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INTRODUCTION

It appears strange that the Assembly of the International Civil Aviation Organization (ICAO), composed of all member States, has no powers in connection with the principle functions of the Organization, i.e., the formulation of Standards and Recommended Practices, nor any over the appointment and creation of the Organization's principle officers and sub-organs. Stranger yet, is the fact that even the little and insignificant powers that the ICAO Assembly possesses are easily and constitutionally/ conventionally "usurped," or interfered with, by the limited thirty-three member Council of the Organization. More puzzling is the fact that the limited membership Council, which normally answers to the Assembly, runs the Organization's entire business exclusively as it sees fit. The remaining one-hundred-fifty or more States have no means of checking it. The result is that the majority of States cannot contribute to the advancement of the international aviation cause as they might have if the universal organ had the voice and say it now lacks.

The entire constitutional and political set-up of ICAO is hardly justified in schools of democracy and its corollary - the supremacy of international organization Assemblies. There is need for a serious and meaningful re-evaluation of the ICAO framework and working methods in order to remedy this anomaly.1 The existing awkward situation readily

lends credence to critics who hold that the ICAO Assembly provides an interesting focus for study not for the powers it has, but for those it does not. The actualization of that proposition comes from the angle of that organ’s sessions. This paper clarifies a number of points on the unique international body called ICAO.

Fifty-three years ago, fifty-two nations\textsuperscript{2} met at the Chicago Convention to establish the ICAO. The ICAO would serve as the medium through which international understanding and agreement on civil aviation would be attained. The Chicago Convention resulted from great concern for the safe and orderly development of international civil aviation, as well as the desire to avoid friction and promote cooperation between nations and peoples upon which the peace of the world depends.\textsuperscript{3}

The reference to ICAO as “an outstanding instrument for better international understanding”\textsuperscript{4} is understandable in the light of the aims and purposes of the Chicago Convention, but the nature of international air transport that ICAO was created to carter for is enough cause for concern. The ICAO has legal capacity of its own\textsuperscript{5} and is composed of an Assembly, a Council, and such other bodies as may be necessary.\textsuperscript{6} It must fulfill its goals through the formulation of principles and other associated arrangements geared towards the safe and orderly development of international civil aviation. This process, in turn, should ensure that international air transport services are established on the basis of equality\textsuperscript{7}.

\begin{thebibliography}{9}
\item Honorable Lionel Chevrier's, (then Canadian Minister of Transport), Address of the Welcome to the Sixth Session of the ICAO Assembly on May 27, 1952, ICAO Doc. 7297 A6-P/21 [hereinafter Sixth Session] at 3.
\item \textit{See Chicago Convention, supra} note 2, at Article 47.
\item Id. at Article 43. This Article represents one of the unique features of ICAO; it creates only two principal organs for the Organization, with the Secretariat being completely ignored.
\item The sovereign equality principle, unrealistic and objectionable as it seems, is already well entrenched in public international law. \textit{See Agreement Governing the Activities of States on the Moon and Other Celestial Bodies}, at Preamble, and Articles 2, 4(1), 6(1), and 11(4), U.N. Doc. A/RES/34/68 (1979); The 1967 Treaty on Principles Governing the Activities of States on the Moon and Other Celestial Bodies, 610 UNTS 205, Preamble and Articles I and II; \textit{Knut
of opportunity and are operated soundly and economically.\textsuperscript{8}

The Chicago Convention, reflecting the preamble, sets out the avowed aims and purposes of ICAO, developing principles and techniques of international air navigation and fostering the planning and development of international air transport so as to: (a) insure the safe and orderly growth of international civil aviation throughout the world; (b) encourage the arts of aircraft design and operation for peaceful purposes; (c) encourage the development of airways, airports, and air navigation facilities for international civil aviation; (d) meet the needs of the peoples of the world for safe, regular, efficient and economical air transport; (e) prevent economic waste caused by unreasonable competition; (f) insure that the rights of contracting States are fully respected and that every contracting State has a fair opportunity to operate international airlines; (g) avoid discrimination between contracting States; (h) promote safety of flight in international air navigation; and (i) promote the development of all aspects of international civil aeronautics.\textsuperscript{9}

The controversy surrounding the extent to which these purposes extend or restrict ICAO's jurisdiction\textsuperscript{10} falls outside the scope of this paper. Nevertheless, if there is any truth in a reading of ICAO's powers in Chicago Convention's Article 37,\textsuperscript{11} which describes the organization as "the supreme world aeronautical organization,"\textsuperscript{12} there is little or none in re-

\textsuperscript{8} See Chicago Convention, supra note 2, at Preamble.
\textsuperscript{9} Id. at Article 44.
\textsuperscript{10} See Richard Janda, Passing the Torch: Why ICAO Should Leave Economic Regulation of International Air Transport to the WTO, 20-1 ANNALS AIR & SPACE L. 409, 410-16; PAUL STEPHEN DEMPSEY, LAW AND FOREIGN POLICY IN INTERNATIONAL AVIATION 7-16 (1987); JUAREZ, supra note 1, at 51 n.2 (where some authorities are cited, including BUERGENTHAL, supra note 2).
\textsuperscript{11} Article 37 of the Chicago Convention gives ICAO powers to adopt international standards and recommended practices and procedures on a wide range of aviation-related matters: (a) communications systems and air navigation aids, including ground marking; (b) characteristics of airports and landing areas; (c) rules of the air and air traffic control practices; (d) licensing of operating and mechanical personnel; (e) airworthiness of aircraft; (f) registration and identification of aircraft; (g) collection and exchange of meteorological information; (h) log books; (i) aeronautical maps and charts; (j) customs and immigration procedures; (k) aircraft in distress and investigation of accidents; and other matters concerned with the safety, regularity, and efficiency of air navigation as may appear appropriate.
\textsuperscript{12} Mr. Luis Chahardet of Venezuela, Fourth Session of ICAO Assembly: ICAO Doc. 725-C/834 at 37. This description is further explained as signifying that this Organization is "the chief
ferring to the Assembly as "the highest body of ICAO."\textsuperscript{13} An organ is sovereign or supreme "if other organs in the same institution are subordinate to it, and it is itself not responsible to any other entity or body in the exercise of its functions and powers."\textsuperscript{14} This strikingly illusory feature of the ICAO, while enormously contributing to the unique distinctiveness of ICAO within the community of international intergovernmental organizations, is reinforced by certain other unique structural and constitutional dispositions of the remarkable 1944 Chicago Convention. These include ICAO's two-organ nature, its two top officer structure, and the fact its Assembly must be convened principally, if not only, by the Council. These curiously distinguishing characteristics combine to practically transform the ICAO Assembly, supposedly supreme, into what can be termed the most un-supreme of supreme organs in the United Nations system. It is now an unnecessary appendage which ought to be, as some critics suggest, restricted to a minimal role.

It is common for people born with infirmity (like the ICAO Assembly) to make up for it by developing in another less suitable area. The ICAO Assembly, it seems, is denied an opportunity to adaptively develop due to the untimely alteration in the frequency of sessions. The important question arises: Is a medical doctor entitled to deprive a person of his arms, even if this person has no use of his legs, just because the person can be transported around despite the malformation? If in the affirmative, is it not tantamount to saying this person is not entitled to movement, unless someone else (the transporter) desires?

The ICAO Council provides very interesting responses to this whole query. The Council, as this modest analysis demonstrates, equates an individual's lameness at birth with the creator's intention of no movement at all, not even with crutches. Such an individual, therefore, must not move unaided. Nothing, it seems, is more flawed than such an argument. The creator might never intend normal movement for the lame, but such intention about movement with crutches cannot be accepted without question.

Moreover, if we are legally entitled to take away the crutches (per-

\textsuperscript{13} Count. F. Franco, Chief Delegate of Italy, 6th Session, supra note 4, at 10.

haps because, in using them to move, one violates others’ rights of moving without worrying about colliding with someone), it is surely not through illegal or unconstitutional means or methods. The ex turpi rule ought to apply and invalidate the end which fails to justify the means. Otherwise, why are there entrances and doors specifically adapted for those in wheel-chairs? Of course, they cannot be denied access to the building because they cannot walk upright.

This paper does not argue as much against the abandonment of annual sessions in ICAO, as it does against the means by which abandonment is achieved. While doctors are entitled to amputate, they cannot do so without the patient consenting to and being well counseled about what is involved in the operation. To the ICAO Assembly, such an operation seems to have taken place in Montreal at the Eight Ordinary Session, during the first half of June 1954.

ICAO Assembly sessions are of two main categories: ordinary and extraordinary. The United Nations General Assembly (UNGA) uses other expressions such as regular, special, and emergency special to cover both situations.\(^{15}\) Whatever the terminology, it is worth pointing out that “[t]he influence of the [ICAO] Assembly was considerably reduced by the introduction of triennial cycles of the Assembly; [which means now that] the Assembly meets only every three years in a regular session of less than three weeks’ duration.”\(^{16}\) Those sessions are now analyzed below, beginning with the ordinary (Part 2), and followed by the extraordinary (Part 3).

II. ICAO Assembly Ordinary Sessions

Both the Chicago Convention and the Assembly’s Standing Rules of Procedures, requires the ICAO Assembly to “meet not less than once in three years” and “convene . . . at a suitable time and place.”\(^{17}\) These are the two arms of Article 48(a) and the famous Standing Rules of Procedure - though mostly sitting when it ought to be standing. The first arm is a post-Chicago innovation; the other arm is not.

Prima facie, this provision effectively means that the Assembly can in theory\(^{18}\) meet as many times in three years as it desires. Even though the practice is for this Assembly to meet once in three years,\(^{19}\) nothing in

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15. See JACOBSEN, supra note 7, at 21.
18. One cannot be sure of the practice since an established ICAO practice seems to be that practice should be at variance with theory. See Oziek, supra note 14, at 1.
19. See generally BUERGERTHAL, supra note 2, at 43, 226-28; see also, Milde, supra note 2, at
Article 48(a) (the first arm), *per se*, is capable of prohibiting meeting more than once within that time frame. The only stumbling block in that regard is perhaps, *ceteris paribus*, the convenor’s argument of “unsuitability” of time and place under the second arm. One already visualizes the importance of “two” always replacing “one” in the ICAO *modus operandi*. This issue is developed later on.

Meanwhile, this unique ICAO *modus operandi* (the uniqueness is explained under section II C of this paper - Convention of the Sessions), while strengthening the position and influence of the ICAO Council, also consolidates the helplessness of its Assembly. Critics have attributed this *strategy* to the conversion of Council status to that of “a primary rather than secondary source of authority.”20 One is thus demonstrating that this result was attained through (a) the change in the frequency of Assembly sessions, (b) the vagueness of the new sessions provision, and (c) the method of convening those sessions.

A. Frequency of Sessions

The frequency of an organ’s sessions is an important indicator of its powers, influence and stature. This section first examines the effect of less sessions. Next, this section examines the arguments for and against such curtailment. Last, is an examination of the actual drama which installed “more frequent sessions” in ICAO.

1. Effects of Change in Frequency of Sessions

Increasing the duration between sessions of a non-permanent organ is shown to achieve at least one of three things: (1) a fall in the level of representation; (2) a change in the *nature* of representation; and (3) a *decline in influence* of the organ, and a rise in favor of the executive organ or branch.21

While all these factors are significant, the third factor is accentuated in international organizations because assemblies (or their “supreme organs”) are often composed of “all the contracting States.” It is not difficult to imagine the damage done to organizations whose supreme organ loses both luster and respectability.22 Perhaps the point is clearer if one

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208-09. This fact, while distinguishing ICAO, ought to serve as a useful caveat to the “frequently dazzling exercises in statutory interpretation” which are common to comparative studies that merely analyze and juxtapose “the provisions found in the consecutive instruments and resolutions of a host of organizations as if they were fungible commodities.” *Buergenthal*, supra note 3, at 1.

20. Tourtelot, *supra* note 1, at 56.


22. Could this be a possible explanation of the apparent lack of respect ICAO often faces
takes a compendious look at all three components. Both level and nature of representation in an organization are merged in its membership. The importance attached to an organization's members cannot be overemphasized.

Two principles of membership in international organizations are: (1) universality (which is either permissive or compulsory) and (2) selectivity.\textsuperscript{23} Universality, often preferred for the respectability and prestige it brings, is almost invariably tainted with the second. For instance, although ICAO (like most other intergovernmental organizations) claims universality,\textsuperscript{24} it still has selective criteria and/or restrictions regarding certain states.\textsuperscript{25}

Membership growth is not a bed of roses. The accompanying "new member majority" drags along challenges and problems.\textsuperscript{26} The Fourteenth Session's Indian Chief Delegate recognized this fact when he cau-

\begin{footnotesize}
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\item See Noorden, supra note 12, at 148-58. As several writers and experts point out, it is unrealistic to attempt to separate international (or external) politics from domestic politics; both are interrelated levels of political activity linked by a common need to reconcile the ideal of justice with the reality of power. See Coolumbious \& Wolfe, supra note 7, at 26-27. It appears that an organization which is at home with undemocratic politics should not expect any sympathy at the external level when it vocally calls for democracy, equality, or respect for its jurisdiction. This admonition is usually only addressed to totalitarian states, however, with the necessity modification, it applies to ICAO (critics would point to the Council's undemocratic modus operandi) with even more force since its own "citizens" are also citizens of the greater international family of organizations. It is likely that the bulk of these "citizens", feeling alienated as most appear to be, would not behave like Athens in the Thucydidean dialogue in the event of the potential disputes which are common between ICAO and its sisters. Id. at 25.
\item See Chen, supra note 2, at 35-36; Haviland, supra note 7, at 28-30.
\item Many ICAO Members consider the dramatic growth in membership as giving "it the aspect not merely of an international organization but of a universal institution." Z. Beydoun, the Chief Delegate of Lebanon, at the Fourteenth Session of the ICAO Assembly, ICAO Doc.8269 [hereinafter 14th Session] at 10. As the Temporary President of the Assembly, Mr. Walter Binaghi of Argentina, and the Chief Delegate of India, respectively pointed out during the same session, the great number of delegates present was not only "the highest in the history of our Organization," but also excellent proof that "ICAO can claim to be a representative body of almost all the independent States." Id. at 4-5.
\item See Chicago Convention, supra note 2, at Articles 91-93; Milde, supra note 1, at 433, declaring that "[d]uring any major review of the Convention Article 92 should be redrafted to remove dated provisions and Article 93 should be deleted." For further discussion of the various aspects of ICAO membership, see Buergenthal, supra note 2, at 13-55. Even the UN Charter is under fire for "habitually" infringing the principle of universality "in another crucial sense" as it "reflects only partially the global system. The UN Charter begins with the words 'We the Peoples of the United Nations... but there the matter ends. The UN system is above all a system of governments in which people are only allowed in through the tradesman's entrance to ECOSOC, and then in a highly circumscribed manner, under the aegis of Article 71 of the Charter." Groom, supra note 7, at 287; see also Nicholas, supra note 7, at 2. Most of these criticisms of the Charter, especially those of Professor Groom, provide enough reason for ICAO and IATA to consider the merger suggestion made by Dr. Tourtelot, supra note 1, at 72.
\item For a discussion of some of them, see, e.g., Gheballi, supra note 2, at 25-28, 204-10; Milde, supra note 1, at 404-05; Tourtelot, supra note 1, at 74.
\end{itemize}
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tioned his colleagues with: “[o]ur responsibilities have also increased in the same proportion.” 27 The question is: How, and to what extent, has the ICAO Assembly not partaken in its share of “increased responsibilities” due to the less frequent nature of its sessions?

Pursuant to the Chicago Convention, membership acquisition is either by ratification, 28 adherence, 29 or admission. 30 Such membership is terminated by either denunciation, expulsion, 31 or suspension. 32 These issues pose problems and challenges that the Chicago architects, although not specific in all cases, 33 placed at the charge of the Assembly. Because of the infrequent meetings, it is necessary for the Council to assume routine and unusual functions that the Chicago conferees may not have intended without the direct supervision of the Assembly. 34

Infrequent sessions have thus necessitated the transfer of power to suspend a member at the UN’s request (the implementation, though undecided by the conferees, was demonstrated by Dr. Buergenthal to fall within the Assembly’s jurisdiction) 35 from the Assembly to the Council. The considerable delay in implementation that results from the Assembly’s meeting once every three years has thus furnished justification. “To prevent such delay the Assembly might have to delegate to the ICAO

27. 14th Session, supra note 24, at 5. Graphically illustrating the fact that, until 1981, the three amendments that were effected on the UN Charter, all dealt with membership. See International Organization and Integration: Annotated Basic Documents and Descriptive Directory of International Organizations and Arrangements (Paul J. G. Kapteyn et al. Eds., 1981) [hereinafter Kapteyn].

28. See Chicago Convention, supra note 2, at Article 91; see also Buergenthal, supra note 2, at 14-15.

29. See Chicago Convention, supra note 2, at Article 92; Buergenthal, supra note 2, at 16-18.

30. See Chicago Convention, supra note 2, at Article 93; Buergenthal, supra note 2, at 18-24; Milde, supra note 1, at 442-43.

31. See Chicago Convention, supra note 2, at Article 93 & 95. See generally Osieke, supra note 14, at 14-17; Buergenthal, supra note 2, at 35-46. For the UN position, see Kapteyn et al., supra note 27, at 5. Withdrawal (which is denunciation in ICAO’s vocabulary) is purposely not provided for in the Charter “to avoid a situation in which a member might explicitly be permitted and even encouraged to withdraw from the Organization. On the other hand, it was not intended explicitly to prohibit withdrawal.” Id. Only Indonesia has withdrawn from the UN (on January 20, 1965), but it “resumed” its full participation on September 28, 1966. Id. at 6.


33. See e.g., Chicago Convention, supra note 2, at Article 93, which does not make clear whether suspension is automatic, as is the case with expulsion; it also does not indicate (should it not be automatic) which ICAO organ effects it. See Buergenthal, supra note 2, at 53.

34. Tourtellot, supra note 1, at 56. In other words, the Council’s “power has become particularly significant in recent years, as the ICAO Assembly (the universal body corresponding to the United Nations General Assembly) has met less regularly.” Id. at 52.

35. See Buergenthal, supra note 2, at 52-53.
Council or the Secretary General the power to comply with the U.N. request in the event that it be received while the Assembly is not in session." Critics then point to the fact that such transfer is not necessary but for the change in annual sessions.

As noted, the issue of delegation is one of many enumerated insignificant powers and duties of the Assembly; critics who think this type of delegation emanated solely from less frequent sessions might be surprised to learn that they are mistaken. The Council’s creeping jurisdiction began as far back as the first session (in the heyday of annual sessions). It got its headway from Resolution A1-9, which in turn, found its justification in the Specialized Agency Agreement between ICAO and the UN. The Agreement provided for the immediate transmission by the ICAO, to the UN, of applications for membership by certain (enemy) states. This immediacy required the Council, which is quasi-permanent in sessions, to be in a comfortable position to receive, process, and transmit them (or it) as required.

Along this line of reasoning, critics claim that the argument begs the question; the argument turns a blind eye to a weightier consideration. Critics point out that ECOSOC meetings (directly responsible for the Agencies) which take place several times a year, as well as annually by the UNGA, logically require that similar organs of the specialized agencies do the same. The former often discuss urgent matters needing speedy response from the latter. In other words, this consideration should prevent thoughts of reducing Assembly sessions. That is why these agencies exist in the first place. Their proliferation is likened to "[t]he tendency of [national] governments to establish special departments or agencies to deal with newly perceived problems of national importance."

Indeed, if the Assembly is to play a dominant role in the life of the

36. Id. at 53 n.170. Delegation (both mandatory and discretionary) of the Assembly’s own powers and functions is one of the amusing little powers and functions in Article 49.
37. For the full text, see ICAO Doc.9558 [Assembly Resolutions in Force (as of October 6, 1989)] at 1-8.
38. For full text of the Agreement, see INTERNATIONAL AVIATION ORGANIZATIONS: CASES AND MATERIALS 42-44 (Michael Milde & M. Siciliano eds. 1994) [hereinafter Milde & Siciliano].
39. The ILO has a better deal with the UN. Professor Victor-Yves Ghebali indicates how its own establishment of links with the United Nations was a more protracted process, owing to a variety of major technical and political obstacles. The ILO was intent on preserving its independence and uniqueness [not in the ICAO sense]. This required delicate negotiations concerning the maintenance of its tripartite structure, less favorable than it enjoyed in the League days.
GHEBALI, supra note 2, at 23-24.
40. See id. at 152. The complexity of this issue is examined when the arguments for and against annual sessions are canvassed.
41. BUERGENTHAL, supra note 2, at 1.
Organization, the question regarding the alteration of the frequency of sessions must be carefully and meticulously studied. This homework appears to be dutifully performed by the UN Special Committee, a Committee that is vested by the General Assembly to look into the possibility of curtailing its sessions to save finances. Of course, for reasons evoked later, the proposals were shelved. The reverse was the case in ICAO. This result is not surprising because, unlike the General Assembly, pursuant to the Charter, "under the present text of the [Chicago] Convention it would be hard to assert with any conviction that the Assembly is the supreme body of the Organization."43

The truism in the passage would be graphically brought out through a study of the rationale behind, or reasons for, the stripping of the Assembly of its annual sessions. All arguments, whether for or against annual sessions, easily play into the hands of ICAO's "anti-annualists." Given the ICAO's background, the function its various organs are intended to fulfill, its entire constitutional framework and its other unique characteristics, it is not surprising that the principal arguments of the "annualists" in other organizations are the greatest against their counterparts in ICAO. All this simply results from the illusory sovereignty of the Assembly in the latter organization. The ICAO Legal Bureau Director could not help exposing "the illusion of [the Council's] subordination to the universal body"44 in Article 50(a)45 when he addressed the Executive Committee of the Council:

While in common parlance it was correct to say that the Assembly was sovereign, this was not legally so - This Assembly did not and could not exist except by virtue of the Convention that established the Organization and its various organs. The Assembly's powers and duties (both implicit and ancillary) were specified in Article 49 of the Convention, as were certain specific limitations on those powers - for example Article 49(k) ... 46

This ineluctable but painful fact makes ICAO the unique inter-governmental organization within the family.

Dr. Thomas Buergenthal warned about the failure to recognize this fact about ICAO when he talked of certain "considerations [which] tend to be overlooked by many who have written on the law of international

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43. Milde, supra note 1, at 430.
44. Tourellet, supra note 1, at 56.
45. "The Council shall be a permanent body responsible to the Assembly ... ."
46. ICAO Doc. A18-Min. Ex/1-16 at 61, cited in Osieke, supra note 14, at 18.
institutions." Although specialized international organizations evince a great many structural and constitutional similarities, the doctor had to explain further that:

each of them has, since its establishment, tended to develop an institutional personality or modus operandi of its own. This institutional personality is the product of a variety of factors. Among these the organization's history, its functions, its membership complexion, and the political or economic power that it commands probably predominate. The organization's modus operandi in turn has a significant effect on the manner in which the organization resolves legal problems or articulates the rules that are applicable to them.48

This explains why ICAO,49 branded as "an agency that gave a strong voice to carrier interests"50 is different from most other organizations such as its senior twin brother,51 the International Telecommunications Union (ITU),52 and the WTO (World Trade Organization), which is at-

47. Buergenthal, supra note 2, at 1.
48. Id. See also Groom, supra note 7, at 289-90.
49. "One specialized international organization whose substantial law-making accomplishments have not received the attention they deserve." Buergenthal, supra note 2, at 2. This might have been true in the 1960's when Dr. Buergenthal wrote, but it may not be so now. In regard to the ICAO Council's Annex 2 on Rules of the Air, Dr. Michael Milde, writing in 1988, noted that:

[i]t is a unique feature in international law-making that an executive body of an international organization can legislate by a two-thirds majority vote with binding effect for all [138] . . . States with respect of the Rules of the Air applicable over the high seas which cover some 70 percent of the surface of the earth.

Michael Milde, Interception of Civil Aircraft vs. Misuse of Civil Aviation (Background of Amendment 27 to Annex 2), 9 ANNALS AIR & SPACE L. 105, 106 (1986) [hereinafter Misuse].

50. Janda, supra note 10, at 413. This tendency is often frowned upon, even by some of the ICAO delegates. This is particularly the case during the 1962 Assembly Session in Rome where J.W.H. Backer of the Kingdom of the Netherlands bluntly told his colleagues that:

I am for good and close cooperation with our friends, the airlines; but forgive me if I ask you not to let them prick too many holes in the pie, because if they do, the pie will become dry and unsavory. And don't we say, with a slight variation, that the proof of the pie is in the eating? . . . Civil aviation has a mission to fulfill and I wish you wisdom to build a good and sound future for civil aviation, ICAO included.

14th Session, supra note 24, at 26-27. Could these airlines be arguing against their admission into the ICAO only through the tradesman's door or the agis of Article 65 of the Chicago Convention?

51. Twin brother in regard to the perennial problem determining where airspace terminates and outer space begins. This is the natural habitat of the object of ITU's whole raison d'etre - the radio frequency spectrum (RFS) and geostationary satellite orbit (GSO). See generally S. Mishra & T. Pauvasek, On the Lack of Bases for Defining a Boundary Between Air Space and Outer Space, 7 ANNALS AIR & SPACE L. 399 (1982).

52. "[T]he oldest specialized agency of the United Nations . . . [which] has been a dynamic and pragmatic organization . . . [as] its members have always revised and up-dated its mandate and its organizational structure." R. S. Jahl, International Regulation of Satellite Telecommunications, in Legal Aspects of Space Commercialization 78, 80 (Kunihiko Tatsuawa ed., 1992). This Union provides the main for a for the drafting of international treaties dealing specifically with the use of radio frequencies for space services and the geostationary orbit. Id. at 80.
tempting the overthrow of ICAO in the Empire-building sphere. In this way, ICAO strongly resembles France which is "without doubt, the most mysterious of the Western countries. It refuses, almost doggedly, to fit the framework of the rest of Western Europe and the Atlantic world." The arguments regarding frequency of sessions would better prove or elucidate the point.

2. Arguments For & Against Less Frequent Sessions

Having explored and discovered the somewhat dire consequences of altering the frequency of sessions, what is the rationale for changing from annual sessions to less frequent sessions in ICAO? Before plunging into this issue, it must be indicated that financial considerations are almost invariably the given motivation for all attempts to reduce the frequency of Assembly sessions, even when larger political motives loom behind the scenes. In the history of the United Nations, and other international organizations,

efforts at reform have been inspired, first, by the need to tackle problems which were not foreseen by the founders, second, to obtain existing goals more effectively, and third, to save money - which has masked a determined attempt to reassert Western, and especially United States, dominance in the system.

This seems to be what happened in the ICAO with the reform of Assembly sessions.

Reduction of sessions of the Assembly in ICAO found justification in the need to lighten financial burdens, as well as the workload falling on both member governments and the Secretariat staff. As a solution to

53. See Dempsey, supra note 10, at 302.
55. Taylor & Groom, supra note 7. Such dominance does not only occur through reform, it is often seen in the stiff opposition to proposed reforms. As Black and Falk indicate, "the dominance of the United States in the quarter-century after 1945... was [so] exceptional" that a reduction in its role, often regarded as a "decline" is instead a misperception. Introduction, in Cyril Edwin Black & Richard Falk, The Future of International Legal Order: Retrospective and Prospect 60 (1982).
56. At the Sixth Session of the ICAO Assembly, the Portuguese Delegation, headed by J. De Brito Subtil, while registering the obvious "result of so many meetings in Montreal", took the time to also note that this entailed "a complete disregard of the expense which a large number of States must incur in coming here." Subtil further noted that "in 1950, 1951, and 1952, an average of less than 50% of the Contracting States were represented at all Divisional meetings held in Montreal." Sixth Session, supra note 4, at 6. Subtil's comment should not be taken as against "so many meetings"; he would simply be contre all such Divisional meetings being held only in Montreal. ICAO is not alone in this practice. Only four ILO Conference Sessions were, until 1989, held outside its Geneva Headquarters since World War II. Ghebali, supra note 2, at 153.
the financial problems that bisected the Organization, problems “due mostly to causes which are completely irrelevant to the activities of the Organization,” Mr. Subtil made the following alternative proposals through which to address the problem: (1) curtail the activities of the Organization, thereby reducing expenses, or (2) curtail or eliminate various budget expenditures (not necessitating a reduction in the activities of the Organization), which would entail (a) moving the headquarters from Montreal to avoid the Canadian national and Quebec provincial taxes, (b) abolishing the permanent status of the Council, which would meet only once a year for a few weeks prior to the session of the Assembly, (c) eliminating some of the regional offices, (d) considering the possibility of eliminating or postponing Divisional meetings at which fifty percent of the Contracting States are not represented, (e) reducing the activities of the Air Navigation Committee to technical matters that prove urgency, and (f) holding sessions of the Assembly only once every three years, with the budget approved for that period. The last alternative is the only one that ICAO adopted at the Eighth Session of the Assembly. Why?

The considerations to be examined, in answering the question, are counterpoises to such a move, weighing all given possibilities and seeing what best suit(s) or suited the needs of the organization concerned. Professor Ghebali’s statement, that those in support of continuing annual sessions are “both numerous and weightier” must be taken with caution as one plunges into the various arguments. These arguments are conveniently termed (a) the legislative, (b) the status, (c) the amendment, and (d) the financial.

(a) The Legislative Arguments

There is the Legislative Argument, exemplified by the ILO Director-General’s Report, arguing, unsuccessfully, against annual sessions and its consequent “regular rhythm of legislative action which exceeds present needs,” and suggesting the use of Committees and Commissions. The

57. Sixth Session, supra note 4, at 6.
58. Id. at 7-8. Even the somewhat innocuous and benevolent Portuguese proposals are loaded with the principal vision of Lisbon replacing Montreal as the International Aviation City.
59. Ghebali, supra note 2, at 152.
60. For details of the proposal, see ILO Director-General’s Report of the Practical Methods of Working of the Conference, submitted to the 137th Session of the Governing Body, para.136, cited in Ghebali, supra note 2, at 152 n.1. This argument weights against the permanent status of the ICAO Council; a similar argument is already directed. See Milde, supra note 1, at 433. As to the strong and weak points in the use of global conference in lieu of Assemblies, see Groom, supra note 7, at 293-95; E.D. DuCharme, R.S. Jakhu, & W.G. Longman, State Sovereignty in the International regulation of Radio communication, 10 Annals Air & Space L. 327, 334, 338 (1985).
argument was countered, *inter alia*, by the fact that altering the frequency inevitably results in shorter discussions of the standards and, therefore, results in low quality (or "sub-human") standards.\(^\text{61}\)

While the above reasoning is tasteless to ILO annualists, it is of much flavor to anti-annualists in ICAO. The latter is quick to indicate that the ICAO Assembly has no such research nor legislative powers which would be the sole prerogative of the Council. The ICAO Council and its subordinate bodies never made any illusion about this. Thus, in rejecting proposed amendments to the INMARSAT Convention, which purportedly infringed ICAO's prerogative in the area, the Council vehemently indicated that "the specific terms of any amendments should unequivocally respect the exclusive right of the ICAO Council to establish international standards, [and] recommended practices and procedures in the field of aeronautical communications."\(^\text{62}\)

It is also gleaned that these legislative considerations accord much weight against the incessant calls for the abolition of the permanent status of the Council; these calls are still being made.\(^\text{63}\) But the Council, it seems, remains adamant (and perhaps rightly so?) when it comes to anything that adversely affects its unduly prestigious position. The ICAO Council, since it is the legislative organ, seems to find authority buttressing its disputed permanent stature (apart from Article 50 of the Convention) in the very arguments of the annualists. It also seems that any recommendations or suggestions for the abolition of that Body's permanency is meaningless unless they go hand in hand with those for an independent Secretariat as a third or fourth (including the Legal Committee) principal organ of ICAO. For the moment, ICAO is essentially a two-organ organization. This unique "Two-Organ" ICAO needs a

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61. GHEBALI, supra note 2, at 152.
63. See generally Milde, supra note 1, at 433.

The permanent nature of the ICAO Council was justified at the time of the creation of the Organization, when the Council faced massive work to prepare a wide range of Standards and Recommended Practices. . . . [But today, s]horter and less frequent sessions of the Council would attract high level participation from States or participation by top level experts in a particular field in which a decision is to be made, the quality and level of decision making would improve and the States' and ICAO's budgets would achieve considerable savings.

Guldemann, supra note 1, at 354. There is even a specific call for the reform of Article 50 "to reduce the number of members, which has reached a level detrimental to decision-making, not to mention what it costs the organization and therefore its member states." Rocha, supra note 1, at 478. To Dr. Tourtelot, the answer to improving the representative quality of the Council does not lie in trying to achieve or regain the original ration of members to Council seats, but rather in revising the method of filling the existing positions. Tourtelot, supra note 1, at 74.
little more elaboration (done under the next argument). It is stressed that advocating the non-permanency of the ICAO Council (in the form it is) entails that activities of ICAO cannot go on during that period of dormancy.

It is otherwise only if the Council loses one of its two heads in the form of an independent Secretariat, a Secretariat which not only assumes contested permanent status, but is also at the disposal of all other organs of the Organization. In this way, it has a status of its own, acting, as it is supposed to, as a moderator or middle person between the other two (or three) principal organs - the Assembly and Council proper. In the absence of this, the status argument clearly has no place in the present ICAO framework.

(a) The Status Arguments

Financial considerations greatly influence decisions in several organizations that consider trimming Assembly sessions. Confronted by even heavier financial and economic pressures and arguments, the UN Special Committee, after their seasoned studies, came to a conclusion - if the General Assembly fulfilled the high responsibilities placed upon it by the Charter, and if the people of the world are to look with increasing respect and confidence to that body as the highest forum of the international community, all questions relating to the manner in which it functions must be resolved primarily from the standpoint of their effect on the General Assembly. In the opinion of the majority of the members of the Special Committee, therefore, the unnecessary lengthening of the regular sessions “detract from the stature of the Assembly in the eyes of the world.” The Special Committee, consequently, acknowledged that financial and other difficulties related to the duration and frequency of the regular sessions should not be resolved at the expense of either the effectiveness of the General Assembly, or the right of any representative to express freely and explain their government’s attitude on problems before the Assembly.

For ICAO anti-annualists (who must side with the advocates of the Council’s permanent status), all would not float for a number of reasons. First, the ICAO Assembly lacks similar responsibilities under its own Convention, which, on the contrary, expressly inhibits it from performing a lot of crucial or “critical duties” such as (1) convening itself, (2) electing or appointing the President of the Council, (3) appointing the Secretary

64. The fact is that “the Council is often generating its own work and vast Secretariat resources are geared specifically to serving the Council.” Milde, supra note 1, at 433.
65. UNGA, supra note 42, at para. 9.
66. Id. at para. 13
General, (4) adopting technical standards (which is the key function of ICAO), (5) settling disputes, and (6) creating subordinate organs of ICAO.\textsuperscript{67} In view of the sixth factor, one can quickly dismiss Mr. Subtil’s proposal regarding the ANC. The Assembly has no locus standi for making such a recommendation. Article 49(k) clearly estops the Assembly from interfering with activities of this Commission, whose formation is completely out of reach. It cannot even ask questions as to how it was constituted, let alone venture near the Commission’s field of activities. This sub-body is entirely one of the Council’s “14 mandatory and 5 permissive functions outlined in Articles 54 and 55 of the Convention respectively.”\textsuperscript{68} The case of appointment to this sub-body not only proves the point,\textsuperscript{69} but also indicates in the clearest fashion, that the ICAO Council, like the French President, “is beyond the reach of Parliament [or the ICAO Assembly].”\textsuperscript{70}

Second, because the Assembly has no stature to defend, no independent Commissions of its own,\textsuperscript{71} and no independent Secretariat to

\textsuperscript{67} See Article 49(k); see also Milde, supra note 1, at 430-31. For further discussions of this unfortunate ability, see Tourtellot, supra note 1, at 56; Dempsey supra note 10, at 274 n.9, 275-76. At this stage, one wonders just what is the role of the Assembly.

\textsuperscript{68} Dempsey, supra note 10, at 274 n.9. The situation here is different from that of the Charter, which places the creation of such bodies on the General Assembly and the three Councils. See S.D. Bailey, The United Nations: A Short Political Guide 30 (1963) [hereinafter GUIDE].

\textsuperscript{69} For a discussion of this appointment aspect, see Ozieke, supra note 14, at 5-8.

\textsuperscript{70} Magstadt, supra note 54, at 106. In fact, it appears that a necessity for any safeguards did not really count in Chicago. For instance, Article 10 of the UN Charter states: “the result of many of the smaller States’ firm determination to develop and expand the Dumbarton Oaks proposals in order to strengthen the role of the Assembly in the political field”, has been rightly hailed by Herbert V. Evatt of Australia as “one of the most important achievements of the San Francisco Conference and one of the main democratic safeguards of the United Nations Organizations.” Haviland, supra note 7, at 11; H.V. Evatt, The United Nations 20 (1948) cited in Haviland, supra note 7, at 13. It must be noted that all the contributions of smaller or medium powers, both at Dumbarton Oaks and San Francisco, towards strengthening the General Assembly, were motivated by the fact that the Soviets were not only on the Big Three side, but because the most vocal and consistent call for a U. N. Assembly of the ICAO model came from them. This was bound to prick Western fears of what the Reds might have behind such a scheme. Even the other major Western powers had to, every once in awhile, abandon the Big Colleague and side with their smaller colleagues in the matter. But all this did not arise in the absence of the Soviets in Chicago; the West could easily agree on focusing and pinning all authority within the Council. To Canada, Australia, New Zealand, and others who stood for a strong UN General Assembly, the ICAO Assembly was not an organ worth standing up for since it was not the Soviets, but Mother Britain and Big Brother U.S.A, with whom they hoped to deal - their exalted seats in the Club guaranteed as a matter of course. To the States in Chicago, it was a matter of waiting patiently while Mother and Big Brother settled their petty dispute before they could all comfortably settle down around the table of the Club with no threat. For an account of the talks between these Big-Two powers, see Marc L. J. Diekixx, Shaping World Aviation: Anglo-American Civil Aviation Relations, 1944-46, 57 J. Air L. & Com. 795 (1992). Maybe ICAO got its “twogene” from here?

\textsuperscript{71} The Assembly’s most influential Executive Committee even comes under the firm grip
turn to, it cannot possibly effect any seasoned studies on the matter in question. Because this matter is not an election for "membership in the Council[,] . . . and states are [only] keen at following and participating in its activities," the Assembly simply rubber-stamps when it meets every three years to carry out its primary task - electing a new Council.

ICAO seems in love with "two" and all its derivatives. Its dual Constitution, the so-called outstanding Chicago Experiment in the Codification of International Law, of which each ICAO Contracting State is a party, uniquely creates (contrary to the thinking of some experts) two principal organs: (1) an Assembly of all the Contracting States and, (2) a Council of limited membership, with its various subordinate bodies, including the Secretariat. One immediately notes that this ICAO modus of the Council. It does so through its permanent President as "Temporary" President. See Assembly Procedure, supra note 17, Rule 8; Chicago Convention, supra note 2, Article 49(a).

72. All proposals for the change of the Assembly’s annual sessions originated from the Council. This fact, while vividly contrasting with both the UNGA Special Committee, and the ILO’s Director-General reports, also corroborate the point on the ICAO Council’s status as embodying the Secretariat.

73. Dempsey, supra note 10, at 274 n.9.

74. See Milde, supra note 2, at 205.

75. The Chicago Convention is a remarkable legal instrument. By today’s standards and experience in the codification of international law it is hard to believe that it was drafted within 37 calendar days, without any significant previous multilateral consultation and without a draft text consulted by the participants prior to the opening of the Conference. During many of the 37 days of the Conference, no formal meetings were held and groups of delegations discussed informally in the seclusion of their hotel rooms.

Milde, supra note 1, at 402. One may think, however, that these Chicago conferees, like their San Francisco counterparts, had a lot of sources (e.g. the 1910 and 1919 Paris Conferences, and the 1928 Havana Conference), and particularly ICAN to copy. Nicholas, who demonstrates how the San Francisco conferees tactically and pointedly omitted any reference to the League (in the same way as Chicago did to the 1919 ICAN – International Commission for Air Navigation) – "as if even a word of allusion might set the ghost of Woodrow Wilson’s failure walking the San Francisco Opera House" – comes down with: "In fact . . . they copied it." Nicholas, supra note 7, at 14. The absence of the Legal Committee in the Chicago Document until 1947 proves the point. Until that time, the Comité International Technique d’Experts Juridiques Aeriens (CITEJA), created in May 1926, performed the functions that the ICAO Legal Committee essentially took over.

The Convention does not provide for its [Legal Committee’s] existence, the Chicago Convention avoided the question of the legal work of the Organization because in 1944 it was hoped that the CITEJA would be brought into relations with ICAO and the Conference did not wish to touch the vested interests some States had in CITEJA.

Milde, supra note 1, at 444.

76. See, e.g., Chen, supra note 2, at 144. Chen states: "The principal organs of ICAO are an Assembly composed of all member states, a Council composed of twenty-seven [now thirty-three] members elected by the Assembly for three-year terms, and a Secretary-General with a staff of about 600." Id.

77. For example, the IMO Constitution goes further than the Charter by creating Sevens. Its Article 11 states that the Organization is to consist of (i) an Assembly, (ii) a Council, (iii) a Maritime Safety Committee, (iv) a Legal Committee, (v) a Maritime Environmental Protection
The ICAO Assembly

operandi, which makes the Secretariat an exclusive subordinate arm of the Council,\textsuperscript{78} subordinates the Assembly to the whims and caprices of that Council. There is thus hardly a difference between the subordination here, and the French Parliament subordination to the presidential will under General de Gaulle's Fifth French Republic Constitution. In fact, it is fascinating to note that the ICAO Assembly is like the French Parliament in many important respects. To Professor Thomas M. Magstadt of the Air War College, each of the two organs "is more interesting for the powers it does not have than for the powers it has."\textsuperscript{79} Due to the lack of essential powers, the present paper cannot join in any chorus that advocates a non-permanent Council in ICAO without similarly calling for a Committee, (vi) a Technical Co-operation Committee and such subsidiary organs as the Organization may at any time consider necessary, and (vii) a Secretariat. See K.R. Simmons, The International Maritime Organization 55 (1994). Guldemann condemned the absence of a Maritime Environmental Protection Committee from the ICAO. Guldemann, supra note 1, at 356. Article 11 expressly tells us that the necessity of "subsidiary organs" is business for the consideration of "the Organization". The equivalent Article of the Chicago Convention is silent on this issue. The ITU is made up of (i) the Plenipotentiary Conference, (ii) Administrative Conferences, (iii) the Administrative Council and (iv) four permanent organs, viz., (a) the General Secretariat headed by a Secretary General, (b) the International Frequency Registration Board (IFRB), (c) the International Radio Consultative Committee (CCIR), and (d) the International Telegraph and Telephone Consultative Committee (CCITT). See Jakhu, supra note 52, at 80-81. In 1989, the Telecommunications Development Bureau (BDT) was established with a status similar to that of other permanent organs of the Union. Id. at 81. The later formation and status of this BDT contrast vividly with those of ICAO's Legal Committee, also formed later. Article 7(1) of the UN Charter establishes the principal organs of the United Nations as, (i) a General Assembly, (ii) a Security Council, (iii) an Economic and Social Council (ECOSOC), (iv) a Trusteeship Council, (v) an International Court of Justice (ICJ), and (vi) a Secretariat (headed, of course, by the renowned UN Secretary General). See U.N. Charter art. 7; see also, Bailey, supra note 68, at 142-47. The ILO Constitution of October 9, 1946 creates three principal organs: the Conference, the Governing Body, and the Labour Office (headed by the Director-General, who is the single head of the Organization). See 15 UNTS 35; see also Chen, supra note 2, at 142-47, for further indications of other similar organizations, all having more than two principal organs.

78. "Apart from the conference and language services for the Council, the Secretariat produces vast amount of documents geared directly only to the Council and frequently prepared at its request." Milde, supra note 1, at 433 n.112 (emphasis added). Even the Legal Committee, subsequently created and regulated by Assembly Resolutions A7-5 and A7-6, could still be regarded as the Council's subordinate body. Resolution A7-5 states that it is "a permanent committee of the Organization, constituted by the Assembly . . . [but] responsible to the Council", which is not responsible to an Assembly. There have been several unheeded calls from high quarters for revision of the Chicago Convention; the unheeded calls ask the Convention to mention this Committee, which "has attained the status of a principal organ of ICAO through accomplishment and necessity." Id. at 444; Guldemann, supra note 1, at 356. It is "desirable to include in the revised Convention the basic elements of the mandate of the Legal Committee." See Tourtellot, supra note 1, at 56-58, for this Committee's history or evolution. See also, Guldemann, supra note 1, at 356-57 for a review of ICAO's other subordinate organs. For those of the UN, see Bailey, supra note 68; Jacobsen, supra note 7, at 21-22.

79. Magstadt, supra note 54, at 106.
distinct Secretariat in particular, and an entire re-evaluation of the Assembly's status as the supreme body of the Organization?

This ICAO two-organ phenomenon appears to put it and its Assembly in a different and strangely interesting class within the UN system. The inevitable consequence is that, just like "the British [who] are at home with [a theory of separation of powers that the Americans, Montesquieu, and others would consider illegitimate] since 1688," ICAO seems comfortable with the solution frowned upon by the UN Special Committee and several other organizations. This is further corroborated by the next argument which is based on amendments.

(c) The Amendments Consideration

The Amendment Argument is also utilized to prevent the altering of Assembly annual sessions. As Ghebali argued, a change in the frequency of ILO Conference sessions is a cumbersome process which involves amendments to both the Constitution and Financial Regulations. This particularly affects Articles 3(1), 7(5), and 22 of the ILO Constitution, a document that is described as an outstanding constitutional exception to the notion that the peoples of the world are enfranchised, if at all, only through governments insofar as the UN system is concerned.

The "cumberliness" seems to be unheard of in ICAO since Article 94(a) of the Constitution gives ample room for each State have its cake and eat it too. The idea is that "the principle of free consent and of good faith and the pacta sunt servanda rule are universally recognized." No one denies the recognition of these principles - they are generally understood with treaties, especially in view of their raison d'être or the underlying idea behind them. It is, however, wondered just how far the

80. The Right Honorable Lord Halishman of St. Marylebone, The Separation of Powers and the Office of the Lord Chancellor, 8 Civil Justice Quarterly 308, 310 (1989). ICAO thus appears to be a real chameleon. It resembles Britain to the distaste of the Americans and both Frenchmen Montesquieu and Jean-Jacques Rousseau. However, one also finds it sleeping with France - as a sort of a compromise? Between the two (U.K. and U.S.), both of whom incarnate the one culture against which France gathered its siblings form around the globe, but in particular "une partie de l'Afrique... dans une guerre." Blaise-Pascal Talla, Editorial: Le poids de nos Etats, 173 Jeune Afrique Economie No. 3 (1993). Maybe ICAO ought to have all these colors in order to not be surprised by the Southern Lilliputians? In the matter of elections and entering into force of its resolutions or amendments, one may also find ICAO comfortably wearing the suit of Hitler's Germany with the Mother UN playing Chamberlain's Britain.
81. Ghebali, supra note 2, at 153.
82. Groom, supra note 7, at 287.
84. The political or ideological philosophy underlying the main innovations of the Vienna Convention are: first, the introduction of restriction on the previously unfettered freedom of States from deviating from certain central core principles of international values, whether States concerned are big or small, powerful or weak; second, a democratization of international legal
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consent principle should be extended. The Vienna rules ought not to be applied indiscriminately, otherwise they defeat their own purpose, as they do in ICAO.

For example, some of the ICAO members cannot explain why they go to Montreal triennially even though they have never "consented" to this Montreal formula, and should rather be going there every year. The Members under such international duress are: Albania, Armenia, Azerbaijan, Bangladesh, Barbados, Belarus, Belize, Benin, Bhutan, Bosnia and Herzegovina, Botswana, Brunei Darussalam, Burundi, Cambodia, Cape Verde, Colombia, Comoros, Cook Islands, Djibouti, Equatorial Guinea, Eritrea, Gabon, Georgia, Grenada, Guinea-Bissau, Guyana, Haiti, Kiribati, Kuwait, Kyrgyzstan, Latvia, Liberia, Lithuania, Maldives, Marshall Islands, Micronesia (Federated States of), Monaco, Mongolia, Mozambique, Namibia, Nepal, Nigeria, Oman, Paraguay, Qatar, Saint Lucia, Saint Vincent and the Grenadines, San Marino, Sierra Leone, Slovakia, Slovenia, Solomon Islands, Suriname, Tajikistan, The former Yugoslav Republic of Macedonia, Togo, Tonga, Trinidad and Tobago, Ukraine, United Arab Emirates, Vietnam, Yemen, and Zimbabwe. How is Vienna realized here?

Moreover, as Ghebali argues, drawing up budgets for a period exceeding a year, requires a revision of the Financial Regulations. This happened in ICAO and the situation's awkwardness that such an amendment created does not seem to attract attention from the purely avia-

relations, unlike the previous oligarchical structure under which Great Powers were allowed to formally impose treaties upon weaker or lesser States. Not only is this practice frowned on but the right of veto, often used by some States to hamper others from participating in treaties, has been done away with; and third, there is the enhancement of international values as opposed to national claims: the interpretation of treaties must now emphasize their potential rather than give pride of place to States' sovereignty. Cassese, supra note 7, at 287.


86. Ghebali, supra note 2, at 287.

87. To the States of note 85 above, the so-called triennial budget is still an annual budget, by virtue of Article 94(a) of the Chicago School, a school which stubbornly refuses to emulate the Schools of Philadelphia, San Francisco or other cities. This illustrates how a blind insistence on the consent principle (a corollary of the well-entrenched sovereignty principle of Article 1 of the Chicago Convention) defeats the ideal of "the determination of the peoples of the United Nations to establish conditions under which justice and respect for the obligations arising from treaties can be maintained", a principle which is found in these same Vienna Convention's preamble (emphasis added). Vienna Convention, supra note 83, art. 5. Of course, one is expressly made to understand that it "applies to any treaty which is the constituent instrument of an international organization without prejudice to any relevant rules of the organization." Id. Vienna Convention, supra note 83, art. 5. But a distinction ought to be made between those which are an initial ratification of constituent instruments of organizations (to gain membership) and subsequent amendments.
tion-oriented distinguished members of ICAO.88 This is so, because the wasteful election of Council members seems to be their sole preoccupation when they come to His Worship Jean Dore’s “International Aviation City.”

In applying the consensual theory, two different types of treaties must be distinguished and treated accordingly. They are: (1) treaties adopted within an international organization generally,89 and (2) treaties so adopted but which are the constituent instruments of international organizations. Article 93 bis of the Chicago Convention has two other bis followers - 83 bis and 3 bis.90 Of the two, the latter justifies the application of the Vienna Consensual rule, however the former, which is found in the Constitution portion of the document, does not. Article 3 bis, properly falling within “treaty adopted within an international organization,” adequately illustrates (apart from the controversy it engendered)91 the folly in attempting to codify the almost uncodifiable in the same international document which is also the constitution of an international organization.92

The consensual theory, it is submitted, ought to only apply to the initial decision whether or not to become a member of an international organization, and not to subsequent modification of its constituent document. In other words, it must be limited to that stage, so that once passed, no member can thereafter raise the question of consent regarding any modification in the constitution - provided the amendment is the result of the decision of the required member majority as embodied in the Constitution assented to (with full knowledge of the provision) by the

88. As Professor Dempsey puts it, the bulk of them have “been selected for their knowledge in aviation rather than for their experience in the law, making them not the best qualified group to resolve complex legal issues.” Dempsey, supra note 10, at 310. See Guldimann, supra note 1; at 353, 55; Milde, supra note 1, at 433.

89. For a catalog of the bulk of them, see 17 Annals of Air and Space Law, Part II (1993); and ICAO, Manual on the Regulation of International Air Transport, CH. 3.2 (Doc. 9626).


disputing State. Otherwise, there is no need requiring any voting on the issue or any majority at all, since an amendment would mean a completely new organization with all the States being required de novo to assent to becoming members or not.

The ICAO Council's answer to the paradoxes created by its general disregard for legality and uncontrollable urge for indiscriminate amendments and their untenable results (as long as they serve its purpose) all have debilitating effects on the Assembly's powers and functions. Most of them cannot be exhaustively canvassed in this paper. For now, note that the overall effect is to deprive the Assembly of the exercise of its "drastic action of expelling non-ratifying States under Article 94(b)." This non-ratifying act could touch any aspect, including the Organization's finances.

(d) The Financial Arguments

All proposals for curtailing sessions are predicated on financial considerations. The Special Committee of the UN acknowledged that financial and other difficulties related to the duration of the regular sessions should not be resolved at the expense either of the effectiveness of the

93. It is in accordance with this view that the response of the other States (championed by Canada) at Nice to the argument of the USA, Japan, and some Latin American States (that the provisional application of any treaty might not be permitted by domestic laws of certain countries) could be considered as very weighty: "In response to these concerns, it was stated by the other delegations that express ratification or accession to the Nice Constitution, containing a provision for provisional application of the Administrative Regulations, also includes express consent to be bound to the provisional application of revisions of such Regulations." Jakhu, supra note 92, at 12 (emphasis added). Also buttressing the theory advanced here, is the example of the European Community. After deciding to join the Community, it would be nonsensical should Norway, for instance, say that legislation duly adopted by the European Parliament does not bind it simply because, in the vote that gave this legislation legitimacy, its representative(s) voted in opposition – and knowing that there was room for majority voting in such a decision. For a similar demonstration of the supranational powers of the organs of the European Union, see Rocha, supra note 1, at 479.

94. Carried to its logical end, if there is any logic in ICAO at all, the consensual theory means that a "third State", which "means a State not party to the treaty", could ratify the amendment alone, thereby becoming entitled to benefits conferred by the original treaty. Viennese Convention, supra note 83, art. 2. How does that tie in? Moreover, when one ever insists on the rule of consent, does one forget international organizations such as the ILO whose Conferences and Governing Bodies are not composed only of States? Must not the Workers and Employers there also agree to be bound, even though they are not States? Must the principles of the Vienna convention be carried to unreasonable limits, even when "only some of its provisions attest to existing customary law, or give rise to rules belonging to the corpus of general [international] law so that . . . for the time being, the Convention as a whole does not yet constitute general international law?" Cassese, supra note 7, at 189. In addition, is "The 'New' Law", "to a large extent 'codified'" as a result of "strong pressure from the socialist and Third World countries" now permitted to supercede the 'old reason'? Id.

95. ICAO Doc. 7505 A8-P/10, at 53.
General Assembly or of the right of any representative freely to explain
their government's attitude on problems before the Assembly. The best
interests of the organ, not the frequency of its sessions as such, must re-
main the overriding consideration in any study to limit its regular ses-
sions. The question, the Special Committee concluded, is not to be
judged solely on technical grounds or on grounds of efficiency. 96

This point of view seems to be refuted by ICAO, which cannot sur-
vive without those technical and efficiency grounds. ICAO

has entered adulthood with vigour and enthusiasm tempered by wisdom
gained over the years. That is what enables ICAO to carry its functions with
such serene efficacy . . . . The serenity comes from the fact that this Organi-
zation, your Organization . . . [is] a fundamental technical organization . . .
[which] must ensure that its regulations reflect that order, equity and justice
without which material and scientific progress would fail to achieve their
goals. Serenity and efficiency . . . are cardinal virtues in our times, when the
geopolitical world is constantly changing, conflicts of interests prevail . . . . 97

Other cynics indicate that weighty political considerations should not be
sacrificed by the Council in the name of privileges, its members, or for the
pleasure of an Olympian affirmation of its own power. 98 Some even sug-
gest that the Council's continued persistence in this somewhat incoherent
stance, rather than put ICAO on the track of promoting air transport,
adds only to the stifling of growth of international air transport. 99 Some
of these critics go as far as arguing that, though the Chicago Convention
defines the Assembly's powers, it cannot exist except by virtue of this
instrument. It "does not mean . . . that the Assembly is not sovereign, for
it has long been accepted that sovereignty connotes supreme rather than
absolute power and could be limited by a constitution and positive

96. UNGA, supra note 42, para.8.
97. ICAO Doc. 9550 A27-MIN P1-16, at 1-2. Other authorities seem to refute the idea that
serenity and efficiency effectively do away with conflicts, thus making discussions inappropriate.
For example, it is held that the plain "fact is that conflicts and discussions cannot be simply swept
under the carpet [of serenity and efficiency]. They resurface again no matter how skillfully they
are glossed over." Casse, supra note 7, at 395. Moreover, it could easily be pointed out that the
so-called serenity and efficiency have

been acquired only through a political system which is very different from those of other . . . [international organizations] in that it gives the president not merely execu-
tive powers but a [total] dominance over the whole system which exceeds by far the
authority of . . . [any other] president.

Blondel, supra note 54; see also P.W. Rodino, Living in the Preamble, 42 Rutgers L. Rev. 685,
694 (1990); P. Archer & L. Reay, Freedom at Stake 9 (1949); Neal Reimer, Political
Science: An Introduction to Politics ch.12 (1983) quoting the dissent of Justice Brandeis in
June 1990 5, quoting, Brazilian Supreme Court Judge Jose Francisco Rezek.
Those weighty considerations, the “annualists” point out, include such things as great value in the maintenance of close personal relations between those with comparable responsibilities in the different countries and organizations. Furthermore, an annual conference fulfills a real need as it has an industrial or aviation relations function which is more effectively discharged through annual meetings. It is evident that this need for an annual Assembly is even more exacting in the field of aviation relations because, as Dr. Enrique Loaeza of Mexico stated at the Sixth Session of the Assembly, “air transport, both national and international, is of the utmost importance in the economic development of nations and in the interests of peace. Civil aviation, as an instrument of peace and harmony, should be given the greatest possible support, even at the cost of sacrifices in other respects.”

It is further argued for the ILO (described as the model of what international co-operation should be), that lengthening the interval between conference sessions weakens the position of the ILO in the United Nations system. Is this view shared by the entire family?

Certainly not by the ICAO Council, to whom the position of ICAO as a whole seems not to matter as long as the Council enjoys the enviable status it undeniably has in ICAO. To the Council, annual sessions are no good and all the same arguments enormously play into the hands of ICAO anti-annualists as the concrete “headquarters” and “two-headed” examples show.

(i) Moving Headquarters and Abolishing Regional Offices?

One Sixth Session proposal concerned permanently moving ICAO’s headquarters. When the Chicago Convention was signed on December 7,
1944, it made provision for the permanent seat of the Organization to be at a place to be determined at the final meeting of the Interim Assembly of the PIČAO105 - the ICAO's predecessor and/or trustee. The PIČAO (Provisional International Civil Aviation Organization) decided the matter on June 6th, 1946, determining that the Organization's permanent seat be at Montreal, Canada – "a city where two of the three working languages of the Organization are spoken"106 – and "a country that is somewhat remote from those areas of the world which are . . . so much disturbed by economic and political difficulties."107

Sapiently realizing that circumstances arise under which it is desirable to transfer the permanent headquarters elsewhere, the ICAO Assembly, by two Resolutions on June 14th, 1954 (Eighth Session), approved an amendment to Article 45.108 The Assembly resolved, in view of the importance that all contracting States have a full opportunity to give adequate consideration to any proposal to move the seat of the Organization,

105. Chicago Convention, supra note 2, art. 45. Another possible strange paradox of the concealed unanimity rule in Article 94(a) of the Convention could be that, while other states are having a session in Montreal, others (though still attending in Montreal) would be having it elsewhere. This is a possible result of the mating of Article 94(a) and the Headquarters Article. The group, the largest of all, could be championed by the United States and the Russian Federation, if one has to assume, for instance, that the amendment effected during the 8th Session moved headquarters. For a list of states that refused to ratify the amendment, see 1994 ANNUAL REPORT, supra note 85. In such a situation, one might ask why these states, especially those who are de facto Council members, are in Montreal, when logically, from the consensuality theory, by refusing to ratify that amendment they are saying that they would not be bound by the end result of the amendment. Can they really eat their cake and have it too? Would this not be making a mockery of the whole theory of prior consent to be bound before being bound?

106. Sixth Session, supra note 4. The appropriateness of the choice of the headquarters of international organizations can also be gleaned from Nicholas who, after indicating the importance of national diversity in their secretariats, made this remark: "From this point of view the location of U.S. Headquarters in New York, a city famous for its comprehensiveness and conspicuous for its capacity to involve even the stranger in its strenuous crusading, may well have advantages which outweigh certain obvious drawbacks." Nicholas, supra note 7, at 164. One of such "obvious drawbacks" that almost cost Canada and Montreal the prestigious "Home of International Civil Aviation" was the existence of both the "GST" and "PST", in large measure, responsible for the charge of high expenses "due mostly to causes . . . completely irrelevant to the activities of the Organization." Sixth Session, supra note 4, at 6. Canada's answer was in the form of the exemption of the Organization from these items of expenses. See Milde & Siciliano, supra note 38, at 51-62 for the Headquarters Agreement and other protocols between the various administrations and the ICAO.

107. Sixth Session, supra note 4, at 3. Montreal fought extremely hard (thanks to their influential southern neighbor and mother-sister Britain) to prevent this Chicago Institution from crossing the Atlantic like most of its sisters and brothers. One should note that the Organization has regional offices in Bangkok, Cairo, Dakar, Lima, Mexico City, Nairobi, and Paris.

108. Resolution A8-4. This substituted the full stop at the end of the original text with a comma and added the following: "and otherwise than temporarily by decision of the Assembly, such decision to be taken by the number of votes specified by the Assembly. The number of votes so specified will not be less than three-fifths of the total number of contracting States."
that no proposal to move the permanent seat of the Organization should be
considered by any future session of the Assembly unless notice thereof, with
all pertinent documentation, has been dispatched to all the Contracting
States at least one hundred and twenty days prior to the convening of such
session of the Assembly.\textsuperscript{109}

The headquarters provisions amendment was effected at the same As-
sembly session as the one amending the sessions provisions discussed
later. What happens to the argument that ICAO should lose a top officer
in order to save finances and curtail expenses?

(ii) Ridding ICAO of One of its Heads?

Another proposal, though not specifically included in those pro-
ferred at the Sixth Session, concerns the abolition of one of ICAO’s “two
top officers.”\textsuperscript{110} The position is sure to remain uncertain, and continue
despite all calls for reform and change - all predicated on the fact that
“ICAO no longer has any need for the duality of its chief officials.”\textsuperscript{111}
ICAO purposely seems to be a two-headed dragon - appearing to make
heed to those calls unlikely.\textsuperscript{112}

Since the European World Wars, control of international aviation
has become strategic\textsuperscript{113} and vital to a state’s hegemonic and economic
interests.\textsuperscript{114} It is thus not surprising that the attention of all major powers
in Chicago was focused primarily on the Council which they were deter-

\textsuperscript{109}. Resolution A8-5. Some years later, the Council was requested to give careful attention
to suggestions or invitations of Contracting States to hold triennial ordinary sessions of the As-
sembly from the Headquarters of the Organization, taking into account the benefits to be de-
rived by the Organization, the nature of the offers to defray all, or a portion of, the additional
expense to the Organization, and all pertinent considerations. Resolution A16-1.

\textsuperscript{110}. There are several advocates of the elimination of “this dichotomy of top officials at
ICAO [which] has only served to increase costs, and perhaps prestige.” Guldimann, supra note 1,
at 355 (emphasis added).

\textsuperscript{111}. Milde, supra note 1, at 437. The author even suggests limitation of terms for the event-
tual single new head (a Director-General) so as “to safeguard rotation in the senior positions
and to keep bringing in fresh knowledge and competence.” \textit{Id.}

\textsuperscript{112}. The chief officers of ICAO’s two principal organs are: the ineffectual President of the
Assembly, and the President of the Council and Secretary General. Both the latter are in effect
President and Secretary General of ICAO.

\textsuperscript{113}. Sir Walter Raleigh’s reputed observation that “he who controls the seas, controls the
trade. He who controls the trade controls the wealth. He who control the wealth controls the
world” holds true for aviation, with the necessary substitution of words, since “[t]hese days,
airways have replaced oceans and airports have replaced seaports in importance.” Paul Stephen

\textsuperscript{114}. Aviation, while exhibiting some strange and virtually contradictory qualities, is thus
more than any of the other spheres of activity, the best tool of (i) national security, (ii) economic
power and advancement, and (iii) foreign policy, and therefore, domination. \textit{See generally,
Dempsey} supra note 10; Raldev Raj Nayer, \textit{Regimes, Power, and International Aviation}, 49 Int’l
mined to make the sole and principal center of influence. The letter sent out by the United States of America "on its own initiative," inviting the other States to the convention, made no illusion about the intent. It told them the intended convention was in order "to make arrangements for the immediate establishment of provisional world air routes and services" and "to set up an interim Council to collect, record and study data concerning international aviation and to make recommendation for its improvement," as well as "discuss the principles and methods to be followed in the adoption of a new aviation convention." ICAO, an established political institution with a right to examination in terms of its processes, as well as its products, and a right to be understood through its politics as well as its constitution, cannot be understood apart from the interest groups that shape it; an institution is not buildings, tables, and chairs, but rather those very interests which act collectively for certain specified purposes.

The strange nature of ICAO is understood only in these terms, and not because of any so-called technicality. There appears to be organizations, such as ITU, which deal with more technical phenomena than those of ICAO. But again, ITU is spared the contradiction called sovereignty, solely on account that its subject-matter is incapable of national appropriation.

Against this background, the two-heads of the ICAO monster are easily understood. Non-Council member States are not a part of the "nucleus" or "club." Their presence is only needed to give it the universality decorum; and they have to be restricted from the aviation business that is solely the Club's. To ensure this, the heads of this organ, its President and Secretary General, must be the effective heads of the entire Organ-

115. Haviland, supra note 7, at 6. The nature of those interests are gleaned from the intention of the drafter of the Chicago Convention.
116. Abeyratne, supra note 2, at 3.
118. Id.
119. Id.
120. See Nicholas, supra note 7, at Foreward.
121. Haviland, supra note 7, at 3. The nature of those interests can thus be gleaned from the intention of the drafter of the Chicago Convention.
122. Abeyratne, after quoting President Roosevelt's admonition to the Chicago conferees to the effect that 'the air which God gave everyone shall not become the means of domination over anyone', then saw the apparent 'two contrary reactions' when he stated: "Ever since, the fate of economic regulation of international air transport has been relegated to the status of an obdurate dilemma which posed the question as to how States could avoid dominance by others without protecting themselves." Abeyratne, supra note 3, at 3.
zation. The result is the so-called "dichotomy of top officials": a modus operandi fashioned solely to permit the two-headed Gulliver of Politics to resist being tied down (while one head sleeps)\textsuperscript{124} by the Lilliputians in the Assembly.

The strategy described above is illustrated during an examination of the Council-orchestrated adoption of session provisions. "The merit of this amendment may be questioned [not only] because the role of the Assembly has been considerably reduced [by it] in favor of the Council and the working methods of the Organization were thus dramatically changed";\textsuperscript{125} and because of the unconstitutional methods employed in its regard. The circumstances surrounding that referendum\textsuperscript{126} consequently require passing through an examination.

3. The Installation of "More Frequent Sessions"

As noted previously, people born with infirmity tend to develop in other areas to make up for their deficiency. It seems at first that the ICAO Assembly hardly attempted to make good of its own limitations (especially when considering the manner in which the Assembly today unwittingly tows the line). But that is not entirely so. This Assembly, it appears, now lives with its situation only because the individual states, and not the institution, as indicated earlier, are the real policy-makers. Those such as Canada, Australia, and New Zealand, that would salvage it through their regular or usual balancing role, simply see no need to do so because their entrenched places in the Club are guaranteed; no institution is understood apart from the interest groups that shape it. Again, an institution is not buildings, tables, and chairs, but those very interests acting collectively for certain specified purposes.

Some events of this assembly's Montreal session from May 27\textsuperscript{th} to June 12\textsuperscript{th}, 1952, give us an idea of what is involved. At this Sixth Session,

\textsuperscript{124} The important role played by the UN Secretary General during periods that the Security Council, being tied down by Gulliver of Politics, could not perform its Charter responsibilities attest to this interpretation. Had the UN Secretary-General been a part and parcel of the Security Council, he would, of course, not be capable of doing that, quite apart from the fact that he would then be an interested party. More importantly, most of his powers would have devolved to the president of the Security Council, as is the case in ICAO.

\textsuperscript{125} Milde, \textit{supra} note 1, at 428.

\textsuperscript{126} An example of how President de Gaulle used (and abused) this power was the 1962 referendum on the direct election of the president. De Gaulle decided somewhat belatedly that it would strengthen the hand of the president (namely De Gaulle) to be directly elected to a seven-year term of office. (At the time the president was indirectly elected to a shorter term by an electoral college.) The referendum passed after de Gaulle announced that he would resign if it failed. Thus he gave the French voters [at least] the choice of granting his wish or losing his leadership. The referendum had the effect of amending the Constitution by clearly unconstitutional means!

\textit{Magstadt, supra} note 54, at 102.
the Assembly, in effect, attempted an assertion of its supremacy in spite of all the limitations noted. Mr. Subtil of Portugal, \textit{(toujours lui)}, invoked Assembly Resolution A5-6 concerning principles of apportionment of the expenses of the Organization among contracting States. Specifically referring to that Resolution, Subtil rebuked the Council, which "instead of taking itself the responsibility for this important matter ... once again relegated the problem to a level [Secretary-General's] consider inappropriate."\textsuperscript{127} In this graphical statement, support is found both for, and against, the theory that the Secretariat is part and parcel of the Council, (however, the former appears weightier). Again, it represents what can be regarded as the Assembly "acting unconstitutionally"\textsuperscript{128} in a sense, as the Council appears to be the sole judge as to what it does in discharging its exclusive mandatory function in Article 54(b). This provision requires the Council to carry "out the directions of the Assembly and discharge the duties and obligations which are laid on it by this Convention."

The Council cannot, however, get away with such an argument here. This is a Chapter XII (Finance) matter regarding the same Convention (in Articles 49(e) and (f), 62, and 61) that gives the Assembly authority to know what is going in its regards. How can one validly vote a budget without being aware of how it came about, and/or what it is all about - except that its presenter or defender wants to vote too? Even failing that (and surely it would not fail), the Assembly might have attempted to act in accordance with the interpretation of supremacy given above.\textsuperscript{129} The Council must have sensed this imminent and in-coming storm, as was made exceedingly pellucid by Mr. Subtil. Before this statement now discussed, Mr. Subtil prefaced this statement thus:

\begin{quote}
It rests with the Assembly to appraise and criticize the work done by the Council, and the Delegations here present should be fully aware of their responsibility and of the necessity and interest for [the] Council to receive their criticisms and advice. We consider it our duty to place before the Assembly, the problems which ... are unsolved or unsatisfactorily solved, and which, due to their particular importance and to the consequences which they entail, must be studied and solved, one way or another, by the Assembly.\textsuperscript{130}
\end{quote}

These are strong words indeed, pointing unambiguously to the Assem-

\textsuperscript{127} Sixth Session, \textit{supra} note 4, at 5.
\textsuperscript{128} Professor Michael Milde, a former ICAO Legal Bureau Director, and current director of McGill University's renowned Institute of Air and Space Law, stated some four years ago that the Assembly would be constitutionally acting \textit{ultra vires} if it were to act on matters which are an exclusive prerogative of the Council. Milde, \textit{supra} note 1, at 430.
\textsuperscript{129} Osiexec, \textit{supra} note 14, at 19.
\textsuperscript{130} Sixth Session, \textit{supra} note 4, at 5 (emphasis added).
bly's use of its budgetary powers to keep the heady Council disciplined, one way or another.

The Council, evidently reading between the lines and sensing danger it never thought Lilliputians could pose, moved faster than the Assembly.\textsuperscript{131} Therefore, at the controversial Eighth Session, even Article 61 (which gives the Assembly powers to vote the budget "with whatever modification it sees fit to prescribe") received the fatal triennial blow. Of course, only the last of Subtil's Sixth Session proposals, giving the Council additional significant advantages and powers, appears to be extracted from the whole set and nicely couched in an ambiguously attractive phrase.

This paper has no quarrel with the movement to change the frequency of Assembly sessions. The arguments so far, coupled with the existence of an amending formula in the Convention, may prove its logic. What is strongly questioned, however, is the manner of achieving that end. The plain fact is that the proposal to amend the session provision was neatly camouflaged and presented for adoption by the uninformed Lilliputians in the Assembly. Moreover, the usual or established procedure appears to be by-passed, perhaps, for fear of rejection through passing through it. These considerations, therefore, seem to grossly taint the entire process, taking it to the all-too-familiar realm of Ebele Osieke's "Unconstitutional Acts of the ICAO."\textsuperscript{132}

The Assembly is said to be ignorant and uninformed due to three important considerations. First, the members of that "highest body of ICAO" might be handicapped by their lack of legal experience.\textsuperscript{133} This was further complicated by the enticingly disastrous phraseology of the amendment. To the unwary, that phrase easily gives the impression of "more frequent sessions."\textsuperscript{134}

Third, it seems that many of those distinguished non-Council members had neither complete facts on what they were voting, nor the necessary time to effect a seasoned study that the circumstance required.

\textsuperscript{131} Especially since the next speakers merely exposed their ignorance of "the particular importance" and the "consequences" of the issue of discussion by unnecessarily diverting from the issues, as illustrated by Count Franco of Italy who, rather than contribute to the point, would take us and the entire Assembly on one of those voyages of irrelevance or "mere exercises in rhetoric". Cassese, supra note 7, at 396; Sixth Session, supra note 4, at 11. Michael Dummett expressed disappointment at such an attitude when he held that "Failure on the part of [most of the consensus] politicians to understand the possible effects of adopting one or another . . . procedure amounts to ignorance of the tools of their trade." M. Dummett, Voting Procedures 13 (Oxford: Clarendon Press) (1984).

\textsuperscript{132} See Osieke, supra note 14.

\textsuperscript{133} See supra text accompanying note 88.

\textsuperscript{134} This illusion is elaborated later under subsections B (Clarity and Specificity) and C (Convening the Sessions).
They also did not receive counselling before the fatal unanimous “voting in favor” of reducing the frequency of Assembly sessions. The Council bulwarks lend preponderant support (perhaps without even realizing it) to the thesis developed in this paper.

According to Mr. J. W. Stone, the Australian Chief Delegate, there was “no opportunity for second thoughts.” The French Delegate (Mr. H. Bouche), too, graphically indicated how there was such “haste” in the whole matter that Rule 10(d) of the Rules of Procedure was suspended. This is certainly one of those several instances of “pricking too many holes in the pie.” An attitude, the French Delegation “had not considered . . . advisable” as it “did not appear to give the necessary consideration to the rights of each State and to the efficiency of the Organization as a whole, such as there should be in a large international organization.”

Clearly, the unabashed suspension of the Rule, like General de Gaulle’s imposed 1962 French referendum, had the effect of amending the constitution by unconstitutional means. Moreover, the Delegate of “the United States as the chief supplier [of rights] to the rest of world” stated, that his Delegation:

135. If the non-Council members received counseling, they could turn to the Secretariat because the Secretariat is an interested party.
136. 8th Session, supra note 95, at 56.
137. Rule 10(d) states that proposals for the amendment of the Convention, together with any comments or recommendations of the Council, must be communicated to the Contracting States so as to reach them at least ninety days before the opening of the session.
138. See supra note 50.
139. 8th Session, supra note 95, at 55. The United Kingdom Delegate states that: as a matter of principle . . . there should be some safeguards in the application of the amended Article 45 and . . . in no circumstances should the removal of the Headquarters be decided by a majority vote of the Assembly . . . in these circumstances there seemed to be no prospect of the substantial unanimity which was so desirable on amendments to the Convention, and for this reason, and because his Delegation could see no urgency in this matter, he would vote against the resolution.
Id. at 53. South Africa and New Zealand naturally followed the British stance. Id. at 53-54.
140. Id. at 55. The “rights of each State and the efficiency of the Organization” seem to only matter when those of a major power are concerned; thus illustrating what Eugene Sochor calls “the conflicting interests of states” and what Segaller demonstrates as “double standards.” See E. SOCHOR, THE POLITICS OF INTERNATIONAL AVIATION 54-55 (1991); S. SEGALLER, INVISIBLE ARMIES: TERRORISM IN THE 1990s 9-10 (1987).

The political agenda of terrorism consists simply in states failing to condemn the terrorism . . . of their allies or of special interest groups close to their strategic political interests; and in denouncing the terrorism of their enemies . . . [which] is a dangerous hypocrisy, for as soon as moral relativism enters into the debate there opens a gap into which some terrorists are able to run for cover.

did not think that the Convention of the Organization should be amended in haste and in an emotional atmosphere and without adequate information having been given to all the States of the Organization, particularly the non-
Council Member States. The Council had not acted on this matter until April 16th, barely two months ago. The documentation had not reached many of the States until just before the Assembly. Such documentation as there had been contained very little information. States had been asked to come here and vote on an amendment without really knowing what the facts were or the background of the proposed action. This confusion had certainly been borne out in the discussions and by the number of abstentions in the meetings.\textsuperscript{142}

All of these delegations were the sole brains behind the move in the Council. Without realizing how betraying it was, they all took to the defense of Canada’s interest by opposing the proposal to amend the Headquarters Article at the same session that the fatal amendment Resolution A8-1 was adopted by forty-three affirmative votes, with only one abstention (Chile). Yet, as the British Delegate said, this is something about which a “substantial unanimity . . . was so desirable.” Maybe the forty-three affirmative votes of the Assembly constituted a substantial unanimity? Be that as it may, that is not the only point.

While vehemently opposing the resolution on amendment to Article 45 of the Convention (permanent seat of the Organization), these entrenched ICAO Council members also exposed the Council’s nasty linen. Resolutions A8-1 and A8-3 (both amending the frequency of sessions), adopted “unanimously” or “overwhelmingly,” also dealt with \textit{an amendment to the Convention} and embodied in the Council documentation now being attacked as inadequate, deceitful, hasty, and, therefore, null and void by its own authors. Is this another illustration of the plethora of the Council’s hoodwinking devices? Who ever said that when the interests of a major power are in issue, illegality is not legitimized at all costs? Where are the democratic safeguards (such as those put in place within the UN Charter) toward the interests of smaller and weaker States? Do they not have interests that need protection?

The Charter of Paris for a New Europe reads:

Democratic government is based on the will of the people, expressed regularly through free and fair elections. Democracy is the best safeguard of freedom of expression, tolerance of all groups of society, and equality of opportunity for each person. Democracy, with its representative and pluralist character, entails accountability to the electorate, the obligation of public authorities to comply with the law and justice administered impartially. No one will be above the law.\textsuperscript{143}

\textsuperscript{142} 8th Session, \textit{supra} note 95, at 54 (emphasis added).

\textsuperscript{143} See Theo van Boven, \textit{Contemporary International Law Issues: Sharing Pan-European and American Perspectives - Proceedings of the Joint Conference Held in the Hague, \textit{The Ameri-
It seems that these principles are merely for window-dressing, especially in international organizations, where the democratic West seems to ignore their own principles. Some factors may explain this reverse phenomenon. First, there are the limitations noted earlier. Second, because ICAO is "simply the culmination of efforts to create a technical framework for managing the political rivalry and commercial competition among nations engaged in international civil aviation," it is hard for States to avoid dominance while protecting themselves; competitive goals are difficult to agree on, since there is no incentive for the side that anticipates losing to agree to compete or concede the possible existence of competition.

It seems that the change from annual sessions is not the only aspect giving the Assembly its unsavory status. The vagueness of the provision also contributes to this status.

B. Necessity for Clarity and Specificity

Since the change from annual sessions, it seems that the Assembly can have as many sessions as it wishes within three years. One authoritative source argues that "the wording of [the present] Article 48 allows for such an eventuality." This is only one of the several fallacies ripe in the ICAO.

The relevant portion of the original unamended text of Article 48(a) provides that "[t]he Assembly shall meet annually and shall be convened by the Council at a suitable time and place." The phraseology of "shall meet annually" is, of course, preferred to "shall meet not less than once in three years" for a number of logical and sensible reasons. First is the as-

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144. See supra, note 7.
146. D. Deudney, Forging Missiles into Spaceships, 2 World Policy J. 271, 276 (1985). This would certainly explain Western suspicion of what they call the "mechanical majority", especially as exemplified in the United Nations General Assembly - which "now increasingly indulges in the highly questionable practice of begetting ever greater number of resolutions, as if to conjure up problems and provide for their solution on paper served to settle them in real life." Cassese, supra note 7, at 396. Much as one may sympathize with the weaker States, it should be remembered that most of these Third World States would voice concern for sovereign equality only when it involves rights-taking but easily turn around and cry out loud how poor they are when it comes to shouldering responsibilities. See their attitude on the so-called "Common Heritage of Mankind", which, in effect, means they have to be given the legal right to reap where they have never sown. Id. at 376-92. Could the West, and the United States in particular, not be entitled to be in control, since they have much at stake that has been sown?
147. Guldimann, supra note 1, at 353.
surance in the number of meetings, and second is to curb the possibility of the Council abusing its enormous powers.

The attempts by smaller nations at Dumbarton Oaks and San Francisco are in line with this suggestion. Their aim was to bring the Security Council under control and strengthen the Assembly through making criteria for the Council’s actions more specific.148 To the contrary, the easy realization of the Americano-British dream of such an enfeebled ICAO Assembly could be pitched on the unfortunate Soviet absence in Chicago. Their presence would set into motion the same East-West Big-Power tangle that was evidently at work both at Dumbarton Oaks and San Francisco. This would necessitate the striking of a balance from the medium Westerners, who consider themselves as being relegated to “outsiders” by this excessive show of Big-Power dominance.” But, as that was not the case, it was not deemed necessary to prevent illusions and vagueness, nor curb the possibility of abusing powers.

1. No Home for Illusions

The former provision (shall meet annually) gives no room for illusions. In the first place, it assures three meetings in three years, while the latter, with all its potential for more meetings, does not. This mirage might lead the Director-General of the ILO into thinking (as he did when unsuccessfully arguing for similar changes in his Organization) that “[t]he plenary bodies of UNESCO, the FAO, ICAO had dropped annual in favor of biannual sessions.”149 Similarly, the point was missed when the African Civil Aviation Commission’s (AFCAC) ordinary Plenary session (held every two years) was amended in 1981 by the Seventh Plenary Session in Dakar, Senegal, which passed Resolution 57-26 changing the session to every three years “to be in line with the ICAO cycle.”150 AFCAC is also wrong, but they might be right in their construction. How is that?

The expression “not less than once in three years” is not necessarily the synonym for “once in three years.” It means that within three years the Assembly must have at least one session. So the Assembly may decide to have three hundred and sixty-five times three meetings within the three-year period in question and still be meeting or holding the sessions

148. Haviland, supra note 7, at 29.
149. ILO Director-General’s Report on the Improvement of the Practical Methods of Working of the Conference, submitted to the 137th Session of the Governing Body, para. 140, cited in Ghebali supra note 2, at 152 (emphasis added). He even talks of biannual and would not be wrong. This gives more weight to the proposition, namely, the illusory and vague nature of the provision. It can be interpreted to mean just anything; from zero-annual to 365-annual and more.
constitutionally. What a Constitution! Paradoxically, the change from *shall meet annually* to *not less than once in three years* is predicated solely on saving expenses supposedly involved in holding annual sessions. But it could logically end up leaving us with potentially 365 sessions in 365 days. Is this another generation of the "two contrary reactions" so common in international aviation?

No one doubts the potential for abuse that vagueness in the law furnishes.\(^{151}\) "This ambiguity [of Article 48(a)] may have been deliberate, but it gives rise to a potential constitutional crisis if the two . . . [organs] are not on parallel tracks."\(^{152}\) Of course, the demonstration from our hypothetical example is a possible and logical outcome, even though the reaction of many people is to say that such a case is unlikely to occur, therefore, the question is of no practical importance.\(^{153}\) This might be insofar as other lesser-placed enactments of the Organization are considered (for the case of 365 sessions), and the fact that the Assembly is not incapacitated by this provision only.

The Director of the ILO, the AFCAC, and others have misinterpreted the provisions of Article 48(a) only insofar as that provision of the Convention is considered in isolation. But they are correct in stating that Assembly sessions in ICAO are triennial. In September 1968, in Buenos Aires, the Assembly decided that the triennial arrangement of ordinary sessions of the Assembly should be regarded as the normal practice of the Organization, with the further understanding that intervening ordinary sessions might be convened by the decision of the Assembly or Council.\(^{154}\) This presents problems. Any student or researcher of international organizations is entitled to assume that the Organization's Constitution represents the supreme law of the organization,\(^{155}\) although

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151. See Groom, *supra* note 7, at 285. The more precise the law, the easier it becomes for evil-doers to skate around it. But, as the renowned criminal law professor, Glanville Williams, indicates, the wider and more imprecise the law, the greater the possibility of someone being caught who was not meant to be caught. Moreover, because a vague penal law is an evil for citizens who want to know how they stand, the modern tendency is to have laws defined with relative precision. Glanville Williams, *Textbook of Criminal Law* 5-6 (1978); see also R.A. Silverman, *Lloyd's Introduction to Jurisprudence* 149-53 (6th ed. 1994). To have a precise (criminal) law does not, however, mean that (sentencing) judges' discretion must disappear. It only means having clearer, more straightforward, and less inconsistent principles and offenses.


153. Dummett, *supra* note 131, at 3. It may be of no practical importance to the extent that the interests of a principal power have not yet been affected. Otherwise, would it be the same?

154. G.A. Res. A16-13, U.N. GAOR, 16th Sess. This was done after a review of its Resolutions A4-6 (second sentence of Resolving Clause 4) and A14-4 which it then decided, pursuant to Resolution A15-2, to consolidate and then cancel.

155. The Constitution of . . . [an organization] is a statement of the will of . . . [its Members] to be governed in accordance with certain principles held as fundamental and certain prescriptions restrictive of the powers of the legislature and government. It
not "a fungible commodity." It is really surprising for the student to be told that their sound interpretation of the Constitution of the Organization is faulty because of the questionable existence of some inferior or lesser text which contradicts that constitution. This point of view even adds to the aggravated ambiguities and inconsistencies of the wording of the section of the Convention in question.

It is a common and indisputable fact that "[i]n legal relations, international as well as national, public as well as private, there is everything to be said for clarity, consistency and knowability." Amending Article 48(a) to reflect Resolution A 16-13 is an effective step in that direction. Until that is done, there is no way the Council can check if it decides to abuse powers by not convening an additional desired ordinary session within the three-year period.

2. An Abuse of Powers Curbing Device

The second advantage with "shall meet annually" lies both in its clarity and in its making the convener's judgment a matter of course, as opposed to not less than once in three years where it is extremely decisive. This point becomes more pellucid when the convening aspect is examined below. In this matter, the Chicago Convention could have emulated the initiative-taking IMO whose Constitution clearly orders regular sessions to "take place once every two years." This will not satisfy the demands of "annualists," but it does have merits of clarity.

However, that does not permit the ICAO Assembly to ride high. The Assembly is weakened through both the frequency of its sessions, and the convening of those sessions – one arm preventing escape from the grip of the other arm.

C. Convening the Sessions

The ICAO Assembly cannot convene itself. Furthermore, its convention by the Council is so vague and dependent on the latter's discretion there seems to be nothing anyone can do about it. The catch-all phrase here is "at a suitable time and place."

is, as s.52 of the [Canadian] Constitution Act, 1982 declares, the 'supreme law' of the . . . [organization], unalterable by normal legislative process, and unsuffering of laws inconsistent with it . . . .
The Manitoba Reference [1985] S.C.R. cited in Chief Justice B. Dickson, Address to the Canadian Bar Association 9-10 (Aug. 21, 1985) (emphasis added). Such a constitution must be a proper one, "one in which no one organ has unlimited power and in which there is legal machinery to prevent violation." H.W.R. WADE, CONSTITUTIONAL FUNDAMENTALS 77 (1980).
156. BUERGENTHAL, supra note 2, at 1.
157. VLASIC, supra note 141, at 50-51.
158. See IMO Constitution, Article 13 reprinted in SIMMONDS, supra note 77.
1. A Suitable Time and Place

A suitable time and place - what does it actually mean? Only the Council\textsuperscript{159} knows. It has different meanings and significance, depending on the particular type of provision with which it is dealing. Confronted with \textit{shall meet annually}, this expression is not as decisive as it seems now that \textit{not less than once in three years} is the inefficient adversary. This is because there must be some suitable time and place before the expiration of the one year period, during which time, if the Council does not convene the meeting, it is validly questioned.\textsuperscript{160} Mr. Evatt of Australia is reputed to have \textit{led another revolt by insisting that the General Assembly} decide for itself when the Security Council actually \textit{exercis[es] the functions assigned to it.}\textsuperscript{161} The Assembly is thus assured (through \textit{shall meet annually}) of three meetings in the three-year period. This assurance carries the idea that the Assembly keeps its hands on the governance of the Organization.

\textsuperscript{159} Minus the so-called Developing States. Developing States are handicapped even when they are in this Council. They simply cannot participate competently and extensively in the preparation of drafts, as they do not have large enough delegations to keep pace with the deliberations and the developments in the various committees and working groups. The result is, their lack of exertion or any influence over the decisions taken. \textit{See R.S. Jaksul, Evolution of the ITU’s Regulatory Regime Governing Space Radiocommunication Services and the Geostationary Satellite Orbit, 8 Annals of Air and Space L. 381, 400-01 (1983).} Perhaps this is what led the “benevolent . . . and enlightened despot . . . to flatly declare in an address to his fellow Third World colleagues that “the Third World nations did not shape the world’s institutions of production and exchange and have virtually no say in them. But we are dominated by them.” Mwalimu Julius K. Nyerere, President of the United Republic of Tanzania, address to the Fourth Ministerial meeting of the Group of 77, (Feb. 12-16, 1979), \textit{reprinted in K.P. Sauvant, The Group of 77: Evolution, Structure, Organization 131, 132 (Oceana, 1981).} To His Excellency, “The present system has been developed by the industrialized States to serve their purpose.” \textit{Id.} But can complaining like this \textit{per se} help them influence the course of these institutions? It seems that the only solution could be for these states (especially those of Africa) to seriously and frankly consider several important proposals for coming together in political federation(s). \textit{See e.g., Tiikier, A COMPARATIVE STUDY OF THE ECONOMIC POLICIES OF THE CAMEROONS AND IVORY COAST 87 (International Institute for Economic Research 1974); Tall, supra note 80; Bechir Ben Yahmed, La maladie des grands, JEUNE AFRIQUE 4 (1993).} No one can doubt the strength of great numbers-in-unity. Is this not one of the principal reasons for the U.S. greatness? And is that not the reason for the European Union? When is Africa going to wake up from its induced slumber?

\textsuperscript{160} It might have been precisely for such reasons of accountability that the other States could not buy the Big Three’s idea put across through Senator Vandenberg’s explanation. He had indicated that the U.N. “Council would be a representative body of the Assembly, just as the Assembly would be representative of the various countries” and that, therefore, the latter should not be able to “encroach” on the former since “it was inconceivable that any action of the Council would be contrary to the wishes of a majority of the Assembly.” \textit{See UNCIO, Documents IX, at 296 & 316, cited in Haviland, supra note 7, at 15-16.}

\textsuperscript{161} Haviland, supra note 7, at 16. Altogether fourteen countries, including France and Canada, submitted amendments along these general lines, with the result that the compromise found itself as Article 12(1) & (2) of the Charter. \textit{Id.} at 16-17.
On the other hand, under the present wording of the *not less than once in three Years* provision, there seems to be no way the Assembly can have more than one meeting in three years if the Council (as it seems inclined to do) looks upon it with disfavor; especially if its so called election is already validated. The Council acts perfectly within the *constitutional* will: provided it already convened one session which validated both its membership and its triennial-annual budget. In view of this, the present study disagrees with the submission "that the present formulation of Article 48(a) is flexible enough to allow for Assembly meetings to be convened at appropriate times . . . [and that, consequently] amendment efforts should be concentrated [only] on other areas of the Convention."162 Ernesto V. Rocha could be right in suggesting that "an entirely new Convention . . . be drafted."163 In such exercise there are a lot of lessons to be learned by ICAO from other organizations.

2. *Necessary Lessons from Other Schools*

In fact, ICAO (or the Chicago School) needs some seasoned lessons from the Philadelphia School (the ILO). This Organization compels attention due to (1) its concept of social justice which is the very basis of its constitutional mandate, (2) its rare skills at reconciling idealism with realism in the planning of its programs, and (3) its flexibility yet straightforwardness in its modes of operation.164 Consequently, it is now the lone survivor of Versailles and "one of the most advanced of the United Nations agencies."165 What can it offer ICAO?

The Constitution of this Organization, regarding the vexed issue of Assembly sessions, authoritatively stipulates in Article 3(1) that meetings of the Conference shall be held from time to time, as occasion may require, and at least once every year.166 And, it is trite that, since 1919 the Conference has, with the exception of 1940, 1942, and 1943, met each

163. Rocha, *supra* note 1, at 477. This is very likely to be opposed with all strength by those whose position is adversely affected by such a move. See Jakhu, *supra* note 159, at 384-85; Deudney, *supra* note 146, at 275 declaring:
   The new order must grow alongside the old order, and reach a certain level of vitality before people will abandon the old order, no matter how dangerous and disliked it may be. Human nature is too resistant to change for a scenario involving the sudden demolition of the old order, followed by a reconstruction along boldly improved lines, to have much appeal. People living in a rickety old firetrap of a house are not likely to leave it until some other shelter becomes available, no matter how clearly they perceive the dangers of living in the old home.

165. *Id.* at 269.
166. *Id.* at 151 n.6.
year (not counting the special maritime sessions held in addition to the
ordinary ones). All this took place in the ILO in spite of the “large
assembly, unwieldy and growing more so (in June 1984 the record figure
of some 1,850 delegates was reached) [which] was already giving cause for
concern in the mid-fifties, when the question of a change in its annual
periodicity was raised.” At the close of the Philadelphia Lecture, what
is the expected Chicago Response? A simple one indeed.

Since the Chicago Assembly cannot convene itself, what can it do
if it desires an ordinary session and the Council does not convene it?
Does it call for an extraordinary one? The existence of extraordinary
sessions in the Convention seem to suggest the affirmative.

III. ICAO Assembly Extraordinary Sessions

Section A looks at the rationale for having these kinds of sessions.
Section B explains the modes of convening the sessions. The two sessions
that the Chicago Convention provides for are: (1) sessions at the call of
the Council, and (2) sessions at the request of one-fifth of the total
number of members.

167. Id.
168. Id. at 151.
169. It could hypothetically run as follows: That is a very interesting expose sir, but we find it
sort of strange for a number of reasons. First, we might have been naive, as they say, but we
were not that complicated to flirt with the “foolish” idea of attempting to be both idealistic and
realistic. There was simply no reason for us to be - were we not lucky to be spared the horrifying
presence of the Reds? We even hear that their presence at Dumbarton and San Francisco was so
scary to our Boys that they had to jump, even at you, for being in the same camp with those
Soviets! Thank God they refused to come to our Chicago Club as initial members. Pragmatism
alone is the thing we are accustomed to. Second, as you can see, we are dealing with the “most
technical” aspect of the Universe. This demands “the highest degree possible” of “serenity and
efficiency” which were the cardinal virtues in our times in Chicago. There we saliently foresaw
that the imminent change in the geopolitical world was going to seriously conflict with our pre-
vailing interests, which we were determined as ever to protect. So we took all the care in the
world not to bebooted out or even encumbered later by the “mechanical majority” of the Lil-
liputians-to-be (as the experiences of several of you of the other Schools, but more particularly
of the Mother school, can attest to) closed. Therefore, in accordance with the intelligent saying,
“to be forewarned is to be forearmed”, we wise Chicago People closed all possible avenues of
surprise attacks. We mean to say that we tied down the Lilliputians before they could do, or
attempt doing the same to us. You can then see that those of us in Chicago Universal have no
use for your preaching. Thanks for the effort though.
170. If ICAO thought its sister, the ILO, might misconceive the whole thing, did it think in a
like manner that even its Mother also suffered from misconception? Why has it not already said
so? The UN General Assembly sessions are annual and charged with a lot of specificity and
clarity. Regular sessions of the General Assembly are held every year, commencing on the Third
Tuesday in September. And these are held at Headquarters unless convened elsewhere by a
decision taken at a previous session or at the request of a majority of the members of the UN.
See Kapteyn, supra note 27, at Dir. I.A.; U.N. CHARTER art. 20; GEN. ASSEMBLY R. P. 1.
A. Rationale for Extraordinary Sessions

This category of sessions is employed or convened for urgent issues and “address[es] a specific problem or group of problems but do not play the full constitutional role of the supreme body with overall responsibility.” How does this tie in with not less than once in three years? It is of course, incompatible with the present wording of the first arm of Article 48(a). Nonsensical, is it not?

1. Extraordinary Sessions’ Incompatibility

It is trite that this kind of session is utterly inappropriate in the event that the not less than once in three years provision actually intends to serve its purpose - because there is no need to provide for extraordinary sessions where sessions can be held “any time that circumstances warrant.” This seems the most reasonable and normal interpretation of “shall meet not less than once in three years.”

The ILO, (toujours egal a lui-meme), shows the way (which ICAO appears to not want to follow) once more. Its provision on the issue makes room for sessions any time circumstances so require; at least once every year. It thus has no need for extraordinary sessions, however, it was not oblivious enough to go ahead and make provisions like ICAO does. Failure to grasp this cunning ICAO provision must have led Werner Guldimann to the faulty submission indicated above. If the present text of the disputed Article 48(a) were flexible enough to permit Assembly meetings to be convened at appropriate times, there is no need for extraordinary sessions, whose presence must be nonsensical. It must be these sessions that the ILO refers to as “special maritime sessions.”

This organ (the ICAO Assembly) does not play any constitutional role since it is neither supreme, nor endowed with responsibility; even during its own sessions. How could it play a full constitutional role at extraordinary sessions, unless there is some ulterior design? A graphical or particularly poignant illustration may suffice. This also indicates the rationale (for these extra-sessions), as making no sense to the ICAO Council.

2. Does Rationale Make Sense to the ICAO Council?

The 25th Session (Extraordinary) meeting in Montreal from April 24 to May 10, 1984, came in the aftermath of the destruction of the Korean

171. Milde, supra note 1, at 430.
172. After all, Theo van Boven indicated, “although you may have a facade of democracy there are power factors at work which do not have their basis in democratic structures, like ... certain economic powers, that frustrate in fact the whole process of democracy and decision-making by those who are elected.” Contemporary Issues, supra note 143, at 134.
Airlines Flight KAL 007 on September 1, 1983. The incident profoundly shocked the international aviation community and immediately prompted an Extraordinary Session of the prestigious ICAO Council which opened — “just a few days before the regular session of the ICAO Assembly” - at the behest of the Republic of Korea and Canada.

The second of three Resolutions adopted at the Extraordinary Session of the Council (on September 16, 1983), reached a decision to convene an Assembly Extraordinary Session to consider an amendment to the Chicago Convention, to flesh it with an undertaking by Members to refrain from resorting to use of weapons against civil aircraft. At the Extraordinary Session of the Assembly, there was an unanimous adoption of an amendment to the Convention popularly known as Article 3 bis.  

173. This incident was described by observers as “a black mark in the history of international civil aviation . . . [which] ranks among the worst man-made aviation catastrophes and is a painful reminder and illustration of the cruelty, callousness, lawlessness and inhumanity in the Cold War attitudes of the former USSR.” Milde & Siciliano, supra note 38, at 291.

174. Id.

175. The most remarkable achievement in this instance is that the 25th Session of the Assembly should have been held at all and that, moreover, agreement was reached on Article 3 bis and this by consensus and even acclamation, without a single adverse vote. In the process, the world has shown with sufficient deliberation, solemnity and ritual (in what may perhaps be described as some form of tribal dance or religious rites collectively to exorcize the evil spirit) its feeling on what happened to KE007, or perhaps more accurately, on what happened to the 269 lives on board, that were abruptly ‘terminated’ at dawn on 1 September 1983, and its insistence that, in future, at least greater humanitarian consideration should be shown in such circumstances . . . . The essential thing is that in the process of elaborating this document, the message appears to have got through. Indeed, if this exercise in the wake of the KE007 tragedy succeeds in subduing henceforth the ‘trigger-happiness’ of States, at least in the field of international civil aviation, so that the ‘international standard concerning the taking of human life’ referred to in Garcia and Garza will from now on be steadfastly upheld at all times by all nations, the dead may yet not have died in vain.

Cheng, supra note 91, at 74. This incident is important here because of Article 3 bis, and the fact it brings Western hypocrisy or double-standards mentioned earlier. It also confirms an earlier point about the absence and presence of the Reds in Chicago and elsewhere respectively. Just a few years later the U.S. committed the same (even worse) savage act on Iranian Airbus 655 with all 290 persons on board killed. But rather than come out again “with sufficient deliberation, solemnity and ritual” and perform the “tribal dance or religious rites collectively to exorcize the evil spirit” as before, the same ICAO Council instead adopted an innocuous resolution which deplored the incident and reaffirmed ICAO’s policy condemning the use of weapons against civil aircraft without, however, referring specifically to he United States.” Sochor, supra note 140, at 142. As Sochor rightly put it, “the Council should have done no less in the Iranian affair than in the earlier KAL incident regardless of the United States’ apology and its admission of blunder.” Id. Moreover,

[it]o destroy a harmless civilian object and murder innocent civilians, and then to attempt to justify such a cowardly act on the ground of self-defence, self-protection, or national security, is to add insult to injustice, not to mention the agony and sufferings of the injured victims and their bereaved families.


176. Supra note 90.
Article 3 bis lays down guidelines on the interception of civil aircraft by state or military aircraft.\textsuperscript{177} Much controversy surrounds this provision but this paper does not contemplate joining in the exercise of making or reversing Article 3 bis.\textsuperscript{178}

The amendment retains our attention because its adoption came through an Extraordinary Session of the venerated ICAO Assembly. Extraordinary Sessions are meant to deal with unforeseen fortuitous incidents that arise and demand some measure of urgency for tackling them. In fact, this particular Extraordinary Session deserves the very name it bears. The KAL 007 incident took place on September 1, 1983, one expects that a supreme Assembly would convene any time on, or before, September 20, 1983 (the date of its 24th Ordinary Session). When an Extraordinary Session had to be convened regarding the same incident seven months later (and with an Ordinary Session in-between), it mocks both the very concept of an Extraordinary Session and the Organ holding it. Why was a session not held when it should have been held? The response is certainly found in the convenor’s non-exercise of its gear-like powers or non-performance of its duties - namely convening.

B. CONVENING THE EXTRAORDINARY SESSIONS

An extraordinary session is convened by either the Council, or by the request of one-fifth of ICAO membership addressed to the Secretary General.\textsuperscript{179} This paper addresses both.

1. By the Council

Placing the Council option before the Members’ option goes its own length towards weakening the already too slackened position of the Assembly. The IMO, for instance, does not ridicule its own supreme organ in the same manner. Its extraordinary sessions (as per its Article 13 already seen above) are convened (1) after a notice of sixty days whenever one-third of the Members give notice to the Secretary General that they desire a session to be arranged; or (2) at any time if deemed necessary by the Council, after a notice of sixty days. The answer to the KAL incident inquiry could thus be explained that the supreme Council never wanted it: an open Olympian affirmation of its powers and privileges. On its own, the immature and lame ICAO Assembly is helpless to such an extent that it needs to be “tossed about” by the Council. Why did it not employ the one-fifth formula (meant to “force the convening of an ex-

\textsuperscript{177} Milde, supra note 49, at 107.

\textsuperscript{178} For further discussion, see Id.; see also supra note 91.

\textsuperscript{179} Chicago Convention, supra note 2, Art. 48(a); Assembly Procedure, supra note 17, Rule 2.
traordinary session of the Assembly?

2. The One-Fifth Formula

Through this seemingly available escape-door, are placed hurdles in the nature of those members who never ratified the not less than once in three years amendments. In this ICAO modus operandi, one visualizes the all too familiar constitutional set-up of several dictatorial "democracies" of the 80s and 90s, characterized by an unholy imbalance of power - always, of course, in favor of the Executive - so neatly camouflaged that only the wary are, prima facie, aware that the document's importance lies more in what is not stated than what is. There is no point in giving one organ of an international organization unbridled powers and discretion as to render the other(s) helpless or useless; except for rubber-stamping.

Antonio Cassese, after studying the political set-up of Third World Countries, made the following remarks:

Third World countries have two other factors in common: a concept of law which, while differing from one culture to the other, is always profoundly distinct from that predominating in the West, and a tendency towards authoritarian structures in their respective domestic legal systems . . . [with] highly centralized and basically autocratic systems of government which tend to rely on power structures where law is easily disregarded whenever it suits the ruling group.

This also holds true for the West or North in international organizations in general and ICAO in particular. This is especially true for an organ like the ICAO Council which, in several respects, seems to be a "Club" of permanent or semi-permanent members.

It is conceivable that, should the Assembly attempt to request a session that the Council disfavors, the latter might block it by raising the question of constitutionality. A question it may neatly and easily

180. Milde, supra note 1, at 428.
182. This obvious contradiction led Asif Hasan Qureshi to ponder aloud:

Is democracy a Western mechanism for the imposition of its own value system? This question is relevant because if one is concerned about tensions between countries which have democratic systems and those that do not, one must address the question whether that is, in part, a cause. If one is to make the institution of democracy attractive, one must deal with the possible suspicion that the avocation of democracy is in fact a disguised call for the imposition of Western value systems. If the institution of democracy is to be sold, then it must come across as though it is not an imposition of a value system. I do not think that it is too far-fetched to be suspicious of these calls for democracy, given that Western international lawyers and Western governments are not too eager to talk about democracy when it comes to the United Nations [and other international organizations].

Contemporary Issues, supra note 143, at 138-39; see also Bailey, supra note 42, at 6-7. One can also ask why these Third World States should be entitled to democracy in international institutions when they do not practice the same at home. See supra note 22.
This particularly concerns election of its members who have not ratified the amendment increasing its size. The second limb (i.e. the request) of Article 48(a) includes the phrase “not less than one-fifth of the total number of contracting States.” This creates the same difficulties as those from the composition of the Council; the same potential for conflict between the two organs exists, as previously indicated regarding the phrase *not less than once in three years*. For instance, the phrase, “not less than one-fifth of the total number of contracting States” violates the dictates of the much-cherished principle of Article 94(a) the concealed unanimity rule with far-reaching consequences - when it purports to include those members who do not endorse this formula. Those members can be quite numerous. Would “one-fifth of the total number of contracting States” of ICAO now have to exclude those 70 or more States still adhering to the ten-contracting-States convening formula? Either way there is a violation. The Council is served well; even though its President permanently and strategically presides over these extraordinary sessions, the Council is the one that decides the meaning to attach.

