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Of Cabbages and Cabotage: The Case for Opening up the U.S. Airline Industry to International Competition

Robert M. Hardaway*†

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† The author gratefully acknowledges the research assistance of Erik Dullea who wrote a first draft of Part IV B (Cabotage and the Labor Problem); Noah Klug who wrote a first draft of Part V (Economics, Bankruptcies, and U.S. Airlines’ Potential for Success); Lisha McKinley who wrote a first draft of Part V. C (International Competitiveness of U.S. Airlines); Jennifer Burroughs who wrote a first draft of Part V. B. (The Realities and Effects of Chapter 11 Bankruptcies in the Airline Industry); and Angela Padilla.
I. INTRODUCTION

The U.S. domestic airline market is one of the very few American industries which, since its inception, has remained tightly closed to any and all foreign competition.\(^1\) Although the reasons for this closed-door policy are mostly geopolitical, the role of economic protectionism as the prime determinant has not heretofore been comprehensively examined.

Often cited as a reason for excluding all foreign competition is the refusal of foreign countries to allow American carriers to compete with the domestic carriers of those foreign countries.\(^2\) The U.S. Policy of excluding all foreign competition from domestic air markets is a legacy of the protectionist policies of U.S. Government Depression era policies. Those policies in turn found their roots in the successful attempts by the large railroad cartels during the late 1800's to enlist the aid of the U.S. Government to fix prices and exclude competition.\(^3\)

Fierce competition in the railroad industry in the late 1800's prompted the most powerful railroads to form cartels in order to fix prices and exclude competition, thereby insuring high oligopoly profits.\(^4\) Particularly irksome to the most powerful railroads were the new industry entrants who offered lower prices to consumers, thereby taking business from the entrenched railroads.\(^5\) Even more alarming was the practice of some members of the railroad cartels to “cheat” by offering lower prices in order to win customers.\(^6\)

When the Sherman Antitrust Act threatened to made oligopoly and monopoly price fixing and collusion illegal, the railroad cartel finally con-

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2. GENERAL ACCOUNTING OFFICE, supra note 1, at 7-9.
5. See id. at 7-11.
cluded that the only way to insure discipline from within and to immunize themselves from criminal charges of price fixing, was to get the government to pass a law which not only condoned price-fixing by enshrining the practice into law, but which actually obligated the government to do the dirty work of fixing prices for them. The result was the Interstate Commerce Act (ICC Act), and the founding of the Interstate Commerce Commission (ICC), under which the government itself set prices on behalf of the railroad cartels. By making it illegal for competitors to offer lower prices to customers, the ICC Act effectively broke the backs of any competitor who tried to enter the industry by offering more efficient or economical service.

The ICC Act more than others epitomized Stigler’s first law of economics: “(E)very industry or occupation that has enough political power to utilize the state will seek to control entry.” The final victory of the railroad cartel was marked by the passage of the Hepburn Act of 1906 which further tightened the power of government to fix prices on behalf of the cartels. This prompted George Perkins to write to his boss, J.P. Morgan, “the Hepburn bill is going to work out for the ultimate and great good of the railroads. There is no question but that rebating (offering lower prices) has been dealt a death blow.” The New York press noted that the railroads themselves had written the law and “that explains why the railroad lobbies did not raise a note of public or private protest against the Hepburn bill in the House.” The Hepburn act set the stage for similar law fixing not only prices, but routes and rights of entry in the motor carrier and airline industries.

The Civil Aeronautics Act of 1938 went further than any of the previous transportation regulatory laws by not only fixing prices, but also by establishing virtually absolute barriers to entry by competitors. Al-

7. See Kolko, supra note 4, at 26 (citing Memorandum from Joseph Nimmo, Jr. on the Present Status of the R.R. Problem (Apr. 15, 1899) (on file with the Library of the Bureau of R.R. Econ.).
9. Id. at 529-30.
10. Id. at 529.
12. Hepburn Act, ch. 3591, 34 Stat. 584, 584-89 (1906) (codified as amended in scattered sections of 45 U.S.C.) (applicable to express companies and sleeping car companies, providing specific fines for rebating and a two year prison term for violations, stipulated that a complain from a shipper or railroad could be remedy by the ICC determining “just and reasonable rates”); Kolko, supra note 4, at 144-45.
15. Civil Aeronautics Act, ch. 601, 52 Stat. 973 (1938); See generally Paul Stephen Dempsey,
though new entrants could, in theory, receive permission to compete with established carriers by persuading the civil aeronautics board to issue a certificate of “public convenience or necessity,” in practice the Civil Aeronautics Board (CAB) succeeded in preventing a single competitor from entering the airline industry during its heavy-handed reign (1938-1975). Professor Paul Dempsey has observed that this excessively rigid regulatory scheme established by the CAB between 1938 and 1975 allowed the creation of an effective oligopoly composed the five largest trunk line carriers - this despite the fact that the airline industry itself expanded by 23,800 percentage points during this same period.

Building on the success of the railroad cartel in enlisting the power of government to fix prices and exclude competition, the airline industry succeeded in establishing itself as a price-fixing cartel thriving on high fares and immunity from competition of any kind. In 1962, President John F. Kennedy demanded in his transportation message “greater reliance on the forces of competition and less reliance on the restraints of regulation.” It was clear that the price-fixing and competition-excluding laws harmed consumers and workers alike.

The final straw was the revelation by the 1975 Kennedy hearings in Congress that regulated air fares were 40% to 100% higher than they would be without government price-fixing on behalf of entrenched carriers, thereby costing consumers up to $3.5 billion in excess fares. The government’s end to sponsored price fixing and exclusion of competition was the Airline Deregulation Act of 1978 (ADA) which placed “maximum reliance on competitive market forces.” Everyone enjoyed the

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The Rise and Fall of the Civil Aeronautics Board – Opening Wide the Floodgates of Entry, 11 Transp. L.J. 91, 181 (1979) (discussing the impacts of airline deregulation on market entry by small carriers and aviation entrepreneurs).

In particular, the following inefficiencies and inequities [of regulation] were singled out [by President Kennedy]: the dulling of managerial initiative; the inability of carriers to divest themselves of traffic that fails to cover costs; the substitution of cost-increasing service competition for cost-reducing rate competition; and, finally, the decline of the common carrier relative to private and exempt carriage.

22. Id. at 457.
benefits of competition. Consumers enjoyed reduced fares, while workers received an expanded industry with many more jobs. Only three years after deregulation eleven newly formed airlines providing jet service had entered the U.S. Airline market.\textsuperscript{25}

By 2000, however, disturbing trends toward renewed concentration in the industry were evident. This trend was exacerbated in part by lax antitrust policies of the U.S. Government which permitted anti-competitive mergers and consolidations, and partly by political forces placed on the government to protect airlines, particularly large ones, from failure and the consequences of their inefficiency. Lax bankruptcy laws allowed failing, inefficient, and bloated carriers to continue operating, often with little prospect of ultimate success or economic viability, instead of allowing those firms to simply dissolve and allow the process of bankruptcy to redistribute its assets to more efficient and cost productive firms.

The most important cause of the reconsolidation of the airline industry has been the continued oligopolization of airport resources.\textsuperscript{26} Deregulation in the "air," in the form of freedom to charge market fares and choose the most efficient routes and schedules, was never followed up with deregulation on the "ground" - that is with access to airport gates and slots. Long term leases with airport authorities assured entrenched trunk lines of access to scarce gates, while landing rights and "slots" awarded without cost to favored carriers during the regulatory years (1938-1975) provided ground right monopolies and a barrier to new entry.\textsuperscript{27}

Since I testified before Congress on September 10, 1985\textsuperscript{28} to urge that the government condemn airport gates and slots and open them up to fair and open bidding by all carriers, including new entrants, little has been done to open up access to airport resources. Without such access, new entrants are denied entry to the market no less than by the arbitrary exclusion policies of the CAB during its regulatory reign.

While opening up airport resources to competitors and new entrants would go far in achieving the ultimate goals of the ADA, true economic deregulation requires that such a policy be combined with opening up the

\textsuperscript{25} Office of Econ. Analysis, Civil Aeronautics Bd., Competition and the Airlines: An Evaluation of Deregulation 125 (1982) [hereinafter cited as CAB Report].

\textsuperscript{26} U.S. Gen. Accounting Office, GAO/RCED-97-4, Airline Deregulation: Barriers to Entry Continue to Limit Competition in Several Key Domestic Markets 3, 22 (1996) [hereinafter Barriers to Entry Continue in Key Markets].

\textsuperscript{27} Id. at 4-7, 9-10.

domestic market to foreign competition. With a stroke of the pen, the
trend toward reconsolidation and oligopolization of the domestic airline
market could be reversed and the benefits of free trade and competition
once again enjoyed by the traveling public.

This article attempts to show that the economic advantages of free
trade in the airline industry is no less than other industries, but also that
the reasons posited for the rejection of free trade do not stand up to com-
prehensive analysis. Proposed herein is the adoption of “cabotage,” de-


32. Open skies is the common term for a liberalized form of bilateral agreement between
nations. Under open skies, cabotage and foreign ownership are still restricted but pricing, sched-
uling, inter-airline cooperation restrictions are eliminated or greatly reduced. See e.g., Gautam
Gowrisankaran, Competition and Regulation in the Airline Industry, in 2002 FRBSF Economic
Letter 01, 1; In the Matter of the Acquisition of Northwest Airlines, Inc. by Wings Holdings,
Order No. 91-1-41 (Dep't of Transp. Jan. 23, 1991) (order modifying conditions).
II. REGULATION TO DeregULATION OF THE AIRLINE INDUSTRY

A. REGULATION

In 1938, Congress first regulated the fledgling airline industry by forming the Civil Aeronautics Board (CAB), on the theory that strict regulation was necessary to protect airlines from "excessive competition." The CAB's chief tool of regulation was to sanction and indeed sponsor the practice of price-fixing, a practice that is criminal when done by private enterprises and difficult in any case to carry out when businesses attempt to engage in it on their own without the benefit of government enforcement. The CAB also tightly restricted rates, routes, and, most notably, entry into the market. The CAB's anti-competitive policies prevented even a single major trunk carrier from entering the industry during the 40 years of its ironhanded rule. This virtual "Berlin Wall" to entry was enforced even as the industry itself grew by 23,800 percentage points. As Professor Dempsey observed, "[t]he excessively rigid regulatory scheme established by the Civil Aeronautics Board . . . allowed the creation of an effective oligopoly . . ."41

Despite the obvious harm to the consumer caused by the CAB's policies, proponents of the CAB felt that the policies were justified to allow the airlines to reap oligopoly profits. If airline profit was the goal,

33. U.S. Gen. Accounting Office, GAO/RCED-90-102, Airline Competition: Higher Fares and Reduced Competition at Concentrated Airports 12 (1990). The CAA (Civil Aeronautics Act) was the predecessor to the CAB. Id.

34. Regulation of Transportation of Passengers and Property by Aircraft: Hearings on S. 2 and S. 17 Before the Subcomm. of the S. Comm. on Interstate Commerce, 75th Cong. 67 (1937) (statement of Edgar Gorrell, Colonel) cited in Dempsey, supra note 15, at 101; see also Aviation Hearings on H.R. 5234 and H.R. 4652 Before the House Comm. on Interstate and Foreign Commerce, 75th Cong. 53 (1937); see also Westwood and Bennett, A Footnote to the Legislative History of the Civil Aeronautics Act of 1938 and Afterward, 42 Notre Dame L. Rev. 309, 320 (1967).


37. Id.

38. CAB Report, supra note 25, at 33. The Civil Aeronautics Board (CAB) through its power to grant certificates of "public convenience or necessity" utilized a test that placed the burden on applicants for certification to show new entry was in the public interest and would not harm an incumbent airline. Since a new entrant had no proven track record to distinguish its merits, it suffered a significant disadvantage in pressing its case. See Robert M. Hardaway, The FAA "Buy-Sell" Slot Rule: Airline Deregulation at the Crossroads, 52 J. Air L. & Comm. 2, 11 (1986).


40. See Dempsey, supra note 15, at 206.

41. See Dempsey, supra note 15, at 206.

42. See generally Levine, supra note 39.

43. See generally Levine, supra note 39.
however, the CAB failed miserably.\textsuperscript{44} Indeed, what profits the airline did earn were attributable to technological advances such as the development of the jet engine rather than economic policies.\textsuperscript{45}

But even the exponential rise in aircraft efficiency resulting from the advent of jet aircraft and improved technology did not appreciably serve to re-capitalize the industry. Potential profits were eaten up by equally exponential rising costs, particularly labor costs.\textsuperscript{46} Shielded from competitive pressures, and secure in their cozy regulated environment, the airlines had no incentive to resist cost inflation.\textsuperscript{47} The CAB's policies allowed the airlines to simply use cost increases as the basis for requesting fare increases.\textsuperscript{48} There was little cause for the airlines to fear competition from new efficient, cost-cutting airlines since any cost savings could not be reflected in lower fares. All fares were price-fixed by the CAB across the board.\textsuperscript{49}

As a result, the CAB reported that during the period of airline regulation, which ended in 1978, typists in the airline industry received forty-one percent more than their counterparts in deregulated industries, computer operators thirty-eight percent more, freight agents fifty-eight percent, and even janitors received eighty-two percent more than their deregulated counterparts.\textsuperscript{50} Indeed, what was remarkable about the airline industry under CAB regulation was not that the industry failed to earn even allowable returns on investment, but that it survived at all.

\section{Deregulation}

President John Kennedy began the dismantling process in his Transportation message of 1962 when he called for "greater reliance on the

\textsuperscript{44} CAB Report, supra note 25.

\textsuperscript{45} See Hardaway, supra note 6, at 137; See also Robert M. Hardaway, Airport Regulation, Law and Public Policy 24 (1991); Paul S. Dempsey et al., Aviation Law and Regulation § 1.05 1-12 (1992); See also Paul W. Macavoy, John W. Snow, Regulation of Passenger Fares and Competition among Airlines 3 (1977); See also CAB Report, supra note 25.

\textsuperscript{46} Levine, supra note 39, at 405.

\textsuperscript{47} Levine, supra note 39, at 405.


\textsuperscript{50} CAB Report, supra note 25, at 114. Since deregulation, airline employee compensation continues to exceed the average for most other industries. In 1984, average compensation per employee was $41,928 and by 1994 that figure had increased to $57,355. Air Transport Association, The Annual Report of the U.S. Scheduled Airline Industry 11 (1995) [hereinafter cited as 1995 Air Transport Association Report].
forces of competition and less reliance on the restraints of regulation.\textsuperscript{51} In 1975, the U.S. Senate Judiciary Subcommittee on the CAB (The Kennedy Hearings) revealed that regulated fares were forty to one-hundred percent higher than the free market would have set,\textsuperscript{52} and that airline regulation had effectively bilked consumers out of \$3.5 billion in excess fares.\textsuperscript{53} Empirical comparisons with unregulated airfares on intrastate routes in states like Texas and California as well as economic data supported the hearing’s findings.\textsuperscript{54}

Although anyone familiar with the airline industry could have predicted these revelations, they were nevertheless alarming to a traveling public conditioned to believe that airline regulation had been in its best interest. Had the perpetrators of such price-fixing been anyone other than a bureaucratic agency acting under the protection of law, they would surely have been the subject of criminal charges.\textsuperscript{55} Congress passed the Airline Deregulation Act of 1978 sixteen years after President Kennedy’s first call for deregulation.\textsuperscript{56} The ADA ended the CAB’s draconian rule by easing entry restrictions, and allowing carriers to choose their own routes and set their own fares.\textsuperscript{57} For the first time in forty years, an airline’s success was to depend on its ability to provide the best service at the lowest fares\textsuperscript{58} - not on its political influence.\textsuperscript{59}

The 1983 report by the American Air Transport Association (AATA) revealed that, had the industry not been deregulated, the CAB Standard Industry Fare would have allowed for fare increases of sixty-seven percent.\textsuperscript{60} Instead, fares in real terms declined dramatically during this period\textsuperscript{61} despite staggering 105\% fuel increases during the period of March 1979-March 1980 alone.\textsuperscript{62} In the regulatory period between 1960 and 1969 the advent of jet aircraft reduced costs per passenger mile by twenty-one percent, but fares declined only seven percent.\textsuperscript{63}

\footnotesize
\textsuperscript{51} Friedlaender, supra note 3, at vii; see also supra text accompanying note 20.
\textsuperscript{52} Kennedy Hearings, supra note 21, at 454 (testimony of Dr. William A. Jordan); Theodore E. Keeler, Airline Regulation and Market Performance, 3 Bell J. Econ. & Mgmt. Sci. 399, 421 (1972) (study indicated price markup between 45 and 84 percent).
\textsuperscript{53} Kennedy Hearings, supra note 21, at 457 (testimony of Dr. William A. Jordan).
\textsuperscript{55} Dempsey & Gesell, supra note 36, at 275-80.
\textsuperscript{56} See Hardaway supra note 6, at 136-37.
\textsuperscript{57} See Hardaway supra note 6, at 137.
\textsuperscript{58} See Hardaway supra note 6, at 137.
\textsuperscript{59} See Hardaway supra note 6, at 137.
\textsuperscript{60} See Hardaway supra note 6, at 143-44.
\textsuperscript{61} Hardaway supra note 6, at 144.
\textsuperscript{62} Hardaway supra note 6, at 144.
\textsuperscript{63} See Hardaway supra note 6, at 138.
In addition to deceasing fares, deregulation allowed many new airlines to begin service throughout the country.\footnote{Hardaway \textit{supra} note 6, at 141.} By 1981 more than eleven newly formed airlines had entered the industry.\footnote{See Hardaway \textit{supra} note 6, at 143.} Market share of new entrants more than tripled between 1978 and 1983,\footnote{Melvin A. Brenner, James O. Leif & Elihu Schott, \textit{Airline Deregulation} 18 (Eno Foundation for Transportation 1985). Table 4 indicated that between 1978 and 1983, trunk revenue-passenger miles increased 7.1 percent. Locals increased 91.5 percent; intrastate increased 123.7 percent.} while that of the major carriers decreased proportionately. By 1984, airline productivity had skyrocketed, the number of passenger miles almost doubled\footnote{See Hardaway \textit{supra} note 6, at 140.} and in the first two years of deregulation the number of employees in the industry increased by over 30,000.\footnote{See \textit{id.} at 140.} Over the first five years of deregulation local service employment even increased by 13,000.\footnote{\textit{Id.} at 146-47.} Airline profits also increased. In early 1984, the Air Transport’s chief economist reported an industry profit for the fourth quarter of 1983 of almost half a billion dollars.\footnote{See Hardaway \textit{supra} note 6, at 147.}

But consumers were the greatest beneficiaries of deregulation. By eliminating costly and inefficient cross-subsidization,\footnote{\textit{Id.} at 146.} deregulation gave airlines the incentive to use appropriately sized aircraft for service to small communities,\footnote{\textit{Id.}} while at the same time increasing service to those communities.\footnote{\textit{Id.} at 146.} During the seventeen years prior to deregulation, the CAB’s policy of subsidizing service to small communities and requiring airlines to take losses on such routes had induced recalcitrant airlines to eliminate service to over 173 communities, devastating those communities.\footnote{\textit{Id.} at 146.} Between 1970 and 1975, airlines cut small community flights by over twenty-five percent.\footnote{\textit{Id.}} By 1983, however, after five years of deregulation, there were more city-pair markets receiving non-stop service than in 1978.\footnote{\textit{Id.}} A study conducted by Graham and Kaplan in 1982 concluded that “on balance, every class of city is benefiting from the better-integrated service network, either through increased flights or more direct service to major cities, and the beneficiaries include the smaller communities (which were considered vulnerable to service losses from
deregulation).”

Even safety statistics showed dramatic improvement under deregulation. The National Transportation Safety Board statistics revealed in 1982 that fatal crashes per 100,000 take-offs had declined dramatically from .10 in 1978 to .08 in 1982. By almost any measure, deregulation was an unmitigated success.

III. AIRLINE INDUSTRY CONCENTRATION AND ITS CAUSES

A. THE CURRENT STATE OF AIRLINE INDUSTRY CONCENTRATION

The heady first years following deregulation were not to last. Today, at most hub airports, one or two airlines dominate the competition and control a large majority of the flights. For example, one study shows that at Chicago-O'Hare Airport, United Airlines and American Airlines each operate about 40 percent of the flights; and Delta Airlines operates over 70% of the flights in Atlanta. In the late 1990s, approximately two-thirds of the U.S.'s fifty largest airports showed an "unprecedented degree of concentration in the airline industry." Concentration also affects the entrance of new airlines and the low cost benefits they offer. Significantly, "[i]n the last four years of the Twentieth Century, only two new entrants began service." Concentration has had a resoundingly negative effect on consumers in the way of higher fares. Domination of airport traffic by one or two carriers tends to produce higher fares compared to airports where traffic is less concentrated. In non-competitive markets, customers pay forty percent more than consumers with choices between legacy and low-cost carriers. The 1st quarter 2000 Domestic Airline Fares Consumer Report demonstrates the effect of a low-fare competitor's presence on average fares:

77. Id. at 147-48 (quoting Graham and Kaplan, Airline Deregulation is Working, AEl J. Gov't & Soc., 26-27 (May-June 1982)).
78. Id. at 148.
FARE COMPARISON: COMPARABLE MARKETS WITH AND WITHOUT LOW-FARE COMPETITION

<table>
<thead>
<tr>
<th>Origin</th>
<th>Destination</th>
<th>Nonstop Distance</th>
<th>Passengers per Day</th>
<th>Avg One-Way Fare</th>
<th>Low-Fare Carrier</th>
</tr>
</thead>
<tbody>
<tr>
<td>Atlanta, GA</td>
<td>Dayton, OH</td>
<td>432</td>
<td>594</td>
<td>$126</td>
<td>AirTran</td>
</tr>
<tr>
<td></td>
<td>Indianapolis, IN</td>
<td>432</td>
<td>430</td>
<td>$242</td>
<td></td>
</tr>
<tr>
<td>St. Louis, MO</td>
<td>Detroit, MI</td>
<td>440</td>
<td>1,008</td>
<td>$83</td>
<td>Southwest</td>
</tr>
<tr>
<td></td>
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<td>449</td>
<td>450</td>
<td>$259</td>
<td></td>
</tr>
<tr>
<td>Cincinnati, OH</td>
<td>Philadelphia, PA</td>
<td>507</td>
<td>341</td>
<td>$278</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Kansas City, MO</td>
<td>539</td>
<td>166</td>
<td>$156</td>
<td>Vanguard</td>
</tr>
</tbody>
</table>

In 1996, the General Accounting Office (GAO) identified the cities of Minneapolis-St. Paul, Detroit, Cincinnati, Charlotte, Newark, and Pittsburgh as homes to the airports of major airline hubs being most dominated by a single airline resulting in higher fares. Northwest Airlines dominated Detroit, and Minneapolis-St. Paul. Northwest’s average hub market share was the highest average of any other U.S. major carrier. The correlation between dominance and higher fares is demonstrated with Northwest’s Detroit-Boston city pair. In an airfare analysis between June, 1996 and June, 1997, while Northwest controlled ninety percent of the traffic between the two cities, fares rose 127%. Altogether, on twenty-five routes with the largest average fares, Northwest was the dominant carrier on seven of them. Northwest’s control of the Minneapolis-St. Paul was such that, “before Sun Country’s entry [into the market], Northwest had no competition on twelve of its busiest routes.” Delta Airlines also has three hubs, one of which is Cincinnati, another airport identified by the GAO as being highly dominated with increased

85. Barriers to Entry Continue in Key Markets, supra note 26.
87. Id. The airline dominates its hub airports more than any other U.S. carrier, controlling an average of 74.8% of the gates. Northwest’s strongest hold over airport facilities is at Minneapolis-St. Paul; dominating 79.5% of the gates and 82.2% of the traffic. At Detroit, figures show Northwest controlling eighty-eight percent of the gates with a market share of close to eighty percent.
89. Id. An analysis of 17.3 million airline tickets purchased at hub airports showed growing monopolies have led to steeper prices, with hub fliers paying fare increases three times as high as all fliers.
90. Id.
fares. Delta's Cincinnati operations with ninety-two percent of passenger control have been called a "near monopoly" and maintain the third highest fares in the nation.92 Delta also controls five out of the twenty-five routes with the largest average fare increases.93

Two of the other hub airports listed by the GAO are under the domination of U.S. Airways.94 The two airports are Charlotte with ninety-one percent passenger control and Pittsburgh with eighty-nine percent.95 The last hub airport identified by the GAO falls under the control of Continental Airlines with fifty-four percent of Newark passengers.96 Continental's largest hub97 however, is located at Houston's Bush Intercontinental Airport with eighty percent of the traffic.98

This type of domination makes price competition among the major carriers virtually nonexistent at hub airports.99 For instance, at Dallas-Ft. Worth, American Airlines' hub, American, Delta and Continental collectively control ninety percent of the market to San Francisco with the average business fares within $170 of each other. The start-up carrier, Vanguard, offered service to San Francisco, carrying less than five percent of the traffic and a fare $300 less.100

B. THE EMERGENCE OF THE HUB-AND-SPOKE SYSTEM

How did the airline industry get so concentrated? One reason is the emergence of the hub-and-spoke system.

Prior to deregulation, the airline industry used a linear route system, where passengers largely flew directly from one destination to their ultimate destination. This system was seen as inefficient and exacerbated the problem of excess capacity.101 When given the freedom to self-regulate, the industry responded by reconfiguring the linear system into a hub-and-

92. Rick Van Sant, Delta's 'Near Monopoly' Can't Go On, Expert Says, CINCINNATI POST, Apr. 7, 1998 at 17A. Delta's other two hubs are located in Salt Lake City, with seventy-six percent of passenger traffic; and, Atlanta with eighty percent of passenger traffic. Id. In a one year period while Delta controlled fifty-nine percent of passenger traffic between Atlanta and Miami, fares rose thirty-nine percent. Rosato, supra note 88.
93. Rosato, supra note 88. Out of the twenty-five routes, United dominates six. Id. United operates its hub out of Denver with seventy percent of the traffic. Sant, supra note 92, at 17A.
94. Barriers to Entry Continue in Key Markets, supra note 26, at 9.
95. Sant, supra note 92, at 17A.
96. Sant, supra note 92, at 17A.
97. Charles Boiseau, Hub Across the Hudson, HOUSTON CHRON., Apr. 19, 1998 at 1. Continental's Summer, 1998 schedule indicates 503 daily flights out of Houston, twenty-three percent more than the airline's Newark operations. Id.
98. Sant, supra note 92, at 17A.
99. Rosato, supra note 88, at 01B.
100. Rosato, supra note 88, at 01B.
spoke network,\textsuperscript{102} whereby "feeder traffic" could be brought in through regional spokes to a large central hub airport.\textsuperscript{103} Such a network allowed more connections between cities than would have been possible with the linear route structure.\textsuperscript{104} The hub-and-spoke system was also touted as providing the airlines with economies of scale by concentrating their resources and allowing better utilization of aircraft and crew.\textsuperscript{105} Further, it was hoped the system would ease the problem of excess capacity by carrying passengers with different origins and destinations on the same aircraft, resulting in higher passenger loads on routes radiating from the hub.\textsuperscript{106}

Despite its apparent advantages, the hub-and-spoke network has not been shown to be more efficient than the linear route system.\textsuperscript{107} Studies have indicated that considerably more fuel, pilot time, airline maintenance and the like are expended in transferring the same passenger from point A to point B under the hub-and-spoke system than under a linear route system.\textsuperscript{108}

Regardless of whether or not the hub-and-spoke system actually is more efficient, the major carriers soon realized that the system has other inherent advantages. Prior to deregulation, "no single airline accounted for more than fifty percent of gates, enplanements or takeoffs and landings at any major airport."\textsuperscript{109} However, under the hub-and-spoke system many simultaneous departures and arrivals are made throughout the day, allowing a single large airline to control multiple gates and concourses,\textsuperscript{110} and even to establish exclusive use rights to a terminal.\textsuperscript{111} Employing such strategies at the hubs as long-term leases,\textsuperscript{112} majority-in-interest

\textsuperscript{102} Robert M. Hardaway & Paul S. Dempsey, \textit{Airlines, Airports and Antitrust: A Proposed Strategy for Enhanced Competition}, 58 J AIR LAW & COM. 455, 465-71 (1993). Among the developments that took place were the adoption of marketing practices that made it difficult for potential competitors to challenge the dominating carrier; and many new entrants and some original carriers merged or went out of business. \textit{General Accounting Office}, supra note 33, at 24.

\textsuperscript{103} \textit{Consumer Union}, \textit{The big trouble with air travel (Why fares are headed up and service down.)} CONSUMER REP. 53, 3 (June 1988).

\textsuperscript{104} \textit{Williams}, supra note 101, at 14-15, 19.

\textsuperscript{105} \textit{Williams}, supra note 101, at 18.

\textsuperscript{106} \textit{Williams}, supra note 101, at 18.


\textsuperscript{109} Hardaway & Dempsey, supra note 102, at 471.

\textsuperscript{110} \textit{General Accounting Office}, supra note 33, at 12.

\textsuperscript{111} \textit{Id.} at 25. This is due to limits on airport capacity and the size of the air travel market.

\textit{Id.}

\textsuperscript{112} Hardaway, supra note 38, at 20. Many long term airline gate leases were, to a large
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clauses,113 and anti-competitive airport scheduling committees,114 the incumbent airlines severely restricted the access of new players, even in an otherwise deregulated industry. These barriers to entry continue to stifle growth and competition.115

Hub-and-spoke consolidation also has a negative effect on consumers. While the advent of deregulation provided pricing benefits for consumers,116 these benefits were short term. For example, the New York Times observed that “[p]assengers who live in a hub city and begin their flight there end up paying higher fares, in some cases 50 percent more than they would had deregulation not occurred.”117

Closing an airline hub can have dramatic effects for travelers as well as discount and legacy airlines.118 When US Airways announced in 2004 that it would cease using Pittsburgh International Airport as a hub, “local travel increased sharply.”119 Five discount airlines quickly began offering service, and existing legacy carriers increased service.120 Even though this change has meant fewer connecting passengers at the airport, the number of passengers who begin trips in Pittsburgh increased 12% in September 2005 from the previous year.121 Fares are cheaper as a whole thanks to what Kent George, the executive director of the Allegheny County Airport Authority, dubs “[t]he good old American free-market

extent, negotiated prior to deregulation; therefore, entrance into the market is regulated from the grave. Id. at 19.


In many airport leases, signatory carriers are given certain rights of approval of airport decision making on specified matters, through what is commonly called a “majority-in-interest” clause. The clause is so named because specified airport proposals must be approved by the signatory carriers constituting a “majority-in-interest.” The definition of a majority-in-interest varies from lease to lease, but is usually cast in terms of a specified percentage of enplanements or operations, such as 60% percent of passengers or operations. Report of the Airport Access Task Force: Hearing Before the Subcomm. on Investigations and Oversight of the Comm. on Public Works and Transportation H. R., 98th Cong. 59 (1983) [hereinafter Airport Access Report].

114. See Airport Access Report, supra note 113, at 82. They concluded that airport scheduling committees tend to “protect the rights of existing carriers and make the admission of new carriers to the community serving the airport more difficult.” Id.;

115. Hardaway & Dempsey, supra note 102, at 479-80.


117. Id. at 695.


119. Id. Communities tend to view the loss of an airline hub as a “doomsday scenario.” Id.

120. Id. US Airways’ decision to stop using Pittsburgh International Airport as a hub is case in point that shows how a lost airline hub can benefit travelers. Id.

121. Id.
system responding to demand."122 While total airport traffic in Pittsburgh has decreased and employment at the airport has fallen, car rentals have increased 10%, the airport has added more parking, and the airport mall’s occupancy rate has remained at 100%.123 In response to discount carriers entering new markets, Delta Air Lines cut business-travel fares at its Cincinnati hub, American Airlines cut fares in Miami, and US Airways matched Southwest’s fares in Philadelphia.124 However, the market does not always respond this quickly, and often the carrier forced to leave the airport is a smaller operation. The following table illustrates the mixed results of hub closings in previous years.

**Case Examples of Markets’ Response to Airline Withdrawals**125

<table>
<thead>
<tr>
<th>Market</th>
<th>Year</th>
<th>Airline</th>
<th>Effect on passenger traffic</th>
<th>Change in fares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nashville, TN</td>
<td>1995</td>
<td>American Airlines eliminated hub</td>
<td>Other airlines’ traffic increased. Origin and destination traffic increased.</td>
<td>−10.2%</td>
</tr>
<tr>
<td>Greensboro, NC</td>
<td>1995</td>
<td>Continental Lite eliminated hub</td>
<td>Other airlines’s traffic increased. Origin and destination traffic decreased.</td>
<td>+5.5%</td>
</tr>
<tr>
<td>Colorado Springs, CO</td>
<td>1997</td>
<td>Western Pacific moved operations to Denver</td>
<td>Other airlines’ traffic decreased. Origin and destination traffic decreased.</td>
<td>+43.6%</td>
</tr>
<tr>
<td>St. Louis, MO</td>
<td>2001</td>
<td>TWA acquired by American Airlines</td>
<td>Other airlines’ traffic decreased. Little change in origin and destination traffic.</td>
<td>+5.4%</td>
</tr>
<tr>
<td>Kansas City, MO</td>
<td>2002</td>
<td>Vanguard Airlines suspended service</td>
<td>Little change in other airlines’ traffic. Little change in origin and destination traffic.</td>
<td>+4.2%</td>
</tr>
<tr>
<td>Columbus, OH</td>
<td>2003</td>
<td>America West eliminated hub</td>
<td>Other airlines’ traffic increased. Little change in origin and destination traffic.</td>
<td>+3.6%</td>
</tr>
</tbody>
</table>

122. *Id.* Losing a hub actually tends to benefit travelers as airport gates free up and discounters tend to move in which results in lower fares. *See, e.g., id.*

123. *Id.*

124. *Id.*

125. *Structural Costs Continue to Challenge Legacy Airlines’ Financial Performance: Testimony Before the Committee on Commerce, Science, and Transportation, Subcommittee on Aviation, U.S. Senate, GAO-05-834T, 12 (July 13, 2005) (statement of JayEtta Z. Hecker, Director Physical Infrastructure Issues). “Note: Little change in traffic means that traffic increased or decreased less than 5 percent and that origin and destination traffic increased or decreased less than 10 percent. Changes in passenger traffic and fares are measured from 4 quarters prior to the airline departure to 8 quarters after.” *Id.*
C. Slots and Gates as a Barrier to Entry

Airline industry concentration is also a product of the control major carriers exercise over slots and gates.\textsuperscript{126} For instance, at Chicago O’Hare airport, two airlines control approximately eighty-five percent of the takeoff and landing slots;\textsuperscript{127} and a few carriers dominate the majority of slots at Reagan National, LaGuardia, and Kennedy.\textsuperscript{128} The established carriers continued to increase their control.\textsuperscript{129} The following table indicates this trend from 1990 – 1999.

\begin{table}[h]
\centering
\begin{tabular}{|l|c|c|c|}
\hline
Airport/Holding Entity & \multicolumn{3}{c|}{Percentage Held} \\
& 1991 & 1996 & 1999 \\
\hline
O’Hare & & & \\
American and United & 83 & 87 & 84 \\
Other established airlines & 13 & 9 & 10 \\
Financial institutions & 3 & 2 & 3 \\
Post-deregulation airlines & 1 & 1 & 3 \\
\hline
Kennedy & & & \\
Shawmut Bank, American, and Delta & 60 & 75 & 84 \\
Other established airlines & 18 & 13 & 14 \\
Other financial institutions & 19 & 6 & 1 \\
Post-deregulation airlines & 3 & 7 & 1 \\
\hline
LaGuardia & & & \\
American, Delta, and USAir & 43 & 64 & 70 \\
Other established airlines & 39 & 14 & 14 \\
Financial institutions & 7 & 20 & 10 \\
Post-deregulation airlines & 12 & 2 & 6 \\
\hline
Reagan National & & & \\
American, Delta, and USAir & 43 & 59 & 65 \\
Other established airlines & 42 & 20 & 18 \\
Financial institutions & 7 & 19 & 14 \\
Post-deregulation airlines & 8 & 3 & 3 \\
\hline
\end{tabular}
\caption{Increase in Slot and Gate Control\textsuperscript{130}}
\end{table}

\textsuperscript{126} Barriers to Entry Continue in Key Markets, supra note 26, at 5.
\textsuperscript{127} Barriers to Entry Continue in Key Markets, supra note 26, at 5.
\textsuperscript{129} See, e.g., Barriers to Entry Continue in Key Markets, supra note 26, at 5.
\textsuperscript{130} Achim I. Czerny & Henning Tegner, Secondary Markets for Runway Capacity, in Implementing Reform on transport Pricing: Identifying Mode-Specific Issues 5 (Berlin
Unfortunately, the unavailability of slots has mostly affected the new airlines.\textsuperscript{131} In 1986, the FAA adopted a regulation permitting slots to be bought, sold, or leased for consideration; often referred to as the "buy/sell" rule.\textsuperscript{132} The fixed number of slots has resulted in a sellers market;\textsuperscript{133} and slots are costly with prices exceeding $2 million for peak period slots and off peak slots selling for about $500,000.\textsuperscript{134} Not only do the airlines consider the slots private assets for sale, but they also use them as collateral in securing loans.\textsuperscript{135}

A new entrant experiences extreme difficulty in buying slots because established carriers rarely put the slots up for sale.\textsuperscript{136} A new entrant requires about six slots to be competitive, with three in the peak periods.\textsuperscript{137} They can lease the slots, but it places them at a disadvantage because the established carrier obtained most of the slots from the FAA at no cost. Therefore, new entrants incur costs that the established carriers never paid.\textsuperscript{138}

New-entrants are also disadvantaged because slot leases are for only a short period of time.\textsuperscript{139} The buy/sell rule contains a "use or lose" provision requiring airlines to use their slots at least eighty percent of the time

\begin{footnotesize}

\textsuperscript{132} 14 C.F.R. § 93.221(a) 1989; Robert M. Hardaway, Economics of Airport Regulation, 20 Transp. L. J. 47, 57-58 (1991). The FAA first implemented the number of takeoffs and landings at Kennedy, O'Hare, National, and LaGuardia in an attempt to reduce congestion. Deregulation increased the number of airlines wanting to serve these airports which in turn complicated the FAA's efforts to allocate the slots among the airlines. In order to minimize the role government played in the allocation of the slots, the DOT began to allow airlines to buy and sell them to one another. The "buy/sell" rule "grandfathered" slots to the airlines that were already holders. Barriers Continue in Markets, supra note 128, at 4.

\textsuperscript{133} Hardaway, supra note 132, at 63.

\textsuperscript{134} Barriers to Entry Continue in Key Markets, supra note 26, at 5. The airlines holding the majority of the slots at the four controlled airports emphasize the large financial investment made in the financing of development at the airports and in buying additional slots to build upon their grandfathered positions. Barriers to Entry Continue in Key Markets, supra note 26, at 5. The airlines however, were forewarned, when the slots were grandfathered, that the DOT still owned the slots, and reserved rights to withdraw the slots at any time. Barriers to Entry Continue in Key Markets, supra note 26, at 4.

\textsuperscript{135} Barriers to Entry Continue in Key Markets, supra note 26, at 4. The slots, of course, are not private assets, but public assets. Barriers to Entry Continue in Key Markets, supra note 26, at 6.

\textsuperscript{136} Barriers to Entry Continue in Key Markets, supra note 26, at 6. When, or if, the carriers sell a slot, usually it is to an airline that already possesses a considerable number of slots at the airport. Barriers to Entry Continue in Key Markets, supra note 26, at 6.

\textsuperscript{137} Barriers to Entry Continue in Key Markets, supra note 26, at 6.

\textsuperscript{138} Barriers to Entry Continue in Key Markets, supra note 26, at 6.

\textsuperscript{139} Barriers to Entry Continue in Key Markets, supra note 26, at 6. Historically, ten percent of slot leases were for less than thirty days, and twelve percent between thirty-one and eighty-nine days. Barriers to Entry Continue in Key Markets, supra note 26, at 6.
\end{footnotesize}
or forfeit.\textsuperscript{140} For the carrier to meet this requirement and thereby protect their slots, the unused slots can only be leased to other airlines for a short term.\textsuperscript{141} With the possibility of a new-entrant's access to an airport being terminated on short notice, starting a new service cannot be justified.\textsuperscript{142}

The Department of Transportation (DOT) recognized the need for increased competition at slot-controlled airports and allowed additional slots for entry at O'Hare, LaGuardia, and Kennedy.\textsuperscript{143} Frontier, AirTran Airlines and AirTran Airways obtained slots into LaGuardia, Reno Air and Trans States Airlines into O'Hare.\textsuperscript{144} The DOT used its power to award additional slots by finding "it to be in the public interest and the circumstances to be exceptional."\textsuperscript{145} Even with new slots being allocated, barriers to entry still exist because an airline cannot serve the airport without gates and other ground facilities.\textsuperscript{146} Development of these facilities is complicated financially.

Concentration at hubs tends to create substantial investment requirements.\textsuperscript{147} The investment capital can be raised through general obligation bonds and/or revenue bonds.\textsuperscript{148} General obligation bonds have the full faith and credit of the issuing government whereas revenue bonds are debt that is paid out of revenues generated by the airport.\textsuperscript{149} Most investment capital is currently raised through revenue bonds and may impact the terms and conditions of an airline's airport use agreement.\textsuperscript{150} An airport use agreement is a contract identifying the rights and privileges between the airport operator and the airline.\textsuperscript{151} The agreement specifies the financial and operational relationship between the two parties and defines how risk and responsibility of airport operations are to be allocated.\textsuperscript{152}

The airport practice of entering into long term lease agreements with

\textsuperscript{140} Barriers to Entry Continue in Key Markets, supra note 26, at 6.
\textsuperscript{141} Barriers to Entry Continue in Key Markets, supra note 26, at 6.
\textsuperscript{142} Barriers to Entry Continue in Key Markets, supra note 26, at 6.
\textsuperscript{143} Barriers Continue in Markets, supra note 128, at 5. The DOT reserved approximately five percent of the slots at National, LaGuardia, and O'Hare. In 1986, the DOT distributed the slots in a random lottery to those airlines having no or few slots at those airports. Barriers to Entry Continue in Key Markets, supra note 26, at 4.
\textsuperscript{144} Barriers Continue in Markets, supra note 128, at 5; Barriers to Entry Continue in Key Markets, supra note 26, at 5.
\textsuperscript{146} Barriers to Entry Continue in Key Markets, supra note 26, at 3; See Robert M. Hardaway, Economics of Airport Regulation, 20 Transp. L.J. 47, 53-56 (1991).
\textsuperscript{148} Id. at 17.
\textsuperscript{149} Id.
\textsuperscript{150} Dempsey & Gesell, supra note 36, at 450.
\textsuperscript{151} Financing U.S. Airports in the 1980's, supra note 147 at 18 (1984).
\textsuperscript{152} Financing U.S. Airports in the 1980's, supra note 147 at 18 (1984).
incumbent airlines permits those airlines to monopolize existing airport resources for long periods of time and to exclude competition. When major carriers do sublet their gates, it is usually to other major carriers with whom they do not directly compete; or if not to majors then to regional carriers, usually code-sharing partners. The subleases frequently restrict use of the gates to non-preferred times and at higher costs than paid by the incumbent. For instance, Southwest leased space at Detroit from Northwest and paid nineteen times what Northwest paid for the space. Northwest also sublets one gate to Frontier at Minneapolis, telling Frontier when the gate can be used. Protection for the new entrant is scarce if the legacy carrier decides to terminate the agreement. Notice periods for terminating and vacating the space range from forty-eight hours to thirty days. With little time to find alternative space at the airport, airline and passengers are left stranded.

Exclusive use agreements also present the potential for an airline to hold more gates than necessary for currently scheduled operations. The nature of these agreements prevents the airport operator from offering underused or unused gates to another airline.

To address this problem, some airports incorporate preferential use clauses allowing the lessee the first right to use the facilities. But if no operations are scheduled, the airport may allow another airline to use the facilities during the unscheduled time. This arrangement still allows the lessee to seize the space if they later decide to schedule operations during those times. Another solution is recapture provisions, allowing the operator to require the incumbent to forfeit or share gates not being used, however only seven percent of concentrated airports have such provisions.

In 1996, the majority of gates at six airports were exclusively leased

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154. Barriers to Entry Continue in Key Markets, supra note 26, at 9.
155. Hardaway, supra note 132, at 54.
158. Id. at 33. For instance, Northwest has the most control over gates with the lowest usage of those gates out of the 10 largest airlines. An average carrier at a hub airport realizes 6.5 daily departures per gate, but Northwest gets 5.1 daily departures. Sharon Schmickie & Tony Kennedy, Dominant Airlines Challenged, Star Trib., Mar. 6, 1998, at 1D.
159. Operating and Marketing Practices, supra note 153, at 43.
160. Id. at 32.
161. Id. at 32.
162. Id. at 32.
163. Id. at 35.
to one airline. A 1990 survey of the sixty-six largest airports indicated that eighty-five percent of their gates were dominated by the incumbent carriers through long-term, exclusive use leases.

At some airports, all gates were governed by exclusive use leases. For example, Northwest controls the majority of gates at Minneapolis and Detroit under long-term, exclusive use agreements; and exclusive use leases at Cincinnati, Charlotte and Pittsburgh have also tied up the vast majority of gates, giving control to one airline. The larger the share of gates leased under the agreements, the higher the fares. The following lists the airports where post-deregulation airlines reported difficulty gaining competitive access to gates.

**Exclusive Gate Leases**

<table>
<thead>
<tr>
<th>Airport</th>
<th>Total Number of Gates</th>
<th>Gates Under Exclusive Leases</th>
<th>Major Lease Holder and Date of Lease Expiration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Charlotte</td>
<td>48</td>
<td>43</td>
<td>34 gates leased to USAir until 2007</td>
</tr>
<tr>
<td>Cincinnati</td>
<td>67</td>
<td>67</td>
<td>50 gates leased to Delta with 9 leases expiring in 2015 and 41 expiring in 2023</td>
</tr>
<tr>
<td>Detroit</td>
<td>86</td>
<td>76</td>
<td>64 gates leased to Northwest until the end of 2008, with all but 10 under exclusive use terms</td>
</tr>
<tr>
<td>Minneapolis</td>
<td>65</td>
<td>65</td>
<td>49 gates leased to Northwest with 16 leases already expired and now on month to month basis, and remainder expiring at various times ranging from the end of 1997 to 2015.</td>
</tr>
<tr>
<td>Newark</td>
<td>94</td>
<td>79</td>
<td>43 gates leased to Continental until 2013, 36 gates leased to the other established airlines until 2018 and 15 gates reserved primarily for international use.</td>
</tr>
<tr>
<td>Pittsburgh</td>
<td>75</td>
<td>66</td>
<td>50 gates leased to USAir until 2018.</td>
</tr>
</tbody>
</table>

Management boards at some airlines consider the airport practice of entering into long term lease agreements with incumbent carriers to constitute a formidable and continuing barrier to entry. However, while airports generally want to attract new airlines, they face constraints such as availability of gates, ticket counters, passenger hold rooms, and baggage claim areas.

Agreements often provide airlines with significant power over air-

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164. *Barriers to Entry Continue in Key Markets*, supra note 26, at 9.
165. *Barriers to Entry Continue in Key Markets*, supra note 26, at 9.
166. *Barriers to Entry Continue in Key Markets*, supra note 26, at 9.
169. *Barriers to Entry Continue in Key Markets*, supra note 26, at 10.
170. *Barriers to Entry Continue in Key Markets*, supra note 26, at 9.
port ventures and pricing policy. These agreements, known as majority-in-interest clauses, give the incumbent airline the right to approve or disapprove any major proposed airport capital development projects. Because the airlines that carry the financial risk of operating the airport could be affected by airport construction through higher lease payments, the airline may require the airport to include such a clause.

Thus airport operators rarely proceed with major projects without conferring with the airlines operating at the airports. This is mostly due to wary investors who might hesitate in a bond issue for a project lacking approval of the airlines.

Long-term agreements negatively affect competition if used to prevent expansion of facilities for new-entrant airlines.

The GAO found that airlines and airports have different perceptions of the timing of projects. Airports try to plan ahead and want facilities available on schedule with growth projections. Airlines, however, tend to focus only on funding projects that address current needs. The GAO found that the airlines’ position may restrict capacity at these airports, possibly discouraging entry. Airline officials claim signatory airline actions under majority-in-interest agreements have never directly precluded new entrants from initiating service. Nevertheless, at the airports surveyed by the GAO, about seventy-five percent with a majority-in-interest agreement stated that such agreements limited or delayed expansion to some degree, and thirty-six large and medium-sized airports reported projects as greatly limited or delayed. Therefore, the resulting delays may discourage competitive entry.

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173. *Financing U.S. Airports in the 1980's*, supra note 147, at 25. These clauses give airlines with the majority of traffic, the ability to approve or veto capital projects that involve significant increases in the rates and fees airlines pay for the use of airport facilities.
176. *Financing U.S. Airports in the 1980's*, supra note 147, at 25. The financial community considers the backing of a tenant airline necessary for an airport planning a major improvement or expansion project. The long-term commitments from tenant airlines enable the airport to get a lower interest rate on the debt issues. When backing airport debt, the airlines want to insure that the airport does not unilaterally issue more debt causing higher lease payments, landing fees or other charges. Therefore, the majority in interest agreement run for the life of the bond issue, twenty or thirty years. *Operating and Marketing Practices*, supra note 153, at 47-48.
D. Mergers, Alliances and Bankruptcies

Mergers, alliances and bankruptcies contribute to airline industry concentration by reducing competition. As increased competition following deregulation began to pressure the legacy airlines, the Reagan administration wanted to avoid the political fall-out that would result if unionized airlines went out of business. Thus, a philosophy borrowed from the FDIC’s experience with savings and loans was adopted: allow failing and inefficient airlines to merge. Using this short-term fix, jobs were saved and political fall-out was reduced. However, the resulting mergers have contributed to today’s highly concentrated industry in which a handful of inefficient, under-capitalized airlines control the industry and monopolize or duopolize most American airports. Recent mergers include US Airways and America West, Air France and KLM Royal Dutch Airlines (KLM), and United Airlines with Mesa Air. United formed this last alliance solely to reduce competition by one of its former low-cost partners, Atlantic Coast Airlines (ACA). ACA was based at Washington Dulles International Airport and operated under the United logo and codes. Another United Airlines partner, Mesa Air, made a bid to purchase ACA. United solved this problem by merging with Mesa Air.

The 2003 merger between Air France and KLM was limited by a European Commission because the Commission identified 14 routes where the merger would “eliminate or significantly reduce competition.” Even still, the merged company became the largest airline in Europe, and one of the largest in the world. US Airways and America West merged in September of 2005 creating the United States’ “largest full-service, low-cost, low-fare airline.” In 1990, America West was the first start-up airline since industry deregulation to reach major-airline

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184. See generally Airport Access Report, supra note 113.
185. See generally Airport Access Report, supra note 113.
186. Dr. Paul Stephen Dempsey, Director, Institute of Air & Space Law at McGill University, Address before the University of Leuven Conference at Eurocontrol Headquarters Brussels, Belgium (May 19, 2005).
188. Id. at 70.
189. Id. at 71.
190. Id.
191. Id. at 65. This included three US to Europe markets: New York, Amsterdam – Atlanta, and Paris – Detroit. The commission required the merged company to surrender enough airport slots at Amsterdam and Paris to “allow competitors to operate up to thirty-one new roundtrip flights per day in the affected markets.”
192. Id. The largest shareholder of the merged entity (44 percent) was the French government.
In addition to these and other mergers, there are currently three major global airline alliances that further reduce competition in the industry and consist of multiple carriers: Oneworld, SkyTeam, and Star Alliance. Oneworld was founded in 1998 and SkyTeam was initiated by Air France and Delta Airlines in 1999. Star Alliance evolved from an agreement in 1992 between Air Canada and United Airlines. These alliances are comprised of global carriers and offer benefits to members and customers by sharing ticket offices, check-in facilities, frequent flyer miles and lounges; information consolidation; smoother transfers between member carriers on connecting flights; and higher customer service satisfaction.

Entry into the industry by new competitors is already difficult, based on present barriers that exist at major airports. The alliances can sometimes intensify concentration at airports such as LaGuardia and Reagan National where concentration is most acute due to slot and gate constraints, the barriers-to-entry are only strengthened by the alliances because they cause market share per competitor to increase substantially.

The potential for losing meaningful competition is greatest on routes where the merged or allied carriers both serve. There may be less incentive for the carriers to compete, causing airfares to rise. The alliances remove the threat that high fares or poor service will attract competition -


198. Oneworld.com, supra note 195; SkyTeam.com, supra note 196; StarAlliance.com, supra note 197.

199. Proposed Domestic Airline Alliances Raise Serious Issues: Testimony Before the Subcomm. On Aviation, Comm. On Commerce, Sci., and Transp., U.S. Senate 2 (June 4, 1998) (statement of John H. Anderson, Jr., Dir., Transp. Issues, Res., Cmty., and Econ. Dev. Div. of GAO) [hereinafter Proposed Alliances]. There are two types of alliances: end-to-end, and horizontal overlapping. End-to-end is pro-competitive in that it provides the participating airlines access to city-pairs and routes not otherwise accessible. The network is extended to provide travelers with more travel options. The horizontal overlapping alliance, however, is anti-consumer because competition is reduced through combined market shares, regional domination and control of important gateways. Aviation Alliances: Testimony Before the Comm. on Commerce, Sci., and Transp., U.S. Senate 3-4 (June 4, 1998) (statement of Hershel I. Kamen, Staff Vice President of Int'l and Regulatory Affairs for Continental Airlines, Inc.).


and to the extent concentration increases, entry will become more difficult. Alliances can arguably create considerable uncertainty regarding the ability of new entrants to compete in many markets.\textsuperscript{202}

Bankruptcy can further affect competition within the airline industry. Professor Dempsey has observed that no one has ever made long term profits transporting people from one place to another.\textsuperscript{203} However, the U.S. Government has traditionally been reluctant to allow airlines to fail.\textsuperscript{204} The result is that while bankruptcies are common, airlines rarely become defunct.

Most U.S. Airlines file for bankruptcy with chapter 11 status, as opposed to chapter 7 status.\textsuperscript{205} Chapter 11 of the bankruptcy code allows for reorganization of a company in hopes of becoming profitable again, while chapter 7 calls for liquidation of the company.\textsuperscript{206} There have been 162 bankruptcy filings in the airline industry since 1978 and 148 of these were under the protection of Chapter 11 status.\textsuperscript{207}

Currently, Delta and Northwest have Chapter 11 status.\textsuperscript{208} American has threatened to file bankruptcy,\textsuperscript{209} United recently emerged from bankruptcy\textsuperscript{210} and US Airways has done the same through a merger.\textsuperscript{211} Prior to the US Airways/America West merger, almost half of the capacity of the airline industry was flying in bankruptcy. The financial hardships within the airline sector have been caused by a number of factors including economic slowing, price pressure, rising fuel costs, less business travel, the 9/11 terrorist attacks, and the SARS epidemic. Operational cuts have been made by most legacy carriers, but bankruptcy is sometimes necessary in order to institute reforms. Many carriers reduce or eliminate labor costs – such as pension benefits – in order to reduce ex-

\textsuperscript{202} Proposed Alliances, supra note 199, at 15

\textsuperscript{203} Dr. Paul Stephen Dempsey, Director, Institute of Air & Space Law at McGill University, Address before the University of Leuven Conference at Eurocontrol Headquarters Brussels, Belgium (May 19, 2005).

\textsuperscript{204} Id. Instead, the government allows bankruptcy proceedings that give the company's additional chances to become profitable again – supposedly for the public good.

\textsuperscript{205} U.S. Gov't Accountability Office, Commercial Aviation: Bankruptcy and Pension Problems are Symptoms of Underlying Structural Issues, GA-05-945, at 19 (2005) [hereinafter Pension Problems].

\textsuperscript{206} Id. at 9, 10, 19.

\textsuperscript{207} Id. at 2, 19. Under chapter 11 status, management still continues to run the day to day business of the airline, but "all significant decisions must be approved by the bankruptcy court."

The idea is that the company can reorganize itself and eventually become profitable again.


\textsuperscript{209} Aviation, supra note 187, at 59.

\textsuperscript{210} Press Release, UAL, United Exits Bankruptcy as a Strong Competitor Committed To Continuous Improvement (Feb. 1, 2006).

\textsuperscript{211} Pension Problems, supra note 205, at 17.
penses and liability while under Chapter 11 bankruptcy status.\textsuperscript{212}

Some commentators believe that the industry's problems stem from over-capacity, and that bankruptcies will assist in solving these problems. However, history shows that airline industry growth has "continued unaffected by major liquidations."\textsuperscript{213} Low-cost carriers benefit most from major airline bankruptcies as they rush in to fill the lost capacity space.\textsuperscript{214} This has forced legacy carriers to turn to international flights for higher profits because they cannot compete with the smaller carriers on domestic ticket prices.\textsuperscript{215} To compensate for these new economic realities, the larger carriers have begun shifting aircraft from domestic to international flights, aggressively vying for service to new foreign locations. For example, Delta plans to reduce domestic capacity by 15-20 percent and increase international flights by 25 percent.\textsuperscript{216}

IV. Is Domestic Cabotage the Answer?

A. The Current State of Cabotage

Airline cabotage is "the carriage of air traffic that originates and terminates within the boundaries of a given country by an air carrier of another country."\textsuperscript{217} The current U.S. cabotage rules stem from the 1920s Jones Act,\textsuperscript{218} which requires that goods shipped between U.S. ports must travel on vessels owned and staffed by Americans.\textsuperscript{219} The Jones Act restrictions were expanded to include all forms of transportation, including aircraft.\textsuperscript{220} Generally, cabotage rights are only granted if the country requesting cabotage rights grants a similar privilege to U.S. carriers, and if

\begin{itemize}
\item \textsuperscript{212} Pension Problems, supra note 205, at 1, 17, 37, 53.
\item \textsuperscript{214} Mary Schlangenstein, Low-cost carriers poised to reap benefits from Delta bankruptcy, deseretnews.com, Sept. 19, 2005, at 1, available at http://deseretnews.com/dn/view/0,1249,610152136,00.html.
\item \textsuperscript{215} Associated Press, Northwest, Delta Look Overseas for Profits, MSNBC.com, Oct. 7, 2005, at 2, http://www.msnbc.msn.com/id/9622222/ (The turn to international flights could be called a "bright spot" for legacy carriers, as they tend to be profitable alternatives to domestic market share).
\item \textsuperscript{216} Id. (President Bush has assisted legacy carriers by agreements that the Departments of State and Transportation have reached with other countries to open up international routes to US companies).
\item \textsuperscript{217} U.S. Dep't of Transp., Office of the General Counsel, Airline Cabotage, U.S. Dep't of Transp., http://www.dot.gov/ost/ogc/subject/faqs/international/airlineCabotage.html.
\item \textsuperscript{218} 46 U.S.C.S. § 883 (Matthew Bender & Co., Inc. 2006)(commonly referred to as the Jones Act).
\item \textsuperscript{219} Id.
\end{itemize}
the CAB determines that the grant is within the public interest and consistent with international agreements.\(^{221}\)

In the United States, foreign air carriers must receive a cabotage permit from the CAB, but the Board may grant an exemption from this requirement when it finds that the exemption would be in the public interest.\(^{222}\) Courts have held that exemptions are to be used sparingly.\(^{223}\) Thus, so-called domestic cabotage, allowing international carriers to “take on for compensation, at a place in the United States, passengers or cargo destined for another place in the United States,” is usually entirely denied or severely restricted.\(^{224}\) The Department of Transportation Office of the General Counsel described the difficult granting of an exemption for international cabotage as follows:

we must find that the authority is required in the public interest; that because of an emergency created by unusual circumstances not arising in the normal course of business the traffic cannot be accommodated by U.S. carriers holding certificates . . . that all possible efforts have been made to place the traffic on U.S. carriers; and that the transportation is necessary to avoid undue hardship to the traffic involved\(^{225}\)

While the current laws are hostile to the concept of domestic cabotage, there have been liberalization efforts with regard to international cabotage, particularly the so-called “Open Skies” agreements. The basic concept of these agreements is to allow carriers to fly from one foreign country to another foreign country without returning to their country of origin in between.\(^{226}\) For example, under an agreement, a U.S. registered aircraft could fly directly from Paris to Belgium without returning to New York first. While these agreements do not allow true domestic cabotage—which would allow internal domestic flights by international carriers—they may be a step in the right direction.

Open Skies operates on reciprocal agreements between participating countries that negotiate the relationship bilaterally.\(^{227}\) Currently the

\(^{221}\) See 49 U.S.C.S. § 41703 (a)-(b) (West 2006); U.S. Dep’t of Transp., supra note 217.


\(^{224}\) 49 U.S.C.A. § 41703(c) (Matthew Bender & Co., Inc. 2006).

\(^{225}\) U.S. Dep’t of Transp., supra note 217.


\(^{227}\) See U.S. Dep’t of State, Current Model Open Skies Agreement Text, Bureau of Eco.
United States has Open Skies agreements with more than 70 countries, including many individual members of the European Union. However, opponents in the EU have stalled efforts to negotiate a multilateral agreement encompassing the entire EU by arguing that EU carriers should be allowed to fly from state to state in the U.S. if U.S. carriers are allowed to fly from country to country in the EU. In other words, the critics want domestic cabotage rights in the United States. These EU proponents also want to abolish ownership limits, which currently restrict foreign ownership of U.S. airlines to 25%.

In 2002, the European Court struck down the draft Open Skies agreement, saying it violated the laws of the 15-nation EU common market. The court, however, urged the sides to continue negotiations and, in 2005, the EU and U.S. began a fifth round of aviation talks to attempt to resolve their differences. While the U.S. has offered to raise the foreign ownership limit to 49%, it has ruled out allowing domestic cabotage because the negotiators feel Congress would not permit it. One basis of concern by Congress is that any agreement on airline cabotage would set undesirable precedent for the maritime sector, a nonnegotiable issue for the United States. Conversely, many countries in the EU worry that if the U.S. had unrestricted access to the European market, national carriers would quickly go out of business.

Still, there is significant pressure from both sides to get an initial agreement in place, while leaving the door open for negotiation of the more contentious issues. One proposal on the table is for the U.S. to allow European carriers to operate subsidiaries and partnerships in the U.S. until a full cabotage agreement can be worked out. Several of the agreements involve only the transportation of cargo between points in the partnering country. It remains to be seen whether Open Skies is the beginning of a wave of liberalization or merely a blip on the radar screen.

Outside of Europe, some international agreements are limited to

230. Id.
231. Id.
232. Id.
233. Id.
234. Id. at 2.
235. The Brattle Group, The Economic Impact of an EU-US Open Aviation Area 8-6 (Dec. 2002).
236. U.S. Dep't of State, supra note 228.
certain carriers. For example, Northwest and United are the "only American carriers with the right to pick up passengers in Japan for flights further into Asia."237 This valuable agreement, which dates back to 1952, is a significant reason why Northwest is the largest carrier between the U.S. and Japan.238

Despite advances in some areas, the U.S. government insists on fighting what many consider a losing battle to prop up the legacy carriers. In 2004 alone, Congress allocated $15 billion in loans and grants to the domestic airline industry in an effort to get the industry back on its feet in the wake of the September 11th attacks.239 Indeed, in many cases, "rather than relax foreign airline restrictions, the government is rigorously enforcing them." For example, in 2004, the U.S. fined Asiana Airlines, "the South Korean carrier, a record $750,000 for unauthorized service between Guam and Saipan, part of a U.S. commonwealth."240 In another famous incident, Virgin Atlantic Airways was forced to cancel plans to launch Virgin America, a U.S. based airline using U.S. aircraft and U.S. workers that would channel passengers to JFK where they could board Virgin Atlantic jets to London.241 The project was scuttled because of U.S. cabotage laws, despite raising $200 million in financing.242

B. Cabotage and the Labor Problem

One barrier to domestic cabotage agreements is negotiations with labor. United States airline pilots, as a representative group, have consistently opposed cabotage. U.S. pilots' main concern regarding liberalization is being played against their European counterparts to seek a competitive advantage.243 During the 1970's TWA and Pan Am exhibited a similar resistance to deregulation; the industry players knew that some carriers would not survive the changes.244

238. Id.
239. Christopher Elliott, Let Foreign Airlines Fly Inside USA, USA TODAY, Dec. 18, 2002, at 13A.
240. Id.
243. Chris Dodd, Rewriting the 'Rules of Engagement', AIR LINE PILOT, May 2000, at 10 (airlines are expanding the competitive arena beyond the national boundaries that were used to rationalize current and future Collective Bargaining Agreements, to include carriers in the European Union).
244. Michael Whitaker, Vice President, Int'l and Regulatory Affairs, United Airlines, Open Aviation for a Global Industry: Removing the Last Barriers to Airline Competition (Aug. 14,
Until 2004, pilots at major U.S. airlines had been at the top of the compensation pyramid and resisted cabotage because they believed they have the most to lose.245 While globalization may not have detrimental effects on an airline as a corporate entity, U.S. union pilots have taken the position that there is a significant impact on the pilots who gain or lose that flying.246 While airline managements and Air Transport Officials believe the industry’s problems can be solved by lowering labor costs, prospective pilots feel that they have already made sacrifices to meet the hiring standards at the major airlines.247 For that reason, it is important that the labor forces in both the United States and the European Union have representatives involved in the globalization talks and have their concerns addressed. This conclusion is affirmed by Mr. Hunnicutt, who recognizes that a significant amount of confidence building will be necessary to demonstrate to the affected parties that substantial commercial benefits will result.248

Successful confidence building or handholding measures will not be easy to achieve with airline labor groups. Pilots often see their relationship with management as being similar to the arrangement between cartoon characters Lucy (management) and Charlie Brown (labor). Lucy has promised to hold a football while Charlie Brown kicks it downfield, and both characters know that on past occasions Lucy has pulled the ball away at the last second, with Charlie Brown falling flat on his back. Nevertheless Lucy promises that this time will be different, and even though Charlie Brown has some reservations, Charlie Brown runs towards the ball with the same results as before.

In looking at industry developments in the 1990’s, pilots have felt like Charlie Brown. At the inception of global alliances and U.S./EU liberalization, free trade advocates extolled the benefits that would mate-


247. See Oliver Sutton, Europe’s Airlines: Brave new world, or what?, 672 EUR. AIR TRANSP. 26, 27 (2003) (Sutton describes the odyssey most prospective airline pilots go through, either paying for their own flight training, or spending eight or more years in the military after graduating from college in order to qualify for an interview. Once hired, pilots earnings potential and work schedule are driven by his or her seniority with that particular company. To quit and be hired at another airline means starting at the bottom of the heap again for both pay and work schedules).

rialize for U.S. carriers because U.S. airline labor costs were cheaper than their European counterparts.\textsuperscript{249} This perceived competitive advantage would allow U.S. carriers to gain market share in Europe. At the time, the Air Line Pilots Association (ALPA) disagreed. ALPA believed that airline managers would pursue the easy money and code-share with European airlines in lieu of actually investing the time and effort to expand the U.S. network.\textsuperscript{250} The results can be seen in the following chart covering growth from 1993 through 1998.\textsuperscript{251}

\textbf{Airline Code-Share Growth between 1993 and 1998}\textsuperscript{252}

In addition to missed opportunities for economic growth, the 1990’s contained alarming instances of airlines attempting to circumvent labor laws by shifting domiciles and/or operating bases to new jurisdictions. In 1995 Federal Express established a pilot domicile in Subic Bay in the Philippines.\textsuperscript{253} A similar event took place involving Atlas Air with the opening of a domicile in the United Kingdom.\textsuperscript{254} FedEx and Atlas claimed that the Railway Labor Act\textsuperscript{255} (RLA) did not apply to the pilots who were based in a foreign domicile, and therefore the wages and work-


\textsuperscript{250}. \textit{Id.}

\textsuperscript{251}. Woerth, \textit{supra} note 249, at figure 2.

\textsuperscript{252}. Captain Duane Woerth, ALPA’s President, Opening statement – Duane Woerth to Transportation Research Board: Looking at Alliances (Jan. 11, 1999), in ALPA.ORG, Jan. 1999, at 3, available at \url{http://cf.alpa.org/internet/speech/sp011199.htm} (contrast Chart A above with what, from a labor perspective, may have been the most palatable international alliance - the agreement between Northwest and KLM. This agreement assures that all block hour growth is split evenly between the two carriers. Furthermore, quantifiable floors are given for international code-share levels between hubs as well as non-hub cities).

\textsuperscript{253}. Woerth, \textit{supra} note 249.

\textsuperscript{254}. Woerth, \textit{supra} note 249.

\textsuperscript{255}. Woerth, \textit{supra} note 249.
ing conditions for those pilots would be negotiated separately from the agreement applicable to pilots based in the United States.\footnote{256}{Woerth, supra note 249 (ALPA brought suit against FedEx in 1995. However the suit was withdrawn after FedEx pilots elected an in-house union assumed bargaining responsibilities. Eventually as part of a bargaining agreement, the Subic Bay pilots were brought under the CBA. The Atlas dispute was also settled through the collective bargaining process in 2002).}

It is not just carriers in the United States that are pushing the envelope on labor law and regulations. The emerging low-cost carriers in Europe are on the cutting edge of turning airline employees into migrating commodities.\footnote{257}{Dodd, supra, note 243.} RyanAir has used the provisions of the European Union to hire pilots from the former Yugoslavia, provide them with Irish piloting licenses and work permits, and then base these pilots in the United Kingdom.\footnote{258}{Id.} This shell game leaves the employee with virtually no means of protest for any disputes with the airline.\footnote{259}{Id.}

Setting aside the lack of trust pilots place in airline management, another group that airline employees would like to keep at arm's length are the negotiators of U.S. trade agreements. European and American trade regulators approach issues from different philosophies. The Europeans place the welfare of local businesses (and therefore employees) high on the priority list while U.S. negotiators give their attention to the interests of the consumer.\footnote{260}{Bob Davis & Anita Raghavan, Competing Views: GE-Honeywell Deal Gets Caught Up in Diverging Histories, WALL ST. J., Jul. 3, 2001, at A1.} Hence, American workers may feel left out in the cold when the federal government does not place the welfare of U.S. corporations and workers on the same level as the European regulators.\footnote{261}{Id.}

It is not only U.S. airline employees who have reason to view cabotage cautiously. European airline employees and management have cause for concern if a bona fide cabotage program were to be enacted. At present, cabotage would allow a foreign carrier to pick up passengers in one U.S. city and deposit those passengers in another U.S. city while operating under that foreign carrier's native laws and regulations pertaining to safety and security, labor and the environment.\footnote{262}{Press Briefing On U.S. Aims for Comprehensive Accord in Air Services Talks with EU by John Byerly, Chief Negotiator for Transportation, U.S. State Department (Sept. 29, 2003), available at http://www.useu.be/Categories/Transportation/Sept2903ByerlyOpenSkies.html.} In order to access the U.S. market share, European airlines would receive a right of establishment so the carrier would have the right to own and operate a subsidiary that complies with U.S. federal and state laws such as immigration, labor, and tax law.\footnote{263}{Id.} In essence the EU operation flying within the U.S. would become a U.S. carrier. Therefore, the EU operation within
the U.S. would incur all of the burdens that come with the benefits of the U.S. marketplace.

United Airlines' Michael Whitaker agrees that as cabotage discussions move from theory towards reality, European enthusiasm will wane.264 Yet Whitaker cites a more significant problem within the EU that must be solved before cabotage or further liberalization can occur: overcapacity.265 Presently, there are 252 airlines operating in Europe and the former Soviet Union.266 Until the EU takes steps to reduce the number of participating airlines, nationality-driven bilateral agreements will remain.267

Just as EU carriers would be required to comply with U.S. laws while serving the domestic market, American carriers would encounter the same problem operating within nations of the EU. Although the EU removed national borders with respect to rights of establishment, cabotage and labor migration, each nation retained sovereign tax, labor and social welfare laws.

C. The Advantages of Cabotage

While the obstacles to making domestic cabotage a reality are formidable, there are significant advantages for U.S. carriers. To begin with, the current malaise that U.S. carriers find themselves in has led them to make significant cutbacks, which affect workers, routes, services—and maybe even safety.268 In contrast, many foreign carriers, such as Lufthansa, operate profitably and offer renowned service.269 Lufthansa's profits were up 172% in 2004 and "[w]hile its U.S. competitors cut back on amenities, meals and flight schedules, Lufthansa . . . added an acclaimed all-business-class service between Newark, N.J., and Düsseldorf, Germany."270 Many commentators believe that increased competition from foreign carriers would cause U.S. airlines to improve their operations in order to survive.271

The question is not whether the U.S. carriers would be able to compete in an open market, but whether foreign carriers would be able to compete in the U.S. and simultaneously exchange the rights to their skies.

264. Whitaker, supra note 244, at 7.
265. Id.
266. Id. at 8 (as an example, Latvia with a population smaller than metropolitan Washington D.C. has two international airlines. Additional consolidation is needed among the carriers serving the U.S. There are 6 American carriers providing service to Europe, and there are 25 European carriers flying into the U.S).
267. Id. at 9.
268. Elliott, supra note 239, at 13A.
269. Elliott, supra note 239, at 13A.
270. Elliott, supra note 239, at 13A.
271. Elliott, supra note 239, at 13A.
The sad truth is that the best competitors in an open market might be the airlines that have entered the U.S. market since deregulation, not the legacy carriers. Brutal competition over the last 25 years has honed U.S. airlines to be more efficient and resourceful. New-entry carriers such as JetBlue, Midwest Express, and Southwest have made service and efficiency the hallmark of their success, and have scrappily competed in the face of many inherent disadvantages to entry discussed above. They are ideally suited to compete with large, efficient and service-oriented European carriers.

Major carriers are increasingly ceding the domestic battleground to the new-entrants while entrenching themselves in international flights. As one Morgan Stanley airline analyst put it, “[i]nternational has been the place for (legacy) U.S. carriers to hide from low-cost competition.” New-entry carriers such as JetBlue do not compete with the major carriers on most international flights. Due to the “long planning horizons” and “years of diplomacy” it takes to operate internationally, particularly in Asia, “[l]ow-cost carriers are reluctant to jump into the international arena.” Another obstacle is that these flights require larger aircraft than most discounters fly.

Meanwhile, the major carriers operate flights such as Amsterdam-to-Bombay at nearly full capacity, allowing them to keep ticket prices high. The success of these flights is why airlines such as Northwest and Delta are making international flying a big part of their bankruptcy makeovers and why United Airlines is increasing its international flights while emerging from bankruptcy to represent half of its revenues. Both Northwest and Delta are increasing their international flights, while cutting domestic flying and both have also added new international routes. Northwest’s Chief Financial Officer went so far as to say that his airline’s future viability depends on foreign operations. However, increased competition could force the major carriers to abandon domestic flying altogether and focus on the inherent advantages their size gives them in the international field.

Of course, one huge obstacle to the profitability of international routes is fuel costs. While major carriers are adding new international routes, they are cutting others, blaming fuel prices. Because profits are never guaranteed, the major carriers may not survive even if they do

retool their operations to focus exclusively on international flights. And just because discount carriers aren't flying from the U.S. to overseas destinations yet, they might someday. The Caribbean and Mexico are seen as likely destinations for discounters in coming years; JetBlue Airways is already flying to Puerto Rico and the Dominican Republic from New York.279

V. ECONOMICS, BANKRUPTCIES, AND U.S. AIRLINES' POTENTIAL FOR SUCCESS

A. THE PRINCIPLE OF COMPARATIVE ADVANTAGE

Underlying arguments for international cabotage is the economic principle of comparative advantage. This principle holds that all international trade provides mutual benefit to all countries that partake in it and that "a country can benefit from trade even if it is absolutely more efficient (or absolutely less efficient) than other countries in the production of every good."280 The key is that countries should specialize in production and export of goods that they can produce at a relatively low cost.281 "Conversely, each country will benefit if it imports those goods which it produces at a relatively high cost."282

The English economist David Ricardo first described the principle of comparative advantage in 1817.283 Ricardo was interested in the trade relationship between the United States and Europe.284 Economist Paul A. Samuelson provides the following example: suppose that in the U.S. it takes 1 hour of labor to produce a unit of food, while a unit of clothing requires 2 hours of labor.285 In Europe, the cost is 3 hours of labor for food and 4 hours of labor for clothing.286

281. Id. at 689.
282. Id.
283. Id.
284. See id.
285. Id. at 690.
286. See id.
Example: American and European Labor Needs for Production

<table>
<thead>
<tr>
<th>Necessary Labor for Production</th>
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<tbody>
<tr>
<td>Product</td>
</tr>
<tr>
<td>1 unit of food</td>
</tr>
<tr>
<td>1 unit of clothing</td>
</tr>
</tbody>
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Clearly, the U.S. in this situation enjoys an "absolute advantage" in both goods, for it can produce both at a lower cost than Europe. However, food is relatively less expensive in the U.S. while clothing is relatively less expensive in Europe. This is true because the cost of food in the U.S. is half that of a unit clothing, while the cost of food in Europe is $\frac{3}{4}$ that of a unit of clothing. Thus, the relative cost of food is lower in the U.S. than in Europe. The real wage of a worker in the U.S. is 1 hour of work per 1 unit of food or $\frac{1}{2}$ unit of clothing. The European worker earns only 1/3 unit of food or $\frac{1}{4}$ unit of clothing per hour of work. In the absence of international trade, the prices of food and clothing in the two areas will be different because of the difference in production costs.

If trade is allowed between the two regions, however, Ricardo indicated that countries would shift production toward their areas of comparative advantage.\(^{287}\) Given the relative prices between the two regions, food will soon be shipped from the U.S. to Europe and clothing from Europe to the U.S. The penetration of clothing into the U.S. market will cause clothing prices to fall and some U.S. clothing manufacturers to be driven out of business. Likewise, European farmers will suffer losses from the import of American food. The net result will be an equalization of relative prices. The exact prices cannot be determined without knowing the exact supply and demand for the goods. However, Ricardo proved that the final price will be somewhere between the U.S. price ratio of $\frac{1}{2}$ for food to clothing and the European price ratio of $\frac{3}{4}$ for these same goods.\(^{288}\)

The overall effect is that the U.S. will benefit from imported clothing costing less than that produced at home, and Europe will benefit from consuming food that is less expensive than domestically produced food. The advantage is best seen by examining the real wages before and after trade. Before trade, a worker in the U.S. had to work 3 hours to get one unit of food and one unit of clothing. Assume that the new price ratio is $\frac{2}{3}$ (a number between the previous U.S. ratio of $\frac{1}{2}$ and the Europe ratio of $\frac{3}{4}$) and so food in the U.S. now costs $2 and clothing $3. Under this

\(^{287}\) Id.
\(^{288}\) Id. at 690.
scenario, a U.S. worker still has to work one hour to buy a unit of food, but need work only 1½ hours to buy one unit of European clothing. Therefore, the same bundle of goods costs the U.S. worker only 2½ hours of work, a real gain of 20%.

Under the same scenario, a European worker had to work 7 hours before trade to purchase the bundle of goods. After trade, the same worker must still work four hours to purchase a unit of clothing. However, to produce a unit of food, a European worker would only need to produce 2/3 of a unit of clothing (2/3 x 4 hours of labor), or 2 2/3 hours of work. This means the total work to purchase the bundle of goods for a European worker is 6 2/3 hours (4 + 2 2/3), or 5% less than before.

The bottom line is that Ricardo proved both regions would benefit if they specialized in their areas of comparative advantage—that is, if the U.S. specialized in the production of food, while Europe specialized in the production of clothing. Only free trade allows the flow of goods and services necessary to produce these advantages.

The illustration above demonstrated that both countries benefited from free trade, but critics might point out that the U.S. benefited more because of its absolute advantage to begin with. It is true that the U.S. benefited by a greater percentage; however, larger countries consume more than smaller countries. When relative consumption is factored in, it turns out smaller countries actually gain more from free trade than larger countries. They “affect world prices the least and therefore can trade at world prices that are very different from domestic prices.”

Economists have also determined that comparative advantage may be extended to many countries without altering the underlying principle. “As far as a single county is concerned, all the other nations can be lumped together into one group as ‘the rest of the world.’” The more countries involved, the more efficient the trade. Thus, multilateral trade is more efficient than bilateral trade.

The monetary principle remains the same as well when the number of goods and services is increased beyond the two in the illustration. Exactly where the comparative advantages lie depends, of course, on the demands and supplies of various goods. Thus, comparative advantages are constantly shifting as the world market shifts.

Samuelson and Nordhaus do note, however, two qualifications to the

289. Id. at 690-691.
290. Id. at 693.
291. Id.
292. Id. at 695.
293. See id.
294. Id. at 694.
theory of comparative advantage. The first is that the theory “assumes a smoothly working competitive economy with flexible prices and wages and no involuntary unemployment.” When workers are laid off in one industry or region due to comparative advantages, they often do not “flow” to the creation of new jobs in other industries, or other regions. This creates inefficiencies. The changes that the theory brings often cause “underutilized labor and capital” to lobby to protect their interests from foreign competitors. As a result, the theory is not very popular during down times, such as when “high tariff walls” were erected during the Great Depression. Samuleson and Nordhaus warn that “[w]hen an economy is in depression or the price system malfunctions, we cannot be sure that countries will gain from trade or that the theory of comparative advantage will hold in every case.

