 135 (Dec. 6, 1995).
106. Id.
107. Telephone Interview with Charlie Zelle, supra note 89.
108. Id.
tive, a tax like that at issue in Jefferson Lines contravenes the purpose of the dormant Commerce Clause because it burdens interstate commerce and thereby "jeopardiz[es] the welfare of the nation as a whole."

IV. THE CONGRESSIONAL RESPONSE

Through Congressional lobbying efforts, the American Bus Association moved quickly to blunt the impact of the decision. Concurrently, states eager for a new source of revenue moved quickly to pass tax legislation. For example, Utah had already approved a tax effective January 1, 1996 on interstate bus service.\textsuperscript{110} Susan Perry, Vice-President of the American Bus Association (ABA) states "we knew as soon as the Supreme Court ruled that the only place to get it fixed was Congress. So we went immediately with two goals: 1) Getting it done using aviation precedent; and 2) Before the 1996 state legislatures convened-and we did it!"\textsuperscript{111}

The aviation precedent Ms. Perry refers to is Title 49 of the United States Code § 40116 which "specifically prohibits non-Federal taxes on the sale of air transportation or on passengers, or their transportation of gross receipts from transportation."\textsuperscript{112} The air travel exemption, originally passed in 1972 states:

(b) Prohibitions. . . a state or political subdivision of a State may not levy or collect a tax, fee, head charge, or other charge on—

(1) an individual traveling in air commerce;
(2) the transportation of an individual traveling in air commerce;
(3) the sale of air transportation; or
(4) the gross receipts from that air commerce or transportation.\textsuperscript{113}

As a consequence of the furious lobbying effort, Congress passed, and President Clinton signed into law, a very similar tax exemption statute for busing.\textsuperscript{114} Buried in the Interstate Commerce Commission Termination Act of 1995\textsuperscript{115} is the following:

A state or political subdivision thereof may not collect or levy a tax, fee, head charge, or other charge on—

(1) a passenger traveling in interstate commerce by motor carrier;

\textsuperscript{109} Jefferson Lines, supra note 1, at 1336.
\textsuperscript{111} Telephone Interview with Susan Perry, supra note 76.
\textsuperscript{113} 49 U.S.C.A. § 40116 (West 1995).
\textsuperscript{115} Id.
(2) the transportation of a passenger traveling in interstate commerce by motor carrier;
(3) the sale of passenger transportation in interstate commerce by motor carrier; or
(4) the gross receipts derived from such transportation.\textsuperscript{116}

The legislative history for the bus travel tax exemption obliquely recognizes the Jefferson Lines\textsuperscript{117} decision. It states that “[n]ew 49 U.S.C. § 14504 (State tax) is a new provision that would prohibit State and local governments from imposing a tax on the sale of intercity bus tickets. This provision is intended to override a recent court decision permitting such a tax.”\textsuperscript{118} Additional explanation of the new provision is extraordinarily brief adding only that the bill “preempt[s] a state’s ability to collect taxes or fees on interstate bus travel.”\textsuperscript{119} Ms. Perry, of the ABA, states that the exemption faced little opposition from Congress.\textsuperscript{120}

The airline travel tax exemption and the bus travel tax exemption employ very similar language. Furthermore, the bus travel exemption was modeled on the air travel exemption.\textsuperscript{121} Thus, the air travel exemption’s legislative history provides some additional insight into the bus travel exemption. The air travel tax exemption was part of the Airport Development Acceleration Act of 1973.\textsuperscript{122} The Senate Conference report accompanying this legislation states that “[t]his prohibition will ensure that passengers and air carriers will be taxed at a uniform rate—by the United States—and that local ‘head’ taxes will not be permitted to inhibit the flow of interstate commerce and the growth and development of air transportation.”\textsuperscript{123}

Similar to the recent bus travel tax exemption, the airport travel tax exemption was in response to a U.S. Supreme Court decision.\textsuperscript{124} Evansville-Vanderburgh Airport Auth. Dist. et al. v. Delta Airlines, Inc.\textsuperscript{125} upheld “passenger head taxes enacted by New Hampshire and by Evansville, Indiana for ‘aviation related purposes.’”\textsuperscript{126} The Committee report states:

the Court decision does not provide adequate safeguards to prevent undue

\begin{footnotes}
\item[116] 49 U.S.C.A. § 14505 (West 1995)
\item[117] Jefferson Lines, supra note 1.
\item[119] Id. at 16.
\item[120] Telephone Interview with Susan Perry, supra note 7.
\item[121] Id.
\item[124] Id. at 1446.
\item[125] 405 U.S. 707 (1972).
\end{footnotes}
or discriminatory taxation. . . . It is significant that revenues which would be derived from some of these local or state head taxes would not be earmarked for airport development, but would be used to gain financial windfalls. . . . Recent experience . . . is indicative of the chaos which such local taxation works on the national air transportation system. The head tax brings on confusion, delay, anger and resentment and cuts against the grain of the traditional American right to travel among the states unburdened by travel taxes.\textsuperscript{127}