Further illustrations are not hard to find. The 28th Session (Extraordinary) of the Assembly met in Montreal from October 22 to October 26, 1990, with 399 participants from 114 Contracting States and fourteen Observer delegations. Dr. Assad Kotaite, President of the Council, was “elected” President of the Assembly. There were three Committees or Commissions, with the Executive Committee (the most important of the Assembly’s so-called subordinate organs) under the Chairmanship of Dr. Assad Kotaite, President of the Assembly and President of the Council. Extraordinary indeed. But that was not all. True to its name, This Extraordinary Assembly, adopted resolutions, *inter alia*, (1) amending the Chicago Convention to increase the size of the Council

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183. Accused of unconstitutionality, the Council boldly declares that “While in common parlance it was correct to say the Assembly was sovereign, this was not legally so.” See Osieke, *supra* notes 14 & 18.

184. The original unamended text of the Convention read: “(a) The Assembly shall meet annually and shall be convened by the Council at a suitable time and place. Extraordinary meetings of the Assembly may be held at any time upon the call of the Council or at the request of any ten contracting States addressed to the Secretary General” (emphasis supplied). At the controversial 8th Session of the Assembly, the first sentence became *not less than once in three years* while the second was unaffected (entry into force was on December 12, 1956). See *supra* note 95. At the 14th Session on September 14, 1962, the ten-member formula received its burial while *not less than once in three years* came to full unencumbered life (as was demonstrated above) and took full force on September 11, 1975. 14th Session, *supra* note 24.

185. Which creates in the Council “ghost members”, “recalcitrant States”, “triennial-but-annual states”, and other weird paradoxes.


187. See *supra* note 71.

188. See 28th Session, Plenary Meetings, Resolutions and Minutes, ICAO Doc. 9563, at 44.
from thirty-three to thirty-six members; drawing up a protocol to that effect which comes into force upon ratification by 108 Contracting States; (2) establishing a worldwide policy toward operating restrictions on subsonic jet aircraft requiring them to meet the noise certification standard specified in Volume 1, Chapter 2, of Annex 16 to the Chicago Convention, but not the standard of Volume 1, Chapter 3, of Annex 16; (3) approving an increase of 14.78 million U.S. dollars in the ICAO Budget for 1990 through 1999, resulting from economic factors such as inflation and actual increases in costs, variations in exchange rates and decisions stemming from United Nations General Assembly Resolution 44/198 with respect to salaries and pensions; and (4) (which must certainly have furnished the excuse for such a meeting) condemning the violation of the sovereignty of the airspace of Kuwait and the plunder of Kuwait International Airport by Iraqi armed forces, including the seizure and removal to Iraq of fifteen aircraft of Kuwait Airways and their purported registration by Iraq.\(^{189}\)

Yet, one has been told that an extraordinary session is not supposed to exercise full constitutional role(s) not having overall responsibility. This only confirms what this study already indicates; namely, that talk of reducing the membership of the ICAO Council is falling on nailed ears. What else could be the justification for such unruly behavior of this servant Council? In fact, the proceedings in this case, as in the 17(A) Extraordinary Session, "raise some very important questions concerning the sovereignty of the Assembly of the ICAO; the extent to which it may by unanimity vote, override or circumvent the express provisions of the Convention, and the right of absent contracting States with respect to decisions adopted by the Assembly."\(^{190}\) This does not augur well for the stature of the Organization.

IV. CONCLUSION

Successful patterns for furthering cooperation, advancing accommodation, and handling political conflicts at all levels requires: (1) agreement on certain constitutional fundamentals, (2) meaningful opportunities for the expression of needs, interests, and desires, (3) sound mechanisms for the wise selection of priorities, (4) acceptable ways for legitimating public policy choices,\(^{191}\) (5) effective governance, and (6)

\(^{189}\) Annual Report of the Council - 1990, ICAO Doc. 9568, at 107 (emphasis added). In 1993, the 30th Session (Extraordinary) of the Assembly also met to elect a Contracting State to fill a vacancy created on the Council, on January 1, as a result of the dissolution of Czechoslovakia on December 31, 1992. See Annual Report of the Council – 1993, ICAO Doc. 9622, at 90.

\(^{190}\) Osielke, supra note 14, at 19.

\(^{191}\) [L]egitimacy is a quality of a rule which pulls subjects of the rule towards voluntary compliance because of qualities of the rule itself. In other words, that rule is perceived...
regular and effective control on government. Professor Neal Riemer of Drew University, after explaining each of these six factors, concludes that for “there . . . [to] be regular and effective controls on government, there must be constitutional mechanisms to ensure that government is a wise and limited servant and not a tyrannical and authoritarian master.” To achieve this, the constitutional framework should limit power and require this limited power to be in separate hands, otherwise it is “the very definition of tyranny.” Power corrupts, and absolute power corrupts absolutely.

The ICAO Assembly is not a sovereign organ and, in spite of all attempts by some commentators to give it that status, it was never intended to be one. As a consequence, the ICAO Council, being the linchpin of the Organization and home to the creators, could have been entitled to legally strip it of the only one source of its semblance of authority -annual sessions. But the somewhat illegal or unconventional mechanism employed to acquire less frequent Assembly sessions would taint the whole process with nullity in the law. The Council would hardly succeed in illegally effecting the (legal?) change, but for the fact that the Assembly, not being sovereign ab initio, (i) is convened only by the Council, and (ii) is strategically “temporarily presided” over by the Council, through both its President and Secretary General, both of whom are also President and Secretary General of ICAO. Why have two main organs in ICAO?

There is no convincing reason why the ICAO Assembly should not convene itself. Reform in this direction, as in several others, seems desirable. It seems that there is every reason for the ICAO Assembly to revert to annual sessions. Should less frequent sessions be justified, the amendment instituting them requires redrafting to render it clear and specific. In addition, the ICAO Assembly ought to exercise general supervisory authority over certain crucial activities of the Organization. The continued existence of Article 49(k) is anomalous and must be seriously reconsidered. There is a need for an ICAO Secretariat distinct

to have certain qualities which make it advisable or advantageous for those to whom the rule applies to carry out the rule absent police force. In fact, most of our domestic law turns on that perception of legitimacy because no state – even the most Draconian dictatorship – has the police power to enforce all laws. But, in international law, the concept of legitimacy becomes absolutely central because of the . . . absence of police enforcement mechanisms. Therefore, the perception of legitimacy of a rule as a way of pulling states and people towards voluntary compliance becomes of great importance. Thus, the topic seems to me to be a particularly poignant one at this moment.

Contemporary Issues, supra note 143, at 136.
192. Riemer, supra note 97, at 242; see also Gaubatz, supra note 143, at 116-18.
193. Id. at 243.
194. Id. at 248.
195. Rodino, supra note 97, at 695.
from, and independent of, the ICAO Council. This means having a single head of the Organization in the person of a Secretary General (or Director-General). Following closely is the need for ICAO Assembly sessions to be conducted solely by the Assembly without the Council President interfering. Until these changes are effected, there is no use talking about the supremacy of the ICAO Assembly, or any of its powers/functions – this is so because it has none.
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* Sessions at which the frequency of sessions was amended.
** Extraordinary sessions.

Richard D. Gritta*
Edward J. Freed**
Garland Chow***

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I. Introduction

Although by some measures the airline industry is doing quite well,¹

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³ Associate Professor of Transportation and Logistics, University of British Columbia. BS and MBA, University of Maryland; Ph.D., Indiana University.
⁴ A number of carriers have reported record or near record profits over the past two
the high-risk nature of the industry has long been apparent. Since 1982, at least 123 U.S. air-carriers have either failed or have lost their certification. Given the cyclical nature of airline revenues, the apparent prosperity of the airlines in recent years may be attributed more to the robustness of the U.S. economy than to any significant change in the basic nature of the industry.

The operating and financial cost structures of the airline industry's members, as well as the industry's cyclical vulnerability, adversely influences the long-term stability of the airline industry. On the operating side, the pressures of an intensely competitive marketplace and the inherently high fixed-cost structure of the industry pose a continual threat to industry stability. On the financial side, the highly-leveraged nature of airline financing leaves the industry particularly vulnerable to increases in interest rates and/or economic downturns. Moreover, the huge demand for the funds necessary to replace aging equipment will exacerbate the problems facing the industry over the next decade.

This paper examines some basic risk measures which may be utilized to assess risk in the airline industry. Values for these risk measures have been computed for the eight major U.S. air carriers over the period 1979-

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2. Several prior studies have established the comparatively high-risk nature of the airline industry. See generally Richard D. Gritta, An Unresolved Issue in Setting the Cost of Capital to the U.S. Domestic Airlines, 31 J. AIR L. & COM. 65 (1975) (comparing the risk levels of major air carriers to a sample of sixteen subgroups of industrial firms, which total 74 companies, and a sample of natural gas, telephone and electric utilities, and finding that air carriers as a group exhibited significantly higher levels of risk); Richard D. Gritta & Bahram Adriani, Risks in the U.S. Airline Industry: Pre and Post Deregulation, 26 Transp. Res. F. 434, 434-40 (1985) (determining that risks for the airline industry actually increased after deregulation). A more recent study confirmed the high-risk nature of the industry by comparing air carrier risk to risk levels for a large random sample of industrial groups. Richard D. Gritta et al., The Causes and Effects of Business and Financial Risk in Air Transportation: Operating and Financial Leverage and the Volatility in Carrier Rates of Return, 6 J. Transp. Mgmt. 127 (1994).


5. Richard D. Gritta, Risks from Operating and Financial Leverage in the U.S. Domestic
1995 and support the proposition that the airlines operate within a particularly high-risk environment. By highlighting the effects of leverage and the differences in carrier financial strategies, this paper argues that high carrier debt burdens are inappropriate given the volatility of the industry.

Section II identifies the generic risks common among nearly every business enterprise and reviews a set of economic measures intended to gauge these risks. Section III applies these measures to the air transportation industry and provides results for all major U.S. air carriers for the years 1979-1995. Section IV describes the implications for the industry as it prepares to replace aging fleets during the next decade. Finally, section V provides several solutions to the problems the industry faces.

II. Defining and Measuring Industry Risks

All firms face three types of risk: business risk, financial risk and combined risk.6 “Business risk” can be defined as the variability in a firm’s operating profit over time (often referred to as “Earnings Before Interest and Taxes,” or “EBIT”). This type of risk is generally attributable to the inherent nature of a firm’s operations and the environment within which it operates. Moreover, a firm’s cost structure, product demand characteristics and intra-industry competitive position drive this type of risk. Some companies may face high business risk solely because of external (and therefore largely uncontrollable) factors such as high fixed costs, the cyclical nature of its business, government regulation and intense competition.7 However, high business risk can also result from poor cost controls, low productivity or pricing practices which dilute revenues. The airline industry suffers a high business risk on virtually all these counts.

Financial risk is generally defined as the added variability in earnings available to a firm’s common shareholders due to the use of long-term debt to finance the acquisition of assets. Financial risk often represents the increased probability of insolvency that comes with excessive debt finance because interest on debt must be paid (unlike common stock dividends, which are paid at management’s discretion). High financial risk may indicate that high interest charges are overwhelming a business enterprise, forcing it in some cases to seek court protection. Unlike business

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6. These three risk categories are commonly identified in financial theory. See generally R. CHARLES MOYER ET AL., CONTEMPORARY FINANCIAL MANAGEMENT 319-53 (6th ed.)

7. Brigham has noted that airlines must invest heavily in fixed assets, which result in high operating leverage. This situation is, therefore, outside the control of management. See EUGENE F. BRIGHAM & LOUIS C. GAPELSKI, INTERMEDIATE FINANCIAL MANAGEMENT 391 (4th ed. 1993).
risk, financial risk is not primarily the product of the environment within which a company operates, but rather results directly from a firm's conscious decision to use financial leverage (i.e., long-term debt or preferred stock) instead of issuing common stock to raise funds.

Finally, "combined," or "total" risk, as the name suggests, refers to the risk that the interaction of both operating and financial risk creates. The interaction of the two risk types produces a multiplicative, rather than an additive, effect. As discussed below, the impact of the combined effect can be extremely powerful.

A. Measuring Business Risk

A firm's degree of operating leverage (DOL) constitutes one of the principal measures of a firm's business risk. Operating leverage generally refers to the firm's incurring fixed operating costs. As a general rule, high fixed costs create more unstable DOLs. An elasticity measure borrowed from microeconomic theory, DOL actually measures the responsiveness of operating profits (EBIT) to changes in operating revenue. In other words, DOL measures the X% change in operating profits that would be induced by a 1% change in operating revenues. The expression below illustrates the calculation:

\[ DOL = \frac{R-V}{R-V-F} \]

where \( R \) = operating revenue
\( V \) = variable costs
\( F \) = fixed costs

The sign and magnitude of DOL are both important indicators of risk.

To illustrate, consider a situation in which a firm's operating revenues ( \( R \) ) are $500, its variable costs ( \( V \) ) are $100 and its fixed costs ( \( F \) ) are $150. In this case:

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8. MOYER ET AL., supra note 6, at 318-28.

9. As an elasticity measure, DOL = % change in operating profits (EBIT) divided by change in operating revenues (OR). Operating revenues can be defined as pq (price per unit of output times output) and variable costs (V) equal vq (variable cost per unit times output). Thus, if the values of p and v remain constant, and fixed costs (F), by definition, are constant:

\[ DOL = \frac{\Delta q(p-v)}{\Delta p q} - \frac{\delta q(p-v)}{q(p-v)-F} \times \frac{
\delta q}{\delta q} \quad = \quad \frac{q(p-v)-F}{q(p-v)-F} \quad = \quad \frac{R-V}{R-V-F} \]
DOL = \frac{500-100}{500-100-150} = +1.6

Since revenues (R) exceed the sum of variable plus fixed costs (V+F) in this situation, the firm acts above its operating break-even point and DOL is positive. The positive DOL indicates that as R increases, operating profits will increase (and vice versa). In this case, a 1% increase in revenues will produce a 1.6% increase in operating profits. Similarly, a 1% decrease in revenues will produce a 1.6% decrease in operating profits. The relatively small positive value for DOL indicates a relatively low business risk (i.e., low variability in operating profit), since changes in revenue will induce relatively small changes in operating profits. In contrast, had fixed costs (F) been higher relative to (R-V), say $350 rather than $150, DOL would increase (to +8.0), indicating a significantly higher level of business risk.

Should costs (V + F) exceed operating revenues, operating profit is negative and the picture changes. Suppose, for example, R=$500, V= $400 and F=$110. Here the firm acts below its operating break-even point:

DOL = \frac{500-400}{500-400-110} = -10

This implies that a 1% change in operating revenues will induce a 10% change in operating profits or, more accurately, operating losses. The negative sign indicates that when revenues increase, operating losses will decrease (and vice versa). The relatively large absolute value for DOL implies a relatively high degree of variability in operating profits (losses), which can be dangerous since the firm operates below its break-even point.

However, such large negative values can actually be interpreted as less serious than very low negative numbers, since large absolute values indicate that current losses are relatively small and that a small increase in operating revenues can be expected to cut deeply into operating losses. Had fixed costs (F) been larger relative to (R - V), say $600 rather than $110, DOL would have remained negative — again indicating an operating loss — but its absolute value would have been substantially smaller. (In this case, DOL would have been -2). This smaller absolute value would be especially alarming since (1) it reflects the large size of current

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10. In general, when R exceeds the sum of (V+F), DOL will take on a value between +1 and +\infty.

11. If the firm has no fixed costs, that is, if F = 0, it has no operating leverage. Thus business risk would be low and DOL would equal +1.0.
operating losses and (2) it implies that positive changes in operating revenues will have only a minimal effect on reducing those losses.\textsuperscript{12}

Although fixed costs are generally seen as the key to determining the value of DOL, inefficient management policies affecting variable costs or gross revenues can also contribute to high business risk. In the airline industry, for example, factors such as poor cost controls or inefficiencies in a carrier’s route structure can produce unfavorable DOLs. Reduced revenues caused by aggressive fare wars may have a similar effect.

B. Measuring Financial Risk

A firm’s degree of financial leverage (DFL) can measure that firm’s financial risk. This interest-driven measure reflects the responsiveness of net profit to changes in operating profit (EBIT). More specifically, if $I = \text{interest}$, then

$$\text{DFL} = \frac{\text{Operating Profit}}{\text{Operating Profit} - I}$$

Since operating profit equals R-V-F (Revenue – Variable Cost – Fixed Cost), the expression can be rewritten as:

$$\text{DFL} = \frac{R-V-F}{(R-V-F)-I}$$\textsuperscript{13}

In this latter form, the roles of both F and I can readily be seen.

Like DOL, DFL is an elasticity measure. Here DFL measures the X\% change in net profit (R-V-F-I) that would be produced by a 1\% change in operating profits. Since tax rates remain relatively constant, net profits before and after taxes will vary in unison. As in the case of DOL, both the sign and the magnitude of DFL are significant.

\textsuperscript{12} Negative DOL values will be between 0 and $-\infty$.

\textsuperscript{13} As an elasticity measure, $\text{DFL} = \frac{\%\Delta NP}{\%\Delta EBIT} = \frac{\Delta NP}{\Delta EBIT} = \frac{\Delta q(p-v)}{q(p-v) - F - I}$. Operating profits (EBIT) can be defined as $q(p-v) - F - I$. Thus, if the values of $p$ and $v$ remain constant, and fixed costs ($F$), by definition, are constant, then:

$$\text{DFL} = \frac{\Delta NP}{\%\Delta EBIT} = \frac{\Delta EBIT}{\Delta q(p-v)} = \frac{\Delta q(p-v)}{q(p-v) - F - I} = \frac{q(p-v) - F - I}{q(p-v) - F - I} = \frac{R-V-F}{R-V-F-I}$$
To illustrate, suppose

\[
\text{Operating Profit} = 90 \text{ (with R=500 V=400 and F=10)}
\]

and

\[
\text{Interest (I) = 10}
\]

then

\[
\text{DFL} = \frac{90}{90 - 10} = +1.125
\]

This indicates that a 1% change in operating profit will produce a 1.125% change in net profit. The positive sign reflects that the firm acts above its financial breakeven point (i.e., operating profits exceed interest). The positive sign also indicates that when operating profits increase, net profits will increase. Consequently, when operating profits decrease, net profits will decrease. The relatively small value of DFL here means that (1) net profit is relatively large (relative to operating profit) and (2) variability in net profit (i.e., risk) is relatively small.

Had interest been higher, the positive value of DFL would increase (so long as interest did not exceed operating profit). For example, if interest (I) were $88, DFL would equal +45. A 1% change in operating profits here would produce a 45% change in net profit. The firm would still operate above financial breakeven point (hence the plus sign), but net profits would vary significantly (risk).14

When interest exceeds operating profit, the firm shows a net loss and DFL is negative. This negative DFL means that an increase in operating profit will lead to a decrease in the firm's net loss and vice versa. As in the case of negative DOLS, small absolute values for negative DFLs are especially serious since they indicate (1) large net losses for the firm and (2) a lack of net loss responsiveness to improvements in operating profits.15

C. Measuring Combined Risk

A firm's combined risk — the product of its business and financial risks — can be measured by its degree of combined leverage (DCL). The multiplicative effect of business and financial risks in the calculation of DCL means that the core causes of risk — interest and fixed costs — magnify total risk to a degree that exceeds their simple sum. Similar to the effect of levers in physics, it is as though one lever (interest) magnifies what another lever (fixed costs) has already magnified. Specifically:

14. For positive DFLs, values will range from +1 (when the firm is debt-free, i.e., when I= 0) to ⇨ (when Interest = Operating Profit).
15. Negative DFL values will range from ⇨ to 0. It should also be noted that if operating profits are negative, DFL will be reported as negative irrespective of the value of I.
As defined here, DCL measures the X% change in net profit that a 1% change in operating revenues would produce.

When revenue (R) exceeds the total costs (V+F+I), the firm operates above its total break-even point and DCL will be positive. In such a case, smaller DCL values indicate relatively low combined risk since fixed costs and interest would be relatively low when compared to revenue. In the extreme, if DCL is +1, combined risk is minimal since fixed costs and interest would necessarily be 0.

When total costs (V + F + I) exceed revenue, the firm operates below its combined breakeven point and DCL will be negative. Low absolute values for DCL cause special concern here since low absolute values indicate that (1) losses are large and (2) responsiveness to improvements in revenue will be sluggish. Insolvency is more likely and the firm has a long way to go to restore profitability.16

Critically, the multiplicative interaction that produces combined risk highlights the danger of employing debt finance when a company faces a high-risk DOL. To illustrate, assume two companies face the same large positive DOL, meaning that a very small decline in revenue can precipitate a very large decrease in net profits. In this case, assume DOL for both companies is +10. Company A, perceiving the business risk it faces and wary of any downturn in the economy, decides to use no debt in its capital structure, and thus has a DFL of +1. Its resulting DCL is 10 x 1 = +10. Company B, on the other hand, chooses to ignore the incremental risk associated with debt financing and, as the result of interest on its debt, faces a DFL of +4. DCL for this firm rises to a more dangerous +40 (10 x 4). Should the industry experience a slowdown in activity or face a recession, Company B clearly faces the greater risk. A 5% reduction in revenue will cause a 50% reduction in Company A’s net profits (5% x 10), a serious enough drop, but B’s net profits will plummet by 200% (5% x 40).

The situation grows even worse in cases where DCL values are negative with small absolute values, especially where such conditions persist over a long period of time. (As suggested earlier, this is because the base

---

16. If either DOL is negative or DFL is negative, or if both DOL and DFL are negative, DCL will be reported as negative.
of losses is so large that the financial solvency of the enterprise in the long run is severely threatened).

Exhibit I below should help clarify the discussion. As the arrow indicates, the direction of increasing risk flows down the chart.

**Exhibit I: Ordering Levels of Risk**

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Because of the multiplicative effect of business and financial risks, most companies and industries try to balance risk. That is, a company high in business risk will tend to avoid significant long term debt finance. A company low in business risk will be more likely to use debt finance since it will tend not to threaten the firm’s basic stability.¹⁷

**III. AIR CARRIER RISK ANALYSIS**

Values for the leverage measures described in Section II were calculated for the eight major U.S. air carriers for the years 1979-1995, a period that spans nearly the entire post-deregulation history of the airline industry. Exhibit II shows the DOL, DFL, and DCL results. (Note: In

¹⁷. The need to balance business and financial risk is a principle advanced by virtually every finance textbook. *See generally* Brigham & Gapenski, *supra* note 7; Moyer et al., *supra* note 6. Richard D. Gritta found this to be true in an empirical study contrasting levels of business, financial and total risk in the airline industry with risk levels in other industries. Gritta, *supra* note 2.
### Exhibit II: DOL, DFL and DCL Values by Carrier 1979-1995

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*Source: Table values computed using data from Air Carrier Financial Statistics*
the computation of these values, variable costs (V) are defined as the sum of flying operations, maintenance, passenger service, and air traffic costs. Fixed costs (F) are the summation of promotion and sales expenses, general and administrative costs, depreciation and amortization expenses, and various transportation related costs).

With one exception, the carriers face a difficult and volatile financial situation. A.

YEARS OF NEGATIVE LEVERAGE VALUES

Exhibit III shows the number of years in which each of the carriers in the study experienced negative DOL, DFL, and/or DCL values. Half of these carriers experienced negative DCLs in nearly 50% of the years studied. (Importantly, negative DFLs produce this result in most of the cases.) Carriers generally recognized as financially unstable do stand out. Continental (CAL) and Trans World Airlines (TWA) lead the group with thirteen and sixteen years of negative DCLs, respectively. These carriers also experienced frequent periods of negative operating leverage. Both carriers show ten years of negative DOLs. (Both carriers have ex-

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18. The accounts used are the standard account lines presented in the publication, Air Carrier Financial Statistics. This publication was formerly published by the Civil Aeronautics Board (CAB) and is now produced by the Transportation Systems Center. One point must be noted here: To the extent that some airline variable costs, such as fuel, are "sticky" or "constant" in the economic lexicon (or as accountants would say are step-variable in nature), the analysis of the DOL presented in this paper actually understates the true level of risk in the airline industry.

19. As described earlier, the most severe conditions a carrier can face are (1) small negative DOLs, DFLs, and DCLs, the latter being the most severe and (2) volatile DOLs, DFLs, and DCLs over time. According to the discussion in section III, there are several reasons for this. First, very small negative DCLs indicate considerable financial distress since net profits (EBIT-I) are strongly negative and the carrier could default on loan payments (interest, principal, and lease obligations). Several bankruptcy studies clearly demonstrate the effect of excess leverage on carrier solvency. See generally Richard D. Gritta, Bankruptcy Risks Facing the Major U.S. Airlines, 48 J. AIR L & COM. 89 (1982) (predicting the demise of both Braniff and CAL before the fact); Richard D. Gritta et al., A New Approach to Forecasting Financial Distress in Air Transportation: The AIRSCORE Model, 31 J. TRANSP. RES. F. 371 (1991); Richard D. Gritta, Solvency and Financial Stress in Air Transportation, 6 TRANSP. L. J. 139 (1974). Second, volatility (extreme variability) is abhorrent to stockholders and other investors, unless compensated by commensurably higher rates of return. Investors, ex-post, must perceive that they will be rewarded for assuming risk. Ex-ante, their expectations may not be fulfilled. See Charles P. Jones, INVESTMENTS: ANALYSIS AND MANAGEMENT 149-77 (5th ed. 1995).

20. As described earlier, if either DOL or DFL is negative, then DCL must also be negative since DCL is the product of the two values. Less obviously, should both DOL and DFL be negative, DCL will also be reported as negative. In every case, the absolute values of DOL and DFL are multiplied, with the sign applied appropriately to the resulting product.
EXHIBIT III: THE NUMBER OF YEARS OF NEGATIVE LEVERAGE EXPERIENCED BY EACH OF THE AIRLINES IN THE STUDY

<table>
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<tr>
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<td>9</td>
<td>11</td>
</tr>
<tr>
<td>USAir</td>
<td>7</td>
<td>6</td>
<td>7</td>
</tr>
</tbody>
</table>

experienced liquidity crises and sought court protection on more than one occasion).

Notably, several carriers reputed to be strong are seriously impacted, such as American, Delta, and United. American Airlines showed only three years of negative DOLs, but its financial policies resulted in seven years of negative DFLs. This illustrates the peculiarity of the industry in the sense that its stronger members, at least in terms of market power, still face significant risk.

Among the other carriers, Northwest Airlines (NWA) serves as a particularly interesting case. NWA followed conservative financial strategies in the early to mid-1980s.21 In fact, in 1984, the carrier reported a 0% long-term debt load. (This marked the first time in modern aviation history that a major carrier experienced no debt). As Exhibit II demonstrates, the airline performed strongly from 1983 to 1988, or until the leveraged buyout (LBO) in 1988 damaged its strong balance sheet and nearly forced the airline into insolvency.

USAIR also provides an interesting case. Although USAIR achieved efficient performance over the period 1979-1988, it became embroiled in the increasingly competitive industry, thereby increasing its reliance on debt to finance expansion. Consequently, USAIR has experienced severe financial problems. All of its negative DCLs occurred in the years 1989-1995.

In general, the data suggest an alarming pattern of reliance on debt.


finance in the face of significant business risk. Southwest Airlines (SWA) constitutes an important exception. With respect to business risk, SWA stands as the one carrier in the study that seems to have consistently employed a conservative operating strategy. Its consistently favorable DOLs reflect SWA's emphasis on "point-to-point" service, in contrast to the "hub-and-spoke" routing of most of the other carriers, and its simplified fleet structure. In addition, SWA's reasoned financial strategies appear to have contributed to its position as a model of long-run stability. The airline has experienced seventeen consecutive years of positive and relatively low DOL, DFL and DCL values.

B. INDUSTRY VOLATILITY

An examination of Exhibit IV illustrates the issue of volatility. The exhibit demonstrates the extremes of each measure of risk for the eight carriers in the study.

EXHIBIT IV: EXTREME VALUES FOR LEVERAGE MEASURES 1979-1995

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<td>DOL</td>
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<td>1.11</td>
<td>1.22</td>
<td>547.69</td>
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<td>2.19</td>
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Several of the dramatic extremes shown in Exhibit IV underscore the volatile nature of the industry. For instance, TWA's maximum positive DCL of +3512 serves as an especially eye-catching example. Such extraordinarily large positive values are typically produced when the base of profits is so small that a relatively small absolute change in value represents a very large percentage change.

Exhibit IV also reveals a large number of cases in which negative

23. The key to lower costs is to maximize aircraft utilization, employ "point-to-point" service, not the "hub-and-spoke" system, and minimize the numbers of types of aircraft in the carrier's fleet. SWA has perfected this strategy. For a discussion of operating strategies in a deregulated environment and their effectiveness, see Dempsey, supra note 3, at 35-41.
levels of DFL are alarmingly small (in absolute value) — an indication that these carriers have followed financial strategies which are inappropriate in an industry characterized by high business risk. The minimum negative levels of DCL are particularly unfavorable for CAL (DCL=-.95) and TWA (DCL=-.07). SWA once again stands out as the exception. Its operating and financial strategies have kept its leverage measures in the low positive range (i.e., the lowest risk range) for every year of the study.

IV. The Future: Increased Need for Funds, Decreased Financing Flexibility

The airlines face a difficult future. Although 1996-1997 profits appear substantial, the financial excesses of the past have weakened the carriers. In all likelihood, more than a few strong years will be required to establish a fair degree of stability and strengthen balance sheets enough to make a real difference. Significantly, the industry will possess less flexibility in securing new funds at a time when the requirement for funds will increase dramatically.

The need to replace aging aircraft will perhaps present the industry’s greatest challenge. Exhibit V illustrates the average age of aircraft for the eight major carriers.

Exhibit V: U.S. Airline Average Fleet Ages (in years)

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<tr>
<td>USAir</td>
<td>8.9</td>
<td>10.6</td>
<td>12.9</td>
</tr>
</tbody>
</table>

As shown, the average age of many of the fleets has steadily in-

24. As already discussed, very small negative values often result when the base of losses is so large that a significant absolute increase in revenue or profits has little effect in percentage terms.

25. And it cannot be assumed that industry profits are going to continue to grow and/or remain high. In the mid-1990s, fuel costs and interest rates were low and stable, and labor had made many concessions to the carriers in response to the losses of the early part of the decade. There is no guarantee this situation will continue. Furthermore, given the tremendous built up operating and financial leverage, an economic downturn will hurt just as much as the record economic growth period has helped.

creased. Not surprisingly, the weaker, more financially distressed carriers such as TWA, CAL, NWA, and USAIR have tended to defer the purchase of new and more efficient jets. In addition to adversely affecting the efficiency of these airlines, such actions have also created concern in the minds of the flying public, as the past several years have realized a surfacing of the issues of safety and airframe age.27 It seems clear that these carriers must reverse this trend in the near future.

The cost of refurbishing fleets while providing for other needs will prove enormous. While the world's airlines spent $147 billion in the 1980s, one Wall Street analyst estimates that the industry will need to spend over $815 billion by the year 2000.28 Boeing has projected that the world's carriers will need about 16,000 aircraft valued at $1.1 trillion over the next 20 years. About 25% of this amount would simply replace aging aircraft. In the immediate future, Boeing estimates necessary purchase costs to be at least $50 billion per year.29

The question of how these funds will be raised necessarily arises. Given the pervasive volatility of the industry, will such massive sums be available at all, especially to those carriers most in need? Historically, the airlines have relied on significant amounts of cash flow to provide funds for asset acquisition. Immediately after deregulation, for example, the industry financing was estimated to be about 60% of its capital spending from internal sources.30 However, cash flow may only cover about 37% of capital spending through the current decade.31 How will the deficit be made up? Given the leverage positions of most carriers, there are few easy answers.

The industry's record of low rates of return presents an additional problem. Faced with the difficulties associated with unfavorable leverage positions and the inherently high-risk nature of the business, rational investors should be expected to require commensurate compensation. During the years of this study, however, compensation has been meager. Exhibits VI and VII support this contention. (Note: Before a discussion of implications, some terms need to be defined. Return on assets (ROA) is computed by dividing operating profits (EBIT) by total assets. ROA measures the returns associated with operating leverage in particular, and business risk in general. Return on equity (ROE) is derived by dividing

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27. Aircraft fleet age has had a direct correlation with the amount of productivity attributable to fuel consumption, maintenance costs per block hour, the hours of aircraft utilization, and higher real costs of ownership. ESG Aviation Services, The Airline Monitor 7, 17 (Feb. 1996).
28. Julius Maldotis, Address at the 7th AIATA High-Level Aviation Symposium.
### Exhibit VI: Yearly ROA and ROE Values for the Years 1979-1995

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<td>3%</td>
<td>10%</td>
<td>6%</td>
<td>-1%</td>
<td>-5%</td>
<td>-4%</td>
<td>2%</td>
<td>4%</td>
<td>7%</td>
</tr>
<tr>
<td>ROE</td>
<td>-33%</td>
<td>-19%</td>
<td>-32%</td>
<td>-34%</td>
<td>-2%</td>
<td>29%</td>
<td>-36%</td>
<td>-14%</td>
<td>3%</td>
<td>34%</td>
<td>18%</td>
<td>-11%</td>
<td>-41%</td>
<td>-106%</td>
<td>-4%</td>
<td>-316%</td>
<td>355%</td>
</tr>
<tr>
<td><strong>USAir</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>ROA</td>
<td>10%</td>
<td>13%</td>
<td>7%</td>
<td>7%</td>
<td>11%</td>
<td>14%</td>
<td>10%</td>
<td>9%</td>
<td>15%</td>
<td>5%</td>
<td>-4%</td>
<td>-8%</td>
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<td>-6%</td>
<td>-2%</td>
<td>-8%</td>
<td>3%</td>
</tr>
<tr>
<td>ROE</td>
<td>17%</td>
<td>26%</td>
<td>10%</td>
<td>11%</td>
<td>18%</td>
<td>25%</td>
<td>17%</td>
<td>14%</td>
<td>31%</td>
<td>8%</td>
<td>-11%</td>
<td>-29%</td>
<td>-18%</td>
<td>-66%</td>
<td>-85%</td>
<td>-285%</td>
<td>-19%</td>
</tr>
</tbody>
</table>

* Source: Values computed from data in Air Carrier Financial Statistics


EXHIBIT VII: RATES OF RETURN SUMMARY 1979-1995

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std Dev</th>
<th>Coeff of Var</th>
<th>Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>American</td>
<td>3.20%</td>
<td>2.98%</td>
<td>0.93</td>
<td>-0.47%</td>
</tr>
<tr>
<td>Continental</td>
<td>-1.11%</td>
<td>7.00%</td>
<td>-6.34</td>
<td>-12.86%</td>
</tr>
<tr>
<td>Delta</td>
<td>2.99%</td>
<td>5.61%</td>
<td>1.88</td>
<td>-8.07%</td>
</tr>
<tr>
<td>Northwest</td>
<td>2.82%</td>
<td>3.60%</td>
<td>1.28</td>
<td>-3.79%</td>
</tr>
<tr>
<td>Southwest</td>
<td>9.81%</td>
<td>4.23%</td>
<td>0.43</td>
<td>3.37%</td>
</tr>
<tr>
<td>TWA</td>
<td>-2.92%</td>
<td>6.01%</td>
<td>-2.06</td>
<td>-17.45%</td>
</tr>
<tr>
<td>United</td>
<td>1.36%</td>
<td>5.38%</td>
<td>3.96</td>
<td>-7.21%</td>
</tr>
<tr>
<td>USAir</td>
<td>4.27%</td>
<td>7.53%</td>
<td>1.77</td>
<td>-8.39%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
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<th>Mean</th>
<th>Std Dev</th>
<th>Coeff of Var</th>
<th>Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROE</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>American</td>
<td>2.80%</td>
<td>11.89%</td>
<td>4.24</td>
<td>-17.81%</td>
</tr>
<tr>
<td>Continental</td>
<td>-49.31%</td>
<td>148.99%</td>
<td>-3.02</td>
<td>-270.28%</td>
</tr>
<tr>
<td>Delta</td>
<td>-0.15%</td>
<td>21.01%</td>
<td>-141.43</td>
<td>-37.02%</td>
</tr>
<tr>
<td>Northwest</td>
<td>3.11%</td>
<td>11.22%</td>
<td>3.61</td>
<td>-24.48%</td>
</tr>
<tr>
<td>Southwest</td>
<td>18.22%</td>
<td>10.40%</td>
<td>0.57</td>
<td>2.87%</td>
</tr>
<tr>
<td>TWA</td>
<td>-172.79%</td>
<td>465.86%</td>
<td>-2.70</td>
<td>-2024.16%</td>
</tr>
<tr>
<td>United</td>
<td>-12.41%</td>
<td>119.73%</td>
<td>-9.65</td>
<td>-316.15%</td>
</tr>
<tr>
<td>USAir</td>
<td>-19.78%</td>
<td>73.36%</td>
<td>-3.71</td>
<td>-284.88%</td>
</tr>
</tbody>
</table>

net profits by equity — the contribution to the asset base made by common stockholders. ROA measures the return associated with financial leverage. ROA will be volatile (i.e., highly variable) primarily because of business risk (i.e., operating leverage). ROE will be volatile because of both operating and financial leverage. In both cases, tracking the variation in average return rates can assess volatility. Here, standard deviations for ROA and ROE have been calculated to measure variation over the seventeen years of the study.\(^ {32} \) To control for disparities in the average size of carrier returns, a coefficient of variation (CV) for each carrier

\(^ {32} \) The ROE calculations in the exhibit are pre-tax and before extraordinary items. In many cases, the carriers were losing money and hence paid no taxes. In any case, given constant tax rates, net profits before and after taxes would vary to the same degree. Because this study seeks to consider the effects of leverage on operations, extraordinary items (in most cases the results of sales of aircraft and/or routes or gate slots) were excluded on the grounds that they should not be part of management’s decision making strategies since they are non-recurring items. For these reasons, the calculated ROEs will not necessarily agree with those returns published in carrier reports. In addition, this paper examines only carrier revenues and profits.
has been computed by dividing the standard deviation of its returns by its average return over the period of the study. 33

Exhibit VII reveals two conditions which should cause serious concern:

(1) Low carrier mean ROAs with high standard deviations around these means, resulting in high CVs and wide ranges in ROAs over time.

(2) Low mean ROEs and/or large negative spreads between carrier ROAs and ROEs over time, high CVs and/or large negative spreads in the CVs, and large ranges in the ROEs over time.

Notably, average ROAs (with one exception) range from modest to poor. Most of the carriers had low nominal returns, but CAL and TWA showed average returns which were actually negative (-1.1% and -2.9%, respectively) over the seventeen-year time period. In addition, in all but two cases (AAL and SWA), standard deviations exceeded average returns, pointing again to the inherent volatility of operating profits already suggested by the DOL measures in Exhibit II. High Coefficients of Variation (CVs) and extreme ranges further reflect this pervasive volatility. SWA serves as an exception. SWA not only showed the highest average ROA (9.8%) and the narrowest range of returns (ROAs between 3.4% and 21.8%), but it also had a standard deviation (4.2%) less than half its mean return. Such indicators suggest SWA’s unique operating strategies.

The prevalence of cases in which ROEs are lower than ROAs create even more concern than the generally poor ROA figures. As shown in Exhibit VI, ROEs were lower than ROAs for six of the eight carriers in the study (NWA’s average ROA just barely exceeded its average ROE). Five carriers had negative ROE means. 34 Such conditions indicate the harmful effects of unfavorable financial leverage as measured by the DFL values computed in Section IV. Also disturbing here are the wider ranges and larger CVs (relative to ROA statistics shown in Exhibit VII).

To add to the negative picture, the small average ROEs shown here, especially in the cases of TWA (-2024%), UAL (-316%), and USAIR (-285%), underscore the severity of the industry’s problems. (The large negative figures for TWA, UAL and USAIR result from small equity ba-

Thus, AAL’s results cannot be compared to those of AMR Corp., the parent company of that airline.

33. An example may be instructive. Suppose Carrier A has a mean return of 20%, with a standard deviation of 10%. Carrier B has a mean return of 1% with the same standard deviation of 10%. One might be led to conclude that, since the standard deviations are equal, both carriers show the same degree of variation (risk). The CV helps to show more clearly the comparative risks. Carrier A’s CV is 0.5 (.10/.20), while B’s is 10.0 (.10/.01). Thus, carrier B’s returns can be correctly judged the more risky.

34. This results from the strong years NWA experienced in the early and mid-1980s, when its debt burden was quite low.
ses as much as they result from large dollar losses).\textsuperscript{35} SWA's performance once again stands as the exception. SWA's mean ROE of 18.2\%, together with its relatively low risk measures, run counter to industry norms, tending to reflect the effectiveness of its conservative financial policies over time.

Thus, Southwest Airlines notwithstanding, industry returns for the years of the study were dismal.

\textbf{V. Conclusion}

This paper has defined several useful measures of airline industry risk by utilizing elasticities borrowed from microeconomic theory. Values for these measures have been presented for the eight major U.S. air carriers over the period 1979 through 1995. Degrees of operating, financial, and combined leverage were linked to carrier rates of return (on assets and on equity) during this seventeen-year span encompassing nearly the entire deregulatory history of the industry.

The findings of the study are revealing, although not wholly unexpected. The airline industry has long been recognized as an industry high in business risk, exhibiting a significant degree of variability in operating profits over extended periods of time. The results of the analysis reported here confirm this observation. The study does reveal surprisingly high degrees of financial leverage. Airlines facing high business risk should, arguably, moderate their exposure to financial risk by employing relatively low levels of financial leverage. Nevertheless, the majority of carriers in the study appear to have ignored this basic axiom. The penalty for such behavior was reflected in the pervasive volatility and low levels of profitability on carrier assets and equity during the period of the study. The approach of SWA, however, stands in sharp contrast and should provide an important lesson for future financial decision making in this industry.

Given the data presented, it seems clear that the long-term operating and financial performance of the airline industry has faltered. Historically high risk levels, as measured by DOL, DFL and DCL indicators, and chronically low rates of return, bode ill for an industry that has experienced more than its share of obstacles to overcome during the past two decades. As the airlines approach the Twenty-first century, the industry appears ill-prepared to generate the vast sums it will need to sustain itself.\textsuperscript{36} Largely closed off to debt financing because of already-

\textsuperscript{35} UAL's financial situation is not quite as bad as indicated by the leverage analysis. UAL is committed to issuing 12.1 million shares of common stock each year through 1999. This results from the employees' buyout in 1994. See Value Line Investment Survey, \textit{supra} note 1, at 263.

\textsuperscript{36} Homi P.R. Mullan, \textit{Financing the Future, in Int'l Air Transport Ass'n, A Vision}
worrisome leverage positions and offering little in the way of reward to potential investors, some of the major carriers may have to sell assets, trade labor concessions for equity, locate new partners with whom to share the risk, or even merge with one another if they are to survive the next twenty years.37

The results of this study also suggest a re-examination of public policy as it relates to the air carriers. While some maintain that deregulation has had some beneficial effects, such as lower air fares in some highly competitive markets, it can be argued that deregulation has done so at the cost of sharply higher risks to many carriers. Two facts are particularly disturbing: (1) The bankruptcy, or near insolvency, of six major airlines since 1982, and (2) the stronger members of this industry are exposed to very high levels of total risk. The public policy implications arise in two important areas, safety and antitrust.

Regarding safety, lower profitability and higher financial risk provide incentives to cut back on resources allocated to safety, or to defer the purchase of modern, safe equipment. This is largely attributable to the continued diligence and efficacy of airline safety regulation and to the adoption of new technology retrofitted into existing aircraft or imbedded in new aircraft replacements. This paper has indicated that aircraft age has increased for six of the eight airlines in the study and that the replacement of the aging fleets will be the industry's greatest challenge. This suggests that (1) the public sector may have to expend additional resources to monitor safety records and procedures of airlines with older aircraft, or (2) more stringent standards should be established (e.g., more frequent inspections) in order to maintain safety in airline travel. The opportunity cost of not replacing aircraft with new, safer aircraft are the additional lives that may have been saved. If the government seeks to stay out of the economic regulation of the airline industry, it may want to consider alternative policies such as loan guarantees for the purchase of safer aircraft.

As industry concentration increases, an examination of antitrust policy becomes relevant. Research reveals an increasingly oligopolistic mar-

37. Some carriers have resorted to these alternatives in an effort to survive. Unfortunately, not all attempts have been successful. For a complete discussion of the different approaches, see Dempsey & Gesell, supra note 3; Paul Stephen Dempsey & Andrew Goetz, Airline De-
ket structure in the airline industry. Consequently, the debate now centers on whether this contributes to consumer welfare in the long run. In addition, many alliances currently being formed involve foreign carriers. This creates complicated foreign policy and trade questions which will have to be integrated with domestic objectives. The findings of this study suggest that the industry may become even more oligopolistic as major airlines use mergers and alliances to reduce business risk and improve asset utilization through the sharing or spreading of the financial risk of aircraft ownership.

Finally, the use of the leveraged buyout in an industry so vested with the public interest must be addressed. The case of NWA, noted above, shows the damage inflicted on a healthy carrier by the use of the LBO and the increased financial leverage which the debt created in the process has caused.38

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38. See Jochner, supra note 22.
Economic Analysis of the Allocation of Liability for Cargo Damage: The Case for the Carrier, or Is It?

David S. Peck*

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I. INTRODUCTION

The Hague Rules,\(^1\) together with several amendments,\(^2\) govern the allocation of risk for damage to cargo which common carriers transport in international ocean commerce pursuant to bills of lading.\(^3\) Throughout history, governing maritime law has generally disfavored common carriers based on the belief that, absent legislation, these carriers would use their superior bargaining power and tight unity to reduce or escape liability. At early maritime law,\(^4\) carriers were strictly liable for losses with a few narrow exceptions.\(^5\) Although strict liability no longer applies to the carriers, they are still quite limited in the type and amount of liability which the carriers may disclaim.\(^6\)

It can be argued that this abridgement of freedom of contract serves to prevent carriers from overreaching.\(^7\) Section 3(8) of COGSA provides:

Any clause, covenant, or agreement in a contract of carriage relieving the carrier or ship from liability for loss or damage to or in connection with the goods, arising from negligence, fault, or failure in the duties and obligations provided in this section, or lessening such liability otherwise than as provided in this Act, shall be null and void and of no effect.\(^8\)

Section 4(5) provides that, absent contrary agreement, a carrier’s liability shall not exceed $500 per package, but in no case should the maximum liability per package be less than $500.\(^9\)

---

2. Some jurisdictions, but not the U.S., have enacted the Visby Amendments to COGSA. Others have opted for the Hamburg Rules instead of COGSA.
4. Prior to the late nineteenth century.
5. See Sturley, supra note 3, at 4.
7. See infra note 130.

Neither the carrier nor the ship shall in any event become liable for any loss or damage to or in connection with the transportation of goods in any amount exceeding $500 per package lawful money of the United States, or in the case of goods not shipped in packages, per customary freight unit, or the equivalent unit of that sum in other currency, unless the nature and value of such goods have been declared by the shipper before shipment and inserted in the bill of lading. This declaration, if embodied in the bill of lading, shall be prima facie evidence, but shall not be conclusive on the carrier.

By agreement between the carrier, master, or agent of the carrier and the shipper another maximum amount than that mentioned in this paragraph may be fixed; provided, that such maximum shall not be less than the figure above named. In no event shall the carrier be liable for more than the amount of damage actually sustained.

Neither the carrier nor the ship shall be responsible in any event for loss or dam-
This article examines whether mandatory allocation of liability efficiently regulates cargo damage in international ocean commerce, and explores where liability should be allocated to achieve efficient results. Part II discusses whether carriers enjoyed and/or continue to enjoy superior bargaining power as compared to shippers. Part III argues that limiting the freedom to contract and allocate liability does not efficiently regulate maritime commerce, as such a limitation impedes the natural progress of market efficiency. Finally, part IV analyzes how initial allocation of liability can affect the costs of the system and studies some principles for analyzing how liability should be allocated to achieve increased efficiency.

II. SUPERIOR BARGAINING POWER OF CARRIERS

During international conferences and legislative debates concerning the allocation of liability, the belief pervaded that carriers possessed superior bargaining power and could dictate the terms of the bill of lading to shippers. Consequently, the legislation and proposals from interna-

age to or in connection with the transportation of the goods if the nature or value thereof has been knowingly and fraudulently misstated by the shipper in the bill of lading.

Id.

10. Lord Diplock’s argument supporting non-disclaimable liability for the carrier is typical:

If, under the terms of the standard contract of carriage, the carrier were immune from all liability for loss or damage which could have been avoided by physical precautions taken while the goods were in his custody, he would have no commercial inducement to expend money on precautions to preserve the cargo from loss or damage. Which were not also required for the safety of the vessel, even if the cost were small in comparison with the resultant reduction in the risk of loss or damage. The terms of the standard contract of carriage should therefore impose upon the carrier a liability for loss or damage to the goods sufficient to provide him with a commercial inducement to undertake precautions, the cost of which would be economically justified by the reduction of the risk of loss or damage to the goods.


But when you have to deal with the conference Liners, they, of course, quite in a business way, all combine to have certain bills of lading worded in a certain way, so that they may work in conference, and they cannot get out of it, and, with such clauses in the bills of lading as there are now, no cargo owner can make any bargain with the shipowner.

Id.

The trend of events . . . has been for the shipping organizations to group themselves together in large powerful organizations controlled by syndicates . . . the result being that the shipper, if he desires to ship, is bound to accept the terms of the contract which is offered to him . . . I think the . . . contract has been very aptly described as being a contract of irresponsibility.

Id. at 32 (statement of Mr. J.P. Rudolf).
tional committees often favored shippers. Without mandatory liability, theoretically, carriers would have little incentive to take the necessary precautions to prevent loss and damage to cargo.

The history of COGSA and its predecessors provide evidence that carriers did once use bills of lading that severely limited or disclaimed their liability for loss. However, this fact fails to prove that carriers did

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13. See Hague Conf., supra note 11, at xliii (report of the Maritime Law Committee on Bills of Lading (1921), reprinted in LEGISLATIVE HISTORY, supra note 11, at 98 (stating that the members of the committee believed that the objects of the committee of “increased diligence and vigilance” could be secured by “a standard compulsory maximum of liability per package, with liberty to cargo owners to stipulate for larger security if they so desired . . . .”); Diplock, supra note 10, at 527.

The terms of the standard contract of carriage should therefore impose upon the carrier a liability for loss or damage to the goods sufficient to provide him with a commercial inducement to undertake precautions, the cost of which would be economically justified by the reduction of the risk of loss or damage to the goods.

Id.; see infra note 130. It was believed that carriers needed this incentive to protect against cargo loss, but that it was not necessary to impose liability for failure to exercise care to use a seaworthy vessel because the safety of the crew and vessel provided adequate incentive. See also Gilmore & Black, supra note 11, at 143.

14. See Liverpool & G.W. Steam Co. v. Phenix Ins. Co., 129 U.S. 397, 402 (1889) (reprinting a bill of lading in which the carrier was excluded from liability for negligence); Encyclopedia Britannica, Inc. v. SS Hong Kong Producer, 422 F.2d 7, 12 (2d Cir. 1969) (stating that COGSA section 3(8) was an effort to stop the “persistent efforts by carriers, who are the drafters of ocean bills of lading, to limit or eliminate their own duties and responsibilities . . . .”); Alan E. Branch, ELEMENTS OF SHIPPING 253 (6th ed. 1989) (stating that “it had been the practice of shipowners to include as many exception clauses as they wished in a bill of lading . . . .”); Gilmore & Black, supra note 11, at 121 (stating that “[b]ills came to include stipulations that the carrier was not liable even for the result of his own negligence or that of his ship’s people.”); Henry N. Longley, COMMON CARRIAGE OF CARGO § 1.04, at 3 (1967) (stating that “[w]henever a carrier was held liable for some particular type of damage, modification of bills of lading promptly appeared setting out an exemption of liability for the type of damage for which the carrier had just been held liable.”); Samuel Robert Mandelbaum, Creating Uniform Worldwide Liability Standards For Sea Carriage of Goods Under the Hague, COGSA, Visby and Hamburg Conventions, 23
enjoy and/or currently enjoy superior bargaining power. First, contrary evidence exists as to the strength of the carrier's bargaining power. Second, the mere existence of limitations on liability does not necessarily prove that the carriers possessed superior bargaining power. Finally, assuming carriers did at one time enjoy superior bargaining power, they have not likely continued to hold such power, and may no longer have it at all.

A. Contrary Evidence

Because bills of lading have, historically, contained many exemptions from liability in favor of carriers, the belief has formed that carriers have a superior bargaining power over shippers. However, contrary evidence reveals that carriers have not, in fact, possessed such bargaining position. Bargaining power is determined, in part, by the supply level of available carrying capacity relative to the demand. Consequently, if tonnage is over-supplied, fierce competition will result among the carriers, and shippers will enjoy greater bargaining power. If scarce tonnage exists, however, cargo owners will face greater competition, allowing carriers to increase freight rates or reduce their liability exposure.

Gradually, large fluctuations have existed between over-supply and under-supply of capacity. However, several factors have contributed to a continuing tendency to create a surplus of carrying capacity, thereby increasing competition among carriers and thus decreasing carriers' relative bargaining advantage. First, surplus carrying capacity tends to arise simply as a result of the economics of the common carriage industry. Specifically, it takes years for a new ship to complete construction. When an under-supply of capacity exists, carriers and new ventures build new ships. However, because construction takes time, the under-supply will continue for years, which spurs others to undertake construction. Eventually, new ships will flood the market and increase the supply. However, if the carriers do not act in unison, there is a tendency to build an over-abundance of ships. Moreover, technological improvements lead to over-

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15. See infra Part II(A).
16. See infra notes 18-36 and accompanying text.
17. See infra notes 18-36 and accompanying text.
18. See supra notes 49-68. The causal relation between such exemptions and superior bargaining power is challenged infra Part II(B).
19. See infra note 61.
20. See infra note 53 and accompanying text.
supply. Technology has increased greatly the speed with which a voyage may be completed. In addition, new technology induces shipbuilding. Thus, a carrier will enjoy a strong advantage if it can construct a ship that will operate substantially more efficiently than current ships.\footnote{21}

However, older ships do not immediately become obsolete. Carriers make large investments in ships which are recovered over a long period.\footnote{22} These constitute “sunk costs.” “Variable costs” make up a small portion of the costs of ocean transportation.\footnote{23} Carriers will continue to operate the vessel as long as marginal revenue exceeds marginal cost.\footnote{24} Because the marginal costs are small, ships with less technology will continue to operate even though they are less efficient than newer ships.\footnote{25}

Alan E. Branch described some of the modern progress in technology as of 1989:

During the past decade the trend has been towards faster vessels of increased size with improved machinery and cargo-handling equipment... However, as we progress through the 1990s more attention in ship design will be given to producing a versatile vessel with optimum capacity and speed – the latter having regard to increased fuel cost... Cargo liners have increased in speed from about 15 to 22 knots, mainly because of market forces and the desire to reduce the number of vessels in a fleet by introducing faster ships... Extensive use is now made of computers to facilitate the optimum specification in a given set of circumstances... Improved techniques of cargo handling have been introduced, with the object of reducing

\footnote{21. See Branch, supra note 14, at 39 (stating that “[n]ew tonnage presents the opportunity to modernize terminal arrangements particularly cargo transhipment, cargo collection and distribution arrangements and reduce ship port turn-around time to a minimum. This all aids in making the fleet more productive.”).}

\footnote{22. See infra note 49.}


\footnote{24. See Campbell R. McConnel, Economics 519 (6th ed. 1975) (stating that “the firm should compare the marginal revenue and the marginal cost of each successive unit of output. Any unit whose marginal revenue exceeds its marginal cost should obviously be produced.”).}

\footnote{25. This argument is often cited in defense of shipping conferences. See Bennathan & Walters, supra note 23, at 43, stating that:}

[s]ome observers have argued that the low variable costs give rise to indeterminacy in the market for freight because under conditions of free entry and competition, each operator would be induced to cut rates down to variable costs. No firm would then be able to cover its total costs, because variable cost is much below average cost. This expectation of “ruinous competition” lies behind many of the arguments for condoning cartels and market-sharing agreements. See also Elkan Turk, Jr. & Russel T. Weil, Economic Regulation of Ocean Carriers, The Shipping Act of 1984, in 1C Benedict On Admiralty § 5(7th ed. 1995) [hereinafter Benedict On Admiralty]. “The inherent tendency of ocean commerce carriage to produce this kind of destructive rate competition in the absence of agreements among competing lines was noted by the Alexander Committee in its report and was the principal reason for its recommendation that such agreements be legalized subject to government supervision.” (footnote omitted). Id.
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turn-around time in port to a minimum. 26

Second, the demand for common carriage derives from the underlying demand for the cargo, which can vary greatly over time. 27 For example, the effective merchant marine tonnage more than tripled in world markets between 1890 and 1910. 28 Moreover, during World War I, shipping rates escalated for allies and neutral merchant marine, squeezing U.S. shippers. 29

A surge of merchant shipping construction followed after the War. The Americans continued two more years of heavy building. The British rebuilt tonnage lost during the war. The Germans soon began rebuilding new tonnage to replace their reparation losses. And the Japanese continued to expand their merchant marine. By the early 1920's, a sizable surplus in world tonnage was evident – with distress for many ship operators . . . . In the Great Depression . . . the merchant shipping surplus was aggravated. World trade flows declined. Many shipowners were distressed . . . [and] a lot of ships were laid up and/or carried less cargo. 30

The situation was described by Charles Haight to the Committee on Merchant Marine and Fisheries:

The International Chamber [of Commerce] had seen for years the pendulum swing from one extreme to another. During the war, a man who wanted to ship goods would pay $100 per ton and would take a bill of lading in any form that ingenuity could devise. After the war the situation was precisely reversed; the steamship owner could not get any cargo to carry at all at any price, speaking broadly. Under those conditions, the shipper could dictate any form bill of lading. A steamship company would have signed a bill of lading drawn in the form of a paragraph from the Declaration of Independence, or Alice in Wonderland, if only the shipper would give him a profitable freight rate. 31

Sir Norman Hill described the then current situation in the Hague Conference in 1921:

[T]he position at the moment . . . [is] the all-powerful shipowners are at their wits end to secure freight to cover their working expenses. Voyage after voyage is being made at a dead loss. Vessels by the hundreds are lying idle in port. At the moment any cargo owner could secure any conditions of

27. See Amos Herman, Shipping Conferences 30 (1983).
29. See id. at 12.
30. See id. at 12-13.
carriage he required provided he would only offer a freight that would square the yards.

But it will be said that the present position is exceptional. I agree, but I have followed the fortunes of shipping for a good many years, and I say that on the average, for at least seven out of every ten years, the cargo interests command the freight market and dictate their own terms. The shipowner's chance comes, on the average, in about two of every ten years . . . .32

Another serious over-supply occurred after the OPEC oil crisis. The crisis provoked construction by many countries, oil companies, and shippers. A round of over-tonnage soon followed, providing tougher price competition to many shipping markets.33 Even as late as 1994, evidence shows that a tonnage surplus existed.34

Third, surplus tonnage exists because many countries subsidize the carrier industry to further national protection. A fleet of ships is crucially important to national security in times of war or other crises. Many countries subsidize shipowners to ensure the availability of a national fleet in case a national crisis should erupt. As a result, the natural equilibrium of the market shifts in favor of oversupply. Because the ships must operate profitably in peacetime as well, a greater competition among carriers exists than if no subsidies had been granted. During the 1920s, Americans, Japanese, Germans, French and Italians engaged in subsidies.35 Today, many countries still maintain and subsidize a merchant marine.36

B. THEORY OF EFFICIENCY

Although carriers often disclaimed liability in bills of lading, this does not necessarily mean that carriers enjoyed superior bargaining power. Carriers may have been able to reduce or eliminate their liability because it resulted from market forces, rather than because they may have been all-powerful and could have dictated the terms of the bill of lading. When carriers and shippers negotiate a bill of lading, they negotiate two things. First, they determine what duties will be performed through such terms as the nature and amount of insurance, the identity of

33. See Lovett, supra note 28, at 32.
35. See Lovett, supra note 28, at 31.
36. Id. at 34; Mandelbaum, supra note 14, at 499 (stating that “[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.”); N. Sashikumar, World Shipping Competition, in United States Shipping Policies and the World Market, supra note 28, at 68-69.
the insurer, the method of transportation and length of voyage, the nature and extent of precautions taken, etc. The parties also negotiate who will perform these duties or bear the expenses of them as between the shipper and the carrier. In determining which duties will be performed, the parties engage in a cost-benefit analysis. If the benefit of a certain precaution outweighs its cost, then the parties will included it in the bill of lading.

The second part of the negotiation involves allocating responsibilities to the party which can handle them most effectively. The lower the cost of performance, the higher the profit that can be split between the carrier and shipper. If the market works efficiently and the parties bear no transaction costs, then the parties will always arrive at the same economic result regardless of where default responsibility lies, as long as the parties are allowed to transfer responsibility freely.\footnote{See generally, R.H. Coase, The Problem of Social Cost, 3 J. L. \\& Econ. 1 (1960) (discussing the harmful effects on business by others).} The result will be that the most efficient party will perform the duties and the difference will be made up in the price of the freight.

One theory maintains that carriers disclaimed liability for loss because it constituted the most efficient scenario.\footnote{See Hague Conf., supra note 11, at 34-46 (statement of Sir Norman Hill), reprinted in Legislative History, supra note 11, at 140-52.} As discussed below, shippers may possibly procure insurance or address the risk of loss more efficiently than carriers.\footnote{See infra notes 116-123 and accompanying text.} The cost of obtaining and evaluating information constitutes a major cost of insuring a risk. The more information available concerning the cargo (i.e. its value, its nature and durability, whether the cargo is perishable, etc.), the more accurately the insurer can evaluate the risk of loss and the cheaper rates it can provide. The shipper enjoys a distinct advantage over the carrier here because it already has substantial knowledge of the characteristics of the cargo. If the carrier must insure the cargo, it must then exert time and effort to obtain information already known to the shipper.\footnote{Commentators have also argued that the shipper can more cheaply deal with the risk of loss because cargo insurance is more efficient that P \\& I insurance. See infra notes 156-58 and accompanying text.}\footnote{See Hague Conf., supra note 11, at 39 (statement of Sir Norman Hill), reprinted in Legislative History, supra note 11, at 145 (“But after that decision the shipowner was not content to free himself from liability for negligent navigation.”).} The fact that carriers did not rush into disclaiming liability when the British courts first allowed them to do so supports this theory.\footnote{The decision of the Court of Common Pleas in Grill v. General Iron Screw Collier Co., 1 L.R.-C. P. 60, 611-12 (1866), aff'd 3 L.R. - C.P. 476 (Ex. Ch. 1868) surprised the commercial world by upholding an exoneration clause based on negligent navigation of the ship. See also} England first approved “negligence clauses” around 1866.\footnote{HeinOnline -- 26 Transp. L.J. 81 1998-1999} Nevertheless, the inclusion of exoneration...
clauses increased gradually with the complexity of the trade.\textsuperscript{43}

As the shipping industry expanded and technology advanced, cargoes grew larger and more varied.\textsuperscript{44} It became increasingly important for carriers to turn ships around as cheaply and as quickly as possible. If the carrier continued to insure the cargo, it would need to evaluate the risks of insuring the goods and use this information to build charges into the freight rate.\textsuperscript{45} On the other hand, if carriers could disclaim financial responsibility for loss, they could then charge all shippers a standard lower rate and avoid the costs associated with insurance.\textsuperscript{46}

Shippers eventually discovered that they could obtain better and cheaper security from an insurance underwriter than from a carrier.\textsuperscript{47} The savings in rates exceeded the expense of insuring the cargo through a cargo insurer. The decrease in both the number of losses and the insurance rates themselves prove the success of this allocation.\textsuperscript{48} While exculpatory clauses may signal uneven bargaining power, they may also represent efficient negotiations between parties possessing equal bargaining power. Such clauses may also symbolize the most efficient allocation of resources for the particular transaction.

C. FLUCTUATING BARGAINING POWER

An evaluation of the relative bargaining power of carriers and shippers over time requires a cursory review of the economics surrounding ocean transportation. First, fixed costs and high capital help to shape ocean transportation.\textsuperscript{49} The cost of building and maintaining a fleet nec-

\textsuperscript{43} See Hague Conf., supra note 11, at 39 (statement of Sir Norman Hill), reprinted in Legislative History, supra note 11, at 145; Sturley, supra note 3, at 5 & n.23.

\textsuperscript{44} See Hague Conf., supra note 11, at 42 (statement of Sir Norman Hill), reprinted in Legislative History, supra note 11, at 148.


\textsuperscript{46} See id.

\textsuperscript{47} See Hague Conf., supra note 11, at 42 (statement of Sir Norman Hill), reprinted in Legislative History, supra note 11, at 148 ("After years of trial commerce satisfied itself that it can get cheaper and better transport facilities, and greater security, by paying an underwriter, rather than a shipowner, to run the risks of negligent navigation . . . ."). Id.

\textsuperscript{48} See Hague Conf., supra note 11, at 43 (statement of Sir Norman Hill), reprinted in Legislative History, supra note 11, at 149:

[I]n the . . . period of thirty years [before World War I] amongst British Ships the yearly number of total losses fell from 956 to 171, and the yearly number of serious casualties from 1,309 to 728. And in the meantime . . . the total number of voyages had increased enormously. [I]f you examine the insurance premiums you will find during the same period a marked decrease.

Id.

\textsuperscript{49} See Bennathan & Walters, supra note 23, at 43; B.M. Deakin & T. Seward, Shipping Conferences — A Study Of Their Origins and Economic Practices 90-92 (1973);
essential for common carriage constitutes a major portion of the cost of a carrier's operations.\textsuperscript{50} Such an expenditure hinders entry into the trade of common carriage.\textsuperscript{51}

Second, the length of time necessary to construct a suitable ship presents another partial barrier to entry.\textsuperscript{52} A contract for ship construction can take twelve to fifteen months provided no backlog of orders exists. If such a backlog persists, it can take up to three years.\textsuperscript{53} This delay increases the risk of entering the market as a common carrier, since no shipyard will construct a ship without a firm commitment from the carrier.\textsuperscript{54} The possibility of negative market forces adds to this risk.

In addition, the cyclical nature of international trade and the effects of international politics compound this risk.\textsuperscript{55} When international trade flourishes, every carrier can secure adequate cargo to yield a sufficient profit.\textsuperscript{56} However, good times breed more competition. Existing carriers will expand their operations by increasing the frequency of their services, and new ventures will offer services from chartered ships. If business continues to flourish the existing carriers and new ventures will eventually contract for the construction of new ships.\textsuperscript{57} Because of the delay required to construct ships, the market cannot immediately reach an equilibrium of supply and demand.\textsuperscript{58} Normally, supply increases to meet

\begin{footnotesize}
\begin{itemize}
\item[50.] See Turk & Weil, supra note 25, in \textit{Benedict on Admiralty}, \textit{supra} note 25, § 5.
\item[51.] See \textit{McConnel}, \textit{supra} note 24, at 543: Modern technology is such in many industries that efficient, low cost production can be achieved only if producers are extremely large . . . Where economies of scale are very significant . . . [it will be] unlikely that a new and untried enterprise will be able to secure the money capital needed to obtain capital facilities [in order to be competitive]
\item[52.] See \textit{id.} at 545.
\item[53.] See Turk & Weil, \textit{supra} note 25, in \textit{Benedict on Admiralty}, \textit{supra} note 25, § 5;
\item[54.] See \textit{Turk & Weil, supra note 25, in Benedict on Admiralty, supra note 25, § 5.}
\item[55.] See \textit{id.}
\item[56.] See \textit{id.}
\item[57.] See \textit{id.}
\item[58.] See \textit{Bennathan & Walters, supra note 23, at 4 (stating that "[i]n a competitive market, freight rates will be driven down to the level of costs.")}. Included among these costs is the minimum required cost of capital or the opportunity cost; this is the best return the capital
\end{itemize}
\end{footnotesize}
demand and returns the price to the point of equilibrium. However, due to the delay, the supply cannot increase, resulting in rising prices and prospering carriers. The supply increase does not arrive until the new ships are completed. The eventual flood of new ships into the market will increase the carrying capacity which will begin to exceed cargo.\textsuperscript{59} If an economic downturn has ensued, the problem worsens, as the excess supply reduces freight prices and carriers' revenues.\textsuperscript{60}

Keeping in mind these economic realities, superior bargaining power results from an imbalance in the forces of supply and demand.\textsuperscript{61} This imbalance may occur naturally or may result from a market breakdown. A supplier can defeat the efficient market only where its marginal revenue curve lies below its average revenue (demand) curve; in other words, when the supplier acts as a price maker rather than price taker.\textsuperscript{62} (A supplier acts as a price maker if it stands as the sole supplier, thereby producing a monopoly. On the other hand, a supplier may act as one of a few suppliers, thereby producing an oligopoly.)\textsuperscript{63} Generally, a supplier acts as a price maker if it produces a significant proportion of total output, produces a non-homogeneous product, or engages in collusion with other suppliers.\textsuperscript{64}

The existence of a small number of producers of a product or service often occurs when large barriers hinder entry into a particular field.\textsuperscript{65} One such barrier is a large capital investment.\textsuperscript{66} In the nineteenth and early twentieth centuries, the cost of building a ship capable of transporting goods was so large relative to the ability to raise capital, that potential
could earn on other investments of similar risk. Just like everything else in the marketplace, investments compete for capital. If ocean transportation cannot provide competitive returns, in the long run capital will leave the trade to enter more productive ventures. "If... low rates... were expected to persist for a long time, shipowners would be induced to transfer their ships to more profitable trades." \textit{Id.} at 48.

\textsuperscript{59} See 1C BENEDICT ON ADMIRALTY, supra note 25, at § 5.

\textsuperscript{60} See \textit{id.}. It is theoretically possible that a reduction in price could actually increase total revenues. This would happen if the lower price induced more cargo to be shipped, and the freight from the additional cargo offset the decrease in the freight of the existing cargo. However, this scenario assumes a very elastic demand for cargo. In fact, cargo levels are relatively price inelastic; i.e., they don't vary widely with price. ("Since the market for a given product in a particular country is normally limited, the almost inevitable upshot of the round of rate reductions will be that about the same total volume of cargo will move in the trade and produce less carrier revenue." \textit{See id.}).

\textsuperscript{61} Other potential causes of superior bargaining power such as disparity in size or sophistication are ignored here because, generally, both carriers and shippers (and their respective insurance agents) are large and sophisticated.


\textsuperscript{63} \textit{id.} at 286, 327.

\textsuperscript{64} \textit{id.} at 258-59, 330.

\textsuperscript{65} \textit{id.} at 344.

\textsuperscript{66} See supra note 24.
carriers were possibly reluctant to enter the market. By today’s standards, the investment required to build a ship is relatively much less. Technology has increased productivity dramatically and, as a result, has reduced the effort required to construct a ship. Additionally, because of the tremendous expansion of the capital markets, it is now much easier to raise the capital needed to finance such a product. Thus, to the extent that barriers to entry created excess bargaining power because of the large investments needed, the bargaining differential should not play as significant of a role today.

Advancements in the ocean transportation industry have also made it less likely that carriers can defeat market forces by collusion. Essentially, countries experience fewer constraints in acquiring new technology. As a result, carriers based in one country can have operations in other countries. Moreover, the location of incorporation plays less of a constraining role in our present global economy. Shippers enjoy greater latitude to shop around for carriers from many different countries. Furthermore, technology has increased the accuracy of determining the causes of a loss. Ascertaining who bears the burden of proof, while still relevant, is less determinative of the outcome today.

III. ECONOMICS OF MANDATORY LIABILITY

A. BASIC PRINCIPLES OF AN ECONOMIC SYSTEM OF INTERNATIONAL CARGO DAMAGE

Several important aspects of international cargo damage regulation exist. First, numerous jurisdictions may apply. As a result, the parties involved must discover and understand more information so they can make informed bargains. Because the allocation of liability for cargo damage influences the freight charged, the parties must understand to whom various countries allocate liability in order to calculate a mutually acceptable freight charge. Even if the countries involved possess uniform laws, interpretations of identical language can vary significantly.

In addition to this inefficiency concern, the application of multiple

67. Almost seventy percent of the dead weight tonnage carried by the fleet with a U.S. controlling interest in 1993 was carried under a foreign flag. See Lovett, supra note 28, at 18. Of this tonnage, the flag country for almost fifty percent was Liberia and for twenty-one percent was the Bahamas. Id. at 20.

68. See Mandelbaum, supra note 14, at 475 (“[The] burden of proof was a very real defensive weapon in the days before effective discovery procedures were developed, and often proved an impossible burden for cargo shippers to bear.”). Id.

jurisdictions also leads to increased uncertainty. Because of transaction costs, the parties will ultimately be unable to gather all the information required to make an accurate decision.\textsuperscript{70} At times, the parties will make the incorrect decisions,\textsuperscript{71} which leads to inefficiency.\textsuperscript{72} If the parties possess different beliefs about an uncertainty, a mutually beneficial bargain may be forfeited.\textsuperscript{73}

In addition to these two concerns, determinations involving choice of law and forum shopping will consume profitable trade through expensive transaction costs.\textsuperscript{74}

A second important aspect of international cargo damage regulation involves the absence of personal injury considerations, which simplifies the economic analysis of cargo damages in three ways. First, difficult issues of calculation can be avoided, such as valuing loss of life. Individuals are generally averse to risk when personal injuries are concerned, so a willingness to accept risk levels cannot be extrapolated to determine the cost of the accident upon occurrence.\textsuperscript{75} Even if personal injuries could be converted into money, such a system is not necessarily desirable.\textsuperscript{76} Second, when personal injury considerations are removed, the perception of fairness becomes much less relevant.\textsuperscript{77} The role fairness plays in systems of accident law remains unclear.\textsuperscript{78} However, as discussed below, because

\textsuperscript{70} Because for some information the cost of obtaining it will exceed its expected yield. See infra note 109.
\textsuperscript{71} By “incorrect decision,” I mean a decision that they would not have made had the relevant information been known to them. An incorrect decision leads to harmful consequences that would have been avoided had there been no uncertainty.
\textsuperscript{72} For example, suppose a shipper wants to ship goods from Country A to either City X or City Y. The carrier quotes lower freight rates for shipment to X then to Y because the liability laws of X are more pro-carrier. Unless the shipper can ascertain the laws of X and Y, it cannot determine the most efficient course of conduct. In other words, the shipper cannot determine which it values more, the favorable laws of country Y or the favorable rates of country X. Since, presumably, the carrier is indifferent, each incorrect choice reduces the utility of the system as a whole.
\textsuperscript{73} For example, suppose a carrier believes that Country A is pro-shipper and, thus, demands a heavy freight. Meanwhile, the shipper believes A to be pro-carrier and requires a small freight. No bargain will be made even though the possibility for a mutually beneficial bargain exists.
\textsuperscript{74} Although the adjective “expensive” is appropriate to describe unnecessary transaction costs in the field of ocean commerce, those same costs can be described as salubrious to maritime lawyers.
\textsuperscript{75} See Guido Calabresi, The Cost of Accidents 91 (1970). To paraphrase Calabresi’s example: An individual may accept $50,000 for one chance in one hundred of dying, but require more than $2,500,000 for a one in two chance of dying.
\textsuperscript{76} Id. at 18
\textsuperscript{77} Id. at 24-26 (stating that the principal goals of an accident system are fairness and reduction of accident costs.)
cargo liability involves large sophisticated parties (primarily insurance carriers) and because of the absence of personal injuries, morality should not play a role in the system of cargo accident law.\textsuperscript{79} Third, a major concern of liability systems which involve personal injury is the minimization of the loss after the accident through proper medical treatment.\textsuperscript{80} Cargo damage regimes avoid such complicated questions as how the cost of medical treatment should be paid for and how facilities for medical treatment should be paid for as well as who should operate them. Mitigating cargo damage is much simpler and much less of a concern.\textsuperscript{81}

A third important characteristic of cargo liability involves its purely voluntary nature, since no liability attaches upon the objection of either party.\textsuperscript{82} The importance of this characteristic becomes clear when considering that voluntary exchanges in the market help to ensure that resources gravitate toward their most valuable uses.\textsuperscript{83} Market determination of the value of accident costs will likely be more accurate if reached through a mutual bargain.\textsuperscript{84} Coase's theorem suggests that efficiency in resource allocation will be achieved through mutual bargaining between the affected parties.\textsuperscript{85} However, since bargaining includes some costs,\textsuperscript{86} bargains may be avoided if costs exceed the desired benefits.\textsuperscript{87} Where the parties contract voluntarily, these costs decrease dramatically as the agreement merely becomes part of the bill of lading negotiations.\textsuperscript{88}

The allocation of liability is also recurring. Entities engaged in shipping carry the vast bulk of goods.\textsuperscript{89} These shippers deal with carriers,

\textsuperscript{79} See infra notes 133-142 and accompanying text.
\textsuperscript{80} See Calabresi, supra note 75, at 27.
\textsuperscript{81} Of course, mitigation of damages still plays a role in minimizing the cost of accidents.
\textsuperscript{82} When I say that liability is voluntary, I mean that the nature of the system is inherently voluntary in that either side could simply refuse to contract. Liability will be assumed by a party only when it is to both parties' advantage, and they so agree. However, once they agree that liability will be assumed, they are not free to assign this liability without limits. This is the basic flaw in the system.
\textsuperscript{84} See Calabresi, supra note 75, at 90-91.
\textsuperscript{86} Id. at 15.
\textsuperscript{87} Id. at 15-16.
\textsuperscript{88} In contrast, transaction costs are high when the liability is involuntary and there are many parties involved. A classic example is the factory emitting smoke. Transaction costs would be much higher in this situation where it must be determined who should be privy to the agreement an where they must all agree.
\textsuperscript{89} Even smaller shippers will use freight forwarders that deal regularly with carriers.
often the same carrier, on a daily basis. The shipper and the carrier form
a continuing working relationship, as each relies on the other to make a
profit. This feature can have significant effects on the behavior of other
parties. For example, when considering the costs and benefits of any par-
ticular action, the party must include an evaluation of how the decision
will affect the relationship with the other party. That relationship rep-
resents a future stream of income. This phenomenon is discussed below in
the context of carriers’ incentives to take appropriate precautions.90 A
carrier may take more precautions than are justified by the liability it is
subject to (for example, $500 per package) because the cost of failing to
take such precaution may damage future profitability in the form of alien-
at ing current shippers.

B. The Basic Model

A system governing the law of ocean transportation performs two
functions. First, it influences the costs and benefits available to the sys-
tem as a whole. Second, it determines, at least initially, who will bear
those costs or receive those benefits. For example, the law imposes tar-
iffs, requires customs inspections, regulates trade routes, places embar-
goes, mandates certain reporting requirements,91 etc. All of these actions
either decrease or increase the profitability of the trade as a whole. Of
course, the optimal scheme would impose only those costs on the system
that are more offset by benefits elsewhere, and allow receipt of benefits
that do not exceed their cost. This article focuses on the second function:
the allocation of rights and obligations within the system. In the aggre-
gate, assuming an efficient market, the system will take full advantage of
resource allocation, maximizing the overall benefits while minimizing
overall costs.92 The maximized “pie” will be divided among the partici-
pants based on mutual negotiation.

In other words, both functions affect the total size of the pie avail-
able to the participants of ocean carriage. At first, market forces deter-
mine the boundaries of the pie. Factors such as technology, cargo supply
and carrier demand, prices of commodities and fuels, competitive pres-
sures from alternative transportation sources (ex. Air freight), and the
general state of the economy93 affect the overall revenues and expenses
of the industry. Governments generally do not control these factors.

90. See infra notes 134-142 and accompanying text.
92. See Coase, supra note 88; Landes & Posner, supra note 78, at 31 (“The [Coase] theo-
rem holds that the efficiency with which resources will be employed is unaffected by the initial
assignment of rights, provided transaction costs are zero.”).
93. Or more specifically, the perceived state of the economy, and more importantly the
perception of the future state of the economy.
Laws which affect the industry in the aggregate also affect the size of the pie by taxing or subsidizing the industry. The customs requirement stands as an example of a tax on the industry that benefits other areas outside the shipping industry.

Finally, the efficiency with which the trade participants perform their duties also affects the size of the pie. In a world of perfect information and no transaction costs, the market would work to allocate the rights and duties to achieve optimal efficiency. However, ill-founded laws can upset this optimal allocation. Consider the following example: A shipper has an opportunity to purchase a load of widgets for $1,000 and to sell those widgets overseas for $2,000. A carrier can transport the goods for $500 absent any concern over cargo damage. External market forces interacting with the laws affecting the aggregate industry determine these prices. Now, assume the general maritime law applies; namely, that strict liability for all loss applies to the carrier. Assume also that the carrier estimates that the cost of cargo liability to it will be $200, so that it must be able to charge at least $700 to enter into a bargain. Now, assume that the shipper is willing to pay $900 under the general maritime law liability regime, or $800 if all the liability is allocated to it. In other words, assumption of the liability will cost the shipper $100. The shipper will require a $100 profit on all shipments if the carrier assumes the liability. Without transaction costs, the parties can easily improve upon the general maritime law regime through mutual agreement. Under the general maritime law rules, the carrier and shipper will agree on a price between $700 and $900. The shipper will pay no more than $900, and the carrier will accept no less than $700. Negotiations determine the eventual price.

Assume now that the final freight charge is $800. The carrier receives an average benefit of $100, and the shipper receives a benefit.
of $200.\textsuperscript{101} The total benefit then is $300. If the parties are allowed the freedom to contract, they will allocate the liability to the shipper. In that case, the shipper would pay no more than $800, while the carrier would accept no less than $500.

Assume the parties agreed on a freight charge of $650. The carrier would receive $150,\textsuperscript{102} and the shipper would receive $250.\textsuperscript{103} The total benefit to the parties is $400, and both parties are better off. The latter scenario is more efficient.\textsuperscript{104} Conversely, a law which forces mandatory liability on the carrier would be inefficient.\textsuperscript{105} In a perfect market, a mandatory liability law can never help; it can only hurt the efficient allocation of resources. If mandatory liability is allocated to the party who can accept it at the least cost (the “cheapest cost avoider”), then it merely reaches the result that the market would have reached naturally. However, if mandatory liability is not allocated to the cheapest cost avoider, a less efficient system would result (assuming, of course, that the market works efficiently to allocate resources). If the market is prevented from working efficiently, resources may be allocated in an inefficient manner.\textsuperscript{106} Part IV discusses challenges to the effectiveness of market allocation.

C. A More Realistic Model

The market, in the absence of transaction costs (and other market

average benefit. On most shipments, the carrier anticipates a $500 benefit, but realizes that some shipments will yield no benefit. On average, it anticipates a $200 benefit.

\textsuperscript{100} $800 freight less $500 transportation costs less $200 average cargo damage costs.

\textsuperscript{101} $2000 sales price less $1000 purchase price less $800 freight.

\textsuperscript{102} $650 freight charge less $500 cost of transportation.

\textsuperscript{103} $2000 sales price less $1000 purchase price less $650 freight less $100 cargo damage cost.

\textsuperscript{104} Economists generally agree that a scenario is more “efficient” than another scenario when it meets the Kaldor-Hicks criterion or is Pareto superior (Pareto preferred). As used in this article, “efficient” refers to the Kaldor Hicks criterion, as it does in many other works. See, e.g., Landes & Posner, supra note 78, at 16. A scenario meets the Kaldor-Hicks criterion when compared to the previous scenario if the dollar value of the gains to the winners is greater than the dollar cost of the losses to the losers. Id. This is also referred to as a wealth maximizing change. A scenario is Pareto superior if at least some parties are better off and no parties are worse off as compared to the previous scenario. Id. at 16-17. Note that a scenario that is Kaldor-Hicks efficient would become Pareto superior if the winners compensated the losers for the amount of their losses. In this example, the post-bargain scenario is both Kaldor-Hicks efficient and Pareto superior.

\textsuperscript{105} Because this is an economic analysis of cargo liability, it is assumed that efficient allocation of resources is the goal of a system of cargo accident law. This is what Posner terms, “The Positive Economic Theory of Tort Law.” See Landes & Posner, supra note 78, at 1. Fairness should not play a role in the system and has already been discussed. Other goals of liability systems have had favor, especially in the past. See Landes & Posner, supra note 78, at 4-9.

\textsuperscript{106} Note that if the market failed, for some reason, to efficiently allocate resources, government intervention to override the market and reallocate the resources to their most efficient use could be desirable.
failures), will allocate liability most efficiently if the market operates freely. However, the market operates less effectively and may not efficiently allocate resources when transaction costs are involved.\textsuperscript{107} The liability system thus plays an important role in efficient resource allocation, namely, allocating risks efficiently initially so as to minimize the transactions that must be entered into.\textsuperscript{108} In other words, when transaction costs are considered, an optimal liability system allocates accident costs "to those acts or activities (or combinations of them) which could avoid the accident costs most cheaply."\textsuperscript{109} By minimizing the overall accident costs, the maximum amount of resources remain to be split between the carrier and the shipper.

Generally, three transaction costs affect the legal liability regime: imperfect level of precaution,\textsuperscript{110} dispute resolution,\textsuperscript{111} and excessive insurance.\textsuperscript{112} The goal of an optimal legal system is to allocate liability to those parties who can most efficiently minimize the liability while incurring as little of these costs as possible.

1. Imperfect Level of Precaution

These costs result from taking too many or too few precautions with regard to a shipment of cargo. Shippers and carriers can take certain precautions to help ensure the safety of a shipment. For example, a shipper takes precautions in packing and sealing the cargo, and a carrier takes precautions in handling cargo and navigating the ship. Unfortunately, precautions cost money. If too few precautions are taken, too much damage may result. If too many precautions are taken, their costs may exceed their benefit. A particular precaution should be taken only if the reduction in probable cargo loss\textsuperscript{113} exceeds the cost of precaution.\textsuperscript{114}

\textsuperscript{107} See Calabresi, supra note 75, at 135-38.
\textsuperscript{108} Or more precisely, to minimize the transaction costs to be incurred in arriving at the optimal outcome.
\textsuperscript{109} See Calabresi, supra note 75, at 135.
\textsuperscript{110} See text accompanying notes 113-143.
\textsuperscript{111} See text accompanying note 144.
\textsuperscript{112} See text accompanying notes 147-150.
\textsuperscript{113} The probable cargo loss is a factor of the probability of loss occurring multiplied by the amount of the loss. This calculation is complicated by the fact that there is a continuum of loss that could occur ranging from slight to total. Because the occurrence of loss is unknown, the parties must deal only in statistical probabilities.
\textsuperscript{114} This is the basic "Hand Formula" of B-PL, devised in United States v. Carroll Towing Co., 159 F.2d 169 (2d Cir. 1947). See Landes & Posner, supra note 78, at 85 ("[T]he owner would be negligent if the burden of precautions (B) was less than the probability of harm times the gravity of the injury (PL) . . . ."); Landes & Richard A. Posner, supra note 78, at 85. See also Michael F. Sturley, Changing Liability Rules and Marine Insurance: Conflicting Empirical Arguments About Hague, Visby, and Hamburg in a Vacuum of Empirical Evidence, 24 J. Mar. L. & Com. 119, 129 (1993) ("[T]he law should allocate responsibility in the way that best encour-
More specifically, a precaution should be taken only when its cost is less than the probability of cargo loss times the amount of that cargo loss. The amount of optimal precautions thus depends on the value of the cargo and the probability of the loss (the "Hand Formula").

Two general reasons exist as to why an optimal amount of precautions may not be taken. First, a party may not have the information necessary to calculate the proper level of precaution, and gathering such information may not be cost-effective. Second, the parties may be unable to reallocate responsibility to the party best able to affect the precaution.\(^{115}\)

Regarding the first reason, inadequate information is most relevant in determining cargo value. The problem usually involves the carrier's lack of knowledge concerning the cargo. Utilizing the Hand Formula, the carrier\(^ {116}\) should take more precautions the greater the value of the cargo. The problem lies in the fact that the carrier does not stand in the best position to determine the value of the cargo. Without this knowledge, the carrier simply cannot make an appropriate calculation of the precautions to be taken. The carrier may obtain some sense of the value of the cargo by its description on the bill of lading, but this may be wholly inadequate. Consider a bill of lading for the shipment of "computer components" or even "computer chips." The value of a container of DRAM chips will vary quite drastically from the value of a container of microprocessors. In addition, the value of a particular cargo depends on what a willing buyer would pay for it. The shipper certainly stands in a better position to know the sales price. Also, the value of the goods may fluctuate over the course of a voyage. The carrier could research the value of the cargo, or require the shipper to provide information. However, research by a carrier is inefficient considering that it would merely duplicate information already known to the shipper. Moreover, the shipper may not wish for the value of the cargo to be known in order to prevent theft. Also, the shipper may not want to disclose the value of the cargo because it may put the shipper at a disadvantage in negotiations over the freight rate. The method of dealing with this problem has been to impose liability on the carrier for a certain defined amount, and to require the shipper to declare any value in excess of this amount.\(^ {117}\) However, this method has proven ineffective. To the extent that the car-

\(^{115}\) I use the term "reallocates" because if responsibility were allocated to the party best able to take the precaution initially, the precaution would be taken (unless the party did have the relevant information to make the Hand Formula calculation.).

\(^{116}\) And the shipper for that matter.

rier takes precautions proper for the imposed amount of liability, in effect substituting the statutory amount of liability for the value of the cargo, the carrier will miscalculate the optimal level of care. When the cargo value is less than the statutory amount, the carrier will take excess precautions, and when it exceeds the statutory amount, the carrier will fail to take adequate precautions.\textsuperscript{118}

The second component of the Hand Formula is the probability of cargo loss. This risk stems from the nature of the goods, actions taken by the parties on the goods,\textsuperscript{119} and other factors outside of the control of the parties.\textsuperscript{120} The nature of the goods affects the probability of loss. Fragility, perishibility, susceptibility to rust and extreme temperature changes, and combustibility of the goods, all will determine their propensity for loss.\textsuperscript{121} Again, the nature of the goods is a matter primarily within the knowledge of the shipper, so the shipper is presumably in the best position to take precautions concerning damage to the goods. Indeed, the law has always placed liability for inherent vice of the goods upon the shipper.\textsuperscript{122} However, in this respect, the law attempts to draw a fine line that cannot be drawn. Very few cargo accidents occur solely due to the inherent vice of the goods. Rather, the susceptibility of the goods to damage increases the probability of loss. For example, iron is particularly sensitive to rust damage. Since risk of loss due to rust is increased, one would expect a proportionate increase in the precautions taken to prevent rust. However, when rust occurs, one would certainly not conclude that the capacity to rust is an inherent vice of iron, and allocate liability to the shipper. Without knowledge of the susceptibilities of the cargo to certain types of damage, the carrier is in no position to take the adequate level of precautions. Whether the cost is in the form of an improper level of precautions which the carrier takes, or in the form of energy which the carrier uses to obtain sufficient knowledge concerning the value and nature of the goods, cost nonetheless exists.\textsuperscript{123} Whether these costs can be avoided cannot be determined without analyzing the other transaction

\textsuperscript{118} See Sturley, \textit{supra} note 114, at 128-29.

\textsuperscript{119} The controllable actions include the care taken in packing, loading, and stowing the cargo and the care in manning and navigation of the ship.

\textsuperscript{120} Examples of such factors include the perils of the sea, acts of governments, sabotage and war. See \textit{Gilmore & Black}, \textit{supra} note 11, at 139-42.

\textsuperscript{121} The nature of the goods an the other factors will also affect losses outside of cargo damage. For example, oil cargo is particularly susceptible to environmental liability. \textit{See}, e.g., \textit{Exxon Valdez} \textit{v. Exxon Corp.}, 104 F.3d 1196 (9th Cir. 1997).

\textsuperscript{122} \textit{See} \textit{Gilmore \\& Black}, \textit{supra} note 11, at 119. \textit{See}, e.g., \textit{46 U.S.C. app § 1304(2)(i), (m)} (1994) (exempting the carrier from liability resulting from an “[a]ct or omission of the shipper or owner of the goods, his agent or representative” and “[w]astage in bulk or weight or any other loss or damage arising from inherent defect, quality, or vice of the goods.”).

\textsuperscript{123} Namely, an information cost.
costs which plague ocean commerce. Regarding these costs, the shipper stands as the cheapest cost avoider.

Other costs besides information costs are transaction costs.  
The actions taken in an ocean shipment can broadly be divided into: packing the goods; loading, stowing and caring for the goods; maintaining, manning, equipping, and supplying a vessel; and navigating the ship. The issue surrounding such actions is who can most cheaply undertake the precautions in conjunction with the actions that are proper in light of the probability of cargo loss. Recall that the goal of an optimal system of accident law is to minimize extraneous costs. One of those costs consists of taking too few or too many precautions. A mistake often made is to ask the wrong question.  

[I]t simply doesn’t matter what level of liability is imposed on shipowners – whether it be high or low – so long as there is some level of liability which can be enforced so as to chastise the wayward shipowner and so as to encourage the recalcitrant or slothful shipowner to forsake indolence and to prefer the exercise of diligence.

This argument suffers three fundamental flaws. First, the analysis frames the argument as punishing a party by imposing liability upon them. This frames the argument in terms of morality – the carrier will engage in immoral behavior unless punishment follows such behavior. A major problem with the regulatory scheme of COGSA lies in that that its underpinnings are based on morality rather than economics. The drafters, and the proponents of revision, announce the goal of regulation is to remedy “unfairness,” “oppression,” or “unconscionability.”  

The arguments are framed as though powerful, oppressive carriers intention-

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124. Note that although I separate the term “information costs” from “transaction costs,” I do so out of convenience. In fact, information costs could be viewed as a form of transaction costs. See Sturley, supra note 114, at 123 n. 3. When the term transaction costs is used elsewhere in the paper, the costs include information costs.


128. See, e.g., William Tetley, Limitation, Non-responsibility and Disclaimer Clauses, 11 Mar. Law, 203, 206-07 (1986) (“The Hague Rules . . . were adopted to provide a clear and fair balance of rights and responsibilities between carriers and shippers.”); Benjamin W. Yancey, The Carriage of Goods: Hague, Cogsa, Visby, and Hamburg, 57 Tul. L. Rev. 1238, 1245 (1983); Encyclopaedia Britannica, Inc. v. SS Hong Kong Producer, 422 F.2d 7, 11 (2d Cir. 1969) (stating that “[t]he purposes behind Harter, the Hague Rules and COGSA were to achieve a fair balancing of the interests of the carrier . . . and the . . . shipper . . .”).

129. See, e.g., Yancey, supra note 128, at 1239.

130. See Hague Conf. (statement of J.P. Rudolf), supra 11, at 31-32, reprinted in LEGISLA-
ally injure helpless shippers for their own benefit. In reality, virtually every conflict over cargo damage is between large sophisticated cargo insurers and large sophisticated P & I clubs. It is more appropriate to view the carrier and shipper as a team engaged in a venture for profit, namely, the purchase, or manufacture, and sale of goods. The shipper has an opportunity for profit because it can sell goods overseas for a greater price than it can purchase them. Otherwise, the shipper would not be shipping the goods overseas. To the extent that this profit exceeds the cost of transportation, the shipper and carrier both stand to gain. The share of this profit that each will receive depends upon the cost of the freight. To the extent that either party can reduce the cost of transportation, there is more overall profit to share, so each will have an incentive to reduce costs.

The punishment theory also suffers from flaws in that it assumes that the carrier will bear the ultimate cost of the liability. If carriers are to remain in business, they must cover their costs through higher freight charges. The sole question in the usual cargo damage case is who should bear the loss as between an innocent P & I insurer and an innocent cargo insurer. Neither party engaged in any “wrongful” conduct which would justify liability under the notion of “fairness.” Instead of questioning whether risks are equitably apportioned . . . the more relevant inquiry is whether an increased standard of care can be effected without an offsetting increase in costs."

The second flaw in this argument is that it assumes due care is a two-sided coin – that due care has or has not been exercised. The argument proposes that just enough liability be allocated to the carrier to ensure the coin lands on due care. In fact, the level of precaution that may be taken is a continuum. The optimal amount of care is based on the Hand Formula, and is determined by the probability of loss. If the carrier perceives the loss to be little, it will take little precaution. If the carrier perceives that its loss will consist of the statutory amount, it will only take those precautions consistent with such an amount. For example, if the carrier believes that the total loss to will not exceed $500 per package or

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\* History, supra note 11 at 137-138 (“[T]here is a very strong feeling . . . that the bills of lading as imposed on shippers today are harsh and unconscionable.”).

131. See infra notes 143-146 and accompanying text for a general discussion of insurers of cargo liability.

132. Lord Diplock sums up the fallacy of the morality argument quite well: “[I]n the court room, as at the diplomatic conference table, we talk and tend to think as if the contest involved a moral conflict about one human being’s duty to his neighbor, instead of an allocation of liability between cargo insurers and protection and indemnity (P and I) insurers of a loss which has occurred through the fault of neither.” Diplock, supra note 10, at 252.

133. See Kimball, supra note 11, at 219.

134. See supra notes 113-115 and accompanying text.
customary freight unit, it will take precautions adequate for the probability for such a loss.\textsuperscript{135}

The final fallacy in this argument is that it assumes that the prospect of liability serves as the only motivation to the carrier to take precautions. In fact, the carrier will have incentive to take some precaution regardless of the level of liability. While it may be true that if only a single voyage is contemplated, the carrier will not have an adequate incentive to take precaution, because in the long term, there are costs associated with shipping that do not take the form of liability for loss, such as loss of business. When a carrier fails to take adequate precautions, excessive losses occur which increase the loss of transportation, thereby decreasing the profitability of shipping goods. Fewer shipments will be made as a result, and fewer profits will be realized on the shipments that are made. Because shippers can realize greater profit if more precautions exist, it may behoove the carrier to take those precautions. The shipper will make more money on the decrease in transportation costs than it paid to the carrier (presumably in the form of a higher rate). Thus, the carrier will make more on the payment than the cost of taking the precaution. The carrier will have an economic incentive to take the precaution.

Cargo insurers also exert pressure. Payment for cargo damages constitutes the major controllable expense of a cargo insurer. Thus, the insurer has an incentive to minimize cargo loss. However, the insurer will not want the carrier to be overly cautious. The shipper, who pays premiums to the insurer, will not want to insure losses that are not cost-efficient, just as it will not want to pay the carrier to avoid such losses. Ironically, the shipper wants these losses to occur because they are less than the cost of prevention. Thus, the insurer has an incentive to pressure carriers into taking the appropriate amount of precaution by giving favorable premium rates to shippers who use such carriers.

This phenomenon did not go unnoticed by the members of the Hague Conference. Sir Norman Hill noted that even though freedom to contract may allow the carrier to free himself of liability:

\begin{quote}
It is still essential to have success that he should exercise all possible Care in the carriage of the goods. The shipowner who does not exercise such care cannot hope to prosper in business. He will not be employed by the merchants, and the rates at which he can insure his vessels will be advanced by the underwriters. So far as the liners are concerned... the goodwill of their business, which is amongst their most valuable assets, is based entirely upon the care with which their cargoes are carried and the satisfaction they give to the merchants.\textsuperscript{136}
\end{quote}

\textsuperscript{135} See Sturley, supra note 114, at 130.

\textsuperscript{136} Hague Conf. (statement of Sir Norman Hill), supra note 11, at 41, reprinted in LEGISLATIVE HISTORY, supra note 11 at 147.
However, this argument was practically ignored as notions of fairness and justice pervaded the discussions. ¹³⁷

Some empirical evidence supports the view that carriers do not rely solely on the statutory liability limits in deciding what precautions to take. Since COGSA’s enactment, liability limits have been set at five hundred dollars per package or customary freight unit. Although the limit has remained the same, in relative terms the limit has decreased with inflation. One would expect the corresponding level of care which carriers take to have decreased proportionately throughout this time, but there is no evidence of dramatic increases in cargo damage. ¹³⁸

Carriers have an incentive to take precautions even absent liability. The issue is whether carriers would have the right amount of incentive. In a world without transaction costs, the carrier would have the right incentive. ¹³⁹ In reality, this may not be the case. The economic incentive a shipper places upon the carrier to take precautions is reduced by numerous transaction costs. The shipper must determine the level of precautions a carrier takes, and in doing so incurs costs. Thus, the shipper must compare the desired level of precautions to the level which the carrier has taken, but the shipper is, again, not in a position to determine what precautions are appropriate for the carrier to take. It must then convince the carrier of the potential for mutual gain. It will be more likely that a shipper will be able to convince a carrier to take certain precautions when the carrier can be assured that it will recover the cost of future shipments, and the carrier will be even more likely to listen to a shipper when a stream of future income is on the line. Similarly, the cargo insurer will use resources in compiling a safety record of carriers which it can use to evaluate the level of precautions taken. There will exist some deficiency in its ability to convince the carrier to use precautions, yet the fact that a carrier fails to take adequate precautions does not mean that the carrier benefits at the expense of the shipper. The consequence of inadequate care will be to reduce the profitability of the trade as a whole, which can have detrimental effects on both the shipper and the carrier.

¹³⁷ See supra notes 131-132 and accompanying text.

¹³⁸ In fact, evidence suggests that damage has decreased. Admittedly, this evidence is imperfect at best. Technology has reduced the cost of taking precautions, as has the characterization of cargo. See Branch, supra note 17, at 26-28; Abrahamsson, supra note 26, at 27. Also, some jurisdictions have implemented the Visby Amendments or Hamburg Rules which increase the liability limitation. See George F. Chandler III, A Comparison of “COGSA,” the Hague/Visby Rules, and/or the Hamburg Rules, 15 J. MAR. L. & COM. 233, 289-91 (1984) (detailing the countries that have enacted the Visby Amendments and/or the Hamburg Rules). Finally, courts have found various ways to defeat the limitation. See, e.g., Steven F. Friedell, The Deviating Ship, 32 HASTINGS L. J. 1535 (1981); 2A Benedict on Admiralty § 128, at 12-30 (M. Cohen ed. 7th ed. 1988). See, e.g., Peacock, supra note 69.

¹³⁹ See supra Part III(A).
In the end, the issue becomes one of transaction costs. In order to minimize transaction costs, liability should be allocated to the party who can most cheaply avoid the loss. However, the party which can most cheaply avoid the loss cannot easily be determined. The carrier stands in the best position to take precautions with regard to loading, stowing and caring for the goods, maintaining a vessel and manning, equipping, and supplying it, and navigating the ship. However, the carrier will not know what level of precaution to take unless it can determine the nature and value of the cargo. To the extent that the carrier must expend effort to determine such facts, it does not avoid the loss cheaply. The shipper has knowledge concerning the nature and value of the cargo, and stands in a position to take precautions in packing, yet it consumes resources to the extent that it must negotiate with the carrier in order for it to take precautions.

The problem worsens when liability is hazy, which results from having a multi-party system. Where many bases of liability exist, confusion over where one stops and others begin will result. Such confusion leads to inaccurate degrees of care. For example, COGSA allocates the liability to the shipper if the damage results from negligent navigation, but allocates liability to the carrier if the damages result from improperly manning, equipping, or supplying the ship. The line between these two is often difficult to draw. Possibly, both the carrier and shipper will presume that the other faces liability, in which case they will take too little care, or presume that each is itself liable and take too much care.

2. Dispute Resolution

Dispute resolution transaction costs result from the uncertainty parties face regarding the extent of their respective liabilities when liability is allocated to more than one party. Theoretically, it is possible to draft a statute so that no ambiguity exists regarding which parties are responsible for any given loss. However, this is probably impractical, and the Carriage of Goods by Sea Act certainly does not meet this criterion. Dispute resolution constitutes a major cost of a multiple-party liability system. Anytime a loss occurs and neither party admits liability, the parties must quarrel over who bears ultimate responsibility, which consumes valuable

140. See Calabresi, supra note 75, at 135.
141. I use the term "multi-party liability system" to describe a system which allocates liability vertically to more than one party. Vertical allocation of liability is allocation of liability to parties dependent on circumstances surrounding the loss without regard to causation. Horizontal allocation of liability is allocation of liability to parties based on the amount of loss.
143. See, e.g., Orient Mid-East Lines, Inc. v. A Shipment of Rice, 496 F.2d 1032 (5th Cir. 1974).
144. See supra note 141 and accompanying text.
resources. Such quarrels over liability relate to the ambiguity of the law, and the costs associated with such disputes reduce the overall profit available to the parties. Elimination of these costs could come from a strict liability system, which does not necessarily mean that one party would bear all of the liability. The liability could be divided horizontally. For example, the carrier may bear the first one-million dollars of liability and the shipper would bear the rest. An even better result may occur if the carrier supplied a sliding scale of freight rates dependent on the level of liability assumed. The shipper could choose the rate that was most economical combined with the premiums which the cargo insurer may charge.

3. Excessive Insurance Costs

There exist three broad categories of excessive insurance costs which can be referred to as duplicative administrative costs,\textsuperscript{145} over-insurance costs,\textsuperscript{146} and inefficient insurance costs. The two basic types of insurance covering cargo damage are protection and indemnity insurance (O & I) and cargo insurance. Cargo insurance is a first-party insurance system which independent cargo insurers administer. Generally, all that is required to recover under a claim is proof of damage. P & I insurance is a third-party insurance system administered by P & I clubs of which the carrier is a member. Eighteen members of the International Group of P & I clubs insure approximately 95 percent of the world’s fleet.\textsuperscript{147} To recover a claim, it must be shown that the insured was liable for the loss.\textsuperscript{148}

a. Duplicative Administrative Costs

Duplicative administrative costs occur when more than one insurer incurs costs in maintaining an information system and surveying/settling claims.\textsuperscript{149} When a dispute regarding liability arises following a loss, both insurers must investigate the causes of the accident, apply the circumstances to the law to determine probable liability, and take action to settle the claim. This constitutes merely another cost of a multiple-party liability system.

One theory asserts that if the carrier were to bear all or most of the liability, the need for cargo insurance would be eliminated along with the

\textsuperscript{145} See infra notes 149-154 and accompanying text.

\textsuperscript{146} See infra notes 156-158 and accompanying text.


\textsuperscript{148} Id.

\textsuperscript{149} See Diamond, The Division of Liability as Between Ship and Cargo (Insofar as it Affects Cargo Insurance) Under the New Rules Proposed by UNICTRAL, Lloyd’s Mar. & Com. L. Q. 192, 193-94.
associated duplicative administrative costs. However, the desire for cargo insurance will probably not be extinguished even under these extreme circumstances. The shipper will still use cargo insurance because (1) payment is more prompt, (2) the cargo owner can deal with a single insurer on all shipments, (3) cargo insurance provides protection before and after P & I insurance coverage is effective, and (4) cargo insurance protects against insolvency. To be certain, some duplication of administrative expenses would cease if the carrier were subject to strict liability. For example, costs of investigation into the cause of the loss would be reduced. However, some duplicative effort would remain.