The second related qualification is that comparative advantage is good for nations, but not always good for every “individual, firm, sector, or factor of production.” Recent studies indicate that unskilled labor in high-income countries has in the last two decades suffered reductions in real wages because of the increased imports of goods in related industries from low-wage developing countries.” However, Samuelson and Nordhaus conclude that “[t]he theory of comparative advantage shows that other sectors will gain more than the injured sectors will lose.” Moreover, the economists note that labor always takes a period of time to gravitate toward better opportunities, so the disadvantages must be viewed long term. Thus, despite the theory’s drawbacks, Samuelson and Nordhaus conclude that “[n]ations that disregard competitive advantage pay a heavy price in terms of their living standards and economic growth.”

B. THE REALITIES AND EFFECTS OF CHAPTER 11 BANKRUPTCIES IN THE AIRLINE INDUSTRY

Some argue that Chapter 11 bankruptcy harms the industry by placing undue stress on other competitors when a failing airline is allowed to

295. See id. at 695.
296. Id.
297. See id.
298. Id. at 696.
299. Id.
300. Id.
301. Id.
302. Id.
303. Id
304. Id.
continue operations under bankruptcy protection. When the financial obligations of these companies are reduced by reorganization it obviously results in lower operational costs. These airlines could then undercut ticket prices of healthy competitors, theoretically causing financial hardship for them as well. The relative moderateness of the reorganization plans imposed enables these defunct airlines to operate ineffectively for lengthened time periods; this further discourages economic growth in an industry already plagued by financial problems.

Daniel Rollman examined these theories and presents the argument that Chapter 11 bankruptcies act as a deterrent to the invisible hand of the market’s supply and demand function: “[b]ecause Chapter 11 does not permit an airline to fail despite its performance and the economics of the industry, there will be excessive price competition and a generally unhealthy unsustainable economic environment.” He also uses the theory of prominent commentators Douglas Baird and Thomas Jackson to support his findings that, “the availability of bankruptcy reorganization causes industries to experience excessive and unhealthy competition because the industry retains an inefficiently large number of competitors.”

However, recent empirical studies find no indication that these bankrupt carriers actually reduce or undercut ticket prices: numerous studies by the government accounting office, culminating in a 2005 report, have examined the effects of Chapter 11 bankruptcy protection on healthy airlines and the industry overall. This report cites numerous other empirical and academic studies summarizing that airline bankruptcy does not create negative effects on capacity, traffic, individual airports, or the industry as a whole.

The National Bureau of Economic Research has also addressed this question. The Bureau investigated the pricing strategies of bankrupt airlines and their competitors. No evidence was presented to support that competitors to bankrupt airlines lower their prices or that they lose passengers to bankrupt rivals.

Even if the filings are not detrimental to the overall health of the industry, they are harmful to pension plan participants and the Pension

307. Id. at 413.
308. See Pension Problems, supra note 205, at 3.
309. See Pension Problems, supra note 205, at 3.
Benefit Guaranty Company (PBGC).\textsuperscript{311} Recent SEC filings of legacy carriers show airline defined benefit pensions to be underfunded by approximately $13.7 billion, which is down from $21 billion at the end of 2004.\textsuperscript{312} The reduction is based primarily on the shedding of liability through bankruptcy provisions that allow some debt to be released, and some debt to be satisfied by the PBGC.\textsuperscript{313} In the last three years alone, the PBGC has taken over $24.9 billion of liability from US Airways and United – at a “cost of over $9.7 billion to the agency.”\textsuperscript{314}

Congress is attempting reform, with three main proposals that would strengthen the defined benefit pension system in the long term by 1) adjusting the evaluation of pension assets and liabilities, 2) increasing PBGC premiums, 3) restricting lump-sum distributions from the plans, and 4) changing the disclosure requirements of the participating companies.\textsuperscript{315}

While the airlines with Chapter 11 status might not directly harm the industry or its competitiveness, most agree that it would be a benefit if these companies were at least liquidated more quickly or taken over by more efficient and successful carriers.\textsuperscript{316}

C. INTERNATIONAL COMPETITIVENESS OF U.S. AIRLINES

Airlines worldwide have faced many challenges in the aftermath of the attacks on September 11, 2001. In an industry that had already faced numerous bankruptcies and changes, the decreased passenger travel, increased regulations, and rising jet fuel prices affected U.S. and foreign carriers alike.\textsuperscript{317} But the ability of low-cost carriers in the U.S. to succeed and profit amidst these and other significant obstacles\textsuperscript{318} are an indication of U.S. potential for success in open domestic competition against foreign carriers.


\textsuperscript{312} See Pension Problems, supra note 205, at 37.

\textsuperscript{313} See Pension Problems, supra note 205, at 37.

\textsuperscript{314} See Pension Problems, supra note 205, at 3.

\textsuperscript{315} See Pension Problems, supra note 205, at 37.

\textsuperscript{316} See generally Barriers to Entry Continue in Key Markets, supra note 26, at 7 (citing The National Commission to Ensure a Strong Competitive Airline Industry, A Report to the President and Congress: Change, Challenge, and Competition (Aug. 1993)).


\textsuperscript{318} See Hearings, supra note 311, at 7.
The key to an airline's profitability lies in unit cost competitiveness.\(^{319}\) As discussed above, low unit costs, such as those maintained by low cost U.S. airlines, deliver a significant comparative advantage.\(^{320}\) Low cost airlines' competitive advantage in 2004 was 2.7 cents per average seat mile over legacy airlines due to their ability to keep overall costs low and maintain greater labor and asset productivity.\(^{321}\) Although legacy airlines have worked to reduce costs since 2001, their focus on capacity reduction has little effect on unit costs and their overall competitiveness.\(^{322}\) The drastic difference is illustrated below:

**LEGACY VS. LOW COST AIRLINE UNIT COST DIFFERENTIAL\(^{323}\)**

When evaluating the potential for U.S. and foreign carriers' success in an open market, the regulations imposed by individual nations will directly affect each airline's unit cost. For example, in February 2004, the European Union adopted Regulation 261/2004, which imposes common rules of compensating and assisting passengers who are denied boarding or whose flights are delayed or cancelled.\(^{324}\) The response from the industry was litigation challenging the appropriateness of all aspects of the

\(^{319}\) See Hearings, supra note 311, at 6.

\(^{320}\) See Hearings, supra note 311, at 6.

\(^{321}\) See Hearings, supra note 311, at 6.

\(^{322}\) See Hearings, supra note 311, at 6.

\(^{323}\) See Hearings, supra note 311, at 7, fig.3.

VI. CONCLUSION

The United States should aggressively pursue cabotage agreements with foreign governments and in particular with the EEC. Such agreements should be reciprocal in principle, offering cabotage rights in the U.S. equal in terms of mileage or other agreed upon benchmark in exchange for equal rights in the foreign country participating in the agreement.

The adoption of cabotage with whomever it can be negotiated should be combined with domestic policies opening up domestic airport gates and resources and slots to all who seek entry, whether new entrants or incumbent foreign carriers.

All foreign airlines granted cabotage rights should be required to satisfy all safety and regulatory and security requirements currently imposed on U.S. carriers, as well as additional security requirements deemed necessary under Homeland Security laws.

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325. See id.
Comments


Lisa Normand*

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I. Introduction

Since its peak in 1978, the general aviation industry in the United States has been on a steady decline. An industry that once sold 17,811 general aviation aircraft per year only sold 899 by 1992. The result has been job losses totaling 100,000 and the deterioration of the United States' position in international trade.

Although several factors contributed to the decline in the general aviation industry, in hearings before Congress, manufacturers and users of general aviation consistently identified excessive product liability costs as a major cause of the industry's decline. Even though safety has improved over the past decades—the accident rate for general aviation dropped thirty percent from 1981 to 1994—manufacturers' litigation costs have continued to increase. As a result, Congress enacted the General Aviation Revitalization Act of 1994 (GARA) in an effort to revitalize a once flourishing industry. GARA establishes “an 18 year statute of repose for a civil action against an aircraft manufacturer for damages arising out of an accident involving a general aviation aircraft.”

Under GARA, a manufacturer is protected from liability if its aircraft is in-

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3. Id.
9. Id. at 1.
volved in an accident more than eighteen years after the aircraft was delivered to its first purchaser.\textsuperscript{10} If a new component part is added to the aircraft or replaced by another part, the statute of repose starts over for that part "beginning on the date of completion of the replacement or addition."\textsuperscript{11}

The stated purpose of the statute was "to limit excessive product liability costs, while at the same time affording fair treatment to persons injured in general aviation aircraft accidents."\textsuperscript{12} One reason Congress determined a statute of repose would not be unfair to consumers is that most general aviation aircraft accidents are caused by pilot error rather than a manufacturing or design defect. Ninety-three percent are caused by pilot error,\textsuperscript{13} while only one percent are caused by manufacturing or design defects.\textsuperscript{14} Of those accidents caused by a manufacturing or design defect, nearly all of such defects are discovered early in the life of the aircraft.\textsuperscript{15} Thus, Congress determined it was "extremely unlikely that there [would] be a valid basis for a suit against the manufacturer of an aircraft that is more than 18 years old."\textsuperscript{16} However, Congress noted that "even though a claimant is unlikely to be successful in a lawsuit against the manufacturer of an aircraft which is more than 18 years old, these suits are frequently filed."\textsuperscript{17} Manufacturers have to spend money either litigating these suits or settling to avoid litigation.\textsuperscript{18} In addition, it would be unfair to hold manufacturers liable after their aircraft have a proven record of reliability: "A statute of repose is a legal recognition that, after an extended period of time, a product has demonstrated its safety and quality, and that it is not reasonable to hold a manufacturer legally responsible for an accident or injury occurring after that much time has elapsed."\textsuperscript{19}

The enactment of GARA marked the first imposition of a federal statute of repose.\textsuperscript{20} Congress stressed that because of the uniqueness of the aviation industry, it was willing to take this unprecedented step; aviation is unlike any other industry in that it is the only one subjected to

\begin{itemize}
\item \textsuperscript{11} Id. § 2(a)(2).
\item \textsuperscript{12} H.R. REP. NO. 103-525, pt. 1, at 1-2 (1994).
\item \textsuperscript{13} 104 CONG. REC. S2991, S2992 (1994) (statement of Sen. McCain).
\item \textsuperscript{14} H.R. REP. NO. 103-525, pt. 1, at 3.
\item \textsuperscript{15} Id.
\item \textsuperscript{16} Id.
\item \textsuperscript{17} Id.
\item \textsuperscript{18} Id.
\item \textsuperscript{19} 140 CONG. REC. H4998, H4999 (1994) (statement of Rep. Fish).
\item \textsuperscript{20} Id. at H5004 (statement of Rep. Synar).
\end{itemize}
"'cradle to grave' Federal regulatory oversight . . . ."21 Because of this oversight, limiting a manufacturer's liability will not be to the detriment of safety.22 Even without the deterrent of infinite liability, manufacturers of general aviation still have to satisfy the rigid safety standards required by the Federal Aviation Administration (FAA).23

Congress identified two other elements of fairness in GARA.24 First, GARA provides four exceptions from the statute of repose: for knowing misrepresentations by manufacturers, for passengers seeking treatment for medical emergencies, for persons injured while not aboard the aircraft when it crashed, and for manufacturers' written warranties.25 Second, the statute is "rolling" with regard to newly installed parts, so that if the part causing the accident is less than eighteen years old, the manufacturer of that part is not protected by GARA.26

Despite all of these rationalizations for the appropriateness of a federal statute of repose, there will still be occasions when a legitimate claimant injured in a general aviation accident because of a design or manufacturing defect is, nevertheless, barred by GARA from bringing a cause of action against the manufacturer. A claimant seeking to bring an action that might be barred by GARA needs to be familiar with the language of the statute and how courts have applied the statute.27 For the claimant pursuing a products liability action against a general aviation manufacturer, "GARA erects a formidable first hurdle . . . ."28 But if the claimant defeats the GARA defense, for example, by showing that one of its exceptions applies or by showing that some aspect of the statute is not satisfied, then the claimant will be left only to contend with her state's usual products liability laws.

This Comment provides an analysis of the practical application of the statute in order to guide plaintiffs who may seek products liability actions against general aviation manufacturers. It looks at the issues that have arisen regarding the application of GARA since its enactment in 1994 and analyzes the various outcomes in the case law to provide some indication of which arguments have merit and which ones are certain losers. Since GARA does not apply to an accident unless the aircraft involved is a general aviation aircraft, this Comment starts, in section II, by helping the reader understand what "general aviation aircraft" means according

22. See id.
23. Id.
25. Id.
26. Id.
28. Id.
the definition set forth in GARA. Then, in section III, the Comment discusses issues surrounding how to determine when the statute begins to run. In section IV, it explains how courts have determined who is a "manufacturer" protected by GARA, since the statute itself does not provide a definition. Next, section V explores the issue of how to know when a manufacturer is acting in its capacity as a manufacturer, and when it is not. Section VI seeks to provide some clarity to the difficult questions that arise regarding GARA's rolling provision, including how courts have handled revised flight manuals and overhauled or redesigned parts. In section VII, the Comment then discusses the four exceptions to GARA's statute of repose, focusing mainly on the exception that has generated the most litigation—the "knowing misrepresentation" exception. Section VIII looks at the jurisdictional issues that have arisen in applying GARA, including whether GARA confers subject matter jurisdiction on federal courts and whether GARA applies to accidents that occurred outside the United States. Finally, section IX outlines the various constitutional challenges that have been lodged against GARA and explains why they have all failed.

II. DEFINING "GENERAL AVIATION AIRCRAFT"

For GARA to bar a claim against a general aviation manufacturer, the injury, accident, or death giving rise to the claim must involve a "general aviation aircraft" as defined by GARA.\footnote{General Aviation Revitalization Act (GARA) of 1994, Pub. L. No. 103-298, § 2(a), 108 Stat. 1552, 1552-53 (1994).} GARA defines a general aviation aircraft as:

[A]ny aircraft for which a type certificate or an airworthiness certificate has been issued by the Administrator of the Federal Aviation Administration, which, at the time such certificate was originally issued, had a maximum seating capacity of fewer than 20 passengers, and which was not, at the time of the accident, engaged in scheduled passenger-carrying operations as defined under regulations in effect under the Federal Aviation Act of 1958 (49 U.S.C. App. 1301 et seq.) [as amended by 49 U.S.C.A. § 40101 et seq.] at the time of the accident.\footnote{Id. § 2(c).}

Plaintiffs need to be aware of how courts have construed and applied this definition because, if a plaintiff can successfully argue that the aircraft does not satisfy some aspect of this definition, then GARA cannot operate to bar that claim.

To be considered a general aviation aircraft as defined by GARA, the aircraft must have either a type or airworthiness certificate.\footnote{Id. § 2(c).} Airworthiness certificate "means an airworthiness certificate issued under section 603(c) of the Federal Aviation Act of 1958 (49 U.S.C. 1423(c)) [see 49 U.S.C.
certificate may be either "restricted" or "standard." 32 GARA adopts the Federal Aviation Act definition of "airworthiness certificate." 33 Because the Act does not distinguish between a standard and a restricted airworthiness certificate, an argument that GARA only applies to aircraft with a "standard" airworthiness certificate and not a "restricted" airworthiness certificate must fail. 34

An airworthiness certificate does not become invalid merely because modifications were made to the aircraft after it was certified, as long as the alterations are done in accordance with FAA regulations Parts 43 and 91. 35 In order to retain its airworthiness certificate after modifications, the FAA must approve the aircraft for return to service, 36 but the regulations do not require a new airworthiness certificate be issued after modifications are made. 37 The plaintiff in Schwartz v. Hawkins & Powers Aviation, Inc. erroneously argued that because modifications made subsequent to the accident had not been approved, the previously issued airworthiness certificate was invalid. 38 Instead, the plaintiff should have argued that the aircraft had not been approved for return to service, which is required for the certificate to remain valid. 39 The district court held that the aircraft in question had a valid airworthiness certificate at the time of the accident. 40 Had the plaintiff offered evidence that the aircraft had not been approved for return to service, the court may have found that the airworthiness certificate was, in fact, invalid—and therefore that the aircraft was not a general aviation aircraft protected by GARA.

In addition, an aircraft that meets the definition of a "public aircraft" is not precluded from also being considered a general aviation aircraft. 41 The plaintiff in Schwartz argued that the aircraft in question was not a

§ 44704(d)(1)) or under any predecessor Federal statute." Id. § 3(2). Type certificate "means a type certificate issued under section 603(a) of the Federal Aviation Act of 1958 (49 U.S.C. 1423(a)) [see 49 U.S.C. § 44704(a)] or under any predecessor Federal statute." Id. § 3(4).

33. GARA § 3(2). The Federal Aviation Act states, "The registered owner of an aircraft may apply to the Administrator for an airworthiness certificate for the aircraft. The Administrator shall issue an airworthiness certificate when the Administrator finds that the aircraft conforms to its type certificate and, after inspection, is in condition for safe operation." 49 U.S.C. § 44704(d)(1) (2005).
35. Id. (citing 14 C.F.R. § 21.181 (2006)).
38. Id.
40. Id. at *13.
41. Id. at *11.
general aviation aircraft under GARA because it satisfied the definition of public aircraft under the Federal Aviation Act. The term public aircraft, as used in the Federal Aviation Act, generally refers to certain aircraft owned or leased by the federal government. The court rejected the plaintiff's argument because each statute has and uses its own definitions and nothing in GARA states that a public aircraft, as defined by the Federal Aviation Act, cannot also be a general aviation aircraft, as defined by GARA.

III. When the Statute Begins to Run

GARA's eighteen-year limitation period begins to run on "the date of delivery of the aircraft to its first purchaser or lessee, if delivered directly from the manufacturer" or, with respect to any part that is added to the aircraft or that replaces another part, the date that such part is added or replaced. If the aircraft is not delivered directly from the manufacturer, then the period begins on "the date of first delivery of the aircraft to a person engaged in the business of selling or leasing such aircraft." GARA bars a claim if the accident upon which it is based occurred more than eighteen years after the aircraft was delivered.

Note that the statute does not state that the limitation period begins from the date the general aviation aircraft is initially delivered. Rather, the period begins on the delivery date of the aircraft. This means that even if the aircraft, upon delivery, does not meet the definition of a "general aviation aircraft," the statutory period still begins to run. The aircraft only need be a general aviation aircraft at the time of the accident for GARA to apply. In Estate of Kennedy v. Bell Helicopter Textron, Inc., the helicopter that was the subject of the litigation was initially delivered to the military in 1970 and used as a "public aircraft." Because the helicopter was not required to have, and did not have, a type or airworthiness certificate it did not qualify as a "general aviation aircraft" under

42. Id. at *10.
46. Id. § 2(a)(2).
47. Id. § 2(a)(1)(B).
48. See id. §§ 2(a)(1), 3(3).
49. See id. § 2(a).
50. Id. § 2(a).
51. Estate of Kennedy v. Bell Helicopter Textron, Inc., 283 F.3d 1107, 1112 (9th Cir. 2002).
52. See id.
53. Id.
GARA at that time. The plaintiff argued that GARA's statutory period did not begin to run until the aircraft became a "general aviation aircraft" in 1986—when it received its first type certificate and airworthiness certificate—which was less than eighteen years before the accident. The court disagreed, finding that the plain language of the statute contradicted the plaintiff's argument. According to GARA, an aircraft cannot satisfy the definition of a general aviation aircraft until the accident occurs because "one condition which must be met in order for an aircraft to qualify as a general aviation aircraft is that it 'was not, at the time of the accident, engaged in scheduled passenger-carrying operations . . . ." GARA, therefore, does not require that the aircraft delivered must be a general aviation aircraft in order for the statute to begin to run because, by definition, an aircraft cannot satisfy GARA's definition of general aviation aircraft until after an accident occurs.

IV. WHO IS A MANUFACTURER

Nowhere does GARA define who qualifies as a manufacturer of general aviation protected by GARA. Because of this, courts have had to address issues regarding how to identify the manufacturer of the particular product and regarding whether the statute protects successor manufacturers and foreign manufacturers.

Because aircraft parts are constantly being replaced and may be replaced by many different manufacturers, it may be difficult to determine who the manufacturer of the allegedly defective part is. One issue that arose in Campbell v. Parker-Hannifin Corp. was whether the defendant, Cessna, was the manufacturer of the new gyroscopic artificial horizon part that replaced an older part in 1994. This was significant because the aircraft, which had been manufactured by Cessna, had been

54. Id.
55. Id.
56. Id.
57. Id. (emphasis added).
58. See id.
63. Id. at 1546-47.
delivered more than eighteen years before the accident. If the plaintiff could establish that Cessna was the manufacturer of the replacement part, then the statutory period would start over in 1994, and the plaintiff's case against Cessna would not be time-barred. The problem was that even though the dataplate attached to the part had the name "Cessna" stamped on it, the dataplate also bore the words "Manufactured by Aeritalia Settore Strumentazione." After Cessna declared that it did not design or manufacture the part, the plaintiff was unsuccessful in arguing that the name "Cessna" being stamped on the part raised enough of an inference that Cessna was the manufacturer to survive summary judgment.

Successor manufacturers are protected by GARA to the same extent the predecessor manufacturer would have been with respect to the newly acquired product lines. A successor manufacture is a manufacturer that acquires an existing product line as part of its ongoing business. The district court in *Burroughs v. Precision Airmotive Corp.* noted that "[t]he term 'manufacturer' is nowhere defined in GARA, and GARA does not specifically include successor manufacturers within the protection of the statute." The court, nevertheless, found that the statute protects successor manufacturers because they take over the responsibilities of the predecessor. To find otherwise would undermine the objective of GARA since the successor manufacturer is also part of the general aviation industry.

A successor manufacturer should be distinguished from a company that merely acquires the assets of a general aviation manufacturer. The issue in *Michaud v. Fairchild Aircraft Inc.* was whether the defendant successor corporation was a manufacturer protected by GARA. The defendant corporation, FAI, purchased the assets of the company that manufactured the aircraft in question from its trustee in bankruptcy. The Delaware appellate court in *Michaud* distinguished FAI from the successor manufacturer in *Burroughs*: "FAI did not take over the respon-
sibilities of the predecessor corporation; it simply acquired its assets." 76
Because FAI did not continue to manufacture the predecessor's products, it was not protected by GARA. 77 Unlike the successor in Burroughs, FAI was "not the type of entity GARA was designed to protect." 78

Regarding whether GARA applies to foreign manufacturers, one could argue that since GARA was designed to revitalize the domestic general aviation industry 79 and since the statute does not specifically state that foreign manufacturers are protected, 80 then Congress must have intended for GARA only to protect domestic manufacturers of general aviation. Yet, the only court to directly discuss this issue held to the contrary. 81 The Ninth Circuit supported its conclusion that GARA also protects foreign manufacturers of general aviation by pointing to the definition of "general aviation aircraft" provided in GARA, which refers to "any aircraft for which the [FAA] has issued a type certificate or airworthiness certificate." 82 Since an aircraft manufactured by a foreign entity can receive a type or airworthiness certificate and satisfy GARA's definition of a general aviation aircraft, then GARA must apply to foreign manufacturers. 83

V. Capacity as a Manufacturer

For a manufacturer to be protected under GARA, the claim must be made against the manufacturer in its capacity as a manufacturer. 84 Congress did not want parties that were acting in a capacity other than as a manufacturer to be protected by GARA just because they also happened to be manufacturers. For example, if a manufacturer committed a negligent act as a mechanic or as a pilot that caused the accident, "the victims would not be barred from bringing a civil suit for damages against the party in its capacity as a mechanic." 85 A manufacturer acting in those capacities is not protected by GARA "to the extent that its role caused or contributed to the accident." 86 Accordingly, plaintiffs have advanced ar-

76. [Referencing page]
77. [Referencing page]
78. [Referencing page]
81. Lahaye v. Galvin Flying Serv., Inc., 144 F. App'x 631, 633 (9th Cir. 2005) (holding previous case implicitly held GARA protects foreign manufacturers of general aviation (citing Lyon v. Agusta S.P.A., 252 F.3d 1078 (9th Cir. 2001))).
82. Lahaye, 144 F. App'x at 633.
83. See id.
84. See GARA § 2(a).
Arguments for how a manufacturer could have been acting in another capacity. 87

Arguments that failure-to-warn claims are not subject to GARA because the duty to warn does not stem from the manufacturer’s role as a manufacturer have been unsuccessful. 88 Claimants have attempted to avoid GARA altogether by couching their claims in terms of failure to warn instead of in terms of manufacturing or design defect. 89 Plaintiffs making this argument have alleged that the defendant’s duty to warn of manufacturing or design defects is ongoing and is not derived from the manufacturer’s duty as a manufacturer. 90 Since GARA only applies to suits against a manufacturer in its capacity as a manufacturer, then, under this theory, GARA would not apply. Courts, however, have found that allowing a failure to warn claim to succeed would eviscerate GARA altogether because any time a manufacturing or design defect suit was barred, a plaintiff could instead sue on the theory of failure to warn of such a defect. 91 Clearly, this was not Congress’s intent. 92

Similarly, selling separate maintenance materials is not an undertaking separate from the manufacture of the aircraft or component part sufficient to trigger a duty to warn distinct from the manufacturer’s duties as a manufacturer. 93 The plaintiff in Mason v. Schweizer Aircraft Corp. purchased a helicopter from the defendant and subsequently purchased materials from the defendant regarding how to inspect and maintain the helicopter. 94 When the helicopter crashed because of a cracked air filter housing, the plaintiff alleged the defendant’s duty to warn of the defective housing did not arise because the defendant manufactured the housing but because it undertook to sell maintenance and inspection materials. 95 The plaintiff argued that “the services provided by [the defendant] went beyond its role as the manufacturer.” 96 After noting that a manufacturer has an initial legal obligation to provide a maintenance manual, the Iowa Supreme Court found that when a manufacturer subsequently sells revised manuals, it does not cross “the line from manufac-

89. See Burroughs, 78 Cal. App. 4th at 692, 694.
90. See, e.g., Burroughs, 78 Cal. App. 4th at 698; Campbell, 69 Cal. App. 4th at 1546.
94. Id. at 545.
95. Id. at 550.
96. Id. at 551.
turer to service provider . . . .” 97

For the same reasons that a manufacturer’s duty to warn is derived from its duty as a manufacturer, so too is a successor manufacturer’s duty to warn derived from its duty as a manufacturer. In Burroughs v. Precision Airmotive Corp., the corporation that initially designed, manufactured, and sold the carburetor, which was the subject of the litigation, had sold the product line, including the carburetor, to the defendant. 98 The plaintiff claimed that the defendant successor corporation was liable for the carburetor’s failure because the defendant, after purchasing the product line, undertook to provide service bulletins and other information about the predecessor manufacturer’s carburetors, implying that the successor’s duty to warn was somehow distinct from the predecessor’s duty to warn. 99 The California appellate court in Burroughs found that the defendant’s “duty with respect to reporting and issuing service bulletins and information was the same as its predecessors’ and derives from its status as the manufacturer . . . for the product.” 100 The defendant, therefore, was acting in its capacity as a manufacturer when it issued the bulletins and was protected by GARA. 101

VI. COMPONENT PARTS: THE “ROLLING” FEATURE

In Congress’s attempt to strike “a fair balance between manufacturers, consumers, and persons injured in aircraft accidents,” it made GARA a “rolling” statute of repose by providing that whenever a part in an aircraft is substituted with a replacement part, the statutory eighteen-year period starts over for that newly added or replaced part. 102 Thus, a newly manufactured component part receives the same limitation period as the aircraft in which it is installed. 103 In addition, the new time period only applies to the manufacturer of the new component part. 104

A. THE PROBLEM OF MAINTENANCE AND REPAIR MANUALS

Recall that basing a claim on the failure to warn of a design or manufacturing defect rather than on the defect itself cannot circumvent GARA’s eighteen-year statute of repose. 105 Presumably because failure

97. Id.
99. See id. at 700.
100. Id. at 699-700.
101. Id. at 700.
to warn claims could not succeed in circumventing GARA, plaintiffs turned to a similar, and sometimes difficult to distinguish, theory that maintenance and repair manuals are component parts. As component parts, when maintenance or repair manuals are revised or updated, GARA's rolling provision would be triggered for that part. For a manual to trigger the rolling feature of GARA, a plaintiff must show that the manual itself was substantially altered, or a provision was deleted, within the repose period and that such "revision or omission is the proximate cause of the accident." 

The key distinction between cases in which courts have allowed an aircraft manual to trigger GARA's rolling feature and those that have not is whether the plaintiff alleges that the manual itself is defective or whether the plaintiff merely alleges the manual failed to warn about a separate manufacturing or design defect. The Ninth Circuit in Caldwell v. Enstrom Helicopter Corp. distinguished the plaintiff's action from a failure to warn claim by noting that the plaintiff was not alleging that the helicopter involved in the crash was defective and that the helicopter's manual failed to warn of that defect; rather, the plaintiff claimed the manual itself was the defective part. The crash in Caldwell occurred because the helicopter's pilot did not know that the helicopter could not burn the last two gallons of gasoline in the fuel tanks. As a result, the helicopter ran out of usable fuel within 10 minutes of its destination and crashed. The plaintiff conceded that the fuel tanks themselves worked properly, but argued that the manual was defective "because it [did] not include relevant information about the limits on the fuel tanks' ability to burn the last two gallons of fuel." The plaintiff successfully argued that the manual was a part of the helicopter and since it had been revised within the last eighteen years, GARA's rolling feature was triggered.

Relying on Driver v. Burlington Aviation, Inc., a pre-GARA case applying a North Carolina statute of repose, the Ninth Circuit in Caldwell agreed that the plaintiff's claim was distinct from a mere failure to warn

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107. Mason, 653 N.W.2d at 552; Carolina Indus. Prods., Inc., 189 F. Supp. at 1170-71; Caldwell, 230 F.3d at 1156.
108. Caldwell, 230 F.3d at 1158.
109. Id. at 1157.
110. Id. at 1156.
111. Id.
112. Id.
113. Id. at 1156-57.
114. Id.
claim, which would be barred by GARA.\textsuperscript{115} In \textit{Driver}, the plaintiffs alleged that the crash of a Cessna model 152 aircraft occurred because the pilot relied on Cessna’s information manual, which provided “dangerously inadequate information.”\textsuperscript{116} The plaintiffs sued Cessna for negligent misrepresentation,\textsuperscript{117} but Cessna argued that the plaintiffs’ underlying action was actually a products liability action for the defective aircraft.\textsuperscript{118} The trial court found the claim was barred by North Carolina’s statute of repose and granted the defendant’s motion to dismiss.\textsuperscript{119} The reviewing court disagreed:

We find . . . that if plaintiffs’ underlying action is a products liability action, the product to which the action applies is not the aircraft as Cessna suggests, but the instructional manual. There are no allegations in plaintiffs’ amended complaint contending that the aircraft was in any way defective. In fact, plaintiffs concede that carburetor icing is a common condition which occurs in any aircraft . . . .\textsuperscript{120}

Because neither party pled the date of the manual’s sale, which would be the date triggering the repose period, the trial court did not have enough information to dismiss the plaintiffs’ action.\textsuperscript{121}

The Ninth Circuit in \textit{Caldwell}, after finding that the plaintiff’s claim was not for a defective aircraft but for a defective manual, was left only to decide whether the flight manual was a part of the aircraft capable of triggering GARA’s rolling provision.\textsuperscript{122} There are only two possibilities for the status of an aircraft flight manual: it is either “a part of the aircraft, or it is a separate product.”\textsuperscript{123} Turning to the facts in \textit{Caldwell}, the court noted that the FAA requires manufacturers of helicopters to include a flight manual with each helicopter.\textsuperscript{124} Given this requirement, the helicopter’s manual could not be considered a separate product.\textsuperscript{125} If the plaintiff, therefore, could show that the defendant “substantively altered, or deleted, a warning about the fuel system from the manual within the last eighteen years, and it is alleged that the revision or omission is the proximate cause of the accident, then GARA does not bar the action.”\textsuperscript{126}

\textsuperscript{115} \textit{Id.} at 1157.
\textsuperscript{117} \textit{Id.}
\textsuperscript{118} See \textit{id.} at 483.
\textsuperscript{119} \textit{Id.}
\textsuperscript{120} \textit{Id.}
\textsuperscript{121} \textit{Id.}
\textsuperscript{122} Caldwell v. Enstrom Helicopter Corp., 230 F.3d 1155, 1157 (9th Cir. 2000).
\textsuperscript{123} \textit{Id.}
\textsuperscript{124} \textit{Id.} (referencing 14 C.F.R. § 27.1581(a)(2)).
\textsuperscript{125} \textit{Id.}
\textsuperscript{126} \textit{Id.} at 1158.
A plaintiff proffering the argument that was successful in Caldwell may have to contend with the pre-GARA case, Alexander v. Beech Aircraft Corp., in which the Tenth Circuit applied Indiana’s statute of repose to very similar facts and came to a different conclusion. But the two cases can be distinguished. Similar to Caldwell, the aircraft accident that was the subject of the litigation in Alexander occurred because the aircraft ran out of fuel. In addition to claiming that the aircraft manual was a defective replacement part because it overstated the amount of usable fuel, the plaintiff also argued that the aircraft’s “fuel gauges were not accurate, the fuel tanks trapped fuel, [and] the fuel system had a propensity to dump or vent fuel overboard . . .” All of these circumstances contributed to the aircraft’s running out of gas, but the only claim that would not be barred by the state statute of repose was the one for the defective manual. In Alexander, the Tenth Circuit noted that the plaintiff did not claim the defective manual made the conditions of the flight more dangerous than if only the other defects were present, and found that the plaintiff's claim was essentially one for a failure to warn of the defects in the fuel system that “existed at the time of the original manufacture and delivery of the aircraft . . .” The Alexander court held the following: “[W]e agree with the district court’s reasoning on the lack of merit in the plaintiffs’ ‘replacement part’ theory . . . . In these arguments the plaintiffs are asserting a claim of failure to warn concerning conditions in the aircraft as manufactured and delivered in 1967.” This holding—that the failure to warn claim disguised as a replacement part theory was barred by the statute of repose—is consistent with Caldwell, which also held that a claim for a failure to correct a defect by issuing a warning cannot circumvent GARA’s statute of repose. The difference in Caldwell was that the court concluded that the plaintiff's claim was genuinely based on a defective manual rather than some underlying claim that would have been barred by GARA.

More difficult to reconcile is how other courts have come to the conclusion that an aircraft manual is not a part of the aircraft. For example, the Tenth Circuit in Alexander said the manual, rather than being a part of the aircraft, was merely “part of the evidence proffered by plain-

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128. Id. at 1217.
129. Id. at 1221.
130. See id.
131. Id.
132. Id. at 1222.
133. See Caldwell v. Enstrom Helicopter Corp., 230 F.3d 1155, 1157-58 (9th Cir. 2000).

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tiffs which bears on a failure to warn theory . . . .”135 The district court in *Alter v. Bell Helicopter Textron, Inc.*, applying GARA, similarly found an aircraft manual was not a part of an aircraft, relying, in part, on the holding in *Alexander*.136

The court in *Caldwell* dealt with these seemingly contrary holdings by distinguishing them as failure to warn claims rather than claims based on a defective manual.137 The rule in *Caldwell* may be the better one to follow because, despite earlier seemingly contrary holdings, several courts have applied the standard set forth in *Caldwell* to decide whether a defective manual triggers GARA’s rolling provision.138

Aside from pointing out that several courts have applied the *Caldwell* standard, a plaintiff could undermine the holdings in *Alexander* and *Alter* in several other ways. First, the *Alexander* court’s conclusion regarding the true nature of the plaintiff’s claims would, in fact, render the manual nothing more than evidence. The *Alexander* court held that the plaintiff was essentially trying to use the replacement part theory as a backdoor to sue for defects that were present at the time of delivery and that the claim was really for a failure to warn of those defects, a cause of action that would be barred by the statute of repose for the same reasons the defects themselves could no longer be subject to suit.139 Therefore, viewing the entire suit as one based on a failure to warn, the only logical function of the manual in such a suit would be as evidence bearing on the failure to warn theory. The status of the manual as a part becomes immaterial when the court concludes that the plaintiff’s suit is actually for defects in the fuel system.

Second, the *Alexander* court was construing an Indiana statute of repose, and the question of whether a manual is a “part” was evaluated pursuant to Indiana state law and does not speak to what Congress had in mind when it used the word “parts” in GARA’s rolling provision.140

Finally, the *Alter* court’s support for its conclusion that an aircraft manual is not a part is unconvincing. One case that the *Alter* court cited for support did not involve a rolling provision at all and only considered whether an instruction manual was a separate product according to the

139. *Alexander*, 952 F.2d at 1222.
140. *Id.* at 1220-21.
state statute of repose being construed.\textsuperscript{141} In another case, the question of whether a manual was a part of an aircraft was not even considered.\textsuperscript{142} Instead, the issue in \textit{Schamel v. Textron-Lycoming} was whether the provision of service manuals was a separate and discrete, post-sale undertaking giving rise to a duty of care not derived from the manufacturer’s duty as a manufacturer.\textsuperscript{143} The Seventh Circuit in \textit{Schamel} found that it was not.\textsuperscript{144} But this goes more to whether the manufacturer was acting in its capacity as a manufacturer than whether the manual is a part of the aircraft. Finally, in several of the cases the \textit{Alter} court cited, the court was not applying GARA, but rather, applying the state’s statute of repose.\textsuperscript{145}

Though courts have applied the \textit{Caldwell} standard, plaintiffs should be careful to note that even courts apparently adopting the \textit{Caldwell} standard have nonetheless found that GARA barred the claim by distinguishing the facts of \textit{Caldwell} from the facts presented in the case before them. For instance, in \textit{Hinkle v. Cessna Aircraft Co.}, a Michigan appellate court held that the supplement manual in question did not trigger GARA’s rolling feature because it did not satisfy the \textit{Caldwell} standard in three respects.\textsuperscript{146} First, because the plaintiff did not provide any evidence that the manual at issue “related to that specific airplane or that it provided specific instructions for the particular airplane in this case,” the plaintiff did not establish that the manual was a part of that aircraft.\textsuperscript{147} Second, the plaintiff did not establish or even allege that there was a causal connection between the supplement manual and the crash.\textsuperscript{148} Finally, the plaintiff “provided no evidence to demonstrate that the supplement added to or replaced a particular provision of the original flight manual.”\textsuperscript{149} Likewise, the district court in \textit{Robinson v. Hartzell Propeller Inc.} held that the flight manual at issue did not fall within GARA’s rolling provision because the plaintiff provided no evidence that the allegedly defective manual proximately caused the accident or that a warning had been substantively altered or deleted.\textsuperscript{150} The district court in \textit{Carolina Industrial Products, Inc. v. Learjet, Inc.} similarly found that the manual in question did not fall within GARA’s rolling provision because the plaintiffs,

\textsuperscript{141} Kochins v. Linden-Alimak, Inc., 799 F.2d 1128, 1134-35 (6th Cir. 1986).
\textsuperscript{142} See \textit{Schamel}, 1 F.3d at 657.
\textsuperscript{143} \textit{id.}
\textsuperscript{144} \textit{id.}
\textsuperscript{145} See \textit{id.} at 656 (applying Indiana’s statute of repose); \textit{Alexander}, 952 F.2d at 1220 (applying Indiana’s statute of repose); \textit{Kochins}, 799 F.2d at 1130 (applying Tennessee’s statute of repose).
\textsuperscript{147} \textit{id.} at *43.
\textsuperscript{148} \textit{id.} at *43-44.
\textsuperscript{149} \textit{id.} at *44.
unlike the plaintiffs in *Caldwell*, did not allege that the flight manual proximately caused the accident.\textsuperscript{151} Thus, even though courts have generally accepted the principle that a manual is capable of being a component part that triggers GARA’s rolling provision, the high standard set forth in *Caldwell* makes it difficult for plaintiffs to establish such a claim.

**B. Modified or Overhauled Parts**

Another issue that has arisen in interpreting GARA’s rolling provision is whether a modified or overhauled part that has been added to the aircraft or that has replaced another part can qualify as a “new component, system, subassembly, or other part.”\textsuperscript{152} The plaintiff in *Robinson* alleged that the overhaul of the aircraft’s propeller “rendered the propeller a ‘new part’” capable of restarting the statutory period for that part because the overhaul “‘essentially’ restored the propeller to its original ‘physical properties’.”\textsuperscript{153} Since the propeller was overhauled within the past eighteen years, a claim based on the propeller’s failure, the plaintiff argued, should not be barred by GARA.\textsuperscript{154} The district court in *Robinson* disagreed, finding that the language of the statute prevented an overhauled part from triggering GARA’s rolling provision: “An overhauled propeller does not replace another propeller and it is not added to the aircraft. It is removed for maintenance and returned to the aircraft.”\textsuperscript{155} Because the statutory period only restarts for a part that is added to the aircraft or that replaces another part, an overhauled part could not trigger the rolling provision.\textsuperscript{156}

The Ninth Circuit came to the same conclusion when confronted by a similar argument, though its reasoning differed.\textsuperscript{157} In *Lahaye v. Galvin Flying Service, Inc.*, the plaintiff alleged that the accident giving rise to the litigation was caused by a defectively designed trim actuator rather than a defect in the part itself.\textsuperscript{158} Because the trim actuator had been overhauled within the last eighteen years, the plaintiff reasoned, the claim was not barred by GARA.\textsuperscript{159} The court, however, found that the claim was barred by GARA because the aspect of the trim actuator that

\textsuperscript{153} *Robinson*, 326 F. Supp. 2d at 663.
\textsuperscript{154} See id.
\textsuperscript{155} Id.
\textsuperscript{157} See Lahaye v. Galvin Flying Serv., Inc., 144 F. App’x. 631 (9th Cir. 2005).
\textsuperscript{158} Id. at 633.
\textsuperscript{159} Id.
the plaintiff claimed was defective was not new; that is, the design of the trim actuator was not affected by the overhaul of the part. The court did not have to reach the question of whether, had the defective aspect of the part also been created by a recent overhaul of the part, it would have allowed the claim to go forward.

A related argument that was rejected by a California appellate court dealt with whether a subsequent reconfiguration of a system can render the system new for purposes of triggering a new repose period. The plaintiff in *Hiser v. Bell Helicopter Textron, Inc.* claimed that the installation of a retrofit kit rendered the entire fuel transfer system new. Even though not all of the physical components of the fuel system had been replaced, the plaintiff claimed the defendant essentially replaced the original design of the system with a new one by substituting some parts and reconfiguring others. The court conceded that the reconfigured fuel system could constitute a new design: “Since a ‘system’ is a combination of parts or components working together, the substitution and rearrangement of these parts arguably constitutes a new design of the fuel transfer system.” Ultimately, the court held that the plain language of the statute prevented the plaintiff’s theory, based on a new design, from succeeding in triggering GARA’s rolling provision: “[T]he words ‘component, system, subassembly, or other part,’ without any other modifiers, or reference to ‘design,’ connotes the replacement of a physical item, i.e., a piece of hardware, and not a new intangible concept or design.”

These cases indicate that courts generally construe GARA’s replacement parts provision to mean that only physical parts that were actually added to the aircraft or that replaced other parts can trigger GARA’s rolling provision, and then only if those particular parts caused the accident giving rise to the litigation. In addition, an overhaul or modification that changes the overall design of the part or system will not be considered a “new part” for purposes of triggering GARA’s rolling provision.

**VII. Exceptions**

There are four situations in which GARA does not apply. First, GARA does not protect a manufacturer that has knowingly misrepresented, withheld, or concealed from the FAA certain required safety in-

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160. *Id.*
161. *See id.*
163. *Id.*
164. *Id.*
165. *Id.* at 649.
166. *Id.* at 650.
formation. Second, “if the person for whose injury or death the claim is being made is a passenger for purposes of receiving treatment for a medical or other emergency,” then GARA does not bar the claim. Third, GARA does not bar a claim “if the person for whose injury or death the claim is being made was not aboard the aircraft at the time of the accident.” Finally, GARA provides an exception for written warranties. If an action is “brought under a written warranty enforceable under law,” then GARA’s time limitation will not apply. The exception that has produced the most litigation—the “knowing misrepresentation” exception—is discussed first and in more detail, followed by a brief discussion of the remaining three exceptions.

A. The “Knowing Misrepresentation” Exception

A manufacturer is not protected by GARA if it knowingly misrepresents certain safety information to the FAA. This exception was included, in part, because of concerns that, without such an exception, manufacturers may have less incentive to report defects to the FAA “because there would be complete immunity from private suits after the statutory period . . . .” The manufacturers’ only incentive to report safety information would be avoiding regulatory penalties, which, some felt, was not a strong enough incentive when safety is concerned. Not only does private action more adequately deter fraudulent conduct, but also “[r]egulatory agencies simply lack the resources to ferret out all cases of concealed fraud.” In addition, allowing total immunity to manufacturers even when they have knowingly misrepresented or concealed important safety information would undermine GARA’s goal of striking a fair balance between manufacturers and consumers: “It is unfair to allow manufacturers of general aviation aircraft or parts to escape liability for a defect if that manufacturer had knowledge or information of the defect that caused the accident in advance, yet failed to come forward with the information.” Specifically, the misrepresentation exception provides that GARA does not apply:

168. Id. § 2(b)(2).
169. Id. § 2(b)(3).
170. Id. § 2(b)(4).
171. Id.
172. Id. § 2(b)(1).
174. Id.
175. Id.
if the claimant pleads with specificity the facts necessary to prove . . . that the manufacturer with respect to a type certificate or airworthiness certificate for, or obligations with respect to continuing airworthiness of, an aircraft or a component, system, subassembly, or other part of an aircraft knowingly misrepresented to the Federal Aviation Administration, or concealed or withheld from the Federal Aviation Administration, required information that is material and relevant to the performance or the maintenance or operation of such aircraft, or the component, system, subassembly, or other part, that is causally related to the harm which the claimant allegedly suffered[.] 178

1. Elements of the Exception

To state a claim that the knowing misrepresentation exception applies, a plaintiff must plead the following with specificity: “(1) knowledge; (2) misrepresentation, concealment, or withholding of required information to the FAA; (3) materiality and relevance; and (4) a causal relationship between the harm and the accident.” 179 This formulation of the elements of the knowing misrepresentation exception, set out by the district court in the Rickert v. Mitsubishi Heavy Indus., Ltd., makes clear that the word “knowingly” modifies “concealed” and “withheld,” as well as “misrepresentation.” 180

a. Establishing Knowledge

To establish the applicability of the knowing misrepresentation exception, the plaintiff must show that the misrepresentation was made knowingly. Whether a claim that a manufacturer should have known of a defect will satisfy the “knowledge” requirement is unclear. Is it enough that the information was available to the manufacturer, and the manufacturer did not disclose the information to the FAA even though it was required information? The plaintiff in Campbell v. Parker-Hannifin Corp. alleged that Cessna should have known there was a problem with the vacuum pumps in the Cessna 310N aircraft because the National Transportation Safety Board (NTSB) had issued a report expressing concerns about the safety of the vacuum pumps in the Cessna 210N aircraft and recommending the FAA further study the issue. 181 A California appellate court disposed of the issue by finding that the report did not support the plaintiff’s claim for two reasons: (1) the report concerned a different model aircraft than the one involved in the accident in this case,

180. See id.
and (2) the NTSB recommendation to the FAA indicated that the FAA was aware of the problem, which undermines the argument that Cessna was misrepresenting or concealing the information since FAA already had the information.\textsuperscript{182} Thus, the court did not have to reach the question of whether, had the report supported the plaintiff's claim, the publication of the report would have established the defendant's knowledge of the problems. The court could have rejected the plaintiff's claim on the theory that the availability of the report was irrelevant to the question of whether the manufacturer knowingly concealed information. Under that theory, the report would be irrelevant regardless of whether it pertained to the aircraft in question.

The plaintiff in \textit{Hinkle v. Cessna Aircraft Co} was more successful and was able to establish knowledge and survive summary judgment.\textsuperscript{183} In 1995, the plaintiff's husband was killed while piloting an aircraft manufactured by Cessna that had been delivered for sale in 1973.\textsuperscript{184} Because delivery had been more than eighteen years before the accident, Cessna was protected by GARA unless one of the four exceptions applied.\textsuperscript{185} The plaintiff in \textit{Hinkle} alleged that Cessna "represented data to the FAA based on engine horsepower in excess of four hundred horsepower" even though the engines were approved for all operations at only 375 horsepower.\textsuperscript{186} She submitted affidavits from experts stating that in order to satisfy the single engine climb requirements of Civil Air Regulation 2.85(b), Cessna knew it had to misrepresent the horsepower data.\textsuperscript{187} In addition, the plaintiff claimed that this misrepresentation was used in the Pilot's Operating Handbook, relied upon by the plaintiff's husband.\textsuperscript{188} As a result, the plaintiff's husband "falsely believe[d] that a margin between the climb rate and the minimum control speed existed," which, an expert concluded, contributed to the accident.\textsuperscript{189} Therefore, the court reversed the summary disposition that the lower court had granted in favor of Cessna.\textsuperscript{190}

\textbf{b. What Information is Required}

The question of whether a manufacturer was required to disclose the allegedly misrepresented or concealed information depends, in part, on

\begin{footnotesize}
\begin{enumerate}
\item \textit{Id.} at 1548.
\item \textit{Id.} at 1548.
\item \textit{Id.} at *2.
\item \textit{Id.} at *31.
\item \textit{Id.} at *35.
\item \textit{Id.} at *34-36.
\item \textit{Id.} at *36-37.
\item \textit{Id.} at *37.
\item \textit{Id.} at *38.
\end{enumerate}
\end{footnotesize}
how a court interprets Federal Aviation Regulations (FARs), such as 14 C.F.R. § 21.3. The district court in Cartman v. Textron Lycoming indicated that a manufacturer is only required to affirmatively disclose information in three situations: (1) when it is "required by statute or regulation," (2) when it is "in response to a direct inquiry by the FAA," or (3) when it is "necessary in order to correct information previously supplied directly by the defendant to the FAA." Regarding the first category of information that must be affirmatively disclosed, FAR section 21.3(c) provides a list of occurrences that have to be reported to the FAA by the holder of a Type Certificate. Among them is "[a]n engine exhaust system failure, malfunction, or defect which causes damage to the engine, adjacent aircraft structure, equipment, or components." Yet, the district court in Cartman held there was no affirmative duty to report to the FAA the alleged problem with the carburetor float, without discussing whether there might be such a duty under section 21.3. This may be because the plaintiffs did not plead there was a duty under section 21.3 or because the court determined the alleged problem was not significant enough to warrant assigning a duty to disclose.

In a later case, Butler v. Bell Helicopter Textron, Inc., a California appellate court articulated its understanding of section 21.3: "The regulation merely requires a manufacturer to report 'any failure, malfunction, or defect' in a part manufactured by it, when the manufacturer has determined the defect has resulted in one of the occurrences listed in the regulation." The plaintiff in Butler alleged that section 21.3 required the defendant manufacturer to report in-flight failures of a helicopter's tail rotor yoke to the FAA. The court agreed, and since the defendant knowingly withheld the required information, summary judgment in favor of the defendant based on GARA was improper.

In addition, the court in Butler found that the reporting requirements of section 21.3 applied to any failure of a part that is in use in a typecertified aircraft even if the failure of the part occurred in a non-typecertified

194. Id.
196. See id. at *10 (noting that the "misrepresentation exception" does not apply because of a failure to disclose "possible" safety concerns).
198. Id. at 1083.
199. Id. at 1087.
The defendant in Butler argued that since section 21.3 requires “the holder of a Type Certificate” to report certain failures, such a type certificate holder only had to report failures in its typecertified aircraft. Therefore, because the previous failures that the plaintiff alleged should have been reported involved non-typecertified, military helicopters, the defendant argued that it should not be required to report those failures. The court found that the plain language of the regulation requires the failures be reported since they involved a part that is also used in typecertified aircraft:

Part 21.3 says Bell is required to report “any failure...in any product, part, process or article manufactured by it” that it determines has resulted in the listed occurrences. Those occurrences include tail rotor yoke failure. Bell determined in 1989 that inflight fatigue failure of the yoke it manufactured cause the military aircraft accidents. Consequently, Bell’s obligation to report those failures is patent.

The defendant could not avoid the reporting requirements merely by using the same part for typecertified and military aircraft.

c. Causation

The causation element requires that there be a causal link between the misrepresented, withheld, or concealed information and the accident. The argument that the FAA might have questioned, evaluated, and intervened to prevent safety issues had the FAA been provided with the required information regarding a design or manufacturing defect has been successful. The appellate court in Butler found that such a link was enough to survive summary judgment regarding the causation element:

If the FAA had been aware of five catastrophic yoke failures in 1989...the FAA may have been inclined to question the increase, or required further evaluation.... We cannot conclude...what the FAA would have done, and we certainly cannot conclude as a matter of law there was no relationship between the withheld information and the accident.

Once the plaintiff has succeeded in establishing fact issues regarding the other elements, the causation element should not present too much of a challenge to the plaintiff trying to satisfy this fairly lenient standard and to survive summary judgment.

200. Id. at 1086.
201. Id. at 1081-83.
202. Id. at 1086.
203. Id. at 1084.
204. Id.
205. Id. at 1087.
206. Id.
2. *Specific Pleading Requirement*

Note that the above elements must be pleaded with specificity. This requirement has been likened to Federal Rule of Civil Procedure 9(b), “which requires that parties plead fraud ‘with particularity.’” The district court in *Rickert v. Mitsubishi Heavy Industries, Ltd.* clarified just how specific a plaintiff must be. In *Rickert*, an aircraft piloted by the plaintiff’s husband crashed into a tall ridge during descent. Since approximately 21 years had passed between first delivery of the aircraft and the accident, GARA would bar a claim against the manufacturer unless an exception applied. The plaintiff claimed the knowing misrepresentation exception applied and offered expert testimony identifying three misrepresentations by Mitsubishi:

First, [the expert] claims that Mitsubishi misrepresented the de-icing systems used on the aircraft. Second, [he] asserts that Mitsubishi misrepresented the controllability of the aircraft. Finally, he alleges that Mitsubishi concealed information from the FAA by failing to report what it should have known were serious design defects in the aircraft.

The court rejected all three claims, finding that none qualified as a misrepresentation to the FAA, and granted summary judgment to Mitsubishi. The alleged misrepresentations were generally based on differences of opinion and mistakes, and the expert failed to identify how any of them involved misrepresented or concealed information. Even if the court assumed the expert’s opinions were true, the opinions did not allege a knowing misrepresentation or concealment. At most the expert’s opinions could be used to show Mitsubishi was negligent.

The plaintiff heeded the court’s message that it would not use such a liberal definition of “misrepresentation,” and on a motion to reconsider, convinced the court to reverse its earlier grant of summary judgment to Mitsubishi. A former employee of Mitsubishi who had piloted the aircraft in question provided an affidavit stating the following regarding an
FAA’s Special Certification Review investigating the safety of the aircraft: “[W]e only tested the short body aircraft when we knew that the long body aircraft was the problem. We withheld this distinction from the FAA.”\textsuperscript{218} Another former employee also submitted an affidavit stating that “Mitsubishi actively covered-up the problem of horizontal tail plane icing on the long body MU-2 aircraft, and withheld and concealed this information from the FAA before, during and after the Special Certification Review.”\textsuperscript{219} Each of these affidavits created a genuine issue of material fact regarding whether Mitsubishi misrepresented to or concealed from the FAA required safety information.\textsuperscript{220}

\section*{B. Other Exceptions}

No reported cases clarify the application of the exceptions for passengers receiving treatment for medical emergencies or written warranties.\textsuperscript{221} Regarding the “warranty” exception, legislative history makes clear that the written warranty exception was meant to clarify that GARA does not abrogate a manufacturer’s written warranty that extends beyond eighteen years: “This means that in the event a manufacturer desires to specifically warrant the safety of its product for a period of time beyond the applicable statute of repose, the courts would honor the manufacturer’s written warranty.”\textsuperscript{222} One congressman suggested that even under a warranty, a manufacturer would not be liable for damages resulting from an accident that occurred more than eighteen years after first delivery of the aircraft.\textsuperscript{223} A manufacturer would only be required to abide by the terms of the warranty, and “[w]arranties are not written to cover accidents.”\textsuperscript{224}

\textsuperscript{218} Id. at 382.
\textsuperscript{219} Id. at 382.
\textsuperscript{220} Id.
\textsuperscript{221} The three cases in which a plaintiff alleged a breach of a written warranty are not instructive. In \textit{Schwartz v. Hawkins & Powers Aviation, Inc.}, the court found that the “written warranty” exception did not apply because the plaintiff failed to allege that there was a written warranty. No. 04-CV-195-D, 2005 U.S. Dist. LEXIS 12188, at *17 (D. Wyo. Apr. 7, 2005). Similarly, in \textit{Hinkle v. Cessna Aircraft Co.}, the warranty claim was considered waived on appeal because the plaintiff merely raised the issue without supporting it with analysis or case law. No. 247099, 2004 Mich. App. LEXIS 2894, at *45-46 (Mich. Ct. App. Oct. 28, 2004). Finally, in \textit{Hiser v. Bell Helicopter Textron, Inc.}, because the court found there was substantial evidence supporting the jury’s finding that a part that had been replaced within last 18 years caused the accident, it did not need to reach the question of whether GARA’s warranty exception applied. 111 Cal. App. 4th 640, 655 (Cal. Ct. App. 2003).
\textsuperscript{224} Id.
Congress included the “medical emergency” exception out of a concern for innocent victims who are passengers in aircraft for the purpose of receiving medical attention.\(^\text{225}\) Because, unlike pilots, they “know nothing about the age or condition of the aircraft they happen to fly in [they] should not be deprived of just compensation for damages . . . .”\(^\text{226}\)

One case that briefly discusses the exception for claimants not aboard the aircraft dealt with a claim for intentional infliction of emotional distress.\(^\text{227}\) The survivors of pilots killed in a plane crash claimed GARA did not bar their claims for emotional distress merely because the survivors were not on the plane at the time of the accident.\(^\text{228}\) The district court held, without reference to the exception, that GARA barred their claims for emotional distress because, pursuant to the language of section 2(a), their damages “undoubtedly . . . arose out of the accident . . . .”\(^\text{229}\) While the literal language of the exception could be construed to apply to an emotional distress claim by a survivor, legislative history suggests Congress meant for the exception to apply to people on the ground who are physically struck by a crashing aircraft.\(^\text{230}\) One congressman noted that the exception protects “innocent victims on the ground who are injured or killed when a defective aircraft crashes, when the plane drops out of the sky . . . .”\(^\text{231}\) He went on to question what would happen if there were no such exception and a plane crashed into a school or a residential area, concluding that “[i]nnocent bystanders should not be left uncompensated when they are injured or killed by defective aircraft that just fall out of the sky.”\(^\text{232}\) This language suggests that, at least to this congressman, the “not aboard the aircraft” exception should not apply to claims of emotional distress by survivors of those killed in accidents.

VIII. Jurisdictional Issues

In interpreting and applying GARA, parties have raised issues regarding both subject matter jurisdiction and territorial jurisdiction. Regarding subject matter jurisdiction, parties seeking to remove a state court cause of action to federal courts have claimed that federal courts have subject matter jurisdiction over claims in which the application and


\(^{226}\) Id.


\(^{228}\) Id. at *18.

\(^{229}\) Id.


\(^{231}\) Id.

\(^{232}\) Id. (emphasis added).
interpretation of GARA is required.233 Regarding territorial jurisdictional, plaintiffs have argued that accidents occurring outside the United States are not subject to GARA’s statute of repose and that manufacturers are not, thereby, protected from liability with regard to such accidents.234

A. FEDERAL QUESTION JURISDICTION

GARA preempts state law that would allow a suit against a general aviation manufacturer filed more than eighteen years after delivery of the aircraft, or replacement or addition of a component part.235 The statute states at section 2(d), “This section supersedes any State law to the extent that such law permits a civil action described in subsection (a) to be brought after the applicable limitation period for such civil action established by subsection (a).”236 Issues have been raised regarding whether 2(d) “completely preempt[s] state law in the field of aviation hardware safety”237 and, alternatively, whether GARA creates enough of a federal issue that federal courts have subject matter jurisdiction over claims involving GARA.238

1. Complete Preemption of State Tort Law

GARA does not completely preempt state law: “Based on the hearing record, the Committee voted to permit, in this exceptional instance, a very limited Federal preemption of State law.”239 The House Judiciary Committee voted to approve GARA instead of “seeking to revise substantially a number of substantive and procedural matters relating to State tort law . . .”240 At least one court noted that GARA’s 2(d) was a “savings clause” that “clarif[ies] the scope and strengthen[s] the role of state tort law applicability to aviation products liability actions.”241 GARA does not create a federal cause of action, nor does it preempt a “state’s substantive law regarding negligence or breach of warranty claims.”242 Rather, it is a very limited, narrow response to the “per-

236. Id. §2(d).
237. Lucia, 173 F. Supp. 2d at 1270.
238. Wright, 930 F. Supp. at 304.
240. Id. at 5.
ceived liability crisis in the general aviation industry” that only preempts state law that would expose general aviation manufacturers to liability for longer than eighteen years after delivery of an aircraft to the first purchaser. Otherwise, “in cases where the statute of repose has not expired, State law will continue to govern fully . . .” Thus, GARA does not apply to states that have their own statutes of repose that are shorter than eighteen years.

2. “Substantial” Federal Question

The only case to squarely address the issue of whether GARA raises a federal question found that GARA did not confer federal question jurisdiction. The defendants’ argument in Wright v. Bond-Air, Ltd. was not that federal question jurisdiction should be conferred because GARA completely preempted federal law, but that it should be conferred because GARA raises a federal question substantial enough to warrant federal question jurisdiction. After the defendants in Wright removed the plaintiff’s state court action to federal district court, the federal court granted the plaintiff’s motion to remand the action back to state court. Defendants alleged the plaintiff had pleaded facts intended to satisfy GARA’s knowing misrepresentation exception without referencing GARA directly in order to disguise the federal nature of the claim. The court, therefore, should look beyond the plaintiff’s pleadings to find that the state-created claim raised a substantial federal question because it necessarily turned on “some construction of federal law.” Under this theory of federal question jurisdiction, the court looks at whether “some substantial, disputed question of federal law is a necessary element of one of the well-pleaded state claims.”

The court found that the cases relied upon by the defendant did not support the defendant’s argument that GARA raised a federal question because those cases involved “situation[s] where the exact same conduct [was] proscribed by federal and state statutes.” In contrast, Congress

247. Wright, 930 F. Supp. at 305.
248. See id. at 303.
249. Id. at 305.
250. Id. at 303.
251. Id. at 302. Federal question jurisdiction also exists if federal law created the cause of action, but that was not alleged here. Id.
252. Id. at 303.
253. Id. at 305.
did not intend for GARA to substantively revise state tort law, and the statute only preempts state law that would allow lawsuits beyond eighteen years. In all other circumstances, state law would continue to govern. Nor does the fact that applying GARA requires consideration of FAA regulations raise a substantial federal issue. The court, therefore, held that the federal issue raised in the plaintiff's state law claim was not "sufficiently substantial . . . to confer federal question jurisdiction." Defendants' argument that federal jurisdiction should be granted because there was a federal interest in uniform interpretation of the statute also failed because the U.S. Supreme Court had previously considered and rejected this argument. Federal question jurisdiction requires more than a federal interest in uniformity; it requires that the federal statute preempt state-court jurisdiction. In addition, concern over uniform application of federal statutes is mitigated by the fact that the Supreme Court "retains power to review the decision of a federal issue in a state cause of action."

B. APPLICABILITY TO ACCIDENTS OUTSIDE THE UNITED STATES

In the only reported case directly addressing whether GARA applies to accidents that occurred outside the United States, the court found that it did. In arguing that GARA did not apply to accidents in foreign countries, the plaintiff in Alter v. Bell Helicopter Textron, Inc. relied on cases tending to show the inapplicability of a federal statute in a foreign country. For example, in Smith v. United States the "Supreme Court held that the Federal Tort Claims Act, 28 U.S.C. § 2680(k), did not waive the United States' sovereign immunity for tort claims arising in Antarctica." In Boureslan v. Aramco, Arabian Am. Oil Co., the Fifth Circuit held that "Title VII does not regulate the employment practices of U.S. employers which employ U.S. citizens outside the United States."

The problem with relying on these cases, as the district court in Alter

254. Id.
255. Id.
256. Id.
257. Id.
258. Id. at 304 (referring to the U.S. Supreme Court's holding in Merrell Dow Pharms. Inc. v. Thompson, 478 U.S. 804, 807-08 (1986)).
259. Id. (citing Merrell Dow Pharms, Inc., 478 U.S. at 816).
260. Id.
262. Id.
263. Id. (discussing the holding in Smith v. United States, 507 U.S. 197, 204 (1993)).
pointed out, is that they refer to statutes that create a cause of action. The effect of not applying them in a foreign country is that certain claims that would be valid if they arose in the United States would not be valid if they arose abroad. In contrast, GARA "eliminates certain claims against aircraft and component manufacturers." Therefore, not applying GARA to accidents that happen in foreign countries "would have the anomalous effect of preventing litigants from bringing an action in the United States for an accident occurring in the United States while allowing litigants to bring the same action in the United States if the accident occurred abroad." This "anomalous effect" coupled with the fact that GARA was clearly intended "to bar any claim based on state law," led the court to conclude that GARA applies to accidents that occur outside the United States, as well as to accidents that occur inside the United States.

IX. CONSTITUTIONALITY OF GARA

Before GARA was enacted, eight states had previously repealed their statutes of repose or declared them unconstitutional. States that declared their statutes of repose unconstitutional generally did so "because they [were] held to violate the principle that State courts are to be open to every person for redress of any injury." Presumably because of this success at the state level, litigants have tried to convince courts that GARA violates the U.S. Constitution. Constitutional challenges based on violations of the Commerce Clause, the Equal Protection Clause, and the Due Process Clause have all been unsuccessful.

A. COMMERCE CLAUSE

Courts have held that Congress has the authority to enact GARA under its Commerce Clause powers, which authorize Congress "[t]o regulate commerce with foreign nations, and among the several states

266. Id.
267. Id.
268. Id.
269. See id.
The U.S. Supreme Court has identified "three broad categories of activity that Congress may regulate under its commerce power":

First, Congress may regulate the use of the channels of interstate commerce. . . . Second, Congress is empowered to regulate and protect the instrumentalities of interstate commerce, or persons or things in interstate commerce, even though the threat may come only from intrastate activities. . . . Finally, Congress' commerce authority includes the power to regulate those activities having a substantial relation to interstate commerce . . . i.e., those activities that substantially affect interstate commerce . . . .

GARA was properly enacted under either the second or third category: Aircraft are an instrumentality of interstate commerce, and "[t]he general aviation industry is certainly one that substantially affects interstate commerce." GARA was passed in response to the decline in the general aviation industry—which led to decreased production, substantial job loss, elevated prices, and a lack of research and development—one cause of which was excessive litigation costs.

In passing GARA, Congress was not only concerned about interstate commerce, but international commerce as well. One of the reasons Congress enacted GARA was because Congress believed relieving manufacturers of excessive litigation costs would enhance the competitiveness of American manufacturers. Thus, Congress was acting within its Commerce Clause power when it intervened to revitalize a failing industry that has widespread interstate and international consequences. Accordingly, an argument that Congress exceeded its Commerce Clause power by passing GARA will not succeed.

**B. Equal Protection**

The federal government is forbidden from making or enforcing laws that "deny to any person within its jurisdiction the equal protection of the laws." Legislation challenged on Equal Protection grounds that involves neither a suspect classification, such as race, nor a fundamental

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275. U.S. CONST. art. 1, § 8, cl. 3.
279. See id. at 2-3.
281. U.S. CONST. amend. XIV, § 1. While the quoted language comes from the Fourteenth Amendment's Equal Protection Clause (which refers only to the inability of states to deny equal protection), the Fifth Amendment's Due Process Clause (which applies to the federal government) is construed as having an Equal Protection component. United States v. Armstrong, 517 U.S. 456, 464 (1996); Bolling v. Sharpe, 347 U.S. 497, 499 (1954).
interest, such as voting, is evaluated under "rational basis review." 282 Under rational basis review a court looks at "whether the legislation is reasonably related to a legitimate governmental purpose." 283 The problem plaintiffs face when challenging GARA on Equal Protection grounds is that GARA easily satisfies this test.

Congress certainly has a legitimate interest in protecting a vital industry 284 that generates billions of dollars per year and that can potentially employ hundreds of thousands of workers. 285 In hearings held in consideration of GARA, Congress heard testimony and received evidence indicating that at least one of the causes of the industry's decline was excessive product liability costs. 286 Several alternative factors have been cited as the real causes of the decline, 287 but regardless of whether high litigation costs were actually the cause of the general aviation industry's decline, Congress certainly had a rational basis for thinking it was and for concluding that one way to revitalize the industry was to enact a statute of repose. And that is all that is required for the legislation to survive a constitutional challenge under rational basis review. 288

The Equal Protection arguments that have been raised are based on the distinction GARA makes between general aviation and commercial aviation. 289 But under rational basis review, "[a] legislative classification may not be set aside if any set of facts may reasonably be conceived to justify it." 290 The plaintiffs in Robinson contended there was no rational reason to distinguish between general aviation manufacturers and commercial manufacturers, 291 while the plaintiffs in Hinkle argued there was no rational reason to distinguish between the general aviation public and the commercial aviation public. 292 The courts in both cases were able to articulate a rational reason for the distinction: Either Con-

284. See Robinson, 326 F. Supp. 2d at 669.
285. General Aviation Manufacturers Association, Report to the President and Congress: The Results of the General Aviation Revitalization Act (noting that in the 1980s and early 1990s, over 100,000 general aviation jobs were lost).
gress decided “that it wanted to provide limited protection for this vulnerable segment of the aviation industry without limiting tort claims against commercial carriers in the hopes that the revitalization of the general aviation industry would spread to other sectors of the aviation industry,” or it decided that the general aviation industry was more seriously threatened by excessive litigation costs.

The plaintiffs in *Hinkle* further argued that Congress’s choice of an eighteen-year statute of repose was irrational since “the average age of a general aviation aircraft is typically over thirty years old.” Again, the court concluded that instituting an eighteen-year statute of repose was a rational way to protect a flagging industry from infinite liability. Relevant to this holding, but not mentioned by the court, is Congress’s finding that “[n]early all defects are discovered during the early years of an aircraft[sic] life.” After a “product has operated safely for a very long period of time . . . accidents are more likely to be due to improper maintenance or repair of the product or operator error . . . “ than a manufacturing or design defect.

For these reasons, claims for design or manufacturing defect of older aircraft are unlikely to succeed. Such claims, nevertheless, were often filed, and manufacturers had to spend money defending themselves or settle to avoid litigation expenses. Given these findings, Congress’s decision to limit the statutory period to eighteen years even though many of the aircraft in service were over thirty years old is rationally related to its goal of revitalizing the general aviation industry by protecting it from liability.

## C. Due Process

The Fifth Amendment of the U.S. Constitution provides, “No person shall . . . be deprived of life, liberty, or property, without due process of law . . . .” Plaintiffs have challenged the constitutionality of GARA on substantive Due Process grounds, arguing that GARA deprived them of a property interest by “fail[ing] to provide plaintiff with an alternative right or remedy before the aircraft reaches its average age.” But

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295. *Id.* at *12.
296. *Id.* at *15-16.
300. *Id.*
301. U.S. CONST. amend. V.
courts have held that a cause of action is not a vested property right until there is a final judgment.\textsuperscript{303} The district court in \textit{Robinson} found that “[i]n GARA, Congress has not taken away plaintiffs’ cause of action or right to be heard in court. It has only set a time limit for bringing an action.”\textsuperscript{304} A substantive Due Process challenge, therefore, must fail because a plaintiff will be unable to “demonstrate the presence of a . . . property interest to which the protection of due process may attach.”\textsuperscript{305} Even if there were a vested property interest, claimants would still have to contend with the lenient rational basis standard.

\section*{D. Application to Pre-Enactment Accidents}

Any claim filed after GARA’s enactment date, August 17, 1994, is subject to GARA’s statute of repose, regardless of whether the accident occurred before GARA was enacted.\textsuperscript{306} The Ninth Circuit in \textit{Lyon v. Agusta S.P.A.} reasoned that since section 4(b) of the statute specifically states that GARA “shall not apply . . . to civil actions commenced before the date of the enactment of this Act” and section 4(a) states that, after enactment, GARA will take effect unless one of the four exceptions listed in (b) applies, then Congress must have intended that any action filed after enactment would be subject to GARA.\textsuperscript{307} The Ninth Circuit in \textit{Lyon}, therefore, found that GARA barred the plaintiffs’ cause of action since the action was filed after GARA’s enactment date, even though the accident from which the cause of action arose occurred before its enactment.\textsuperscript{308} The plaintiffs in \textit{Lyon} challenged the application of GARA to their pre-enactment accident on substantive and procedural Due Process grounds and on Equal Protection grounds.\textsuperscript{309}

First, the plaintiffs argued that applying GARA to their claims violated their substantive Due Process rights because it deprived them of their cause of action, in which they had a vested property right, presumably because the property right arose when the pre-GARA accident happened, but was cut short by the subsequent enactment of GARA.\textsuperscript{310} The Ninth Circuit rejected the plaintiffs’ substantive Due Process challenge because it had previously held that “although a cause of action is a ‘species of property, a party’s property right in any cause of action does not

\begin{thebibliography}{9}
\bibitem{303} \textit{Hinkle}, 2004 Mich. App. LEXIS 2894, at *16; \textit{Lyon}, 252 F.3d at 1086.
\bibitem{304} \textit{Robinson}, 326 F. Supp. 2d at 668.
\bibitem{306} \textit{See Lyon}, 252 F.3d at 1085.
\bibitem{307} \textit{Id.}
\bibitem{308} \textit{Id.} at 1089.
\bibitem{309} \textit{Id.} at 1085-87.
\bibitem{310} \textit{See id.} at 1086.
\end{thebibliography}
vest until a final *unreviewable* judgment is obtained." 311

Next, the plaintiffs claimed that applying GARA to their cause of action violated "a procedural due process right because a statute of limitations cannot be shortened in a way that eliminates the plaintiff's ability to file an action." 312 But the Ninth Circuit distinguished between statutes of repose and statutes of limitations by discussing the different focus of each:

The latter bars a plaintiff from proceeding because he has slept on his rights, or otherwise been inattentive. Therefore, it is manifestly unjust to tell somebody that he has X years to file an action, and then shorten the time in midstream. However, a statute of repose proceeds on the basis that it is unfair to make somebody defend an action long after something was done or some product was sold. 313

Under a statute of repose, then, requiring someone to defend an action after the statutory period has run would be unfair regardless of "the injured party's alacrity or merit." 314 While courts evaluate both statutes of repose and statutes of limitations under rational basis review, what is rational for one may not be rational for the other. 315 Because, "barring irrational or arbitrary conduct, Congress can adjust the incidents of our economic lives as it sees fit," the Ninth Circuit found the application of GARA's statute of repose to the plaintiffs' pre-enactment accident satisfied rational basis review since it only reallocated the benefits and burdens of economic life. 316

Finally, the plaintiffs' Equal Protection challenge was based on the fact that other people involved in the accident in question who had already filed actions were allowed to proceed under GARA. 317 They alleged Congress had no rational reason to protect those who had already filed actions, while barring the plaintiffs' claim based on the same accident. 318 The Ninth Circuit rejected this constitutional challenge, in part, because it had previously rejected a similar argument. 319 In that earlier case, the Ninth Circuit had to resolve an issue that arose because of a U.S. Supreme Court decision, which held that the proper statute of limitations in securities cases was one year. In response to the Court's holding, Congress decided to allow relief despite the one-year statute of

311. *Id.* (quoting Grimsey v. Huff, 876 F.2d 738, 743-44 (9th Cir. 1989)).
312. *Lyon*, 252 F.3d at 1086.
313. *Id.*
314. *Id.*
315. *Id.* at 1087.
316. *Id.* at 1086-87.
317. *Id.* at 1087.
318. *Id.* at 1087-88.
319. *Id.* at 1087-88 (quoting to the Ninth Circuit's holding in Gray v. First Winthrop Corp., 989 F.2d 1564, 1573-74 (9th Cir. 1993)).
limitation, for those who had already filed securities actions on the day of the Court's decision.\textsuperscript{320} When a challenge was brought to the disparate application of the statute of limitations on Equal Protection grounds, the Ninth Circuit held the following:

> It is not irrational for Congress to limit its remedy to those individuals who have gone so far as to file suit in reliance upon the existing statute of limitations. These individuals will suffer the most concrete injury because they have expended significant time and effort to bring their action, not to mention substantial funds for attorney's fees and court costs.\textsuperscript{321}

Congress similarly acted rationally when it exempted those who had already filed actions before GARA's enactment date from GARA's statute of repose.\textsuperscript{322}

The case law makes clear that courts find GARA to be constitutionally permissible, at least with respect to the Commerce, Equal Protection, and Due Process Clauses. Because it is unlikely that such arguments will ever be successful, plaintiffs should look to other theories for ways to survive the GARA defense.

\section{Conclusion}

GARA was enacted with the strong support of both manufacturers of general aviation and its users.\textsuperscript{323} Even though the users of general aviation are the ones most likely to be involved in general aviation accidents—and, therefore, the ones most likely to support GARA's repeal—they supported enactment of the statute because they are also the ones who have to pay higher prices for aircraft as a result of excessive litigation.\textsuperscript{324} There have been indications that GARA has been successful in revitalizing the general aviation industry. After only five years, 25,000 new jobs had been created, aircraft production was up one hundred percent, "revenues from the export of general aviation [had] more than doubled," and research and development had grown by more than 150 percent.\textsuperscript{325} There are no signs that the General Aviation Revitalization Act will be repealed anytime soon. A plaintiff's only hope for obtaining relief in a products liability suit against general aviation manufacturers, therefore, is to know how GARA applies to her claim.

\begin{thebibliography}{99}
\bibitem{320} Lyons, 252 F.3d at 1087 (referring to the U.S. Supreme Court's holding in Lampf, Pleva, Lipkind, Frulpis & Petigrow v. Gilbertson, 501 U.S. 350 (1991)).
\bibitem{321} Lyons, 252 F.3d at 1087-88.
\bibitem{322} Id. at 1088.
\end{thebibliography}
Road Pricing as a Solution to the Harms of Traffic Congestion

Michael H. Schuitema*

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I. INTRODUCTION

In cities throughout the United States commuters are increasingly finding themselves stuck in traffic. The host of vehicles sitting motionless on the nation's freeways each day impose massive costs upon society; including air pollution, lost time, wasted fuel, added noise, reduced civility, etc. In addition, traffic congestion is an epidemic that is growing. In the nation's largest urban areas the growth in the number of motorists has risen faster than the growth of roadway capacity and will continue to do so.

An effective and administrable measure for reducing traffic congestion and the resulting negative impacts is congestion pricing. Congestion pricing simply refers to any method of charging road users a fee for the congestion costs they impose upon society.\(^1\) Since road users are not currently forced to consider the external costs of commuting when deciding when and how much to drive, the nation's roadways have become an

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\(^1\) Office of Mobile Sources, EPA, Transportation Control Measures: Congestion Pricing 1 (1998), available at \url{http://www.epa.gov/epahome/search.html} (type in the title in the “all of these words” box and then select “in the title” from the drop down menu).
overused resource. Congestion pricing seeks to aid drivers in making more efficient decisions by making them aware of the true costs of driving.\(^2\)

Even though domestic and international congestion pricing programs have proven successful, the chief obstacle to widespread implementation remains public and political acceptance. State and local governments must put time, money and effort into “selling” congestion pricing schemes if they are to have any hope of gaining the requisite support. This necessitates an extensive public debate of congestion pricing, addressing both its strengths and weaknesses as well as considering alternative measures.

Part II of this paper addresses America’s infatuation with – and reliance upon – the automobile. Part III analyzes the costs imposed upon society by traffic congestion; including (1) those costs felt directly by motorists, (2) costs incurred by the government, and (3) external costs hidden from commuters. Part IV takes a look at the different forms congestion pricing can take, including the second-best option of parking policy reform. Part V considers the most prominent examples of domestic and international congestion pricing and the success such programs have had. Part VI examines the impediments to popular acceptance of congestion pricing schemes and suggests some ways to overcome initial opposition.

II. AMERICAN CULTURE OF MOBILITY

About one thing there can be no doubt – Americans love their cars. Not only do automobiles play a central role in the nation’s economy as the primary source of transportation, but cars, trucks and SUVs are essential to the American conception of mobility and personal autonomy. Inexorably linked to the ideals represented by automobile use and ownership is the popularity of suburban living. According to an AAA poll, 65 percent of Washington metropolitan area residents stated that they preferred to live in a less densely populated suburb and use their cars to get to work, school and shopping.\(^3\) In contrast, only 29 percent of residents preferred city living with public transportation.\(^4\) Americans generally enjoy suburban living and “prefer detached homes over row houses, rural living over city life, and home ownership over renting.”\(^5\) The open spaces associated with rural and suburban living provide a manifestation of the

\(^2\) Id.


\(^4\) Id.

\(^5\) Id. at 205.
American ideals of individualism and freedom and is made possible by automobile use.