The long term implications of the bus travel tax exemption can only be imagined. Nonetheless, it is clear that while the bus travel tax exemption occurred in response to the decision in Jefferson Lines, the bus travel tax umbrella covers more than just the stipulated facts of that decision. Jefferson Lines did not "speak to sales taxes levied on tickets for travel wholly outside of Oklahoma or on routes originating in other states."\textsuperscript{128} The recent legislation does speak to these taxes by enacting a flat ban on the taxation of interstate bus passengers.\textsuperscript{129}

Taxation of the gross receipts derived from interstate commerce are banned by § 14505(4). Hence, states will apparently not be able to impose an income tax on interstate bus companies for income derived from interstate ticket sales regardless of whether such a tax is apportioned. A tax such as the unapportioned income tax at issue in Central Greyhound is likely preempted.\textsuperscript{130}

It is not clear, however, whether the bus travel exemption could be used to challenge an ad valorem tax imposed on interstate bus companies.\textsuperscript{131} Cases dealing with the airline tax exemption may provide some guidance. Aloha Airlines, Inc. v. Director of Taxation\textsuperscript{132} held that the airline tax exemption prevented Hawaii from imposing a gross receipts tax on the personal property of airlines operating within the state. In so doing, the Supreme Court rejected the reasoning of the Hawaii Supreme Court. The Hawaii Supreme Court felt the state tax stood outside the scope of the airline tax exemption because it was imposed upon air carriers rather than air passengers.\textsuperscript{133} At the very least, a plausible challenge could be raised by the intercity busing industry to ad valorem taxes.

Congressional authority to enact such legislation is well-established. The Court in Evansville-Vanderburgh\textsuperscript{134} wrote that Congress has the

\textsuperscript{127} Id. at 1446.
\textsuperscript{128} Greyhound Lines, supra note 2, at 318.
\textsuperscript{129} 49 U.S.C.A. §14505 (West 1995).
\textsuperscript{130} See supra, note 3.
\textsuperscript{131} Telephone interview with Charlie Zelle, supra note 89.
\textsuperscript{132} 464 U.S. 7 (1983)
\textsuperscript{133} Louisa A. Barash, State Airline Tax Grounded: Aloha Airlines, Inc. v. Director of Taxation, 38 Tax Law. 545, 545 (1985).
\textsuperscript{134} See supra note 126, 405 U.S. at 707.
power to preempt state taxation, noting that

[n]o federal statute or specific congressional action or declaration evidences a congressional purpose to deny or pre-empt state and local power to levy charges designed to help defray the costs of airport construction and maintenance. A contrary purpose is evident in the Airport and Airway Act of 1970. . . . ‘[A]t least until Congress chooses to enact a nation-wide rule, the power will not be denied to the State[s].’ 135

Note also, Justice Scalia in his concurrence in *Jefferson Lines* stated that “it is for Congress to make the judgment that interstate commerce must immunized from certain sorts of nondiscriminatory state action (i.e. taxation).” 136

Other Congressional action in response to the *Jefferson Lines* decision is present in the proposed Amtrak Reform and Privatization Act of 1995. An accompanying Senate Report explicitly recognizes the decision and states that “this ruling could be used to justify state taxes on Amtrak’s interstate passenger tickets and possibly on its interstate mail or freight transportation services.” 137 If passed, the bill would preempt such taxation authority. The report recognizes the potential fiscal impact by noting that Amtrak “collected about $830 million from ticket sales and about $60 million from mail and express services.” 138

In sum, while the Supreme Court may be submerging the dormant Commerce Clause, Congress appears ready to exercise its power to reduce the adverse fiscal impact on interstate commerce.

V. Conclusion

The U.S. Supreme Court decision in *Jefferson Lines* v. Oklahoma Tax Commission paved the way for states to enact sales taxes on the full price of interstate transportation tickets and may have opened the door for taxation of other services, as well. This decision signals an erosion of the dormant Commerce Clause doctrine and hence an augmentation of state taxing power. Congress, spurred by special interest groups such as the American Bus Association, stands prepared to preempt additional state taxation of interstate transportation. Such relief will be required to preserve the integrity of industries directly involved in interstate commerce such as intercity busing.

138. Id.