Duplicative insurance expenses may well be curtailed if the carrier were absolved of liability, but such a proposal has never received serious support, based on the belief that absent liability, the carrier would have no incentive to take adequate precautions. However, as noted above, this belief may well be unfounded. In addition, as discussed below, it may well be possible to take measures to ensure that the carrier has adequate incentive without allocating liability to it.

b. Over-insurance

Over-insurance occurs when two insurers insure more than one-hundred percent of the risk. This is not necessarily the case when two insurers insure the same loss. For example, suppose P & I insurance and cargo insurance insure the same loss. The P & I Club will be liable for loss seventy-five percent of the time. The cargo insurer estimates that it can recover from the P & I club in seventy-five percent of the losses. No over-insurance will occur because the chance of loss is properly discounted. This estimate of the probability of loss will be built into the amount of premiums paid to the cargo insurer. However, assume that the cargo insurer estimates it will recover only fifty percent of the time. Now the cargo insurer will charge premiums unrepresentative of the risk of loss. Over-insurance will result. Assume more realistically that the cargo insurer estimates it will recover between sixty-five and eighty-five percent of the time. Being risk averse, the cargo owner will again overcharge. This cost again results from having a multiple-party liability system.

c. Inefficient Insurance

Assuming that one system of insurance is more efficient, choosing

\[150. \text{See Sturley, supra note 114, at 143 & n.97 (citing examples of such proposals).}\]
\[151. \text{See Kimball, supra note 11, at 246-47; Sturley, supra note 114, at 143-44.}\]
\[152. \text{Sturley, supra note 114, at 143 n.97.}\]
\[153. \text{Id.}\]
\[154. \text{See infra text accompanying note 172.}\]
\[155. \text{See supra 141.}\]
the wrong system will lead to more costs expended than necessary. A hotly contested issue is whether P & I insurance is less expensive.\footnote{156} This question cannot be resolved without empirical evidence that may be impossible to gather.\footnote{157} Lord Diplock argues that at the current rates, P & I insurance is more expensive than cargo insurance, otherwise the carrier would be in a position of arbitrage.

If it had been more economical for the carrier to insure against the excess liability than for the cargo-owner to cover it with his cargo insurer, without the insurer's having any prospect of recovery against the carrier, this would have been discovered sometime in the forty six years since 1924, and the carrier would have quoted, for the goods declared to be of a higher value than the limitation figure, freight rates which would have reflected the lower cost of covering the excess liability himself.\footnote{158}

In other words, the carrier would have increased its liability limits and charged the shipper more in freight than the additional cost of insurance. This argument would be true in the absence of transaction costs, but such costs may prevent the carrier from passing on the increased cost in the form of higher freight rates. If P & I insurance is in fact cheaper (which cannot be proven), it is not by much, since, if it were cheaper, eventually the potential for gain would outweigh the transaction costs and Diplock's prediction would ring true.

\section*{IV. Criticisms of the Market Analysis}

This article has assumed that the market effectively allocates resources. For example, liability is placed on the carrier, it is assumed that the freight rates will increase proportionately (except to the extent that transaction costs impede the effectiveness of the market). John D. Kimball stated that:

\begin{quote}
[it] is almost universally recognized that any shifting of responsibility to the carrier will ultimately be passed back to the cargo owner and the ultimate
\end{quote}


\footnote{157} The lack of even approximate or indicative information on the size and relative weight of the various cost elements [that make up cargo and P & I insurance] had the result that [the UNCTAD study] became mainly an exchange of opinions which appeared to be based on assumptions and beliefs, and no one eventually succeeded in convincing the others of the validity of his own opinion [that one type of insurance was more efficient than the other]. Selvig, supra note 156, at 315. See Kimball, supra note 11, at 250 (stating that "[t]here is still a basic lack of accurate data available as to the relationship of freight and insurance rates to determine what the impact of a change in the existing liability regime would be."). Even if it were proven that one type of insurance is cheaper at the current level of volume that may not be helpful for other levels of volume.

\footnote{158} See Diplock, supra note 10, at 529-30.
consumer in the form of increased freight rates. A change of rules that expands the right of cargo to recover from the carrier should result in lower rates for cargo insurance as the cargo insurer experiences a higher level of recovery from the carrier. Simultaneously, however, the carrier's insurer will be paying out more on cargo claims and the cost of P & I will in turn rise. These increases can be expected to lead to an increase in freight rates that may or may not offset any savings gained by reduced cargo insurance rates.\(^{159}\)

Although many commentators agree,\(^{160}\) support is not universal.\(^{161}\) Empirical evidence may never provide the answer because it is virtually impossible to shift the allocation of liability while holding all other things constant.

One reason the market may not work effectively is the participation of carriers in shipping conferences where rates are mutually set.\(^{162}\) Conferences were originally formed to halt the tendency of carriers to over-supply the market, thereby drastically reducing profitability.\(^{163}\) It remains unclear whether the result of these conferences is to merely eliminate the natural tendency for cutthroat competition among carriers, or whether they go further to allow carriers to defeat the market's attempt to efficiently allocate resources.\(^{164}\) One view of the power of the conferences states as follows:

There is no doubt that organizations of carriers create power, and through cooperation, shipowners make greater profits . . . However, conferences cannot monopolize the route over which they operate because of lack of a right or a license or a privilege to serve exclusively the trade. New entries into the business are not restricted and alternative sources of transportation and routes are available to shippers who can also use alternative suppliers and goods. Competition from independent liners, competition from tramp, competition among conference members themselves and competition from similar cargoes that are shipped from different origins and also the possibil-

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\(^{159}\) See Kimball, supra note 11, at 249.

\(^{160}\) See, e.g., Secretary General, Responsibility of Ocean Carriers for Cargo – Bills of Lading, in 3 UNCTRAL Yearbook 295 (1972); Carl E. McDowell, Containerization: Comments on Insurance and Liability, 3 J. MAR. L. & COM. 503, 503-08 (1972); Mandelbaum, supra note 14, at 501 (stating that “[d]espite the shift of risk in the Hamburg Rules favoring shippers, it is always the shipper that ultimately pays for the loss.”); William Warren, The Red Hot Issue or Red Herring? Legal Liability and Cost of Cargo Insurance, 34 AM. SHIPPER 40 (1992); Selvig, supra note 156, at 315 (stating that “[t]he increase of these payments must result in a corresponding increase of the P & I premium and – as the liner freight rates reflect the carrier’s cost level – also in an increase of the freight rates.”); Yancey, supra note 128, at 1258; Sturley, supra note 114, at 147 n.116 (citing sources supporting the view that carriers must pass on their higher costs).

\(^{161}\) See Sturley, supra note 114, at 147 n.117 (citing sources that argue carriers may not pass on higher costs and stating that dependable empirical evidence is needed to settle the argument).

\(^{162}\) See HERMAN, supra note 27, at 15-16.

\(^{163}\) See supra note 28 and accompanying text.

\(^{164}\) See BENNATHAN & WALTERS, supra note 23, at 43.
 Liability For Cargo Damage

ity of the beginning of production of goods in a domestic market which cannot afford the cost of sea transport negate the conference's powers. And when the conferences set their prices they have to take into consideration the bargaining power of shippers' councils. The effect of all these factors substantially limits the conference's market powers.165

The economic effects of shipping conferences is beyond the scope of this article.166 Notably, if shipping conferences do give carriers monopolistic characteristics, the present system of mandatory liability allocation will not resolve this problem. If carriers have monopolistic powers, they can force a combination of more liability and higher rates on the shippers. To the extent that they cannot force liability, they will simply force higher rates. If shipping conferences are destructive, either the whole industry should be regulated, or measures must be taken to reduce the ability of carriers to defeat the market.

V. Conclusion

While COGSA certainly stands as an improvement over the general maritime law because of its increased uniformity, it still requires the consumption of a large amount of unnecessary transaction costs. A large portion of these costs derive from the fact that COGSA is a multiparty liability system, i.e., a system based on fault.167 This uncertainty leads to inefficiency in three ways. First, when loss occurs the parties often consume resources in disputing who should bear responsibility for the loss.168 The less clearly the lines of responsibility are drawn, the greater the dispute resolution costs. These costs become greater in the international context where many jurisdictions interpret the same text.

Second, this uncertainty leads to inefficient actions. The parties will take precautions based in part on their perceived liability for loss.169 To the extent that the parties misconceive their respective liabilities for loss, they will take either two many or too few precautions. Similarly, in situations where P & I clubs base calls and cargo insurers base premiums on the probability each will be likely for a given loss, over-insurance will result.170

165. See Herman, supra note 27, at 79.
166. For a discussion of the effects of shipping conferences, see Bennathan & Walters, supra note 23, at 43; Herman, supra note 27.
167. See supra note 141 and accompanying text.
168. I refer to these expenses as cost of dispute resolution. See supra text accompanying note 143.
169. Recall that a carrier will take precautions consistent with the probability of liability for cargo damage and probability of loss of business. It will attempt to take the amount of precautions that minimizes the sum of these costs plus the cost of the precautions. See supra note 136 and accompanying text.
170. See supra note 157 and accompanying text.
Finally, uncertainty leads to inefficiency where the parties are risk averse. The risk aversion of cargo owners is demonstrated by their willingness to procure cargo insurance. Cargo insurance premiums are based on the perceived probability of loss less the probability of recovery from the carrier's insurance club. To the extent that the probability of recovery is uncertain, the risk to the cargo insurer increases. The cargo insurer will demand a risk premium in order to assume this additional risk because it is also risk averse. This results in a shift of resources from the ocean trade industry to the marine insurance industry which, in turn, increases the costs of ocean trade.

The imposition of a strict liability system could reduce the vast majority of these costs. In fact, such a system has often been proposed. However, as stated earlier, such a regime would lead to other inefficiencies. A carrier would have to assess the probable value of the loss in order to take appropriate precautions, yet certain crucial information for making this calculation is not within the knowledge of the carrier.

An improved system would allow the parties to freely allocate liability amongst themselves. The market would then determine liability allocation based on who can most cheaply control the costs. An improved system would also avoid a multiple-party liability system and the attendant costs. One such improved system would allow the parties to freely allocate liability without regard to fault. For example, the law could allow the parties to allocate X percent of the loss up to Y amount to the carrier, with the shipper retaining the remaining liability. The carrier would provide a sliding rate schedule dependent upon the percentage of liability which it agreed to accept. In turn, the rates would depend on the cost to the carrier of procuring insurance. The shipper would compare the list of rates with the cost to it of cargo insurance (which would be based on the amount of liability accepted by the carrier) and choose the cheapest combination of freight and insurance.

To be sure that the carrier has adequate incentive to take precautions, new legislation could help ensure the market worked effectively. For example, carriers could be required to disclose all shipping accidents involving a certain level of cargo damage. As a result, shippers and cargo insurers could easily evaluate the precautions carriers take, and put pressure on them to take an optimal amount of precautions.

171. See Kimball, supra note 11, at 244 & n.166 (citing the consideration of a strict liability system is a convention on intermodal transport); Sturley, supra note 114, at 143 & 26, 27 (citing proposals and arguments in favor of imposing a strict liability regime on the carrier).

172. Disclosure is required by some jurisdictions of certain information. The Shipping Act of 1916 and the UNCTAD and CENSA Codes require carriers to publish tariffs. See Herman, supra note 27, at 43. In addition, the Shipping Act of 1984 requires disclosure of certain agreements between carriers and shippers.
Arguably, this system suffers from some inefficiency since the level of liability each party assumed would vary greatly among bills of lading. This lack of uniformity would require inspection of each bill of lading to determine the rights of the parties. Two responses serve to reduce this concern. First, any increase in resources used to examine non-uniform bills of lading would possibly be offset by a decrease in resources used to counter the uncertainty of ultimate liability. This non-uniformity will be much easier to address than the non-uniformity found in general maritime law where bills of lading contained various exceptions to carrier liability.\textsuperscript{173} Back then, it was necessary to scan each bill of lading to determine each exception and then project the consequences of each exception under the laws of various jurisdictions which could apply. Here, however, the laws of the various jurisdictions would be identical with the only variant being the percentage of loss insured by each party.

Second, after some trial and error, an industry custom would likely develop. The parties may find that it is most efficient for the carrier to assume a certain percentage of liability, and the standard practice would be to allocate that percentage to the carrier in most bills. It fact, it is possible that the percentage will vary depending on the nature of the cargo. For example, for cargo which is inherently susceptible to damage, it may become custom for the carrier to accept a lesser amount of liability than for cargo not so susceptible to damage. This reflects the fact that the shipper is more able to control the loss in the former situation. The end result may be that the market will settle on an equilized allocation of liability, which will become standard practice in the industry.

Additionally, P & I insurance and cargo insurance may converge. P & I insurance currently requires proof of fault in order to recover, but under this system, fault is no longer a basis for liability. P & I insurance will become much more like cargo insurance during the time the carrier is in control of the goods. If the insurance systems converge, liability allocation will ultimately be irrelevant because the parties will bargain over who pays the insurance premium. However, the premium will cost the same to either party and the cost will factor into the freight cost. This is exactly the result one would expect in an efficient system.


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.

\textit{Id.}
Canadian Perspectives on the Impact of the CMI Rules for Electronic Bills of Lading on the Liability of the Carrier Towards the Endorsee

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I. INTRODUCTION

In June of 1990, the International Maritime Committee\(^1\) adopted
rules governing electronic bills of lading.\(^2\) These rules, which parties
adopt on a voluntary basis, are intended to supplement national legis-
lation, which is still too strict with respect to evidence,\(^3\) and allow for
negotiation of a bill of lading in an electronic environment.\(^4\) The use
of electronic bills of lading is justified by the costs and risk of error
associated with the use of paper as well as the more rapid communication
of information such a vehicle allows. The idea of the electronic bill of lading
was contemplated during the 1980's. SeaDocs Registry Limited, a
company formed by Chase Manhattan and Intertanko, an association of oil
tanker operators, launched a system similar to that of the CMI, known as
the "SeaDocs Experiment."\(^5\) The Bolero Project,\(^6\) a consortium made up
of carriers, shippers, banks, insurers, and telecommunication companies
is even more recent than the CMI Rules.

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1. The international Maritime Committee office is in Belgium. It is made up of national
associations of maritime law from more than fifty countries.

2. Reprinted in Hugh M. Kindred, Trading Internationally by Electronic Bills of Lading, 7
BANKING & FINANCE L. REV. 265, 283 (1992); Documents, CMI Rules for Electronic Bills of
Lading, 22 J. M. L. & COM., [Hereinafter Rules].

3. See generally Kevin J. Kott, Addressing the Legal Problems of International Electronic
Data Interchange: The Use of Computer Records as Evidence in Different Legal Systems, 6 TEMP.
INT'L & COMP. L.J. 451 (1992); Christopher Nisoll, E.D.I. Evidence and the Vienna Convention,

4. See John Livermore & Kraeler Euarjai, Electronic Bills of Lading: A Progress Report,
28 J. MAR. L. & COM. 55 (1997); Richard Brett Kelly, Comment, The CMI Charts a Course on
the Sea of Electronic Data Interchange: Rules for Electronic Bills of Lading, 16 TUL. MAR. L.J.

5. For an interesting overview of the attempts prior to the SeaDocs Experiment, see Boris
Kozolchyk, Evolution and Present State of the Ocean Bill of Lading from a Banking Perspective,

6. See generally Diana Faber, Electronic Bills of Lading, LMCLQ 232, 242 (1996); Sharona
Tamor, Bolero Trade Steps, BANKER, Feb. 1995, at 72; Ken Cottrill, Banking on Electronic Ship-
CMI Rules are distinguished from the projects mentioned above as follows. Projects such as SeaDocs or Bolero are relatively closed. They are like a private club which pre-approves new members. In contrast, to join the CMI Rules, parties need only send in a contract. Second, in the other systems, all operations relating to the negotiation of goods in transit are contained in one central registry operated by an independent third party. Under the CMI Rules, each carrier has its own registry, which means that it is not forced to use technology or software compatible with a central registry or other "members." The CMI Rules appear to offer more flexibility.

The bill of lading constitutes a central aspect of an international sale. It is a document that the carrier remits to the shipper at the carrier's request.\(^7\) Although few laws in common law jurisdictions define "bill of lading,"\(^8\) it serves three essential functions: (i) a receipt for goods loaded onto a ship, (ii) a statement or evidence of a contract and, (iii) a title to the goods.\(^9\) Function three makes the bill of lading especially important in international maritime trade. Under the international system, possession of a bill of lading is equivalent to possession of the goods,\(^10\) giving title to the goods.\(^11\) For its holder, it constitutes title to the goods and may be negotiated, by endorsement and delivery,\(^12\) while the goods are in transit, thus operating as a symbolical delivery of cargo.\(^13\) A bank may use it as guarantee for the issuance of credit which is often necessary to finance a sale. Therefore, the same document is always negotiated by endorsement and delivery, which increases confidence in commercial trade.

The carrier normally remits goods to the person who has possession of the bill of lading and who presents him with the document at the destination port. The carrier initially remits documentation to the shipper, and the shipper then sends them the consignee of the goods - this is usually done by air. The consignee may then take possession of the goods only upon presentation of the bill of lading to the carrier. Although this is one of the simplest scenarios taking place, one can imagine problems

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8. Section 1-201(6) of the Uniform Commercial Code defines "bill of lading" as "a document evidencing the receipt of goods for shipment issued by a person engaged in the business of transporting or forwarding goods." Section 2041 of the Quebec Civil Code (L.Q. ch. 64 (1991)) defines it as "a writing, which evidences a contract for the carriage of property." See also Banks Act, S.C. ch. 46 § 425 (1991).
that would arise if goods arrived at the destination port before the documents – a purchaser could not claim goods intended for him. This major inconvenience slows down the speed of commercial trade and reduces the profitability of businesses involved either directly, or indirectly, in the transaction. It also causes storage costs to be incurred as well as port tie-ups. The situation becomes even more complex if paperwork were to go through several intermediaries, such as buyers and resellers of goods in transit, as is frequently the case in the petroleum industry.

International maritime business law can be viewed as a “law of document.” The transition from paper documents to electronic or computerized data (EDI) is, therefore, no simple task. In an electronic environment, the challenge is to make computerized data negotiable, in particular, securing its authentic and confidential nature so as not to diminish confidence in the international system. The CMI accomplished this task by instituting a system based on possession and issuance of a “Private Key,” which is a kind of personal identification number. Under this method, it is no longer possible for the seller of goods in transit to negotiate directly with the purchase without the knowledge of the carrier, as is currently the case. Instead of a paper document delivered by the carrier, the seller has a Private Key. However, breaking with tradition, the Rules prohibit the seller from negotiating the Private Key. The seller remits the key to the carrier, who delivers a new key to the person wishing to hold the right of control and transfer of goods. There is, therefore, one key in circulation and its holder is the only person that can claim goods from the carrier.

The carrier plays a major role in the transfer of the right to goods. As he is the only person issuing the Private Key, he necessarily acts as registrar for the transactions. Contrary to the Bolero project, which has one central registry operated by a third party, the CMI system has one register per ship. One wonders what obligations result for the carrier. These technical aspects are intimately linked to the security and reliability of the computerized systems. This essay does not address those points.

Rather, this essay addresses the relationships which, because of the role of intermediary taken on by the carrier, are created between the carrier and the new holder of the Right of Control and Transfer of the goods in transit. Will the new role of the carrier in the “negotiation” process of


the bill of lading create a new legal relationship between the carrier and the endorsee? Would this legal relationship be of a contractual nature? What would be the terms of contract? This last question is important because section 2 of the Bills of Lading Act,16 does not allow the endorsee (the new holder of the Private Key) in an action against the carrier, to invoke the contract of carriage between the carrier and shipper. These are the types of questions with which this essay deals. The purpose of this essay is to determine whether the CMI Rules could have an impact on the current legal framework governing the relationship between carrier and endorsee. It emphasizes the responsibility of the carrier because his traditional role is the one that dramatically changes.

II. THE NON-CREATION OF A RIGHT FOR THE ENDORSEE TO SUED THE CARRIER BASED ON THE TRANSPORTATION CONTRACT

A. THE EXCEPTIONAL CHARACTER OF THE ENDORSEE'S RIGHT TO SUE ON THE BASIS OF THE TRANSPORTATION CONTRACT UNDER THE CURRENT BILLS OF LADING ACT

1. A Literal or Restrictive Interpretation of Section 2 of the Bills of Lading Act

Generally speaking, the endorsee is not a party to the contract of carriage entered into by the seller and carrier. Section 2 of the Bills of Lading Act17 stipulates that the endorsee cannot institute an action against the carrier based on the contract of carriage. This provision is based on the doctrine of “privity of contract,” which describes the relationship existing between two contracting parties and provides that only parties to the contract can invoke it.18 Generally, the endorsee is not a party to the contract, which arises between shipper and carrier.19 Section 2 of the Act provides an exception. It allows the endorsee to sue the carrier based on the contract of carriage if he proves that he acquired title on or by reason of endorsement. In other words, the endorsement must cause the transfer of property.20 The provision reads as follows:

2. Every consignee of goods named in a bill of lading, and every endorsee of a bill of lading to whom the property in the goods therein mentioned passes on or by reason of the consignment or endorsement, has and is vested with

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17. Id.
all rights of action and is subject to all liabilities in respect of those goods as if the contract contained in the bill of lading had been made with himself.

It is important to note the exceptional character of the endorsee's right of action against the carrier. The expression "to whom the property in the goods therein mentioned passes on or by reason of the consignment or endorsement" must be examined. What happens if the property passes before or after endorsement? A literal interpretation of the article leads to the conclusion that the right to sue between the endorsee and the carrier is only possible if the property passes at the time of the endorsement.

Canadian jurisprudence does not seem to have difficulty confirming a restrictive or literal interpretation of section 2 as British courts have done on occasion. The words of Honorable Judge Kerwin, speaking for the majority in The Ins. Co. of North America v. Colonial Steamships Ltd., are very clear in this respect:

It is not every endorsee who by reason of this section is vested with the rights of action in respect of the goods mentioned as if the contract contained in the bill of lading had been made with himself. It is only an endorsee to whom the property in the goods passed upon or by reason of the endorsement. Sewell v. Burdick.

If, as proposed by the CMI, a literal interpretation prevails in the electronic environment, the stakes for the carrier are high. The purchaser cannot take advantage of the contract of carriage in an action against the carrier where the purchaser in his capacity as endorsee or holder of the new Private Key, is not given property "on or by reason of the endorsement." The only recourse left to the purchaser in such a situation is to argue that the transfer rights process provided by the CMI is, on one hand, the equivalent of a traditional endorsement, but on the other hand,

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23. Id. at 364.
causes title to pass simultaneously. In other words, could the process of transferring rights affect the exceptional character of the right to sue provided for in section 2 of the Act, such that the new purchaser of the goods and holder of the Private Key could invoke the contract of carriage against the carrier each time? As shown in the next section, this question is answered in the negative.

2. The CMI Rules

One purpose of the CMI Rules is to preserve the function of title to goods attributed to the bill of lading which, as a result, allows the document to be negotiated. To do this, the system is based on the use of a Private Key, a sort of personal identification number that allows each transmission to be authenticated. Instead of the traditional paper bill of lading, the carrier issues the Private Key to the shipper of goods. As with the holder of a paper bill of lading, only the holder of the Private Key can claim delivery or give instructions to the carrier.

This method of negotiation breaks with tradition in that it requires participation of the carrier. Traditionally, a bill of lading is negotiated by endorsing and delivering the document. This operation gives the endorsee the right to claim the goods from the carrier, the bill of lading constituting title to goods. Under the CMI, the Private Key, contrary to the paper bill of lading, is unique to each successive holder and is not transferable, as only the carrier is authorized to issue it. The carrier therefore is involved in the negotiation process every time a bill is negotiated. This process is described in article 7b of the Rules:

b. A transfer of the Right of Control and Transfer shall be effected: (i) by notification of the current Holder to the carrier of its intention to transfer its Right of Control and Transfer to a proposed new Holder, and (ii) confirmation by the carrier of such notification message, whereupon (iii) the carrier shall transmit the information as referred to in article 4 (except for the Private Key) to the proposed new Holder, whereafter (iv) the proposed new Holder shall advise the carrier of its acceptance of the Right of Control and Transfer, whereupon (v) the carrier shall cancel the current Private Key and issue a new Private Key to the new Holder.

This method is substituted for the traditional method of endorse-

24. Article 2f of the Rules defines “authenticated” as “any technically appropriate form, such as a combination of numbers and/or letters, which the parties may agree for securing the authenticity and integrity of a transmission.” Kindred, supra note 2.
25. Id.
26. Id.
ment. Operations relating to the transfer right of goods hinge on the carrier. In addition to acting as registrar, there is a new relationship with the endorsee, the legal nature of which merits study. The question arises whether the new relationship between the carrier and endorsee gives the carrier a right of action based on the contract of carriage. The following discussion suggests, however, that the new holder of the Private Key, in capacity of purchaser and "endorsee," cannot take advantage of the contract of carriage and therefore cannot invoke it in an action against the carrier.


1. The Absence of a Causal Link Between the Transfer of Property and the Transfer of the Right of Control and Transfer

The preceding analysis demonstrated that section 2 of the Act refers implicitly and indirectly to the rules on the transfer of property applicable to individual cases. To measure the impact of the CMI Rules on the situation just described, one must ask the following question: if section 2 of the act is interpreted literally, does the system introduced by the CMI create a causal link between the process of transferring rights and the transfer of property? If so, the new holder has a right of action against the carrier. If not, the parties simply refer to the jurisdiction they decided on or which otherwise applies to the transfer of property. An examination of the CMI Rules concludes that reference must be made to the jurisdiction determined by the seller and purchaser in the contract of sale underlying the contract of carriage. The CMI Rules are examined first because they were expressly chosen by the parties and therefore constitute the first source of law.

The relevant provisions are found in article 7:

7. Right of Control and Transfer
   a. The Holder is the only party who may, as against the carrier:
      (i) claim delivery of the goods;

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29. Kindred, supra note 2, at 275-76. But cf. Boris Kozolchyk, The Paperless Letter of Credit, 55 LAW & CONTEMP. PROBS. 84, 91 (1992). Reflecting on the reason such a system exists, it is easy to understand that the carrier is less reticent to deliver goods to the holder of a code he issued and where he is the only one able to do so (analogous to the paper bill of lading that comes from a single source), rather than to someone who presents him with a simple print-out of a transaction carried out electronically between seller and purchaser. Even if such a print-out were admissible as evidence under a general treaty on EDI's, the number of possible sources of this print-out decreases confidence in the use of an electronic bill of lading. In short, everyone wants assurance that they are carrying out unique and concrete transactions.
(ii) nominate the consignee or substitute a nominated consignee for any other party, including itself;
(iii) transfer the Right of Control and Transfer to another party;
(iv) instruct the carrier on any other subject concerning the goods, in accordance with the terms and conditions of the Contract of Carriage, as if he were the holder of a paper bill or lading.

b. A transfer of the Right of Control and Transfer shall be effected: (i) by notification of the current Holder to the carrier of its intention to transfer its Right of Control and Transfer to a proposed new Holder, and (ii) confirmation by the carrier of such notification message, whereupon (iii) the carrier shall transmit the information as referred to in article 4 (except for the Private Key) to the proposed new Holder, whereafter (iv) the proposed new Holder shall advise the carrier of its acceptance of the Right of Control and Transfer, whereupon (v) the carrier shall cancel the current Private Key and issue a new Private Key to the new Holder.

c. If the proposed new Holder advises the carrier that it does not accept the Right of Control and Transfer or fails to advise the carrier of such acceptance within a reasonable time, the proposed transfer of the Right of Control and Transfer shall not take place. The carrier shall notify the current Holder accordingly and the current Private Key shall retain its validity.

d. The transfer of the Right of Control and Transfer in the manner described above shall have the same effects as the transfer of such rights under a paper bill of lading.

As the section heading suggests, the holder only has a right of "control and transfer." Reference is made neither to the right to property nor to the right of action against the carrier, except for the right to claim goods. At first glance, it seems that the CMI left it to the parties to settle questions as to transfer of the right of property. Note that paragraph 7d states that the effects shall be the same as under a paper bill of lading. It was mentioned in the previous section\(^30\) that due to the wording of section 2 of the Act, the negotiation of a bill of lading does not always result in the simultaneous transfer of property. In this respect, the remarks of Professor William Tetley are relevant when he confirms that: "[b]ills of lading acts were adopted not to decide when risk or title passed but to transfer the shipper's contractual rights against the carrier to the consignee and also to third parties."\(^31\) Paragraph 7d, giving full effect to section 2 of the Act, suggests a referral to external rules relating to property.

Such an interpretation is confirmed by article 6 of the CMI Rules, stating that "[t]he Contract of Carriage shall be subject to any international convention or national law which would have been compulsorily applicable if a paper bill of lading had been issued." This provision brings out the essence/goals of the CMI Rules, saving the three essential functions of the bill of lading and, as a whole, providing for its negotiability in an

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\(^{30}\) See supra p. 5.

electronic environment. This is in response to problems arising from the use of EDI's in international trade; these problems have repercussions on maritime transport. This goals can be attained without upsetting rules relating to property which are not national nor international problems. The next section is therefore devoted to the examination of these rules as they are ordinarily applied. The general rules provide that property is transferred according to the wishes of the parties, and endorsement cannot be assimilated to the transfer of property.

2. Maintaining the Rule of Free-Will in Determining When Property Passes When Endorsement Occurs in Transit

In international sales, the parties choose which law governs conflict, except where an international convention must be followed. On the specific question of transfer of property, the Vienna Convention\(^32\) does not offer guidelines. Therefore, recourse is made to the rules of the jurisdiction agreed on by the parties. In common law and civil law countries, the parties determine when property passes unless determination is against public order or legislative provision. The transfer of property between seller-endorser and purchaser-endorsee of goods sold in transit is subject to the contract of sale, not the time of endorsement, even if the transfer of risk occurs instantaneously.\(^33\) Section 2 of the Act, as applied by the courts, implies that transfer of property can take place either before or after endorsement.

Cases may arise where parties have not clearly stipulated the time of transfer; for example, where a clause stipulates “f.o.b. Vancouver” without any express referral to the time property is transferred. One cannot rely on the \textit{Incoterms}\(^34\) as defined by the International Chamber of Commerce because they deal mostly with transfer of risk, not transfer of property. A few times, Canadian courts were asked to determine the time when property was transferred when the contract only stated “f.o.b.” a destination port. Consignment generally resulted in the transfer of property, giving rise to the consignee’s recourse under section 2 of the Act. Can the same be said for endorsement?

In the case of \textit{Paterson Steamships Ltd. V. Aluminum Co. of Canada Ltd.}\(^35\), the appellant claimed that the respondent did not acquire title to goods as a result of consignment and, therefore, had no right to sue. The


\(^{33}\) Article 68 of the Vienna Convention decrees that when goods are sold in transit, the risk passes to the purchaser upon formation of the contract. This convention does not deal with the transfer of property.


words of Honorable Judge Rand, while suggestion application of a literal interpretation, give a satisfactory reply to the question of when the transfer of property takes place in a f.o.b. contract:

The respondent is therefore the named consignee; and that title to the bauxite passed to it on the consignment is equally clear. It is mere trifling with the facts to suggest anything else. "Consigning" goods is delivering them to a carrier who accepts them as initiating his obligation to carry and deliver. The bill of lading is to evidence the terms of the undertaking and operate as a document of title. Whether it is issued five seconds or five hours after the last pound has been stowed is immaterial; in either case it takes effect as from the moment of the commencement of the duty of the carrier as such. The title passes to the purchaser when the goods have been committed to the vessel for the journey; that is, it has passed on the "consignment" and the requirement of the Bills of Lading Act has been satisfied.36 [Emphasis added.]

The Court's reasoning is based on two premises. First, the transfer of property takes place when goods are loaded. Second, the loading of goods constitutes "consignment." As a result, unless indicated otherwise, almost all f.o.b. contracts give the consignee recourse under section 2 of the Act.38 In Canadian law, the consignment and transfer of property are simultaneous in a f.o.b. contract.

This situation does not, however, apply to endorsement. There is no implied simultaneous endorsement and transfer of property. When dealing with consignment, courts have inferred the will of the parties to pass title to respective interest as soon as goods cross the rail of the ship. This position might be based on two facts. First, risk is transferred as soon as goods cross the rail. Second, the seller, who is beneficiary of an irrevocable credit, claims payment immediately after loading, when the carrier gives him the bill of lading stipulated in the credit conditions; knowing he will be paid, the seller no longer has an interest in retaining property to


37. Loading goods onto a ship does not always transfer title, even though the risk may be transferred. For example, when a chose du genre is sold, property is only acquired at the time the thing is individualized, which only happens once the goods arrive at their destination. This is also the case of the contract containing a clause whereby the seller retains title. Thus, even if the purchaser assumes the risk from the time the goods are loaded, should the goods arrive damaged, based on section 2 of the Act, he would have no recourse against the carrier, even in his capacity as consignee or endorsee. See e.g., Leigh & Sillavan Ltd. v. Aliakmon Shipping Co. Ltd. The Aliakmon, 2 All E.R. 145 (Eng. C.A. 1986); see also, The Aramis, 1 Lloyd's Rep. 213 (Eng. C.A. 1989). This situation benefits the carrier in two ways. First, the carrier does not have to worry about which party might sue him, and second, the purchaser assumes any loss or damage.

the goods.\textsuperscript{39}

According to the Supreme Court, if loading goods is the equivalent of consignment, it cannot be the equivalent of endorsement because when endorsement occurs, the goods have been loaded for some time. The \textit{Incoterms} are especially aimed at determining the sharing of risk before and after intervention of the carrier; it is an important moment in an international transaction culminating when the goods cross the ship's rails. As a result, the \textit{Incoterms} are less useful in determining when title to goods in transit passed. As for the CMI, this system adds nothing new to applicable rules. The main novelty is that the carrier knows the identity of each endorsee. This does not prevent the terms of a contract of sale of goods in transit, including the transfer of property, from continued governance by rules that previously applied. Unless there is a rule of law that endorsement transfers title, the will of the parties apply. In common law, endorsement alone is not enough to transfer title. The dichotomy of the transfer of property and endorsement is clearly stated in the well-known case of \textit{Lickbarrow v. Masson},\textsuperscript{40} rendered over two centuries ago:

A bill of lading is the written evidence of a \textit{contract for the carriage and delivery} of goods sent by sea for a certain freight. . . . The general property remains with the shipper of the goods, until he has disposed of it by some act \textit{sufficient in law to transfer property}. The endorsement of the bill of lading is simply a direction of the delivery of the goods. When this endorsement is in blank, the holder of the bill of lading may receive the goods, and his receipt will discharge the shipmaster; but the holder of the bill, if it came into his hands casually, without any just title, can acquire no property in the goods.\textsuperscript{41} [Emphasis added.]

British jurisprudence changed despite the adoption in 1855 of section 1 of the Bills of Lading Act 1855.\textsuperscript{42} \textit{Sewell v. Burdick}\textsuperscript{43} rendered at the end of the nineteenth century, became the main authority for the literal interpretation of section 1 of the Bills of Lading Act. The court expressed itself as follows: "[n]ow the truth is that the property does not

\textsuperscript{39} The following words of Professor Treitel should be noted, [p]assing of property under c.i.f. contracts commonly occurs on transfer of shipping documents, including a bill of lading, against payment of price. Property passes at this point, not because there is any rule of law to this effect, but because of an inference as to the intention of the parties, and in particular as to the intention of the seller: it is assumed that he would intend to retain the property, until payment, by way of security for that payment.

\textsuperscript{40} G.H. Treitel \textit{Passing Property Under C.I.F. Contracts and the Bills of Lading Act 1855}, LLOYD'S MAR. & COM. L. Q. 1, 2 (1990) (referring to \textit{Benjamin's Sale of Goods} ¶ 1690 (3rd Ed. 1987)).


\textsuperscript{42} \textit{See supra} note 21.

\textsuperscript{43} [1884] 10 App. Cas. 74.
pass by the endorsement, but by the contract in pursuance of which the endorsement is made." The position adopted by the Court was not set aside until the British Parliament replaced it in 1992.

Canadian jurisprudence is to the same effect. As an illustration, note the following words of the Manitoba Court of King's Bench in Bedard v. Spencer Grain Co.: [Emphasis added.]

The authorities I have cited seem to me quite clear that as between the shipper and the endorsee of a bill of lading, the intention of the parties must govern the rights conferred by an endorsement, and that unless the shipper by his agreement with the endorsee intended, when he endorsed the bill of lading, that the property in the goods should pass absolutely out of him to the endorsee, such a property did not pass merely by the manual act of endorsing and delivering the bill of lading.

The moment property passes is determined by either the intention of the parties expressed in the contract of sale, or by legislation; endorsement alone does not transfer property. In addition, the terms of section 2 of the Act imply that the question of the transfer of property is completely separate from that of endorsement, as they anticipate the possibility of endorsement without transfer of property, the Act not dealing with the rules on the transfer of property.  

This analysis demonstrated that endorsement must be separated from the question of transfer of property, the latter being up to either the parties contracting, or the legislator. The CMI Rules do not alter this situation; at the time of transfer-endorsement, the question of transfer of property is already settled by the principal contract according to the intention of the parties - independently of carrier intervention in the process. Therefore, in response to the initial question, the CMI Rules do not result in the creation of a causal link between the transfer of rights and the transfer of property so that the exceptional character of the recourse provided for in section 2 of the act is preserved. However, there is nothing to stop the new purchaser in his capacity as endorsee from giving himself the opportunity to eventually sue the carrier under section 2 of the Act; the purchaser-endorsee can stipulate in the contract of sale that transfer of property took place at the time the carrier issued the purchaser the Private Key under article 7b of the Rules. Property is therefore passed “on or by reason of the endorsement.”

44. *Id.* at 105.
46. *Id.* at 730.
48. These arrangements are impossible where the legislator does not give the parties the right to determine when property is transferred, as is the case when the goods must be individualized before there can be a transfer of property.
III. TOWARDS A REDEFINITION OF THE LIABILITY OF THE CARRIER TOWARDS THE ENDORSEE UNDER THE CMI RULES

A. POSSIBLE FORMATION OF A BRANDT V. LIVERPOOL Contract

As discussed earlier, section 2 of the Bills of Lading Act provides that the carrier and new holder cannot invoke the contract of carriage against each other unless property in the goods passed on or by reason of the transfer of the right of control and transfer. However, the courts already allowed a right of action despite the absence of the condition relating to the transfer of property under the terms of the contract of carriage pursuant to the theory of an implied contract, commonly called the "Brandt v. Liverpool" contract. The implied contract appeared in England as a desirable solution in maritime law. It allowed parties to circumvent the literal interpretation of the first section of the Bills of Lading Act of 1855 which reflected a strict adherence by the courts to the privity of contract doctrine. The formation of such a contract depends on particular facts that arise at some point between the carrier and the endorsee. One may ask whether the CMI Rules, which imply a direct relationship between the carrier and endorsee, can give rise to the application of the theory of implied contract.

The Brandt v. Liverpool decision is the modern authority for this theory. In this case, the carrier delivered to the shipper a bill of lading which read "Apparent good order and condition." The goods, bags of zinc ashes, arrived at the destination port both late and in less quantity than indicated in the bill of lading. Meanwhile, its market price decreased causing damage to the plaintiff and endorsee that held the bill of lading in warranty against the purchaser of funds used to finance the purchase. The goods were delivered and accepted by the plaintiff in consideration for which the bill of lading and freight were delivered and paid to the carrier. The plaintiff could not validly base his recourse on section 1 of the Bills of Lading Act of 1855 since, even though he was endorsee, he did not have title to the goods on or by reason of the endorsement. In fact, he never acquired title to the goods. The action was nevertheless granted on the basis of an implied contract between the plaintiff and the carrier. The following words of Lord Judge Bankers indicate the position taken by the Court of Appeal:

50. Id.
52. Supra note 49.
By those authorities it has been clearly established that where the holder of a bill of lading presents it and offers to accept delivery, if that offer is accepted by the shipowner, the holder of the bill of lading comes under an obligation to pay the freight and to pay the demurrage, if any, and there are general expressions in all those three cases, I think, in which the learned judges have said that the contract so made by that offer and acceptance covers, so as to include, the terms of the bill of lading. In my opinion in this particular case the contract must include the terms and conditions of the bills of lading and for this reason. In this case the bill of lading holder offered the freight before the goods were delivered; and in fact paid it, and under those circumstances it seems to me that by acceptance of the freight and the subsequent delivery the shipowners undertook an obligation to deliver the goods as described in the bill of lading. I think from the shipowner's point of view it must necessarily include the whole of the terms of the bill of lading, because he must desire that he should be covered by the exception in the bill of lading. I think, therefore, that the learned judge is right when he states his conclusion that on the facts in this case it is sufficient to say there was a promise by the shipowners to deliver the goods to Brandt & Co. in the condition in which they ought to be delivered under the bill of lading.¹⁵³

A contract, the terms of which appear on the bill of lading, can therefore be inferred when the carrier delivers the goods in exchange for the document.

In The Aramis¹⁵⁴, the Court of Appeal of England had another chance to look into the theory of implicit contract. Judge Lord Bingham suggested the following questions.

The questions to be answered are, I think, twofold:

1. Whether the conduct of the bill of lading holder in presenting the bill of lading to the ship's agent would be reasonably understood by the agents (or the shipowner) as an offer to enter into a contract on the bill of lading terms.
2. Whether the conduct of the ship's agent in accepting the bill or the conduct of the master in agreeing to give delivery or in giving delivery would be reasonably understood by the bill of lading holder as an acceptance of his offer.¹⁵⁵

Thus, according to the jurisprudence, the circumstances surrounding the formation of such a contract are a de facto relationship between the carrier and the endorsee arising at the destination port as the only place where delivery may take place. In an environment proposed by the CMI, such a de facto relationship arises not only at the destination port, but also, at sea while the goods are in transit. In the latter case, the goods cannot be delivered and the bill of lading cannot be presented. Thus, judging only by this distinction, one must conclude that the Brandt v. Liv-

¹⁵³. Id. at 589-90.
¹⁵⁵. Id. at 224.
eralpools\textsuperscript{56} contract theory does not apply due to the participation of the carrier in the transfer of the Right of Control and Transfer under the CMI.

It should be noted that the Court of Appeal refers to general principles of the formation of contracts. Thus, if the offer, acceptance, intention to contract, and any other consideration exist while the goods are in transit, one may ask whether a \textit{Brandt v. Liverpool}\textsuperscript{57} contract is formed when the rights are transferred under the CMI, the time at which the carrier and endorsee first communicate with each other. On this point, reference may be made to the terms of article 7b of the Rules:

b. A transfer of the Right of Control and Transfer shall be effected: (i) by notification of the current Holder to the carrier of its intention to transfer its Right of Control and Transfer to a proposed new Holder, and (ii) confirmation by the carrier of such notification message, whereupon (iii) the carrier shall transmit the information as referred to in article 4 (except for the Private Key) to the proposed new Holder, whereafter (iv) the proposed new Holder shall advise the carrier of its acceptance of the Right of Control and Transfer, whereupon (v) the carrier shall cancel the current Private Key and issue a new Private Key to the new Holder.

The transmission by the carrier (iii) is similar to an offer and may be considered as such. Note that “acceptance” is required from the proposed holder (iv) or, if one prefers, from the endorsee. By analogy with the questions asked by Judge Lord Bingham in \textit{The Aramis}\textsuperscript{58}, one may first ask whether the conduct of the carrier, when he transmits information to the proposed holder, may reasonably be seen as an offer to enter a contract based on the information transmitted. One must then ask if the conduct of the proposed holder, in accepting the transfer of rights, may reasonably be seen to be an acceptance of an offer to enter a contract by the carrier. In this respect, the following comments of author Diana Faber\textsuperscript{59} on the Bolero project\textsuperscript{60} are relevant:

Such a solution may be found as a consequence of the communication between the parties which is involved in an electronic bill of lading system and which is not found when paper bills are being used. The participants in the Bolero project do not claim to be involved in business process re-engineering and state that they are trying to establish the exact electronic equivalent of a paper bill. They have, however, introduced a system under which the carrier is involved in the “endorsement” of the electronic bill to subsequent holders. The registry which receives and passes on the messages which effect the transfer of the right of control is the agent of the carrier. It may be that

\textsuperscript{56} Supra note 49.
\textsuperscript{57} Supra note 49.
\textsuperscript{58} Supra note 54.
\textsuperscript{59} Faber, supra note 6.
\textsuperscript{60} Tamor, supra note 6.
as a result a new legal relationship is created between the carrier and the 
new holder. The effect of the messages may be said to be an attornment or 
promise to deliver he goods to the new holder or in accordance to his new 
instructions. Since the carrier also transmits the full bill of lading message 
which contains, or contains reference to, his terms and condition, it could be 
said that there is an attornment on the terms and conditions of the contract 
of carriage. The effectiveness of the holder's right of action would depend 
on the court finding contractual intent and consideration.61

The presence of an intention to enter a contract and give consider-
ation is more obvious in a situation where, in an electronic environment, 
the business relations between the carrier and the “proposed holder” oc-
cur when the goods are in transit as opposed to cases such as those in 
Brandt v. Liverpool62 and The Aramis63, where these same relations only 
occur at the destination port. In the latter case, the respective obligations 
of the parties are practically fulfilled. This is different from the first case, 
where the parties continue to worry whether the obligations will be com-
pletely and properly fulfilled. As an aside, the respective advantages 
gained from a sale in transit are greater.

The possibility of a Brandt v. Liverpool64 contract being formed is, 
however, lessened by the following words of Judge Lord Bingham in The 
Aramis65, on the question of behavior of parties and the intention to 
enter a contract. These words are further to his test or reasoning in the 
two questions studied above:66

I do not think it is enough for the party seeking the implication of a contract 
to obtain “it might” as an answer to these questions, for it would, in my view, 
be contrary to principle to countenance the implication of a contract from 
conduct if the conduct relied upon is no more consistent with an intention to 
contract than with an intention not to contract. It must, surely, be necessary 
to identify conduct referable to the contract contended for or, at the very 
least, conduct inconsistent with there being no contract made between the 
parties to the effect contended for. Put another way, I think it must be fatal 
to the implication of a contract if the parties would or might have acted exactly 
as they did in the absence of a contract.67 [Emphasis added.]

Applied to paragraph 7b, the above reasoning allows the argument 
that one cannot infer the formation of a contract because the parties’ 
conduct is, in effect, imposed on by the terms of this paragraph. Despite

61. Faber, supra note 6, at 243.
62. Supra note 49.
63. Supra note 54.
64. Supra note 49.
65. Supra note 54.
66. See supra text p. 18.
67. Supra note 54, at 224. Accord Mitsui & Co. Ltd. v. Novorossiysk Shipping Co. (The 
the existence of an offer and acceptance, the parties behave exactly the same way as they do in the absence of a contract.68

However, in applying paragraph 7b, the above reasoning of Judge Lord Bingham lets us see the situation in a different light. According to the Court of Appeal, the intention to enter a contract is at the heart of implied contract theory. CMI Rules are not legally binding; parties must agree to them. Moreover, for paragraph 7b to apply, the carrier and proposed holder must agree at some point to be governed by this provision. When they express desire to abide by the Rules, they are therefore fully aware of the offer and acceptance provisions contained therein.

The question arises whether by expressing desire, the carrier and proposed holder indicate their intention to be bound contractually every time rights are transferred. It is conceivable that the reason the carrier agreed to be bound by the CMI Rules and invest in the purchase of necessary equipment for the transmission, management, and confidentiality of the terms of the bill of lading, was to keep an eye on any new purchaser and holder of the Private Key and, should he be sued by the latter, invoke the exceptions contained in the bill of lading. Similarly, the proposed holder may wish to create a contractual relationship with the carrier, allowing him to avoid section 2 of the Bills of Lading Act should the goods arrive damaged or late.

The above remarks are along the same lines as the following words of Professor George F. Chandler III:69

Such a system would make the carrier privy to each transfer, unlike the existing system in which the carrier usually does not learn of the identity of the last holder of the bill of lading until that holder presents it. It was felt that some companies could have concerns about the privacy of some trades, but not so many as to overcome the net benefit of such a system, which would put the carrier in privity of contract with each holder.70

Such an application of the Rules allows financial institutions to sue the carrier irrespective of the question of the passing of property, sine qua non condition imposed by section 2 of the Act. To this effect, reference may be made to the famous case Sewell v. Burdick,71 where the terms of section 1 of the Bills of Lading Act 1855 prevented the carrier from suing the bank because the latter only became holder of the bill of lading in order to give himself a guarantee and not to become holder of the goods.72 The financial institution only has to become holder of the Pri-
vate Key under paragraph 7b of the Rules in order to have a right to sue under section 2 of the Act. Note that paragraph 7b of the Rules does not allow the carrier to oppose transfer of rights nor does it give him any discretion in the choice of proposed holder.

Liability of the carrier is similar to that of a “mandatory”; liability is limited to acting as intermediary between the purchaser and seller. Thus, as long as acting within limits of his mandate, the carrier is not contractually liable because he is not acting in his own name. The question arises: in whose name does the carrier act; the seller’s or both? A review of article 7b concludes that the carrier acts as mandatory for both purchaser and seller, in which case the fault of the carrier when rights are transferred is a breach of contract either towards the purchaser or seller, depending at which state of the transfer process fault occurs.

The purchaser, a speculator in a hurry, accepts the offer of another person at a higher price. In this case, the only person whom the carrier is liable to is the purchaser. In fact, damage incurred by the seller is not linked to fault of the carrier but instead to that of the purchaser; the purchaser who acquired title to the goods by virtue of the contract of sale that is independent of the endorsement or transfer. The purchaser fulfills his corresponding obligation, which is to pay the price. The seller’s recourse should be against the purchaser and not against the carrier. As for the purchaser, he can sue the carrier for damages suffered, amounting to the difference between amount paid for the goods and that which should appear in the electronic transmission representing the terms of the contract with the initial seller.

One may conclude from this subsection that the nature of the new relationship between carrier and endorsee, the proposed holder of the Private Key, may be attacked by contractual liability. Creation of such a relationship is problematic. Although some authors want to see the existence of privity between the carrier and new holder of the Private Key, the principles developed in Brandt v. Liverpool\(^{73}\) and subsequent jurisprudence, mitigate such a possibility to a certain extent. The formation of a contract is nevertheless possible provided that certain elements are present: offer, acceptance, intention, and consideration. The circumstances of each particular case are important. Finally, one may consider the exist-

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\(^{73}\) \textit{Todd, Actions by Banks Against Carriers – an Update of the Tort Position}, 2 JIBL 127 (1986). Section 435 of the Banks Act, \textit{supra} note 8, provides that property transfers automatically in favor of a bank if the latter holds the bill of lading as security for a debt of which it is the creditor:

“(2) Any warehouse receipt or bill of lading acquired by a bank under subsection (1) vests in the bank, from the date of acquisition thereof, (a) all the right and title to the warehouse receipt or bill of lading and to the goods, wares and merchandise covered thereby of the previous holder or owner thereof . . . .” \textit{See also} \textit{Ian G. Baxter, Law of Banking} 151-52 (1992).

\(^{73}\) \textit{Supra} note 49.
ence of a contractual relationship according to the rules applying to mandates. The actual functioning of the system established by the CMI appears to make the carrier the mandatory of the seller and purchaser. In any event, it would certainly represent an increase in the obligations of the carrier compared to his traditional situation.

B. INCREASE IN THE OBLIGATIONS OF THE CARRIER UNDER SECTION 4 OF THE BILLS OF LADING ACT

1. The Private Key as Conclusive Evidence of Shipment

When delivering the bill of lading, the carrier risks liability as to both the presence of goods on board ship and the state of goods indicated in the bill of lading. Section 4 of the Act provides that the bill of lading constitutes "conclusive evidence" that the goods mentioned therein are shipped. This provision reads as follows:

4. Every bill of lading in the hands of a consignee or endorse for valuable consideration, representing goods to have been shipped on board a vessel or train, is conclusive evidence of the shipment as against the master or other signing the bill of lading, notwithstanding that the goods or some part thereof may not have been shipped, unless the holder of the bill of lading has actual notice, at the time of receiving it, that the goods had not in fact been laden on board, or unless the bill of lading has a stipulation to the contrary, but the master or other person so signing may exonerate himself in respect of such misrepresentation by showing that it was caused without any default on his part, and wholly by the fault of the shipper or the holder, or some person under whom the holder claims.

Paragraph 7b of the CMI Rules forces the carrier to retransmit information contained in the register to the proposed holder of the Private Key. If, by error, any such transmission does not correspond to the actual state of goods on board the ship, and the proposed holder accepts the right of control and transfer based on such information, the latter will, according to section 4 of the Act, constitute conclusive evidence against the carrier. Thus, the new purchaser could claim the amount of goods described in the electronic transmission even if a lesser quantity was loaded on board ship. Here, the impact under the CMI Rules is an increase in the carrier's obligations because of potential liability every time rights are transferred.

2. Increase in the Burden of Proof Relating to the Means of Exoneration

In case of a transmission error by the carrier, one could ask whether the carrier's more active role has an impact on the means of exoneration available under section 4 of the Act. The carrier may exonerate himself
in respect of such misrepresentation by showing that it was caused without any default on his part, and wholly by the fault of the shipper or the holder. Section 4 of the Act does not distinguish between a voluntary or involuntary misrepresentation.\textsuperscript{74} An involuntary misrepresentation is, for example, a misrepresentation resulting from fraud on the part of the loader of which the carrier is unaware.

Suppose an electronic bill of lading indicates that 189 containers of coffee were loaded but in actuality only 168 were loaded. Suppose further that this situation results from fraud on the part of the seller. The transfer of rights to a subsequent purchaser takes place according to two hypotheses depending on whether or not the carrier’s misrepresentation is voluntary. In the first hypothesis, the carrier becomes aware of the situation and, when transferring the information to the subsequent purchaser, he indicates that 189 boxes will be delivered. Here, the misrepresentation is voluntary or, at least, known to the carrier. The purchaser accepts and the transfer of rights takes place. At the port, the purchaser, as endorsee or holder of the Private Key, demands the 189 boxes and the carrier tells him that he can only deliver 168. In court, the endorsee claims that the bill of lading, the electronic transmission in this case, constitutes conclusive evidence within the meaning of section 4 of the Act. Under the same section, the carrier claims that he only retransmitted the information that the shipper gave him, therefore the misrepresentation is that of the shipper. The carrier thereby alleges that the misrepresentation was caused wholly by the fault of the shipper.

The second hypothesis arises when a carrier in good faith transmits information fraudulently transmitted by the loader. This is the case where the misrepresentation is involuntary. The purchaser accepts and the transfer takes place. The court investigation demonstrates that the carrier was a victim of fraud and that it was realized at the destination port when the purchaser claimed the goods. As in the previous hypothesis, the purchaser argues that of conclusive evidence, and the carrier argues that the misrepresentation was caused by the shipper’s fault.

In these hypotheses, the carrier pleads that his obligation is limited to re-transmitting the information contained in the computer file. If this initial information turns out not to correspond with the actual state of goods on board ship due to the shipper’s false declaration, he should not suffer consequences.\textsuperscript{75} This raises the question as to whether, in the strict

\textsuperscript{74} Such a distinction exists in insurance law as well as banking. It appears in section 565(1) of the Banks Act above, which reads as follows: “Every person who wilfully makes any false statement (a) in any warehouse receipt or bill of lading given to a bank under the authority of this Act . . . .”. Note that both French versions of the Banks Act and of section 4 of the Bills of Lading Act use the terms fausse déclaration.

\textsuperscript{75} Cf. Kotolchyk, supra note 29, at 91-92.
framework of the means of exoneration provided for in section 4 of the Act, the CMI Rules create a new obligation for the carrier and, if so, the extent of the obligation. This question is new because under the traditional method of endorsement, the carrier is not involved at all. The carrier, therefore, has no control over the information transmitted each time the bill of lading is negotiated. However, under the CMI Rules, the carrier is the issuer of each new Private Key. He is, therefore, able to see if the goods on board ship correspond to the terms of the electronic bill of lading.

A careful reading of the following part of section 4 of the Act should clarify this point: “by showing that it was caused without any default on his part, and wholly by the fault of the shipper or the holder . . .” 76 This section deals with the notion of fault. For the purpose of this analysis, without going into the questions of legislative jurisdiction and civil or common law concepts, one may think of how a reasonable and diligent person would act in similar circumstances. It is not necessary to examine this aspect further; one can agree that the shipper’s initial fraud constitutes a fault under the law. Rather, the words “wholly” and “default” are the ones at which one should look. The first imposes a relatively heavy burden of proof and does not allow for shared liability. The second suggests a lesser standard than the word “fault” used in the same paragraph.

At this point, it would be useful to examine the distinction between a voluntary and involuntary misrepresentation. Where the carrier becomes aware of the shipper’s fraud but does not tell the new holder, it would be difficult to say that the false declaration contained in the electronic transmission is the whole result of the loader’s fault. Where the misrepresentation is involuntary, i.e. the carrier only becomes aware of the fraud after the transfer rights, it is difficult to see how fault can be attributed to the carrier.

Even if the misrepresentation is involuntary, it must be recognized that it is always possible for the carrier, before transmitting the information to the proposed holder, to verify goods contained in his ship. Is that enough to create an obligation to verify goods? Such an obligation, if it exists, emanates from the word “default” found in section 4 of the Act. According to this interpretation, it seems that the carrier, because he acts as registrar, finds it difficult to exonerate himself under the traditional system where the loader commits fraud.

It is unreasonable to check whether goods, every time they are loaded aboard a carrier’s ship, correspond to the information required by the CMI. This indirectly makes the carrier responsible for the shipper’s

76. Article III(4) of the Hague Rules states that “[s]uch a bill of lading shall be prima facie evidence of the receipt by the carrier of the goods therein described . . . .”
fraud. The inaccessibility of certain goods, once loaded, would make such verification impossible. In addition, the simultaneous sale of goods belonging to different owners slows the speed of commercial trades unless additional personnel is hired for this sole purpose. If any obligation on the part of the carrier exists, the particular circumstances of each case should be taken into consideration; one should ask whether the carrier had the reasonable chance to examine goods.

Even if the carrier is asked to issue several Private Keys, the register always contains the same information originally provided by the shipper. Without a confidential and secure system, doubts may arise as to the integrity of the information transmitted by the carrier. The carrier may claim that the false declaration results from shipper's fraud, where in reality, it results from a computer system error. This is a question of proof requiring examination of the carrier's register to ensure that the declaration of the shipper was not altered between the time of initial and final transmission of the holder suffering damages. A systematic check of the goods each time a Private Key is issued is prudent and allows the time of fraud or deficiency to be defined.

IV. Conclusion

The process for transfer of right of control and transfer established by the CMI directly involves the carrier. In contrast to the way the system operates traditionally, the carrier deals directly with the endorsee at the time of transfer of rights to the goods sold in transit. However, these new relationships do not allow the new purchaser of goods and holder of the unique Private Key to take advantage of the contract of carriage in an action taken against the carrier. The transfer of the right of control and transfer does not pass property, and section 2 of the Act makes the passing of property a sine qua non condition of the right of action under the contract of carriage. Moreover, the endorsement alone does not transfer property unless there is a clear intention to do so. Thus, to be successful in an action against the carrier, the new holder of the Private Key must ensure that he obtains property to the goods on or by reason of the transfer of the right of control and transfer.

As for formation of a Brandt v. Liverpool\textsuperscript{77} contract, one should expect that the courts are reluctant to apply this theory. Contracts between carrier and proposed holder occur when the goods are at sea, whereas the theory of implicit contract is only applied in circumstances where relationships are physical and arrive at the destination port. Even if one finds an offer by the carrier, and acceptance by the proposed holder, during the transfer of the right of control and transfer the intention to enter a con-

\textsuperscript{77} Supra note 49.
tract remains a problem. The British Court of Appeal is clear in this re-
spect when it requires that parties behave in a manner incompatible with
respective obligations. Thus, to the extent that the offer and acceptance
process is imposed by the Rules, we admit that parties behave in a man-
ner that is compatible with respective obligations. The parties, however,
abide by the CMI Rules on a voluntary basis and, in some cases indicate
their intention to be bound contractually. To conclude that a \textit{Brandt v.
Liverpool}\textsuperscript{78} contract exists, courts must use imagination because, until
now, jurisprudential rules governing the formation of such a contract
have not applied to a virtual situation.

It is easier to view the new liability of the carrier as that of a
mandatory who is both the current and proposed holder of the Private
Key. The participation of the carrier may be viewed as limited to the role
of intermediary where the main purpose remains to negotiate electronic
bills of lading and not to revolutionize maritime trade. New obligations
for the carrier result; he is both operator of the register of information,
and mandatory of the contracting parties.

The carrier must be careful when transmitting information to the
proposed holder. Section 4 of the Act states that the bill of lading is
conclusive evidence of the shipment of goods. Although this provision is
drafted with the intent that only one bill of lading is delivered, and those
goods are only shipped once, we expect the courts to easily make the
necessary adaptation for the electronic bill of lading. Thus, each Private
Key issued is equivalent to a bill of lading within the meaning of section 4
of the Act, and the information transmitted electronically is conclusive
evidence against the carrier that it corresponds, in quality and amount, to
the goods on board ship. The carrier risks incurring liability as often as
the right of control and transfer is passed. Moreover, the carrier cannot
automatically exonerate himself from the misrepresentation even if the
shipper committed fraud. The courts decide whether the carrier has an
obligation to systematically verify the goods each time a Private Key is
issued.

The CMI Rules are better adapted to commercial reality than na-
tional or international laws. However, the integrity and confidentiality of
the information contained in the carrier's register and electronic trans-
missions are the cornerstone of the future success of the system estab-
lished by CMI, especially since the international system is based on
confidence. The last real obstacle is the uniformity of technology.
Although the CMI Rules are for everyone, not everyone can afford to
submit to technology which is often imposed by the stronger or more
financially influential party. Moreover, the current tendency varies be-

\textsuperscript{78} \textit{Id.}
tween two types of electronic environments. Aside from the system proposed by the CMI, a private system exists. It is based on a central registry operated by a third party instead of the carrier. This is the case of the Bolero project, which brings together strong and influential economic partners internationally. This kind of system may ultimately lead to the establishment of economic partnership "blocks" - an interesting option for the carrier because he would not act as registrar, thus submitting himself to the resulting obligations.
Comment

Viability of a Sustainable and Feasible National Transportation System

Cynthia J. McNabb*

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I. Introduction

The United States requires a feasible and sustainable national transportation system (NTS). Every year, the citizens of the United States spend billions of dollars on transportation costs which a more efficiently

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organized transportation system could prevent.\textsuperscript{1} While this country sorely needs efficient and effective transportation systems, the form which such systems should take presents a difficult determination. F. Kaid Benfield, Senior Attorney and Director of the Transportation Project at the National Resources Defense Council, presents one view of a sustainable and feasible NTS in his article, "Running on Empty: The Case for a Sustainable National Transportation System."\textsuperscript{2}

This comment addresses the issues presented in the above article. Part II presents examples of current Department of Transportation (DOT) projects. Specifically, Part II addresses efforts at implementing the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA). Part III comments on the author's framework for a NTS, and will also critique its feasibility and sustainability as a vision for a NTS. Part IV concludes with a look at the most effective approach for implementing society's transportation goals.

II. NATIONAL TRANSPORTATION SYSTEMS AT WORK

Under ISTEA, several current and recently completed projects seek to alleviate some of the transportation burdens facing the United States economy. Cities across the United States have sought to find innovative and creative methods to utilize ISTEA funding to implement regionalized transportation systems. For example, the St. Louis city government has searched for alternatives to motorized transportation by investing in pedestrian-friendly projects.\textsuperscript{3} Moreover, the Chicago city government recently engaged in a very similar project.\textsuperscript{4} Delray Beach, Florida invested in restoring an unused rail station as a means of coordinating a "transportation hub" that would enable train, bus, and AmTrak passengers greater

\begin{enumerate}
\item Theodore C. Taub \textit{et al.}, \textit{ISTEA: Too Soon to Evaluate Its Impact}, CA34 ALI-ABA 143, 147. "In St. Louis, approximately $4 million is designated for development of 100 miles of pathways to accommodate pedestrians, equestrians, handicapped, roller-bladers, and mountain bikers." \textit{Id}.
\item \textit{Id}. "Among many ISTEA projects in the Chicago area, bicycle paths are being laid out like never before: 201 proposed bicycle-pedestrian projects totaling 693 miles have been funded with $106 million from ISTEA from 1992 through 1995." \textit{Id}.
\end{enumerate}
access to transportation.\textsuperscript{5} Also, New Jersey sought to resurrect dead rail routes to provide alternatives to daily commutes into Philadelphia.\textsuperscript{6} Most of these programs focus on the belief that traditional transportation projects do not provide viable means of securing success at meeting U.S. transportation goals. The DOT, in implementing ISTE A, recognizes that not all transportation projects are feasible or sustainable.\textsuperscript{7} The DOT attempts, when allocating ISTE A resources, to locate programs it feels will meet society's goals of safety, security, efficiency, and environment-friendly transportation systems.

Since its inception, ISTE A has achieved critical success.\textsuperscript{8} For instance, enactment of the ISTE A legislation illustrates that U.S. citizens "will abandon their cars - if a well-planned, convenient and comfortable transit option is available."\textsuperscript{9} Additionally, supporters of ISTE A attribute reduced crime rates in such states as New York to the legislation.\textsuperscript{10} Given the achievements of ISTE A, the question of whether the United States government should implement an entirely new NTS program arises.

\section*{III. The Proposal for a National Transportation System}

Again, the creation of some form of NTS would greatly fulfill the transportation needs of many U.S. citizens. Benfield advocates a redefined NTS which expands on a DOT transportation proposition dating to late 1993. Benfield's article raises serious issues regarding the feasibility and sustainability of such a NTS. While creating a NTS seems a useful

\begin{footnotesize}
\begin{itemize}
\item[5.] Id. "Delray Beach, Florida hopes to restore the historic Seaboard Coastline Railway station with $1.83 million in enhancement dollars. The funds would be used to restore the building, develop new parking areas, and create a transportation hub that would serve AmTrak passengers, the Tri-Rail commuter train, bus service and more." Id.
\item[6.] Id.
\item[7.] New Jersey transportation planners hope to use about $10 million in transportation enhancement funds during 1995. Proposals for pedestrian pathways, bike trails and historic preservation projects have been reviewed. Citizens in Glassboro, New Jersey, outside Philadelphia, hope to restore the decrepit [sic] train station which once ran trains to Philadelphia every half hour. Id.
\item[8.] Cynthia Burbank & S. Lawrence Paulson, Congress Battles Over Successor to ISTE A, 61 PUBROADS 41, July 17, 1997. "We can continue to focus on building new roads and larger airports where land is available, with the realization that this cannot possibly meet demand." Id.
\item[9.] Jimmy D. Morrison, ISTE A's here (almost). Now What, 64 MASTRINST, May 15, 1998, available in 1998 WL 12061529. "There's no question that the original ISTE A legislation was a huge success." Id.
\item[10.] Ellen Yan, ISTE A Refill Uncertain as States Seek More Funds, NWSDAY, Mar. 22, 1998, at A28. "ISTEA fans credit the act with boosting LIRR and subway ridership by lowering crime." Id.
\end{itemize}
\end{footnotesize}
endeavor conceptually, Benfield’s proposal provides an untenable framework.

A. EXPANDED GOVERNMENT BUREAUCRACY

First, Benfield advocates the expansion of a new government entity which would constitute the focal point for an expanded transportation system. 11 This agency or entity would consolidate many existing administrative agencies into a “new Intermodal Transportation Administration” under the auspices of the DOT. 12 The problems inherent in the coordination of this massive enterprise highlight the infeasibility and lack of sustainability of creating a NTS in such a manner. A new Intermodal Transportation Administration would require that each of the existing agencies and “subagencies” accept the consolidation effort. 13 Such an assumption ignores the competing interests prevalent among members of the transportation industry. 14

Furthermore, in order to create a sustainable Intermodal Transportation Administration, the budgets of each of the subagencies would require formality for the new agency to possess sufficient resources for the re-organization. Typically, budgetary stability rarely exists. Recent years have marked drastic reductions in agency budgets, particularly in light of the continued emphasis on balanced budget initiatives.

B. WIDE-SPREAD INFORMATION/DATA COLLECTION

Benfield also indicates that in order for a NTS to fully comply with the goals of a “strategic planning process,” large amounts of information would need gathering in order to evaluate program performance. 15 Such data collection would, in all likelihood, cost an immense amount in both dollars and resources. In many instances, wide-scale data consolidation is not considered feasible, as information/data collection places a large burden on the private sector to provide the information. 16

11. Benfield, supra note 2, at 652. “The Department also intends to adopt a new administrative structure that integrates the functions historically performed by the federal Highway Administration, federal Railroad Administration, federal Transit Administration, and certain other subagencies into a new ‘Intermodal Transportation Administration.’” Id.
12. Id.
13. Id.
15. Benfield, supra note 2, at 665.
16. For instance, Mr. Benfield calls for the collection of data on “energy intensity and usage, equity and access, performance efficiency, safety and security, economic costs, air and water pollution, land use, and infrastructure conditions.” Id. at 665. In many cases, the burden of providing such quantitative data will fall on not only government agencies, but on the private sector.
Second, the number of existing administrative agencies which would bear the responsibility for the providing and processing data ranges would be quite high. The Environmental Protection Agency, Department of Energy, Department of Housing and Urban Development, Department of Agriculture, and the Department of Labor provide just a sample of the agencies required to provide the quantitative data that Benfield suggests are key to a successful NTS. This places a large burden on the already overloaded administrative system. Moreover, a consolidated transportation department would need to account for annual data collection and processing. Lack of resources to provide for such an effort would render a NTS ineffective.

C. CONSOLIDATION OF CONSTITUENT BODIES AND LEGISLATION

There also exists the difficulty in organizing the countless constituent groups into one unified decision-making body, yet Benfield calls precisely for this effort. Such an attempt is not feasible since constituent groups will probably change every five years. In the meantime, the election of a new city government could occur or new relevant constituent groups created. Disjointed and confused policy decisions would result. Furthermore, among the various constituent groups, full agreement on a management style or new piece of legislation would not be forthcoming. It is not likely that the new NTS would accomplish much by requiring full consultation on the set of issues presented. Any policy directive and assessment of where to invest public resources becomes moot with the passage of time. Additionally, sustainable efforts at consolidated decision-making would become nearly impossible.

The NTS as envisioned in Benfield’s article would require the consolidation of many federal regulations now in existence. First, ISTEA provides the framework for establishing an NTS. Beyond this framework, Benfield suggests that a sustainable and feasible DOT/NTS program should also turn to the National Environmental Policy Act, the Energy Policy Act, the Clean Water Act, the Civil Rights Act, and the Americans with Disabilities Act for guidance. Coordinating the intent

17. One need only examine the type of data being requested to determine the large number of administrative agencies required for this form of massive data collection.
18. Id.
19. Id. “[T]he Department should articulate, after full consultation with its state and local government partners and citizen constituents, its assessments of where to invest public resources along with appropriate management, policy direction, and proposals for new legislation, if appropriate. DOT should repeat this undertaking periodically, perhaps at five-year intervals.” Id.
20. Id at 660. “The National Environmental Policy Act (NEPA) provides further direction to the federal DOT, both in administering its program generally and in undertaking significant exercises such as establishing the NTS.” Id.
21. Id. at 662.
and structure of each massive regulatory regimes into a national transportation legislative act seems an insurmountable feat.

D. LACK OF VIABLE MODELS

Benfield cites three models of successful strategic planning efforts to argue for performance assessments in conjunction with a NTS: The U.S. Forest Service’s Forest and Rangeland Renewable Resources Planning Act (RPA),22 the U.S. Department of Agriculture’s Soil and Water Resources Conservation Act (RCA),23 and the United Kingdom’s Royal Commission on Environmental Protection.24 None of these three models provides a feasible or sustainable model on which to base the strategic planning aspect of a NTS. First, a NTS proposes a larger program than either the RPA or the RCA. In fact, Benfield conceives of a NTS requiring the consolidation of agencies and federal regulatory programs. Neither the RPA or the RCA were created with such an extensive vision in mind. Second, the Royal Commission on Environmental Protection should also be discounted. While broad in scope, the environmental concerns in a nation the size of the United Kingdom hardly compare in size and scope to the consolidation of a United States NTS.

For the reasons listed above, Benfield does not provide a feasible or sustainable framework for the creation of a NTS. First, such a national system conceives of both a time intensive and resource exhaustive method of forming an entirely unique government entity. Second, the maintenance of a state agency to measure the performance of a new system is costly. Nevertheless, Benfield completely ignores this cost factor. Finally, the models provided as a basis for the planning state of the NTS do not provide sufficient examples on which to compare a new NTS. Therefore, the United States government should consider other alternatives to the one which Benfield advocates.

IV. CONCLUSION

One such alternative presents itself in the reauthorization of ISTEA: TEA-21 (Transportation Equity Act for the 21st Century). President Clinton signed this six-year transportation reauthorization on June 9, 1998.25 TEA-21 guarantees a record $198 billion investment within the limits of a balanced budget,26 and seeks to meet the majority of society’s

26. Id.
transportation goals. For instance, the Secretary of Transportation, Rodney E. Slater, stated that TEA-21 "focuses on improving safety, rebuilding America, protecting the environment, creating opportunity and ensuring global competitiveness."\(^27\) In fact, TEA-21 expands ISTEA funding in many of the above areas such as the environment, which will receive 35% more funding under TEA-21 than it did under ISTEA.\(^28\) Because TEA-21 is an expansion of ISTEA, the United States government already has years of experience on which to reflect when determining whether this type of federal legislation meets the country’s needs for a NTS.

Most of the evidence suggests the success of ISTEA. In fact, reauthorization of ISTEA received high levels of bi-partisan support.\(^29\) Furthermore, both the House and Senate have approved measures that guarantee continued funding for federal and state transportation projects through the application of gas tax revenue.\(^30\) With such a pool of continued revenue, national transportation projects as financed through TEA-21 should continue to flourish and expand.

In conclusion, that which is not broken should not be fixed. TEA-21 already provides the kind of NTS which Benfield endorses in his article. Instead of wasting taxpayer dollars on a new NTS, the DOT should focus on the continuation of the already successful NTS programs in place. While billions of dollars each year are spent inefficiently on transportation costs, the Department is moving in the right direction. With the assurance of continued funding through TEA-21, the DOT now has the capability and flexibility to strategically plan for the future. Through innovation and creativity, as witnessed by the NTS programs under ISTEA, we begin to see the formation of a sustainable and feasible NTS. With both time and continued public support, the DOT will likely meet Benfield’s challenge of creating a NTS which will meet society’s transportation goals.

\(^{27}\) Id.
Articles

Shipping Conference Legislation in Canada, the European Economic Community and the United States: Background, Emerging Developments, Trends and a Few Major Issues*

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I. INTRODUCTION

Shipping conference legislation provides an exemption from the pro-
visions of the Competition Act for certain ocean liner shipping practices.
This exemption is a privilege which most industries in the economy do
not enjoy. With deregulation being introduced in most of the regulated
sectors, the rationale and the need for continued exemption is being increasingly challenged.

In light of this disparity, a number of agencies have expressed dissatisfaction with the state of conference legislation. For example, in Canada, the National Transportation Act Review Commission expressed opposition to the intent of the Shipping Conference Exemption Act,¹ arguing that it runs counter to the general policy of encouraging competition. In addition, the Canadian Shippers' Council opposes the philosophy of continuing the exemption. Similarly, in Europe and Japan, Shippers' Councils are strenuously advocating an end to open antitrust exemption enjoyed by liner conferences. Pressures for change in the United States too have recently resulted in a new shipping act, as evidenced by numerous attempts for reform. The competition agencies in Canada, the European Union ("E.U.") and the United States prefer that the liner shipping industry, like any other industry, be subject to competition and not be protected by an outdated and antiquated system of shipping laws.

Everyone seems to agree that some change is necessary. The question is what kind and how much? In addition, fundamental changes in technology are occurring which are rendering these laws inappropriate, as the circumstances which first gave rise to them are no longer prevalent. New forms of organization, new business arrangements, and the demand for new services all accentuate the need for change. Under such circumstances, free market forces best determine the most appropriate policy. Facilitating and encouraging the role of market forces by eliminating the exemption could lead to greater competition among ocean liner carriers and ultimately to increased efficiency, lower prices, improved services and perhaps greater international trade.

In this paper, the emerging developments and trends in liner shipping and some of the associated issues will be briefly examined. Section two reviews the background to shipping conference legislation in Canada, the European Economic Community ("EEC") and the United States. The conference exemption legislation in each of these jurisdictions is examined in section three, with a schematic chart on its evolution in Appendix 1. This is followed by a brief examination of the two basic rationales for exempting ocean liner shipping from competition laws: the economic (i.e., the need to provide stability of rates and services) and the political (i.e., considerations of international comity) in section four. The theory behind the economic argument is elaborated in Appendix 2. Its purpose is to shed some light on why conference legislation developed and what were the justifications used to retain the exemption of conferences from the competition laws.

Section five examines the recent developments such as technological change (i.e., containerization, new mega-sized carriers, etc.), new forms of organizations (i.e., superconferences, consortia, etc.), new forms of agreements (i.e., capacity, space chartering, etc.), and new forms of service (i.e., global service, etc.) that have led to some of the emerging legislative developments. Thereafter, some of the ensuing issues from this debate such as intermodal rates, service contracts, independent action, tariff filing and antitrust immunity are briefly reviewed. The conclusion briefly examines the implications of the above developments for competition policy in the liner trade.

II. BACKGROUND TO CONFERENCE LEGISLATION IN CANADA, EEC AND THE UNITED STATES

A. CANADA

Canada did not have any specific legislation governing shipping conferences until 1971. After World War I, the shipping policies in Great Britain dominated the Canadian approach to conferences. In the early 1920s, three separate inquiries in their reports strongly criticized shipping conferences. After the 1920’s, no formal inquiries were made into shipping conferences or ocean freight rates until 1959, nor did the government attempt to legislate the regulation of rates.

In February 1959, the Industrial and Trade Bureau of Greater Québec invited the Helga-Dan, a ship specially fitted for winter navigation, to sail to and from the port of Québec. As the Helga-Dan belonged to a shipping line not a member of the shipping conference it was necessary for the shipper to obtain a release from their exclusive patronage contract with the Eastern Canada-United Kingdom Shipping Conference. The Conference refused to release the shipper despite the fact that it did not provide winter service. This resulted in a complaint being filed with the Director of Investigation and Research and led to an inquiry under the Combines Investigation Act. The investigation subsequently resulted in charges by the Director and hearings before the Restrictive Trade Practices Commission (“R.T.P.C.”). In 1965, the R.T.P.C. issued its report. Though the R.T.P.C. determined that the Conference did hinder competi-

2. SHIPPING CONFERENCES ARRANGEMENTS AND PRACTICES, Restrictive Trade Practices Commission, Department of Justice, Ottawa, 1965, at 15 [hereinafter SHIPPING CONFERENCES].
3. One final attempt by the government to control rates on shipping grain in the Great Lakes also failed because of the withdrawal of American carriers. This withdrawal was due to the control of rates by the Board of Commissioners.
5. Id.
6. Id.
tion and take advantage of shippers, it mainly criticized exclusive patronage contracts. However, it declined to apply the Combines Investigation Act to shipping conferences. It maintained that “[a]lthough the member lines lessened competition within the meaning of the Combines Investigation Act, the public interest would not be served by excessive rate competition and instability in the liner trades.” The R.T.P.C. declined to regulate shipping conferences indicating that “governmental regulation of rates in ocean transport would not be feasible or conducive to the welfare of the Canadian public.” Based on the rationale and recommendations of the R.T.P.C., the Shipping Conferences Exemption Act (“Act”) was passed in 1970.

Despite the R.T.P.C.'s strong criticism against patronage contracts, the Act continued to allow them. Further, the Act did not give any regulatory role to the Canadian Transport Commission. Its sole responsibility was to ensure that agreements were properly filed with it. Furthermore, no specific provisions designated responsibility for the enforcement of the Act. The main penalty for prohibited practices of shipping conferences was that agreements lost their exemption from the Combines Investigation Act. Other than the exemptions provided in the Act, shipping conferences continued to be subject to the Combines Investigation Act. This led to the Shipping Conferences Exemption Act of 1979. However, it did not introduce any effective procompetitive measures. The provision to strengthen the position of the shippers through a shipper group, designated to represent shipper interest, was not very effective due to the vagueness of the provision on the meaning of “information sufficient for the satisfactory conduct of the meeting.” The 1979 Act further increased the power of the conferences by extending the scope of the exemption between one or more conferences and between conference and non-conference carriers. This led to the Shipping Conferences Exemption Act of 1987.

7. Id.
8. Shipping Conferences, supra note 2, at 100.
9. Id. at 101.
10. Bryan & Kotowitz, supra note 4, at 82.
11. Id.
12. Id.
13. Id.
14. Id.
B. EEC

In the early 1900s, Western Europe adopted the United Kingdom's laissez-faire approach to conferences. Since then, conferences have enjoyed a peaceful existence in Western Europe. In general, conferences were excluded de facto or de jure from the application of competition laws as the European governments tolerated and even favored them. When European shipowners wanted their governments to protect them from the United States antitrust laws, those governments wanted to know what would be done to protect shippers' interests. In 1963, a note of understanding was signed by the representatives of European liner conferences and shippers, which was considered the right way for taking into account shippers' interests. As a result, the Committee of European National Shipowner's Associations was formed.

Simultaneously, developing countries were largely concerned with discriminatory practices of conferences. This resulted in the adoption of the Code of Conduct for Liner Conferences by a number of Member States even though the Economic Community was not a party to the Code because of its incompatibility with the competition provisions of the EC Treaty. As a compromise, EC Council of Ministers adopted the "Brussels Package" in 1979. The package recognized the stabilizing influence of conferences while implicitly establishing the principle of block exemption. As a result, a regulation on the application of competition rules to maritime transport was proposed. In addition, a regulation exempting liner conferences from Articles 85 and 86 of the Treaty of Rome was adopted and went into force on July 1, 1987.

The principal regulation concerning the exemption of shipping conference agreements from the application of competition rules is Council Regulation No. 4056/86 of 22 December 1986, which set forth rules for the application of Articles 85 and 86 of the Treaty of Rome to Maritime Transport. In addition, a number of supplementary regulations on maritime transport were adopted.

17. Id.
18. Id.
19. Id. at 5.
20. Id.
C. The United States

Before the passage of the 1916 legislation on shipping, the United States Government brought legal suits under the Sherman Act against a number of international steamship combines. The House Committee on Merchant Marine and Fisheries under the chairmanship of J. W. Alexander investigated the problem of shipping combinations and published its findings in 1914.23 Based on these recommendations, Congress decided in 1916 that with federal regulation, the shipping industry could provide public benefits not otherwise available.24 It feared that if this industry was precluded from entering into anti-competitive agreements rate wars would erupt, resulting in increased concentration. Such concentration would make for a more effective monopoly than existed by agreement in a less concentrated environment.

Congress, however, recognized that the conference carriers had abused their power. It believed that it could prevent this industry from abusing its monopolistic power in several ways. First, it prohibited certain particularly anti-competitive or discriminatory practices. Second, it required all carriers to disclose to a federal agency, the Shipping Board, and to the public all multicarrier agreements. Finally, the carriers were required to obtain the agency’s approval prior to implementing their agreements. Unapproved agreements were declared unlawful.

The United States Shipping Act of 191625 was largely based on the recommendations of the Alexander Report. It recognized certain benefits and shortcomings of the conference system and therefore provided for limited acceptance of the conference system with active government supervision. In 1960, two congressional committees investigated the industry and its regulations and noted the dissatisfaction with the operation of the system. Congress, however, remained persuaded that the conference system was necessary to avoid rate wars and monopoly.26 Consequently, the

24. Id. at 6.
25. This is the short title of the Act. See section 44 of the Shipping Act of 1916.
26. One point that was heavily emphasized in the Shipping Act of 1916 that was not relied
quently, the Shipping Act of 1916 was amended. A number of developments led to the United States Shipping Act of 1984:27 Dissatisfaction with the regulatory process,28 uncertainties about the outcome of regulatory decisions, the container revolution and development of intermodal services, and general dissatisfaction with the existing legislation.

III. Shipping Conferences Exemption Act of 1987, EEC Regulation 4056/86 and The United States Shipping Act of 1984

A. Shipping Conferences Exemption Act of 1987

The Shipping Conferences Exemption Act of 1987 ("SCEA") came into force on December 17, 1987.29 This revised Act (formerly Shipping Conferences Exemption Act 1979) consists of 29 sections30 and its administration is the responsibility of the Canadian Transportation Agency (formerly the National Transportation Agency).31 The provisions of the Act can be classified into five categories: (1) exemptions from the Competition Act, (2) restrictions on the exemptions, (3) investigations, (4) availability of information, and (5) filing and administration. These are briefly reviewed hereafter.

1. Exemptions from the Competition Act

The Act continued to exempt certain shipping conference agreements or interconference agreements from the Competition Act, subject to certain restrictions or prohibitions.32 It allowed the use of tariffs by

upon to any great degree in 1961 was that a strong conference system would benefit the American merchant marine. The Senate Report (#860, 87th Cong., 1st Sess., at 2 (1961)) in the 1961 amendments emphasized the fact that . . . the only nonconference lines today which desire to operate regularly on a basis of cutting conference rates are foreign flag lines . . . ." Id.

27. See section 1 of the United States Shipping Act of 1984 for title.

28. This was basically a result of delays in obtaining approval for conference agreements from the FMC. This was amplified in the Supreme Court Decision (Federal Maritime Commission vs. Aktiebolaget Svenska Amerika Linen, 390 U.S. 238 (1968)) which shifted the burden of proof to the conferences to show that agreements were not anticompetitive.

29. See CANADA GAZETTE, Part II, Vol. 122, No. 2, 20/1/88, SI/TR/88-9. Subsection 4(3) came into force on February 17, 1988. This is the short title of the Act, see section 1. The full title is now "An Act to exempt certain shipping conference practices from the provisions of the Competition Act, to repeal the Shipping Conferences Exemption Act and to amend other Acts in consequence thereof."

30. There are nine new sections, three sections of the previous Act were deleted, two earlier sections were combined into one and one earlier section was divided into two. The definitions in section 2(1) were increased to include definitions on conference agreement, loyalty contract, designated shipper group, independent action, interconference agreement, and service contract. It also contains definitions on contract rate, dual rate and non-contract rate previously in subsection 5(2) of the SCEA, 1979.


32. Id. at §4(1).
member lines set by the shipping conference or interconference. It permitted the use of loyalty contracts provided that: all contracts may be terminated by either party at any time after ninety days notice, the differential between contract and non-contract rates would be a maximum of fifteen percent of the contract rate, rebates would not be prohibited by agreement among conference members, and there would be no requirement that a shipper transport 'all' its goods by the conference. It permitted the conference to establish the terms and conditions respecting the use of service contracts. It allowed for the allocation of ports in Canada among members, regulation of times of sailings and the kind of services which shipping conference members were allowed to supply for the transportation of goods, and legalized pooling arrangements, whether of revenue or of cargoes. It also allowed shipping conferences to regulate the admission of new members and the expulsion of members from the conference thereby sanctioning closed conferences.33

2. Restrictions on the Exemptions

The restrictions referred to above are: 1) Failing to file agreements with the Agency, 34 2) agreements that do not provide for independent action, 35 3) engaging in or conspiring, combining, agreeing or arranging to engage in predatory pricing described in section 50(1)(c) of the Competition Act, 36 4) engaging in three specific predatory practices by shipping conferences — the use of fighting ships by conferences; refusal to transport goods for a shipper for his use of a non-conference vessel; and, preventing or limiting the use of port or other facilities and services relating to the transportation of goods by an ocean carrier in Canada or elsewhere, because that carrier was not a member of a shipping conference, and 5) arrangements that cover agreed multimodal rates. 38

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33. Id. at §§ 4(1)(a) –(g).
34. Id. at § 4(2).
35. Id. at § 4(3)(a). Any member of a conference may take independent action after giving fifteen days notice to other members of a conference, except with regard to service contracts. Id. at § 4(3)(a) (an earlier version of the Bill on this Act provided for independent action on service contracts). Id. at § 4(3)(b) (providing that the members of a conference shall publish the new rate or service within fifteen days). Id. at §4(3)(c) (providing for the adoption of independent action in response to independent action, on or after the first day that it is taken).
36. Id. at § 4(4). The predatory pricing offense under subsection 50(1)(c) pertains to engaging in a policy of selling products at prices unreasonably low, having the effect or tendency of substantially lessening competition or eliminating a competitor, or designed to have that effect.
37. Id. at § 5.
38. Id. at § 5(2). This section however does not prevent an individual member of a conference from agreeing with any carrier for inland transportation for a through rate.
3. **Investigations**

Notwithstanding the exemptions noted earlier, these exemptions had no effect on the investigative powers of the Director of Investigation and Research. As the Director could, on his own initiative, initiate an inquiry concerning the operations of shipping conferences and their effects on competition, and was to do so on direction from the Minister of Industry.\(^{39}\) Such inquiries are pursuant to the Competition Act\(^{40}\) and the Director may take any action pursuant to the Competition Act.\(^{41}\) The Act also provides a new mechanism for investigation of complaints. The Director, like any other person, may file a complaint to the Agency.\(^{42}\) The Agency can conduct an investigation of the complaint if it is warranted in its opinion. It may make an order if the agency finds that the conference agreement or practice has or is likely to have by a reduction in competition an unreasonable reduction in transportation service or an unreasonable increase in transportation costs. The order may require the parties or members of the conference to remove the offending feature of the agreement or stop the practice or any other order that the Agency considers necessary.\(^{43}\) In conducting such an investigation, the Agency may consider the contents of any service contract or hold hearings or may decide the matter on the basis of documents filed.\(^{44}\) Further, the Director has to be notified by the Agency of every complaint filed under subsection 13(1). Furthermore, the Director of the Agency may bring any evidence obtained in an inquiry under the Competition Act.\(^{45}\) This however does not affect the operation of the Competition Act in situations where the agreement or agreements or practice of a conference or a member is not exempted under section 4 of the Act.\(^{46}\)

4. **Availability of Information**

Members of a conference were to maintain an office in Canada where they operated and make available to the public copies of all docu-

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39. *Id.* at § 16(1).
40. *Id.* at § 16.
41. *Id.* at § 16(3).
42. If there is reason to believe that any conference or interconference agreement is required to be filed, or any practice of a conference or member has or is likely to have by a reduction in competition an unreasonable reduction in transportation service or an unreasonable increase in transportation costs, see subsection 13(1)(b). However, such a complaint is precluded if an application has been made under subsection 26(2) of the National Transportation Act, see subsection 13(5). Section 26(2) deals with special appeal and investigation.
43. A decision must be rendered within 120 days after the complaint is filed unless the parties agree to an extension. See section 15.
44. *Id.* at §§ 13(3), 15(4).
45. *Id.* at §§ 13(1), 16(3).
46. *Id.* at § 13(6).
ments filed and in force (other than service contracts) with the Agency. Further, copies of all current tariffs and any revisions or notifications filed with the Agency are to be made available at all their principal offices for inspection. In addition, section 21 makes provision for a shipper group (i.e., Canadian Shippers' Council designated by the Minister of Transport). The purpose of this group was to strengthen the bargaining position of shippers vis-à-vis the conferences. Members of a shipping conference were obliged to meet with a shipper group when requested in writing and to provide information sufficient for the satisfactory conduct of the meeting. The Act also empowered the Governor-in-Council to make regulations requiring the production of information reasonably available by members of a shipping conference to the Agency, at such times and such forms, necessary for their effective supervision. Further confidential information made available pursuant to the regulations shall not be made available to any competitor. The section on regulations was broadened to include access through an electronic network to documents to be filed and fees to be paid for the use of this service.

5. Filing and Administration

Filing and administrative provisions are also contained in the Act. It requires all members of shipping conferences to file a copy of their contracts and agreements or interconference agreements including a description of oral agreements, a copy of every service contract, changes in membership, tariffs, a copy of each loyalty contract and amendment to loyalty contracts in considerable detail with the Agency. The tariffs to

47. Id. at § 18. "The documents filed under the previous Act shall be deemed to comply with the filing provisions under this Act if a certificate is signed by a member of the conference describing those documents and indicating that no modification has been made since the coming into force of the Act." Id. at § 25.
48. Id. at § 19.
49. Id. at § 21 (an organization or association of shippers designated by the Minister of Transport).
50. See id. at § 20.
51. Regulations under this section have to be published in the Canada Gazette at least sixty days before the effective date affording interested persons a reasonable opportunity to be heard, it need not be published more than once whether or not amended as a result of representation by interested persons. Id.
52. Id. at § 22(3).
53. Conference and non-conference agreements are to be filed on the day it becomes effective; service contracts, changes to tariff or loyalty contracts, and changes in membership shall be filed not later than thirty days after it becomes effective or after the change. Id. at § 7.
54. Id. at § 6(1). Subsection 6(2) spells out the contents of each tariff: every rate and charge, places to which it is applicable; every rule and regulation determining its calculation or affecting or altering any term or condition; and the address in Canada to which communications regarding the above may be directed.
be filed do not have to provide the rates on any service contract. Further, written notice of a proposed increase in a tariff shall be given to the Agency and to the designated shipper group thirty days before it becomes effective, and in the case of a surcharge or increase in surcharge, fourteen days before it becomes effective. Furthermore, written notice of any proposed amendment to a loyalty contract or tariff other than a rate increase shall be given to the Agency not later than the date on which the proposed amendment becomes effective. All the documents that had to be filed were to be certified as true by a person designated by the shipping conference. The documents filed by the shipping conference with the Agency may be destroyed five years after they are no longer in effect and necessary for the administration of this Act.

The Agency may direct an ocean carrier of a shipping conference to deposit with it a sum of $10,000 as financial security to ensure that the carrier would comply with this Act and could order seizure and detention of any vessel of the ocean carrier for failure. In case of conviction of an offense under this Act or the Competition Act and failure to pay any fine due to conviction, the deposit or sale of any deposited security could be used to pay the fine. Shipping conferences that failed to comply with any obligation or regulation under this Act could be fined up to $1,000 for each offense on summary conviction. Further, when the offense is committed or continued for more than one day it shall be considered as a separate offense. The time limitation for proceedings in respect of an offense for failure to comply under this section was now raised to less than three years from the time of the proceedings.

Summarily, the Shipping Conferences Exemption Act of 1987 introduced substantive new features to promote competition. The Act pro-

55. Id. at § 6(2). It should also be noted that subsection 17(1) does not provide for the inspection of service contracts by any person. Members of a conference shall now maintain jointly an office or agency for inspection and purchase copies of all documents and notices in force that have been filed with the Commission under section 6 where they operate. The word jointly was not in the earlier provision. Further it does not have to make available copies of service contracts at the office or agency for inspection. Similarly, every member of a conference has to maintain every tariff and notices of tariff amendments at their principal office or agency. Strangely this section does not exclude service contracts that have been filed with the Commission, perhaps this omission was an oversight, the intent of the Act was to keep service contracts confidential. See id. at §§18, 19.

56. Id. at § 9.
57. Id. at § 10.
58. Id. at § 8.
59. Id. at § 17(2).
60. Id. at §§ 23(1), (2) (describing return or cancellation of security).
61. Id. at § 24(1) (indicating that the member was "punishable" and then liable to a fine for failure to comply).
62. Id. at §§ 24(2), (3).
vided provisions for restricting agreements between conference members and independent ocean carriers, restrictions on loyalty contracts, a provision for service contracts, a provision for independent action on rates, a limitation of exemption in the case of conspiracy, combination, agreement or arrangement to engage in predatory pricing described in section 50(1)(c) of the Competition Act, and restriction of the exemption to agreements that do not cover multimodal rates. 63 However, it failed to deregulate the industry through its exemption of shipping conferences from the Competition Act. 64 Further, the provision to strengthen the position of the shippers through a shipper group, designated to represent shipper interest, continued to be ineffective due to the vagueness of the provision on the meaning of "information sufficient for the satisfactory conduct of the meeting." Finally, it failed to consider the appropriateness of the Act in light of the changing conditions such as superconferences and other types of agreements such as stabilization, discussion and bridging agreements.

B. EEC Regulation Laying Down Detailed Rules for the Application of Articles 85 and 86 of the Treaty of Rome to Maritime Transport

This regulation came into force on July 1, 1987. It lays down detailed rules for the application of competition to agreements which have as their object or effect the prevention, restriction or distortion of competition (Article 85) and the abuse by undertakings of a dominant position (Article 86) to international maritime transport services from or to one or

63. Corresponding to the above are subsections: 4(1) and the definitions of conference and interconference agreement; 4(b)(iv) which specifies that the loyalty contract not contain the requirement that a shipper transport all or one hundred percent of their goods under the loyalty contract; subsection 4(1)(c); 4(3)(a) - any member of a conference may take independent action after giving 15 days notice to other members of a conference, except with regard to service contracts. An earlier version of the Bill on this Act provided for independent action on service contracts. But this feature was later deleted in the final Bill. Further, subsection 4(3)(b) provides that the members of a conference shall publish the new rate or service within 15 days. Furthermore, subsection 4(3)(c) provides for adopting independent action, such as independent action in response to independent action, on or after the first day that it is taken; subsection 4(4) - the predatory pricing offense under subsection 50(1)(c) pertains to engaging in a policy of selling products at prices unreasonably low, having the effect or tendency of substantially lessening competition or eliminating a competitor, or designed to have that effect; and 5(2) - this section however does not prevent an individual member of a conference from agreeing with any carrier for inland transportation for a through rate.

64. The limited effectiveness of these procompetitive measures have been indicated in the Submission to the National Transportation Act Review Commission, by the Director of Investigation and Research, Competition Act, June 30, 1992, at 12-16. The Director also indicated other measures to enhance competition such as a competitive approach to multimodal rate-setting through independent offering of such rates, reduction in the notice period for independent action, and individual service contracts. Id. at 27-30.
more Community ports, other than tramp vessels. The articles of the Regulation in Section I can be classified into four categories: (1) exemptions from certain Articles of the Treaty of Rome, (2) restrictions on the exemptions, (3) monitoring of agreements, and (4) conflicts with international law.

1. Exemptions From Certain Articles of the Treaty of Rome

Technical or cooperation agreements are granted exemption in Article 2 from Articles 85 and 86 of the Treaty of Rome. This exclusion includes improvements such as the introduction or uniform application of standards or types for vessels, equipment, supplies or fixed installations; exchange or pooling for the purpose of operating transport services of vessels, space or slots, other means of transport, staff or equipment; the organization and execution of successive or supplementary maritime transport operations and the establishment or application of inclusive rates and conditions for such operations; the coordination of transport timetables for connecting routes; the consolidation of individual consignments; and the establishment or application of uniform rules concerning the structure and the conditions governing the application of transport tariffs. Further, liner agreements, decisions and concerted practices are also exempted from Article 85(1) when it has the object of fixing rates and conditions of carriage. This includes the coordination of shipping timetables, sailing dates or dates of calls; the determination of the frequency of sailings or calls; the coordination or allocation of sailings or calls among members of the conference; the regulation of carrying capacity by each member; and the allocation of cargo or revenue among members. Furthermore, exemption is also provided for agreements, decisions and concerted practices between transport users and conferences, and between transport users concerning rates, conditions and quality of liner services as long as they are provided for in Articles 5(1) and 5(2).

2. Restrictions on the Exemptions

The above exemption is subject to the condition that the agreements, decisions agreements, or concerted practices shall not cause detriment to certain ports, transport users or carriers because of the application of dif-

66. Id. at art. 6.
67. Id. at art. 2, (1)(a) – (f).
68. Id. at art. 3.
69. Id. at art. 3 (a) –(e).
70. Id. at art. 6.
ferentiated rates and conditions that cannot be economically justified.\textsuperscript{71} In addition, certain obligations are attached to the exemptions provided for liner agreements, decisions and concerted practices.\textsuperscript{72} These obligations include the right of consultation concerning rates, conditions and quality of scheduled services;\textsuperscript{73} the entitlement to loyalty contracts which provide for safeguards;\textsuperscript{74} free choice of inland transport operations and quayside services not covered by the freight charge;\textsuperscript{75} the availability of tariffs covering all conditions and charges for service at reasonable costs or their availability in offices of shipping lines or agents;\textsuperscript{76} and notification to the Commission of awards at arbitration and recommendations.\textsuperscript{77} The loyalty contracts shall offer a system of immediate rebates or deferred rebates; and after consultation with users: inclusion and exclusion of any portion of cargo from the loyalty contract, non unilateral imposition of one hundred percent loyalty arrangements and circumstances of release from the loyalty contract.\textsuperscript{78}

It should be also be noted that the prohibition of an abuse of a dominant position within the meaning of Article 86 of the Treaty of Rome is provided for in Article 8. Exemption of agreements may be withdrawn if it has effects which are incompatible with Article 86. Further, all appropriate measures may be taken for bringing to an end infringements of this article.\textsuperscript{79}

3. \textit{Monitoring of Agreements}

Article 7 provides for the monitoring of agreements. In the event of a breach of an obligation, conditions are laid down to put an end to such a breach.\textsuperscript{80} Where the agreement which qualifies for exemption is incompatible owing to special circumstances with the conditions laid down in Article 85(3) of the Treaty of Rome, the Commission may take measures whose severity is in proportion to the gravity of the situation.\textsuperscript{81} The special circumstances are created by acts of conferences or changes in market conditions resulting in the absence of actual or potential

\textsuperscript{71} The condition applies to the exemption granted in Articles 3 and 6 of Council regulation 4056/86.
\textsuperscript{72} \textit{Id.} at art. 5.
\textsuperscript{73} \textit{Id.} at art. 5(1).
\textsuperscript{74} \textit{Id.} at art. 5(2).
\textsuperscript{75} \textit{Id.} at art. 5(3).
\textsuperscript{76} \textit{Id.} at art. 5(4).
\textsuperscript{77} \textit{Id.} at art. 5(5).
\textsuperscript{78} \textit{Id.} at art. 5(2)(b).
\textsuperscript{79} \textit{Id.} at art. 8.
\textsuperscript{80} \textit{Id.} at art. 7(1).
\textsuperscript{81} \textit{Id.} at art. 7(2).
competition acts of conferences which may prevent technical or economic progress or user participation in the benefits and acts of third countries which prevent the operation of outsiders, impose unfair tariffs on conference member or impose arrangements which impede technical or economic progress.

4. Conflicts with International Law

Conflicts with international law are provided for in Article 9. Where as a result of this regulation, conflict arises with important Community trading partners, the Commission shall undertake consultations aimed at reconciliation. Where agreements need to be negotiated, the Commission shall make recommendations to the Council which shall authorize the necessary negotiations to be undertaken.

Section II of Regulation EEC 4056/86 addresses rules of procedure. It covers procedure on complaint or on the Commission’s own initiative; the result of procedures on complaint or on the Commission’s own initiative; objections to the application of Article 85(3); duration and revocation of the decisions applying Article 85(3); powers; liaison with the authorities of the Member States; requests for information; investigations by the authorities of the Member States; investigative powers of the Commission; fines; periodic penalty payments; review by the Court of Justice; unit of account; hearing of the parties and of third persons; professional secrecy; publication of decisions; implementing provisions; and entry into force of this regulation.

In summary, Regulation EEC 4056/86 is the first regulation that the EEC has adopted providing explicit exemption to shipping conferences. Although initial reports indicate that it has been an effective means of ensuring compliance in shipping with Articles 85 and 86 of the Treaty of Rome, some commentators believe that it is outdated since it was based on studies in the mid 1960s.

C. THE UNITED STATES SHIPPING ACT OF 1984

President Ronald Reagan signed the United States Shipping Act of

82. The Commission may enter into consultation with the competent authorities of the third country concerned, if, actual or potential competition is absent or may be eliminated as a result of action by the third country. It can also withdraw the block exemption if the special circumstances result in the absence or elimination of actual or potential competition contrary to Article 85(3)(h). It shall also rule when an additional exemption should be granted to obtaining access to the market for non-conference lines.

83. Id. at art. 9(1).
84. Id. at art. 9(2).
85. Id. at § II.
1984\textsuperscript{86} (the "1984 Act") into law on March 20, 1984.\textsuperscript{87} The revised Act (formerly the United States Shipping Act of 1916) consists of 23 sections and its administration is the responsibility of the Federal Maritime Commission. The provisions of the 1984 Act can be classified into five categories: (1) declaration of policy; (2) exemptions from the antitrust laws, (3) restrictions on the exemptions or prohibited acts, (4) investigations, and (5) filing, tariffs and administration. These are briefly reviewed hereafter.

1. Declaration of Policy

The purpose of the 1984 Act was explicitly stated in Section 1701, and establishes three principle goals of regulation. It establishes a non-discriminatory regulatory process with the minimum of government intervention, provides for an efficient economic transportation system, and encourages the development of an economically sound efficient United States flag liner fleet.\textsuperscript{88}

2. Exemptions From Antitrust Laws

The 1984 Act provides antitrust exemption to ocean common carrier agreements (this includes not only conference agreements but also interconference agreements and agreements between a conference and independent carriers, etc.) that are filed with the Federal Maritime Commission (FMC) unless these agreements are rejected. These agreements can cover 1) discussing, fixing or regulation of transportation rates, including through rates, and other conditions of service; 2) pooling or apportionment of traffic, revenues or loses; 3) allocation of ports or regulation of sailings; 4) limiting or regulating the volume or character of traffic (cargo or passenger); 5) engaging in exclusive, preferential or cooperative working arrangements among themselves, marine terminal operators or non-vessel-operating common carriers; 6) controlling, regulating, or preventing competition in international ocean transportation; and 7) regulating or prohibiting the use of service contracts.\textsuperscript{89} The exemption also covers agreements (which involve ocean transportation in US foreign commerce) among marine terminal operators or among marine terminal operators and ocean common carriers to the extent that it involves 1) discussion, fixing or regulating rates or other conditions of service; and 2) engaging in exclusive, preferential, or cooperative working

\textsuperscript{87} Id. (the act became effective 90 days after enactment, except §§ 1716-17 which became effective on the date of enactment).
\textsuperscript{88} Id. at § 1701.
\textsuperscript{89} Id. at § 1703(a).
arrangements. The 1984 Act does not apply to acquisitions.