Not only do Americans prefer suburban living, but when given the choice between driving and public transportation, the vast majority of Americans choose to drive – and drive alone. Now that many middle-class families own three or more cars, driving has become a solitary experience. In 1990, the average American car commuting to or from work contained only 1.09 occupants. The lone driver is often seen as a symbol of American individualism and one who represents the ideals of freedom and liberation. Some also feel that the car is one of the last places free from civilization and the burdens of modern life. Driving in particular – and commuting in general – is not seen as an opportunity to interact with family members, colleagues, and friends. In fact, quite the opposite is true – the car is viewed as a private space where one can collect his thoughts and as a reprieve from the pressures and people of everyday life.

III. Costs of Congestion

Unfortunately, America’s love of the automobile and solo driving too often results in overcrowded roadways. Just like a pipe carrying water, there are only so many vehicles that can be moved on a roadway at any given time. The maximum number of vehicles that can move freely on a highway system is referred to as the “physical capacity” of the roadway and is determined by several factors: how many lanes are available to carry traffic, the curvature of the highway, side clearance, and interchange and intersection design. Physical capacity on a normal freeway lane is between 2,050 and 2,200 vehicles in an hour. Unfortunately, as is all too common in cities throughout the United States, when the number of vehicles in an hour reaches the upper limits of capacity, speeds decline and a stop-and-go condition (i.e. congestion) results. In addition, the number of cars that can be carried on the freeway also decreases. Thus, fewer cars and trucks can use each lane and once they do, it is at a slower speed. Congestion, in essence, reduces the value of the commu-

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7. Id.
8. Id.
nity's investment in the freeway by causing actual capacity to fall far below physical capacity.

In addition to the wealth of anecdotal evidence that can be found in households and offices throughout the nation, empirical studies confirm the general intuition that congestion is a major problem that has only been getting worse, especially in and around large urban areas. In its 2003 report, the Texas Transportation Institute's (TTI) researchers found that "congestion levels in 75 of the largest metropolitan areas have grown continuously in almost every year in all population groups from 1982 to 2001."11 In its analysis of congestion trends between 1990 and 2001, the TTI report concluded that peak period trips took an average of 10 percent longer in 2001 than they did in 1990.12 "Travelers spent 51 extra hours per year in travel compared to 42 hours in 1990, [and] the percentage of freeway mileage that is congested grew from 49 percent to 60 percent."13 By some measures, overall roadway congestion has increased by "more than 50 percent between 1982 and 2000 in the largest metropolitan areas"14 and approximately "70 percent of all urban interstates are congested during rush hour."15

Moreover, the future seems to promise a continuation of this troubling trend. Population and employment trends in America's largest cities are both expected to lead to a growth in highway congestion of around two percent each year, resulting in more severe congestion on a greater percentage of the nation's transportation system.16 Not only is passenger vehicle travel expected to grow by twenty-five percent in the next five years, but freight movement by truck is expected to grow in similar proportion as demand for freight transportation in the United States is expected to grow substantially.17

The costs imposed by such a systemic state of congestion in the United States can be divided into three broad categories: (1) motorists' direct costs, (2) governmental costs, and (3) external costs.

A. Motorists' Direct Costs

The most obvious and significant costs imposed directly upon drivers who confront congestion are wasted time and fuel. Congestion causes

11. Id. at 3-1.
12. A "peak period" is a period of heavy traffic, such as the beginning and end of the working day.
13. CAMBRIDGE SYSTEMATICS, INC., supra note 10, at 3-1.
15. Strahilevitz, supra note 6, at 1237.
16. CAMBRIDGE SYSTEMATICS INC., supra note 9, at ES-9.
commuters to spend a substantial amount of additional time (and thus fuel) on the roadways each year. Washington area residents, for example, spend about 216 million hours each year in traffic delays, with the average driver delayed seventy-six hours. In addition, the average Washingtonian commuter consumes an added 116 gallons of fuel sitting in traffic each year. TTI estimates that congestion costs Washington area residents a total of 3.5 billion dollars per year in lost time and fuel, which corresponds to a cost of 1,260 dollars for the average commuter. Congestion is not only a problem in the northeast, however, as it plagues sizeable cities throughout the country. In Atlanta, for example, the average resident wastes twenty-three hours each year stuck in traffic, which is the equivalent of 1.5 billion dollars annually in lost fuel and time throughout the city.

In addition, there is a host of other costs levied upon drivers as a result of congestion. Vehicle maintenance demands huge amounts of money from owners and is exacerbated by worsening traffic. Significant correlative costs result from time lost in traffic; including late fees at child care centers and expenses such as take out dinners and housekeeping costs. Also, the time spent sitting in traffic is time that commuters could have spent with family or enjoying recreational activities or pursuing educational aspirations. Furthermore, congestion caused by unexpected events often leads to increased vehicle crashes and injury. Although the extent of these direct costs may be substantial, drivers actually bear much of these costs and presumably take them into account when deciding whether and how much to drive. As such, these costs are not the primary concern of this paper.

B. GOVERNMENTAL COSTS

Further costs that result from congestion are those borne by the public sector for building, maintaining, and controlling highways. Despite funding obtained through gasoline taxes, tolls, and parking tickets, states and the federal government spend considerably more on highways than they receive from motorists. In New York, for example, public agencies spend about seven billion dollars each year on roads and collect only 4.5 billion dollars in motorist user fees. This results in a taxpayer subsidiza-

19. Id.
20. Id. at 201.
tion of New York drivers at a rate of over two billion dollars annually.\textsuperscript{23} A national analysis indicates that drivers throughout the country are subsidized through income, property and sales taxes at a rate of twenty to thirty billion dollars per year.\textsuperscript{24} In addition, there is a considerable amount of money spent each year on pollution control measures for automobiles. According to the U.S. Department of Commerce, "consumers, businesses, and governments in the United States spent 17.2 billion dollars on air and water pollution controls for highway transportation in 1993 [and] this is approximately 1,150 dollars per vehicle for emissions control."\textsuperscript{25}

C. EXTERNAL COSTS

1. Environmental Costs

   a. Air Pollution

   First and foremost, vehicle use and traffic congestion are major contributors of air pollution. Although automobile emissions have been reduced by ninety-six percent since 1968 due to the Clean Air Act, there has been a simultaneous increase in the use of automobiles.\textsuperscript{26} The increase in travel has, unfortunately, offset many of the gains resulting from cleaner emissions. The end result is a slight reduction in each automotive pollutant except lead, for which emissions have dropped more than ninety-five percent.\textsuperscript{27} In addition, emission-control devices require periodic inspection and maintenance, and the EPA estimates that only thirty-three percent of vehicles have properly working devices at any given time.\textsuperscript{28} Also, SUVs and mini-vans are defined as light-duty vehicles under the Clean Air Act, and as such are exempt from the strict emissions standards that apply to automobiles.\textsuperscript{29} Similarly, heavy-duty engines in trucks are not regulated as tightly as engines in automobiles.\textsuperscript{30} The result is that "automobiles are currently responsible for [seventy-five percent] of hydrocarbon emissions, [forty-five percent] of nitrogen oxide emissions and [thirty-four percent] of the volatile organic compound

\textsuperscript{23} Id.
\textsuperscript{24} Id.
\textsuperscript{26} Tirza S. Wahrman, BREAKING THE LOGJAM: THE PEAK PRICING OF CONGESTED URBAN ROADWAYS UNDER THE CLEAN AIR ACT TO IMPROVE AIR QUALITY AND REDUCE VEHICLE MILES TRAVELED, 8 DUKE ENVT'L. & POL'Y F. 181, 184 (1998).
\textsuperscript{28} Wahrman, supra note 26, at 185.
\textsuperscript{29} Id.
\textsuperscript{30} Id.
emissions in the United States.\textsuperscript{31} Automobile exhaust also accounts for a substantial amount of carbon monoxide emissions.\textsuperscript{32} Congestion only exacerbates this problem since vehicle emissions are 250 percent higher at congestion than when the traffic flows freely.\textsuperscript{33} The health effects of these air pollutants range from headaches and eye irritation to reduced lung function, lung damage, respiratory disease, and cancer. In fact, according to the American Lung Association, "the health effects of air pollution are estimated to cost fifty billion dollars each year."\textsuperscript{34} When crop loss and ecosystem damage is added, the annual total cost of motor fuel pollution has been estimated as high as sixty-six billion dollars.\textsuperscript{35} Despite the high level of air pollution harm that results from vehicle emissions, there is evidence that motorists only bear about five percent of air pollution costs, leaving the other ninety-five percent to be felt by the public.\textsuperscript{36}

b. Global Climate Change

Given the harmfulness of vehicle emissions, it should come as no surprise that automobile use also has damaging effects on the global climate. The combustion of fossil fuels, such as motor fuel, is one of the major contributors of carbon dioxide and emissions of other greenhouse gases. The transportation sector alone is responsible for thirty-two percent of the nation's human-caused carbon dioxide emissions, which is seven percent of greenhouse gases worldwide.\textsuperscript{37} Congestion contributes significantly to these emissions. One study indicates that "congestion causes an extra thirty million tons of carbon dioxide to be released into the air" each year in the United States.\textsuperscript{38} Moreover, the transportation sector has the highest rate of growth of carbon dioxide emissions in the country.\textsuperscript{39}

c. Water Pollution

Vehicle use is also responsible for a significant amount of water pollution throughout the country, as pollutants originating as air emissions

\begin{itemize}
  \item \textsuperscript{31} Nelson, supra note 3, at 203.
  \item \textsuperscript{32} Wahrman, supra note 26, at 186.
  \item \textsuperscript{33} Transer AB, Swedish National Road Administration (Vägverket), Road Pricing in Urban Areas 22 (The Federation of European Transport and Environment and the Swedish National Road Administration (Vägverket) 2002), available at http://www.transport-pricing.net/download/swedishreport.pdf.
  \item \textsuperscript{34} ICF, Inc., supra note 25, at 4.
  \item \textsuperscript{35} Komanoff, supra note 22, at 130.
  \item \textsuperscript{36} Id.
  \item \textsuperscript{37} ICF, Inc., supra note 25, at 5.
  \item \textsuperscript{38} Office of Mobile Sources, supra note 1, at 2.
  \item \textsuperscript{39} ICF, Inc., supra note 25, at 5.
\end{itemize}
often find their way into surface waters. Much of this pollution is achieved through atmospheric deposition, but urban runoff is also a contributor. Paving land for roads and parking in urban areas (amounting to about forty percent in many cities) increases the amount of impermeable surface which results in increased runoff.

d. Land Use and Habitat Loss

Roads consume land – both rural and urban. The nation is continually adding to its already expansive system of roadways, appropriating larger segments of land for automobile use and thereby intruding on more landscapes and communities. Throughout the United States, paved and unpaved roads occupy 25,000 square miles of land, an area equal to the size of West Virginia. Although freeway construction obviously takes a toll on the land, the costs of construction are also lodged against the public sector in the form of lost tax revenue and production assets. In fact, one commentator estimates that such losses reach sixty-five billion dollars each year.

2. Other External Costs
   a. Congestion Costs

Traffic delays cost Americans billions of dollars each year in lost time and wasted fuel. Much of this cost is felt directly by the individual driver, but a considerable portion is levied upon other drivers and non-drivers. When a commuter joins an already congested roadway, he adds to the time delay (and fuel costs) experienced by all the commuters behind him as well as his own delay. Non-drivers also feel the effects of any additional congestion since stop-and-go conditions on the roadways consume walkers’, cyclists’, and bus travelers’ time as well. Some estimates put these costs as high as twenty-five billion dollars annually.

b. Accidents

Automobile crashes in the United States cause losses in the hundreds of billions of dollars each year. Motorists feel most of the pain, suffering, and lost life, but “employers and taxpayers finance most of the associated health insurance and workers’ compensation costs [as well as bearing] much of the cost of workplace disruption” and rehabilitation for injured

40. Id. at 6
41. Id.
42. Id.
43. Id. at 7.
44. Komanoff, supra note 22, at 130.
45. Id. at 129
workers. Non-motorists are also affected through loss of life to pedestrians and cyclists struck by vehicles. Some commentators, however, point out that reducing congestion may reduce the total number of accidents but could increase the number of serious accidents as average vehicle speeds rise.

c. Economic Costs

Congestion has several negative economic effects. First, time wasted in traffic results in a less productive work force. Except for the few distracted motorists on their cell phones, most commuters are not very productive while traveling to work. And once these drivers get to work, they are often stressed and frustrated. Moreover, as congestion continues to grow so will the unpredictability of travel times, forcing drivers to budget even more time into their trips in order to avoid being late.

The effects of congestion are especially important for those in service industries, such as technical and maintenance workers. Service workers make fewer calls per day as a result of traffic delays and therefore the nonproductive time per day for each driver increases, forcing companies to raise their hourly rates. Burgeoning traffic also affects emergency medical, fire, and police services that are delayed from attending medical, crime and disaster situations.

Additionally, travel time is critical to the trucking industry. There is a direct link between “travel conditions (congestion and reliability) and economic productivity for truckers.” As such, any impact congestion has on reliability will have a corresponding effect on the total cost of freight transportation. If congestion continues to spread into the midday periods, which is the peak travel period for trucks, more costs will be incurred by the trucking industry which will eventually trickle down to the final consumer. Furthermore, as the ability of truckers to hit their delivery target-times decreases, costs will be levied upon companies attempting to optimize delivery schedules. This is especially troublesome and costly for firms that are attempting to establish a “just-in-time” delivery schedule. Such effects on the trucking industry have implications for the nation as a whole and for consumers in particular. “In 1999, [for example], purchases of transportation-related goods and services accounted for 10.6 percent of GDP ($980 billion) of GDP.” In addition, transportation costs account for a share of many products’ final price, ranging from one percent to fourteen percent depending on the product and dis-

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46. Id.
47. CAMBRIDGE SYSTEMATICS INC., supra note 10, at 3-18.
tance traveled. Thus, even a relatively small change in the physical condition or operating characteristics of a highway system can have a major influence on the final price consumers pay for goods and services.

As mentioned above, transportation has a direct effect on companies that rely on the timely arrival of products and materials. When congestion makes shipment arrival-times unpredictable, businesses with production schedules designed to take advantage of reliable transportation must instead plan for items to arrive early. This takes up valuable space and inventory, wasting resources that could otherwise be spent on productive activities. Also, any increase in transportation costs caused by congestion reduces a company's ability to invest in making more products, improving quality, or introducing new product lines.

d. Noise and Vibration Costs

The increased vehicular noise (from tires, engines, brakes, horns, sirens, etc.) caused by stop-and-go conditions takes a toll on the public in terms of stress, lost sleep, and impaired activity (estimated at twenty-two billion dollars by one commentator\textsuperscript{50}). In addition, automobiles cause vibrations which can damage buildings and underground infrastructure, such as water mains. This is especially harmful for older northeastern cities where highways are situated close to older structures.

e. Costs to Civility

As many of us can testify to from personal experience, congestion also contributes to a distinct lack of civility in society. In a hurry to arrive at their destinations, many otherwise law-abiding citizens frequently break traffic laws. This in turn sparks another phenomenon, known as "road rage." Road rage has been defined as violent behavior exhibited by drivers in traffic, often as a manifestation of stress. Although such incidents are not commonplace, they do undermine commuters' sense of safety on the roads. For instance, "the AAA Mid-Atlantic Transportation Poll 2000 found that [fifty-three percent] of area residents rated aggressive driving as the number one highway safety concern.\textsuperscript{51}"

D. Estimates of Total External Costs

Several studies have measured the hidden costs (i.e. those not felt directly by the driver imposing the costs) of automobile use in the United


\textsuperscript{50} Komanoff, supra note 22, at 130.

\textsuperscript{51} Nelson, supra note 3, at 204.
States. In estimating these figures, the studies included the costs of all or some part of the following: (1) police, fire, ambulance, road construction and maintenance, and other related local government expenditures, (2) property taxes lost from land cleared for freeways, (3) parking, (4) air, water, land pollution, (5) noise, vibration damage to structures, (6) global warming, (7) petroleum supply line policing, security, petroleum production subsidies, (8) trade deficit, infrastructure deficit, (9) sprawl, loss of transportation options, (9) uncompensated auto accidents, and (10) congestion.52

These studies concluded "that the total annual hidden costs of automobile usage ranged from 378 to 739 billion dollars (in 1991 dollars)."53 This correlates to a subsidy of 2,185 to 4,220 dollars per car to automobile users.

E. COST INTERNALIZATION

Because drivers do not bear a considerable amount of the costs they impose upon society in the form of noise and air pollution, road construction, global warming, accidents, etc., these costs are not taken into account when drivers decide to use their cars. Thus, driving becomes an over-consumed resource and the nation’s highway systems become a classic "tragedy of the commons." Although those who experience congestion incur costs to their own time, lost fuel, and wear on their automobiles, they do not internalize the loss levied upon others. The more efficient approach to driving is to craft mechanisms to internalize these costs into the price of automobile use, so that individual decisions on whether and how much to drive more accurately reflect the cost of driving to society. The objectives of both equity and efficiency would be served through such a scheme because the costs of vehicle-related harms would be shifted onto those benefiting from driving (equity) and commuters would be encouraged to choose the most socially beneficial travel option for each trip (efficiency).

IV. CONGESTION PRICING, PARKING POLICIES, AND INTERNALIZATION

A. CONGESTION PRICING

A basic theoretical representation of the economic analysis often used in describing congestion pricing is presented in Figure 1 below.54 The willingness of road users to pay for a trip is represented by the de-

52. See generally CAMBRIDGE SYSTEMATICS INC., supra note 10.
53. Id.
mand curve (D). The marginal private cost curve (MPC) represents those costs felt directly by the commuter when taking a given trip. The marginal social cost curve (MSC) depicts the aggregate of the direct costs felt by the commuter and the hidden costs the driver imposes on society when taking a trip. Due to congestion, the marginal social cost is far higher than the marginal private cost (i.e. congestion inflates the hidden costs of driving). The free market equilibrium outcome rests where demand intersects marginal private cost (N\textsuperscript{0}) and shows the level of driving that occurs when commuters do not take into consideration the hidden costs of driving. The socially optimum road usage, however, lies where demand intersects marginal social cost (N*\textsuperscript{*}) and represents the level of driving that occurs when drivers consider the costs they are imposing on society. The road price that causes socially optimal road usage is r* and is equal to the marginal external congestion costs (i.e. the hidden costs of driving imposed on society but not felt by the driver, which is equal to MSC – MPC). The welfare gained from such a charge is given by the shaded area.

Although the results depicted in Figure 1 may be idealized, the principles represented are sound – charging road users a congestion fee would make commuters aware of the external costs associated with making a trip and thereby cause drivers to base their decisions on more accurate knowledge of the costs of their actions. Simply put, congestion pricing seeks to assess vehicles for the costs they impose on society, which may include time costs, external congestion costs, and other variable costs (e.g. environmental or governmental costs). Ideally, congestion charges would vary based on each vehicle’s responsibility in creating congestion. This can be done in two ways; (1) basing fees on the time of day (higher charges for peak hours and lower charges for off-peak hours) or (2) basing fees directly on the level of congestion on a given roadway. Airlines, train travel, and other modes of transportation have used similar pricing schemes for several decades to shift demand to off-peak periods. Only roads have by tradition been “free” and failed to take into account the effects of peak period usage. Several different impacts of road pricing may affect automobile congestion: its affect on (1) the number of trips, (2) total miles traveled, (3) the length of trips, (4) traffic speeds, (5) the routes taken by travelers, (6) the times at which trips are taken, (7) the amount of carpooling and public transportation used, and (8) smoother traffic flow.

There are three types of congestion pricing schemes. First, there is facility pricing, which charges fees for use of a bridge, tunnel, or small segment of road. Second, there is road pricing, which assesses a fee along a specific roadway (usually a road connecting two more densely populated areas). Lastly, there is cordon pricing, which establishes a series of
Figure 1. The simple economics of congestion pricing

congestion toll collection stations in a ring around a congested area (usually a city). Commuters are charged a fee as they enter the area. One variation to road-style pricing which has become popular in the United States is to modify high occupancy vehicle (HOV) lanes. Instead of building a new roadway that is subject to congestion pricing or to convert an existing freeway, several states have opened HOV lanes on congested roadways to paying commuters. This allows single drivers to buy their

way onto less-congested HOV lanes traditionally reserved for carpooling. Such a pricing system decreases congestion along crowded highways by spreading traffic more evenly among available lanes.

Regardless of which pricing scheme is used (facility, roadway, or cordon) there are several different methods by which the fee structure can be determined. The method chosen depends primarily on the purpose of the pricing scheme that is implemented. First, although not as efficient, a pricing scheme could be designed to raise revenue. Funds obtained through such automobile user fees can be used to finance new road construction and maintenance on existing highway systems or to improve and expand public transportation. In order to be effective, however, the fees should be lower than those aimed at curbing congestion and should remain constant. Because the objective is to raise as much revenue as possible, vehicle use would be expected to remain relatively stable. The weakness of such an approach is that drivers are not charged enough to truly feel the costs that their trips impose on society and thus results in marginal efficiency gains.

The second option is to design a pricing scheme aimed at achieving economic efficiency and congestion relief. Again, the revenue can be used for funding road construction and maintenance as well as public transportation, but the amount of the charge and the hours of application should vary throughout the day depending on traffic levels. If user fees are set so that they reflect congestion, drivers will pay according to the marginal external costs they are imposing on society by joining the roadway and thereby make more economically efficient choices. Thus, if a commuter enters onto a highway that is experiencing congestion, he will be charged more than if he were to enter a highway that is flowing freely. One way to closely approximate periods of traffic congestion is to use "time-of-day pricing," where higher congestion fees are charged during peak periods, less during shoulder-periods (in between peak and off-peak), and minimal fees during off-peak hours. A second and more accurate approach is to vary congestion fees according to congestion levels on an affected roadway at any given time. This has been made possible by the advent of transponders and cash cards which allow travelers to be tracked and the average speed of commuters determined. The reason congestion pricing based directly on roadway congestion is more accurate and efficient than time-of-day pricing is that it approximates the marginal external costs imposed by drivers more closely than time-of-day pricing, which uses the average marginal external cost imposed by drivers over a given time period (during peak periods, for example). In order to better understand this difference, imagine a large group of friends meeting for an expensive dinner and, in order to reduce the bookkeeping, the bill is
divided evenly amongst each friend (as in time-of-day pricing). Since each individual friend could not lower the group bill significantly by ordering less, there is reason for excessive consumption. If, however, every individual friend is charged according to the amount of food he orders (as in direct congestion pricing) there is reason for self-restraint.

Furthermore, two recent technological advancements have made congestion pricing schemes both affordable and administratively feasible. The first is electronic road pricing of the type currently used in many states as a part of their tolling schemes. Drivers purchase accounts with the state or road operator and receive a transponder which is placed on the dashboard of the vehicle. When the commuter enters a road or area subject to congestion pricing the transponder signals a sensor, and a deduction in the amount of the toll is automatically made from the user’s account. The second option is to use “cash cards,” an approach currently used in Singapore’s congestion pricing system. Such cards work much like telephone cards and can be bought or recharged at retail outlets, banks, gas stations, and automatic machines. The driver can place funds onto the card and then fix it to a vehicle’s windshield. As with the transponder system, once the commuter passes onto a road subject to user charges, the card signals a sensor and a deduction in the amount of the toll is made from the card. In addition, technological advancements have also made enforcement more effective. As with toll systems throughout the country, surveillance cameras can be used to photograph the license plates of violators or those who do not have adequate funds to account for the toll. Tickets with appropriate penalty charges can then be sent to those drivers.

B. Parking Policies

Although not the focus of this paper, urban parking policies provide an alternative to congestion pricing as a method of reducing car trips to a more socially optimal number. It should be noted, however, that parking is a second-best solution to the problem of congestion because, unlike congestion pricing, parking policies can not generally differentiate between types of trips (e.g. length of trip, time of trip, route taken). Al-

59. Id.
60. Id.
61. Id.
though parking policies are unable to target specific external costs associated with congestion, they can easily and effectively shift some associated external costs onto commuters. "Parking is effective for several reasons: (1) virtually every car is parked at the end of a trip, (2) on-street parking affects road capacity, (3) the cost of parking is substantial and many times the largest cost of a commute, and (4) cruising for parking is a major contributor to downtown traffic congestion." Thus, increasing the price of parking with the purpose of decreasing demand for road use has the beneficial effect of reducing many of the costs associated with urban congestion.

A simple and effective parking policy that can be adopted by cities with congestion problems is to abolish free parking for downtown employees. The reason parking prices do not currently affect drivers' decisions is because about ninety percent of the nation's commuters park free of charge at work. Instead of providing free parking, employers might instead charge each employee for their parking space and then disperse the funds equally amongst all the employees, regardless of whether they used a parking space or not. As an illustration, consider an office park with 1,000 workers, 700 of whom drive and park. If each car were charged the actual cost of providing a parking space (taking into consideration land, maintenance, etc.), say five dollars per day, each day's parking revenue would be 3,500 dollars. This money would then be distributed to each worker (3.50 dollars each) whether they drove or not. The group as a whole breaks even, but those who choose to drive are still spending 1.50 dollars each day to park while those who find other modes of travel are making 3.50 dollars each day. In addition, empirical studies performed in Ottawa, Los Angeles, and Washington, D.C. confirm the intuition that parking costs affect the number of people who commute to work. In one study, parking fees of about ½ the commercial rate were imposed on governmental employees who previously had free parking. The result was a decreased number of people who commuted by automobile. Other studies have determined that employer-subsidized parking

64. Komanoff, supra note 22, at 148.
65. Id.
66. Id.
68. Id. at 719-20.
69. Id. at 720.
increases solo driving among all groups and has a substantial effect on marginal commuting decisions.\textsuperscript{70} In addition, subsidized or free parking at train stations has been shown to increase rail commuting.\textsuperscript{71} Given the implications of such studies, there seems to be powerful evidence that an urban parking policy which reduces or abolishes free employee parking while at the same time providing cheap or free parking for public transportation users would have a significant influence on automobile commuters.

C. FUNDING

Even if a state decides that congestion pricing or parking policies would be an appropriate and effective approach for addressing the problem of congestion, the issue of funding remains. In order to pay for the planning and implementation of a congestion pricing scheme or parking policy, states can either fund the operation themselves or enlist the services of a private firm. As recently as two years ago states that chose to handle the project alone could apply for federal funding through the Federal Highway Administration (FHWA).\textsuperscript{72} FHWA funds were available to “support the development, operation and evaluation of pilot tests of innovative road and parking pricing projects.”\textsuperscript{73} The project was mandated by Congress as an experimental program to learn the potential of different value pricing approaches for reducing congestion.\textsuperscript{74} Upon application, states were eligible to receive grants up to eighty percent of the cost of the project.\textsuperscript{75} The project, which reserved eleven million dollars each year for congestion pricing programs, was discontinued by Congress in 2003.\textsuperscript{76} This loss of funds means that federal support is not currently available for new projects or to support the implementation of current “pre-project” studies. Reinstitution of federal support would be critical to the expansion of the current level of congestion pricing projects. With the loss of federal monies, the best option for state and local governments is to support pricing projects through the issuance of revenue bonds that are payable from the funds generated by the congestion tolls. In this way,

\textsuperscript{70} Id.
\textsuperscript{71} Id. at 720-21.
\textsuperscript{75} Bloom, \textit{supra} note 72, at 1.
\textsuperscript{76} Id.
a state can avoid backing any bond issuance with the full faith and credit of the state’s treasury.

If a state feels overwhelmed by the operation of a congestion pricing system or finds it difficult to obtain the approval of local officials, a private firm could be used. An example of such a consortium can be found on State Road (SR) 91 in Orange County, California. In December 1995, the State contracted with California Private Transportation Company (CPTC), a private firm, to construct, finance, and operate a congestion pricing project which would add four new lanes, termed “ExpressLanes,” to SR-91. To encourage carpooling, automobiles with three or more passengers may use the ExpressLanes for free, but all others pay a toll ranging from 1.15 dollars during off-peak hours to 9.25 dollars during peak periods. Under its agreement with the State, the rate of return for CPTC is maxed out at 175 percent with any excess revenues going to State and local highway projects.

V. Domestic and International Congestion Pricing

A. Singapore

Singapore was the first country to experiment with congestion pricing when, in 1975, a one dollar charge was instituted for private vehicles entering the central business district (CBD). The cordon-style charging scheme initially applied to automobiles entering the CBD during the morning peak hours (7:30 to 9:30). Only vehicles displaying a particular license were allowed to enter the zone, although carpools, buses, motorcycles, and freight vehicles were exempt from the requirement. The result was an immediate seventy-three percent reduction in the use of private cars within the CBD, a thirty percent increase in carpooling, and a doubling of bus usage. It was also found that many people shifted their travel times within the CBD to just before and after the restricted hours. One negative impact of the congestion pricing scheme was a

77. Wahrman, supra note 26, at 199-200.
78. Id. at 200.
84. Id.
85. Zolla, supra note 82, at 2.
slight traffic increase on roadways around the CBD as commuters sought to avoid the restricted area and find alternate routes. 86

In 1989, in an effort to strengthen the results of the CBD’s congestion pricing scheme, the charging hours were extended to the afternoon peak hours and the exemptions were eliminated for all vehicles expect public transit. 87

Five years later, in 1994, the charging hours were once again extended, but this time lower fees were added to cover the hours between the morning peak and afternoon peak hours (10:15 to 4:30). 88 Then, in 1998, the paper license system was replaced by an electronic cash card system. 89 As mentioned above, the cash cards operate much like telephone cards and may be purchased or recharged at retail outlets, banks, gas stations, and automatic machines. The cards are then affixed to the vehicle’s windshield and different charges for different roads at different times are automatically deducted from the card as the vehicle passes under gantries.

The lasting effects of Singapore’s congestion pricing system have been encouraging. Although the morning peak hour traffic has slowly increased since 1975, congestion is still thirty-one percent lower than before the charges were introduced. 90 These results have held in spite of a thirty-three percent increase in employment and a seventy-seven percent increase in the number of cars. 91 In addition, the reliability of the cash card debiting system has been studied and estimated at 99.99 percent accuracy. 92 The annual revenue from the congestion pricing system equals about forty to fifty million Euros, while the costs for operation and maintenance are only about eight million Euros. 93

B. Norway Toll Rings

A cordon-style system of toll rings surround three Norwegian cities (Bergen, Oslo, and Trondheim). 94 Unlike in Singapore, however, the tolls are designed to generate revenue instead of reduce traffic congestion. Since congestion reduction is not an objective, the tolls are relatively low and do not vary much throughout the day (the charging period is from 6:00am to 6:00pm on weekdays). Toll locations were chosen to achieve political acceptance of the balance between the amounts paid by

86. Id.
87. Small & Gomez-Ibanez, supra note 80, at 215-216.
88. Id.
89. Id.
90. TRANSEK AB., supra note 33, at 18.
91. Id.
92. Id. at 38.
93. Id. at 39
94. Small & Gomez-Ibanez, supra note 80, at 221.
city and suburban residents while altering commuting behavior as little as possible.\textsuperscript{95} As in many American states, the toll systems in Norway utilize “unmanned electronic toll booths that deduct fees from dashboard-mounted transponders each time a vehicle enters the toll zone or passes a toll point.”\textsuperscript{96} While heavy goods vehicles pay a double toll (corresponding to the damage they cause the roadways), residents who live close to a toll station or who make frequent crossings are protected by a one-charge limit per hour.\textsuperscript{97}

Even though congestion management was not an objective of the Norwegian toll systems, Trondheim has experienced a ten percent reduction in traffic during peak periods and an eight percent increase in traffic during off-peak periods within the charging zone.\textsuperscript{98} Furthermore, as a revenue generating asset, the toll rings have exceeded expectations. “The revenue in 2002 was about one billion NOK (Norwegian Krone), [while] the operative costs were only ten percent of that revenue.”\textsuperscript{99} The annual maintenance costs are also minimal, amounting to about ten million NOK.\textsuperscript{100} Revenues from the tolling system have been used to improve roads, build bypasses, upgrade public transit, build bicycle paths, and even to provide 200 free bicycles for use downtown.\textsuperscript{101}

C. London

On February 17, 2003, London introduced a cordon-style congestion pricing scheme aimed at reducing traffic levels within the city. The system charges the equivalent of fourteen dollars a day to drive through the center of London between 7:00am and 6:30pm.\textsuperscript{102} “The congestion charging zone is enclosed within a boundary formed by the Inner Ring Road, which [is not subject] to the congestion charge.\textsuperscript{103} Enforcement of the charging system is left to a network of cameras situated at entry and exit points to the congestion zone.\textsuperscript{104} “These cameras record images of traffic and sends them to a central processor where the [license plate] numbers are checked against the list of vehicles that have been paid for.”\textsuperscript{105} Unless charges have been paid for in advance or are paid before

\begin{itemize}
\item \textsuperscript{95} Id.
\item \textsuperscript{96} Transp. Alternatives, supra note 58, at 13.
\item \textsuperscript{97} Id.
\item \textsuperscript{98} U.S. GEN. ACCOUNTING OFFICE, supra note 14, at 12.
\item \textsuperscript{99} TRANSEK AB supra note 30, at 38.
\item \textsuperscript{100} Id.
\item \textsuperscript{101} Transp. Alternatives, supra note 58.
\item \textsuperscript{103} Id.
\item \textsuperscript{104} Id.
\item \textsuperscript{105} Id.
\end{itemize}
midnight on the day of travel, the automobile's registered owner will be fined.\textsuperscript{106} Several groups of drivers are exempt from the congestion charges, including licensed taxis, public service vehicles, motorcycles, mopeds, emergency vehicles, disabled drivers, and alternative fuel vehicles.\textsuperscript{107} Exempting and thereby incentivizing the use of alternative fuel vehicles such as hybrids\textsuperscript{108} is especially important from an environmental perspective since they not only use less gasoline (the Toyota Prius, for example, gets up to fifty-three mpg in the city) but also emit ninety percent fewer smog-forming pollutants and half of the carbon dioxide that a conventional automobile does.\textsuperscript{109} Also, residents within the congestion charging zone pay only ten percent of the charge.\textsuperscript{110} The immediate result of London's pricing scheme is a twenty percent decrease in traffic within the city and a fourteen percent increase in bus use during the morning commute.\textsuperscript{111} In addition, average speeds within London are at their highest since the 1960s, travel times are more reliable, and even businesses within the zone have seen benefits.\textsuperscript{112} Furthermore, the exemption for alternative fuel vehicles may be influencing sales of hybrid vehicles, such as the popular Toyota Prius. Prius sales during the first quarter of 2005, for example, were more than double the sales in the first quarter of 2004.\textsuperscript{113} Overall, Toyota expected 2005 British sales to more than double those in 2004.\textsuperscript{114} Owning exempt vehicles means significant savings for London commuters who could avoid up to 1,250 pounds per year in congestion charges.\textsuperscript{115}

D. NEW YORK

In May of 2000 the Port Authority of New York and New Jersey instituted a weak facility-based congestion pricing system for the tolls on the George Washington Bridge, Lincoln Tunnel, Holland Tunnel, Goe-

\textsuperscript{106} Id.
\textsuperscript{107} Id.
\textsuperscript{108} Hybrids are vehicles whose engines rely on both gasoline and electricity for their power. See, e.g., Fueleconomy.gov, How Hybrids Work, http://www.fueleconomy.gov/fg/fit hybridtech.shtml (last visited November 25, 2006).
\textsuperscript{110} RoadTraffic-Technology.com, supra note 102, at 2.
\textsuperscript{111} U.S. General Accounting Office, supra note 14, at 11.
\textsuperscript{113} Carpages.co.uk, Toyota Prius Sales Surge in 2005 (July 7, 2005), http://www.carpages.co.uk/toyota/toyota-prius-07-04-05.asp?switched=on&echo=981703353.
\textsuperscript{114} Id.
\textsuperscript{115} Id.
thals Bridge, and Outerbridge Crossing. The scheme increased the four dollar charge on these facilities to five dollars for the morning hours of 6:00am to 9:00am, the afternoon hours of 4:00pm to 7:00pm and weekend hours of 12:00pm to 8:00pm. The charge for trucks increased from five dollars to six dollars per axle during these same periods. The results of this pricing scheme, unfortunately, have been slight. One year after the scheme was implemented, four percent fewer motorists used the facilities during the afternoon peak period which corresponded to a seven percent increase in travel after the afternoon peak period. In addition, "[seven] percent fewer commuters and trucks traveled during the morning peak period." Such small shifts in traffic patterns are probably attributable to the marginal increase in charges during peak periods, although there may also be a lack of alternatives to using the facilities during these hours. More recently, Mayor Bloomberg, who is in favor of congestion pricing schemes to address traffic problems in Manhattan, proposed expanding the congestion pricing system to the East Bridge but was forced to abandon the idea after State lawmakers, whose approval he requires, rejected the idea.

E. Orange County, California

The congestion pricing program on SR-91 in Orange County, California is an example of a road-style pricing scheme that is operated by a private firm. SR-91 is a particularly congested commuter link between residential and employment centers in Orange, Riverside, and San Bernardino Counties. From 1980 to 1994 the eight-lane highway experienced an annual growth rate of six percent and carried over 200,000 vehicles per day with one-way delays reaching as high as fifty minutes. In 1995 the State contracted with CPTC to build and operate four new "ExpressLanes," along ten miles in the median of the highway. Unless carpooling with three or more passengers, all drivers pay a charge for using the ExpressLanes, which varies by time of travel, ranging from 1.15

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117. Id.
118. Id.
120. Id.
122. Wahrman, supra note 26, at 200.
123. Small & Gomez-Ibanez, supra note 80, at 228.
124. Wahrman, supra note 26, at 200.
to 9.25 dollars per trip. Each car has a transponder in its windshield that corresponds to an account maintained by the operator. As the driver approaches the ExpressLanes, the price is announced on an electronic message sign so that the motorist can decide whether to opt for the priced or un-priced lanes. If a commuter chooses to enter the ExpressLanes, a charge equal to that displayed on the sign is deducted from the user’s account. As mentioned above, under CPTC’s contract with the State, the rate of return is limited to 175 percent with any excess revenues going to the State to finance local highway projects.

From a business perspective CPTC’s operation of the ExpressLanes has paid off, with revenues growing 8.4 percent in 2004 to 31.2 million dollars.

This increase in revenues was due, in part, to an overall traffic volume increase of 12.1 percent in 2004, from ten million trips to 11.2 million trips. The popularity of the ExpressLanes continues to grow as drivers find that they can save about thirty-six minutes per trip in the afternoon by using the toll roads. Nowhere has this time savings been more evident than in the city of Corona, where the average speed and travel times in the city for westbound rush hour before the tolls was twelve mph and fifty-eight minutes. After the ExpressLanes were introduced the average speed and travel times improved to fifty-two mph and 13.5 minutes. What’s more, delays have been decreased in the other “free” lanes along SR-91. Average delays of thirty to forty minutes were reduced to twelve to thirteen minutes as traffic moved to the ExpressLanes.

F. SAN DIEGO, CALIFORNIA

Similar to the scheme implemented on SR-91, San Diego utilizes a road-style congestion system to address burgeoning traffic. Unlike SR-91, however, San Diego varies congestion charges based on actual levels of congestion on the roadway at any given time. San Diego is one of the nation’s most congested metropolitan areas and the traffic on Inter-

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125. Orange County Transp. Auth., supra note 79.
126. Small & Gomez-Ibanez, supra note 80, at 230.
127. Id. at 229.
130. Id.
131. 91 EXPRESS LANES, supra note 128, at 5
132. Id.
134. See Strahilevitz, supra note 6, at 1251.
135. Id.
state 15 (I-15), a main commuter artery connecting northern suburbs with the southern downtown area, was a problem for the city. As a possible solution, San Diego began opening HOV lanes on I-15 in 1988.\textsuperscript{136} Although vehicles with two or more occupants could use the HOV lanes, they remained underutilized and congestion worsened on the rest of I-15.\textsuperscript{137} Finally, a simple yet effective congestion pricing plan was implemented in December of 1996, called FasTrak.\textsuperscript{138} FasTrak allows solo drivers to pay a per trip fee to use the existing HOV lanes located along an eight mile stretch of I-15.\textsuperscript{139} Normally, congestion charges range from 0.50 to four dollars, although to maintain free-flow on the FasTrak lanes at all times, tolls may be raised up to eight dollars in the event of severe congestion.\textsuperscript{140} The actual fee is posted on the roadside prior to entering the FasTrak lanes so that drivers can make informed decisions. When entering onto FasTrak lanes, a solo driver must pass through a particular lane where a transponder inside the car signals a ground-based sensor and a deduction in the amount of the posted fee is made from the user’s prepaid account (carpoolers have their own marked lane and no deduction is made).\textsuperscript{141}

During the first year of the program’s operation, the amount of traffic in the FasTrak lanes increased by twenty percent during the morning peak period and by twelve percent during the afternoon peak period.\textsuperscript{142} The overall impact of the FasTrak program has been to increase the average daily traffic on the HOV lanes from 9,400 to 20,000 vehicles per day and to double the number of daily carpools to more than 15,000 each day.\textsuperscript{143} This change corresponds to a two to three percent decrease in traffic volume on the main, “free” lanes as well.\textsuperscript{144} This decrease in congestion along I-15 has brought reduced travel time, reliability of on-time arrival, and improved safety for all commuters. As a result of FasTrak, the economic costs of congestion along the I-15 corridor to the San Diego region dropped eighteen percent during the first year of operation alone.\textsuperscript{145} In fact, this figure may be a modest approximation, since it does not take into consideration that many of the solo drivers using the HOV

\textsuperscript{136} Id. at 1250.
\textsuperscript{137} Id. at 1250-1251.
\textsuperscript{138} See id. at 1251.
\textsuperscript{141} Strahilevitz, supra note 6, at 1251.
\textsuperscript{142} Id. at 1252.
\textsuperscript{143} Kiewit, supra note 139.
\textsuperscript{144} Strahilevitz, supra note 6, at 1252.
\textsuperscript{145} Id.
lanes and realizing the greatest time savings are those whose time is most valuable.\textsuperscript{146} It also does not include the slight increase in business patronage that resulted from the program.\textsuperscript{147}

Revenue gained from the FasTrak congestion charges pays for the 750,000 dollars in operating costs each year as well as 60,000 dollars for enforcement by the California Highway Patrol.\textsuperscript{148} State law requires that the remaining revenue be spent improving public transportation and ridesharing services along the I-15 corridor.\textsuperscript{149} In fact, the San Diego congestion pricing scheme has been so successful that other states, such as Minnesota, are initiating plans to convert their underutilized HOV lanes to congestion lanes using I-15 as a model.\textsuperscript{150}

\section{VI. Problems of Inequity and Political Viability}

There is general agreement that congestion pricing is an effective measure for internalizing the hidden costs of driving and reducing traffic problems. The relevant question to be asked, then, when an area struggling with burgeoning traffic considers a congestion pricing solution is not "will it work," but "will there be enough public and political support to get the scheme started." There have been many attempts to introduce pricing systems on urban roadways around the world in the last forty years and most have failed due to lack of public (and therefore political) acceptability.\textsuperscript{151} Thus, the most important part of many congestion pricing schemes may be the way in which it is "sold" to the public. In fact, there is evidence that once initial opposition to a pricing scheme is overcome, people generally accept the system. In Trondheim, Norway, for example, seventy-two percent of residents were opposed to the tolling ring prior to implementation while only thirty-five percent were opposed two years later.\textsuperscript{152} What follows is an analysis of the issues affecting public support for congestion pricing schemes.

\subsection{A. Inequity}

Simply put, if all vehicles of the same type are charged the same fees
during the same periods, these fees will constitute a more significant barrier to travel for those who have less discretionary income. Highway networks are seen as one of the few situations where people are treated equally as commuters and where all have equal access to the roadways, regardless of income or stature. Since there is little doubt that peak period fees will impact lower-income commuters more severely than higher-income commuters, special concern is paid to those lower-income users with little or no flexibility in setting their schedules. For many commuters, it is often difficult to find co-workers with similar routes and work schedules who also agree on travel routes and times and who can arrange for backup transportation if the carpool falls through. In addition, those with low incomes are more likely to live far from the city-center and their destination is more often located outside the city’s core where public transportation is poor.\textsuperscript{153} Such problems are compounded for households with multiple-workers or households with young children. The fear is that these conditions will allow wealthy commuters to travel during the most convenient peak period hours while lower-income drivers will be forced to travel at less convenient times or will have to bear the brunt of higher peak period charges.

There are several responses and methods for addressing the inherent problem of inequity in congestion pricing. First, reduced traffic congestion will have disproportionate benefits for those with low incomes. More than any other group, the poor are victims of pedestrian deaths (especially children) which are attributable, in part, to traffic levels.\textsuperscript{154} The poor also tend to congregate closer to noisome highways and in areas with higher levels of automobile-caused air pollution that will become cleaner, safer, and quieter with less congestion.\textsuperscript{155} Reduced air pollution alone would have a substantial impact on the poor since they are more likely to be asthma sufferers vulnerable to such pollutants and, at moderate income levels, such health benefits may outweigh modest congestion charging impacts.\textsuperscript{156} Additionally, road-style congestion pricing schemes like the one used on I-15 in San Diego provide direct benefits to the poor as well as the wealthy. Low income commuters will never be priced off the road since there are free lanes adjacent to the tolled lanes. They may face longer commutes than the wealthy, but even the free lanes should become less congested and move more smoothly as toll-paying drivers are siphoned from the free lanes.

\textsuperscript{153} Id. at 26.
\textsuperscript{154} Komanoff, supra note 22, at 154.
\textsuperscript{155} Id.
A second option is to provide rebates for certain categories of commuters. The use of electronic tolling systems in congestion pricing schemes provides an opportunity for targeted relief. For instance, congestion charges could vary with income upon submission of W-2 forms and income tax returns.\textsuperscript{157} This allows communities to minimize the disparate impacts congestion pricing may have on the poor. The problem with such a strategy, of course, is designing a fee structure for both the wealthy and poor that diverts enough traffic from the priced roads to generate adequate time savings and yet is equitable among different income groups. A related measure designed to provide relief for those living within a cordon-style congestion zone is to allow those drivers a certain number of free trips each month or to provide them with a discount (as in London). Another alternative suggested by some commentators is a Fast and Intertwined Regular (FAIR) lanes approach.\textsuperscript{158} If a FAIR system were implemented on I-15 in San Diego, for example, funds generated from commuters using the electronically tolled FasTrak lanes would be transferred to drivers using the adjacent free lanes. This would be accomplished through transponders in vehicles using both the tolled lanes and the free lanes. Those in the free lanes would receive a credit to their FasTrak account equal to some percentage of the effective toll, which could then be used for public transportation charges or toward the use of the FasTrak lanes another day.

Additionally, the way in which revenue from a congestion pricing system is used provides an opportunity to benefit low income groups. In fact, if there is to be any public support for a congestion pricing scheme the revenue must be allocated to achieve a range of transportation and other social benefits. Congestion pricing funds can be used to expand existing road capacity, install traffic control systems that enhance road network capacity, improve public transportation, mitigate harms from traffic congestion, and address other social and economic problems that plague many large urban areas. An integral aspect of any congestion pricing system is to improve public transportation systems and improve facilities for walking and cycling, particularly in areas where alternatives to driving are inadequate. Furthermore, some funds could be directed toward repairing damages caused by traffic congestion; such as investing in communities blighted by highways, healthcare for people with asthma or other victims of air pollution and accidents, soundproofing schools against highway noise, etc.\textsuperscript{159} When analyzed under a “redistributinal” lens, this begins to look like a progressive tax, where wealthy motorists are paying fees that support low income transportation and social pro-

\textsuperscript{157} Id. at 248-249.
\textsuperscript{158} U.S. GEN. ACCOUNTING OFFICE, supra note 14, at 6-7.
\textsuperscript{159} Komanoff, supra note 22, at 153.
grams. But unlike many other redistribution schemes, this one will retain the support of high-income individuals since they are getting something valuable in return. Moreover, it has been shown that support for congestion pricing systems increases drastically when it is understood that the revenue will be used for local transportation and environmental projects. One British survey found, for example, that thirty percent of adults supported road pricing as a stand alone measure, but support increased to fifty-seven percent for a road pricing scheme where the money raised was used to fund public transportation improvements, traffic safety measures, and better facilities for pedestrians and cyclists.\textsuperscript{160}

Lastly, congestion pricing revenue could be directly returned to the citizenry in the form of tax breaks. One option is to cut the most regressive taxes that disproportionately burden the poor, such as the gasoline and sales taxes. An alternative is to direct a certain percentage of toll revenue toward providing income tax credits for those in low income groups. A similar approach that would provide more local relief is to provide property tax credits for the lowest income brackets.

\textbf{B. CONGESTION PRICING IS AN IMPROPER SOLUTION}

Belief that congestion pricing is an improper solution to traffic problems stems from two different sources. First, many drivers are unable to accept the notion that they should be charged for congestion. Road pricing is seen as another form of taxation that takes away what was previously considered free as a matter of right. Moreover, many commuters do not see themselves as part of a larger problem, but as victims of congestion. Drivers feel that they already pay enough for congestion through delays and increased stress. Second, some road users do not believe that congestion pricing is needed. They do not perceive traffic conditions to be bad enough to warrant such an extreme measure as road pricing and feel that other remedies would be more appropriate.

Given the widespread adoption of these beliefs and the disastrous impact they can have on the implementation of a congestion pricing scheme, there is general agreement that congestion must be considered a serious problem and charges must be regarded as essential to solve the problem before any road pricing system can gain public support.\textsuperscript{161} This means that both communication and public awareness are prerequisites to congestion pricing. Many groups in society must be involved and different alternatives for improving traffic must be openly considered. The public must come to the conclusion that the alternatives to congestion pricing are alone inadequate to address the problem. This process neces-

\textsuperscript{160} Jones, \emph{supra} note 151, at 275-276.

\textsuperscript{161} Transek AB, \emph{supra} note 33, at 51.
sirates a good description given of the positive effects on the problem that the charges are meant to address, how the potential negative effects should be handled, and what distributional effects are to be expected and how they are to be dealt with, etc. 162

C. CONGESTION PRICING WILL BE INEFFECTIVE

Some people believe that drivers are inelastic to road charges so that congestion pricing will not change drivers’ behavior (i.e. commuters will not switch the times they drive, begin to carpool, take public transportation, etc.). The idea is that drivers already pay for their car and its running and maintenance costs, which leaves the costs of use a small proportion of the total. This proportion is not considered nearly high enough to keep drivers from maximizing the benefit of their investment. The evidence, however, suggests that this is largely a faulty perception rather than an observed fact (e.g. London and Singapore’s successful congestion pricing schemes).

D. PRIVACY CONCERNS

One concern with an electronic tolling scheme is that tracking of an individual’s car trips by the government leads to the potential for invasions of privacy. But in many situations, such a capability may actually prove to be quite beneficial. For example, transponder information may be useful to law enforcement for checking the alibi of a suspected criminal. This information could also help the police track down the location of a stolen vehicle if the transponder is in a difficult-to-find area of the car. Even if the consensus is that the government should not have this information, there are technological solutions to the privacy problem. A simple system could allow individuals to opt for a class of identifying codes that would erase information regarding place and time from the record as soon as the appropriate charge has been deducted. 163 Also, as in Singapore, a system of cash cards could be used so that the actual owner of each card is unknown and once funds have been deducted from the commuter’s card, any information about place and time could be erased.

E. CONGESTION PRICING IS JUST ANOTHER TAX

The fear many people have with congestion pricing is that the revenue might become an easy “rainy-day-fund” when additional tax revenue is needed. Such distrust in politics and politicians must be defeated before a congestion pricing scheme will be accepted. One solution is to

162. Id. at 53-54.
163. Strahilevitz, supra note 6, at 1249.
have the revenue from congestion charges tagged in advance in order to make clear the benefit and to take discretion away from politicians. Regulations or state laws mandating that the revenues be used only in the transportation sector or for urban social programs is another way to prevent political corruption of the congestion pricing system. A third option is to have a private firm collect the tolls, thereby operating as a buffer against governmental use for unrelated purposes (e.g. CPTC’s operation of SR-91 in Orange County, California). With the government taking a secondary role in the scheme, the public’s inherent distrust in politicians may be overcome.

F. Negative Affects on Local Businesses and Shops

Some fear that congestion pricing may have adverse effects on shop-keepers and businesses that rely on priced roadways. The counterargument is that, as accessibility improves, economic growth should be stimulated since businesses have more potential customers. Moreover, as commuters spend less on vehicles and fuel, more income will be available for local goods and services. Even without increased business patronage, firms with a high time-value (e.g. professionals, merchandise deliverers, and the service industry) should see benefits from shorter trips; including less spending on automobile fuel and more productive-hours during the day. Additionally, congestion pricing schemes can be designed with businesses in mind by allowing for discounted daily permits for fleet vehicles or short periods of free on or off-street parking for drivers entering the city. Given the beneficial effects congestion pricing will have on businesses, any negative consequences should be minimal. A simulation study of a typical European city, for example, showed that only about two percent of workplaces and shops would move out of the city center as a result of congestion pricing.164

G. Real Estate Prices and Housing

Congestion pricing schemes make car trips more expensive. This increased transportation cost incentivizes households to move closer to destinations in order to avoid congestion charges. In a city with an obvious city-center, this means an increased demand for housing and residences in the downtown area. Areas with good public transportation would also become more popular. The result is an increase in housing prices as well as an increase in the supply (through new construction and/or increased sales of existing homes).165 As with business relocation, however, any such effects are expected to be small. In the same simulation study of a

164. Transek AB, supra note 33, at 31.
165. Id. at 29-30.
typical European city mentioned above, it was shown that only about two percent of households would relocate as a result of congestion pricing.\footnote{Id. at 31.}

H. Phasing in Congestion Pricing

Trucks constitute fourteen percent of vehicle miles traveled in the United States but account for disproportionately more air pollution, infrastructure damage, and road congestion, especially on city streets and urban highways.\footnote{Komanoff, supra note 22, at 157.} Given the general perception that trucks contribute more than their share to traffic problems, the public is more likely to accept a congestion pricing scheme that initially applies only to trucks. User fees targeting truckers would reduce per-mile harms by encouraging shippers to switch to rail transport, consolidate loads, travel during off-peak hours, use smaller vehicles in congested areas, and use nearby suppliers.\footnote{Id.} Most importantly, though, a congestion pricing scheme that is implemented on the back of the trucking industry is more likely to garner public support should it ever be expanded.

VII. Conclusion

In the context of congestion pricing, one commentator rightly observes that "it has been a commonplace event for transportation economists to put the conventional diagram on the board, note the self-evident optimality of pricing solutions, and then sit down waiting for the world to adopt this obviously correct solution. Well, we have been waiting for seventy years now... why is the world reluctant to do the obvious?\footnote{Piet Rietveld & Erik T. Verhoef, Social Feasibility of Policies to Reduce Externalities in Transport, in ROAD PRICING, TRAFFIC CONGESTION AND THE ENVIRONMENT 285, 285 (Kenneth J. Button & Erik T. Verhoef eds., 1998).} This paper suggests that the problem with congestion pricing has nothing to do with its effectiveness as a congestion-reducing measure, but with its ability to overcome public opposition. Popular reaction to being charged for something which was previously considered free as a matter of right will always be skepticism and resistance. As such, any region or locale considering road pricing as a solution to traffic congestion must address the public’s concerns head-on. State and local governments must have a two-way conversation with the public that both explains the purpose of congestion pricing and makes the government aware of major concerns. This information can then be used to design a publicly and politically acceptable congestion pricing scheme.

\footnotetext{166. Id. at 31.}  
\footnotetext{167. Komanoff, supra note 22, at 157.}  
\footnotetext{168. Id.}  
Comments

Piloting in Post-Kirby Waters: Navigating the Circuit Split Over Whether the Carmack Amendment Applies to the Land Leg of an Intermodal Carriage of Goods on a Through Bill of Lading

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I. INTRODUCTION

Multimodal carriage of goods has become the state of the art in international trade. Contracts for carriage of goods now frequently involve a through bill of lading, whereby the same contract governs the entire shipment, even though multiple carriers and multiple modes of transportation are used. Unfortunately, the United States lacks a uniform regulatory scheme covering multimodal carriage of goods. What the United States does have is a cluster of statutes that relate to land, air, and sea transportation individually. The interplay between these statutes has produced much confusion. The Supreme Court recently resolved some of this confusion by announcing that state law does not apply to through bills of lading that qualify as maritime contracts in *Norfolk Southern Railway Co. v. Kirby.* However, *Kirby* still leaves much unresolved and a recent circuit split over the applicability of the Carmack Amendment, a land-based statute, does nothing to resolve the ambiguity surrounding multimodal carriage of goods.

In announcing its opinion in *Sompo Japan Insurance Co. of America v. Union Pacific R.R. Co.*, the Second Circuit departed from the established rule that the Carmack Amendment to the Interstate Commerce Act only applies to the domestic inland leg of an international multimodal shipment of goods when a separate bill of lading is issued. In coming to its conclusion, the Second Circuit rejected the holdings of the Pennsylvania Supreme Court, the Fourth, Sixth, Seventh and Eleventh Circuits, and narrowly interpreted the Supreme Court's decision in *Norfolk Southern Railway Co. v. Kirby.* The problem with *Sompo* is not its departure from well-established precedent. The problem with *Sompo* is that when the court looked to the contractual extension of Carriage of Goods by Sea Act's (COGSA) terms and the Carmack statutory re-

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4. *Id.* at 68.
5. *Kirby,* 543 U.S. at 22-23.
quirements, it saw two dramatically different schemes of liability whose terms could not be reconciled. By holding that the carrier’s through bills of lading did not meet the limitation of liability requirements of Carmack, Sompo creates enormous uncertainty in the world of international carriage of goods. As a result of this decision, inland carriers are now exposed to unlimited liability if they are operating under any of a number of standard through bills of lading. Ultimately this confusion is part of a larger problem: the lack of a multimodal statutory regime. The burden of developing such a scheme lies at the feet of the legislature. Until the legislature takes action, all parties involved in this billion-dollar industry need to know that the contracts they are operating under are eventually going to be enforced and may be subject to the Second Circuit’s holding that could allow for greater liability than the parties contemplated.

This article will address the two statutes at issue in the current circuit split: COGSA and the Carmack Amendment. Because the split primarily concerns the applicability of the Carmack Amendment, I will pay particular attention to that statute’s legislative history and judicial interpretation. Next, I will outline the facts and opinion of Sompo. While I agree with the Second Circuit on the issue of whether Carmack applies, it is my contention that the Second Circuit went astray at several key points in its analysis. I also believe that the Circuit’s holding unreasonably confuses an already complex issue. Only Congress can properly fix this state of affairs by developing a unified statute to govern the liability of multimodal carriage. But, until the issue is legislated, courts should be loath to make this bad situation worse. As such, in this article I suggest a course of action for circuit courts that have not yet dealt with the issue, and I put forward steps that the Supreme Court should take to resolve this circuit split.

II. MULTIMODAL CARRIAGE OF GOODS IN THE UNITED STATES – CONFUSED SEAS

In the mid-eighties, commentators began predicting that standard containers would dominate the international shipping regime. Today, “increasing volumes of cargo are moving under multimodal ‘through’ bills of lading issued by ocean carriers and intermediaries, such as freight forwarders and nonvessel owning common carriers (NVOCCs), providing the shippers an efficient, stream-lined method of moving goods from ‘door to door.’” The United States’ cargo liability regime is out-of-date.

7. Sompo, 456 F.3d at 76.
and unsuited to deal with multimodal carriage. While the Supreme Court made a positive step when it swept aside state law in *Norfolk Southern Railway Co. v. Kirby*, there is still significant uncertainty over how the several federal statutes that govern transportation relate to multimodal carriage of goods.

A. **The Carriage of Goods by Sea Act and Kirby**

Shipments to and from the United States under bills of lading and similar documents of title are governed by COGSA, the U.S. enactment of the Hague Rules. COGSA only applies to the time the goods are physically on board the vessel, or from “tackle-to-tackle.” However, COGSA allows the parties to contractually extend its provisions to areas where they would not normally apply.

Under COGSA, a shipper claiming damages must establish a prima facie case by showing that the goods in question were delivered to the carrier in good condition and were received damaged, or not received at all (“good order, bad order”). A COGSA carrier is obligated to exercise due diligence to make the vessel seaworthy, properly man and equip the vessel, and ensure that the vessel’s holds are fit for the carriage of cargo. But, a carrier may completely exonerate itself by establishing one of several affirmative defenses available under COGSA. COGSA also limits the carrier’s liability to $500 per package. But, the statute provides that this limitation of liability is applicable “unless the nature and value of the goods have been declared by the shipper before shipment and inserted into the bill of lading.” Therefore, so long as a shipper does not declare a higher value on the bill of lading, the carrier’s liability will be limited to $500.

The Supreme Court announced a sweeping decision in 2004 that established that general maritime law preempted state law and that maritime law governed contracts such as through bills of lading involved in

10. *Id.*
17. *Id.* at §1303(1); See also Force, *supra* note 13, at 64.
20. *Id.*
the multimodal shipment of goods.21 Norfolk Southern Railway Co. v. Kirby involved a shipment from Australia to Huntsville, Alabama on a through bill of lading that contained a Clause Paramount extending its COGSA $500-per-package limitation to inland carriage, as well as a Himalaya Clause22 extending its liability limitations to additional parties.23 The goods were damaged during the inland voyage and the land carrier sought to limit its liability under the through bill of lading.24 Faced with an issue raised by the Court on its own accord only three months before oral argument, the Court held that state law did not apply to the case because the bill of lading was a maritime contract, and therefore federal maritime law applied.25 The Court announced that the test for whether a contract was a maritime contract turned on whether the water portion of the voyage was “substantial.”26

In deciding the case the Court established that federal courts have admiralty jurisdiction over multimodal bills of lading no matter how far inland the damage or loss occurs.27 The Court further held that federal maritime law, not state law, governed the contract dispute.28 In coming to its conclusion, the Court applied the two-step analysis from Kossick v. United Fruit Co. to hold that federal law controls contract interpretation when (1) the contract is a maritime contract and (2) the dispute is not inherently local.29

In order to answer the first prong of the Kossick test, the Court examined the nature and character of the multimodal contracts in this case and determined that their principal objective was maritime commerce.30 The Court also recognized that the conventional tackle-to-tackle approach of COGSA had not kept up with changes in the industry:

While it may once have seemed natural to think that only contracts embodying commercial obligations between the ‘tackles’ (i.e., from port to port) have maritime objectives, the shore is now an artificial place to draw a line. Maritime commerce has evolved along with the nature of transportation and is often inseparable from some land-based obligations. The international transportation industry ‘clearly has moved into a new era – the age of multimodalism, door-to-door transport based on efficient use of all available modes of transportation by air, water, and land.’ . . . The popularity of that

22. Id. at 19-20.
23. Id. at 20.
24. Id. at 21.
25. Id. at 27-29.
26. Id. at 27.
27. See Kirby, 543 U.S. at 28.
28. Id. at 28-29.
30. Id. at 25.
efficient choice, to assimilate land legs into international ocean bills of lading, should not render bills for oceancarriage nonmaritime contracts.\textsuperscript{31}

The Court announced that the following rule regarding whether a contract is a maritime contract: "[S]o long as a bill of lading requires substantial carriage of goods by sea, its purpose is to effectuate maritime commerce—and thus it is a maritime contract."\textsuperscript{32}

Turning to the second prong of the Kossick test, the Court determined that there was nothing inherently local about this dispute to justify interference with the uniformity of federal maritime law.\textsuperscript{33} The Court noted that "[a]pplying state law to cases like this one would undermine the uniformity of general maritime law."\textsuperscript{34} The Court further declared that, "[c]onfusion and inefficiency will inevitably result if more than one body of law governs a given contract's meaning."\textsuperscript{35}

Therefore, the Supreme Court held that through bills of lading are maritime contracts so long as the water leg of the voyage is substantial, and federal maritime law governs the interpretation of these contracts, not state law.\textsuperscript{36} By so doing, the Court affirmed the standard industry practice of contractually extending COGSA's terms to inland carriers.\textsuperscript{37}

\textbf{B. Charting the Carmack Amendment's Course}

Congress passed the Interstate Commerce Act (ICA) in 1887, which established the Interstate Commerce Commission (ICC) and empowered the Commission to regulate railroad rates, amongst other activities.\textsuperscript{38} The Carmack Amendment to the ICA of June 29, 1906 placed responsibility for damages on the initial railroad line with respect to transportation wholly within the United States.\textsuperscript{39} The addition of Section 20 in the Carmack Amendment was made in an effort "to create a national scheme of carrier liability for goods damaged or lost during interstate shipment under a valid bill of lading."\textsuperscript{40} Congress intended "to relieve shippers of the burden of searching out a particular negligent carrier from among the

\textsuperscript{31} \textit{id.} at 25-26 (citing THOMAS J. SCHOENBAUM, ADMIRALTY AND MARITIME LAW 589 (4th ed. 2004)).

\textsuperscript{32} \textit{id.} at 27.


\textsuperscript{34} \textit{id.} at 28.

\textsuperscript{35} \textit{id.} at 29.

\textsuperscript{36} \textit{id.} at 27-28.

\textsuperscript{37} See \textit{id.} at 28 (citing THOMAS J. SCHOENBAUM, ADMIRALTY AND MARITIME LAW 589 (4th ed. 2004)).

\textsuperscript{38} Sompo Japan Ins. Co. of Am. v. Union Pac. R.R. Co., 456 F.3d 54, 58 (2d Cir. 2006).


\textsuperscript{40} Shao v. Link Cargo (Taiwan) Ltd., 986 F.2d 700, 704 (4th Cir. 1993).
often numerous carriers handling an interstate shipment of goods."\textsuperscript{41}

In \textit{J. H. Hamlen \& Sons Co. v. Illinois Central Railroad Co.}, the District Court for the Eastern District of Arkansas held that this legislation was not applicable to transportation to a foreign country.\textsuperscript{42} Congress responded to the court’s decision by passing the Cummins Amendment of March 4, 1915\textsuperscript{43} which extended the applicability of the statute to include transportation to a foreign country on a through bill of lading.\textsuperscript{44} The ICC analyzed the scope of this Amendment in the Bills of Lading Cases.\textsuperscript{45} In these cases, the Commission announced that the first Cummins Amendment "extended the territorial application of the provisions of the Carmack amendment to the transportation of goods within the territories of the United States, the District of Columbia, or to goods exported to adjacent foreign countries."\textsuperscript{46}

Congress changed the statutory scheme again on March 4, 1927 when it passed the Newton Amendment.\textsuperscript{47} The Newton Amendment made the delivering carrier on a through bill of lading liable for damages occurring on a preceding carrier.\textsuperscript{48} The Newton Amendment did not change the language defining its application but rather kept the "to a foreign country" language present in the previous amendment.\textsuperscript{49}

Congress later changed Section 1 of the ICA, which deals with the general scope of the ICA, namely the jurisdiction of the ICC.\textsuperscript{50} These changes were apparently made in reaction to the state court decision in \textit{Woodbury v. Galveston, Harrisburg \& San Antonio Railway Co.}\textsuperscript{51} In \textit{Woodbury}, a rail passenger lost baggage during a voyage which was to take the passenger from Canada into the United States and then back into Canada.\textsuperscript{52} The Texas court held that state law applied to this case because the ICC did not have jurisdiction over such a voyage.\textsuperscript{53} After the announcement of the Texas court’s decision, Congress set about to change the language of Section 1 to include transportation "from or to any place in the United States to or from a foreign country, but only in so

\begin{footnotes}
\begin{enumerate}
\item \textit{Alwine}, 15 A.2d at 510.
\item Bills of Lading, 52 I.C.C. 671, 671 (April 14, 1919).
\item \textit{Id.} at 683.
\item \textit{Alwine}, 15 A.2d at 510.
\item \textit{Id.}
\item \textit{Id.}
\item \textit{Woodbury}, 209 S.W. at 433.
\item \textit{See id.} at 435.
\end{enumerate}
\end{footnotes}
far as such transportation . . . takes place within the United States.”

This change in statutory language was adopted two months after the Supreme Court announced the reversal of the Texas court’s decision. In *Galveston, Harrisburg & San Antonio Railway Co. v. Woodbury*, the Supreme Court reversed the Texas opinion and held that the ICA did indeed apply to transport into the United States from a foreign country. The Court noted that the statute applied to “any common carrier . . . engaged in the transportation of passengers or property . . . from any place in the United States to an adjacent foreign country.” The Court went on to state that a “carrier engaged in transportation by rail to an adjacent foreign country is, at least ordinarily, engaged in transportation also from that country to the United States.” Application of the ICA, therefore, did not revolve around the direction of the transport, but rather the “nature of the transportation as determined by the field of the carrier's operation.” In coming to this conclusion, the Court noted that such reasoning was “in harmony with that placed upon the words of § 1 of the Harter Act.” Namely, that the Harter Act’s language that the ICA applied to “any vessel transporting merchandise or property from or between ports of the United States and foreign ports,” was construed to include vessels bringing cargos from foreign ports to the United States.

Two months after the Supreme Court’s decision was announced, Congress finally passed a revised wording of Section 1, resulting in the ICA’s jurisdiction extending to transportation “from or to any place in the United States to or from a foreign country, but only in so far as such transportation or transmission takes place within the United States.” While the Supreme Court had interpreted the prior language in a way that made Congress’s action unnecessary, apparently the momentum from the Texas decision pushed the change in statutory language through. While making this amendment to the ICA, Congress also revised portions of Section 20 but failed to broaden the text of the section to match the updated language of Section 1.

The unchanged wording in Section 20 became an issue in *Alwine v.*

55. *Sompo Japan Ins. Co. of Am. v. Union Pac. R.R. Co.*, 456 F.3d 54, 66 (2d Cir. 2006).
57. *Id.* at 359.
58. *Id.*
59. *Id.* at 360.
60. *Id.*
61. *Id.* (citing Knott v. Botany Mills, 179 U.S. 69, 75 (1900)).
Pennsylvania R.R. Co. where a shipment of cattle from Canada was damaged en route to Pennsylvania. The cattle were shipped under a through bill of lading that extended its protections to the delivering carrier and stated that each carrier was only to be held responsible for damages occurring during its leg of the voyage. The cattle were injured while in the custody of a proceeding carrier, but the buyer sued the delivering carrier arguing that the ICA's liability rules applied and that the delivering carrier could be held liable for damage occurring at any leg of the voyage. The settled rule at the time of Alwine was that each connecting carrier on a through route was only liable for damage that occurred during its leg of the voyage. The court noted that the through bill of lading granted no more protection to the carriers than that available under common law. Therefore, the court stated, unless ICA's Section 20 liability rules applied, the delivering carrier could not be held liable for damage that occurred on a previous leg.

The Alwine plaintiff argued that the reasoning in Woodsbury applied with equal force to Section 20, namely that the language "to a point in an adjacent foreign country" should be read to apply with even force to shipments from an adjacent foreign country. The Alwine court declined to read Section 20 in such a way. The court cited two reasons for its opinion. First, the court noted that the ICC had interpreted the Cummins Amendment as "extend[ing] the territorial application of the provisions of the Carmack Amendment to . . . goods exported to adjacent foreign countries." Therefore, if Congress intended the ICC to be the agency in charge of enforcing the ICA, and the ICC thought that Section 20 only applied to exports, then the Pennsylvania Supreme Court was not going to issue a conflicting opinion. Second, the Alwine court inferred that because Congress amended Section 1's language and neglected to change identical language in Section 20, Congress clearly no longer intended the two statutes to be co-extensive. Therefore, the Alwine court decided that while the ICA extends the ICC's jurisdiction to imports and exports under Section 1, the ICA's liability provisions only extend to exports under Section 20.

The Supreme Court again took up the question of the applicability of

64. Alwine, 15 A.2d at 508.
65. Id.
66. Id.
67. Id. at 509.
68. See id. at 511.
69. Id. at 563.
70. Alwine, 15 A.2d at 561.
71. Id. at 564 (quoting 52 I.C.C. 671, 683 (Apr. 14, 1919)).
72. Id. at 563.
Carmack in *Reider v. Thompson*.\(^73\) *Reider* involved a shipment from Buenos Aires to Boston.\(^74\) The ocean carrier issued a bill of lading that listed the destination of the goods as New Orleans.\(^75\) After the arrival of the goods in New Orleans, a land-based carrier issued a bill of lading for transport from New Orleans to Boston.\(^76\) In the Fifth Circuit opinion, a divided court held that, (1) the transaction was intended to be a single, continuous shipment from a foreign country to a point in the United States.\(^77\) In support of this finding the court relied on a Supreme Court decision in *United States v. Erie R. R. Co.*\(^78\) that held that the ICA had jurisdiction to control rates in a case where the goods were shipped from a foreign country to a point in the United States and the shipper intended the shipment to be single and continuous despite the fact that multiple modes of transportation were used.\(^79\) The circuit court, relying on the Pennsylvania opinion in *Alwine*, held that (2) the Carmack Amendment did not apply to shipments from a foreign country to a point in the United States.\(^80\) The Supreme Court disagreed.

The Supreme Court stated in *Reider* that the question of whether the transaction fell within the liability provisions of the ICA must be answered by reference to the bills of lading.\(^81\) The test was "not where the shipment originated, but where the obligation of the carrier as receiving carrier originated."\(^82\) The Court went on to emphasize that it was of no significance that the shipment originated in a foreign country, because the foreign portion of the voyage terminated when the ship moored up in New Orleans.\(^83\) What was left, therefore, was merely an interstate shipment from New Orleans to Boston, covered under a domestic bill of lading that clearly fell within the liability provisions of Section 20.\(^84\)

In *Reider*, the Court distinguished *Alwine* by pointing out that the Pennsylvania Supreme Court was dealing with an import case involving a through bill of lading.\(^85\) Because *Reider* did not involve a through bill of lading,\(^86\) the Court expressly abstained from determining whether the *Al-

\(^73\) Reider v. Thompson, 339 U.S. 113, 114 (1950).
\(^74\) Id. at 115.
\(^75\) Id.
\(^76\) Id. at 116.
\(^77\) Reider v. Thompson, 176 F.2d 13, 15 (5th Cir. 1949), vacated, 339 U.S. 113 (1950).
\(^79\) Reider, 176 F.2d at 17.
\(^80\) Id. at 15.
\(^81\) Reider, 339 U.S. at 117.
\(^82\) Id.
\(^83\) Id.
\(^84\) Id.
\(^85\) Id. at 118 (This point is debatable, as language in the Fifth Circuit opinion suggests that the goods were indeed shipped on a through bill of lading. *See Reider*, 176 F.2d at 14).
wine case was correctly decided.\textsuperscript{87} After Reider, therefore, the established rule was that where a shipment commenced in a foreign nation and involved an ocean voyage and a separate, domestic land leg, but no through bill of lading, Section 20 of ICA applied. And for courts outside of Pennsylvania, the rule that imports shipped under a through bill of lading were not covered under Section 20, was only persuasive authority.

In 1978, as part of a larger overhaul of the ICA, Congress amended the ICA, and replaced the "from . . . to" language with the word "between."\textsuperscript{88} Carmack now read as applying to "transportation in the United States between a place in . . . the United States and a place in a foreign country."\textsuperscript{89} The expressed legislative intent of this revision was to recodify the statute, and restore without substantive change the applicable laws enacted prior to May 16, 1978.\textsuperscript{90} The language previously found in Section 20(11) was codified at 49 U.S.C. § 10730. Use of the word "between" is a notable change to the statutory language as it replaced the directional language previously used in section 20.

\textit{Swift Textiles, Inc. v. Watkins Motor Lines, Inc.}, was the first appellate court case to tackle the ICA’s changed language and was authored by the esteemed admiralty judge Judge John R. Brown, sitting by designation in the Eleventh Circuit.\textsuperscript{91} Swift involved an intermodal shipment from Switzerland to LaGrange, Georgia.\textsuperscript{92} The goods were transported by rail to Hamburg where they were loaded onto a ship.\textsuperscript{93} The ocean carrier issued a bill of lading that covered the voyage from Hamburg to Savannah, Georgia.\textsuperscript{94} The ship berthed in Charleston, South Carolina, where the goods were unloaded and shipped to Savannah under the ocean bill of lading.\textsuperscript{95} Once in Savannah, the goods were turned over to a broker who arranged for transport from Savannah to LaGrange.\textsuperscript{96} The land-based carrier for this trip across the Georgia countryside issued a new bill of lading.\textsuperscript{97} Unfortunately, the goods were damaged while en route to LaGrange and the land carrier sought to apply the statute of limitations in the Carmack Amendment to the intrastate portion of the

\textsuperscript{87} Reider, 339 U.S. at 118.
\textsuperscript{92} \textit{Id.} at 698.
\textsuperscript{93} \textit{Id.}
\textsuperscript{94} \textit{Id.}
\textsuperscript{95} \textit{Id.}
\textsuperscript{96} \textit{Id.}
\textsuperscript{97} Swift, 799 F.2d at 698.
voyage. 98 In Swift, Judge Brown began by noting that:

The Carmack Amendment applies when the ICC has jurisdiction over the shipment in question, 49 U.S.C. § 11707(a). Among the shipments over which the ICC has jurisdiction are shipments "between a place in . . . the United States and a place in a foreign country to the extent the transportation is in the United States." 99

The court rejected the argument that the voyage from Savannah to LaGrange was a purely intrastate journey and not covered by the Carmack Amendment. 100 Judge Brown instead applied the "intent" test for determining the nature of an intermodal shipment. 101 Citing language from United States v. Erie R. R. Co., 102 Judge Brown stated that the proper focus of determining whether the voyage was a continuous unified shipment turned on the shipper's intent at the time of initiating the voyage. 103 The court said that the shipment itself had the character of an international shipment and therefore was properly under the jurisdiction of the ICC and the Carmack Amendment despite that a bill of lading had been issued for the purely intrastate portion of the journey. 104

The carrier asserted that under the Supreme Court's decision in Reider v. Thompson, inland transport not covered under a through bill of lading should be handled as a separate and distinct shipment. 105 Therefore, the carrier argued, its shipment was not some part of a shipment from a foreign nation but was rather a purely intrastate voyage where Carmack did apply. 106 Judge Brown rejected this assertion and stated that the Supreme Court in Reider had identified that the interstate voyage at issue there was "new, separate, and distinct" from the ocean leg of the voyage based on the intent of the parties by examining the bills of lading. 107 Here, however, Judge Brown found that the domestic shipment was not separate based on the fact that the shipper intended the domestic leg of the voyage to be a continuation of the international ocean leg. 108 Judge Brown then went on to articulate the Court's holding by stating, "[w]e therefore hold that when a shipment of foreign goods is sent to the United States with the intention that it come to final rest at a

98. Id. at 698-99.
100. Swift, 799 F.2d at 700.
101. Id.
103. Swift, 799 F.2d at 699.
104. Id at 700.
105. Id.
106. Id.
107. Swift, 799 F.2d at 700; See also Reider v. Thompson, 339 U.S. 113, 117 (1950).
108. Swift, 799 F.2d at 701.
specific destination beyond its port of discharge, then the domestic leg of the journey (from the port of discharge to the intended destination) will be subject to the Carmack Amendment as long as the domestic leg is covered by separate bill or bills of lading."\textsuperscript{109} This articulation of Swift's holding would become the basis of disagreement between the circuits.

The first courts to examine the issue after \textit{Swift Textiles, Inc. v. Watkins Motor Lines, Inc.} came to dramatically different conclusions. The District Court for the Northern District of Illinois, in \textit{Capitol Converting Equipment, Inc. v. LEP Transp., Inc.},\textsuperscript{110} used Swift's holding to conclude that Carmack did not apply to a shipment that was shipped on a through bill of lading, where a separate bill of lading was not issued to cover the land leg of the voyage.\textsuperscript{111} But another district court sitting in the Northern District of Illinois rejected this conclusion in \textit{Canon USA, Inc. v. Nippon Liner Sys., Ltd.}\textsuperscript{112} The Canon court agreed with Swift's use of the "intent test" to determine whether the land leg of an intermodal shipment was covered by the Carmack Amendment.\textsuperscript{113} However, the court took issue with Swift's articulated holding, stating that, the "‘as long as’ language is inconsistent with the court’s underlying reasoning and explicit language. Indeed, one must wonder if the ‘as long as’ language is a typographical error and whether the court in fact meant to say ‘even if’ the domestic leg is covered by separate bill or bills of lading.”\textsuperscript{114} The Canon court went on to hold that Carmack applied to the land leg of an intermodal shipment covered by a through bill of lading regardless of whether a separate bill of lading was issued for the inland voyage.\textsuperscript{115}

The Seventh Circuit solved this division among district courts when it took up \textit{Capitol Converting Equipment, Inc. v. LEP Transp., Inc.} on appeal.\textsuperscript{116} The court made no mention of Canon's holding, nor did it devote any attention to the apparent disconnect between Swift's articulated holding and its reasoning.\textsuperscript{117} However, the court agreed with Swift's articulated holding and declined to apply Carmack to an intermodal shipment on a through bill of lading where the inland leg was not covered by a separate bill of lading.\textsuperscript{118}

\textsuperscript{109} \textit{Id.} at 701.
\textsuperscript{111} \textit{Id.} at 864.
\textsuperscript{113} \textit{Id.} at *6.
\textsuperscript{114} \textit{Id.} at *7.
\textsuperscript{115} \textit{Id.} at *8.
\textsuperscript{116} 965 F.2d 391, 394 (7th Cir. 1992).
\textsuperscript{117} \textit{Id.}
\textsuperscript{118} \textit{Id.} at 394-395.
A year later, the Fourth Circuit joined the Seventh and Eleventh in *Shao v. Link Cargo (Taiwan) Ltd.* The Fourth Circuit agreed with the articulated holding of *Swift*, noting that the Carmack Amendment only applied to shipments from a foreign country where a separate domestic bill of lading is issued. A decade later, the Sixth Circuit also found *Swift* persuasive in *American Road Service Co. v. Consolidated Rail Corp.*

While the Fifth Circuit has yet to weigh in on the issue, in *Berlanga v. Terrier Transportation, Inc.*, a Texas District Court took issue with *Swift*’s articulated holding and the line of precedent it established in the Fourth, Seventh, and Sixth Circuits. The Texas court noted that the present version of the Carmack Amendment was subject to the Board’s general jurisdictional standard. “Today, the Amendment’s applicability turns on whether the Secretary or the STB exercises jurisdiction over the shipment, not on the direction of the shipment.” The court noted that the prior statutory language seemed to imply some directional element, perhaps explaining prior courts’ difficulty interpreting the statute. But, in the revised version of the statute, Congress clearly stated that the Board and Carmack apply to motor carriers that ship goods “between a place in . . . the United States and a place in a foreign country.” The Texas court went on to point out the inconsistency between *Swift*’s articulated holding and its “intent test” reasoning. For the Texas court, in the face of such plainly applicable statutory language, case law based on *Swift*’s questionable holding was not persuasive. Therefore, the court held that Carmack applied to the domestic leg of a shipment from Mexico City to Plano, Texas covered under through bill of lading.