3. Restrictions on the Exemptions or Prohibited Acts

The exemptions noted above do not apply to any agreement with respect to other modes of transportation (including domestic waters), to any discussion or agreement on apportionment of inland of through rates within United States, and to any agreement among common carriers under the 1984 Act regarding establishing, operating or maintaining a marine terminal in the United States. The prohibited acts are categorized into four groups: 1) General; 2) Common carriers; 3) Concerted action; and 4) Common carriers, ocean freight forwarders, and marine terminal operators.

The first includes: attempting to falsely provide ocean carriage at rates less than those applicable; operating an agreement that has not become effective or has been rejected, disapproved or canceled; and operating an agreement not in accordance with the filed agreement or agreement modified by the FMC. The second group includes: charging rates other than those shown in its tariffs or service contracts; providing rebates other than those in its tariffs or service contracts; extending or denying any privilege, concession, equipment or facility except in accordance with its tariffs; allowing a person to obtain transportation falsely at rates less than those in its tariff or service contracts; retaliating against a shipper because the shipper has patronized another carrier, filed a complaint or any other reason; engaging in unfair or unjustly discriminatory practices (regarding rates, cargo classifications, cargo space or other facilities, loading or landing of freight, and adjustment and settlement of claims) except for service contracts; employing fighting ships; offering or paying deferred rebates; using a loyalty contract in non-conformity with the antitrust laws; demanding, charging or collecting rates or charges that are unjustly discriminatory between shippers or ports; giving undue or unreasonable preference or advantage to any person, locality or traffic, except for service contracts; subjecting any person, locality or traffic to an undue or unreasonably prejudice or disadvantage; refusing to negotiate with a shippers’ association; and disclosing any information that may be prejudicial to a shipper or consignee or common carrier or improperly disclosing a shipper or consignee business transaction to a competitor.

The third group includes: boycotting or unreasonable refusing to deal;

90. Id. at § 1703(b).
91. Id. at § 1706(b).
92. Id. at § 1709 (draws together the prohibited acts in §§ 1713, 1715-16 and elsewhere of the 1916 Shipping Act).
93. Id. at § 1709(a).
94. Id. at § 1709(b).
restricting unreasonably the use of intermodal services or technological innovations; engaging in any predatory practice to eliminate the participation or deny entry; negotiating with a nonocean carrier or group of nonocean carriers on rates and services; denying compensation to an ocean freight forwarder or limiting compensation to less than a reasonable amount; and allocating shippers to carriers or prohibiting a carrier from soliciting cargo from a particular shipper that are parties to the agreement.\textsuperscript{95} The fourth group includes: failing to establish, observe and enforce just and reasonable regulations related to their business; agreements to boycott or discriminate unreasonably in the provision of terminal services to any common carrier or ocean tramp vessel, together with the last three factors mentioned in the second group.\textsuperscript{96}

4. \textit{Investigations}

Section 11 deals with investigations. The FMC, upon complaint or upon its own motion, may investigate any conduct or agreement that it believes may be in violation of this Act. The investigation remains in effect until the FMC issues an order. Within ten days after the initiation of a proceeding under this section, the Commission shall set a date on or before which its final decision will be issued. This date may be extended. Section 11 also covers complaints, reports, reparations and injunctions,\textsuperscript{97} and section 12 provides for the utilization of subpoenas and the discovery procedures. Section 13 addresses penalties and, in addition, it provides for additional penalties and Presidential review of orders. Further, orders of the Commission relating to a violation of the Act or a regulation are dealt with under section 14.\textsuperscript{98}

5. \textit{Filing, Tariffs and Administration}

Section 1704 of the 1984 Act provides for filing of every agreement regarding ocean common carriers and ocean terminal operators involved in ocean transportation in United States foreign commerce. The filing provision also applies to oral agreements.\textsuperscript{99} Such agreements become effective on the forty-fifth day of filing unless the FMC seeks additional information. The FMC may also seek injunctive relief if, after the filing or the effective date of an agreement, it determines that the agreement is

\textsuperscript{95} Id. at § 1709(c).
\textsuperscript{96} Id. at § 1709(d).
\textsuperscript{98} Id. at § 822 (the 1916 act is similar to the 1984 act covering general orders, cover ups reversal or suspension of orders, enforcement of nonreparation orders, and enforcement of reparation orders).
likely to produce an unreasonable reduction in transportation service. Carriers and conferences must also file their service contract’s confidentially with the FMC, however, those covering commodities excepted from tariff filing are not required to be filed. Further, these service contracts must provide the public with a statement of the contracts’ essential terms and make them available to all other shippers similarly situated.100

Section 1707 of the 1984 Act covers tariffs. Tariffs of each ocean common carrier (for products other than bulk cargo, forest products, recycled metal scrap, waste paper, and paper waste) shall show all rates, charges, classifications, rules, and practices between all points or ports on its own route and on any through transportation route that has been established.101 The inland division of through rates need not be stated.102 The tariffs filed with the FMC shall be kept open for public inspection and copies of tariffs shall be made available to any person for a reasonable charge. Rates shown in tariffs filed may vary with the volume of cargo offered over a specified period of time.103 Rate increases may become effective thirty days after filing unless otherwise authorized, however rate decreases may become effective on filing or publication.104 The FMC may also allow refund of freight charges collected or waive a collection of a portion of the charges upon application of a carrier or shipper subject to certain conditions.105 The FMC prescribes the form and manner of filing tariffs.

The 1984 Act also contains numerous administrative and other features. Section 1716 empowers the Commission to make rules and regulations to carry out the Act, it also enables the Commission to prescribe interim rules and regulations.106 Further, the rules under which controlled carriers (i.e., government owned carriers) can operate are provided for in section 9. Furthermore, ocean freight forwarders are covered under section 19 of the Act, which deals with licensing, revocation or suspension of their licenses, exceptions, and compensation. Finally, section 23 provides for the bonding of non-vessel operating common carriers.

In summary, it should be noted that the 1984 Act introduced a number of substantial changes concerning agreement standards,107 anti-

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100. Id. at § 1707.
101. Id. at § 1717(a).
102. Id.
103. Id. at § 1717(d).
104. Id.
105. Id.
106. Section 1715 of the 1984 Act is virtually the same as § 833(a) of the 1916 Act, except that it adds an additional condition to be satisfied, namely that the exemption will not result in a substantial reduction in competition. Id. at § 1715. Section 1716 of the 1984 Act is similar to section 841(a) of the 1916 Act.
107. 46 App. U.S.C. §§ 1705, 1717 (regulating the assessment of agreements, the “public in-
trust immunity, independent action, service contracts, common carriage, tariff filing and enforcement, and discrimination in foreign-to-foreign trades. The 1984 Act made several smaller changes as well. For example, the declaration of policy was explicitly stated, several new definitions were added, others were changed or deleted, and the scope of agreements within the 1984 Act was reworded.

IV. Rationale for Exempting Ocean Liner Shipping from Competition

Over the history of conferences, two basic rationales - the economic and the political - have been provided to justify the exemption of ocean liner shipping from competition. The economic rationale which has been developed under various theoretical models has been increasingly questioned and its justification for continuing the exemption for ocean liner shipping from competition has been challenged. This rationale is based on the argument that conferences are needed to provide stability of rates and services in an otherwise unstable industry which works to the benefit of users as well as carriers. This rationalization has been advanced

108. 46 App. U.S.C. § 1706. This section was introduced to bring about clarity as to what activities fall within the scope of an agreement that is granted antitrust exemption. It provided for antitrust exemption for "any agreement that has been filed under section 1704 and has become effective under section 1704(d) or 1705, or is exempt under section 1715 of this Act from any requirement of this chapter." Id. at § 1706. Further, this section provides that carriers are immunized for conduct which they had a reasonable basis to conclude and which is covered in the filed agreement. It clarifies its application to nonocean carriers, the division of through rates and the operation of a marine terminal in the United States.

109. Id. at § 1714 (increasing the scope of independent action). Individual conference carriers have the statutory right to take unilateral action on any rate or service item required to be filed in a tariff subject to a 10 day notice period and adopting the same action was made possible after its effective date. The right of independent action was also required in agreements between carriers not in the same conference and between interconference agreements.

110. Id. at § 1707 (allowing an exchange of service contracts for antitrust immunity of dual rates or loyalty contracts were removed).

111. Id. at § 1701.

112. Id. at § 1717.

113. Id. at § 1702 (containing 27 definitions).

114. Id. at § 1703(a) (describing in different subsections the agreements to which the 1984 Act applies and covers up marine terminal operators in § 1703(b) and excludes acquisitions in § 1703(c) (in the shipping act of 1916 these were summarized in one paragraph in 46 U.S.C. 814).

115. The RTPC stated: "The public interest would not be served by excessive rate competition and instability in the liner trades," see SHIPPING CONFERENCE ARRANGEMENTS AND PRACTICES, Restrictive Trade Practices Commission, Department of Justice, Ottawa, 1965, at 100. See
under two basic models: The monopoly-cartel model, and the theory of the core model.

The rationale for the monopoly-cartel theory is based on the presence of cream-skimming and fly-by-night entry by competitors. This leads to excessive entry and unrestrained competition, resulting in instability and destructive competition. This forces carriers to collude and erect barriers which prevent entry. The above rationale and result has been subject to careful scrutiny. The literature generally concludes that in order for instability or destructive competition to occur, the industry must exhibit three major characteristics. One, sunk costs - costs which cannot be recouped - must represent a large portion of total costs. Two, the industry which is profitable in the short run must be vulnerable to entry of competitors even when it is inefficient from a social point of view. And three, there are extended periods of excess capacity - production at less than one's lowest cost - when demand falls. In such circumstances, it is possible that firms may reduce prices to levels that are too low to cover their total costs.

Whether the above characteristics hold has been the subject of extensive discussion. In general, it is argued that liner markets do not exhibit the characteristics of markets that are subject to destructive competition. First, sunk costs do not appear to be a large proportion of total costs, as ships are mobile and firms can move their assets from one shipping route to another. However, it is recognized that in some trades ships have been developed to meet special requirements of users and are therefore less readily transferable than in other routes. Further, some carriers may also have significant investment in port facilities on


116. In addition to the above models, there are two other models that have been used to justify the instability argument. The contestability market model and the normal cost based model of oligopoly.

117. In the earlier stages of conference development this led to the formation of closed conferences and the erection of other barriers for example denial of use of infrastructure owned or leased by conference carriers. The exemption of conferences from competition enables the trade to form conferences which can self-regulate the industry ensuring stability and provision of rationalized high quality service. The monopoly-cartel theory emphasizes certain structural characteristics such as a single supplier or a few suppliers who jointly act as a single supplier and entry barriers. These structural characteristics lead to certain types of performance such as higher prices, reduced output and supra-normal profits. Where there is collusion among suppliers, part of the supra-normal profits often is wasted in excessive service competition forcing up costs.


particular trade routes some of which may obviously be saleable. Second, regarding inefficient entry, the danger is rather limited as firm level economies of scale on individual trade routes are not extensive. This is suggested by the number of firms with varying capacities which exist on major trades in a Federal Maritime Commission report. It indicates that concentration on major routes is typically in the low to moderate range. Third, the purported risks associated with uncertain demand can be addressed through long term contracts between carriers and shippers.

In view of the above, other economic models have been used to provide an alternative justification for the destructive competition argument which has received attention recently. One such model is the "economic theory of the core," which implies that in certain kinds of markets, there is no sustainable competitive equilibrium. It has been argued in a paper in 1989 that liner shipping may be an example of such an "empty core" industry.

However, it has been pointed out that the theory of the empty core is of questionable relevance as a justification for shipping conferences. The principal paper on which this view of conferences is based has been criticized on technical grounds. More generally, the evidence indicates that in most trade routes, there are a large number of carriers operating at different levels of capacity. This is a condition that is unlikely to prevail if there is an empty core. The existence of the empty core is most probable if an individual firm's capacity in the industry is large relative to the total demand, and if firms are homogeneous in their cost structures. This does not appear to be so in the liner industry.

It may also be noted that conferences have not, in practice, provided stability of rates and services. Indeed, in recent times, conference rates have tended to be volatile. In 1990, conference rates were affected by significant increases in surcharges as well as base rates. Evidence of instability of services was provided in a number of submissions to the Industry Advisory Group Relating to the Review of the SCEA, which drew

120. Id. at 6.
122. Lester G. Telser, Cooperation, Competition, and Efficiency, 28 J.L. & Econ. 271, 271-95 (1985).
125. Id. at 33-34.
126. Id. at 204 (stating that of the eighteen trades analyzed in the U.S., six trades were significantly more unstable in the post 1984 period).
attention to the recent withdrawals of conference services from the Atlantic ports despite SCEA.

The political rationale is based on the argument that conferences are required by considerations of international comity. 127 Conferences operate on all of Canada's major trading routes with Europe, the United Kingdom, Japan, Southeast Asia and South America. Their role has been sanctioned by specific legislation in many jurisdictions. In this context, a desire to ensure compatibility of Canadian maritime policy with our major trading partners appears to have been a consideration in adopting the present exemption for conferences from competition law under SCEA.

The argument that conferences should be accepted by Canada for reasons of international comity, while still important to consider, also seems less compelling than in the past. In 1991, the United States Assistant Attorney for Antitrust, James F. Rill, categorically rejected the view that acceptance of conferences is required by the traditional concept of comity in international law. In his remarks before the U.S. Advisory Commission on Conferences, Mr. Rill stated "[I]t takes a broad stretch of ingenuity to transform the comity doctrine to a justification for an outmoded and wasteful regulatory regime." 128 American jurisprudence indicating that the comity doctrine does not require nations to maintain policies which are fundamentally prejudicial to their national interests supports Mr. Rill's viewpoint. 129

V. EMERGING DEVELOPMENTS AND TRENDS, AND A FEW MAJOR ENSUING ISSUES

A. EMERGING DEVELOPMENTS AND TRENDS

Even as the rationale for exemption is being challenged, fundamental changes are occurring in liner shipping. The most significant of these changes is technological change. This, together with developments such as new forms of organizations, new forms of agreements, and new forms of services, are having a dramatic impact on liner shipping. These developments have become so noticeable that some authors refer to them as "the new paradigm." Though less important when viewed individually,
these developments are quite significant when considered jointly, since they can be considered as enhancing the power of conferences. Some of the emerging developments and trends will hereafter be examined.

1. Technological Changes, New Forms of Organizations, New Forms of Agreements and New Forms of Services

a. Technological Changes

Though containers were introduced into the shipping industry several decades ago, containerized cargo continues to grow and represent an increasing share of international cargoes handled at ports. For example, in Canada this is indicated in Table 1 hereafter which shows that containerized cargo has nearly doubled over the period 1981-1995. Though the total percent of containerized cargo (i.e., 6.0 percent) may not appear very large, in terms of value it is much more significant (i.e., 25 percent of the total value) than appears on the surface. The change in containerized cargo can also be seen in the growth of TEUs (twenty-foot equivalent units) at a few international ports shown in Table 2.

**Table 1 - Containerized Tonnage Loaded and Unloaded in International Shipping 1981-1995**

<table>
<thead>
<tr>
<th>Yr.</th>
<th>Loaded ('000 t)</th>
<th>%</th>
<th>Unloaded ('000 t)</th>
<th>%</th>
<th>Handled ('000 t)</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981</td>
<td>4,344</td>
<td>3.0</td>
<td>3,232</td>
<td>4.7</td>
<td>7,576</td>
<td>3.5</td>
</tr>
<tr>
<td>1985</td>
<td>4,546</td>
<td>3.2</td>
<td>4,547</td>
<td>7.6</td>
<td>9,093</td>
<td>4.5</td>
</tr>
<tr>
<td>1990</td>
<td>7,063</td>
<td>4.4</td>
<td>5,194</td>
<td>7.1</td>
<td>12,257</td>
<td>5.3</td>
</tr>
<tr>
<td>1995</td>
<td>9,242</td>
<td>5.2</td>
<td>6,354</td>
<td>7.6</td>
<td>15,596</td>
<td>6.0</td>
</tr>
</tbody>
</table>

*Source: SHIPPING IN CANADA, Statistics Canada, Catalogue 54-205 Annual.*

**Table 2 - TEUs at a Few Selected Ports 1970-1997**

<table>
<thead>
<tr>
<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>NY</td>
<td>920,000</td>
<td>1,700,000</td>
<td>1,800,000</td>
<td>1,900,000</td>
<td>2,300,000</td>
<td>1,900,000</td>
<td>2,000,000</td>
<td>2,518,000</td>
<td>171</td>
</tr>
<tr>
<td>Seattle</td>
<td>20,000</td>
<td>430,000</td>
<td>640,000</td>
<td>800,000</td>
<td>850,000</td>
<td>1,200,000</td>
<td>1,400,000</td>
<td>1,480,000</td>
<td>705</td>
</tr>
<tr>
<td>Long Beach</td>
<td>400,000</td>
<td>560,000</td>
<td>720,000</td>
<td>1,400,000</td>
<td>1,600,000</td>
<td>2,600,000</td>
<td>3,400,000</td>
<td>75</td>
<td></td>
</tr>
<tr>
<td>Hamburg</td>
<td>78,000</td>
<td>310,000</td>
<td>600,000</td>
<td>890,000</td>
<td>1,200,000</td>
<td>2,000,000</td>
<td>2,700,000</td>
<td>NA</td>
<td>3,361</td>
</tr>
<tr>
<td>Rotterdam</td>
<td>300,000</td>
<td>1,100,000</td>
<td>1,600,000</td>
<td>2,200,000</td>
<td>2,900,000</td>
<td>3,700,000</td>
<td>4,500,000</td>
<td>NA</td>
<td>1,400</td>
</tr>
<tr>
<td>Felixtowe</td>
<td>150,000</td>
<td>220,000</td>
<td>300,000</td>
<td>650,000</td>
<td>900,000</td>
<td>1,400,000</td>
<td>1,700,000</td>
<td>NA</td>
<td>1,033</td>
</tr>
<tr>
<td>Montreal</td>
<td>72,000</td>
<td>100,000</td>
<td>190,000</td>
<td>320,000</td>
<td>530,000</td>
<td>570,000</td>
<td>730,000</td>
<td>900,000</td>
<td>115</td>
</tr>
<tr>
<td>Halifax</td>
<td>30,000</td>
<td>170,000</td>
<td>190,000</td>
<td>170,000</td>
<td>270,000</td>
<td>450,000</td>
<td>310,000</td>
<td>450,000</td>
<td>1,400</td>
</tr>
<tr>
<td>GLOBAL</td>
<td>6.3m</td>
<td>16m</td>
<td>28m</td>
<td>43m</td>
<td>61m</td>
<td>86m</td>
<td>125m</td>
<td>NA</td>
<td>1,884</td>
</tr>
</tbody>
</table>

Figures for 1997 are Estimates. Where figures are not available, the % change refers to 1970-1994.  
*Source: Containerisation International Yearbook data and Journal of Commerce/Piers and ports.*

This growth in containerization has had a tremendous impact on the entire shipping industry. It has led to developments such as new multimodal networks, new technologies in port infrastructure, sophisticated
logistical network systems, and new vessel configurations. This has not only led to dramatic operating efficiencies but has also led to an unprecedented improvement in services throughout the world.

The above noted developments have now also attracted greater attention. This can be seen in the increase in multimodal traffic which has been particularly pronounced in the United States. This is shown in the figures on trailer/container loadings in the following table.

**Table 3 - Annual Trailer/Container Loadings 1982-1994**

<table>
<thead>
<tr>
<th>Year</th>
<th>Trailers</th>
<th>Containers</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1982</td>
<td>3,496,262</td>
<td>2,491,093</td>
<td>3,396,973</td>
</tr>
<tr>
<td>1985</td>
<td>4,590,952</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1989</td>
<td>3,451,953</td>
<td>2,754,829</td>
<td>5,206,782</td>
</tr>
<tr>
<td>1990</td>
<td>3,209,239</td>
<td>3,034,208</td>
<td>6,243,447</td>
</tr>
<tr>
<td>1991</td>
<td>3,305,506</td>
<td>3,359,926</td>
<td>6,709,732</td>
</tr>
<tr>
<td>1992</td>
<td>3,458,406</td>
<td>3,692,051</td>
<td>7,150,457</td>
</tr>
<tr>
<td>1994</td>
<td>3,763,799</td>
<td>4,280,589</td>
<td>8,044,388*</td>
</tr>
</tbody>
</table>


As one source noted: “To say that 1994 was really a good year for intermodal would be understating its growth. Bordering on the incredible would be a fairer description.” 130 Perhaps what is noteworthy is that the growth in containers in the foregoing figures is more dramatic and relevant to liner shipping as containers are used basically in international and offshore trade.

The increase in intermodal traffic has also spread to Canada, as noted by the National Transportation Agency of Canada “Intermodal traffic increased more than any other major traffic segment in 1994.” 131 In terms of magnitude, in 1992, intermodal rail traffic (i.e., containers and trailers-on-flat-cars) totaled 13m tons or 7 percent of total freight of Class I carriers (in terms of value this intermodal traffic is significantly more important). Of this total, 4.5m tons were domestic intermodal movements and 8.5m tons were international (i.e., it moved intermodally either through or from Canadian ports, or to or from the United States). This increasing trend was noted earlier by the NTARC in its statement: “The widespread implementation of an intermodal approach to the movement of domestic and export/import freight has been one of the most significant developments on the transportation scene in North America in re-

---

cent years.”

To accommodate the increase in intermodal traffic a number of strategic investments have also taken place. CP Rail undertook a 27.5 million-dollar investment to enlarge its Windsor-Detroit tunnel, which it opened in May 1994, and CN undertook a 155 million-dollar investment in its recently completed Sarnia-Port Huron tunnel. This would enable the railways to move tri-level railcars or double-stack cars, the latter has been described as the most important innovation in multimodal transportation. CN also undertook a 17 million-dollar investment in the Halifax intermodal terminal, and has set up a network of modern hub terminals across Canada equipped with top-lifting equipment. In keeping with the latest developments elsewhere, CN has offered an Internet-based shipment tracking system, becoming the world’s first rail carrier to offer such a service.

Even in Europe, intermodalism is beginning to take hold, though it has not kept up with the pace of developments in United States and Canada. In terms of volume, the EU Transport Directorate calculated that intermodal transport moved about 5.6 million TEUs in 1993 compared to the 6.4m TEUs in 1994. This represents about 4 percent of the total European freight market. Maritime containers moving by rail to and from seaports were estimated to be about 2.5m TEUs. The interest in intermodalism has recently been renewed with the opening of the Channel Tunnel and EEC Directives 440/91, 18/95 and 19/95.

In addition to the foregoing changes, one of the latest technological developments that has attracted attention is a new vessel configuration. The size of containerships has evolved over the last two decades and has reached dimensions that have been termed “behemoth,” as the quest to achieve economies of ship size continues. This can be seen in the statistics on size of containerships of one company (i.e., Maersk) as an example. Other shipping companies are following in the footsteps of Maersk. For example, P & O Containers, NYK, Evergreen, OOCL, Neptune Orient Lines, Hanjin Shipping, Hyundai Merchant Marine and Cosco have ordered ships with capacities of nearly 5,000 TEUs or more. As if the new sizes were not enough, the concept of a 15,000 TEU ship was recently considered. Experts claim that further evolution in sizes may lead to ships of up to 8,000 TEUs. Sizes beyond that have raised doubts as to whether further economies of ship size could be achieved and whether


133. Recently it was reported that “Maersk Line has launched the world’s largest containership, a behemoth that is the first to break the 6,000-TEU mark.” Philip Dumas, The Scramble for Position, American Shipper, Mar. 1996, at 40.

134. Economies of size are basically achieved through savings on labor costs, not only
the present day size of cranes and terminal landside facilities could cope
with this increase.\textsuperscript{135}

\begin{table}[h]
\centering
\caption{Size and Speed of a Typical Maersk Containership 1968-1996}
\begin{tabular}{|c|c|c|c|}
\hline
Year & Name of Vessel & TEU Capacity & Speed (knots) \\
\hline
1968 & Weser Express & 700 & 20.6 \\
1969 & Encounter Bay & 1,500 & 21.5 \\
1972 & Liverpool Bay & 3,000 & 26 \\
1984 & American New York & 4,482 & 18 \\
1992 & CGM Normandie & 4,425 & 24 \\
1996 & Regina Maersk & 6,000 & 25 \\
\hline
\end{tabular}
\end{table}


b. New Forms of Organizations

"Superconferences" constitute the first of these recent forms of or-
ganization. Superconferences are basically large entities formed from
the amalgamation of existing smaller conferences. Their emergence in vari-
ous jurisdictions did not occur simultaneously. In Canada, they began to
emerge after 1987. At times, as many as nineteen smaller conferences
joined to form one major conference.\textsuperscript{136} In 1984, there were forty-four
conferences. Ten years later, the number of conferences had fallen to
twenty-five.

In the United States, the formation of superconferences began much
earlier — roughly in 1984. This has been attributed to the United States
Shipping Act of 1984 which moved away from a public interest standard.
This provided the opportunity for the consolidation of smaller confer-
ences into larger superconferences. For example, in 1984, nine confer-
ences operating between the East Coast of the United States and Europe
combined into one eastbound and westbound conference; and on the U.S.
East Coast there were nineteen conference and rate agreements in the
Pacific Far East trade which were replaced by one superconference and
three small conferences.

through fewer crew but perhaps more TEU per crewmember. The larger container-size ships
have also succeeded in maintaining their speed if not increasing it.

\textsuperscript{135} Philip Damas, \textit{Big, Bigger, Biggest}, \textit{American Shipper}, July 1996, at 54-58.

\textsuperscript{136} The well known superconferences that have been formed are the US Atlantic-North
Europe Conference, the North Europe-US Atlantic Conference, Asia North America Rate
Agreement, Transpacific Westbound Rate Agreement, and the Mediterranean/USA Freight
Conference. The FMC indicates that this development is the most apparent structural conse-
quence of the U.S. Shipping Act of 1984. Professor Butz attributes the development to extended
immunity to intermodal rate making which greatly increased competition.
While superconferences have attracted attention in Canada and the U.S., the development of consortia has been particularly noticeable in the EEC.\textsuperscript{137} Of the fifty-seven consortia operating worldwide in 1990, forty consortia operated in Community liner trade.\textsuperscript{138} The Competition Directorate of the European Commission believes that consortia are the wave of the future as these arrangements are generally based on the need for technical rationalization, an increase in the capital intensity of the shipping industry, the development of containerization, bigger ships and the need to compete.\textsuperscript{139}

Another organizational form that has recently come into the limelight are global alliances. A global alliance is simply another consortium or carrier agreement. The basic difference is that a traditional consortium operates in a single trade lane and a global alliance is a multiple trade lane consortium. The significance of this new form of organization is shown in the formation of five alliances as of the beginning of January 1996 and in their total market share shown in the Table 5 below for the Asia/US West Coast market. Since the above data was published, a sixth alliance was formed between K Line and Yang Ming. These newly formed alliances deploy an armada of between 49 and 67 big boxships, each representing a shipboard capacity of between 189,000 and 230,000 TEUs. These numbers appear to be dwarfed in comparison to some of the big ships that have been ordered and are currently entering service.\textsuperscript{140} In the words of one observer, "big is beautiful. Global alliances are another quantum leap in that direction and . . . they are here to stay."\textsuperscript{141}

\textsuperscript{137} In brief, a consortium is a joint-service agreement between liner shipping companies with the aim of rationalizing their operations by means of technical, operational and/or commercial arrangements. The European Commission in the first paragraph of EEC 870/95 has provided a more elaborate definition.


\textsuperscript{139} The concept of a consortia has alluded precise definition. Nevertheless, the Commission defines a consortium as "a joint-service agreement between liner shipping companies with the aim of rationalizing their operations by means of technical, operational and/or commercial arrangements."

\textsuperscript{140} The concept of 15,000 TEU has been considered too big since there are limits to economic size. Damas, supra note 135, at 54-58.

\textsuperscript{141} Id. at 36.
This effect is rubbing off on shippers too, as shippers are forming global alliances. In 1994, the NITL, the European Shippers' Council (consisting of seventeen Shippers' Council from various countries in Europe) and the Japan Shipper's Council formed a Tripartite Shippers' Council. Though information sharing appears to be one of their major activities, they support each other in efforts such as shipping reform legislation, international agreements on maritime, shippers' changing relationship with ocean carriers, etc. This effort at shipper solidarity ‘could well translate into cooperative joint ventures in educational opportunities and coordinated activities of a host of policy issues.'\textsuperscript{142} The Tripartite was expected to expand its membership to shippers in Canada, Hong Kong and Korea in 1997.

c. New Forms of Agreements

Besides the foregoing developments, new forms of commercial agreements have emerged. For instance in Canada, discussion agreements, bridging agreements, space chartering agreements, etc. have evolved since SCEA, 1987. Table 6 shows the number and types of these new agreements. The significance of these new agreements is shown in the last row as a percent.

\textsuperscript{142} Tim Sansbury, \textit{Shippers Group Follows the Fold, Starts an Alliance}, J. Com., Nov. 18, 1996, at 6C.
**Shipping Conference Legislation**

**Table 6 - Number and Type of Agreements in Canadian Shipping 1988-1992**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Discussion Agreements</td>
<td>0</td>
<td>3</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>Bridging Agreements</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Capacity Reduction Agreements</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Inter Conference Agreements</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Space Chartering Agreements</td>
<td>0</td>
<td>0</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>Rate Agreements</td>
<td>32</td>
<td>30</td>
<td>25</td>
<td>23</td>
</tr>
<tr>
<td>Total Agreements</td>
<td>32</td>
<td>36</td>
<td>37</td>
<td>31</td>
</tr>
<tr>
<td>Other Agreements as a % of total</td>
<td>0</td>
<td>16.6</td>
<td>32.4</td>
<td>25.8</td>
</tr>
</tbody>
</table>

Sources: Annual Reviews of the National Transportation Agency of Canada. See Reviews for the years 1988, at 71; 1989, at 91-92; and 1992, at 140.

These agreements have increased from zero in 1988 to 32.4 percent in 1992 or 25.8 percent in 1997. Discussion and bridging agreements provide a forum to discuss general conditions of liner trade. Space chartering and sailing agreements are formed for the purpose of rationalizing service through vessel space, including equipment interchange and scheduling of ports. Stabilization agreements attempt to reduce the available carrying capacity on a trade route in an attempt to stabilize rates and improve profitability.

In the EEC too, a number of new commercial arrangements have also emerged, some of which go beyond conference agreements. They not only include agreements between conference and non-conference carriers but also consortia agreements. For example, the most notable agreements between conference and non-conference carriers are Eurocorde I, the Trans Atlantic Agreement and the Trans Atlantic Carriers Agreement. The importance of consortia agreements has been reflected in the EC Council Decision of December 1991, and later with the passage of Regulation 870/95 which provided shipping lines antitrust immunity to form operational consortia in ocean transportation. The first four consortia to have been approved under the new regulation are the St. Lawrence Coordinated Service between North Europe and Canada, the Joint Mediterranean Canada Service, the East African Container Service between Europe and East Africa and the U.K./Poland Joint Pool Agreement.

In the United States also, new types of agreements have increased in proportion to all agreements filed. This can be seen in the statistics on agreements filed with the Federal Maritime Commission which indicates that the proportion of other types of agreements filed in 1987 has risen to

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143. For example, agreements between conferences and independents, stabilization agreements, discussion agreements, open rate agreements, etc.
37 percent from 15 percent in 1981; and that of all new agreements, as much as, 96 percent are other types of agreements (see Table 7).

In addition, the geographic scope of agreements have increased in several ways. Conference agreements typically now involve superconferences, whose geographic scope has been expanded. Further, a number of recent agreements also include independent carriers covering a significant share of a trade, for example the Trans Atlantic Agreement. Agreements also include intermodal rates covering other modes of transportation. These new developments have tended not only to increase the power of conferences, but also to provide more efficient and varied services.

**Table 7 - Number and Type of Agreements in U. S. Shipping 1981-1987**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate Agreements</td>
<td>2</td>
<td>127</td>
<td>3</td>
<td>112</td>
<td>3</td>
<td>147</td>
</tr>
<tr>
<td>Joint Ser. &amp; Con. Ag.</td>
<td>0</td>
<td>5</td>
<td>1</td>
<td>10</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Pooling Agreements</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>15</td>
<td>0</td>
<td>25</td>
</tr>
<tr>
<td>Sail &amp; Space Ch. Ag.</td>
<td>3</td>
<td>6</td>
<td>5</td>
<td>12</td>
<td>15</td>
<td>14</td>
</tr>
<tr>
<td>Coop. Work &amp; Dis Ag.</td>
<td>2</td>
<td>3</td>
<td>1</td>
<td>3</td>
<td>14</td>
<td>28</td>
</tr>
<tr>
<td>Misc. Agreements</td>
<td>6</td>
<td>7</td>
<td>8</td>
<td>3</td>
<td>38</td>
<td>15</td>
</tr>
<tr>
<td>Total Agreements</td>
<td>13</td>
<td>149</td>
<td>18</td>
<td>155</td>
<td>74</td>
<td>234</td>
</tr>
<tr>
<td>Other Agreements as a % of Total</td>
<td>84.6</td>
<td>14.7</td>
<td>83.3</td>
<td>27.7</td>
<td>95.9</td>
<td>37.2</td>
</tr>
</tbody>
</table>

Mod=Modifications to existing agreements.

d. New Forms of Services

As a consequence of the above developments and in response to demand, new forms of services are developing for frequent, reliable, rapid service at a minimum cost so as to enable exported products to be competitive with domestic production. Over the last few years (1987-1994), the growth in conference landbridge services (i.e., the overland portion of international intermodal movements) has been spectacular (see Table 8).
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**Table 8 - Number of Weekly Landbridge Services 1987-1994**

<table>
<thead>
<tr>
<th>Year</th>
<th>Eastern Canada to Far East Conference</th>
<th>Western Canada to U.K./Continent Conference</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Non-Conference</td>
<td>Non-Conference</td>
</tr>
<tr>
<td>1987</td>
<td>9</td>
<td>3</td>
</tr>
<tr>
<td>1988</td>
<td>10</td>
<td>1</td>
</tr>
<tr>
<td>1989</td>
<td>12</td>
<td>3</td>
</tr>
<tr>
<td>1990</td>
<td>14</td>
<td>3</td>
</tr>
<tr>
<td>1991</td>
<td>17</td>
<td>6</td>
</tr>
<tr>
<td>1992</td>
<td>23</td>
<td>6</td>
</tr>
<tr>
<td>1993</td>
<td>28</td>
<td>9</td>
</tr>
<tr>
<td>1994</td>
<td>24</td>
<td>13</td>
</tr>
</tbody>
</table>

*Source: Annual Review of the National Agency of Canada 159 (1994).*

Besides the intermodal services shown above the new global alliances serving North America have established a number of services on the trades shown in Table 9.

**Table 9 - Service Routes of the Global Alliances**

<table>
<thead>
<tr>
<th>Carriers</th>
<th>Routes</th>
</tr>
</thead>
<tbody>
<tr>
<td>NOL-APL/MOL/Hyundai</td>
<td>Trans-Pacific, Asia-Europe, Transatlantic, Latin America</td>
</tr>
<tr>
<td>Sea-Land/Maersk</td>
<td>Trans-Pacific, Asia-Europe, Asia-U.S. East Coast, Europe-Middle East, Asia-Middle East/Mediterranean</td>
</tr>
<tr>
<td>P&amp;O Nedlloyd/NYK/Hapag</td>
<td>Trans-Pacific, Asia-Europe</td>
</tr>
<tr>
<td>Lloyd/ OOCL/Malaysia</td>
<td></td>
</tr>
<tr>
<td>International</td>
<td></td>
</tr>
<tr>
<td>Hanjin/DSR Senator/Cho</td>
<td>Trans-Pacific, Asia-Europe, Transatlantic, Middle East</td>
</tr>
<tr>
<td>Yang/UASC</td>
<td></td>
</tr>
<tr>
<td>K Line/Yang Ming</td>
<td>Trans-Pacific, Asia-Europe</td>
</tr>
</tbody>
</table>


2. **Legislative Developments in Canada, EEC and the United States**

In an effort to ensure that conference legislation appropriately considers these emerging developments, attempts are being made to withdraw the exemption or to amend liner legislation in the major jurisdictions throughout the world. In particular, attempts are being made to restrict the scope of the exemption for liner conferences and to bring about a convergence in liner legislation which has often created friction between various jurisdictions. The legislative changes or developments in Canada, EEC and the United States are examined below.

a. **Canada**

In Canada, since the SCEA was enacted, three major developments on legislative proposals have occurred. First, an Industry Advisory
Group conducted hearings on the SCEA. The major issues recurring through the majority of the submissions submitted to the Group were whether there is a need for conference exemption from the Competition Act and what the major difficulties are with the SCEA. The majority of submissions indicated that the SCEA had little or no impact and that the potential repercussions do not provide any convincing reasons for the retention of the exemption. The discussion on the major difficulties with the SCEA focused on the interpretative difficulties of the Act pertaining to definitions, the ineffectiveness of the Canadian Shippers' Council, the dispute mechanism provision, the notice period provision, and how the SCEA should be interpreted in a changing environment. The roles and responsibilities of the National Transportation Agency and Industry Canada were also raised.

Second, in March 1993, the National Transportation Act Review Commission ("NTARC") reviewed transportation legislation and released its report. It made three recommendations and a few proposals on conference liners. The Commission noted that the exemption runs counter to the general policy of encouraging competition. In principle, opposition was expressed regarding the intent of the SCEA as it clearly conflicts with the competitive thrust of the NTA, 1987. Due to the possible uncertainty and the need for international action, the Commission recommended that "the Minister of Transport introduce legislation to repeal SCEA at such time as United States antitrust immunity for shipping conferences is withdrawn." On the issue of multimodal rates, the Commission indicated that conferences should be allowed to negotiate with inland carriers for through freight rates. To encourage more carriers to set independent rates, the Commission recommended that "the federal Cabinet reduce to ten days the notice period for independent action by


145. The recommendations are in line with the proposals put forward by the Director of Investigation in Research, other than the one pertaining to conference agreements with other transport modes. Should this latter proposal be accepted by the government, it is suggested that certain conditions be attached: the right of independent action with regard to the entire multimodal rate or the inland portion of the rate; and the freedom of shippers to demand carriage by other multimodal modes in the event of any form of ownership of inland modes of transport by the conference. The first condition will ensure that the agreement is the most efficient and shippers will also benefit. The second condition would avoid conferences using their own high cost inland carriers or foreclosing other inland carriers from overseas traffic, thus eliminating agreements as occurred in the FEPC complaint to the European Commission. SUBMISSION TO THE NATIONAL TRANSPORTATION ACT REVIEW COMMISSION, The Director of Investigation and Research Competition Act, June 30, 1992, at 27-30.

146. COMPETITION IN TRANSPORTATION, supra note 144, Volume II, at 139.
shipping conference members."\textsuperscript{147} The Commission also listed a number of other proposals for considerations.\textsuperscript{148}

Third, the Standing Committee on Transport in June 1993 commented on the recommendations of the Commission.\textsuperscript{149} The Standing Committee agreed with two of the recommendations of the NTARC — to shorten the notice period to 10 days, and to permit intermodal conference contracts for "through freight rates for precarriage or onward land carriage."\textsuperscript{150} Regarding the NTARC's recommendation to repeal SCEA when the United States repeals its legislation, the Standing Committee recommended that "[t]hat the Minister of Transport not accept the NTARC's recommendation to automatically repeal the SCEA when the U.S. government removes anti-trust immunity of shipping conferences, but undertake a review of the legislation at that time and refer it to the Standing Committee on Transport."\textsuperscript{151} Since June 1993, no further major attempts at legislative reforms in conference legislation have been undertaken in Canada.

b. EEC

In the EEC regulatory reform has gradually begun to take off. This can be seen in the passage of the recent regulation on consortia and other developments regarding conference legislation. The Vice-President of the European Commission stated that "[t]imes are changing. Criticism is mounting against the conference system and efforts towards liberalization are being pursued worldwide. How can the European Community ignore this trend?"\textsuperscript{152} Attempts at bringing about further regulatory reform are continuing.

On April 21, 1995, Regulation No. 870/95 pertaining to rules for consortia went into effect. The key elements of this regulation are: (1) A consortium formed from members within a conference will be exempt from EU competition laws if its market share is less than 30 percent; (2) a consortium of non-conference carriers can have a market share of up to

\textsuperscript{147} Id.
\textsuperscript{148} These pertain to a definition of a "conference" and a "service contract," the nature of the information conferences must supply for the satisfactory conduct of the meeting, and filing of tariffs by non-vessel operating carriers and independent action on service contracts. Submission to the National Transportation Act Review Commission, supra note 145.
\textsuperscript{150} Id.
\textsuperscript{151} Id. at 16.
\textsuperscript{152} The Right Honorable Sir Leon Brittan, QC, Vice-President of the Commission of the European Communities, Liner Shipping: Developments and Prospects for the Community, Address Before the Insitut Francais de la Mer, Paris, France (Mar. 8, 1994).
35 percent; (3) a consortium with a market share of between 30 percent or 35 percent and 50 percent must notify the European Commission and will be granted exemption if no objection is issued within six months; (4) members of a consortium must have the right to withdraw without penalty on six months notice, after an initial period of eighteen months. In the case of a highly integrated consortium, the initial period is thirty months.

The above consortium regulation does not address the issue of joint intermodal operations by alliances. Nevertheless, it is held that global shipping alliances wishing to cooperate on inland transportation or to negotiate jointly with inland transportation modes or to jointly determine intermodal rates must apply for individual exemption from the European Commission.153

Besides the recently adopted consortia regulation, an advisory group has been working on establishing guidelines to determine whether certain inland cooperation practices of ocean carriers should be exempted. Simultaneously, jurisprudence is evolving on the Commission’s view of intermodal pricing, as several cases involving intermodal pricing are before the European Courts.

A more serious issue has developed regarding the applicability of EEC Regulation 4056/86 granting antitrust immunity to conferences. This regulation specifies that a conference must operate under ‘uniform or common rates’ sometimes termed as the ‘uniform rates doctrine.’ Taken literally, this could imply that a carrier agreement which allows its members to deviate from the conference tariff is not a true conference and consequently loses its exemption from the competition laws.154 Thus according to a 1995 OECD report, “it is apparent that, with respect to tariff discipline, the idea of a common or uniform rate by conferences is a definition which no longer reflects the reality of ocean container shipping industry.”155

Even as the interpretation of Regulation EEC 4056/86 is being challenged, the European Shippers’ Council consisting of seventeen Shippers’ Councils from various European countries are calling for a withdrawal of the block exemption for liner conferences. Other organizations are calling for a new regulation that would force shipping lines wanting to form a


154. While the EC views that an agreement that provides for total pricing flexibility does not qualify for exemption (as it could be viewed as eliminating competition through attracting non-conferences lines and as it serves no benefit to consumers in the form of meaningful and stable prices), there appears to be some continuum where some flexibility is compatible with present day commercial practices and EEC Regulation 4056/86.

conference to apply for individual exemptions rather than obtaining automatic block exemption without having to notify the European Commission. Neither the EU Commissioner for Competition, Karel Van Miert nor other EU competition agencies have left any doubt they would prefer to see EEC Regulation 4056/86 disappear.\textsuperscript{156} Unfortunately, recent reports indicate that EC is unlikely to revise this Regulation in the immediate future, since it is a new law and currently under judicial scrutiny.

c. United States

The developments on the legislative front in the United States since 1992 can perhaps be grouped under two major headings: The report of the Presidential Advisory Commission released on April 10, 1992,\textsuperscript{157} and bills introduced to revise or repeal the United States Shipping Act of 1984. These developments are briefly reviewed below.

The Report of the Advisory Commission examined a number of issues in the shipping industries and in the absence of consensus, the Report did not provide any conclusions or recommendations. On antitrust immunity to conferences, ports and terminal operators, carriers believe that conferences are a necessary part of the liner shipping industry. Supporters of conference antitrust immunity indicate the absence of abuses of antitrust immunity, the increase in the level of service and lack of supra-competitive profits. Opponents point to the health of the U.S. flag fleet, the possibility of excessive service competition, new commercial arrangements that would arise to deal with rate fluctuations, and the development of superconferences and discussion agreements which have undermined competitive forces. Regarding need for retention of antitrust immunity for ports and marine terminal operators, a number of reasons were advanced, such as the absence of abuse of immunity, immunity resulting from other legislation and uncertainty due to non-uniformity.

On tariff filing and enforcement (TFE),\textsuperscript{158} common carriage and service contracting, proponents of TFE contend that its benefits come largely from principles of access and nondiscrimination, in addition to its stabilizing influence on rates. Opponents of TFE see it as too bureaucratic, inflexible, expensive and, most importantly, incapable of ade-


\textsuperscript{157} Other discussions, such as U.S. Vice President’s, Al Gore’s, report entitled \textit{Congress Should Deregulate The Maritime Industry}, and the FMC discussion of section 6(g) of the United States Shipping Act of 1984 have been excluded.

\textsuperscript{158} Under the TFE provisions, conference members must be permitted to take independent action on ten days notice; however, it does not require independent action on service contracts. Tariff rates and essential terms of service contracts are published and must be made available to similarly situated shippers. See Shipping Act of 1984, 46 App. U.S.C. § 1709(b), (e) (Supp. 1994).
quately protecting small shippers from unjust discrimination. The similarly situated shipper arguments are largely ineffective given the commodity specific nature of tariffs and the availability of point-to-point through rates. Further, it is pointed out that TFE permits price-signaling. Furthermore, the need to file tariffs by NVOCCs (i.e., non-vessel operating common carriers) has been questioned because it would disadvantage NVOCCs in attracting cargo of small shippers.

The 1984 Act embodies the principles of common carriage and nondiscrimination. The 1984 Act does not, however, call for blanket “non-discrimination.” For example, FAK tariff, service contracts, time/volume contracts, etc. Most carriers, in their testimony before the Advisory Commission, argued for a system of common carriage as it ensures a nondiscriminatory shipping industry. Intermediaries and shippers presented more divergent views than the carriers.

Service contracts (“SCs”) are being used in most trade lanes. The Commission noted a number of problems relating to SCs: Lack of independent action, the requirement that they must be negotiated by the conference, disclosure of essential terms, the inability to sign global SCs, the prohibition of percentage-based contracts, and restrictions on modifying contracts. Conferences viewed SCs as a mixed blessing. While opposing mandatory independent action on SCs, they favor retaining public availability of essential terms as it is consistent with common carriage principles.

Regarding relations of conferences with shippers and transportation intermediaries, intermediaries have differing views regarding the conference system. NVOCCs have expressed concern that they have not been granted antitrust immunity despite the fact that they also are common carriers. This enhances conference market power making it more difficult for NVOCCs to enter into contractual arrangements with ocean carriers. Further, NVOCCs are not given the discounted rates provided to “similarly situated shippers” as they are not “beneficial owners” of the goods shipped. Furthermore, some NVOCCs feel that they should be allowed to sign service contracts. Freight Forwarders pointed out that artificial distinctions between various kinds of forwarders be removed for purposes of determining carrier compensation.

A number of bills were introduced to revise or repeal the US Shipping Act of 1984. The first attempt to repeal the Shipping Act of 1984 was Bill H.R. 5841 introduced in Congress by Thomas R. Carper entitled the “Shipping Act of 1992.” This Bill contained four new important features: confidential rate contracts with individual shipping lines; limiting

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159. These principles include: (1) non-arbitrary refusal of a carrier; and (2) same compensation for the same service under similar conditions. *Id.* at § 1704(b)(8).
anti-trust immunity to a conference and placing conditions when conference market share exceeds 60% of liner capacity on a trade lane; long-term contracts without conference or FMC interference; and minimum "percentage" service contracts. This Bill was strongly opposed by carriers and died on the House floor.

The second attempt was a bill introduced by Senator Metzenbaum that would repeal antitrust exemption for ocean carriers. The exemption, according to Senator Metzenbaum, raises costs to exporters, drives up cost of imports and increases transportation costs which consumers are forced to pay. Conferences also have the effect of neutralizing low cost non-conference rates through stabilization or discussion agreements. Further, the increase in costs will put U.S. exports at a competitive disadvantage. Furthermore, conferences can determine the fate of certain ports and US should not be protecting foreign dominated cartels due to the increasing number of lines seeking foreign registry. The Metzenbaum bill's thrust was weakened with the publication of the final version of Vice-President Al Gore's Report, and it ultimately died due to lack of support.

The third attempt to repeal the United States Shipping Act of 1984 was put forward by the National Industrial Transportation League (i.e., NITL) in January 1995, who introduced a plan entitled the "Shipping De-regulation Act of 1995." According to the plan, the DOJ would take over the FMC's job of regulating shipping and DOT would be responsible for policing carriers operated by foreign governments and protecting U.S. flag carriers. The NITL bill attempted to remedy some of the deficiencies of the Carper Bill. 'Simultaneously, in January 1995, Congress appointed a Subcommittee chaired by Representative Howard Coble to look into antitrust exemption provided under the United States Shipping Act of 1984 and the possibility of eliminating the Federal Maritime Commission. In March 1995, Chairman of the House Transportation Committee, Rep. Bud Shuster, said that his Committee will meticulously and slowly consider any legislation to deregulate shipping and eliminate the FMC. This led to the House Bill which was a product similar to the NITL and Sea-Land Service Bill. The major provisions of this bill known as the 'Ocean Shipping Reform Act' provided for: the elimination of the FMC; mandatory independent action on service contracts; elimination of tariff


and contract filings; and provided for the negotiation of confidential contracts between shippers and carriers.

On May 1, the House Transportation Committee passed the Bill. This initial success was however short-lived. A dual attempt to push the bill forward (as a stand alone Bill and as a Bill tacked to the Budget Conciliation measure through Congress) ended in failure. The Senate blocked the stand-alone Bill. It appears that certain provisions of the House Bill were unacceptable and that further hearings on the matter were needed so as to satisfy other vested interests such as port authorities, labor, etc. Some commentators believe that the true reason was because there were forces behind the Senate that wanted to see the Bill capsized.

In a sudden twist of events, to salvage what was left of the attempts to introduce regulatory reforms, three U.S. Senators - Larry Pressler, Trent Lott and John Breaux - introduced their own bill (known as the Senate Bill). The Senate Bill could be viewed more as a deregulation bill, it favors shippers, considers matters such as filing of individual contracts, retention of their confidentiality and endorses closed conferences.

In 1996, the House voted for a "second time" to overhaul the Shipping Act of 1984. The Bill cleared the House on May 1 by a vote of 239-182 and is identical to the earlier Bill that died in 1995. House Representative James L. Oberstar tried unsuccessfully to amend this House Bill by making contract terms publicly available and placing the FMC's functions under the independent Surface Transportation Board instead of the Transportation Department. However, given the problems of reconciling views and the lack of time in the 1996 session, attempts to reform shipping legislation were not successful.

Prospects of introducing reform in 1997 initially appeared bright when the Senate introduced a Bill in March 1997, which included several refinements to the previous bill. This Bill provides for individual confidential contracts, protection to US flag ships from foreign predatory pric-

163. Commentators indicate that even if the bill was passed by the Senate it would have been vetoed by the President as it would fall short of the two-thirds majority required as suggested by the House vote. See Tony Beargie, Back to Senate for Shipping Reform, American Shipper, June 1996, at 16; Tony Beargie, Senate Starts anew on Shipping Bill, American Shipper, Jan. 1996, at 15; Tony Beargie, Lott Sidetracks Shipping-Reform Bill, American Shipper, Feb. 1996, at 15; Michael Berzon B., Shipping Reform Compromise: A Resurrected Carrier Bill?, American Shipper, Feb. 1996, at 22-23.

164. Peter Gatti, the NITL's policy director, indicated that "this issue is now ripe for consideration. We expect that to occur early in the legislative year." He further indicated that the old arguments (that not enough time has been spent by our legislators, that no debate or hearings have been held, nor have a wide variety of interest groups consulted) can no longer be used to stall action. See Tim Sansbury, Ship Reform Inevitable, NIT League Chief Says, J. Com., Nov. 18, 1996, at 1C-3C.
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ing, merger of the FMC and the DOT, elimination of tariff filing, tariff enforcement by the Intermodal Transportation Board and the reduction of the notice period on independent action to five days from ten days.165 After a one-day hearing in April and the markup in May, efforts to find common ground of interest were not successful. In mid July 1997, maritime officials reported that the reform Bill before the Senate was dead as the International Longshore and Warehouse Union would not support the Bill and political support was not forthcoming.

Late in 1997, hope was once again rekindled as a compromise Bill was agreed on by Senator Trent Lott and Senator John Breaux to deal with some of the criticisms. The three major revisions were with regard to service contracts, standalone FMC retention and permitting the ILWU to obtain some of the information it needed to ensure that collective bargaining contracts will be enforced. Regarding service contracts, the Bill would now also permit these contracts between the conference and shippers, and confidential multiple carrier and shipper contracts on segmented services besides the confidential contracts between a shipping line and shippers in the earlier Bill.166 Initial concerns about the lack of uniform treatment on the confidentiality aspects of the two types of service contracts in the proposed revision have now been resolved. But freight consolidators are still unhappy. However, enthusiasts hope for a solution. The bill which was expected to be pushed forward in 1998 appears to be finally moving as everyone is coming to believe that some reform is necessary.167

On April 21, 1998, the U.S. Senate passed the Bill entitled “Ocean Shipping Reform Act” by a vote of 71 to 26. The key features of the Bill are: the FMC is retained as an independent agency; tariff filing at the FMC is eliminated and is replaced by electronic publishing; conferences are prohibited from restricting independent action of individual carriers and the notice period required for independent action has been reduced

165. The bill received mixed reviews. The FMC chairman supported the bill, but labor voiced its opposition. One of the major criticisms of the bill was that it did not permit confidential contracts between shippers and conferences and confidential contracts between shippers and consortia. Some of the key players in the reform bill were: Sen. Kay Bailey Hutchison; sponsor of the bill and chairman of the subcommittee; Sen. Trent Lott; Sen. John Breaux; Sen. John McCain; Rep. Bud Shuster; and Rep. Tom Delay. See William Roberts and Stephanie Nall, New Bill Afloat, J. COM., Mar. 7, 1997, at B1-B4.

166. It is worthwhile noting that the Administration is opposed to the bill’s provision that allows service contracts between shippers and conferences or multiple carriers due to the possibility of undue discrimination against small shippers. The provision also allows conferences the right to restrict individual confidential shippers contracts and would require the merging of the FMC with the STB. See Shipping Reform gets Boost from DOT, AMERICAN SHIPPER, Nov. 1997, at 16.

to 5 days from 10 days; confidential contracting between individual lines and shippers are allowed; information on dock movement of cargo in conference contracts will be made available to longshore unions; shipping lines cannot discriminate against shipper associations or freight intermediaries by refusing to deal with them; and freight forwarders must continue to publish tariffs. The Bill does not extend confidential contract rights to non-vessel operating common carriers. The Bill was sent to the House of Representatives, approved by it on August 4, 1998 with one minor change and returned once again to the Senate for approval. Following approval, the Bill was signed by U.S. President Bill Clinton on October 14, 1998. It will take effect on May 1, 1999.

B. A Few Major Ensuing Issues

From the above debate, the ensuing issues that have arisen are on (1) intermodal rates, (2) service contracts, (3) independent action, (4) tariff filing and (5) antitrust immunity. These issues will be examined as their significance has been accentuated not only because of the recent changes in the industry but also because of their potential impact on competition.

1. Intermodal Rates

Intermodal rates set by a conference in the United States that are filed and accepted by the FMC are granted immunity from the United States antitrust laws. Antitrust exemption does not cover “agreements” between a conference and other transport modes. Similarly, in

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171. In the US, intermodal rates are covered under section 7; in Canada it is covered under section 5(2). Intermodal rates are not covered under ECC Regulation 4056/86. Application for such exemption must satisfy the test of Article 85(3) of the Treaty of Rome.

172. Section 1709 of the Shipping Act of 1984 specifies that “no conference of group of two or more ocean carriers may ... negotiate with a non-ocean carrier or group of non-ocean carriers (for example, truck, rail or air operators) on any matters related to rates and services provided to ocean common carriers within the U.S.” However, it concludes with “[f]or purposes of this section, a joint venture or consortium of two or more common carriers but operated as a single entity shall be treated as a single carrier.”

173. Much of the confusion about antitrust immunity in this area has resulted from a failure to distinguish between intermodal rates or pricing, intermodal rate agreements or contracting,
Canada the conference loses its exemption if the multimodal rate is set by "agreement" between "the conference" and "another mode." In the U.S., "a member" of a conference (or a consortium acting as a single entity) can negotiate with another mode and offer multimodal rates, if approved. In Canada, such an agreement also does not lose its exemption. In the EEC, intermodal rates set by the conference (or an individual line) are not granted an exemption. This is the interpretation of Regulation 4056/86 by the European Commission, a matter being contested in the Court of Justice. Intermodal rates 'agreed' to between a conference (or individual shipping line) and another mode are not permitted.\(^{174}\) However, intermodal agreements in the EEC can be exempted under section 85(3) of the Treaty of Rome.

It is believed that the provisions on intermodal rates in Canada and the EEC are more conducive to a competitive market environment than those in the U.S.\(^{175}\) This has also been indicated in submissions to the U.S. Advisory Commission. It appears that the preference for intermodal conference rate making is their lower cost and convenience. However, this must be weighed against the disadvantages of less competition, the potential for technological change and the threat of collusion.\(^{176}\) An example of the latter is the FEFC complaint to the Competition Directorate and joint intermodal operations. In the US, joint intermodal operations between an ocean line or lines (acting as a single entity) and a railway is permitted. However, it should be noted that this does not apply to the operation by several ocean carriers. In Europe, joint operation is illegal, unless specifically exempted from the competition laws. In Canada, the matter is not covered under SCEA, 1987. Shipping Conferences Exemption Act, R.S.C. § 3 (1987).


175. In the United States, whether an individual shipping line can offer intermodal rates is within the jurisdiction of the conference. In Canada, the offering of rates agreed to by an individual carrier or more than one (but not the conference) and other modes are encouraged. The recent recommendation of National Transportation Act Review Commission (NTARC) that SCEA be amended to permit intermodal rate making between a conference and other transport modes appears to be heading in the opposite direction. It appears that the NTARC's view is based on the belief that the gains from efficiency of such arrangements and the demand of shippers outweigh the potential benefits from competition. Shipping Conferences Exemption Act, R.S.C. § 3 (1987).

176. In considering lower short run costs resulting from intermodal agreements without competition, one should compare this state to another state where there is more competition and the potential for faster technological change. One of the criticisms of a monopolist is not that it is deliberately extortionist or predatory but that it retards progress by opting for lower prices and a quiet life. From a dynamic perspective a looser market structure is preferable to a tighter market structure especially if the gains resulting from a tighter market structure do not result from real cost advantages, for example if the lower costs results from a redistribution of income. In conjunction to the above, the increasing concentration in this industry and the increasing multimodal ownership have also raised concern. It is for these reasons that intermodal agreements between individual shipping lines and other transportation modes are preferable. This position
in the EEC, where intermodal rates were agreed to between the conference and its own trucking lines depriving shippers of the choice of alternative trucking.

2. Service Contracts

Service contracts are agreements between a shipper and a conference for the transportation of a minimum quantity or a proportion of a shipper’s goods, over a specified period of time, at a specified rate and level of service. In the United States, service contracts on a minimum quantity are permitted. The U.S. Shipping Act of 1984 permits the conference to regulate or prohibit the use of service contracts and can decide whether to permit individual members to contract with a shipper (i.e., to take independent action). In Canada, filed service contracts between conferences and shippers are exempt from the provisions of the Competition Act. Service contracts are for a minimum quantity and conferences determine the terms and conditions of service contracts. Further, loyalty contracts are permitted in Canada, but they must not specify all or 100 percent of the goods of a shipper. The EEC regulations on service contracts are more liberal. Shippers can enter directly into contracts with the shipping line of their choice. In other words, independent action on service contracts is permitted. There is no requirement that the service contracts be kept confidential. The regulations also provide for loyalty arrangements (that could be less than 100%) and deferred or immediate rebates. The terms of these arrangements are matters for consultation between the conference and transport users’ organization.

The potential benefits of service contracts have been highlighted not only by the Canadian Conference Board study and the submission of the Canadian Manufacturers’ Association to the National Transportation Act Review Commission but also by various studies in the U.S. As a result, there have been proposals in Canada and the USA to ensure that the conditions applicable to service contracts are more conducive to a competitive environment. For example, in the U.S., a private bill has proposed the alternative of a percentage to the existing minimum quantity requirement to increase their use. One of the conditions for accepting the TAA by the FMC was that the minimum TEU requirement for service contracts be dropped and that the notice period for service contracts be reduced to three days from five days with a provision for a fifteen-day window for unilateral action. Similarly in Canada, the National Transpor-

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177. In the United States, service contracts are covered under sections 1709(c) and 1704 (b)(8); and in Canada it is covered under section 1703(1)(c). 46 App. U.S.C. §§ 1709(c), 1704(b)(8) (1984); Combines Investigation Act § 4(1)(c), (1985).
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The Act Review Commission has suggested that the definition of a service contract be amended to permit a shipper to contract a proportion of his business as an alternative to a specified volume.

Even the FMC has shown a preference for the EC provision by stipulating the requirement that service contracts be entered into by individual member lines of the TACA (i.e., Trans-Atlantic Carrier Agreement) as a condition to accepting the proposed settlement by the TACA to end the FMC investigation into the TACA. These developments suggest a preference for the treatment of service contracts as is currently the situation in the EEC. This preference has recently been endorsed in the USA, as the reforms will now permit 'confidential' service contracts between an 'individual' conference line and a shipper.

3. Independent Action

Independent Action enhances the competitiveness of intra-conference competition and also permits the members of a conference to compete with independents. In the United States, conferences must permit member lines to take independent action within ten days notice to the conference, on any rate or service item in its filed tariff. Members may adopt the same rate or service on the same day or after it becomes effective. Independent action on service contracts (i.e., service contracts between an individual shipping line of a conference and shippers) is within the jurisdiction of a conference. It is also permitted on inter-conference agreements, an action that was available even under the U.S. Shipping Act of 1916. In Canada, members of a conference are permitted to take independent action within fifteen days notice to the conference on any filed tariff or service item. Similar adopting action on the same day is also permitted after written notice is given to other members of the conference. SCEA does not permit independent action on service contracts. In the EEC, members of a conference may take independent action on any tariff and no notice period is required. Independent action on service contracts is also permitted.

178. Tim Sansbury, TACA Lines Get Thursday FMC Deadline, J. COM., Mar. 6, 1995, at 1A; see also Tim Sansbury TACA Agrees to FMC Terms; Inquiry Dropped, J. COM., Mar. 10, 1995, at A1. (Stating that the FMC has ended its investigation of TACA.) One of the conditions applicable for TAA to be legal was that a minimum of five member lines of a conference had to approve a service contract, in addition, shippers had the right to negotiate service contracts with any other members. Recently, members of TACA have accepted the FMC terms resulting in the inquiry being dropped. One of the conditions was that individual conference shipping lines would allow shippers to negotiate service contracts without requiring the approval of five shipping lines.

Of the three jurisdictions, the legislative provisions on independent action in the EEC appear to be the most pro-competitive. The U.S. provisions are considered to be more competitive than the Canadian provisions because these provide for a shorter notice period. A shorter notice period discourages the conference from persuading their members to refrain from taking independent action and also gives greater flexibility to the conference to react spontaneously to changes in the market situation and to external competition. Most studies on the effect of independent action have indicated that it has positive benefits in that it has brought about lower rates. As a result, the NTARC has recommended that the notice period for independent action be reduced to 10 days, similar to the notice period requirement in the USA. Recently, the notice period requirement in the U.S has been lowered to 5 days bringing this provision nearer to the more pro-competitive provision of the EEC.

4. **Tariff Filing**

In the United States, tariff filing by conferences and ocean carriers is required under the provisions of the U.S. Shipping Act of 1984 with exceptions for a few commodities. Service contracts, except for certain commodities, are also required to be filed; their essential terms, together with the filed tariffs, are available to the public. The FMC enforces the filed tariffs and service contracts. In Canada, only conferences are required to file their tariff rates, which are not enforced by the government. A copy of every service contract is required to be filed, this however is not available to the public. In the EEC, conferences and shipping lines are not required to file tariffs, service contracts and loyalty contracts.

The requirement to file and enforce tariffs is considered to be anti-competitive by the administrative authorities in the EEC. Tariff filing and enforcement in the U.S. has also been severely criticized by a number of prominent witnesses - DOJ, FTC, and Prof. Butz - before the Advisory Commission, who have indicated that the disadvantages appear to outweigh any possible advantages. It is doubtful whether tariff filing in Canada, in the absence of enforcement, has any advantages, especially since carriers can provide rebates (except on loyalty contracts). The recent reforms in the U.S. eliminating tariff enforcement and filing indicate a preference for the existing regulatory regime in the EEC on tariff filing and enforcement.

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181. The basic reason for tariff filing and enforcement is that it provides protection to the small shipper against possible discrimination.
5. **Antitrust Immunity**\(^{182}\)

Of all the issues considered, the antitrust issue appears to be the most contentious. In the three jurisdictions — the United States, EEC and Canada — the scope of the exemption granted to the liner industry varies considerably. In the U.S., all filed agreements that are not disallowed between liner carriers and conferences are exempt from the provisions of the antitrust laws. As a result, the exemption is applicable to conference agreements and agreements between conferences and independents. The exemption is narrower in Canada and in the EEC. In both Canada and the EEC, the exemption is applicable only to agreements between conference liners. As a result, agreements involving independent liners and conferences are not exempted in Canada and the EEC. Further, whether other types of agreements (e.g., bridging agreements, space chartering agreements, etc.) are exempt, unlike the situation in the US, depends on the existing legislation. In Canada, the exemption status of these other types of agreements requires the consideration of other legislation and their exemption status is therefore a matter for the Court to decide. In the EEC, these types of agreements have to be considered under the exemption applicable to agreements in the competition laws or other regulations on block exemption that may be applicable.

The question as to whether the antitrust exemption should be continued has received increased attention recently. In the U.S., two major agencies — the DOJ and the FTC - have called for an abolition to conference immunity. However, the Advisory Commission has not made any specific recommendations to bring about change. In 1993, a private Bill in the U.S. and other proposals have sought to terminate anti-trust immunity to conferences,\(^{183}\) however, subsequent Bills have not adopted this proposal. In Canada, both the Canadian Shippers’ Council and other academic submissions have also called for an end to the exemption. The Vice President of the European Communities also holds this view for Competition Policy.\(^ {184}\)

The legislative developments regarding some of the major issues in Canada, EEC and the U.S. suggest that the three jurisdictions are gravitating towards introducing more competition either through adopting more competitive provisions or through consideration of removing the antitrust immunity that the conferences enjoy. Perhaps, the development

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\(^{182}\) In the United States, antitrust immunity is covered under section 1706. In Canada, it is covered under sections 4 to 5. In the EEC it is covered under sections 3 to 5. 46 USC at § 1707; Combines Investigation Act §§ 4, 5 (1985) (Can.).


\(^{184}\) See *Conferences and Competition, Lloyd’s Shipping Economist*, Aug. 1991, at 22.
of uniform regulations on some of the major issues is a stepping stone to obtaining consensus on the fundamental issue of whether antitrust immunity should be continued or repealed multilaterally.\textsuperscript{185} The harmonization of laws in various jurisdictions could lead to less international tension, reduce uncertainty, increase competition, reduce rates and create the potential for increased world trade.

VI. Conclusion

In a period when promoting international competition and facilitating the role of market forces have become the cornerstone of government policy throughout the industrialized world, it is appropriate to consider whether the present philosophy towards liner conferences is appropriate. Providing clear-cut uncontroversial policy proposals are often not easy, especially when different interests groups have different views. Yet some change is needed. The question now is what kind of change and how much?

An examination of the basic rationales for liner shipping sheds some light. The instability rationale indicates that the weight of evidence fails to support the proponents who argue that exemption is needed because of industry instability. As a supporting argument for the exemption, the international comity rationale has also been put forth. While there are differences in shipping practices and regulations among different nations, the overall goal is the same — to bring about stability in rates and service and an increase in trade. International comity may be served as well by joint consideration between trading nations to repeal outdated laws that are not beneficial to the welfare of trading nations.

Quite apart from the above, fundamental changes have been occurring in liner shipping which some observers have termed the ‘new paradigm.’ The most important of these are fundamental technological changes, new forms of organization, new forms of agreement and new forms of service. The confluence of all these developments has increased the potential for market control and abuse which could enable conferences to exercise too much power now with existing antitrust immunity. It has also opened up the possibility of relying more on market forces and competition enforcement.

\textsuperscript{185} Regarding the issue of jurisdiction, a good case can be made to support Canadian jurisdiction over agreements and practices that impact directly on Canada’s foreign trading interests and are routinely implemented in Canada. It is possible, nonetheless, that alleged conflicts of jurisdiction could be raised in litigation if Canada acts unilaterally to eliminate competition law immunity for conferences operating in international trade routes. Many maritime countries also have blocking legislation that could be applicable in litigation relating to international conference activities. Foreign jurisdictions that remain committed to the conference system might also indicate their concerns to the government of Canada through diplomatic or other channels.
The above developments have implications for the applicability of competition law. First, both consortia and global alliances are not given explicit exemption in SCEA from the Competition Act. They may be exempt if they are between members of a conference. However, in the majority of cases, these agreements are between conference and non-conference members for which exemption is not provided. As a result, these consortia or alliances lose their exemption. Second, a number of new types of agreements have been filed by the conferences which have not been given explicit exemption under SCEA. Third, collectively determined multimodal agreements between the conference and inland carriers are not provided exemption under the Competition Act. In all the above cases, these agreements are subject to the provisions of the Competition Act. The most applicable sections of the Competition Act are the sections concerned with conspiracy, abuse of dominance and mergers or joint ventures.

It is important to note that though the above sections of the Competition Act are most applicable, it does not mean that these new agreements or arrangements are necessarily illegal. The conspiracy provision of the Competition Act applies to agreements that lessen competition unduly. This standard requires that agreements impact on a substantial proportion of the relevant markets. Other types of arrangements such as consortia that are not explicitly exempted under SCEA also are not necessarily in violation of the Competition Act. Although they sometimes give rise to competition concerns, such arrangements often make possible the provision of services that would not otherwise be available to users.\textsuperscript{186} Factors that could be taken into consideration in assessing consortia include the market share of consortium members, the terms on which members may withdraw from the arrangement and provide service independently and any specific advantages for users created by the consortium.\textsuperscript{187}

In the case of the abuse of dominance provision, a number of factors such as whether the consortium or alliance has substantial or complete control, whether it has engaged in a practice of anti-competitive acts, and whether these acts have had the effect of preventing or lessening competition substantially in a market will have to be considered to determine if the actions of these new organizations have run counter to this specific provision.

As the conference laws in the major jurisdictions are becoming more outdated and inapplicable, various attempts are being made to bring

\textsuperscript{186} The \textit{Competition Act} contains a specific exception to facilitate pro-competitive joint ventures.

\textsuperscript{187} Submission to the National Transportation Act Review Commission, by the Director of Investigation and Research, Competition Act, June 30, 1992, at 26-27.
about legislative changes. For instance in Canada, the NTARC has expressed opposition in principle to the intent of SCEA and has called for its repeal as soon as the U.S. withdraws its antitrust immunity for shipping. 188 In the EEC too, serious problems have arisen regarding the applicability of the EEC regulation granting immunity to conferences and a OECD Report indicates that some of the important definitions no longer reflect the reality of ocean container shipping industry. Even in the U.S., numerous attempts are being made to revise the shipping laws granting antitrust immunity to conferences.

The new developments in the industry are also affecting shippers. Shippers in the major jurisdictions are calling for a repeal of the conference laws. In Canada, the Canadian Shippers' Council called for the outright abolition of SCEA, claiming that it "represents a clear trade hindrance and a tariff barrier . . . [and] [that] conferences have done everything possible to negate whatever few pro-competitive modifications were made to the Act in 1987." 189 In Europe too, the European Shippers' Council called on the European Commission to withdraw the automatic, open-ended antitrust immunity enjoyed by liner conferences serving the European Union. Even in the U.S., the President of the NITL indicated that shippers and carriers realize that reform is needed to make the global ocean liner trade consistent and that some form of shipping deregulation is going to occur. This is also having its effect as far as Japan, as the Japan Shippers' Council began lobbying its Ministry of International Trade and Industry to review its regulation and end anti-trust immunity. These developments have added to the increase in the power of conferences and have exacerbated shippers' concerns about market control by a few powerful alliances. As a result, opinions have been expressed that competition policy has failed.

These events have not gone unnoticed by the Competition Authorities in major jurisdictions. In Canada, the Director in his submission to the NTARC stated "the Commission might wish to consider whether Canada should explore possibilities for mutual withdrawal of competition law immunity for conferences with our major trading partners, before considering unilateral action." 190 Similarly in the U.S., the Department of Justice has explicitly recommended the abolition of existing immunity

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188. Problems have also arisen in the interpretation of SCEA. For example: responsibility for administration of SCEA; the definition of a conference in SCEA; and multimodal rate setting under SCEA. For a further discussion, see Submission to the National Transportation Act Review Commission, by The Director of Investigation and Research, Competition Act, June 30, 1992. Id. at 23-27. Shipping Conferences Exemption Act of 1987 (1987) (Can.).


190. Submission to the National Transportation Act Review Commission, by the Director of Investigation and Research, Competition Act, June 30, 1992, at 22, 23.
for conferences from the U.S. antitrust laws, a view also shared by the Federal Trade Commission.

In light of the above, it appears that the time has come to eliminate the privilege of antitrust exemption that conferences have enjoyed for nearly half a century. Unfortunately, in light of the developments that have occurred in the U.S., antitrust immunity will continue, though additional conditions will have to be satisfied to obtain the immunity which will have the effect of reducing the power of the conferences. This implies that Canada is unlikely to revoke the exemption unilaterally though it will most probably adopt similar amendments to its conference legislation. Nevertheless, reducing the scope of the exemption will make the task of eliminating the reduced exemption much easier in the future, notwithstanding diverse vested interests. It will also enable various jurisdictions to bring about an increasing convergence of shipping conference exemption laws so that multilateral action will be facilitated. Facilitating and encouraging the role of market forces by eliminating the exemption could lead to greater competition among ocean liner carriers and ultimately to increased efficiency, lower prices, improved services and perhaps greater international trade. It will also bring about greater equity in the treatment of shipping versus other transport subsectors and other industries in the economy.
## APPENDIX I - TABLE OF LEGISLATIVE CHANGES IN CONFERENCE LEGISLATION

### Evolution of SCEA Legislation

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1. Short title
2. Interpretation
3. Non-Application of the Combines Investigation Act
4. Loss of exemption
5. Filing with the Commission
6. Time for filing of Documents
7. Verification of Documents filed
8. Offence
9. Limitation
10. Security
11. Investigation of Shipping Conferences
12. Annual Report
13. Commencement
14. Expiry

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1. Short title
2. Interpretation
5. Non-Application of the Combines Investigation Act
6. Limitation
7. Filing with the Commission
8. Time for filing of Documents
9. Certification of Documents
10. Inspection of Documents
11. Offence
12. Time Limitation
13. Security
14. Investigation of Shipping Conferences
15. Annual Report
16. Coming into Force and duration (deleted)
17. Administration
18. Investigation
19. Offices in Canada
20. Tariffs
21. Meetings
22. Regulations
23. Transitional
24. Repeal
25. Exception
26. Investigation of Complaints
27. Commission shall notify Director
28. Commission must render decision with 120 days
29. Consequential and Related Amendments

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4. Non-Application of the Competition Act
5. Limitation
6. Filing of Documents
7. Time for filing of Documents
8. Certification of Documents
10. Inspection and Destruction of Documents
17. Offense and Punishment (deleted)
22. Security
23. Investigation of Shipping Conferences (deleted)
24. Coming into Force
25. Administration (deleted)
(see section 17 above)
18. Office
19. Inspection of Tariffs
20. Meetings
21. Designated Shipper Groups
22. Regulations
25. Transitional
28. Repeal
30. Giving of Notices (increase in rates/surcharges or increases)
31. Giving of Notices (amendments to loyalty contracts or tariffs)
32. Disclosure of Service Contracts
33. Exceptions
34. Investigation of Complaints
35. Commission shall notify Director
36. Commission must render decision with 120 days
37. Consequential and Related Amendments
### Shipping Conference Legislation

**Major Provisions of the Shipping Act in the European Economic Community**

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<td>[13 Articles]</td>
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3. Exemption for Agreements
4. Condition Attaching to Exemption
5. Obligations attaching to exemption
6. Exemption for agreements between users and conferences
7. Monitoring of exempted agreements
8. Effects incompatible with Article 86 of the Treaty
9. Conflicts of international law
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12. Application of Art 85(3) Objections
13. Duration & revocation of decisions applying to 85(3)
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18. Investigating Powers
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20. Periodic penalty payments
21. Review by the Court of Justice
22. Unit of Account
23. Hearing of the parties and of third persons
24. Professional secrecy
25. Publication of Decisions
26. Implementing provisions
27. Entry into force

1. Definitions
2. Scope
3. Exempted Agreements
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5. Basic condition for the grant of exemption
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10. Exemption for Agreements between for transport users and consortia
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<td><strong>13. Issuance of Panama Canal Bonds</strong></td>
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<td><strong>15. Filing of Agreements, modifications, cancellation and antitrust approval adding public interest standard</strong></td>
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<td><strong>16-17. Prohibits discriminatory actions and forbid rates other than the filed rates</strong></td>
<td><strong>16-17. Prohibits discriminatory action and forbids rates other than the filed rates. FMC may adjust unjustly discriminatory rate</strong></td>
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<td><strong>18. Domestic rate regulation. Rates to be filed by carriers in foreign commerce; no prior approval for rate changes; prohibits other than filed rates and rates can be disapproved</strong></td>
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<td><strong>22. Filing of Complaint and Investigation</strong></td>
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<td><strong>25. Reverse, suspend or modify orders</strong></td>
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<td><strong>27. Subpoena witnesses or records</strong></td>
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<td><strong>28. Privilege against self-incrimination and immunity</strong></td>
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<td><strong>20. Confidential information not to be released</strong></td>
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<td><strong>32. Penalty for violation</strong></td>
<td><strong>32. Penalty for violation</strong></td>
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<td><strong>34. Constitutional Severability clause</strong></td>
<td><strong>34. Constitutional Severability clause</strong></td>
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<td><strong>35. Appropriation of initial expenses (Repealed)</strong></td>
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<td><strong>36. Refusal of Vessel Clearance</strong></td>
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<td><strong>43. Termination of national emergency (Repealed)</strong></td>
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<td><strong>44. Short Title</strong></td>
<td><strong>44. Short Title</strong></td>
<td><strong>30-31. Procedure and Venue</strong></td>
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</table>
### Evolution of the Shipping Act in the United States

<table>
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36. Refusal of Vessel Clearance.
37.-42. Restrictions during national emergency
43. Short Title
44. Making rules and regulations.
45. Licensing of forwarders.
3. Filing of Rates for barges
35. Exemption of agreements
The Cartel-Monopoly Theory

The theory of cartel-monopoly views firms as having an incentive to coordinate their production and pricing activities to increase their collective and individual profits by restricting market output and raising market price. A firm’s profits go up when it forms a cartel even though competitive firms may be “maximizing their profits.” The firm in the competitive situation ignores the increase in profits to other firms from a reduction of its own output, which it believes to be insignificant as it cannot affect price. In contrast, a cartel is able to capture the benefits of a reduction of output by its members.

To illustrate the nature of this collective gain, consider two polar cases. First, consider a firm made up of many identical competitive firms having identical cost curves with each firm acting as a price taker. In contrast, consider the same situation, with the firms forming a cartel and acting as a monopoly. The industry’s marginal cost curve, which is the aggregation of their individual marginal cost curves, is the industry’s supply curve. The equilibrium output of the competitive industry is determined by the intersection of the industry demand and supply curves (i.e., the average revenue curve and aggregate marginal cost curve - where equilibrium output is \( Q^e \) in the figure 1b). The equilibrium output of the cartel is determined by the intersection of the industry marginal revenue curve and the supply curve (i.e., equilibrium output is \( Q^c \) in the figure). This equilibrium cartel output is less than the equilibrium output of competitive firms and it earns a profit \( CR^m \) \( p^m \). The reason for the reduction in output of the cartel is that the cartel’s marginal cost is greater than its marginal revenue at the competitive output. The reduction will take place till the above cartel equilibrium is reached.

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191. Assuming a competitive case.
192. The gain to the cartel from a reduction in output comes about because it faces a downward sloping demand curve. On the other hand, each competitive firm is considered to face a horizontal demand curve. More precisely, a nearly horizontal demand curve (i.e. with a small downward slope). While this small downward slope can be ignored for a single competitive firm, it cannot be ignored when taking all firms collectively or for the cartel. The competitive firms place no value on the gain that each one derives from a reduction in output of one unit by each firm because its effect is considered to be negligible. However, the gains to a cartel from a reduction of one unit is internalized, namely the cartel realizes the gain from its reduction.
Firms in the competitive industry on its own do not reduce its output because the competitive firm sets its output where marginal revenue equals marginal cost. A lowering of its output will cause it to lose more than it gains, as the marginal revenue on the last unit exceeds its cost, i.e., at output less than $Q^m$, the marginal revenue is greater than marginal cost (see figure 1b). Competitive firms are maximizing their output at the competitive equilibrium indicated above namely at output $Q^e$ and price $P^e$.

Once in a cartel, is there an incentive for firms to cheat? Firms would want to cheat by producing more than the cartel says they should, because at the higher price each member would like to sell more. This can be seen in figure 1a, where a firm’s equilibrium output is $q^m$, at price $p^m$, but it would like to sell $q^1$, at price $p^m$. The crosshatched area indicates the gain from chiseling in figure 1a. At price $p^m$, figure 1a also shows that the individual firm in the cartel earns a profit of $LOEp^m$, the competitive firms in the cartel sells an output $q^1$, at price $pm$, and earns a profit of $LRp^m$. The profit $LRp^m$ is greater than the profit $LOEp^m$. It is the above considerations that give rise to statements such as “firms would want to cheat by producing more than the cartel says they should: at every output, non members earn more than cartel members, because they produce more and sell at the same price.”

The cartel model can also be used to explain differential pricing by a discriminating cartel or monopolist in shipping. Cartels possess monopoly power because there are either institutional or economic barriers to entry. Shipping conferences, acting as cartels can subdivide the market for their services by differentiating between shippers according to the commodities they ship. In other words, the rates for shipping can vary based on the different elasticity of demand of the commodities for liner services.

Since the conference acts as a cartel or multi-plant monopolist, it may determine price and output simultaneously in each of the commodity sub-markets by equating respective marginal revenues with the overall marginal cost of production. This pricing produces a differential (discriminatory) rate structure. As a result, it is not only possible for the shipping lines to maximize profits but it is also not possible for the shipper to use the tariff on oranges to transport lumber which would render price discrimination unlikely. It thereby enables the lines to maximize their joint profit at the expense of the shippers by appropriating some of the surplus which otherwise would have accrued to the latter under a more uniform pricing structure or an FAK tariff structure.\footnote{Section 18 Report on the Shipping Act of 1984, Federal Maritime Commission, Sept. 1989, at 403-10.}

In terms of diagram 1b, if perfect discrimination has taken place, the marginal revenue curve coincides with the demand curve, and all the consumer surplus represented by the triangle $P^X T^X$ is captured by the conference. The minimum rate on some commodities charged by the conference is $XQ^e$. The highest rates charged by the conference on some commodities is $T^m0$.

This model has a number of implications. First, a conference which perfectly discriminates should be making the maximum profits. Second, in order to maximize their joint profit, the lines will price so as to operate on the elastic part of the respective demand curves for their services. Third, there is absence of entry, as entry would imply that the established carriers would not be able to have complete discretion over price. Finally, the model suggests that conference tariffs should be designed so that the lowest quoted tariff rate would make a full contribution to overhead (fixed) costs when a trade is in long-run equilibrium. This assumes that liner shipping is a constant cost industry.

\textbf{The Theory of the Empty Core}

The theory of the core is a theory that is supposed to represent the competitive process.\footnote{Telser G. Lester, Theories of Competition xiii (North-Holland 1988).} The core is basically a set of cooperative game solutions that are feasible under which players optimize their winnings. The core could be empty. In other words, there is no optimal solution and, therefore, no sustainable competitive equilibrium. Where markets have no sustainable competitive equilibrium, the theory of the core can be used to explain it. The existence of the empty core will be described hereafter under simplifying assumptions.

Assume that firms in the industry are identical, each having U shaped average cost curves where entry is free and exit is costless. Sup-
pose that the minimum average cost for each firm is \( C_0 \) for output \( Q_0 \). If demand is not an exact integer multiple of the output produced at minimum average cost, there will not be room for all firms to produce at the minimum average cost. Some of the firms will have to exit. Since the output produced is less than the total demand, prices will rise. This will attract new firms who charge below the existing price, as exit is costless. This will drive out the existing firms and so on. Unless the quantity demanded at a price of \( C_0 \) is an exact integer multiple of \( Q_0 \) (output), there will be no competitive equilibrium or the core will be empty. This theory is illustrated in figure 1, where there are three firms, each with its supply curves \( S_1 \), \( S_2 \), and \( S_3 \) producing at a minimum cost \( C_0 \). As long as the demand curve (D) does not pass through \( Q_0 \), \( 2Q_0 \) or \( 3Q_0 \) there will be no equilibrium.

![Figure 1](image1.png)

**Figure 1**

![Figure 2](image2.png)

**Figure 2**

The assumption that the firms are identical, all having the same minimum average costs, is not necessary for the empty core to exist. Such a situation with different minimum average costs is shown in Figure 2, as a series of disconnected upward sloping supply segments. The length of the gap between the segments is equal to capacity. The empty core can still exist, if the demand curve passes through any of the disconnected segments. The existence of an empty core is more probable under the following conditions: (1) the greater is the homogeneity of firms in the industry; (2) the larger is an individual firm’s capacity in relation to total demand (i.e., the smaller the number of incumbents); (3) the more an industry is in a slump; (4) the more variable is demand and/or supply; (5) the more inelastic is market demand; and (6) the more entry is legally restricted. These conditions are briefly described.

First, the more heterogeneous the firms, the more their minimum average costs differ and the more likely there will be competitive equilibrium. This is because the length of the parts of the supply curve depends on the heterogeneity of the firms. When each firm has the same minimum average costs, the possibility of the empty core is greater since the demand curve must intersect at a point, the minimum point on the average cost curve. However, when firms have different minimum average costs, the possibility of the demand curve intersecting the supply segment
is greater, as the probability of intersecting with a segment or series or points is greater than with one point. In other words, the possibility of an empty core is greater when firms are homogeneous.

Second, the larger the number of firms, the greater the possibility of competitive equilibrium or the absence of an empty core. For example, if there are a small number of firms, an increase in demand would need a larger increase in price and output than if there were a larger number of firms assuming that the increase in demand is equally divided among existing firms. With the introduction of contracting and recontracting costs, it is more likely that the shipper negotiate new contracts with entrants only if these costs are lower than the increase in price in response to the increase in demand. Therefore, with a larger number of firms, it is less likely that the increase in price due to a given increase in demand will outweigh the costs of contracting and recontracting. Therefore the greater these costs, the greater the possibility of an empty core.

Third, if sunk costs must be incurred, potential entrants may be unwilling to enter even if the existing firms are earning profits. The entry of new firms would drive down prices below average total costs (which now include sunk costs) and the new firms would not be able to exit costlessly. A small increase in demand will not attract a new entrant because a new entrant would drive price down below the minimum long run average cost (including entry costs) causing losses for the entrant as well as the existing firms. A small drop in demand (provided it stops above the minimum shortrun average cost) will not cause exit in the short run because entry cost is sunk. However, if demand should fall so much (i.e., below minimum shortrun average cost) that there is excess capacity in the short run, the core will be empty. Thus, the greater the slump in demand, the greater the probability that there will be no competitive equilibrium. (The slump would also be the result of an increase in avoidable costs that pushes the discontinuous part of the supply curve up to the demand curve).

Fourth, the greater is the variability of demand (or costs), the more likely that demand will fall into the region in which supply is discontinuous (or that the discontinuous part of the supply curve will rise to the demand curve). The reasoning above is also applicable in this situation — an implication of sunk costs. That is, if the demand curve shifts only slightly, that it does not fall below minimum shortrun average cost, there will be no incentive for firms to exit, whereas if it shifts significantly, a firm will exit and the supply curve would fall in the discontinuous region or where the core is empty.

Fifth, the more elastic the demand curve, the greater the probability of a competitive equilibrium. For example, in the extreme situation, if the supply curves are represented by vertical segments, the probability
that the demand curve passes through the disconnected segments diminishes to zero with a horizontal or perfectly elastic demand curve, as it must intersect one of the supply segments. Therefore, as the demand curve becomes more inelastic, the possibility of it intersecting with any one of the disconnected segments increases.

Sixth, legal restrictions on entry, also increase the possibility of an empty core. An equilibrium does not exist because the number of potential producers exceeds the number of active producers. If there are legal restrictions on entry, the number of potential producers will be smaller, making it less likely that the number of potential producers will exceed the number of active producers. 196

Given these implications, it has been argued that core theory can be used to explain the existence of shipping conferences. In the words of one Report:

Core theory offers a raison d'etre for the conference system — conferences exist to solve the problem of the empty core by imposing an equilibrium where none would otherwise exist. Market theory appears to offer a policy prescription rather than a raison d'etre — if liner markets are contestable, a conference presence can be safely ignored from the point of view of the efficient functioning of the market, although it too can explain most of the mechanisms established in the conference system (such as loyalty ties) in terms of the need for market sustainability. 197

The Theory of Contestability

The principal focus of contestability theory is the competitive consequence of potential entry. The theory holds that the number of competitors in themselves are irrelevant as indicators of competition, for what matters is the relative position of the entrant vis-à-vis incumbents. "The message of the new theory is that the strength of competition should be judged not on a priori notions of structure or behavioral variables but on conditions promoting or inhibiting ease or exit." 198 In addition, it emphasizes the significance of multiproduct interrelationships and desirable pricing behavior under real world constraints.

Contestability theory highlights the risks of entry. It shows that such risks are determined by the ease or difficulty of recovering the investment costs incurred if firms exit after entry and not necessarily the magnitude of any investment. If on exit, those investment costs are completely re-

coverable, the risks of entry will be zero and entrants will exercise a disciplining force on incumbents in the market, sufficient to constrain their use of market power.

The costs of exit and the ability to compete are thus the key factors influencing the strength of competition by new entry. The former is determined by sunk costs; the latter by the symmetrical placement of entrant and incumbent. This can be achieved by preventing the incumbent firms from taking price action that will lead to zero expected profits. This condition has been referred to as the “price sustainability” condition. Price sustainability is likely to be achieved if the firms existing in the market cannot change their prices as fast as the new entrant or if the entrant can secure a contract with customers that guarantee him fixed prices and positive profits.

There are thus three conditions necessary for perfect contestability: (1) the absence of sunk costs; (2) a symmetrical positioning of entrant and incumbent; and, (3) price sustainability.

This theory specifically emphasizes the significance of multiproduct firms and the problems arising from such cost structures. For multiproduct firms, the average cost curve is not a meaningful concept due to the presence of common costs. Further, the costs of multiproduct firms are not only affected by economies of scale but also by economies of scope which result from the composition of output. Economies of scope arise when it is cheaper to produce a combination of outputs than if each output was produced individually by different firms. The theory also emphasizes the cost of joint production. Joint production arises when the production of one product gives rise to the production of another, which results in lower costs than if the products were individually produced. Production may also be subject to economies of scale, and if the indivisible capital which gives arise to it can be fully utilized by producing other products, the cost of production would be lower from producing additional products than from producing products individually.

Contestability theory permits no inefficient method of production to exist in the long run. Consequently, if a market is contestable, a stable industry configuration has to be the most efficient configuration. Concerning natural monopoly, in a multiproduct context, conditions of natural monopoly will occur if and only if the costs of joint production are

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199. A sunk cost is an outlay that cannot be recouped without substantial delay.
200. Common costs are costs common in the production of several goods.
201. Economies of scale means a proportionately greater increase in output for a proportionate increase in input. There is no single measure of scale economies in a multi-product setting. They are measured in three ways.
202. A natural monopoly is defined as a situation where the industry is supplied by a firm or firms with decreasing long run costs.
less than the costs of separate production for any scale or any combination of outputs.

The policy implications of this analysis of costs are numerous. First, excepting natural monopoly, it is evident that if the conditions of contestability can be ensured, then in the long run the resulting industry structure is the most efficient industry structure. Second, it appears that natural monopoly situations are not nearly so obvious as normally assumed for in addition to scale economies, determination of such situations will require knowledge of cost complementarities and demand interrelationships. Third, the existence of a natural monopoly will mean that the costs of producing a certain range of products will be lowest if production of those goods are concentrated in the hand of a single firm. This structure though socially desirable, is neither the inevitable result of market forces or necessarily sustainable; wasteful and inefficient entry may nevertheless be forthcoming. Contestable markets in themselves do not guarantee social efficiency.

Contestability theory finally emphasizes the significance of desirable pricing behavior under real world constraints. Maximization of social welfare, in decreasing cost industries, is not possible under marginal cost pricing. However, Ramsey pricing, which involves adding a markup over marginal cost which varies inversely with the elasticity of demand, is capable of providing the allocation of resources which imposes a minimum welfare loss.

In contestable markets, Ramsey pricing has several implications. First, sustainable prices which allow no profitable entry must admit to no cross-subsidization. Second, if a natural monopolist has a strictly subadditive cost function, exhibiting both economies of scale and economies of scope, the maximum sustainable (non-entry inviting) set of prices will be the Ramsey optimal set of prices. Thus, it appears that the pursuit of maximal profit by the monopolist will simultaneously promote the (Ramsey) optimal allocation of resources, given perfect contestability. If natu-

203. Davies, supra note 198, at 71.

204. A sustainable industry structure means one where no outside potential competitor can enter by cutting prices and still make money, supplying quantities that do not exceed total market demand at those prices, given a feasible configuration (i.e., production equal to demand, no firm is losing money, and a firm's output is positive or zero).

205. A decreasing cost industry is one faced with decreasing costs as output increases.

206. Under decreasing costs, if the firm is to continue in production and bring about an efficient allocation of resources, it must receive subsidies, if it is to set price equal to MC. The imposition of subsidies are not considered an efficient way of achieving marginal cost pricing.

207. The basic idea in Ramsey pricing is to capture the consumer surplus so as to achieve an efficient allocation of resources. The consumer that derives the greatest consumer surplus pays the most, so as to avoid using subsidies to achieve an optimal allocation.

208. A cost function is subadditive at output y if it is more expensive for two or more firms to produce y than it is for y to be produced by a single firm.
r al monopolists do not have a strictly subadditive cost function, Ramsey optimal set of prices will not be sustainable. Market forces will not in themselves promote the most efficient allocation of resources; they may need to be assisted by some mechanism to restrict socially wasteful new entry competition.

The theory promises to provide a guide in respect of the general design of regulatory and antitrust policy that is much more relevant than the traditional yardstick of perfect competition. "Whatever the appearances . . . we can no longer accept as per se indicators of poor market performance evidence such as concentration, price discrimination, conglomerate mergers, or vertical and horizontal integration."209

Ocean Shipping Deregulation and Maritime Ports: Lessons Learned from Airline Deregulation

Christopher Clott*
Gary S. Wilson**

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I. Introduction

United States ocean shipping deregulation has prompted a great deal of interest and controversy in the various pieces of proposed and recently enacted legislation including the most recent, The Ocean Shipping Reform Act of 1998. Deregulation proposals had included such changes to the industry as allowing for confidential service contracts between shippers and common carriers, eliminating the current rate filing requirements prescribed under Federal law, and for the sunset or transformation of the Federal Maritime Commission.

Major companies and organizations involved in maritime shipping, their customers, and political bodies expressed their opinions, both positive and negative, on the pending legislation regarding this issue. Advocates of deregulation suggested that the market will become more efficient as competition is promoted. They argued that maritime deregulation would force incumbent carriers to streamline their operations and reduce operating costs as well as produce a wider variety of price and service options for customers. Shipper’s organizations, such as the National Industrial Transportation League (NITL), favored deregulation, stating that it was essential to the continued health of the maritime industry.

Opponents of maritime deregulation and the pending Act concluded that the negative impacts of this type of legislation far outweigh any efficiencies gained through its passage. First, large shipping customers and those select companies that could negotiate confidential contracts for lower rates would benefit at the expense of smaller volume shippers and importers. Second, opponents predicted that the deregulation would not only destroy the rate setting mechanisms of international shipping conferences but would also drive some carriers into bankruptcy. Finally, the passage of any current maritime deregulation legislation would cause a major shifting of traffic from one port to another. This may cause some major economic hardships for those locales that have invested heavily in port terminal infrastructure.

Policy lessons learned from past deregulatory movements suggest any deregulation bill, like the Ocean Shipping Act of 1998, may have some unintended side effects not apparent on first observation. A previous study on the results of the airline industry deregulation provides a useful foundation for a preliminary discussion on the impact of the dereg-
ulation on the competitive nature of the maritime industry.¹

Twenty years have elapsed since the Airline Deregulation Act (ADA) of 1978 was passed. While the overall results of the ADA have been generally positive when measured at the industry level, study at the airport level yields decidedly different results. There are now more airline passengers and cargo consignments flying at lower air rates than ever before on both domestic and international flights.² However, there also appears to be a recent trend toward concentration by major air carriers at select U.S. airports. Several concerns being raised by this behavior are the ability of an airline to exercise market power, limit competition at a particular airport and potentially raise airfares while reducing the level of service.³

Numerous observations can be made regarding the similarities between the airline and maritime deregulation movements. These similarities include the potential market behavior between the airlines and steamship companies in the use of marketing strategies, the building of the fortress hubs, and the use of physical barriers to entry as a means to possibly reduce competition. In the long run, the end result of these practices in the maritime industry may be contradictory to what is predicted by the advocates of deregulation—increased container rates and reduced service for shippers.

Today, if one is to predict if the maritime deregulation would be considered a success or failure in the year 2002, the answer probably will be a resounding success as measured by the entire industry. However, what will be the answer to that same question posed to the various ports and cities adversely affected by the maritime deregulation?

II. Background

In the 1960’s and early 1970’s, a number of noted economists published a substantial volume of research critical of economic regulation in the transportation industry. Principal criticisms were that pricing and entry restrictions resulted in excessive service, insufficient price competition, inflated transportation costs, and less than adequate profits.⁴ Deregulation occurred first in the airline industry (Air Cargo-1977, Air-


line Passenger Deregulation Act-1978), followed closely by trucking (Motor Carrier Act 1980), and railroads (Staggers Rail Act 1980). Researchers and practitioners have suggested that in all three instances, industry movement toward deregulation was well under way prior to its official sanctioning by Congress.

The results of the various deregulation acts of the last two decades have been controversial. In general, the competitive nature and flexibility of modal operations have occurred as predicted by advocates of deregulation. In the case of trucking deregulation, a number of older carriers either merged with competitors or were forced out of business. There has also been a substantial growth in the number of new for-hire interstate motor carriers. The industry grew from about 17,000 entrants in 1980 to over 60,000 by the early 1990’s.5 Research suggests that the majority of new entrants focused on full-truckload business that does not require the added expense of operating freight terminals where freight is sorted. In addition, studies have suggested that rates initially declined from 15 percent to 25 percent in the early years of deregulation but that the decrease leveled out with some spot rate increases once deregulation took full effect.6

The purpose of railroad deregulation, unlike trucking, was not to encourage more competition so much as to establish an environment whereby a financially weak industry could prosper. While rail rates did not significantly increase due to passage of the Staggers Bill as many had suggested, the service levels experienced a significant decline.7 In addition, several recent and proposed mergers have left many shippers wondering if they are really better off than before the Staggers Bill. The airline industry preceded both the trucking and rail industry in deregulation and has been the most heavily studied as to its effects on the health of the industry over the past two decades. As predicted by its proponents, the initial years of deregulation brought an influx of new carriers, driving prices down and forcing older established carriers to match the lower rates of new carriers. The new competitive marketplace, like the trucking industry, resulted in numerous casualties as well as a wave of mergers and acquisitions in the industry.8 Recent findings suggest that the airline industry is more concentrated now than at any other time since deregula-

tion.9 Some policy analysts have suggested that the entry of new carriers into certain airports is limited if not impossible.10

The effective utilization of airport concentration as a competitive strategy has enabled the incumbent carriers to substantially reduce the amount of competition. A 1989 General Accounting Office report suggested that the ability of major air carriers to establish a dominant position at an airport "might have an anti-competitive impact on the industry and eventually frustrate the goals of airline deregulation."11

The effects of deregulation have varied across the three transportation modes. However, one experience common to all was that each mode experienced drastic industry changes that significantly and permanently altered the manner in which business was conducted.

III. HISTORY OF THE MARITIME DeregULATION MOVEMENT

Efforts to manage competition in ocean shipping have been in practice for many years through the utilization of the ocean shipping conference system. Conference agreements among major shipping lines began in the nineteenth century in the hopes that they may prevent cutthroat competition among steamship lines.12 Left unchecked, this destructive competition would lead to many maritime company failures and irregularities in shipping schedules.

Arguments in favor of and in opposition to the conference pricing systems have been made throughout this century. In addition, the continual problems of uneven traffic flow coupled with chronic overcapacity in busy trade lanes such as the Pacific-East Asian marketplace have continually plagued the maritime industry.13 Shipping lines have long argued that a conference system is needed to stabilize rates, control capacity and maintain adequate profit levels for the ocean carrier industry.14 According to its supporters, the bankruptcies caused by a free market pricing system would cause major disruptions in the timely movement of international commerce.15

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Opponents to collective ratemaking practices suggest that ocean rates are kept artificially high, thereby allowing inefficient carriers to remain in business under the current system. In addition, advocates of deregulation are quick to point out that individual carrier marketing strategies have already undermined the collective rate setting activities. Many carriers offer independent rate actions, service contracts to large or key customers, and preferential treatment at key ports to differentiate their organization on the basis of price and service.

IV. OCEAN SHIPPING ACT OF 1984

In the late 1970's and early 1980's, competition from independent foreign flag operators seeking hard currency for their governments and the rise of non-vessel owning common carriers (NVOCC's) spurred breakdowns in the traditional conference system. As international commerce increased, shippers also became more vocal in their criticism of ill-defined antitrust conference practices. In 1984, the federal government attempted to simplify the confusing patchwork of antiquated laws affecting maritime commerce through passage of the Ocean Shipping Act of 1984. This new law changed many aspects of the maritime industry. The most salient changes were 1) the granting of antitrust immunity for carriers (provided tariffs were filed to the FMC and rates published and open to inspection); 2) the ability of shippers and shipper associations to enter into service contracts with carriers; and 3) the role of NVOCC's as carriers was clarified.

Similar to ocean shipping conferences, the 1984 Act granted maritime ports antitrust immunity and the ability to set collective pricing policies. Collective pricing by the ports was allowed for reasons of economic stability for future planning, elimination of destructive competition, protection of public investment, preservation of market share, the need to counter the strength of liner conferences and elimination of management risk. Intense competition between ports for market share on the basis of pricing or increased productivity has prevented any exploitation of the ability to set collective pricing similar to shipping conferences.

Since the Ocean Shipping Reform Act of 1984, many business envi-

17. See Edward R. Emmett, Our System is a Throwback to Another Era, J. COM., Sept. 19, 1997, at 1A.
Environmental factors have begun to change the competitive nature of the maritime industry market structure. In particular, the carriers' market behavior has had to adjust to a new, more competitive market as well as make changes to operation to accommodate the emerging concepts of supply chain management. Similar to the airline industry of the 1980's, increased competition forced a series of mergers and acquisitions to take place among the major shipping lines. In addition, many changes to vessel port rotations have altered maritime operations similar to the hub and spoke delivery systems adopted by air carriers.

Since the 1984 legislation, the dramatic growth and changing nature of global trade has established different patterns in international shipping. New methods of supply chain management are utilizing more outsourcing, smaller inventories, advanced communications technologies, third party logistics providers, and changing trade routes due to the expansion of emerging nations buying and selling patterns. The desire for efficiency and uniformity in global distribution businesses has placed pressure on the maritime industry. The emerging global marketplace, as well as perceived inefficiencies in carrier pricing and operations, has prompted many companies and organizations to support further deregulation provided by various pieces of legislation introduced in Congress.

V. THE CURRENT MARITIME DEREGLATORY MOVEMENT

Deregulation of the shipping industry was initially proposed in 1995 in the House backed Ocean Shipping Reform Bill of 1995. Major provisions of the Act, among other items, would allow for individual confidential service contracts, end the public filing of tariffs, and merge the FMC with the Surface Transportation Board to create a new regulatory agency. The new Intermodal Transportation Board would enforce both shipping and ground transportation regulations beginning with its establishment in 1999. In addition, the current requirement that mandates carriers to provide similar shippers with the same contracts would be eliminated.

This initial deregulation bill passed the House in 1996 but stalled in the Senate. The bill was reintroduced in 1997 with passage in the House.

26. See Barnes, supra note 24.
but failure again in the Senate. Reasons cited for its failure at the time included 1) the fact it was considered too late in the Congressional session and 2) criticism from a disparate coalition of opponents including organized labor, maritime ports, smaller shippers, the National Customs Brokers and Forwarders Association of America, some foreign-owned carriers, and other cooperative shipping groups.  

Opponents argued that the maritime deregulation bill would eliminate the concept of common carriage in ocean shipping, benefit larger shippers at the expense of smaller and create a two-tiered rate structure that would shift contracting to individual agreements thus destroying the shipping conference arrangement. Organized labor and maritime ports opposed the deregulation bill, arguing that there was no guarantee that confidential information could be obtained to track the movement of goods and service and ensure that terminal contracts and union agreements are being honored.  

A compromise plan that kept some aspects of the 1984 Shipping Act in place as well as providing rate confidentiality in a uniform manner and enough information for organized labor to monitor compliance with collective bargaining agreements was eventually crafted in the Spring and Summer of 1998 and passed out of both Houses of Congress. The Ocean Shipping Reform Act of 1998 was signed into law in October of 1998 and will take effect on May 1, 1999.  

VI. MARITIME PORTS AND DEREGULATION  

Along with their historic role as a point of entry and exit to the sea, maritime ports serve several important economic purposes for the cities as well. As a key source of tax monies, jobs, and income derived from processing cargo, the ports have a mission that includes economic development within their geographic political structure.  