It is uncertain whether the Ninth Circuit has actually weighed in on this issue. In *Neptune Orient Lines, Ltd. v. Burlington N. & Santa Fe Ry. Co.*, the court was faced with a case where goods were shipped from Jakarta, Indonesia to Memphis, Tennessee under a through bill of lad-

119. 986 F.2d 700, 703 (4th Cir. 1993).
120. *Id.*
121. 348 F.3d 565, 568 (6th Cir. 2003).
123. *Id.* at 829-30.
124. *Id.* at 826.
125. *Id.* at 827.
126. *Id.*
127. *Id.*
128. 269 F.Supp. 2d at 829.
129. *Id.*
130. *Id.* at 829-830.
The court noted that "in the past we have held that an earlier incarnation of [the Carmack Amendment] applies to separate inland bills of lading for shipments to or from overseas ports." The court then goes on to say that "language of the statute also encompasses the inland leg of an overseas shipment conducted under a single "through" bill of lading . . . to the extent that the shipment runs beyond the dominion of the Carriage of Goods by Sea Act. However, in making this second assertion, the court cites no prior precedent. In fact, it does not appear that the applicability of Carmack was even raised as an issue and therefore was not actually before the court. Furthermore, the Ninth Circuit had established a precedent of enforcing through bills of lading containing a Himalaya clause that contractually extended COGSA’s regime inland in Sea-Land Serv., Inc. v. Lozen Int’l, LLC even before the Supreme Court endorsed such a holding. However, in Lozen, Carmack was not applicable because the through bill of lading covered a foreign-to-foreign shipment of goods from Mexico to England even though the parties intended to ship the goods by rail across the entire continental United States. Regardless of the Ninth Circuit’s willingness to extend COGSA inland, Neptune’s apparent endorsement of the application of Carmack to the inland portion of a multimodal shipment under a through bill of lading should be considered dicta because the only issue on appeal in Neptune was the proper calculation of damages available under Carmack.

The most recent appellate court case involving the application of Carmack was announced three weeks after the Second Circuit announced its decision in Sompo Japan Insurance Co. of America v. Union Pacific R.R. Co. The Eleventh Circuit reaffirmed its position that the Carmack Amendment applied to the inland portion of a multimodal shipment only where the inland leg was covered under a separate bill of lading in Altadis

133. Id.
134. See id. at 119. See also Altadis USA, Inc. ex rel. Fireman’s Ins. Co. v. Sea Star Line, LLC, 458 F.3d 1288, 1288 (11th Cir. 2006).
136. Sea-Land Serv., Inc. v. Lozen Int’l, LLC, 285 F.3d 808 (9th Cir. 2002) (holding COGSA may be contractually extended to apply to an inland carrier).
137. See id. at 817.
138. See 213 F.3d at 1120.
USA, Inc. ex rel. Fireman's Ins. Co. v. Sea Star Line, LLC.\textsuperscript{139} Probably due to criticism of Swift's wording, the court treated Swift's articulated holding as dicta but reaffirmed the fact that Carmack demanded a separate inland bill of lading based on the fact that the Sixth, Seventh, and Fourth Circuits were in accord with this opinion.\textsuperscript{140} The court also placed considerable emphasis on the fact that the Supreme Court stated in \textit{Reider} that the "test is not where the shipment originated, but where the obligation of the carrier as receiving carrier originated."\textsuperscript{141}

C. Limiting Liability Under Carmack

In order to alleviate some of the oppressive effects of the original ICA regime, Congress embarked on a deregulation effort, enacting the Staggers Rail Act of 1980.\textsuperscript{142} Staggers reorganized the provisions of the ICA and the Carmack Amendment "which, among other things, authorized the ICC ‘to exempt transportation that is provided by a rail carrier as part of a continuous intermodal movement.’"\textsuperscript{143} The ICC used this authority to exempt rail carriers that operate on one leg of a continuous intermodal movement from some of the ICC’s regulatory schemes.\textsuperscript{144}

Congress again revised the statutory scheme in 1995, replacing the ICC with the Surface Transportation Board.\textsuperscript{145} Using its power to exempt carriers, the Board created some exemptions but did not allow carriers to contract out of all of its regulations. In particular, these carriers must still satisfy the requirements of 49 U.S.C. § 10502(e), which states:

No exemption order issued pursuant to this section shall operate to relieve any rail carrier from an obligation to provide contractual terms for liability and claims which are consistent with the provisions of section 11706 of this title. Nothing in this subsection or section 11706 of this title shall prevent rail carriers from offering alternative terms nor give the Board the authority to require any specific level of rates or services based upon the provisions of section 11706 of this title.\textsuperscript{146}

As mentioned above, Section 11706 is the prior Section 20, which governs the liability of rail carriers. It provides that the "rail carrier and any other carrier that delivers the property and is providing transporta-

\textsuperscript{139} See 458 F.3d at 1288.
\textsuperscript{140} Id. at 1291-2.
\textsuperscript{141} Id.
\textsuperscript{143} Sompo, 456 F.3d at 59 (summarizing 49 U.S.C. § 10502(f)).
\textsuperscript{144} See 49 C.F.R. § 1090.2 (2007).
\textsuperscript{145} Emerson Elec. Supply Co. v. Estes Express Lines, Corp., 451 F.3d 179, 185-86 (3d Cir. 2006).
\textsuperscript{146} 49 U.S.C. § 10502(e).
tion or service subject to the jurisdiction of the Board under this part are liable to the person entitled to recover under the receipt or bill of lading. The liability imposed under this subsection is for the actual loss or injury to the property."\textsuperscript{147} Therefore, an exempt carrier may limit its liability by contracting alternate terms so long as it meets the ICA's requirements.

Prior to statutory amendments made in 1995, in order to limit liability under Carmack, a carrier must have: "(1) maintain[ed] a tariff within the prescribed guidelines of the Interstate Commerce Commission; (2) obtain[ed] the shipper's agreement as to [the shipper's] choice of liability; (3) given the shipper a reasonable opportunity to choose between two or more levels of liability; and (4) issue[d] a receipt or bill of lading prior to moving the shipment."\textsuperscript{148} Presently, carriers wishing to limit their liability must: (1) file certain tariffs with the Surface Transportation Board for transportation of property in noncontiguous trade and household goods carriers that are not required to file these tariffs must still "provide to the shipper, on request of the shipper, a written or electronic copy of the rate, classification, rules, and practices, upon which any rate . . . is based";\textsuperscript{149} (2) obtain the shipper's agreement as to the shipper's choice of liability; (3) give the shipper a reasonable opportunity to choose between two or more levels of liability; and (4) issue a receipt or bill of lading prior to moving the shipment.\textsuperscript{150}

Cases dealing with the issue of providing alternate terms tend to turn on the Carmack Amendment's third requirement that carriers wishing to limit their liability must give the shipper reasonable opportunity to choose between different levels of liability.\textsuperscript{151} This requirement is satisfied by the presence of a "declared value box" on the bill of lading, but only in cases where declaring an increased value would result in actually increasing the carrier's liability under the contract.\textsuperscript{152} Bills of lading that give the option of declaring a higher value but do not actually give the option of increasing the carrier's liability do not meet the standard set forth in the Carmack Amendment.\textsuperscript{153}

\section*{III. Announcing a Split}

In \textit{Sompo Japan Insurance Co. of America v. Union Pacific R.R. Co.},

\textsuperscript{147} 49 U.S.C. § 11706(a).
\textsuperscript{148} \textit{Emerson}, 451 F.3d at 186.
\textsuperscript{149} 49 U.S.C. § 13710(a).
\textsuperscript{150} \textit{See} Emerson, 451 F.3d at 186-8.
\textsuperscript{151} \textit{See id.}
\textsuperscript{152} \textit{Emerson}, 451 F.3d at 188 (citing Nat'l Small Shipments Traffic Conference, Inc. v. United States, 887 F.2d 443, 444 (3d Cir. 1989); Hollingsworth & Vose Co. v. A-P-A Transp. Corp., 158 F.3d 617, 619 (1st Cir. 1998)).
\textsuperscript{153} \textit{Id.}
the Second Circuit departed from the established rule that the Carmack Amendment to the Interstate Commerce Act only applies to the domestic inland leg of an international multimodal shipment of goods when a separate bill of lading is issued. In doing so, the Second Circuit rejected the holdings of the Pennsylvania Supreme Court, the Fourth, Sixth, Seventh, and Eleventh Circuits, and narrowly interpreted the Supreme Court's decision in *Norfolk Southern Railway Company v. Kirby*.

A. *Sompo*’s Facts

The facts of *Sompo* involve all of the usual parties to a multimodal shipment of goods – a shipper, an ocean carrier, a land carrier and an insurance company. Sompo Japan Insurance of America ("Sompo") brought an action against Union Pacific Railroad Company ("Union Pacific"), a land carrier, to recover the cost paid to the insured shipper, Kubota Tractor Corporation ("Kubota") for tractors damaged en route to Swansiee, Georgia. Liability for the damaged goods was not in dispute and the only issue at the trial court was the extent of Union Pacific’s liability.

Mitsui OSK Line Ltd. ("MOL"), an ocean carrier, shipped thirty-two Kubota tractors, valued at $479,500.00, from Tokyo, Japan to Swaneee, Georgia. MOL issued three "intermodal" or "through bills of lading" to Kubota covering the entire shipment from Tokyo to Swaneee. The backside of the bills of lading contained various provisions dealing with the liability of MOL and others involved in the transport of the tractors.

MOL’s ship got underway from Tokyo and moored up in Los Angeles. After arriving in the United States, the tractors were placed on Union Pacific railcars for shipment to Swansiee. Union Pacific issued electronic waybills for this land leg of the shipment but the waybills made no reference to a limitation of liability.

Union Pacific’s train derailed in Texas resulting in damage to the cargo. Upon notification of the loss, Sompo paid the insured, Kubota, $479,500 in settlement of the loss. Sompo, as subrogee of Kubota’s

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154. Hereinafter referred to as Kubota.
155. *Sompo*, 456 F.3d at 55.
156. Id. at 55-56.
157. Id.
158. See id. at 63.
159. See id. at 56.
160. See id.
161. See *Sompo*, 456 F.3d at 56.
162. See id.
163. See id.
164. See id. at 55.
claims, brought this action.\textsuperscript{165}

MOL's bill of lading contained two clauses that purported to extend the Carriage of Goods by Sea Act's $500 limitation of liability to all parties involved in the shipment.\textsuperscript{166} The first of these clauses, Clause 4, titled "SUB-CONTRACTING AND INDEMNITY," (otherwise known as a "Himalaya" clause) states:

(1) The Carrier shall be entitled to sub-contract the Carriage on any terms whatsoever.
(2) The Merchant undertakes that no claim or allegation shall be made against any servant, agent or Sub-Contractor of the Carrier . . . Without prejudice to the foregoing, every such servant, agent and Sub-contractor shall have the benefit of all provisions herein benefiting the Carrier as if such provisions were expressly for their benefit, and in entering into this contract, the Carrier, to the extent of those provisions, does so not only on its own behalf, but also as agent and trustee for such servants, agents and Sub-contractors.\textsuperscript{167}

Section 1, entitled "DEFINITIONS," defines "Sub-contractor" as:

owners and operators of vessels and space providers of Vessels other than the Carrier . . . inland carriers, road, rail and air transport operators, any independent contractor directly or indirectly employed by the Carrier in performance of the Carriage, their respective servants or agents, and anyone assisting in the performance of the Carriage.\textsuperscript{168}

These two provisions were asserted by Union Pacific as evidence that MOL's bills of lading enabled Union Pacific to avail itself of MOL's applicable defenses.\textsuperscript{169} The applicable defense is found in Clause 29, titled "US CLAUSE PARAMOUNT." It states:

(1) If the carriage covered by this bill of lading includes Carriage to or from a port or place in the United States of America, this Bill of Lading shall be subject to the United States Carriage of Goods by Sea Act 1936 (U.S. COGSA), the terms of which are incorporated herein and shall govern throughout the entire Carriage set forth in this Bill of Lading. Neither clause 5(1)(a), (b), the Hamburg Rules nor the Visby Amendments shall apply to the Carriage to or from the United States. The Carrier shall be entitled to the benefits of the defences [sic] and limitations in the U.S. COGSA, whether the loss or damage to the Goods occurs at sea or not.
(2) If the U.S. COGSA applies as Clause 29(1) above, neither the Carrier nor the Vessel shall, in any event, be or become liable for any loss or damage to or in connection with the Goods in an amount exceeding $500.00 per

\textsuperscript{165} See id.
\textsuperscript{166} See id. at 56.
\textsuperscript{167} Sompo Japan Ins. of Am. v. Union Pac. R.R. Co., No. 03 Civ. 1604(RCC), 2003 WL 22510361, at *2-*3 (S.D.N.Y. Nov. 5, 2003).
\textsuperscript{168} Id.
\textsuperscript{169} See Sompo, 456 F.3d at 56.
package, lawful money of the United States, or in the case of goods not shipped in packages, per customary freight unit, unless the value of the Goods has been declared and inserted in the declared value box on the face hereof, in which case Clause 6(2) shall apply.\textsuperscript{170}

Clause 6(2) states,

\textit{Ad Valorem}
Higher compensation may be claimed only when, with the consent of the carrier, the value for the Goods declared by the Shipper which exceeds the limits laid down in this Bill of Lading has been stated in the declared value box on the face of this Bill of Lading and, if applicable, the ad valorem freight has been paid. In that case the amount of the declared value shall be substituted for that limit. Any partial loss or damage shall be adjusted pro rata on the basis of such declared value.\textsuperscript{171}

The trial court found that Kubota never declared the value of the goods on the face of the relevant documents as required by Clause 29(2) and Clause 6(2).\textsuperscript{172} And therefore, under the through bill of lading, the carrier’s liability should be limited to $500 per package.\textsuperscript{173}

\section*{B. Sompo’s Reasoning}

The Second Circuit began its analysis by noting that “MOL’s through bills of lading gave Kubota a ‘fair opportunity’ to declare a value for the tractors in excess of $500 per package,” thus satisfying COGSA and triggering the statute’s limitation of liability.\textsuperscript{174} The court went on to address the question of “whether Carmack applies to the inland portion of Kubota’s shipment, a carriage of goods by rail shipped under a through bill of lading from a foreign country to a destination in the United States.”\textsuperscript{175}

The court noted that “Carmack applies to common carriers ‘providing transportation or service subject to the jurisdiction of the [Surface Transportation] Board,’”\textsuperscript{176} and that, “the Board’s jurisdiction over rail carriers applies to ‘transportation in the United States between a place in . . . the United States and a place in a foreign country.’”\textsuperscript{177} The court acknowledged that the question of whether Carmack applies to a carriage of goods shipped under a through bill of lading was an issue of first im-

\textsuperscript{170} Sompo, 2003 WL 22510361, at *3.
\textsuperscript{172} Sompo, 456 F.3d at 55.
\textsuperscript{173} See \textit{id}.
\textsuperscript{174} \textit{id}. at 60.
\textsuperscript{175} \textit{id}.
\textsuperscript{176} \textit{id}.
\textsuperscript{177} \textit{id}. at 61 (quoting 49 U.S.C. § 10501(a)(2)(F) (2006)).
pression in the Second Circuit, and that most courts have determined that Carmack does not apply.\textsuperscript{178}

The court seemed to place some of the blame for this state of affairs on the Eleventh Circuit case, \textit{Swift Textiles v. Watkins Lines, Inc.},\textsuperscript{179} suggesting that the \textit{Swift} court's holding was misworded.\textsuperscript{180} The court went on to affirm \textit{Swift}'s intent-based analysis but rejected its holding that Carmack does not apply to a shipment of foreign goods into the United States under a through bill of lading unless a separate bill of lading is issued to cover the land portion of the shipment.\textsuperscript{181}

After addressing the fact that most courts currently followed \textit{Swift}'s supposedly flawed holding, the court addressed the first prong of their inquiry into the application of the Carmack Amendment.\textsuperscript{182} In answering the question of whether the nature of the shipment was a single multimodal voyage, as in \textit{Swift Textiles v. Watkins Lines, Inc.}, or multiple shipments consisting of separate ocean and domestic legs, as in \textit{Reider v. Thompson}, the court applied the "intent test" and looked to the parties' intent at the time of contracting for the carriage of goods.\textsuperscript{183} The court quickly disposed of this question as it was readily apparent that Kubota intended that the tractors travel from Tokyo to Swanee as evidenced by the through bill of lading.\textsuperscript{184} The court noted that the fact that Union Pacific issued separate electronic waybills did not change the nature of the shipment or provide contrary evidence of Kubota's intent.\textsuperscript{185} Deciding that this shipment was a single voyage, the Court turned next to the more difficult question of whether Carmack applies to the domestic rail portion of a single-continuous intermodal shipment.\textsuperscript{186}

In turning to this question, the Second Circuit announced that it did not blame the current state of confusion in the law on the \textit{Swift} court's articulated holding, but nevertheless rejected the "separate bill of lading" requirement announced in \textit{Swift} and thereby rejected the persuasive precedent of the Sixth, Fourth, Seventh, and Eleventh Circuits.\textsuperscript{187} The Second Circuit instead identified the complexity of the issue as stemming from the Carmack Amendment's language and statutory history.\textsuperscript{188} Looking at the current version of Carmack, the court noted that the stat-

\begin{itemize}
  \item 178. \textit{Sompo}, 456 F.3d at 61.
  \item 179. \textit{Id.}
  \item 180. \textit{Id.} at 62-63.
  \item 181. \textit{Id.} at 63.
  \item 182. \textit{Id.} at 60-63.
  \item 183. \textit{See id.} at 61, 63, 67.
  \item 184. \textit{Sompo}, 456 F.3d at 63.
  \item 185. \textit{Id.}
  \item 186. \textit{Id.}
  \item 187. \textit{Id.}
  \item 188. \textit{Id.}
\end{itemize}
ute applies to "transportation in the United States between a place in . . . the United States and a place in a foreign country." The court refused to see such language as implying that the statute plainly applied to both imports and exports and instead said that the language might be read as "distinguishing between exports and imports."

In an attempt to clarify the supposed confusion caused by use of the word "between," the court looked to the most recent change in statutory language. Prior to the 1978 amendments to the ICA, Carmack applied to transportation "from any point in the United States to a point in [an adjacent] country." The court noted that while the District Court for the Northern District of Texas, in *Berlanga v. Terrier Transp., Inc.*, had interpreted this change to mean that Congress intended Carmack to apply to imports and exports by "employing the canon of statutory construction "requiring a change in language to be read, if possible to have some effect."

However, the Second Circuit declined to take the easy way out. The Second Circuit noted that the District Court for the Northern District of Texas, in *Berlanga v. Terrier Transp., Inc.*, had interpreted this change to mean that Congress intended Carmack to apply to imports and exports by "employing the canon of statutory construction requiring a change in language to be read, if possible to have some effect."

Instead, the court pointed out "that the 1978 amendments were adopted in a codification bill enacting the ICA into positive law." Employing yet another canon of statutory interpretation, the court stated "courts should not 'infer that Congress, in revising and consolidating the laws, intended to change their effect, unless such intention is clearly expressed.'" Pointing to the legislative record, the court noted that the 1978 codification bill was intended to leave the law "substantively unchanged."

Therefore, the court declined to place any significance on the amendments of 1978 and instead jumped back to the Carmack Amendment’s enactment in 1906 and the cases that followed.

The Second Circuit turned to the confusion over whether the 1915 Cummins Amendment’s "to . . . from" language covered both imports

189. *Id.* at 64 (citing 49 U.S.C. § 10501(a)(2)(F) (2006)).
190. *Sompo*, 456 F.3d at 64.
191. *Id.*
192. *Id.* (citing 49 U.S.C. § 20(11) (1971)).
193. *Id.* (quoting Am Nat’l Red Cross v. S.G., 505 U.S. 247, 263 (1992)).
194. *Id.*
195. *Id.*
196. *Sompo*, 456 F.3d 64.
197. *Id.* (quoting Fourco Glass Co. v. Transmirra Prods. Corp., 353 U.S. 222, 227 (1957)).
199. *Id.* at 65.
and exports. Looking to the Supreme Court’s decision in \textit{Woodbury}, the court noted that at least Section 1 of the ICA covered both imports and exports, and therefore the ICA (and accordingly its successor, the Surface Board of Transportation) had jurisdiction over imports and exports shipped via land transport in the United States.\footnote{Id. at 65-66.} The Second Circuit noted prior courts’ general resistance to reading \textit{Woodbury}’s interpretation of Section 1 into the identical Section 20 and placed the blame on the Pennsylvania Supreme Court’s opinion in \textit{Alwine v. Pennsylvania R.R. Co.}.\footnote{Id. at 66.}

The Second Circuit rejected both of \textit{Alwine}’s rationales for declining to extend \textit{Galveston, Harrisburg & San Antonio Railway Co. v. Woodbury}’s interpretation of Section 1 to Section 20.\footnote{See \textit{Sompo}, 456 F.3d at 66-67.} First, the \textit{Alwine} court placed emphasis on the fact that the ICC itself had interpreted its authority to extend to exports, but had never interpreted its authority to extend to imports. The Second Circuit rejected this rationale because it was unclear if the ICC’s announcement was the ICC’s official interpretation of the statute.\footnote{Id.} Further, the court pointed out that the ICC never said that its authority did not extend to imports.\footnote{Id.} Therefore, the Second Circuit did not give weight to the ICC’s failure to speak on its jurisdiction over imports. Second, the \textit{Alwine} court had inferred that Congress’s change in the language of Section 1 after the Supreme Court’s decision in \textit{Woodbury}, but failure to change the language in Section 20, meant that Congress no longer intended the two provisions to be coextensive.\footnote{Id.} The Second Circuit soundly rejected this inference since the \textit{Woodbury} opinion’s rationale seemed to apply evenly to both sections and because courts should be reluctant to draw inferences from Congress’s failure to act.\footnote{Id. at 67 (citing Brecht v. Abrahamson, 507 U.S. 619, 632 (1993)).}

The Second Circuit also broke from other circuits in its characterization of \textit{Reider v. Thompson}. The Second Circuit chose not to read \textit{Reider} broadly as requiring a separate bill of lading for Carmack to apply. The \textit{Sompo} court noted that \textit{Reider} did not involve a through bill of lading and that the Supreme Court therefore treated the ocean voyage and the interstate land voyage as separate and distinct shipments.\footnote{Id. (citing \textit{Reider v. Thompson}, 339 U.S. 113, 117 (1950)).} The court pointed out that \textit{Reider} could not guide the analysis of the application of the Carmack Amendment to multimodal shipments because the \textit{Reider}
court specifically reserved that question from its judgment. Therefore, by rejecting Alwine and strictly construing Reider, the Second Circuit held that Carmack applies to the inland, interstate voyage of a multimodal shipment under a through bill of lading.

The Second Circuit went on to address the effect of the Carmack Amendment’s applicability and noted “COGSA only applies to ‘the period from the time when the goods are loaded on to the time when they are discharged from the ship.’” But the terms of COGSA may be extended by contract to a greater portion of the voyage. The court pointed out that when such an extension occurs, COGSA applies as a matter of contract and not with the force of statute. Therefore, if there is a conflict between the terms of the Carmack Amendment and COGSA’s terms as incorporated into the bill of lading, Carmack must prevail.

As support for this assertion, the Sompo court cited several cases that either hold or suggest that contracts extending COGSA must yield to conflicting Harter Act provisions. The Second Circuit held the a “contractual provision extending COGSA’s terms inland must yield to Carmack,” and therefore Carmack terms, not COGSA’s, cover an inland carrier’s liability where COGSA has been extended by a through bill of lading.

Having determined that Carmack, rather than COGSA, controls the issue of Union Pacific’s liability, as the district court held, the Second Circuit remanded the case for a determination of whether Union Pacific satisfied the requirements of 49 U.S.C. § 10502(e). However, rather than leave the entire issue to be decided on remand, the Second Circuit ruled out the possibility that the primary contract in the case, MOL’s through bill of lading, satisfied the Carmack Amendment’s limitation of liability requirements. The court noted that in order to limit liability under Carmack, the carrier had to first offer the shipper an opportunity

208. Sompo, 456 F. 3d at 67 (citing Reider v. Thompson, 339 U.S. 113, 118 (1950)) (stating, “we need not now determine whether [Alwine] was correctly decided. For purposes of this case it is sufficient to note that the Pennsylvania court emphasized that the shipment came into this country on a through bill of lading from Canada. The contract of carriage did not terminate at the border, as in the instant case.”)
210. Id.
211. Id.
212. Id. at 70.
213. Id. at 71 (citing Uncle Ben’s Int’l Div. of Uncle Ben’s Inc. v. Hapag-Lloyd Aktiengesellschaft, 855 F.2d 215, 217 (5th Cir. 1988)).
214. Sompo, 456 F.3d at 73.
215. Id. at 75.
216. Id. at 75-76.
to have full coverage.\textsuperscript{217} The court dismissed the argument that Carmack was satisfied because the bills of lading gave the shipper the opportunity to declare a higher value.\textsuperscript{218} The court said that such a declaration was not enough to satisfy Carmack because the liability scheme under the bills of lading was COGSA’s negligence scheme and not the Carmack Amendment’s strict liability scheme.\textsuperscript{219} Thus, the shipper never had the opportunity to get full Carmack coverage, a requirement that must be met if the carrier is allowed to contract for alternate terms. On remand, Union Pacific must show that its waybills or some other communication satisfied the Carmack Amendment’s limitation of liability requirements. Otherwise, Union Pacific will face liability it thought it had limited under its contract with MOL.

IV. Making a Course Correction

The Second Circuit is correct in holding that the Carmack Amendment applies to the inland leg of a multimodal shipment regardless of whether a separate bill of lading is issued. However, the Circuit’s holding that MOL’s bill of lading does not satisfy the Carmack Amendment’s limitation of liability requirements unreasonably confuses an already complex issue. Had the court given more consideration to the policy announced by the Supreme Court in \textit{Norfolk Southern Railway Company v. Kirby}, the Circuit might have come to a different result. While only Congress can fix the current state of multimodal carriage, future courts should seek to issue decisions that do not similarly and unnecessarily cloud the waters of international commerce.

A. The Mistake that Judge John R. Brown Didn’t Make in \textit{Swift}

The intent test announced in \textit{United States v. Erie R.R. Co.} is irreconcilable with the test announced in \textit{Reider v. Thompson}. The Supreme Court stated in \textit{Reider} that the question of whether the transaction fell within the liability provisions of the ICA must be answered by reference to the bills of lading.\textsuperscript{220} The Court stated that the test was “not where the shipment originated, but where the obligation of the carrier as receiving carrier originated.”\textsuperscript{221} However, in \textit{Erie} the Supreme Court stated that the nature of a shipment is not determined by a mechanical inspection of the bill of lading nor by when and to whom title passes but rather by “the

\begin{footnotes}
\item[217] \textit{Id.}
\item[218] \textit{Id.}
\item[219] \textit{Id. at 76.}
\item[221] \textit{Id.} (citing Rice v. Oregon Short Line R. Co., 198 P. 161, 163 (Idaho 1921)).
\end{footnotes}
essential character of the commerce.”

The Supreme Court may have come to the same conclusion in *Reider* if it had actually applied the “intent test” that it announced in *Erie*. The language in *Reider* suggests, however, that the Court focused exclusively on the bills of lading to determine whether the shipment was domestic or foreign. In fact, the word “intent” does not even appear in the Court’s opinion in *Reider v. Thompson*. The Court’s focus cannot be reconciled with the “intent test” which requires that a determination should hinge on the shipper’s intent at the time the first contract of carriage was established. How should an appellate court address future cases on this topic given the confusion created by the Supreme Court’s decision?

If *Reider v. Thompson* is the appropriate test, *Swift’s* purely intrastate voyage, covered under its own bill of lading, surely did not fall within the jurisdiction of the Carmack Amendment. Like *Reider*’s bill of lading, which terminated in New Orleans, the ocean bill of lading in *Swift* terminated in Savannah, thereby leaving the inland carrier with a mere intrastate trip. Unlike the Supreme Court in *Reider*, however, Judge Brown in *Swift* appears to have applied the appropriate test - the test announced in *Erie*. In *Swift*, Judge Brown explained that

> ... when a shipment of foreign goods is sent to the United States with the intention that it come to final rest at a specific destination beyond its port of discharge, then the domestic leg of the journey ... will be subject to the Carmack Amendment as long as the domestic leg is covered by separate bill or bills of lading.

This rule appears to be both consistent with the Supreme Court’s “intent test” announced in *Erie*, and the Court’s announcement in *Reider* that the test was “not where the shipment originated, but where the obligation of the carrier as receiving carrier originated.” Even the courts that have taken issue with the *Swift* holding have agreed that Judge Brown’s interpretation of the intent test was proper.

Should the Supreme Court elect to resolve this circuit split, its first step should be to clarify that the *Erie* intent test is the applicable test to determine whether a shipment is international or domestic. The Supreme Court should then clarify that *Reider* merely applied the *Erie* test without specifically referencing its language. This clarification would narrow *Reider*’s holding and make the bill of lading relevant to the analysis of the parties’ intent, but not dispositive as the *Reider* holding currently sug-

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gests. The Court should then sweep aside the line of cases that hold that a separate bill of lading is required in order for Carmack to apply.

B. **Holding that the Carmack Amendment Applies is not a Problem**

The Texas court in *Berlanga* was right when it stated that, “the statute is clear . . . the case law is not.”226 The Carmack Amendment currently applies “to transportation in the United States between a place in . . . the United States and a place in a foreign country.”227 When the statutory language is clear, courts should not need to look to case law, legislative history, or intent.228 Furthermore, courts should not attempt to read ambiguity into a statute in order to address issues of legislative intent.229 Therefore, on its face, the Carmack Amendment simply and unambiguously applies to transportation in the United States between a place in the United States and a foreign country. Because the statute does not contain language that would suggest that a separate bill of lading is required for Carmack to apply to an intermodal shipment, the requirement should not be read into the statute.

C. **Holding that the Through Bill of Lading Does not Satisfy the Carmack Amendment is a Problem**

The primary document in this international shipment was the through bill of lading issued by MOL. If there ever was a document that reflects a meeting of the minds or the parties’ intent, it is this document. The bill of lading was a standard MOL form and its limitation clause met all of the requirements to limit liability under both Carmack and COGSA. Therefore, finding that the MOL bill of lading failed to offer the shipper Carmack coverage was a mistake.

1. **Failure to Take Industry Custom into Account**

In refusing to uphold the MOL bill of lading, the Second Circuit failed to take into account the realities of the intermodal shipping transaction. The standard intermodal transportation contract involves multi-

229. See id. at 16-23; See also *Sompo*, 456 F.3d at 64 (reading the word “between” as ambiguous).
ple parties, various modes of transportation, and many miles. Complex contracts such as these easily produce significant transaction costs. However, the parties involved in the shipping industry have created an efficient system that reduces the transaction costs associated with intermodal carriage. Under the current system, a shipper who needs to transport goods over both land and sea seeks a party who can issue a through bill of lading covering the entire voyage. A through bill of lading may be issued by an ocean carrier or an intermediary such as a freight forwarder or a nonvessel operating common carrier (NVOCC). These entities qualify as “carriers” under COGSA and are frequently the shipper’s sole point of contact regarding the intermodal shipment. Once the shipper has agreed to the through bill of lading’s terms, the COGSA carrier arranges the inland contract of carriage as required under the through bill of lading. The COGSA carrier, who presumably engages in a large volume of such transactions, uses its commercial leverage to obtain an inland carriage contract at the lowest possible price.

While the Second Circuit does not expressly state that the inland carrier must contract with the shipper, it does place some obstacles in the way of these transactions. The Second Circuit requires the COGSA carrier to expressly offer the shipper (1) unlimited liability with regard to the ocean leg of the voyage as well as (2) unlimited liability with regard to the land leg of the voyage. Contracting parties under the prevailing mode of intermodal shipping transactions, however, already take these requirements into account. As the shipper’s limited agent, the COGSA carrier contracts inland terms according to the shipper’s terms in the through bill of lading. If the shipper wanted unlimited liability, it would have taken advantage of its opportunity under the through bill of lading. The idea that a shipper would want to contract for unlimited liability for one leg of a voyage but not the other seems commercially unsound.

In fact, commentators familiar with the international carriage of goods suggest that contracting for unlimited carrier liability is so cost prohibitive that it almost never occurs. Rather than pay the high cost of obtaining unlimited carrier liability, shippers purchase cargo insurance from underwriters who are more willing to bear the risk of the transaction. Conceivably, the difference in the cost of full liability under the contract of carriage and full liability under a cargo insurance policy stems from the underwriters’ specialization. The underwriter is in a much better position than the carrier to correctly value the risk of insuring a cer-

230. Crowley, supra note 9, at 1461.
231. Sompo, 456 F.3d at 76.
233. Id.
tain shipment, and the underwriter’s volume of contracts allows it to profit despite having to pay out for claims that arise under specific policies. The current custom of the shipping industry therefore meets the needs of all parties - carriers, shippers, and underwriters - while reducing transaction costs.

Because the Second Circuit rejected the argument that MOL’s bill of lading provided limited liability for the inland carrier, some may argue that the inland carrier must now contract directly with the shipper in order to obtain limited liability – a result that was expressly rejected by the Supreme Court. In Kirby, the Supreme Court announced an “efficient default,” or “limited agency,” rule that allowed the issuer of a through bill of lading to serve as the shipper’s agent for the limited purpose of extending the terms of the through bill of lading to the inland carrier. The Court reasoned that such a result was consistent with industry custom and was necessary to promote equity in the shipping industry. The Second Circuit should have followed the lead of the Supreme Court and given deference to the needs of the industry and current custom. Introducing new complexities in carrier limitation of liability can only result in complicating an already efficient transaction, increasing transaction costs, and creating confusion in the seas of international commerce.

2. Failure to Promote Uniformity in the Law

Congress evidently believes that a carrier’s ability to limit its liability is important, because Congress allows carriers to limit their liability under the Carmack Amendment and COGSA. Conceivably, this limitation enables carriers and insurers to keep rates down, and encourages carriers to continue to carry goods. But Congress has not given carriers free reign to limit their liability. Instead, under both Carmack and COGSA, carriers must meet certain requirements before being allowed to limit liability. Meeting these requirements under COGSA and Carmack tends to revolve around the same issue: Was the shipper given an opportunity to have the full value of its goods covered? In Sompo, MOL’s bills of lading contained a standard “opt out” clause, which gave the shipper the option of obtaining full coverage so long as it declared the true value of

234. Kirby, 543 U.S. at 32-36.
235. Id.
236. Compare Tamini Transformatori S.R.L. v. Union Pacific R. R., No. 02 Civ. 129, 2003 WL 135722, at *4 (S.D.N.Y. Jan. 17, 2003) (stating that liability to the carrier for actual loss under Carmack may be limited by bargaining with the shipper as long as the shipper is given the option of choosing Carmack protection for the full value of the shipment) with Nippon Fire & Marine Ins. Co. v. M.V. Tourcoing, 167 F.3d 99, 101 (2d Cir. 1999) (stating that COGSA liability is limited to $500 per package for the carrier only if the shipper has a fair opportunity to declare a higher value).
the goods.\textsuperscript{237} The trial court found that the shipper did not declare the true value of the goods as was required under the bill of lading.\textsuperscript{238} On appeal, the shipper did not contest this finding. In fact, Sompo acknowledged in its appellate brief that the MOL Bills of Lading offered the shipper unlimited liability.\textsuperscript{239} However, the Second Circuit found that it was not enough for the carrier to meet this requirement in order to limit its liability under Carmack.\textsuperscript{240}

The Second Circuit found that the MOL bill of lading sought to extend COGSA's liability scheme into the realm of the Carmack Amendment.\textsuperscript{241} Stating that Carmack was a strict liability statute and that COGSA was a negligence statute, the Second Circuit held that MOL had not offered the shipper true Carmack liability because the carrier had not actually offered the shipper Carmack's strict liability regime.\textsuperscript{242} Therefore, the carrier had not met the limited liability requirements set forth in Carmack.\textsuperscript{243} What was the result? Union Pacific, which thought it was operating under a valid limitation of liability agreement when it negotiated its inland carriage rates, would now face unlimited liability - a risk it had likely neither contemplated nor insured against.

While Carmack is rooted in strict liability and COGSA is rooted in negligence, neither Carmack nor COGSA are pure strict liability or negligence regimes. Rather, they are hybrid constructs. Both require "good order" / "bad order" to establish a prima facie case.\textsuperscript{244} Both shift the burden to the carrier to show that a statutory affirmative defense applies.\textsuperscript{245} While COGSA provides more defenses, several courts dealing with contractual extensions of COGSA have held that certain of these defenses are not available where the defenses conflict with statutes that would otherwise apply.\textsuperscript{246} The principle difference between the two statutes is that COGSA provides an affirmative defense for carriers that display due diligence.\textsuperscript{247}

A court could easily find that Carmack's requirements were met for

\textsuperscript{237} See Sompo, 456 F.3d at 75-76.
\textsuperscript{239} Sompo, 456 F.3d at 76.
\textsuperscript{240} Id.
\textsuperscript{241} Id.
\textsuperscript{242} Id.
\textsuperscript{243} Id.
\textsuperscript{244} Compare Project Hope v. M/V Ibn Sina, 250 F.3d 67, 74 (2d Cir. 2001) with Transatlantic Marine Claims Agency, Inc. v. M/V OOCL Inspiration, 137 F.3d 94, 98 (2d Cir. 1998).
\textsuperscript{245} Project Hope, 250 F.3d at 74; Transatlantic, 137 F.3d at 98.
\textsuperscript{246} See Sunpride Ltd. v. Mediterranean Shipping Co., 2004 A.M.C. 1, 119 (S.D.N.Y. 2004) (holding that a carrier may not invoke the COGSA quarantine exception because such an exception would violate §190 of the Harter Act).
\textsuperscript{247} See Nissan Fire & Marine Ins. Co., Ltd., v. M/V Hyundai Explorer, 93 F.3d 641, 646-47
the purposes of providing alternate "limitation of liability" terms, but that COGSA's affirmative defenses could not displace the more stringent liability scheme imposed by Carmack. The Second Circuit held that Carmack controlled the issue of the carrier's liability and the contractual extension of COGSA's affirmative defenses was displaced. By stating that Carmack controlled the issue of liability, the court ensured that the shipper obtained the benefit of Carmack's strict liability scheme, regardless of the contractual terms. Consequently, the terms of the contract, as they relate to substantive liability, should not have carried over to the issue of the carrier's limitation of liability. Had the court distinguished between substantive liability and the limitation of liability, it could have upheld the carrier's limitation of liability because the Carmack Amendment always controls the issue of substantive liability and because the bill of lading's limitation of liability clause gave the shipper the option to obtain full liability.

The Second Circuit could have come to the same result using a different route. Clause 27 of MOL's bill of lading provides that "[i]n the event that anything herein contained is inconsistent with any applicable international convention or national law which cannot be departed from by private contract, the provisions hereof shall be null and void to the extent of such inconsistency but no further." Therefore, while MOL's bill of lading did not explicitly offer the shipper "Carmack strict liability," the terms of the contract ensured that the shipper's statutory rights were protected and were consistent with legislative intent that land-based carriers face strict liability.

 Courts that seek to compare federal statutes that potentially overlap should look to provide uniformity, not inconsistency. Here, the court could have found that the bill of lading satisfied the Carmack requirements for limitation, but that inconsistent affirmative defenses were extinguished. Because the terms of a bill of lading can be reconciled with the Carmack Amendment, the court should not have been so quick to throw out this contract and expose the carrier to full liability. This is particularly true in the Sompo case, where the parties to the bill of lading were sophisticated business entities that should rarely be released from contractual obligations. Instead of providing uniformity, the opinion of the Second Circuit places a million common carriers' standard bills of lading into question, drives a wedge right down the center of the federal circuit courts, and places international carriage of goods law once again in unknown waters.

(9th Cir. 1996) (explaining the difference between the due diligence requirement imposed by different sections of COGSA).

D. Navigating by Kirby – How to Keep It Between the Buoys

The two circuit courts that dealt with the applicability of Carmack after Norfolk Southern Railway Co. v. Kirby came to dramatically different conclusions, not only about Carmack but also about Kirby's role in analyzing conflicts concerning through bills of lading.249 The Second Circuit in Sompo interpreted Kirby narrowly, noting that "in Kirby, the cargo owner failed to raise the issue of Carmack's applicability.”250 The court went on to state that, “[c]onsequently, Kirby only established the principle that maritime contracts should be interpreted in light of federal maritime law”251 and that “it does not follow from that principle that the only federal law to apply is COGSA.”252 The court therefore came to the conclusion that if a federal statute applied by its terms to the facts of a case, then that statute governs the dispute, not federal common law.253 Therefore, in Sompo, Kirby plays no role because Kirby does not speak to the applicability of the Carmack Amendment or to a through bill of lading’s ability to satisfy the Carmack limitation of liability requirements.

The Eleventh Circuit took a different approach by interpreting Kirby broadly. In Altadis, the Eleventh Circuit based its holding on the fact that the weight of precedence supported the view that Carmack was inapplicable to the facts of the case.254 Kirby's reasoning, therefore, was not a necessary element of Altadis' holding. Nevertheless, the court felt that it was worth noting that the shipper's argument that Carmack applied was "in tension with [Kirby] in that [applying Carmack] would introduce uncertainty and lack of uniformity into the process of contracting for carriage [of goods] by sea, upsetting contractual expectations expressed in through bills of lading.”255 For the Eleventh Circuit, Kirby's holding stands for the premise that “[t]he purpose of COGSA [was] to ‘facilitate efficient contracting in contracts for carriage by sea.’”256 Without uniformity, parties to a contract would have no idea whether their contract's terms would be upheld.

The application of the Carmack Amendment was not an issue in Norfolk Southern Railway Company v. Kirby. Therefore, the Supreme Court's decision in Kirby cannot guide the issue of whether Carmack applies to the domestic portion of an intermodal shipment of goods between

249. See Sompo, 456 F.3d at 71-75; Altadis USA, Inc., v. Sea Star Line, LLC, 458 F.3d 1288, 1294 (11th Cir. 2006).
250. See Sompo, 456 F.3d at 74.
251. Id.
252. Id.
253. Id.
254. Altadis, 458 F.3d at 1294.
255. Id.
256. Id. (citing Norfolk S. Ry. Co. v. Kirby Pty Ltd., 543 U.S. 14, 29 (2004)).
the United States and a foreign country. However, if there is one guiding policy that came out of Kirby, it is that international commerce demands uniformity and consistency. The Court’s holding that maritime law demands uniformity does not mean that courts can reject this requirement when the statute at issue is land-based. Maritime law demands uniformity because of its wide-reaching international and commercial implications. Therefore, the need for uniformity announced in Norfolk Southern Railway Company v. Kirby should be extended to equally apply to international carriage of goods cases involving federal land based statutes such as Carmack.

As this article shows above, holding the parties to their bargained-for limitation of liability in Sompo would not have eviscerated the liability scheme in Carmack. Instead, upholding the contracted limitation of liability would have promoted uniformity and consistency by reading Carmack and COGSA’s limitation of liability requirements as complementary, thereby promoting uniformity in the construction of two related statutes. Enforcing contracts between sophisticated parties also facilitates international carriage of goods by providing reliability and certainty – necessary elements of international trade. If the Supreme Court elects to resolve this split it should reiterate that Norfolk Southern Railway Company v. Kirby stands for the general policy that international commerce demands uniformity. Courts faced with potential conflicts between a contractual extension[s] of COGSA should therefore look to provide the “best fit” between the parties’ contractual intent and the language of the statute at issue. Only where genuine conflicts exist should the contract’s terms be voided - and only those conflicting terms should be voided.

V. Conclusion

Courts faced with the issue of whether Carmack applies to the domestic leg of an international intermodal shipment on a through bill of lading should look to the statute’s clear language and find that Carmack applies. However, the Kirby court’s proclamation that international carriage of goods requires uniformity in order to maintain efficient contracting should guide courts to seek clear rules that maintain as much of the parties’ contract as possible. As this article explains, Congress provided that carriers may limit their liability under both Carmack and COGSA. The limitation requirements established in these statutes are remarkably similar and what satisfies one should be read to satisfy the other if the facts of the case so allow. The Supreme Court should make this clear by resolving the circuit split in a way that applies Carmack uniformly but ensures that future courts look to only expel those contract terms that are directly at odds with the statute’s requirements. While
only Congress can create a liability scheme that meets the needs of this changed industry, courts should follow a simple policy in the mean time: avoid mining the waters of international commerce at all cost.
Canada's Railway Safety Regulatory Regime: Past, Present & Future

E. Wayne Benedict*

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I. Introduction

When accidents happen on the railway, catastrophe usually follows for individuals, the public, property, and the environment. The extreme

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weights involved in moving railway equipment give no quarter to anything unfortunate enough to get in its path—whether metal, rock, or flesh. In addition, trains regularly carry dangerous goods through populated urban areas; products whose potential to inflict death and destruction is immense and previously proven.

Canada is no stranger to railway accidents. Part II of this essay explores a few of the more recent accident examples. The country has a complex regulatory regime in place to ensure the safe operation of railways running within its borders, and the safety of those who could suffer damage as a result of railway mishaps—railway employees, the public, the environment. Part III of this essay examines Canada’s historical and current railway safety regulatory regime and the “deregulation” of railways, which began in the late 1980s. This part also discusses the present trend toward creeping re-regulation that seems to be occurring in light of a recent spate of headline-grabbing derailments in Canada. Part IV concludes the essay with the suggestion that the government should take back the self-regulation privileges that have been granted to the industry (such as self-inspection and safety management systems) and recognize that deregulation of safety, wherein the railway is responsible for the management of its own safety, is not adequately protecting the interests of the Canadian public, the Canadian environment, or Canadian railway workers.

II. RAILWAY ACCIDENTS IN CANADA

Canada is no stranger to railway accidents both large and small. This section explores a few of the more recent and devastating accidents that have occurred.

A. RAILWAY EMPLOYEES

Although rarely reported in newspapers, injuries and deaths of railway employees due to accidents on the job are not infrequent. In a contest between flesh and multi-ton moving railway equipment, the latter always prevails. For example, between 1991 and 2004, the Workers’ Compensation Board of British Columbia alone accepted lost time claims relating to work accidents from 282 yard locomotive engineers, 667 conductors/brakemen, 319 yard workers, and 331 track maintenance workers.1 Multiply those statistics across all provinces with operative railways

and one can imagine the magnitude of injuries and fatalities suffered by federally and provincially regulated railway employees.

A few recent examples reported in the press highlight the danger that railway employees face. On September 3, 2006, volunteer heavy equipment operator Bruce Harder, 45, was fatally crushed in a derailment on a deactivated section of the White Pass Yukon Railway that sent three other employees to the hospital. 2 On June 29, 2006, Canadian National Railway (CNR) conductor Don Faulkner, 59, and Brakeperson Tom Dodd, 55, were killed when their runaway train plunged into the Fraser Canyon; Locomotive Engineer Gordon Rhodes, 41, sustained injuries when he was thrown from the wreck. 3 Canadian Pacific Railway (CPR) employee Robert Murdock Martin, 44, of Bowden, A.B. was working on an ice-clearing crew in Glacier National Park on December 14, 2005, when a 300 kg. slab of ice fell on him—he died later in the hospital. 4 Darrell Ross, 42, a conductor with Southern Railway (SRY), died October 11, 2005, after being struck by a train that was being coupled in SRY’s Abbotsford works yard. 5 A CPR employee was fatally injured while working on the tracks as part of a train crew switching rail cars in the Scotsford Industrial area near Fort Saskatchewan on February 6, 2004. 6 In February 2003, near Belleville, exploding propane tank cars on CPR tracks—including one that was propelled more than a kilometer through the air—resulted in two seriously injured employees. 7 On May 14, 2003, CNR conductor Ken LeQuene and locomotive engineer Art McKay died when the locomotive they were riding in fell through a trestle bridge and burned near McBride B.C. 8 On December 30, 1999, an


5. Family of Dead Man Wants Answers, ABBOTSFORD TIMES, Oct. 21, 2005 at 8.


eastbound CNR train slammed into a "derailed tank car, sparking an explosion. Engineer Yves Theriault, 47, and conductor Paul Davis, 49, were killed instantly, and thirty-five tanker cars were consumed in the resulting fire." In April 1999, two VIA Rail engineers were killed when a Toronto-bound passenger train derailed on a track maintained by CNR near Thamesville. About seventy-five passengers suffered minor injuries. CNR employee William Carson died when a trestle bridge collapsed under the weight of the crane that he was operating which fell into a water-filled ravine during a project to replace wooden trestles with steel frames on October 27, 1997. "The freight train . . . two [employees] were riding in plunged into the Fraser Canyon eight miles south of Lytton on March 26, 1997, an hour and a half after a landslide swept away a portion of the embankment supporting the CNR's track." On August 12, 1996, Ken Trout, Jake Elder, and John Fraser died when their train slammed into runaway boxcars outside of Edson A.B. On January 20, 1995, two CPR crew members were killed when three locomotives and two freight cars carrying zinc sulphide fell thirty-eight meters into Kootenay Lake. Track foreman Roy Rabe, 48, died instantly June 4, 1992,
after being hit by a train.\textsuperscript{15} A CPR track maintenance employee died September 24, 1987, in an industrial accident near the Mayfair industrial park in Coquitlam.\textsuperscript{16}

Note that only a small fraction of the injuries and fatalities of railway employees across Canada are ever reported in the media; only the spectacular accidents are profitably newsworthy. Lost limbs and unremarkable fatalities are often buried in the back pages or omitted from publication altogether.

In 2005 unions representing CNR employees asked federal Transport Minister Jean Lapierre for a safety review of CNR, citing concerns about maintenance and inspection practices and such things as CNR’s decision to use long trains.\textsuperscript{17} Lapierre ordered a safety review of CNR’s operations.\textsuperscript{18}

\section*{B. The Public}

There are three major railway accidents in Canadian history that so profoundly affected the public that policy and regulatory changes resulted from the post-incident political fallout. The first major railway accident occurred in Mississauga, ON, on November 10, 1979, when twenty-four cars of a CPR train derailed at the Mavis Road crossing-at-grade after a journal burnt off, including tank cars of dangerous goods—Toluene, Liquefied Petroleum Gas (LPG), and Chlorine.\textsuperscript{19} Fire ensued and three of the LPG tank cars exploded causing extensive damage to property. A tank car loaded with Chlorine ruptured causing escape of the deadly product in gaseous form and nearly a quarter of a million citizens were evacuated for up to five days.\textsuperscript{20}

The second major railway accident occurred eleven miles east of Hinton, A.B., on February 8, 1986, when twenty-three people died and seventy-one were seriously injured in a collision between a CNR freight train and a VIA Rail passenger train.\textsuperscript{21} Property damage exceeded thirty

\footnotesize


\textsuperscript{15} CP Rail Charged in Worker’s Death, \textit{The Ottawa Citizen}, Nov. 12, 1993, at B1.


\textsuperscript{17} Gerry Bellett, Safety Review of CN Rail Ordered: Summer of Accidents Prompts Action by Transport Minister, \textit{The Vancouver Sun}, Sept. 2, 2005, at A2.

\textsuperscript{18} \textit{Id.}


\textsuperscript{20} \textit{Grange Comm’n, supra note 19, at 1-2.}

million dollars and the environment was polluted by spilled sulfur, diesel fuel from damaged locomotives, and fire.\textsuperscript{22}

The third railway accident that affected safety regulatory policy in Canada occurred on Monday, August 12, 1996. All three occupants in the operating cab of the lead locomotive of CNR westward freight train No. 117 were fatally injured in their train, which was travelling at about 54 mph when it collided head-on with a cut of twenty runaway cars moving eastward at about 30 mph, some six miles east of Edson, A.B.\textsuperscript{23} The repercussions of this accident are discussed in Part III. A. below.

There are several other more recent railway accidents that have similarly affected the public in general. For instance, on September 30, 2006, traffic was blocked at downtown Abbotsford railway crossings and power cut to 6,500 homes for six hours after twelve cars on a westbound Southern Railway train jumped the track.\textsuperscript{24} About 250 passengers on a Via Rail Toronto-Ottawa train were delayed for five hours on October 1, 2006, when three carriages left the tracks.\textsuperscript{25} On July 14, 2006, 65,000 Toronto GO Transit commuters were told to find alternate transportation home after a CNR freight train derailed in the city’s western suburbs.\textsuperscript{26} And on May 28, 2006, hundreds of passengers were evacuated from a Rocky Mountaineer Vacations train after a six car derailment.\textsuperscript{27} On May 2, 2005, an Ottawa Central Railway train collision in Maxville resulted in the spill of 98,000 liters of ethanol and the evacuation of roughly 200 residents.\textsuperscript{28} On August 8, 2004, a derailment in Estevan forced a number of residents to leave their home and jobs as a result of an anhydrous ammonia leak from one of the derailed cars.\textsuperscript{29} On April 12, 2002, a VIA Rail train carrying 109 passengers and fourteen crew, traveling at more than 70 km/h derailed in Stewiacke, folded like an accordion, and crashed into a feed store. An estimated twenty-four of the 123 people on board the

\begin{itemize}
\item \textsuperscript{22} Wikipedia, \textit{Hinton Train Collision} at 3.
\item \textsuperscript{23} \textsc{Trans. Safety Bd. of Canada}, \textsc{Railway Investigation Report R96C0172}, \textit{supra} note 14.
\item \textsuperscript{24} Christina Toth, \textit{Train Wreck Takes Out Power, Abbotsford Times}, October 3, 2006, at 1.
\item \textsuperscript{25} \textit{Derailment Delays VIA Riders for Five Hours, The Ottawa Citizen}, Oct. 3, 2006, at B3.
\item \textsuperscript{26} \textit{Thousands Stranded by Toronto Derailment, Calgary Herald}, July 15, 2006, at A11.
\item \textsuperscript{27} \textit{Train Derailment, The Province}, May 29, 2006, at A3.
\item \textsuperscript{28} Kevin Lajoie, \textit{Faulty Brake Application Resulted in Train Collision, Standard-Freeholder}, Apr. 21, 2006, at 2.
\end{itemize}
train were injured, some seriously but there was no loss of life.\textsuperscript{30} In Red Deer, A.B., on February 2, 2001, the derailment of two cars of toxic chemicals caused one fatality and the evacuation of 1,300 people, thirty-four of whom were treated in hospitals.\textsuperscript{31} On December 30, 1999, two CNR trains carrying petroleum products and waste respectively collided causing several explosions and a major fire; 700 people were evacuated from their Mont-St-Hilaire residences near the crash site and passenger and freight rail operations between Montreal and Quebec City were halted or diverted for several days.\textsuperscript{32} On February 15, 1986, forty-two people were injured when a Via Rail passenger train from Moncton to Montreal rammed a stationary CNR freight train on a siding at Bernieres, the third accident in a week for Via Rail. It prompted the then Transport Minister Don Mazankowski to order a sweeping crackdown on the safety practices of railways and their employees.\textsuperscript{33}

C. The Environment

In addition to the Mississauga and Hinton disasters mentioned above, the following environmentally detrimental railway accidents are notable. On August 2, 2006, twenty loaded cars of a 124-car CPR coal train travelling on CNR track derailed on a railway bridge over the Thompson River; twelve loaded cars of coal spilled into the fish-bearing river.\textsuperscript{34} On June 4, 2006, 200,000 liters of petroleum products spilled from four tank cars, half of which spilt into the Riviere-du-Loup, after a CNR derailment 250 kilometers north of Quebec City.\textsuperscript{35} The derailment of a forty-four car CNR train on August 3, 2005, spilled 730,000 liters of bunker C oil and wood preservative into Lake Wabamun near Edmonton.\textsuperscript{36} Two days later, a CNR derailment in the Cheakamus Canyon near Squamish spilled 40,000 liters of sodium hydroxide into the Cheakamus and other rivers, which wiped out fish stocks.\textsuperscript{37}

On August 31, 2005, just west of Hope nine CNR cars that jumped

\textsuperscript{32} Fatal Wreck to Stall Rail Service for Days, Toronto Star, Jan. 1, 2000, at 1. See also Transp. Safety Bd. of Canada, supra note 9.
\textsuperscript{34} Derailment Dumps Coal in River, National Post, Aug. 3, 2006, at A6.
\textsuperscript{35} CN Cleaning Up After Derailment, Journal-Pioneer, June 7, 2006, at 6.
\textsuperscript{36} Bellett, supra note 17. See also Toxic Spill, Pollution and Urbanization Put Rivers at Risk, The Leader, Mar. 29, 2006 at 25.
\textsuperscript{37} Id.
the track spilled sulphur from open rail cars. A wildfire in May 2001 that started beside CNR rail tracks near Chisholm consumed 1,045 square kilometers of forest and wiped out about a dozen homes and other buildings. Hundreds of firefighters took weeks to quell the blaze at an estimated cost of $31 million. The fire likely started by sparks flying from a faulty wheel on a freight train; CNR, while not admitting guilt or responsibility, paid $10 million in cash and $8.6 million over the next decade toward property damage and a long list of fire-prevention projects in settlement of a lawsuit initiated by the Alberta Crown.

On February 2, 2001, four rail tankers derailed near Red Deer, one of which began leaking toxic ammonia fertilizer. Seventy-five to eighty tons of pressurized ammonia leaked from the tanker, some of which vaporized into a deadly gas. On January 20, 1995, three locomotives leaking diesel and two freight cars carrying zinc sulphide fell into Kootenay Lake. On October 30, 1987, 16 rail cars of a BC Rail train derailed and an estimated 200 tons of sulphur were dumped into the Cheakamus River. Deadly sulphur-dioxide gas, generated when friction ignited spilled sulphur, settled around the wreck. On March 10, 1980, thirty-one cars of a CNR freight train derailed near MacGregor M.B., twelve of which were carrying vinyl chloride monomer. Two of those cars leaked product into the environment.

The foregoing is but a small slice of the most recent railway accidents in Canada. From these news stories, one can see the need for effective regulation of railway safety to safeguard the interests of the public and society, the environment, and railways and their personnel.

III. CANADA'S RAILWAY SAFETY REGULATORY REGIME

Canada's federal and provincial governments have long recognized the need for effective safety regulation and enforcement of same in the railway industry. While provincial governments regulate railways that

38. Bellet, supra note 17, at A2.
43. RY. TRANSP. COMM., W. DIV., SASKATOON, SASKATCHEWAN, CANADIAN TRANSP. COMM'N, REPORT ON INQUIRY INTO THE DERAILMENT OF CNR TRAIN B806QM09 ON MARCH 10, 1980 AT DEER, MANITOBA, OTHERWISE REFERRED TO AS "THE MACGREGOR DERAILMENT" (1980).
44. For a brief historical review of some of Canada's more disastrous railway accidents, see HUGH A. HALLIDAY, WRECK!: CANADA'S WORST RAILWAY ACCIDENTS (Toronto: Robin Brass 1997).
operate solely within the borders of the applicable province, the federal government regulates the safety of inter-provincial and international railway operations. This essay focuses on Canada’s federal railway safety regulatory regime.

A. THE PAST

For most of the first century after Canada first had railways, the industry was heavily regulated. The Railway Act of 1868 created the Railway Committee. By the Railway Act of 1903, the Board of Railway Commissioners was established in 1904 with “powers and jurisdiction . . . comprehensive in their scope [and] far-reaching in their effects.” The Board of Railway Commissioners had regulatory jurisdiction over federally regulated railways until 1938 when, by virtue of The Transport Act, it was replaced by the Board of Transport Commissioners, which had “authority over inland waterways and airlines, along with jurisdiction over railways, telegraphs, telephones, and express companies.” The Board of Transport Commissioners existed until 1967 when the National Transportation Act caused the amalgamation of the Board of Transport Commissioners, the Air Transport Board, and the Canadian Maritime Commission, which formed the new Canadian Transport Commission (CTC). “The [CTC’s] mandate was to deal with all modes of transport as a competitive whole ‘with the object of co-ordinating and harmonizing the operations of all carriers engaged in transport by railways, water, aircraft, extra-provincial motor vehicle transport and commodity pipelines.’”

The CTC exercised three main functions over the transportation industries in Canada: adjudication, economic and safety regulation, and accident investigation. “This could lead to a conflict of interest where all

46. Railway Act, 1868 S.C., ch. 68 (Can.).
47. Railway Act, 1903 S.C., ch. 58 (Can.).
49. The Transport Act, 1938 S.C., ch. 68 (Can.). See also CANADIAN TRANSP. AGENCY, supra note 48, at 26.
50. CANADIAN TRANSP. AGENCY, supra note 48, at 30.
51. National Transportation Act, 1967 S.C., ch. 68 (Can.). See also CANADIAN TRANSP. AGENCY, supra note 48, at 48.
52. Id.
53. Id. at 53.
three of these functions were carried out by the same body."

After the Mississauga disaster, the Privy Council took the extraordinary measure of appointing a Board of Inquiry to investigate it. This was unusual because "[t]he railway industry and its accidents [were] by statute under the continuous [jurisdiction] of the Canadian Transport Commission." In addition to recommending more stringent regulation regarding dangerous goods transportation, the Grange Commission recommended that the "CTC should continue and expand its Monitoring of Train Operations Programme [because] the supervision of train repairs and train inspections cannot be left entirely to the railways." The Commission also recommended that the "CTC should continue and expand its independent investigations of accidents and should report thereon regularly to the public." As a result of the inquiry into the Hinton disaster, the Foisy Commission stated that "the legislative and regulatory environment within which the railway system operates, including the supervisory activities of the CTC, the process whereby regulations are promulgated and enforced, and the effectiveness and rigour with which the CTC moves to correct identified problems, is inadequate."

By the late 1980s, the federal government believed "that safety, no matter what the prevailing regulatory environment might be, should be addressed through the development and enforcement of effective safety standards and education, not by increasing the degree of economic regulation." A major reorganization of the transportation regulatory regime took place in 1988. The amended National Transportation Act became law on January 1, 1988, and the CTC was disbanded, its functions being split between various new bodies. The adjudicative function was vested in the National Transportation Agency, which became the Canadian Transportation Agency in 1996. More importantly (for the purposes of this paper) the regulatory function, including safety regulation, was vested in Transport Canada and the investigative function was vested in

55. Grange Comm'n, supra note 19, at i.
56. Id. at 207-8.
57. Id. at 208.
58. Foisy Comm'n, supra note 21, at 5.
60. National Transportation Act, 1987 S.C., ch. 34 (Can.).
61. Canada Transportation Act, 1996 S.C., ch. 10 (Can.).
the Transportation Safety Board of Canada. This reorganization/deregulation "effectively created the institutional separation of rail safety regulation, accident investigation and economic regulation." As a result of the Edson accident in 1996, the Transportation Safety Board of Canada identified six broad areas of safety concern that were putting the rail transportation system at risk. The Board questions: [1] The effectiveness of standard railway operating procedures and practices for securing equipment from the perspective of determining how many hand brakes to apply, the training and supervision of operating personnel, and any special considerations that may pertain at particular locations. [2] The adequacy of the rail traffic control system for detecting runaways from the perspective of the ergonomics of workstation displays and warnings, and the policies, procedures, and training for controllers. [3] The variability of braking effectiveness on Government grain covered hopper cars with respect to the design of the hand brakes and their maintenance and the apparent lack of knowledge among railway employees of that variability. [4] The adequacy of rail safety regulatory overview with respect to the capability to evaluate the rail industry's compliance with national safety standards. [5] The effectiveness of company safety management programs from the perspective of ensuring that safety-related information is effectively communicated. [6] The extent to which the railways rely on strict rules compliance, often as the only defence against human error. . . . [T]he Board has issued two recommendations: one aimed at improving employee understanding of the wide variability in hand brake effectiveness, particularly on Government grain covered hopper cars, and one aimed at improving the regulator's ability to effectively evaluate the railways' ability to maintain national safety standards. In addition, in its future investigations of rail occurrences, the Board will continue to assess both the effectiveness of the railways' supervisory policies, procedures and practices, and the degree to which the railways are able to balance the role of rules compliance with the need for a safety system that is resistant to human error.

B. The Present

1. Transport Canada

Presently in Canada, Transport Canada regulates railway safety and the Transportation Safety Board of Canada investigates and reports on railway accidents. One of Transport Canada's mandates is to carry out the objects of the Railway Safety Act.

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64. Canadian Transportation Accident Investigation and Safety Board Act, 1989 S.C., ch. 3 (Can.).
66. TRANS. SAFETY BD. OF CANADA, supra note 14 (emphasis added).
(a) promote and provide for the safety of the public and personnel, and the
protection of property and the environment, in the operation of railways; (b)
encourage the collaboration and participation of interested parties in im-
proving railway safety; (c) recognize the responsibility of railway companies
in ensuring the safety of their operations; and (d) facilitate a modern, flexi-
ble and efficient regulatory scheme that will ensure the continuing enhance-
ment of railway safety. 68

Transport Canada believes that "[u]nder the Railway Safety Act, re-
ponsibility for safety lies with those who are subject to the Act [the rail-
ways themselves]. Railway companies must conform to the requirements
of the Act and related rules and regulations in operating and maintaining
their railways." 69

In 1993, Transport Canada predicted that "[o]ne third of the rail
safety regulations [would] be revoked, and another half would be revised
to reflect new technologies and maintenance practices or reoriented to
performance standards." 70 Subsequent to the deregulation of the trans-
portation industries, the railway safety regulatory regime has become one
of practical self-regulation whereby the railways themselves formulate
safety rules which the regulator must then approve. 71 With regard to en-
forcement and compliance:

[a]n inspector's key compliance and safety activities involve: MONITORING:
Inspectors ensure compliance through audits and inspections. They also in-
vestigate complaints and incidents. ENFORCEMENT: In the event of non-
compliance, inspectors are also required to enforce legal obligations, which
can result in the prosecution of corporations and individuals. PROMOTION:
Inspectors routinely advise individuals and groups on legal and regulatory
requirements. By promoting awareness of the requirements, these activities
enhance safety and security. 72

In practice, Transport Canada's Railway Safety Inspectors (RSIs)
have relied on the railways' voluntary compliance and only as a last resort
would they issue notices or orders under Railway Safety Act Section 31. 73
In fact, "[a]n order can only be issued when there is an immediate threat
to safe railway operation [and the] railway may request an immediate
review and the Minister has the power to revoke or alter the decision of
the Inspector. Finally, the order may not tell the railway how to resolve

68. Id. § 3.
69. Transport Canada, The Role of Railway Safety Inspectors (emphasis added),
72. Id.
73. Ry. Safety Act Review Comm., supra note 65 at 70. See also Churcher, supra note 54, at 16.
the problem because this is a management prerogative."74

Only in the last decade has Transport Canada begun to prosecute railways for non-compliance under Railway Safety Act Section 41 and the Canada Labour Code?5 Section 148.76 Prior to 1994, the Railway Safety Directorate of Transport Canada had never used Railway Safety Act Section 41 because it did "not believe that the use of [the section was] an appropriate avenue for safety enhancement."77 The Railway Safety Management System Regulations?8 allow railways the opportunity to "define the safety plan and regime against which their safety and compliance performance will be assessed."79 Under deregulation "[i]t is now very clear that the railway is responsible for the management of its own safety."80 In 2001, Transport Canada reaffirmed that "[m]onitoring the transportation industry to ensure the continued fulfillment of safety obligations that have been granted to industry (i.e. self-inspection, safety management systems) will continue to be one of the department's key priorities."81

2. Transportation Safety Board of Canada

The Transportation Safety Board of Canada's mandate is:

to advance transportation safety by (a) conducting independent investigations, including, when necessary, public inquiries, into selected transportation occurrences in order to make findings as to their causes and contributing factors; (b) identifying safety deficiencies as evidenced by transportation occurrences; (c) making recommendations designed to eliminate or reduce any such safety deficiencies; and (d) reporting publicly on its investigations and on the findings in relation thereto.82

In making its findings as to the causes and contributing factors of a transportation occurrence, it is not the function of the Board to assign fault or determine civil or criminal liability, but the Board shall not refrain from fully reporting on the causes and contributing factors merely because fault or liability might be inferred from the Board's findings.83

78. Railway Safety Management System Regulations, SOR/2001-37 (Can.).
79. Railway Safety Compliance Policy, supra note 76.
80. Churcher, supra note 54 at 14, 15.
82. Canadian Transportation Accident Investigation and Safety Board Act, 1989 S.C., ch. 3 § 7(1) (Can.).
83. Id. § 7(2).
In 1994, the government received a recommendation that the "TSBC should adopt risk management as a fundamental organizational principle."\textsuperscript{84} The government agreed and added that "risk management principles [prove] especially useful in setting priorities and allocating resources."\textsuperscript{85} This is an important point since "only 1.3 per cent of all accidents are investigated by the TSB"\textsuperscript{86} and thus the Board must apparently prioritize heavily when allocating the sparse resources it procures from the federal government to fulfill its mandate.

3. \textit{Statistics}

How has Canada’s railway safety fared under deregulation?

\begin{center}
\textbf{ACCIDENTS 1981-1990} \textsuperscript{87}
\end{center}


From the foregoing statistics, it appears deregulation may have initially contributed to lower reportable incident rates, fatalities, and injuries. However, while railway accident rates were in a decade-long steady decline under the more rigorous pre-1989 regulatory system, after deregulation, accident rates shot up dramatically until 1996. Once again, since 2002, railway accident rates in Canada have been suffering a steep increase. In a recent report, the TSB made the following findings:


Although railways recognize the accelerated rate of track degradation associated with bulk unit train tonnage on secondary main lines, the occurrence record indicates that an appropriate balance between increased track degradation and timely infrastructure maintenance and/or renewal has not been achieved. Although railways are responsible for putting measures in place to keep the track safe and in compliance with the Railway Track Safety Rules (TSR), the TSR may be insufficient to ensure safety because they do not consider the adverse effects of overall increased traffic and specifically bulk unit train tonnage on secondary or feeder track systems over the long term. Inadequately inspected and maintained rail joints represent a critical point of vulnerability since they are prone to defect development and failure. Inspections of rail joints using current rail defect detection equipment or geometry cars are unable to identify joint bar defects. . . . While rail defect testing reduces the risk of broken rail derailments, the detection of all internal rail defects is not within the capacity of the defect testing methods currently in use.91

British Columbia recorded 15 main-track train derailments in the first five months of 2006, up from 12 in the same period of 2005 according to the TSB.92

C. The Future

In January 2004, "[a] group of railway industry professionals [called] for Ottawa to conduct an inquiry on rail safety [after a] train derailment, which killed two women in Whitby. A Canadian Pacific train jumped the rails and several containers rolled down an embankment, crushing a car and its occupants."93

Winston Smith, . . . a Winnipeg-based lawyer who lectures at the University of Manitoba on rail safety, says the group of like-minded railway professionals got together to shine a spotlight on 'a disturbing trend' of derailments that raise 'concerns about the safety of railway operations in Canada.' . . . 'Our concern here is about the deteriorating condition of the railway bed,' said Smith. 'The railways will tell you they're spending a lot of money on upgrading their cars and siding lengths. What they're ignoring in our view is the maintenance and inspection practices. There's fewer and fewer people out there and fewer inspections taking place.' Smith said an inquiry should look at whether Transport Canada should regulate railways and conduct maintenance checks, or audit the checks that are now [done] by the railways themselves. 'Railways have been allowed in the last little while to regulate their own safety,' said Smith. 'Do we go back into regulation? Something's got to happen to force the railways to start concentrating on keeping (the track bed) conditioned to handle the heavier cars, the longer trains and it

91. Id at 23.
93. McGran, supra note 7.
appears they're not spending the money to do so."[94] Only 1.3 per cent of all accidents are investigated by the TSB, with the rest filed under 'data collection.' . . . [S]erious accidents not probed by the TSB include some in which dangerous goods such as ammonium nitrate, sodium chlorate and sulphuric acid were spilled. The TSB says it's at the limit of its staff and has to be selective in what it investigates—injuries, evacuations and magnitude of damage are factors considered. . . . Transport Canada—the rail industry's regulator—is either unable or unwilling to prosecute the railways, with five convictions from seven prosecutions since 1999 under the Railway Safety Act, a span that includes 7,658 accidents. . . . Critics—unions, environmentalists and former rail employees—believe the industry accepts derailments as the cost of doing business, that speed is more important than safety [and] they're not happy the industry is allowed to write its own rules and rewrite recommendations from the investigating body before accident reports are published.[95]

"In the past 10 years, CN Rail has been prosecuted seven times for offences under the Railway Safety Act. In the same period, there have been no prosecutions of its competitor, CP Rail—the second largest rail carrier in Canada. Of those seven charges, CN Rail pleaded guilty on three occasions and was acquitted once. Three cases were still before the courts [in September 2005]."[96] In one of those cases, CN pled guilty under the Railway Safety Act and was fined $75,000 while two charges under the Canada Labour Code were stayed.[97]

A March 8, 2006, editorial in the Toronto Star called on Ottawa to "consider taking a more active role in pressing regulations on" the railway industry after "analyzing accident reports produced by the Transportation Safety Board and obtained through a federal access to information request, the Star found there were 1,246 train accidents [in 2005]—more than in any year over the past decade—including 215 accidents involving hazardous and toxic loads."[98] Presently a federal NDP Member of Parliament is pressing for an "inquiry based on recent figures showing a sharp increase in rail accidents across Canada" and that given the "number of violations of the Railway Safety Act[, t]he government must urgently and immediately take up the responsibility for the public's safety."[99]

In light of the increased rate and notoriety of railway accidents in Canada, Transport Canada Railway Safety Inspectors appear to have increased their use of enforcement tools; viz. orders under Railway Safety

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94. Id.
95. McGran, supra note 86.
96. Bellett, supra note 17.
97. Keating, supra note 76.
Act Section 31. In December 2005, Transport Canada ordered CNR to observe “specific safety requirements ‘to help ensure they can operate safely’ on a section of track near Squamish, B.C.” on the former BC Rail line where CNR had several notorious derailments in 2005.\textsuperscript{100} However, creeping re-regulation through inspectors’ reactive \textit{ad hoc} use of notices and orders, while commendable, will not cure the problems with Canada’s virtually self-regulated railway safety regulatory regime.

In order to restore the confidence of the Canadian public in the safety of railway transportation in Canada, Parliament must move to restore rail safety regulatory power primarily to Transport Canada or an equivalent independent body. Government should take back the “safety obligations that have been granted to industry (i.e. self-inspection and safety management systems)” and recognize that deregulation of safety wherein “the railway is responsible for the management of its own safety” is not adequately protecting the interests of the Canadian public, the Canadian environment, or Canadian railway workers. To private railway companies, whose \textit{raison d’être} is to make maximum profits, expensive investments in safety—i.e. proactive track and equipment maintenance—will always be subordinate to other competitive factors when subjected to a cost-benefit analysis. There is an inherent conflict of interest in vesting the subject of regulation with the power of self-regulation. In the context of railway safety—where thousands of tons of steel and dangerous commodities careen through our communities twenty-four hours a day, seven days a week, Canadians cannot afford to allow that conflict to continue.

In August 2006, Lytton’s Mayor Chris O’Connor called on “[c]ommunities . . . to put pressure on the provincial and federal governments to raise the safety standards of Canada’s railways.”\textsuperscript{101} There is hope that Canada’s parliamentarians are beginning to take note. On October 31, 2006, the all-party Standing Committee on Transport, Infrastructure and Communities “unanimously decided to conduct an in-depth inquiry into rail safety in Canada and particularly rail accidents in British Columbia and Western Canada.”\textsuperscript{102}

What the future holds for Canada’s railway safety regulatory regime is difficult to discern.\textsuperscript{103} However, if the trend toward increased rates of railway accidents continues unchecked, it is only a matter of time before


\textsuperscript{101} UTU Local 353 London, \url{http://www.utu353.org/News/2006/Aug06/standards.php} (last visit May 12, 2007).

\textsuperscript{102} Scott Simpson, \textit{MPs Set to Grill CN Over Railway Safety in B.C.}, \textit{The Vancouver Sun}, Nov. 3, 2006, at H3.

\textsuperscript{103} This is particularly the case given the recent election of a free-market oriented, industry
Canadians are confronted with another Mississauga, Hinton, Edson, or worse.

IV. Conclusion

Trains are fast, powerful, may weigh many thousands of tons, often carry explosive or deadly poisonous dangerous goods, and operate day and night around the clock through our communities, mere meters from our homes and our children’s schools. Accidents can and do happen, often with fatal and sometimes with catastrophic results. Railways’ potential to inflict death and destruction is immense and previously proven.

The deregulation of Canada’s railway safety regulatory regime, which occurred in the late 1980s, making the railway responsible for the management of its own safety has not, and is not, adequately protecting the interests of the Canadian public, the Canadian environment, or Canadian railway workers. In order to restore the confidence of the Canadian public in the safety of railway transportation in Canada, Parliament must move to restore rail safety regulatory and effective enforcement power to Transport Canada, or an equivalent independent body. It is time for government to take back the safety obligations that have been granted to the railway industry; viz. self-regulation.

friendly minority federal Conservative government. It was the Mulroney Conservatives that initially deregulated railway safety in 1989.
The Evolving Pipeline Regulations:  
Historical Perspectives and a New Model for  
Pipeline Safety in the Arctic National  
Wildlife Refuge

Michael T. Jewell*

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I. INTRODUCTION

Significant questions lie beyond the political issue of drilling for oil in the Arctic National Wildlife Refuge (ANWR) regarding the safe removal and transport of its vast petroleum reserve.¹ This reserve exists largely within the 1.5 million acre coastal plain of ANWR that is referred as the "1002 area" from its reference in the Alaska National Interest Lands Conservation Act of 1980 (ANILCA).² The economic viability of ANWR drilling rests partially on the ability to transport the petroleum from the remote and harsh Alaskan wilderness.³ Pipelines hold the critical answer to this transport issue as few alternatives exist for petroleum transport. The base infrastructure for pipelining minerals from Northern Alaska is the 800 mile Trans-Alaska Pipeline (also known as TAPS or the Alyeska Pipeline) that currently serves to move petroleum from the Prudhoe Bay fields to Valdez in Southern Alaska.⁴ The distance between the potential oil fields of the 1002 area in ANWR and TAPS ranges seventy-five to two hundred miles, but these lines travel through federal land before reaching a connection point with TAPS.⁵ While Congress and lobbyists battle to answer the question of whether drilling should be allowed,⁶ responsible plans for pipeline development in ANWR that is safe and environmentally proactive should be prepared to make available the strategic reserve of domestic oil while preserving our environmental

⁶ See Robert W. Corbisier, The Arctic National Wildlife Refuge, Correlative Rights, and Sourdough: Not Just for Bread Anymore, 19 Alaska L. Rev. 393 (a good discussion of reasons for development of the ANWR oil fields. This discussion is beyond the scope of this paper, but it is helpful to be familiar with the political situation from both the environmental and developmental perspectives).
treasures and heritage. This comment outlines a short history of the development of pipeline regulations through an examination of legal milestones that involve economic regulation, constitutional law, safety regulation, and environmental law. This comment also argues that potential oil operations in ANWR invite a new era for pipeline regulation in environmentally sensitive federal areas.