As fixed economic entities however, port centers must remain vital to the shipping lines that utilize them and the customers served by them through increasing infrastructure investment or watch their market share erode to competition.  

Traditionally, ports with higher operating costs favored a collective pricing system that negated competition for carriers on the basis of cost. Competition was limited to attempting to lock in carriers through attractive long-term leases or by adding additional berths and equipment that

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28. Id. at 18-19.  
often resulted in excess capacity.\textsuperscript{31} The quality of service necessary for coastal ports to be able to attract cargo, however, varied with their ability to acquire supporting land for terminal operations and the need for dredging to maintain necessary channel depths. Due to the need for continual dredging for many ports on the East Coast to allow calls by larger deep-draft container ships, the ports levied a harbor maintenance tax on all exports and imports, created by the Water Resources Development Act of 1986, to maintain the depth of navigable waterways through dredging for all United States maritime ports.\textsuperscript{32} After a series of court cases within the United States questioned the constitutionality of assessing the harbor tax upon exporters, the Supreme Court declared the tax unconstitutional in March of 1998. At this writing, individual ports will be required to pay for future dredging; a development that may add considerable cost to ports as carriers shift to ever-larger vessels.\textsuperscript{33}

\textbf{VII. Some Lessons To Be Learned From Airline Deregulation}

While deregulation as a whole has benefited the growth of the airline industry, there exists a conspicuous lack of competition at many major United States airports.\textsuperscript{34} The series of mergers during the mid 1980’s, changes in marketing strategies (such as frequent flier programs) coupled with a growing problem of physical facilities and airway constraints in many cities has limited competition severely.\textsuperscript{35}

Policy makers have offered two basic solutions: (1) Add physical capacity or (2) use the current capacity more efficiently.\textsuperscript{36} Since there has been little in the way of new airport construction since deregulation, the addition of more capacity seems unlikely. In both options, major carriers currently in a dominant position at major hub airports have refused to cooperate by shifting these underutilized resources to new entrants, fearing that their competitive position would be negatively affected. Further, the movement of mobile capital (airplanes) from one market to another

\begin{flushright}
\textsuperscript{34} See Jim Glab, \textit{Deregulation – Has it Worked Too Well?}, Frequent Flyer Magazine, Sept. 1998, at 26-34.
\textsuperscript{35} Id.
\end{flushright}
may leave the hub airport at a competitive disadvantage.\textsuperscript{37} As an example, the major air carriers operating out of O'Hare Airport and the City of Chicago oppose the building of a third metropolitan airport. The airport would most likely lie outside of the city's jurisdiction and include additional landing slots and boarding gates for competitors that are currently blocked from entering the Chicago market.\textsuperscript{38}

Both airports and ocean ports feature public and private entities competing and cooperating with each other in a common marketplace. For example, a "public" port facility consists of private marine terminals, lift equipment and container facilities utilized by individual carriers.\textsuperscript{39} Similarly, airports are publicly owned and operated with air carriers building their own gates or lease terminal space for long periods of time.

The problems currently experienced by passengers at many airports may be similar to the ones shippers will face at many ports with the passage of deregulation. Like the airports, two areas that may have a great impact on the competitive nature of ports are the distinct but interrelated areas of liner marketing strategies and geographic physical constraints. While these two factors predate the onset the maritime industry deregulation, it may be argued that ocean shipping reform will further change the nature of competition at maritime ports in a similar fashion to how deregulation has affected U.S. airports.

\textbf{VIII. Liner Marketing and Operational Strategies}

Ocean shipping lines are entering a period of transformation that will impact ports in dramatic ways. A surge of mergers, alliances and acquisitions over the last two years will continue to shrink the number of competing carriers. This movement will eventually lead, as we have seen in the airline industry, to large integrated operations with global ownership, multiple trade lanes and large "jumbo" container vessels making fewer port calls. The port rotation (is the sequence in which the vessel will call ports) has lead to the marginalization of those ports that are not the first entry or last exit point. Ports not directly on the sea (e.g., Baltimore or Philadelphia) and those in the middle of a rotation (e.g., Oakland) must fight to avoid being bypassed or accept the status of a feeder port for a small group of large load centers, also known as megaports. The greater efficiencies of container carriers also bring greater scrutiny by carriers of the ports they choose to serve. For example, two large carriers serving the Port of New York, Sealand and Maersk, have both indicated

\textsuperscript{37} Id.
\textsuperscript{38} See Dennis Byrne, Mayor's Airport Plan Needs an Upgrade, CHI. SUN TIMES, Feb. 7, 1999, at 26.
\textsuperscript{39} See JANSSON & SCHRNEERSON, supra note 31.
that large-scale capital improvements and reduced costs will be necessary for continued use of the port in the next year.40

The relationship between the build-up to ocean shipping deregulation and the liner marketing strategies described has not been addressed by researchers at this time in part due to the ongoing nature of the process. Further, there has been little research by policy makers as to the exact causality of the relationship between the two. Edward Emmett, chairman of the NITL, argues that the question of rationalization of port calls would take place with or without deregulation.41 Major port operators have suggested otherwise. Observations from airline deregulation suggest that ports may evolve into a series of four or five hub points for specific carriers. The carriers at the hub will restrict competition by limiting access to scarce terminal/storage space and intermodal access to rail and highway transportation facilities through dedicated equipment. It is possible that the monopoly on a given facility cost structure and transit times will restrict entry and eventually lead to carrier rate increases. To further reduce the competitive nature of the market, there is a possibility of replacing conferences in the future with "discussion groups" among large carriers that set policy guidelines among themselves as to maritime port use.42

IX. PHYSICAL CONSTRAINTS

The competition for cargo at many ports has lead to tremendous pressure to invest in infrastructure development. Carriers have asked ports to add available land, deepen channels for much larger containerships, add and modernize existing intermodal rail connections, form separate connections for truck traffic and/or create dedicated freight corridors, and manage waterfront work rules practices.43 Demands for growth at the ports may also be hindered by infrastructure bottlenecks far outside of control of a port authority. For example, the ports of Seattle and Tacoma are hampered by intermodal rail connections in eastern Washington.44

To remain competitive, ports must create sophisticated coalitions that involve local cities, counties, state and governmental bodies as well


41. See Edward Emmett, In His Own Words; "Our System is a Throwback to Another Era", J. Com., Sept. 19, 1997, at 1A, 14A.

42. See Bill Mongelluzzo, Feds Scrutinize Discussion Agreements; Their Ability to Affect Rates Concerns FMC, J. Com., Feb. 20, 1998, at 13A.

43. See Bill Mongelluzzo, How Big Ships Will Change Port System, J. Com., Sept. 29, 1997, at 1A.

44. See Bill Mongelluzzo, Megaports are Facing Increasing Problems; Support Infrastructure as Key to Efficient Handling of Cargo, J. Com., Feb. 20, 1998, at 1B.
as public and private sector competitors to gain consensus on the overall direction of port facility development. The intricate public/private relationships that exist in maritime ports leave the municipality in which the port is located exposed to complex questions of how to mediate between competing private interests. How heavily should the private sector be subsidized at the cost of creating fewer potential users of the maritime port?

In addition to all of the concerns cited rest a series of tangential public interest questions related to port development and its effects on the offshore environment and historical preservation of a city’s waterfront. There is an ongoing debate over the effects of increased harbor dredging on offshore fishing grounds, particularly on the East Coast. Preservationists and politicians have moved to block the wholesale demolition of historic waterfront buildings as well as the sale of attractive waterfront acreage to foreign flag shipping operators.45

The growth of large containerships is dividing the port industry into two camps - an elite tier of large megaports with deep harbors and excellent inland infrastructure and a second tier of feeder ports that cannot accommodate the new vessels.46 The enormous financial resources needed to provide adequate road, rail, and terminal infrastructure demanded by the ocean carriers has created fierce competition in Washington D.C. for scarce federal funds to ensure a ports status among the leaders. This is also a never-ending cycle with giant megaports facing increasing difficulties in securing infrastructure financing, more large land parcels, dredging deeper channels to facilitate calls of the jumbo carriers and gaining adequate rail/highway access when they get there. Recent evidence suggests that credit-rating agencies question the large debts taken on by municipal ports to remain as chosen load centers.47

Ocean carriers and their customers are asking ports to think like marketing managers rather than traditional operations personnel. Unlike marketing managers, however, maritime ports must operate in an environment where few variables are completely within their control and the geographical movement of the facility is limited. Facilities and locales designed around commercial needs of another era bedevil their attempts to address current logistical needs. Some experts suggest that the large megaports of the future may not be near major population centers, thereby enabling them to facilitate the construction of specially designed

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47. See Bill Mongelluzzo, In a Sea of Red Ink, J. Com., Mar. 3, 1998, at 1B.
cargo loading and unloading points.\textsuperscript{48} The current competition between cities, counties and states for revenue sources to pay for infrastructure development, and the conflicting need to cut fees to carriers for their use, may only be settled by the Federal government. Failing this, ports may need to cooperate with one another more closely to ensure their individual economic livelihoods.

The relationship between the ongoing deregulation efforts and physical constraints at maritime ports suggests that individual ocean carriers may be in a position to exert pressure on the ports in much the same way dominant hub carriers in the airline industry can leverage airports. Selected maritime megaports will seek to lock up ocean carrier tenants through the use of long term contracts. However, ocean carriers will seek to play ports off against each other to extract concessions on fees and infrastructure improvements. To continue as a major megaport will require constant attention to infrastructure with no guarantee that they will remain one of the favored ports in the future.

\textbf{X. Conclusion}

Several observations from airline industry deregulation suggest that applying free market competition to the international shipping industry may not bring about greater competition and lower prices as predicted. First, changes in liner marketing and operations strategies may defeat the original intention of maritime deregulation, namely more service options and better container rates. Practices such as mergers to form international alliances and multiple port rotations to satisfy supply chain considerations may eventually cause an increase rather than a decrease in container rates.

Secondly, physical constraints at maritime ports such as available berthing space, infrastructure congestion, costly dredging requirements and access to inland points, may act to further restrict competition to a handful of carriers at a small number of megaport facilities.

Thirdly, while shipping customers wait for the benefits of reduced costs and increased services from deregulation, a smaller number of competing ocean carriers will possibly be able to enact the "fortress" hubs prevalent in the air industry. Surviving carriers in deregulation will be able to support extensive supply chain needs of global businesses through a handful of major maritime ports that are configured to precise intermodal needs.

Fourthly, export and import customers may have little choice as to what carrier can be used with the possible exception of routing cargo through Canadian ports. As in many United States cities, airline passen-

\textsuperscript{48} See Mongelluzzo, \textit{supra} note 43.
gers have little or no choice as to the airline that might fly to a specific destination. Dominant airlines control the majority of landing slots as well as the physical facilities-gatespace and baggage areas.

Lastly, service may well deteriorate and grow redundant rather than improve to meet customer niche requirements in the deregulated maritime environment. For example, by the early 1990's, the major U.S. passenger airlines were operating similar hub and spoke route structures, minimalist passenger services, mileage based loyalty programs and ownership of reservation systems as travel agents issue fewer tickets. The result has been a downward spiral of customer expectations and pricing policies more along the lines of commodity based products than towards adding value to passengers.\textsuperscript{49} A lesson learned from the airline industry which may be applicable to the maritime industry is greater concentration of key transportation components with increased market power for fewer firms. For example, capacity constraints at the busiest U.S. airports have resulted in increasing linkages of major U.S. airlines with those of other countries and static competition resulting in significantly higher airfares.\textsuperscript{50}

Many observations from the airline industry suggest that further policy research be performed in examining the effectiveness of deregulation, not just in the overall industry but also upon site-specific market factors such as maritime ports. The true test of the success or failure of ocean shipping deregulation will be how it will affect the ports, since that is where freight moves to and from in international commerce.

Testing the Limits of Federal Tolerance: Strategic Alliances in the Airline Industry

Michael J. AuBuchon*

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I. INTRODUCTION

In the business world, different definitions exist for the term “strategic alliance.” This business activity may include minority equity investments, special supply arrangements, combined research and development, joint purchasing, joint production, and joint marketing through co-promotion or co-branding. Strategic alliances are often viewed as synonymous with “joint ventures,” which have been defined as “all collaborations, short of a merger, between or among entities that would have been actual or likely potential competitors in a relevant market absent that collaboration.” Under any definition, the goal of a strategic alliance is the same - pursuit of strategic objectives by enabling the strategic alliance partners to use their complementary resources efficiently and effectively.

Strategic alliances are becoming a common mechanism for businesses to seek economies of scale, through use of these complementary resources, without an outright merger. In the last decade the number of these alliances increased by about twenty-five percent per year. While the concept of strategic alliances elicits abundant attention from management journals, it attracts little attention in antitrust law review literature. The management journals explain that strategic alliances respond to the increased need for cooperation to maintain profitability in complex tech-
nologies and global markets. The journals expound five factors that contribute to the increased need for cooperation:

1. **Globalization.** Competing in a global economy requires a much larger scale and scope of operations.

2. **Increasing economies of scale and scope.** More generally, in more and more industries, the scale and scope of the optimal-sized firm seems to be expanding dramatically due to technological change.

3. **Specialization.** At the same time as the economies of scale and scope in individual markets increase, there is increased consciousness of the diseconomies of a large firm trying to do everything itself. The current business school mantra is to concentrate on your core competencies.

4. **Complexity.** Many key technologies have grown so complex that few if any companies can master them all, especially considering the risk involved.

5. **Pace of technological change.** R&D alliances are frequently a response to the need to move quickly in rapidly changing markets. Alliances are flexible enough to adapt to changing market conditions, have comparatively low entry and exit costs, and can be abandoned if the market, or the technology, takes a different course.

6. **Network effects.** In technology-driven markets, network effects make it critical that a firm capture the first mover advantage so that its technology becomes the industry standard.

Additionally, strategic alliances can be a key factor to the reduction of transaction costs, by coordinating firms' interests to limit the chance of opportunism—i.e., where a firm attempts to capture all gains from an investment—and by extinguishing the need to continuously negotiate new deals in response to convoluted and dynamic business decisions. This transaction cost reduction is usually carried out via reciprocity and exclusivity agreements; sometimes, the alliance relationship is further anchored through co-ownership of assets or through mutual equity investments.

Many of the largest attempted strategic alliances occurred in the airline industry, where they were used to surmount obsolescent hurdles to enable airlines to compete internationally. Several obstacles exist for these domestic airlines desiring an alliance with foreign carriers to ensure increased international reach: limitation on foreign ownership, the existence of entrenched local airlines, differing cost structures, and diverse preferences and customs. Although these obstacles exist to dissuade airlines to embark on strategic alliances with foreign carriers, several do-

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6. Id.
7. Id. at 502-03 (emphasis added).
8. Id. at 503.
9. Id.
10. Id.
11. Id.
mestic airlines nonetheless initiate these alliances because "customers are demanding integrated services that cross international lines."\textsuperscript{12}

While management journals explain the business rationale for strategic alliances, few litigated cases expressly address the issue from a public policy perspective.\textsuperscript{13} However, the United States Department of Justice (DOJ) conducted several recent investigations to study the effect, from an antitrust vantage point of strategic alliances in the airline industry.\textsuperscript{14} This Note focuses on international and domestic strategic alliances in the airline industry. It focuses on antitrust and overall public policy concerns. Part II of this Note discusses "code-sharing," the prevalent way strategic alliances are accomplished in the airline industry.\textsuperscript{15} Part III examines recent federal regulatory analyses of strategic alliances. Part IV theorizes a legal standard for airline strategic alliances and applies that standard to a recent test case.

II. CODE-SHARING

A. DEFINITION

"Code-sharing" is defined by the DOJ to mean "as little as allowing another airline to use its code when it sells seats on your plane on a route in which it cannot compete."\textsuperscript{16} However, code-sharing "also can mean as

\begin{footnotes}
12. Id.
13. Id. at 502.
15. In this Note, references to code-sharing alliances, strategic alliances, and joint ventures are meant to be synonymous, although code-sharing is not completely synonymous with strategic alliances or joint ventures. A strategic alliance, in the context of the airline industry, can encompass fusion of frequent flyer programs, sharing of airport lounge space, locating gate space near the alliance partner's gate space for marketing association purposes, and, of course, code-sharing. The synonymous use is mostly because code-sharing is the most significant aspect of an airline strategic alliance or joint venture.
16. Roger W. Fones, \textit{International Code Sharing—An Antitrust Perspective}, \textit{10 Air \& Space L.} 1, 5 (1995) [hereinafter \textit{International Code Sharing}]. Mr. Fones is the Chief of the Transportation, Energy, and Agriculture Section, Antitrust Division, of the DOJ. \textit{Id.} at n.1. An example applying the DOJ's code-sharing definition is the planned domestic code-sharing alliance involving Northwest Airlines and Continental Airlines. \textit{See Pilots' Union Urges Intervention to Block 'Virtual Merger' of Northwest, Continental Airlines}, PR Newswire, Nov. 5, 1998. \textit{See also infra Part IV.B.2. If the code-sharing alliance is initiated, the two carriers would be allowed to ticket passengers on each other's aircraft as though they were their own. Id. Gordon Bethune, Chairman and Chief Executive Officer of Continental Airlines, recently testified before the Antitrust, Business Rights, and Competition Subcommittee of the Senate Committee on the Judiciary; he gave an example of code-sharing and how the Northwest and Continental code-sharing plan would affect the two airlines' customers:}

The creation of new online options for the U.S. consumer is a key benefit of any alliance. Take a market like Madison, Wisconsin. Northwest is currently one of nine airlines flying to Madison. Continental does not fly to Madison at all. Now let's consider destinations like Panama City, Panama or Midland, Texas. The only online option cur-
much as comprehensive integration of marketing and operations that involve joint decisions on price, capacity, schedule, and other competitively sensitive matters.\textsuperscript{17} To the DOJ, code-sharing arrangements are basically types of corporate combinations that "fall somewhere between outright merger[s] and traditional arm's length interlining agreements."\textsuperscript{18}

B. Benefits and Detriments

The DOJ acknowledges both benefits and detriments of code-sharing.\textsuperscript{19} Benefits include pro-competitive aspects that benefit the traveling public: creation of new service, improved existing service, lower costs, and increased efficiency.\textsuperscript{20} However, "code sharing can also be a mask for anti-competitive arrangements between actual or potential competitors to allocate markets, limit capacity, raise fares, or foreclose rivals from markets—all to the ultimate injury of consumers."\textsuperscript{21} Distinguishing between these benefits and detriments is essential for airlines, aviation policymakers, and antitrust enforcement personnel.\textsuperscript{22}

III. Analyses by Regulatory Agencies

A. Department of Transportation Authority

The United States Department of Transportation (DOT) is the federal regulatory body with the power to grant antitrust immunity to code-sharing partners and approve code-sharing agreements.\textsuperscript{23} The DOT is granted this authority through 49 U.S.C. sections 41308 and 41309.\textsuperscript{24} Section 41309 authorizes the DOT to approve agreements involving international air transportation.\textsuperscript{25} To approve such an agreement, the DOT must find that the agreement is not contrary to the public interest and not

\begin{footnotesize}
\begin{itemize}
  \item \textsuperscript{17} International Code Sharing, supra note 16, at 5.
  \item \textsuperscript{18} Id.
  \item \textsuperscript{19} Id.
  \item \textsuperscript{20} See Aviation Agreements, supra note 16, at *3.
  \item \textsuperscript{21} See International Code Sharing, supra note 16, at 5.
  \item \textsuperscript{22} Id.
  \item \textsuperscript{23} See Joint Appl. of United Air Lines, Inc. and Air Canada, Ltd.: Dep't of Transp. Order No. 97-9-1, at 1 (Sept. 19, 1997) [hereinafter UAL/AC Joint Appl.].
  \item \textsuperscript{24} See 49 U.S.C. §§ 41308 & 41309 (1998).
  \item \textsuperscript{25} Id. at § 41309.
\end{itemize}
\end{footnotesize}
otherwise in violation of the statute. The DOT is precluded from approving an agreement that substantially reduces or eliminates competition unless the agreement is necessary to meet a serious transportation need or to achieve important public benefits and the Department finds that those needs or benefits cannot be obtained by any reasonably available alternative that is materially less anti-competitive. Public benefits can include international comity and foreign policy considerations. Section 41308 authorizes the DOT to grant antitrust immunity to an agreement approved under section 41309 if it finds that immunity is required by the public interest. Unless an approved agreement substantially reduces or eliminates competition, the DOT usually withholds antitrust immunity as being unnecessary. However, if there is a strong showing on the record that antitrust immunity is required by the public interest and that parties will not proceed without it, the Department may nonetheless grant immunity to permit the transaction to go forward.

B. DEPARTMENT OF TRANSPORTATION AND DEPARTMENT OF JUSTICE AUTHORITY

1. Authority and Code-Sharing Nature

The DOJ is empowered to enjoin an agreement or arrangement not given DOT approval or antitrust immunity pursuant to Section 15 of the Clayton Act, as amended. The DOJ may also file suit pursuant to Section 4 of the Sherman Act to prevent and restrain violations of Section 7 of the Clayton Act, as amended, and Section 1 of the Sherman Act.

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26. Id.
27. Id.
28. See Joint Appl. of American Airlines, Inc. and British Airways PLC: Dept. of Transp. Order No. 97-3-34, at 1 (Mar. 21, 1997) [hereinafter AA/BA Joint Appl.].
31. Id.
32. DOT authority is mentioned again in Part III.B. because both the DOJ and the DOT use the open skies analysis discussed in Part III.B.4.
34. See id. at § 4.
35. See id. at § 18. The amended Section 7 of the Clayton act would govern where an airline strategic alliance crosses over into equity ownership. See id. It provides:

No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

Id. See United States v. Penn-Olin Chemical Co., 378 U.S. 158, 167 (1964) (holding that Section 7 of the Clayton Act applies to joint ventures). A strategic alliance crossover into equity ownership has been alleged in a filed DOJ complaint attempting to enjoin Northwest Airlines' pro-
If a code-share arrangement simulates a merger, the DOJ “will analyze it that way.” A significant factor the Department intends to study is whether code-sharing partners are true or potential horizontal competitors and, if they are, in what city pairs. Here, from an antitrust viewpoint, the DOJ is concerned about the situation where only a few airlines compete on a city pair in which the strategic partners enter into a code-sharing agreement. The Department recognizes that most code-sharing agreements, typically governing a domestic and a foreign carrier, have raised few horizontal concerns because the code-sharing partners are not direct competitors and likely will not become direct competitors in the near future.

2. Hub-to-Hub Markets

Despite the DOJ’s recognition that few horizontal concerns arise in code-sharing, it has also stated that there are “numerous situations in


36. See 15 U.S.C.A. § 1 (West 1998). Section 1 of the Sherman Act is the primary arsenal the DOJ has in blocking future code-sharing relationships if it chooses to do so. The provision, which does not require equity ownership, provides:

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine . . . .

Id. See Pan Am. World Airways, Inc. v. United States, 371 U.S. 296, 306 (1963) (holding that joint ventures may be combinations in violation of the Sherman Act). The DOJ has cited Section 1 of the Sherman Act in its attempt to enjoin the Northwest Airlines/Continental Airlines equity/code-sharing agreement discussed above. See U.S. v. Northwest, supra note 35, at 3. See infra Part IV.B.2. Recall, the Northwest/Continental transaction could not be granted approval or antitrust immunity under sections 41309 or 41308, as those provisions only apply to international agreements.


38. See U.S. v. Northwest, supra note 35, at 7. “Horizontal alliances” in the airline industry, according to Gordon Bethune of Continental Airlines, are alliances which offer code-sharing between alliance partners with overlapping service or routes. See Aviation Agreements, supra note 16, at *4. Bethune states that horizontal alliances are characterized by: “[r]eduction of competition without substantial consumer benefits,” “[l]arge combined market shares,” “[r]egional domination,” “[c]ontrol of the largest or most important gateways,” and “[c]losure of key gateways to expansion or competition.” Id. at *4-*5. A “city pair” is an airline route that serves two cities, usually on a nonstop basis. For example, a route from Dallas-Fort Worth (DFW) to Minneapolis-St. Paul (MSP), including a route from MSP to DFW, would constitute a city pair.

39. See International Code Sharing, supra note 16, at 5. “Any time two of very few airlines on a city pair act jointly, whether in a domestic U.S. market or an international city pair, we are concerned about the effect on competition.” Id.

which potential code-share partners are, at least to some extent, actual or potential competitors."41 Primarily, the DOJ is troubled by the situation in which code-sharing partners have a hub at one or both of the endpoints of any given route.42 To the Department, "the most serious threat to competition is presented when two carriers enter a code-share or other joint marketing agreement that includes a hub-to-hub market."43 If hub-to-hub routes are covered in a code-share alliance, and antitrust immunity is not granted by the DOT,44 the DOJ considers the possibility that competitive harm will occur to competing airlines on these routes.45 In this consideration, the DOJ ascertains whether both airlines have flight operations in the market, as well as the extent to which pricing, capacity, and scheduling decisions remain autonomous.46 If autonomy is not achieved by the code-share agreement, the DOJ searches for evidence that, absent the agreement, one of the alliance partners would not likely enter a market or, is likely to exit that market if the agreement were not established.47 Concurrent with this examination, the DOJ will inquire

42. Edward H. Phillips, U.S. Antitrust Suit Targets Northwest/Continental, AVIA TION Wk. & SPACE TECH., Nov. 2, 1998, at 48. See also U.S. v. Northwest, supra note 35, at 12. A "hub" is a primary operations location for any given airline. The term was derived after deregulation of the airline industry in 1978, which gave birth to a number of airlines operating on a "hub-and-spoke" system. For example, American Airlines has as its primary hubs Dallas-Fort Worth International (headquarters), Chicago O'Hare International, New York Kennedy International, and Miami International airports. Between these hub airports, a large concentration of American flights can be found. Using part of the Bethune example in footnote 14 above, assume a passenger wishes to travel from Dallas-Fort Worth to Madison, Wisconsin. This passenger will have to fly into Chicago O'Hare, whereby he or she will likely catch American's commuter subsidiary, American Eagle, for a flight into Madison. The flight from Dallas-Fort Worth to Chicago was a hub-to-hub flight, whereas the flight from Chicago to Madison was a "spoke" flight.

43. See International Code Sharing, supra note 16, at 6. To illustrate this situation, consider American Airlines again with its proposed domestic strategic alliance partner US Airways (USAir). See Katie Fairbank, Allies in the Air, HOUS. CHRON., Apr. 25, 1998, at B1. One of USAir's primary hubs is Pittsburgh. With the American-USAir code-sharing arrangement, the DOJ would be concerned, for example, about code-sharing from Pittsburgh to Dallas-Fort Worth and Dallas-Fort Worth to Pittsburgh. Because American and USAir would control a large number of the flights between these cities, and arguably all of the nonstop flights, the two carriers, the DOJ would assert, could potentially stifle competition on that route, precluding entry by other carriers or perhaps driving other carriers out of that market.

44. See supra Part III.A.
45. Id. at 11. The DOJ defines "autonomous" to mean more than just maintaining the legal right for each code-share partner to act alone. See International Code Sharing, supra note 16, at 8. The DOJ states that the code-share agreement must be structured more like a traditional interline pact, where there would be less likelihood of competitive harm. Id. In achieving this autonomy, the DOJ contemplates that the agreement should "give[] each carrier the strongest possible incentive to sell seats on the flights it operates, rather than on those of its code-share partner . . . ." Id.
whether the alliance partners’ collective cooperation on the hub-to-hub market is “necessary to achieve significant pro-competitive efficiencies” for service to cities beyond the hub cities which are served and benefited by the code-share mechanism. However, the DOJ emphasized that “[t]he evidence that such efficiencies outweigh the potential competitive harm in the hub-to-hub market must be clear.”

3. *Open Skies* Bilateral

a. DOT/DOJ Open Skies Policy

The hub-to-hub market and interline passenger analyses are only the initial competitive studies the DOJ undertakes to ascertain whether code-sharing alliances violate the antitrust laws. Another factor considered is whether a hub-to-hub market adheres to an “open skies” bilateral. “Open skies” contemplates the possibility of non-hub carrier entry into the market in which the code-share partners serve. The DOJ examines the likelihood of such entry if the alliance partners strive to increase fares or limit service. The DOT recently discussed open skies in its own parlance:

> International traffic rights are essentially unrestricted in an open-skies agreement. Agreements permit United States carriers to serve from points behind the United States and intermediate points, to any point or points in the partner’s territory and to points beyond that country. Similarly, it would permit partner’s flag carriers to serve from points behind their homeland, via the homeland and intermediate points, to a point or points in the United States and beyond.

Open skies issues often surface in the realm of international travel; for example, international gateway-to-gateway city pairs are often governed by restrictive bilateral agreements, the antithesis of open skies,

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48. See International Code Sharing, supra note 16, at 8. To see how beyond-hub cities are benefited by code-sharing, see supra note 16 and accompanying text. In other words, if hub-to-hub code-sharing is essential to achieve the efficiencies associated with an airline using its alliance partner to help extend its service reach for its customers, the DOJ might allow such cooperation even on hub-to-hub routes.

49. Id.

50. Both the DOT and the DOJ utilize the open skies analysis. The DOT uses the doctrine in its consideration of whether to grant approval and antitrust immunity under sections 41309 and 41308. The DOJ, on the other hand, uses the doctrine in its antitrust assessment. Despite the different uses, the basic analysis is the same.

51. Id. at 6.

52. Id.

53. See AA/BA JOINT APPLIC., supra note 28, at 5.


which limit entry into a country to only certain foreign carriers and limit the frequency of that entry. In response to carriers opposing the joint application of American Airlines and British Airways for approval and antitrust immunity for the proposed code-sharing alliance, the DOT stated:

Under our established policy and practice, we will not grant approval and antitrust immunity without an Open-Skies agreement. We reaffirm that policy and practice here. We are unwilling to approve and immunize an alliance if other airlines are unable to provide effective competition to the alliance partners. This policy is directly relevant here, for U.S. airlines have had little or no opportunity to enter or expand service at London's Heathrow airport, British Airways' hub, due to policies applied by the United Kingdom. Obviously, we could not grant approval and immunity for the Joint Applicants' alliance unless other U.S. airlines could compete effectively in the markets affected by the Alliance, since otherwise the Alliance would not be in the public interest.

The DOT and DOJ thus assert that a liberal bilateral reduces antitrust concerns that might otherwise flow from an international code-sharing agreement. While a liberal bilateral does diminish antitrust concerns,

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56. See International Code Sharing, supra note 16, at 8. A "gateway-to-gateway" city pair is essentially a city pair which serves two markets that are the launching points for international service to countries. For example, a flight from Washington Dulles International to London Heathrow International would be a gateway-to-gateway market, because the airports serve as launching points for their respective countries. "Bilateral agreements" are agreements transportation agencies of two different countries enter into whereby the number of foreign carriers entering into any given country's domestic market is limited by certain carriers and a certain number of flights per a specific time period. See e.g., Aviation Agreements, supra note 16, at 6 (discussing American Airlines' request for antitrust immunity from its proposed code-sharing alliance with British Airways).


58. Id.

59. Id. at 4. Besides the open skies elements discussed earlier, the other elements include:

(1) no limits on the number of airlines that may be designated by either country;
(2) unrestricted capacity and frequencies on all routes;
(3) full fifth-freedom (local international traffic) and sixth-freedom (traffic from behind home country to other party) rights, unlimited "change of gauge" (change of aircraft type at any points on the route), coterminization, and substantial routing flexibility;
(4) a double-disapproval pricing provision on all routes, including fifth/sixth freedom markets (both countries must agree to disapprove a fare to prevent it from taking effect);
(5) liberal charter arrangements (the least restrictive charter regulations of the two governments would apply regardless of the origin of the flight);
(6) open code-sharing opportunities;
(7) the right to convert earnings and remit them in hard currency promptly and without restrictions;
(8) the right of airlines to perform ground handling of their own passengers and cargo;
(9) procompetitive doing-business provisions, including commercial opportunities, user charges, fair competition, and intermodal rights;
the DOJ notes that all code-sharing agreements are different with different impacts on competitors and consumers. In other words, the DOJ "examine[s] all of the facts and circumstances surrounding each code-share agreement and make[s] [its] competitive assessment on a case-by-case basis." 60

b. DOT/DOJ Open Skies Policy Applied – Oneworld Alliance 61

On January 10, 1997, Great Britain-based British Airways and Ft. Worth-based American Airlines filed a Joint Application with the DOT for a grant of approval and antitrust immunity to a sweeping strategic alliance.62 This alliance, recently named “Oneworld,” 63 is, in its most modest form, a cooperative agreement whereby the two carriers will code-share on beyond-gateway markets, fuse frequent-flier programs, and share airport lounges.64 The strategic alliance’s not-so-modest form is largely unknown because the details of the agreement are confidential between the carriers; however, industry experts speculate that the link-up agreement could involve much more than the above-referenced provisions: joint determination of pricing and scheduling, coordinated consideration of aircraft utilization for specific routes, and dual assessment of travel agent commissions.65 Moreover, a pooling of revenues from British-American operations is also mentioned as a possible agreement provision.66

The DOT concluded, via an order issued on March 21, 1997, that it was in the “public interest” to commence processing the AA/BA alliance

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61. Although both agencies examine the open skies policy, discussion of the AA/BA proposed alliance here is limited to the DOT’s consideration of that policy. This limitation to DOT discussion is logical because a DOT granting of approval and antitrust immunity under sections 41309 and 41308 would mute the DOJ’s consideration of the antitrust aspects of the alliance. However, the DOJ does provide antitrust input to the DOT in the latter’s assessment of whether to grant approval and antitrust immunity. See AA/BA JOINT APPLIC., supra note 28, at 6.
63. See Charles Goldsmith, British Airways, American Air Face Foes Even on Gradual Phase-In of Union, WALL ST. J., NOV. 2, 1998, at 23A.
64. Id.
66. Id.
agreement even though open skies negotiations were (and are) ongoing between the DOT and the British government. 67 Although the Order initially appeared to be a departure from the DOT’s long-held policy of open skies prior to approval of international strategic alliance agreements, the Department quickly noted that it was not ruling on the merits of the application. 68 The Order provided, “[T]his procedural decision reflects no change in our substantive policy, which we reaffirm here, i.e., that the completion of an Open-Skies agreement is one necessary precondition to any decision to grant approval and immunity, even tentatively, to a proposed alliance, which must also be found to be pro-competitive.” 69 Nevertheless, the DOT determined that, since the “application [would] be difficult to process in a timely manner,” processing of the AA/BA agreement should begin “to avoid undue delay in providing the substantial public benefits of implementing an Open-Skies regime.” 70 The Department determined that it would ultimately reach a decision as to whether the application is both pro-competitive and in the interests of United States consumers after both de jure and de facto open skies with Great Britain is achieved. 71

Currently, an Open Skies agreement does not exist between the DOT and Great Britain/European Union officials. 72 American Airlines and British Airways officials now claim their companies are entitled to go forward with their strategic alliance under existing treaties. 73 However, DOT officials made it clear that they are hesitant to approve even modest continued cooperation between carriers without a new liberalized Open Skies agreement. 74 Because American Airlines and United Airlines are the only United States carriers currently allowed to utilize “London’s coveted Heathrow Airport,” the DOT continues to deny outright approval and antitrust immunity to the AA/BA strategic alliance until other United States carriers are guaranteed access to Heathrow. 75 The major stumbling-block in the consummation of the strategic alliance appears to be British Airways’ unwillingness to surrender 267 weekly Heathrow Air-

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67. See AA/BA JOINT APPLIC., supra note 28, at 5.
68. Id. at 6.
69. Id. at 5 (emphasis added).
70. Id.
71. Id. The DOT emphasized that the processing of the agreement was necessary to make sure that open skies are achieved beyond just paper when they occur—that open skies exist in fact. See id. at 4.
72. See Goldsmith, supra note 63, at 23A. United States-Great Britain talks on a liberalized open skies agreement broke off in early October, 1998, when American negotiators broke off discussion due to the British government’s alleged unwillingness to liberalize existing air service treaties. Id.
73. See id.
74. Id.
75. Id.
port slots to rival carriers, a condition imposed by European Union regulators.\textsuperscript{76} Stating that the surrender of slots was not "acceptable to us commercially," British Airways officials now favor a gradual phase-in of Oneworld in the next four or five years.\textsuperscript{77} While one market analyst praised the carrier for its protective stance in light of "economic uncertainties" in Great Britain, he warned that other strategic alliances will only grow stronger and build more customer loyalty while the Oneworld alliance "proceeds at less than full speed."\textsuperscript{78}

IV. Predicted Analysis by Courts

A. Definitions and Exertion of Market Power

While litigation involving airline strategic alliances is rare to nonexistent, code-sharing agreements could potentially be analyzed, if challenged by the DOJ, under the same tests used by courts for joint ventures and horizontal agreements.\textsuperscript{79} Therefore, the formation and operation of strategic alliances may be assessed under a test drawn from Section 1 of the Sherman Act or Section 7 of the Clayton Act, as amended.\textsuperscript{80} The first step in this test "is to determine whether an alliance is facially anti-competitive."\textsuperscript{81} If the arrangement is more substantive than the "strategic alliance" label, and the venture's only purpose is to restrict output or fix prices, then it is treated as \textit{per se} unlawful.\textsuperscript{82} However, because a strategic alliance will rarely be \textit{facially} anti-competitive, the second step requires evaluation under the "rule of reason" test.\textsuperscript{83} "The rule of reason looks at the anti-competitive effects of the alliance and balances those effects against the pro-competitive and efficiency justifications."\textsuperscript{84} Under this test, the agency has the initial burden of showing the arrangement has lessened, or is likely to lessen competition.\textsuperscript{85} This burden is satisfied

\textsuperscript{76} Id.

\textsuperscript{77} Id.

\textsuperscript{78} Id. The other alliances that "will only grow stronger and build customer loyalty" include: the "Star Alliance," which includes United Airlines, Lufthansa, Thai International, Air Canada, Varig, and SAS; Delta Airlines' alliance with Austrian, Sabena, Belgian, and Swissair; Northwest's alliance with KLM Royal Dutch, which also has an agreement with Alitalia; and Continental's alliance with Air France, Alitalia, and Virgin Atlantic. See Tom Belden, \textit{Airline alliances can lead to higher travel costs}, \textit{Seattle Times}, Feb. 22, 1998, at K11.

\textsuperscript{79} See Kolasky, \textit{supra} note 1, at 506. Recall that strategic alliances and joint ventures are often synonymous.


\textsuperscript{81} See Kolasky, \textit{supra} note 1, at 506.

\textsuperscript{82} Id.

\textsuperscript{83} Id.

\textsuperscript{84} Id.

by the agency if it shows either proof that the alliance will originate or promote the exertion of market power, or proof of anti-competitive effects such as contraction of output.\textsuperscript{86} If the agency meets this showing, the burden then shifts to the challenged alliance partners to prove the pro-competitive benefits of the alliance.\textsuperscript{87} If the alliance partners demonstrate that the alliance arrangement has pro-competitive benefits, then the burden shifts again to the agency to establish that “the alliance is not reasonably necessary to achieve the pro-competitive benefits.”\textsuperscript{88}

Administrative agencies, like the DOJ, usually approach their initial burden by attempting to show that the strategic alliance, or joint venture, promotes exertion of market power.\textsuperscript{89} The Supreme Court defined “market power” as the ability to increase prices “above the levels that would be charged in a competitive market.”\textsuperscript{90} Due to the variety of horizontal arrangements that fall between outright mergers and strategic alliances, market power analysis in the joint venture context is often a difficult undertaking.\textsuperscript{91} Even when joint ventures are restricted to one function, the joint venture agreement’s terms and operation may vary significantly from one context to the next.\textsuperscript{92} Therefore, assessment of the market power of airline strategic alliances, which is restricted to the one broad function of coordination of air services, often depends on the terms of the agreement that solidifies the strategic alliance.\textsuperscript{93}

\textsuperscript{86} See Capital Imaging Assoc. v. Mohawk Valley Med. Assoc., 996 F.2d 537, 546 (2d Cir. 1993).

\textsuperscript{87} See Kolasky, supra note 1, at 506.

\textsuperscript{88} Id. Courts may examine specific restraints included in the alliance even though the alliance passes overall judicial scrutiny. Id. (citing United States v. Addyson Pipe & Steel Co., 85 F. 271 (6th Cir. 1898)). “Under this doctrine, a restraint will be upheld if it ‘is reasonably necessary . . . to the legitimate ends of the existing partnership.’” Id. (quoting United States v. Addyson Pipe & Steel Co., 85 F. 271, 281 (6th Cir. 1898)). “If an individual restraint does not withstand scrutiny, the court may approve the alliance subject to removal or modification of the unlawful restraint.” See Kolasky, supra note 1, at 506.

\textsuperscript{89} See McFalls, supra note 80, at 657.

\textsuperscript{90} Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 27 (1984). The DOJ has defined “market power” in its Merger Guidelines written in conjunction with the Federal Trade Commission:

\textquote[The Guidelines focus on the one potential source of gain that is of concern under the antitrust laws: market power. The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise. Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time.]

United States Department of Justice and the Federal Trade Commission (FTC) Revision to the Horizontal Merger Guidelines § 0.1 (Apr. 8, 1997) (emphasis added) [hereinafter Merger Guidelines].

\textsuperscript{91} See McFalls, supra note 80, at 653.

\textsuperscript{92} Id.

\textsuperscript{93} Id. The terms of the strategic alliance agreement, however, must always be checked against the circumstances at hand. See id. For example, the terms in the strategic alliance agreement might be innocuous, in antitrust terms, on their face and at the time of inception. How-
B. Joint Venture Standard and Predicted Analysis in the Airline Strategic Alliance Context

1. Joint Venture Standard

Because the formation of joint ventures or strategic alliances among actual competitors raise issues similar to those examined in conventional merger analysis, merger analysis can predict the effects of these transactions—"transactions in which the [alliance partners] contribute all of their productive assets in the relevant market to the collaboration and jointly determine output and price, even when the ventures are of limited duration and the [alliance partners] retain a legal right to withdraw from the collaboration."94 A groundbreaking case for examination of a joint venture using the merger analysis occurred in United States v. Ivaco, where the district court enjoined a joint venture between the two leading manufacturers of automatic railroad tampers.95 Under the joint venture agreement, the two companies would have shared equal ownership and control of their merged automatic tamper and railway maintenance businesses.96

The court initially determined that the inquiry of whether the transaction would harm competition does not change significantly when the transaction is termed a "joint venture" versus an outright merger.97 Continuing its analysis, the court defined the relevant product market as automatic tampers. It did so despite the defendants' argument that the market consisted either of a cluster of tamper markets or of entirely separate tamper markets.98 The defendants were making this cluster argument to attempt to illustrate low entry barriers, whereby potential future competitors would not be deterred from entering the allegedly non-monopolistic market.99 The court noted, however, that the defendants' argument was inconsistent with their assertion that the joint venture was necessary to compete in the continuous action tamper market.100 Once the relevant market was pinpointed, the court applied what was essentially the "rule of reason" test, and held that the government had made a

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94. Id. at 664-65. In a sense, airlines would be contributing "all of their productive assets" in a strategic alliance agreement, because they would be co-marketing and co-promoting one another's service—flights, reservation services, frequent flyer programs, etc.—which would essentially be tantamount to utilization of the other alliance partner's productive assets.


96. Id. at 1412.

97. Id. at 1414.

98. Id. at 1417.

99. Id.

100. Id.
prima facie case of illegality because the statistical device offered by the
government demonstrated the creation or enhancement of market
power.\textsuperscript{101} The statistical index utilized, the Herfindahl-Hirschman Index
(HHI),\textsuperscript{102} provided that the HHI in the relevant market would increase
from 3549 to 5809 if the joint venture were approved.\textsuperscript{103} To support this
showing, the government offered comprehensive evidence illustrating the
defendants' previous lively competition, whereby they proactively re-
sponded to each other's price adjustments.\textsuperscript{104} The court emphasized the
government's showing that this competition would cease with the joint
venture's initiation.\textsuperscript{105}

To rebut the government's prima facie showing of illegality, the de-
fendants asserted two main allegations.\textsuperscript{106} First, they argued that they
were faltering companies in a declining market.\textsuperscript{107} The court rejected the
argument by holding that, even if one of the firms did have to exit the
market, the result would be more "natural" because it would result from
competition rather than the result of the combination of the two largest
competitors in the relevant market.\textsuperscript{108} Next, the defendants argued that

\textsuperscript{101} Id. While the court discussed anticompetitive effects later in the opinion, which could
have been used alone to meet the government's burden, it stressed the government's evidence of
market power exertion.

\textsuperscript{102} The HHI Analysis has been used by courts to examine horizontal mergers in which
parties integrate their productive capacities in a relevant market into a single firm. See McFalls,
supra note 80, at 654, 663. The calculation "squares the market shares of all firms in the relevant
market to arrive at a statistical measure of concentration, thereby giving greater weight to the
market shares of larger firms." Id. A firm's "market share" represents the percent of sales or
capacity that firm controls in a relevant market. Id. at 661. The HHI seeks to reflect the
probability of oligopolistic organization in the post-merger market. Id. at 663. In measuring the
HHI, the governmental agency—typically the DOJ or the FTC—will first calculate the HHI for
the relevant market before the merger. See Merger Guidelines, supra note 90, at § 1.51. Then,
the agencies calculate the post-merger HHI by integrating the market shares of the merging
firms and squaring the result. Id. Finally, the pre-merger HHI is compared with the post-merger
HHI to ascertain the likely competitive effects of the merger. Id. If the HHI numbers fall within
certain specific ranges set out in the Horizontal Merger Guidelines, the agencies are not likely to
challenge the transaction. Id. However, if the HHI differences fall outside of their safe harbor
values, they create a presumption that the merger is "likely to create or enhance market power
or facilitate its exercise." Id. Sections 2 through 5 of the Merger Guidelines provide factors that,
if shown, may overcome the presumption of market power. See generally Merger Guidelines,
supra note 90, at §§ 2-5. Among these factors are: whether the transaction will promote greater
cooperation among firms in the post-merger market, whether the merging entities would be
predisposed to raising prices through agreed output limitation, whether entry by new firms
would be likely and adequate to discourage joint price increases, and whether the transaction
will produce efficiencies from which consumers will benefit. Id.

\textsuperscript{103} Id

\textsuperscript{104} Id.

\textsuperscript{105} Id.

\textsuperscript{106} Id. at 1425.

\textsuperscript{107} Id.

\textsuperscript{108} Id.
the collaboration would allow development of innovative products.\textsuperscript{109} The court agreed that the joint venture \textit{might} have been the most financially attractive scheme for innovation; however, it held that less restrictive schemes were available, such as a vertical joint venture with large railroad customers.\textsuperscript{110} Finally, the court expressed doubt that the cost savings from the joint venture would have been adequate enough to fund the innovation of new machinery without concurrently increasing prices on current products.\textsuperscript{111}

The \textit{Ivaco} court apparently focused on the agreement in reaching its decision, the terms of which would certainly have ended all output and price competition between the parties in the relevant market.\textsuperscript{112} Moreover, the court found that the possible anti-competitive effects of the joint venture were basically the same effects that would have resulted from the parties' outright merger.\textsuperscript{113} The key to the court's holding appears to be the assignment of a sole post-joint venture market share, which was focused upon to ascertain the potential market power of the joint venture in the relevant market.\textsuperscript{114} Holding that the defendants failed to rebut the government's evidence of market power exertion, or potential anti-competitive effects,\textsuperscript{115} the court granted a preliminary injunction to stop the joint venture's consummation.\textsuperscript{116}

2. \textit{Joint Venture Predicted Analysis in the Airline Strategic Alliance}

\hspace{1cm} a. DOJ's Complaint

\hspace{2cm} i. Investment Agreement

On October 23, 1998, the DOJ, alluding to consumer harm through diminished competition and increased airfares, filed an antitrust lawsuit under Section 7 of the Clayton Act and Section 1 of the Sherman Act which seeks to permanently enjoin Northwest Airlines' proposed acquisition of an equity stake in competitor Continental Airlines.\textsuperscript{117} The "Investment Agreement"\textsuperscript{118} provides for Northwest's purchase of Continental's Class A voting stock, constituting 14 percent of the total outstanding equity of Continental, and 51 percent of the voting rights cur-

\begin{itemize}
  \item \textsuperscript{109} Id. at 1425-26.
  \item \textsuperscript{110} Id.
  \item \textsuperscript{111} Id. at 1426.
  \item \textsuperscript{112} See McFalls, supra note 80, at 666.
  \item \textsuperscript{113} Id.
  \item \textsuperscript{114} Id.
  \item \textsuperscript{115} Again, while discussion of anticompetitive effects was secondary to the market power analysis in the court's reasoning, proof of anticompetitive effects will alone suffice to make a prima facie case of an antitrust violation.
  \item \textsuperscript{116} Id.
  \item \textsuperscript{117} See Phillips, supra note 42, at 48.
  \item \textsuperscript{118} This is DOJ terminology.
\end{itemize}
rently held by Air Partners, L.P. (Air Partners). By the terms of the Investment Agreement, the owners of Air Partners exchange their interests for stock and cash in a newly-formed holding company, Coulco, Inc., that immediately merge into Northwest. As a result, Northwest gains voting control of Continental. The Investment Agreement further grants the former Air Partners owners almost five percent of Northwest’s voting shares and the right to designate, through Coulco, one person to sit on Northwest’s board. The Coulco designee, according to the Investment Agreement, must be acceptable to Northwest.

ii. Other Agreements

Concurrent with the execution of the Investment Agreement, Northwest and Continental entered into a “Governance Agreement,” setting forth “how Northwest would exercise its control over Continental during the next six years . . . .” The Governance Agreement provides that Continental stock purchased by Northwest will be placed in a voting trust for six years with Northwest selecting the trustee. Additionally, the Governance Agreement grants Northwest various means to exercise control of Continental, including: the voting power to affect the future competitiveness of Continental, including a vote on major corporate transactions; the power to designate the appointment of one director to the Continental board and the ability to influence the selection of others; and the ability to otherwise exercise control for all other Continental shareholder matters through the Northwest-appointed trustee. The DOJ emphasized that the expiration of the Governance Agreement in six years, which terminates the voting trust, would give Northwest even more

120. Id.
121. Id.
122. Id.
123. Id. Notably, the Investment Agreement named James Coulter and William S. Price, former Air Partners owners, as acceptable designees to the Northwest board. Id. The DOJ noted:

[The] consummation of the Proposed Acquisition is likely to create interlocking directors on the boards of directors of Northwest and Continental. William S. Price currently sits on the Continental board and, if he is elected to the Northwest board, the two airlines will have a common director. In addition to Price, three other individuals affiliated with Air Partners currently sit on the Continental board . . . . If Coulter, Price, or any other person affiliated with Air Partners is designated to the Northwest board, the Air Partners owners will have representatives on the boards of both Northwest and Continental.

Id. at 4-5.
124. This is DOJ terminology.
126. Id.
127. Id. at 5-6.
power to control Continental's operations.\(^{128}\)

Along with the Investment and Governance Agreements, the two carriers entered into an "Alliance Agreement,"\(^ {129}\) which governs a system-wide joint marketing of Northwest's and Continental's services.\(^ {130}\) While the DOJ noted the commonness of these types of alliance agreements between domestic and international carriers, it stated, "[s]ubstantial equity ownership between alliance partners is uncommon; few, if any, have involved a majority interest."\(^ {131}\) The DOJ did recognize, however, the mutual exclusivity of the Alliance Agreement and the other agreements—it was not contingent upon the consummation of the other agreements.\(^ {132}\)

iii. Relevant Markets

Like the Ivaco court's decision, the DOJ's complaint focused on defining the relevant product markets involved in the Northwest and Continental transaction.\(^ {133}\) The DOJ asserted two relevant product markets to consider, as well as a relevant geographic market.\(^ {134}\) The first relevant product market, according to the DOJ, was scheduled airline passenger service. Considering the large number of passengers who wish to travel by air in the United States, the DOJ reasoned that no other mode of transportation would substitute for scheduled airline passenger service in response to a significant increase in airfares.\(^ {135}\) Therefore, the DOJ asserted that "[s]cheduled airline passenger service . . . constitutes a line of commerce and a relevant product market within the meaning of Section 7 of the Clayton Act, and within the meaning of Section 1 of the Sherman Act."\(^ {136}\) Turning to the second relevant product market, the DOJ declared that nonstop scheduled airline passenger service constituted "a line of commerce and a relevant product market within the meaning of Section 7 of the Clayton Act, and within the meaning of Section 1 of the Sherman Act."\(^ {137}\) To support this claim, the DOJ stated that few passengers flying nonstop between United States cities would choose connecting service—i.e., service with one or more stops en route—over nonstop service as a result of notable increases in airfares for nonstop scheduled air-

\(^{128}\) Id. at 6.

\(^{129}\) This is DOJ terminology.


\(^{131}\) Id.

\(^{132}\) Id.

\(^{133}\) Id. at 6-7. See supra note 107 and accompanying text for a further discussion of the Ivaco court's focus on defining the relevant product market.

\(^{134}\) Id.

\(^{135}\) Id.

\(^{136}\) Id.

\(^{137}\) Id. at 7.
line passenger service. Finally, discussing the relevant geographic market, the DOJ contended that few passengers wishing to fly between specific cities in the United States would switch to flights between other airports or cities in response to a significant increase in airfares. In other words, the DOJ claimed that many passengers will continue to fly out of an airport convenient to their homes despite fare increases on routes out of the convenient airport; conversely, travelers will, for the most part, continue to fly into airports convenient to their destination locations despite fare increases on routes into the airport convenient to their destination. Therefore, the DOJ determined that city pairs constitute a section of the country and a relevant geographic market under Section 7 of the Clayton Act and Section 1 of the Sherman Act.

iv. Concentration and Entry

After defining the relevant markets, the DOJ focused next on the creation of market power through the concentration of Northwest-Continental service, including the likelihood of new carrier or new service entry resulting from such concentration. Primarily, the DOJ pinpointed seven hub-to-hub markets in which Northwest and Continental “together dominate the market for nonstop service and for all scheduled airline passenger service.” The market shares in each of the seven hub-to-hub city pairs are:

<table>
<thead>
<tr>
<th>Route</th>
<th>Northwest Share of Nonstop Flights</th>
<th>Continental Share of Nonstop Flights</th>
<th>Combined Share of Nonstop Flights</th>
</tr>
</thead>
<tbody>
<tr>
<td>Detroit-Cleveland</td>
<td>54%</td>
<td>40%</td>
<td>94%</td>
</tr>
<tr>
<td>Detroit-New York</td>
<td>70%</td>
<td>17%</td>
<td>87%</td>
</tr>
<tr>
<td>Detroit-Houston</td>
<td>36%</td>
<td>64%</td>
<td>100%</td>
</tr>
<tr>
<td>Cleveland-Minneapolis</td>
<td>53%</td>
<td>47%</td>
<td>100%</td>
</tr>
<tr>
<td>Minneapolis-New York</td>
<td>80%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>Houston-Minneapolis</td>
<td>42%</td>
<td>58%</td>
<td>100%</td>
</tr>
<tr>
<td>Houston-Memphis</td>
<td>39%</td>
<td>61%</td>
<td>100%</td>
</tr>
</tbody>
</table>

138. Id.
139. Id.
140. For example, Houston-based travelers are unlikely to drive four hours to Dallas to catch a flight as a result of fare increases at Houston’s Bush Intercontinental Airport; conversely, Houston-bound passengers will likely fly into Houston instead of Dallas despite fare increases on routes into Houston.
142. Id. at 7-8. Defining this concentration, the DOJ stated that “Northwest and Continental compete for passengers in thousands of city-pair markets.” Id. at 7.
143. Id. at 8 (emphasis added). Referencing the table above, Northwest operates hubs at Detroit, Minneapolis/St. Paul, and Memphis, whereas Continental operates hubs at Newark, Cleveland, and Houston. Id. at 7-8. For a further discussion of the hub-and-spoke system, see supra note 42.
144. Id. at 8.
Additionally, the DOJ noted two other hub-to-hub markets, Memphis-Newark and Cleveland-Memphis, in which Northwest has a nonstop monopoly. These routes are of particular concern to the DOJ, because Continental, the only carrier with Newark and Cleveland hubs, is the most likely entrant to challenge the Northwest nonstop monopoly on these two routes.

Besides an analysis of Continental’s likelihood of entry, the DOJ discussed new entry by other carriers, stating that “[e]ffective new entry for the provision of nonstop service in the hub-to-hub markets is unlikely by any carrier without a hub at one of the endpoints of the city pair.” The DOJ reasoned that new carrier entry was not likely because Northwest and Continental have significant cost advantages over a non-hub airline, thereby making the time-consuming and costly establishment of a non-hub airline unlikely as a response to Northwest-Continental increased airfares in the hub-to-hub markets. Despite the DOJ’s emphasis on the “virtual duopoly” created by the hub-to-hub routes, the Department did not ignore the large number of Northwest/Continental passengers traveling on connecting flights in a plethora of city pair markets: “Because of the light traffic on these routes and the short flights to the Northwest or Continental hubs, carriers with more distant hubs are unlikely to initiate or expand competitive service to these destinations from their hubs in response to significant fare increases.”

v. Anti-Competitive Effects

While the DOJ’s “concentration and entry” argument was intended to demonstrate the transaction’s potential to exert market power, the Department’s final argument addressed the anti-competitive effects of the Northwest/Continental strategic alliance. First, to further its “anti-competitive effects” argument, the DOJ asserted that Northwest’s acquisition of controlling interest in Continental will diminish Continental’s incentive to aggressively compete with Northwest; moreover, Northwest’s 14 percent equity stake in Continental’s profits will reduce Northwest’s incentive to aggressively compete with Continental. Next, the DOJ stated that Northwest’s controlling interest in Continental would de-

145. Id.
146. Id. at 9.
147. Id.
148. Id. The DOJ also emphasized that new entry was burdened by other factors, including problems gaining access to gate facilities, the lure of frequent flyer passengers to the established hub airlines, and the risk of contentious responses to new entry by the dominant incumbent airline in the given market. Id.
149. Id.
150. Id. at 10.
151. Id.
crease actual competition in the seven hub-to-hub markets and other concentrated markets.\textsuperscript{152} Furthermore, the DOJ pointed to the diminished probability of Continental's entry into nonstop Memphis-Cleveland and Memphis-Newark service, as well as lessened competition in other markets where the carriers are among the few likely providers of scheduled service, as evidence of the anti-competitive effects of the transaction.\textsuperscript{153} Consequently, the DOJ declared, airfares will likely increase and service will likely decrease in these city pairs.\textsuperscript{154} The Department also alluded to the possibility that the equity control could deter Continental from initiating nonstop service from its Cleveland hub due to its close proximity to Northwest's Detroit hub.\textsuperscript{155} Finally, the DOJ considered the Governance Agreement in light of the anti-competitive effects of the transaction.\textsuperscript{156} The DOJ was adamant in its claim that "no private agreement can alter the fact that Northwest still owns Continental, and Continental will not compete vigorously with its owner during the term of the Governance Agreement."\textsuperscript{157} Although the Governance Agreement purported to limit Northwest's control of Continental, the DOJ contended that Northwest still retains direct control over strategic decisions made by Continental.\textsuperscript{158} The DOJ stated that, even assuming the Governance Agreement dilutes Northwest's immediate control of Continental, its expiration in six years would essentially erase any limitation placed on Northwest's perpetual control of Continental.\textsuperscript{159}

\textsuperscript{152} Id.
\textsuperscript{153} Id.
\textsuperscript{154} Id.
\textsuperscript{155} Id. Many passengers living midway between Cleveland and Detroit often drive to the city in which they can get a cheaper airfare. In this instance, the DOJ is concerned that Northwest's equity control will effectively tend to lure those customers to Detroit, Northwest's hub, and away from Cleveland, Continental's hub. The presupposition of this Detroit/Cleveland scenario is essential to the "relevant geographic market" analysis.
\textsuperscript{156} Id.
\textsuperscript{157} Id.
\textsuperscript{158} Id.
\textsuperscript{159} Id. Continental's Executive Vice President and General Counsel, Jeff Smisek, recently noted that he was disappointed with the DOJ's decision to file the antitrust lawsuit because the carriers have "structured the transaction to ensure Continental's independence and preserve competition." See Phillips, supra note 42, at 48. Douglas M. Steenland, Northwest's Executive Vice President and General Counsel, also noted that, under the carriers' agreements, Continental would "retain total, independent control of its own operations," which include route planning, pricing decisions, and aircraft purchases. Id. The carriers also engaged in negotiations with the DOJ in an attempt to settle the case. Id. However, Northwest and Continental rejected to key conditions sought by the DOJ: the reduction of Northwest's voting stake from 51 percent to 15 percent within two years along with an agreement from Northwest not to use its 51 percent in the meantime to block a merger between Continental and another airline. Id.
b. Predicted Analysis of the DOJ’s Complaint

Because the formation of the Northwest/Continental strategic alliance with equity exchange potentially raises issues similar to those examined in conventional merger analysis, the United States District Court for the Eastern District of Michigan will likely follow the Ivaco court’s lead in examining the transaction under merger theories. While Northwest and Continental are not the two leading producers of airline service in the United States market, unlike the manufacturers in Ivaco, the court will likely recognize the two carriers’ significant combined impact in the domestic airline market. Analyzing Northwest’s and Continental’s Investment and Governance Agreements, the court could analogize them with the defendants’ agreement in Ivaco, whereby the two companies would have shared equal ownership and control of their merged businesses. However, unlike the Ivaco defendants, Northwest and Continental would retain control of their respective businesses, at least in theory. In any event, the district court will probably determine that the Northwest/Continental transaction must be examined with regard to its effect on competition, despite its label as a “strategic alliance” instead of an outright merger.

The next key inquiry the district court could undertake might be an analysis of the relevant product markets. Northwest and Continental will possibly attempt to define the relevant product market more broadly than the DOJ. For example, instead of arguing for “scheduled airline passenger service” being the relevant product market, the carriers could argue that transportation in general is the relevant product market. Under this assertion, the carriers could claim that travelers would, in fact, discontinue air travel in exchange for another mode of transportation if air travel becomes too expensive. Answering the DOJ’s argument that nonstop scheduled airline passenger service is a relevant product market, Northwest and Continental might attempt to show that passengers often forego nonstop service for cheaper connecting service. To demonstrate low entry barriers, the carriers may offer evidence that more dominant carriers could enter any given market to effectively compete with Northwest or Continental service. Moreover, the carriers will undoubtedly stress the overall competitive nature of the airline industry after deregulation in 1978. Regarding the DOJ’s claim that city pairs constitute a relevant geographic market within the meaning of the antitrust laws, the carriers could offer proof that passengers would drive a minimal distance.

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160. In fact, Northwest and Continental are the fifth and sixth largest carriers, respectively, based on revenue. See Michael Meyer, Now, It's Spring Fever In the Skies—Airline Mergers: Better Service at a Cost?, Newsweek, May 4, 1998, at 49.
in order to attain cheaper fares at another airport.\textsuperscript{161}

Northwest and Continental, like the \textit{Ivaco} defendants, will likely argue the necessity of their joint venture. To further this argument, the carriers would attempt to show that the joint venture allows each of them to serve markets that could not be served without the transaction.\textsuperscript{162} This argument, however, is not likely to benefit the carriers to a large extent, because the DOJ was \textit{much more critical} of the equity ownership and control aspects of the transaction furthered by the Investment and Governance Agreements, respectively; however, this criticism did not extend, for the most part, to the code-sharing provisions furthered by the Alliance Agreement.\textsuperscript{163}

While the Complaint does not specifically mention the DOJ’s utilization of the HHI analysis to demonstrate market power, the Department will likely use that method to illustrate Northwest’s and Continental’s exertion of market power in whatever market the court determines to be the relevant product market. It might be assumed that the DOJ already performed an HHI analysis and determined the transaction to fall outside of the Merger Guidelines’ safe harbor.\textsuperscript{164} If the relevant product markets are defined by the district court in favor of the DOJ and it is able to demonstrate through the HHI statistical index that the Northwest and Continental transaction, as to those markets, is “likely to create or enhance market power or facilitate its exercise,” the district court may hold that the DOJ has made a prima facie case that the Investment Agreement

\textsuperscript{161} For example, Northwest and Continental could offer Denver International Airport (DIA) as an example. When DIA was opened, many passengers living in the Denver metropolitan area favored the use of Colorado Springs’ airport due to the significant cost savings compared with service out of DIA. Even travelers living closer to DIA would often drive a few extra miles to Colorado Springs to get cheaper airfares.

\textsuperscript{162} See \textit{Aviation Agreements}, supra note 16, at *3 (demonstrating how integration of service allows carriers to extend their market service beyond what was possible without the integration arrangement).

\textsuperscript{163} See supra text accompanying note 140.

\textsuperscript{164} This assumption is present because, if the HHI calculation was within the Merger Guidelines’ safe harbor, the DOJ would not have brought suit to enjoin the transaction. Referring to the table in Part IV.B.2.a.i.v., recalling that the HHI is calculated by squaring the relative market shares, the applicable HHI values would be:

\begin{center}
\begin{tabular}{|l|l|l|l|l|}
\hline
Route & Northwest HHI of Nonstop Flights & Continental HHI of Nonstop Flights & HHI Total Without Alliance & HHI Total With Alliance \\
\hline
Detroit-Cleveland & 2916 & 1600 & 4516 & 8836 \\
Detroit-New York & 4900 & 289 & 5189 & 7569 \\
Detroit-Houston & 1296 & 4096 & 5392 & 10000 \\
Cleveland-Minneapolis & 2809 & 2200 & 5018 & 10000 \\
Minneapolis-Newark & 6400 & 400 & 6800 & 10000 \\
Houston-Minneapolis & 1764 & 3364 & 5128 & 10000 \\
Houston-Memphis & 1521 & 3721 & 5242 & 10000 \\
\hline
\end{tabular}
\end{center}

Note that the HHI increases are much more drastic here than the defendants’ HHIs in \textit{Ivaco}, indicating that a finding of market power in the Northwest/Continental transaction is likely.
is illegal.\textsuperscript{165} To support such a prima facie ruling, the DOJ, like the government agency in \textit{Ivaco}, may attempt to supplement the HHI index with evidence of Northwest's and Continental's engaging competition before the consummation of the Investment and Governance Agreements. Undoubtedly, the DOJ will focus on the seven Northwest-Continental hub markets outlined in the Part IV.B.2.a.iv. table to illustrate the previous engaging competition. In its complaint, the DOJ stresses that this competition will cease with the active execution of the Investment and Governance Agreements. If the district court is persuaded by this argument, it is even more likely to hold that the Investment and Governance Agreements are \textit{per se} illegal.

If the Investment and Governance Agreements are held by the district court to be \textit{per se} illegal, Northwest and Continental might look to the \textit{Ivaco} defendants' arguments to understand what assertions \textit{will not} rebut the DOJ's prima facie showing of illegality and what assertions \textit{might} rebut such a showing. Obviously, the carriers would claim they are faltering airlines in a declining market.\textsuperscript{166} Even assuming the carriers are faltering airlines in a declining market, the district court might allow a natural failure versus the allowance of the virtual combination of the fifth and sixth largest carriers. Northwest's and Continental's better argument is found in the innovation, or creation of efficiencies, that could result from the transaction. Like the \textit{Ivaco} defendants' "development of innovative products" argument, the carriers could show that pro-competitive benefits are found in the expansion of service for customers in general.\textsuperscript{167}

\textsuperscript{165} Northwest and Continental may attempt to challenge the HHI's viability with reference to the mitigating factors in sections 2-5 of the Merger Guidelines. The carriers might be able to show greater cooperation among airlines after consummation of the agreements by demonstrating, for example, other airlines' increased desire to interline passengers through either Northwest or Continental with the combined networks. However, the issue regarding the DOJ's main challenge being the Investment Agreement arises again, because this improved route structure would be the result of code-sharing—not the equity exchange. While the Northwest/Continental agreements do not provide for pricing or output collusion expressly, this argument on the carriers' behalf will likely not overcome the HHI's demonstration of market power because the Merger Guidelines require the lack of a \textit{predisposition} to raise prices or limit output. The \textit{lack} of such a predisposition might be difficult for the carriers to show. Perhaps the carriers' strongest argument to overcome the presumption of market power created by the HHI analysis would be the creation of expanded service that benefits consumers as a result of the Alliance Agreement; again, however, this argument does not support the Investment and Governance Agreements' viability.

\textsuperscript{166} However the market is defined, airline profits have not been declining. On the contrary, "[a]irline profits are at record highs." See Meyer, \textit{ supra} note 160, at 49.

\textsuperscript{167} For example, see the example of expanded service in \textit{Aviation Agreements}, \textit{ supra} note 16, at *3. Allowing a Northwest customer to fly from Madison, Wisconsin to Panama City, Panama under one integrated service provides procompetitive benefits for passengers flying out of Madison. Now, American Airlines has a competitor in this market, and Madison consumers will benefit from this competition. Alternatively, if a Continental customer is allowed to fly from Panama City, Panama to Madison, Wisconsin under one integrated service, procompetitive ben-
While this argument is certainly compelling, the district court, like the *Ivaco* court, could determine that a less restrictive scheme was available for the creation of these pro-competitive benefits. The court could rule that this less restrictive scheme is found in the enactment of the Alliance Agreement alone. After all, as stipulated by the DOJ, the Alliance Agreement is a stand-alone agreement that is not dependent on the execution of the Investment or Governance Agreement. Therefore, the court could decide the case in a way to benefit consumers and further competition, while still holding the Investment and Governance Agreements in violation of the antitrust laws.

The district court might hold, consistent with the court’s ruling in *Ivaco*, that allowance of the Investment and Governance Agreements essentially end significant output and price competition between Northwest and Continental in the relevant product market, if the relevant product market is defined as provided in the DOJ Complaint. The court could declare that application of the Investment and Governance Agreements is tantamount to an outright merger of Northwest and Continental. If convinced of the carriers’ concentration of service that precludes new entry and the existence of anti-competitive effects, the district court could block Northwest Airlines’ acquisition of a controlling stake in Continental Airlines.

**V. Conclusion**

International and domestic airlines will likely continue to strategically ally themselves to the extent allowed by the federal government. The potential for economies of scale and increased service reach resulting from these cooperative agreements are the motivating force behind the trend. While the regulatory threshold governing these alliances is ambiguous at best, the DOT and the DOJ have certainly provided indicators of when these alliances will be challenged on public interest or antitrust grounds.

Future foreign-domestic alliance partners should look to the DOT’s regulatory power for guidance. For international airline strategic alliances, the DOT’s focus remains achievement of open skies as a prerequisite for the granting of approval and antitrust immunity via 49 U.S.C. §§ 41309 and 41308. Once open skies is achieved, these agreements will likely be approved and granted immunity from a DOJ antitrust inquiry. Likely, open skies between Great Britain and the United States will be

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*fits for Panama City passengers, who might be American citizens traveling from Panama on business, are created through the new competition with American. To reiterate again, however, this Northwest and Continental argument assumes the need for the Investment and Governance Agreements to make this integration possible, and that assumption is, at best, questionable.*
achieved and the Oneworld Alliance will be approved and granted antitrust immunity by the DOT. British Airways and American Airlines, along with the government regulators on both sides of the Atlantic, realize that other alliances will be strengthened only to the detriment of Oneworld the longer open skies is withheld. The Oneworld airlines especially will not want to be placed at a competitive disadvantage as other worldwide airline strategic alliances thrive.

Because domestic partnerships are not given DOT immunity protection, a domestic airline should closely monitor the DOJ’s regulatory power to block such domestic linkups before engaging in or broadening an alliance with another domestic airline. Apparently, equity ownership is the line of demarcation for the DOJ in ascertaining the antitrust nature of domestic airline strategic alliances. Airlines seemingly have free reign to engage in a broad array of coordinated activities short of equity ownership. Northwest Airlines and Continental Airlines have transgressed the DOJ’s antitrust tolerance by coupling an equity exchange with a marketing alliance agreement. The Eastern District of Michigan must now decide whether the DOJ’s tolerance threshold is proper for analysis under the antitrust laws.
Divide and Conquer: Resolution of the 1996 Dispute Between American Airlines and the Colombian Civil Aviation Authority

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I. INTRODUCTION

Let every eye negotiate for itself
And trust no Agent.

(Much Ado About Nothing, II, i, 184)

Although Shakespeare was referring to affairs of the heart, his advice was appropriate for American Airlines (“AA”) in its 1996 dispute with the government of Colombia over a New York City – Bogota route it proposed to open. What began as a purely legal controversy became a political conflict when AA sought to bring what it perceived as the U.S. government’s overwhelming bargaining power to bear against the Colombian Civil Aviation Authority. AA trusted an agent to look after its affairs without thinking through the consequences. AA did not realize that U.S. involvement also invited the participation of additional, influential actors which diluted the government’s concern for its interests. Beholden to many parties, the U.S. government proved an ineffective negotiator. Although AA eventually won its objective in the narrowest sense (Colombian permission to open the route), it limited possibilities for future expansion while allowing its rivals increased access to the market for air travel between the two countries.
II. ANTECEDENTS

A. THE BILATERAL AGREEMENT

The commercial air relationship between Colombia and the United States is governed by a bilateral agreement, signed on October 24, 1957. The agreement’s governing principle is that of mutual reciprocity; the U.S. would authorize a Colombia to U.S. route, and the Colombian government would approve a U.S. to Colombia route.

The articles of agreement which were in contention during the 1996 dispute are the following:

Article 3

Air services on a specified route may be inaugurated by an airline or airlines of one contracting party at any time that the contracting party has designated such airline or airlines for that route and the other contracting party has given the appropriate operating permission. In accordance with article 4, a contracting party shall be obliged to concede the authorization, but it could require evidence to prove capacity from the carriers.¹

Article 8

The contracting parties must offer an equal and fair opportunity for the air carriers of both contracting parties in any route covered by this Agreement.

Article 9

For the performance of one or the other of the contracting parties’ airlines, in the main routes described in this agreement, the interests of the airlines of the other party shall be taken into account so that the services which the carrier offers in whole or part of the same route shall not be unnecessarily affected.

Article 10

The air services which are offered to the public by airlines which operate in accord with this agreement shall be closely adapted to the needs of the public for those services.

In Article 12, the bilateral agreement provides for formal arbitration as a possible dispute resolution mechanism, however, arbitration was never considered in the 1996 dispute.² Arbitration’s use in air transport regulation is extremely rare because it is an expensive and time-consuming process.³

¹. Bilateral Agreement on Air Transportation, Oct. 24, 1957, U.S.-Colom., art. 3-4, 14 U.S.T. 429, 1964 [hereinafter Bilateral Agreement]. “Each contracting party has the right to deny, revoke, or sanction another contracting party’s carriers in regard to operation authorizations.” Id.
². Interview with Abel E. Jimenez, General Director of the Colombian Civil Aeronautics Authority (Jan. 5, 1998) [hereinafter Jimenez Interview].
³. International Civil Aviation Organization, Doc. 9626, Manual on the Regulation of International Air Transport, § 2.3, at 3 (no date) [hereinafter ICAO].
B. U.S. Carrier Service to Latin America in the 1990's

In the 1990's, due to strengthening economies led by increasingly stable governments and liberalized markets, Latin America was one of the world's fastest-growing aviation markets. Between 1990 and 1995, the total passenger market between the U.S. and Latin America grew from 14.8 million to 21 million per year. In 1995, 12.5 million passengers from Latin America visited the U.S., and that figure was expected to double by the year 2000. A Boeing forecast put revenue passenger mile (RPM) growth at 5.7 percent per annum, starting with 49.1 billion in 1996.

Miami handled approximately seventy percent of passenger traffic to the region, and about eighty percent of the freight. However, about seventy percent of both passenger and cargo traffic going to Miami was forwarded to beyond. Other airports became increasingly important.

The biggest change in U.S. service to the region occurred early in the decade when AA bought Eastern's routes and United bought Pan Am's. Both airlines used Miami as their Latin American gateway. As traffic built, however, both airlines added routes beyond Miami. AA started service out of Dallas-Fort Worth and New York, while United used New York's JFK, Los Angeles, and San Francisco. Continental, which already served Mexico and Central America, began service to South America in 1991 out of Houston and Newark, significantly avoiding Miami. By 1996, Continental was serving 17 countries and 30 markets in Latin America. The airline planned to continue expanding until 1998 when it would serve virtually every major South American city.

Latin American carriers did not share in market growth to the same extent. Many carriers were stymied by their countries being placed on Category II status in the FAA's International Aviation Safety Assessment Program; this status prevented the countries from increasing traffic or starting new service into the U.S. In 1996, six Latin American countries were Category II: Bolivia, Colombia, Ecuador, Guatemala, Peru, and Venezuela.

C. The Colombian Market

Colombian international passenger traffic more than doubled in the
ten years prior to the dispute.\textsuperscript{12} The greatest expansion took place between 1991 and 1996; all indications were that the market would continue to grow.\textsuperscript{13} Travel to and from the U.S. also grew, albeit more slowly than the total.\textsuperscript{14} As a result, U.S. traffic as a percentage of the total fell from 45.8 in 1985 to 39.3 in 1995.\textsuperscript{15}

In 1996, the Colombian market in terms of passengers carried was about evenly divided between U.S. and Colombian carriers. This was a decrease from the 57 percent of the market historically enjoyed by Colombian carriers and was much less than the peak of 70 percent achieved by the Colombians in 1989.\textsuperscript{16} U.S. carriers gradually pushed the Colombians out, and gobbled up the small market share which was enjoyed by carriers flagged in third countries.

Bogota – Miami was the most important route on the eve of the dispute; it accounted for more than one third of the seats offered and almost half of the passengers flown.\textsuperscript{17} The next two important markets were Miami-Cali and Miami-Barranquilla.\textsuperscript{18} Routes from Bogota to New York, Los Angeles, and Houston rounded out services offered in 1995.\textsuperscript{19} Average load factors ranged from 48.7 (Bogota – Houston) to 57.5 (Bogota – Miami). U.S. carriers offered more seats, but carried fewer passengers than Colombian carriers.\textsuperscript{20} This may be due to higher fares charged by U.S. carriers.

The event prompting the controversy which unfolded between AA and the Colombian Civil Air Authority in 1996, took place in 1995 - Continental Airlines applied to serve the Newark – Bogota market (with onward service to Quito). Continental served the Houston – Bogota market since 1993,\textsuperscript{21} but the newly proposed route greatly expanded the carrier’s relative position in the U.S. – Colombia market. In what was generally seen as a purely strategic decision to block Continental, AA decided to serve the New York – Bogota market as well. In fact, AA operated that route for less than a year (from December 1992 to August 1993) before abandoning it as unprofitable.\textsuperscript{22} According to the Colombian Civil Air

\textsuperscript{12} See infra Chart 1.
\textsuperscript{13} Id.
\textsuperscript{14} Id.
\textsuperscript{15} Id.
\textsuperscript{16} See infra Chart 2.
\textsuperscript{17} See infra Chart 3.
\textsuperscript{18} Id.
\textsuperscript{19} Id.
\textsuperscript{20} Id.
\textsuperscript{21} Interview with Hector H. Rios, Chief, Office of Air Transport, Colombian Civil Aeronautics Authority (Jan. 5, 1998) [hereinafter Rios Interview].
\textsuperscript{22} See id.
Authority, AA lost the right to the route by ceasing to operate it, however, the airline could reapply for the route by taking the steps required by Colombian regulations (Continental had fulfilled all requirements in its application for the Newark – Bogota route). AA felt that, by the terms of the bilateral agreement, it was entitled to resume route operations at any time, without completing any bureaucratic requirements. This was the crux of the initial legal dispute between AA and the Colombian government.

III. THE PLAYERS AND THEIR INTERESTS

A. AMERICAN AIRLINES

AA was unwilling to fulfill the Colombian administrative requirements to reopen the route because the time lost by complying with the procedures would allow Continental to gain the initiative in the struggle. AA probably felt that it could bring enough U.S. political pressure on Colombia that Colombia would quickly yield. AA counted on support from the White House because it was a large contributor to President Clinton’s campaigns.

During the dispute, American Airlines had a dominant position in the Latin American market. AA had just formed an extensive code-sharing pact with the El Salvador-based TACA consortium of airlines to take advantage of U.S.-Central America Open Skies. Ironically, while AA pushed for sanctions, it also talked to Colombian carrier AVIANCA about establishing a code-sharing alliance.

B. CONTINENTAL AIRLINES

While American Airlines was well positioned in Latin America, Continental Airlines was just getting started. Continental, which flew to Bogota from Houston, received Colombian permission to begin Newark-Bogota service in June 1996. Continental sought approval for daily passenger, cargo, and mail service on Boeing 757-200s from Newark to Quito, Ecuador via Bogota. The Houston-based carrier, which did not

25. See Jimenez Interview, supra note 2.
26. See id.
27. Nelms, supra note 4, at 56.
28. See Jennings, supra note 24, at 7.
have a strong foothold in the Latin American market, worked to strengthen its position. Part of Continental’s plan was to develop Newark International Airport into a South American gateway. For example, Continental was also planning to sign a code-sharing pact with TACA.

C. DEPARTMENT OF TRANSPORTATION

The public objective of the Department of Transportation (DOT) was to honor the bilateral agreement between the U.S. and Colombia. The DOT, however, was primarily interested in advancing the interests of U.S. passenger and cargo carriers. Secretary of Transportation, Federico Pena, said: “[W]e will make every effort to resolve this dispute through further negotiations, but are prepared to impose sanctions if we cannot.” DOT was however, generally impartial when the interests of two U.S. carriers conflicted.

D. FEDERAL AVIATION ADMINISTRATION

Colombian airlines serving the U.S. market were required to meet the Federal Aviation Administration’s (FAA) mandatory security and safety regulations. Since 1995, Colombian airlines faced restrictions on their operations to the United States since the FAA categorized Colombia as Category II. This prevented Colombian airlines from adding to their fleets or expanding routes to the U.S.

E. THE STATE DEPARTMENT

The U.S. Department of State, which provided the head negotiator in the dispute, coordinated the positions of the DOT and FAA, and attempted to satisfy political pressures brought to bear by U.S. senators and members of Congress. In addition, it had to protect the interests of other U.S. passenger and cargo carriers while advocating for AA. The Department’s head negotiator, Edward O’Donnell, Jr., hammered out differences within his own team in order to present a united front to the

31. See Burgess & Kayal, supra note 29.
32. Letter from Robert Torricelli, Member of Congress, Congress of the United States, to Ernesto Samper, President of Colombia (June 26, 1996) [hereinafter Torricelli Letter 1].
35. See Jimenez Interview, supra note 2.
36. See id.
Colombian delegation. The United States delegation was composed of 14 members representing government agencies, airlines, cargo carriers, airports, and the Air Transport Association of America.

F. ROBERT TORRICELLI

Representative Robert Torricelli of New Jersey was the politician who was most effective in putting pressure on the U.S. delegation. Many of Torricelli's constituents worked either for Continental Airlines or Newark Airport. The Colombian government saw Torricelli as protector of Continental Airlines, with the power to effectively lobby against imposition of sanctions on Colombia. The Colombian Commercial Office in Washington quickly recognized Torricelli's potential to help. On June 27, 1996, in a letter to Civil Air Director General, Abel Enrique Jimenez, the Office wrote:

It is necessary to begin contact with Representative Torricelli, who is running for the Senate from the state of New Jersey this year. If the Congressman is interested, he could apply pressure that could help us to avoid sanctions as he has pull with the White House. It is important to find out how interested he is in defending Continental Airlines. We have already begun to approach his aides.

In fact, Torricelli initiated the contact by writing to Colombian President Ernesto Samper. Torricelli argued that any Colombian counter-sanctions applied to Continental would only serve to reward AA for its intransigence by eliminating a rival from the New York City – Bogota market. Torricelli explicitly suggested that the government of Colombia sanction AA by halting its Miami – Bogota flights (undoubtedly, Torricelli's letter was not coordinated with his esteemed colleagues from Florida). However, Colombian Commercial Office Director, Nicolas Lloreda Ricaurte, wisely told Torricelli's staffers that, to avoid widening the conflict, any Colombian counter sanctions would have to be imposed on the same route which was the source of the dispute. This kept pres-

38. See Jimenez Interview, supra note 2.
40. See Rios Interview, supra note 21.
41. See id.
42. Letter from Nicolas Lloreda, Director, Colombian Commercial Office, to Abel E. Jimenez, General Director, Colombian Civil Aeronautics Authority (June 27, 1996) [hereinafter Lloreda Letter I].
43. See Torricelli Letter I, supra note 32.
44. See id.
45. See id.
46. See Lloreda Letter I, supra note 42.
sure on Torricelli.

In the same letter to Samper, Torricelli assured the Colombian president that he would talk to the DOT in order to find a quick resolution to the impasse between the two countries, but only if Colombia did not sanction Continental. Torricelli met Secretary of Transportation, Federico Pena, and requested him to abstain from sanctioning Colombia.\textsuperscript{47} Pena stated that he would delay the imposition of sanctions for a few weeks, but emphasized that the U.S. considered it important to enforce the rights and obligations contained in the bilateral agreement.\textsuperscript{48} The delay played into Colombia’s hands by giving its delegation time to maneuver and increase pressure on the U.S. delegation.\textsuperscript{49}

G. THE COLOMBIAN CIVIL AVIATION AUTHORITY

The primary publicly-stated goal of the Colombian Civil Air Authority was to enforce its interpretation of the bilateral agreement and Colombian law.\textsuperscript{50} The Authority did not want to approve AA’s proposed route until AA complied with Colombian legal norms to apply for the route.\textsuperscript{51} Politically, the Authority could not collapse under pressure from AA and the U.S. government and approve the route without AA’s satisfying the legal requirements. The Authority was also clear about its responsibilities to defend the interests of Colombian carriers - a goal more important than the primary public goal.

In addition, the Authority likely saw an opportunity to score a political victory for itself, as well as Colombia. 1996 represented a low point in bilateral Colombian – U.S. relations.\textsuperscript{52} The U.S. government had just “decertified” Colombia’s performance in the struggle against narcotrafficking, thus disqualifying it for certain types of aid.\textsuperscript{53} The Department of State also revoked the visa of the Colombian president, Ernesto Samper, whom the U.S. government suspected of having received a $6 million campaign contribution from the Cali cartel.\textsuperscript{54} Many Colombians took

\textsuperscript{47} Letter from Nicolas Lloreda, Director, Colombian Commercial Office in Washington, to Abel E. Jimenez, General Director, Colombian Civil Aviation Authority, (July 1, 1996) [hereinafter Lloreda Letter II].
\textsuperscript{48} See id.
\textsuperscript{49} See id.
\textsuperscript{50} Colombian Civil Aeronautics Authority, Official Minutes of Apr. 23-25, 1996 Meeting Between Representatives of the Colombian and United States Governments [hereinafter Round One].
\textsuperscript{51} Id.
\textsuperscript{53} Id.
\textsuperscript{54} See Katherine Culbertson, U.S. Revokes Colombian President’s Visa, OIL DAILY, July 12, 1996, at 31.
these measures as affronts to national pride. The Civil Air Authority probably felt that defending Colombian sovereignty from U.S. attacks would restore a measure of national pride and boost institutional prestige.

H. COLOMBIAN CARRIERS

The Colombian carriers' goal during the dispute was to preserve their current access to the U.S. market and perhaps to exploit the controversy obtained to expanded access. At the time, Aerovias Nacionales de Colombia S.A. (AVIANCA) was serving the New York - Bogota market with daily non-stop flights, plus intermediate stop service on a less frequent basis. AVIANCA was also serving the Miami - Bogota market non-stop with daily flights, as well as some additional one-stop service. Aerolineas Centrales de Colombia (ACES) was serving the Miami - Bogota market with daily non-stop flights and one additional frequency three times a week.

The two Colombian carriers each had one representative named to the Colombian delegation. However, neither representative attended the talks, preferring to trust the president of the Colombian air carriers' association, Manuel Leal Angarita, to speak for them. Leal stuck to a hard line and criticized the moderation of the Colombian team. He even accused the chief Colombian negotiator, Civil Aviation Director General Jimenez, of cowardice for not unilaterally abrogating the bilateral agreement. An abrogation would have served the interests of the Colombian carriers in the short run. In the absence of an agreement, commercial aviation between the U.S. and Colombia would be governed only by the principal of strict reciprocity which would limit the growing presence of U.S. carriers in the market. In the long run, however, lack of an agreement would severely retard the growth of the market overall – with less profits for all carriers.

55. See Rios Interview, supra note 21.
57. Id.
59. See Round One, supra note 50.
60. See Rios Interview, supra note 21.
61. See id.
62. See id.
IV. LEGAL MANEUVERINGS

A. AMERICAN AIRLINES'S SHOW CAUSE ORDER

The 1996 dispute formally began when AA, which was unsuccessful in getting Colombian approval to begin New York-Bogota service, tried to pressure the Colombian government through the U.S. regulatory system. On April 26, AA filed a complaint with DOT, alleging that Colombia was violating the bilateral agreement by refusing to permit the carrier to operate daily flights from New York to Bogota (and beyond to Quito, Ecuador), which AA proposed to resume on June 1. AA filed the complaint under 49 U.S.C. section 41310 against AVIANCA, ACES, and the Government of Colombia. By this order, AA sought to have sanctions imposed on one or both Colombian carriers in order to prohibit daily non-stop service between New York or Miami and Bogota. AA cited Article 3 of the bilateral agreement between the United States and Colombia:

Air services on a specified route may be inaugurated by an airline or airlines of one contracting party at any time that the contracting party has designated such airline or airlines for that route and the other contracting party has given the appropriate operating permission.

(Note that AA failed to quote the rest of Article 3 which reads: "In accordance with article 4, a contracting party shall be obliged to concede the authorization, but it could require evidence to prove capacity from the carriers.")

By filing, AA turned the legal controversy into a political controversy. In contrast with the usual practice of U.S.-flag carriers facing discrimination in a foreign market, AA made little attempt to resolve the matter informally with the Colombian Civil Aviation Authority. AA went to the DOT without even seeking recourse in the Colombian courts, a move which inflamed Colombian resentment and nationalistic sentiment.

The Government of Colombia indicated publicly that AA would not be permitted to resume its service. The Government of Colombia, AVIANCA, and ACES filed formal answers in response to AA’s complaint. Continental Airlines filed a legal brief requesting that any sanctions be

64. See id.
65. See id.
66. See id.
67. See id.
68. See DEMPSEY, supra note 37, at 167.
69. See Jimenez Interview, supra note 2.
deferred. After consideration of all comments filed, the DOT approved AA’s complaint by Order 96-5-42, issued May 29, 1996. The DOT found that the bilateral provisions were violated and that Colombia’s failure to permit AA to operate “constituted an unjustifiable or unreasonable restriction on access of an air carrier to a foreign market.”

The Department of Transportation attempted to resolve the issue through contacts with the Colombian Civil Air Authority, but the efforts were unsuccessful. Due to the refusal of Colombia to authorize AA to serve New York - Bogota, supposed violations of the bilateral agreement, and the apparent inability to resolve the dispute through negotiations, the Department of Transportation tentatively decided to take appropriate countermeasures. The DOT based such possible sanctions upon Section 41310 which permits the Secretary of the DOT to take actions in the public interest.

The public interest was defined by the DOT as the impositions of sanctions against AVIANCA or ACES in the New York - Bogota or the Miami - Bogota market. Such action was to take effect on July 15, 1996.

B. THE COLOMBIAN GOVERNMENT’S RESPONSE

The government of Colombia, after receiving notification of the DOT’s decision, initially considered not responding. It thought that a sovereign state should not have to reply to the administrative action of a foreign agency. After consulting with the Colombian Embassy in Washington, and U.S. lawyers retained by Colombia, the Civil Aviation Authority filed an objection reiterating that the government of Colombia had not violated the Air Transportation Agreement. Moreover, the Colombian government reaffirmed that it never denied an authorization to

72. See id.
73. See Order to Show Cause, supra note 58.
74. See id.
75. See id.
76. See id.
77. See id.
78. See Jimenez Interview, supra note 2.
79. See id.
80. Letter from Dick Mathias, Attorney of Zuckert, Scoult & Rasenberger, L.L.P, to Juan Emilio Posada, President of ACES (June 25, 1996) [hereinafter Mathias Letter].
81. Comments by the government of Colombia before the Department of Transportation, American Airlines v. AVIANCA, ACES (1996) (No. 96-1315) [hereinafter Comments].
AA of the New York - Bogota route, but rather AA had never complied with the proper procedures provided under Colombian laws and regulations to renew service.\textsuperscript{82}

The Colombian government said that the tentative sanctions would render the United States in violation of the provisions of the Air Transportation Agreement between the two countries.\textsuperscript{83} The use of unilateral sanctions would be contrary to the spirit of cooperation that characterized commercial aviation negotiations between the two countries.

The Colombian government further expressed that it would be forced to retaliate proportionately, against either the U.S. airlines operating in Colombia, or with respect to any of their routes.\textsuperscript{84} The Colombian government indicated that sanctions would be applied to Continental at Newark.\textsuperscript{85} This would enlist the airline's and airport's political influence and public sympathy.\textsuperscript{86} Focusing on the New York/Newark market allowed Colombia to emphasize its position: Colombia had one carrier (AVIANCA) flying to the market and the U.S. could have one as well, but two U.S. carriers would drive AVIANCA out of the market.\textsuperscript{87} The Colombian government also stated that if a solution were not found, the possibility of annulling the Air Transportation Agreement would be considered,\textsuperscript{88} as provided under Article 15 of the Bilateral Agreement.\textsuperscript{89}

The government also pointed out that as long as Colombia continued to be designated an FAA Category II country, Colombia could not obtain operating permits for new services.\textsuperscript{90} Thus, AA's initiation of a new service would unfairly affect the market conditions faced by Colombian air carriers, creating additional imbalance.\textsuperscript{91} Despite its strong opposition to the Show Cause Order, the Colombian Government was willing to continue with further negotiations.\textsuperscript{92}

\textsuperscript{82} Reunion Crucial para las Aerolines Colombianas, ECONOMICAS DEL COLOMBIANO, July 16, 1996 at 1 <http://www.sistecol.com/elcolombiano/960716/m2006.htm>. American Airlines abandoned this route for more than three years because it was no longer profitable. Id. Moreover, in April 1996 American Airlines did not participate in a bid offered by the Colombian government to resume the route again. Id.

\textsuperscript{83} See id. at 2.

\textsuperscript{84} See id.

\textsuperscript{85} See Jimenez Interview, supra note 2.

\textsuperscript{86} See Mathias Letter, supra note 80, at 1.

\textsuperscript{87} See id. at 2.

\textsuperscript{88} See id.

\textsuperscript{89} See Bilateral Agreement, supra note 1. Article 15 provides that any of the contracting parties may at any moment notify the other of its intention to terminate the agreement. Id. Such notification must be sent to the International Civil Aviation Organization. Id. In case that such notifications have effect, the bilateral agreement will terminate one year after the receiving of such notification. Id.

\textsuperscript{90} See Jimenez Interview, supra note 2.

\textsuperscript{91} See Comments, supra note 81, at 4.

\textsuperscript{92} See id. at 5.
C. The Colombian Carriers’ Response

AVIANCA lobbied for the unilateral abrogation of the bilateral agreement. It felt that a return to tit-for-tat reciprocity in routes served its interests better than any agreement that the Civil Air Authority could negotiate with the U.S.\textsuperscript{93}

ACES

ACES learned that its inclusion as a potential target of sanctions in DOT’s Show Cause Order arose only because DOT’s lawyers recommended that ACES be named since “it would look right from a legal standpoint” to name both carriers.\textsuperscript{94} It was understood that officials in the DOT were considering sanctions only against AVIANCA, not ACES.\textsuperscript{95} As a result, ACES was not legally active in the case.\textsuperscript{96}

Besides the Colombian airlines, the Colombian export guild expressed concerns due to the possibility of air sanctions. Jorge Ramirez, president of the National Export Association (ANLDEX) stated that in the event of sanctions, perishable goods for export would suffer irreparable damages.\textsuperscript{97} Moreover, most goods exported to Europe by plane went via Miami.\textsuperscript{98} The United States was the first commercial partner with Colombia, and in 1995 the sale of goods to that country reached $3.5 million (34 percent of the total Colombian exports).\textsuperscript{99} In addition, 30 to 50 flights with Colombian flowers are sent to the U.S. daily.\textsuperscript{100}

D. Continental’s Response

After the Colombian government objected to the order, Continental Airlines also filed an objection. Continental opposed the sanctions proposed by the DOT on the following grounds:

a. DOT actions would jeopardize U.S.-flag competition in the U.S.-Colombia market. Colombia also allowed Continental to institute daily New York – Bogota - Quito service, and allowed American International Airways to initiate Miami-Bogota all cargo service.

b. AA would do whatever necessary to protect its dominance of the

\textsuperscript{93} See Rios Interview, supra note 21.
\textsuperscript{94} See Mathias Letter, supra note 80.
\textsuperscript{95} See id.
\textsuperscript{96} See id.
\textsuperscript{99} See id. at 2.
\textsuperscript{100} Letter from Maria I. Patino, President of Asocolfores, to Abel E. Jimenez, General Director, Colombian Civil Aeronautics Authority (June 6, 1996) [hereinafter Maria Letter].
Miami-Bogota market. AA already operated more weekly frequencies than both Colombian carriers combined.

c. AA’s non-stop New York - Bogota service was abandoned three years ago because it was uneconomic. How could the flight now be considered economic with an additional carrier serving the New York market daily? The DOT should not facilitate predation by risking Continental and AVIANCA’s services in support of AA’s sudden and targeted entry. “If the beneficial consumer impact of low cost new entry, especially in disciplining fares and filling service voids, is too important to permit predation to undermine it in domestic markets, the same principle should also apply in international markets.”

d. Colombian airlines was already precluded from increasing services to Colombia, although AA added a daily frequency at Miami, Continental added a daily frequency at Newark, and additional U.S.-flag cargo operations were permitted. Since Colombian carriers’ flights are already constrained, the DOT ought to reconsider its proposal to reduce their flights by an additional daily frequency. Restraining Colombia invites retaliation.

e. If the U.S. imposed sanctions on AVIANCA’s JFK service and Colombia retaliated by sanctioning Continental’s Newark-Bogota service, AA’s goal of eliminating competition at the New York/Newark gateway would be achieved. Thus, public interest would not be served, and passengers traveling between U.S. and Colombia would be forced to pay high prices for scarce seats on American flights at Miami.

f. Instead of imposing sanctions on AVIANCA flights at New York, the DOT ought to impose sanctions at Miami, where thirty-five weekly non-stop Colombia flights are offered by American, fourteen by ACES, and twenty-three by AVIANCA, not counting additional one-stop services. Even if Colombia imposed counter-sanctions, Miami would continue to receive substantial Bogota service as well as substantial service from other Colombian points, while New York/Newark would risk the loss of all non-stop Bogota service if counter-sanctions were imposed.

g. The DOT proposed sanctions effective on July 15, ignoring the evident inconvenience to passengers during the peak summer season. Rather than creating chaos for the traveling public and forcing Colombia to countermeasures than further negotiations, the DOT sought to postpone the implementation of sanctions for at least 30 days after issuing a final order to allow the governments to meet and attempt to reach a satisfactory compromise.101

101. See Objections, supra note 71.
V. NEGOTIATIONS

A. FIRST ROUND

In February 1996, before the DOT's decision, but faced with possible action by the DOT in the near future, the Colombian government requested a formal consultation with its U.S. counterpart under the provisions of the bilateral agreement.\textsuperscript{102} The first meeting between representatives of Colombia and the U.S. took place in Washington D.C. from April 23, 1996 to April 25, 1996.\textsuperscript{103}

The Colombian government requested the meeting and submitted an agenda beforehand, however, the U.S. government requested the inclusion of several additional points of interest. These included: (1) the possibility of opening new routes between the two countries (the U.S. wanted to open Medellin); (2) establishing code sharing agreements between airlines; and (3) adopting an article for flight operations of non-scheduled or charter airlines.\textsuperscript{104} As is typical in these circumstances,\textsuperscript{105} the Colombians found U.S. attempts to introduce new issues without allowing time to prepare counter-views objectionable. Attempting to ameliorate the effect,\textsuperscript{106} the Colombian delegation responded that it was not prepared to deal with these issues, however, it could take note of them after its agenda was addressed.\textsuperscript{107}

The Colombian delegation then presented its analysis of the current situation of the air transportation between the two countries, reaching the following conclusions:

1) There was a growing tendency of U.S. airlines to dominate the Colombian market in comparison to the weak position of Colombian airlines operating in the U.S. market. The trend would accentuate the imbalance that already existed.

2) It was impossible for the new flying points sought by the U.S. airlines to generate enough demand to make Colombian airline participation economically viable.

3) The air traffic effectuated by U.S. airlines under the sixth freedom was not permitted under the Air Transportation Agreement between the two countries.

4) According to the "route schedule", flights may not operate in a triangular route, via points south of Colombia, thereby omitting the exer-

\textsuperscript{102} See Round One, supra note 50.
\textsuperscript{103} Id. See also Bilateral Agreement, supra note 1. Article 11 provides that in any given moment the contracting parties may solicit a consultation meeting in order to discuss the interpretation, application, or amendment of the Bilateral Agreement. Id.
\textsuperscript{104} See Round One, supra note 50.
\textsuperscript{105} See ICAO, supra note 3, at 8, § 2.1.
\textsuperscript{106} See id.
\textsuperscript{107} See Round One, supra note 50.
cise of the third freedom right.108

The Colombian delegation also proposed that services which U.S.
carriers offered to Colombia would freeze for a period of three years,
thus allowing Colombian carriers to catch up and restore balance in the
market.109

The U.S. delegation replied that it could not accept the proposal be-
cause it was inconsistent with the U.S. policy of promoting free markets
and permitting private companies to develop their own commercial inter-
est.110 The U.S. counter-proposed that it would freeze the total capacity
of U.S. carriers on the New York (including Newark) – Bogota route if
Colombia was prepared to give landing rights to two U.S. airlines on that
route.111 It added that although sixth freedom and triangular routing op-
erations were not specifically addressed in the bilateral agreement, they
represented internationally accepted commercial practice.112

The Colombian Delegation offered some additional minor conces-
sions, but did not accept the operation of two U.S. airlines on the New
York – Bogota route.113 From the Colombian delegation’s point of view,
it was not possible to authorize all new services requested by the U.S.
since it would not conform to the provisions of Article 9 and 10 of the
agreement, and because of the negative effects Colombian airlines would
suffer.114 Since an agreement was not reached, both delegations declared
interest in recessing and continuing when appropriate.115

In private meetings, the Colombian delegation tried to push for a
limitation on capacity as a key to future agreement.116 The existing bilat-
eral agreement only limited routes. The Colombians pointed to Chile,
Argentina, and Peru as countries with whom the U.S. accepted capacity
limitation.117 While the U.S. delegation guardedly accepted the potential
acceptance of a capacity limitation, it said that to accept a limitation, Co-
lombia would have to: (1) approve landing rights for both Continental
and AA on the New York – Bogota route; (2) authorize air cargo service
by American International Airways and Fine Air; and (3) allow Federal
Express and UPS to operate their air courier services in Colombia. This
was a non-starter for Colombia. When it was clear that the first round
would end in failure, the Colombian delegation demanded a memoran-

108. See id. at 1-3.
109. See id. at 3.
110. See id.
111. See id.
112. See id.
113. See id.
114. See id.
115. See id.
116. See Rios Interview, supra note 21.
117. See id.
dum of consultations which included a statement of failure.\textsuperscript{118}

B. Second Round

After the DOT's decision, delegations from the U.S. and Colombia met in Washington again from June 18-21, 1996.\textsuperscript{119} The U.S. Delegation expressed appreciation because Colombia authorized Continental Airlines and American International Airways to operate in the Colombian market.\textsuperscript{120} Nevertheless, the U.S. Delegation asserted the bilateral right of other U.S. carriers to operate in Colombia, such as American Airlines in the New York-Bogota-Quito route planned for initiation on July 1, 1996, and Federal Express and Fine Air as cargo carriers.\textsuperscript{121} In response, the Colombian Delegation stated that if such requests were presented in accordance to Colombian norms and regulations, they would be considered according to Articles 8, 9, and 10 of the Bilateral Agreement.\textsuperscript{122}

The Colombian delegation expressed its discontent because of possible sanctions against Colombian airlines by the DOT.\textsuperscript{123} Moreover, in 1995, the Colombian airlines froze their operations in the U.S. due to the classification of Colombia as a category II country by the Federal Aviation Administration (FAA).\textsuperscript{124} Such a categorization, said the Colombian delegation, constituted a unilateral restriction, not provided for in the Agreement.\textsuperscript{125} It also made it impossible for the Colombian carriers to expand services or fleet. Thus, since Colombian carriers did not have equal opportunity to expand in the U.S., it was unthinkable to expand U.S. carrier services in the Colombian market.\textsuperscript{126}

The Colombian delegation also emphasized that the judicial complaint made by AA did not have firm legal basis because the airline had not performed the Colombian legal procedure in order to get an authorization to start operations.\textsuperscript{127} With the intention of reaching an agreement, the Colombian delegation indicated that it was willing to authorize

\begin{footnotesize}
\begin{enumerate}
\item See id.
\item Colombian Civil Aeronautics Authority, Official Minutes of June 18-21, 1996 Meeting Between Representatives of the Colombian and United States Governments [hereinafter Round Two].
\item Id.
\item See id. at 3.
\item See id.
\item See id.
\item See Bilateral Agreement, supra note 1. The Colombian Delegation supported this allegation on the basis of a possible violation of Article 8 of the Air Transportation Agreement. Id. Article 8 provides that the contracting parties must offer it an equal opportunity for the airline carriers of both contracting parties in any route in which they may operate. Id.
\item See Round Two, supra note 120, at 3.
\item See id.
\end{enumerate}
\end{footnotesize}
AA in the Bogota - New York route, as long as the U.S. accepted a freezing of the U.S. carriers’ capacity.128 The U.S. delegation responded that freezing the capacity would not resolve the problem of Colombian classification under category II, because the U.S. policy insulated air security issues from commercial issues.129

Again, since an agreement was not reached, both delegations willed to continue further negotiations when deemed appropriate.

C. Third Round

After the second round, the Colombian Civil Air Authority decided to abrogate the bilateral agreement if there was no movement during the third round.130 Civil Aviation Chief Jimenez secured Colombian president Samper’s permission to cancel the agreement (Samper was upset because the U.S. just cancelled his visa).131

The U.S. government attempted to find other Colombian institutions with whom it could negotiate and which could intervene on its behalf with the Colombian delegation.132 The Americans tried the Colombian Embassy in Washington, and the Colombian Trade Minister, Morris Harf.133 Both told the Americans that only Jimenez had legal competence to handle international civil aviation negotiations.134 The U.S. government could not bypass Jimenez because the cancellation of Samper’s visa probably precluded a cordial meeting of minds.

The two delegations met in Washington again from July 16-19, 1996.135 During this round, since many proposals were discussed without settlement, the U.S. Delegation requested a suspension of the negotiation. They did so at the request of Secretary of Transportation Federico Pena.136 The U.S. government promised to carefully review all proposals discussed. Department of Transportation sources stated that negotiations were suspended to review the Colombian proposal, and because of the TWA flight 800 accident.137

128. See id.
129. See id. at 4.
130. See Jimenez Interview, supra note 2.
131. See Rios Interview, supra note 21.
132. See id.
133. See id.
134. See id.
During the ensuing week, Colombia suspended operations of LAC, a Colombian carrier, for safety violations, even though it suffered no accidents.\textsuperscript{138} This bolstered the Colombian argument for its removal from FAA category II status.\textsuperscript{139}

D. \textbf{FOURTH ROUND AND SETTLEMENT}

Perhaps sensing that the U.S. delegation might show more flexibility if removed from the insistent political pressures in Washington, the Colombian government suggested that talks reconvene in the historic Colombian city of Cartagena.\textsuperscript{140} The U.S. delegation suggested Miami instead, and the fourth round was held in Miami from August 19 to August 22, 1996.\textsuperscript{141} This time the talks were successful.

The agreement allowed American Airlines to resume direct flights between New York - Bogota and allowed Colombian airlines to add seven new flights a week on the same route as long as Colombia improved its safety designation.\textsuperscript{142} The agreement was reached under the following grounds:

The following dispositions will apply to combined services of passengers and cargo, exclusive service of cargo and any route authorized under the Annex II of the bilateral agreement of 1956:

1. Neither the United States, nor Colombia will increase the number of airlines related to combination of cargo and passengers or number of frequencies including "extra sections" until 1 March 1999, except:
   a) AA will have the right to operate three new weekly frequencies from New York - Bogota, according to Annex II of the agreement. At its selection, AA will also have the right to transfer four weekly frequencies of its current Bogota - Miami flights to the New York - Bogota route.
   b) One Colombian airline or airlines designated by the Colombian government will have the right to operate seven weekly frequencies, according to Annex II of the Agreement. Six of these frequencies might be freely utilized in any of the authorized routes. One of the seven frequencies must be used only in the New York - Bogota route.

2. Neither the United States nor Colombia will increase the number of enterprises in the regular services of cargo, which are operating or are authorized as of August 22, 1996, except:
   a) From September 1, 1998, an additional operator appointed by U.S. will have the right to operate regular cargo services in any of the routes authorized under Annex II of the agreement.

\textsuperscript{138} See Rios Interview, supra note 21.

\textsuperscript{139} See id.

\textsuperscript{140} See id.

\textsuperscript{141} See Round Four, supra note 39.

\textsuperscript{142} Colombia, American Airlines Agreement Reached, Dow Jones Int'l News, Aug. 23, 1996, at 1.
b) An additional operator appointed by Colombia will have the right to operate regular exclusive services of cargo in any of the routes authorized under Annex II of the agreement. From September 1, 1998, a second additional operator designated by Colombia will have the right to operate regular exclusive services of cargo in any of the routes authorized under Annex II of the agreement.

3. Neither U.S. nor Colombia will impose additional restrictions in frequency or capacity respect to the carriers that are operating regular cargo services.

4. Both parties could authorize by mutual assent additional increments of capacity than those established under these dispositions in order to attend special market situations.143

VI. HOW COLOMBIA WON

The resolution of the crisis was a victory for Colombia. AA received the landing rights it sought, plus three additional frequencies, however, it limited its own future growth in Colombia as well as the growth of other U.S. carriers.144 Colombia was compensated with seven additional frequencies.145 Colombia sweetened its victory by gaining permission for two new cargo carriers to fly to the U.S. compared to one new U.S. cargo carrier allowed to fly to Colombia under the agreement.146 The Colombian triumph was heralded by the press as a victory for the Civil Aviation Authority and country as a whole.

Following is an analysis of Colombia’s success from three viewpoints: power, culture, and war.

A. POWER

Although the U.S. seemingly enjoyed overwhelming power over Colombia, this was not the case. The U.S. rejected linkages when it refused the Colombian proposal to include the FAA’s classification of Colombia as a category II country. It, therefore, could not use its influence over Colombia in spheres beyond the bilateral civil aviation. This was tactically sound, but strategically unwise. In any case, as a result of the narcotics de-certification controversy, many appropriate coercive measures were already applied by the U.S. to Colombia.

Many advantages which the U.S. usually counts on in aviation disputes147 did not apply in this case. The U.S. market represented a significant but declining portion of Colombia’s international flights. The

143. See Round Four, supra note 39.
144. See id.
145. See id.
146. See id.
147. See Dempsey, supra note 37, at 171-74.
market was almost shared evenly between the U.S. and Colombian carriers, with the Colombians slowly losing ground. The tourist sector, of little importance to Colombia's overall economy, would be little hurt by a suspension of air services because most foreign tourists were from Europe or other Latin American countries. The U.S. did not enjoy the same geographic leverage it did when negotiating with European countries. Land access to Colombia from surrounding countries is difficult because of mountainous terrain, poor roads, non-existent railroads, and security concerns. A U.S. traveler could fly to Caracas, Venezuela on a U.S. carrier and then switch to a Venezuelan or Colombian flight to Bogota. But a Colombian could just as easily take AVIANCA to Mexico and then a Mexican or U.S. carrier to the U.S.

In reality, it was Colombia that had power in the negotiations. Since the bilateral agreement was signed in 1956, the U.S. slowly built up an advantage over Colombia in terms of routes, flights, and frequencies offered. The U.S. had more to lose. Colombia, on the other hand, had the best alternative to a negotiated agreement - abrogation of the bilateral agreement, and a return to strict reciprocity. Although total U.S. - Colombia traffic would fall considerably under this scenario, Colombia's share of what remained would increase. More importantly, Colombian carriers would charge passengers a lot more money, as demand would grow even as supply was cut. As mentioned above, AVIANCA lobbied for abrogation of the agreement because it saw the economic possibilities.

In fact, when negotiations appeared stagnant during the third round of talks, the Colombian Civil Aviation Authority seriously considered abrogation. Director Jimenez prepared to issue an ultimatum if the U.S. did not prove more flexible.

B. Culture

Different nations negotiate with different styles. Those styles are shaped by the nation's culture, history, political system, and place in the world. Of course, each international negotiation has its own set of substantive issues and each individual negotiator is distinctive. But a better understanding of each nation's particular style can strengthen the ability of the United States to negotiate a better deal.

The quote above comes from an official U.S. State Department study. It applies to all negotiations between nations, in particular, the importance of national cultural differences in international air negotia-

149. See Jimenez Interview, supra note 2.
tions is also recognized.\textsuperscript{151}

The Colombian negotiators did an excellent job of identifying American cultural traits which could be manipulated during the course of talks. They focused on the American sense of quantification, time, and fair play.

The Colombian team arrived at the first round of talks with charts, graphs, and tables. Colombian negotiators were able to make their points in figures.\textsuperscript{152} The U.S. side also had statistics, but was taken aback by the thoroughness of the Colombian presentation. Normally, U.S. delegations are better prepared than their interlocutors in terms of research and hard data. By surprising the U.S. team, the Colombians seized the initiative and established the pace of future discussions.

In addition, by eschewing rhetoric, the Colombian team appealed to the American sense of quantification:

[A] fundamental aspect of the American view lies in the stress placed on concreteness . . . . To the American, the essential quality is measurability. The world to him is seen as having dimensions that can be quantified . . . . The quantification of the world and experience is deeply ingrained in the American.\textsuperscript{153}

The Colombians also used the American sense of time to their advantage. For Americans, "Time is Money," and lack of progress equals failure and worthlessness.\textsuperscript{154} The Colombians understood that as talks dragged on, the U.S. team would feel pressure to make concessions to get negotiations moving. Negotiators would feel pressure from themselves, as well as U.S. organizations. AA wanted landing rights before the summer travel season passed. Continental feared uncertainty during the same season, and Torricelli wanted a victory to show New Jersey voters before November elections. The Colombian delegation was under no such pressure. After all, negotiations were conducted under the status quo of air services between the two countries, and it was the U.S. that sought a change.

The Colombians also constantly appealed to the American sense of "fair play." The Colombian team returned repeatedly to the contention that Colombia did not deny AA's application to renew its route. Instead, Colombia insisted that AA follow proper procedures, and stated that AA was not "playing by the rules." Since the Americans accepted the Colombian team's statistical demonstration of Colombian carriers' market weakness, they were in an awkward position to demand concessions. The

\textsuperscript{151} See Dempsey, supra note 37, at 171.
\textsuperscript{152} See Jimenez Interview, supra note 2.
\textsuperscript{153} Edward C. Stewart, American Cultural Patterns 68 (1985).
\textsuperscript{154} See id. at 38-39.
Colombians continually pointed to differences in routes served, seats offered, and frequencies maintained. The U.S team found it difficult to beat up on the underdog: "[T]he inclusion of the other person's weakness inside the rule so that "fair play" included in it a statement of relative strength of the opponents and it ceased to be fair to beat a weak opponent."155

VII. War

War is used as a metaphor for all types of conflict. AA's CEO Robert Crandall reportedly runs his airline like a military campaign.156 It is useful to examine the U.S. and Colombian negotiators' performance from the viewpoint of classic military principles.

The Principles of War were first elaborated by British Major General J.F.C. Fuller from his country's experiences during the First World War.157 Though modified slightly in subsequent years, the Principles stand the test of time. Of the nine Principles now recognized by the U.S. Army, three have particular significance for the 1996 controversy: Offensive, Economy of Force, and Unity of Command.

The Principle of Offensive states "seize, retain, and exploit the initiative."158 The Colombians did this well. They seized the Americans during the first meeting with a well-prepared, quantitative analysis of the situation which defined the basis for future discussions. The Colombian team also arrived at all meetings with a new proposal for discussion. By always introducing new proposals, the Colombian team kept the U.S. team off balance, in a reactive rather than proactive mode. The Americans, in contrast, stated their demands in the first round of talks and essentially reiterated the same demands in later talks. The Americans never gained the initiative.

Economy of Force means that a commander should put to use all resources and energy necessary to achieve the main objective.159 Only then should surplus resources be allocated to secondary efforts. During negotiations, the Colombian team focused on the main issue - passenger carrier routes and frequencies. The American team, on the other hand, divided attention between passenger and cargo issues. The reasoning behind the U.S. delegation's strategy may have been to identify and focus on aspects of common interest which could form a base for agreement.

155. See id. at 57.
158. Id.
159. Id.
while de-emphasizing areas of conflict.\textsuperscript{160}

The biggest U.S. failure was under the principle of \textit{Unity of Command}. Apart from the brief disagreement between Civil Aviation Chief Jimenez, and Air Transport Association Delegate Leal, the Colombian team worked closely, and well, together. For example, ACES' legal counsel in Washington, the law firm of Zuckert, Scott, and Rasenberger, provided advice to the company which was passed to the negotiators and incorporated in the overall Colombian strategy.\textsuperscript{161}

The U.S. team had to respond to many different interests and political pressures. The Colombians were quick to exploit these divisions. The Colombian Commercial Office urged Jimenez, on June 27, 1996, to maintain the Colombian \textit{Unity of Command} and disrupt the American. The letter reads, "[I]t is imperative to maintain a strict coordination in contacts that the Colombian government makes with its U.S. counterpart and U.S. airlines."\textsuperscript{162} The letter further suggests making contacts with Continental, Torricelli, and Federal Express to recruit them as allies and make sure that the U.S. front was fragmented.\textsuperscript{163}

\textbf{VIII. Conclusion}

American Airlines opened a can of worms by taking its dispute with Colombia to the DOT. Suddenly many interested parties, some inimical to American's interests, had input on American's regulatory relationship with Colombia. The Colombians saw an opportunity and proceeded to \textit{Divide and Conquer}.

\textsuperscript{160} See ICAO, supra note 3, at 7.
\textsuperscript{161} See Mathias Letter, supra note 80.
\textsuperscript{162} See id.
\textsuperscript{163} See id.
Comment

The IATA Intercarrier Agreement: Finally, Justice for Victims of International Air Disasters?

Richard Spilde, Jr.*

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I. Introduction

On September 2, 1998, Swissair Flight 111 plunged into the icy waters off the coast of Nova Scotia on its way to Switzerland, killing all of the 229 passengers on board.1 While the cause of the crash remains unknown, reports of smoke in the cockpit fueled speculation that wiring

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problems may be to blame. In the past, international treaties imposed limits on damage liability creating substantial hurdles for recovery by grief stricken families of victims. Recent developments, however, have removed many of those limits, making it easier for victims’ families to recover amounts similar to those in domestic crashes.

This comment explores the issue of damages in international air disasters. Section II of this comment discusses the Warsaw Convention and its effect on damages in relation to the crash of American Airlines Flight 965 in Cali, Colombia. Section III provides an overview of the substantive changes, in the form of the IATA Intercarrier Agreement, which removed the outdated cap of the Warsaw Convention. Finally, Section IV examines the amendment’s potential effects on the families of victims of Swissair Flight 111.

II. THE WARSAW CONVENTION

The Convention for the Unification of Certain Rules Relating to International Transportation by Air, also known as the Warsaw Convention, concluded on October 12, 1929. According to the language of the treaty, the convention recognized a need for uniform regulation of carrier liability and documents used for international air transportation. The purposes of the convention were to set limits on carriers’ liability, thereby encouraging the growth of a fledgling industry, and to establish a set of uniform rules to govern international aviation. The convention, therefore, creates a framework of procedural rules and liability limits designed

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3. The applicability of the Death on the High Seas Act (DOHSA) to Swissair Flight 111 is beyond the scope of this comment.
5. Id. 49 Stat. at 3014, 137 L.T.N.S. at 15.
6. Trans World Airlines, Inc. v. Franklin Mint Corp., 466 U.S. 243, 256, 104 S.Ct. 1776, 1784, 80 L.Ed.2d 273, 284 (1984), rehearing denied, 467 U.S. 1231, 104 S.Ct. 2691, 81 L.Ed.2d 885 (1984); See also James N. Fincher, Watching Liability Limits Under the Warsaw Convention Fly Away, and the IATA Initiative, 10 Transnat’l Law. 309, 310 (1997). Fincher states: The Warsaw Convention occurred when the aviation industry was a mere infant. The international aviation industry needed the convention to provide a uniform system of law applicable to aircraft accidents and to protect the young fragile industry from the potential of high damage awards from a crash by limiting liability.
to create uniformity in international aviation.⁸

A. LIABILITY OF INTERNATIONAL AIR CARRIERS

Chapter III of the Warsaw Convention discusses the liability of carriers engaged in international air transportation. Article 17, the first provision in Chapter III, provides that carriers are liable for injuries suffered by passengers, including death, occurring on the aircraft or while embarking or disembarking.⁹ Article 21 establishes limitations on a carrier’s liability for each passenger which cannot exceed 125,000 francs¹⁰ (approximately $8300 U.S. dollars in 1929).¹¹ Article 21 also includes a provision which allows the international air carriers themselves to agree to higher liability limits by contracting with passengers.¹² Finally, Article 25 provides that the convention provisions excluding or limiting liability do not apply to carriers who caused damage by “wilful misconduct.”¹³ “Wilful misconduct” is defined as acting “with knowledge that the act . . . could probably result in damage or injury, or in a manner that implies a reckless disregard of the probable consequences.”¹⁴ The intentional omission of an act may also support a finding of wilful misconduct.¹⁵

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⁸ Id.
⁹ Warsaw Convention, art. 17, 49 Stat. at 3018, 137 L.T.N.S. at 23. Article 17 states in relevant part:
The carrier shall be liable for damage sustained in the event of the death or wounding of a passenger or any other bodily injury suffered by a passenger, if the accident which caused the damage so sustained took place on board the aircraft or in the course of any of the operations of embarking or disembarking.
Id.
¹⁰ Warsaw Convention, art. 22(1), 49 Stat. at 3019, 137 L.T.N.S. at 25. Article 22(1) states in relevant part:
In the transportation of passengers the liability of the carrier for each passenger shall be limited to the sum of 125,000 francs. Where, in accordance with the law of the court to which the case is submitted, damages may be awarded in the form of periodical payments, the equivalent capital value of the said payments shall not exceed 125,000 francs.
Id.
¹² Warsaw Convention, art. 22(1), 49 Stat. at 3019, 137 L.N.T.S. at 25 (“Nevertheless, by special contract, the carrier and the passenger may agree to a higher limit of liability.”). Id.
¹³ Warsaw Convention, art. 25, 49 Stat. at 3020, 137 L.T.N.S. at 27. Article 25(1) states in relevant part:
The carrier shall not be entitled to avail himself of the provisions of this convention which exclude or limit his liability, if the damage is caused by his wilful misconduct or by such default on his part as, in accordance with the law of the court to which the case is submitted, is considered to be equivalent to wilful misconduct.
Id.
¹⁵ Id.
 Acts or omissions constituting wilful misconduct include an airline crew's failure to discern that the execution of a 360° turn resulted in the aircraft heading into known dangerous terrain, as well as a crew's deactivation of radar equipment in spite of signs of bad weather and continued descent after losing visibility.

The convention's stringent limits drew criticism almost from their inception. Over time, opponents of the low liability limits succeeded in raising the limits, first in 1955 through the Hague Protocol, and later in 1966 through the Montreal Interim Agreement. The Hague Protocol doubled the Warsaw Convention's previous liability limit to 250,000 francs (approximately $16,600 U.S. dollars). The Montreal Agreement, consisting of a contractual agreement between international air carriers and passengers as provided in Article 22 of the Warsaw Convention, imposed absolute liability upon carriers up to $75,000. While efforts to raise the liability limits of the Warsaw Convention and the Montreal Interim Agreement continued, both agreements remain in force today.

B. APPLICATION OF THE WARSAW CONVENTION—AMERICAN AIRLINES FLIGHT 965

While a number of airline disasters in recent years have involved a finding of wilful misconduct, the most recent example arose out of the crash of American Airlines Flight 965 near Cali, Colombia. The litigation resulting from the crash of Flight 965 occurred in two phases. The first phase related to the finding of liability. The second phase consisted of separate trials to determine damage awards for all remaining plaintiffs.

On the evening of December 20, 1995, Captain Nicholas Tafuri and First Officer Donnie Ray Williams, pilots of American Airlines Flight

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16. Koirala v. Thai Airways Intern., Ltd., 126 F.3d 1205, 1210 (9th Cir. 1997).
18. See Buff, supra note 11, at 1779.
21. See Buff, supra note 11, at 1781.
22. Id. at 1785.
23. Id.
965, discovered they were lost.25 Both were experienced pilots, having logged over 2200 flight hours in the Boeing 757 aircraft.26 While Captain Tafuri completed 13 previous flights on the Miami to Cali, Columbia route in the past and received his international line check only eleven days before, Williams had never flown an American Airlines airplane into Cali.27 In an effort to find the proper runway, one of the pilots entered the incorrect code for a directional beacon into the aircraft’s computer.28 Instead of placing the aircraft on the proscribed approach route for the Alfonso Bonilla Aragon airport at Cali, flight 965 turned east, directly toward the summit of El Deluvio, with catastrophic results.29

According to Flight 965’s cockpit and flight data recorders, the aircraft’s terrain warning alarm sounded at approximately 9:41.30 The pilots tried to gain altitude, but it was too late.31 Thirteen seconds later, Flight 965 slammed into the Colombian mountainside, killing 159 of the 163 passengers and crew members on board.32

The subsequent trial brought by relatives of victims and survivors of the crash was a consolidation of almost 160 lawsuits.33 In their consolidated action, the plaintiffs essentially alleged four discrete acts, all of which involved pilot error.34 First, plaintiffs’ asserted that the pilots violated policies of American Airlines and the Federal Aviation Regulations by continuing their descent after the plane deviated from the proscribed approach path to the Cali Airport.35 Second, they asserted that the pilots’ knowing deviation from the flight plan and attempted shortcut to the Cali airport violated American Airlines policy.36 Third, they alleged that the pilot’s failure to verify the proper identifier for a waypoint prior to entering it on the FMC.37 Finally, the plaintiffs asserted that the pilots violated American Airlines policy by ignoring the instructions of the Co-
lombian air traffic controller and attempting to bypass a required way-
point.\textsuperscript{38}

After an extensive trial on the liability issue, the court concluded,
"[s]imply put, no reasonable jury could find that the acts of the pilots of
Flight 965—and in particular the pilots decision to continue their descent
at night from a grievously off course position in mountainous terrain—
amounted to anything less than wilful misconduct."\textsuperscript{39}

C. DAMAGES UNDER THE WARSAW CONVENTION

Under the limits proscribed under the Warsaw Convention, a plain-
tiff is limited to a maximum recovery of $75,000 unless it is shown that the
carrier engaged in wilful misconduct.\textsuperscript{40} Once this showing is made, a jury
may apportion damages in a manner limited only by the law of the
forum.\textsuperscript{41}

In the case of Flight 965, the finding of wilful misconduct has thus far
opened the door for damages far in excess of the $75,000 liability limit
under the Warsaw Convention.\textsuperscript{42} Jamie and Lucy Montero, parents of
Ernesto Montero, a college student killed in the crash, were awarded $2.4
million dollars.\textsuperscript{43} Similarly, a Miami jury awarded the family of Carmen
Eliza Ruiz $2.4 million.\textsuperscript{44}

III. AMENDMENTS TO THE WARSAW CONVENTION

The recent changes in liability limits with respect to air disasters cov-
ered by the Warsaw Convention comes after efforts to change the limits
spanning over thirty years. Under the Warsaw Convention’s original pro-
visions, a carrier’s liability was limited to approximately $8300 per
passenger.\textsuperscript{45}

While the Warsaw Convention places stringent limits on a victim’s
ability to recover absent a showing of wilful misconduct\textsuperscript{46} the convention
does allow for the creation of more liberal limits short of amendment.
Article 22 of the Convention provides that carriers and passengers may,

\textsuperscript{38} Id.
\textsuperscript{39} Id. at 1109.
\textsuperscript{40} See Warsaw Convention, supra note 13 and accompanying text.
\textsuperscript{41} Id.
\textsuperscript{42} Catherine Wilson, N.J. Couple Awarded $2.4M in Air Crash, The Record, Northern
\textsuperscript{43} Id.
\textsuperscript{44} Michael Connor, Miami Jury orders $2.4 million payment in air crash—COURTS: The
Award is Another Stemming from an American Airlines Plane Slamming into a Mountain in
Colombia, The Orange County Register, Aug. 1, 1998 at A10.
\textsuperscript{45} See Fincher, supra note 6, at 310.
\textsuperscript{46} See Warsaw Convention, supra note 13 and accompanying text.
through a special contract, agree to a higher limit of liability.\textsuperscript{47}

In October 1995, pursuant to Article 22, the International Air Transport Association (IATA) adopted a contractual agreement among participating air carriers to voluntarily waive the liability limits provided by the Warsaw Convention.\textsuperscript{48} The goal of the IATA agreement was to modernize the liability limits under the Warsaw Convention.\textsuperscript{49} The United States Department of Transportation approved the IATA initiative, together with two implementation agreements, on November 12, 1996.\textsuperscript{50}

In essence, the IATA agreement relating to passenger liability is composed of two provisions.\textsuperscript{51} First, the IATA carriers agree to waive all liability limits relating to compensatory damages.\textsuperscript{52} Second, the IATA carriers agree that compensatory damages will be awarded based on the law of the passenger’s domicile.\textsuperscript{53}

In addition to the liability provision of the IATA agreement, separate agreements concerning the implementation of the new liability limits were adopted.\textsuperscript{54} One such agreement, the IATA Implementation Agreement,\textsuperscript{55} includes a provision requiring air carriers to include in their conditions of carriage an additional waiver making them strictly liable for any claims up to $145,000.\textsuperscript{56}

\section*{IV. Effects of the IATA Agreement}

The IATA intercarrier agreement paves the way for the families of victims of international airline disasters to recover damages consistent with those in domestic crashes. The families who lost loved ones to the Swissair Flight 111 tragedy will be the first to test the new limits. Swissair was one of a number of international air carriers who signed the IATA Intercarrier Agreement.\textsuperscript{57} The first suit arising out of the Swissair crash was filed September 9, 1997, by former boxer Jake LaMotta in federal district court in Brooklyn, New York.\textsuperscript{58} LaMotta lost his 49-year-old son, Joseph, in the tragedy.\textsuperscript{59} The suit names Swissair, Delta Airlines, which operated Flight 111 with Swissair, McDonnell Douglas, the manufacturer

\textsuperscript{47} See Warsaw Convention, supra note 10, and accompanying text.
\textsuperscript{48} See Buff, supra note 11, at 1812-14.
\textsuperscript{49} Id. at 1813.
\textsuperscript{50} Id. at 1814.
\textsuperscript{51} See Fincher, supra note 6, at 310.
\textsuperscript{52} Id.
\textsuperscript{53} Id.
\textsuperscript{54} See Buff, supra note 11, at 1815-17.
\textsuperscript{55} See Buff, supra note 11, at 1816 (discussing the IATA Implementation Agreement).
\textsuperscript{56} Lee S. Kreindler, Goodbye to Liability Limitations, 217 N.Y.L.J. 33 (1997).
\textsuperscript{58} Id.
\textsuperscript{59} Id.
of the MD-11 airplane, and Boeing, Co., the parent company of McDonnell Douglas.\textsuperscript{60} The suit alleges claims of negligence, strict liability, breach of warranty, and seeks damages for pain and suffering of the decedent of $50 million plus $75 million in punitive damages.\textsuperscript{61} Unlike previous disasters however, the IATA agreement ensures that Mr. LaMotta will be spared the costly and time consuming burden of proving wilful misconduct in order to recover damages for the loss of his son.\textsuperscript{62}

While the passage of the IATA Intercarrier Agreement lifted a substantial legal burden from the shoulders of victim's families, other remnants of the Warsaw Convention remain. Article 20(1) of the Warsaw Convention provides the carrier with a defense to liability if the carrier can show that all necessary measures were taken to avoid the resulting harm.\textsuperscript{63} In addition, the passage of the IATA Intercarrier Agreement reopens the inquiry as to whether punitive damages are available under the Warsaw Convention.

V. Conclusion

While the results of the IATA Intercarrier Agreements have yet to be applied, it appears the amendments will eliminate much of the inequity under the prior Warsaw Convention limits. It is unlikely that the families of victims of Swissair Flight 111 will be forced to subject themselves to the lengthy trial process for the purpose of satisfying an antiquated statutory provision.

However, with the application of the new agreements still untested, critics still contend that the Warsaw Convention requires a full overhaul. The patchwork of agreements developed over the past several decades to raise the liability limits seems to lack the uniformity and consistency the Warsaw Convention sought to provide.\textsuperscript{64}

Despite the legal complexities readily apparent in international air travel, perhaps the proper inquiry with respect to the families of airline disaster victims is whether justice has been done. Under the new liability regime created by the IATA Intercarrier Agreement, the families of the 229 people aboard Swissair Flight 111 will be the first to find out.

\textsuperscript{60} Id.
\textsuperscript{61} Id.
\textsuperscript{62} Id.
\textsuperscript{63} See Warsaw Convention, supra note 4, art. 20, 49 Stat. at 3019, 137 L.T.N.S at 25 ("The carrier shall not be liable if he proves that he and his agents have taken all necessary measures to avoid the damage or that it was impossible for him or them to take such measures.") Id.
\textsuperscript{64} See Buff, supra note 11, at 1834 (arguing that despite the IATA Agreement, the Warsaw Convention remains in need of amendment).
Articles

Injecting Competition in the Railroad Industry Through Access

Salvatore Massa*

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* United States Department of Justice - Antitrust Division; J.D., University of Wisconsin, 1997. The views of the author do not necessarily reflect the views of the United States Department of Justice. The author thanks Diana Cook, Mark Meitzen, Russell Pittmann, Robert Rosenberg, and Neal Stevens for their assistance and comments.
I. INTRODUCTION

With the recent consolidation of several large track networks, the railroad industry has become highly concentrated. In spite of the increased profitability of the industry, the number of major networks has dwindled because the immense costs of creating new networks prohibits entry into the market. While the industry often competes with other modes of transportation to move freight, shippers who are relatively dependent on railroad transportation now have few competitive alternatives and face poorer service. Competitive access provides a remedy to constrain anticompetitive abuses in the industry and offers shippers more efficient transportation options. While various proposals exist, the core principle of competitive access is that potential entrants are permitted to use "facilities owned by one railroad for services provided by or in conjunction with another railroad." 

This Article explores the use of different regulatory regimes to encourage competition in the railroad industry. Section II of this Article explores railroad control of bottlenecks - portions of the network where only one railroad can provide service. This section relies on the economic theories concerning bottleneck control as well as anecdotal evidence of the impact of recent consolidations. Section III analyzes the current regulatory tools for encouraging competition: limited competitive access and rate regulation. This section also examines the administrative cases applying the competitive access and rate regulation provisions. Section IV surveys other approaches to enhance competition and discusses the bur-

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1. These consolidations also allowed the newly merged firms to pare down parallel networks. As a result of such line sales, a growing number of independent carriers operate smaller, light density and labor intensive lines. Such lines provide the benefits of localized service at lower cost than many major railroad networks could provide. See Stephen R. Klein, Railroads' Second Golden Era May Be Dawning, STANDARD & POOR'S INDUSTRY SURVEYS, Nov. 4, 1993, at R15. Many of these short or regional lines, however, have a limited role in competing against the larger networks that spawned them.

2. Currently, only one regional railroad has proposed an expansion which would "become the country's first major new railroad in more than a half-century." However, this new railroad would hardly be a national competitor, as it will only offer competition in the delivery of coal from the Powder River Basin in Wyoming to various electric utilities in the Midwest. See Anna Wilde Mathews, Regional Railroad Plans Big Expansion, WALL ST. J., June 9, 1997, at A2; Steve Glishinski, DM&E Takes First Step Toward Powder River, 58 TRAINS 6, June 1, 1998, at 26-27. The Surface Transportation Board has given preliminary approval of the expansion - pending an environmental impact study. See Dakota, Minnesota & Eastern R.R. Corp. Constr. Powder River Basin, Fin. Docket No. 33407, 1998 WL 869567 (Surface Transp. Bd. Dec. 10, 1998).


dens these approaches bring. Section V provides a brief summary and concluding remarks.

II. PROBLEMS AT THE BOTTLENECK: RAILROAD ANTICOMPETITIVE BEHAVIOR

The railroad industry has undergone a steady process of consolidation that may soon result in two competing transcontinental systems. The remaining major networks overlap, with at least two firms competing on each significant transportation corridor. However, these overlapping networks are not parallel on a regional level. While two networks may provide service between Los Angeles and Chicago, only one may provide a shipper with service to or from an intermediate point. As a result, many shippers have only one option for railroad service for a portion of the freight movement.

This concentration in itself, however, may not trigger abuse of market power. Other modes of transportation, such as trucking, pipelines and barges, provide competing services that some shippers may employ. These substitutes may place a ceiling on the price that a railroad firm exploiting its market power may charge. For many commodities, transportation costs may directly affect the supply of those goods. When transportation costs rise sufficiently in a regional market, product substitution and product source substitution may occur. For example, if Iowa corn farmers face higher transportation costs to move corn to a particular location, consumers, such as food processors, may use corn - or another substitutable grain - from another region to avoid paying the higher transportation cost for Iowa corn. In short, three options combat higher railroad transportation costs: (1) shippers may switch the mode of

---


6. This would be especially true for products where the transportation service constitutes a substantial portion of the cost of the good.

transportation; (2) consumers of the good may substitute the commodity with another good; and (3) consumers may obtain the commodity from another location where transportation costs are lower.  

For some products in certain locations, railroad transportation may provide the only viable or most cost effective means of shipping a commodity. Anticompetitive behavior is possible under these circumstances when a railroad has exclusive control of either a destination or origin point in a movement. In this case, the price ceiling of other transportation substitutes may be very high, allowing a railroad to exploit its market power unless consumers can offset this market power with product substitution or product source substitution. When consumers are unable to offset this power, such a railroad becomes a bottleneck for the movement and may leverage its bottleneck onto other competitive portions of the movement. Bottleneck control has a profound competitive impact on shippers because substantial barriers to entry exist which dissuade a new entrant from building a competing line to the shipper.

Illustration 1 exemplifies a typical bottleneck situation where one carrier provides service between two points and the other carrier must

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The regulatory body governing railroad mergers has also discussed and accepted this scenario. See Burlington N., Inc. - Control - Santa Fe Pac. Corp., No. 32549 at 76 (I.C.C. Aug. 16, 1995) [hereinafter BN-SF], aff'd sub. nom., 109 F.3d 782 (D.C. Cir. 1997) (“it is a perfectly rational strategy for a destination bottleneck carrier to name, and stick to, a revenue division among interconnecting railroads that will allow it to extract substantially all of the economic profits that are available from a particular movement, letting connecting carriers set their divisions in response.”); Union Pac. R.E. C. & Missouri Pac. R.R. Co. - Control - Chicago & N. W. Transp. Co. 366 I.C.C. 462, 538 (1982) (“a carrier with a destination monopoly will likely push the through rate as high as possible and keep the monopoly profits to itself . . . and the destination carrier will establish favorable through service with the origin carrier willing to take the lowest division of the through rate for its segment of the movement.”).

11. “A barrier to entry is any factor that permits firms already in the market to earn returns above the competitive level while deterring outsiders from entering.” See Phillip E. Areeda & Herbert Hovenkamp, 2A Antitrust Law ¶ 420, at 55-56 (1996). Areeda and Hovenkamp note that a large initial investment could act as a barrier to entry. See id. at ¶ 421b at 64. Barriers to entry are high in the railroad industry because of the significant costs associated with building a track network. No major entrant to the market has joined the railroad industry in over fifty years. See supra note 2.
exchange traffic with its competitor at an intermediate point to provide service between the same two points:  

**Illustration 1**

```
 Railroad X  Railroad X  
--------------------------
             |             |
             B             C

A

Railroad Y
```

In this illustration, Railroad X can provide single-line service between points A and C for a shipment of freight. In contrast, Railroad Y must interchange with Railroad X at an intermediate point to provide service between A and C. Railroad X may even set the location of the interchange to extend the length of the bottleneck portion of the route or it may choose not to deal with Railroad Y altogether. When denied access entirely, Railroad Y becomes subject to "vertical foreclosure." If the costs of interchanging and using Railroad Y’s service were undesirable, Railroad X’s bottleneck power would be irrelevant in terms of selecting the more efficient routing because a shipper would always choose Railroad X’s service over the competitive portion of the movement.

However, if a superior network or another factor enabled Railroad Y to provide better service through that segment despite the costs of interchanging, then bottleneck control distorts the competitive options of a shipper. Railroad X could control the movement by subsidizing its less efficient segment through the monopoly segment. Table 1 provides a hypothetical example of the potential effects of this distortion:

---

12. The agency governing railroad mergers used a similar chart to illustrate this theory in Union Pacific Corp. & Miss. Pac. R.R. Co. - Control - Chicago and N. W. Transp. Corp., 1995 WL 141757 (I.C.C. Feb. 21, 1995). The agency discussed the foreclosure of non-bottleneck carriers from providing interline service on bottleneck routes.


14. Under this scenario, the “efficient” routing would be selected. However, this does not escape the question of the bottleneck carrier’s leverage with respect to price. Recognizing the bottleneck carrier’s route as the most efficient, and one that the shipper would always prefer, grants the bottleneck provider an effective monopoly over the entire movement. See Areeda & Hovenkamp, supra note 11, ¶ 764b1, at 74 (discussion in context of intrabrand competition).

15. See Grimm & Harris, supra note 10, at 50-51.
Table 1
COST OF SHIPPER SERVICE OPTIONS

<table>
<thead>
<tr>
<th></th>
<th>Monopoly Segment</th>
<th>Competitive Segment</th>
<th>Total Cost A to C</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A to B</td>
<td>B to C</td>
<td></td>
</tr>
<tr>
<td>Railroad X Only:</td>
<td>15</td>
<td>11</td>
<td>26</td>
</tr>
<tr>
<td>Railroads X and Y:</td>
<td>18</td>
<td>9</td>
<td>27</td>
</tr>
</tbody>
</table>

If a shipper uses Railroad Y’s service for the competitive portion of the movement (B to C), Railroad X will raise its rate for the bottleneck portion of the movement (A to B). Some of this price increase could be attributable to the cost of interchanging at an intermediate point with Railroad Y because interchange could require additional facilities and labor. If market restraints exist on the pricing leverage of railroads, through limitations on information or industry custom, Railroad X may use its bottleneck control not to extract profits from Railroad Y’s lower cost network, but it could attempt to use its position to capture the competitive portion of the movement entirely and foreclose Railroad Y from competing for this movement.

The three-unit increase in Railroad X’s price over its bottleneck segment could represent only a one-unit increase in cost attributable to interchange, with the remainder representing market leverage. In this case, stripping Railroad X of this bottleneck leverage would reveal that interchange with Railroad Y is the more efficient option. The dual carrier service would be 25 - 16 on the bottleneck portion and 9 on the competitive portion - instead of the 26 that Railroad X offers for single-line service.

Manipulation of bottleneck pricing in order to control freight movements over competitive segments of the network has pernicious effects on two levels. First, the bottleneck carrier distorts the incentives of shippers,


17. See Grimm, et al., supra note 13, at 299-300. The authors suggest that certain market constraints prevent bottleneck carriers from directly using pricing leverage. They argue that standard revenue division rules common in the industry govern such arrangements. Alternatively, they suggest that a bottleneck carrier may prefer to foreclose an interlining railroad over the competitive portion of the movement in order to maintain exclusivity with a customer who otherwise could use “the threat of shipping via the interline route to gain leverage in negotiations.” See id. at 300.

18. See Tye, supra note 10, at 215. As Tye has noted, railroad regulators have intervened in some merger proceedings to prevent this type of foreclosure by either creating conditions on the adversely affected firm or granting trackage rights to that firm, allowing it to operate over the bottleneck segment. Examples of such cases are noted in infra note 62.
causing them to use a more inefficient network that provides poorer service or that simply has a higher cost structure.\textsuperscript{19} Like a classic tying arrangement, the bottleneck carrier uses its bottleneck service to divert traffic onto its own network for the competitive portion of the movement.\textsuperscript{20} Second, the shipper ultimately pays more for the service or receives lower service quality.\textsuperscript{21} Since the bottleneck carrier is able to raise the rate charged over the bottleneck segment, the shipper pays more than the efficient price by keeping traffic on the bottleneck network.

The Chicago leverage theory challenges this viewpoint, contending that a bottleneck carrier would have the incentive to route the traffic on the less costly network in order to obtain a higher return on its investment.\textsuperscript{22} According to this theory, vertical integration of firms is almost always harmless and often efficiency enhancing.\textsuperscript{23} Using the figures from Table 1, Railroad X would rather pay Railroad Y to accrue the gains of using its bottleneck power without being hampered by a lower return on the less efficient portion of its network. Railroad X could effectively charge 17 for the bottleneck portion of the movement, making the shipper indifferent as to which routing to use. Railroad X’s behavior illustrates an example of a price squeeze on Railroad Y because Railroad X appropriates a portion of its profits.\textsuperscript{24}

Some economists have opined that the bottleneck carrier will then have an incentive to insure that the interchange carrier receives a return to sustain its operations over the line in order to perpetuate its monopoly profits:

A bottleneck railroad whose end-to-end price for rail service is effectively constrained by market forces or by regulation has every reason to encourage use of the facilities of a more efficient connecting carrier and to make certain that rates earned by that carrier are sufficient to permit it to survive and prosper in the long run. Assume for example, that segment A is the bottleneck and segment B can be served both by the owner of the bottleneck and

\begin{enumerate}
\item See Grimm et al., supra note 13, at 298.
\item See Tye, supra note 13, at 54-55. Tye notes that transportation costs to shippers may be increased if there is an absence of intermodal competition, product or product source substitution, or regulatory intervention. See id. at 55.
\item See Grimm et al., supra note 13, at 298-99; Tye, supra note 13, at 42.
\item The Interstate Commerce Commission, the agency responsible for railroad merger oversight until recently, adopted this theory to permit many so-called end-to-end mergers which joined non-parallel track networks. See, e.g., Union Pac. R.R. Co. - Control - Missouri-Kan.-Tex. R.R. Co., 4 I.C.C.2d 409, 436 (1988) (“parallel mergers generally present more serious competitive problems than end-to-end ones”).
\item Tye has defined a price squeeze as “a situation where a firm manipulates the input and output prices faced by a competitor to prevent that firm from competing effectively.” See Tye, supra note 10, at 212 n.24.
\end{enumerate}
one or more other railroads. If the market allows end-to-end rates of $100 and the long-run incremental cost to the bottleneck railroad of transportation along the non-bottleneck segment B is $40, then if the connecting carrier can carry it for $30 and offers service at a price of $39, the bottleneck carrier’s profit will be increased by $1 . . . . Since a $1 . . . gain in profits is always better than zero, the bottleneck carrier always gains by perpetual continuation of service by the connecting carrier.25

Table 2 illustrates this concept by showing the profits Railroad X could accrue and the cost to the shipper under either scenario, assuming that Railroad X’s cost to operate the bottleneck segment is 12 and the competitive segment is 10.

**Table 2**

**Chicago Leverage Theory Applied to Bottlenecks**

**What the Shipper Pays:**

<table>
<thead>
<tr>
<th></th>
<th>Monopoly Segment</th>
<th>Competitive Segment</th>
<th>Total Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>X only</td>
<td>15</td>
<td>11</td>
<td>26</td>
</tr>
<tr>
<td>X and Y</td>
<td>17</td>
<td>9</td>
<td>26</td>
</tr>
</tbody>
</table>

**How Railroad X Profits from the Two Options:**

<table>
<thead>
<tr>
<th></th>
<th>Monopoly Segment</th>
<th>Competitive Segment</th>
<th>Total Profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>X only</td>
<td>3</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>X and Y</td>
<td>5</td>
<td>0</td>
<td>5</td>
</tr>
</tbody>
</table>

Some critics of the Chicago leverage theory have questioned the validity of its assumptions.26 For example, the theory assumes that a railroad is able to extract a price squeeze on its interlining rival, but certain industry customs - such as standard division rules that set mileage as a proxy for cost - may preclude27 or distort the use of a price squeeze.28 If rate divisions are set according to the distance freight travels, in many cases the bottleneck carrier will prefer to provide single-line service, even if it is less efficient.29 And, in order to exercise even a partially successful price squeeze, the bottleneck railroad would have to possess some knowledge of an interlining rival’s cost structure to enhance returns.

Indeed, a bottleneck railroad may prefer to foreclose an interlining

26. See Grimm, et al., supra note 13, at 305-08; Tye, supra note 13, at 54-56.
27. See Grimm, et al., supra note 13, at 299-300.
28. See Grimm & Harris, supra note 10, at 52-53.
29. See id.
competitor to prevent it from gaining knowledge about a customer. While the bottleneck railroad may earn the same or greater short-run profits by interlining in that particular market, the customer may need service in other markets where the bottleneck and the rival compete more directly.\textsuperscript{30} By withholding information from the interlining railroad, the bottleneck carrier may attempt to keep an exclusive relationship with the customer to prevent future competitive threats or customer leverage in other markets. Similarly, other strategic reasons, such as the desire to weaken the interlining competitor to gain additional market power in other markets, may also act as an incentive for foreclosure.

In addition, foreclosure may take subtler forms, in order to fly below the regulatory radar screen. Vertical foreclosure scenarios in the railroad industry commonly occur when the bottleneck carrier "threatens" the shipper with reduced service quality or reliability for interlined shipments.\textsuperscript{31} Other situations are more obvious. For example, prior to a merger, Southern Pacific and Wisconsin Central provided interlined competition against Union Pacific for the movement of taconite pellets from mines in Minnesota to a steel manufacturer in Utah.\textsuperscript{32} Because the railroads provided an innovative service by backhauling coal to the Midwest, they were able to compete effectively with the single-line service of Union Pacific. After Southern Pacific merged with Union Pacific, this service was eliminated and the Union Pacific now provides single-line service.\textsuperscript{33} In another recent, and perhaps extreme example of such behavior, Union Pacific sought to divert its traffic onto ships to relieve network congestion rather than give the freight to a rival railroad.\textsuperscript{34}

Regardless of the validity of the Chicago leverage theory, captive shippers pay more for railroad transportation or receive poorer service because the bottleneck provider will use its position to maintain higher rates over the bottleneck portion of the movement like a monopolist. Clearly, a railroad that provides the exclusive rail service at both the origin and destination for a captive shipper could use its monopoly position to exploit the market price of the movement.\textsuperscript{35} Similarly, bottleneck lev-

\begin{itemize}
\item \textsuperscript{30} Grimm, et al., \textit{supra} note 13, at 300.
\item \textsuperscript{31} Grimm & Harris, \textit{supra} note 10, at 53.
\item \textsuperscript{32} Mark W. Hemphill, \textit{Taconite West, Coal East: How Wisconsin Central and Southern Pacific Snared the Big Geneva Ore Haul}, 55 \textit{Trains} 3, Mar. 1, 1995, at 36-47.
\item \textsuperscript{33} See Scanner, 58 \textit{Trains} 8, Aug. 1998, at 21. ("Wisconsin Central has come to terms with UP on moving Geneva . . . iron-ore trains . . . to an all UP routing from northern Minnesota, which took place in 1997, over a year before the contract expires.").
\item \textsuperscript{35} In the proposed merger of Santa Fe and Southern Pacific, the number of carriers for shipping many commodities would have been reduced to only the new merged entity. Analyzing other economic estimates, Pittman observed that the proposed merger would have increased
\end{itemize}
age creates a wealth transfer from captive shippers to railroad firms and from interlining railroads to bottleneck railroads. In addition to these wealth transfers, this leverage creates a dead-weight loss to society through inefficiency. Furthermore, bottleneck control does not represent the only potential scenario for anticompetitive behavior. And, of course, other concerns exist regarding the wisdom of a policy that has embraced nearly all railroad consolidations.


36. See Grimm et al., supra note 13, at 299; Tye, supra note 13, at 54.
37. See Tye, supra note 13, at 52-54.
38. See, e.g., Pittman, supra note 35, at 34-35; Timothy J. Brennan, Why Regulated Firms Should Be Kept Out of Unregulated Markets: Understanding the Divestiture in United States v. AT&T, 32 ANTITRUST BULL. 741, 747 (1987) ("monopoly is generally thought to lead to inefficient undersupply of goods").

39. In a classic antitrust law analysis, the competitive problems posed by industry concentration are two-fold. First, as indicated, firms may take unilateral action. Second, fewer competing firms create greater opportunities for collusion. Such behavior was a very common antitrust concern at the turn of the century. See United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898); United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897).

The United States Department of Justice has recognized competitive harm from both unilateral and collusive conduct. See UNITED STATES DEPARTMENT OF JUSTICE & FEDERAL TRADE COMMISSION, HORIZONTAL MERGER GUIDELINES 18-25 (1992, rev. Apr. 8, 1997). With respect to unilateral conduct, “[a] merger may diminish competition . . . because merging firms may find it profitable to alter their behavior unilaterally following the acquisition by elevating price and suppressing output.” See id. at 22.

40. Several other considerations may mitigate against pursuing such a policy. First, a poorly crafted consolidation may lead to a weakening of the newly created firm. See Joseph R. Daughen & Peter Binzen, The Wreck of the Penn Central (1971). See also Brian O'Reilly, The Wreck of the Union Pacific, FORTUNE, Mar. 30, 1998, at 94. And, because of the reliance of other carriers on interlining shipments with each other, the woes of a newly merged railroad may spread to other railroads in the form of delays, inadequate interlining and diminution of traffic. See, e.g., Daniel Machalaba, Delays and Snaflus Grip Nation's Rail Freight, WALL ST. J., May 29, 1998, at B1.

Second, the newly consolidated firms may grow too large to efficiently manage operations and provide adequate service to shippers. Ronald Coase, for example, has suggested that firm size is constrained by the cost of organizing a firm. Once the organization costs approach the cost of carrying out the transactions in the market, the efficiencies of the firm are lost. See RONALD H. COASE, THE FIRM, THE MARKET, AND THE LAW 7, 44-45 (1988). See also GEORGE STIGLER, THE ORGANIZATION OF INDUSTRY 67-70 (1968).

Third, the significant rationalization of railroad track in the nation has cut off communities to freight or potential passenger service, and the lack of "redundant" networks in regions imposes a risk on the free flow of commodities when one railroad's network breaks down and no other firm can provide service on another competitive line. Since 1980, the Class I railroads have abandoned or sold nearly 20 percent of preexisting trackage. See Wesley A. Wilson, Cost Savings and Productivity in the Railroad Industry, 11 J. REG. ECON. 21, 23 (1997).

Fourth, notable safety problems may arise as a result of mergers. The Union Pacific safety record provides an example of a safety breakdown during the early implementation of a merger. See Daniel Machalaba, Union Pacific Is Criticized for Safety Breakdown, WALL ST. J., Sept. 10,
whether some form of market abuse has occurred in the railroad industry. While declines in price may indicate vigorous competition, this information, standing alone, can be misleading. Decreases in cost resulting from new technology or automation may outstrip falling prices, allowing firms to reap greater returns. A firm that is able to control price declines over time may be exercising market power like a firm that increases prices in spite of a stable cost structure. Since the implementation of railroad deregulation, the railroad industry has gone through a period of substantial price reductions in freight movements. From 1982 to 1996, rail rates have declined by 26 percent after adjusting for inflation.\textsuperscript{41} At the same time, the industry has dramatically reduced its cost structure.\textsuperscript{42}

Comparing the two trends, one trade magazine observed that, for coal shippers, “trends in rail rates have generally not tracked declines in the railroads’ costs of providing service.”\textsuperscript{43} This conclusion is further bolstered by the evidence that during the period immediately following deregulation, transportation prices for some commodities initially rose, probably because the short term cost savings from deregulation were still generally modest.\textsuperscript{44} Moreover, shippers claim that the savings from deregulation are not shared, with captive shippers paying 20 to 30 percent higher rates than shippers who can choose between railroad carriers or even another form of transportation, such as barges.\textsuperscript{45} In addition to these price effects, shippers have fewer railroad routing alternatives. As one commentator has observed, “[f]ewer and larger railroads resulting from consolidation resulted in fewer interlined shipments.”\textsuperscript{46}

\textsuperscript{41} See Klein, supra note 1, at 1.

\textsuperscript{42} See id. at 1-2, 3. See also Wilson, supra note 40, at 39. Wilson’s study has estimated that cost savings in the industry fell in the range of 41 to 44 percent over the period 1981-1989.

\textsuperscript{43} See Coal’s History of Dependence on Transportation, supra note 9, at 42.

\textsuperscript{44} See Wesley A. Wilson, Market-Specific Effects of Rail Deregulation, 42 J. INDUS. ECON. 1, 20 (1994). This Wilson article reflects a study in rail rates for thirty-four commodity classifications for the period 1972-88. Wilson concludes that while commodity prices initially rose under deregulation, by 1988, “deregulation produced lower prices in most commodity classifications and did not increase prices in other classifications, suggesting that advances on productivity have dominated any adverse market power effects.” See id. See also Ronald R. Braeutigam, Consequences of Regulatory Reform in the American Railroad Industry, 59 SOUTHERN ECON. J. 468, 473-74 (1993).

\textsuperscript{45} See Bruce Ingersoll, Deregulation Aids Rails Too Much, Shippers Say, WALL ST. J., Apr. 2, 1998, at A2 (comparing rates of West Virginia steel mills and coal mines that rely on one railroad for service and rates for the same class of shippers who have either more than one railroad option or a competing barge line to move freight).

\textsuperscript{46} See Wilson, supra note 40, at 23. Wilson’s study, however, suggests that overall, the ICC and STB’s policies supporting deregulation and permissive attitude toward mergers has improved consumer welfare. See id. at 39. Other economists have suggested, however, that most improvements in the industry are attributable to policies promoting deregulation, and not merg-
Service and reliability of freight movements, which represent indicators of the competitiveness of the market, have also declined.\textsuperscript{47} In the wake of recent mergers, the number of captive shippers who are building their own redundant railroad tracks to link up with competitors is growing.\textsuperscript{48} One study indicates that transit times for "general" freight have increased 25 to 30 percent in the past three decades with on-time performance of 60 percent, a far cry from the 95 percent timeliness the trucking industry offers.\textsuperscript{49} In one very recent merger proposal, the acquiring railroads have proposed to "slash" New York City to Chicago transit times for high priority freight to 26 hours, two hours slower than similar service offered 30 years ago.\textsuperscript{50} One railroad executive has likened the industry as "about where the automobile industry was 15 years ago."\textsuperscript{51} After the Union Pacific - Southern Pacific (UP-SP) merger, which promised improved service and cost savings, shippers have complained extensively about substantial service problems.\textsuperscript{52} In addition to sug-


48. See Daniel Machalaba, Opening Lines: Tired of Costs, Delays of Railroads, Firms Lay Their Own Tracks, WALL ST. J., Feb. 6, 1998, at A1. One financial analyst has stated: "Unquestionably, the construction of a track spur by a shipper points to a state of extreme displeasure with a carrier's rate/service package. Railroads that lose business in this way should undertake some deep soul-searching to determine how they lost touch with the customer." See Klein, supra note 1, at R17.


50. See Bill Stephens, Will Eastern Intermodal Match the Hype?, TRAINS, Mar. 1998, at 24. Stephens discusses the Norfolk Southern and CSX joint acquisition of Conrail. Conrail's intermodal schedule averaged thirty to thirty-two hours for this routing. The author asserts that transit times will improve partly because Conrail will be divided in two, and the railroads will have "two fast, high density ... routes." See id. at 25. Apparently, when Conrail owned these two parallel routes itself, it failed to have the proper incentives to develop such transit speeds. See id.

51. See Machalaba, supra note 49, at A1 (quoting Edward Burkhardt, chairman of Wisconsin Central Transportation Corp.).

suggesting that it would ship freight via the Panama Canal, UP-SP has also discussed barring new shipments on its lines. These problems, at the very least, demonstrate some shippers’ dependence on railroads and their inability to switch to other carriers when service problems arise. According to a study by Bernard Weinstein and Terry Clower for the Texas Railroad Commission, the UP-SP service disruptions have cost the national economy in excess of $2 billion as of February 1998. And, significantly, many affected shippers have avoided confronting UP-SP about these problems “for fear the railroad will punish them with higher rates in the future.” The service problems related to the UP-SP merger are not unique, as Union Pacific experienced similar difficulties during its 1995 acquisition of the Chicago & Northwestern, as did the parties in the recent Burlington Northern - Santa Fe merger.

III. CURRENT STB POLICIES TOWARD COMPETITIVE ACCESS

In most industries, antitrust laws would attempt to prevent the development or entrenchment of market power, and possible subsequent abuse through the preclusion or substantial modification of mergers. Significantly, railroad consolidations are not subject to the antitrust laws, but instead are reviewed by the Surface Transportation Board (STB) under a “public interest” standard of review. Empirically, the STB and its predecessor, the Interstate Commerce Commission (ICC), have pur-

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53. See Daniel Machalaba, Union Pacific May Bar New Shipments If Problems Aren’t Solved in 30 Days, WALL ST. J., Mar. 12, 1998, at A2; see also supra note 34 and accompanying text.


55. See O’Reilly, supra note 40, at 102.


59. The “public interest” standard is congressionally mandated. 49 U.S.C. § 11324(b). Five factors guide whether this standard is satisfied in a merger application. The factors are: (1) the merger’s impact on the adequacy of public transportation; (2) the effect of including or excluding other railroads in the region from the transaction; (3) the fixed charges resulting from the transaction; (4) the interests of railroad employees; and (5) the adverse effect on railroad competition. See id.

60. The Surface Transportation Board became the agency successor to the now defunct Interstate Commerce Commission, which was abolished effective January 1, 1996. See 49 U.S.C.S.
sued a policy that favored consolidations. To remedy anticompetitive behavior, the ICC originally regulated freight pricing and other aspects of operations. However, reforms to deregulate the industry encouraged railroad firms to have independence in pricing and other service decisions. Two crucial elements of this independence which affect bottleneck shippers are the ability of a bottleneck carrier to set the interchange point and the ability to bid on a freight movement through either single-line service or in conjunction with another carrier.

At present, the STB has pursued a policy of granting mergers - even when they create bottlenecks - but imposing limited conditions on railroads as well as allowing shippers to petition for relief. The first two parts of this section discuss the tools the STB uses to regulate market abuse in bottleneck or monopoly situations. The third part of this section analyzes two recent STB cases that address competitive abuse in the railroad industry.

A. CONTROLS ON THE INTERCHANGE POINT

Prior to deregulation, a shipper was entitled to select any particular routing it wished without regard to the economic costs imposed on the railroads to maintain interchange facilities and service. This “open routing” system was characterized as one that required railroads to maintain interchanges “on practically all combinations of railroad tracks between two points.” The Staggers Act of 1980 and the Railroad Revitalization and Regulatory Reform Act of 1976 eliminated this absolute shipper right and ultimately replaced it with a limited right to petition the STB.

The ICC permitted shippers to petition the agency for three basic


61. See supra note 5.


66. See 49 U.S.C. § 10705(a). This provision grants the STB the power to establish new routings for freight movements “when it considers it desirable in the public interest.” See id. at § 10705(a)(1). The statute provides two possible scenarios for STB intervention: (1) the competition policies of the Staggers Act are defeated or other anticompetitive behavior has occurred; or (2) other statutory criteria in 49 U.S.C. §§ 10705 or 11103 are satisfied.
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types of network access remedies that affect the routing of their freight. First, the agency could prescribe a "through route" between two or more railroads. The through route remedy establishes the interchange points at which the railroads switch traffic on their respective networks. To further allow access for shippers, the through route remedy can be supplemented with the prescription of a joint rate covering the movement as well as establishing the division of the rate.

Second, the agency has authority to permit a competing railroad to operate over the terminal portion of the network to provide service to the shipper. The agency is empowered to require the railroad firm owning the network to provide access "including main-line tracks for a reasonable distance outside of a terminal [to] another rail carrier." The STB has characterized this remedy as "full access, for a fee, permitting the non-bottleneck carrier to provide service over the lines of the bottleneck carrier and thereby complete its own single-line service." Like the through route remedy, the STB is empowered to establish the fee the tenant railroad pays to the owner of the bottleneck as well as the price that it charges the shipper.

The agency could exercise a third alternative - "reciprocal switching." Under this arrangement, a bottleneck carrier, for a fee, transports the cars of the non-bottleneck carrier over its lines to [the] destination, thereby permitting the non-bottleneck carrier to establish single-line rates for customers to which it does not have direct access. Thus, the non-bottleneck carrier can independently set a single-line rate for the movement because the switching fee of the bottleneck portion is established. When disputes occur with respect to the cost of the switching portion of the move, the STB is empowered to prescribe the terms of such agreements.

The statutes allow broad discretion in applying these remedies be-

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69. See id.

70. Section 223 of the Staggers Act, Pub. L. No. 96-448, 94 Stat. 1895 (1980), explicitly authorized this sort of operation. This section is now codified as 49 U.S.C. § 11102(a).


73. See 49 U.S.C. § 11102(a).

74. See id. § 11102(c)(1).

75. See 49 U.S.C. § 11102(c)(1).
cause the STB may impose them when it is in “the public interest.”76 While these remedies suggest significant regulatory discretion, the STB has interpreted the “public interest” standard more narrowly, deciding that the goal of allowing railroads to “rationalize their route structures making maximum use of efficient routings and eliminating others” was of greater importance.77 According to the STB, the access remedies were crafted to provide relief when a bottleneck carrier with market power provides inadequate service or forecloses more efficient service from a competing firm.78 Thus, a railroad firm’s refusal to voluntarily establish a through route is insufficient to establish a case for an access remedy.79

The STB has recognized that a bottleneck carrier can maintain control of the bottleneck portion of the movement “unless it can be shown that the alternative routes sought are more efficient, or that the carrier[] has exploited [its] market power by providing inadequate service.”80 Under STB regulations, the agency considers “all relevant factors” in

76. Each remedy has a similar “public interest” standard of application. The STB is permitted to impose through routes when “it considers it desirable in the public interest.” See 49 U.S.C. § 10705(a)(1). It is permitted to impose actual direct access to the non-bottleneck carrier when it is “practicable and in the public interest without substantially impairing the ability of the rail carrier owning the facilities or entitled to use the facilities to handle its own business.” See 49 U.S.C. § 11102(a). Similarly, the STB may impose reciprocal switching arrangements when “practicable and in the public interest.” See id. at § 11102(c)(1).

77. See Central Power & Light Co. v. Southern Pac. Transp. Co., Fin. Docket No. 31242 at 6 (quoting Interchange Provisions at Jacksonville, Fla., 365 I.C.C. 905, 916 (1982)). However, in merger proceedings, the STB uses a more liberal “public interest” standard in granting competitive access relief to petitioning shippers. See UP-SP, supra note 47, at *140-41.

78. In Central Power & Light Co., the STB repeatedly indicated the importance of this market abuse or inadequate service requirement in order to obtain relief. See Central Power & Light Co. v. Southern Pac. Transp. Co., Fin. Docket No. 31242, at 6-7 (Surface Transp. Bd. Dec. 27, 1996) (a shipper must demonstrate that the bottleneck carrier “has used its market power to extract unreasonable terms on through movements, or, because of its monopoly position, has shown a disregard for the shipper’s needs by rendering inadequate service” (quoting Midtec Paper Corp., 3 I.C.C.2d at 181)).

In a fairly new development related to the UP-SP service crisis, the STB has also approved the use of these remedies “to provide temporary relief from serious, localized railroad service problems more quickly and effectively.” See Expedited Relief for Service Inadequacies, Ex Parte No. 628, 1998 WL 887188, at *2 (Surface Transp. Bd. Dec. 21, 1998). The agency’s decision to grant such relief is not premised on competitive considerations, but instead is based on a determination that “over an identified period of time, there has been a substantial, measurable deterioration or other demonstrated inadequacy in rail service provided by the incumbent carrier.” See 49 C.F.R. §§ 1146.1(a) & 1147.1(a). Relief is available only when a shipper is able to obtain a commitment from another railroad to provide service and, once the incumbent can demonstrate that it can provide adequate service again, the relief ends. See 49 C.F.R. §§ 1146.1(b)(1)(C) & (d)(1), 1147.1(b)(1)(C) & (c)(1). The effectiveness of these remedies to ameliorate the impact of a service breakdown remains untested.


80. See id.
making such determinations. The STB claims that it is “attentive to the ‘classical categories of competitive abuse’ that could produce such a result, including foreclosure, refusal to deal, or other ‘recognizable forms of monopolization or predation.” In crafting a remedy, the STB also considers operational and service criteria, such as the comparative efficiency of routings. These factors further temper the application of competitive access remedies, even in light of clearly anticompetitive behavior by a bottleneck carrier.

Each remedy option provides a distinct level of intrusiveness on the bottleneck carrier’s operations. This variation can be seen as a progression, from the through route remedy where the bottleneck carrier must accept another carrier’s freight at a specified interchange point, to terminal trackage rights where the non-bottleneck carrier directly operates over the bottleneck carrier’s network. The STB approach to considering all factors results in the assessment of the least intrusive remedy against a bottleneck carrier. Therefore the STB is more likely to prescribe a through route, rather than reciprocal switching or terminal trackage rights.

B. Price Ceilings

Price controls regulating maximum freight rates are closely tied to the three access remedies described above. During the 1970s, the ICC regulated freight pricing heavily, employing a policy of “rate equalization.” Under rate equalization, the cost of shipping freight between two given points are the same on each competing network, regardless of the actual efficiency of each routing. In combination with the open routing practices described above, the ICC sought to “preserve the widest possible network of through routes in order to protect disadvantageously located shippers, and apparently viewed price competition on routes between the same two points as a form of improper ‘discrimination.’”

81. See 49 C.F.R. 1144.5(a)(1).
83. See id.
84. See Vista Chem. Co. v. Atchison T. & S.F. Ry., 5 I.C.C.2d 331 (1989) (reciprocal switching); Shenango, Inc. v. Pittsburgh, C. & Y. Ry., 5 I.C.C.2d 995 (1989), aff’d sub nom., Shenango, Inc. v. I.C.C., 904 F.2d 696 (3d Cir. 1990) (terminal trackage rights). When rejecting an argument that Congress intended reciprocal switching to be prescribed more frequently, the Midtec court said, “If Congress intended any disparity in [the Board’s] discretion to deny these remedies, . . . it would almost certainly have been making reciprocal switching less rather than more available [than through routes].” See Midtec, 857 F.2d at 1501.
86. See supra note 63 and accompanying text.
87. See Baltimore Gas, 817 F.2d at 110-11.
This policy of rate equalization was abandoned after the reforms. Instead, “rate reasonableness” review was established which relied on the actual costs of the network. A shipper may petition the STB with respect to the rate reasonableness of a particular freight movement. Congress has fixed a universal benchmark for rate reasonableness claims. Congress must show that the rate it charges “results in a revenue-variable cost percentage for such transportation that is less than 180 percent.” The ICC interpreted this benchmark as a guideline that did not necessarily trigger a finding that a rate is unreasonable.

Subsequent adjudication has led the STB to determine whether rates are unreasonable by using constrained market pricing theory. Constrained market pricing theory examines the extent to which a firm may leverage prices on captive customers. The STB has recognized three possible approaches to apply constrained market pricing theory. In one approach, the stand-alone cost method, the shipper develops a hypothetical railroad and “calculate[s] the revenue requirements . . . to provide the rail service needed . . . free from costs associated with inefficiencies and free from cross-subsidies of other traffic.” Using the data from this method, the STB then compares actual freight rates to determine whether they are excessive. Constrained market pricing theory may yield results that can justify a railroad’s charges, even if they are substantially above the congressional benchmark.

Before examining the reasonableness of the rate, the STB must determine whether the railroad is “market dominant.” Under the relevant statute, market dominance is defined as “an absence of effective competition from other rail carriers or modes of transportation.” Until very recently, the STB had considered four factors that established mar-

90. See id. Congress has also defined the components of “variable cost” in this calculation. This benchmark has remained relatively unchanged even though it was expected to be reduced as the health of the railroad industry improved. See Keeler, supra note 5, at 100.
93. The ICC recognized the following three approaches: (1) revenue adequacy; (2) management efficiency or pricing efficiency; and (3) stand-alone cost. See Coal Rate Guidelines, 1 I.C.C.2d 520, 537, 547 (1985), aff’d sub. nom., 812 F.2d 1444 (3d Cir. 1987).
94. McCarty Farms II, at *3.
95. See, e.g., id.
96. See 49 U.S.C. § 10707(b). A showing that a rate exceeds a particular level does not necessarily establish market dominance. See id. at § 10707(d)(2).
97. See id. at § 10707(a).
ket dominance: (1) lack of intramodal competition; (2) lack of intermodal competition; (3) lack of geographic competition; and (4) lack of product competition. Geographic and product competition are analogous to the source competition and product substitution concepts discussed in Section II.

However, in late 1998, the STB has modified its position, considering only two factors: lack of intramodal and intermodal competition. Railroad firms are currently challenging the modified rules, petitioning to reopen the matter and threatening to appeal to the federal courts if the agency's position remains adverse. Regardless of which factors the STB will ultimately consider, market dominance is an affirmative defense, and it is incumbent on the responding railroad to present convincing evidence on any one of the four factors in order to avoid rate reasonableness review.

The STB’s authority to review freight rates is limited to rates that the parties have not set by contracts. When a shipment is moved under a combination of a contractual agreement and a rate set by the STB, rate review extends only to the non-contractual portion of the movement. Outside of the limited exception for a combination of contract and non-contract movement of freight, a shipper can request review of only the entire rate charged. The STB has emphasized this point, quoting from

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99. See id. at 128. The I.C.C., in defining these two concepts, has stated: Geographic competition is a restraint on rail pricing stemming from a shipper's or receiver's ability to get the product to which the rate applies from another source, or ship it to another destination. Because the shippers and receivers can do this, the railroad must compete with the railroad serving the alternate source or destination. Product competition occurs when a receiver or shipper can use a substitute(s) for the product covered by the rail rate. In that case, the railroad must compete with the railroad or other mode who carries that other product, and again, must keep its rate competitive if it wants the traffic.
See id.
103. 49 U.S.C. section 10709(c)(1) explicitly states that such contracts “may not be subsequently challenged before the Board or in any court on the grounds that such contract violates a provision [of the rate reasonableness statutes and regulations].” 49 U.S.C. § 10709(c)(1) (1994).
105. See id. at 12. The STB has emphasized this point with regard to the relevance of contracts in various disputes. The STB has explained that in “competitive access” cases, i.e., those cases involving a request by a shipper or railroad firm to obtain a through route, reciprocal switching or terminal access, “a contract may be used by a shipper to demonstrate that a connecting carrier should be required to provide competitive service.” See id. at 13 n.23. However,
an earlier United States Supreme Court case that said: "The shipper’s only interest is that the charge shall be reasonable as a whole." In a recent ruling, the STB concluded that this approach “has continuing vitality.”

C. APPLICATION OF THE COMPETITIVE ACCESS CASES

When these access remedies are construed narrowly and combined with a very onerous standard of federal appellate court review, it is unsurprising that many shippers have felt that the “deck is stacked against [them]” in obtaining regulatory relief. A review of the STB’s application of these principles in two recent cases supports this perception.

The first, *Central Power & Light Co. v. Southern Pacific Transportation Co.* was a consolidated case that involved three different shippers and fact patterns. The first shipper, Central Power & Light (CP&L), opened a new generating facility in Coleto Creek, Texas, which could burn low sulfur coal mined from Wyoming’s Powder River Basin. Southern Pacific (SP), whose railroad network did not extend to the Powder River Basin, provided exclusive service to CP&L. CP&L sought to obtain a rate on the SP network to the nearest interchange points with carriers who had direct access to the Powder River Basin coal mines and then sought to contract separately with those parties for that portion of the movement between the interchange point and the mine. SP refused to provide such a rate and CP&L petitioned the STB to prescribe a rate for the bottleneck portion of movement on the SP network.

The second shipper, Pennsylvania Power & Light (PP&L), owned the STB notes, “In a rate case, review of the through rate would indeed subject the contract to regulation.” See *id.* Other older ICC decisions emphasize that rate relief is generally allowed only for the entire freight movement. See, e.g., *BN-SF, supra* note 10, at 76 (quoting *Union Pacific R.R. Co. v. Control-Missouri Pac. R.R. Co.*, 366 I.C.C. 462, 538 (1982)).

106. See *CP&L, supra* note 5, at 12 (quoting *Great Northern Ry. v. Sullivan*, 294 U.S. 458, 463 (1935)).

107. See *id.* at 13 (citing *Metropolitan Edison Co. v. Conrail*, 5 I.C.C.2d 385 (1989)).

108. See, e.g., *Western Resources, Inc. v. Surface Transp. Bd.*, 109 F.3d 782 (D.C. Cir. 1997) (examining “substantial evidence” standard of review for STB’s findings of no anticompetitive effects from merger); *Midtec Paper Corp.*, 857 F.2d at 1496-97 (federal appellate court will overturn an agency’s interpretation of an ambiguous statute only if it is unreasonable).


four power stations served exclusively by Conrail. While PP&L originally received coal from mines in Pennsylvania, also served by Conrail, it sought to contract with mines that provided low sulfur coal in Kentucky and West Virginia served by other carriers. In earlier proceedings, the ICC prescribed a through route for access to the other mines. However, PP&L petitioned the STB to challenge the rate reasonableness of the bottleneck portion of the service at the established interchange points or, alternatively, to provide a local rate for the bottleneck portion of the movement.

The third shipper, MidAmerican, owned a power plant in Iowa that was served exclusively by Union Pacific (UP). UP provided single-line service to the shipper, delivering coal from mines in the Powder River Basin to MidAmerican under a contract set to expire in 1997. Anticipating the expiration of the contract, MidAmerican sought to obtain a local rate for coal movements to the plant from an interchange point with a competitor. MidAmerican then sought to bargain separately with the competitor for the competitive segment of the movement. UP denied MidAmerican’s request and MidAmerican then petitioned the STB for prescription of a local rate.

The shippers argued that they could request a rate reasonableness review for bottleneck portions of a freight movement. The shippers tried to support their position by suggesting that their freight moved on “two journeys,” one over a competitive segment and then a localized bottleneck movement. A shipper could then subject the bottleneck portion of the movement to separate review as a “local rate.” The shippers relied on two previous United States Supreme Court cases that suggested that such a division of rates was permissible in certain circumstances.

However, the STB rejected each of the petitions and distinguished the facts of each case the shippers had brought forward. It concluded that CP&L failed to demonstrate that SP was providing inadequate service or that SP was exploiting its market power to trigger the competitive access remedies. The STB also rejected PP&L’s application to the extent that it could challenge the through route rate only over the entire

111. See id. at 2.
112. A local rate is “a rate for transportation originating and terminating on the carrier’s line.” See id. at 2 n.3.
113. Great N. Ry. v. Sullivan, 294 U.S. 458 (1935) arose out of a dispute involving a Canadian published tariff rate that was outside the ICC’s jurisdiction. Under these facts, a rate reasonableness analysis was applied only to the U.S. portion of the movement. The other case, Atchison, Topeka & Santa Fe Ry. v. United States, 279 U.S. 768 (1929) involved a dispute between railroads where one firm alleged that it was being foreclosed from using an established through route.
portion of the movement and could not seek a local rate prescription for the bottleneck segment. The STB also denied MidAmerican's petition on grounds substantially similar to the other shipper petitions. Finally, the STB bolstered its disposition of the MidAmerican petition on ripeness grounds since the contract with UP had not yet expired.

As the fact patterns of Central Power & Light indicate, the STB has avoided an approach that directly regulates the bottleneck portion of a freight movement for competitive access or rate reasonableness remedies. STB Commissioner Owen perceived the dispute in Central Power & Light as a tug-of-war "to transfer wealth from one great corporate entity to another [railroads to electric utilities] without a showing that the status quo is causing electricity rates to be higher than they otherwise would be and without a showing that there are inherent inefficiencies in the status quo."117

The woeful state of shipper redress, however, is perhaps best illustrated by the litigation in McCarty Farms v. Burlington Northern Railroad Co., which spanned approximately eighteen years. The petitioners in McCarty Farms were wheat producers in Montana that shipped much of their crop to ports in the Pacific Northwest. During the period in dispute, Burlington Northern (BN) was nearly the exclusive railroad transportation provider, serving 98 percent of all Montana grain elevators. BN controlled approximately 75 to 80 percent of the transportation market for transporting grain to these ports from Montana for the period 1981-

115. See id. at 16-17. Interestingly, the Eighth Circuit, which reviewed CP&L, relied on the agency's "considerable expertise in the economic underpinnings of the railroad industry" to affirm the decision. See MidAmerican Energy Co. v. Surface Transp. Bd., No. 97-1081, 1999 WL 60501, at *6 (8th Cir. Feb. 10, 1999).


117. See id. at 19 (Commissioner Owen, commenting). Commissioner Owen believed that "[t]he economic benefits of fewer railroads, coupled with deregulation have been enormous and largely shared with railroad customers." See id. However, these shippers now "complain that they want an even bigger share" of the savings even though they have considerable competitive options that place caps on market exploitation. See id. at 20. At the same time, Commissioner Owen apparently conceded that railroads were no longer revenue inadequate. See id. at 19.

With respect to the electric industry, Commissioner Owen observed that 55 percent of the nation's electricity is generated from coal and that somewhat over half of that coal was moved by railroad. Commissioner Owen also alluded to a new competitive option for electric utilities to "wheel" power on the wholesale market. Presumably, this option will allow utilities who have lower shipping rates to transmit power to other utilities facing steeper shipping costs. Wheeling power then acts as a form of intermodal competition. See id. at 20.


Based on this evidence and other evidence showing a lack of geographic and product competition, the ICC concluded that BN was market dominant.\textsuperscript{121} Despite the congressional benchmark setting the revenue-variable cost ratio at 180 percent, the ICC concluded that a reasonable benchmark in this case would be approximately 230 percent by obtaining data of comparable grain movements during the period in question.\textsuperscript{122} Nonetheless, using this elevated benchmark, the ICC found that rates in certain years were excessive. After a subsequent reversal and remand from a federal court, however, the STB used the stand alone cost method to determine the reasonableness of BN's rates. The STB concluded that the McCarty Farms stand-alone cost hypothetical railroad had a "cumulative shortfall in revenues" and that BN's rates were not unreasonable "[b]ecause the revenues that would be collected from the shipping group would not be sufficient for the [hypothetical] carrier."\textsuperscript{123} Prior to this final STB decision, the McCarty Farms case was used as a model of an effective example of market dominance and unreasonable rates.\textsuperscript{124}

**IV. ALTERNATIVE POLICIES TO INJECT COMPETITION**

This section discusses three regulatory reforms that could better protect shippers from anticompetitive behavior stemming from bottleneck control: (1) divestiture; (2) enhanced price regulation and open routing reforms; and (3) various forms of mandated open access of the national railroad network. Before delving into these options, the burdens associated with escalating the level of regulation is examined.

**A. THE ROLE OF REGULATION**

Other regulations that enhance competition provide a means of offsetting the undesirable effects of deregulation. However, the cure may often prove worse than the disease, especially in situations where increased regulation imposes administrative costs for the regulatory agency and regulatory costs for the industry. Burdensome regulatory policies in the 1970s played a significant role in the financial decline of the railroad industry.\textsuperscript{125} Economists generally agree that extensive re-regulation would saddle the railroad industry's ability to compete with other modes

\textsuperscript{120} See id. at 830.
\textsuperscript{121} See id. at 837-39.
\textsuperscript{124} See Wilson, supra note 8, at 58-62.
\textsuperscript{125} See, e.g., Keeler, supra note 5, at 96.
of transportation.\textsuperscript{126} Therefore, regulators need to carefully assess the regulatory tools available to them to minimize the burdens on the industry while encouraging the benefits of robust competition.

Regulators will invariably consider the effects of such policies on shippers and railroads. As one commentator has observed with respect to deregulating the gas industry and allowing some customers to "bypass" traditional service providers:

Changes in regulatory policies create winners and losers. In particular, competitive entry may improve the position of large industrial customers seeking to bypass the regulated utility while creating losses for captive customers who face higher prices after entry. Policymakers inevitably compare gains and losses, weighting them on the basis of various considerations, including the preferences of regulators, the political influence of the winners and losers and the ability of market participants to communicate with the regulators. If bypass leads to a price increase for captive customers and a price drop for switching customers, the regulator must evaluate the welfare effects in formulating regulatory policy toward entry.\textsuperscript{127}

This regulatory calculus is further complicated by rail labor - a third interest group affected by competitive access reforms.\textsuperscript{128} Rail unions will most actively oppose regulatory reforms that are perceived as policies that adversely affect employment levels or working conditions.\textsuperscript{129} Access

\textsuperscript{126} See Woodman & Starke, supra note 67 at 290. See, e.g., Ordover & Pittman, supra note 110, at 275 ("tighter regulation in the United States in the past . . . brought many railroads to bankruptcy."); Tye, supra note 10, at 216 (a goal of railroad regulators should be to "minimize the scope of regulatory intervention").


\textsuperscript{128} While the rail workforce has decreased significantly, rail unions still remain well organized with the ability to reshape regulatory outcomes that would otherwise benefit railroads and shippers. See Rip Watson, \textit{Rail, Unions Unite To Deflect Shippers}, J. Com., Feb. 1, 1999, at 1A. In the 1993-94 election cycle, rail unions contributed $1,929,507 to House and Senate campaigns throughout the country. Union contributions exceeded contributions from railroads. See David Barnes, \textit{Where the Money Flows}, \textit{Traffic World}, June 19, 1995, at 8.

In addition to rail labor, other interest groups, such as railroad industry suppliers or trade groups representing competing modes of transportation, may also seek to influence regulatory outcomes to their perceived benefit. For example, one trucking industry trade group has sought to have an impact on potential railroad competitive access reforms before Congress. See Frank N. Wilner, \textit{Truck-Rail War Looms}, \textit{Traffic World}, Feb. 22, 1999, at 12. However, such groups may play a less influential role than labor, shippers and railroads, because their interests are less directly affected by policy changes.

\textsuperscript{129} For example, labor unions were active in challenging recent STB policies that curtailed certain benefits that employees enjoyed if their railroad employer was the target of a takeover. See Association of American Railroads v. Surface Transp. Bd., 162 F.3d 101 (D.C. Cir. 1998).
reforms are sufficiently amorphous in their impact on rail labor that they may provoke support or opposition. For example, divestiture and open access may be viewed positively because such reforms would create employment opportunities in the new firms that may enter the market to compete with incumbents. Rail labor may be less receptive if these reforms are perceived as worsening working conditions or displacing unionized workers of the incumbent railroads with a non-unionized workforce of the new entrants.130 Rail unions appear to have embraced the latter view.131 With respect to rail labor unions, regulators will face pressure to weigh the economic benefits of competition against labor impacts on unions.

Reforms encouraging competitive access will inevitably affect these parties differently and will require a careful consideration of these impacts. However, injecting competition into the industry eliminates the dead-weight loss to society associated with monopolies and creates greater efficiency in the industry. Pursuing a policy of efficiency should improve social welfare as shippers pass their cost savings to consumers.132 While using regulatory tools to guide the market toward efficiency may seem counterintuitive, successful policies to spur or preserve competition have often required government intervention. In their roles as antitrust regulators, for example, the U.S. Department of Justice and the Federal Trade Commission have attempted to preserve competition in the marketplace.133 While some role in policing the market improves social welfare through enhanced efficiency, the appropriate extent of antitrust regulation and an optimal regulatory policy for the railroad industry that avoids over-regulation remain contentious issues.134

B. DIVESTITURE

In retrospect, some mergers have increased bottleneck problems and

130. In the European Union, rail labor has become opposed to access reforms, fearing that unionized employees of state railways will lose their jobs to non-unionized workers. See Aviva Freundmann, Strikes in EU Protest Railroad Competition Plan, J. Com., Nov. 24, 1998, at 12A.
131. See Watson, supra note 129, at 1A.
132. Shippers who are competing against other firms in their respective industries have incentives to pass these costs off to consumers unless regulations or other factors preclude competition. See, e.g., Richard A. Posner, Economic Analysis of Law 7-10 (1986).
133. See United States Department of Justice & Federal Trade Commission, supra note 39, at 1-3.
134. See Robert H. Bork, The Antitrust Paradox: A Policy at War with Itself 10-11, 20-21 (1978); Posner, supra note 133, at 265-96. Posner emphasizes that antitrust policy should primarily police inefficient behavior. However, antitrust enforcement may play other important roles, including reducing economic concentration and corporate influence over the political system. See, e.g., Harlan M. Blake, Conglomerate Mergers and the Antitrust Law, 73 Colum. L. Rev. 555, 575-78 (1973).
failed to deliver better service or increased efficiency. A policy of selective divestiture of certain railroad lines to create competing networks offers one solution to alleviate competitive concerns. Such a policy recognizes that many railroad mergers may benefit consumers or fail to raise competitive concerns in many instances. And, such a policy may encourage mergers that enhance competition. For example, the recent Norfolk Southern and CSX acquisition and division of the Conrail network has created two competing railroad networks linking the Northeastern states with the Midwest, replacing a single firm.

However, logistical problems may plague the effective implementation of divestiture policies. As railroad networks have consolidated, they have shed substantial portions of their track network and deferred maintenance on other portions, especially in the case of mergers involving parallel lines. In many instances, effective divestiture would tax substantial resources in simply rebuilding abandoned lines or improving existing secondary lines that would provide competition. Existing railroads face similar capacity and logistical problems from shedding too much trackage. In divestiture situations, the issue of who should pay for the restoration of the network also exists.

In addition to the high costs involved with rebuilding a network, divestiture also raises the challenge of recreating corporate entities that were merged out of existence several years ago. The lack of institutional knowledge of operations for these newly independent lines would create logistical problems unless other more experienced railroad operators assumed control of the lines. Because of the significant number of railroad mergers, few major railroads remain that have experience in large-scale

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135. The implementation of the UP-SP merger illustrates this point. See supra notes 52-56 and accompanying text.

136. Some investors have questioned the wisdom of this merger because of the high acquisition price. The merger was the result of a bidding war, where Norfolk Southern and CSX Transportation agreed to split Conrail’s assets rather than allow either to acquire it entirely. See Daniel Machalaba, Conrail’s Breakup Plan Is Released by Norfolk Southern, CSX Corp., WALL ST. J., Apr. 9, 1997, at B4. See also Stephen R. Klein, Transportation: Commercial, Standard & Poors Industry Surveys, July 17, 1997, at 3. Interestingly, the proposal to divide Conrail has the effect of undoing another poorly crafted merger: the Penn Central merger which combined two significant competing networks in the 1960s. See Daughen & Binzen, supra note 40, at 67-68.

137. Dempsey has observed this trend since the early 1980s. See Dempsey, supra note 62, at 568. As a recent example, the current plans to split Conrail also involve the elimination of “redundant” tracks. See Klein, supra note 137, at 3.

138. For example, in 1989, Burlington Northern decided to abandon parallel trackage that linked the Tacoma and Seattle, Washington areas to the Cascade Mountains. This segment of trackage linked a route that reached the Midwest. When capacity problems plagued Burlington Northern’s other track segment, it decided to reopen the trackage in 1996. The cost of rebuilding the 77.9 mile mountain crossing was estimated at $125 million. See Bruce Kelly, The Thunder Returns to Stampede Pass, TRAINS, Nov. 1997, at 40.
operations, and even fewer have the operating knowledge of the region where independent operations are to be restored. Moreover, for these new entities or operators to succeed, they must be able to be competitive relative to their larger rivals. This could require access to a track network larger than the bottleneck or monopoly segments.

Regulators would also have to monitor other circumstances surrounding the implementation of a divestiture scheme carefully. The timing of the sale could alter the competitive position of any newly divested firm. The choice of buyers for the new entities is also an important consideration. An incumbent firm may attempt to weaken its divested rival by selling the divestiture assets to a competitively weaker buyer or selling during an unattractive time. These basic monitoring issues have been problematic in previous divestitures of other industries.

As operating problems persisted on UP-SP, the STB considered limited divestiture to alleviate competitive and service problems in the Houston, Texas, area. However, the STB ultimately rejected all divestiture schemes because service levels began improving on UP-SP. The board also concluded that the merger had not spawned anticompetitive conduct that would justify divestiture. In spite of the STB inaction, UP-SP has voluntarily coordinated operations and has even allowed joint ownership of certain facilities to limit the impact of its recent service difficulties. In the short term, these changes will probably not alleviate the service problems UP-SP has encountered since its consolidation, although it might enhance competition in the long run.

The limited scope of the STB proceedings with respect to a UP-SP divestiture in portions of Texas perhaps reflects the practical considerations discouraging divestiture. In short, the difficulties in determining which areas are adversely affected by competition, in allocating costs for rebuilding abandoned or ill-maintained trackage, and in determining the scope of a divested firm’s operations require significant regulatory intervention. Moreover, while divestiture may limit the competitive problems

139. East of the Mississippi River, two major systems will remain after the Conrail consolidation: CSX Transportation and Norfolk Southern. West of the Mississippi, BN-SF and UP-SP remain. There are also a few regional railroads that are dwarfed by the major networks, such as Wisconsin Central, Illinois Central and Kansas City Southern. See also supra note 5.

140. An internal study conducted by the Federal Trade Commission has raised these concerns in examining the effectiveness of previous divestitures. See George S. Cary & Marian R. Bruno, Merger Remedies, 49 ADMIN. L. REV. 875, 876-77 (1997).


associated with bottleneck control, it is unlikely to eliminate every bottleneck situation.

C. Regulation of Rates and Choice of Interchange Point

Over the years, shippers have advanced proposals, such as creating easier access for reciprocal switching, terminal facilities, or joint rates to encourage greater competition.\textsuperscript{144} Shut out from the STB, shippers are again petitioning for relief from Congress.\textsuperscript{145} The latest incarnation of these reform efforts is the Railroad Competition and Service Improvement Act of 1999 pending before Congress that seeks to “ensure reasonable rail rates for captive shippers.”\textsuperscript{146} Among other things, the proposed bill overturns Central Power & Light in favor of shippers. It permits a shipper to request a rate for any two points of a movement “where traffic originates, terminates, or may reasonably be interchanged” without regard to “whether the rate established is for only part of a movement between an origin or destination” or “whether the shipper has made arrangements for transportation for any part of that movement.”\textsuperscript{147}

The proposed bill extends STB rate review even if the parties have contracted for some form of service as long as the shipper is seeking a rate that does “not apply to transportation covered by such a contract.”\textsuperscript{148} In addition, the proposed bill supports the STB’s most recent position and prohibits consideration of “evidence of product or geographic competition in making a market dominance determination . . . .”\textsuperscript{149} The proposed bill also remedies many of the barriers agricultural shippers have faced in cases like \textit{McCarty Farms}.\textsuperscript{150} However, it does not address the appropriate measure for establishing the reasonableness of rates, which currently appears to be the stand-alone cost method used in \textit{McCarty Farms}.\textsuperscript{151}

\textsuperscript{144} For example, Woodman and Starke analyzed a bill that was proposed in 1987. See Woodman & Starke, supra note 67, at 282-90. See also The Railroad Shipper Protection Act, S. 1429, 105th Cong., § 5 (1997) (the most recent failed bill seeking shipper relief).

\textsuperscript{145} While many shippers seek reforms, they are not a monolithic group. Many shippers disagree on the appropriate approach and form of any remedial legislation. See Rip Watson, \textit{Rail Reform Uncertainty Remains as Sides Differ}, J. COM., Jan. 27, 1999, at 1A; Rip Watson, \textit{Rail Group Ponders Approaches To New Congress on Competition}, J. COM., Nov. 12, 1999, at 1A.

\textsuperscript{146} One group, however, plans to use the failed bill as a model for the new one. See Rip Watson, \textit{Shippers Seek CURE for Rail Competition Ills}, J. COM., Feb. 10, 1999, at 1A.

\textsuperscript{147} See S. 621, 106th Cong., § 2(3) (1999).

\textsuperscript{148} See id. at § 5.

\textsuperscript{149} See id. at § 5.

\textsuperscript{150} See id. at § 6. Section 6 shortens the length of proceedings, lowers the cost of filing an action, simplifies rate reasonableness review, and creates service obligations on railroads for captive grain shippers that ship fewer than 4,000 cars annually.

\textsuperscript{151} See McCarty Farms v. Burlington N., Inc., Fin. Docket No. 37809, 1997 WL 472908 at *3
Injecting Competition in the Railroad Industry

The adoption of such proposed reforms would effectively regulate all bottlenecks for rate reasonableness and allow greater routing freedom for shippers. The Association of American Railroads (AAR), a trade group that represents the major railroads in North America, submitted comments in Central Power & Light which suggested that bottleneck shippers constituted a substantial traffic base of the major railroads. Moreover, the AAR’s experts estimated that enforcing price ceilings on bottleneck movements, like the reforms envisioned in the failed legislation, would reduce annual industry-wide revenues by $1.5 to $2.4 billion.

Reforms of this type will also impose administrative costs. In the short term, the reforms would increase the number of cases the STB would have to resolve. However, once a growing body of administrative decisions shapes the extent of shipper relief, these costs would probably decrease.

Such reforms may also harm the railroad industry. The reforms return railroad policy closer to an “open routing” and “rate equalization” system. Critics of such regulations allege that they effectively limit the ability of railroads to differentially price commodities. One critic has argued:

Any mandated reduction in rates for a specific commodity would have a destructive effect on the rail carriers’ ability to differentially price. Any such mandated reduction would require rail carriers to increase rates on other traffic. As a result, traffic subject to intermodal competition would shift to other transportation modes where it could move at lower rates, leaving the rail carriers with less market share and decreased sources of revenue to cover their costs. Any contribution made by those shippers to capital and


153. See id., at 12, n.21.

154. Posner’s general observations that the force of precedent in the adjudicative process is illustrative. See Posner, supra note 133, at 509-15. As precedent builds in an area of law, it “reduces the costs of litigation by enabling the parties to a case, and the tribunal also, to use information that has been generated . . . in previous cases.” Id. at 515.

155. See Baltimore Gas & Elec. Co. v. United States, 817 F.2d 108, 110 (D.C. Cir. 1987); See also supra note 63 and 86-88 and accompanying text.

operating costs would be lost, forcing carriers to make up that shortfall through rate increases on the remaining traffic to the extent competitive pressures permit. The ultimate effect would be a loss of the ability to differentially price rail service, resulting in rate increases, lost traffic, decline in revenues, lost jobs and deterioration in service . . . 157

However, a profit-seeking firm would not provide transportation for freight that does not generate additional profits, relying on other captive shippers to subsidize this traffic. Instead, a railroad would decline to offer or provide services that face excessive levels of competition.158 However, this critique does have force to the extent that railroads have returns to density.159 Intuitively, this conclusion seems reasonable since railroads require massive fixed costs to establish a functional right-of-way. Once these costs are paid, the railroad simply incurs the variable costs associated with moving freight up to the physical capacity of the network.160 Thus, a railroad has incentives to price differentially to the extent it can obtain from captive shippers a greater share of fixed costs in order to pursue other traffic as long as it provides revenues in excess of variable cost and there are no capacity constraints in adding more freight.161 In this manner, the firm can acquire an optimal mix of traffic.

The validity of this critique rests on two important assumptions.

157. See id. In criticizing the shipper petition for relief in Central Power & Light, the AAR also provided a grim forecast of the effect of such remedies. The AAR contended that railroads will substantially curtail capital expenditures and that the industry will begin to decline less profitable intermodal traffic, so that trailers and shipping containers "would be driven back onto the highway" rather than on trains. See Association of American Railroads, supra note 153, at 21-22.

158. See, e.g., Jim Giblin, Making Rail Intermodal Profitable, TRAINS, July 1998, at 64, 66 (describing Santa Fe's decision to abandon Chicago to Denver routing of intermodal traffic for cost reasons).

159. See Douglas W. Caves, et al., Network Effects and the Measurement of Returns to Scale and Density in the Railroad Industry, in Analytical Studies in Transport Economics 97-120 (Andrew F. Daughety, ed., 1985) [hereinafter Caves et al., Network]; Douglas W. Caves, et al., Productivity Growth, Scale Economies, and Capacity in U.S. Railroads, 1954-74, 71 AM. ECON. REV. 994 (1981) [hereinafter Caves et al., Productivity]. Caves et al., have described returns to density as "the proportional increase in output made possible by a proportional increase in all inputs, with network and input prices held fixed." See Caves et al., Network, supra, at 100. Returns to density should not be confused with returns to scale, which they define as a "proportional increase in both output made possible by a proportional increase in all inputs, with input prices fixed." See id. They conclude that the industry does have returns to density, but not returns to scale. See id. at 109-10, 112.

160. In economic terms, variable cost is defined as a cost directly related to output, increasing as output increases. See Paul A. Samuelson, Economics 464-66 (9th ed. 1973).

161. Baumol and Willig described the need for differential pricing in Central Power & Light by noting that

with vigorous competition in the non-bottleneck portion of an end-to-end railroad service, market forces can be relied upon to drive the prices of that portion of the rail service toward incremental cost. If the revenues attributable to the related bottleneck service are not allowed to cover more than the purported stand-alone costs of the bot-
First, it assumes that railroads are unable to price their services differentially. Railroads may still use differential pricing until reaching the price ceiling. Even if shippers have open routing and some form of rate equalization, railroads may raise their rates on competitive segments of the line to shippers of certain commodities that are traditionally considered "captive," like coal shipments, to recover a greater contribution of their fixed costs rather than at the bottleneck. This pricing strategy would equalize rates across commodity groupings, treating bottleneck and non-bottleneck shippers similarly. Second, this critique assumes that the price ceiling placed on the STB's rate reasonableness review is so low that it prevents any discriminatory pricing practices. The resolution of the McCarty Farms case demonstrates that the price ceiling on rate reasonableness is relatively high and underscores the need for limiting the upper bound of rates because of the limited competitive options many shippers face.162

The Canadian experience also undermines criticism of such reforms. In the late 1980s, Canada adopted similar legislation to counteract other deregulatory measures.163 The regulations apply to shippers who have access to only a bottleneck carrier at either the origin or destination.164 The regulations permit shippers to request a "competitive line rate applicable to the movement of the traffic between the point of origin or destination, whichever is served exclusively by the local carrier, and the nearest interchange with a connecting carrier."165 Thus, a shipper may "designate the continuous route for the movement of the . . . traffic."166 This relief is subject to certain restrictions, including a cap on the length of the bottleneck portion and consent from the connecting carrier to provide service.167 Such relief is available to all shippers, except for intermodal shippers, unless their traffic originates or terminates in a port.168 The
longevity of such reforms and the present strength of the Canadian railroad industry suggest that the dire consequences propounded by critics of such reforms may be exaggerated. However, the benefits of the regulations also remain unclear.

D. MORE RADICAL REGULATORY REFORM: OPEN ACCESS

Railroad firms provide two distinct services: they maintain track networks and operate trains. By "unbundling" these services, firms could "rent" railroad trackage for their operations without owning a network, while other firms may simply own the right-of-way, renting it to operators, without moving any freight. Open access would foster the most direct form of competitive access. Just as truckers pay for their highway usage, tenants of the track network would operate over something akin to a system of private toll roads, paying according to their usage.

Conceptually, such an arrangement is not far removed from the present state of the industry. Joint use of facilities and equipment coordination are not uncommon in the industry and have deep historical origins. United States v. Terminal Railroad Association provides an excellent example of directly mandated joint use of facilities. The Terminal Railroad Association represented a collective of railroads that owned terminal trackage in St. Louis, Missouri. Twenty-four railroads converged on St. Louis, terminating in an equal proportion west and east of the Mississippi River, but none crossed the river. The association controlled the only two toll bridges that crossed the river and connected the movement of trailers on flat cars, containers on flat cars or less than carload traffic, unless they arrive at a port in Canada by water for movement by rail or by rail for movement by water." Id. at § 131(3).

169. In the mid-1990s, Canadian railroads faced competitive difficulties as a result of government regulation. The subsequent adoption of the Canada Transportation Act, 1996, and the privatization of CN Rail have greatly improved the industry. Christopher J. Chipello, Canada's Freight Railroads Try to Board the Gravy Train, WALL ST. J., July 7, 1997, at B4; Rising Railway Profits Make CN, CP Shares Attractive, Analysts Say, FIN. POST, July 8, 1997, at 24.


171. See United States v. Terminal R.R. Ass'n, 224 U.S. 383 (1912). Terminal Railroad has also been recognized as the case that founded the "essential facilities" doctrine in antitrust law. See Areeda & Hovenkamp, supra note 11, ¶ 772b1, at 179.
carriers.\textsuperscript{172} Eventually, it also gained control of the terminal trackage of the only ferry line that offered rail transportation service across the river.\textsuperscript{173}

The association was effectively a monopoly in control of all bridge traffic in St. Louis,\textsuperscript{174} charging non-member railroads higher rates and increasing rates on certain shippers.\textsuperscript{175} The association enforced the higher rates by limiting membership, which was allowed only on the unanimous consent of the existing members, and by foreclosing future rivals from entering the market through the membership agreement which obligated members to forever use the association’s facilities for their traffic.\textsuperscript{176} Recognizing that efficiencies and public policy considerations favored maintaining unified terminal lines rather than having “the city . . . cut to pieces with the many lines of railroad intersecting it in every direction,”\textsuperscript{177} the United States Supreme Court elected to require open access to the terminal facilities.\textsuperscript{178} The open access remedy allowed all railroads to join the association if they wished and required nondiscriminatory pricing for any party using the terminal service. The remedy also created the opportunity for other rivals to become terminal network providers by allowing anyone in the association to use other terminal facilities in the future.\textsuperscript{179}

More contemporary examples of open access situations also exist. Trackage rights arrangements, which allow a tenant railroad to operate on a designated segment of the network paying on a use basis, represent another manifestation of joint use of a network. In the most recent wave of railroad consolidations, the STB and ICC imposed expansive trackage rights arrangements on merging parties and competing carriers to protect competition in regions adversely affected by the mergers.\textsuperscript{180} The STB has recently permitted open access on a national scale by allowing Amtrak, the nationalized passenger rail provider, to provide express service for freight on lines it rents from railroads who compete for the same traffic.\textsuperscript{181} In addition, voluntary agreements exist, although they typically in-

\begin{itemize}
\item \textsuperscript{172} See Terminal R.R. Ass’n, 224 U.S. at 395.
\item \textsuperscript{173} See id. at 394.
\item \textsuperscript{174} Significantly, as a case decided during the early part of the twentieth century, intermodal competition was not an issue in this case because it predated trucking.
\item \textsuperscript{175} See Terminal Railroad Ass’n, 224 U.S. at 406-10.
\item \textsuperscript{176} See id. at 399-400.
\item \textsuperscript{177} See id. at 403 (quoted source omitted).
\item \textsuperscript{178} See id. at 411-12.
\item \textsuperscript{179} See id. at 411.
\item \textsuperscript{180} See supra note 62 and accompanying text.
\end{itemize}
volve the coordination of the movement of freight and do not permit the tenant operator to compete with the landlord for customers on the network.\textsuperscript{182} One clear explanation for the lack of such an arrangement is that the owners of the network are better able to fully exploit their bottleneck segments without access because it would be impractical for a new firm to build a competing network.\textsuperscript{183}

Generally, open access regulation requires network owners to allow any operators to use their network on a nondiscriminatory basis, with the landlord charging itself the same cost to use the network as any other competitor.\textsuperscript{184} The key to engendering effective competition under an open access system is to ensure that landlords receive an amount of rent that encourages them to maintain the network without exploiting their ownership of the network.\textsuperscript{185} A rental rate that is set too low would encourage tenants to exploit the low rate while creating competitive burdens on the landlord. The assessment of the appropriate fee has been a contentious issue in the railroad industry where parties have often challenged the fees assessed by landlord railroads for trackage rights.\textsuperscript{186}

The general principles of open access have been endorsed in other deregulation settings, most notably in the telecommunications field. After the AT&T antitrust settlement in the early 1980s, newly created regional telephone companies, carved from AT&T, were required to provide long distance telephone companies “equal access” to local tele-

\textsuperscript{182} Numerous examples of such arrangements are provided in Massa, supra note 5, at 432 n. 104. See also, e.g., Hemphill, supra note 32, at 36-47. Another form of a track sharing arrangement is provided in the National Detour Agreement, signed by several railroads, which allow “one railroad to use the tracks of another railroad to avoid temporary service disruptions caused by construction or other unforeseen events such as derailments or natural disasters.” Jahan-shahi, supra note 171, at 29.

\textsuperscript{183} As Alfred Kahn has put it: “Mandatory interconnection becomes the logical way to ensure competition in the presence of concentrated control over nodes that cannot practically be duplicated . . . it makes sense to request railroads to make their trackage available to competitors, where nobody is going to build a new major track for over 1,000 miles.” See Alfred E. Kahn, panelist, in Exclusionary Conduct, 57 Antitrust L.J. 723, 740 (1989). And, according to the AAR’s filings in Central Power & Light, railroads have approximately $1.5 to $2.4 billion in annual revenues at stake if bottleneck segments were opened to competition. See Association of American Railroads, supra note 153, at 20.

\textsuperscript{184} See William J. Baumol & J. Gregory Sidak, Toward Competition in Local Telephony 122 (1994).

\textsuperscript{185} See id. at 97-101. Baumol and Sidak argue that the rent a tenant should pay on the network should include the economic costs associated with use, such as wear and tear on the track network, as well as the opportunity cost of allowing the operator to occupy the track when the landlord could be providing the service.

\textsuperscript{186} For example, in the UP-SP merger proceedings, the compensation for trackage rights agreements became a contentious issue. See Union Pac. Corp.—Control—Southern Pac. Rail Corp., Fin. Docket No. 32760, 1996 WL 467636, at *119-21 (Surface Transp. Bd. Aug. 6, 1996). See also Marshall & Cook, supra note 4, at 25-29 (arguing the costs associated with labor protection liability should be included in competitive access fees).
phone lines and switching facilities required to reach local customers. 187 And more recently, Congress created an affirmative duty on local exchange carriers, 188 who have historically controlled bottleneck networks - local telephone lines - to provide to "any requesting telecommunication carrier" interconnection onto the network at nondiscriminatory rates "at any technically feasible point within the . . . network." 189 The regulations also permit the local exchange carrier to charge a rate that is "based on the cost . . . of providing the interconnection or network element" and includes a "reasonable profit." 190

One observer explained the necessity of such regulations:

There is only one local exchange network today - that of the incumbent LEC [local exchange carrier]. At present, all LEC competitors are dependent on the ability to use that existing network - in part or in whole - in order to provide local exchange service comparable to the LEC. To meaningfully compete with the LEC competitors must have access to that network at the same price as the incumbent, i.e., the direct economic cost of such access. 191

These regulations allow other firms to rent capacity on the local bottleneck to provide any range of services at their cost plus a reasonable return for the network owner. Because of the nondiscriminatory element of these regulations, one local exchange provider has actually unbundled network ownership and service over the network by separating its operations. 192 However, the success of these recent open access measures remains uncertain, in part because of the novelty of the reforms and unresolved issues with respect to implementation, 193 and also in part because of legal questions. 194

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188. A local exchange carrier is "[a] provider of local transport and exchange service—the local telephone company." See BAUMOL & SIDAK, supra note 185, at 147.


193. Using the Frontier example in supra note 193, as of mid-1997, the incumbent service provider appeared to maintain in excess of 95 percent of the business in spite of open access. See Duff & Phelps Cites Poor Results in Downgrading Frontier Ratings, COMM. BUS. & FIN., May 26, 1997, at 4. However, more vigorous competition is expected as new start-up firms emerge. See Mike Dickinson, Tiny Phone Firm Plans Local Service, ROCHESTER BUS. J., Apr. 11, 1997, at 1.