II. PIPELINE REGULATIONS: A HISTORICAL PERSPECTIVE

A. EARLY ATTEMPTS AT PIPELINE CONSTRUCTION

The first pipelines in the United States lacked regulatory oversight with respect to commerce, safety, and environmental issues. Attempts to build the first operational pipelines by S.D. Karns and J.L. Hutchinson in West Virginia failed in 1862.7 Hutchinson’s best attempt, which relied on siphoning, delivered only fifty of 1,000 barrels sent through the pipeline.8 This meant 950 barrels were lost either because of leaking en route or a failure to budge over the line. Early pipelines were made from wood and were either above ground or in shallow ditches.9 While these wooden pipelines promised a better transportation system compared to the traditional use of oak barrels, the lack of regulatory oversight meant that early development would occur at the expense of the environment.10

This absence of regulations also emphasized anticompetitive dangers. Tidewater, built in 1879 to connect the Oil Regions of Pennsylvania to the Reading Railroad, was the first long distance pipeline.11 Its construction and operation by Standard Oil revealed the economic efficiencies that pipelines offered but it also extended Standard’s use of methods that led to unfair competition.12

B. INTERSTATE COMMERCE COMMISSION: ECONOMIC REGULATION AND CONSTITUTIONALITY

The first federal agency to address economic fairness issues in pipeline usage, the Interstate Commerce Commission (ICC),13 implemented tariff controls under the Hepburn Act of 1906.14 The ICC’s tariff efforts

7. WILLIAM W. THORNTON, THE LAW OF OIL AND GAS 57 (Simeon S. Willis rev. and rewritten).
8. Id.
9. Id.
10. Id. at 56-57.
12. See id. at 39-44.
resulted in weak regulatory oversight until the late 1930’s when “fair valuation” methodologies became the standard for determining pipeline usage rates.15

The real effects of the ICC on pipeline oversight were the constitutional challenges that the ICC’s regulations raised. The Pipeline Cases provides a helpful analysis for understanding the constitutionality of the Hepburn Act. Particularly, an issue in The Pipeline Cases was whether the government may require an oil company to post rates and schedules concerning interstate oil transports even when a company ships only its own oil across state lines through its own pipelines. The court held that the government’s exercise of power was constitutional and recognized that the former Standard Oil subsidiaries required other companies to sell their oil to them before shipping it on the pipeline.16 The pipelines were supposed to be common carriers, not dealers who could conduct business on their own terms. The issue of constitutionality qua commerce among the states was clear;17 it just took the ICC’s requirement of rate posting to level the playing field in the era after Standard Oil. Economic oversight thus provided the impetus for fair business dealing in the pipeline sector of the oil transportation business.

The broad constitutional power of the commerce clause empowered the ICC to regulate in ways that proved to be a snare to oil companies. In Champlin Refining Company v. United States, Champlin Oil ("Champlin") found that despite the fact that it carried its own product to its own refineries in its own pipelines, it would be deemed a “common carrier” due to ICC requirements to file inventory of its property for purposes of valuation. Arguing that “transportation” did not apply to the movement of one’s own goods for the purposes of the commerce clause, Champlin sought relief from having to be considered a “common carrier” under 49 USC §1 (omitted).18 Resting on the Valvoline decision,19 the court held that the distinction Champlin argued did not hold because “[t]hese interstate facilities are operated to put [Champlin's] finished products in the market in interstate commerce at the greatest economic advantage,”20 thereby upholding a broad interpretation of the commerce clause.

Despite its progress in asserting economic regulation through tariffs and establishing constitutional authority in its regulation of pipelines, the

15. Id.
17. Id. at 560.
20. Champlin, 329 U.S. at 34.
ICC did little to provide steps toward pipeline safety and environmental protection.

C. DEPARTMENT OF TRANSPORTATION – SAFETY AND ADMINISTRATION

Congress created the Department of Transportation (DOT) in 1967. Its stated mission is to
develop and coordinate policies that will provide an efficient and economical
national transportation system, with due regard for need, the environment,
and the national defense. It is the primary agency in the federal government
with the responsibility for shaping and administering policies and programs
to protect and enhance the safety, adequacy, and efficiency of the transporta-
tion system and services.

The transition of safety administration from the ICC to the DOT marked the start of intensified safety regulations. Safety regulations for pipelines were originally administered by the Surface Transportation Board, which also regulated railroads and interstate trucking. The DOT deemed this arrangement to be inadequate to the challenges presented by
pipeline regulation. So, in 2004, Congress created a new sub-agency of
the DOT, called the Pipeline and Hazardous Materials Safety Administra-
tion (PHMSA), to oversee the special needs of pipelines. PHMSA’s
stated purpose is to provide “the Department [of Transportation] a more
focused research organization and establish a separate operating adminis-
tration for pipeline safety and hazardous materials transportation safety
operations.” Pipeline safety administration authority lies with another
older agency below the PHMSA, the Office of Pipeline Safety (OPS). Created in 1968, OPS is to “oversee and implement pipeline safety regu-
lations.” OPS maintains five regional offices around the United
States and it demonstrates a level of federalism through its cooperation
with individual state partners, which often include state public utilities
commissions.

The pipeline safety statutes\(^{29}\) prescribe "minimum safety standards"\(^{30}\) that apply to owners and operators of pipeline facilities,\(^{31}\) their design, installation, inspection, emergency plans, \textit{inter alia},\(^{32}\) to protect the public from accidents. The statute also seeks to protect pipeline operators and employees by establishing qualifications for operators.\(^{33}\) Accidents occur despite these laws and fuel media attention for their impact on human life and the environment. A sample of pipeline incidents describe how DOT safety regulations coupled with lax OPS oversight\(^{34}\) did not equate to environmental security:

An oil spill that released 90,000 gallons of light crude in sensitive coastal marsh environment\(^{35}\) near Lafitte, Louisiana, occurred on April 6, 2002.\(^{36}\) The spill was effectively contained, but not before substantial environmental threat arose.\(^{37}\)

On June 10, 1999, a pipeline carrying gasoline ruptured near Bellingham, Washington, and released about 237,000 gallons of gasoline into a nearby creek\(^{38}\) killing two boys and one man.\(^{39}\) A report later blamed OPS for failing to adopt National Transportation Safety Board (NTSB) recommendations for safety improvements.\(^{40}\)

In 2002, Defenders of Wildlife produced a study of oil spills in Kenai National Wildlife Refuge that contains, among other things, an admonition not to drill in ANWR given the cognate situation in Kenai.\(^{41}\)

These stories show that in the public's eye, DOT regulations failed to provide pipeline safety in a manner that protected the environment. PHMSA believes that pipelines are extremely safe when compared to other modes of transportation.\(^{42}\) Spills occur rarely at a rate of one gallon per million barrel-miles, and deaths due to pipeline transport are 1/

\(^{29}\) 49 U.S.C. § 60101 \textit{et seq.}


\(^{32}\) \textit{Id.} § 60102 (a)(2)(B).

\(^{33}\) \textit{Id.} § 60102 (a)(3).


\(^{35}\) \textit{Id.}


\(^{37}\) \textit{Id.}

\(^{38}\) NTSB Report, supra note 34, at 1.

\(^{39}\) NTSB Report, supra note 34, at 1.

\(^{40}\) \textit{NTSB Chief Raps Pipeline Agency's Record on Safety, Congressional Panel to Hold Hearing, SEATTLE TIMES, Jul. 27, 1997, at B1.}


87th of deaths occurring among oil trucking.\textsuperscript{43} The high-volume loads of pipelines remain the key factor of environmental threat when compared to trucking accidents.\textsuperscript{44} New regulations must therefore demand that safety equals environmental protection. Legislative actions in 2002 and 2006 moved to make this a closer reality.

D. Pipeline Safety Improvement Act of 2002

Safety concerns and an ever-growing history of OPS blundering spurned the passage\textsuperscript{45} of the Pipeline Safety Improvement Act of 2002 (PSIA-2002).\textsuperscript{46} The provisions of PSIA-2002 were originally part of the failed Energy Policy Act of 2002,\textsuperscript{47} which failed at least in part because it contained provisions for opening ANWR to oil drilling.\textsuperscript{48} The Energy Policy Act suggested that increased safety measures would be required for any potential pipeline transportation systems given the presence of safety protocols within the bill. Key provisions of PSIA-2002 that change safety measures to attempt to prove that safety can equal environmental protection include:

- Adoption of best practices protocol;\textsuperscript{49}
- Defined state oversight;\textsuperscript{50}
- Public education programs\textsuperscript{51} and pipeline safety information grants to communities;\textsuperscript{52}
- Employee protection;\textsuperscript{53}
- Real penalties for violation of safety orders;\textsuperscript{54}
- Population encroachment and rights-of-way;\textsuperscript{55}
- Pipeline integrity, safety, and reliability research and development;\textsuperscript{56} and
- Verification of Pipeline Qualification programs.\textsuperscript{57}

\textsuperscript{43} Id.
\textsuperscript{44} Parker, supra note 26, at 246.
\textsuperscript{45} Parker, supra note 26, at 244-49.
\textsuperscript{48} Parker, supra note 26, at 260.
\textsuperscript{49} Pipeline Safety Improvement Act § 2(c)(1)(a) (amending 49 U.S.C.A. § 6105).
\textsuperscript{50} Id. § 4 (amending 49 U.S.C. §60106).
\textsuperscript{51} Id. § 5 (amending 49 U.S.C. §60116).
\textsuperscript{52} Id. § 9 (amending 49 U.S.C. §60130).
\textsuperscript{53} Id. § 6 (amending 49 U.S.C. §60129).
\textsuperscript{54} Id. § 8 (amending 49 U.S.C. §60112 et seq).
\textsuperscript{55} Id. § 11 (amending 49 U.S.C. §60127).
\textsuperscript{56} Id. § 12.
\textsuperscript{57} Id. § 13 (to amend 49 U.S.C. 60131).
Rights-of-way, penalties, and pipeline integrity, safety, and reliability research and development provisions hold particular merit for this discussion. Rights-of-way for pipelines refer to the area around a pipeline lane that is restricted from public encroachment. These rights-of-way are important to prevent the actions of saboteurs who disrupt pipelines. For example, in October 2001, an Alaskan man trespassed on the right-of-way and shot at the Trans Alaskan Pipeline. This caused a leak that not only polluted two acres of spruce forest but also brought oil production in Prudhoe Bay to a near halt. While this case reflects little probability for a similar situation occurring at pipelines in ANWR due to the region's remoteness, the case raises awareness of the magnitude of effects of future disruptions to TAPS in the event ANWR oil begins to run through TAPS. If TAPS runs at full capacity, the potential for larger spills due to right-of-way encroachment increases. PSIA-2002 provides for the securing of rights-of-way by its mandated study to gather information on “land use practices, zoning ordinances, and preservation of environmental resources with regard to pipeline rights-of-way and their maintenance.”

Penalties for safety violations have been under-enforced by OPS for a long time. PSIA’s penalty updates put teeth in the safety orders of the Secretary and provide a natural incentive to follow safety protocols. In addition to raising general penalties from $25,000 to $100,000 and from $500,000 to $1,000,000, the penalties provision paves the way for “civil actions to enforce [safety provisions]” as well as “civil actions to require compliance with subpoenas or allow for inspections.”

Section 12 of PSIA-2002 initiates an inter-agency pooling of expertise “for ensuring that the elements of the program within its expertise are implemented in accordance with this section.” This gathering of the Department of Transportation, Department of Energy, and the National Institute of Standards and Technology received charge to “carry out a program of research, development, demonstration, and standardization to ensure the integrity of pipeline facilities.” Among other issues, this

59. Pipeline Safety Improvement Act § 11(a).
61. Pipeline Safety Improvement Act § 8, at 2993.
62. Id. at 2993-2994.
63. Id. at 2994.
64. Pipeline Safety Improvement Act § 12, at 2997.
65. Id.
team will assess material inspection, stress and fracture analysis, internal inspection and leak detection technologies, methods of analyzing content of pipeline throughput, pipeline security, and risk assessment methodology. As part of this joint venture, DOT submitted a broad agency announcement that called for cost-sharing ideas to improve pipeline damage prevention and leakage detection. By August 2004, OPS delivered a final R&D strategic plan that met the objectives set forth in section 12 of the PSIA-2002. This report contains analysis regarding new pipeline technologies that improve safety while proposing areas for improvement such as increased pipeline capacity and decreased safety breaches on pipelines. PSIA-2002 has already reversed delinquent areas of OPS oversight and introduced a new era of pipeline safety regulation, but it remains to be seen if the safety additions provide environmental security in environmentally-sensitive areas.

E. PIPELINE SAFETY IMPROVEMENT ACT OF 2006

On the heels of the PSIA-2002 came the 2006 Pipeline Safety Improvement Act amendments (PSIA-2006) that were enacted on December 29, 2006. Like PSIA-2002, the provisions of PSIA-2006 further changed pipeline safety and damage prevention, civil penalties, public education and awareness, and safety orders.

Most notably, PSIA-2006 included an amendment for “Petroleum Transportation Capacity and Regulatory Adequacy Study.” Subsection (a) of the 49 USC § 60136 portion of this section reads:

In General.—The Secretaries of Transportation and Energy shall conduct

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66. Id. at 2998.
68. PHMSA Research and Development: R&D Strategic Plan, http://primis.phmsa.dot.gov/rd/strategicplan.htm (last visited May 27, 2007). “PSIA-2002 also set forth the requirement that the Department of Transportation (DOT), the Department of Energy (DOE), and the National Institute of Standards and Technology (NIST) in the Department of Commerce (DOC) ‘shall carry out a program of research, development, demonstration and standardization to ensure the integrity of pipeline facilities.’ These agencies, along with the Minerals Management Service (MMS), have agreed to areas of responsibility as described in a Five Year Interagency Research and Development Program Plan for Pipeline Safety and integrity and implemented in a Memorandum of Understanding.” Id.
69. Id. at III.
70. Id. at IV(1)-(2).
72. Id. at § 2.
73. Id. at § 3.
74. Id. at § 13.
75. Id. at § 8.
periodic analyses of the domestic transport of petroleum products by pipeline. Such analyses should identify areas of the United States where unplanned loss of individual pipeline facilities may cause shortages of petroleum products or price disruptions and where shortages of pipeline capacity and reliability concerns may have or are anticipated to contribute to shortages of petroleum products or price disruptions. Upon identifying such areas, the Secretaries may determine if the current level of regulation is sufficient to minimize the potential for unplanned losses of pipeline capacity.

The court in *United States v. Alaska* stated that TAPS ran at a surplus of 600,000 barrels of oil per day. As of June 23, 2004, this figure still holds true. This differential is largely attributed to the decreased outputs by the Prudhoe Bay fields. Though ANWR is not the stated focal point of PSIA-2006 Section 8, this fact about TAPS and Alaskan oil bears interest in light of this statutory amendment. Because Alaska boasts some of the largest oil fields in the United States and has the Trans-Alaska Pipeline, it seems that PSIA-2006 paves the road for joint-agency regulation of the Trans-Alaska Pipeline and the potentially adjoining pipelines from ANWR in a manner that may increase safety precautions relative to potential increased throughputs.

F. REGULATORY AND LEGAL CHALLENGES FOR ANWR PIPES

Though PSIA-2002 and PSIA-2006 bring DOT safety regulations promulgated by PHMSA and OPS up-to-date, more administrative and statutory considerations must be made when contemplating pipeline construction and regulation in environmentally-sensitive areas such as ANWR. Even if all statutes and regulations surrounding pipelines in sensitive environmental areas are followed, the issue of public assurance remains an issue. To surmount this hurdle, oil companies vying to develop ANWR's fields must produce plans and practices that not only establish a new standard for environmental and safety controls, but that also permit new joint-agency government regulation. These plans and practices must address two additional challenges beyond "mere" compliance with PSIA-2002 and PSIA-2006: they must take into account the nature of ANWR's existence through the Alaska National Interest Lands Conservation Act (ANILCA), its organic legislative act, and compliance policies set forth in the National Environmental Policy Act (NEPA).

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G. Alaska National Interest Lands Conservation Act

Congress created the Arctic National Wildlife Refuge in 1960 under Public Land Order 2214.80 This range expanded and received a new name in 1980 under ANILCA.81 ANILCA’s purpose is the following:

In order to preserve for the benefit, use, education, and inspiration of present and future generations certain lands and waters in the State of Alaska that contain nationally significant natural, scenic, historic, archeological, geological, scientific, wilderness, cultural, recreational, and wildlife values, the units described in the following titles are hereby established. . . . This Act provides sufficient protection for the national interest in the scenic, natural, cultural and environmental values on the public lands in Alaska, and at the same time provides adequate opportunity for satisfaction of the economic and social needs of the State of Alaska and its people; accordingly, the designation and disposition of the public lands in Alaska pursuant to this Act are found to represent a proper balance between the reservation of national conservation system units and those public lands necessary and appropriate for more intensive use and disposition, and thus Congress believes that the need for future legislation designating new conservation system units, new national conservation areas, or new national recreation areas, has been obviated thereby.82

This statement reaches beyond the strictures of the Federal Land Policy Management Act of 1976 (FLPMA), which applies to all other federal lands of the United States according to its stated purpose:

(1) the public lands be retained in Federal ownership, unless as a result of the land use planning procedure provided for in this Act, it is determined that disposal of a particular parcel will serve the national interest;
(2) the national interest will be best realized if the public lands and their resources are periodically and systematically inventoried and their present and future use is projected through a land use planning process coordinated with other Federal and State planning efforts.83

The language of ANILCA possesses the same withdrawal power as the FLPMA but in a way that commands a higher sense of congressional purpose. The generic language of FLPMA merely “retains” federal land unless “disposal of a particular parcel will serve the national interest”84 while ANILCA uses colorful language describing the particular “nationally significant natural, scenic, historic, archeological, geological, scien-

82. Id.
84. Id. at § 1701 (1).
tific, wilderness, cultural, recreational, and wildlife values”\(^85\) of Alaskan lands to be withdrawn. In constitutional terms, this likens to a heightened standard of review that applies to federal lands covered under ANILCA. Section 1002 of ANILCA segregates the 1.5 million acre coastal plain for the study of oil exploration feasibility.\(^86\) This land, compared to other lands within ANWR, can be opened only by authorization of Congress for the specific purpose of oil development.\(^87\) If Congress decides to open the 1002 area, the authorization to lay pipelines would not be automatic because the general provisions of ANILCA\(^88\) and NEPA\(^89\) apply to the permitting process. One particular issue highlighted by ANILCA is the relationship between oil development and caribou.\(^90\)

Advocates of ANWR drilling point out that caribou seem to get along with drilling operations around Prudhoe Bay,\(^91\) but anecdotes cannot simply satisfy the requirements of a federal statute. The resulting tension between the developer’s pipelines and caribou will need to find analysis within an environmental impact statement.

H. ENVIRONMENTAL CHALLENGES

NEPA requires an environmental impact statement (EIS) for “major Federal actions significantly affecting the quality of the human environment.”\(^92\) The EIS contains comprehensive analysis of all viable alternatives of major federal action, including an analysis of the “no action” option.\(^93\) Caribou aside, this means the analysis must cover all environmental issues relative to the delicate nature of the coastal plain by the discretion of the Fish and Wildlife Service. The two major questions are (1) what does NEPA require concerning cumulative impacts and scope for a pipeline system in ANWR, and (2) do the provisions of PSIA-2002 and PSIA-2006, in their efforts to equate safety with environmental protection, contribute clarity and support to NEPA analysis given the higher standard of ANILCA?

I. NEPA Cumulative Impacts/Scope

NEPA regulations provide for cumulative impact\(^94\) and scope\(^95\) to be

\(^86\). Alaska National Interest Lands Conservation Act § 1002, at 2449.
\(^87\). Alaska National Interest Lands Conservation Act § 1003, at 2452.
\(^88\). Alaska National Interest Lands Conservation Act §1002, at 2379, 2389.
\(^90\). Alaska National Interest Lands Conservation Act § 1002, at 2450.
\(^94\). Id. at 1508.7.
considered in the formation of an EIS. Both of these issues relate oil drilling and extraction to the necessary pipeline building and administration. Pipelines are "foreseeable future actions" under an analysis of cumulative impacts because oil extraction necessitates a delivery system. Pipelines are also "connected actions . . . closely related" for the same symbiotic reason given above.

Kleppe v. Sierra Club discusses parameters for determining whether cumulative impact and scope warrant a single EIS versus separate EIS's. In this case, Sierra Club challenged the ruling that allowed the defendants to construct four EIS's for four separate coal mining operations in the Northern Great Plains. On review, the Supreme Court upheld respondent's argument that one EIS better contained the true impacts of the development project because the activities were "programmatically," "geographically," and "environmentally" related. Segmented EIS's for the development project would not have taken into account "diminished availability of water, air and water pollution, increases in population and industrial densities, and perhaps even climatic changes." Pipelines supporting potential oil extraction in the 1002 area of ANWR certainly fit the programmatic and geographic categories because pipelines are the only reasonable method of petroleum transportation in the harsh Arctic climate of ANWR. Both operational elements of oil extraction and pipeline transport exist within the same proximity (and indeed would be physically linked). Thus, the geographic requirement is strong. The "environmentally related" issue applies on its face because the nature of ANILCA sets aside the entire 1002 area for assessment and study given the potential environmental impacts of petroleum development. "Cumulative environmental impacts are, indeed, what require a comprehensive impact statement." This EIS would not sufficiently support a pipeline system in ANWR because another EIS might be required by the increased usage of TAPS. The federal government oversees the operations of TAPS, so increasing its load by transporting oil from ANWR in addition to Prudhoe runs the risk of triggering federal

95. Id. at 1508.25.
96. See id. at 1508.7.
97. See id. at 1508.25
99. Id. at 394.
100. See id. at 412-15.
101. See id. at 413-15.
103. Kleppe, 427 U.S. at 413.
action\textsuperscript{105} due to increased spill volume danger. Using the same analysis of cumulative impacts and scope as the court used in \textit{Kleppe v. Sierra Club},\textsuperscript{106} a separate EIS would be necessary for the increased use of TAPS because not all the parameters for a unitary EIS are met with TAPS. TAPS transport meets the “programmatic” requirement\textsuperscript{107} because the link it provides from ANWR pipelines establishes the necessary connection to the market. However, TAPS does not meet the criteria for “geographically”\textsuperscript{108} or “environmentally”\textsuperscript{109} related because TAPS runs over 800 miles through the length of Alaska.\textsuperscript{110} NEPA’s scoping requirements encourage the inclusion of similar actions within the EIS,\textsuperscript{111} and TAPS’s gigantic length and terrain coverage exceed the scope of the ANWR operation.

III. \textbf{The Next Phase in Regulating Pipelines: A New Model For Assuring Pipeline Safety in Sensitive Environmental Areas}

NEPA requires that all possible environmental impacts be considered in the EIS.\textsuperscript{112} Without adequate safety measures to steer away potential oil spills, the EIS would have to assume a certain level of oil spills. No standard preventing spills and enforcing penalties of safety violations would stand in the way of environmentally marginal operational practices, so the prospect of oil pipelines in ANWR would look very grim from the public comment portion of the EIS.\textsuperscript{113} This would only give fodder to a new media blitz against ANWR operations.

PSIA-2002 and PSIA-2006 go a long way towards meeting NEPA scrutiny for building pipelines systems in environmentally sensitive areas such as ANWR. PSIA-2002 delivers the broad substantive overhaul to pipeline safety regulations that not only protect employees but also provide safety buffers from oil spills that can harm the environment. While PSIA-2002 provides increased fines, right-of-way encroachment protection, and pipeline integrity development, the statute is not clear as to how these requirements will be administered or enforced. OPS already struggles with a dismal track record for administration and the newly-minted

\textsuperscript{105} See generally 42 U.S.C. § 4332 (2007) (illustrating federal action that may occur if oil transportation is increased).


\textsuperscript{107} Id.

\textsuperscript{108} Id.

\textsuperscript{109} Id.


\textsuperscript{111} 40 C.F.R. § 1508.25 (a)(3) (2007).


\textsuperscript{113} See 40 C.F.R. § 1503.4 (2007).
PHMSA has yet to exercise its administrative capacity in a challenging environmental situation such as ANWR. PSIA-2006 provides the procedural bolstering to PSIA-2002 through its appropriations provision and mandate for the Petroleum Transportation Capacity and Regulatory Adequacy Study (PTCRAS). The question is now whether future appropriations will be made after the current funds go away in 2010\textsuperscript{114} and whether reporting will continually update statistics on how well safety regulations of PSIA-2002 and PSIA-2006 serve the NEPA goals of environmentally sensitive areas. The PTCRAS served a definite but static purpose. Reports provide critical information to the public that keeps government regulation in check. A measure providing for periodic reports should be included in an amendment to PSIA-2006.

Though PSIA-2002 and PSIA-2006 fixed failed attempts at pipeline safety and provided real solutions that help satisfy NEPA, surmounting the huge environmental question of pipelines in environmentally-sensitive areas requires a new approach. This approach includes (1) an augmented NEPA that extends from the typical EIS requirements to post-project assessment that is (2) controlled by a consortium of federal agencies, discussed briefly below. This system invokes governmental oversight through NEPA’s EIS process to assure that PSIA-2002 and PSIA-2006 see implementation in ANWR in a manner that addresses ANWR’s inherent environmental sensitivities. This idea also picks up where the deficiencies of administration, continued appropriations, and reporting leave off in PSIA-2002 and PSIA-2006. This solution may offer the best answer to safety regulations and might finally equate to real environmental protection.

A. EIS Post-Assessment Oversight

NEPA does not generally require post project assessment\textsuperscript{115} because NEPA is generally procedural in nature.\textsuperscript{116} As Bradley Karkkainen laments:

If the pre-project EIS turns out to have been mistaken about the environmental consequences of the action, the interested parties ordinarily have little recourse, and in most cases nothing more is required of the agency.


\textsuperscript{116} Robertson v. Methow Valley Citizens Council, 490 U.S. 332, 350-351 (1989) (“Although these procedures are almost certain to affect the agency’s substantive decision, it is now well settled that NEPA itself does not mandate particular results, but simply prescribes the necessary process... other statutes may impose substantive environmental obligations on federal agencies, but NEPA merely prohibits uninformed—rather than unwise—agency action”).
But most of the time we do not know the actual consequences of the action or whether the EIS predictions turned out to be accurate. Under NEPA, the agency conducting the EA or EIS ordinarily has no obligation to follow up on its predictions to determine their accuracy, nor do agencies regularly make it their practice to do so. Nor does anyone else within or outside of government make it their business to do so on a regular basis. For all we know, the predictions contained in any given EIS could turn out to be wildly inaccurate, and no one would be the wiser.\footnote{Karkkainen, supra note 115, at 927.}

Karkkainen suggests that some agency oversight would be beneficial in order to ensure that EIS achieves the level of environmental assurance that it sets out to achieve in the beginning. The idea of such a post-project review runs contrary to NEPA’s procedural spirit, yet this assurance and accountability to an inter-agency council might just strike the deal between allowing ANWR production given the assurances in pipeline safety it would provide. Of course, such an action demands special-circumstance status which clarifies that EIS oversight occurs only for environmentally-sensitive areas where the proposed activity would not occur without such oversight measures.

B. INTER-AGENCY COUNCIL FOR EIS DEVELOPMENT AND OPERATIONAL OVERSIGHT

Borrowing from PSIA-2002’s inter-agency pooling of expertise,\footnote{Pipeline Safety Improvement Act of 2002, Pub. L. No. 107-355, §12, 116 Stat. 2985 (2002) (Section 12 is PSIA-2002’s pipeline integrity, safety, and reliability research).} an EIS system involving post-project oversight would benefit best from a council of inter-agency representatives who offer their expertise to both EIS development and oversight. The necessary players include representatives from the DOI, DOT, DOE, and EPA to address the public lands, transportation safety regulations, energy supply issues, and environmental regulations, respectively. The agency representatives would be individually responsible for appending action items relating to their respective issues into the standard EIS developed by the FWS. This sets up the ability for the council to request regular reports from the pipeline operators and serves not only as a quasi-regulatory body but also as an advisory board. This resource to the oil pipeline operators assures that operations follow all applicable environmental issues while also acting as an ombudsman to the public. Pipeline safety regulations can equate to environmental protection in sensitive areas under this model. See the appendix diagram for a model of the proposed procedures.
IV. Conclusion

Pipeline safety regulation efforts have not always equated to adequate environmental protection. The new PSIA-2002 and PSIA-2006 measures moved safety regulations in a direction that undergirds NEPA analysis but do not completely solve the issue of laying and operating pipelines in environmentally-sensitive areas such as ANWR. Oil companies hoping to drill in ANWR should look to expand the progress of PSIA-2002/2006 by submitting to interagency oversight and regulation. This process represents a new era of pipeline safety management that, if successful, could be a model for development of environmentally sensitive areas whose disposal or exploitation is deemed to be in the national interest.119

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APPENDIX: PROPOSED OVERSIGHT PROCEDURES

A. "TYPICAL" EIS PROCEDURE

Proposal → Initial Decision 1501.4 → Construct EIS → DEIS

Public Comment Period/Litigation

FEIS/Project Commencement

B. PROPOSED EIS WITH OVERSIGHT PROCEDURE

Proposal DOI/FWS → Build Agency Council: DOI, DOT, DOE, EPA; to advise EIS and Oversee Application → Construct EIS → DEIS

Public Comment

FEIS/Project Commencement → Ongoing project oversight by Agency Council.

Erik M. Dullea*

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I. INTRODUCTION

On May 26, 2006, the Transportation Security Administration (TSA) published the Air Cargo Security Regulations, which are the first substantive change to air cargo regulations since 1999. The major provisions of the new regulations apply to airports, aircraft operators (domestic and foreign), and freight forwarders/indirect air carriers (IACs). The regulations are organized into discrete sections based on the type of regulated entity (e.g. airports, domestic aircraft operators, foreign air carriers, and IACs), but in most cases the specific provisions for each of the regulated entities are functionally equivalent. For the sake of clarity, this comment is organized by the type of regulation (e.g. background checks) and the application of the regulation to all regulated entities. Where the provision has unique or disparate application to one or more entities, those differences are also described.

II. EXECUTIVE SUMMARY

The changes to 40 CFR Part 1520, and Parts 1540–1548 are the first substantive regulatory changes for air cargo since 1999. Although interim rules and programs were implemented in the aftermath of September 11, 2001 (some of which are incorporated into the final regulations), it took nearly five years and additional pressure from Congress on the Department of Homeland Security (DHS) and TSA to issue the final regulations called for in the Aviation and Transportation Security Act (ATSA) of 2001.

Due to sheer size and the diversity of stakeholders in the air cargo industry, TSA’s task of developing a set of comprehensive rules could be described as Herculean. In addition, there is an underlying tension be-
between the implementation of effective security procedures and the facilitation of unimpeded commerce, which is essential to the success of a market-based economy. The Final Rule includes significant changes to airport operations, creates a new category of aircraft carriers – the “Full All Cargo” category, requires TSA to consolidate and maintain a central database of Known Shippers, and places a greater burden on IACs regarding aviation security. However, the Final Rule did not require 100% inspection of all air cargo, or even 100% inspection of all air cargo loaded onto passenger aircraft.

While there are occasional differences in the rules for passenger aircraft, all-cargo carriers, and the small “on-demand” air cargo carriers, the precise rationale for these differences can only be inferred, because the TSA does not disclose to the public the specific elements of its security procedures. In addition, TSA does not publicly disclose threat assessments or the intelligence data from which those assessments are made. However, based on the preamble and supplemental information for the Final Rule, when differences between entities do exist, it appears that those differences are intended to address the specific threats that each regulated entity is more likely to encounter.

The ongoing differences between the security requirements for passenger carriers and air cargo carriers created a perception that the security procedures for cargo airlines were less stringent than the procedures

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Testimony before Subcomm. on Federal Workforce and Agency Organization of the H. Comm. on Gov. Reform, 7 (Apr. 4, 2006) (statement of Cathleen A. Berrick, Dir. Homeland Sec. and Justice Issues) [hereinafter Statement of Cathleen Berrick] (Roughly 23 billion pounds of air cargo were transported within the United States in 2004. TSA is responsible for inspecting over 285 air carriers, with 2800 facilities nationwide, along with 3800 Indirect Air Carriers (IAC) with approximately 10,000 domestic locations.)


5. See Aviation Security: Securing Cargo, supra note 1 (describing major new initiatives in the Air Cargo Final Rule including “[c]onsolidating approximately 4,000 private industry Known Shipper lists into one central database managed by TSA”).

6. Testimony before the Senate Comm. on Commerce, Science and Transp., 8 (Jan. 17, 2007) (see statement of Asst. Sec. Edmund “Kip” Hawley, TSA) available at http://commerce. senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=1807 (The agency wants to screen as much cargo placed on passenger flights as possible. However, a mandate similar to what the House endorsed—forcing the agency to scan and inspect all cargo—might provide only a small incremental benefit of security while taking away resources for other efforts. “[A]ny mandate to physically inspect 100 percent of air cargo within three years is not feasible without impeding the legitimate flow of commerce and imposing an unreasonable cost on the government.”)


8. Id. at 30,479.
used by passenger airlines. Moreover, the absence of a 100% inspection requirement for all cargo transported in the belly of passenger jets is often viewed as a significant gap in combatting terrorism. In response, industry stakeholders and the TSA have articulated legitimate reasons why TSA did not require the inspection of 100% of air cargo. The perception that the security standards for air cargo carriers are weaker than the standards for passenger carriers simply because the security standards are different is erroneous. Instead of applying a one-size-fits-all program, TSA applied a risk management program that was recommended by other governmental organizations.

The 100% inspection issue boils down to an acceptable risk question on which reasonable people can reach different opinions. Regardless of what may be construed as an acceptable level of risk for air cargo security, the new regulation has an additional area that is cause for concern. All of the new requirements for airports, aircraft operators, and IACs are predicated on self-imposed compliance under the threat of TSA inspections. If the inspections are frequent, thorough, and generate severe


11. Air Cargo Security Requirements; Final Rule, 71 Fed. Reg. 30,493 (May 26, 2006) (to be codified at 49 C.F.R. pts. 1520, 1540-1548) (stating in Section 11.H that TSA considered 100 percent inspection but determined it was not feasible and would have a significant burden on the U.S. economy).


13. See generally Letter from Air Transport Association Coalition to Sen. Inouye (Feb. 9, 2007) at http://www.airlines.org/NA/rdonlyres/7F55C1C3-797D-49C6-B5CDFB5BDA3700795/CoalitionSenateBillLetterInouye.pdf [hereinafter Letter to Sen. Inouye] (discussing S.B. 509; a coalition representing a broad range of air cargo supply-chain participants, including producers and shippers of goods, air freight forwarders, passenger and cargo airlines, airports and retailers who rely upon express delivery to serve their customers sent a letter to Sen. Inouye asking Congress to focus on realistic solutions based on a framework that identifies and prioritizes risks, works methodically to apply effective and proven security measures, and that optimizes federal and industry resources).

14. See generally 49 C.F.R. §§ 1542.5, 1544.3, 1546.3 and 1548.3 (May 26, 2006) (granting TSA the authority to enter and inspect premises and records of regulated airports, aircraft operators and indirect air carriers).
penalties for non-compliance, operators will have ample incentive to comply with the rules. However, if the industry believes that corners can be cut without being sanctioned, the air cargo system will be perceived as being just as vulnerable as it was under the former regulations. In addition, the General Accounting Office (GAO) has raised concerns about the validity of TSA's statistical data relating to security violations. In 2005, the GAO reported that the current data collection process used by TSA was unable to highlight weak areas in the cargo security system or provide sufficient data for TSA to fulfill its oversight responsibilities.

III. BACKGROUND

On May 26, 2006, TSA published the “Air Cargo Security Requirements; Final Rule.” This rule implements the security requirements mandated under the Aviation and Transportation Security Act (ATSA) of 2001 and the Department of Homeland Security Appropriations Act of 2005. The rule also takes into account the findings of the Department of Transportation (DOT) 2002 audit report, the Aviation Security Advisory Committee recommendations of 2003, and the Air Cargo Strategic Plan (ACSP) approved by DHS in 2004.

A. TERMS AND DEFINITIONS

The following terms are defined in Subchapter B of 49 CFR Part 1520 et seq. and 1540.5 and are used throughout this article.

*Indirect Air Carrier* (IAC): a person or entity within the United States not in possession of an FAA air carrier operating certificate that undertakes to engage indirectly in air transportation of property and uses for all or any part of such transportation the services of a passenger air carrier. (Note: An IAC may also be described as a freight forwarder or a cargo/freight agent.)

*Security Program*: a plan, program, or strategy, along with all prior and subsequent amendments, which includes comments, instructions, or guidance for the security of an airport, aircraft or cargo operation.

*Security Identification Display Area* (SIDA): a portion of an airport specified

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18. *Id.* at 30,478-79.

19. *Id.*


in the airport security program, in which security measures are carried out, which may include limiting access and verifying individuals' identification. Sensitive Security Information (SSI): that information obtained or developed in the conduct of security activities where TSA has determined that the disclosure of such information would be an unwarranted invasion of privacy, reveal trade secrets or company-confidential information, or be detrimental to the security of transportation.

B. Scope of Air Cargo Industry

As of August 2005, the TSA reported that 65 passenger carriers transport 1.8 million passengers per day on 30,000 flights from approximately 450 airports. The cargo industry also operates from approximately 450 airports, but is composed of more than 280 air carriers and transports roughly 50,000 tons (one hundred million pounds) of cargo per day.

Passenger and all-cargo airlines have approximately 2800 cargo facilities nationwide; there are also approximately 3800 IACs accepting cargo at over 10,000 delivery sites. These IACs are hired by approximately 1.5 million customers who are registered and listed as Known Shippers on over 4,000 databases maintained by private industry.

C. Preliminary Policies and Procedures

TSA presented the ACSP in November of 2003 as an interim step towards the creation of “a comprehensive approach that will significantly enhance air cargo security.” The ACSP was the first change to air cargo regulations since 1999. The goal of ACSP was to reduce the risk to air travel without constraining the nation’s supply chain that supports a myriad number of industries through high-value, just-in-time inventory man-

27. Id.
agreement.\textsuperscript{30} To achieve this goal, the ACSP adopted a multi-layered approach based on a threat-based, risk management algorithm that reached across the entire air cargo supply chain.\textsuperscript{31}

Even before the ACSP was released, TSA had already determined that physically inspecting 100\% of air-cargo was not technologically feasible and that security procedures were needed to screen or filter air cargo shipments and separate the wheat from the chaff.\textsuperscript{32} The purpose of these screening processes would be to ensure that all cargo which posed an elevated risk would be set aside for inspection.\textsuperscript{33} The basic components of the air cargo security plan followed the procedures that were utilized for the maritime cargo industry.\textsuperscript{34} As is true for many DHS programs, there is great emphasis on the need to scrutinize cargo from unknown shippers.\textsuperscript{35}

Although ACSP included substantive steps to improve the security procedures relating to air cargo shipments entering the United States, TSA encountered concern and skepticism from Congress and aviation security experts regarding the ACSP provisions. Congressman Edward Markey succeeded in passing an amendment to the DHS Appropriations Act, 2004 (HR 2555) which would have required all packages placed onto passenger airlines be screened.\textsuperscript{36} At the time, packages weighing less than sixteen ounces were not screened.\textsuperscript{37} Section VI below discusses in greater detail Congressman Markey’s use of the term “screened” as opposed to the term “inspected.” FedEx and United Parcel Service were strongly opposed to Congressman Markey’s amendment.\textsuperscript{38} The Senate’s version of HR 2555 did not contain the Markey provision and the provision was not incorporated into the final version of the bill.\textsuperscript{39}

IV. Procedural Developments and Compliance Deadlines

The Notice of Proposed Rule Making (NPRM) for Air Cargo Secur-
ity Regulations was published on November 10, 2004.\textsuperscript{40} The NPRM incorporated the ACSP threat-based risk management program and suggested a multi-layered interagency approach to implementing cargo security regulations,\textsuperscript{41} primarily because TSA had already concluded that inspecting 100\% of cargo carried on passenger aircraft was not economically or technologically feasible.\textsuperscript{42}

In addition to electing not to require physical inspection of all air cargo, which some critics view as a fatal flaw of the rule,\textsuperscript{43} TSA also failed to meet the legislative deadline for issuing the final regulations. Under the 2004 Intelligence Reform Act, TSA was required to finalize air cargo screening regulations by August 15, 2005,\textsuperscript{44} but the final rule was not published until May 26, 2006.

The Air Cargo Security Requirements in the final rule were scheduled to go into effect on October 23, 2006, and specified two compliance dates for the regulated community. First, 49 CFR Part 1548.11 requires that all employees of IACs who accept, handle, transport, or deliver cargo were to complete security training by November 22, 2006.\textsuperscript{45} Second, by December 1, 2006, all IACs, aircraft operators, and foreign air carriers were to submit Security Threat Assessment paperwork (as described in 49 CFR Part 1540 Subpart C) for all employees who have unescorted access to cargo and have not previously undergone a background check.\textsuperscript{46} IACs which do not presently operate under a TSA security program must establish and operate under a TSA security program if the IAC intends to continue offering cargo to operators of a Full All Cargo Program or a comparable foreign air carrier.\textsuperscript{47}

In the seven months following the Final Rule's publication, TSA has extended the compliance deadlines twice.\textsuperscript{48} The extensions were made because the regulated community was not able to meet the original deadlines for submitting employee background checks, and technological


\textsuperscript{41} Id. at 65,260.

\textsuperscript{42} Robert W. Moorman, Fire in the Belly, HOMELAND SECURITY, Sept. 2004, at 44, 46 [hereinafter Moorman].

\textsuperscript{43} TSA Receives Air Cargo Security Recommendations, supra note 36.

\textsuperscript{44} Govexec.com, TSA Misses Deadline for Rule on Air Cargo Screening (2005), http://www.govexec.com/dailyfed/0805/082205c1.htm.


\textsuperscript{46} Id. at 30,478.

\textsuperscript{47} Id.

problems TSA encountered while processing these background checks.\textsuperscript{49}

The recent deadline extensions may not be the final activity in this area. In 2007 despite TSA's previous conclusions that 100% inspection of air cargo is not technologically feasible, the newly elected Democratic party-controlled Congress is considering legislation that will require 100% inspection of air cargo loaded onto passenger aircraft within three years.\textsuperscript{50}

V. SPECIFIC PROVISIONS OF THE FINAL RULE

The Final Rule is organized based on categories of regulated entities (airports, aircraft operators, IACs) and steps through the security rules for each category. Thus, certain sections of the rule repeat requirements that apply to more than one category of regulated entities (e.g. aircraft operators and IACs). Because many of the rule's requirements are applicable to multiple categories, this article describes the significant new requirements individually and points out the occasional differences amongst regulated entities where they occur.

A. CATEGORIES OF REGULATED ENTITIES

The Final Rule regulations are applicable to airports, aircraft operators, and Indirect Air Carriers. Within these generic groups, TSA segregates each entity based upon the type of Security Program the entity uses.

TSA requires airports to comply with either a "Complete Program" or a "Partial Program."\textsuperscript{51} Aircraft operators, on the other hand can receive approval to operate under one of six security programs based on the type of air service they provide, and the weight of the aircraft used by the operator.\textsuperscript{52} Aircraft operator programs are described in general terms within 49 CFR Part 1544.101.\textsuperscript{53} Conversely, all IACs (freight forwarders) are subject to the same regulation regardless of the size of the business or corporation.

While the two airport security program categories remain unchanged, TSA added a requirement that all airports, which load or un-

\textsuperscript{49} Air Cargo Security Requirements; Compliance Dates; Amendment, 71 Fed. Reg. 62,546 (Oct. 25, 2006); Air Cargo Security Requirements; Compliance Dates; Amendment, 72 Fed. Reg. 13,024 (Mar. 20, 2007).


\textsuperscript{51} Airport Security, 49 C.F.R. § 1542.103 (2005).


\textsuperscript{53} Id.
load cargo from aircraft operators that are operating under an approved Full Program or Full All Cargo Program, must create a SIDA for these cargo operations. This provision is discussed in greater detail below in subsection C. TSA also created an additional security program category for aircraft operators. Before this Final Rule went into effect, aircraft operator programs were classified as Full, Partial, Twelve-Five, Private Charter, or Limited.

All aircraft operators providing scheduled passenger service are required to operate under a Full Program. The new security program, titled the Full All Cargo Program contains similar requirements to those found in the full programs adopted by passenger airlines. The Full All Cargo Program is mandatory for each operation that uses aircraft with a maximum takeoff weight over 45,500 kg and carries cargo but not passengers. The Final Rule also modified the original Twelve-Five Program. Originally, the Twelve-Five program was available to any operator that

54. 49 C.F.R. § 1542.103(a); Airport Security, 49 C.F.R. § 1542.205 (2006).
58. Id. at 30,510.
59. Id. (providing the revisions and new language for 40 CFR Part 1544.101).
provided *charter or scheduled cargo service* in aircraft with a maximum certified takeoff weight greater than 12,500 pounds. Under the new regulation, the Twelve-Five Program is now limited to only those operators that use aircraft with a maximum takeoff weight over 12,500 pounds and are *not* required to participate in a Full Program or a Full “All Cargo” Program.\textsuperscript{60}

To put the 45,500 kg and 12,500 pound weights into perspective, a Boeing 737 has a maximum certified takeoff weight of 66,000 kg.\textsuperscript{61} The entire Gulfstream business jet family has maximum certified takeoff weights ranging from 26,100 pounds to 41,277 kg, and the majority of the Cessna Citation business jet models have maximum certified takeoff weights between 12,500 and 36,000 pounds (which equals 16,329 kg).\textsuperscript{62} Thus, all cargo operations that utilize traditional passenger-jet sized aircraft must operate under the Full “All Cargo” program, while aircraft operators that use regional/business-jet sized aircraft will be able to operate under the Twelve-Five program.

\section*{B. Adoption and Implementation of Standard Security Programs}

In order to conduct operations within the United States, U.S. airports, all air carriers, and all IACs located within the United States must possess and operate in accordance with a security program approved by TSA. The Federal Aviation Administration has required aviation security programs for more than twenty years.\textsuperscript{63} Security programs contain the specific guidance required to implement these regulatory changes. In the Final Rule, TSA is creating two additional security programs for Full “All Cargo” operators and all indirect air carriers.\textsuperscript{64}

All security programs are categorized as SSI and therefore are not authorized for public disclosure; in addition, regulated entities can petition for operating exceptions from SSP requirements.\textsuperscript{65} Due to the lack

\textsuperscript{60} Id.


\textsuperscript{64} Air Cargo Security Requirements: Final Rule, 71 Fed. Reg. 30,489-90 (May 26, 2006) (to be codified at 49 C.F.R. pts. 1520, 1540-1548); BECKIUS, supra note 26, at 8 (describing these regulations as the foundation for the roll-out of seven revised security programs).

of public information and the potential for regulated entities to receive variances from SSP requirements, this article does not address individual airport or aircraft operators' security programs. However, the titles and descriptions of security programs along with the general provisions of the Final Rule allow comparisons to be made amongst the various categories of regulated entities. For example, Full All Cargo operators are not authorized to transport passengers or checked baggage. As a result, there is no reason to require these carriers to comply with security provisions dealing with those subjects. Accordingly, the SSP for aircraft operators exempts Full All Cargo operators from complying with the security provisions involving screening checked baggage, transporting passengers, and using explosive detection systems on checked bags. Aside from these logical differences, the only disparity between the security provisions for the Full Program and the Full All Cargo Program involve the Known Shipper requirement which is discussed below in Section F. Otherwise, the security requirements for a passenger operation and a Full All Cargo operation are virtually identical.

C. Expansion of Security Identification Display Areas

Each airport that currently operates under a Complete Program (per 49 CFR 1542) is required to have an “expansion of security identification area” (SIDA). Previous TSA regulations required airports approved under a Complete Program to conduct all passenger boarding and bag- age screening within a SIDA. The Final Rule broadens the SIDA requirements to encompass the following:

airport premises which are regularly used to load or unload cargo from aircraft that operate under a Full Program or a Full All Cargo Program; and those areas in which air cargo is accepted by an aircraft operator, foreign air carrier, or indirect air carrier.

During the notice and comment period, the expansion of SIDA re-

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68. Id.
70. See 49 CFR §1542.205 (2002) (requiring that airport operators working under a Complete Program per 49 CFR 1542.103(a) must have at least one SIDA; Complete Programs are used to service aircraft operators who perform scheduled service and/or public charters on aircraft with more than 60 seats).
ceived vocal opposition from airport authorities, small aircraft operators, and private aircraft owners, based on the cost, practicality and ineffectiveness of expanding SIDA to increase security.\textsuperscript{72} Despite the opposition, TSA concluded that preventing unauthorized persons from accessing cargo operations is necessary to prevent tampering with cargo and to remove potential access points for hostile stowaways.\textsuperscript{73} The cargo facilities provide ample opportunity for a terrorist to tamper with cargo prior to it being loaded onto an aircraft because the cargo can sit in these facilities while being sorted, staged, or consolidated.\textsuperscript{74} By including these cargo facilities within a SIDA, unauthorized access to cargo shipments should be reduced, thereby providing increased security to one part of the supply chain.

D. SECURITY THREAT ASSESSMENTS

TSA requires that certain aircraft operator, foreign carrier, and IAC employees undergo security threat assessments (STA). The burden is on the employer, not the applicant, to verify the applicant’s identity and submit the required data to TSA for review.\textsuperscript{75} TSA will search domestic and international databases to verify that the employee or agent’s unescorted access to air cargo anywhere along the delivery process will not be a threat to national security or transportation security.\textsuperscript{76}

There are only two categories of aircraft operators whose employees are subject to the STA requirement – Full Program operators and Full All Cargo operators. An aircraft operator in one of these categories must submit an STA application for each employee and agent that will have unescorted access to air cargo. The timeframe during which unescorted access might occur is from acceptance of the cargo by the carrier to the point at which the cargo arrives in a SIDA, is transferred to another carrier, or is removed at the destination airport.\textsuperscript{77}

Foreign carriers must also submit STAs for employees and agents that will have unescorted access to air cargo, but only for those individuals located within the United States.\textsuperscript{78} The International Civil Aviation

\textsuperscript{72} Id. at 30,485-86 (describing comments submitted by American Associates of Airport Executives, Aircraft Owners and Pilots Association, Cargo Airline Association, UPS, DHL and FedEx).

\textsuperscript{73} Id. at 30,486.

\textsuperscript{74} Id. at 30,486; see generally Cargo and Freight Agents, supra note 20 (describing the handling, consolidation and loading of cargo).


\textsuperscript{76} Id. at 30,508.

\textsuperscript{77} Id. at 30,507, 30,511.

\textsuperscript{78} Id. at 30,483 (stating that TSA does not require STA’s for unescorted access to cargo at foreign locations because appropriate background checks are already required under Interna-
Organization already requires background checks for access to restricted airport areas, and therefore, TSA will not require STAs for individuals with unescorted access at foreign locations.\textsuperscript{79}

IACs on the other hand, are required to submit STAs on a wider range of individuals. In addition to employees and agents who will have unescorted access to air cargo, IACs must submit STAs for proprietors, partners, officers, directors, and owners.\textsuperscript{80} The final rule and the preamble do not provide an express reason for this additional requirement but in the \textit{Security Threat Assessment Population} section of the preamble, TSA stated that most IACs were small businesses with less than fifteen employees.\textsuperscript{81} In a separate part of the preamble, TSA also stated that if the IAC can demonstrate that a proprietor \textit{et al.} is unable to influence the business practices of the IAC, an unfavorable STA determination relating to that individual will not necessarily preclude the approval of the IAC’s security program.\textsuperscript{82} The inference from these comments is that STAs are required for persons who own or control the operation of an IAC because these persons will have significant influence over the IAC’s probability of complying with the regulations.

As far as what data must be submitted for an STA application, TSA will accept previous Criminal History Records Checks (CHRC) or other TSA-approved STAs for individuals in all regulated entity categories.\textsuperscript{83} TSA believes that accepting results from previous STAs and CHRCs will lessen the burden on aircraft operators, foreign air carriers, and IACs.\textsuperscript{84} This claim is obviously true for aircraft operators because pilots, mechanics, and ground personnel have already undergone an STA review to obtain authorization to enter the SIDA.\textsuperscript{85} However, the benefit also carries over to the air cargo operators. According to TSA, most cargo screeners and their immediate supervisors at Full “All Cargo” operations have already undergone a CHRC to obtain authorization to enter a SIDA and therefore do not require an STA.\textsuperscript{86}

\textsuperscript{79} Id. at 30,480.
\textsuperscript{80} Indirect Air Carrier Security, 49 C.F.R. § 1548.16.
\textsuperscript{82} Id. at 30,496.
\textsuperscript{83} Id. at 30,480-81.
\textsuperscript{84} Id.
\textsuperscript{85} Id.
\textsuperscript{86} Id.
E. Accepting and Screening Cargo

The new rule expressly states that IACs, foreign air carriers, and aircraft operators utilizing Full, Twelve-Five, and Full “All Cargo” Programs are responsible for preventing or deterring the carriage of unauthorized persons or unauthorized explosives, incendiaries, and destructive substances in cargo onboard an aircraft.87 The Final Rule added “unauthorized persons” to the previous version in order to address the critical risks of stowaways and bombs on the aircraft.88 This obligation can be addressed by screening passengers, baggage, and cargo, inspecting these items, and accepting cargo only from Known Shippers. In addition, all regulated entities are required to refuse transportation of cargo if the shipper refuses to grant consent for the screening or inspection of the cargo.89 These regulatory provisions went into effect despite opposing comments from the industry alleging that sensitive cargo could be damaged if the shipper was forced to consent to the inspection.90 TSA’s response was unsympathetic. The requirement for aircraft operators utilizing a Full Program, Full All Cargo Program, or Twelve-Five Program to screen and inspect cargo is “necessary to prevent and deter the introduction of stowaway hijackers, explosive devices, or other threats.”91 The inference from the Final Rule and the TSA comments is that TSA is classifying the screening and inspecting of cargo as a duty for all participants in the air cargo industry.

F. Known Shipper Program

One of the more significant changes in the cargo security rule pertains to the Known Shipper Program. The Known Shipper concept has been used in air cargo security for thirty years.92 There are approximately 4,000 separate Known Shipper lists containing records for roughly 1.5 million manufacturers, small businesses, and individuals.93 TSA will consolidate these lists into one centralized database, which will be accessible by all regulated entities in order to verify each shipper’s status. While TSA will maintain the database, it will be up to the regulated enti-

87. Id. at 30,484, 30,510.
88. Id. at 30,498.
89. Id. at 30,484.
90. Id. (carrying high cash value cargo such as jewelry and other sensitive or fragile cargo is shipped in sealed containers that may result in damage if opened). See also Jeff Berman, Air Cargo Security on Congress’ Radar Screen Again, LOGISTICS MANAGEMENT, Mar. 1, 2007, http://www.logisticsmag.com/article/CA6424069.html (last visited March 29, 2007) [hereafter Berman].
92. Id. at 65,272.
93. TSA Issues New Regulations, supra note 29; Beckius, supra note 26.
ties to submit shipper data for inclusion in the database.94 Although specific criteria are not included in the final rule, one aviation journalist claims that a carrier must demonstrate two years of shipments for a given freight forwarder and must have made at least twenty-four shipments on behalf of that forwarder in order for the freight forwarder to be considered for status as a Known Shipper.95

Several parties have suggested that cargo from unknown shippers could be allowed on passenger aircraft after proper screening, but TSA has declined to adopt this suggestion. TSA explained that the industry lacks the technology to rapidly and accurately inspect the wide range of cargo and packaging, and for the time being only those shippers which are recognized as Known Shippers can have their cargo transported on passenger aircraft.96

G. INDIRECT AIR CARRIERS SPECIFIC REQUIREMENTS

The specific provisions of the IAC security programs are broader in scope and impose additional duties on the IAC to “provide for the security of persons and property traveling in air transportation against acts of criminal violence and air piracy and against the introduction of any unauthorized person [or] unauthorized explosive [device].”97 Any IAC not operating under an approved security program is forbidden from offering cargo to an air carrier operating under a Full Program, Full “All Cargo” Program, or a foreign air carrier conducting passenger operations.98

The final rule also imposes training and accountability requirements on the IAC.99 Employees and agents of an IAC who perform security related duties are now required to attend security training on an annual basis.100 Any employee or agent who has not attended training as of November 22, 2006 was to be prohibited from performing security related duties on behalf of the IAC, but this deadline was extended to June 15, 2007.101 IACs are required to designate Indirect Air Carrier Security

97. Id. at 30,500.
98. Id.
99. Id.
100. Id.
Coordinators (IACSC) similar to the security coordinator positions required of airports and aircraft operators.\textsuperscript{102} The IACSC is a corporate level position, and this person shall be the IAC's primary contact regarding security related issues.\textsuperscript{103}

VI. CRITICISMS OF PREVIOUS AND CURRENT AIR CARGO SECURITY REQUIREMENTS

Predictably, industry stakeholders have argued that the interim and final rules have been too lax or too restrictive in combatting terrorism. Rafi Ron, a former head of the Israeli Airport Authority, argued that it is ridiculous to have different security standards for items taken into the passenger cabin and items loaded in the cargo bay.\textsuperscript{104} Mr. Ron believes that TSA should not differentiate between two items that are being loaded on the same aircraft.\textsuperscript{105} However, the amount of passenger and cargo traffic within the United States is 200 times larger than the amount of traffic moving through Israel.\textsuperscript{106} Coast Guard Admiral James Loy, a former head of TSA, personally observed the security procedures used at Israel's airports.\textsuperscript{107} The admiral doubted that the high levels of readiness seen at two Israeli airports could be extrapolated out to over 500 U.S. airports.\textsuperscript{108}

The Air Line Pilots Association believes that the STA is an inadequate review process and that a CHRC should be performed for each employee or agent who has unescorted access to cargo.\textsuperscript{109} Conversely, the Aircraft Owners and Pilots Association (AOPA) and the National Air

\begin{footnotesize}
\begin{enumerate}
\item[102.] Id.
\item[103.] Id.
\item[104.] Moorman, supra note 42, at 45-46 (Mr. Rafi Ron is the president of New Age Security Solutions and formerly in charge of security for the Israel Airport Authority.). In fairness to Mr. Ron, his comments were made before the liquid bomb plot was thwarted in London, England in August 2006. Since then, TSA has drastically limited the type and quantity of liquids and gels that passengers are allowed to have in their carry-on luggage, while permitting those liquids and gels to be in the cargo hold of the same aircraft. The basis for this disparity is to prevent liquid ingredients from being combined in flight to create an explosive device.
\item[105.] Id. at 46.
\item[106.] Peter Robinson, Israeli-Style Air Security, Costly and Intrusive, May Head West, Bloomberg (Aug. 25, 2006), available at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=AFyfihM1e3G4 [hereinafter Robinson] (noting that Israel had 1.3 million air passengers during 2005 compared to 737 million air passengers in the United States, and whereas the U.S. commercial aircraft fleet has 6800 aircraft, El Al has 35 aircraft); see also CIA World Factbook, Israel: Transportation, available at https://www.cia.gov/cia/publications/factbook/geos/is.html#Trans (noting that there are only commercial 6 airports in Israel that have paved runways greater than 8,000 feet in length, which is the baseline length for jet aircraft operations).
\item[107.] Robinson, supra note 106.
\item[108.] Id.
Transportation Association (NATA) believe that the NPRM went too far with the expansions of SIDA and STA requirements.\textsuperscript{110} Several stakeholders submitted comments in opposition to inspections for 100\% of air cargo stating that the requirement would be impractical in light of existing technology and industry needs.\textsuperscript{111} NATA endorsed TSA’s decision to preserve the Twelve-Five program, as recognition of the differences between scheduled cargo carriers and on-demand carriers.\textsuperscript{112} NATA stressed that a one-size-fits-all standard would not be an appropriate means of solving air cargo security and that the final rule merely codifies existing requirements but does not impose additional burdens on operators.\textsuperscript{113}

In stark contrast to NATA’s endorsement, a November 2004 press release by Senator Schumer condemned the proposed rule, charging that it left significant gaps in the cargo security system.\textsuperscript{114} Specifically, the Senator opposed TSA’s decision not to screen 100\% of cargo on passenger aircraft and argued that all cargo, especially foreign cargo, should be inspected before being loaded onto a passenger aircraft.\textsuperscript{115}

The statements by Senator Schumer and Congressman Markey’s amendment described earlier appear to use screening and inspecting interchangeably, which indicates a misunderstanding of the rule’s provisions. According to TSA, inspections are one component of a larger screening system or network.\textsuperscript{116} TSA defines screening as a “systematic evaluation of a person or property to assess whether either poses a threat to security.”\textsuperscript{117} A cargo shipment that has been flagged or highlighted during a screening process can be inspected to determine whether it is a security threat. Additionally, random inspections of cargo, regardless of a perceived threat, are another facet of a screening system.\textsuperscript{118} Random inspections and surge events with sustained periods of increased vigilance serve as deterrents against terrorists by reducing or eliminating predictable behavioral patterns for security personnel.\textsuperscript{119}

These divergent opinions illustrate the underlying tension between

\begin{itemize}
  \item\textsuperscript{110} Air Cargo Security Requirements; Final Rule, 71 Fed. Reg. 30,481 (May 26, 2006) (to be codified at 49 C.F.R. pts. 1520, 1540-1548).
  \item\textsuperscript{111} Id. at 30,493.
  \item\textsuperscript{112} Lynch, supra note 109.
  \item\textsuperscript{113} Id.
  \item\textsuperscript{114} Schumer, supra note 10.
  \item\textsuperscript{115} Id.
  \item\textsuperscript{116} Air Cargo Security Requirements; Final Rule, 71 Fed. Reg. 30,481 (May 26, 2006) (to be codified at 49 C.F.R. pts. 1520, 1540-1548).
  \item\textsuperscript{117} Id.
  \item\textsuperscript{118} Moorman, supra note 42, at 44-45.
  \item\textsuperscript{119} See generally Transportation Security Administration, Our Security Strat.
perfect security, the unimpeded flow of commerce, and the law of diminishing returns. In December 2005, TSA adopted a risk-based strategy towards security threats and acknowledged that it cannot eliminate each and every threat to transportation security. Consequently, TSA now strives to focus its vast (albeit finite) resources on countering threats that are either more probable to occur or have more severe consequences. This mindset accounts for the differences in security requirements for passenger aircraft and all-cargo aircraft.

VII. UNIQUE NATURE OF CARGO CARRIERS VERSUS PASSENGER CARRIERS

Within certain segments of the transportation industry, there is the belief or perception that the security requirements for airlines engaged in the shipping of cargo are less stringent than the security requirements for passenger airlines because the security requirements are not exactly the same. However, cargo security requirements need to be different from passenger airline requirements for at least three reasons that pertain to the (1) nature of the persons/cargo being transported, (2) the predictable schedules that are widely available to the public, (3) and the number of entry points into the air carrier system.

A. NATURE OF THE PERSONS OR CARGO BEING TRANSPORTED

One of the main differences between passenger and cargo carriers is that the payload for passenger airlines is more uniform than the payload found on cargo airlines. Passenger airlines can screen their passengers and checked bags in minimal time because the human body and passenger luggage are relatively uniform in both size and composition for the general passenger population. Also, the transport of people and luggage constitutes the majority of the revenue stream for passenger airlines.

120. Id.
121. Id.
122. Id.
125. FRIED, supra note 124.
For example, transporting cargo at United Airlines generates only five percent of the airline’s revenue and approximately eighty percent of that cargo revenue is derived from shipping small packages. Hence, passenger airlines do not rely on transporting the large, unwieldy shipments that are handled by dedicated cargo operations. Conversely, bulk cargo constitutes the main revenue source for cargo airlines, the contents of which come in various sizes, shapes, and materials. There is no single technology that can handle the wide variety of cargo containers used today. The equipment that is available to inspect those shipments is large, expensive, and slow. It can take more than one hour for some devices to screen a cargo container.

B. Predictability of Schedules

Another difference between passenger and cargo carriers is that passenger carriers offer scheduled service and provide passengers with an advance itinerary of departure times and connecting cities, while cargo carriers do not publish pre-determined timetables. The timetables allow the general public to determine in advance which flights will arrive and depart from particular cities on specific dates (e.g. Dallas, TX to Cheyenne, WY with a connection through Denver, CO). Whereas the passenger airline’s business plan is to provide scheduled service between cities, the business plan of a cargo carrier does not need to provide scheduled service. Instead, a cargo airline provides shippers with just-in-time delivery service, which has become a fundamental element of the business strategy for many U.S. manufacturing and distribution industries. In most cases, the shipper is only concerned with the cargo’s arrival time, not the route or mode of transportation. Therefore, the cargo carrier or its agent is free to use whichever transportation mode is

127. Moorman, supra note 42, at 44.
128. Fried, supra note 124.
130. Moorman, supra note 42, at 46.
131. Patterson, supra note 9.
133. See generally Air Carriers and Operators for Compensation or Hire: Certification and Operations, 14 C.F.R. § 119.3 (2007) (definitions include: all-cargo operations; passenger-carrying operations; schedules operations; and passenger airlines which are typically common carriers that publish in advance the departure location, departure time, and arrival location for potential customers).
134. Lukas, supra note 4, at 4.
135. Letter to Sen. Inouye, supra note 13; see also Berman, supra note 90.
available while ensuring that the cargo arrives by the promised delivery date.\textsuperscript{136}

The just-in-time delivery system does not operate based on a set schedule and therefore becomes a less attractive target for terrorists because it is harder to predict when and where an explosive package will be at any point in time.\textsuperscript{137} Proponents of 100\% inspection for air cargo disagree and point to online tracking programs offered by carriers such as UPS and FedEx to allow customers to track the progress of their packages online.\textsuperscript{138} However, while these tracking applications show where a package has been, they do not show where the package is going. Furthermore, these online tools do not provide prospective flight itineraries, flight numbers, or departure times.\textsuperscript{139} Hence, while it may be possible for a would-be terrorist to deduce when a package could be in an aircraft, the terrorist would not be able to determine which aircraft or the aircraft’s location. Moreover, TSA acknowledged that there is a historical link between passenger aircraft and terrorist operations.\textsuperscript{140} It is beyond the scope of this comment to examine the mindset of terrorist organizations when choosing potential targets.

C. Number of Entry Points

A third difference between passenger carriers and cargo carriers is that the respective entry and exit points for cargo shipments to enter the transportation network are more diverse than those found in the passenger airline system. Airline passengers arrive at the airport, some passengers may check luggage, and all passengers go through a security screening process along with their carry-on items. As mentioned earlier, passenger airlines operate from approximately 450 airports.\textsuperscript{141} Although 450 airports appears to be a large number, the long lines at the check-in counters and security checkpoints demonstrate the number of access

\textsuperscript{137} Bloom, supra note 124.
\textsuperscript{138} Id.
\textsuperscript{139} See generally UPS, Tracking, http://www.ups.com (last visited Apr. 11, 2007); FedEx, Track, http://www.fedex.com (last visited Apr. 11, 2007) (online demonstrations of each corporation’s tracking software informs the user the date when a package has departed or arrived at a particular city, but does not indicate the mode of travel or the time when the package departed or arrived).
points is limited compared to the number of passengers entering the system.\textsuperscript{142}

Unlike people who board passenger airlines, air cargo can enter the cargo system through entry points far away from the airport. Cargo and packages can enter system through remote drop off sites (e.g. FedEx Drop Boxes), retail stores (e.g. Mailboxes Etc.), or through freight agents that pick up the cargo at the shipper's location.\textsuperscript{143} The large number of delivery sites, IACs, and cargo facilities create a much larger number of entry points for the air cargo system than what is found for passenger airlines.

In addition, air cargo may be received by a shipper and then transferred to an IAC who places the package on a truck. The truck driver delivers the package to the airport and hands it over to the air carrier, which places the package in a warehouse. Eventually the package is moved from the warehouse and loaded onto an aircraft. The package is at risk of being tampered with at any of these points on its journey from the shipper to the aircraft.\textsuperscript{144}

If a 100\% inspection requirement were imposed on the air cargo system, not only would TSA need to decide "how to inspect" air cargo, but TSA would also have to decide "when to inspect" it.\textsuperscript{145} Regardless of how and when the cargo is inspected, using existing technology, a 100\% inspection requirement of air cargo system would significantly degrade the speed and efficiency of commerce.\textsuperscript{146}

\section*{VIII. Differences Between Full and Full "All Cargo" Programs}

Although cargo was banned from passenger aircraft in the immediate aftermath of 9/11, that ban was partially rescinded by 2002. As of 2004, passenger aircraft were only able to transport cargo that originated with a participant in a Known Shipper program.\textsuperscript{147} Although ATSA required 100\% screening of all cargo loaded onto passenger aircraft, the statute expressly provided that the Known Shipper program was a form

\begin{itemize}
\item[143.] See generally \textit{Cargo and Freight Agents}, supra note 20.
\item[144.] \textit{Lukas}, supra note 4, at 15.
\item[145.] \textit{Beckius}, supra note 26 (describing the number of people who touch the cargo before it arrives at an aircraft to include: seller, shipper, freight forwarder, air carrier personnel).
\item[146.] \textit{Wong}, supra note 142 (describing the cumulative effect of an extra 10 seconds spent on each of the 50,000 departing passenger at Seattle-Tacoma airport each day resulted in an additional 139 man-hours of work).
\end{itemize}
of screening. Accordingly, TSA determined that the decision not to inspect 100% of the cargo on passenger aircraft did not contravene Congressional direction because the cargo from Known Shippers was screened. Despite the express language in ATSA, in response to the DOT Inspector General’s 2002 audit and the Government Accountability Office 2002 report, Congress directed TSA to triple the inspection rate for cargo loaded onto passenger airliners. Many passenger airlines had already increased the inspection rates for belly cargo in anticipation of the regulatory requirements. TSA received 134 letters commenting on the NPRM from a wide range of industry stakeholders including aircraft operators, foreign air carriers, airports, indirect air carriers, and state and local governments. The agency acknowledged that the DOT audit, GAO report, and recommendations from the aviation industry all played a role in the development of the final regulation.

TSA views explosives as the greatest threat to the United States transportation infrastructure. The continued prohibition of cargo from unknown shippers on passenger aircraft, the long-standing practice of positive bag matching, and the use of trace explosive detection equipment at passenger security gates are strong indicators that deterring and detecting explosive devices smuggled onboard passenger aircraft is still a TSA priority. Passenger aircraft appear to be lucrative and easy targets in the eyes of a terrorist. The predictable schedules and the number of lives involved may account for terrorists’s historical preference for targeting passenger aircraft, as seen with Pan Am Flight 103 and the Russian flights on August 24, 2004. Detection of explosives on a passenger aircraft may therefore be a higher-priority task for security personnel at passenger carriers than at cargo carriers.

However, it would appear that TSA views a hostile takeover of a cargo jet as a more likely risk than an onboard explosive. The Final Rule

148. Id.
149. Air Cargo Security Requirements; Final Rule, 71 Fed. Reg. 30,484 (May 26, 2006) (to be codified at 49 C.F.R. pts. 1520, 1540-1548) (responding to whether “inspect” and “screen” are interchangeable terms, TSA answered in the negative, and TSA interprets inspection as a subset of screening).
151. MOORMAN, supra note 42, at 44.
153. Id. at 30,478.
154. Id.
157. Id.
makes numerous references to stowaway hijackers and their use of aircraft as a weapon of mass destruction.\textsuperscript{158} The potential for stowaways in air cargo was demonstrated when Mr. Charles McKinley shipped himself from New Jersey to Texas in a wooden crate aboard a Kitty Hawk Cargo aircraft.\textsuperscript{159} In the post-9/11 environment, a hijacker of a passenger airline will most likely have to subdue the passengers as well as the flight crew in order to commandeer an aircraft. A stowaway on a cargo plane will only have to subdue the two to four pilots onboard in order to use a jet aircraft as a weapon of mass destruction.\textsuperscript{160} The unique characteristics of passenger and cargo airline operations justify the different areas of emphasis for countering the more probable threats to passenger and cargo aircraft.

IX. Adequacy of the Air Cargo Security Requirements

Senator Schumer and Congressman Markey have both supported 100\% inspection for cargo that is shipped on aircraft.\textsuperscript{161} Although a 100\% inspection rate is an ideal standard, the existing explosive detection technology cannot meet that goal without generating a significant number of false positive results.\textsuperscript{162} In addition, TSA views fluctuating inspection rates as a form of deterrence.\textsuperscript{163} If a credible 100\% inspection rate cannot be achieved, continuously operating at maximum effort leaves TSA with no means to increase security during heightened threat periods.\textsuperscript{164} Also, by adding an element of unpredictability, would-be attackers have a more difficult time exploiting security procedures.\textsuperscript{165}

Irrespective of the ideal inspection rate, one of the primary areas of concern with the final rule will be accountability. The entire air cargo security system is predicated on the compliance of regulated entities.\textsuperscript{166}

\textsuperscript{158} Id. at 30,480, 30,498.
\textsuperscript{162} Cargo Security is Not Elementary, supra note 95.
\textsuperscript{163} Beckius, supra note 26, at 9, 11 (describing focused inspections of known weak areas along with concentrated week-long inspections of IACs at airports with high cargo volume).
\textsuperscript{164} Telephone interview with Security Coordinator at a major U.S. airline (July 19, 2006) (discussing the benefit of tailoring security procedures based on probable threats and existing capabilities).
\textsuperscript{165} See Our Security Strategy, supra note 119.
\textsuperscript{166} Statement of Cathleen Berrick, supra note 3, at 22 (stating that TSA has increased the
While the Aviation and Transportation Security Act required Transportation Security Officers (TSO) to conduct the screening of all passengers and checked baggage at passenger airports, the Act did not require TSOs to conduct the screening of air cargo.167 Instead, TSA is responsible for the security of air cargo by establishing security rules and regulations (which it has done) and overseeing the implementation of these regulations through compliance inspections.168 These inspections may consist of reviewing documentation, interviewing personnel, observing air cargo operations, or conducting compliance tests.169

Because privately owned air cargo companies are in business to earn a profit and the increased costs of complying with TSA security regulations will affect profits, the success of the security system will depend to a large extent on the diligence of aircraft operators and the indirect air carriers. The assumption is that by publishing rules and regulations, the regulated entities will comply with them, but as was the case with the ValuJet crash in 1996, a willful or inadvertent failure to comply can cause an aviation disaster.170

Air carriers are not required to verify that an IAC is in compliance with STA requirements as part of the acceptance process for air cargo.171 The compliance burden will be on TSA inspectors to verify that regulated entities are complying with the regulations. To meet this additional burden, TSA is hiring an additional 300 air cargo inspectors to supplement the existing cadre of inspectors, which will be stationed at 102 airports from which ninety-five per cent of domestic cargo originates.172 Although the hiring of additional inspectors will help, as of April 2006, TSA had not developed performance measures by which the agency could determine to what extent air carriers and IACs were complying with the air cargo security requirements.173 Even though TSA has been able to determine that IACs have more violations than air carriers, TSA has not developed a baseline of acceptable performance. Accordingly, TSA cannot

number of inspectors used to assess whether air carriers and IACs are complying with security requirements.

167. Id. at 4-7.
168. Id. at 6.
169. Id. at 7.
170. Aviation Security: Securing Cargo, supra note 1 (describing NTSB findings that FAA oversights contributed to the loading of hazardous materials onto the aircraft, and that these hazardous materials caused the fire which lead to the crash).
172. TSA Issues New Regulations, supra note 29.
173. Statement of Cathleen Berrick, supra note 3, at 22-23 (indicating that TSA performed over 36,500 inspections between 2003 and 2004 and found 4,343 violations, but had not determined what constituted an acceptable level of performance).
compare an air carrier's or IAC's performance against this baseline.\textsuperscript{174}

X. CONCLUSION

The Air Cargo Security Requirements represent a substantial improvement over the previous security structure. The agency's transition to a threat-based risk management approach as a means of properly allocating its resources and protecting a diverse and porous supply chain appears to be reasonable on its face. The critical element of the Rule will be the frequency and depth of scrutiny utilized by TSA inspectors against aircraft operators and IACs and the ripple effect of those inspections within the industry in order to maintain a high degree of awareness and vigilance for transporting cargo.

\textsuperscript{174} Id. at 23-25.
Challenging State Accounting Methods and Discriminatory Taxation Against Railroad Properties Under the 4-R Act

Bridgette M. Miller*

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I. INTRODUCTION

This comment analyzes issues and constitutionality concerns that arise from Section 11501(b)(1) of the Railroad Revitalization and Regulatory Reform Act,1 ("4-R Act"). While the 4-R Act is an expansive federal law enacted to address a wide range of problems confronting the railroad industry,2 the purpose of Section 11501(b)(1) is to prevent states from assessing "rail transportation property" at levels that "unreasonably burden and discriminate against interstate commerce."3 The exact scope of Section 11501(b)(1), however, is not clear and has generated a split in the circuit courts of appeal on the issue of "whether a railroad may, in an action under [Section 11501(b)(1)], challenge in the district court the appropriateness of the accounting methods by which [a] State determined the railroad's value, or [whether it] is instead restricted to challenging the factual determinations to which the State's preferred accounting methods were applied."4

Initially, railroads that brought claims under Section 11501(b)(1) would challenge the state's assessed value of the railroad property without challenging the state's accounting methods.5 Usually, to accomplish this, a railroad would hire an appraiser who would use alternative accounting methods in order to demonstrate that the state's valuation of the railroad's property exceeded values permissible under Section 11501(b)(1).6 Railroads would also compare the state's property assessment values to the true market value of "other commercial and industrial property in the same assessment jurisdiction"7 to demonstrate that the state's valuation of the railroad's property exceeded Section 11501(b)(1) limits.8 More recently, however, railroads have challenged state property assessments by using other accounting methods to show that a state's ac-

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1. Tax Discrimination Against Rail Transportation Property, 49 U.S.C. § 11501 (1976) [hereinafter 4-R Act]. Section 11501(b) of the 4-R Act states, (b) The following acts unreasonably burden and discriminate against interstate commerce, and a State, subdivision of a State, or authority acting for a State or subdivision of a State may not do any of them: (1) Assess rail transportation property at a value that has a higher ratio to the true market value of the rail transportation property than the ratio that the assessed value of other commercial and industrial property in the same assessment jurisdiction has to the true market value of the other commercial and industrial property. (emphasis added).
3. 4-R Act, supra note 1.
7. 4-R Act, supra note 1.
counting method, rather than merely the assessed property valuation, violated the 4-R Act. This comment analyzes whether Section 11501(b)(1) permits a railroad to use such alternative accounting methods to show that a state’s accounting method is erroneous and should not be applied.

On December 11, 2006, the Eleventh Circuit published the most recent opinion on the issue of whether a railroad may challenge a state’s accounting methods in an action brought under Section 11501(b)(1). In *CSX Transportation Inc. v. State Board of Equalization*, the railroad argued that when a railroad is discriminated against by the state in the calculation of taxes assessed against its railroad properties, the railroad may challenge the validity of the state’s accounting methods pursuant to Section 11501(b). The Eleventh Circuit disagreed and found that while the railroad could challenge the state’s assessment of the railroad property, it could not challenge the validity of the state’s accounting method. In other words, the court rejected the claim that Section 11501(b)(1) subjects the state’s accounting methods to judicial scrutiny. This case is just one of four cases that address the scope of 11501(b)(1). The Second and Ninth Circuits have held differently, concluding that railroads may challenge a state’s tax accounting methods.

The Supreme Court has not answered the issue of whether a railroad may challenge a state’s accounting methods since the Court initially left the issue open in *Burlington N. R.R. Co. v. Oklahoma*. In that case, the Court granted certiorari to review the Tenth Circuit’s holding in *Burlington N. R.R. v. Lennen* that the 4-R Act did “not permit the exercise of federal jurisdiction to review claims of state taxation based upon alleged overvaluation of railroad property, unless the railroad ‘can make a strong showing of purposeful overvaluation with discriminatory intent.’”* Burlington N. R.R. refuted the Tenth’s Circuit holding and argued that it could bring suit against Oklahoma because Oklahoma had overvalued its railroad property in violation of Section 11503, currently re-codified at 11501(b)(1). In particular, *Burlington N. R.R.* argued that in order to

10. *Id.* at 1287.
11. *Id.*
12. *Id.* at 1288.
13. *Id.*
17. *Burlington N. R.R. Co.*, 481 U.S. at 460 (quoting *Lennen*, 715 F.2d at 498 (internal quotation marks omitted)).
prove that Oklahoma was unreasonably burdening and discriminating against the railroad in interstate commerce, the railroad must be able to challenge Oklahoma’s property assessment.\textsuperscript{19} After reviewing the statutory language of Section 11501, the Court concluded that the section did provide for review of Burlington’s claims and that to hold otherwise would be to disregard the legislative purpose of the section.\textsuperscript{20} Moreover, the Court held that Burlington did not have to show “purposeful overvaluation with discriminatory intent” because the purpose of Section 11501 is to eliminate discrimination against railroads, regardless of whether discrimination was done with intent.\textsuperscript{21} However, because Burlington did not challenge the validity of Oklahoma’s accounting method, the scope of Section 11501(b)(1) remains unanswered.\textsuperscript{22}

This comment explores the questions left open in \textit{Burlington N. R.R. v. Oklahoma} and discusses the related circuit court opinions, relevant legislative history, and the provisions of Section 11501. First, this comment will provide a brief overview of the railroad industry as well as the problems that Section 11501(b) was designed to address. Included within this analysis is an inquiry into the constitutionality of Section 11501(b) and the manner in which states have challenged Section 11501(b)(1) when faced with suits by railroads. This comment then reviews various circuit court opinions that address challenges to a state’s accounting methods, discusses the legislative history of Section 11501(b), evaluates principles of statutory interpretation, and outlines case law that the circuit courts relied on to justify their holdings. Finally, this comment evaluates the opinions of the circuit courts, the arguments put forth by the plaintiff railroads and defendant states, and the legislative history of the 4-R Act in an attempt to determine whether railroads may challenge state accounting methods in actions brought under Section 11501(b)(1).