194. Some debate has arisen with respect to the constitutionality of rate regulation in the telecommunications industry. The arguments center on the question of whether the Takings
Other nations have implemented varying open access strategies in the railroad industry to achieve different goals.\textsuperscript{195} For example, in the United Kingdom, government efforts to privatize the industry and encourage competition led to the creation of a firm that owns the track network and rents it to train operators.\textsuperscript{196} This open access policy has attracted foreign investment, including one U.S. firm that manages a train operator in the United Kingdom.\textsuperscript{197} Three freight operators compete under this system, with one firm maintaining an 80 percent market share; others are considering entry into the market.\textsuperscript{198} At present, the freight operators seem to be enjoying economic success and greater investment in the railroad infrastructure is occurring, although some conflicts have arisen with the entity that owns the track network over infrastructure and the appropriate rental fee.\textsuperscript{199}

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\textsuperscript{196} For example, Sweden has “separated track services and train operation into two public agencies, with the train operator paying charges for track use.” See Ordover & Pittman, \textit{supra} note 110, at 276. Competing train operators have also used the network. However, the purpose of this reform was to facilitate equalization of rail and truck carriers, and not to engender competition. See \textit{id}. In contrast, the United Kingdom’s effort to create an open access system, which is described in the text, was intended to encourage competition and efficiency over the previous national railroad system. See \textit{id}. In addition, reforms in the European Union are underway to transform the national railway systems into “freeways” open to other private operators. These reforms, however, are in their infancy. See \textit{supra} note 171. In Germany, United Parcel Service is now considering running overnight trains over state owned tracks. See \textit{UPS Will Decide Soon If Overnight Rail Service in Germany Is Feasible}, J. Com., Jan. 5, 1999, at 12A.

\textsuperscript{197} See Ordover & Pittman, \textit{supra} note 110, at 276.

\textsuperscript{198} Wisconsin Central Transportation has acquired a 34 percent stake in the English Welsh & Scottish Railway, a train operator. Interestingly, Wisconsin Central has characterized its main competitive rival as the trucking industry. See \textit{Wisconsin Cent. Trans. Corp., Annual Report} 10-13 (1997). See also Mel Holly & Nigel Harris, \textit{Britain’s Freight Rail Revolution}, Trains Mag., July 1998, at 54.

\textsuperscript{199} See Holly & Harris, \textit{supra} note 198, at 62-63.

\textsuperscript{199} See \textit{id}. at 58, 63. In a very recent decision, the British courts have limited the permissible return the track owning entity can earn. The decision will likely lower access fees to operators. See Aviva Freundmann, \textit{British Rail Owner Reined In}, J. Com., Dec. 11, 1998, at 13A.
Use of Freight Rail Lines for Commuter Operations: Public Interest, Private Property

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I. INTRODUCTION

Ask a public official with responsibility for planning the expansion of public transportation alternatives for a wish list of the top ten ways to grow efficiently. Do not be surprised to hear among those a clear explanation of how the long-standing freight rail lines that extend into the heart of the city’s downtown area are ideal for some form of rail-based transit. Now ask a freight railroad official for a list of the top ten nightmares he or she faces on the job. That list will almost certainly include the presence of passenger trains (whether long distance intercity or shorter distance commuters) on the company’s lines.

The conflict between freight and passenger operations is not new – passenger trains traditionally have had operating priority over freights. Railroads have long recognized the substantial difference in the profitability, liability exposure and customer service sensitivity presented by passengers as opposed to freight. Historically, the decrease in passenger traffic and the drain it began to place on the railroads’ ability to fulfill their freight common carrier obligations provided the railroads with a rationale to exit that side of their business. With the creation of the National Railroad Passenger Corporation (Amtrak) in 1970, Congress enabled the railroads to choose to exit the intercity passenger business altogether. Some retained commuter service, but soon that too became the province of others, usually public agencies. However, within the past ten years a resurgence of interest in commuter rail operations has caused railroads to face again the questions associated with the presence of passengers on their lines.

Faced with resistance from the freight railroads, commuter agencies looking to start new or expand existing service have struggled with the question of how to gain access to existing lines to avoid the enormous cost of corridor assemblage and infrastructure construction. The freight railroads have resisted, arguing that they should not be forced to use private property for public purposes without their consent, that increases in freight traffic following years of infrastructure rationalization have strained the available capacity of their lines, and that the presence of passengers creates an unwelcome increase in potential liability exposure.

This article reviews the history of the decline in passenger service on
traditional railroads to provide a backdrop for the examination of the questions both of the rights, if any, of commuter operators to gain access to freight lines against the owner's will, and of the obligation, if any, of freight railroads to grant that access. In some cases, existing statutory remedies can resolve the conflict between the public interest in such access and the private companies' disinterest in providing it, but other situations may require additional clarification by the U.S. Congress.

II. Passenger Services – An Historical Perspective

From the beginning of the regulation of the rail industry, Congress recognized that the railroads' common carrier obligation extended to freight and passenger services alike. In the Act to Regulate Commerce enacted on February 4, 1887 (subsequently referred to as the Interstate Commerce Act) that created the Interstate Commerce Commission ("ICC"), Congress provided the first regulation of the railroads' obligation to provide facilities for transportation of both passengers and freight, and to provide for interchange between or among the various carriers.1 This statute specifically recognized two distinct common carrier obligations – one to passengers and one to freight shippers.2 Initially, the carriers did not distinguish between commuter and long-haul or intercity passenger operations.3 They simply provided the service as required by the markets they served. Extensive commuter operations grew up around the major cities, such as Chicago, New York, Philadelphia and Boston.4 In the railroads' heyday, passenger service was available throughout the network and virtually every community was connected to the entire country by rail.

2. Id. at sections 1 ("[T]he provisions of this act shall apply to any common carrier or carriers engaged in the transportation of passengers or property . . . ."), 3(2) ("Every common carrier subject to the provisions of this act shall . . . afford all reasonable, proper and equal facilities . . . for the receiving, forwarding and delivering of passengers and property . . ."), 4 ("[I]t shall be unlawful for any common carrier subject to the provisions of this act to charge or receive any greater compensation in the aggregate for the transportation of passengers or of like kind of property, under similar circumstances and conditions . . ."), and 6 ("That every common carrier subject to the provisions of this act shall print and keep for public inspection schedules showing the rates and fares and charges for the transportation of passengers and property . . .").
3. The Interstate Commerce Act since its first enactment has recognized a distinction between commuter services provided by railroads on the lines used for freight service as well, on the one hand, and the types of service now commonly referred to as "light rail". The distinction has survived in the exclusion from the definition of "rail carrier" in the Interstate Commerce Act of "street, suburban or interurban electric railways not operated as part of the general system of transportation." 49 U.S.C. §10102(5) (Supp. II 1996).
4. In other cities, such as Los Angeles, Washington, and a host of smaller cities around the nation, interurban trolley lines fulfilled some of the same functions. As noted previously, these "interurban" services were never included within the ambit of interstate commerce.
As cars, busses and then airplanes began to whittle away at, then take enormous bites out of, the passenger market share, railroads abandoned passenger service. What began as a trickle of abandonments turned into a torrent as railroads identified corridors in which they could no longer sustain passenger service. According to a report issued by the House of Representatives in 1970, the number of passenger trains in the United States had decreased from a high of 20,000 trains in 1929. "[N]ine thousand of these had disappeared by 1946" and by 1970 "there [were] less than 500 and over 100 of these are in the process of discontinuance."

The Interstate Commerce Act set forth criteria for abandonment of passenger service, which could only occur with the approval of the ICC. As with freight service, the question the ICC had to answer "was whether continued operation is required by public convenience and necessity and whether such continued operation will not unduly burden interstate commerce." The ICC developed a set of criteria, no one of which was controlling, for determining when it would approve a passenger services abandonment, and summarized the process in a case that was decided in the midst of the avalanche of requests for abandonment authority.

The fundamental question for resolution in proceedings under section 13a(1) . . . is " . . . what effect the discontinuance of the specific train or service in question will have upon the public convenience and necessity upon interstate operations or commerce." Southern R. Co. v. North Carolina, 376 U.S. 93, 104 (1964). Among the factors this Commission considers in making such a determination are the population of the territory serviced, the use by the public of the service sought to be discontinued, other available transportation in the area, the general financial condition of the carrier involved, and the losses it suffers in providing the service. No one factor is, standing alone, dispositive. Thus, the fact that these trains are operating at a deficit is significant. By the same token, public use of, and reliance upon, this rail service is also an important consideration. Missouri Pac. R. Co. Discontinuance of Passenger Trains, 320 I.C.C. 1. (1963). The short of the matter is: we must balance public convenience and necessity against undue burden on interstate commerce. Cf. Southern Pac. Co. Discontinuance of Trains, 334 I.C.C. 159,


A. The Creation of Amtrak

The railroads’ unwillingness or inability to continue operating passenger service led Congress to recognize that a nationwide solution was required. In passing the Rail Passenger Service Act of 1970 (“RPSA”)\(^9\), Congress acknowledged that absent direct intervention the nation was faced with the immediate threat of complete curtailment of rail passenger service. Faced as we are with clogged highway traffic in our densely populated areas, and to a considerable extent with growing and uneconomic congestion in our air transportation system again particularly surrounding the densely populated areas of the country, we simply cannot afford to abandon what has established as a highly serviceable and – where properly planned – convenient form of transportation.\(^11\)

The RPSA created a new corporation, the National Railroad Passenger Corporation\(^12\) (now commonly known as Amtrak), the purpose of which was to allow the railroads the choice whether to relinquish their obligation to provide intercity passenger service. In describing the obligations that the new corporation was to assume, Congress made a statutory distinction between the long-haul intercity and the shorter haul passenger services provided by the railroads.\(^13\) “Commuter” service was coupled with “other short haul service” and defined as service “characterized by reduced fare, multiple-ride and commutation tickets, and by morning and evening peak period operations.”\(^14\) Intercity service was everything else (other than auto-ferry service).\(^15\)

A railroad that wanted to exit the intercity passenger business could enter into a contract with Amtrak and thereby be completely absolved of its obligation to provide intercity rail passenger service.\(^16\) Railroads thus

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13. The statute, in essence, added a third category of passenger service on rails: (1) the “street, suburban, or electric interurban railways”; (2) intercity; and (3) commuter. 49 U.S.C. §10102(5).
15. Id. Once a major factor in the services provided by railroads nationwide, the number of auto-ferry operations has dwindled dramatically.
16. Railway Passenger Service Act of 1970, Pub. L. No. 91-518, §401(a)(1), 84 Stat. 1327, 1334. A railroad that did not enter into a contract for Amtrak to assume the passenger service obligation on its lines faced a five year moratorium on discontinuances. After that five year period, a railroad wishing to discontinue any train was required to comply with the ICC’s §13a(1) procedures. Id., §404(a), 84 Stat. at 1336.
exiting the intercity passenger business avoided the lengthy process and uncertainty of the ICC's §13a(1) proceedings, and were freed of the long standing common carrier obligation to long distance passengers that had been confirmed in 1887 by the first version of the Interstate Commerce Act. Railroads had the choice about whether to relinquish their passenger operations to Amtrak, and not all of them did. For instance, the Southern Railway Company retained its passenger operations, but surrendered to the inevitable before the end of the decade with the last run of its signature long distance train the Southern Crescent (operating between Washington, D.C. and New Orleans) in 1978.

When Amtrak took over a railroad's passenger obligations, the railroad paid Amtrak for the privilege of being relieved of that drain on its resources. In addition, Congress recognized that even though a railroad that had left the business was unlikely ever to return, new demands for passenger service might surface and Amtrak should have the ability to initiate that new service. Amtrak was now the passenger common carrier, and even though its obligation was not absolute, it owned no right-of-way of its own to be able to fulfill that obligation. As a result, Congress granted Amtrak the power to obtain the right to operate intercity service on new routes other than those it operated when it first began providing service. Congress wanted Amtrak to negotiate first, but if that did not work Amtrak could force its way onto the subject railroad's lines. Once it won that right, Amtrak had to pay the railroads the amount the ICC determined was just and reasonable to conduct those operations. The current version of the Amtrak authorizing legislation is clear that Amtrak’s “just and reasonable” compensation to the owning railroads can not be greater than “the incremental costs” of Amtrak’s use

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17. Section 13a(1) was not repealed, only modified in various respects by RPSA. However, a railroad entering into a contract with Amtrak at the beginning was required only to provide the 30 day notice required by §13a(1) before discontinuing a train. Id.


of the railroad's facilities or of any services that railroad might provide.23 This, to Congress and to the railroads at the time, as well, was a fair trade. The railroads received a benefit from Amtrak's assumption of their burdensome passenger obligations, while Amtrak has the right to decide which of their lines it might wish to use to provide passenger service in the future, and to pay only the "incremental", not the fully allocated, cost of its presence on and use of those lines and facilities.

B. THE TRANSFER OF COMMUTER OPERATIONS TO GOVERNMENT AGENCIES

The RPSA did not provide for Amtrak to take on the railroads' commuter services, and many continued them. Conrail in Philadelphia and the northern New York City suburbs, the Boston & Maine in Boston, the Long Island Railroad in New York, and in Chicago, a host of railroads – the "Milwaukee Road" (the Chicago, Milwaukee, St. Paul & Pacific Railroad Company), the Chicago Rock Island & Pacific ("Rock Island"), the Norfolk & Western Railway, the Burlington Northern (successor to the Chicago, Burlington & Quincy), the Illinois Central Gulf Railroad, and the "North Western" (the Chicago & North Western Transportation Company) – all continued providing passenger services to commuters even as Amtrak took over those same railroads' long distance passenger obligations. However, even those arrangements began to transform as railroads either went bankrupt and could not afford to continue operating passenger services, or governments began recognizing that state or local subsidization (at least) or complete take over and operation (at most) of these services was essential to their continued existence.

In Chicago, for example, the state legislature recognized that mass transportation is:

|essential to the public health, safety and welfare . . . [and to] economic well-being, maintenance of full employment, conservation of sources of energy and land for open space and reduction of traffic congestion and for providing and maintaining a healthful environment for the benefit of present and future generations in the metropolitan region.|24 |

In 1973, the state created a Regional Transportation Authority ("RTA"), which was authorized to acquire and operate public transit facilities in the six-county Chicago metropolitan area, or to enter into purchase of service contracts with public or private entities to provide transportation services.25 As a result of this legislation, purchase of service agreements were

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25. Id. at §§3615/2.02, 3615/2.05.
entered into with all of the railroads providing commuter service in Illinois except for the (former) Penn Central and the Chicago South Shore and South Bend Railroad, both of which served the Indiana suburbs principally.

In 1983, the Illinois legislature recognized that deficits were continuing and that further action was required to preserve commuter rail service. New legislation created the “Commuter Rail Division” as “the operating division responsible for providing public transportation by commuter rail.” The jurisdiction of the new Division, operating under the trade name “Metra”, was over “any public transportation within the metropolitan region outside of the City of Chicago by commuter rail” and within the City of Chicago any public transportation furnished by the Burlington Northern, the Milwaukee Road, the Rock Island, the Illinois Central, the N&W, the North Western and the South Shore, other than public transportation provided by the Chicago Transit Authority. As a result of this legislation, all commuter rail service in northeastern Illinois came within the purview of the public agency, even if the private railroads were still operating the service through purchase of service agreements.

In the Northeast U.S., as the federal government came to grips with the need to allow Conrail to make a success of the freight operations it inherited from the wrecks of the Penn Central (the ill-advised and ill-fated combination of the once-mighty Pennsylvania Railroad and New York Central Railroad companies), the Erie- Lackawanna (the equally ill-fated combination of the former Erie Railroad and the Delaware, Lackawanna & Western Railroad), the New Haven, the Lehigh Valley, and the Central of New Jersey, Conrail was allowed to pass off the commuter obligations to local public agencies. The Southeastern Pennsylvania Transportation Authority in the Philadelphia area, the New Jersey Transit Corporation, and Metro-North on the Conrail lines north of New York City took over Conrail’s remaining passenger operations in their service areas. In Boston, the Massachusetts Bay Transportation Authority took over the commuter service previously provided by the bankrupt Boston & Maine and by Conrail.

26. 70 ILCS 3615/3B.011 (1993 ed.).

27. 70 ILCC 3615B.08 (1993 ed.). Similar provisions are found in both Public Act 83-885 (Nov. 2, 1983) and Public Act 83-886, §1 (Nov. 2, 1983). Ill. Rev. Stat. ch. 1, ¶1105 deals with the effect of (1) more than one amendment of a section at the same session of the General Assembly or (2) two or more acts relating to the same subject matter enacted by the same General Assembly, and provides that two such acts be “construed together to give full effect to each Act except in case of an irreconcilable conflict.” Because there is no such irreconcilable conflict between the two versions of this section passed by the General Assembly on November 2, 1983, this jurisdictional grant remains in effect.

Where once the great railroad companies took pride in marketing their sleek and modern passenger operations to long-haul (now called intercity) and short-haul (now called commuter) passengers, they now are either out of the business altogether or operating the services as contractor for a local government authority. Passengers, however, along with environmental activists, urban planners and fans of rail service, have not lost sight of the value provided to communities by the presence of commuter rail on existing rail infrastructure. The voices of these constituencies were not stilled entirely by the decline in interest in rail passenger service, and through the 1980’s they began to be heard in communities around the country. Gradually, interest in the provision of commuter rail service swelled to the point where government agencies in Los Angeles, San Diego, Dallas, the Seattle area, San Francisco and the nearby Peninsula, Miami and Salt Lake City began acquiring lines or interests in lines to begin providing commuter rail service. 29

However, as interest in using these rights-of-way expands on the local level, a seemingly insurmountable obstacle often appears in the path of the oncoming passenger train: the freight railroads, anxious to see the passenger trains virtually disappear when they were such a drain on their resources, do not always welcome their return. In fact, in most cases, the railroads are quite adamant that there is no room on their lines for this service. Arguing about capacity constraints, service obligations that could be impeded by the need to give commuting passengers priority during peak rush hours, and potential liability exposure, the freight railroads have become quite adept at saying “no,” even in the face of mounting public pressure. Public agencies, unlike Amtrak, do not have a statutory right created specifically to allow them to gain access when the freight carrier does not acquiesce. The commuter operators argue that, when this occurs, there is a need for a specific and carefully tailored statutory remedy and for a forum with power to order its implementation. 30

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30. See, e.g., Testimony of William W. Millar, President, American Public Transit Associa-
III. Solving The Question Of Commuter Access To Freight Rail Lines

When the local agencies identify a track on which they wish to move commuters, the optimal way to achieve that goal is through negotiation. This has occurred in locations across the country, to the advantage of commuters.\textsuperscript{31} However, negotiation does not always work. In some circumstances, the railroads have agreed to allow access for a few trains but balk at the addition of more when the commuter service proves successful. In other cases, the railroads object from the outset.

In similar situations outside the railroad context, when a government wants to use private property and the owner disagrees, the government can use its eminent domain powers to force the issue. In the railroad arena, this does not work. The STB's jurisdiction over transportation by rail carriers, including the facilities of such carriers, is exclusive.\textsuperscript{32} The STB has recently confirmed that local governments can not, on their own, seize, regulate or otherwise assert control over rail facilities dedicated to or used in interstate commerce if the taking or local regulation will unreasonably burden the ability of the railroad to fulfill its common carrier obligation in interstate commerce.\textsuperscript{33} For some of the situations where public and private interests cannot agree, the Interstate Commerce Act already includes a remedy that permits the commuter agency to force its way onto the railroad's lines. For others, that remedy may not be available according to some interpretations, and additional clarification by Congress may be required.

In the Transportation Act of 1920,\textsuperscript{34} when returning the railroads to private ownership after the federalization that occurred during World War I, Congress added a provision that became the basis for the solution


\textsuperscript{32} 49 U.S.C. §10501(b) (1996).


\textsuperscript{34} Pub. L. No. 66-152, ch. 91, 41 Stat. 456 (1920).
to commuter agencies’ inability to accomplish their service objectives. Congress added a new provision to the Interstate Commerce Act as follows:

If the Commission finds it to be in the public interest and to be practicable, without substantially impairing the ability of a carrier owning or entitled to the enjoyment of terminal facilities to handle its own business, it shall have power to require the use of any such terminal facilities, including main-line track or tracks for a reasonable distance outside of such terminal, of any carrier, by another carrier or other carriers, on such terms and for such compensation as the affected carriers may agree upon, or in the event of a failure to agree, as the Commission may fix as just and reasonable for the use so required, to be ascertained on the principle controlling compensation in condemnation proceedings.\(^{35}\)

In its current incarnation following the recodification of the Interstate Commerce Act in the ICC Termination Act of 1995 (the “ICCTA”),\(^{36}\) the statute now states the following:

The Board may require terminal facilities, including mainline tracks for a reasonable distance outside a terminal, owned by a rail carrier providing transportation subject to the jurisdiction of the Board under this part, to be used by another rail carrier if the Board finds that use to be practicable and in the public interest without substantially impairing the ability of the rail carrier owning the facilities or entitled to use the facilities to handle its own business.\(^{37}\)

Continuing, the statute requires the parties to try to set the terms and conditions of the tenant’s use. If they can not, the STB will establish conditions and compensation “under the principle controlling compensation in condemnation proceedings.”\(^{38}\)

The ICC and its successor the STB have viewed this section as one that is available to redress competitive abuses on the freight side.\(^{39}\) However, it is not by either specific statutory language or judicial interpretation limited to that context. A careful parsing of the language of the statute demonstrates that commuter agencies can use this statute to gain leverage in negotiations with railroads that own property over which they seek the right to operate.\(^{40}\)

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35. Id. at §405, 41 Stat. at 479, now revised and codified at 49 U.S.C. §11102(a).
38. Id.
40. Indeed, two local transportation agencies in Southern California sought the forced ac-
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A. What Property Can the STB Require be Used?

The property must be either a “terminal facility” or “main line track for a reasonable distance outside a terminal”, and these must be owned by a “rail carrier providing transportation subject to the jurisdiction of the Board under this part.” The ICC has stated that a terminal facility is “any property of a carrier which assists in the performance of the functions of a terminal.” Use, however, is not the only subject of inquiry; the nature of the facilities and the area in which they are located are as important as the use. The ICC and the STB have considered significant a number of circumstances, such as whether operations take place within a railroad’s yard limits and whether service is performed within a cohesive commercial area, in determining whether a particular track or facility meets this description.

When the track a commuter agency seeks to use is in the heart of a bustling metropolis, or when tracks are within city limits leading to or into the vicinity of a passenger station, determining whether the statutory requirements are satisfied is an easy one. As the tracks become more distant from the center of downtown commercial or central city industrial activity, the question of the meaning of a “reasonable distance outside a terminal area” comes to the fore. The ICC has been willing to find that trackage rights over 60 miles of track met the test when that track passed through the heavily industrialized Chicago Sanitary and Ship Corridor.

It seems logical that the only lines a commuter authority would seek to use would be within a reasonable distance outside a central city “terminal” area. However, in many major metropolitan centers where several different business districts exist within the city, and suburbs have them-

cess to terminal trackage that is provided in this section, but withdrew their applications when negotiations led to a resolution of the dispute with the owning railroad. Application of Ventura County Transp. Comm'N for an Order Requiring Joint Use of Terminal Facilities in Ventura County, CA, STB Finance Docket No. 33557; Application of Southern California Regional Rail Auth. for an Order Requiring Joint Use of Terminal Facilities of The Atchison, T. & S.F. Ry., ICC Finance Docket No. 31951.

42. CSX Corp. – Control – Chessie Sys., Inc., 363 I.C.C. 518, 585 (1980).
43. See Midtce, 3 I.C.C.2d at 179.
44. Rio Grande Indus. – Purchase and Trackage Rights – Chicago, M.&W. Ry, 5 I.C.C.2d 952, 983 (1989). One commentator disagreed with the ICC's extension of the “terminal trackage rights” remedy to this extent and its interpretation of the law. See Fritz R. Kahn, Stretching Terminal Trackage Rights, 58 Transp. Prac. J., 165 (1991). Kahn views the remedy as one that should be used to provide one railroad with access to another’s terminal, with the trackage rights available only as necessary to allow the newcomer or tenant to reach that terminal facility. While he cites substantial legislative history of the Transportation Act of 1920 to support his thesis, the literal language of the statute can be read more broadly. In fact, subsequent legislative expressions, discussed more fully infra indicate that Congress acknowledges and does not necessarily dispute the broader reading of the statute.
selves become major commercial centers, this definitional line is blurred. How far out into or beyond the Chicago suburbs is a "reasonable distance", when Des Plaines and Schaumburg, to cite only two examples among the far western suburban communities, are significant business centers on their own? What about in Los Angeles, where the Southern California Regional Rail Authority ("SCARRA") "Inland Empire - Orange County" service (between San Bernardino and Irvine, via a route that goes around and not through the downtown Los Angeles system hub) is the first inter-suburban, as opposed to city center-suburban (hub-and-spoke) commuter rail operation in the country? San Bernardino and Riverside, at the eastern edges of the SCRRA system are in some respects actual terminals themselves. How far beyond them is a "reasonable distance"?

The property must be "owned by a rail carrier providing transportation subject to the jurisdiction of the Board under this part." This means nearly all of the freight railroads and terminal area switching companies in the United States. The STB, like the ICC, reads its broad grant of jurisdiction very broadly.\footnote{Under 49 U.S.C. \$10501(a)(2) (1996), the STB has jurisdiction over rail transportation "in the United States between a place in:"
(A) a State and a place in the same or another State as part of the interstate rail network;
(B) a State and a place in a territory or possession of the United States;
(C) a territory or possession of the United States and a place in another such territory or possession;
(D) a territory or possession of the United States and another place in the same territory or possession;
(E) the United States and another place in the United States through a foreign country;
(F) the United States and a foreign country.

46. 49 U.S.C. \$10501(c)(2) (1996). "Local government authority" here has the same meaning as in 49 U.S.C. \$5302(a), and includes a person or entity that contracts with that authority to provide transportation services. 49 U.S.C. \$10501(c)(1)(A). According to \$10501(c)(1)(B), "mass transportation" has the same meaning as in 49 U.S.C. \$5302, i.e., "transportation by a conveyance that provides regular continuing general or special transportation to the public, but does not include schoolbus, charter or sightseeing transportation." 49 U.S.C. \$5302(a)(6) (1996).}
ICCTA, at the request of public agencies that had faced questions about their ability to assert the remedy in §11102, Congress added the following:

The Board has jurisdiction under sections 11102 and 11103 of this title over transportation provided by a local governmental authority only if the Board finds that such governmental authority meets all of the standards and requirements for being a rail carrier providing transportation subject to the jurisdiction of the Interstate Commerce Commission that were in effect immediately before the effective date of the ICC Termination Act of 1995.47

Thus, if a local agency owns transportation facilities that fall within the definition of “transportation” in 49 U.S.C. §10102(9), and if that agency meets the standards set forth in §10501(c)(3)(B), another carrier – freight or passenger – can invoke the §11102 remedy and secure the right to use that property as well.

B. CAN NON-STB REGULATED CARRIERS Invoke THIS REMEDY?

The current statute allows “another rail carrier” to seek the STB’s help in gaining access to terminal facilities or main line track. The text of the statute does not require the rail carrier seeking the authority to be one providing transportation subject to the Board’s jurisdiction, even though the owner of the property over which the applicant seeks authority to operate must be such a carrier. Recent changes in the statute have further confused the law on this issue.

Who is a rail carrier? Any “person who is providing common carrier railroad transportation for compensation”, except for “street, suburban, or interurban electric railways not operated as part of the general system of rail transportation” is included.48 A government agency that is just planning to start service is not a rail carrier until it begins to provide service, or until it acquires sufficient interests in existing rail property to bring it within the ambit of the STB’s jurisdiction.

However, even for authorities that are already providing service, the current formulation of §11102 raises questions. The statute permits the STB to require “terminal facilities . . . owned by a rail carrier providing transportation subject to the jurisdiction of the Board . . . to be used by another rail carrier . . . “49 Neither the statutory definition of “rail carrier,” nor the definition of “transportation” includes a tie to the Board’s jurisdiction.50 A company or authority can be a rail carrier providing

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50. See supra note 48 and accompanying text for the definition of “rail carrier.” Transportation means:

[A] a locomotive, car, vehicle, vessel, warehouse, wharf, pier, dock, yard, property.
Use of Freight Rail Lines for Commuter Operations

transportation, but there is rail transportation that is not subject to the jurisdiction of the STB.\textsuperscript{51} Can a rail carrier that is providing transportation that is \textit{not} subject to the STB's jurisdiction invoke this remedy? The statute as originally formulated suggests that the answer should be yes.

A review of the history of this section is instructive. When the terminal access provision was added to the Interstate Commerce Act in 1920, the statutory language did not require that the applicant seeking to force its way onto the lines of a jurisdictional rail carrier itself be providing transportation subject to the jurisdiction of the ICC. The statute stated the following (in pertinent part):

If the Commission finds it to be in the public interest and to be practicable, without substantially impairing the ability of a carrier owning or entitled to the enjoyment of terminal facilities to handle its own business, it shall have power to require the use of any such terminal facilities, including main-line track or tracks for a reasonable distance outside of such terminal of any carrier, by another carrier or carriers \ldots \textsuperscript{52}

This statute makes no mention here of a requirement that the applicant carrier be one whose transportation services are subject to the jurisdiction of the ICC.

A 1940 amendment to section 3(4) revised this text somewhat. Following the enactment of the Transportation Act of 1940, the statute read (in pertinent part) as follows:

If the Commission finds it to be in the public interest and to be practicable, without substantially impairing the ability of a \textit{common carrier by railroad} owning or entitled to the enjoyment of terminal facilities to handle its own business, it shall have power to require the use of any such terminal facilities, including main-line track or tracks for a reasonable distance outside of such terminal of \textit{any common carrier by railroad}, by another such carrier or

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\textsuperscript{51} For example, even though the counties that are the members of the Joint Powers Board that is the SCARRA have been found by the ICC to be rail carriers providing transportation subject to the jurisdiction of the ICC (now the STB) because of the rights and obligations they undertook when acquiring rail lines from two freight railroads, the ICC specifically ruled that it did not have jurisdiction over the actual passenger train service operated by SCARRA since it was wholly within a state. Orange Co. Transp. Auth., 10 I.C.C.2d 75. \textit{See also} 49 U.S.C. §10501(c)(3)(B).

\textsuperscript{52} Transportation Act of 1920, §405, amending the second paragraph of section 3 of the Interstate Commerce Act. 41 Stat. at 479.
Still, there is no mention of a requirement that the transportation provided by the invoking carrier be subject to the jurisdiction of the STB. The reference, "such carrier", refers only to the earlier-mentioned "common carrier by railroad", not to any tie to the scope of the ICC's jurisdiction. The current version of the statute, like its immediate predecessor, is the same -- only the carrier over whose property the applicant seeks the right to operate must be one providing STB-jurisdictional transportation.

The ICCTA, however, introduced confusion. Can a public agency planning for new service use this statutory remedy if the freight railroad proves intransigent in the negotiations? Sections 11102 seems to say yes (as long as that agency is already providing some railroad transportation). However, the legislative history of the ICCTA suggests the answer might be no. A close reading of §11102 demonstrates the only transportation that must be subject to the STB's jurisdiction is that provided by the owner, not the applicant. Thus, it should not matter that §10501(c)(2) states clearly that the STB does not have jurisdiction over mass transportation provided by a local government authority, or that §10501(c)(3)(B) makes an exception to that for the purpose of §§11102 and 11103.

What, then, is the meaning or purpose of the following text from the Conference Report on the ICCTA:

This section also clarifies that, although regulation of passenger transportation is generally eliminated, public transportation authorities that meet existing criteria for being rail carriers may invoke the terminal area and reciprocal switching remedies of section 11102 and 11103.

Even though §11102 on its face does not require that the invoking carrier be one that provides transportation subject to the jurisdiction of the STB, this legislative history suggests that perhaps there is such a limitation. The question is whether by this reference in the House Report to the rail carrier that is "invoking the terminal area and switching remedies," Congress meant to amend §11102. Congress clearly meant to be amending something when it added §10501(c)(3)(B). However, when the two sections — §11102 and 10501(c)(3)(B) — are read together, and when the

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53. Transportation Act of 1940, Pub. L. No. 76-785, §5(f), 554 Stat. 898, 904 (Sept. 18, 1940). The italicized words show the changes from the original text.


explanation in H.R. 104-422 is added to the analysis, it is not clear what Congress’ objective was, and whether that objective was achieved.

Here, then, is an area that requires clarification by Congress. Congress seemed to intend that this remedy be available to public agencies seeking to use existing rail lines for commuter service. For it to be useful to newly beginning operations as well as to established systems and to avoid any argument that would prevent “new starts” from using this remedy, Congress must state clearly its intentions in this regard.

C. How Much Must the User Pay the Owner?

The statute has been consistent on this point since its inception — “principles controlling compensation in condemnation proceedings” is the standard. The ICC has been quite clear in defining the methodology for determining compensation. The same methodology that is used in determining compensation in merger cases where trackage rights are imposed applies in the “terminal access” context as well. The ICC described the formula it uses to determine compensation for imposed trackage rights, referred to as the “SSW formula”, as follows:

[C]ompensation should be determined in three parts: (1) the variable cost of operation including standard additives; (2) a proportionate share of maintenance and operation expenses based on the tenant’s usage of the facility, and (3) interest rental.

The “interest rental” part of the formula, that is, the computation of return on investment, is to be determined by using the “capitalized earnings approach.” According to the ICC:

We believe the capitalized earnings multiplier is the most appropriate technique for valuing railroad assets in these proceedings. The capitalized earnings approach estimates the value of the lines on the basis of a contemporaneous arms-length transaction, thereby reasonably approximating the fair market value. The going concern value of a corporation has been found to be an appropriate method of valuation . . . . In evaluating “going concern value,” the “commercial value of property consists in the expectation of income from it.”

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57. See Finance Docket No. 32760, Union Pacific Corp., et al. – Control and Merger – Southern Pacific Rail Corp., et al., Decision No. 44, slip op. at 150, 1996 W.L. 467636, (Service Date August 12, 1996).
58. St. Louis Southwestern Ry. Co. – Trackage Rights over Missouri Pac. R.R. Co. – Kansas City to St. Louis, 4 I.C.C.2d 668, 670 (1987). In a merger case, the Board and parties have information about the valuation of the railroad, whether in terms of property value or earning stream, that can be allocated to the segment in question. Outside of that context, the Board will require information about recent valuation, as well as other data to determine appropriate compensation.
59. Id. at 674 (citation omitted).
This is a different compensation structure than Congress used in permitting Amtrak to force its way onto the lines of unwilling railroads. Amtrak, as noted previously, pays only the "incremental cost" of its operations on a freight railroad's lines.\textsuperscript{60} Amtrak earned the right to pay less than the fully allocated cost of its presence on these lines because it was relieving those carriers of the duty to provide intercity passenger services themselves. Commuter authorities seeking to force their way onto the lines of unwilling host railroads are not in the same position and have no claim for the same reduced consideration. The STB has determined that the "SSW formula" is one that is appropriate to compensate owners of rail lines for forced use of their lines by others, and is one possibly fair way to assess commuter authorities for use of others' lines.

A commuter authority might argue that using this methodology does not make sense because passenger-only agencies are not in precisely the same position as a freight railroad competitor that wins the right to use another's track. Part of the value that is inherent in the compensation paid by a freight railroad to the owner in this context is some measure of the owner's lost business opportunities. The commuter operator, while consuming capacity, is not necessarily taking away revenue that would otherwise be available to the owner of the lines if there is surplus capacity on the line. As a result, another compensation formula might be appropriate for this arrangement, presenting another issue that could be clarified by Congress or the STB in a future proceeding.

Allocation of liability also relates to the cost of the presence of the commuter operator on the freight railroad's lines. Amtrak struggled for several years with questions of allocation of liability arising from its use of the owning railroad's lines and continuously sought ways to limit the liability of both itself and the freights.\textsuperscript{61} In 1997, Congress finally adopted a liability allocation structure that imposes limits applicable to all passenger operations on a particular freight line. Congress limited punitive damages to cases where "the harm that is the subject of the action was the result of conduct carried out by the defendant with a conscious, flagrant indifference to the rights or safety of others."\textsuperscript{62} Congress also placed a $200 million cap on liability from any single incident, and encouraged all providers of rail passenger transportation to enter into con-

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tracts that allocate financial responsibility for claims. Resolving an issue that had plagued freight railroads that host Amtrak trains, Congress also affirmed the enforceability of contracts that include indemnification obligations. As a result of these recent changes in the law, the liability issue is one that should not be perceived as necessarily adding cost to the freight railroads. The parties can be free to negotiate an arrangement, or the STB can require that one be reached, that is mutually beneficial and that recognizes the reality of the relationship and the responsibilities of each party.

D. What are the Limitations on Use of this Remedy?

Among the reasons articulated by freight railroads for denying access to commuter agencies is lack of capacity. Section 11102, like its predecessors, will not allow the STB to order railroads to grant access to terminal facilities or lines if the introduction of the second carrier will not be "practicable" or would "substantially [impair] the ability of the rail carrier owning the facilities or entitled to use the facilities to handle its own business." In many locations, lack of capacity has become a serious issue. If a railroad can prove that the subject lines or facilities do not have sufficient capacity, the STB does not in all situations have the authority to order the company to make enhancements that would make commuter operations "practicable."

The limited infrastructure capacity is a relatively new phenomenon. At one time, nearly all major metropolitan areas were served by multiple competing railroads that laid down a spiderweb of interconnected tracks leading to and within the central commercial districts. However, the spate of mergers and consolidations in the rail industry over the past 20 years, while reducing the number of major freight railroads, has also exposed the duplication of facilities within nearly every major city in the

63. Id.
64. Id. at (a)(2)(b). See S. Rep. No. 105-85, at 3063. The Senate explained the need for this provision as follows: The need for this provision arises because of concern about liability in the case of an accident. This concern is the result of a court decision that required Conrail to pay substantial damages for a collision between an Amtrak train and a Conrail train, despite the existence of a contract limiting Conrail's liability. Without enactment of this provision, it is possible that owners of rail rights-of-way, such as Conrail, would press rail passenger operators, including state and local commuter rail authorities, for higher compensation to cover this increased risk when current operating agreements come up for renegotiation.
66. If terminal access is sought as a condition of a merger, the STB has broad powers to impose requirements on the merging carriers that could include capacity enhancements, if necessary to offset an adverse impact of the proposed merger. See 49 U.S.C. §11324(c) (1996); 49 C.F.R. §1180 2(d).
country. Railroad managers faced with excess lines in an era of explosive commercial growth in those cities took the opportunity to harvest many of those properties and thereby enhance the companies' financial performance and value to shareholders. That worked well in a time when rail traffic volumes were diminishing. However, the nation's railroads and their customers learned a hard lesson when the reduction in infrastructure and personnel following the merger of the Union Pacific Railroad and the Southern Pacific Transportation Companies in 1996 coincided with an increase in freight traffic bought about by a booming, healthy economy. The resulting meltdown of rail operations brought extensive shipper outcry, media attention, and an investigation by the STB at the direct request of two Senators who states (Texas and Arizona) were among the hardest hit by the UP's problems.

However, notwithstanding UP's well-publicized problems, not all claims of insufficient capacity are valid. Most commuter agencies are not seeking high volume, high frequency operating rights and are willing to cooperate with the freight railroads to find a workable schedule. It is true that commuter trains want to run at certain peak hours when freight might need to be delivered to customers to satisfy just-in-time inventory requirements. It is also true that freight railroads have the ability, in most instances if they choose, to stage their operations so that trains can be on sidings or near customers' facilities before peak commuter hours begin in order to meet the customers' needs.

"Practicability" is a fact-specific inquiry, and one that can be answered only by fact-finders, where a dispute exists, with expertise in understanding the realities and complexities of railroad operations. Where the public is clamoring for passenger service, the railroads, the public and the STB need to think carefully before coming to conclusions about whether use by the commuter trains will unduly interfere with the freight operations. Sometimes they will, many times they will not. Where they will, the public needs to be prepared to fund improvements that will


68. See Ex Parte 573, Rail Service in the Western United States.
make operations possible, and the STB needs to be authorized and prepared to render decisions about what level of improvements is necessary to make the proposed operations practicable. Where there will not be undue interference, the railroads need to recognize that they will be compensated fairly and that increases in either their own or the commuters’ operations in the future will require contributions to the cost of capacity enhancements by the party whose volume or frequency of operations has grown.

IV. CONCLUSION

Judging from the increasing public support for commuter rail service, there needs to be an accommodation between the public interest in securing the use of rail right-of-way for this purpose and the private interest in discouraging such use. State and local governments, accustomed to using their eminent domain powers to force agreements with private property owners, are stymied by the STB’s exclusive jurisdiction over any use of rail lines that would burden interstate commerce. Congress needs to clarify the ability of the STB to require the railroads to share their tracks and facilities with the public. This is not a situation in which the public should have all of the leverage and the railroads none. To the contrary, railroads have made substantial investments using largely private capital69 and their shareholders deserve to reap the benefits. If Congress is serious, as suggested by the legislative history of the ICCTA, about public agencies gaining access to private right-of-way, it needs to clarify the answers to questions raised by the current statutory framework. These include:

- Whether public agencies, either new starts or established systems, should have the same right as Amtrak to force private owners to relinquish some use of their property for the public good.
- If so, how can the railroads be adequately and appropriately compensated for the mandated transfer of an interest in their property and for the new tenant’s continued use of that property?
- What is an appropriate standard for determining whether the railroad has capacity to allow the proposed use (the “practicability” question)?
- How will the parties allocate the cost of improvements required to enhance capacity when required by growth in freight traffic or increased frequency of commuter trains?

The debate between public and private sectors will continue, and the current statutory framework suggests possible answers. Somewhere, there is a middle ground between the public interest and the private objection to sharing use of the right-of-way.

69. Not all of the investment has been privately funded. For example, Congress and the taxpayers invested enormous amounts of money in Conrail during the 11 years it was government owned. Also, state governments nationwide have aided railroads that serve their populace.
The Future of Railroad Labor-Management Relations as an Industry of Five, or Three, or Two Mega-Railroads Enter the Next Millennium

William G. Mahoney*

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I. Introduction

Labor relations in the railroad industry have been governed by the provisions of the Railway Labor Act, 45 U.S.C. Sec. 151, et seq., for the latter three-quarters of the 20th Century. For the most part, the Railway Labor Act has been considered an adequate instrument in keeping the railroads running despite times of severe labor-management stress. Given the turbulent and sometimes bloody history of railroad labor relations

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before the Act's enactment, one must conclude that the Act was a relatively successful expression of national policy.\(^1\) Its success has been due to several factors, the first of which is the Act's emphasis upon the settlement of disputes between the parties by negotiation and mutual agreement.\(^2\) A salient feature of the Act is its postponement of the possibility of self-help by any of the parties until its procedures are exhausted.\(^3\) This postponement can be extended for a very long time, particularly when the services of the National Mediation Board are invoked by one of the parties.\(^4\)

For more than two-thirds of its life the RLA (or simple voluntary mutual agreement by the parties outside the RLA's procedural provisions) provided the only means which could be employed to change the rates of pay, rules and working conditions the parties had agreed upon as a result of their negotiations. In addition, the laws governing the conduct of railroads in their financial and operational aspects included provisions designed to protect the interests of employees that might be adversely affected by the actions of the railroads.\(^5\) These safeguards provided rail-

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3. Railway Labor Act, §§ 2 First, 6 and 10 (codified at 45 U.S.C. §§ 152 First, 156 and 160 (1994)).

4. Railway Labor Act § 5, (codified at 45 U.S.C. § 155 (1994)). Once a notice of intended change is served or the services of the NMB are invoked, the parties may not engage in self-help and it is entirely within the discretion of the NMB as to how long it will keep the parties in mediation. Detroit, Toledo & Shore Line R.R. v. United Transport. Union, 396 U.S. 142, 150 (1968). Although the party seeking the contract change may feel that the delay caused by mediation seems interminable, that delay is an essential feature of the Act's bargaining process because it creates in the party seeking the change an incentive to compromise. Id.; Brotherhood of R.R. Trainmen v. Jacksonville Terminal Co., 394 U.S. 369, 378 (1969).

road employees with a sense of security in their employment, as well as a
sense of individual dignity conveyed by the knowledge that they had con-
tractual rights which could not be taken from them without the consent of
their elected statutory representatives. As a result, a working relation-
ship between the management and employee representatives of the rail-
roads, while not always serene, was effective, as exemplified by the many
successful results achieved through labor-management cooperation in
joint legislative efforts between 1960 and 1980.6

Employees had a long history of fierce loyalty to their home rail-
roads - evidenced by the ability of many to trace their railroad lineage to
grandfathers and great-grandfathers. This loyalty was enhanced by
knowledge that when dealing with railroad management, the employees’
representatives were operating on a relatively level playing field.

II. COLLECTIVE BARGAINING AND LABOR RELATIONS

Prior to World War I, about 30 percent of the non-operating railroad
employees were organized and about 80 percent of the operating employ-
ees were organized.7 Except for one or two instances, which involved
operating employees, collective bargaining was conducted on a railroad-
by-railroad basis.8 The Coordinator of Railroads, appointed by President
Woodrow Wilson to take over railroad operations for the World War I
war effort, began negotiating with each of the unions on a nationwide
basis9 and, as a result of such negotiations and his prohibition against
anti-union discrimination, union membership in the industry increased
dramatically.10 By 1920 the non-operating employees were 80 percent
organized, and the operating employees were 90 percent organized.11 The

6. E.g., Railroad Retirement legislation; the Regional Rail Reorganization Act of 1973
creating Conrail (Pub. L. 93-236, 87 Stat. 986); the Rail Passenger Service Act of 1970 creating
Amtrak (Pub. L. 103-272, § 7(b), 108 Stat. 1379 (codified at 45 U.S.C. § 501)) and the mainte-
nance of the existence of Amtrak despite repeated attempts to eliminate it; the Railroad Revital-
ization and Regulatory Reform Act of 1976 (Pub. L. 94-210, 90 Stat. 31); Staggers Rail Act of
1980 (Pub. L. 96-448, 94 Stat. 1895); and, the defeats of Coal Slurry Pipeline legislation in the
Congress as well as many other bills thought to be inimical to the interests of the railroad indus-
try and its employees.


8. For a history of the development of collective bargaining in the railroad industry see
The Railway Labor Act (Douglas L. Leslie ed. 1995); The Railway Labor Act at Fifty,
Collective Bargaining in the Railroad and Airline Industries (Charles M. Rehms ed.
1977).

9. Leslie, supra note 8, at 25-26; Army Appropriations Act, ch. 8, 39 Stat. 619 (1916) (codi-
fied in scattered sections of 18 U.S.C. (1976); see also William G. Mahoney, Interstate Commerce
Commission/Surface Transportation Board as Regulator of Labor’s Rights and Deregulator of
Railroads’ Obligations: The Contrived Collision of the Interstate Commerce Act with the Railway


11. Membership in the Brotherhood of Maintenance of Way Employees increased from
Government's method of national bargaining continued until Congress returned the industry to its private owners in 1920.\textsuperscript{12}

The railroads divided themselves into regions for operational purposes: The Eastern Region or Territory consisting of approximately 67 railroads; the Western Region with about 188 railroads; and, the Southeastern Region representing 52 railroads.\textsuperscript{13} They established Carriers' Conference Committees to negotiate for the railroads in each region.\textsuperscript{14} The railroads in each region then selected their individual bargaining representatives to meet with the representatives of the various unions to bargain collectively on wages.\textsuperscript{15} Other issues involving rules, working conditions, and other matters, were left for the individual railroads to bargain.\textsuperscript{16}

In 1926 and 1934, the passage of the Railway Labor Act and its primary amendment,\textsuperscript{17} established a procedure for bargaining to make and maintain agreements, as well as, to handle disputes in the application and interpretation of such agreements.\textsuperscript{18} The procedure has not changed significantly during the seven decades of its existence.

In 1963, however, the railroads did make a significant change in their method of bargaining with the establishment of the National Railway Labor Conference (its negotiating arm), the National Carriers' Conference Committee, and the dissolution of the regional system of bargaining.\textsuperscript{19} Under this method of bargaining, which continues today, the railroads negotiate national wages and rules with the national unions representing

\textsuperscript{12} Transportation Act, 1920, Pub. L. No. 66-152, 41 Stat. 456. At the time of its return to private ownership, the industry had over 1,993,000 employees. WOLF, supra note 7, at 67.

\textsuperscript{13} The Washington Job Protection Agreement of May 1936, at 11-19.

\textsuperscript{14} Rehmus, supra note 8, at 84-85.

\textsuperscript{15} Id.

\textsuperscript{16} Leslie, supra, note 8 at 29-30; Rehmus, supra note 8, at 80-81.

\textsuperscript{17} Railway Labor Act, ch. 347, 44 Stat. 577 (1926) (adopting compulsory mediation and voluntary arbitration as the preferred means of dispute resolution in railroad labor relations); Act of June 21, 1934, ch. 691, 48 Stat. 1185 (eliminating the Board of Mediation and establishing the present National Mediation Board; establishing the National Railroad Adjustment Board to resolve disputes involving the interpretation and application of agreements).

\textsuperscript{18} Railway Labor Act, §§ 2, 3, 6 and 10 (codified at 45 U.S.C. §§ 152, 153, 156 and 160); Terminal R.R. Ass'n of St. Louis v. Brotherhood of R.R. Trainmen, 318 U.S. 1, 6 (1942) (stating that the Railway Labor Act merely provides a procedure for dispute resolution and is indifferent to the parties' terms of agreement which may be as favorable or unfavorable to labor or management as they choose).

\textsuperscript{19} Rehmus, supra note 8, at 84-85. This bargaining is sometimes conducted with individual unions and sometimes with groups of unions.
the industry's employees. Individual railroads bargaining with individual unions on issues is, however, still carried on.

Labor relations by nature, are not continually tranquil. Over the years, strong disagreements between the parties arose which necessitated appointment of Presidential Emergency Boards under section 10 of the Act (45 U.S.C. 160). These Boards recommend solutions to disputes over bargaining issues. The Boards' recommendations are not binding on the parties, and if one party rejects a Board's recommendations, a strike or lockout may occur after a prescribed period of time. Between 1963 and 1988, Congress enacted 14 bills in ten disputes which remained unresolved following Emergency Board recommendations. This legislation either required further bargaining, or settled the pending disputes by imposing of a solution to avoid a nationwide strike or one, which would seriously affect the nation's commerce or economy. While there were a number of strikes over contract issues, most involved individual railroads and individual unions over local issues. In such disputes, each side recognized the legitimate right of the other to differ with regard to the issues involved in the pending dispute. While these labor disputes were often heated, and resulted in strikes or lockouts, employee morale did not suffer because both parties were aware that each was exercising its legitimate rights in the area of labor relations. The employees were also secure in the knowledge that whatever agreement resulted from the dispute it would be one which could not be modified without the consent of their representatives.

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20. Id. at 80-84.
21. Id.
22. Section 10 requires the National Mediation Board to notify the President, if in its judgment an unadjusted dispute "threaten[s] substantially to interrupt interstate commerce to a degree such as to deprive any section of the country of essential transportation service." Then the President, at his discretion, may appoint the board. 45 U.S.C. § 160.
23. See generally, Rehms, supra note 8, at 151-86.
27. Rehms, supra note 8, at 155.
28. For a discussion of railroad strike experience generally to 1976 see Rehms, supra note 8, at 187-207; for a discussion of the various types of self-help employed by unions and management, see Leslie, supra note 8, at 310-24.
29. Id.
An agreement which contributed immensely to the stability of labor relations following the passage of the Railway Labor Act was the Agreement that occurred in Washington, D.C. during May 1936, known as the Washington Agreement or the Washington Job Protection Agreement.\(^\text{30}\) This Agreement was executed by railroads that operated 85 percent of the mileage in the United States, and all of the standard railroad labor unions. It was executed one month before the 1933 Emergency Transportation Act, which effectively froze the number of jobs in the industry, was to expire or be renewed for another year. The Washington Agreement provided partial financial protection to employees who were deprived of their employment or otherwise adversely affected in their employment as a result of coordination.\(^\text{31}\) The Washington Agreement also provides for negotiation of a means of protecting employees in their seniority rights, and their place and type of work, before the railroad can take action to affect them.\(^\text{32}\) That agreement is still in effect, has never been amended, and has been the basis of all subsequent employee protective arrangements, whether reached by agreement or imposed by statute.\(^\text{33}\)

The Railway Labor Act, together with the Washington Agreement and its progeny of employee protective arrangements, provided the basis for labor relation's stability in the industry until 1983.

### III. Effects of Mergers and Abandonments on Labor Relations, 1957-1975

Mergers did not play a significant part in railroad economics for many years prior to 1957.\(^\text{34}\) In that year the President of the Norfolk & Western Railroad ("N&W"), Stuart Saunders, began a campaign to merge the Virginian Railroad ("Virginia") into the N&W. An attempt to merge those railroads had failed in 1926 and Mr. Saunders wanted to ensure the success of this later attempt by personally lobbying the parties that opposed the earlier merger, and those that might oppose the later merger.

One day in 1957, Mr. Saunders called at the offices of the law firm, which represented the labor organizations with contracts on the N&W

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30. This latter name is a misnomer since the agreement does not protect jobs, but rather protects the compensation that is paid to employees.

31. "Coordination" is a joint action by two or more carriers whereby they unify, consolidate, merge, or pool in whole or in part their separate railroad facilities or any of the operations or services previously performed by them through such facilities. Washington Agreement, § 2a.


34. A readable guide to the history of the railroad merger movement in the United States is to be found in Frank N. Wilner, Railroad Mergers, History, Analysis, Insight (1997). This book, informative as it is, deals with the employee issues that arose in railroad mergers from a management perspective.
and Virginian. He commenced what clearly appeared to be a set speech that he delivered to every Chamber of Commerce and shipper on the lines of the two railroads. What was extraordinary about his presentation was that it was to two lawyers in the privacy of their firm’s conference room, rather than a room full of people. He began by saying that the two railroads served mines which produced different types of coal and that “blending coal is like blending scotch”; the purpose of the merger was to form a railroad that efficiently serves the producers of two types of coal, have the coal properly blended, and then it deliver it to the merged railroad’s customers.

When Mr. Saunders turned to the effects of the merger upon the employees of the two railroads, he assured the two lawyers that no employees would lose their jobs or be otherwise adversely affected. The senior lawyer then asked Mr. Saunders if he would put that assurance in writing. Mr. Saunders paused a moment and then asked if he could call his Vice President-Law, John P. Fishwick. After speaking privately to Mr. Fishwick, Mr. Saunders announced that he would put his assurances in writing and so, the merger attrition agreement was born.

The merger attrition agreement adopted the Washington Agreement as the basic protective arrangement for the employees, with a number of specific modifications. The merged railroad agreed to take into its employ all employees who had an employment relationship with the railroads between the date of the agreement and the date of consummation of the merger. The railroad also guaranteed that these employees “would not be deprived of employment or placed in a worse position with respect to compensation, fringe benefits, or rights and privileges pertaining at any time during such employment by” the merged company with exceptions for death, retirement disciplinary dismissal, emergency force reduction (strike, act of God, etc.), or a decline in business as specified in the agreement. In return for this guarantee, the unions agreed to enter into implementing agreements with the merged company and provide for the transfer and use of employees, allocations, and rearrangements of forces made necessary by transfers of work throughout the merged system to the extent not otherwise permissible under existing rules and agreements. This latter provision was extremely important to the railroads.

35. The lawyers were the firm’s senior partner and the author.
37. Id. at § 1(a).
38. Id. at § 1(b).
39. Agreement for the Protection of Employees as a Result of the Merger of the Norfolk & Western Railway Company and the Virginian Railway Company, June 18, 1959, Stuart T. Saun-
because without it, they could not transfer their employees beyond the boundaries of the employees' seniority districts without violating their union contracts. As expressed to Congress in 1973, by then Southern Railroad President Graham Clayton, that type of provision made the merged railroad a viable thing for without it employees could not be transferred.40

The merged company also took over and assumed all contracts, schedules and agreements between the merging carriers and the unions subject to changes in accordance with the provisions of the Railway Labor Act.41

The attrition agreement proved beneficial both to rail labor and to rail management. It was beneficial to rail labor because it provided security to employees. It was beneficial to rail management because it allowed the reduction of jobs through natural attrition42 and enabled the transfers of work and employees between the former separate railroad properties which otherwise would have been prohibited by the railroads' existing contracts with the rail unions.43 It improved employee morale thereby making difficult transitions more efficient and economical and it facilitated the successful negotiation of implementing agreements. These agreements effected the rearrangement of work and the work force prior to the carrier's proposed date for particular consolidations resulting from the merger. Thus, attrition agreements, when administered in a spirit of good faith (as they generally were) were advantageous to both management and labor.

The ICC's approval of the N&W-Virginian merger opened a floodgate of major merger and control approvals throughout the following decade, until the collapse of the Penn-Central in 1970.44 Employment on


42. The overall attrition rate in the industry at the time was about five percent or six percent a year, so that within four years all job reductions resulting from the merger could be realized. The protective arrangement required by statute at that time provided compensation protection to employees who lost their jobs following approval of the merger at 100 percent for four years and at 60 percent thereafter. See infra note 47.

43. See text accompanying note 52.

Class I railroads during this period declined from approximately 950,000 in 1957 to about 488,000 in 1975. This drastic loss of jobs was due primarily to the merger-mania which swept the industry; technological advances, abandonment of miles of railroad lines and, the deterioration of rail passenger service were also contributing factors.

Despite this severe, unrelenting decline in employment, employee morale did not suffer as much as one might have expected because, even in those cases in which attrition agreements were not executed, the ICC imposed an employee protective arrangement known as the New Orleans Conditions. The New Orleans Conditions, theoretically at least, protected adversely affected employees for periods of up to five years from the time they were first affected by the merger. The employees who remained in the employ of the merged carrier were secure in the knowledge that their contracts protected them from arbitrary actions of management which could affect their income, the location of their work, or the rules under which they worked. This combination of contractual and statutory protections of employee interests provided relative tranquility in railroad labor relations while the industry experienced some of the


46. First imposed in the New Orleans Union Passenger Terminal Case, 282 I.C.C. 271, 280-81 (1952), these conditions adopted by reference the provisions of the Washington Agreement and for the first four years following ICC approval of the merger, superimposed upon that agreement the provisions of the Oklahoma Conditions. The effect of this was to begin the employee’s protective period (up to four or five years) on the date he or she was affected rather than on the date of the ICC’s order of approval and to provide full compensatory protection for employees deprived of employment for the first four years following the ICC’s order. These protections were imposed in order to comply with the terms of Section 5(2)(f) of the Interstate Commerce Act, 49 U.S.C. § 5(2)(f), as interpreted by the U.S. Supreme Court in Railway Labor Executives Association v. I.C.C., 339 U.S. 142, 155 (1950).

47. The attrition agreements negotiated by the unions provided effective protection from all causes for all employees of the merging railroads. However, the employee protective conditions required by law to be imposed by the I.C.C. protected only against effects caused by the merger and therefore were often not as effective at protecting employees since management often claimed that the effects suffered by the employees were the results of declines in business or technological advances and left it to the employees to prove otherwise to an arbitrator - an often impossible burden since the facts underlying a carrier’s position were within its sole knowledge.
most traumatic events in its history as its workforce declined by half.\textsuperscript{48}

IV. Effects of Mergers and Line Sales on Labor Relations, 1980-1998

The years between 1975 and 1980 produced no railroad mergers with any significant effects upon the employees in that industry, but they did produce two statutes which had lasting effects upon the welfare of railroad employees, both in their application and in their misapplication: the 4R Act\textsuperscript{49} and the Staggers Rail Act.\textsuperscript{50} These statutes were designed to relieve the rail industry of burdensome, unnecessary regulation by government. Because it was evident that providing railroad management with a freer hand in their financial and operational activities might jeopardize the interests of their employees, Congress expanded, both in scope and quality, the protection it afforded employees who might be affected by its enactment of these statutes.

In the 4R Act, Congress expanded the protection traditionally afforded employees under the Interstate Commerce Act\textsuperscript{51} and in the Staggers Act, it provided specific protections for employees at each point in the statute where it relieved railroads of some form of regulation.\textsuperscript{52} In

\textsuperscript{48} CSX Corporation—Control—Chessie System, Inc. and Seaboard Coast Line Industries, Inc. (Arbitration Review), Finance Docket No. 28905 (Sub-No. 22) Slip op. at 10 WL 661418, (I.C.C. Sept. 25, 1998): “[T]he enactment of section 5(2)(f) in the Transportation Act of 1940 [requiring the imposition of employee protective conditions] codified the legal framework that had been agreed upon by the negotiators of the WJPA in 1936, and set the stage for a 40-year era of labor peace with regard to mergers and consolidations.”


\textsuperscript{51} Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210 § 402(a), 90 Stat. 31 (revised at 49 U.S.C. § 11326(a)). Section 402(a) provided employees with the protections developed by the Secretary of Labor under the law creating Amtrak as well as the protections already developed by the I.C.C. The effect of this, inter alia, was to extend the protection period for employees to six years and to expressly direct the then Interstate Commerce Commission to condition its orders of approval upon terms requiring the carriers to preserve all existing statutory and contract rights of the employees involved should the carriers decide to carry out the permissive authority granted. The protective arrangement developed by the I.C.C. pursuant to Section 402(a) became known as the New York Dock Conditions.

\textsuperscript{52} Staggers Rail Act of 1980, Pub. L.96-448, 94 Stat. 1895. Section 213 (relief from all ICA requirements and I.C.C. regulations except (1) employee protection provisions and (2) prohibited intermodal ownership); Section 219 (lessened need for rate bureaus but required Section 11326(a) employee protection for employees affected); Section 221 (construction of rail lines liberalized-discretionary protection provided equal to Section 11326(a)); Section 223 (reciprocal switching agreements-discretionary employee protection provided); Section 226 (limitations on issuance of car service orders-required hiring of employees who had performed that work); Section 227 (bankruptcy courts bound by section 11326(a)); Section 228 (liberalized merger provisions but left Section 11326(a) untouched); Section 401 (sales of lines to financially responsible persons for feeder line development-required use of employees who normally would have per-
short, in 1976 and 1980, Congress continued the policy it pursued since 1933\textsuperscript{53} - of protecting the interests of railroad employees in furtherance of efficient railroad operations throughout the country.\textsuperscript{54} The Interstate Commerce Commission, charged with administering the employee protective provisions of the Interstate Commerce Act, continued to apply the compensatory protections to employees as it had since 1944.\textsuperscript{55} It also refused to meddle in the contractual relationships between labor and management.\textsuperscript{56} Consequently, labor-management relationships on the nation’s railroads remained stable.

This stability began to weaken in 1982 when the ICC refused to impose the traditional employee protective provisions in the sales of lines by major railroads to non-carrier companies created to purchase them.\textsuperscript{57} The ICC converted that decision into an official policy in December 1985, with its promulgation of regulations formally exempting sales of such lines from virtually all regulation and ruling that employee protective conditions would be imposed only in “exceptional circumstances.”\textsuperscript{58}

The ICC accomplished this objective by a creative interpretation of the Interstate Commerce Act. Sales of rail lines between carriers were subject to the provisions of then Sections 11343 and 11347 of the Act (now Sections 11323 and 11326(a), respectively). The latter section required the ICC to impose employee protective conditions upon the sale. The ICC opined, correctly as it turned out, that if it could eliminate em-

\textsuperscript{53} Emergency Railroad Transportation Act of 1933, 48 Stat. 211, \textit{expired} June 17, 1936, 49 Stat. 376. Particularly Section 7(b) which prohibited a reduction in the number of jobs by reason of any action taken pursuant to the authority of the Federal Railroad Coordinator and guaranteed against individual employees being deprived of employment or placed in a worse position with respect to compensation by reason of any action taken pursuant to the authority of the Coordinator.

\textsuperscript{54} United States v. Lowden, 308 U.S. 225, 234 (1939):
One must disregard the entire history of railroad labor relations in the United States to be able to say that the just and reasonable treatment railroad employees in mitigation of the hardship imposed on them in carrying out the national policy of railway consolidation has no bearing on the successful prosecution of that policy and no relationship to the maintenance of an adequate and efficient transportation system.


\textsuperscript{57} Knox & Kane R.R. Co. (Petition for Exemption), 366 I.C.C. 439 (1982).

\textsuperscript{58} \textit{See} Ex Parte No. 392 (Sub.-No. 1), I I.C.C.82d 810, 811 (1985). The ICC made its determination without reference to any study or any evidence as to what protective conditions had cost railroads in the past and never required any applicant to produce evidence as to such costs in any case before it.
ployee protective conditions from the purchase equation, sales of railroad lines would soar.

The ICC decided to declare the sales of such lines subject to that provision of the Act which dealt with the construction of railroad lines and the extension of a railroad's lines caused by acquisition of additional lines. The advantage in utilizing this provision was that the imposition of employee protective conditions, while always imposed under this section when it appeared that employees might be affected by its use, was not mandated but was left to the discretion of the Commission. The ICC simply refused to impose such conditions in sales conducted under this section to non-carriers or to operating short lines. The fact that Section 10901 by its express terms could be invoked only by a rail carrier providing transportation subject to the jurisdiction of the Interstate Commerce Commission did not impede the Commission from encouraging non-carrier corporations that did not provide transportation to utilize Section 10901. The ICC merely ruled that these corporations would become carriers providing transportation after the ICC approved their purchase of the rail lines in question. Therefore, under the ICC's novel interpretation, such non-carriers (including newly formed subsidiaries of major railroads that purchased lines from their own parent carriers) could avail themselves of the new ICC policy of rejecting employee protection as these non-carriers purchased thousands of miles of lines from the Class I carriers.

Employment opportunities on the Class I railroads were not only reduced by these sales, but jobs offered by the new short lines were fewer in number. Short lines employ about 71 percent fewer workers per mile of line than do Class I carriers and short line pay was about 15

60. The I.C.C. at first held that it would not impose employee protective conditions unless the employee adverse effects were "significant" but when confronted with a sale of 700 miles of track in which 261 employees would lose their jobs with the Illinois Central Gulf Railroad, it held that to impose protection with so many employees affected would defeat the sale. Gulf & Mississippi R.R. Corp. – Purchase (Portion) – Exemption – Illinois Cent. Gulf R.R. Co., F.D. 30439 (Jan. 2, 1985) (not printed). Later that year the ICC issued its formal exemption policy, see supra note 58, and in 1989 interpreted its "exceptional circumstances" test, "in a manner (to quote dissenting Commissioner Lamboley) which precludes petitioners (i.e., employees' representatives) from ever prevailing on the merits of their arguments." Southeastern Rail Corp. – Acquisition and Operation Exemption – Gulf and Mississippi R.R. Corp., F.D. 31187 (Aug. 31, 1989) (not printed).
61. Italic supplied.
63. The number of employees of a railroad divided by the number of miles of line operated by that railroad provides the number of employees per mile operated. Nine Class I railroads have 177,981 employees and operate 121,670 miles of line or 1.46 employees per mile; 34 re-
percent less than on the Class I pay.\textsuperscript{64} Needless to say, this new philosophy of the ICC and the enthusiasm with which railroad management embraced it, did not improve labor relations in the industry. To the contrary, it began the most highly litigious period in the history of the industry; one which continues to this day.\textsuperscript{65}

In 1983, the Commission decided to deregulate the railroad managements’ obligations to their employees under their labor contracts by holding that 49 U.S.C. § 11341(a) (now § 11321(a)) overrode collective bargaining agreements and where those agreements conflict with a transaction which we have approved they must give way to the implementation of the transaction.\textsuperscript{66} This decision was appealed to the U.S. Court of Appeals for the D.C. Circuit which vacated and remanded it to the Commission holding that the ICC gave no justification for a view that waiver of the Railway Labor Act [was] necessary to effectuate the [trackage rights] transactions at issue.\textsuperscript{67} The U.S. Supreme Court, in a 5-4 decision, dismissed the case on a technical deficiency which was raised \textit{sua sponte} by a member of the Court at oral argument - the appeal was filed too late as it was taken from an ICC decision on clarification which does not toll the time for appeal, rather than from an ICC decision on reconsideration which does toll such time.\textsuperscript{68}

That decision of the ICC was followed in 1985 by its decision in the \textit{Maine Central} case\textsuperscript{69} in which the Commission announced that its orders, not the RLA or Washington Agreement (WJPA) govern employee-management relations in connection with an approved transaction.\textsuperscript{70}

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\textsuperscript{65} Id.


\textsuperscript{67} Brotherhood of Locomotive Eng'rs v. I.C.C., 761 F.2d 714, 725 (D.C. Cir. 1985): We thus vacate the 1983 orders and remand the case to the Commission. The Commission is not empowered to rely mechanically on its approval of the underlying transaction as justification for the denial of a statutory right. On remand, to exercise its exemption authority, the Commission must explain why termination of the asserted right to participate in crew selection is necessary to effectuate the pro-competitive purpose of the grant of trackage rights or some other purpose sufficiently related to the transaction. Until such finding of necessity is made, the provisions of the Railway Labor Act and the Interstate Commerce Act remain in force.

\textsuperscript{68} I.C.C. v Brotherhood of Locomotive Eng'rs, 482 U.S. 270 (1987).


\textsuperscript{70} Id. at 6.
Since these two decisions were issued, there has been continuous litigation before the ICC, its successor Surface Transportation Board, and the federal courts. The issue of the STB's authority over the collective bargaining agreement and statutory rights of employees has not been resolved. The Supreme Court had two opportunities to determine the matter and each time avoided it. In the first case, ICC v. BLE, it dismissed on a technical deficiency. In the second case, eight years later, the Supreme Court chose to reverse the decision of the D.C. Circuit (which had again reversed and remanded the ICC's decision) by assuming the railroad had met all of the requirements of the statute which, as is manifest from a reading of the dissenting opinion, was an ill-founded assumption.

Eight more years have passed since the Supreme Court last had an opportunity to address the issue. During this time, the ICC, and its successor STB, have continuously extended government control over the agreement, as well as statutory rights of railroad employees in a series of decisions. The agency held that a railroad does not need to show a connection between the change it wishes to make and a specific ICC or STB order containing the so-called employee protective conditions in order to force changes in employees' agreement rights by compulsory arbitration. Nor does the carrier have time limits when deciding to make a change effecting elimination of employee contract rights even though the order containing the conditions on which the railroad relies may have been issued over 30 years before. The STB has expressly held that the explicit language of its New York Dock Conditions, language required by Section 11326(a), does not mean what it plainly says. That statute requires the STB to mandate that rates of pay, rules, working conditions and other rights, privileges and benefits under existing collective bargaining agreements or otherwise must be preserved by railroads obtaining STB merger approval. However, the STB holds that this language in reality means quite the opposite: rates of pay, rules and working condi-

74. Id. at 8, 9; CSX Corporation—Control—Chessie System, Inc. and Seaboard Coast Line Indus., Inc. (Arbitration Review), Finance Docket No. 28905 (Sub-No. 22) Slip op. at 25 (Sept. 25, 1998): "Moreover, it is now settled that the mere passage of time does not prevent a finding of nexus between the proposed changes and the initially approved transaction."
tions are not to be preserved if their modification or elimination would be beneficial to the railroad involved:

[C]hanges in rates of pay, rules, and working conditions can be required by this agency acting under New York Dock. Carriers may invoke New York Dock to modify such CBA terms when modification is necessary to obtain the benefits of a transaction that was approved as being in the public interest.76

In rendering this extraordinary reading of the statute, however, the STB held that its arbitrators must not modify contracts beyond the extent to which they traditionally modified them between 1940 and 1980.77

The six major railroads existing today78 are the result of ICC and STB orders approving the merger of some 47 railroads into those six carriers over the past 40 years with each order subject to either the New Orleans, or New York Dock Conditions.79 Consequently, the collective bargaining agreement rights of virtually every railroad employee in the United States are threatened with modification or elimination by their railroad employers under the New Orleans or New York Dock conditions as the STB interprets and applies them. A railroad need only claim that it is the product of an approved merger or control application and that its planned changes are necessary in order to achieve efficiencies or benefits. On the basis of such claims the employees can be forced to arbitration. And, if an arbitrator’s decision proves in any way unsatisfactory to the railroad, the railroad can appeal to the STB for a more satisfactory result

76. Id. at 29.

77. Id. at 12, 20, 36. The STB based this conclusion upon the assumption that such modifications traditionally must have been made by arbitrators during that period. Id. at 23. In fact there was no such tradition of modification of agreements between 1940 and 1980, or at any other time prior to 1983. Consequently, it remains to be seen whether the STB meant what it has said and now require the railroads to adduce evidence of the existence of such traditional modifications when they seek to change agreements before arbitrators or, whether the STB in future decisions will reverse that directive to its arbitrators, clarify it out of existence, or perhaps, simply ignore it.

78. Norfolk Southern; Burlington Northern/Santa Fe; Union Pacific/Southern Pacific; CSX; Conrail; CN/ICG. These six are about to become five with the STB-approved division of Conrail between Norfolk Southern and CSX.

79. The single exception is Conrail, which was created by Congress from the remains of Penn Central and had congressionally imposed attrition-agreement-type protection for the employees of Penn Central. 3R Act, Title V, Pub. L. No. 93-236, 87 Stat. 1012 (repealed). The employees subject to attrition agreements have virtually all left the railroads as the last agreement became effective in 1971. See Chicago, St. Paul, Minneapolis & Omaha Ry.—Lease, 295 I.C.C. 696, 701 (1958); Leavens v. Burlington N., Inc., 348 I.C.C. 962, 975, 976 (1977); Brotherhood of Locomotive Eng’rs v. Chicago and N. W. Transp. Co., 366 I.C.C. 857, 861 (1983).

Since that those railroads either have merged, controlled or come under the control of other railroads through ICC or STB orders of approval upon which the New Orleans or New York Dock Conditions were imposed.
or simply serve another notice of change.  

New York Dock arbitrators are bound by the policy of the STB in all cases so that New York Dock arbitrators must conform to the agency’s wishes even though they would decide otherwise on the basis of the evidence before them.  

Entire seniority districts of employees may be removed from their agreements and moved to other agreements or to unrepresented status, thereby being stripped of all agreement rights and their collective bargaining representation if to do so would save the railroad but one job.

The STB’s basic justification for the removal of employees’ contract and statutory rights is its contention that the modification or loss of such rights is the quid pro quo for the employees’ receipt of six years compensation protection under the protective conditions.  

Aside from the questionable credibility of a contention first raised some 60 years into the history of employee protection, it is fallacious because there is no compensation provided in any formula of employee protection, including the original Washington Agreement, for the loss of contractual or statutory rights.  

As the plain language of the protective formulas reflect, compensation protection is provided only for specific adverse effects to employees (dismissal, displacement, and transfer). No compensation is provided for the loss of one’s collective bargaining agreement rights or the loss of one’s representation by their elected bargaining agent. In short, an employee who is not dismissed, displaced, or transferred, re-

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80. In no other American industry are employees’ collective bargaining agreement rights so subject to governmental modification or elimination.


82. Union Pac. Corp., Pac. Rail Sys., Inc., and Union Pac. R.R. Co.—Control—Missouri Pac. Corp. and Missouri Pac. R.R. Co., Finance Docket No. 30000 (Sub-No. 48) (Arbitration Review) slip op. at 8 (July 17, 1996) (not printed). Because the parties in this case had resolved their dispute, the union agreed to move to dismiss the Petition for Review of the decision it had filed with the D.C. Circuit Court of Appeals provided the STB would vacate its decision. The STB agreed, the appeal was dismissed, and the decision was vacated by STB on February 26, 1997.


84. The reason no compensation is provided is because neither the Washington Agreement nor its progeny were designed to affect, nor did they affect, rates of pay, rules or working conditions except in the very limited area of adjustments in seniority when work is consolidated. All other rights privileges and benefits under collective bargaining agreements remain unaffected. See Washington Agreement, Journal of Negotiations, Feb. 3 – May 21, 1936, at 3, 8, 11-12, 16-17, 19, 136, 142, 160-61, 168, 183-84. See also, I.C.C. v Brotherhood of Locomotive Eng’rs, 482 U.S. 270 (1987); Maine Cent. R.R.-Exemption from 49 U.S.C. 11342 and 11343, Finance Docket No. 30522 (Sept. 16, 1985) (not printed), aff’d per curiam, Railway Labor Executive Ass’n v. I.C.C., 812 F.2d 1443 (D.C. Cir. 1987) (Table).
receives no compensation under New York Dock or any other protective arrangement. Yet, that employee can have his agreement and statutory rights modified or eliminated just like the employees who do receive compensation under the arrangement. It is disingenuous for anyone who understands railroad labor relations and employee protective arrangements to claim that *quid pro quo* is provided employees for the loss of their contractual and statutory rights.

The loss of those rights, when compounded by the severe decline in employment and employment opportunities in the railroad industry, has had a gravely enervating effect upon relations between labor and management in the industry. Little else is expected when a contract, negotiated as the result of an exchange of consideration, with each side having provided the other with significant concessions, can be changed or eliminated by management without return of the employees' consideration. This can be done a day, a week, a month or ten years after the contract's execution through a governmentally imposed compulsory arbitration process. And it can occur because, in the eyes of the railroad, such changes are necessary in order for it to achieve "efficiencies," "economies," or "benefits."86

A sense of the tenor of labor relations in the industry today can be found in an article written by Mr. Sonny Hall, President of the Transportation Trades Department, AFL-CIO and President of the Transport Workers Union. This article appears in the October 26, 1998 issue of the Journal of Commerce. Mr. Hall said in part:

The irony is rich: emboldened by the STB's advocacy, carriers now bypass the collective-bargaining process and go straight to the agency to change labor agreements in their favor. Why sit down with your workers when the federal government will give you a better deal?

So, as past and future mergers are played out, mega-rail corporations will be free to do what they want with their employees. Workers who thought they were protected by contracts they negotiated will instead be at the mercy of powerful corporations and government seemingly unconcerned with their plight.

Sound familiar? More than 100 years ago, this was the modus operandi of the robber barons, the monopolists who built American railroads on the mistreated backs of workers.

Little has changed. Today, the STB is undermining its explicit mandate to


86. Id. at 296-97.
protect the public interest by fostering the types of abuses that harmed workers more than a century ago.

The jobs and rights of tens of thousands of workers are on the line. Dealing fairly with these people is a big part of what our government is supposed to do. It's called the public interest, and current and future STB members must be forced to understand what the term means or be replaced with appointees who do.

V. Labor Relations into the Next Millennium

As the railroads become fewer, their size larger, and the number of jobs on those railroads decline, the members of unions will become fewer and the pressure on unions to merge will become greater. As the efforts of the labor force become more unified and focused through merger among unions, their effects upon the industry will become more pronounced. And, as the railroads rely more and more upon the compulsory arbitration provisions of a STB-imposed arrangement as a vehicle to modify or eliminate employee rights in the name of efficiency, the futility of negotiating contracts with those railroads become more and more apparent to the employees and their representatives.

When the railroad industry's workforce determines it is fruitless to negotiate contracts with the railroads, the entire fabric of labor relations will be changed. What might occur is speculation but, to determine what might happen, we can look to the history of the industry during that very unfortunate period in the 19th Century when employees had no contract right protection upon which to rely.

Such a dark future seems likely unless railroad management: (1) becomes aware of the long term damage their present course can inflict upon themselves; or (2) Congress acts to avoid future damage to the nation's economy by removing the STB from that field about which it knows nothing - labor relations; or (3) the STB once again acknowledges it has no expertise in labor relations as it has attested so many times in the past and removes itself from the field; or (4) the Supreme Court

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87. Ironically, the protective arrangements imposed by the STB were originally designed to protect employee rights and effectively did so for some 50 years. See Mahoney, supra note 9, at 251-62, 264-75.

88. Contracts can be changed at any time a railroad wishes to go to arbitration to change or eliminate them and the employees right to strike is now effectively eliminated because each Class I railroad is a combination of a number of railroads and serves a large region of the country. Consequently, Congress is most unlikely to permit strikes to occur in the future. See supra notes 20 and 25.

89. Those who cannot remember the past are condemned to repeat it. George Santayana, The Life of Reason, Vol. 1 (1905).

90. See Hearings on H.R. 7650 Before the House Committee on Interstate and Foreign Commerce, 73rd Cong., 2d Sess. at 54 (1934); Chicago, St. Paul, Minneapolis & Omaha Ry.
confronts and decides the issue if it is again presented; or (5) the employees and their representatives decide to acquiesce meekly in the modification or elimination of their rights by the STB or its arbitrators. Absent the realization of one of these alternatives, as we proceed into the next millennium, the future of labor relations in the railroad industry is ominous.

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To Hell On the Railroads: Why Our Technology and Law Encourage a Degrading Culture

Daniel M. Warner*

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To Hell On the Railroads

In olden days a glimpse of stocking
Was looked on as something shocking,
Now Heaven knows, anything goes.
Good authors too who once knew
better words
Now only use four-letter words, writing
prose
Anything goes.
The world has gone mad today
And good's bad today
And black's white today
And day's night today . . .
Anything goes.1

I. INTRODUCTION

A. PURPOSE AND ORGANIZATION

This interdisciplinary essay has two related purposes. First, it considers yet again the ancient "Railroad Problem."2 - Why did people hate the railroads? "How was it that an innovation as clearly revolutionary as the steam railway in its potential to do so many things better . . . came to be 'despised and rejected' by a politically contentious people who made it the chief scapegoat of their discontents? Why did the making of basic business decisions become a matter for political rather than economic resolution on the railroads?"3

The reason people hated the railroads was that railroads destroyed pre-industrial civilization and replaced what was with what is - a civilization increasingly highly offensive and full of discontents. This paper argues that the railroads, the great engine of modernity, the first major...

2. It is a measure of how far railroads have fallen in importance that in our daily discourse we no longer understand what is meant by "the railway problem." It has been, at least, a very common and commonly-used expression. Writers used to assume their readers were familiar with the term. Lewis Haney starts his long history of the railroads as follows: "Without attempting to define the railway problem, it may be broadly stated that this problem is a social one: whether it be regarded as one of relatively reasonable rates or of absolutely reasonable rates, the welfare and best development of society are the end and solution of the matter." Lewis Henry Haney, A Congressional History of Railways in the United States to 1850 9 (1908). Albrow Martin begins his book this way: "To a person reaching adolescence in the 1930s, the nature of the 'American Railroad Problem' was all too clear [the roads had hit hard times in the Depression] . . . But I soon learned that there had always been a Railroad Problem." Albrow Martin, Enterprise Denied: Origins of the Decline of American Railroads, 1897-1917 xi (1971).
flowering of post-Enlightenment industrial civilization,\textsuperscript{4} promoted in the 19th Century a cultural and ethical system so offensive and destructive that it was “the Problem” for one hundred years. The observation is not entirely uncommon.\textsuperscript{5} It is less common to view railroad regulatory legislation (so-called “granger laws”) as a response to a cultural problem, as opposed to an economic, problem.\textsuperscript{6} Views that laws were “a matter for political rather than economic resolution” are not unreasonable. Indeed, it may be argued that railroad regulation was too much an economic resolution, and not enough of a political, cultural, or ethical one; what regulation should have done was respond to offensive modern industrial culture and its concomitant ethical system. Because the parties interested in regulation addressed economic aspects of the problem (muddled no doubt by politics), they failed to deal completely - then or now - with the larger problem; it is no wonder that the regulation was not considered successful (it ruined the railroads).

Second, this paper insists that our “Modern Problem” is derived from the Railroad Problem, that much of our capitalistic ethos is baleful junk, a vast social disaster; it is unsustainable. We cannot go on this way, measuring our progress by the number of new housing starts. The Railroad Problem was a consequence of post-Enlightenment civilization, a precursor and microcosm of our Modern Problem. The same ethical and legal system developed by or through the railroads tolerates, indeed encourages, junk and destructiveness today. This essay points toward a line of analysis that might encourage new thinking toward our salvation.

To these purposes, following this introduction (which substantiates the Railroad and the Modern Problem) this paper briefly reviews how 18th Century philosophes in France ended Western Civilization’s old order by liberating humans from the shackles of tradition. It traces the effect the Enlightenment had during the next century in the development of modernism, capitalism and industrialism and considers how our 20th

\textsuperscript{4} There is a vast literature on the railroad, some of which is cited in this paper; there are hundreds of books referred to in the bibliographies accompanying the sources.

The machine fascinates on many levels, but really what is most striking is that the railroads were the first. They were the first instrumentality of modern industrialism that affected most people; they changed the world from what we would consider “old fashioned” to what we would recognize as modern. They were the first in modern management, first in modern tort law, first in labor law, first in modern accounting, first in government regulation, first in modern industrialism. The problems created by modern industrialism were first experienced with the railroads. We have had longer to consider our responses to this machine than we have to any other, and because it was the first, huge attention has been devoted to it. And it remains fascinating.

\textsuperscript{5} Just as Haney suggested, the Problem involved “the welfare and best development of society.” \textit{Haney, supra} note 2.

\textsuperscript{6} “It does not capture the cultural meaning of [antitrust] laws to describe them in purely \textit{economic} terms.” \textit{Lawrence M. Friedman, The Republic of Choice: Law, Authority, and Culture} 66 (1990).
Century culture, with its emphasis on personality and consumption, grew out of the 19th Century's emphasis on character.

B. To Hell on the Railroads: The "Railroad Problem" and the Modern Problem

Certainly there was a Railroad Problem - indeed, objection to the railroads caused major civil disturbances in the late 19th Century. People rioted in the streets. In 1887, West Virginia railroad workers first rose up against perceived railroad abuses. Local militia, called out at the governor's request, sided with the workers. The strike spread all across the county. In Pittsburgh, howling mobs besieged the state militia in a roundhouse and destroyed more than $5 million worth of property; violent unrest spread to Buffalo, Chicago, St. Louis, Omaha, St. Paul, and San Francisco. First the police were overwhelmed. Then the militia, and finally the regular Army was called out, and it had to be backed up by Civil War veterans: ten thousand of them were needed to reopen the Pennsylvania Railroad. Uncontrolled, the railroads were, or were perceived to be, ruining farmers, laborers, the polity, and the roads.

Now we are confronted with a Modern Problem, a ruination thrown up by the same revolutionary forces that made the railroads 150 years ago and to which they contributed vastly. This Modern Problem is perceived to be more cultural than was the railroad ruination, but for the most part the "legitimate" tools we use to address it (antitrust laws) are the same ones that were developed one hundred years ago to curb the railroads. Those tools were an incomplete response then, and they are still. We are loathe to apply any tools to the real problem - the business driven imposition of a degraded and degrading culture.

In January of 1997, Mark Helprin described the legal-cultural revolution of the last twenty-five years as one

in which individual rights have become group rights, in which responsibility has become entitlement, marriage has become divorce, birth has become abortion, medicine has become euthanasia, homosexuality is a norm, murder is neither a surprise nor necessarily punishable, pornography is piped into almost every home, gambling is legal, drugs are rife, students think Alaska is an island south of Los Angeles, and mothers of small children are sent off to war with great fanfare and pride.  

Halprin - hyperbole notwithstanding - seems reasonably accurate. He might have added some further observations about our culture's physical manifestations:

[S]omething is wrong with the places where we live and work and go about

7. See infra note 44.
our daily business . . . We drive up and down the gruesome, tragic suburban boulevards of commerce, and we’re overwhelmed at the fantastic, awesome, stupefying ugliness of absolutely everything in sight - the fry pits, the big-box stores, the office units,9 the lube joints, the carpet warehouses, the parking lagoons, the jive plastic townhouse clusters, the uproar of signs, the highway itself clogged with cars - as though the whole thing had been designed by some diabolical force bent on making human beings miserable. And naturally, this experience can make us feel glum about the nature and future of our civilization . . . This ugliness is the surface expression of deeper problems - problems that relate to the issue of our national character.10

Helprin is hopelessly defending last ditches. In November of 1996, California and Arizona voted to legalize the use of marijuana for medical purposes (Washington State rejected a similar initiative in November 1997, but a narrower version was approved in November 1998); Massachusetts’ Department of Health was set, in January 1997, to promulgate regulations for the drug’s medical use in that state.11 General decriminalization is probably in the future. The state of Hawaii is well on its way to recognizing homosexual marriages.12 As to abortion,

The battle . . . is over, and the pro-choicers have won. Leading Republicans were so desperate to avoid the subject [in 1996] that they claimed not to have read their own platform. The current pro-life strategy of concentrating on so-called partial-birth abortion shows that the basic right to choose abor-


12. Linda Hosek, Reciprocal Benefits: A Peek Inside Hawaii’s ‘Pandora’s Box’, HONOLULU STAR-BULL., June 4, 1997 (via Internet), reporting that Governor Cayetano approved a bill creating “reciprocal benefits” for same-sex couples; the Hawaii Supreme Court had before it in October of 1998 the question whether the state’s denial of same-sex marriage violates the Hawaii constitution. In February of 1998 a trial court in Anchorage, Alaska, ruled in a declaratory judgment that the recognition of one’s choice of a life partner is a fundamental right. Brause v. Bureau of Vital Statistics, Case No. 3AN-95-6562 C1, 1998 WL 88743 (Alaska Super. Feb. 27, 1998). Gay rights groups think Vermont may be the likeliest place to legalize same-sex marriage. Patricia Novotny & Gwynne Skinner, Same-Sex Marriage: The State of the Law, WASH. ST. BAR NEWS 14, 16 (Sept. 1998). San Francisco adopted an ordinance in November of 1996 requiring that all companies doing business with The City (as it is called) “must offer the same benefits to domestic partners - lesbian, gay, straight, married, or not - they do to spouses.” There were protests from the Catholic Church, which contracts with San Francisco to provide programs for the needy, but the Church “may be shouting in the wind . . . . [T]he trend is growing nationwide.” Businesses Struggle with Domestic Partner Law, THE BELLINGHAM HERALD, Feb. 6, 1997, at A7.
tion in the vast majority of circumstances is beyond challenge.\textsuperscript{13} Oregon voters in November 1997 overwhelmingly re-approved their support for doctor-assisted suicide (though it lost in Michigan in 1998).

We may think that the revolution’s manifestations as gay rights, women’s rights, gambling rights, divorce rights, marijuana-smoking rights, birth-control rights, abortion rights, right-to-die, even cloning-human-rights, and so on are laudable. But then must we also accept, say, transvestite rights, bestiality rights,\textsuperscript{14} backwards-baseball-caps-at-concert rights, cop-killing-rap-music rights, lurid-tabloid-sensationalism rights, pierced-body-part rights, personal water-craft-roaring-around rights, call-everyone-by-first-name-immediately rights, and ugly, destructive land-development rights?

In the last 100 years, there has been an indisputable retreat of traditional authority such as parents, the church, the school; there has been an apparent surrender in many contexts of our ability to say, “No. This is unacceptable.” We have abdicated limits in much of our culture, ethics, and our law. And related, nearly every technological advance, always heralded with bright promise, turns to dross in our hands, becoming a vehicle that reflects our worst sensibilities instead of our best. It was over thirty-five years ago that Newton Minow, then head of the FCC, described television as “a vast wasteland.”\textsuperscript{15} To most discerning viewers, a great deal of television programming (now hundreds of channels for some people) is still a vast wasteland. Indeed it is fair to observe that Kunstler’s suburban wasteland and Minow’s video wasteland are cut from the same cloth - one real, the other virtual.\textsuperscript{16} It does seem that anything goes, that there are no limits, that nothing is sacred.

Why are there no riots in the streets today demanding action for a decent culture?\textsuperscript{17} There are three reasons why the necessity to curtail


\textsuperscript{14} As Jack Paar used to say, “I kid you not.” Search the Internet for the words “bestiality” and see what comes up.

\textsuperscript{15} Newton Minow address to the National Association of Broadcasters, N.Y. Times, May 10, 1961, \textit{reprinted in Contemporary Quotations} 403 (James B. Simpson ed. 1964).

\textsuperscript{16} Regarding the Internet: It is probably about as much a “vast wasteland” as television; as with television, there is much good, interesting, and valuable material on the Internet. But also there is much concern about the pornography, racism, and right-wing militant nut-ballism on the Internet. One growing concern is the proliferation of dangerous information on bomb-making and terrorism spread on the Internet. Warren Richey, \textit{Bomb-Building Books Come Under Fire}, \textit{Christian Sci. Monitor}, May 6, 1997, at 1. Following the suicide in March 1997 of 39 followers of Heaven’s Gate there was new concern about the proliferation of cult sites on the Internet. And of course there is much on the Internet that is simply banal.

\textsuperscript{17} Sometimes there are civil disturbances, even murderous attacks, on abortionists or regarding environmental issues, but these almost never require calling out federal troops to keep the peace. However, Washington State Governor Gary Locke mobilized hundreds of National
modern cultural-economic ruination has not been as apparent as was the necessity to curtail 19th Century cultural-economic ruination, and why the efforts made to date have been mostly feckless. First, serious criticism of our culture was - until the collapse of Communism - un-American and unacceptable.  

Second, many of the interests injured by modernism's on-going ruination of our civilization are not as immediately economic as those injured in the 19th Century, and the modern victims of ruination (being less economic) have no universally-recognized claim to any protection. Indeed, curtailing modernism's abuses are perceived to cost money, and promoting modern culture (much of it offensive) makes money.

Third, the entire thrust and tenor of modernism, necessarily fascinated as it is with novelty (to promote consumption) militates against curtailing its own abuse - we are loath to re-establish any authority the likes of which we threw off only 300 years ago. We think any effective "imposition" of standards of constraint, or so-called decency (civility, really), would be setting the clock back, that the traditions of civility were "abandoned because they became antiquated." We don't know what to do about it.

The 19th Century's "Railroad Problem", and the response to it, may offer us some insights concerning our Modern Problem. It is at base the same problem; it is only partly or even incidentally economic. If we could see why railroad regulation was necessary, and understand more clearly why it was not entirely successful, perhaps we would have some lessons to

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Guardsmen who joined federal, state, and local law officers in late August, 1998 to protect the Makah Indian Tribe's "Makah Days Festival" which included the resumption of whale hunting. Environmental groups had threatened serious disruption of the activities. Governor Activates National Guard to Protect Makah Fete, The Bellingham Herald, Aug. 22, 1998, at A3.

18. "I now fear that the untrammeled intensification of laissez-faire capitalism and the spread of market values into all areas of life is endangering our open and democratic society. The main enemy...is no longer the communist but the capitalist threat." George Soros, The Capitalist Threat, Atlantic Monthly, Feb. 1, 1997, at 45. Brian Arthur, a Stanford economist who argued beginning in 1984 (but could not get his papers published for five years) that the free market system does not work in large parts of the economy, particularly the high-technology and communications industries, observed: "I was saying all this during the Cold War, so ideology got in the way...I spent about ten years in the wilderness." John Cassidy, The Force of an Idea, New Yorker, Jan. 12, 1998, at 32.

This is not to suggest, of course, that there have not been trenchant public critics of our cultural and economic civilization before 1990. There have been many. John Kenneth Galbraith's classic The Affluent Society was first published in 1958, and it remains popular. The critics of capitalism (Marx included) have not been wanting, they have only rather recently not been considered traitors or, as Galbraith puts it, heretics. John Kenneth Galbraith, The Affluent Society ix (1998).

19. See, e.g., Dirk Smillie, Tuning in First Global TV Generation: Marketing Bonanza, Christian Science Monitor, June 4, 1997, at 1. Smillie writes that "media moguls" are spreading American culture to young people all around the world because young people want to consume American-type products and they have $1.9 trillion in spending power to buy them with.

20. Walter Lippmann, Essays in the Public Philosophy 102 (1955). The traditions have become unstylish because advertisers don't like them.
apply to our Modern Problem. Perhaps we could consider what steps to take to develop a decent, respectable culture and a satisfying legal and ethical system.

Necessarily, throughout this essay, generalizations are made; this paper examines tendencies, and trends. Always there are counter-movements and notable exceptions. For the most part, these go unconsidered and this qualifier is not repeated. This is an interdisciplinary essay, drawing on law, but also aspects of economics, sociology, political science, theology, marketing, philosophy, history, and even engineering.

II. The 18th Century Foundations of Modernism in the West

A. Crush the Infamous Thing!

The foundations of modern American - modern Western - culture reach back to the 17th Century and the French Enlightenment. Perhaps the most important part of the Enlightenment, the supreme act of the Revolution against the Ancient Regime, was its anti-religiosity. God was removed as a trans-personal authority, and man became the measure of all things.

The philosophes (the French term for philosopher, used to describe the Enlightenment's propagandists) believed that human reason, addressed to the problems of the human condition, could make a positive difference in mankind's lot. Human society could progress. The cause of human degradation and misery was that the use of reason was corrupted by superstition, prejudice, poverty, ignorance, and above all by the Christian churches. Voltaire wrote "[t]he most absurd of despotisms, the most humiliating to human reason and nature, the most contradictory, the most deadly, is that of priests. Of all priestly dominations, that of the priests of Christianity is beyond question the most criminal. It is an outrage ...." And of course one of Voltaire's most famous lines was "er- asez l'infame, - crush the infamous thing".

The theory was that if you provided humans with a social environment, that allowed them free play of right reason, they and society would realize their potential. For the philosophes

[T]he mission of man, which gives meaning to his life, lies in the effort to acquire the widest possible range of autonomous and critical knowledge in order to apply it technologically in nature and, through moral and political action, to society. Furthermore, in acquiring his knowledge, man must not let his thought be influenced by any authority or any prejudice; he must let


the content of his judgments be determined only by his own critical reason.23

B. MODERN CAPITALISM AS THE HEIR OF THE ENLIGHTENMENT

As the old authorities of church and state disappeared from human consciousness ("norms and collective values no longer rooted in a theological universe")24 they also disappeared from the economy. Strictures of place (feudal caste) faded, and men sensed themselves as self-governed, not only in personal thought, but also as to matters of the economy. It seems self-evident that there is a close relationship between the development of the market economy, in which every individual appears as the autonomous source of his decisions and actions, and the evolution of... philosophical visions of the world which treat the individual's consciousness as the absolute origin of his knowledge and action. Likewise, the disappearance from human consciousness of all trans-individual authority regulating production and distribution is marked by the fundamental claim of all the writers of the Enlightenment that individual reason must be recognized as the supreme arbiter and subjected to no higher authority. All the fundamental categories of Enlightenment thought have a basic stricture analogous to that of the market economy, which constitutes in turn the social basis of the evolving bourgeoisie.25

Enlightenment thought and the development of the modern, capitalist, industrial state, including railroads, are inseparable. The railroads would not have been built in a pre-Enlightenment culture; originally they were created by men who were significantly the autonomous sources of their own decisions and actions, but as the roads grew they came to deny others their own autonomy.

C. THERE ARE NO MODERN TRANS-PERSONAL ETHICS

The economic and cultural consequences of post-Enlightenment civilization have certainly been mixed blessings. The reason is because the fundamental institutions of our society are essentially amoral. Modernism divorces knowledge from value-judgment. The market is morally

23. at 2.

The core project of the Enlightenment was the displacement of local, customary or traditional morality, and of all forms of transcendental faith, by a critical or rational morality, which was projected as the basis of a universal civilization... [T]his morality would be secular and humanist, and it would set universal standards for the assessment of human institutions.


25. GOLDMANN, supra note 22, at 20 (emphasis added). This removal of customary, traditional transpersonal authority has been called "the Enlightenment Project." See GRAY, supra note 23, passim. Moral judgments become mere preferences, and the only unassailable truth is the primacy of capital accumulation.
neutral. So is science; engineers may develop new means of transportation (railroads, the internet) or new weapons without particular thought as to whether the devices are morally beneficial. And culture is also morally neutral. There is no trans-personal standard of morality or ethics that can universally apply to constrain anyone, at least in the traditional sense. Certainly we may all agree that it is wrong to lie, steal, and cheat, because if everyone were free to do so, each of us would spend so much time protecting our property from others’ predations that we could do little else. But beyond that, it is difficult to develop a defensible theory of social ethics; to set up any standard is to impose some authority, some limits, exactly what the Enlightenment threw out the window.

Socialist critics were correct to point out that capitalism had for the first time created a fundamentally secular society in which an economy at least indifferent to the distinction between the divine and the demonic, good and evil, beautiful and ugly, gained ground irresistibly. Post-Enlightenment society has embraced the material world as the primary reality, materialism as the dominant value, and economic growth as the primary human purpose. When the philosophers removed God as the trans-personal authority, and declared that man was the measure of all things, they set up a system that encouraged scientific and technological advances (including the development of the railroad) and personal gratification. But the system was, and is, essentially devoid of moral content, however its forms promote liberty, equality, tolerance, and justice. All scientific and economic progress is morally neutral and can contribute almost nothing to the establishment of any moral position or scale of values. In the wake of the French Revolution, we have

experienced a break with religion . . . so essential it can be considered responsible for the creation of the European cultural sphere as a whole. We are talking now about the birth of secularity . . . . [N]orms and collective values are no longer rooted in a theological universe . . . . The “Declaration of [the] Rights [of Man]” symbolizes the advent of norms which no longer draw legitimacy from religious inspiration. Another way of saying it is this: men have discovered that they can and even must resolve the questions of what constitutes a good life or good decision on their own, without taking orders from above.27

26. It has been observed that capitalism does not co-exist with any other social-economic order; it triumphs over them all. “Capitalism in modern business societies has not coexisted with other value systems. It has triumphed over alternative world views, such as those of religion.”

PAUL F. HOAPP, ETHICS IN THE BUSINESS WORLD 3 (1994).

27. FERRY, supra note 24, at 135.

The central objection of the Enlightenment project of reconstituting morality as a construction of the human reason . . . is that neither the experimental or empirical method which the thinkers of the Enlightenment revered in the sciences nor any other mode of rational inquiry will yield the morality on whose content they are all agreed.

GRAY, supra note 23, at 161.
A further aspect of the Enlightenment rebellion against traditional constraints is the subordination of the non-human world to human will and valuation. Without a God to ordain the order of the material world, or any transpersonal ethical standard that recognizes the earth as having intrinsic value, humans are free to use it for their own ends: “Man enters into insurrection. The world changes into object . . . . The earth itself can show itself only as the object of assault that, in human willing, establishes itself as unconditional objectification. Nature appears everywhere . . . as the object of technology.” 28 Philosophically this is the reason for the physical wasteland that Kunstler observes. 29 The unleashing of enormous technical power with no constraining moral direction - splitting the atom, harnessing steam - is bound to result in disaster; it is nihilism.

The point here is not to lament the death of societal religiosity, but to observe that after God was thrown out as the authority, nothing was available to replace the concept.

But if nothing has been invented to replace the ethical authority discarded by the Enlightenment, something was invented to replace the economic authority discarded by the Enlightenment. 30 By the 1880s, when it became apparent that the exercise of post-Enlightenment autonomy by railroad magnates threatened the autonomy of other interests, a social construct very potent, but less ancient than religiosity, was called into question - the idea that business should for the most part be left to oper-

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29. Kunstler, supra note 10. Harvey Cox, comparing traditional religion to the new religion of “The Market” (Gray’s “free-market fundamentalists”), notes that “[T]here is, however, one contradiction between the religion of The Market and the traditional religions that seems to be insurmountable. All of the traditional religions teach that human beings are finite creatures and that there are limits to any early enterprise . . . . The Market[s] . . . . First Commandment is ‘There is never enough.’” Harvey Cox, The Market as God, Atlantic Monthly, Mar. 1, 1999, at 23. See infra text accompanying note 136.

30. The economic constraints existing in pre-Enlightenment Europe were the guilds, the basic economic institutions in the medieval cities . . . . The main functions of the merchant guild were to maintain a monopoly of the local market for its own members and to preserve a stable, non-competitive economic system. To accomplish these ends the guild severely restricted trading by foreign merchants in the city, guaranteed to every member the rights to participate in every purchase of goods made by any other member, required all of its members to charge uniform prices for things they sold, drastically punished cornering of the market, and prohibited many forms of advertising. The function of the craft guild was to groom master craftsmen through a system of apprenticeship. “The industrious and intelligent journeyman could eventually become a master craftsman by accumulating enough money to set up his own shop and by passing an examination . . . .” The economic system of the guilds was “not to furnish opportunities for the few to get rich at the expense of the many . . . .” but, significantly reflecting religious doctrine, “to provide goods and services for the community and to enable each member of society to live in security and freedom from want.” Edward M. Burns, Western Civilizations: Their History and Their Culture 325-26, 329 (1958).
ate by itself, without constraints. The historical and philosophical underpinnings of laissez faire are examined by Henry Carter Adams in his seminal 1887 essay "Relation of the State to Industrial Action" (where he takes special care to lambast the English economist and philosopher Herbert Spencer, who conceived of laissez faire as something of a "scientific doctrine" of evolutionary philosophy - social Darwinism). It is sufficient to observe that as a political/economic philosophy, laissez faire was widely accepted across a broad scope of disciplines, including law. In law it was based on what Morton Horwitz describes as the "old conservative world view that presumed the existence of decentralized political and economic institutions."

Laissez faire was the application to the economy of the Enlightenment concept that each person could determine what was the good life without taking orders from above. Laissez faire permitted the railroads. To understand how the railroad revolution brought about the end of laissez faire in the economic realm, some further understanding of "the Railroad Problem" is in order.

III. THE RAILROADS UNDER LAISSEZ FAIRE

A. THE RAILROAD PROBLEM

Despite the limitations of different gauges (width between the rails) and surprisingly few bridges, the railroads just before the Civil War provided a transportation system far surpassing anything that existed before. The railroads, perceived as reasonably benign by most Americans, up to the middle 50's at least, were seen differently. They became big business, the first big business, and they were resented. Venality is not the only reason why railroads became, or appeared to become, abusive. A number of circumstances and difficulties made them that way.

At base, all of these problems stemmed from the conjunction of Enlightenment economic philosophy and the power of industrialization. The contents of the railroad magnates' judgment, their moral system, came to be determined only by their own critical reasoning, without reference to any external, limiting, transpersonal "truth." Traditional constraints on business practices were significantly loosened. The railroads proposed to effect the emancipation of humanity by appealing to or harnessing economic liberalism, by making a solid front against the tyranny of tradition, including the tyranny of time and distance, at the same time their reason for existence was to make money. Economic success was all

important; it was built on the aggrandizement of big business over small (accomplished primarily by rates favoring big shippers and discriminating against small ones), destruction of localism, of the small-town (i.e., face-to-face) attributes of personal integrity, upon the promotion of a universalist civilization that simplified big business operations (symbolized by the great effort to standardize railroad gauges and the adoption of standard time zones), and by the subduing of nature (that interfered with business activities).

Problems touched on nearly every aspect of railroad operation—financing and construction, rate setting (that is, operation and competition), employee relations, and industrial safety.

1. Problems in Financing and Construction

The need to raise huge amounts of initial capital for construction, and to obtain approval from the political establishment for easements, property, and space upon which to lay rails, and construct the ancillary buildings and railroad yards gave rise to great abuses, summed up by

33. Wisconsin's experience is illustrative. In that state, Byron Kilbourn orchestrated a successful land grant from the U.S. Congress to finance two railroads. ROBERT S. HUNT, LAW AND LOCOMOTIVES: THE IMPACT OF THE RAILROADS ON WISCONSIN LAW IN THE NINETEENTH CENTURY 7-8 (1958). The state now had at its disposal vast tracts of federal land that it would give to railroads to finance construction. Kilbourn wanted his company, the La Crosse and Milwaukee line, to get the grants, and he proceeded to bribe the Wisconsin legislature. Id. In 1856 he paid each agreeable senator $10,000 and each agreeable assemblyman $5,000 in the form of construction bonds. Id. at 12. Kilbourn also paid the state "comptroller, the lieutenant-governor, the chief and assistant clerks of the Assembly, and the governor's private secretary five or ten thousand dollars in securities," and he had packages of bonds prepared for judges and for the governor. Id. He bribed the press, too. Id. at 22.