Based on the discussion within this comment, it is the opinion of the author that Section 11501(b)(1) permits railroads to challenge the validity of state accounting and valuation methods. Although the language of the Section does not expressly provide that a state’s accounting methods may be subject to suit, it is simply another way in which a railroad can show that it has been discriminated against in interstate commerce. Moreover, based on the following discussion of the constitutionality of Section 11501(b)(1) and the Section’s legislative history, it is likely that Congress, by using its powers under Section 5 of the Fourteenth Amendment, impliedly permits railroads to subject states to suits under Section 11501.

\textsuperscript{19} \textit{Id.}; 4-R Act, \textit{supra} note 1.
\textsuperscript{20} \textit{Burlington N. R.R. Co.}, 481 U.S. at 462.
\textsuperscript{21} \textit{Id.} at 464.
\textsuperscript{22} \textit{Id.} at 463, n.5.
II. THE DEVELOPMENT OF THE 4-R ACT AND THE PROVISIONS UNDER ATTACK

A. CONGRESS TAKES ACTION: THE PASSING OF SECTION 11501(b)(1)

Railroads depend upon their track to move extensive amounts of goods across the country, the construction and maintenance of which often results in high costs to the railroad.23 In return, the public depends on railroads to carry those goods across the country. The value of railroads is obviously immense but it is worth noting the benefits that the railroad industry offers the transportation industry. In 2000, for example, railroads reduced congestion on the United State’s highway system by handling “28 percent of our nation’s freight mile tonnage.”24 Had the same freight been moved by motor carriers, the traffic on the highway system would have increased by fifty percent.25 Moreover, “[f]reight rail is a critical link in the nation’s intermodal network, serving the trucking and maritime shipping industries, and supporting our global competitiveness.”26 The need for railroad carriers is not going to end any time soon. According to a study conducted by the Department of Transportation in 2003, “freight transportation will increase by nearly seventy percent between 2000 and 2020.”27 This translates into increased freight traffic for all modes of transportation, including railroads.28 Therefore, in order to provide for the increasing freight traffic, railroads must be able to maintain and add to existing structures.

Burlington N. Santa Fe Corp., for example, is preparing for the increase in freight traffic by investing its capital in the maintenance of its rails, ties, bridges, and signals.29 Unlike other modes of transportation, the railroad must spend “far more . . . on maintenance and renewal to ensure the reliability and safety of its physical plant.”30 In addition, Burlington N. Santa Fe Corp. is preparing for the increased freight traffic by extending its track lines. Just recently, the company added “about 33 miles of second main track [to its] line between Chicago and Los Angeles,” and “19 miles of second main track on the coal line in Wyoming and Nebraska,” with plans to add more track in the near future.31 Yet the

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25. Id.
26. Id.
27. Id. at 10.
28. Id.
29. Id. at 11.
31. Id. at 13-14.
cost of increasing lines and maintaining structures is immense. Over the past three years, Burlington N. Santa Fe Corp. spent $1.75 billion to increase track lines and in 2006 alone spent $1.2 billion to maintain its existing track. 32

In order to ensure that railroads can maintain and improve their current structure, railroads must not only keep a successful business running but also be shielded from acts which would hinder the railroads’ ability to prosper. 33 In passing Section 11501 of the 4-R Act, Congress chose to prohibit discriminatory taxation as a way to protect and maintain the railroad industry 34 because “railroads are easy prey for State and local tax assessors in that they are nonvoting, often nonresident, targets for local taxation, which cannot easily remove themselves from the locality.” 35 In other words, state laws might not offer railroads the same protection from over-taxation because railroads do not have the same leverage as voters in the state, and because railroads are unable to move out of the state due to the amount of tracks they have invested on their properties. 36 Moreover, when Congress passed Section 11501 in 1976, proof of the then-prevailing discriminatory taxation was the fact that railroads were being over-taxed by fifty million dollars per year. 37 While today this figure seems relatively small compared to the amount that railroads are spending on maintenance and construction of existing structures, current suits under Section 11501 allege that states have over-valued railroad properties in the billion dollar range. 38 For example, in CSX Transp. Inc., the railroad alleged that the state had overvalued its property approximately $2 billion above the true market values of other commercial and industrial properties in violation of Section 11501(b)(1). 39 In CSX Transp. Inc., the result of overvaluing the railroad’s property could mean that one railroad alone was overtaxed in the $100 million range. 40

Therefore, because railroads are potentially being overtaxed in such significant amounts, it is likely that the funds that could be spent on maintenance or construction of tracks are diverted to other uses in the state. 41 With the limited amount of track in the country and the overwhelming need to transport goods, 42 the federal government has an important inter-

32. Id. at 11-13.
36. Id.
37. Id.
38. See, e.g., CSX Transp., Inc., 472 F.3d at 1285-86.
39. Id.
40. Id. at 1286.
est in preserving the railroad industry from the potentially overreaching arms of state governments. Congress thus enacted Section 11501 of the 4-R Act as a means to protect railroads from discriminatory taxation by states.\footnote{Id.}

While the power to levy taxes is a power that is within the state’s discretion and is considered an essential tool in carrying out vital state functions, it cannot be used to discriminate against the railroad industry.\footnote{CSX Transp., Inc., 472 F.3d at 1288 (citing Dows v. City of Chicago, 78 U.S. (11 Wall.) 108, 110 (1871)).} Prior to the passing of the 4-R Act, railroads wishing to challenge a state’s taxation method were generally limited to actions in state courts. If a railroad did bring a cause of action against a state in federal court, the railroad would first have to overcome a high bar set forth in the Tax Injunction Act.\footnote{Tax Injunction Act, 28 U.S.C. §1341 (2006).} Pursuant to the Tax Injunction Act, “district courts shall not enjoin, suspend or restrain the assessment, levy, or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.”\footnote{Id.} Absent any statute or exception to the contrary, the Tax Injunction Act requires that a railroad prove that no “plain, speedy and efficient remedy”\footnote{Id.} is available in state court. Thus, the purpose of the Tax Injunction Act is to “eliminate interference by federal courts in state internal economy and taxation matters.”\footnote{Arizona v. Atchison, Topeka & Santa Fe R.R., 656 F.2d 398, 402 (9th Cir. 1981) (citing Great Lakes Dredge & Dock Co. v. Huffman, 319 U.S. 293, 298-99 (1943)).} However, when Congress passed the 4-R Act, it created an exception to the Tax Injunction Act. Subsection 11501(c) declares that the Tax Injunction Act will not bar suits from railroads challenging a state’s alleged discriminatory taxation.\footnote{4-R Act, supra note 1 (providing that “[n]otwithstanding section 1341 of title 28 . . . a district court of the United States has jurisdiction . . . to prevent a violation of subsection (b) of this section.”).} This is because the 4-R Act “contains its own jurisdictional predicate, and creates an explicit exception of the jurisdiction bar of [Section 1341].”\footnote{Atchison, Topeka and Santa Fe R.R. Co., 656 F.2d at 402.} This means that Section 11501(c) provides federal courts with jurisdiction to decide claims brought under the Section’s provisions without having to overcome the Tax Injunction Act.

The question remains as to what type of relief Congress intended to provide railroads under Section 11501. The type of relief granted to the railroads in suits against states is a delicate issue. For example, if Congress were to provide for relief in the form of monetary damages, the state might arguably defeat the railroad on Eleventh Amendment
grounds.\textsuperscript{51} In \textit{McKesson Corp.}, however, the U.S. Supreme Court held that where “a State places a taxpayer under duress promptly to pay a tax when due and relegates him to a postpayment refund action in which he can challenge the tax’s legality, the Due Process Clause of the Fourteenth Amendment obligates the State to provide meaningful backward-looking relief to rectify any unconstitutional deprivation.”\textsuperscript{52} Therefore, it is possible that the railroads could use \textit{McKesson} to argue that they are entitled to monetary damages in the form of “backward-looking relief”\textsuperscript{53} because the state’s discriminatory taxation arguably violated the Commerce Clause.\textsuperscript{54}

States, of course, could counter this argument on traditional Eleventh Amendment grounds. For example, the state could argue that allowing railroads to seek monetary relief from the state hinders the state’s ability to provide for its citizens. As articulated by the Supreme Court in \textit{Hans v. Louisiana} over a century ago, “there is no color to pretend that the state governments would, by the adoption of that plan, be divested of the privilege of paying their own debts in their own way, free from every constraint but that which flows from the obligations of good faith.”\textsuperscript{55} In other words, the Court in \textit{Hans} proposes that if states were subject to suits for monetary damages, the states would lose their financial independence – at least to the extent that a state is able to self-sustain.\textsuperscript{56} The purpose behind the Eleventh Amendment immunity is, therefore, to shield the states from suits seeking monetary damages which might drain their economic resources.\textsuperscript{57}

Thus, in an attempt to avoid the application of the Eleventh Amendment, at least with regard to suits for monetary relief, Congress fashioned a different remedy. Pursuant to Section 11501(c), “a district court of the United States has jurisdiction . . . to prevent a violation of subsection (b) of this Section.” Put differently, a federal court has the power to grant a railroad some form of injunctive relief in order to prevent a violation of the 4-R Act.\textsuperscript{58} Unlike monetary damages, injunctive relief is permitted

\textsuperscript{52} Id.
\textsuperscript{53} Id.
\textsuperscript{54} Id. (citing Atchison, T. & S.F.R. Co. v. O’Connor, 223 U.S. 280 (1912)).
\textsuperscript{55} 134 U.S. 1, 13 (1890).
\textsuperscript{56} Id.
\textsuperscript{57} Id.
\textsuperscript{58} Burlington N. and Santa Fe Ry. Co. v. Burton, 270 F.3d 942, 944 (10th Cir. 2001). \textit{See also} Trailer Train Co. v. State Bd. of Equalization, 697 F.2d 860, 866 (9th Cir. 1983) (finding that the 4-R Act has a “procedural component” that allows railroads to sue for injunctive relief in federal court).
under the Eleventh Amendment as interpreted in *Ex Parte Young*. While the traditional standard for granting injunctive relief is whether the moving party can demonstrate irreparable harm and “a likelihood of success on the merits,” a railroad seeking injunctive relief under the 4-R Act must show “reasonable cause” that a violation of the 4-R Act has or will occur. The purpose of the increased standard of reasonable cause is to prevent railroads from filing claims based on a mere “scintilla of evidence,” which in turn protects the states from frivolous claims while still allowing railroads an opportunity to present legitimate claims of discriminatory taxation to the district court.

B. CONSTITUTIONAL CHALLENGES TO THE 4-R ACT

Currently, railroads may bring suits against states in federal court without having to hurdle the Tax Injunction Act and perhaps only with a reasonable burden to seek injunctive relief. Thus, states have had to strengthen their defensive tactics, at least since the passing of the 4-R Act, and have begun to attack the constitutional validity of Section 11501. First, because the language of Section 11501 seems to imply that Congress was acting pursuant to its Commerce Clause powers when enacting its taxation provisions, states have attacked the Section on Tenth Amendment grounds. In particular, states have argued that the Commerce Power does not permit Congress to interfere with state taxation matters because those matters are reserved to the states under the Tenth Amendment. Pursuant to the Tenth Amendment, “[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.”

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59. 209 U.S. 123, 190 (1908).
62. *Id.* at 555.
63. 4-R Act, supra note 1 (providing that “[n]otwithstanding section 1341 of title 28 [the Tax Injunction Act] ... a district court of the United States has jurisdiction ... to prevent a violation of subsection (b) of this Section.”). See also *Atchison, Topeka & Santa Fe R.R.*, 656 F.2d at 402 (finding that the 4-R Act creates an exception to the jurisdictional bar set forth in the Tax Injunction Act); *CSX Transp., Inc.*., 964 F.2d at 551 (finding that the railroad must show “reasonable cause” that a violation of the 4-R Act has or will occur when seeking injunctive relief). Cf., *Polymer Tech. Corp.*, 975 F.2d at 61 (holding that a “preliminary injunction may issue if the plaintiff demonstrates irreparable harm, and either a likelihood of success on the merits, or sufficiently serious questions going to the merits to make them a fair ground for litigation and a balance of hardships tipping decidedly in its favor.”).
64. U.S. CONST. art. I, §8, cl. 3.
65. 4-R Act, supra note 1 (stating that “[t]he following acts unreasonably burden and discriminate against interstate commerce”) (emphasis added).
67. U.S. CONST. amend. X.
example, in *Atchison, Topeka and Santa Fe R.R. Co.*, the State of Arizona relied on *National League of Cities v. Usery*\(^6\) for the proposition that the power to tax, including the power to tax the railroad industry, is an integral function of the Arizona government and therefore reserved to the state.\(^6\) The Ninth Circuit rejected Arizona's argument, holding that Section 11501 did not violate the Tenth Amendment.\(^7\) In so holding, the Ninth Circuit relied on *United States v. California*, which held that the federal government is permitted to regulate railroads that operate in interstate commerce.\(^7\) Although the Ninth Circuit seemed to agree that the assessment of property taxes is an integral function of the government, Arizona could not expect to be exempt from federal regulations because railroads are instrumentalities of interstate commerce.\(^7\) The Ninth Circuit also applied Justice Blackman's balancing test in *National League of Cities* and concluded that the federal government's interest in protecting railroads against discriminatory taxation outweighs Arizona's interest to regulate railroads free from federal regulations.\(^7\)

Although Arizona did not succeed in its Tenth Amendment challenge in *Atchison, Topeka and Santa Fe R.R. Co.*,\(^7\) states have also looked to the Eleventh Amendment, albeit unsuccessfully,\(^7\) to challenge the 4-R Act as an unconstitutional infringement on state sovereignty. As previously mentioned, *Ex Parte Young* held that suits for injunctive relief are permissible.\(^7\) Nonetheless, the Supreme Court has yet to address the validity of an Eleventh Amendment claim to Section 11501. Therefore, to the extent a state may confront such a challenge in the Supreme Court (as well as other courts), the Eleventh Amendment argument merits discussion.

The Eleventh Amendment commands that "[t]he Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign

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69. *Atchison, Topeka & Santa Fe R.R. Co.*, 656 F.2d at 406.

70. *Id.*

71. *Id.* at 408.

72. *Id.*

73. *Id.*

74. At the time this article is written, there have been very few challenges to the 4-R Act on Tenth Amendment grounds. The other known case addressing the issue was heard in the U.S. District Court of Tennessee. In that case, the court rejected the Tenth Amendment challenge and upheld the constitutionality of the 4-R Act. *Tennessee v. Louisville & Nashville R.R.*, 478 F. Supp. 199, 203 (M.D. Tenn. 1979).

75. The following Section notes the cases where states have tried unsuccessfully to overturn the 4-R Act with the Eleventh Amendment.

76. 209 U.S. 123, 190 (1908).
State.” 77 Thus, pursuant to the Eleventh Amendment, citizens cannot bring suits against the state absent consent because the state has sovereign immunity. 78 However, consent is not the only exception to Eleventh Amendment grant of state sovereignty. Congress may also abrogate a state’s immunity if it has “unequivocally expresse[d] its intent to abrogate the immunity” and has acted “pursuant to a valid exercise of power.” 79

Applying this test to Section 11501(b), the states would first need to argue that Section 11501(b) was not an unequivocal expression of Congress to abrogate its immunity. One state has argued that while Congress has declared that the 4-R Act gives jurisdiction to bring a claim in federal court under 11501(c), the Act fails to identify whether the suit can be brought for discrimination on a sales tax claim or merely a property claim. 80 Therefore, the state argues, the railroad cannot bring its claim of discriminatory taxation in federal court because Congress did not unequivocally express that a state’s sovereign immunity is abrogated for discriminatory sales tax claims. 81

Second, in order to show that Congress impermissibly abrogated state immunity, the state must also show that the 4-R Act is an invalid exercise of Congressional power. Here, Seminole has clearly held that Congress cannot use its Commerce Clause powers to abrogate state immunity under the Eleventh Amendment. 82 Therefore, a state may argue that Section 11501(b) is an unconstitutional exercise of Congress’s Commerce Clause powers pursuant to the Eleventh Amendment. Moreover, the state would argue, the language of Section 11501(b) was enacted specifically through the use of Congress’s Commerce Clause powers because it directly forbids acts which “unreasonably burden and discriminate against interstate commerce.” 83 Even the legislative history behind the 4-R Act seems to support a finding that it was passed pursuant to Congress’s Commerce Clause powers. 84

Unfortunately for the states, the majority of circuit courts that have heard challenges to Section 11501(b) on Eleventh Amendment grounds

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77. U.S. Const. amend. XI.
79. Id. at 55 (citing Green v. Mansour, 474 U.S. 64, 68 (1985)).
81. See id. at *1.
82. See Seminole, 517 U.S. at 58.
83. 4-R Act, supra note 1, at 49 U.S.C. § 11501(b).
84. See, e.g., Common and Contract Carrier State Property Tax Discrimination Hearings Before the Subcomm. on Transportation and Aeronautics of the H. Tax Comm’n on Interstate and Foreign Commerce, 91st Cong. 7 (1970) (testimony discussing the power of Congress to legislate under the Commerce Clause).
hold that it is a valid exercise of Congress's power, not under the Commerce Clause, but under Section 5 of the Fourteenth Amendment. The circuits courts rely on Seminole, which held that although Congress could not abrogate a state's sovereign immunity under the Commerce Clause, Section 5 of the Fourteenth Amendment would permit Congress the authority to abrogate state sovereignty where it otherwise could not with its Commerce Clause authority.

Section 5 of the Fourteenth Amendment provides that "Congress shall have the power to enforce, by appropriate legislation, the provisions of this article." The types of legislation that Congress may enforce within the Fourteenth Amendment "include the due process and equal protection rights." However, Congress's power prescribed by the Fourteenth Amendment is remedial in nature and cannot be used to "determine what constitutes a constitutional violation." To determine whether Congress has acted pursuant to its powers under Section 5 of the Fourteenth Amendment involves a two-part test. First, did "Congress identify a history and pattern of Constitutional discrimination by the states against the non-suspect class?" Second, if so, is there a "congruence and proportionality between the injury to be prevented or remedied and the means adopted to that end?"

According to the reasoning set forth in CSX Transp., Inc., Congress satisfied the two-part test set forth above. Congress identified a history

85. See CSX Transp., Inc. v. N.Y. Office of Real Prop. Servs., 306 F.3d 87, 96 (2d Cir. 2002); Union Pac. R.R. v. Utah, 198 F.3d 1201, 1203 (10th Cir. 1999); Wheeling & Lake Erie Ry. v. Pub. Util. Comm'n of Pa., 141 F.3d 88, 100 (3d Cir. 1998); Or. Short Line R.R. v. Dept. of Revenue Or., 139 F.3d 1259, 1265 (9th Cir. 1998).

86. However, in Aitchison, Topeka and Santa Fe R.R. Co., the Ninth Circuit took a different view and upheld the constitutionality of the 4-R Act as a valid exercise of Congress' Commerce Clause power. 656 F.2d at 410. In addition to finding that the 4-R Act does not violate the Tenth Amendment, as previously discussed, the Ninth Circuit concluded that the 4-R Act does not intrude on a state's sovereignty because it "requires no change in structure of state government," and at most, "requires states to alter their tax structures so that railroad property is assessed at a ratio no higher than that of other commercial and industrial properties." Id. at 408. This case is instructive in two respects, on the one hand it upholds the constitutionality of the 4-R Act, and on the other hand, provides an argument for the railroad's challenge to a state's accounting methods. The argument follows that states will only be required to change their accounting methods to accommodate the provisions of the 4-R Act - versus having to comply with a court imposed regulatory system. Thus, if the state fails to alter its accounting methods so as to not unreasonably burden and discriminate against the railroad, the railroad's cause of action under the 4-R Act is simply to force the state's hand in adopting non-discriminatory measures.


88. CSX Transp., Inc., 306 F.3d at 96 (citing City of Beorne v. Flores, 521 U.S. 507 (1997)).

89. City of Beorne, 521 U.S. at 519.

90. See CSX Transp., Inc., 306 F.3d at 97.

91. Id. (citing Bd. of Tr. of the Univ. of Ala. v. Garrett, 531 U.S. 356, 368 (2001)).

92. City of Beorne, 521 U.S. at 520.
and pattern of Constitutional discrimination during its fifteen year deliberation period in which railroads had been overtaxed approximately fifty million dollars per year, received unequal tax treatment when compared to other property owners, and had little if any political power to halt the discriminatory tax treatment. In addition, Section 11501(b) is also a congruent and proportional remedy to address a railroad’s discriminatory tax treatment: Section 11501(b) is only available to the railroads, the provisions are meant to exclusively address discriminatory tax treatment, the taxation must “exceed by at least 5 percent” of the assessed value of “other commercial and industrial property,” and the remedy is only for injunctive relief as to the excess amount taxed on the railroad property.

Based on the holdings of several circuit courts, it appears that the states will face an uphill battle when challenging the constitutionality of Section 11501(b) of the 4-R Act. Nevertheless, states continue to challenge the validity of the provision in the trial courts. In Union Pacific Railroad Co v. Utah State Tax Commission for example, the State of Utah is currently arguing that Congress created a new right under the Fourteenth Amendment and did not fashion a remedy that passes the “congruence and proportionality” test. However, until the Supreme Court definitively decides the issue, Section 11501(b) will continue to regulate the states, and the states will continue to challenge its constitutional validity.

III. A Split in the Circuit Courts

A. The Fourth Circuit and Chesapeake Western Railway v. Forst

Obviously, if a state prevails on constitutional grounds, there is no need to address the issue of whether a railroad may challenge a state’s accounting methods under Section 11501(b) of the 4-R Act. Section 11501(b) would be invalidated and the states would be free to tax the railroads in accordance with their preferred methods of taxation. The focus of this Section now turns away from the constitutionality of Section 11501(b) and towards the issue of whether a railroad may challenge a state’s accounting methods.

The first circuit court to hear a challenge was the Fourth Circuit in Chesapeake Western Railway v. Forst. In that case, appellants Chesapeake...
peake Western Railway, along with several other railroad companies that operate in Virginia, brought suit against the Virginia state tax commissioner claiming the accounting methods (not just the assessed value) discriminated against them in violation of Section 11501(b)(1) of the 4-R Act. In particular, appellants argued "the inventory and summation methods [used by the state] resulted in such property being assessed at a value greater than true market value." If this is true, as the court explained, then the appellant's properties were being assessed at a value greater than one while all other properties in the state were being assessed at a value less than one, which would have been discrimination prohibited under the 4-R Act. The alleged discriminatory taxation however, was based on the appellant's use of other accounting methods. In other words, the appellants challenged the validity of the state's accounting methods by comparing it to other accounting methods which the state did not use.

The court rejected the appellant's argument that Section 11501(b)(1) provides an opportunity for a railroad to challenge a state's accounting methods. First, the court looked to the history of general prohibitions on federal intrusion into state tax matters. The court cited to 28 U.S.C. §1341, the Tax Injunction Act, and Burlington N. R.R. v. Lennen for the general principle that the federal government is not to interfere with state taxation matters. Because there is no express language in Section 11501 providing that a railroad may challenge a state's accounting methods, the Fourth Circuit declined to make an exception to the policy of non-interference in state matters. In so holding, the court found that "federal courts are ill equipped to evaluate the merits of a challenge to a

99. See id. at 529.
100. Virginia uses two accounting methods when determining the value of railroad property, one for land and another for non-land. See id. at 529. The first method assesses the fair market value of the railroad property land on the basis of what other adjacent or similarity situated commercial properties are worth. See id. This method is termed the "over-the-fence" accounting method because it values the railroad property "on the best use and value . . . of the land across the fence from the railroad land." Id. The second method however, is limited to non-land railroad property. In calculating the value of non-land railroad property, the state first determines the value of the property when it was originally purchased, less a fixed value to account for depreciation of the property. Id. Collectively, these two methods are called the "inventory and summation" evaluation methods. Id.
101. Id. at 530.
102. See id.
103. See id. at 531.
104. See id.
106. Chesapeake W. Ry., 938 F.2d at 531.
107. Id.
state taxation scheme."\textsuperscript{108}

However, \textit{Lennen} has since been overruled by \textit{Burlington N. R.R. v. Oklahoma}. Recall that in \textit{Lennon}, the Court of Appeals for the Tenth Circuit held that the railroad must make a "prima facie case of retaliation or intentional discrimination" before bringing a claim under the 4-R Act.\textsuperscript{109} The Supreme Court has of course rejected this argument and now holds that no preliminary showing of discrimination is necessary for the railroads to file suit under Section 11501.\textsuperscript{110} Rather, the Supreme Court found that the Section 11501(b)(1) expressly allows a railroad to challenge the state's assessed value of the railroad property.\textsuperscript{111} Therefore, to the extent that the Fourth Circuit relies on principles of non-interference to prohibit a railroad from challenging a state's accounting methods, its rationale has been diminished.

Nevertheless, the Fourth Circuit in \textit{Chesapeake W. Ry.} found that Section 11501(b)(1) did not expressly provide that a railroad may challenge a state's evaluation methods.\textsuperscript{112} To determine whether Congress intended to provide railroads with such an opportunity, the court turned to the legislative history of the 4-R Act.\textsuperscript{113} Citing to Senate Bill 927, the court concluded that Congress did not intend to create an avenue whereby a railroad could challenge the state's accounting methods.\textsuperscript{114} The testimony from the bill states that the purpose of the 4-R Act does not suggest or require a State to change its assessment standards, assessment practices, or the assessments themselves. It merely provides a single standard against which all affected assessments must be measured in order to determine their relationship to each other. It is not a standard for determining value; it is a standard to which values that have already been determined must be compared.\textsuperscript{115}

Using the language set out in Senate Bill 926, the court concluded that the 4-R Act provided railroads with the ability to challenge the end result of the state's taxation accounting methods, but not the accounting methods itself.\textsuperscript{116} This seems to be a proper conclusion, particularly if the court focused on the language of the 4-R Act which instructs that the Act "merely provides a single standard against which all affected assessments must be measured."\textsuperscript{117}

\textsuperscript{108} \textit{Id.} at 531.
\textsuperscript{109} \textit{Lennen}, 715 F.2d at 498.
\textsuperscript{110} \textit{Burlington N. R.R.}, 481 U.S. at 462-63.
\textsuperscript{111} \textit{Id.} at 461-63. 4-R Act, \textit{supra} note 1, at 49 U.S.C. §11501(b).
\textsuperscript{112} \textit{Chesapeake W. Ry.}, 938 F.2d at 531.
\textsuperscript{113} \textit{Id.}
\textsuperscript{114} \textit{Id.}
\textsuperscript{115} \textit{Id.} (citing S. \textit{Rep.} No. 1483, 90th Cong., 2d Sess. app. B (1968)).
\textsuperscript{116} \textit{Id.} at 533.
\textsuperscript{117} \textit{Id.} at 531.
The Fourth Circuit in *Chesapeake W. Ry.* also cited to the Hearing Before the Subcommittee on Transportation and Aeronautics of the Committee on Interstate and Foreign Commerce on H.R. 16245.118 There, the court seemed to have found another reason to prohibit railroads from challenging the state’s evaluation methods. According to the testimony cited in the hearing records, Section 11501 of the 4-R Act “does not deal with valuation methods that any State wishes to use [and such valuation methods] would be totally unaffected by this legislation.”119 On the one hand, this statement means that courts are not intended to explore the validity of the state’s evaluation methods. On the other hand, a state’s valuation methods which “unreasonably burden and discriminate against interstate commerce” come directly into play under Section 11501(b) of the 4-R Act, be it not directly, but through the means achieved by the state’s evaluation methods. Thus, contrary to the Fourth Circuit’s opinion, it appears that Congress has not provided a clear and definite answer on the issue.

Finally, the court in *Chesapeake W. Ry.* found that allowing a railroad to challenge a state’s accounting methods would be an inefficient waste of judicial resources. The court’s justification for coming to this conclusion is that the judiciary would, in essence, be battling with the state legislature over which accounting methods to use.120 This, according to the court, is really “at its core, a policy choice.”121 Moreover, the court found that when the states undertake the task of determining the “true market value” of railroad property, there is no set standard.122 For example, in *Union Pacific R.R.*, to which the *Chesapeake W. Ry.* court cited, the District Court of Utah spent countless pages attempting to determine whether the state’s accounting method was discriminatory.123 In a court system already inundated with full dockets, efficiency considerations would seem to disfavor requiring courts to engage in this level of fact finding. However, the court did not explain why clearly unreasonable accounting methods could not be scrutinized, particularly if the discrimination was readily apparent.

In summary, the Fourth Circuit’s holding that a railroad is not permitted to challenge a state’s accounting methods hinges closely on principles of state sovereignty and non-interference with state matters absent express language from Congress. While the Fourth Circuit places considerable weight on the Congressional history of the 4-R Act, it is the opin-

119. *Id.*
120. *Chesapeake W. Ry.*, 938 F.2d at 531.
121. *Id.*
122. *Id.*
ion of the author that the intent of Congress with regard to challenges to a state's accounting methods does not provide a clear answer. Nonetheless, the Fourth Circuit discussed important legal issues and policy considerations in attempting to determine whether it could review a state's accounting methods. In the next three circuit court opinions, we will see these considerations addressed again, often with some variation in their application.

B. THE NINTH CIRCUIT AND BURLINGTON NORTHERN RAILROAD COMPANY V. DEPARTMENT OF REVENUE OF WASHINGTON

The next circuit court to hear a challenge to a state's accounting method under Section 11501 of the 4-R Act was the Ninth Circuit in Burlington N. R.R. Co. v. Dep't. of Revenue of Washington. In that case, Burlington Northern Railroad ("Burlington") sued the state of Washington alleging that the state had violated section 11501(b)(1) in assessing Burlington's property values.

Although the Ninth Circuit concluded that the state had not overvalued the property, the court nonetheless held that it could consider the state's accounting method to determine if the accounting method itself amounted to discriminatory taxation under the 4-R Act. The Ninth Circuit rejected the holding in Chesapeake W. Ry. v. Forst that a railroad is prohibited from challenging the state's method under Section 11501(b)(1). Instead, the court looked to Section 11501(c), which provides that the "burden of proof in determining assessed value and true market value is governed by State law." In particular, the court looked to the Washington Revised Code which provides that "the determination of the value of property by public officials is presumed correct" and may only be defeated by "clear, cogent, and convincing" evidence. Although the court did not expressly provide why the burden of proof is relevant in considering whether a state's accounting methods can be challenged, the Eleventh Circuit in CSX, Transp. Inc. interpreted the Second Circuit's holding to mean that "[b]ecause determinations of property value by public officials in the State of Washington may be defeated by 'clear, cogent and convincing evidence,' the . . . state valuation methodologies may likewise be defeated by clear, cogent, and convincing

124. Burlington N. R.R. v. Dep't of Revenue of Wash., 23 F.3d 239 (9th Cir. 1994).
125. Id. at 240-41.
126. Id.
127. Id.
128. 4-R Act, supra note 1, at 49 U.S.C. §11501(c).
129. Burlington N. R.R., 23 F.3d at 240 (quoting WASH. REV. CODE §84.40.0301(1) (2007)).
Therefore, because Washington allows its method of determining property value to be overcome by “clear, cogent, and convincing” evidence, the Ninth Circuit could have considered Washington’s accounting methods as long as Burlington had presented clear, cogent, and convincing evidence that the state’s method assessed Burlington’s railroad property in excess of the true market value of other commercial or industrial properties. Because Burlington failed to meet this burden of proof, the Ninth Circuit denied Burlington relief.\textsuperscript{131}

The Ninth Circuit’s approach, however, leaves a critical link unanswered as to why the burden of proof is relevant to subjecting a state’s accounting methods to judicial scrutiny. Section 11051(c) merely provides that the “burden of proof . . . is governed by State law.”\textsuperscript{132} It does not provide that the state may authorize suits challenging its accounting methods - rather, it means that the state can set the standard as to how much evidence the railroad must put forward to demonstrate that the state’s property assessment violated Section 11501(b).\textsuperscript{133} Despite the Ninth Circuit’s unclear answer, it is the opinion of the author that the court’s holding rests on the fact that because the state of Washington expressly provided that property determinations by its public officials may be overcome by “clear, cogent, and convincing,”\textsuperscript{134} so too can the state’s accounting methods be overcome. In this way, it is not merely the assessed value of the railroad property that the railroad may challenge, but the accounting method that the officials used to determine the value as well.

C. The Second Circuit and Consolidated Rail Corporation v. Town of Hyde Park

Just one year after Burlington N. R.R., the Second Circuit became the third circuit court to hear a challenge to a state’s evaluation method in Consolidated Rail Corp. v. Town of Hyde Park.\textsuperscript{135} Like Burlington in Burlington N. R.R., Consolidated Rail Corporation (“Conrail”) alleged that the state had discriminated against it in violation of Section 11501(b)(1).\textsuperscript{136} In this case, however, the Second Circuit found that the state had discriminated against Conrail not only by over-taxing the rail-

\textsuperscript{130} CSX Transp., Inc. v. State Bd. of Equalization, 472 F.3d 1281, 1287 (11th Cir. 2006) (quoting Burlington N. R.R., 23 F.3d at 240).
\textsuperscript{131} Burlington N. R.R., 23 F.3d at 240.
\textsuperscript{132} 4-R Act, supra note 1, at 49 U.S.C. §11501(c).
\textsuperscript{133} Id.
\textsuperscript{134} WASH. REV. CODE §84.40.0301.
\textsuperscript{135} Consol. Rail Corp. v. Town of Hyde Park, 47 F.3d 473, 475 (2d Cir. 1995).
\textsuperscript{136} Id. at 475.
road property in violation of Section 11501(b)(1), but also by applying impermissible methods to assess the property's value.137

Conrail, an interstate railroad carrier with extensive holdings of property in New York, argued that New York had used a tax accounting method that assessed its property in excess of five percent of "the calculated ratio with respect to all other commercial and industrial property."138 For years leading up to the lawsuit, Conrail had received special treatment in the form of a tax exemption when New York calculated the railroad's property values.139 The tax exemption employed a formula for calculating the highest rate that the state was permitted to tax the railroad.140 In 1993, however, the New York legislature discontinued the exemption and, as a result, the New York State Board of Equalization and Assessments ("SBEA") allegedly overtaxed Conrail's railroad property by $19 million.141 With the exemption removed, there was no longer a maximum rate at which the state could tax the railroad - therefore, Conrail filed suit alleging that the new taxation scheme assessed its property values in violation of Section 11501(b)(1).142

In order to determine whether New York assessed Conrail's property within the scope permitted by Section 11510(b)(1), the Second Circuit concluded that it must be able to consider the state's accounting methods.143 According to the court, the "4-R Act prohibits . . . discrimination against railroads in the ratios of sets of numbers: assessed values [of the railroad properties] and true market values . . . of other commercial and industrial properties."144 By evaluating the state's accounting methods, the court is able to compare the accounting methods used to assess the railroad against those that are used to assess other commercial and industrial properties.145

The Second Circuit rejected the argument that a state's accounting method is an area of state control.146 "If the [4-R] Act were to be interpreted . . . so that the [state, here, New York] could adopt a special method for railroads alone, then the whole nondiscrimination objective of the statute could be circumvented."147 Thus, the Second Circuit found that Congress empowered the federal courts to review and otherwise de-
feat a state’s accounting method. Furthermore, the Second Circuit viewed the evaluation of a state’s accounting methods as an efficient tool to determine whether the state is violating the 4-R Act. This is in direct conflict with the Fourth Circuit’s holding in *Chesapeake W. Ry.* which found that evaluating a state’s accounting methods would be a burden on judicial resources. These are, of course, arguments of judicial efficiency and ultimately may not have a momentous impact on the debate surrounding challenges to a state’s accounting methods. The reality is that the final ratio assessed against the state “must exceed, by at least 5%”148 the value of other commercial and industrial properties, whether that is shown using the state’s evaluation method or not.

D. THE ELEVENTH CIRCUIT AND CSX TRANSPORTATION INC. V. STATE BOARD OF EQUALIZATION

The most recent case concerning whether a railroad can challenge a state’s accounting methods was heard by the Eleventh Circuit in *CSX Transp., Inc. v. State Bd. of Equalization.*149 Decided in December 2006, the Eleventh Circuit pushed the pendulum in the opposite direction and concluded the railroads were prohibited from challenging the state’s accounting methods.

At issue in *CSX Transp., Inc.* was the adoption of a new accounting method that the state of Georgia used to calculate the property tax assessments against CSX Corporation (“CSX”).150 The decision of what accounting method to use in calculating the values of railroad properties is determined by the Property Tax Division of the Georgia Department of Revenue (“the Department”).151 Once the accounting method is chosen and the property values are calculated, the Department will issue a digest of its assessments to the State Board of Equalization of Georgia (“the Board”).152 The Board will then review the digest.153 If the Board finds the values satisfactory, the Board will certify the proposed assessments to the counties of Georgia.154 In return, the counties are permitted to use the certified values to determine the railroad’s tax assessment.155 In this particular case, “59 of the 71 Georgia counties . . . adopted the proposed assessment of the Board.”156

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148. *Id.* at 475.
150. *Id.*
151. *Id.*
152. *Id.*
153. *Id.*
154. *Id.*
155. *Id.*
156. *Id.*
To calculate the property assessments in *CSX Transp., Inc.*, the Department had used three accounting methods: the “stock and debt method,” the “cash flow method” and the “market multiples method.”\(^{157}\) These values were then averaged together, the lowest of which was used to tax CSX which, according to the Department, amounted to $8.2 billion.\(^{158}\) Using its expert and accounting methods, CSX came up with less than $6 billion - a value far below the Department’s assessed value of the railroad property.\(^{159}\) Thus, CSX filed suit. Specifically, CSX argued that the Department’s accounting methods violated Section 11501(b)(1) “because the true market value of its property for 2002 [the preceding tax year] did not exceed $6 billion.”\(^{160}\)

CSX sets out several arguments for the proposition that the court may review the Department’s accounting methods. First, CSX argued that the language in the Supreme Court’s opinion in *Burlington N. R.R. v. Oklahoma* implies that a railroad may challenge the state’s evaluation method.\(^{161}\) For example, in *Burlington N. R.R. v. Oklahoma*, the Court provided that “[the 4-R Act] speaks only in terms of ‘acts which unreasonably burden and discriminate against interstate commerce.’”\(^{162}\) Therefore, if a state’s accounting methods constitute an act by the state and a court may review a discriminatory act by a state, a court may review the state’s accounting methods. Although the Eleventh Circuit did not flatly reject this argument, the court concluded that Section 11501(b)(1) does not permit challenges to a state’s accounting methods because Congress did not expressly provide for such review in Section 11501.

The second argument CSX asserted derives from earlier opinions in the Eleventh Circuit. In *S. Ry. v. State Bd. of Equalization*, for example, the Eleventh Circuit stated that the “legislative history and broad language of the Act show Congress possessed a general concern with the discrimination in all its guises.”\(^{163}\) Taking the Eleventh Circuit’s language

\(^{157}\) *Id.*. The stock and debt method determines the value of the railroad company by taking the railroad’s total equity less its outstanding debts. The cash flow method determines the value of the railroad company by projecting the expected cash flow of the company for a certain period of years less its expected depreciation value. Finally, the market multiples method is determined by an appraiser who compares the value of the railroad stock to other similarly situated companies. *Id.* at 1284. The accounting methods used by Georgia, as well as CSX, take into consideration real property and equities. However, the 4-R Act does appear to restrict how a railroad’s transportation property value is calculated. Therefore, the accounting methods used by the parties in *CSX Transp., Inc.* do not appear to conflict with the provisions of the 4-R Act.

\(^{158}\) *Id.*

\(^{159}\) *Id.*

\(^{160}\) *Id.* at 1285-86.

\(^{161}\) *Id.* at 1287.

\(^{162}\) *Id.* (quoting *Burlington N. R.R. v. Okla. Tax Comm’n*, 481 U.S. 454, 463 (1987)).

\(^{163}\) *Id.* at 1288 (quoting *S. Ry. v. State Bd. of Equalization*, 715 F.2d 522, 528 (11th Cir. 1983)).
by its literal meaning, CSX argued that the court has expressed an intention to protect railroads from discrimination and should therefore protect CSX from discriminatory taxation in this case.\textsuperscript{164} The Eleventh Circuit rejected CSX's argument and found that the court's statement in \textit{S. Ry. v. State Bd. of Equalization} was not intended to be an absolute or unconditional protection afforded to the railroad.\textsuperscript{165} CSX argued in the alternative that even if the court did not find the language of the court's earlier cases persuasive, "principles of federalism and comity should play no role in [the court's] interpretation of the 4-R Act."\textsuperscript{166} In other words, because Congress has carved out an exception to the general principle of non-interference with state matters,\textsuperscript{167} the court may review Georgia's accounting methods.

The Eleventh Circuit disagreed. Citing to \textit{Dept. of Revenue of Oregon v. ACF Industries, Inc.}, the court found that in order to review challenges against a state's accounting methods and thereby preempt the powers reserved to the states, it must be "the clear and manifest purpose of Congress."\textsuperscript{168} In \textit{ACF Industries, Inc.}, several carline companies, or companies that lease railroad cars to shippers, brought suit against Oregon under Section 11501(b)(4) because the carline companies did not qualify under Oregon's tax exemption for business property.\textsuperscript{169} The carline companies argued that Oregon was discriminating against them by exempting other commercial and industrial properties from certain taxation while requiring them to pay in full.\textsuperscript{170} The Supreme Court rejected the carline companies' argument, finding that the 4-R Act does not expressly "restrict state power to exempt nonrailroad property."\textsuperscript{171} Moreover, the Court stated, "[p]roperty tax exemptions are an important aspect of state and local tax policy" and therefore, absent language permitting interference in this area, courts should refrain from meddling in a state's

\textsuperscript{164} \textit{Id.}

\textsuperscript{165} \textit{Id.}

\textsuperscript{166} \textit{Id.} at 1289.

\textsuperscript{167} 4-R Act, \textit{supra} note 1, at 49 U.S.C. §11501(c).

\textsuperscript{168} CSX Transp., Inc. v. State Bd. of Equalization of Ga., 472 F.3d 1281, 1289 (11th Cir. 2006) (citing Dep't. of Revenue of Or. v. ACF Indus., Inc., 510 U.S. 332, 345 (1994)). Justice Fay argues in the dissenting opinion that language of the statute is clear: state's "could not use one method to assess the market value of the railroad property and a different method to assess other commercial and industrial property if such resulted in the gross discrimination toward the railroad." \textit{Id.} at 1293. Agreeing with the Second Circuit in \textit{Consolidated Rail Corp.}, Justice Fay argues that to permit this type of discriminatory tax method would skirt the entire purpose behind the 4-R Act. \textit{Id.} at 1294. Therefore, the railroad should be allowed to contest the state's accounting methods to effectuate the purpose behind the 4-R Act. \textit{Id.} at 1293.

\textsuperscript{169} \textit{ACF Indus., Inc.}, 510 U.S. at 335.

\textsuperscript{170} \textit{Id.} at 337.

\textsuperscript{171} \textit{Id.} at 344.
Challenging State Accounting Methods Under the 4-R Act

...taxation processes.172

Unlike tax exemptions for nonrailroad carriers in *ACF Industries, Inc.*, the 4-R Act does speak directly to discriminatory taxation against railroad properties.173 Nonetheless, the Eleventh Circuit went on to agree with the Fourth Circuit in *Chesapeake W. Ry.* that the 4-R Act does not permit a railroad to challenge a state’s evaluation methods.174 In addition to the reasoning set forth above, the court found that the selection of a state’s accounting methods involves “[i]mportant questions of state policy. Time pressures and limited resources, for example, may compel a state to choose a simple valuation methodology rather than a complicated one.”175 Lastly, the Eleventh Circuit cited to the same legislative history as *Chesapeake W. Ry.* and concluded that its decision not to allow railroads to challenge a state’s accounting methods is thoroughly supported.176 In the end, the $8.2 billion tax assessment against the railroad by the Board was upheld.177

In summary, the Eleventh Circuit’s opinion in *CSX Transp., Inc.* parallels the Fourth Circuit’s opinion in *Chesapeake W. Ry.* in many respects. Both opinions rely on principles of state sovereignty and on the absence of clear language in the 4-R Act to hold that a state’s accounting methods cannot be challenged. Both circuit courts interpreted the legislative history of the 4-R Act to protect a state’s accounting methods to judicial review. Finally, both circuit courts looked to arguments of judicial efficiency and public policy choices to support their holdings against permitting a railroad to challenge a state’s accounting methods. However, for other courts that have not decided the issue, there are other significant considerations to weigh before denying the railroad’s claim or subjecting the state’s accounting methods to judicial review.

IV. CONCLUSION

The need to protect and maintain the railroad industry is at the core of the debate concerning challenges to the 4-R Act. Railroads transport much of the nation’s essential goods, some of which would be inefficient to transport by any other means. Because railroads play a fundamental role in the U.S. economy, Congress clearly has an incentive to preserve

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172. *Id.*
173. The dissent in *ACF Industries, Inc.* sets forth a broad argument (similar to the argument that CSX puts forth in citing to the Supreme Court’s decision *Burlington N. R.R. v. Oklahoma*) that the purpose of the 4-R Act is “to bar discrimination by any means.” *Id.* at 350. Being a dissenting opinion however, the Ninth Circuit takes note of Justice Stevens’ interpretation of the 4-R Act but goes no further. *CSX Transp., Inc.*, 472 F.3d at 1290.
174. *CSX Transp., Inc.*, 472 F.3d at 1288.
175. *Id.* at 1288-89.
176. *Id.* at 1289.
177. *Id.*
the railroad industry. In deciding how best to protect the railroad industry, Congress must also consider the state's ability to maintain control over its internal government structure. A state's ability to tax, for instance, provides a state with vital resources to stabilize and run an efficient state government and economy. Therefore, it is the balance of these two competing interests that lies at the heart of the issues surrounding the 4-R Act. If a court were to declare Section 11501 of the 4-R Act unconstitutional, the railroads would lose a vital tool to protect themselves from discriminatory state taxation. By the same token, if a court were to find that a state's accounting methods violate Section 11501(b)(1) of the 4-R Act, the state might lose considerable tax revenues and incur incidental costs of having to comply with a judicially imposed tax accounting system. This is, of course, assuming that the state could not simply recalculate its property tax assessment against the railroad or select another tax system of its own choosing.

With these important considerations in mind, it is the opinion of the author that Section 11501(b)(1) permits a railroad to challenge the validity of the state's accounting methods under the reasoning set forth in Consolidated Rail Corp. v. Town of Hyde Park.178 "If the [4-R] Act were to be interpreted . . . so that the [state] could adopt a special method for railroads alone, then the whole nondiscrimination objective of the statute could be circumvented."179 Although the language of Section 11501(b)(1) does not expressly provide that a state's accounting methods may be subject to suit, it is simply another way in which a railroad can show that it has been discriminated against in interstate commerce. Moreover, the 4-R Act already allows a state to be subject to suit by the railroads,180 which means that a state may have to change its accounting methods to comply with the 4-R Act if it is found in violation of Section 11501(b)(1), regardless of whether its accounting methods are subject to scrutiny. However, it may be beyond the powers of the court to require a state to comply with a certain accounting method. Rather, the court is likely limited to providing injunctive relief to the railroad,181 or perhaps in some instances, backward looking relief.182

In closing, the issue concerning a railroad's ability to challenge a state's accounting methods affects not only the continued maintenance and structure of the railroad industry, but also a state's ability to run an efficient government. Until the Supreme Court grants certiorari on this

178. Consol. Rail Corp. v. Town of Hyde Park, 47 F.3d 473, 482 (2d Cir. 1995).
179. Id.
181. Ex Parte Young, 209 U.S. 123, 190 (1908).
issue,\textsuperscript{183} railroad companies and states must be willing to recognize that both have important interests at stake.

\textsuperscript{183} On March 23, 2007, CSX Transportation Inc. filed a Petitioner for Writ of Certiorari to the United States Supreme Court. CSX Transp., Inc. v. State Bd. of Equalization, 472 F.3d 1281 (11th Cir. 2006), petition for cert filed, 2007 WL 868962 (U.S. Mar. 23, 2006) (No. 06-1287). CSX is appealing the decision of the Eleventh Circuit and has submitted the following question for review: “Whether, under the federal statute prohibiting state tax discrimination against railroads, 49 U.S.C. §11501(b)(1), a federal district court determining the ‘true market value’ of railroad property must accept the valuation method chosen by the State.” \textit{Id.}
Special Symposium Edition:
Third Party Surface Transportation –
Common Issues and Recent Trends

Legal, Practical, and Economic Aspects of Third
Party Motor Carrier Services: An Overview

James C. Hardman*

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I. Introduction

Economic deregulation of the motor carrier industry in 1980\(^1\) had many effects on the nature of the service performed, the number of carriers and equipment capacity flowing into the marketplace, and also in the growth and importance of third-party providers.\(^2\) Most new motor carriers were single-operator entities or those with limited fleets.\(^3\) Because new grants of Certificates of Public Convenience and Necessity or Permits allowed the carriage of general commodities, with limited exceptions, to points in the United States,\(^4\) carrier management in the new companies, as well as those who were attempting to expand their operations, frequently did not have the time, money, or ability to develop sales staffs to capture the type and volume of freight movements to produce profitable operations.\(^5\) Where trip leasing\(^6\) and interlining/interchange\(^7\) played a significant role in many carrier operations prior to deregulation, these alternative sources of business became less common as carriers

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4. See 49 U.S.C. § 13902 (2007) (Authority issued to common carriers was by a Certificate of Public Convenience and Necessity and contract carriers were issued a document referred to as a Permit. The distinction between common and contract carriers has been eliminated and all regulated motor carriers are registered merely as a motor carrier); see also 49 U.S.C. § 14101(b) (2007) (stating that motor carriers can provide transportation under contract by choice).
5. See generally Glaskowsky, supra note 2.
6. See 49 C.F.R. § 376.22 (2007) (This practice allows a regulated motor carrier to lease its equipment to another regulated motor carrier with driver services for a single trip which had to be in the general direction of an authorized point or territory the lessor-carrier was authorized to serve. Currently, there is no directional requirement and successive trips can occur between the carriers).
7. See 49 C.F.R. § 376.31 (2007).
could provide the service they either previously trip-leased or interlined directly through themselves when authority became available.

Freight brokers fulfilled a role that many carriers needed and desired, for instance, to find freight from shippers throughout the United States and have it available when and where the carriers needed it. They substituted for carriers’ sales and marketing personnel. There were also advantages in dealing with brokers as opposed to trip leasing, as brokers eliminated the need for equipment inspections, leases, and identifying the equipment required under trip leasing regulations and case law.

Shippers, rather than dealing with the multiple carriers now in the marketplace, could outsource the costly functions of locating the carriers, investigating them, contracting with them, and otherwise dealing with them by merely working with a broker or minimal number of brokers. Similar advantages existed in terms of using freight forwarders. By assembling less-than-truckload (LTL) freight from multiple shippers, the shippers’ freight could be moved by the bulging truckload carrier population at lower costs than shipping on an LTL basis where fewer carriers competed and service was frequently higher priced because of union wages and work rules. Other entities called “logistics companies” ultimately came into existence with the rise of intermodal services,8 “just-in-time” service,9 the demise of tariffs,10 and technology advances. In the current environment, these third-party intermediaries have established themselves as valuable contributors to movement of freight and, while growth may not be as rapid as in the past twenty years, there is no reason to believe that they will not be a continuing force in transportation.11

II. Brokers

A federally regulated freight “broker” is defined as “a person, other than a motor carrier or an employee or agent of a motor carrier, that as a principal or agent, sells, offers for sale, negotiates for, or holds itself out

8. See, e.g., Improvement of TOFC/COFC Regulation, Ex Parte No. 230 (Sub-No. 5), 364 I.C.C. 731 (1981) (“ Trailer-on-flat-car” and “ container-on-flat-car” transportation was deregulated in the 1980s and early 1990s, which created the opportunity for expansion); see also Am. Trucking Ass’ns v. ICC, 656 F.2d 1115, 1122 (5th Cir. 1981); see also Richard W. Palmer & Frank P. DeGiulio, Terminal Operations and Multimodal Carriage: History and Prognosis, 64 Tul. L. Rev. 281, 300 (1989).

9. See Wikipedia.org, Just in Time (Business), http://en.wikipedia.org/wiki/Just_In_Time_%28business%29 (last visited Mar. 17, 2007) (“Just-in-time” service is a practice designed to eliminate or decrease warehousing and have materials and supplies move directly from the delivery truck into the production or processing line of the receiver).

10. 49 U.S.C. § 13702 (2007) (At the current time, tariffs are only required for the movement of household good and in non-contiguous domestic trade, with some exceptions).

11. 3 I.C.C.2d 689, 690 (1987) (Before deregulation of motor carriers in 1980, there were less than 100 licensed brokers and by 1987 there were over 5000 licensed brokers).
by solicitation, advertisement, or otherwise as selling, providing, or assigning for, transportation by motor carrier for compensation. A broker normally does not have a direct role in assembling LTL quantities of goods into truckloads or in the carriage of the freight. A broker is thought of as an independent party who acts as a middleperson between carriers and the shipping public. Registration is required with the Federal Motor Carrier Safety Administration and the broker is required to provide security to the public and appoint registered agents for service of process in the state or states in which it contracts. Regulations also govern certain aspects of brokers’ operations including advertising, record keeping, and accounting.

III. Freight Forwarders

A federally registered surface freight forwarder arranges for transportation, and (1) plays a role in the assembly, consolidation, break bulk and distribution of freight, (2) assumes responsibility and liability for transportation from the place of receipt to the place of destination, and (3) uses regulated interstate carriers for any part of the transportation. There are differing opinions as to whether all criteria must be met to satisfy the statutory requirement, or whether the mere proffer of the services meets the statutory provision.

Like brokers, freight forwarders must also register with the Federal

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19. See Jeffrey S. Wood, Intermodal Transportation and the Freight Forwarder, 76 Yale L.J. 1360, 1367-73 (1967) (Freight forwarders also exist in terms of air freight or ocean freight movements and may exist in terms of surface freight).
20. See Chemsource, Inc. v. Hub Group, Inc., 106 F.3d 1358, 1361 (7th Cir. 1997) (The term “assemble and consolidate” was interpreted to mean “the assembly or consolidation of less than carload quantities into carload shipments”).
22. See Chemsource Inc., 106 F.3d at 1361 (holding that all statutory criteria must be met); see also Indep. Mach., Inc. v. Kuehne & Nagle, Inc., 867 F. Supp. 752, 758-59 (N.D. Ill. 1994) (holding that all statutory criteria must be met).
23. See Phoenix Assurance Co. v. K-Mart Corp., 977 F. Supp. 319, 325 (D. N.J. 1997) (holding that “to qualify as a ‘freight forwarder’ one need not perform all of the functions authorized under the statute, as long as the party ‘proffers all of the services’”).
Motor Carrier Safety Administration (FMCSA)\textsuperscript{24} and are subject to security provisions.\textsuperscript{25} The freight forwarder is generally considered a "shipper" to the carrier and the "carrier" to the shipper.\textsuperscript{26} While the freight forwarder would generally be thought of as an independent contractor,\textsuperscript{27} particularly if it services multiple shippers,\textsuperscript{28} depending upon the particular freight services provided,\textsuperscript{29} it could be considered an agent of the shipper.\textsuperscript{30}

IV. Shipper Agents

Shipper Agents arrange transportation on behalf of a shipper, and generally do not have to register with the FMCSA.\textsuperscript{31} An agent has a continuing relationship with the shipper and, under contract, functions as part of the shipper's organization, performs duties under the direction of the shipper in a status similar to an employee, and cannot exercise discretion in awarding traffic to a motor carrier, broker or freight forwarder.\textsuperscript{32} In this respect, the shipper emulates the definition of bona fide agents of motor carrier. The non-discretionary allocation of traffic between competing carriers assists in determining whether an agency relationship exists.

V. Logistics Company

The word "logistics" is not the subject of any particular statutory or common law definition. It may involve some or all of the services of a carrier, a broker, a freight forwarder, an agent, a warehouseman, a custom broker, or others providing some function related to the movement of freight. Except where the logistics company provides a regulated service such as carrier, broker or freight forwarder, no registration is required.\textsuperscript{33}

\begin{footnotes}
\item[26] See 14 AM. JUR. 2D Carriers § 651 (2007) ("a freight forwarder . . . assumes responsibility for the shipment from receipt to the place of destination").
\item[28] See Consol. Freightways Corp. v. Admiral Corp., 442 F.2d 56, 63 (7th Cir. 1971).
\item[30] See Zenith Elecs. Corp. v. Panalpina, Inc., 68 F.3d 197, 199, 201-02 (7th Cir. 1995) (holding that a forwarder can be deemed an agent of the shipper).
\item[33] See generally Andrews, supra note 31.
\end{footnotes}
VI. Supply Chain Management

Frequently referred to as 4PL, supply chain outsourcing is an outgrowth of the logistics industry and involves an integrator who directs a client and selects teaming partners.\(^{34}\) The 4PL assembles and manages the resources, capabilities, and technologies of its own organization with those of complementary service providers to deliver a comprehensive supply chain status.\(^{35}\) As one observer noted, supply chain management (SCM) "is truly a closed loop pipeline that starts with customer needs and raw materials and ends with customer satisfaction and a sustained environment. SCM is a pipeline that moves all its outcomes in two directions – not only product-flow but also information-flow and financial-flow."\(^{36}\) Like the logistics company, a 4PL is not regulated except to the extent it performs a regulated service such as motor carriage, brokering, freight forwarding or other functions such as warehousing.\(^{37}\)

VII. Identifying Roles

The cross fertilization among the various disciplines involved in moving freight from "here" to "there" has created numerous legal issues, starting with the role the participants in the movement play and how this affects such issues as the collection of freight charges, responsibility for loss or damage of freight, public liability, and antitrust considerations. Due to diverse legal consequences flowing from the provider's status as carrier or transportation intermediary, it is important to clarify and determine such status at the outset. A starting point in deciding the issue should begin with the agreement between the parties. When the shipper and the other party agree to a movement, it should be clear whether the individual or entity to which the freight movement is tendered is acting as a carrier or third-party intermediary and what status the intermediary is taking. The decision should be predicated on the exact functions the parties will perform.

Courts will look beyond the "titles" assigned by the parties to what tasks are actually held out\(^{38}\) or performed.\(^{39}\) This is true even if the par-

\(^{34}\) See Helen Richardson, *What are you Willing to Give Up?* 46 *Logistics Today* 27 (Mar. 1, 2005).

\(^{35}\) See id.


\(^{37}\) See generally Richardson, supra note 34.

\(^{38}\) See United States v. California, 297 U.S. 175, 181 (1936); ENSCO, Inc. v. Weicker Transfer & Storage Co., 689 F.2d 921, 925 (10th Cir. 1982).

ticular party does not have the requisite registration to perform the service.\textsuperscript{40} The failure to identify the roles of the parties can lead to unintended consequences that will be discussed subsequently.

VIII. Freight Charges

The subject of freight charges involves application of various statutory and regulatory provisions,\textsuperscript{41} and case law concerning disputes over freight charges is usually complex and fact specific. In a typical situation, a broker has failed to pay the carrier although the shipper had made payment to the intermediary and the carrier seeks payment directly from the shipper. Recovery may depend upon whether the broker was acting as an agent for the shipper or as an independent contractor.

In \textit{Consolidated Freightways Corp. v. Admiral Corp.}, the carrier sued a consignee for charges when the broker failed to pay its freight charges.\textsuperscript{42} The court found that the broker had not acted as the consignee’s agent as the consignee had no control over the broker’s business and the broker’s remuneration was based on individual shipments.\textsuperscript{43} The fact that the broker had other customers, selected the carriers, and prepared the bills of lading was also considered in the decision.\textsuperscript{44} The motor carrier conveyed its intention to seek freight charges from the broker and did so until the broker defaulted.\textsuperscript{45} The motor carrier then sought redress against the shipper for such freight charges, and the legal principle of equitable estoppel was applied.\textsuperscript{46} The shipper was found to have acted in good faith on the actions of the carrier in paying the freight charges to the broker and thus, under the principle of equitable estoppel, was not required to pay a second time.\textsuperscript{47} Equitable estoppel has been applied in various broker cases,\textsuperscript{48} but there are several decisions to the contrary.\textsuperscript{49}

\textsuperscript{40} Id. at 326.
\textsuperscript{42} Consol. Freightways Corp. of Delaware v. Admiral Corp., 442 F.2d 56, 58 (7th Cir. 1971).
\textsuperscript{43} Id. at 63.
\textsuperscript{44} Id.
\textsuperscript{45} See id. at 58.
\textsuperscript{46} Id. at 58, 62-63.
\textsuperscript{47} Id.
It should be noted that the referenced cases all involved a dependence upon the broker having the status of an independent contractor relationship with the shipper.

If a broker is found to be an agent of a disclosed shipper-principal, the shipper will be bound by the commitments of its agent and will be liable for the payment of freight charges to the carrier even if it already paid the broker.\(^{50}\) In the case of freight forwarders, the shipper deals only with forwarder. The forwarder then issues its bill of lading to the shipper and the carrier issues its bill of lading to the freight forwarder. There is no privity of contract between the shipper and the carrier, and it would be more difficult to collect freight charges than in the brokerage situation unless an agency situation existed. Freight forwarders have been found to be both agents of the shipper\(^{51}\) and independent contractors,\(^{52}\) depending on the facts of the particular freight movement scenario.\(^{53}\)

*In National Shipping Co. of Saudi Arabia v. Omni Lines*, the court held a shipper liable to the carrier even though the shipper had already paid a freight forwarder.\(^{54}\) After noting that intermediaries have few assets and that carriers have a contractual right to expect payment from the shipper under a bill of lading, the court found:

Carriers must expect payment will come to the shipper, although it may pass through the [intermediary's] hands. While the carrier may extend credit to the [intermediary], there is no economically rational motive for the carrier to release the shipper. The more parties that are liable, the greater the assurance for the carrier that he will be paid.\(^{55}\)

Henry Seaton, in a recent article in the *Commercial Carrier Journal*, discussed some of the steps that a carrier may take to make sure the broker or freight forwarder is considered an agent of its shipper/customers and that freight charges will be paid:

1. Provide in the contract that the broker must comply with federal regulations requiring segregation of funds.

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49. Ranger Transp., Inc. v. Wal-Mart Stores, 903 F.2d 1185, 1187 (8th Cir. 1990); see also Missouri Pac. R.R. Co. v. Ctr. Plains Indus., Inc., 720 F.2d 818, 819 (5th Cir. 1983); Nat'l Shipping Co. of Saudi Arabia v. Omni Lines, Inc., 106 F.3d 1544, 1546 (11th Cir. 1997).


54. Nat'l Shipping Co. of Saudi Arabia, 106 F.3d at 1546-47.

55. Id. at 1547 (citing Strachan Shipping Co. v. Dresser Indus., Inc., 701 F.2d 483, 490 (5th Cir. 1983)).
2. Contract to make the broker the guarantor of payments in case the shipper does not pay.
3. Have the carrier's name appear on the bill of lading as the carrier of record instead of the broker's name.
4. Do not accept "non-recourse" shipments.
5. Prepare a rules circular indicating recourse under the bill of lading and reference the circular in all contracts.
6. Send all invoices to the party liable for freight charges in care of the intermediary.
7. Request an accounting of the broker if timely payments are not being made and, if a timely response is not received, put the shipper on notice that you are preserving recourse to the shipper.\footnote{56}

Another protection for carriers involves the constructive trust theory. This theory holds that the monies an intermediary receives from a shipper to pay freight charges are really the funds of the shipper and belong to the carrier that provided the service.\footnote{57} As a result, the carrier receives rights of a secured creditor in a shipper's bankruptcy proceeding.\footnote{58} This theory has also been used to the brokers' advantage in \textit{New Prime Inc. v. Professional Logistics Management Co., Inc.}, where the court held that the broker was not obligated to pay the carrier unless it received funds from the shipper.\footnote{59}

\section*{IX. Cargo Loss and Damage Claims}

A frequently litigated issue between shippers and carriers involves liability for cargo loss and damage. The benchmark for this area of the law in terms of motor carrier interstate shipments is the Carmack Amendment to the Interstate Commerce Act.\footnote{60} The Carmack Amendment's operative provision reads: "A carrier . . . [is] liable to the person entitled to recover under the receipt or bill of lading. The liability imposed under this paragraph is for the actual loss or injury to the property caused by . . . the . . . carrier."\footnote{61}

\footnotesize{\begin{itemize}
\item \footnote{56} Henry Seaton, \textit{Don't Bank on Brokers: Protect Your Right to Seek Payment From Shippers}, 159 \textit{Com. Carrier} J. 21 (2002).
\item \footnote{57} Parker Motor Freight, Inc. \textit{v.} Fifth Third Bank, 116 F.3d 1137, 1139 (6th Cir. 1997); \textit{see also} Transp. Revenue Mgmt. \textit{v.} Freight Peddlers, Inc., No. C.A.2-99-2585-23, 2000 WL 33399885 (D. S.C. 2000) (While Parker did not decide whether the "trust fund" theory extended to broker and logistics company, one commentator indicates "applying the Court's reasoning, an argument can be made that trust fund remedy is equally applicable to third-party brokers and logistics companies as well").
\item \footnote{58} \textit{See} Parker, 116 F.3d at 1139.
\end{itemize}}
A broker is not considered a carrier for purposes of the Carmack Amendment, and thus any liability for freight charges must arise, if at all, under contract or common law. Perhaps the most prevalent way that a broker might assume freight loss liability is by contract. Shippers may exert pressure on the broker to be liable, or the broker may volunteer to undertake liability as a marketing tool. The contract should spell out the liability clearly, and both parties to the contract should understand such liability. A mere statement that XYZ broker will be liable for loss or damage to cargo is not the same as undertaking Carmack liability. Carmack liability involves special features developed by a long history of judicial interpretations as further discussed below.

Under Carmack, a plaintiff-shipper needs not prove negligence. Rather, a prima facie case of a carrier’s liability is established by a preponderance of the evidence showing that the goods (1) were transported to the carrier in fine condition, (2) arrived damaged or were lost, and (3) resulted in a specific amount of damages. Once the prima facie case is established, the burden shifts to the carrier to show that it was free of negligence and that damage or loss was caused by the several specific causes that relieve the carrier of liability.

Another issue arising under Carmack includes consequential damages - losses or damages not arising from immediate actions of a party, but in unforeseeable consequence to such actions. Such damages involve attorneys’ fees, missed appointments, goodwill business reputation, loss of use, loss of profits, penalties, and other similar items. Ordinarily, consequential damages are not available under the Carmack Amendment.

Several other issues arise in regards to broker liability under the Carmack Amendment. For instance, if a broker merely assumes liability for cargo damages or loss, does it accept the above liability? Will the broker be subject to the state law of choice or to laws of multiple states, which may have varying provisions regarding the burden of proof, standards for establishing negligence, defenses (if any), and damages? What rights does a broker have against a carrier if the broker assumes liability? Does Carmack apply when the broker is not the shipper? Will the right be one

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64. See Missouri Pac. R.R. Co., 377 U.S. at 137 (the causes are: an act of God, the public enemy, the act of shipper, public authority, or the inherent vice or nature of the goods).


of subrogation, subject to state law? Will the shipper cooperate in prosecuting the broker’s attempt to recoup against the carrier, and if so, to what extent?

Apart from contractual liability, a broker might be liable to a shipper for loss of or damage to freight on a negligence theory, which is a tort cause of action. However, under a negligence theory, the shipper would have the burden of proving negligence rather than the broker having to prove freedom from negligence or an excepted cause under Carmack. Since a broker is not directly involved in the actual movement, it may be difficult to find a broker liable for freight loss or damage on the basis of negligence, particularly if the broker does not appear as the “carrier” on the bill of lading.

At best, such liability of a broker might only arise under a negligent entrustment theory. However, this theory involves “due care” in selecting a carrier, as subsequent breaches after the carrier is selected are generally not attributed to the broker. In order to hold the broker directly responsible for a shipper’s loss, the plaintiff must prove the broker’s negligence.

A court might also hold a broker liable for loss of, or damage to, freight if the court determines on the facts that the broker was acting as the carrier or freight forwarder, rather than merely coordinating business between such entities.

X. Insurance

While brokers might not be responsible under Carmack for cargo loss or damage, many brokers will still assume responsibility (via contract) for losses on movements that the broker coordinates. A broker often assumes responsibility to subsequently exert business pressure on the motor carrier to accept a claim and settle, even if such a settlement requires the broker to offset the revenues due the carrier to cover the claim. This type of business pressure on carriers may hurt or even terminate a business relationship, but most motor carriers probably acquire the pressure eventually. Submission, however, may cause

problems with the carrier’s cargo insurer, particularly when there is a significant difference between the carrier’s actual legal liability and the amount of the damages which the shipper asserts. Indeed, the broker, anxious to maintain the shipper’s business, is often arguably only concerned with the shipper’s demands.

Brokers often purchase their own cargo insurance. Commonly referred to as contingent cargo liability insurance, these insurance policies are legal liability policies that allow the broker’s insurer to adjust and defend against cargo liability claims. Certain types of broker’s insurance also pay for a motor carrier’s failure to assume responsibility or satisfy claims for cargo liability. William Augello, a renowned transportation attorney, notes that contingent insurers occasionally disavow liability on the grounds that the broker had no insurable interest. To avoid this result, Mr. Augello suggests that the shipper and broker enter into a contract whereby the broker assumes liability for the transit losses that would generally create such an interest. While this solution may resolve the problem Mr. Augello addresses, the broader issue is whether encouraging shippers to look to the broker for settlement of cargo claims will erode the shipper’s historically strong claim status against carriers.

Why would anyone, except possibly shippers that demand as much coverage as possible, want a freight broker to assume the liabilities of a motor carrier? One reason may be that a competent broker will investigate and know the carriers with whom he is doing business and have a contract with such carriers that spell out cargo liability terms for loads they are handling for a mutual customer.

By law, motor carriers are liable for the care and custody of freight entrusted to them and should therefore be considered the first line of recovery. Freight forwarders liable under Carmack, however, are required to have cargo insurance including a Freight Forwarder Endorsement Form. Thus, to the extent the loss or damage was caused by a motor carrier with whom the freight forwarder contracted, the freight forwarder would have a right of indemnity and/or contribution against the carrier.

Cargo insurance, primary or contingent, must be evaluated by bro-

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72. See id.
73. See id.
75. Id.
76. 49 C.F.R. § 387.403(a) (2007).
kers and freight forwarders based on a logical evaluation of the risks involved and the insurance product itself - a task which may be eased by consultation with insurance counsel or consultants and insurance brokers or agents.

XI. CONTRACTS

The transportation contract, which is a defining element of the shipper-carrier relationship, should play a similarly central role in third-party operations. While contracts between shippers, carriers, and third parties will not necessarily override the transportation activities and their related legal consequences, it is important to have a sound, well-drafted contract that can serve as a road map for conducting day-to-day operations and providing opportunities for mutual economic success.

The volume and diversity of contracts used in the world of logistics makes contract negotiations and review a time-consuming and costly task and frequently leads one or both parties to execute contracts without fully understanding the ramifications. This lack of knowledge often leads to discord, litigation, and even economic devastation. The key to contract drafting is to create a document that eliminates costly and duplicative negotiations, hidden liabilities, and other problems resulting from poor drafting or a lack of understanding the legal consequences that such contracts may bring with them.

To remedy contract-drafting problems, the American Trucking Association (ATA), with the assistance of the Truckload Carriers Association and The National Industrial Traffic League (NITL), has drafted a model truckload shipper-carrier contract. Similarly, the Transportation Intermediaries Association (TIA) and the NITL have done the same with respect to a model broker-shipper contract. The ATA-NITL contract has generally received good reviews and implementation of the standard form appears to be under way in the industry. The TIA-NITL broker-shipper contract, however, has been criticized by the motor carrier segment of the industry and might not be used to the degree that its drafters had contemplated. As a result of this criticism, the ATA issued its own draft model broker-shipper contracts that have yet to received broad acceptance.

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79. Id.
81. American Trucking Ass'n, ATA Unveils Model Motor Carrier/Broker Agreements
The core difficulty posed by broker-shipper contracts is that these contracts should satisfy the demands of a three-way relationship – not merely the interests of brokers and shippers to the exclusion of carriers. Thus, in third-party operations it is essential that the interests of all three parties be considered in each contract in order to give each party an opportunity to negotiate for satisfactory provisions even though only two parties sign each contract.

XII. Antitrust Concerns

Parties to third-party motor carrier contracts frequently overlook antitrust issues arising from certain forms of cooperation. Third-party operations generally raise significant antitrust issues, particularly with respect to logistics operations involving the opportunity and need for substantial contacts, cooperation, and information exchange between parties that would otherwise be competitors. Specifically, antitrust concerns arise when logistics companies:

1. request confidential price or cost related information which may flow between competing carriers, or
2. are subsidiaries or affiliates of motor carriers and frequently enter into actual or potential cooperative agreements with competitors of their parent or affiliated companies, or
3. as asset-based companies will operate their own motor carrier businesses as subsidiaries and enter into cooperative arrangements with actual or potential competitors, or
4. partner with other logistics companies for particular business or customers, or
5. may simultaneously be serving two or more shippers that are competitors.

These "suspect" activities may lead to civil or even criminal liability when there is potential for:

1. price fixing through the logistics company as it negotiates and prepares logistics contracts, or
2. market allocations, or
3. unlawful group boycott against carriers who want to seek traffic directly from shippers or change terms of logistics company contracts, or
4. the unlawful exchange of information.\(^{82}\)

Given the penalties that antitrust violators face, logistics companies

\(^{82}\) United States v. Container Corp. of Am., 393 U.S. 333, 337 (1969) (exchange of price information among competitors constitutes a per se violation of the law); see also Sugar Inst., Inc., v. United States, 297 U.S. 553 (1936) (agreement among competitors to a uniform discount schedule, detention charges and similar items would also constitute a per se violation); see also United States v. Am. Radiator & Standard Sanitary Corp., 433 F.2d 174 (3d Cir. 1970).
and shippers must take steps to avoid engaging in conduct that could lead to antitrust problems. For instance, the relationship between the logistics company and the shipper should reflect a general contractor structure where the logistics company is the shipper's exclusive or principal contractor and deals with each motor carrier individually so that each motor carrier has an incentive to act in its own economic self-interest. Specifically, the logistics company must take care not to provide its affiliated trucking companies (if any) with access to confidential information that may be supplied by non-affiliates. In such circumstances, a proverbial "Chinese Wall" should be constructed to ensure that this information remains confidential. Similar measures should be implemented for confidential cost-related information when the logistics company is providing services to a particular industry or group of industries. Parties involved in suspect activity should seek advice from antitrust specialists or attend relevant seminars to understand antitrust compliance and reduce the danger of antitrust prosecution.

XIII. PUBLIC LIABILITY CONCERNS

Third-party intermediaries are often exposed to public liability claims. There is authority for holding brokers and freight forwarders liable for conduct by carriers upon proof of:

1. a joint venture between the broker and carrier,83
2. the existence of an agency relationship between the broker and the trucking company or its driver,84 and
3. the broker's failure to determine whether the truck was properly licensed or insured.85

While third-party intermediaries are not often held liable in public liability situations, the threat of such liability is real.86 For instance, in a trial court ruling in Illinois, the court ruled that the broker-defendant was both a partner and a joint venturer with its contracting motor carrier whose driver caused a catastrophic accident; the court held the broker

84. See King v. Young, 107 So.2d 751, 752 (Fla. Dist. Ct. App. 1958); see also Tartaglione v. Shaw's Express, Inc., 790 F. Supp. 438, 440-41 (S.D.N.Y. 1992); Gross v. Eustis Fruit Co., 160 So.2d 55, 56-57 (Fla. Dist. Ct. App. 1964) (A case involving a contention that a shipper's sales agent who used the services of a truck broker to arrange for a load was the truck driver's principal).
jointly and severally liable together with the motor carrier for the deaths of the accident victims.\textsuperscript{87}

Tort liability of brokers might also arise under a theory of negligent aiding. For instance, a broker may be held liable for negligently aiding a carrier in violating federal law when it forces the carrier to violate safety regulations such as those which set maximum hours of service.\textsuperscript{88} Under such federal safety regulations, a carrier, employee, or "other person," which arguably includes brokers, who knowingly or willingly violates the regulations is subject to criminal and civil liability.\textsuperscript{89}

Considering the proliferation of litigation, it is not unreasonable to believe brokers and other third-party intermediaries will continually be dragged into the quagmire of tort litigation. Therefore, third-party intermediaries must (a) diligently research and select motor carriers, (b) maintain their independence from the actual transportation movement of the freight, and (c) avoid or report illegal or unsafe operations.

XIV. Avoiding Problems

Many problems that arise in third-party movements can be avoided using common sense business approaches. For instance, participants might diligently research the issues involved in transportation deals to find out as much as possible about the trustworthiness and financial condition of contracting parties. With respect to motor carriers, the third-party intermediary should secure a copy of the carrier's authority and confirm that the authority is still valid. Confirmation is also necessary to ensure that the motor carrier has filed listing agents for service of process consistent with the authority and that the carrier has adequate insurance coverage on file in accordance with the FMCSA regulations.\textsuperscript{90} The third-party intermediary should also secure a certificate of insurance from the carrier's insurer and, if possible, be named as a certificate holder on the policy itself. These precautions present merely a starting point for satisfying the requirements of due diligence. Additional issues that third-party intermediaries should investigate include:

1. the financial condition of the motor carrier and its financial ability to provide continuing service.\textsuperscript{91}

\textsuperscript{87} Id.

\textsuperscript{88} See 49 C.F.R. § 395.1 (2007).

\textsuperscript{89} See 49 C.F.R. § 390.13 (2007).


\textsuperscript{91} See generally id.
2. the motor carrier's safety rating and its operating record with respect to safety,92 and
3. the motor carrier's reputation within the industry.

This broad exploratory approach is not only necessary to ensure that the motor carrier is capable of providing the transportation requested but is also helpful to avoid liability that may arise from potential negligent entrustment claims.

Similarly, motor carriers and shippers should perform due diligence in order to ensure that their relationships with third-party intermediaries are conducted in a proper manner. Specifically, when a motor carrier or shipper engages in business deals with a broker or freight forwarder (or logistics company that provides broker or freight forwarder services), the carrier or shipper ideally should:

1. secure a copy of the third-party's operating license to confirm the validity of the third-party's operations,93
2. confirm that the third-party intermediary has the requisite insurance and security trust instrument in place and secure a Certificate of Insurance or a copy of the security trust instrument,94
3. acquire copies of the financials of the third-party particularly if a continuing relationship is anticipated,
4. secure credit reports to determine the third-party's history of financial obligations, and
5. investigate the reputation of third-parties with respect to making freight payments.

The first tool for conducting this type of due diligence investigation involves the use of products such as the Gold Book. CompuNet Credit Service, Inc. regularly publishes the Gold Book guide, which lists more than 1,000 credit-worthy brokers who meet the criteria for inclusion in the book.95 The criteria include having full broker authority and bonding, being in business for at least three years, having five credit references on file with CompuNet, and having a history of paying all freight bills.

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within 30 days.\textsuperscript{96} Credit reports will indicate whether a broker is merely slow to pay, while the Bulletin, published by CompuNet on a monthly basis, provides details about non-paying brokers.\textsuperscript{97}

The second tool for conducting such due diligence investigation involves the use of services offered by members of the TIA.\textsuperscript{98} TIA registers particularly reliable brokers who have been licensed and bonded and who embrace strict ethical standards.\textsuperscript{99} TIA also maintains an effective alternative dispute resolution (ADR) program to resolve disputes that might arise between members and carriers.\textsuperscript{100}

Thorough investigation and due diligence research demands a significant time commitment by each party. The resulting high costs should prompt parties to limit the number of contracting brokers, freight forwarders, or motor carrier participants, and to establish long-lasting business relationships that might improve each party’s commitment towards improving service.

\textbf{XV. Dealing With Problems}

Freight charges present perhaps the most prevalent problems in third-party relations. Luckily, a well-drafted contract should minimize such problems. Most importantly, however, all parties must pay particular attention to following and enforcing the terms of the contract. If payments of freight charges by a broker or freight forwarder are not made promptly, an immediate investigation and a determination should be made as to whether further or longer credit can be granted or extended, or whether enforcement steps should be taken.

Certain problems may warrant the use of security arrangements. Parties should also consider initiating actions against a broker’s security bond or trust to remedy an issue,\textsuperscript{101} and generally may want to put the shipper on notice to prevent estoppel claims. Of course, parties might also want to determine whether the shipper can be held liable for freight charges especially under “conduit” or “trust” theories. If the relationship is contemplated as a continuing one and the volume of freight will be significant, brokers contractually should be obligated to render a bond or establish a trust fund specifically to cover the contractual movements in

\textsuperscript{96} \textit{id.}

\textsuperscript{97} \textit{id.}


\textsuperscript{99} \textit{id.}

\textsuperscript{100} \textit{id.}

\textsuperscript{101} See Milan Express Co. v. Western Surety Co., 792 F. Supp 571, 574-75 (M.D. Tenn. 1992) (Direct action is allowable against a bonding company or bank trustee); \textit{see also Transportation Revenue Mgmt. Inc.}, 886 F. Supp at 892.
an amount comparable to the carrier's monetary exposure for freight charges.

XVI. ALTERNATIVE DISPUTE RESOLUTION

Although a well-drafted contract and a good faith implementation of the contract may help to avoid disputes between the parties, there may still be situations where the parties disagree. In these cases, parties may want to consider including final and binding arbitration arrangements in their contracts. As a general rule, it makes sense to avoid the quagmire of litigation. Litigation is costly, time consuming, and diverts attention away from business and creative pursuits. Litigation also entails stress and worry that may lead to an unnecessary waste of energy. Sensible business people should be able to reach a resolution that serves their interests far better than any judgment of a court.

Business disputes such as those in third-party situations frequently arise between parties who intend to maintain continuing relations despite the disputes. These disputes can quickly lead to litigation that might not serve the best interests of both parties. For instance, despite best intentions to the contrary, the parties may become emotionally involved in disputes and seek vindication by "fighting to the end" without regard to rational business needs. Of course, successful lawsuits serve to vindicate a party's judgment and arguably improve the party's stature as a "winner" who fights hard to prove he or she was "right." As a corporate defendant, drawn-out litigation may also help to avoid recognizing costs on current financial statements associated with the claim until a later fiscal period.

Arguably, zealous trial lawyers who love the challenge of lawsuits may tend to pave the way towards such adversarial proceedings simply in order to participate in the contest. For these attorneys, "mere" alternative dispute resolution has as much appeal as the chance for Tiger Woods to play the caddy during the Masters Tournament. Seasoned lawyers frequently also fear recommending a settlement particularly when there is a chance that co-defendants or other plaintiffs may continue litigation to acquire awards that are more favorable to the client. In such situations there is also a financial disincentive to settle early and forego litigation particularly because prolonged litigation results in lengthy discovery, motions, trial preparations, and possible appeals that are profitable for the attorney. In other words, the choice between settling and litigating disputes implicates the lifeline of a law firm.

Arguably, however, too many disputes in recent times have ended in litigation instead of proper settlement. Such litigation is not desirable because it decides legal issues when business people would otherwise
have reconciled their own interests. Negotiation and settlement with or without an attorney is the most obvious way to settle a dispute, and the key to success is preparation and presentation. There must be a thorough investigation of the facts, meaningful research, an honest evaluation of the case, and client preparation. If negotiations are not successful, sage clients and attorneys will consider alternative means of dispute resolution. Legislators and courts have recognized the value of ADR. Federal law, such as the Federal Arbitration Act,\textsuperscript{102} and the Uniform Arbitration Act of Minnesota,\textsuperscript{103} provides for arbitration in private litigation and is increasingly being used in transportation matters.

ADR is and should be an important priority in any program of dispute analysis. ADR involves an approach to dispute resolution in which parties agree to resolve their disputes through means other than formal litigation.\textsuperscript{104} Numerous ADR forums exist although the two more popular approaches involve mediation and arbitration.\textsuperscript{105}

In mediation, an independent person with some expertise of the process and the disputed matter actively works with the parties to come up with a mutually agreeable solution.\textsuperscript{106} This “reality tester” helps generate settlement options and persuades the parties to test the strengths and weaknesses of their positions.\textsuperscript{107} Arbitration involves a binding or non-binding decision handed down by a third-party arbitrator or panel of arbitrators generally after the exchange of key documents and the parties’ presentation of their respective case.\textsuperscript{108} While arbitration is similar to typical judicial adversarial resolution, arbitration is private, usually involves relaxed rules of evidence and procedure, and tends to be more attuned to business realities than a judicial court that may have little, if any, business experience or knowledge in the area involving the dispute.\textsuperscript{109} In the context of third-party contract disputes, mediation and arbitration offer a number of benefits including the following:

1. \textit{Confidentiality}. Mediation and arbitration allow for a high degree of confidentiality of sensitive business information including information concerning business practices, business philosophy, and the style of doing business.\textsuperscript{110} Federal and state laws ordinarily protect confidential com-

\textsuperscript{103} \textsc{Minn. Stat. Ann.} §§ 572.08-30 (West 2006); \textit{see also} \textsc{Minn. Stat. Ann.} §§ 572.31-40 (West 2006).
\textsuperscript{104} \textsc{44 Am. Jur. Trials} § 507, sec. I.1 (2007).
\textsuperscript{105} \textit{See} \textsc{4 Am. Jur. 2d Alternative Dispute Resolution} § 2 (2007).
\textsuperscript{106} \textsc{44 Am. Jur. Trials} § 507, sec. I.1 (2007).
\textsuperscript{107} \textit{Id.}
\textsuperscript{108} \textit{Id.}
\textsuperscript{109} \textit{Id.}
\textsuperscript{110} \textsc{4 Am. Jur. 2d Alternative Dispute Resolution} § 16 (2007).
communications that result from mediation proceedings.\textsuperscript{111} In court-referred mediation, the only information that may be communicated to the court is whether the parties settled.\textsuperscript{112} The breach of confidentiality in mediation situations can also meet with severe sanctions.\textsuperscript{113} In arbitration, the parties and arbitrators may agree to close proceedings to third parties in order to provide for full confidentiality except to the extent that disclosure is necessary to enforce an award in court.\textsuperscript{114}

2. \textit{Costs}. Mediation and arbitration generally require less legal time and associated costs than judicial litigation. Discovery and motion practice - the greatest expenses in litigation - can frequently be eliminated or reduced using ADR. Moreover, the fact that all possible evidence has not been accumulated or discovered is not a legitimate reason to avoid ADR processes especially because almost all cases settle before trial on the proverbial "courthouse steps." Why incur the expense of motions and trial preparation if these expenses can be avoided using ADR? The outcome of litigation is never certain and the uncertainty of a party's position may promote an alternative settlement. The reduced costs of ADR allow business people to pursue more profitable ventures.

3. \textit{Expertise}. Knowledgeable mediators and arbitrators are often more adept at coming to terms with complicated facts than non-expert lay juries or judges might be. Specialized knowledge by mediators and arbitrators is particularly important where a defined body of law already exists or the dispute turns entirely on tricky and convoluted facts. Private organizations such as the American Arbitration Association have set qualifications for arbitrators and mediators with expertise in particular fields on their specialized panels. These professionals are ordinarily familiar with controlling statutes, administrative rules, and important industry practices that might help to achieve agreeable settlements.

4. \textit{Fairness}. In mediation, the forum is non-adversarial and the process and results are within full control of the parties. Each party has the opportunity to have a say, and the process focuses on the concerns and needs of the parties rather than just on the legal issues. While arbitration is adversarial dispute resolution, it is typically consensual and the parties can establish their own boundaries as to the procedures and limits of the process. This flexibility, coupled with the parties' ability to select the arbitrator, leads to the realization that arbitration is a fair mode of dispute resolution.

5. \textit{Prompt Disposition}. Routine disputes can be disposed of efficiently and rapidly. Mediation is arguably a successful process that can achieve its results more rapidly than litigation, which may linger in court for years.\textsuperscript{115} In many instances mediation and arbitration can be completed in one day or within a minimal number of days. Written resolution is concurrent with the end of a successful mediation, and arbitration awards

\textsuperscript{111} Id.
\textsuperscript{112} Id.
\textsuperscript{113} Id.
\textsuperscript{115} 4 Am. Jur. 2d Alternative Dispute Resolution § 2 (2007).
are usually made in thirty days or less after the record is closed.\textsuperscript{116} The ability to resolve a business dispute in the \textit{current} business climate cannot be overstated. A desired settlement or arbitration award might possibly be based on today's cost of goods, employment needs, the availability and demands of customers, suppliers, subcontractors, and construction or rental costs. A final judgment in a judicial proceeding, which often includes many years of appeals proceedings, begs the question "who really won?" particularly considering the lower value of the claim at the later date, the disruption of current operations, and changes in business conditions.

6. \textit{Convenience.} Mediation and arbitration can be scheduled as promptly as agreed to by the parties. Parties are not subject to the whims of a full court calendar and the frequent cancellations and delays.

7. \textit{Forum selection.} Unlike judicial proceedings where the defendant is generally bound to the forum selected by the plaintiff, arbitration and mediation allow parties to select locations before disputes arise that are convenient for both parties.

While mediation and arbitration offer these and many other advantages, parties contemplating ADR provisions in business contracts should be aware of significant disadvantages such as the following:

1. \textit{Failure.} Clearly, mediation and arbitration may fail to produce agreeable results. As a result of subsequent litigation, the expenses and investment of time in a case may increase. Ultimately, alternative dispute mechanisms that fail may take longer to produce acceptable results than if the parties had initiated judicial proceedings from the beginning.

2. \textit{Unwillingness to settle.} Adversarial emotions can increase if the participants simply cannot work together and there are emotional or even violent displays in the session. The lack of formality and power of a court may make parties less amiable to concessions and some parties will simply not settle unless a third-party makes the decision for them.

3. \textit{Lack of good faith.} The party with greater bargaining power may lack the initiative to mediate in good faith especially when it feels that it can force the weaker party to give in to one-sided demands.

4. \textit{Lack of necessary information.} Parties in arbitration proceedings are not always assured that they will be able to secure critical information needed during the hearing. The exchange of information, documents, and attendance of witnesses is dependent upon the arbitration rules or agreement.

5. \textit{Unpredictable procedures and results.} Some parties feel that a lack of application of the rules of evidence may hinder a predictable and fair hearing. Moreover, parties may conclude that an award not constrained by precedent may be unfair or contrary to the law. Unless the parties request a reasoned decision, most arbitration awards have no explanation. The parties will not know why a decision was made or how the result was reached and thus no basis exists for precedent.

6. \textit{Lack of non-judicial review.} The limited possibility to appeal arbitration

\textsuperscript{116} \textit{Id.}
awards may concern parties who still feel aggrieved even after the arbitration process has ended.

Many third-party transportation disputes are particularly susceptible to successful ADR processes. In most instances, a continuing relationship exists between carriers, shippers, brokers, and freight forwarders. The desire to maintain such relationships and to avoid future problems prompts parties to focus on resolving problems amicably. The disputes generally do not involve clear questions of law but are more factual in nature covering issues such as cargo loss and damage claims that make up a large percentage of all motor carrier litigation. Thus, there is clearly room for mediation and arbitration.

In the realm of transportation, ADR is particularly valuable. Most litigation involves relatively small claims ranging from a few thousand dollars to the low to mid hundred thousands of dollars. Litigation of such claims is extremely costly in relation to the sums involved - the cost-effectiveness of ADR procedures offers a welcome alternative. The confidentiality that ADR proceedings afford is particularly helpful for shipping and logistics companies that want to prevent their transportation rates and fees from becoming public. Fairness is another benefit that ADR provides in transportation disputes. Participants generally feel better when they are able to participate in how disputes are handled and when their concerns and ideas are being considered.

Unlike in many courtroom proceedings, arbitration and mediation sessions also offer parties more opportunities to clarify complex laws and situations by allowing for an informal setting along with extra time for explanation and education. This is particularly important where contracts, statutes, or administrative regulations are not clear or otherwise not easy to understand.

In terms of forum selection, ADR provides transportation parties the possibility to select sites for dispute resolution that are sensible considering the circumstances. For example, in the case of a loss or damage claim, the best location to resolve the dispute may be the point of the loading of goods, the point of delivery, or another point rather than the headquarters location of the carrier or shipper. The selection of relevant forums in ADR provisions also prevents parties from using venue matters as weapons to force settlement through causing inconvenience.

Finally, transportation parties in ADR proceedings benefit particularly from the ability to rely on predetermined dispute resolution procedures. The parties do not need to be concerned with laws that would otherwise apply in proper judicial proceedings. This is particularly helpful when issues arise in foreign locations where the parties would other-
wise be subject to unknown and potentially disadvantageous foreign procedures and rules.

Considering the lack of oversight in third-party service contracts and the need to reduce dispute costs, transportation businesses are well-served by Abraham Lincoln’s advice: “Discourage litigation. Persuade your neighbors to compromise whenever you can. Point out to them how the normal winner is often a real loser . . . in fees, expenses and waste of time.”\(^\text{117}\)

XVII. CONCLUSIONS

The use of third-party intermediaries is well accepted in the industry particularly because these intermediaries play important and efficient roles in streamlining the movement of freight. However, the rapid growth and large number of intermediaries, coupled with the absence of any significant legislative and administrative oversight, has caused significant concern within the transportation industry. Motor carriers in particular lament that they must often bear the economic impact of this lack of oversight and regulation that frequently results in damaged business relationships with brokers who mismanage their business or engage in corrupt or unscrupulous activities. Luckily, the rise of programs such as the “Gold Book,” along with efforts by the TIA to standardize relevant contracts as well as industry-wide attempts to provide relevant education with regard to pertinent legal principles and sound management techniques, should help to eliminate problems experienced in the past and facilitate mutually rewarding services in the future.

Regulation of Third Party Surface Transportation: Who is a Third Party Provider and What Regulations Cover Third Party Operations in the United States?

Matthias M. Edrich*

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I. Introduction

Regulation of third party surface transportation intermediaries was historically an issue that states addressed through local licensing and registration requirements.\textsuperscript{1} Federal legislation did not arise until approximately 1887 when Congress enacted the Interstate Commerce Act\textsuperscript{2} and established the Interstate Commerce Commission.\textsuperscript{3} Through the Motor Carrier Act of 1935,\textsuperscript{4} the ICC eventually became the first regulatory body with the power to supervise carrier and broker surface transportation operations.\textsuperscript{5} Under the ICC and its successor agencies, including the Surface Transportation Board and the Federal Motor Carrier Safety Administration,\textsuperscript{6} government oversight of third party surface transportation has blossomed and withered.\textsuperscript{7} While the Motor Carrier Act of 1980,\textsuperscript{8} the ICC Termination Act of 1995,\textsuperscript{9} and, most recently, SAFETEA-LU\textsuperscript{10} in 2005 significantly deregulated the transportation industry, several important regulatory regimes still affect third party surface operations. Counsel to shippers, carriers, and intermediaries will want to become familiar with these regulations in order to correctly understand the risks involved in maintaining third party surface transportation relationships.

The first section of this article following the introduction provides an overview of the history of third party regulation and briefly explains the reasons that underlie the regulation of transportation intermediaries. This section also highlights contemporary legislation that gives rise to current regulatory issues. The second section outlines the regulatory provisions in Title 49 of the U.S. Code that determine the classification and registration of third party providers. Classification is particularly important because statutory liability standards do not apply evenhandedly to all

\begin{itemize}
\item \textsuperscript{1} Charles E. Nadeau, Carriers: Federal Regulation of Motor Transportation Brokers, 36\textit{ Mich. L. Rev.} 963, 963 (1938).
\item \textsuperscript{2} Interstate Commerce Act of 1887, Pub. L. No. 49-104, 24 Stat. 379 (1887) (codified in relevant part as 49 U.S.C. § 10101 (2005)).
\item \textsuperscript{4} Motor Carrier Act of 1935, ch. 498, 49 Stat. 543 (1935).
\item \textsuperscript{5} \textit{Id.} at 546.
\item \textsuperscript{7} Joe Pappalardo & Anna Fister, Trucking Broker/Logistics Provider Liability Presentation at the Transportation Lawyers Association's 2006 Annual Conference (2006), http://www.gsfn.com/useful_tools/TLA.pdf.
\item \textsuperscript{8} Motor Carrier Act of 1980, Pub. L. No. 96-296, 94 Stat. 793 (1980).
\end{itemize}
types of third party providers. The last section in this article discusses current regulatory problems that transportation attorneys frequently encounter. In particular, this section discusses legislative oversight of shipping agents, the effect of SAFETEA-LU on the registration of intermediaries, basic regulatory requirements set forth in the Carmack Amendment, and possible regulatory and common law foundations for requiring brokers to hold freight charges in trust for carriers.

II. A Brief History of Third Party Surface Regulations

Regulatory efforts to supervise and guide third party surface transportation over time look like a bell curve and are closely related to the history of regulating motor carriers. Until the early twentieth century motor carriers enjoyed broad independence from any permanent federal or state regulations. While several states had implemented certain registration and licensing requirements to encourage competition and improve the quality of transportation services, the United States Supreme Court ended state regulation abruptly in 1925. In its holding in Buck v. Kuykendall, the Court decided that state measures to regulate motor carriers significantly affected interstate commerce — a power properly vested in the federal government. In response to the Buck decision and “almost overnight,” independent operators and individuals began overflowing the transportation market with transportation services. Undoubtedly, many of these transportation providers entered into the business with the intention of offering honest services. The depressions in the early 1900s attracted hardworking individuals who were able to start their own business on a “shoe string” budget of a few hundred dollars. Unfortunately, the growing abundance of trucks led to an oversupply of transportation services that depressed prices and profit margins. Overzealous salesmen aimed to take advantage of opportunities made possible in the absence of regulation — often to the disadvantage of customers and the industry overall. Unscrupulous operators skipped maintenance of their equipment; operators discontinued freight services midway between load and unload points to pick up more profitable freight; carriers avoided insurance coverage; freight was stolen; driv-

11. See generally Nadeau, supra note 1.
12. Id. at 963.
13. Id.
15. Id. at 316.
17. See id. at 964.
18. Id.
19. Id. at 965.
20. Id. at 964-65.
ers were pressured to work unreasonable and dangerous hours.\textsuperscript{21}

During this period of lax regulation and fierce competition among carriers, the need for brokers and freight forwarders grew substantially particularly because these intermediaries offered carriers a method to streamline their transportation services by facilitating communications between shippers and carriers.\textsuperscript{22} Unfortunately, “because there were no prerequisites to entering the business, these agents were often shiftless and irresponsible.”\textsuperscript{23} Third party intermediaries often profited heavily by contracting carriage services with dishonest and irresponsible operators who would offer low rates in return for the broker’s blind eye towards lacking business practices.\textsuperscript{24} In addition, because brokers tended to focus heavily on lowering shipping rates by engaging in numerous shady scams and tricks, “merchants could not tell what allowances to make for transportation.”\textsuperscript{25}

Racketeering among brokers and between brokers and carriers to the disadvantage of the public grew out of proportion and harmed the reputation of the intermediary industry to such an extent that in 1935, Congress finally felt compelled to provide for broad relief.\textsuperscript{26} The solution appeared in the form of the Federal Motor Carrier Act of 1935 which gave the Interstate Commerce Commission the power to promulgate regulations for reigning in transportation intermediaries.\textsuperscript{27} Specifically, the policy underlying the Act was to “protect carriers and the traveling and the shipping public against dishonest and financially unstable middlemen in the transportation industry.”\textsuperscript{28}

Rigid regulation until 1980 met with only partial success.\textsuperscript{29} While the 1935 Act and the ICC appeared to succeed in relieving shippers from dealing with dishonest and corrupt transportation intermediaries, the regulations imposed extreme regulatory burdens “that, among other impositions, required anyone applying to become a broker demonstrate [that] their services would be consistent with the public interest”\textsuperscript{30} and that its services would not “unnecessarily duplicate existing brokerage services.”\textsuperscript{31} At the height of this regulatory “bell curve,” federal oversight created virtual monopolies for select intermediaries and consequently in-

\begin{itemize}
  \item 21. Id. at 964.
  \item 22. See id. at 963.
  \item 23. Id. at 966.
  \item 24. Id.
  \item 25. Id.
  \item 26. Id. at 969.
  \item 27. Pappalardo, supra note 7, at 3.
  \item 29. Pappalardo, supra note 7, at 3.
  \item 30. Id.
  \item 31. Id.
\end{itemize}
creased the cost to shippers for transporting goods.\textsuperscript{32}

It was not until 1980 that Congress decided to reconsider the effect that federal regulation had on brokers. The legislature's Motor Carrier Act of 1980\textsuperscript{33} "ushered in an era of virtual deregulation"\textsuperscript{34} of the motor carrier industry. While the Act did not go as far as to remove all restrictions on the operations of intermediaries, Congress did decide to make it easier for intermediaries to register and do business.\textsuperscript{35} Current registration requirements for brokers and freight forwarders are outlined in section III of this article. Unlike the rather one-sided policy of the 1935 Act towards permitting monopolies,\textsuperscript{36} today's federal legislation does a better job of balancing the competing needs of shippers and brokers.\textsuperscript{37} For instance, United States Code Title 49 after the 1980 Act specifically aims to:

(A) encourage fair competition, and reasonable rates for transportation by motor carriers of property;

\ldots

(D) allow a variety of quality and price options to meet changing market demands and the diverse requirements of the shipping and traveling public;

\ldots

(F) enable efficient and well-managed carriers to earn adequate profits, attract capital, and maintain fair wages and working conditions.\textsuperscript{38}

Since the Motor Carrier Act was implemented in 1980, the federal government has amended the U.S. Code in many other respects that affect transportation brokers and freight forwarders. The most relevant amendments to the Code include the following:

\textit{ICC Termination Act of 1995}: Efforts to deregulate the transportation industry necessarily took away powers that the ICC had managed.\textsuperscript{39} By 1995, the agency was left with only remnants of the economic control it once wielded.\textsuperscript{40} The ICC Termination Act terminated the ICC effective December 31, 1995 and transferred the few remaining functions, such as

\begin{itemize}
\item \textsuperscript{32} \textit{Id.}
\item \textsuperscript{34} Pappalardo, \textit{supra} note 7, at 3.
\item \textsuperscript{35} \textit{See id.}
\item \textsuperscript{36} \textit{Id.}
\item \textsuperscript{37} \textit{See id.}
\item \textsuperscript{40} \textit{See id.} at 154.
\end{itemize}
licensing of motor carriers and economic regulation to the Federal Highway Administration and the Surface Transportation Board.\textsuperscript{41} Oversight of brokers and freight forwarders was henceforth managed by these two agencies until the Federal Motor Carrier Safety Administration was established in 2000.\textsuperscript{42}

Carmack Amendment:\textsuperscript{43} In 1906, Congress enacted the Carmack Amendment to the Interstate Commerce Act of 1887 to address liability claims against railroads for damaged or lost goods in interstate commerce.\textsuperscript{44} The Motor Carrier Act of 1935 eventually extended the Amendment's reach to motor carriers and freight forwarders.\textsuperscript{45} After the termination of the ICC in 1995, Congress reenacted the Carmack Amendment in U.S. Code section 14706.\textsuperscript{46}

Motor Carrier Safety Improvement Act of 1999:\textsuperscript{47} Congress decided that a separate agency, called the Federal Motor Carrier Safety Administration, was needed to improve the safety of motor carrier operations.\textsuperscript{48} The FMCSA, which began its work on January 1, 2000, has since been the principal government agency to issue regulations that cover the operations of brokers and freight forwarders.\textsuperscript{49}

Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU): On August 10, 2005, Congress enacted SAFETEA-LU with the main purpose of authorizing federal surface transportation programs through 2009 and enhancing highway transportation safety.\textsuperscript{50} The Act is particularly relevant to third party transportation because its provisions appear to weaken the licensing and bonding requirements for surface transportation brokers and freight forwarders.\textsuperscript{51}

\begin{itemize}
\item \textsuperscript{42} Mullenbach, \textit{supra} note 39, at 154.
\item \textsuperscript{43} 49 U.S.C. § 14706 (2005).
\item \textsuperscript{44} \textit{See} Sompo Japan Ins. Co. of Am. v. Union Pac. R.R. Co., 456 F.3d 54, 57-59 (2d Cir. 2006); \textit{see also} Kelly A. Fisher, The Carmack Amendment and the American Rule: Is Arbitration a Necessary Prerequisite to an Award of Attorney's Fees? 33 TRANSP. L.J. 163, 164 (2005-2006).
\item \textsuperscript{46} 49 U.S.C. § 14706 (2005).
\item \textsuperscript{48} \textit{Id.}
\item \textsuperscript{49} \textit{See, e.g., id.} § 205. Current rules and regulations established by the Federal Motor Carrier Safety Administration can be accessed at http://www.fmcsa.dot.gov/.
\item \textsuperscript{50} \textit{See} Kevin M. McDonald, \textit{Recall the Recall}, 33 TRANSP. L.J. 253, 277 (2006).
\end{itemize}
Section IV of this article discusses the issues and rumors surrounding SAFETEA-LU with respect to brokers and freight forwarders.

III. Classification and Registration Requirements

The classification of a third party surface transportation provider often determines whether the provider can be held liable under tort or contract to a shipper or a carrier for a delay in delivery, the loss of goods, or the damage to goods. The U.S. Code and the Federal Motor Carrier Safety Regulations distinguish between general freight and household goods forwarders, property brokers, and shipper and carrier agents to impose a varying degree of governmental oversight of third party services. Unless the services of a third party provider are exempt from federal or state regulation, the provider may not engage in intermediary services without proper registration.52

The regulations covering each type of provider give effect to the legislative policy set forth in Title 49 Section 13101 and aim to protect the public and shippers from unfair collusion among and between carriers and intermediaries.53 However, the degree of protection that these regulations currently offer depends on the type of goods transported, the general characteristics of the provider, and the services offered by the intermediary in specific situations. Regulatory definitions of the different classifications of intermediaries and relevant registration requirements are described below.

A. Freight Forwarders

1. Regulatory Definition

The transportation attorney may encounter a number of terms variously used to describe freight forwarders including the terms “freight agent” and “freight merchant.”54 For the purpose of this section, these terms are taken to be synonymous with respect to the definition of forwarders in federal regulations.

Under the general definitions section in Title 49 Part B of the U.S. Code, a freight forwarder is defined as a company or individual that provides transportation of cargo belonging to others, and in the course of its business:

(A) assembles and consolidates, or provides for assembling and consolidating, shipments and performs or provides for break-bulk and distribution operations of the shipments;

(B) assumes responsibility for the transportation from the place of receipt to the place of destination; and
(C) uses for any part of the transportation a carrier subject to [the] jurisdiction under [the Code].

The freight forwarder assumes responsibility for the transportation and assembles the loads but often does not conduct the actual transportation. Rather, the forwarder generally uses for-hire carriers to conduct the line-haul movement from origin to destination. The freight forwarder may provide transportation as the carrier itself "only if the freight forwarder also has registered to provide transportation as a carrier." The regulations that define freight forwarders might seem straightforward. As with many aspects of the law, however, special fact patterns and numerous differing court interpretations over the years have clouded the issue and have forced attorneys to rely heavily on case law to establish whether a party in a dispute is truly a freight forwarder or merely a broker or agent. Discussion of relevant case law is outside the scope of this note. The apt transportation lawyer may, however, want to reference cases such as Koninklijke Nedlloyd BV v. Uniroyal, Inc., Consolidated Freightways Corp. of Del. v. Admiral Corp., Constructors Técnicos v. Sea-Land Services, Inc. and Zenith Electronics Corporation v. Panalpina, Inc. to gain a broad understanding of current issues that affect the determination of whether a party should be classified a freight forwarder.

Despite partial deregulation of the transportation industry in the late twentieth century, the federal government through the Secretary of the Department of Transportation and the Surface Transportation Board has retained "jurisdiction...over service that a freight forwarder undertakes

57. See id.
60. 433 F.Supp. 121, 128-129 (S.D.N.Y. 1977) (holding that the usual agency principles such as control and oversight by the principal can be used to determine whether an intermediary was operating as a freight forwarder).
61. 442 F.2d 56, 63-64 (7th Cir. 1971) (holding that the lack of a freight forwarder license was irrelevant for determining whether an intermediary should be considered liable to the carrier for charges paid to the intermediary by the shipper).
62. 945 F.2d 841, 846 (5th Cir. 1991) ("[T]he question whether a freight forwarder acts as agent for either party to the contract of carriage tends to turn on the facts of the particular transaction under scrutiny").
63. 68 F.3d 197, 198-199, 201-203 (7th Cir. 1995) (holding that the freight forwarder was not absolved from liability by virtue of carrier's sole negligence where shipper and forwarder had a contractual relationship distinct from the relationship between forwarder and carrier).
to provide, or is authorized or required . . . to provide."⁶⁴ Most importantly this means that the intermediary must adhere to specific registration provisions established in the U.S. Code and enforced by the Federal Motor Carrier Safety Administration.

2. Regulatory Registration Requirements

The application procedures to acquire a freight forwarding license are laid out in the Federal Motor Carrier Safety Regulations (FMCSR).⁶⁵ General registration requirements and definitions can be found in the U.S. Code. Under Title 49 Section 13903(a)(2), the Secretary of Transportation will register a freight forwarder if the forwarder is fit, willing, and able to provide the forwarding service.⁶⁶ The Secretary and Federal Motor Carrier Safety Administration must specifically determine that registration of the particular freight forwarder is “consistent with the public interest and the national transportation policy of 49 U.S.C. 13101”⁶⁷ and is necessary to protect shippers.⁶⁸

It is important to point out that after SAFETEA-LU, 49 U.S.C. Section 13903 and the FMCSR regulations at Section 365.107 distinguish general freight forwarders from household goods forwarders in their registration guidelines. Household goods are defined in the U.S. Code and in the FMCSR as:

personal effects or property used, or to be used, in a dwelling, when part of the equipment or supplies of the dwelling. Transportation of the household goods must be arranged and paid for by the individual shipper or by another individual on behalf of the shipper. Household goods includes property moving from a factory or store if purchased with the intent to use in a dwelling and transported at the request of the householder, who also pays the transportation charges.⁶⁹

Under the Federal Motor Carrier Safety Regulations, general freight and household goods freight forwarders submit the same application for registration.⁷⁰ The distinction between the two types of forwarders is significant, however, because the recent SAFETEA-LU amendment appears to remove legislative registration requirements for “mere” general freight forwarders as opposed to household goods forwarders.⁷¹

⁶⁴ 49 U.S.C. § 13531(a) (2007). Note, however, that neither the Secretary nor the Board has jurisdiction over service provided by a forwarder using air carriers. See 49 U.S.C. § 13531(b).
⁷⁰ 49 C.F.R. § 365.105(a).
IV of this comment addresses the impact of SAFETEA-LU in more detail.

This distinction is also important because 49 U.S.C. Section 14708 makes it a condition to registration that a forwarder of *household goods* provide shippers an opportunity to settle disputes via arbitration. Shippers may rely on this arbitration right to settle disputes concerning “damage or loss to the household goods transported and to determine whether carrier charges, in addition to those collected at delivery, must be paid by shippers for transportation and services related to transportation of household goods.”

A freight forwarder registered under 49 U.S.C. Section 13903 must acquire proper financial support to satisfy federal liability insurance requirements. Specifically, the forwarder may not operate until it has filed a surety bond, insurance policy, or other type of security to cover potential loss or damage to property and to satisfy potential public liability claims. This “financial responsibility” document must be filed “within 20 days from the date an application notice is published in the FMCSA Register.” The minimum amount of security that the forwarder must maintain is identical to the levels prescribed for motor carriers and depends on the type of property transported and the size of the equipment used for the transportation.

Finally, before the application for the forwarding license is complete, the applicant must provide proof to the Secretary and any relevant state agencies that it has engaged process agents in each state in which the forwarder will operate. These process agents are the forwarder’s representatives upon whom court papers can be served in proceedings that may be brought against the intermediary. The freight forwarder must file FMCSA Form BOC-3, which designates these process agents, “within 20 days from the date an application notice is published in the FMCSA Register.”

An application for registration or recertification may be opposed on at least two grounds: First, the party opposing the registration may claim that the carrier or forwarder is not fit to provide the regulated service.

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74. Id.
75. Id. at § 13906(c)(1); see also 49 C.F.R. § 387.403 (2007).
76. 49 C.F.R. § 365.109(a)(5)(i) and (iii) (2007).
77. 49 C.F.R. § 387.405 (2007).
78. 49 C.F.R. § 387.303(b) (2007).
79. 49 U.S.C. § 13303(a) and (b) (2007); see also 49 C.F.R. § 365.109(a)(6).
81. 49 C.F.R. § 365.109(a)(6).
82. 49 C.F.R. § 365.107(a) (2007).
Under FMCSR Section 365.107(a), fitness might be measured by considering the service provider's compliance with financial registration requirements and the applicant's history of safe operations and adherence to safety rules.\textsuperscript{83} Second, the Secretary or the federal agency may suspend or revoke an operating license once the freight forwarder ceases to satisfy the required security and insurance measures.\textsuperscript{84}

B. Property Brokers

1. Regulatory Definition

The name "property broker" is generally considered the "correct terminology" to define the work that broker intermediaries do.\textsuperscript{85} Other terms used synonymously include "truck broker," "freight broker," "freight agent," or "transportation broker."\textsuperscript{86} A "freight broker agent," however, is merely an agent of the broker and is not covered directly by federal regulations concerning property brokers.\textsuperscript{87} Under the U.S. Code, a property broker is defined as:

a person, other than a motor carrier or an employee or agent of a motor carrier, that as a principal or agent sells, offers for sale, negotiates for, or holds itself out by solicitation, advertisement, or otherwise as selling, providing, or arranging for, transportation by motor carrier for compensation.\textsuperscript{88}

Brokers eliminate the need for motor carriers to solicit contracts from individual shippers by establishing "centralized clearinghouses" where carriers are able to service many shipping contracts at once.\textsuperscript{89} Brokers are explicitly not included in the definition of carriers and, as this article will explain in subsequent sections, are not subject to a number of regulations that impose certain tort and contract liability on freight forwarders.\textsuperscript{90}

The lay reader of the federal regulations may wonder why the law distinguishes in the definition of carriers between freight forwarders and brokers when, in reality, both types of intermediaries engage in very similar transactions. After all, both parties negotiate among shippers with the aim of creating bulk break shipments to benefit from volume discounts. However, unlike freight forwarders, brokers do not actually play a role in

\textsuperscript{83} Id.
\textsuperscript{84} 49 U.S.C. § 13906(d) (2007).
\textsuperscript{86} Id.
\textsuperscript{87} Id.
\textsuperscript{89} Pappalardo, supra note 7, at 2.
\textsuperscript{90} 49 U.S.C. § 13102(3).
the "assembly or carriage of the goods." The property broker never acts as the carrier itself while the freight forwarder may become directly engaged in the assembly of shiploads, assumes responsibility for the shipment, and may even use its own resources to conduct the transportation. Therefore, the freight forwarder becomes liable exactly as the carrier would for the loss or damage of the freight while the property broker is largely shielded from claims of liability.

2. Regulatory Registration Requirements

The regulations for registering as a property broker are outlined in the FMCSR and Title 49 of the U.S. Code and do not differ substantively from the registration requirements for freight forwarders. Under FMCSR Section 365.107(e), the applicant must prove that it is "fit, willing, and able to provide the involved transportation and to comply with all applicable statutory and regulatory provisions," and that the service will be consistent with public interests and the policy underlying Title 49. After SAFETEA-LU, the code distinguishes between "mere" general freight brokers and brokers of household goods in the same manner as for freight forwarders. As section IV of this article will discuss, counsel should not falsely believe that SAFETEA-LU amendments to Title 49 now dispense of the registration requirement for general freight intermediaries.

Like the freight forwarder, a broker must file form BOC-3 to designate a processing agent in compliance with 49 U.S.C. Section 13303 and must adhere to the FMCSA's surety bond requirements. These surety bond and insurance requirements, however, do differ from those required for operating a freight forwarding business. Specifically, Title 49 and the FMCSR demand merely that a broker maintain some type of policy or security approved by the Secretary to ensure that the transportation service arranged by the broker can be provided. The Code does not demand that brokers maintain tort liability insurance of the sort required of

91. 14 AM. JUR. 2D Carriers § 651 (2007).
98. Id.
100. 49 U.S.C. §§ 13904(c)-(d); 49 C.F.R. § 387.307.
freight forwarders.\textsuperscript{101} The Federal Motor Carrier Safety Administration in FMCSR Section 387.307(a) currently requires that property brokers maintain surety bonds or trust funds of at least $10,000. This "financial responsibility" document, as with freight forwarders, must be filed within twenty days after the application notice is published in the FMCSA Register.\textsuperscript{102} "The FMCSA will not issue a property broker license until a surety bond or trust fund for the full limits of liability prescribed [in the FMCSR] is in effect."\textsuperscript{103}

The license to operate as a broker does not in itself allow the broker to provide the transportation itself.\textsuperscript{104} Thus, the broker cannot, by virtue of its registration as a property broker decide to operate the carrier service and transport the goods.\textsuperscript{105} Title 49 U.S.C. Section 13904(b)(1) instead demands that the broker "also has been registered to provide the transportation as a motor carrier."\textsuperscript{106}

C. Carrier and Shippers' Agents

In most situations, carrier and shippers' agents are not required to register with the FMCSA as a condition to providing transportation services.\textsuperscript{107} Under the FMCSR, a carrier agent belongs to the "normal organization of a motor carrier" and performs transportation services under the carrier's direction.\textsuperscript{108} Unlike brokers or freight forwarders, who may at times also act as agents for carriers,\textsuperscript{109} "mere" bona fide carrier agents are characterized particularly by a "preexisting agreement which provides for a continuing relationship [with the carrier], precluding the exercise of discretion on the part of the agent in allocating traffic between the carrier and others."\textsuperscript{110} The actions of a bona fide carrier agent are governed by general rules of agency.\textsuperscript{111} Of course, once the carrier agent engages in broker or freight forwarder services outside the scope of the agreement or relationship with the carrier, the bona fide agent exception to registration will not apply.\textsuperscript{112} For instance, if the agent assists the carrier in ar-

\textsuperscript{101} 49 U.S.C. §§ 13906(c)(1)-(2).
\textsuperscript{102} 49 C.F.R. § 365.109(a)(5)(ii).
\textsuperscript{103} 49 C.F.R. § 387.307(a).
\textsuperscript{104} 49 U.S.C. § 13904(b)(1).
\textsuperscript{105} Id.
\textsuperscript{106} Id.
\textsuperscript{108} 49 C.F.R. § 371.2(b) (2007).
\textsuperscript{109} See, e.g., 49 U.S.C. § 13102(2).
\textsuperscript{110} 49 C.F.R. § 371.2(b); see also Andrews, supra note 107, at 5.
\textsuperscript{112} Andrews, supra note 107, at 5.
ranging transportation under a bill of lading issued by another carrier, FMCSR Section 371.2 suggests that the agent must register as a broker. Similarly, if the agent acts independently of the carrier to arrange for motor carrier transportation without any participation by the carrier, it does so subject to federal regulations.\footnote{Dal-Tile, 1990 WL 288088 at *2.}

Unfortunately, the Federal Motor Carrier Safety Regulations do not clarify whether this "bona fide" agent exception to registration also applies to agents who work for shippers. The next section will address this issue and identify a few solutions for coming to terms with the apparent ambiguity in the regulations.

\section*{IV. Current Legislative and Regulatory Issues}

\subsection*{A. Registration Requirements for Shippers' Agents}

Similar to the brokerage or freight forwarding services that a carrier agent may provide to carriers, a shippers' agent may engage in intermediary services directly for the shipper.\footnote{See generally Andrews, supra note 107.} As broker or forwarder for the shipper, the shippers' agent searches for carriers or forwarders that will transport the shipper's goods.\footnote{See Dal-Tile, 1990 WL 288088 at *3.} The shippers' agent might also be called upon to search for other shippers who want to participate in a shipment to share shipping costs.\footnote{See \emph{id}.} Unlike a freight forwarder, however, the shippers' agent does not hold itself out as a common carrier "vis-a-vis the shippers it serves" and does not accept full responsibility as a common carrier.\footnote{R&R Trucking, Inc., 13 M.C.C. 291, 294 (S.T.B. Nov. 4, 1983).} Rather, the shippers' agent "undertakes only to obtain the desired transportation services on behalf of and as agent for the shippers it represents."\footnote{\emph{Id.}} Is this distinction between shippers' agents and "mere" independent forwarders or brokers enough to qualify shippers' agents for the "bona fide" agent exception to the regulatory registration requirements?

Unlike the "bona fide" registration exception that excludes motor carrier agents from the registration requirement,\footnote{49 C.F.R. § 371.2(b).} the federal regulations do not mention whether a similar exception applies to shippers' agents. Fortunately, there are a handful of agency decisions that shed light on how the Department of Transportation might interpret this issue.

Early railroad and motor carrier cases suggest that "shippers' agents were generally exempt from regulatory requirements."\footnote{Andrews, supra note 107, at 6.} With respect to
these agents, 49 U.S.C. Section 10562(4) specifically exempted from jurisdiction “the service of an agent of a shipper in consolidating or distributing pool cars when the service is provided for the shipper only in a terminal area in which the service is performed.”\(^{121}\) While Section 10562(4) was limited to railroad shippers’ agents, the ICC later sanctioned the same exception for motor carrier shippers’ agents.\(^{122}\) However, because the Surface Freight Forwarder Deregulation Act\(^{123}\) repealed Section 10562 in 1986, the language of that section today merely evidences the historical distinction between freight forwarders and shippers’ agents.

Recent agency findings described below suggest that this early exemption of shippers’ agents still applies in the motor carrier context. In R&R Trucking, a transportation provider applied for an extension of authority to transport general commodities for a shipping agent.\(^{124}\) The ICC denied the application on the basis that the applicant was attempting to transport goods for a mere shippers’ agent who “cannot assume responsibility [as a shipper] for . . . traffic from the point of origin to point of destination.”\(^{125}\) In its holding, the ICC explained that a shippers’ agent was therefore exempt from registration requirements but, as a result, could not engage in the same type of broad activities that registered intermediaries were able to operate in.\(^{126}\)

A more recent ICC hearing in 1990 concerning an unregistered motor carrier broker in a fee dispute case reiterated that a motor carrier “shippers’ agent [has] always . . . been exempt from Commission regulation.”\(^{127}\) The hearing, which took place several years after the Section 10562 exemption was repealed, suggests that the Commission still accepted the regulatory exemption for shippers’ agents who consolidate and dispatch shipments for van load movements.\(^{128}\)

It would certainly be convenient to have clear regulatory guidance to understand whether the carrier agent exception may still be extended to shippers’ agents today. Yet, after the repeal of Section 10562, nothing exists to firmly anchor this exception for shippers’ agents. Surely, ambiguity in the law is often celebrated as an opportunity to engage in legal craftsmanship, and given case history described above, counsel to shippers’ agents might successfully wager the odds to advise clients that an


\(^{124}\) R & R Trucking, Inc., 133 M.C.C. at 291.

\(^{125}\) Id. at 292.

\(^{126}\) Id.

\(^{127}\) Dal-Tile, 1990 WL 288088 at *3.

\(^{128}\) See id.
exception will protect the agent’s activities. In light of the rather insignificant registration burden, however, "the prudent course for a shippers’ agent today is to pay the $300 fee and obtain a broker’s license if there exists even a possibility that the agent will arrange motor carrier shipments."129

B. B. Registration Requirements after SAFETEA-LU

SAFETEA-LU could have filled the gap left by repealed Section 10562 to clarify registration requirements for third party intermediaries and agents. Indeed, while the Act, signed on August 10, 2005 by President George W. Bush, primarily reauthorizes funding of $286 billion for federal transportation programs in fiscal years 2004 – 2009,130 it also attempts to simplify regulatory oversight of third party intermediaries.131 Specifically, after SAFETEA-LU, Title 49 now distinguishes registration of household goods from registration of general freight intermediaries and substantively requires the following:

1. Household goods. The Secretary of the Department of Transportation shall register a person to be a broker or forwarder of household goods if the Secretary finds that the person is fit, willing, and able to be a broker or forwarder for transportation.132

2. Others. The Secretary may register a person to provide service as a broker or forwarders (other than a broker or forwarder of household goods) if the Secretary finds that such registration is needed for the protection of shippers and that the person is fit, willing, and able to provide the service.133

By making registration for non-household goods intermediaries optional, SAFETEA-LU provides the Secretary of the Department of Transportation (and the FMCSA) with the power to abolish registration requirements for general freight brokers and forwarders.134 SAFETEA-LU also obviates the need for general freight intermediaries to file a bond or other type of security with the FMCSA as long as the FMCSA does not require registration of these intermediaries.135 Indeed, 49 U.S.C. Section 13906(b) and (c) expressly condition registration of brokers and forwarders on proof of security (under Section 13903 for brokers) and liability insurance (under Section 13904 for forwarders).136

130. McDonald, supra note 50, at 277.
132. The household goods registration requirements for brokers and forwarders mirror one another in substance. See 49 U.S.C. §§ 13903, 13904.
134. See SAFETEA-LU § 4142.
135. See id.
That would mean that a "mere" general freight intermediary who might not be required to register would not need to maintain liability insurance or other security as a condition to operating.

These changes to the federal registration regulations clearly have the potential to impact the way intermediaries operate. Without strict registration requirements and assuming acquiescence by the FMCSA, an increasing number of brokers and freight forwarders will probably enter the business. Greater supply of intermediary transportation services thus increases competition in the third party transportation market and makes such services more affordable for shippers and carriers. Less regulatory oversight, however, may also increase the risk involved in doing business with intermediaries. For instance, shippers of non-household goods might not be able to recover for damaged shipments when an underfunded broker or forwarder has not voluntarily acquired liability insurance.

SAFETEA-LU, in effect, allows partial deregulation of the intermediary industry and thus continues the trend towards less government involvement. In many aspects, this deregulation and simplification of oversight is an excellent result that could benefit public consumers:

Recognizes changes in the industry: Modern technology has generally made business dealings more transparent.\textsuperscript{137} Shippers and carriers now use the Internet and various other electronic means to compare and exchange information concerning the reputation and reliability of broker and freight forwarder services.\textsuperscript{138} As a result of increased information exchange, market forces should play a far greater role in filtering out intermediaries that engage in dishonest business practices. SAFETEA-LU appears to recognize this shift towards market-regulation and aims to remove redundant government oversight.

Maintains protection for less sophisticated shippers: While SAFETEA-LU permits the Department of Transportation to relax oversight of general commodities intermediaries, the Act still maintains full oversight of household goods transactions.\textsuperscript{139} SAFETEA-LU and the FMCSA recognize that continued regulation is needed in order to protect less-sophisticated parties that often engage in household goods transactions.\textsuperscript{140}

Improves efficiency of general freight services: The shift from regulatory


\textsuperscript{138} Popular online sources used by shippers and carriers include http://www.uship.com (last visited Apr. 8, 2007), http://www.freightcenter.com (last visited Apr. 8, 2007), and http://www.freight101.com (last visited Apr. 8, 2007).

\textsuperscript{139} SAFETEA-LU § 4142.

oversight to market regulation improves the efficiency with which the third party transportation industry functions. For instance, SAFETEA-LU enables individuals to enter the general freight intermediary industry without the financial burden of filing licensing applications and setting up trust funds or liability insurance. As a result of this lower regulatory overhead, a broker or freight forwarder can offer intermediary services at a lower cost.

SAFETEA-LU therefore finally implements changes that have been overdue for a long time. Unfortunately, however, the Act initially created significant confusion, precisely because it delegated power to the FMCSA to determine whether continued registration was needed. More than one year after the Act amended Title 49, there was still "no consensus as to whether the Secretary must initiate a rulemaking to determine whether continued regulation [was] needed to protect the public, or whether this change [had] been accomplished effective August 20, 2005."142

This confusion continued until late 2006 when the FMCSA eventually decided to make a public finding to clarify the gap created by SAFETEA-LU.143 In its public "notice of determination" on August 24, 2006, the agency, under Administrator John H. Hill, found that registration of general freight intermediaries is still needed in order to protect shippers from potentially dishonest and unstable intermediaries. The agency based its decision on the continuing significance of freight forwarders and brokers with respect to shipments of general commodities. According to the FMCSA's Motor Carrier Management Information System, applications for non-household goods brokers increased by thirty percent since 2003 while the number of applications for freight forwarders grew by an astonishing eighty percent since 2003.147 Considering this growth, associated revenues of over $16 billion, and significant employment, the agency found that there could be a devastating impact on the national economy if general freight brokers and freight forwarders were to become unreliable "due to lack of confidence in their activities and financial responsibilities."148 Registration must therefore continue even for general freight intermediaries in order to ensure proper financial

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142. Id.
144. Id.
145. Id. at 50,117.
146. Id. at 50,116.
147. Id.
148. Id.
C. LIABILITY FOR LOST OR DAMAGED GOODS

When shippers and their counsel sue to recover damages for lost or damaged goods as a result of the interstate transportation of the goods, they frequently raise state law claims such as breach of contract, negligence, and fraud. The losses or damages probably implicate each of these areas of liability. What many attorneys might not be aware of, however, is that the Carmack Amendment, currently encoded at 40 U.S.C. Section 14706, preempts all such state law claims and is the "exclusive cause of action for contract claims alleging delay, loss, failure to deliver or damage to property." The Amendment also preempts "claims of damage or loss relating to storage and other services rendered by interstate carriers."

The Carmack Amendment was initially enacted in 1906 to cover claims for damages and losses that resulted from interstate transportation of goods by rail. In 1935, particularly in response to the emergence of automobiles and trucks, Congress broadened the scope of the Carmack Amendment to create a uniform national liability scheme that extends to motor carriers.

Perhaps the most important aspect of Carmack that an attorney for motor carrier intermediaries should be aware of is that the Amendment applies not only to motor carriers but also to freight forwarders. In other words, the freight forwarding company that handles goods which become damaged or lost in the course of interstate transportation will be liable to the shipper under federal law. It does not matter that the freight forwarder itself did not actually transport the goods or cause the

149. See generally id.
151. Hughes Aircraft v. North American Van Lines, 970 F.2d 609, 613 (9th Cir. 1992). In Adams Express Co. v. Croninger, the Supreme Court specifically held that the Carmack Amendment covers "[a]lmost every detail . . . so completely that there can be no rational doubt that Congress intended to take possession of the subject, and supercede all state regulation with reference to it." 226 U.S. 491, 505-06 (1913).
152. Hall v. N. Amer. Van Lines, Inc., 476 F.3d 683, 688 (9th Cir. 2007).
154. See Sompo Japan Ins. Co. of America v. Union Pacific R.R. Co., 456 F.3d 54, 58-59 (2d Cir. 2006); see also Fisher, supra note 44, at 164.
157. Id.
damage or loss. The provisions added by the Carmack Amendment create strict liability as long as the plaintiff can set forth by a preponderance of the evidence the prima facie elements of the cause of action. Thus, the plaintiff does not need to prove negligence. The carrier or freight forwarder may limit this strict liability only by bargaining with the shipper for alternative contract terms. To establish the prima facie case, the plaintiff-shipper must specifically prove that:

(1) the goods were delivered to the carrier in good condition, and
(2) the goods arrived in damaged condition, and
(3) there were specific, quantifiable damages.

Unlike a freight forwarder, a property broker is not considered a "carrier" within the meaning of the Carmack Amendment. The freight forwarder is directly involved in the assembly and carriage of the shipper's goods. In contrast, the broker merely facilitates communication and cooperation between shippers and carriers. The broker generally does not take ownership of the freight or organize the transportation on its own behalf. The broker therefore assumes the rights of a shipper in Carmack claims against carriers and is largely shielded from claims of liability that might arise when the carrier damages or loses the shipper's goods.

In a dispute involving damaged or lost goods, the Carmack Amendment gives the freight forwarder several procedural rights. For instance, the freight forwarder may require that the shipper state its claim within nine months of the shipment that resulted in the damage or loss of the shipper's goods. In addition, the forwarder cannot be held liable for claims under the Carmack Amendment if the shipper does not initiate a civil action within two years after the shipper's claim for damages is de-

159. Id. at 1464-65.
160. See id.
166. See id.
167. See, e.g., B & D Appraisals v. Gaudette Machinery Movers, Inc., 733 F.Supp. 505, 509 (D. R.I. 1990) (broker who organized shipping was entitled to raise Carmack liability claims as shipper against the carrier); Taft Equip. Sales Co. v. Ace Transp., Inc., 851 F.Supp. 1208, 1211 (N.D. Ill. 1994) (carrier, who acted as transportation broker for shipper and hired another carrier to conduct the actual transportation service, was entitled to enforce Carmack liability against the other carrier).
nied.169 "The purpose of a claim period is to provide the carrier with knowledge that the shipper will be seeking reimbursement."170

Counsel for carriers and freight forwarders may be particularly interested in the limitation of liability provisions set forth in the Carmack Amendment. Generally, the Carmack Amendment subjects a motor carrier to absolute liability for "actual loss or . . . injury . . . to property."171 However, according to the Amendment, a carrier may limit its liability for lost or damaged goods that were shipped in interstate commerce "to a value established by written declaration of the shipper or by a written agreement."172 In an action concerning the enforceability of such a limited liability agreement, the carrier has the burden of proving that it has complied with the following requirements.173 Specifically, the carrier must:

(1) maintain a tariff that is within the prescribed guidelines of the Surface Transportation Board,174
(2) provide the shipper with an opportunity to "choose between two or more levels of liability,"175
(3) obtain the shipper's agreement with respect to its choice of liability,176 and
(4) issue "a receipt or bill of lading prior to moving the shipment."177

The Carmack Amendment impliedly prescribes a number of common sense steps that counsel representing interstate common carriers and intermediaries should follow in order to steer clear of tort liability that might arise from damage to, or loss of, goods. First, an attorney should move to dismiss all state law claims that aggrieved shippers lodge against the carrier or freight forwarder.178 "This will typically result in the reduction of a shipper's available damages"179 because the various and potentially costly state tort and contract claims are replaced by the likelihood of liability created by only one cause of action. The carrier's attorney must then determine whether the claimant-shipper complied with the

169. Id.
170. Humphrey, supra note 150.
174. Id. To effectively limit its liability in a filing with the Surface Transportation board, "a carrier must list with each rate listed in the tariffs a 'released rate,' which is the maximum dollar liability per unit of weight for which the carrier will be liable in the even of damage to the cargo." Id. (citing Rohner Gehrig Co., Inc. v. Tri-State Motor Transit, 950 F.2d 1079, 1082 (5th Cir. 1992)).
175. Hughes Aircraft, 970 F.2d at 612.
176. Id.
177. Id.
178. See Humphrey, supra note 150.
179. Id.
maximum periods for filing claims and initiating civil actions. Obviously, a late claim or action will probably eliminate the potential for liability. Finally, the attorney should discuss with the carrier the possibility of creating limited liability riders to shipping contracts in order to circumscribe the possible liability that may result from damaged or lost goods.

D. HOLDING FREIGHT CHARGES IN TRUST FOR CARRIERS

An issue that often arises in the context of third party intermediary services involves non-payment of transportation charges where the intermediary receives payment for the transportation service from the shipper but does not properly disburse the payment to its carriers. Should the intermediary be liable to come up with funds to satisfy the carriers’ claims, or does ultimate responsibility always remain with the shipper? The answer depends on the type of relationship that the shipper has with the intermediary.

Ordinarily, when a shipper deals with a freight forwarder, transportation charges billed by the carrier are enforceable only against the forwarder. The shipper is absolved from a carrier’s claims by virtue of a lack of privity of contract between the parties. Indeed, the freight forwarder by definition takes charge of the shipment, issues a bill of lading to the shipper, and deals with the shipper as if the forwarder were the carrier. On its own behalf, the forwarder then deals with actual carriers as the de facto shipper. The carriers issue their bills of lading to the freight forwarder and might never be aware of who the original shippers are. The freight forwarder becomes responsible to the carrier for all freight charges.

The result is different where a freight forwarder or broker deals with the shipper in the capacity of an agent or conduit for the shipper. The broker’s activity, by definition, generally does not affect privity of contract between the shipper and the carrier because the broker does not interact with the carrier on its own behalf. Instead, the broker merely

180. See Andrews, supra note 107, at 8.
182. See 14 AM. JUR. 2D Carriers § 651 (2007) ("a freight forwader . . . assumes responsibility for the shipment from receipt to the place of destination").
185. Id.
186. Id.
assists the shipper in identifying acceptable carriers and takes the role of a conduit for forwarding shipping charges from the shipper to the carrier.\textsuperscript{188} The carrier therefore still issues its bill of lading directly to the original shipper or to the broker with the knowledge that the broker is acting on behalf of the identified shipper.\textsuperscript{189} Of course, when a freight forwarder interacts with the shipper in a similar broker-shipper agency manner, the same relationship between shipper and carrier results whereby the shipper ultimately remains responsible for all freight charges.\textsuperscript{190}

In a "mere" conduit relationship with the intermediary, can a shipper satisfy its duty to pay the carrier by making a bulk payment to the intermediary with instructions to satisfy carrier charges? Does this payment to the intermediary establish a constructive trust where the intermediary retains only legal title while the carriers hold equitable title as beneficiaries of the trust?

1. Using Intermediaries as Conduits to Satisfy Shipping Charges

As described above, the property broker is by definition a conduit.\textsuperscript{191} Not only does the broker interact with shippers to facilitate communications between carriers and shippers, but the broker may also contract with shippers and carriers to collect and forward shipping charges.\textsuperscript{192} There is nothing inherently risky or wrong in this type of "collection" agreement. Indeed, federal regulations concerning record retention requirements implicitly allow brokers to act as payment conduits by specifically requiring brokers to record "[t]he amount of any freight charges collected by the broker and the date of payment to the carrier."\textsuperscript{193}

2. Satisfying Carrier Claims with Surety Agreements or Trust Funds

What responsibilities does the intermediary-conduit have once it accepts the shipper's payment? By merely collecting shipping charges, the intermediary-conduit does not automatically absolve the shipper from making sure that carriers are paid, because the intermediary does not destroy the privity of contract between shippers and carriers.\textsuperscript{194} This is because conduits do not attempt to assume the liabilities and rights of

\textsuperscript{188} Id.
\textsuperscript{189} Id.
\textsuperscript{190} Id.
\textsuperscript{191} Brokers and freight forwarders are defined by the roles they assume. Thus, a freight forwarder who engages in brokerage activities only must be considered a broker. See 13 Am. Jur. 2d Carriers § 87 (2007) (outlining the roles that define brokers and freight forwarders).
\textsuperscript{192} E.g., Freight Peddlers, Inc., 2000 WL 33399885, at *6 (intermediary contracted with carriers to collect and forward freight charges).
\textsuperscript{193} 49 C.F.R. § 371.3(a)(6) (2007).
\textsuperscript{194} See Registration of Brokers and Freight Forwarders of Non-Household Goods, Notice
shippers. The risk therefore remains with the shipper to make sure that carriers are paid even when a dishonest intermediary-conduit does not correctly forward the shipper’s payment.

The FMCSA has recognized this risk to shippers and carriers and therefore “will not issue a property broker license until a surety bond or trust fund for the full limits of liability” is in effect. The purpose of the security is to “ensure the financial responsibility of the broker” and arguably to protect shippers and carriers from nonpayment that might occur when the intermediary absconds with the collected payments. Theoretically, outstanding shipping claims can be paid from this security or trust fund. FMCSR Section 387.313 specifically prevents a broker from canceling or withdrawing a security agreement “until 30 days after written notice has been submitted to the FMCSA” in order to prevent the broker from frustrating a shipper’s or carrier’s claim to the security.

Unfortunately, many carriers and shippers are either unaware of the broker’s surety requirement or have claims that surpass the $10,000 minimum surety level. In response, on February 8, 2007, the FMCSA published an announcement inviting public comments concerning potential changes to the surety regulations – at least with regard to household goods brokers. The FMCSA’s proposals would modify FMCSR Section 387.307 to raise the minimum level of security to $25,000 and to require brokers to notify consumers about the availability of sureties or trust funds.

3. **Imposing Constructive Trusts Upon Freight Payments**

General freight carriers and shippers or those with higher shipping claims are not significantly benefited by the proposed changes and no regulations apart from the surety requirement exist that might directly protect shippers and carriers when transportation payments given to brokers become unavailable. As a result, injured parties have claimed that

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195. *E.g.*, Freight Peddlers, 2000 WL 33399885, at *6 (agreement between intermediary and carrier to collect shippers’ payments did not thereby impose liability for non-payment upon intermediary).
196. *See id.*
198. *Id.*
199. 49 C.F.R. § 387.313(d) (2007). The thirty day limit does not apply where the broker is merely replacing one security with another. *Id.* at § 387.313(e). Termination in this situation can be effective immediately as long as a new security bond or surety becomes available. *Id.*
201. *Id.* at 5947 & 5951.
202. *Id.* at 5950 & 5953.
payments to intermediary-conduits are held in trust for the benefit of carriers. In some Canadian provinces, such as Québec, trust accounts are expressly required when certain brokers accept payments from shippers. While similar outright trust requirements do not exist in the United States, some Circuits, such as the Second Circuit in Transportation Revenue Management v. Freight Peddlers, have been willing to impose constructive trusts.

Freight Peddlers provides a helpful analysis for understanding when a court might impose a constructive trust specifically on intermediaries. In Freight Peddlers, the carriers, represented by assignee Transportation Revenue Management (TRM), sued bankrupt broker Freight Peddlers for shipping charges that Freight Peddlers had collected but never forwarded to its carriers. Instead of forwarding the payment, Freight Peddlers transferred the collected charges to defendant bank pursuant to a security interest that the bank maintained in Freight Peddlers’ accounts receivable. TRM claimed that the broker, as “mere” conduit, had received the shipping charges as trustee for the benefit of the carriers. As such, the bank as creditor of Freight Peddlers did not have a valid claim to the charges and could not acquire full equitable and legal title. The bank, therefore, should be obliged to transfer the charges to TRM. In counterargument, the bank claimed that Freight Peddlers had received full legal and equitable title in the freight charges and became nothing more than a debtor to the carriers for the outstanding shipping payments.

The court found that the language of the agreement between Freight Peddlers and the motor carriers did not create an express trust. However, according to the court, a constructive trust could be imposed because (1) the language and conduct of the parties proved that Freight Peddlers was a “mere” conduit, (2) the circumstances surrounding the transaction made this the only rational finding, and (3) a different holding would lead to inequity and potential fraud.

204. Transport Act, R.S.Q., ch. T-12, § 42.1 (2007) (Qué.), http://www.canlii.org/qc/laws/sta/t-12/20070117/whole.html (last visited May 18, 2007). The holder of a brokerage permit “shall deposit in a trust account the sums he receives . . . and administer them in accordance with the administrative and management standards prescribed by government regulation.” Id.
206. Id. at *1.
207. Id.
208. Id.
209. Id.
210. Id.
211. See id. at *3.
212. Id.
213. See id. at *5.
The court specifically referenced the language of the parties' contract which required Freight Peddlers to perform "all billing and collecting services" and to "pay the carrier . . . upon receipt of the . . . bill of lading." These requirements, the court determined, were consistent with the FMCSR Section 371.3(a)(4) definition of a "conduit" that held only legal title. The conduct expected of a conduit would be to merely forward the shippers' payments to the carriers. Freight Peddlers could contradict this presumption only by proving that the company paid carriers from its own general fund before receiving shippers' payments. Ultimately, the defendant was unable to rebut this presumption because it failed to prove circumstances where it did pay carriers from its general fund. Determining that "it would indeed be unjust and inequitable to allow Freight Peddlers to hold anything other than legal title to the freight charges," the court finally concluded that Freight Peddlers "was merely a collecting conduit" which could not "use the collected freight charges to pay off its loan from the bank."

Earlier cases expand on several assertions underlying the decision in *Freight Peddlers*. In the 1973 case *In re Penn Central Transportation Company* and the 1997 case *Columbia Gas Systems*, the Third Circuit expressed the fundamental rule that "[f]ederal common law imposes a trust when an entity acts as a conduit, collecting money from one source and forwarding it to its intended recipient." *In re Penn Central* developed this rule by analyzing the basic common law requirements for establishing a trust. The court first looked towards the Restatement (Second) of Trusts Section 2, which requires that parties to a trust agreement manifest an intention to split the equitable and legal title to property. The court explained that this manifestation could be ascertained from "the facts and circumstances surrounding the transaction and the relationship of the parties." In particular, the fact that the parties were not demanding interest on conduit payments underscored the difference to the

214. *Id.* at *3.
215. *Id.* at *5; 49 C.F.R. § 371.3(a)(4).
217. *Id.* The court also noted that "the commingling of trust funds with general revenues [typically] indicates a debtor-creditor relationship." *Id.* at *5 n.5 (quoting *In re Columbia Gas Sys. Inc.*, 997 F.2d 1039, 1060 (3d Cir. 1993)).
218. *Id.* at *5.
219. *Id.*
220. *Id.*
223. *Id.* at 1056.
usual debtor-creditor relationship that "entails the right to use another's money, the usual quid pro qui for which is the obligation to pay interest." 226

While In re Penn Central concerned trusts that arose from railroad interline contracts, the more recent 1997 Sixth Circuit case, Parker Motor Freight v. Fifth Third Bank,227 extends the same conduit trust analysis to motor carrier interline arrangements.228 Few cases beyond Freight Peddlers discuss the In re Penn Central analysis with respect to motor carrier intermediaries. The most current case on point is the 2006 federal bankruptcy case In re Gulf Northern Transport,229 which concluded that a payment made by the shipper directly to the carrier satisfied any service fee claims that a broker had against the shipper.230 In particular, the bankruptcy court maintained that the broker, as agent of the carrier, should have been able to retrieve the fee after the payment was made to the carrier.231 The shipper was not required to submit the payment directly via the broker because the broker was a "mere" conduit.232 As a conduit, the broker would simply have held the money in trust for the carrier and, absent consent by the carrier, would not have had any right to claim brokerage fees from the charges held in trust.233

While a basis for imposing constructive trusts is not explicitly mentioned within federal regulations, courts such as those involved in the cases discussed above have generously relied on the constructive trust theory to remedy fraud and inequity. Brokers might therefore prudently expect that courts will attempt to establish outcomes similar to Freight Peddlers in future cases that involve non-paying conduits and potential unjust enrichment.234

V. CONCLUSIONS

Federal regulations create a complex web of rules and procedures that attorneys for shippers, carriers, and intermediaries must master in order to provide adequate legal counseling. To correctly interpret these rules and procedures, an attorney must understand the public policy implications that give rise to government regulation. A history of fraud and collusion in the third party transportation industry was the main impetus

226. Id.
228. Id. at 1140.
230. Id. at 122-23.
231. Id. at 122.
232. See id. at 122-23.
233. See id.
234. See Andrews, supra note 107, at 8.
for greater oversight and control. From these historical concerns arise the fairly strict registration and operating procedures that brokers and freight forwarders must still grapple with today.

Considering the current state of the transportation industry and the greater sophistication of commercial and household shippers thanks to technological innovation, the government's approach to heavy-handed regulation appears out of place. Instead of taking a skeptical view towards brokers and freight forwarders, the government should loosen its grip over the industry to allow for greater flexibility in the provision of services to carriers and shippers. Perhaps most obviously, shippers and carriers in today's technologically-savvy environment are able to compare and contrast intermediary services, reliability, and reputation. The shipping public is therefore less frequently prone to the often horrific ethical violations that ignited the government's regulatory quests at the end of the nineteenth century.

SAFETEA-LU provides for an opportunity to relax the non-HHG registration requirements that have, up until to now, increased the burden of providing intermediary services for non-consumer shippers. Unfortunately, any hope that the Act might simplify intermediary services by potentially eliminating registration requirements for general commodities intermediaries was extinguished in August 2006 when the Department of Transportation issued its finding that it would continue to impose its strict oversight.

Instead of maintaining regulations to restrict participation in the industry, the government should expand on its efforts to consolidate and streamline laws that affect third party transportation. The government should look towards the Carmack Amendment as the role model for future regulation, which provides fairly clear guidance with respect to claims for lost and damaged goods. In particular, the government should establish guidelines with respect to trust relationships between carriers, shippers, and conduits. Considering the outcome in cases such as Freight Peddlers, Parker Motor Freight, and In re Penn Central, an opportunity exists for creating a uniform rule that explains whether conduits hold payments in trust for the benefit of motor carriers. Unlike restrictive regulations that aim to reduce the supply of third party intermediaries, a comprehensive "trust" rule has the potential to avoid expensive litigation and ambiguity that raises the cost of providing transportation services.

235. See Nadeau, supra note 1, at 964.
237. See generally Andrews, supra note 107, at 8.
238. Id.
Transportation Tort Liability Travels Up the Supply Chain

Daniel C. Sullivan & Matthew P. Barrette*

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I. Introduction

"In the last analysis, this is a case in which the law may simply have to catch up with an obligation that Robinson has voluntarily assumed, presumably in response to the demands of the market." This pithy and portentous observation by United States District Judge J. Frederick Motz in the seminal case *Schramm v. Foster*,¹ fairly states the present exposures facing parties (i.e. shippers, brokers, and third party logistics companies)

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as they establish a new and evolving economic presence in the supply chain. In short, how does a company that provides logistics services in self-defined contract relationships properly apprehend tort liability that occurs downstream or upstream in the supply chain?

II. Historical Treatment of Tort Liability

Historically, there is a paucity of case law in the transportation arena dealing with tort liability that extends beyond those parties immediate to the event proximately causing a plaintiff's injury. Traditionally, where a motor carrier's driver, operating a tractor-trailer combination, injured a pedestrian or the occupants of an automobile, only the motor carrier and the driver were sued.\(^2\)

Under previous practice, the liability extended no further than the time honored precedents dealing with master-servant relationships. These precedents evolved into the concept identified as respondeat superior that extended liability beyond the driver causing injury only to the carrier employer under a duty of vicarious liability. In short, an economic relationship of an employer deriving an economic benefit from an employee allowed a determination that the employer controlled the employee and because of this, there was a responsibility for the actions of the employee.\(^3\) An obvious concomitant economic consideration for even suing the employer was to reach the worth of the employer. Stated crudely, the employer usually has deeper pockets than the employee and the award of money is the objective manifestation of justice for the injured party at law.

In the context of interstate motor carrier transportation of property, the Interstate Commerce Act, passed pursuant to the Commerce Clause of the United States Constitution,\(^4\) essentially preempted judicial imagination by state court judges and state regulatory bodies, thus limiting the extension of a duty sounding in tort to the immediate actor and the employer.\(^5\) Prior to deregulation, the ability to jump beyond the immediate

\(^{2}\) This is so well settled that Judge Motz had little difficulty resolving that issue by summary judgment in the separate opinion contained in Schramm, 2004 U.S. Dist LEXIS 16990.


\(^{4}\) U.S. CONST. art. I, § 8, cl. 3.

\(^{5}\) The Interstate Commerce Act (ICA) was passed in 1887 and led to a huge body of case law that pre-empts action contrary to, or infringing upon, the ICA and regulations of administrative agencies implementing the ICA. Cf. 49 U.S.C. §§ 10501-10502, 14501 (2005); Adams Express Co. v. Croninger, 226 U.S. 491 (1913); I.C.C. v. Tex., 499 U.S. 450 (1987). But see R. Mayer of Atlanta, Inc. v. City of Atlanta, 158 F.3d 538 (11th Cir. 1998), overruled by City of Columbus v. Ours Garage & Wrecker Serv., 536 U.S. 424 (2002) (Supreme Court overruled decision striking down municipal ordinance regulating towing companies which was passed pursuant to the safety regulation exception to federal preemption under 49 U.S.C. § 14501(c)(1)).
master and servant relationship was limited to regulatory-based efforts such as those manifested by the placard liability cases.

These placard liability cases arose out of the regulations of a federal administrative agency that allowed a motor carrier to use “independent contractor” owners of their own vehicles.6 However, any motor carrier using independent contractor/owner operators must operate the owner-operator’s vehicles pursuant to the safety regulations and identify them as the motor carrier’s vehicles.7 This identification of the vehicle as that of the motor carrier led to repeated instances of litigation that sought recovery from motor carriers when an independent contractor/owner operator failed to remove the placard and an act injuring another party sounding in tort occurred.8 Federal Regulations imposed a duty on the part of the motor carrier to remove the placard when the independent contractor left the motor carrier’s service. In these cases, the injured party could sue the motor carrier seeking recourse against the motor carrier’s assets and insurance9 on the basis that the motor carrier was still acting as the master as a matter of law. But, as imaginative as the plaintiffs’ bar might have been, there was the essential relationship of master-servant between the driver causing the injury and the party once removed (generally the motor carrier) before the law would impose a duty on the master resulting in liability and money damages.

This discussion of master and servant applies the same principles when the terms principal and agent are used. Under these principles, a duty may be imposed upon a non-actor for the actions of the actor where the non-actor was the “principal” of the agent.10 Historically, the case

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6. See the Truth-In-Leasing Regulations, 49 C.F.R. § 376 (2007). This area can be developed by recourse to a plethora of case law. Whether an owner operator/independent contractor is really independent represents an issue fascinating the Internal Revenue Service, the labor law bar, every state court system, and every economic relationship where a liability is sought to be extended beyond the independent contractor to another entity.


10. Of course the law of agency is broader than the law of master-servant. See Leadership Council for Metro Open Communities v. Red Carpet Contempo Realty, Inc., 1984 U.S. Dist. LEXIS 23736, *3 (N.D. Ill. 1984) (citing Restatement (Second) of Agency § 2 (1958)). The authors believe the terms roughly synonymous when considering their use for cases sounding in tort. For example, an obligation or duty for the actions of an agent is assumed by the principal
law in transportation appears to apply the concept for finding a duty that arises in cases sounding in tort where there is a direct relationship; that is, the liability extends to a duty imposed upon an entity once removed from the actor causing the injury.

III. DEREGULATION AND ITS INFLUENCE

The statutory and regulatory foundations for this structure regarding tort liability have now been replaced by deregulation of the economic structure of surface transportation; particularly motor carrier transportation in the United States. Before 1979, the basic economic structure of transportation principally included shippers and carriers. This was the case for a number of historical reasons but almost all of them were grounded on the bedrock of a public utility type of regulation that had existed since 1887.

In 1979, the Interstate Commerce Commission unlocked several limitations on the actions and conduct of motor carrier brokers. Motor carrier brokers were allowed to contract with motor carriers and motor carriers were allowed to become brokers.

In 1980, Congress substantially deregulated rail and motor transportation which led to the deregulation of railroad intermodal service. This deregulation was important as it allowed exempt freight forwarders of rail service (such as shippers’ agents), steamship lines and other entities to broaden the economic nature of their service offerings. In fact, over the next few years these shippers’ agents and other exempt forwarders became known as Intermodal Marketing Companies (IMC) or Logistics Service Providers (LSP).

The congressional action in 1980 precipitated other statutes in 1982, 1986, 1993, and 1994 that temporarily deregulated freight forwarders,


11. Cf. Dixie Midwest, Extension General Commodities, 132 M.C.C. 794 (I.C.C. 1982), where the Interstate Commerce Commission (I.C.C.) allowed motor carrier brokers to support carriers for contract authority where the broker had “working control” of the transportation. One can wonder if the I.C.C. had any idea that control of transportation by a broker could be found as a nexus for allegations of tort liability.


eliminated the filed rate doctrine for motor carriers of general property, and essentially deregulated intrastate commerce.\textsuperscript{15} In 1995, Congress decided to eliminate the Interstate Commerce Commission altogether and opened the door to an economic environment that led to the \textit{Schramm} decision.\textsuperscript{16}

The essential aspect of the deregulated market is that participating entities can be and can engage in anything they can economically prove will work. A motor carrier can also be a motor carrier broker, run a warehouse, act as an IMC, develop and operate intellectual property to be utilized for supply chain management, and participate in every aspect of the diverse intermodal service offerings that exist. The point of this observation is that an entity participating in a supply chain will not have a presumed structure but only the structure shown by the unique facts that exist at the time of every event of injury that sounds in tort. In the deregulated environment, the resultant duties that arise with the injury depend upon the facts that plaintiff's counsel finds and believes can apply to an entity.

Therefore, the traditional structure or transportation role of service providers is disappearing or has disappeared. The transportation market between an asset-based direct transportation provider and the beneficial owner of goods who wants to sell them to an ultimate consumer is now very fluid. Intermediaries have generally interjected themselves into this historically simple economic relationship. The parties to each such comprehensive transportation transaction are no longer the consignor, carrier, and consignee where the economic relationships were defined by a single bill of lading. The market is now known as the supply chain and each movement in the supply chain can have a number of different actors functioning in different interlocking capacities depending upon perceived economic benefits that will accrue to each actor. This dynamic unsettles the body of law applicable to tort law in at least the domestic surface transportation area. Judge Motz's observation quoted at the beginning of this article appears well grounded.

This indicates that any discussion of the possibility of an extension of the parameters of tort liability is necessarily prophetic in nature and therefore speculative. However, the \textit{Schramm} case shows there is no


speculation in a pronouncement that the plaintiffs' bar will seek to extend duties lying in tort to third party participants in the supply chain who are variously known as "Third Party Logistics" companies, IMC's, LSP's, brokers, shippers' agents, stack train operators, transportation intermediaries, or by other names, but including entities at least once removed from the actor or the direct master/principal of the actor causing the injury.\textsuperscript{17}

IV. CURRENT SOURCES OF LIABILITY

In answering the basic question of how, or even if, tort liability can extend up and down the supply chain beyond the actor causing the injury, there must be at least a general appreciation of what a tort represents. Most generally, a tort is a wrong and a tortious act is a wrongful act.\textsuperscript{18} In order to find a tort there must be a duty at law extending from the defendant to the plaintiff proximately causing a resulting injury that is distinct from nonperformance of a contract.\textsuperscript{19} Stated differently, if the entire duty is imposed by contract then a violation of the duty (a breach) sounds solely in contract and it is not a tort.\textsuperscript{20} A duty sounding in tort is premised upon a wrong and a resulting injury to the person, a person's property, or a person's reputation.\textsuperscript{21}

In examining the scope of torts that apply to the supply chain there must be a determination of the scope of the duties. In this examination it is important to understand that the application of liability for violation of a duty does not depend upon the concept of privity.\textsuperscript{22} However, in cer-

\textsuperscript{17} Henceforth referred to generically as 3PLs.


\textsuperscript{20} State ex. rel. Cummins Mo.Diesel Sales Corp. v. Eversole, 332 S.W.2d 53 (Ct. App. Mo. 1960). See also Kaloti Enters., Inc. v. Kellogg Sales Co., 699 N.W.2d 205 (Wis. 2005) (in situations involving fraud claims relating to misrepresentations about the quality of goods, the plaintiff is limited to contract remedies).

\textsuperscript{21} This right arises constitutionally. See, e.g., Ill. CONST. art. I, § 12 ("Right to Remedy and Justice. Every person shall find a certain remedy in the laws for all injuries and wrongs which he receives to his person, privacy, property or reputation. He shall obtain justice by law, freely, completely and promptly."); Ohio CONST. art. I, § 16 ("All courts shall be open, and every person, for an injury done him in his land, goods, person, or reputation, shall have remedy by due course of law, and shall have justice administered without denial or delay").

\textsuperscript{22} Rozny v. Marnul, 250 N.E.2d 656 (Ill. 1969); Wright v. Creative Corp., 498 P.2d 1179 (Colo. Ct. App. 1972) ("concept of tort duty therefore is not restricted by that of contractual privity").
tain limited cases, even if an obligation is assumed by contract, a duty may appear that gives rise to liability not because of the failure to perform a contract obligation but because of the breach of a duty imposed by law.23

The blurring of this dichotomy of contract and tort led to an interesting case recently tried by the authors to a jury in Kane County, Illinois.24 The jury was presented with a breach of an oral contract by a stack train operator to a retail IMC.25 Specifically, the breach alleged was of an oral covenant not to back solicit the customer of the IMC who was shipping large volumes of coil steel to the west coast.26 These shipments of steel coil allowed the stack train operator to reposition large numbers of its parent company’s twenty foot containers to the west coast for transportation by the parent company’s steamships back to the far east.27 The breach of the oral contract resulted in a limited award of $60,000 for a limited contract term contemplated by the oral contract.28 However, the second count in this case sounded in tort based upon an unlawful interference with an expectancy.29 On that count, grounded in duties not to use deception and not to back solicit, the jury awarded $665,000.30 Besides establishing the scope of the tort by the underlying contract duties, this case extended liability up the supply chain to the steamship line, the parent company of the stack train operator, because of a determination that the stack train operator was the alter ego of the ocean carrier.31

This case raises issues that are concerning to the defense bar and a delight the plaintiffs’ bar. This is especially the case where there are catastrophic damages and large well-funded 3PLs or other well-funded parties who are a part of the supply chain and involved with the tort. When the injury occurs, the plaintiff will attempt to find a nexus between the damage or injury and the duty imposed by law in order to extend the

27. Id. at 3.
29. Id.; See generally Chase v. Clinton County, 217 N.W. 565, 567 (Mich. 1928) (discussing the principle that “every contract is a common-law duty to perform the thing agreed to be done with care, skill, reasonable expediency, and faithfulness, and a negligent failure to observe any of these conditions is a tort”).
liability to an entity with resources to accommodate the amount of damage that exists. With personal injuries, this nexus is usually the shipment. When damage occurs, the shipment being transported provides a large arcane body of law establishing the duties of the entities involved with the shipment. The body of law that ties the injury to the supply chain is the law peculiar to transportation. The scope of the duties that arise out of a shipment comprises duties attendant to the bailment of the goods that make up the shipment and the implied or actual contracts that exist in relationship to those bailment duties. Of course, historically the bailment duties on the transportation of a shipment are found in the bill of lading. Where regulated freight is being shipped, this bill of lading is deemed issued even if the carrier involved with the shipment fails to issue it.

When a carrier is transporting a shipment, that carrier assumes a number of duties at law. Some duties peculiar to transportation arise from common law. In this regard, note Lord Holt’s delineation of common law liability in 1703 that is still essentially applicable:

One that exercises a publick employment . . . and is to have a reward [such as a common carrier], is bound to answer for the goods at all events . . . The law charges this person entrusted to carry goods against all events but acts of God and of enemies of the King.