The blatant bribing of whole legislatures by railroad interests to obtain charters or approval of securities issuances was not of course limited to Wisconsin. It was as late as 1911 that California adopted the initiative and referendum, largely in response to the perception that the Sacramento legislature had been corrupted by lobbyists, especially by the Southern Pacific Railroad.

The Progressives, California's populist party, were primarily responsible for the movement of direct democracy against the Southern Pacific Railroad and other strong interest groups in California. Historians generally agree that the Progressives' platform consisted of "[e]xpanding citizen participation in politics (initiative, referendum, recall, and . . . the direct primary); [i]ntroducing competitive corporate influence . . . protecting the environment . . . [and] [i]mproving living adverse living and working conditions . . . . Advocates believed the initiative process would allow the poor and other minority groups some access to the state legislative process.


Throughout the United States the entire era from 1855 to 1895 was highly colored by what we today would consider unacceptable scandal. Railroad promoters organized railroad "construction companies" that sold securities to finance construction and paid dividends from the railroads' profits. Politicians such as James G. Blaine, James A. Garfield and others bought into such securities; the amount of "water" in such stock apparently somehow correlated to the purchaser's political influence. JOHN F. STOVER, THE LIFE AND DECLINE OF THE AMERICAN RAILROAD 79-80 (1970). In the North, railroads were built, however corrupt the financing; in the
one writer as follows:

The power of railway corporations was growing and was being used to influence public officials; the system of construction was wasteful and corrupt; the stocks and bonds were badly watered; and in some instances the rates were undoubtedly higher than necessary for a fair return on the physical value of the road.34

These abuses stemmed from a high interest in capitalization and a low interest in any countervailing constraints (traditional conceptions of "decent" business practices). Heaven knows, anything goes.

2. Problems in Rate Setting

For nearly 100 years, from 1830 to 1930, no single economic issue so consistently dominated American civilization as "the Railroad Problem,"35 and in the '80s and '90s, when the railroads reached their apogee of power and importance, the most apparent and disturbing problem was rate setting, an issue of great complexity that roiled every element of society and every point of the manufacturing and distribution chain. The primary mechanism of rate manipulation were rebates - discrimination in rates charged, a practice that had a profound effect upon the development of our modern economic system by aggrandizing the biggest shippers.36 In a nutshell, the problem was that railroads did not, and really

South, progress was much slower and corruption more debilitating. Id. at 81. All throughout the railroads' areas of expansion, farmers and shopkeepers were encouraged to invest in the railroads' securities, mortgaging their farms to secure the indebtedness, always with the promise that the ever-increasing prosperity wrought by the railroads would easily offset any debt owed. Solon Justus Buck, The Granger Movement: A Study of Agricultural Organization and its Political, Economic and Social Manifestations 10 (1913). Most of the farmers lost their investments. Id.

In the Northeast, Commodore Cornelius Vanderbilt, who had accumulated a fortune of some $11 million by 1865 from his steamboat operations, convinced the New York legislature that the combination of the New York Central and Hudson River Railroad was good public policy. To the assertion that such a combination might violate the common law against monopoly, Vanderbilt - one of the 19th Century robber barons - is said to have snorted, "Law! What do I care about law? Hain't I got the power?" John F. Stover, The Life and Decline of the American Railroad 83 (1970). When he died in 1877 his fortune was $105 million.

34. Buck, supra note 33, at 15. Buck does not assert that all discriminations were unjust. The railroads operated in an arena of the most vicious competition and were frequently driven to rate-cutting for survival. Buck's complains that the railroads bribed public officials; Albro Martin, interestingly revisionist, says: "About bribes, from petty requests for free passes on the railroads' passenger trains to real money, railroad men often remarked that the hand was usually outstretched to demand them before the offer was made. Such remarks fairly infuriated critics . . . ." Martin, supra note 3, at 330.

35. The Problem was not always the same: in the early days it was insufficient capital, technological primitiveness, obstructive competition from canals and stage coaches. See, e.g., John F. Stover, American Railroads 17 (1961). Later, in the 1850s, it was insufficient mileage, confused gauges and corruption.

36. The rate issue at base involved three types of discrimination: between classes of traffic.
or freight, between places, and between persons. Corrupt financing directly affected financiers, including the small farmer and shopkeeper; corrupt pricing (part of operations) affected customers, that is, everyone, and pricing - rate setting - was the apparent heart of the Railroad Problem. During the period of railroad expansion following the Civil War, it became clear that competition was not going to check railroad pricing problems. Price fixing was rampant (and not illegal). There was considerable justification for the practice, actually: railroads required such huge capital investment that competition often meant rate wars that threatened investors with bankruptcy. If the railroads survived those wars, it was often because they charged shockingly high rates where there was no competition. Gross discrimination in pricing was common and galling.

In freight service, discrimination most often took the form of secret rates and rebates and was almost always in favor of the large and powerful shipper. Obviously railroads involved an enormous fixed cost in all the track, equipment, depots and stations. The total cost of operating the railroad did not increase proportionally with an increase of traffic. Therefore, a large volume of traffic was thought desirable so that overhead expenses could be spread over a large number of units. This seemed to justify low (and often discriminatory) inducement rates. Also, costs did not increase in proportion with the distance traveled because switching and terminal costs were the same for a long or a short run. Therefore, it seemed reasonable that long-haul traffic should be charged less per mile than short-haul traffic. Additionally, there was always unused capacity. At harvest time rolling stock was in great demand, but the cars sat idle most of the year and would have to be hauled back to the granaries empty. Therefore, business solicited for the return trip was not expected to pay the full cost. Moreover, despite popular perception to the contrary, most of the railroads in populated areas, at least, had vigorous competition. This was not only from other railroads, but from canals, turnpikes, and river traffic. A small difference in price could cause a shipper to move from one type of transport to another. Again the response was price discrimination and the cutting of individual deals for each shipper.

Railroad rate-setting was not a science; modern cost accounting was in its infancy and rate setting was not based primarily on economics. Railroad rates were set based on what the market would bear. The need to adjust rates so as to meet the requirements of the local situation was universally acknowledged by railroad managers, and for this reason freight agents were generally authorized to alter rates at will. The printed tariff was merely a guide. Martin, supra note 2, at 200.

Shippers often exerted favorable rates from the roads, on the threat of taking their business elsewhere. Martin, supra note 2, at 44; Stover, supra note 33, at 87. William H. Vanderbilt, son of the Commodore, continued after his father's death to operate the New York Central with prudence and acumen, but not even the Vanderbilts had the power to stop rate wars. The wars raged regularly and often, like "small pox or the change of seasons," driving some railroads into periodic bankruptcy (from which refuge, like airlines 100 years later, they were sometimes able to operate with savings from not paying bond interest or dividends). Id. at 85. If passengers and shippers benefited from cheap rates, for example, cattle from Buffalo to New York once went for $1.00 a head, and passengers from New York to Chicago paid $5.00, they were baffled by the frequent rate changes and fluctuations. Id. at 86.

In passenger service, price discrimination was mainly in the form of the free passes, "by which all public officials from the highest judges to the local selectmen received free transportation for themselves and their families over the lines of interested railroads." Buck, supra note 33, at 13. The railroad evil of mixed blackmail and bribery was finally outlawed by the Hepburn Act in 1906. This subtle bribery was particularly galling to those who paid full fare, and was a source of great resentment. Stover, supra note 35, at 123. In short, "[t]here were gross and often totally unjustifiable discriminations which injured both shippers and consumers and indirectly added to another cause of complaint by fostering monopolies." Buck, supra note 33, at 15.

Railroads had obtained the power to produce either a concentrated economy, with progressively larger business units, or to perpetuate the small-scale economy of antebellum America. "The proliferation of rebates hastened the shift toward an integrated national economy, top-
could not, set their rates in a way that was consistently fair to their customers. Perhaps it is more correct to say that the railroads could set reasonably fair rates, but the problem was their inability to collect them. During good times the railroads laid track space, and during bad times, disregarding their own schedules, they cut their rates in ruinous competition (and then flopped into bankruptcy regularly). One of the railroads’ responses to this very difficult problem of competition was to concentrate the business (reduce competition by reducing the number of competitors), to form “pools” or trusts to organize competitors (and thus rate-setters) into some kind of controllable group or into one company. Early efforts were not particularly objectionable, but success encouraged ever grander schemes of monopolistic control.\textsuperscript{37}

3. Problems in Employee Relations

If the investors and customers had cause to complain about abuses, so did the employees. Railroad employees were the first to work in large numbers for big impersonal corporations that grew up after the Civil War, and many of these employees - engineers, conductors, brakemen, switchmen - were highly trained workers upon whose competence and professionalism millions of dollars in equipment and thousands of lives depended. These employees formed the first successful modern labor unions, edifices constructed out of desperation to provide an effective counter-force to the edifice of the first modern big business.\textsuperscript{38} Big business was - and is - informed with the post-Enlightenment assumption, or pretension, that the free-market science of management (like science in general) contained a rationally privileged world-view that was not particularly inherently supportive of human needs, needs such as belonging and

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\textsuperscript{37} In 1901 Edward H. Harriman (the major stakeholder in the Illinois Central and of the Union Pacific) jousted with James J. Hill (owner of the Great Northern and the Northern Pacific) over control of the Southern Pacific (with its access to California) and the Chicago, Burlington & Quincy (with lines into Chicago). The contest was resolved when the principals met and “wrapped up the Burlington and Hill’s two lines . . . in a monster trust to be called the Northern Securities Company.” \textsc{Martin}, \textit{supra} note 2, at 101. It is in this libidinous urge toward monopolies and bigness that the colors of Enlightenment-industrialism are most clearly shown: always the thrust is to eschew the local, particular, the customary; always “to disrupt traditional conceptions of the human relationship with the earth, and to supplant them by humanist and Baconian instrumentalist understandings, in which nature is nor more than an object of human purposes.” \textsc{Gray}, \textit{supra} note 23, at 146.
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\textsuperscript{38} Organized originally as mutual-insurance societies, the Big Four Brotherhoods (Engineers, 1863; Conductors, 1868; Firemen, 1873; and Trainmen, 1883) became collective-bargaining entities by the mid-seventies, when the railroads moved from their period of growth to competition. The unions represented workers who could not easily be replaced, and that, practically, but not legally, forced management to recognize and bargain with them. \textsc{Alfred D. Chandler Jr.}, \textit{The Railroads: The Nation’s First Big Business} 129 (1965).
\end{tabular}}
membership, security and continuity, that in the past were met by social institutions sheltered from the market. Given management's view that labor was a commodity to exploit as fully as possible, problems were inevitable.\footnote{The attitude of the post-Civil War industrialist toward labor differed little from that of the industrialist of pre-War days. He opposed unions and supported long hours and low pay. Only a small minority recognized that hours, wages, and productivity were interrelated. Labor was regarded by most businessmen and by most of the public as a commodity, and in the interest of economizing on resources, it behooved the businessman to buy it at as low a price as possible and in as small amounts as possible. \textit{Herman E. Kroos \& Charles Gilbert, American Business History} 169 (1972).}

4. \textit{Problems in Safety}

Unconstrained, the railroads' record of good-faith dealings in financing, rate-setting, and labor relations was not good. Their record of good-faith efforts to make train travel safe was not good either.\footnote{Three major improvements in safety were needed. One was in the signaling and control of trains: it was essential that only one train be on a track at a time (a train might be switched onto a track that, 50 miles ahead, was being used by another). The second was in braking: it was no longer feasible to have brakemen take their place on car tops at a signal from the conductor, to turn wheels on top of the cars to apply brakes; the trains had become too fast and too heavy, and - as cars got bigger - the headroom above bridges and overpasses narrowed to dangerous limits (of course too, twisting hand brakes on top of moving cars in an icy blizzard at night was dangerous at best). The third necessary improvement was in coupling: the old link and pin set up cost many a brakeman fingers or a hand, because he had to stand in between two cars to line up the holes and drop the pin inside.} It is no criticism of railroad management that the business itself was dangerous and new. Complain more that many railroad managers apparently took for granted the fact that railroad workers risked life and limb, and that the knowledgeable railroad safety reformer Lorenzo S. Coffin, a former school teacher and Civil War chaplain (who witnessed a brakeman lose the remaining two fingers on his right hand in the familiar link-and-coupler accident), was regularly rebuffed when he wanted to discuss railroad safety; managers "refused to see him, or were 'in conference,' or had
Managers would not adopt available safety devices because "they were expensive, while labor was cheap," because no one could make them do it, and because any line that spent money on safety was at a competitive disadvantage with those that did not. Humans were commodities.

Some aspects of the more traditionally examined Railroad Problem are outlined here. Underlying the superficially economic problems of the railroad, however, were the overwhelming cultural problems, as discussed more fully in the sections below. The railroads changed everything; they destroyed the old ways. The response to the economic Problem was government regulation, the end of laissez faire, the reimposition, in a way, of the God that had been thrown out the window in the Enlightenment. This story is told in a vast body of literature on the regulation of railroads and on the legal history of business regulation. A brief review of its death in the railroad industry is considered here. There was, and has not been, any significant regulation of the railroads' cultural spawn.

B. THE END OF ECONOMIC LAISSEZ FAIRE

1. The Failure of Railroad Laissez Faire in General

The first significant labor strike of the new industrial age occurred in the summer of 1877. First the police were overwhelmed, than the militia, and finally the regular army was called, and it had to be backed up by 10,000 civil war veterans. The rebellion was crushed by a huge military force. In the 1880s there were increasingly volatile swings in the eco-

41. Stover, supra note 33, at 72.
42. Id.
43. The literature is vast. For an annotated bibliography see Martin, supra note 3, at 339-416.
44. Railroad workers protested eastern railroad pay cuts (while the newspapers ran feature stories on the lives of shocking opulence led by the Hills, Vanderbilts, and their ilk). In the half-dozen years from 1871 railroads had "systematically cut wages until by 1877, on some roads, workers had undergone a 35 percent cut in wages." Ronald L. Filippelli, Labor in the USA: A History 72 (1984). In addition, management had taken the opportunity to crush the young unions. Id. Workers in Martinsburg, West Virginia, struck, refusing to allow freight trains to move. Local militia, called out at the governor's request, sided with the workers. The strike spread all across the county. In Pittsburgh howling mobs besieged the state militia in a roundhouse and destroyed more than $5 million worth of property; violent unrest spread to Buffalo, Chicago, St. Louis, Omaha and St. Paul. First the police were overwhelmed. Then the militia, and finally the regular army were called out, and it had to be backed up by GAR veterans, "10,000 of them being required to reopen the main line of the Pennsylvania." Stover, supra note 33, at 119. And the strike was not only of railroad workers: miners supported the strike in Martinsburg and Pittsburgh and Scranton; millhands and the unemployed, black sewermen in Louisville and stevedores in Cairo held sympathetic strikes. Twenty-thousand workmen demonstrated in Chicago. Ronald L. Filippelli, Labor in the USA: A History 73 (1984). The strikes and demonstrations ended, of course; the worst of the recession was over by late fall of 1877, and activists turned their attention to political organization. Id.
nomic cycle and there was increasing violence in labor relations: property
destruction and mob violence were not uncommon. By no means could
authorities trust the police, militia, or even the army to obey strike-break-
ning orders. Major crises of civil disturbance threatened.\footnote{45}

The widening sense of crisis in the 1880s gave profound thought and
couragement to those who questioned whether government in fact had
no role in controlling business, and to those who questioned whether the
"law" of supply and demand was really written in the stars. More and
more "Classical Legal Thought was . . . criticized for its insistence on an
anachronistic vision of social relations, a vision that expressed outmoded
individualistic ideals that had been nurtured by decentralized institu-
tions."\footnote{46} Amid this growing crisis of social, ethical, legal, and economic
culture, it became clearer that laissez faire was outmoded. A revolu-
tionary machine\footnote{47} required a revolution in society. In 1896 Henry Carter Ad-

\footnote{45. In 1886 tensions caused by labor disputes (low wages, long hours, perceived judicial and
dependent lack of sympathy for working-class issues) were brought to the boiling point when
Chicago police attacked demonstrators at the Haymarket Square labor rally and eight labor
leaders were framed as riot leaders. An interlude of prosperity was followed by another eco-
omic downturn in 1893. Eugene Debs' American Railway Union, formed in that year, author-
ized a boycott of the Chicago-based Pullman Palace Car Company in June of 1894 (the company
had laid off a large number of men and reduced the wages of those remaining). Deb's fledgling
organization was no match for the railroad managers, who were ready and, indeed, eager, to
wage industrial war. The General Managers Association "recruited strikebreakers, brought legal
action against the strikers and their unions, and kept in close communication with civil and
military authorities as to the movement of police, marshals, and troops." \textit{Chandler, supra} note
38, at 131. Violence broke out early in the strike; on July 2 (at the request of the U.S. govern-
ment - not the railroads) a district judge issued a sweeping injunction order; when Debs and his
followers disregarded it, they were arrested and jailed. \textit{Id.} The injunction, issued under the
Sherman Antitrust Act, was upheld by the Supreme Court, not on the grounds that the strike
violated the Sherman Act, but rather under the Commerce Clause; Justice Brewer wrote: "The
strong arm of the national government may be put forth to brush away all obstructions to the
freedom of interstate commerce or the transportation of the mails." In\textit{ Re Debs, 158 U.S. 564,
582 (1895).} It was because the working people had "no property, privilege, or advantage that
they can place in jeopardy as a pledge for the fulfillment of a labor contract" that the U.S. labor
movement was so violent. \textit{Adams, supra} note 31, at 152. That is, workers had nothing to lose.

William Deverell devotes a long chapter to the Pullman Strike of 1894 in California. \textit{Wil-
liam Deverell, Railroad Crossing: Californians and the Railroad: 1850-1910} 70-71, 80-81 (1994). As in other states, workers, railroad and others, did not refuse to allow trains to
run, but only refused to allow trains with Pullman cars to run. \textit{Id.} The strike started as a Pull-
man boycott. \textit{Id.} When it escalated in violence because of a few strikers' actions in Oakland, the
National Guard was called out to preserve peace and protect property, but the Guardsmen,
disobeying orders, refused to fire on their family and friends. \textit{Id.} In Los Angeles, federal troops
were mustered, but it was clear that their sympathies were largely with the strikers. \textit{Id.}

\footnote{46. Horwitz, supra note 32, at 66.}

\footnote{47. That the machine was revolutionary was apparent to contemporary observers. Writing
in 1906, Professor of Economics Lewis Henry Haney, described the railroad revolution:

We know that with the introduction of the railway there came a new factor into the life
of the nation and of the world, which radically affected all phases of that life. The
railway is both quantitatively and qualitatively different from other and earlier means
ams, in a speech before the American Economics Association (of which he was then president), said:

[E]very change in the social structure, every modification of the principle of political or industrial association, as well as the acceptance of a new social ideal, must be accompanied by a corresponding change in those rights and duties acknowledged and enforced by law. Should this development in jurisprudence be arrested or proceed sluggishly, as compared with that of some particular phase of associated action, serious mischief will inevitably follow. This is true because such unequal development would evidence the general appreciation by men that the law fails to express rights which they hold to be fundamental . . . . In all this there is nothing new . . . . The only strange thing in the situation is that, while this is easily seen with regard to controversies of the past, it is with difficulty appreciated when a controversy that touches our lives is the subject of the analysis.  

A corresponding change in rights and duties - standards of acceptable behavior in society - acknowledged and enforced by law was forthcoming. Until about 1870 the aim of most railroad legislation in the United States "had been to secure rapid increase of railroad facilities."  

But after 1870 a reaction set in. State regulation of the railroads had begun in Rhode Island in 1839, but the states were unable to deal effectively with the railroad problem because railroads were interstate commerce. In many ways, the task was a new one - it fell upon the federal government. Before the Civil War the responsibilities of both state and

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of conveyance and communication. But was this apparent to the men . . . of the early 19th Century? On the whole, it may be said that it was.

HANEY, supra note 2, at 75.

On his 91st birthday and 50 years after the fateful gathering in 1776, Charles Carroll, the last surviving signer of the Declaration of Independence was asked by the citizens of Baltimore to participate in a ground-breaking for the Baltimore and Ohio Railroad on July 4, 1828. As he turned the ceremonial spade he said: "I consider what I have just done now to be among the most important acts of my life, second only to my signing the Declaration of Independence, if indeed it be second to even that." MARTIN, supra note 3, at 5. And Samuel Bowles, an English traveler writing in 1870, said of the transcontinental railroad experience: "It is the unrolling of a new map . . . a revelation of a new map empire, the creation of a new civilization." Id. at 55.


49. ARTHUR T. HADLEY, RAILROAD TRANSPORTATION, ITS HISTORY AND ITS LAWS 22 (1903, reprinted 1968). This appears to be the aim in general, still of government-subsidized port and airport authorities, trade booster associations, chambers of commerce, departments of commerce, and the like.

50. For a discussion of state regulation in Illinois, Minnesota, Iowa and Wisconsin respectively see, e.g., BUCK, supra note 33, at 123-58, 159-66, 166-79, 179-94.

51. See STOVER, supra note 35, at 104-143; STOVER, supra note 33, Chapters 3 and 4: YEARS OF INTEGRATION, CORRUPTION, AND SERVICE, A NEW CENTURY, YEARS OF MATURITY; BUCK, supra note 33, Chapters IV, V, and VI: GREATER RAILWAY LEGISLATION; LEWIS H. HANEY, A CONGRESSIONAL HISTORY OF THE RAILWAYS IN THE UNITED STATES, 1850-1887, Book III: REGULATION ("This is a history of action and reaction between railroads or railroad companies and the government.") 7 (1906).
federal governments were, for the most part, to confer benefits; “the hand of the government doled out benefits to individuals; it did not restrain or discipline them by regulatory inhibitions.”

2. The Railroad Problem Addressed

By 1886 most businessmen - including railroad executives - were ready for regulatory inhibitions, especially to address the classic Railroad Problem - rates. President Cleveland signed the Interstate Commerce Act on February 4, 1887. It was the first piece of general government regulation of business in the United States.

The ICCA, in its first 15 years, was not very effective. Gabriel Kolko sums it up when he observes that “the basically competitive and semichaotic structure of the railroad industry was not significantly altered during the 1890's by the consolidation movement, rate associations or the


53. Clearly necessary because of the continued civil unrest generated from the perception, at least, that railroad rate-setting as it had been practiced was socially unacceptable. The roads themselves favored regulation. Gabriel Kolko, Railroads and Regulation 1877-1916 232 (1965): “[T]he railroads . . . supported the basic principle and institution of federal regulation . . . [a]nd . . . enthusiastically worked for its extension . . . .” Id. This was because the railroads' own inter-road efforts to control competition were politically and practically infeasible.

54. The Interstate Commerce Act, in language perhaps deliberately vague, required that all interstate rates be “reasonable and just” and prohibited the familiar competitive practices of rebates, drawbacks, and pools [rebates were refunds of money paid by the railroads to certain shippers to lower those shippers' rates; drawbacks were “rebates” paid to certain shippers from the higher rates the railroads charged those shippers' competitors; pools were arranged to assign carriage to competitors and to fix the rates charged among them]. It required the railroads to publish their rate schedules, a practice rarely observed, though normally required in most of their charters, and directed the roads not only to post their schedules “in every depot or station” but also to file them with the government. Higher charges for non-competitive short hauls than for competitive long hauls were also prohibited. A five-man Interstate Commerce Commission was created to administer the Act and enforce it prohibitions. The Commission could hear complaints from shippers, examine witnesses, and look into the records and books of railroad companies. It could also demand annual reports from the railroads . . . . While the Commission could not fix railroad rates, it could issue a cease-and-desist order for the carrier to reduce its charges. If the railroad refused to comply, the Commission could only enforce obedience through the federal courts.

Stover, supra note 35, at 131-32.

Here is part of the ICC's description of the power granted to it by Congress:

All charges made for services by carriers subject to the act must be reasonable and just. Every unjust and unreasonable charge is prohibited and declared to be illegal. The direct or indirect charging, demanding, collecting or receiving, for any service rendered, of a greater of less compensation from any . . . person than from any other for a like . . . service is declared to be unjust discrimination and is prohibited. The giving of any undue preference, as between persons or localities or kinds of traffic . . . is declared to be unlawful . . . . Contracts, agreements, or combinations for the pooling of freights of competing railroads . . . are unlawful. All carriers . . . are required to print their tariffs . . . . Copies of all tariffs are required to filed with this Commission . . . .

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ICC. Rates continued to decline.\textsuperscript{55} However feckless were the earliest efforts at government regulation, by 1889 the country had "passed beyond the stage at which the right of legal control [of railroads] was questioned."\textsuperscript{56}

Besides dealing with the general problem of rate setting, the government engaged in other arenas of the railroad business: safety, labor relations, and antitrust regulation.\textsuperscript{57} By 1926, it was possible to say that

\textsuperscript{55} Kolko, \textit{supra} note 53, at 66. It is conventionally assumed that the Supreme Court, when it had the opportunity to decide, ruled in favor of the railroads, against the ICC and the public interest. Kolko disputes this; sometimes the Court declined to interpret the ICCA so as to make it effective, and at the same time it struck down industry efforts at desperately needed self regulation. Kolko asserts that "[t]he Supreme Court left the railroad industry in a state of anarchy, without legal or voluntary relief." Id. at 83.

\textsuperscript{56} Adams, \textit{supra} note 31, at 62. Significant and effective railroad regulation dealing with the problem of railroad rates had to wait for Theodore Roosevelt. In June, 1906 the Hepburn Act was overwhelmingly approved in Congress, giving the ICC the power to actually set rates. Kolko, \textit{supra} note 53, at 113-14. The Commission's rate-setting authority did not, certainly, end "the railroad problem. The "problem" included terrible shortages of rail cars during the period 1914-1919, as allowable rates that had fallen far behind the increases in the cost of living (the cost of living went up - or the value of the dollar down - by 30% between 1900-1915, but rail rates "stayed practically motionless)." Stover, \textit{supra} note 33, 117-18. Still by the eve of World War I the railroads of America had become increasingly regulated by a comprehensive system of governmental controls. Generation-long mismanagement, discrimination, and corruption from the days of Gould, Drew, and Vanderbilt had eventually resulted in Granger state regulation which had now been made much more stringent on a national level. . . . Id. at 116.

In a somewhat different interpretation Kolko observes that the roads themselves had attempted without success to give effect to essentially feckless legislation; they were thwarted in their efforts at self regulation (through pooling and consolidation) by the Supreme Court and by uncooperative road owners, and so "[n]ew legislation was the only means left open to the railroads." Kolko, \textit{supra} note 53, at 83.

\textsuperscript{57} Railroad safety. In railroad safety, George Coffin, inexhaustible, finally prevailed. Major Eli H. Janney's automatic car coupler, George Westinghouse's air brake, and sophisticated electro-mechanical switching systems were adopted as standards in the industry and then mandated by the Railroad Safety Appliance Act, approved by Benjamin Harrison in 1893. "The improvement in railroad safety was dramatic. The railroad-employee accident rate, which had gone as high as 30,000 in 1881, was quickly cut 60 percent." Stover, \textit{supra} note 35, at 154. Albright Martin points out that the railroads themselves voluntarily adopted the new safety equipment system-wide ten years before the federal mandate required it. Martin, \textit{supra} note 3, at 308.

Labor relations. In labor relations, the summer 1894 was long and difficult. The Pullman riots were that June. But the year marked a turning point in government regulation of the labor-management relationship. President Cleveland had appointed a commission to investigate the Pullman riots. The commission recommended the appointment of a board of professionals to mediate future industrial conflict; the Erdman Act, in 1898, did that. Chandler, \textit{supra} note 38, at 132. The Erdman Act, 30 Stat. 424 (1898), was the second attempt to deal with railroad labor unrest. The first effort, the Railway Labor Arbitration Act, 25 Stat. 501 (1888), provided for voluntary mediation of disputes and official investigations labor problems, but it had no enforcement provisions; its arbitration power was never used, and its investigation power was used only once, following the Pullman strike. E. Edward Herman & Gordon S. Skinner, \textit{Labor Law}:
American railroads were, in every aspect of their economic operation, subject to such pervasive government regulation that they were no longer free competitors.

3. The Effect of Railroad Regulation

It is beyond the scope of this paper to analyze in any detail whether railroad regulation was an economic success. It is apparent, however, 

C A S E S ,  T E X T ,  A N D  L E G I S L A T I O N  64 (1972). The Act also provided for enforcement of voluntary arbitration decisions and it outlawed the yellow-dog contract (an employee agreed, as a term of his employment, never to join a union, and if he did, he could be fired). Id. at 64. Other labor legislation followed, including the Newlands Act, 38 Stat. 103 (1913), which established a full-time Commissioner of Mediation, and the Adamson Act, 39 Stat. 721 (1916), which implemented an eight-hour day.

The Army Appropriation Act of 1916 gave the federal government authority to take over the nation’s entire railroad business. The railroads were well organized when it came to making a solid face against the internal problem of unionization, but far too disorganized to deal with the huge increase in freight volume accompanying the increasing industrial output necessary to arm the Allies in Europe in 1917; on December 26, 1917, using the Act of 1916, President Wilson announced that the federal government would take control of the railroads. The government ran the nation’s entire railroad system under Director-General of Railroads William G. McAdoo; it retained control of the vast industrial enterprise until 1920. For a discussion of the take-over and its consequences see STOVER, supra note 33, at 158-77. Railroad owners were not entirely unhappy with government control, the government certainly had a deep pocket for capital acquisition and maintenance, but the experience was bad enough so that after Pearl Harbor “a rather substantial co-operation within the rail industry was formed. . . . American railroads managed to meet the tremendous transport requirements of World War II without having to endure any substantial measure of governmental direction.” Id. at 159.

Antitrust regulations. The railroads’ freedom to contract with each other in restraint of trade was constrained, too. See supra note 37 and accompanying text. The huge trust proposed by Edward Harriman and James J. Hill, the Northern Securities Company exceeded the limits to which the community-of-interests technique could be pushed in the trust-conscious America of the 1900s. The decision of the Supreme Court in recent years had greatly weakened the application of both federal and state laws in controlling large corporations, to be sure. And the simultaneous arrival of prosperity and William McKinley in 1897 seemed to guarantee a maximum of freedom for the proponents of cooperation. An assassin’s bullet, however, was to change these conditions drastically so that by the end of the decade trustification, for better or worse, would no longer be an available means for reconciling divergent points of view among industrial leaders . . . . In three short years the government’s demand for dissolution [of the Northern Securities Company] reached the Supreme Court, which, by a surprise five-to-four decision, ordered the combine dismantled. This was by far the most significant application of the restraint-of-trade concept in preventing the centripetal forces of high finance from placing the entire American transportation system under an oligarchy of three or four powerful men.

MARTIN, supra note 2, at 101-02.

Upon return of the railroads to private control in 1920 it was apparent that new, effective labor legislation would be needed, and this was forthcoming, finally, in the Railway Labor Act, 44 Stat. 577 (1926). This act for the first time in American legal history forced management to recognize and bargain with unions; it also created an elaborate mediation process and, in the event mediation failed, it authorized Presidential intervention. Various amendmend, the act of 1926 is still in effect, governing not only railroads but also airlines. It was the first modern labor legislation.
that railroads today are a mere shadow of their former glories. We may take it from thoughtful, well-spoken scholars like Albro Martin (there are also other commentators who are less graceful about it) that the railroads were ruined by

the so-called Progressive movement, so idealistic in theory and so devastatingly self-serving of politicians and special interests alike in practice. It was the factor that destroyed the wholesome environment in which America's railroads were facing the perils of [late 19th Century] prosperity. It was on the railroads that these philosophies of government intervention in business were carried farthest in the direction of ultimate disaster.\textsuperscript{58}

Why was railroad regulation not a success? If railroad men were not ogres, if they were not really Robber Barons, do we need to look instead at Theodore Roosevelt, William Borah and "Fighting Bob" LaFollette, to name only three Progressive Era politicians, and say that they were the ogres in the piece? Martin gets testy toward the end of his book; he refers to the American peoples' "deathwish against the indispensable railroad," and says that "the enthusiastic cooperation of politicians were consistently eager to pander to cheap public opinion and short-term expediency."\textsuperscript{59} Martin says that the Granger Laws, (all the railroad regulatory statutes from 1886-1920) were stupid, "almost as silly an act of public policy as the (1830's) Windom Committee's recommendation to dig canals furiously across the Appalachians."\textsuperscript{60} For the most part, with good humor, Martin denounces historians, journalists, and college professors who have misunderstood or misrepresented the Railroad Problem.\textsuperscript{61} He also describes the seminal Interstate Commerce Act, which was adopted just as the railroads were figuring out what to do with their own problem (consolidate, consolidate), as the "doors of political demagogy slamming in their face."\textsuperscript{62} The ICC is described as so short-sighted and ignorant that it consistently turned down "almost every railroad innovation that came before them"\textsuperscript{63}; and those whose way of life was altered and destroyed by the railroads are depicted as sputtering complaints in "loud, indignant squawks."\textsuperscript{64}

Whether the laws were successful or not depends upon what they were intended to do. If they were intended to invigorate the roads, attract the best minds to the business and encourage them to innovative competition and capitalization, apparently the laws were not a success, as

\textsuperscript{58} \textit{Martin}, supra note 3, at 349.
\textsuperscript{59} \textit{Id.} at 385.
\textsuperscript{60} \textit{Id.} at 329.
\textsuperscript{61} \textit{Id.} at 150, 175, 180, 382, 385.
\textsuperscript{62} \textit{Id.} at 214.
\textsuperscript{63} \textit{Id.} at 302.
\textsuperscript{64} \textit{Id.} at 231.
the revisionists convincingly argue; it was pretty much down hill for the railroads from about 1890 on. If, on the other hand, railroad regulation was really intended to return to the people some of what the railroad - modernism - seemed to have taken from them, then the effort to regulate, at least, may be viewed more favorably. In short, the Granger Laws significantly addressed the wrong Railroad Problem. If they had any success in dealing with the real problem, the success was incidental. The significant problems were not economic, but rather ethical and cultural. The problem was the destruction of localism, of the importance of the character of place and person and the substitution of uniformity, of urbanity and urbanization and of personality.

Almost coincident with legislation that finally gave the government effective and ultimate control over the railroads by removing from them any broad-based freedom to contract\(^{65}\) came the beginning of the end of railroad dominance. By 1914 the Ford Motor Company was selling half a million automobiles a year; by 1930 there were 23 million passenger automobiles in the United States.\(^ {66}\) In the “teens” the states and the federal government began enormous road-building programs, hugely subsidizing the growing automobile, truck, and bus industries and making possible a vast movement of people and freight on paved roads and highways.\(^ {67}\) Only a few far-sighted people predicted in 1904, the year of Kitty Hawk, that air travel was feasible\(^ {68}\); 25 years later, in 1930, over 73 million passenger-miles were flown; in 1965 it was 58 billion air miles,\(^ {69}\) and in 1992, 367 billion domestic air-passenger miles.\(^ {70}\) The railroad era is over, but before the railroads departed from American imagination as the primary instrumentality of modernism (they are still of real and romantic importance) they worked a transformation in law, as here suggested, and of ethics and culture. We turn to this latter transformation that was not addressed by railroad regulation.

\(^{65}\) The railroads, as here discussed, lost the freedom to contract for fares, rates, routes, with each other, or with their employees.


\(^{67}\) Stover, supra note 33, at 134-43.

\(^{68}\) John Jacob Astor, who died in the Titanic disaster in 1912, predicted that “an age of air travel will soon be possible.” Id. at 143.

\(^{69}\) Id. at 147.

\(^{70}\) Census: 1994, supra note 66, at 622. While airlines flew 367 billion passenger miles in 1992, for 17.7 percent of total, railroads, including intercity (Amtrak) and rail commuter service, ran up 14 billion passenger miles, for .7 percent of the total. Id.
IV. 19TH CENTURY CULTURE

A. LAISSEZ FAIRE AND THE MOVEMENT FROM CHARACTER TO PERSONALITY

In earlier sections of this paper the path of modern culture was traced through the 18th Century. It was observed that humans refashioned themselves so that each one's own choice tended to become the controlling factor in development, economic and spiritual (but not so much social or cultural). The manifestations of this revolution were sketched as they played out in the rise of capitalism, and more specifically, in the rise of the railroads, industrial capitalism's first really grand offspring. And we see how, by the 1880s, a kind of counter-revolution took place; economic laissez faire, a spent force, was no longer socially acceptable. To understand why our culture is very often dross and why the law supports it, we need to consider the 19th Century's application of laissez faire, not in the economic realm, but in the cultural realm, where again the railroads were critically influential. It is asserted here that as certainly as laissez faire had socially unacceptable effects in the economic realm, so too did it in the cultural realm, and it still does.

In his stimulating 1990 book *The Republic of Choice*\(^{71}\), Lawrence Friedman described the social and popular underpinnings of Western legal systems. Friedman observed that although the 19th Century is often associated with freedom, the extensive liberty of the citizen applied most notably to aspects of economy (as a reaction to the mercantilistic monarchies) and polity. The American argument for self-government visualized, most certainly, the abolition of kings and aristocracies; in the 19th Century people (white men, mostly) were free to vote, and they were legally free to make and take employment with very little government restraint. There were zones of open choice for people with the strength and maturity to choose correctly.

But 19th Century American society did not visualize a radically different social - as opposed to economic - order from the 18th Century in matters of family, leisure, moral norms and ways of life. In private life, society had certain rigorously enforced expectations. Sex, marriage, divorce, and family life were "fettered by custom and law."\(^{72}\) Men (and women, in their place) were expected to be God-fearing, hard-working, disciplined and traditional.\(^{73}\) They were expected to exercise "massive self-control, temperance and moderation in all things"\(^{74}\) and to control

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71. *Friedman, supra* note 6.
72. *Id.*
73. *Id. at 37.*
74. *Id. at 27.*

Since the child's initial job would be as an employee, ready obedience and disciplined
(or conceal) deviant desires and impulses. According to Friedman, "nineteenth-century democracy, outside the economic sphere, continued to assume a code of traditional personal values and to value moderate, respectable behavior which did not offend time-honored norms. People were not generally free to choose a particular way of life; rather, "they were trained to accept a preformed, pre-existing model." Those who did not conform were dealt with harshly - the poor, unemployed, sick, unfortunate, deviant, mentally ill, criminally inclined, were punished.

Sustaining these traditional norms in an open society, where the kings and bishops were long gone or deconsecrated, was the pressure of small-town conformity, the small social and geographic scale within which people lived and worked "good morals had their source in close-knit families, in surrounding institutions such as the church and in the cohesion and solidarity found in village life. Bad morals came from peers, from "society," from horizontal transient groupings." Before the railroads, travel beyond the boundaries of a hometown or region was uncom-

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75. HEIDELBERG, supra note 6, at 32.
76. FRIEDMAN observes that the Victorian upper classes (and later the American Prohibitionists) were not merely hypocritical when they approved of legislation making adultery, cohabitation, fornication, drinking and gambling illegal, even if they themselves sometimes practiced these vices. The Victorians knew people did these things; the point of the legislation was to keep such activities underground, to keep sin in its place, to keep it from being a social problem, to delegitimize it. Id. at 144.
77. Id. at 30. From 1826 to 1834 Lydia Maria Child published a children's magazine, delivered by the postman, entitled Juvenile Miscellany. The magazine enjoyed huge popularity with its didactic exhortations to children to live an industrious, sober life. Titles include "The Industrious Family" which "presents poverty as a temporary reverse that hard work and frugality can always overcome .... In this favored land, no one, who is blessed with health, and willing to be industrious and economical, need be destitute of the comforts of life." Over and over the stories praised the virtues of hard work, frugality, deference and obedience to authority. The obvious sexual stereotyping and unconscious but "unrelieved subordination of women to men" in the stories did not offend subscribers. However, starting in 1830 Child began to espouse the anti-slavery cause, and readership fell off dramatically. Years after the magazine's demise adults recalled fondly the magazine's influence which was "ennobling & purifying, & elevating & stimulating to benevolence and charity." CAROLYN A. KARSHER, Lydia Maria Child and the Juvenile Miscellany: The Creation of an American Children's Literature, in Periodical Literature in Nineteenth Century America 90, 99, 107-08 (Kenneth M. Price & Susan Belasco Smith eds., 1996).
78. FRIEDMAN, supra note 6, at 33.
79. A strict and, to visiting Europeans, remarkable new institution was invented in the United States to deal with deviancy: the penitentiary, "models of stern but salutary order" that were regimented, paternal, rigidly disciplined. Id.
mon; mostly people traveled by walking. The influence of one’s community was inescapable and unrelenting.

By the late 19th Century, just as laissez faire began to fade from the economic realm and government began to project its positive power through the Commerce Clause to control business, redefinitions operating in the opposite direction, still propelled by the influence of the Enlightenment, began to affect the individual realm. Constraints on the individual shrank more and more; what was becoming important was not so much the development of character as of personality. In the 20th Century the emphasis is on self-development; the business of life is to develop one’s full potential, to become a complete person, to opt for a complete expression of the person, to unfold all there is to be. The “idea of personal autonomy . . . is the vision of people controlling, to some degree, their own destiny, fashioning it through successive decisions throughout all their lives.” The regnant idea is that people should be the authors of their own lives, that relationships should be structured contractually rather than through time-honored customs and mores, that people should not be forced into fixed social roles decreed by tradition and fixed at birth. Inheritance and ascription are eschewed; the door is open to freedom, mobility, and choice.

B. Options Within Reasonable Reach - The Railroad

This change from character to personality was made possible in the 19th Century by the railroad; this change and its portents were really the nub of the Modern Problem. The first necessary circumstance for humans to make was the removal of religiosity as a constraining influence. That was accomplished in the 18th Century. People then stood receptive to embrace a range of choices that could make them anew. But receptivity was not very useful without some stimulus (or, as Friedman put it, “[o]ptions have to be with reasonable reach”), and the constraining factor in the 19th Century was lack of stimulus, or of options within reach; the railroads changed that. A child born in northern New York in 1830 could hardly choose to repudiate his parents’ authority, or his pastor’s, or school teachers’, or assume a novel career or join a new religion. There were no other authority figures; there were no novel careers, and the idea that a person could choose or change his religion would seem extremely exotic, if not dangerous. There were no other reli-

80. Id.
81. O.J. Simpson, as a defendant in a wrongful death suit, was asked by a plaintiffs’ attorney if he considered himself an actor. “I don’t think I’ve ever called myself an actor in my life,” Simpson replied. “I have always said that I was a personality.” Jeffrey Toobin, The Simpson Civil Trial, New Yorker, Dec. 9, 1996, at 60.
82. Friedman, supra note 6, at 44.
regions readily at hand; and only with great effort could a person leave his home town, burdened and freighted (if not blasted) as it was with filial expectation and the pressure of conformity. Almost impinged upon the senses of a 17 year old boy or girl in the rural early 19th Century United States except what was filtered through their parents, their teachers, their pastors, or their friend’s parents.

The railroad’s role as a medium carrying the ideas of a liberating consciousness was replaced by automobiles, airplanes, telephones, radio, television\(^\text{83}\), and now the Internet. In its day, however, there was nothing to beat the railroad. Today we have all of this technology, but the railroad was first, and for a long time, alone. “From the end of the Civil War until the beginning of the First World War, the railroad was a central, if the not the major, element in the political, economic, and social development of the United States.”\(^\text{84}\) How the railroads put options within reach is traced here; what the options came to be, is the 20th Century’s inheritance and burden, the new Modern Problem.

I. The Railroads and Reading

A very important thing the railroad did to affect “the republic of choice” was to encourage reading. Reading on the train was enormously popular among all classes of travelers because it obviated the necessity to converse with the person next over who - unlike on the stage coaches - would be a travelling companion for only a short time.\(^\text{85}\) The sale of reading material, especially periodicals, to travelers became a big business. Ralph Waldo Emerson delivered an address on “The Fugitive Slave Law,” in New York City on March 7, 1854; he reflected on the dissemination of his ideas:

For who are the readers and thinkers of 1854? Owing to the silent revolution which the newspaper has wrought, this class has come in this country to take in all classes. Look into the morning trains, which, from every suburb, carry the business men into the city to their shops, counting-rooms, workyards and warehouses. With them enters the car - the newsboy, that humble priest of politics, finance, philosophy and religion. He unfolds his magical sheets - twopence a head his bread of knowledge costs - and instantly the entire rectangular assembly, fresh from their breakfast, are bending as one man to their second breakfast. There is no doubt, chaff enough in what he brings, but there is fact, thought, and wisdom in the crude mass, from all

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\(^{83}\) Id. at 99.

\(^{84}\) Television is boldly going where no railroad went before. Taking advantage of deregulated telecommunications and media markets, television is spreading its allure to young people around the world. “Even in Vietnam, the message is being felt: What you wear and how you look is important.” Smillie, supra note 19.

\(^{85}\) KOLKO, supra note 53, at 1.
regions of the world.86

Contemporary observers held that “reading will remain the most natural occupation of railway travelers, in this new form of locomotion that has so profoundly altered the travelers’ relations to one another.”87

More important, even than providing a socially acceptable venue for reading, the railroads carried the mail that supplied newspapers and magazines to every mailbox in the country. In 1838, the U.S. government declared that every railway in the United States was a post route.88 The action encouraged railroad building, but more importantly it provided a fast, regular vehicle of conveyance for periodical literature, for the spread of ideas. Richard Kielbowicz traces the carriage of colonial and U.S. mails from 1700-1870 in his News in the Mail.89 The volume of mail delivered, most of it newspapers and magazines, increased enormously with the coming of the railroad.90 The railroad carried the mail that carried the trade journals that promoted advancements in machine technology to make the stuff of modern civilization; the railroad carried the advertisements and mail-order catalogues that promised rural and small town Americans that they could look and dress and talk like people they never saw in person. The railroad carried the entire production of early 20th Century American industrial output, providing the goods necessary to satisfy the material desires generated by the new consumer industries. The railroads carried the mail that carried the installment credit correspondence. The spread of installment credit did more than anything else to demolish the Protestant work ethic.91

88. Schivelbusch, supra note 85, quoting an (unnamed) contemporary medical doctor in The Influence of Railway Travel on Public Health (ca. 1860).
89. Haney, supra note 2, at 239.
91. In 1847 the 2400 residents of Crown Point, New York (240 miles north of New York City), received 487 subscriptions to 66 periodicals, 39 percent of which came from New York City; ten years later, 57 percent of the periodicals brought into Crown Point came from New York. The New York Tribune was a daily paper, but specialized magazines (from Boston and Philadelphia, especially) were popular, including those dealing with religion, farming, cultural affairs, medical cures, reform movements, fashions, and children’s activities. Id. at 111. In the South, Rocky Mount, North Carolina “sat along a rail line that carried two mails daily”; so favored, 208 readers in the town consumed “408 subscriptions to 94 newspapers and magazines” in 1859-60. The New York Times boasted in 1860 that the new express railroad “will make the whole country between this and Albany merely a suburb of New York, as far as the supply of morning newspaper is concerned.” Id. at 102. By 1850 railroads were the preeminent vehicle for mail transportation. Kielbowicz relates postal audit figures showing that between July 1, 1851 and June 30, 1852 the post office carried 95.8 million letters, 87.7 million newspapers and other
In short, the railroad carried the mails that provided a window to a whole new world; in the mail, carried by the railroad, the new post-Enlightenment culture was disseminated. Here for the first time in history, the average person, now the Enlightenment personality, exhilarated by the possibilities of liberation, could read about immediately contemporary happenings, the new ideas and philosophies, every day. And more than just news was available; magazines full of articles, editorials, commentary, analysis, stories, travelogues, cartoons, anecdotes and—very powerfully—ads that made people realize they had choices in life, that in other places people were doing things differently, and that they could do things differently too.\(^92\)

2. The Railroads and People to Gawk at; Identities to Assume

Railroads not only presented people with periodical literature that opened new horizons for them, it also carried people and presented them with throngs of other people, strangers to examine, mingle with, watch, emulate, comment on, prey upon, con and assault in various ways. Here were educated Northeasterners, black slaves (before the Civil War), merchants, genteel Southerners, entertainers, business men, women (much to the surprise and alarm of some men, who considered it unseemly for women to travel on trains and mingle with "dirty emigrants or lowland homespun fellows in petticoats or breeches")\(^93\); here were people

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92. American culture was once a mass market’s nightmare. "Frugality and thrift were central to the famed ‘Puritan Ethic . . . ’. The Puritans believed in hard work, participation in community, temperate living, and devotion to a spiritual life. Their basic rule of living was that one should desire more material things than could be used effectively." **David Korten**, *When Corporations Rule the World* 150 (1995). Mass consumption, which began in the 1920s, was made possible by revolution in technology, principally the application of electrical energy to household tasks (washing machines, refrigerators, vacuum cleaners and the like), and by three social inventions: "mass production on an assembly line, which made a cheap automobile possible; the development of marketing, which rationalized the art of identifying different kinds of buying groups and whetting consumer appetites, and the spread of installment buying, which, more than any other social device, broke down the old Protestant fear of debt." **Daniel Bell**, *The Cultural Contradictions of Capitalism* 66 (1976). William Leach observes that "a system of easy credit was created to speed up consumption" **William Leach**, *Land of Desire: Merchants, Power, and the Rise of a New American Culture* 123-24 (1993).

93. One of the most popular and influential periodicals at mid-century was the *New York Ledger*, edited by Robert Bonner. The Ledger’s appeal to a remarkably broad readership, working-class people as well as senators and college presidents, was sharpened by four factors: it was cheap, contained a variety of material, had excellent writers, and had famous and highly paid contributors. Fanny Fern (Sara Farrington) was a regular contributor from 1856 to 1872. Flourishing under the famous and uncensurable editor Bonner, Fern became the most highly paid
from every class and region.94

3. The Railroads and Separation of Production from Consumption

And there was another aspect of the "railroadization" of the United States that had a profound effect upon our civilization's development - railroads contributed enormously to the separation between production and consumption. Before the railroads, transportation systems in the United States were primitive and, most people knew where the goods came from, "because they themselves produced them, knew their value, and understood the costs and sufferings required to bring them into existence."95 But with railroads came a new relationship between production

columnist in the United States (in 1855 Bonner paid Fern $100 a column). Joyce W. Warren, Uncommon Discourse: Fanny Fern and the New York Ledger, in Periodical Literature in Nineteenth Century America 51, 56 (Kenneth M. Price & Susan Belasco Smith eds., 1995.) The paper's circulation, bolstered by the sensationaly popular writer, rose from 180,000 in 1856 to 400,000 in 1860. Fern had unconventional ideas and Bonner's Ledger carried them to a vast readership. First she thought that she, a woman, could make a living in a man's business: "I have made my fortune in the world, and taken care of myself" Fern said with pride, "and thanks to nobody." Id. at 55.

And she wrote about things that other writers, and most certainly women, did not. Fern used her widely-read column to argue for women's suffrage, and dismissed those who objected to it on the grounds that voting would cast women "into the rowdy company of both sexes" at the polls: "Pshaw!" she scoffed, women see all types of people every day on the streets, in stores, and in other public places. "All such talk is humbug, as the men themselves very well know. We are always 'dear - delicate fragile creatures,' who should be immediately gagged with this sugar plum whenever we talk about that of which it is their interest to keep us ignorant." Id. at 62.

Fern also supported women doctors, wrote in favor of divorce, and told women not to be held back by the forces of mere tradition, which urged for them

no higher aim in life than an eligible matrimonial establishment; no career, as have their brothers, to look forward to; but merely, like a pretty statue, to sit still and be admired . . . . Can I be a governor? Can I be a senator? Can I even be President? Bah - you know I can't. Free? Humph!

Id. at 63.

Eventually women gained the right to vote and to be doctors and to divorce. We have women governors and senators, at least.


95. Many of these railroad travelers were very rowdy. Id. at 92-103. They thrust heads, arms and legs out the windows, they hung on the outside of the cars, they rode on the roof or in the locomotive, they jumped on and off slow-moving trains at will; at stops, scheduled or otherwise, they urinated and defecated with little attempt at modesty (there was no modesty available), they stole fruit from orchards. Id. They smoked, they spat tobacco, they made sexual advances, they talked business, they read, they watched their fellow passengers, they slept and ate. Id.

Less rowdy were the group travelers that asked for discount fares to ride to conventions, such as the Women's Christian Temperance Union, the YMCA, the National Education Association, the Wholesale Merchants of Chicago, and the Grand Army of the Republic. Such requests reached "flood tide" in the 1880's. Id. at 180. Also reasonably orderly were political whistle-stop campaigners and reformers.

The women's movement gained much of its momentum in this way, through the hun-
and consumption - production could occur in one place, finished goods were transported hundreds of miles, and displayed for consumption with no hint of the work required to bring them into existence. As the cost of production was intentionally hidden by merchandisers the fantasy of consumption as a paradise free from pain and suffering, and so guiltless and costless, flourished. (Today, of course, the hidden producers often labor in foreign countries.)

4. The Railroads and Urbanization.

The railroad achieved another effect; it created the city as we know it, and finished off the political and cultural influence of small towns and rural areas.

With urbanization, or more especially modern suburban sprawl, we see the most obvious consequences of the "Enlightenment Project" and the objectification of the earth (though rural slag heaps and deforestation are good examples too). Nineteenth Century Americans realized early that the railroad could lay the earth low, tame it, level it, subjugate it. The railroads - as the phrase was - "annihilated time and space." The further modern man is removed from any effective sense of societal ethics, of an organic sense of belonging to place, the more deconsecrated the earth becomes, until it seems, for the most part, that the only point to "progress" (the further appropriation of the non-human world) is making money to buy more progress.

Because the railroad with its fixed capital was most profitable when it served the largest number of people, railroad companies pressed to extend their tracks further and further, from coast to coast; the railroads intentionally encouraged people to settle in new places. A pattern of urbanization emerged. Cities like Chicago, Minneapolis, Detroit, St. Louis, Cincinnati, Memphis, and Seattle matured; established cities such as New York grew even larger. Small towns lagged behind.

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dreds of thousands of miles traveled in railroad cars, to all states, by suffragists such as Susan B. Anthony and Elizabeth Cady Stanton, municipal reformers such as Jane Addams and Alice Hamilton, and temperance advocates such as Frances Willard. The American Federation of Labor, and of course the American Railroad Union both brought local union chapters and brotherhoods under a national organization made possible primarily because of the railroad.

**Id.** at 181.

In short, the railroads presented travelers with whole worlds of fellow travelers to gawk at, marvel at, emulate.


97. *Id.* As late as 1875 New York department stores still "conducted manufacturing and selling in the same place, in full gaze of customers." *Id.* at 147. That was all changed by 1910.

98. The term, seen frequently in railroad literature, may have first been used by a passenger "signing himself 'Jockey of York,' who had been one of 141 passengers on an 1830 Christmas outing over the Charleston and Hamburg Railroad." WARD, *supra* note 39, at 110.
The process of urbanization accelerated in the 1880's and 1890's when the railroads began to standardize their operations and merge their lines. Small towns were completely left out of the high-speed runs between Boston and Washington, New York to Chicago, Chicago to New Orleans. These trains - The Twentieth Century Limited, the Broadway Limited, the Orange Blossom Special, the Miamian, the Gulf Coast Limited, the Everglades, the North Coast Limited - traveled at 60 miles per hour, and "in the name of speed and efficiency many small towns found themselves bypassed in the rush to connect major metropolitan areas by rail." Bypassed, the small towns lost economic, social, cultural, and political influence.

With urbanization and all its lures and distractions came the dissolution of small-town authority. To escape to the city was to be free from the desolate intolerance and narrow-mindedness of small towns. Cities provided glorious anonymity that made it possible for people to assume a new identity of self-expression, modeling themselves on what they read in magazines or on what they saw in the city; anonymity also required that people display their consumption in order to establish social status.

One result of the growth of cities was the advance of fashion as a popular pursuit. Anonymity in the crowd was one new result of urbanization, and fashionable clothes provided an opportunity for people to express themselves in their daily business . . . . Dress in the city street was a performance, a subtle indicator of calling or leisure activities, hinting at sexual proclivities as much as rank, and symbolizing countless allegiances. For men as well as women, to dress in fashion was to make a statement about yourself and your aspirations.

The concentration of large numbers of people made the distribution of a daily press practical, with all its news, gossip, scandals, fashions and advertising. Motion pictures - certainly one of the most powerful tools of social change - became profitable and practical "more because of the social organization of the modern industrial city than as a result of any properties inherent in the technology itself . . . . Hollywood provided the prototype for a new way of life, teaching the United States the fashiona-

99. Gordon, supra note 93, at 269.
100. Id. at 273. The same thing happened, of course, with the advent of the interstate highway system in the 1950's and early 1960's: many small towns along Route 66 or Highway 99 disappeared as important stopping points. Id.
101. Richard Posner observes that homosexuals move from small towns (where they cannot practice homosexuality for lack of partners and lack of anonymity) and tend to congregate in cities, where there are lower "search costs" for relationships, sexual and non-sexual, than in small towns. "The total number of practicing homosexuals in a society will therefore increase with the rise of cities, making homosexuality seem, and in a valid if partial sense be, a by-product of economic development and modernity." Richard A. Posner, Sex and Reason 127 (1992). Prostitution increases with urbanization, for the same reasons. Id. at 133.
ble pleasures of conspicuous consumption.”

The signals that bombarded Americans in the new cities of the new century presented people with an enormous stock of information. There were so many models and cues that people no longer felt they “must stick with the old, inherited models and codes of the primary group.” Among the old models and codes that disappeared was the entire small-town relationship that characterized life in most of the United States; as the cities grew, small towns and the small-town mentality and concept shrank:

Railroads, which affected the economic and social order in virtually every American community, took away local people who had to move in order to support themselves. Strangers began to replace the web of family relationships that distinguished each community. Undercut were the distinctly local patterns of town and farm life which emphasized loyalty to family, land, and town institutions. In their place came a new emphasis on mobility, capital, investment, and industry.

The previously-existing integrated social pattern, emphasizing character, self-restraint, and self-control, was fundamentally inconsistent with capitalism as it developed; the old order was eschewed.

V. TWENTIETH CENTURY CULTURE

A. A NEW SOCIAL ORDER

By the beginning of the 20th Century the railroads’ work for good or bad was nearly finished. They had brought about “a new social order in the United States . . . overwhelmingly based on the principle of national commercial exchange.” A social order based on national commercial exchange means the triumph of big business over small, the erosion of traditional values, and the celebration of materialism and consumption. This is the real Railroad Problem. It is still not addressed.

1. Big Business Over Small

A social order based on national commercial exchange means that selling and buying becomes the most important thing in society; those who can sell and buy most efficiently become the most important people

103. Id. at 36.
104. Friedman, supra note 6, at 128.
105. Gordon, supra note 93, at 45. Gordon quotes Nathan Hale (father of Edward Everett Hale [1822-1909], the famous American Unitarian minister) who attempted to describe to Boston business interests the importance of the railroad. At a town meeting in that city in 1831 he declared that “if people could come from Springfield to Boston in five hours an average of nine people would come every day.” At the time the prospect of nine strangers coming to town daily seemed an impossibly high number.” Id. at 49. This was the city of Boston!
in society. They project their value system effectively, and their businesses become the most important ones. Those who cannot sell and buy efficiently become less important. Money is the measure of all things. Because success in making money becomes invaluable, old-fashioned values, "the major constituents of real cultures - family, religion, ethics, manners, impersonal criteria for distinguishing between truth and false - shr[il]nk almost to the vanishing point as authorities over individual behavior." 106 Unencumbered by the constraints of custom, economic or cultural, the railroad raised up a civilization that “thrust aside the traditional efforts of men to withhold the world from men,” 107 putting a vast new array of options within reach. But it also created a regime that, all over again, withheld the world from men; it dashed the entrepreneurial expectations that the Enlightenment had enshrined among the Rights of Man. Frank Norris said of the Southern Pacific that it was a frightful, all-consuming octopus. 108

No longer did people control their own business affairs. “Business deals great and small hinged on what railroad promoters, sitting miles from the scene, might decide,” 109 and the livelihoods of hundreds, even tens of thousands, of people were directly affected by decisions about railroad courses, though these people had nothing to say about it. At the local level, discrimination against localities, usually the result of local competitive factors, affected “the economic well-being of every member of a community.” 110 Some businesses and some localities were just out of luck: on the wrong side of the tracks. And the railroads

distorted the competitive process and limited equality of opportunity in many businesses. They denied the equal right of small dealers to participate effectively in an open market, and they prevented the independent shipper from choosing his own outlet by dictating the destination of his produce by means of the rate structure. 111

The aggregation of business in cities (promoted by railroad rate discrimination) gave large businesses an advantage over small ones - the small businessman could no longer count on local custom; his personal attention to detail became less important, the small capitalist and independent businessman were crushed out, the distinction between employer and employee became more pronounced, capitalization requirements increased, and workers could no longer hope to become the

106. Id. at 64.
employer of their own labor. The largest and most unscrupulous businesses got the best railroad rates, for they could demand them and threaten any railroad that did not cooperate with ruinous withdrawal of their business. Railroads changed markets from local to national or international; if a few producers over-supplied, prices fell and railroad charges were reduced to unremunerative levels to retain business because competition was fierce. This led, reasonably, to an interest in inter-railroad rate agreements ("combinations in restraint of trade," to use the Sherman Act's terminology), in pooling and consolidation so that the roads became concentrated in a few hands.

And these railroad owners, riding in their luxurious private cars, and living in palaces of oriental opulence came more and more to be removed from the communities they served, and less and less concerned about their welfare. Railroads "arrang[ed] passenger schedules and connections to suit their financial interests, and [the railroad magnates] became known for their high-handed manipulation of city and state governments for their own ends."\(^{112}\)

These business leaders commanded vast enterprises and undreamed-of riches; they were the new emperors of the day.\(^{113}\) Commodore Vanderbilt stitched together "a stupendous property," a transfer of capital "in the classic style";\(^{114}\) Governor Henry Haight of California did not deny that these "combinations of capital execute works of great public utility" but, he said, "we object to their conversion into agencies for public plunder and we also object to placing the government in the hands of their managers and making the people their serfs and tributaries."\(^{115}\)

Henry Carter Adams, an economist and political scientist at the University of Michigan observed that "the tyranny of corporations, which grew naturally from conditions of 'industrial freedom,' was as grievous as any tyranny ever established by government agency,"\(^{116}\) including those pre-Enlightenment government agencies controlled by the Church. Voltaire's "priestly despotisms" were gone, but now it seemed they were replaced by railroad-boss despotisms. And to what purpose did the new empires exist? The purpose of the railroad was, of course, to make money,\(^{117}\) the heart of commercial exchange. The self-interest of a few,

\(^{112}\) Id. at 22.
\(^{113}\) Gordon, supra note 93, at 111.
\(^{114}\) The emperor of Austria-Hungary, Franz Joseph, was tardy for a meeting with the railroad magnate Edward H. Harriman. The emperor apologized; Harriman responded that it was all right, "I, of all people, know the problems of empire." Ward, supra note 23, at 151. Bill Gates is today's equivalent, with his palatial house and, like Rockefeller and Carnegie, his philanthropy.
\(^{115}\) Martin, supra note 3, at 57.
\(^{116}\) Governor Haight in 1871, in Deverell, supra note 45, at 30.
\(^{117}\) Adams, supra note 31, at 66.
magnified and projected by the railroad, and unrestrained by any traditional countervailing influences, affected the general interest. One man's ego, laid out across the land, over chasms and through mountains, propelled across thousands of miles by track and steam, affected millions of people.

Yes, the railroads created new cities with great opportunities for the new urbanites, but they often ruined small towns. For all that was gained, much was lost "[d]uring the quarter century after 1873, Americans had been forced to come to terms with an accelerating sense of loss of control over their destinies, as those familiar "island communities" that had structured an earlier way of life were seen to be rapidly fading away."\(^{118}\) The railroads brought new "options within reach," but they also cut out options. It was feared that the new giants of industrial civilization would squeeze the independence out of farmers\(^{119}\), small manufacturers and merchants, shopkeepers and consumers and make the populace "their serfs and tributaries."

2. The Erosion of Traditional Values: Money Talks

A social system based on national commercial exchange means that big business tends to squeeze out small business. It means that money talks, and little else does. This crassly-worded philosophy has significant further implications, some of them not immediately apparent. Among these is the erosion of traditional values, the idea that society should not disapprove of any "lifestyle." Anything goes.

In a broad cultural sense "money talks" is very much a post-Enlightenment capitalistic concept that we readily accept, because, in theory, money can be made by anyone who is hard working, imaginative, and lucky. Skin color, national origin, gender, handicap, age, social class, and religion do not, in theory, matter.\(^{120}\) If those traditional ascriptions and

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\(^{118}\) "[T]he principal object of the construction of the Pennsylvania Rail Road, was the promotion of the mercantile interests of Philadelphia." Ward, supra note 39, at 139-40.

\(^{119}\) Horwitz, supra note 32, at 65.

\(^{120}\) Of all the businessmen in the 19th Century, none complained more bitterly than farmers (of whom there were many more in the 1890s than there are in the 1990s), whose problems included excessive indebtedness, high interest rates, post-war inflation, heavy and inequitable taxes, low commodity prices, lack of representation in Congress, declining social position, inadequate agricultural educational systems, rural isolation and, most galling of all, utter dependence upon railroads, whose rates were set in eastern cities by multimillionaires. Buck, supra note 31, at 41. The farmers organized, agitated and lobbied, creating in less than ten years a powerful social and political organization, the Grange. This organization, founded in 1867 by Oliver H. Kelly, had as an early goal lobbying the state and federal legislatures, relentlessly demanding railroad regulation. Revisionists dispute that the Granger movement, properly defined to refer to members of the Grange, really had very much to do with the granger laws; the modern interpretation tends show "the relative insignificance of the Patrons of Husbandry, or the Grange as it is more commonly called, in the struggle to regulate rail carriers." D. Sven Nordin, Rich
place-putters no longer control, why, it is asked, should any, such as sexual orientation, marital status, or occupation? If money talks, a woman with money is no less respected than a man, a homosexual no less respected than a heterosexual, a black man no less respected than a white man, a war profiteer than a car salesman, a pornographer than a grocer.

A social order based on national commercial exchange thus means that people are not bound by traditional constraints because these constraints are not relevant. Moreover, people sense they have an affirmative right to the general societal acceptance of their "lifestyle," however non-traditional, because modernism and capitalism eschew restraints, ascription, putting-in-place, and formalism, and promote equality and toleration. When the railroads showed a new range of possibilities, people saw they did not have to be old-fashioned any more. If people do not want to be old-fashioned, if they want to make or re-make themselves, the law will accommodate, and has accommodated.

Because "all normative standards of behavior and achievement are fading away," the people are sovereign; our system views their ideas as good. Law is, to some extent, an instrument; it bends to the peoples' will; it is an instrument that "constituent parts of society can manipulate deliberately for personal or social ends." To the extent that we are not Anglo-Saxon, heterosexual, Protestant, male, or heir to money, we like modernism's equal opportunity; immigrants come to the United States where their immutable characteristics do not limit opportunity for success. To the extent that we have an attribute that is now devalued, we resent the intrusion of upstarts and the erosion of standards.

A social order based on national (and now international) commercial exchange contributes, at least, to the loss of traditional values and to the expansion of non-traditional rights; this, and the recognition that the law is complicit in this loss, is disquieting (what Mark Helprin complained about - society is going to hell in a handbasket). In this system, what


121. The fundamental categories of Enlightenment thought that parallel the market economy are the primacy of contract as the method for ordering human affairs (including the social contract for ordering the relationship between government and governed); equality as between parties to a commercial transaction (the act of exchange is essentially democratic); universality (the character of the buyer is of no importance to the seller, and the rules of the exchange are fixed by the system); toleration (religious and moral convictions of buyer and seller are of no importance); freedom (essential for the workings of the market economy) and property (the right to alienate the property, goods or real estate, that is the subject of the contract).

122. Clausen, supra note 106, at 6.

123. Friedman, supra note 6, at 22. Society has manipulated the law to obtain ever-greater rights for personal expression and free development. If gays want freedom from discrimination in housing and employment, they work through interest groups and lobbying to get the city council to approve a non-discrimination law protecting them. If they want to get married, they
does not contribute to commerce is old-fashioned, devalued, including peoples' ability to commit themselves, to establish binding relationships, to sink permanent roots, to maintain continuity with previous generations, to remember, to make ethical judgments, to seek pleasure in work, to remain steadfast on behalf of principle and loyal to community or country (to the degree that community or country strives to be just and fair), to seek spiritual transcendence beyond the self, and to fight a cause through to the end. 124
3. The Triumph of Materialism

To have a money-making business become the most profound influence in informing an urban civilization means the triumph of big business over small; it portends a cultural revolution where traditional values lose their importance, and it means the triumph of materialism. If commercial exchange is the driving force of society, then necessarily, to promote continued exchange, there must be continued consumption. With the rise of a "modern consumer society," people are driven by the conscious designs of marketing, to want material things, to consume.\textsuperscript{125} People have always wanted material things, and it is nothing new to observe that we are going to hell in a handbasket. Every generation wrings its hands at the decline of decency.\textsuperscript{126} But what is different, what is becoming apparent, is that the rate of decline is increasing due to the availability of what the railroads first presented people with: "options within reasonable reach,"\textsuperscript{127} and the continuing lack of any generally-acceptable restraining influences. People inherently feel incomplete, unsatisfied; we yearn for more. Modern marketing wants people to believe that the yearning can be satisfied by consuming; people think that this is reasonable because society in general promotes little else to believe.

By the 1890's businessmen perceived that people developing "character" would not consume beyond traditional limits, but that those fash-

\textsuperscript{125} Leach, supra note 91, at 387. In this context, regarding commitment to one's own higher principles, continuity with previous generations, steadfastness to principle, seeking spiritual transcendence beyond the self, fighting a cause through to the end, it is disheartening to read what feminism may have become. Feminism used to speak to serious issues of women's rights, to the best aspects of the search for women's self-fulfillment outside the traditional roles ascribed by male-dominated society (equal employment, political, and economic rights). But now much of feminism has devolved into the silly. [It offers] images of grown single women as frazzled, self-absorbed girls. Ally McBeal is the most popular female character on television \ldots{} Ally spends much of her time fantasizing about her ex-boyfriend, who is married and in the next office, and manages to work references to her mangled love life into nearly every summation she delivers. She has fits in supermarkets because there are too few cans of Pringles.

Ginia Bellafante, Feminism: It's All About ME!, TIME, June 29, 1998, at 54.

Post-feminism has, certainly not completely, but to some extent, "degenerated into an excuse for media-hungry would-be feminists to share their adventures in the mall or in bed" or ala Linda Tripp (who tape-recorded the infamous Lewinski conversations) to denounce male hypocrisy.

\textsuperscript{126} This, indirectly, in its architectural manifestation is what Kunstler complains about. See generally Kunstler, supra note 10 (discussing the loss of community due to zoning). When money talks we eschew limitations on personal fulfillment, we also eschew limitations on material consumption (which are satisfied with credit cards if there is no cash in the bank), and, moreover, we fail to say "no" as well to the purveyors of this materialism and to the horrible strips and malls in which they sell their stuff.

\textsuperscript{127} It was a generation ago that Walter Lippman wrote, "We must find a way to re-establish confidence in the validity of public standards." Lippmann, supra note 20, at 114.
ioning their “personalities” would. So consumer-oriented capitalism was consciously developed.128 John Wanamaker, the department-store empire builder, wrote that consumer capitalism “does not say ‘Pray, obey, sacrifice thyself, respect the King, fear thy master.’ It whispers, ‘Amuse thyself, take care of yourself.’ Is this not the natural and logical effect of an age of individualism?” 129 In a society where consumption is King everything must be new - why consume new if the old is still acceptable? Not to consume is to be old-fashioned. No one wants to be old-fashioned! We are driven to embrace modernity. Young people of the world are becoming “hook[ed]” on U.S.-style consumerism and by the often tawdry publications that promote consumerism. Certainly the railroads are no longer the vehicle for hooking people; now consumerism is promoted by global movies and especially television.130

Religion, art, culture, quietude and solitude, have all been pushed

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128. See supra text accompanying note 82. “This inflation of personality at the expense of external reality did not begin with the computer age . . . . Computers and their sibling, cable television, have, however, greatly accelerated the process.” Clausen, supra note 106, at 6.

129. At the turn of the last century it appeared that production was outstripping consumption:

[S]omething beyond dependence on the “natural laws” of supply and demand was called for to ensure [inventory] turnover. Businessmen would have to intervene more aggressively . . . by persuading and changing minds, by transforming the imagination . . . . It required the diffusion of “desire” throughout the entire population . . . . And money was not the decisive factor in building desire. “Without imagination, no wants . . . . Without wants, no demand to have them satisfied.” Leach, note 91 supra, at 37.

Leach points out that our present consumer culture was not chosen by people; it was, rather, forced upon us. It was not produced by the people, but by commercial groups bent on making profits and accumulating capital. And:

second, it was nonconsensual because, in its mere day-to-day conduct (but not in any conspiratorial way), it raised to the fore only one vision of the good life and pushed out all others. In this way, it diminished American public life, denying the American people access to insight into other ways of organizing and conceiving life . . . .

Id. at xv.

130. Id. at 3 (quoting the famous and pioneering department-store magnate). Individualism taken to the extreme is a sense of selfishness, a sense that rules designed to constrain others do not apply to me. On the contemporary sports scene of professional basketball and hockey “[t]he players, rather than working to win inside the rules, devote themselves to seeing how much that can get away with outside the rules.” Douglas S. Looney, When Rule-Busting Becomes the Norm, Christian Sci. Monitor, May 29, 1998, at B8. The reason for this disintegration of manners is easy to understand: the game officials “think a little violence, like dessert, adds to the enjoyment of the meal.” Id. The more enjoyable the meal, the more people will order it up, and the more money sponsors will spend on advertising during the games. Perhaps even more distressing than the trend here to see how much a person can get away with “outside the rules” is the reasonable consequence: an inability to understand that there even are any rules, or why there should be. Rules imply hierarchy, place-putting, the antithesis of the modern trend. So the traditional university lecture “is rejected as a form of bondage, an imposition of the lecturer’s view upon active minds forced into passivity.” Kenneth R. Stunkel, The Lecture: a Powerful Tool for Intellectual Liberation, Chron. Higher Educ., June 26, 1998, at A52. When “dress-down Fridays” at a business office expand to all week and degenerate into “short shorts, a
aside by a fixation with 12-mile-per gallon four-wheel-drive "sport utility vehicles," jet skies and snowmobiles, off-road vehicles that roar up and down upon the face of nature, the vast wasteland of television, AM radio, the Internet, and the violence and tastelessness of many movies. We can hardly, as a society, say no to any of it. We can hardly say no, not because the First Amendment protects freedom of speech (the freedom that liberates us and demeans us131) but because producers have convinced most of us that consuming from the smorgasbord of options brought within reach by modern technology gratifies us, and satisfies us.132 We have, as a society, nothing else to turn to. We dismissed God 300 years ago, and now, "[i]nsofar as there is a dominant belief in our society today, it is a belief in the magic of the marketplace . . . that the common good is best served by the uninhibited pursuit of self-interest,"133 which, we are told,

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131. For examples, MTV. The Music Television station is available in the U.S., Australia, India, Mandarin, Latin America, Japan, Brazil, Europe, Toronto. Smillie, supra note 19. As to the reach of global television:
The cumulative effect of initiating our children into a consumerist ethos at an ever earlier age may be profound. As kids drink in the world around them, many of their cultural encounters - from books to movies to TV - have become little more than sales pitches, devoid of any moral beyond a plea for purchase . . . . Instead of transmitting a sense of who we are and what we hold important, today's marketing-driven culture is instilling in them the sense that little exists without a sales pitch attached and that self-worth is something you buy at a shopping mall.

David Leonhardt & Kathleen Kerwin, Hey Kid, Buy This!, BUS. WK., June 30, 1997, at 62 .

Perhaps hearteningly, the invasion of U.S. culture is not being greeted without resistance. Around the world various countries, Canada, Korea, France, among them are regulating the quantity of American content on tv and movie screens. But Hollywood moguls respond: “Attempts to promote [indigenous] culture while ignoring the demands of the market are doomed to fail.” Gloria Goodale, US Pop Culture Envelops Globe (Globe Not Entirely Pleased), CHRISTIAN SCI. MONITOR, Aug. 7, 1998, B1 and B6.

132. The author informed his introduction to law class that law was once a respected profession; he asked the class of 120 how many felt the law was today a respected profession. Not one student raised a hand. Justice O'Connor reflected upon the demeaning effect of advertising on the once-respectable profession of law:

I continue to believe that this Court took a wrong turn with Bates v. State Bar of Arizona . . . and that it has compounded this error by finding increasingly unprofessional forms of attorney advertising to be protected speech. These cases consistently focus on whether the challenged advertisement directly harms the listener; whether it is false or misleading, or amounts to “overreaching, invasion of privacy, [or] the exercise of undue influence.” This focus is too narrow. In my view, the States have the broader authority to prohibit commercial speech that, albeit not directly harmful to the listener, is inconsistent with the speaker's membership in a learned profession and therefore damaging to the profession and society at large. In particular, the States may prohibit certain "forms of competition usual in the business world," on the grounds that pure profit seeking degrades the public-spirited culture of the profession . . . . Commercialization has an incremental, indirect, yet profound effect on professional culture, as lawyers know all too well.


133. As Ralph Waldo Emerson said, “Things are in the saddle and ride mankind.” The pop-
is consumption.

Perhaps the longest lasting, and currently most apparent, effect of the railroad (that is, industrialized-post Enlightenment) mentality as been alluded to before. It has “transmitted to nearly all cultures the radical modernist project of subjugating nature by deploying technology to exploit the earth for human purposes . . . turning nature into an object of human will.”\textsuperscript{134} The earth is the victim; it has become an object to use up. Even today the railroads amaze us. The railroads’ bridges, tunnels, and trestles show man’s dominion over nature. So does one-hundred-fifty years of coal and iron extraction necessary to build and feed the railroad and the environmental ruination left from such activities.

Throughout history, there have been countervailing influences to ameliorate the pressure to consume. The idea of people expressing themselves through market behavior was tempered;

people [used to be] guided by a set of moral principles that found expression in behavior outside the scope of the market mechanism. Deeply rooted in tradition, religion, and culture, these principles were not necessarily rational in the sense of presenting conscious choices among available alternatives. Indeed, they often could not hold their own when alternatives became available. Market values served to undermine traditional values . . . . What used to be professions have turned into businesses. The cult of success has replaced a belief in principles. Society has lost its anchor.\textsuperscript{135}

William Leach, in his provocative study of the history of the American department store, quotes Samuel Strauss, who wrote an article for \textit{The Village} in which he said,

In normal times there are spiritual goods which compete with the merchant’s wares automatically setting limitations upon the number of material goods that can be forced upon the community. Ours, however, have been abnormal times; for more than a century things have little by little been filling the stream of existence, little by little absorbing the place normally held by the imponderables, by religion, by art and culture. The fact is that capital’s appetite for profits, meeting with no restraint, has been literally eating its way into our right existence and throwing it all out of proportion.\textsuperscript{136}

\textsuperscript{134} Soros, \textit{supra} note 18, at 48.

\textsuperscript{135} Gray, \textit{supra} note 23, at 178. A good example of subjugating nature to human will is the business, industry, of “swim-with-dolphin” programs. The idea is to capture dolphins, domesticate them, and allow (force) them to swim in fenced-off sea lagoons with humans for the latter’s entertainment and the enrichment of the program’s proprietors. Alex Salkever, \textit{New Rules Revive Ecological Dispute Over Swim-with-Dolphin Programs}, \textit{Christian Sci. Monitor}, Sept. 30, 1998, at 3.

\textsuperscript{136} Gray, \textit{supra} note 23, at 52.
It has been argued here that the cultural, legal, ethical, social, and economic system promoted by the railroads created a Railroad Problem that was only partially addressed in the 19th Century, and has not been successfully addressed in the 20th. The Granger Laws were the first attempt to deal with the Railroad Problem on a national level, but they only addressed specific abuses. These laws were not very effective because some of the “abuses” of the railroads, particularly their attempts to reduce inter-railroad competition, made sense, and because the fundamental Railroad Problem went far beyond those addressed. People were aware that the problem contained more than rate-setting, safety, pooling, and employee relations, but nothing could be done about it (“de-urbanization” - as the 1980s Cambodian Pol Pot’s Khmer Rouge discovered - cannot be accomplished neatly); the railroad revolution cannot be undone by government. Modern revisionists suggest that the laws were worse than useless - they ruined the railroads. However, as argued here, the economic aspects of the Railroad were only part of the problem, and the regulation directly addressed economics. No effort was made, or perhaps could be made, to deal with the fundamental problem, the disappearance of any authority to curb the materialistic enthusiasms that the railroads promoted in order to make money; or, more broadly expressed, the lack of any societally-supported alternative to capitalism and consumerism. Thus, whether the Granger Laws made “economic sense or were even effective is not the issue here. It does not capture the cultural meaning of these laws to describe them in purely economic terms.”\(^{137}\)

B. THE 20TH CENTURY RESPONSE.

Our response to the “Modern Problem” has not been very successful either. Again, it is suggested that the problem was, and is, threefold: the triumph of big business over small, the erosion of traditional values, and the celebration of materialism and consumption, with concomitant environmental destruction.

1. Antitrust Laws

Antitrust laws, fraught enough with difficulties and self-contradictions,\(^ {138}\) are the tool of choice for dealing with “big business over small.” However, they are not rigorously enough imposed to do more than curb the most egregious abuses (though they are better than nothing).\(^ {139}\)

\(^{137}\) Leach, supra note 91, at 268. Harvey Cox said “the market’s first commandment is there is never enough.” Cox, supra note 29, at 290.

\(^{138}\) Friedman, supra note 6, at 66.

\(^{139}\) Judge Learned Hand famously observed, “The successful competitor, having been urged to compete, must not be turned upon when he wins.” United States v. ALCOA, 148 F.2d 416, 430 (2d Cir. 1945).
2. The Reassertion of Traditional Values

Conservatives worry, and not without reason, about the erosion of traditional values, individualism run amok: abortion rights, divorce rights, affirmative action (as part of the civil rights movement) gay rights, the right to die, the right to use marijuana, and so on. This concern may represent some progress in a way: at least the conservatives focus social and cultural problems, not exclusively on economic ones, and some efforts have been made to curtail “excessive” license.\textsuperscript{140} For the most part, these gestures are at the grass-roots level are ridiculed.\textsuperscript{141} And insofar as

\textsuperscript{140} Faced with potentially hostile judges, the executive branch has traditionally deliberated very carefully before launching a criminal antitrust action. ‘The Justice Department, as an institution, is extremely conservative,’ Philip Verveer, a former government lawyer [says].” Cassidy, supra note 18.

\textsuperscript{141} In 1993 public criticism of “gansta rap” part of a “budding national backlash against explicit rap music,” convinced a number of broadcasters to censor themselves. It seemed that every second piece of legislation coming out of the 1994-96 Congress had “decency” or “family” in its name, including the instantly infamous “Communications Decency Act of 1996.” Scott Armstrong, Backlash is Brewing Over ‘Gansta Rap’ Lyrics as Public Says ‘Enough’, CHRISTIAN SCI. MONITOR, Dec. 13, 1993, at 1.

In April 1997 the TV actress Ellen DeGeneres attracted nationwide media attention by “coming out” as a lesbian on her television program; the ABC affiliate in Birmingham, Alabama refused to air the episode. (A more promising approach than censorship to concerns about sex and violence on television might be suggested by the television networks’ decision in 1996 to create their own system of ratings that would alert viewers, particularly parents, to violence, sex or coarse language in programming. When technology permits, parents or other viewers could use these ratings in combination with the proposed v-chip, to be installed in most TV sets, to block programming they find objectionable. Would the “v-chip” censor Ellen, a program with no sex or violence, but which discussed a current social issue of some importance and which used the word “gay”? And a Charlotte, N.C. county commissioner was “besieged with thank you notes from constituents cheering his vote to stop funding groups that expose the public to homosexuality.” Elizabeth Levitan Spaid, Conservative South Clashes with Open Homosexuality, CHRISTIAN SCI. MONITOR, Apr. 30, 1997, at 3. The Disney company, parent of the ABC television network, was boycotted by Southern Baptists in protest over its gay-friendly company policies and the publication, by one of its subsidiary record companies, of records with obscene lyrics.

The resolution agreed to by the Southern Baptists here last week condemned Disney for extending benefits to the same-sex partners of its employees. But many Baptists admit the convention’s beef with the entertainment giant is largely driven by the content of TV shows and movies it produces - including the film “Pulp Fiction” and the ABC sitcom “Ellen.”


A few days later, Disney announced it was recalling an estimated 100,000 copies of a new, obscenity-laced album from store shelves. The Baptists claimed a victory for family values. Michelle Dearmond, Disney Pulls Hip-Hop Album, ASSOCIATED PRESS, June 27, 1997, available at 1997 WL 4875540. Always the on-off switch remains available.

Judge Roy Moore, a circuit judge in Gadsden, Alabama was praised by over 6000 people at a prayer rally for his refusal to remove from his courtroom wall a hand-carved tablet of the Ten Commandments. His stand against “the assault on religious beliefs” was equally condemned by those who argued he and the state have no right to promote religious beliefs. Elizabeth Levitan
they tread on our cherished individualism, they are unlikely to be successful:

Individualism is an historic force and not a formal argument . . . . It is bound up in the emancipation of the worker from the restraints of serfdom, in the evolution of property, in the assertion of intellectual liberty, in the development of popular government and all that goes to make up a society adjusted to the idea of autonomy and spontaneity . . . . It is the sweep of modern history.142

Nor have political leaders, conservative or otherwise, been effective in showing a good response. It may appear that 19th Century politicians imposed constraint on the railroads (and on big business in general) to bring about the end of laissez faire; one might think, that if it could be done 100 years ago, it can be done today. But politicians did not impose much; they followed the interests of industry and the dictates of popular demand143 and - as suggested here - were generally not successful. Today, politicians who propose doses of the bitter medicine of self-restraint or who suggest that there should be some limits on any “culture’s” freedom of expression or consumption are generally not popular; they are considered “politically incorrect,” laughable, old-fashioned,144 meddling, or


The reaction to “casual Friday” business attire has been observed; businesses “need to define what casual means, what is acceptable and what is not. Id. That is, there needs to be some assertion of authority over business dress. Sahm, supra note 129.

142. If they are not unconstitutional, however, the Communications Decency Act of 1996 was declared unconstitutional by the Supreme Court. See Reno v. American Civil Liberties, 117 S. Ct. 2329 (1997). Judge Moore cannot be doing much to improve Alabama’s image as a backwater of ridiculous narrow-mindedness, and many people from outside the South roll their eyes at ham-handed censoring of television, thinking that this is simply more of the same antediluvian mentality that caused Southern police to hose down civil rights marchers in the sixties, more of the same “great tradition of doing things the same way we have always done them.” Elizabeth Levitan Spaid, Dixie Politics: Boys Clubs Still Prevail, Christian Sci. Monitor, June 10, 1997, at 1 (quoting a male Southern politician).

143. Adams, supra note 48, at 142.

144. There were a large number of people - farmers and the working class in the nascent labor unions - who wanted constraints imposed on the roads; by 1886 the idea of imposing constraints on the railroads was not unpopular, not against popular opinion. Riots in the streets may be helpful in focussing government attention on a problem, and in the 1880s riots led to the formation of government commissions to consider and, if feasible, address the causes of popular unrest. What the railroads had been doing was perceived by the public not to be in the public interest; the self-interest of the magnates was perceived not to be in the public interest.

As Kolko convincingly demonstrates, the railroad bosses themselves wanted government regulation; they saw themselves that what they had been doing was not in their own interest:

The Great Strike of 1877 pointed to the danger of attacks on the railroads, not merely from the workers . . . but from the states and the Granger movement. The hostility of workers and farmers, many of whom controlled state politics, pointed to the possibility of local attacks which threatened to dislocate railroad systems that were regional, if not national, in their scope. Federal railroad regulation appeared to many railroad leaders
dangerous, and have a hard time getting elected or re-elected. Moreover, even if politicians did have the courage to propose any significant curtailing of individualism, it would be no more acceptable or successful than it has been by those conservatives working at the grass-roots level.

So it seems clear that an attempt to impose culture, standards, or ethics is not going to work either from below or from above. No public philosophy of a "decent" culture has ever been imposed by fiat in a free society (Prohibition failed spectacularly), and there is no clear public agreement about what constraints should be imposed; there is no agreement as to what values should be promoted besides free enterprise. American free enterprise, which seems to be particularly cherished by those conservatives most offended by its licentious manifestations, is inexorably tied up with license as has been suggested above.

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as a safe shield behind which to hide from the consequences of local democracy, as well as a means of solving their own internal problems ... [T]he railroads ... supported the basic principle and institution of federal regulation [a]nd enthusiastically worked for its extension and for the supremacy of federal regulation over the states.

KOLKO, supra note 49, at 41, 232.

The railroads' general position was that "many of the leading railway managers admit the justice of [the ICCA's] ... terms and join in demand for its passage. The irregularities that have gradually crept into [the railroad system], got beyond their capacity to manage." Id. (quoting the Chicago Inter-Ocean, Jan. 2, 1887).

145. Or they are almost apologetic. Brian Baird, a candidate for the U.S. Congress from the 3rd District in Washington State, said in his kick-off speech: "[A]nd I know this may be controversial, but it won't cost us a penny more in taxes - the single most important step we need to take right now is to turn off the darn television ... a device that spews meaningless garbage. We have an entire generation that has been trained not to think critically about the information that bombards them." Brian Baird, Campaign Kickoff Speech, Strategies: The Washington State Democratic Party [NEWSLETTER], 5/1 (1997) at 6.

146. With exceptions so rare that they are regarded as miracles and freaks of nature, successful democratic politicians are insecure and intimidated men. They advance politically only as they placate, appease, bribe, seduce, bamboozle, or otherwise manage to manipulate the demanding and threatening elements in their constituency. The decisive consideration is not whether the proposition is good but whether it is popular - not whether it will work well and prove itself but whether the active talking constituents like it immediately ...

LIPPMANN, supra note 20, at 27.

147. For example, should our society allow its citizens, in their public interaction and via our airwaves, to speak languages other than English? Should we allow doctor-assisted suicide, research into cloning humans (the acceptance of human cloning has gained ground remarkably. It seems very unlikely that calls for caution [will be] ... enough to stop lab research once it has begun. And here again is a new technology, morally neutral itself, with disturbing ethical implications about which we are "never saying, 'Maybe we should put up a red light.'"

Illinois physicist Richard Seed makes a persuasive case for developing the technology: there is market for it; it will make money. Robert Marquand, Cloning Bolls Ahead ... Toward People?, CHRISTIAN SCI. MONITOR, Jan. 22, 1998, at 4. "Normal" homosexuals on television, "gratuitous" violence on television (the fall 1998 television lineup featured a new show, the premise of which was "revenge for hire"), the Ten Commandments on the courtroom wall, death as a penalty for some crimes? What about clear cutting in public forest lands, limits on the freedom to extinguish endangered species, or restrictions on taking salmon, or whales, or sharks? Cigarette advertis-
wants throw the baby out with the bath water or kill the goose laying the golden eggs, least of all conservatives. The economic policies conservatives promote tend to create the social circumstances they deplore.

Individualism swept modern history because, at one time, "equity and progress, both social and political, resulted from its influence."148 One hundred years ago it became apparent that unrestrained economic freedom was not in the general interest, because it was possible with the industrial revolution, and more specifically, with the development of steam transportation for the self-interested economic activities of a few (J.D. Rockefeller, Jay Gould, James J. Hill) to affect the general interest, and because those adversely affected literally rioted in the streets. The rules of industrial conduct, formulated under the conditions of the 18th Century, failed to take into consideration important facets of industrial life. Those rules were changed. Again, we are at the point where the self-interested economic activities of a few (and of many who must compete with them) affect the general interest, where the rules of post-Enlightenment conduct (lack of trans-personal authority or restraint) fail to take into consideration important facts of post-industrial life (that personal restraint is necessary for a decent society). The problem is aggra-

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148. See supra text accompanying note 119.


Gray, supra note 23, at 110-11.
vated and compounded by the relentless pressure to consume. Individualism has been perverted, and has become the thrall of big business.

3. The Triumph of Materialism

The third aspect of the Railroad Problem that is unresolved is the triumph of materialism. This problem too seems intractable. Would not our economy crumble if people stopped consuming? Possibly not. Some people rebelled against this materialism, but for the most part these people are not taken seriously. If a person says he does not watch television he is looked at strangely, people who advocate a “green” philosophy are not in positions of authority, and those who really give up the “comforts” of modernism are thought bizarre, or insane.

Why are we not rioting in the streets? Because the Enlightenment convinced that us it is in our interest to be free of most constraints, material and cultural, and to exploit the earth for material gain. This conviction is consciously fostered by producers to promotion consumption, and we are lead to appreciate, protect, and admire those who most directly satisfy our interest in self-satisfaction and consumption. We do not associate our malaise with its truest source. Self-satisfaction or gratification has become the new reality, the touchstone upon which the things of our society are measured.

Self-satisfaction, though, has no limit; it has no external or limiting reality. Bertrand Russell wrote

The concept of “truth” as something dependent upon facts largely outside human control has been one of the ways in which philosophy hitherto has inculcated the necessary element of humility. When this check upon pride is removed, a further step is taken on the road towards a certain kind of madness - the intoxication of power... to which modern men... are prone. I am persuaded that this intoxication is the greatest danger of our time, and that any philosophy, which however unintentionally, contributes to it is increasing the danger of vast social disaster.

149. Adams, supra note 48, at 142.

150. Thoughtful alternatives to our consumer-oriented society have been considered. For a classic in the area see Alternatives to Growth: A Search for Sustainable Futures (Dennis L. Meadows ed. 1977).

151. Defense attorneys for Theodore Kaczynski, who later confessed to being the “Unabomber,” intended to show at his Sacramento trial that anyone who would choose to live in a one-room, “isolated cabin with no plumbing or electricity could not have the mental capacity to be executed for the crimes for which he stood accused.” Brad Knickerbocker, Tracing Kaczynski From Cabin to Court, CHRISTIAN SCI. MONITOR, Jan. 5, 1998, at 1. That is, it is considered persuasive, or at least probative, evidence a man is crazy that he has eschewed the trappings of modernity!
VI. Conclusion

The idea once reigned that business should be unconstrained, that each person's self interest would, if pursued, work for the common economic good. The railroad experience taught the 19th Century that this idea was not necessarily correct. It was not "wrong" that a politically contentious people should come to despise and reject the railroad and make it "the chief scapegoat of their discontents"152 - people had discontents, and the railroads, the foremost instrumentality of modernism, were a focus for them. But the 19th Century response to the problem was less than successful because the unconstrained pursuit of economic interest adversely affected the economy. This resulted from modern industrialism's unprecedented ability to magnify the railroad magnates' self interest and project it across the land. The real Railroad Problem was inherent in the roads' creation of a "culture of national commercial exchange" that strongly appealed to the American post-Enlightenment mentality eager for self expression, unfettered by constraining ideology, and open to new ideas; indeed, national commercial exchange became the new religion, and it has squeezed out all the other informing interests.

Experience is now teaching us that we still have a Railroad Problem. The ability of modern electronic media to magnify corporate interests and project them across the land, combined with the constant insistence by most of our influential institutions that national commercial exchange is the only broadly acceptable societal purpose, has shrunk the non-materialistic options within reach to those that at base cannot satisfy us. There is nothing wrong with materialism, unless its allure is never challenged by any respectable alternatives. Even in the face of an increasingly "vast

152. See supra text accompanying note 3. Thoreau wrote:

Men think that it is essential that the Nation have commerce, and export ice, and talk through a telegraph, and ride thirty miles an hour, whether they do or not; but whether we should live like baboons or men, is a little uncertain. If we do not get out sleepers [wooden railroad ties], and forge rails, and devote days and nights to the work, but go to tinkering upon our lives to improve them, who will build railroads? And if railroads are not built, how shall we get to heaven in season? But if we stay at home and mind our business, who will want railroads? We do not ride on the railroad; it rides upon us. Did you every think what those sleepers are that underlie the railroad? Each one is a man, an Irishman, or a Yankee man. The rails are laid on them, and they are covered with sand, and the cars run smoothly over them. They are sound sleepers, I assure you. And every few years a new lot is laid down and run over; so that, if some have the pleasure of riding on a rail, others have the misfortune to be ridden upon. And when they run over a man that is walking in his sleep, a supernumerary sleeper in the wrong position, and wake him up, they suddenly stop the cars and make a hue and cry about it, as if this were an exception. I am glad to know that it takes a gang of men for every five miles to keep the sleepers down and level in their beds as it is, for this is a sign that they might sometime get up again.

social disaster”\textsuperscript{153} - the ruination of the environment - we are loath to reimpose any major constraints on ourselves, to set any significant ethical or cultural standards for the creation of a decent social structure. Heaven knows, anything goes.

The Railroad Problem still exists. What are we to do?

Our political leaders cannot impose decency upon us. Perhaps our teachers, business people, political leaders, those with the inclination to reflect on such things, could agree to honestly discuss the erosion of our standards; perhaps we could agree to face front-on our progressive barbarization, its descent into violence and ugliness and crassness.\textsuperscript{154} The railroad abuses born of laissez faire were, by the 1880s, apparent to almost everyone (including the railroad bosses). The relationship between today’s dissatisfactions - that we “feel glum about the nature and future of our civilization”\textsuperscript{155} - and today’s cultural laissez-faire need to be made apparent, played up, noticed.\textsuperscript{156}

Advocates for some principles of decency should not be intellectually discredited; these principles and their discussions should not be dismissed out of hand as superstition, obscurantism, meaningless metaphysics, reactionarism, self-seeking rationalizations, narrow-mindedness, politically incorrect, chauvinistic, intolerant, elitist, culturally imperielalist, anti-business, or protectionist.\textsuperscript{157} In our public discussions we

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\textsuperscript{153} See supra text accompanying note 148. It is apparent that we cannot, for example, go on indefinitely expanding our population and paving over the planet.
\textsuperscript{154} Look in the telephone book yellow pages under “Attorneys” and see if the profession has not, in general, degenerated into a crass, sordid business.
\textsuperscript{155} See supra note 10 and accompanying text. It still takes a gang of men for every five miles to keep the sleepers down.
\textsuperscript{156} The death of Diana, Princess of Wales, at least focussed some attention on the corrupting and degrading influence of one of the most demoralizing aspects of popular culture, the tabloid press. As Henry Carter Adams said, the strange thing is not that we recognize how unacceptable free license was one hundred years ago, the “strange thing in the situation is that, while this is easily seen with regard to controversies of the past, it is with difficulty appreciated when a controversy that touches our lives is the subject of the analysis.” See supra note 48 and accompanying text. It is also heartening to see some restrictions now being imposed on one of the most offensive neighborhood-noise makers, the leaf blower. In California, 44 cities have enacted restrictions on blowers, including Beverly Hills, Santa Monica, Dana Point, Laguna Beach, South Pasadena and Claremont; the obnoxious machines have been banned from Berkeley since 1990, and in Los Angeles their use is to be highly restricted as of January 1, 1998. Limitations on leaf blowers have also been effected in Scarsdale, Oyster Bay, and North Hempstead, New York. Winnetka, Illinois defines the use of gasoline-powered leaf blowers at certain times of the day to be a public nuisance. Ted Ruet, \textit{Ssh! Can You Turn Down that Leaf Blower?}, \textsc{Christian Sci. Monitor}, Oct. 3, 1997, at 19.
\textsuperscript{157} Part of the problem here is that the advocates of a “decent” society are very often perceived to be the most reactionary and oppressive troglodytes. Internationally we have seen the Chinese “cultural revolution” of the 1970s, the horrors of the Khmer Rouge, the repressive fundamentalism of Muslim rulers in Iran and, more recently, the Taliban in Afghanistan; we know what kind of society resulted from the old Soviet Union’s efforts to discourage “decadent”
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need to stop feeling that we should apologize for saying things are going
to hell in a handbasket, that some aspects of modern culture are unac-
ceptable, that there is something wrong with letting people “vote with
their dollars” when the rich can buy more “votes” than others, that some
peoples’ “cultural” manifestations (for the most part promoted by adver-
tising) are so injurious to the general society as to be unacceptable, that
while all men may be created equal, not all cultures are, even if that ex-
pression offends some people’s sensibilities.

Even if we recognize the social disaster already upon us and allowed
some honest discussion of the problem, it would still be difficult to articu-
late any broadly acceptable principles upon which we could all agree,158
much less impose. For here we tread on dangerous ground in a democ-
rracy159 - we intimate the imposition of some standards.

It is not necessary for our institutions to impose “decent values”
upon us, it cannot, and should not, be done. It would be a good start if
we stopped actively promoting, at home and world wide, values of com-
mercialism and consumerism that too easily fill the void caused by the
disintegration of traditional values. Where is it written in the Constitu-
tion that the business of government is business? This is not to denigrate
business or the International Monetary Fund, but only to give other phi-

behavior and today we watch with a horrible fascination at the bizarre goings-on in North Korea.
Even the effort of the French establishment to discourage the invasion of American culture
seems odd, at least. See generally Mark Clayton, It’s “Piano” vs. “Jurassic Park” in Movie Joust,
CHRISTIAN SCI. MONITOR, Feb. 7, 1996, at 14 (describing the French Ministry of Culture’s at-
tempt to resist “the U.S. cultural invasion”). All of these societies promote their variously re-
pressive regimes as protectors and defenders of decent culture and true values. In the United
States “decency’” is too often associated with its promotion by those who appear ignorant and
narrow-minded, most especially by the uncharitable, unattractive repressiveness of the religious
right who are correct to emphasize “family” values, but too narrow-minded to appreciate that a
“family” may be something other than their traditional fantasy.

158. Could we agree that our suburban landscape is truly ugly and demoralizing, and assent
to a significant increase in the gasoline tax to fund public transit and to pay landowners for
aesthetic improvement? Is it yet beyond the pale to assert that the environment should have
some legal rights? See, e.g., Warner, supra note 21, at 455 (the article includes some review
and argument on whether, to use Christopher Stone’s famous phrase, “trees should have standing’’;
if environmental entities had legal rights independent of the entities’ usefulness to us, we would be
constrained by a non-human limitation). If giving legal rights to the environment is unaccept-
able, we could perhaps promote “environmental accounting,” the idea that businesses should
account, in their books and records, for the negative externalities of their operations and be
required to ameliorate them over time. Or could we agree, say, that children should not be born
out of wedlock? And once that was agreed we might craft laws and regulations to discourage
illegitimacy. Maybe we could agree that everyone should graduate from high school and learn a
marketable trade.

159. It has recently been suggested that democracy is just a moment, and that future govern-
ments, including our own, will become some kind of corporate/government oligarchic hybrid.
See, e.g., Robert D. Kaplan, Was Democracy Just a Moment, ATLANTIC MONTHLY, Dec. 1997, at
55-80 (discussing the evolution of governments into democratic entities and whether this is
permanent).
losophies an opportunity to flourish. Let us consumers look capitalism squarely in the face;\footnote{[T]he reformer Florence Kelley \ldots demanded that consumers take responsibility for the world they lived in, that they look capitalism squarely in the face, and that they acknowledge the working people who make the goods and under what conditions.” Leach, supra note 91, at 389.} make it take responsibility for what it has wrought, and have business compete fairly for the affections and loyalty of a truly free people. We could disassociate the state from business as we have from religion, and consider that government support of business is as harmful to us as we think government support of religion would be. Free enterprise is not the same as active governmental promotion of capital accumulation (capitalism). We have no Federal Department of Religion, but we have a Federal Department of Commerce, as well as, state-supported Colleges of Business, Chambers of Commerce, and whole panoplies of international, national, regional and local “boosterisms.”\footnote{Regarding “boosterism,” Washington State law provides that “It shall be in the public purpose for all port districts to engage in economic development programs.” WASH. REV. CODE § 53.08.245 (1998). It also provides that they may “expend moneys \ldots to attract visitors and encourage tourist expansion.” WASH. REV. CODE § 53.08.255 (1998). We could, for example reconsider tax treatment of advertising, government highway, range- land, crop, and business-loan subsidies, export promotion, maintenance and dissemination of business statistics, to name just a few items. If the government, through its taxes and subsidies, allowed the price of gasoline to reflect its true “price” to society (if we internalized the externalities for motor vehicles), Norman Myers of Oxford University estimates that gasoline would cost $7-10 a gallon. Don Mayer, Automobiles, Consumption and the Environment, 31 ENVIRONMENT AND BUSINESS NEWSLETTER, ACADEMY OF LEGAL STUDIES IN BUSINESS (May 1998) (quoting Mayer, Consumption in Relation to Population, Environment, and Development, Paper for Proceedings of the U.S. National Academy of Science (July 1996)).} Individualism is “an historic force”\footnote{See supra text accompanying note 141.} that is not spent, but it is perverted when it is manipulated to the exclusion of other interests by the promoters of commercial exchange to make money. Let individualism roam more freely, not just among the brutal artifacts of modernity, but also in those quieter places where the values of community and charity are found.\footnote{It is somehow gratifying to read that some countries around the world, alarmed by the disastrous economic consequences of the imposition of capitalism in 1998, are experimenting with “a less rigorous form of free enterprise,” though the experiments are so far limited to restricting the free flow of capital. David R. Francis, World Cools to Capitalist Ideals, CHRISTIAN SCI. MONITOR, Sept. 17, 1998, at 1.} No economic system lasts forever. The change would be revolutionary, but no more so than the railroad revolution itself.\footnote{A valuable analysis of some, many, of the ways government supports and promotes business at the expense of public welfare was presented in a four-part series in Time. Donald L. Barlett & James B. Steele, What Corporate Welfare Costs You, Time, Nov. 9, 1998; Donald L. Barlett & James B. Steele, Corporate Welfare: How the Feds Play the Game, Time, Nov. 16, 1998; Donald L. Barlett & James B. Steele, Corporate Welfare: The Polluters, Time, Nov. 23, 1998; Donald L. Barlett & James B. Steele, The Empire of the Pigs, and Five Ways Out, Time, Nov. 30, 1998. Ending “corporate welfare” would be a step, a revolutionary step, in the right direction.}
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