Other directly applicable duties related to cases that lay in tort are grounded in statute or regulation. For example, the placard liability cases previously referenced found their genesis in the leasing regulations of the former Interstate Commerce Commission. In addition, federal law imposes upon motor carriers the duty to maintain agents for service of process in and through each state in which they operate thus exposing them to litigation in unfavorable venues. Motor carriers must maintain liability insurance subject to specific endorsements that continue the lia-

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 LIABILITY insurance until cancelled with notice assuring plaintiff of a defendant with a minimum amount of prescribed insurance coverage. 37 Also, motor carriers must operate the equipment used for transporting a shipment whether that equipment is purchased or leased from an independent contractor who furnishes the driver or drivers. 38

The result was that in Schramm, the court had no problem in finding the motor carrier liable for the violation of a duty not to injure the plaintiffs by hitting their pickup. 39 This result extends to the use of independent contractors by non-asset based motor carriers. The scope of the duty arises out of the shipment, not the mere transportation of the shipment. The duty extends to the motor carrier responsible for the shipment, not the independent contractor transporting the shipment for the motor carrier. 40 In fact, this focus on the underlying business and the concomitant duties imposed by the Truth-in-Leasing Regulations 41 has attracted the attention of regulators in various states and representatives of the independent contractors. 42

With deregulation, the focus of the shipment as structuring the duties between a shipper and a carrier as the primary parties to the specific commercial relationship was fragmented. Schramm explains this change in detail. 43 3PLs expanded their role in the market by booking, managing, and assuming other incidents of the control of shipments historically residing with carriers. They did this without assets that a carrier must maintain to provide transportation service. As they grew, they contracted services from motor carriers who, by reason of deregulation, could easily obtain authority and enter the market. The 3PLs assumed a major part of the role that many motor carriers formerly provided with independent contractor fleet operators. 44 However, to provide service on behalf of

44. Brief of Transp. Intermediaries Ass’n as Amicus Curiae Supporting Affirmance in Part of the Decision Below at 3-4, Norfolk S. Ry. Co. v. Kirby, (No. 02-1025), 2004 WL 1216277 rev’d 543 U.S. 14 (2004). Historically, fleet operators owned more than one truck and leased two or more as a fleet to a motor carrier when authority to operate was difficult to obtain fleet operators, as well as individual operators who signed on with motor carriers who coordinated the operations under the franchise of the operating authorities secured from the I.C.C. and its counterparts at the state level. See, e.g., Matt Glyn, Unique co-op saves area shippers money 150 local companies own nation’s only freight cooperation, BUFFALO NEWS, Nov. 19, 2006, at D1.
3PLs, the small fleet operators had to secure their own authority (easily obtainable after deregulation) and insurance, and had to maintain their own safety programs. The result is that the direct vendor of transportation to the shipper, in an increasing number of instances, is a 3PL while the duty to transport a shipment remains with the small fleet operator/motor carriers. In other words, an integrated service on which a tort duty was based under regulation was split with deregulation.

With deregulation, the direct customer for many motor carriers is the 3PL which provides market coordination and controls the routing of a shipment. In some instances in the supply chain, the 3PL will pass the shipment to yet another 3PL, so that one 3PL books the shipment from the shipper and another 3PL books the carrier's service for the shipment. The authors have been involved in situations where as many as four intermediate 3PLs have been involved in the supply chain. This can get quite confusing when a motor carrier also acts as a 3PL broker on a shipment without the shipper's knowledge. What results is complex multiparty litigation that requires a search for which entity has what duty.

When this fact situation is presented in the context of a serious injury, most often a personal injury, the injured party can be faced with major damages and no recourse for recovering significant amounts of those damages from the driver or motor carrier. For example, in Schramm, the motor carrier maintained the federally mandated $750,000 of liability insurance. This was patently inadequate.

V. THE QUEST FOR JOINT TORT LIABILITY

The result is a quest to secure liability up and down the supply chain through various tort concepts that seek to hold additional entities liable for the natural, ordinary, and probable consequences of their wrongful actions. The concepts that allow such actions include the concepts of joint tortfeasors, multiple tortfeasors, and imputed negligence. For purposes of this article, we have excluded consideration of comparative fault

45. Brief of Transp. Intermediaries Ass'n as Amicus Curiae Supporting Affirmance in Part of the Decision Below, supra note 44, at 3. This observation focuses on a truckload operation. There is a distinct difference in the motor carrier market segment known as less than truckload and parcel. See Charles L. Schultz, Keynote Presentation, Intermodalism-The Past is Prologue, 28 Transp. L.J. 393, 395 (2001).
46. New Orleans Lokal Envelope Co., Inc v. Chicago Express, Inc., No. 99-2174, 1999 WL 1124788, at *1 (Dec. 7, 1999). While personal injuries were not involved, this case alleged various torts as well as Carmack liability under 49 U.S.C. § 14706. Id. This unpublished decision involved a shipper that sued a motor carrier for damages "caused by the late delivery of damaged machinery [shipper] plaintiff purchased from a third party." Id.
47. Schramm, 341 F. Supp. 2d at 541-42. See 49 U.S.C. § 13906(a)(1); 49 C.F.R. § 387.7(b)(1).
and the Uniform Comparative Fault Act as beyond the scope of an examination of the single issue of tort liability.\textsuperscript{49}

Joint tort liability may be particularly suited to application up and down the supply chain. This is because the distribution of a shipment that previously moved under an integrated economic model under regulation has been broken down into several economically viable functions following deregulation. That is, deregulation sought market efficiencies by encouraging the unfettered operation of the transportation marketplace and has achieved this by splitting formerly integrated functions into separate distinct profit-generating operations.

Under regulation, a motor carrier had direct contact with a shipper under a statutorily-mandated holding out as a common carrier. That common carrier provided service pursuant to published tariffs offering service to all on a non-discriminatory basis. These offerings integrated a specific service on a “shipment” that included rules that a specific rate applied from the pickup of and receipt for the shipment to the delivery upon a standard bill of lading whose terms were uniformly prescribed. The functions surrounding the service, such as billing, payment, and resolution of claims, were similarly structured to support the bill of lading’s terms and conditions applicable to a shipment.

With deregulation, entrepreneurs could buy and sell the intangible of transportation as a tradable function in and of itself. That is, a 3PL could buy and sell the intangible of service.\textsuperscript{50} The result was a rapid expansion of intermediaries who deal in transportation but do not maintain the assets necessary for the provision of transportation. Essentially, 3PLs buy capacity from motor carriers and railroad intermodal operations and sell it to shippers. However, the carriers nonetheless still pick up shipments with the bill of lading contract or a receipt (if there is another type of contract) receipting for the shipment.\textsuperscript{51} 3PLs as stack train operator intermediaries selling to other 3PLs sometimes contract capacity from the railroads or motor carriers, purchase drayage, or lease trailers and sell the resulting transportation to shippers as an integrated service billed on a single bill of lading.

Variations of this separation of previously structured and integrated functions have arisen and are still evolving. A noteworthy aspect of this


\textsuperscript{50} Cf. 49 U.S.C. §13102(2) (2005) (defines motor carrier broker that says a broker can act as a “principal” that can buy or sell “transportation”).

change in the supply chain landscape is the correlation between volume and rates; that is, as the 3PLs secure and arrange for the shipment of greater volumes, their bargaining position is enhanced. This has led to the growth of large, non-asset intermediaries in the supply chain such as C. H. Robinson Worldwide, Inc., as described in Schramm.\textsuperscript{52}

As the supply chain extends internationally, the shift to a coordinator that can efficiently tie the supply chain together results in an intermodal coordination of a single shipment. Under this economic model, the shipper can use one entity to move a shipment through the entire supply chain, receive one invoice, deal with claims through that same entity and receive at least an indirect economic benefit derived by pooling the shipper’s volume with other volumes to achieve cheaper overall transportation. This logistics model now exists and its use appears to be expanding. It is also the economic model in Schramm where the shipper looked only to the 3PL as the service provider for the entire service on the shipment.\textsuperscript{53}

However, when liability arises (e.g. as a result of a catastrophic accident), the 3PL will typically deny tort responsibility or any legal duty to the injured party and seek to pin liability on the actual service provider, which is usually the motor carrier or the asset-based entity. The 3PL will contend the duty arising by the issuance of the bill of lading or receipt defines a distinct responsibility and the carrier is the sole repository of liability.\textsuperscript{54}

The separation of the formerly integrated functions suggests that 3PLs must be careful to avoid possible resulting tort involvement. There is a natural desire by the 3PL to sell service to a shipper touting its “partnership” with its stable of carriers. In fact, the term partners, as in carrier partners and shipper partners, or the use of concepts styled as “partnerships” is common to transportation.

Such activity points to a potential future area where tort law may catch up with the transportation sector. This is true especially where there are small carriers with limited worth subject to the economic guidance of large economically viable intermediaries connected in the supply chain to the shipment that is involved with a catastrophic accident. À

\textsuperscript{52} Schramm, 2004 U.S. Dist. LEXIS 16990 at *2.

\textsuperscript{53} Id. at 3.

\textsuperscript{54} Note should be taken that each situation depends on the exact facts. For example, assume a contract between the 3PL and the motor carrier where the 3PL essentially assumes total control of the shipment and displaces the motor carrier in every material regard; Travelers Indem. Co. of Illinois v. Schneider Specialized Carriers, Inc., 04 Civ. 5307 (RJH), 2005 U.S. Dist. LEXIS 2029, at *13 (S.D.N.Y. Feb. 9, 2005) (“What a party labels itself and what a party is registered as [are] not controlling.” “[W]hether a company is a broker or a carrier/forwarder is not determined by how it labels itself, but by how it holds itself out to the world and its relationship to the shipper” (internal citations omitted)).
primary area representing a possible exposure for 3PLs in the supply chain is the area of joint tort liability.

An example of this area of liability is contained in the unreported Madison County, Illinois case of Trout v. Stewart, involving C. H. Robinson Company, a large third party transportation company. In that case, the court treated a small motor carrier as a partner with C. H. Robinson, a large intermediary, based upon the facts presented. The control of the actual transportation of the supply chain by the intermediary led to a finding of a joint venture. The court found control on the part of the 3PL among the following facts: controlled dispatch by the 3PL of a driver handling a particular shipment, the 3PL’s allowing the carrier or driver authority to sign or otherwise act as a putative agent of the 3PL, the 3PL’s management of freight in the supply chain with mandatory tracing requirements imposed upon the motor carrier, certain web page references to “shipper” and “carrier” partners, and other facts indicating a joint venture that were developed in discovery.

A joint venture is generally deemed to be an association that carries out a single business enterprise for profit. Joint ventures are usually governed by the same rules that apply to general partnerships, and there usually exists a mutual agency among the venturers for activities within the scope of the venture. In a partnership, each partner is liable for the damages caused by the action or inaction of another partner. Hence, the facts surrounding a 3PL involvement in a supply chain in any particular injury scenario can suggest joint tort liability.

This joint liability suggests an evolution of the law from a time when traditional functions were integrated into a particular economic relationship to a time where traditional functions are rearranged by imagination and the entrepreneurial spirit. This evolution presents an inherent tension in every 3PL business offering in the supply chain. On one hand, the 3PL generally desires to control the source of shipments by offering the shipper a complete logistics solution and by representing to the shipper the 3PL’s accountability for service on the shipment. On the other hand,

56. See id.
57. See id.
58. See id.
60. State ex rel McCrory v. Bland, 355 Mo. 706, 712 (Mo. 1946); Johnson, 662 S.W.2d at 241.
61. Wisconsin Cent. R.R. Co. v. Ross, 142 Ill. 9, 15 (Wisc. 1892); Wolfe v. Harms, 413 S.W.2d 204, 215 (Mo. 1967).
when something goes wrong and cargo damage, property damage, or personal injury occurs, the 3PL generally adopts the role of an innocent bystander claiming a lack of control, oversight, or accountability for the natural consequences of the asset-based carrier's course of conduct. Because injuries allowing recovery seem a certain event, the plaintiffs' bar will examine the facts surrounding each injury and try to apply traditional causes of action that sound in tort. The result is that supply chain participants have started developing (and will continue to develop) procedures and representations that anticipate claims of joint action or joint enterprise in conjunction with the asset-based service provider.

Of course, if the response of the courts is to broaden the scope of supply chain liability, there will be an economic response. An example of an earlier similar response to the expansion of tort liability was the regulatory requirement that motor carriers secure insurance to cover the actions of employee drivers and the requirement that owner operators provide financial security for the benefit of shippers.62

VI. THE BAILMENT RELATIONSHIP AND ITS CONSEQUENCES

The application of the concept of imputed negligence up and down the supply chain is limited. Because the connection between parties in a supply chain often arises from the shipment,63 the underlying relationship that ties together the supply chain is somewhat unique. The supply chain therefore rests upon bailment relationships between the various entities that are engaged in the shipment.

In every bailment, the bailor (who may not be the beneficial owner) entrusts the possession of distinct personal property to a bailee to perform a contracted service.64 Each bailee has a direct obligation with regard to the personal property that begins with possession and ends with delivery to the bailor or to another at the direction of the bailor.65 For two reasons, recognition of this relationship is critical for examining the limitations of imputed negligence in the supply chain.

The first reason is that the bailment on a shipment is specific and depends upon possession.66 3PLs generally do not assume direct posses-

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62. See 49 C.F.R. § 387.7(a) (2001) (for motor carrier insurance and self insurance requirements).
63. Types of shipments that connect parties might include a movement of personal property in a single package, a consolidation of packages from a single origin to a single destination, or a consolidation and shipment of packages from multiple origins to multiple destinations.
64. BLACK'S LAW DICTIONARY 151 (8th ed. 2004).
sion of the shipment as a master or principal which would allow direct application of the principle of vicarious liability that depends upon a respondeat superior relationship. 3PLs are known generically as non-asset based entities that do not maintain the physical assets allowing the bailment.

The second reason is that case law seems clear that at common law there can be no imputation of negligence by a bailee to a bailor.67 This means common law disallows an effort by a member of plaintiffs' bar to fish upstream or downstream in the supply chain merely by reference to the logistics chain involved with a shipment. Of course, this proposition would seem subject to exceptions as is just about any pronouncement of the law.

Nevertheless, upstream or downstream duties might be imposed by contract or by regulation. For example, the shipment itself could be a dangerous instrumentality, like a hazardous material. In that situation, there are regulatory duties that rest upon offerors of hazardous materials.68 A 3PL's involvement could conceivably include a duty regarding such a shipment. The regulations seem to indicate that a 3PL dealing with hazardous materials is an offeror if the 3PL buys and sells a shipment. Certainly, it is foreseeable that improperly shipping or even offering or arranging a shipment of hazardous materials could have catastrophic consequences. Such liability extending up and down the supply chain, however, would not depend on a duty arising out of the bailment but would arise out of knowledge of a dangerous instrumentality and negligence in relationship to the dangerous instrumentality.69

Of course, this is the premise in Schramm where the judge allowed the case to continue for negligent entrustment.70 The case appears to hold that tractor-trailer combinations or Class 8 trucks are dangerous instrumentalities.71 The resulting duty resting on the 3PL is that of selecting a carrier subject to vicarious liability who is considered safe by the Federal Motor Carrier Safety Administration, an agency charged at law with an obligation to make that determination.72

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67. Restatement (Second) of Torts § 489 (1965); White v. Saunders, 158 S.W.2d 393, 396 (1942); See also Smesrud v. Brown, 303 Minn. 330, 332 (1975).


69. Cf. 57A Am. Jur. 2d Negligence § 298 (2006); So. Cotton Oil Co. v. Anderson, 86 So. 629, 636 (Fla. 1920); But see Pullman, Inc. v. Johnson, 543 So.2d 231 (1987) ("The trailer portion of a tractor-trailer rig is not a dangerous instrumentality for the purpose of applying the vicarious liability enunciated in [So. Cotton Oil]").


71. Id. at 3.

VII. SUBSUMED LIABILITY

Apart from these concepts, negligence appears imputable from motor carriers or other carriers to a 3PL only if the facts of the particular situation surrounding an injury can show that the 3PL has subsumed a position of an employer to a servant or a principal to an agent allowing a finding of vicarious liability based upon the principle of respondeat superior.73 However, in finding that the 3PL is either the employer liable for his servant or a principal liable for his agent, the facts showing control are central to an argument of vicarious liability. The control that is involved in any such examination of the facts appears to arise out of the shipment being transported at the time of the injury.74

If the 3PL protects the 3PL's market by slipping over the line and assuming the actual control of a shipment as a carrier in every essential regard, application of traditional tort principles would then appear to impose a duty not to act negligently.75 However, if the 3PL appreciates the tension between keeping shippers but avoids liability so as to enhance the non-asset based business model of avoiding all the costs and risks an asset-based carrier faces, then the 3PL enhances the possibility of avoiding catastrophic tort liability that most 3PLs have not contemplated.76 But 3PLs must be ever mindful of the fact that the law seeks a remedy for injury. The real remedy is an actual recovery of money. The reality of Schramm is that such a remedy may only be possible from the large well-funded 3PLs as the deregulated market continues to evolve.

VIII. CONCLUSION

In the face of such a reality, the transportation marketplace should be aware that evolving case law will require action to accommodate increased risk exposure. If that adjustment extends the imputation of tort liability, then the business models and economic assumptions of 3PLs will

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73. For a discussion of principal-agent law applied to a broker on a shipment transported by an independent contractor terminated by a carrier two months prior to the accident, see Tartaglione v. Shaw’s Express, Inc., 790 F. Supp. 438, 441 (S.D.N.Y. 1992).
74. Of course, the 3PL could contract for dedicated service of a carrier and directly control a bobtail or a dead head where the equipment is empty. That fact would extend any consideration of whether the facts show a duty that sounds in tort.
75. CGU Int'l Ins. v. Keystone Lines Corp, No. C-02-3751 SC, 2004 U.S. Dist. LEXIS 8123, at *5 (N.D. Cal. 2004) ("The difference between a carrier and a broker is often blurry. The crucial distinction is whether the party legally binds itself to transport, in which case it is considered a carrier.") This case is also noteworthy for its discussion regarding the tort of negligent selection of a carrier. See also Chubb Group of Ins. Co. v. H.A Transp. Sys., Inc., 243 F. Supp. 2d 1064, 1067 (C.D. Cal. 2002) where the court analyzed a cause of action against a broker for negligent entrustment.
have to materially change. On one hand, this change may require innovative insurance developments. On the other hand, it may also facilitate the growth of 3PLs into even larger economic units that are the only units that can accommodate such risk and thereby further the centralization of control of the supply chain into the hands of fewer and fewer 3PL entities.
Third Party Contract Issues Concerning Motor Carriers, Brokers, and Shippers

James C. Hardman*

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I. Introduction

The growth of third party participation in the movement of interstate freight by motor carriers¹ and the diminishing administrative oversight of

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¹ The latest government figures indicate that approximately 16,930 active general commodities brokers are registered with the Federal Motor Carriers Safety Administration (FMCSA) as of April 17, 2006. The number of property broker applications has increased by thirty percent since 2003. Approximately 1,040 active general commodities freight forwarders are registered with the FMCSA and applications filed annually have increased by approximately

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such movement has increased the necessity to design contracts that will reflect the role of the various business interests involved. These changes in the industry require a well-founded understanding of liabilities involved in the movement of interstate freight and an awareness of the consequences that might flow from poorly drafted documents.

Significant contract litigation has arisen because parties have not understood or identified the specific roles they are undertaking in a freight movement. This is a particularly serious problem because the rights and liabilities of the multiple parties vary based on their relationship with the immediate contracting party. In most instances, rights and liabilities of parties also depend on the types of parties that will be involved in a three-party freight movement.

One very common issue that arises with regard to third party contracts involves the difference between an express classification of a transportation provider and the provider's actual activities. For instance, a broker is defined as

> a person, other than a motor carrier or an employee or agent of a motor carrier, that as a principal or agent sells, offers for sale, negotiates for, or holds itself out by solicitation, advertisement, or otherwise as selling, providing, or arranging for, transportation by motor carrier for compensation.

However, while holding a license as a broker, the provider might pursue contract or operations practices in a manner that exceeds the definitional scope of a "broker" and thereby effectively engage in the transportation as a motor carrier or shipper. Courts will take cognizance of the formal titles that parties adopt within contracts. However, courts will also look beyond such titles to determine what tasks parties are actually engaged in or performing in order to determine whether or not the authority that a party possesses is controlling.

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4. *See United States v. California, 297 U.S. 175, 181-82 (1936); See also Enesco, Inc. v. Weicker Transfer & Storage Co., 689 F.2d 921, 925-26 (10th Cir. 1982).*


Third Party Contract Issues

Schramm v. Foster? highlights the contract problems that might arise when third party providers become engaged in activities beyond the scope of their authority. In Schramm, a broker who appeared to be acting as a carrier for the interstate shipment of goods was sued for personal injury damages that occurred during the transportation. Despite fairly strong evidence by the plaintiff that the broker should be held liable as a shipper, the broker was eventually able to escape liability thanks to an extensive analysis of the services held out and provided. In the opinion of one noted legal commentator, this case provides several lessons that are fundamental to creating valid and enforceable contracts in the realm of third party transportation:

Contracting can make a difference. Courts will refer to the monikers ascribed to the contracting parties in the various contacts involved in a 3PL shipping scenario in an effort to assess liabilities among those parties. Consequently, as often is stated, it is important to memorialize the contractual relationships to properly designated contracting parties.

II. COMMON CONTRACTUAL ISSUES

Third party surface transportation providers operate in an extremely competitive environment. As a result of time pressures and the need to maintain efficient and flexible operations, parties have tended to neglect several critical considerations that implicate their business and which could be addressed by proper contract drafting. The failure to sufficiently design contracts that contemplate these issues has led to many significant legal problems outlined below.

A. DOUBLE BROKERING

A growing practice in third party transportation operations involves "double brokering." The legislative and administrative regulations that underlie third party transportation do not contemplate double brokering, and the practice only exists because the Federal Motor Carrier Safety

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8. Id. at 540-43.
9. Id. at 541.
10. Id. at 543-44.
12. This involves the practice of a broker receiving a shipment from a shipper and subsequently tendering the shipment to another broker for movement by a motor carrier. It is frequently done without the shipper's knowledge or the motor carrier's knowledge. No written or even oral contracts exist between the shipper and the second broker or between the motor carrier ultimately used and the initial broker. Jets Prolink Cargo, Inc. v. Brenny Transp., Inc., No. Civ. 02-1294 ADMRLE, 2003 WL 22047910, 1 n.1 (D. Minn. Aug. 29, 2003).
Administration has mainly focused its attention on “safety-related” matters.\textsuperscript{13} Initially, participants should be aware and concerned over the legality of double brokering. While there do not appear to be any reported administrative or court decisions that deal with this precise issue, double brokering is often considered illegal in light of the wording of federal regulations.\textsuperscript{14} A review of the Regulations shows:

(1) 49 C.F.R. § 371.2(a) defines a broker as “a person who, for compensation, arranges, or offers to arrange, the transportation of property by an authorized motor carrier.”\textsuperscript{15}

(2) 49 C.F.R. § 311.2(d): “Brokerage or brokerage service” is defined as “the arranging of transportation or the physical movement of a motor vehicle or of property. It can be performed on behalf of a motor carrier, consignor or consignee.”\textsuperscript{16}

(3) 49 C.F.R. § 371.3 covers the records to be kept by brokers and requires the broker, in part, to keep data of:
   (a) the originating carrier;
   (b) bill of lading or freight bill number;
   (c) the amount of any collected freight charges and the date of payment to the carrier;\textsuperscript{17}

(4) 49 C.F.R. § 371.7 provides that a broker shall not:
   (a) “perform or offer to perform any brokerage service (including advertising) in any name other than in which its registration is issued”;
   and
   (b) “directly or indirectly, represent its operation to be that of a carrier.”\textsuperscript{18}

While these regulations are no “clarion” of good draftsmanship, the regulations appear to be clear enough to indicate that a three-part relationship is contemplated with, for instance, a motor carrier, a broker, and a consignor or consignee.\textsuperscript{19} The regulations also seem to indicate that the broker must be performing on behalf of a motor carrier or the consignor/consignee.\textsuperscript{20} When a second broker is involved, is that person or entity providing service on behalf of a motor carrier or the consignor/consignee particularly where the remuneration of the second broker is established and comes from the first broker? It seems that this is not the case. The second broker would appear to be acting on behalf of the first broker and not for an entity named in 49 C.F.R. Section 311.2(d).

In order to understand the double brokering practice, it is also perti-
nent to see that 49 C.F.R. Section 371.2(a) specifies that the third party transportation arrangement must involve transportation by an authorized motor carrier. 21 Section 371.2 does not mention another broker or freight forwarder or logistics company. 22 Because the initial broker has no relationship with the motor carrier providing the service in a double brokering situation, the initial broker has therefore not adequately arranged transportation by an authorized motor carrier in compliance with Section 371.2.

A broker might argued that the phrase “or offer to arrange” in Section 371.2 implicitly permits double brokering. However, the term “offer to arrange” probably more accurately relates to the holding out of the service of being a broker which is regulated under 49 C.F.R. Section 371.7(a). 23 This also seems evident when reviewing 49 C.F.R. Section 371.3 because the information or records that a broker must keep does not include information in broker-to-broker situations. 24 In light of 49 C.F.R. Section 371.7, it also appears that actual broker services in a double broker situation are not being done in the name of the initial broker as to the carrier nor in the name of the second broker as far as the shipper is concerned. 25

At best, a broker could argue that the second broker was acting as an agent of the first broker. This argument might be difficult to sustain because (a) shippers rarely are aware of, or authorize, double brokering, and (b) motor carriers are usually not aware of double brokering or generally do not consent to one broker acting as an agent under the brokers’ double brokering agreement.

If a broker utilizes the service of a second broker on behalf of the shipper’s movement, the broker would be providing a “non-brokerage service” under 49 C.F.R. Section 371.2(d) and would be considered an agent of the shipper, assuming the shipper was aware that the tendered shipment was to be given to a second broker.

The broker could only accomplish the objective of double brokerage if, in reality, the broker were considered an agent of the shipper and not an independent third party. Most shippers would probably not want to undertake the resulting legal obligations in such a relationship.

Apart from the issue of legality, double brokering raises significant issues concerning the proper payment of freight charges and the distribution of liability in personal injury damage claims. While most sensible motor carriers and brokers do not engage in double brokering and ship-

21. Id. at § 371.2(a).
22. Id. at § 371.2.
23. Id. at § 371.7(a).
24. Id. at § 371.3.
25. Id. at § 371.7(a).
pers distance themselves when they are aware of it, contract provisions are particularly helpful in thwarting the practice or establishing how it will be conducted. A simple alternative to double brokering, which would avoid the problems that double brokering creates, is to utilize a "referral agreement." Under a referral agreement, federally regulated brokers may enter into a written contract in which the brokers agree to refer motor carriers to other brokers when the broker who has accepted a load from a shipper is unable to engage an available or reliable motor carrier. The referring broker will only refer to motor carriers who have been advised of the specifics of the load and payment and which the referring broker has used in the past without problems. However, the receiving broker would have the responsibility to make its own independent investigation of the motor carrier and to actually contract with the referred motor carrier. A reasonable referral fee, payable within a reasonable period to the referring broker, would be paid for a referral that results in the movement of the load.

Other contractual terms in a referral agreement might include non-compete considerations wherein the broker to whom the carrier was referred would agree not to have the referred motor carrier handle brokered loads on an exclusive basis. The contract might also incorporate confidentiality and indemnification clauses that would hold the referring party harmless from all liability that might arise from use of the referred motor carrier.

The referral agreement approach is clearly legal because the broker contracted by the shipper actually performs the service contemplated. The agreement between the brokers merely reflects two parties mutually making a referral for a possible reasonable fee with no liability exposures and with reasonable "competitive" protection. It is difficult to understand why this simple contractual procedure hasn't been adopted broadly in lieu of double brokering.

26. A typical clause between a broker and a carrier on this subject might read:

"CARRIER WILL NOT RE-BROKER, ASSIGN, OR INTERLINE THE SHIPMENTS HERUNDER WITHOUT PRIOR WRITTEN CONSENT OF BROKER. If CARRIER breaches this provision, BROKER shall have the right of paying the monies it owes CARRIER directly to the delivering carrier, in lieu of payment to CARRIER. Upon BROKER'S payment to delivering carrier, CARRIER shall not be released from any liability to BROKER under this Agreement. CARRIER assumes all risk of loss and shall defend, indemnify, and hold BROKER harmless for any liability arising out of violation of this paragraph including consequential damages, costs, expenses, and reasonable attorney fees."

B. SELECTION OF A QUALIFIED CARRIER

Brokers can be held liable for damages that arise from negligence or breach of contract in the selection and enforcement of proper procedures for qualifying carriers before brokers make arrangements for the engagement of the carriers. While recovery for such damages is normally sought under tort claims, contractual terms that set forth exactly what duties a broker will undertake may prevent or ameliorate the risk of liability. Although there are some general negligence principles that apply to the selection of carriers, parties can be subject to varying principles based on a particular state's law.

Professional Communications, Inc. v. Contractor Freighters, Inc.\textsuperscript{28} involves analysis of such varying principles. In Professional Communications, a shipper brought suit against the broker, carrier, and warehouse, alleging negligent shipping, storing, and maintaining of a shipment of cell phones that moved from Florida to Maryland.\textsuperscript{29} One of the issues the court raised was whether Maryland law would apply the doctrines of \textit{lex loci delicti}, which results in the application of the procedural law of the forum state, and the application of the substantive law of the place/state of the wrong.\textsuperscript{30} While the court felt it was appropriate to apply either Florida or Maryland law in the case, it found that laws in both jurisdictions were essentially in line with general negligence principles covering duty, breach, harm, and proximate cause.\textsuperscript{31} While in this specific case the state's laws did not prejudice the parties, state law could, in a specific factual situation, not only bear on the issue of negligence \textit{per se} but also possibly affect the measure of damages and available legal fees.

In a contract, it would be possible to set forth the specific duties that the broker is required to undertake. For instance, parties might specify that the carrier tendering freight must (a) be a registered carrier with the FMCSA;\textsuperscript{32} (b) hold insurance consistent with federal requirements or specific requirements made known by shipper;\textsuperscript{33} (c) operate suitable equipment; and (d) maintain a “satisfactory” rating from the FMCSA.\textsuperscript{34} Other clauses in a well-drafted contract could cover “choice of law” issues as well as “alternative dispute resolution” clauses.

\textsuperscript{29} Id. at 549.
\textsuperscript{30} Id. at 550. Maryland belongs to the minority of states that continue to apply \textit{lex loci delicti}. Id.
\textsuperscript{31} Id. at 552.
\textsuperscript{34} 49 C.F.R. § 385.5 (2006).
C. Freight Claims

A frequently litigated area between shippers and carriers involves liability for cargo loss and damage. This area is of significant importance in the use of third party intermediaries. Although the broker status does not contemplate that brokers will not be involved in the issue of freight liability or claims, it is not uncommon for broker-shipper contracts to provide that the broker will handle such claims. Significant questions that affect the broker-motor carrier relationships arise when a broker by contract takes on freight claim obligations. Where such a contract is ambiguous with regard to the scope of the liability or does not clearly identify which party handles liability claims, the contract becomes subject to common law interpretations of similar situations where the applicable precedents might vary significantly from one state to the next. It is therefore clear that the assignment of freight claim duties, if engaged in, should be covered by a clear and effective contractual provision in the broker’s contract with the shipper and the motor carrier.

D. Insurance andOffsetting

Brokers that undertake responsibility for loss and damage claims or the handling of such claims have increasingly engaged in or become subject to the abusive practice of offsetting. The practice of a shipper or broker to offset a cargo claim against freight charges has existed for many years but was controlled to a certain extent by early dictates of the Interstate Commerce Commission. After the virtual demise of the "filed rate doctrine" and because the successors of the ICC took no further action, courts now willingly accept the common law right to offset under

35. See generally Transportation Law Institute, Carrier Liability in an Evolving Regulatory Environment: Claims and Antitrust (University of Denver College of Law 1980); See also William J. Augello & George Carl Pezold, Freight Claims in Plain English (Transportation Claims & Prevention Council, Inc., 3d ed. 1995).

36. Apart from the fact that a broker’s function by definition “does not involve actual transportation other than by a motor carrier,” court decisions have found brokers not liable for loss and damage claims on the basis that the Carmack Amendment, which covers the matter, is inapplicable to brokers. 49 U.S.C. § 13102(2) (2001), 49 C.F.R. § 1371.2(a) (2001); See, e.g., Hewlett-Packard Co. v. Brother’s Trucking Enter., Inc., 373 F.Supp.2d 1349, 1351-52 (S.D. Fla. 2005).


39. The “filed rate doctrine” provided that motor carriers were entitled to receive their freight charges as set forth in their lawful tariffs under almost any situation. See, e.g., Maislin Indus. v. Primary Steel, 497 U.S. 116 (1990); James C. Hardman, Motor Common Carriage and the Filed Rate Doctrine, 57 TRANSP. PRAC. J. 404 (1990).
state law or to offset by a contract term allowing it.\textsuperscript{40} There are numerous problems with offsetting in the context of third party surface transportation, including the following:

(1) Shippers and brokers act as judge and jury to decide the propriety and amount of the setoff;

(2) Brokers who look to shippers for business use unreasonable, if not unconscionable, setoff provisions for the shippers' benefit without regard to the carrier's interests;\textsuperscript{41}

(3) Brokers offset the value of the cargo claim of one shipper against freight charges due from other shippers;\textsuperscript{42}

(4) If the broker is not liable for freight claims, legal questions arise as to the broker's authority to act on the claim and as to the extent of that authority to compromise and settle;

(5) Most carriers' insurance will frequently not honor a claim if the insurer is not involved in the mitigation and settlement process and in most instances will not approve a settlement until a reasonable investigation is made and until damages are confirmed.\textsuperscript{43}

The consequence of these problems is that carriers, in particular small carriers, will suffer cash flow issues and may even go out of business because the only recourse against discriminatory offsetting is to engage in costly and lengthy suits in court for outstanding freight charges.\textsuperscript{44}

In defense of offsetting practices, shippers and brokers often argue that carriers do not take loss and damage claims seriously and delay investigations and settlement as long as possible or ultimately go out of business before a claim is paid. These are non-meritorious claims because (a) motor carriers are obligated to carry cargo insurance\textsuperscript{45} and thus the insurer is obligated for the cargo claim irrespective of whether the carrier personally defaults, and (b) if the shipper or broker legitimately feels that the carrier is abusing the investigation process, there is nothing to preclude the shipper or broker from filing a lawsuit immediately upon the damage or loss. Further, declination of claim is not a prerequisite to a lawsuit.

Brokers will often purchase their own cargo insurance, commonly referred to as "Contingent Cargo Liability Insurance," whereby the broker's insurer has an opportunity to adjust and defend any claim against

\textsuperscript{40} 49 C.F.R. § 371.7(a) (2007).

\textsuperscript{41} Seaton, \textit{supra} note 37, at 16.

\textsuperscript{42} \textit{Id}.

\textsuperscript{43} \textit{Id}.

\textsuperscript{44} Henry Seaton, a strong advocate of contracting against setoffs, explains that many small carriers also have factoring agreements which require motor carriers to warrant that each freight invoice is due, owing, and not subject to setoff, defense, or adjustment. Any setoff of a large cargo claim can place the carrier in default of the factoring agreement and reach in the seizure of all of its accounts receivable and other collateral. Seaton, \textit{supra} note 37, at 9.

\textsuperscript{45} 49 C.F.R. § 387.301 (2007).
the broker. In such instances, coverage is provided if the motor carrier fails to pay a claim for which the carrier is liable and the shipper looks to the broker for payment of the claims.

William Augello notes that in some instances contingent insurers have disavowed liability on the grounds that a broker did not have an insurable interest.

To avoid this result, Mr. Augello suggests that the shipper and broker should enter into a contract whereby the broker assumes liability for transit losses that would create such an interest. While this solution may resolve the problem that Mr. Augello addresses the broader issue is whether encouraging shippers to look to the broker for settlement of cargo claims will erode the shipper's historic strong claim status against carriers. Furthermore, why would anyone, except possibly some shippers who merely want as much insurance coverage as possible, require a freight broker to assume the liabilities of a motor carrier? After all, a competent broker will investigate and know the carriers with whom he is doing business and will have a contract with such carriers that spells out liability terms for loads that the carriers are handling for a mutual customer.

By law, motor carriers are liable for the care and custody of freight entrusted to them and therefore should be first in the line of recovery. Cargo insurance, primary or contingent, must be evaluated by brokers based on a logical and educated evaluation of the risk involved and based on the insurance product itself - a task which may be eased by consultation with insurance counsel, consultants, and insurance brokers or agents.

46. 49 C.F.R. § 387.311 (2007).
47. Seaton, supra note 37, at 9.
49. Id.
50. The contractual liability assumed might create primary liability in the broker for goods in transit. The Transportation Consumer Protection Council in 1999 offered a primary cargo insurance policy developed by a company called BROKER FIRST, which permitted brokers to assume the liability which Mr. Augello proposes, e.g., legal liability for loss and damage by contractual arrangements with shippers. William J. Augello, A Break-Through for Truck Brokers in Logistics Management & Distribution Report, 35 (October 1999). The value of such proposal was contested by various members of the transportation community and it does not appear to be a product on the market at this time. See William J. Tucker, The ‘Downside’ of Making Brokers Liable, TRAFFIC WORLD, November 1, 1999, at 6, available at http://www.tuckerco.com/articles_letters/articles/twarticle.shtml.
51. However, freight forwarders, who have Carmack liability, are required to have cargo insurance including an FF Endorsement Form. 49 C.F.R. § 387.403 (2007). To the extent the loss or damage was caused by a motor carrier with whom the freight forwarder contracted, the freight forwarder would have a right of indemnification and/or contribution. 49 U.S.C. § 14706(a) (2005). See, e.g., Season-All Indus, Inc. v. Merch. Shippers, 417 F. Supp. 998 (W.D. Penn. 1976).
III. Brokerage Operations and Model Contracts

A. Operational Considerations

In the Schramm case, the broker had contracts with more than 20,000 licensed motor carriers. Even smaller brokers than the broker involved in Schramm may have hundreds, if not thousands, of such contracts because the nature of the brokerage business is to have a "stable" of potential motor carriers available when shippers call for brokerage service.

Many shippers will attempt to deal directly with the motor carrier initially and will only resort to brokerage services when they are unable to find a willing motor carrier. Thus, movements tendered to the brokers are frequently made at the last moment possible to meet delivery times or are not the most attractive loads in terms of rates and requirements, necessitating the use of a broker to find a motor carrier who is essentially desperate for a shipment. A broker who accepts an assignment to arrange for motor carriage must feel confident that the load can be brokered at a price that guarantees a profit. This pressure also accounts, in part, for double brokering because the initial broker does not want the shipper to know of his inability to sate the tender if such occurs. Some of the larger motor carriers attempt to avoid brokered loads because such loads are usually lower rated and fear exists about the financial stability and/or honesty of the broker to pay the freight charges agreed upon. Smaller carriers and "one-operator" shops are much more prevalent participants in third party movements.

These variations in services also result in a proliferation of different types of contracts between the motor carrier and a broker. For instance, in a casual relationship that is initiated for one shipment with a new motor carrier for an immediate or short-notice movement, a detailed, custom contract is simply not feasible from a business standpoint. If a continuing relationship exists between the broker and motor carrier, a detailed contract is feasible and advisable. Similarly, in shipper-broker contracts, when a shipper has a "stable" of brokers it uses, a separately negotiated and written contract is not always available before a load is tendered. If a continuing relationship exists, however, a detailed negoti-

54. Smaller carriers are more dependent upon "brokered" loads because they do not have a sales force or a sales force of significant depth to solicit shippers for the direct tender of sufficient freight.
55. The difference was recognized by the American Trucking Associations, hereafter ATA, in their model contracts for the carrier-broker relationship two distinct contracts were drafted and adopted.
ated or standard contract should be created to guide the parties’ cooperation.

Shipper-broker and broker-carrier contracts are overwhelmingly adhesion contracts that vary only with regard to rate information and specifics of the shipment involved.\textsuperscript{56} The fact that many brokers and carriers who engage in hauling brokered loads are frequently small sole proprietors who have little business training makes contractual engagement, especially when adhesion contracts are involved, a rocky road. As William Augello, Esq., a highly knowledgeable observer, indicates,\textsuperscript{57} "[u]nfortunately, experience has demonstrated that many brokers do not thoroughly read these [costly contractual liability terms] and conditions, and even when they do, [they] do not comprehend their legal significance."\textsuperscript{58} Unfortunately, the same can be said for many motor carriers when a broker presents a contract.

\section*{B. Advent of Model Contacts}

The circumstances and problems inherent in third party operations have exposed the need for model contracts. In response, shippers, motor carriers, brokers, and even railroad associations have begun to develop and implement such agreements. Currently, there exist at least three model contracts involving third party operations: (1) The "Shipper/Broker Transportation Agreement"\textsuperscript{59} developed by the National Industrial Transportation League (NITL) and the Transportation Intermediaries Association (TIA); (2) The "Broker/Carrier Agreement" developed by the TIA;\textsuperscript{60} and (3) the American Trucking Association’s (ATA) Carrier/Broker Agreements.\textsuperscript{61} A model contract is a sage objective. Such a contract potentially not only decreases the time and cost of negotiating multiple and individual contracts simply because of an individual drafter’s

\begin{itemize}
\item \textsuperscript{56} See William J. Augello, \textit{Brokers and the Law}, \textit{The Logistics J.} 1 (January 2003).
\item \textsuperscript{57} Id.
\item \textsuperscript{58} Id.
\item \textsuperscript{59} \textsc{Nat’l Indus. Transp. League (NITL) & Transp. Intermediaries Ass’n (TIA), Broker/Shipper Transportation Agreement (2004), available at http://www.nitl.org/ModelBrokerContractFinalv1.pdf.}
\end{itemize}
writing style, but also reflects the assessment by a learned group of drafters and diverse interested parties that the provisions are written clearly in covering the essentials of the subject matter. A model contract is not necessarily a complete and inflexible document that precludes modifications, additions, or deletions, but it also minimizes the need for such actions. Moreover, a model contract exposes, if not eliminates, contracts that are essentially negotiated by mere economic strength underlined by possible greed or ignorance of the need to mutually share in the benefits of a business relationship.

William Augello, despite his recognition that a significant problem exists in the current contract practices with regard to the inability of participants to understand the significance of contract terms, strangely rejects the "model contract" approach and feels that individually negotiated contracts are ordinarily always necessary. While his views are hardly defensible in light of the current "mess" that exists in the industry, participants in the industry have not yet shown enthusiasm for the model contracts that have been promulgated.

It is felt that some of the problems of acceptance were a result of the fact that the various association sponsors have not publicized and explained the benefits of their products sufficiently. Since the initial press releases of the introduction of the various model contracts, there have not been any notable educational endeavors to discuss the advantages of the contracts or to explain how to implement the documents. Nor has there been any publicity of successful acceptance and implementation of the models by signatories.

The fact that the various models differ in critically substantive areas and have resulted in open public criticism may also have hindered their use. For example, after review of the NITL-TIA Model Shipper/Broker Agreement, the ATA advised its members and motor carriers to be leery of the agreement on the basis that the contract required the broker to agree that any motor carrier to be utilized would have to sign a bilateral contract which had unreasonable requirements.

The NITL-TIA Model Shipper/Broker Agreement has a specific clause dictating what provisions are to be included in contracts with motor carriers. Among the provisions are the following:

A. Carrier shall agree to defend, indemnify, and hold BROKER and SHIPPER harmless from all damages, claims or losses arising out of its per-

63. Id. at 52.
64. See, e.g., Bill Carey, Whose Model Kit?, TRAFFIC WORLD, Sept. 4, 2006, at 22.
65. Id.
66. NITL, supra note 59, at § 4(A), (B), (E ).
formance of the Agreement, including cargo loss and damage, theft, delay, damage to property, and personal injury or death.

B. Carrier shall agree that its liability for cargo loss and damage shall be no less than that of a Common Carrier as provided for in 49 USC 14706 (the Carmack Amendment). Exclusions in Carrier’s insurance coverage shall not exonerate Carrier from this liability.

* * *

E. Carrier shall authorize BROKER to invoice SHIPPER for services provided by the Carrier. Carrier shall further agree that BROKER is the sole party responsible for payment of its invoices and that under no circumstances will Carrier seek payment from the shipper, consignee, or BROKER’s customer.

It is clear that the ATA had cause to take issue with this model contract. Each of the cited provisions if in fact attempted to be imposed on a motor carrier would be completely offensive to the interests of the motor carrier. The broad indemnity clause could very well be illegal in some states because it includes indemnification against the parties’ own negligence.\footnote{See, e.g., N.C. GEN. STAT. § 62-212 (2006); S.C. CODE ANN. § 58-23-110 (2006).} Significantly, the indemnity clause in the ATA-NITL model contract between shippers and carriers provides that “[n]either party shall be liable to the other party for any claims, actions, or damages due to the negligence of the other party.”\footnote{TRANS. INTERMEDIARIES ASS’N (TIA), BROKER - CARRIER AGREEMENT, Version 1.1, § 1(H)(i) (2006).} This raises the question why the NITL would endorse a different indemnification clause in the NITL-TIA Shipper/Broker Agreement.

Stipulating that only brokers must pay carriers,\footnote{NITL, supra note 59, at 4(E).} thereby relieving the shipper and others, also appears to be an unworkable requirement considering the history of brokers who were often financially unable to make such payments or who fled with such funds. The broker’s bond, an alternative to requiring outright payment by the broker, does not offer a feasible remedy to carriers because such a bond is limited to a certain dollar amount\footnote{49 C.F.R. § 387.307(a) (2007).} and brings with it several related collection problems.\footnote{While courts have allowed carriers to file suit directly against surety insurers, the insurers have advised some carriers that if the insured raises the question about an offset, payment will not be made, and also that insurers will not pay unless or until a court judgment is secured.}

Interestingly, when the TIA Model Broker/Carrier Agreement was issued, it did not fully comply with the dictates of the TIA-NITL Shipper/Broker Agreement. For instance, unlike the requirements under the Shipper/Broker Agreement, the Broker/Carrier Agreement’s indemnification provisions in Clause 1(H)(i) state that:

BROKER AND CARRIER shall defend, indemnify and hold harmless
from any claims, actions, or damages, arising out of their respective performance under this Agreement. Neither Party shall be liable to the other for any claims, actions, or damages due the negligence of the other Party.\textsuperscript{72}

Thus, for some reason, the Broker/Carrier contract does not automatically indemnify the shipper. The two model contracts also differ with respect to the carrier's rights to demand payment from the other contract partners. Contrary to Clause 4.E of the Shipper/Broker agreement,\textsuperscript{73} the TIA Model Broker/Carrier contract gives a carrier a limited right to seek payment from the shipper or other party responsible unless the shipper has paid the charges to the broker.\textsuperscript{74}

A fair evaluation of the NITL-TIA Shipper/Broker Contract would lead one to conclude that the drafters did not really realize that a three-party relationship is involved in these transportation agreements, and that any contract must reflect the needs and interests of all three parties to be effective. The attempt of NITL and TIA to dictate the terms that must be included in the third party agreements has hindered the success of the proposed model contracts and has invariably led to criticism by the ATA and others.\textsuperscript{75}

Unlike the NITL and the TIA, the ATA did not draft a shipper/broker contract. Instead, the ATA concentrated on drafting a broker/carrier contract at the same time as TIA efforts were under way to draft a similar model agreement. While the parties attempted to coordinate their efforts, the fact that the TIA-NITL Shipper/Broker Contract was already published and the fact that it contained the offensive provisions discussed above acted as a barrier to achieving a coordinated effort. Both contracts were completed at approximately the same time and are substantively similar. After the release of the two documents, however, it became apparent that the most critical differences involved one issue that many motor carriers were most concerned about\textsuperscript{76} and that involves recourse to the shipper for freight charges if the broker fails to collect and remit

\textsuperscript{72} TIA, supra note 68, at 1(H)(i).

\textsuperscript{73} NITL, supra note 59, at 4(E).

\textsuperscript{74} TIA, supra note 68, at D(i). Significantly, the first sentence in the clause reads: "The Parties agree that BROKER is the sole party responsible for payment of CARRIER's charges." \textit{Id.} (emphasis added). It would appear that the end result is that the carrier is expected to be a "bill collector" if the shipper does not pay. \textit{See id.}

\textsuperscript{75} Robert Digges, Jr., Esq., Assistant General Counsel, in addition to denigrating specific provisions of the TIA-Broker-Carrier Contract, argued that it, in general, is "especially slanted" in favor of brokers and shippers. Todd Spencer of the 141,000 member Owner-Operator Independent Driver Association shared the view that the TIA Contract was biased and "totally self-serving and unfairly disadvantageous to the trucker, the carrier, in that relationship." \textit{See} Carey, supra note 64.

\textsuperscript{76} \textit{See} Henry Seaton, \textit{TIA Model Contract Not Pretty – Don't Sign Away Recourse For Freight Charges, Com. Carrier J.}, Aug. 2006, at 44. An ATA representative indicated that "shipper recourse" became the major issue" between TIA and ATA and ultimately led to the
freight charges. The major historical complaints that motor carriers had regarding “brokers” were that motor carriers failed to receive freight charges and the brokers just disappeared owing them money. Many observers thought a model contract would resolve this issue while making “contracting” more efficient.

C. Shipper Recourse

As previously noted, under the TIA’s model contract the carrier must give the broker “X” days notice before the carrier contacts the shipper to demand freight charges, and the contract relieves the shipper of liability if the shipper satisfies the charges. The ATA’s Model Contract is strangely silent on the subject presumably because the subject was proverbially such a “hot potato” that its resolution should be left to the contracting parties.

In the past, and perhaps still today, the vast majority of broker-carrier contracts provided that the motor carrier would only look to the broker for its freight charges - a provision arising because shippers required a complementary provision from brokers in shipper-broker contracts that there would be no recourse for carriers seeking payment directly. While many courts have precluded motor carriers from recovering freight charges from shippers when such clauses exist, the cases virtually all involve a factual situation where the shipper has already paid the freight charges to a broker. The courts, on an equity basis, will not allow the shipper to be “double-dipped.”

However, some courts have held that a shipper was liable to a motor carrier even though payment was made to a third party. In National Shipping Co. of Saudi Arabia v. Omni Lines, for instance, the court noted that intermediaries have few assets and that carriers have a contractual right to expect payment from the shipper under a bill of lading. The court stated:

Carriers must expect payment will come to the shipper, although it may pass

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79. TIA, supra note 68, at 2.D(i).
80. Id.
81. See, e.g., Hampton v. Paramount Pictures Corp., 279 F.2d 100, 104-05 (9th Cir. 1960).
83. See id. at 1547.
through the [intermediary's] hands. While the carrier may extend credit to the [intermediary], there is no economical and rational motive for the carrier to release the shipper. The more parties that are liable, the greater assurance the carrier will be paid.\textsuperscript{84}

Pressure on the shipper to be ultimately responsible for freight charges appears to be a logical position for the following reasons:

(a) It should force shippers to be more concerned about the brokers it selects and conducts business with. Brokers are expected to select responsible and responsive motor carriers. The shipper could bear the same or similar responsibility in choosing "brokers" and be responsible for freight charges or face negligent entrustment charges; and

(b) It would encourage shippers (i) to monitor payments through the broker to shippers; (ii) to consider third party payment programs where banks and third parties would distribute payments; or (iii) to have direct billing of freight charges to the shipper.

Shippers are not generally opposed to (b)(i) or (b)(iii), but are concerned about the potential of (b)(ii) although such programs were used extensively in carrier freight payments in the past. Steps that a carrier might take to provide that a broker or freight forwarder is considered an agent of its shipper/customers and that freight charges will be paid include the following:

(1) Provide in contract that broker comply with federal regulations requiring segregation of funds;
(2) Contract to make broker guarantor of payment in case shipper does not pay;
(3) Have carrier's name appear on the bill of lading and not broker's name as the carrier of record;
(4) Do not accept "non-recourse" shipments;
(5) Prepare a rules circular indicating that recourse under the bill of lading is reserved and reference the circular in all contracts;
(6) Send all invoices to the party liable for freight charges in care of the intermediary;
(7) Request an accounting of the broker if timely payments are not being made and, if a timely response is not received, put shipper on notice that you are preserving recourse to the shipper.\textsuperscript{85}

Another protective device that may apply in a particular factual situation involves the "constructive trust" theory. In effect, this theory holds that the monies an intermediary receives from a shipper to pay freight charges are really the funds of the shipper and belong to the carrier providing the service, thus giving the carrier the rights of a secured creditor.

\textsuperscript{84} Id.

\textsuperscript{85} Henry Seaton, Don't Bank on Brokers: Protect Your Right to Seek Payment from Shippers, supra note 78.
in a bankruptcy proceeding. This theory has also been used to a broker's advantage in *New Prime v. Professional Logistics Management* where a broker was held not to be obligated to pay a carrier unless the broker received funds from the shipper. Overall, case law is diverse and unreliable in determining the rights and liabilities of the parties in respect to freight charges and clearly and empathetically indicates that the parties should, by contract, attempt to clarify how freight charges should be applied.

During the negotiations of the respective model contracts, a suggestion was made to the ATA, the TIA, and the NITL to resolve this issue with a “differential payment schedule.” Under this payment schedule, the broker and carrier could agree on one payment period and the shipper and broker could agree on another, perhaps more convenient, payment period. The periods, however, would be fixed so that the motor carrier would always be assured that a reasonable period was available upon default to notify the shipper before the shipper was obligated to pay the broker. The difference in the payment period would be a reasonable period, whether it might be ten days or less.

According to the proposal, shippers would never be forced to pay the broker at a sooner time. The broker also would never be forced to pay the motor carrier sooner than agreed upon. As a result, the shipper would not pay the broker unless it had evidence that the motor carrier was paid by the broker and would receive immunity for payment of freight charges to the broker until the motor carrier was paid. Immunity only applies if the shipper waits until the fixed contract payment period term passes and as long as the shipper does not receive written notice from the motor carrier that the broker defaulted. The broker is not be precluded from paying the motor carrier earlier but must do so at least by the time agreed to with the carrier. If a default occurs, the carrier may

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88. Id. at 904.


90. Id.

91. Id.
timely notify the shipper of the broker’s default before the shipper’s contractual payment period is reached and payment, in fact, is made to the broker. If the broker, in fact, pays the motor carrier earlier than the shipper’s contract payment date and the broker and carrier give notice, adequate to the shipper, of satisfactory payment, the shipper could, at that point, make earlier payment to the broker, but would not be obligated to do so. The payment period in the shipper-broker contract would be the contractual payment date. Contract language suggested by the proposal was as follows:

(a) Motor Carrier-Broker Contract:

Broker shall pay Motor Carrier’s freight charges within ___ days after delivery and submittal of the necessary documents to bill Shipper. Broker warrants that the payment period is not less than ___ days before Shipper is obligated to pay Broker. Motor Carrier shall not directly bill or seek payment from Shipper unless Broker defaults in remittance and written notice is given by the Motor Carrier to broker and a designated employee of the Shipper prior to Shipper’s payment to Broker. Motor Carrier and Broker may agree in a joint written remittance advice to the Shipper after such default notice that payment has been made by the broker, but, in the absence of such agreement, the Shipper may reasonably hold the amount otherwise due in a trust account until a court or arbitration order directs such payment with reasonable interest.

(b) Broker-Shipper Contract:

Shipper shall pay Broker’s freight charges in not less than ___ days unless it receives written notice prior to such payment that the motor carrier utilized to transport Shipper’s freight has not been paid freight charges by the Broker. If such notice is received, Shipper may withhold payment related to said shipment until Broker and Motor Carrier jointly, in writing, give advice to Shipper that the freight charge payment may be released to Broker or the Carrier or, in the absence of such mutual advice, until a court or an arbitration order directs such payment.

A highly-respected shipper representative indicated that the proposal had merit. A highly-respected broker, however, rejected the possible remedy essentially because it would affect the broker’s working capital requirement. In any respect, however, the proposal, to date, has not been adopted.

While the working capital issue is a valid concern, it is based on the supposition that most brokers either need the shipper’s payment before the broker can afford to pay the carrier or chooses to do so, and that a motor carrier should recognize and accept this “need-choice” at the risk of losing freight charge payment. The differential date interval as noted previously could be ten days or less and any adequately capitalized business should be able to carry a reasonable working capital burden. An individual or entity that could not carry such a burden would reflect the
current severity of risk which motor carriers are attempting to minimize. Further, the TIA's treatment of broker payments, in one commentator's view, should be as troubling to small brokers as it is to carriers.92 The TIA contract turns the broker from an agent of the principal to transmit shipper's payments into a principal who is solely responsible for the carrier even upon default of the shipper.93

Until the three relevant parties, shippers, brokers, and carriers, recognize that their interests are intertwined and that the advantages of a single model agreement in terms of time, costs, and compliance outweigh the benefits of existing model contracts, the work already expended will be for naught.

IV. Conclusions

The problems that exist in third party operations must and should be resolved by reinstitution of reasonable and effective federal governmental oversight complemented by similar oversight of participants individually or through their trade associations. The attempt to draft model contracts that would be acceptable to all parties involved in third party surface transportation movement was a significant step in the right direction and should not be abandoned. The respective groups that drafted these model contracts should learn from their attempts and seek to remedy the continuing problems that have arisen from initial use and review.94 If this is not done, "contracting" will continue to be unnecessarily expensive and time consuming. Until adequate model contracts are implemented, success in business deals will continue to be measured by the relative economic strength of the respective parties. Until suitable model contracts are drafted and accepted in the wonderful world of logistics, it would behoove contract participants to appreciate the importance of written contracts in their operations and to negotiate and implement reasonable and clear terms.

92. See Henry Seaton, TIA Model Contract Not Pretty, COMM. CARRIER J., August 2006, at 44.
93. Id.
94. Kenneth E. Siegel and Ronald H. Usem, Remarks at the TLA Regional Seminar, Model Broker-Carrier Contracts: The Best Thing Since Sliced Bread or the End of Western Civilization as We Know It (Jan. 19, 2007) (Messer's Siegal and Usem felt that the parties would be successful in achieving true model contracts based on the analysis and comments received from interested parties who have been afforded the opportunity to review the various documents).
The Puerto Rico Ports Authority v. Umpierre-Solares: Can the “Dead Ship” Doctrine Ever Remove a Suit Brought in Personam on a Maritime Contract from Federal Admiralty Jurisdiction?

Braxton Williams∗

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C. The “Dead Ship” Doctrine Can Still Remove a Case From Admiralty Jurisdiction When Obstruction to Navigation Is Not at Issue

I. INTRODUCTION

In 1989, the violent seas created by Hurricane Hugo caused a ship to sink in Puerto Rico’s San Juan Harbor.1 The owners contracted to have the ship disposed of by raising and removing the vessel from the path of heavy maritime navigation.2 The owners transported the ship to a nearby harbor, where she remained moored at a dock.3 Over a decade later, when the ship had not been removed, the ship owners sued to compel specific performance of the contract to dispose of the vessel.4 The plaintiff, attempting to avoid the time-barring effects of laches, argued that the vessel was a “dead ship” – one that had so lost its navigation function that it no longer qualified as a “vessel” under federal admiralty jurisdiction.5

Does the so-called “dead ship” doctrine play any role in such a case given that the defendants were sued in personam on a service contract that a federal court determined to be maritime in nature? The United States Court of Appeals for the First Circuit addressed this question in the case of The Puerto Rico Ports Authority v. Umpierre-Solares (The Isla Nena).6

II. BACKGROUND: WHETHER ADMIRALTY JURISDICTION REACHES THE CONTRACT, AND THUS ALLOWS THE PLAINTIFFS IN THE ISLA NENA TO MAINTAIN AN ACTION FOR SPECIFIC PERFORMANCE

A. THE “DEAD SHIP” DOCTRINE

Article 3, § 2 of the United States Constitution states that the judicial power of the United States “shall extend . . . to all Cases of admiralty and maritime Jurisdiction.”7 A dispute over a contract may be cognizable under the admiralty law if the contract relates to a ship in its use as a ship.8 Under the doctrine, a ship no longer falls within the purview of admiralty jurisdiction

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1. P.R. Ports Auth. v. Umpierre-Solares (The Isla Nena), 456 F.3d 220, 222 (1st Cir. 2006).
2. See id. at 222-23.
3. See id. at 223.
4. See id.
6. 456 F.3d 220.
7. U.S. CONST. art. III, § 2, cl. 1.
The “Dead Ship” Doctrine

when its function has changed so much that it no longer has a navigation function. The doctrine has its origins in the maxim that “a ship is made to plough the seas, and not to lie at the walls.” It follows from this that a contract involving a “dead ship” is not maritime, and therefore does not invoke admiralty jurisdiction.

A classic example of a “dead ship” is found in the case of Mammoet Shipping Co. v. Mark Twain. In that case, the United States District Court for the Southern District of New York concluded that a nineteenth-century riverboat, docked at a Manhattan pier for use as a restaurant and showboat, was not a vessel for the purposes of admiralty jurisdiction. The contract to ship the Mark Twain from Toronto, Canada to New York City did not relate to ships or maritime commerce, the court said, because the vessel was used as a restaurant, and not as a “ship per se.”

Courts tend to apply the “dead ship” doctrine when the change from a vessel’s former navigation function is considerable. For example, a vessel does not become a “dead ship” merely because her registration has expired or is in need of repair, or because she has been stored in dry dock. However, the “dead ship” doctrine may apply when more substantial changes are needed to return the ship to navigation, such as in Hanna v. The Meteor. In that case, the court applied the “dead ship” doctrine to a member of a reserve fleet made up of out-of-service vessels that would have required extensive repairs and documentation in order to return to service.

One commentator observed, at least with respect to the law regarding maritime liens, that “[the dead ship doctrine] would appear to be a dying doctrine, and the maxim of maritime law on which it and related rules were based appears to have been generally discarded.” However, the doctrine’s effectiveness in cases not involving maritime liens shows it is still used to determine whether a federal court may exercise its admiralty jurisdiction.

9. See Goodman, 859 F.2d at 73.
12. Id. at 866-67.
13. Id. at 866.
17. See id.
B. EXXON CORP. V. CENTRAL GULF LINES, INC.

In this case, the Supreme Court decided whether it should follow a per se rule holding that agency contracts do not fall under admiralty jurisdiction.\(^{20}\) The Court overruled the holding of Minturn v. Maynard\(^{21}\) excluding all agency contracts from admiralty jurisdiction.\(^{22}\) It held that admiralty jurisdiction applied to the agency contract under which Exxon agreed to obtain fuel from other suppliers for ships in ports where Exxon could not supply the fuel itself.\(^{23}\) The relevant inquiry, according to Exxon, is an examination of “the subject matter of the agency contract” to determine “whether the services actually performed under the contract are maritime in nature.”\(^{24}\) The Court reiterated its statement that “the fundamental interest giving rise to maritime jurisdiction is ‘the protection of maritime commerce.’”\(^{25}\)

C. MARITIME CONTRACTS

The Supreme Court’s emphasis on the protection of maritime commerce in determining admiralty jurisdiction has been applied to contracts in subsequent cases with similar results.\(^{26}\) In 2004, the First Circuit, the same court that decided The Isla Nena, emphasized the protection of maritime commerce in Cunningham v. Director, Office of Workers’ Compensation Programs.\(^{27}\) Although that case involved a dispute under the Longshore and Harbor Workers’ Compensation Act,\(^{28}\) the court noted that courts deciding admiralty jurisdiction cases regarding contracts, as opposed to torts, have traditionally had wide berth on whether transactions “relate to the navigation, business or commerce of the sea.”\(^{29}\)

Later in 2004, in Norfolk Southern Railway Co. v. Kirby,\(^{30}\) the Supreme Court held that a bill of lading for a contract that included transportation of goods by sea, as well as by land, was maritime in nature.\(^{31}\) The “protection of maritime commerce” of Exxon,\(^{32}\) the court stated, is achieved in contract cases

\(^{21}\) Minturn v. Maynard, 58 U.S. 477 (1855).
\(^{22}\) See Exxon Corp., 500 U.S. at 612.
\(^{23}\) Id.
\(^{24}\) Id.
\(^{25}\) Id. at 608 (quoting Sisson v. Ruby, 497 U.S. 358, 367 (1990)).
\(^{26}\) See Cunningham v. Dir., Office of Workers’ Comp. Programs, 377 F.3d 98 (1st Cir. 2004);
\(^{27}\) See 377 F.3d at 109 n.12.
\(^{29}\) Cunningham, 377 F.3d at 109 n.11 (quoting Nacirema Operating Co. v. Johnson, 396 U.S. 212, 216 n.7 (1969)).
\(^{30}\) 543 U.S. at 14.
\(^{31}\) See id. at 27.
The "Dead Ship" Doctrine

by focusing on “whether the principal objective of a contract is maritime commerce.”

III. THE PUERTO RICO PORTS AUTHORITY v. UMPIERRE-SOLARES DECISION

A. FACTS

The Puerto Rico Ports Authority stemmed from a dispute over performance of a contract to remove and dispose of the Isla Nena, a ship moored at a shipyard in Puerto Rico. The vessel’s slow demise began when she sunk in 35 feet of water in San Juan Harbor during Hurricane Hugo in 1989. The U.S. Army Corps of Engineers ordered The Puerto Rico Ports Authority, owner of the vessel, to have it raised and removed. The order was issued pursuant to Section 15 of the Rivers and Harbors Act of 1899, providing that in order to maintain safety in navigation, obstructions in navigable waters must be removed.

The Authority hired defendants, two men and their diving crane companies, to complete the task. The Puerto Rico Ports Authority paid $85,000 and the defendants raised the ship and moored her at a dock at a shipyard in the municipality of Catano. Defendants had contractually agreed to re-sink the vessel in the sea after raising her, but were unable to do so because of the permitting process involved. The individual defendants, Jose Umpierre-Solares and Milton Andrews-Figueroa, also wanted to acquire the ship’s “remains” and offered to pay the Ports Authority $1,000. The parties then modified the contract so that for $84,000, instead of $85,000, the defendants would remove the vessel “in the most convenient and speedy way possible.” Plaintiff paid the defendants, who then failed to perform. In July 2006, when the First Circuit wrote its opinion, the vessel was still at the shipyard in Catano, partially sunk because of another storm that occurred in

33. Kirby, 543 U.S. at 25.
34. P.R. Ports Auth. v. Umpierre-Solares (The Isla Nena), 456 F.3d 220, 222-23 (1st Cir. 2006).
35. Appellant’s Brief at 10, P.R. Ports Auth. v. Umpierre-Solares, 456 F.3d 220 (1st Cir. 2006) (No. 05-1637).
36. P.R. Ports Auth., 456 F.3d at 222.
38. See P.R. Ports Auth., 456 F.3d at 222-23.
39. Id. at 223.
40. See id.
42. P.R. Ports Auth., 456 F.3d at 223.
43. See id.
44. Id.
In 2003, the Puerto Rico Ports Authority and its executive director filed a complaint in Puerto Rico Superior Court seeking specific performance. The defendants removed the case to the United States District Court for the District of Puerto Rico based on the court’s admiralty jurisdiction, contending that the contract for re-float and disposal of the ship was a maritime service contract. The defendants also filed a summary judgment motion claiming that the action was barred by laches. In the alternative, the defendants argued that the agreement constituted a salvage contract, and as such, was governed by a two-year statute of limitations.

The Puerto Rico Ports Authority contended that the contract was for professional services and that their complaint was filed within the relevant 15-year statute of limitations. The Ports Authority argued that the doctrine of laches did not apply. The federal court agreed with the defendants’ laches argument, and granted the defendants’ summary judgment motion.

The “dead ship” doctrine only entered the picture when the Puerto Rico Ports Authority filed a motion with the district court to alter, amend, or vacate the judgment. The Isla Nena was a “dead ship”, the Ports Authority argued, and therefore the contract for its removal and disposal could not be reached by admiralty jurisdiction. The motion was denied; the Ports Authority appealed the denial of that motion, as well as the district court’s grant of the summary judgment motion, to the First Circuit.

B. THE FIRST CIRCUIT’S OPINION

The Ports Authority was equally unsuccessful on appeal. The First Circuit, in The Isla Nena, held that the contract claim was cognizable under admiralty jurisdiction, and therefore was barred by laches. In making its

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45. Id.
46. Id.
47. See id.
48. Id.
49. Id.
50. Id.
51. Id.
52. Id.
53. See id. (noting PRPA did not bring its action until at least eleven years after it first knew that the ship had not been re-sunk and had been moved to Catano. The court found this delay was unreasonable and economically prejudiced the defendants in the case).
54. Id.
55. Id. at 224.
56. See id. at 223.
57. See id. at 224, 227.
The “Dead Ship” Doctrine

ruling, the First Circuit began with a general jurisdictional analysis to determine the Isla Nena’s status as a vessel under the “dead ship” doctrine.\(^{58}\) Guided by the Supreme Court’s reiteration in *Exxon Corp. v. Central Gulf Lines*,\(^{59}\) namely, that the interest in the granting of admiralty jurisdiction is “the protection of maritime commerce,”\(^{60}\) the court looked to the nature of the transaction. Specifically, the court examined the original contract to remove and dispose of the Isla Nena when she sank in San Juan Harbor.\(^{61}\) The court held that because the contract involved the removal of an object that was obstructing the “navigation, business or commerce of the sea,” the contract was maritime in nature.\(^{62}\)

Next, the court considered the Ports Authority’s “dead ship” argument. The Ports Authority contended that admiralty jurisdiction did not govern the contract dispute because the Isla Nena was a “dead ship,” a vessel whose function has changed so much that it no longer has a navigation function.\(^{63}\) Whether the Isla Nena was alive or dead was irrelevant, the court held, because the nature of the contract was maritime and because the contract related to an object that obstructed navigation in San Juan Harbor.\(^{64}\) Unlike the “dead ship” cases cited by the plaintiff, the present case involved a “contract for removal of a ship obstructing navigable waters.”\(^{65}\) Therefore, the Isla Nena, whether dead or alive for the purposes of the “dead ship” doctrine, fell within the reach of federal admiralty jurisdiction simply because of where she lay – a place where she obstructed navigation.\(^{66}\)

The court’s reasoning is in accord with cases finding admiralty jurisdiction over contracts for the salvage of objects that were not vessels and were not involved in maritime commerce. For example, in the 1879 case of *Maltby v. Steam Derrick Boat*,\(^{67}\) the United States District Court for the Eastern District of Virginia sustained a finding of admiralty jurisdiction over a contract to salvage a sunken boat that had no means of propulsion or sails.\(^{68}\) The test, according to *Maltby*, was not whether the object to be saved was maritime in nature, but whether the particular contract involved the salvage of some movable thing “possessing the attributes of property” on navigable

\(^{58}\) See id. at 224.

\(^{59}\) 500 U.S. at 603.

\(^{60}\) P.R. Ports Auth., 456 F.2d at 224 (quoting Exxon Corp., 500 U.S. at 608).

\(^{61}\) Id. at 224.

\(^{62}\) P.R. Ports Auth., 456 F.2d at 225 (quoting Cunningham v. Dir., Office of Workers’ Comp. Programs, 377 F.3d 98, 109 (1st Cir. 2004).

\(^{63}\) See id. at 225.

\(^{64}\) Id.

\(^{65}\) Id.

\(^{66}\) Id.

\(^{67}\) Maltby v. Steam Derrick Boat, 16 F.Cas. 564 (E.D. Va. 1879) (No. 9000).

\(^{68}\) See id. at 566.
Furthermore, the First Circuit distinguished *Luvi Trucking, Inc. v. Sea-Land Service, Inc.*,\(^{70}\) another case cited by the Ports Authority in support of its “dead ship” theory. In *Luvi Trucking*, the court held that it did not have admiralty jurisdiction over a contract to transport cargo on land from one pier to another.\(^{71}\) However, the court in *Luvi Trucking* noted that simply because a contract involves a ship does not mean it is governed by maritime law; there must be a “link between the contract and the operation of the ship, its navigation or its management afloat.”\(^{72}\) The Ports Authority argued that the contract governing the removal and disposal of the *Isla Nena* was not maritime in nature because it involved a dead ship, as opposed to the operation, navigation, or management of a ship that was afloat.\(^{73}\) The First Circuit refuted that distinction. It pointed out that the holding in *Luvi Trucking* did not rely on the “dead ship” doctrine.\(^{74}\) It relied on the fact that the contract involved a trucking company that never came in contact with a vessel.\(^{75}\) The court observed that in contrast, the defendants in the present case had substantial contact with the *Isla Nena*; in particular, they raised her from the bottom of the harbor and transported her to the shipyard.\(^{76}\) Therefore, the court held that the Ports Authority’s contract was maritime in nature.\(^{77}\)

Finally, the First Circuit held that the district court did not err in holding that the Ports Authority’s action was barred by laches.\(^{78}\) Overall, the First Circuit affirmed the district court’s orders granting the defendants’ summary judgment motion and denying plaintiff’s motion to alter/amend, with costs.\(^{79}\)

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69. *Id.* (noting that in cases “in which the courts have denied salvage where property other than vessels of navigation or their furniture or cargoes has been saved … these will nearly all be found to have turned on questions of place, or questions not affecting the character of the thing saved.”) However, as will be explored later in this note, other cases take an opposing view, those cases have since been distinguished on the facts. See, e.g., *Cope v. Vallette Dry-Dock Co.*, 119 U.S. 625, 627 (1887).

70. *P.R. Ports Auth.*, 456 F.2d at 226 (rejecting plaintiff’s reliance upon *Luvi Trucking, Inc. v. Sea-Land Service, Inc.*, 650 F.2d 371 (1st Cir. 1981)).

71. *See Luvi Trucking, Inc.*, 650 F.2d at 373-74.

72. *Id.* at 373 (citing E. E. Jhirad & A. Sann, 1 Benedict on Admiralty § 183, at 11-7-8 (6th ed. 1974)).

73. *P.R. Ports Auth.*, 456 F.2d at 226.

74. *Id.*

75. *Id.* (quoting *Luvi Trucking, Inc.*, 650 F.2d at 373-74).

76. *Id.*

77. *Id.*

78. See *id.* at 227-28 (noting district court’s holding Ports Authority waiting eleven years to bring its suit to be unreasonable and that the defendants would be economically prejudiced if they had to dispose of the *Isla Nena* at no cost to the plaintiffs).

79. *Id.* at 228.
IV. ANALYSIS

While the court in The Isla Nena may have followed the direction of Exxon, and the cases before it, in stressing the protection of maritime commerce as the “fundamental interest giving rise to maritime jurisdiction,” a close look at the court’s application of this law to the facts brings its analysis into troublesome waters. First, the court focused on the original contract in April 1992 to remove the ship from San Juan Harbor, but the parties modified the contract in September, five months after the original contract was executed. Subtracting $1,000 from the contract price, the defendants agreed to remove the ship from her mooring at the shipyard in Catano and dispose of her in the easiest possible way. Under the original contract, the defendants had agreed to remove her from San Juan Harbor and dispose of her at sea. It is the modified version of the contract under which the plaintiffs sought performance some 11 years later, not the original version.

It now appears that the First Circuit applied the correct jurisdictional analysis to the wrong version of the contract. Parties to a contract are free to modify their agreement in whole or in part. When they modify their contract, the new version supersedes the old version. The new version of the contract in this case, required the defendants to dispose of a ship that was moored at a shipyard. It is at this situs that the court should have applied its admiralty jurisdiction analysis. The contract was still for removal and disposal of a vessel, but the removal and disposal of the vessel were to take place in new locations. So what would have happened if the court had applied its analysis to the amended contract? The admiralty law governing wharfage is illustrative on this point.

Wharfage is the fee that vessel owners pay to use a dock to load and unload cargo, receive and let off passengers, or to conduct repairs. As the court noted in Howmet Corp. v. Tokyo Shipping Co., “[a]ll of the services embraced in wharfage are intimately related to and are essential incidents to a ship in the ordinary course of navigation.” Without piers or wharves, ships

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81. P.R. Ports Auth., 456 F.2d at 222-23.
82. Id. at 223.
83. Id. at 222-23.
85. See Decca Records, Inc. v. Republic Recording Co., 235 F.2d 360, 363 (6th Cir. 1956); See also Housekeeper Pub. Co. v. Swift, 97 F. 290, 294 (8th Cir. 1899).
86. P.R. Ports Auth., 456 F.2d at 223.
87. See Ex Parte Easton, 95 U.S. 68, 73 (1877).
89. Id. at 978.
engaged in commerce and navigation would be “subjected to great . . .delay.”

The factual record does not indicate whether the Ports Authority paid a wharfage fee to the owner of the dock to which the Isla Nena was moored. Regardless, the law on wharves is relevant because of the importance of wharves to commerce and navigation. The Isla Nena, half-sunk and moored to a dock, prevented other ships from using that mooring during their trips to Catano. Indeed, the defendants argued that the partially-sunk ship affected commerce because of its location in the heavily-trafficked Army Terminal channel. As such, the ailing vessel constituted an obstruction to navigation, an “essential” maritime interest served by wharves. The contract for its removal, therefore, was maritime in nature because it “relate[d] to the navigation, business or commerce of the sea.” In light of the importance of wharves in serving the maritime interests of navigation and commerce, the First Circuit most likely would have reached the same holding had it analyzed the amended the contract instead of the original version.

However, one difference in fact might have led the court to find against admiralty jurisdiction. Specifically, the First Circuit’s conclusion that the presence of the Isla Nena at the bottom of the sea in San Juan Harbor constituted an obstruction to navigation was based in part on the U.S. Army Corps of Engineers’ order to remove the ship pursuant to the Rivers and Harbors Act of 1899. 

Section 15 of that statute provides that to maintain safety in navigation, obstructions in navigable waters must be removed. Had the Corps not ordered the ship’s removal, the absence of that fact might have resulted in a different holding.

However, the possibility that the contract to remove the Isla Nena from its mooring could be construed as one for ship breaking is not likely. There appears to be no case addressing whether contracts for ship-breaking, under which a ship’s parts are sold for scrap, are within the purview of admiralty law. Ship breakers are considered to be workers in maritime employment covered by the Longshore and Harbor Workers’ Compensation

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90. Ex Parte Easton, 95 U.S. 68 at 73.
91. Appellee Response Brief at 11, P.R. Ports Auth. v. Umpierre-Solares, 456 F.3d 220 (1st Cir. 2006) (No. 05-1637).
94. P.R. Ports Auth. v. Umpierre-Solares (The Isla Nena), 456 F.3d 220, 225 (1st Cir. 2006).
95. Id.
96. See generally REA v. Eclipse, 135 U.S. 599, 608 (1890) (holding that admiralty does not have jurisdiction over a contract for the sale of a vessel). If a court holds that a ship-breaking contract is a contract for the sale of a vessel, the case could be removed from admiralty jurisdiction.
97. The author was unable to find any cases or secondary authority deciding whether a contract for ship-breaking is cognizable under admiralty law.
The “Dead Ship” Doctrine

Act, but a contract for sale of a ship is not considered maritime in nature. Here, the parties had agreed to dispose of the ship. As part of the same agreement, the two individual defendants paid $1,000 to acquire her remains. However, there is no indication that the ship’s parts were to be sold for scrap. If construed as a contract for the sale of a ship, it appears the transaction would not be reached by admiralty law. But even if it was construed as a sale, the sale was to occur only after the considerable task of removing her from her location obstructing maritime navigation. That service, as the court in The Isla Nena concluded, is cognizable under admiralty law because of its relation to maritime navigation and commerce.

V. FUTURE EFFECT

A. THE COURT’S APPLICATION OF THE LAW TO THE FACTS INDICATES A POSSIBLE PRESUMPTION THAT THE CONTRACT IS MARITIME IN NATURE

In light of the court’s decision to use the terms of the original unmodified contract as its jurisdictional point of origin, the future effect of this case is unclear. In other words, the court’s reliance on the original contract to remove and dispose of the Isla Nena at San Juan Harbor, as opposed to the amended contract to remove and dispose of it when it was moored at Catano, could be construed as a willingness to look to the part of the contract or stage in the evolution of the contract that is most maritime in nature. Based on these considerations, the First Circuit appears to take a broad view of the contract for the purposes of jurisdiction, thus opening a door for future courts to find contracts maritime in nature by relying on a provision or stage in the evolution of the contract that is most maritime in nature.

B. THE FUTURE OF THE “DEAD SHIP” DOCTRINE AS APPLIED TO MARITIME CONTRACTS

The First Circuit in The Isla Nena noted that whether the Isla Nena was

100. REA, 135 U.S. at 698.
102. P.R. Ports Auth. v. Umpierre-Solares (The Isla Nena), 456 F.3d 220, 225 (1st Cir. 2006).
104. Id.
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“live” or “dead” for the purposes of the “dead ship” doctrine was irrelevant.105 What brought the contract for its removal under admiralty jurisdiction, with its attendant use of the equitable doctrine of laches instead of local statutes of limitation, was the fact that the nature of the contract was maritime.106 The outcome of this case begs the question: has the “dead ship” doctrine become powerless to remove a contract from the reach of admiralty law? Or, more specifically, if a contract falls under admiralty jurisdiction because it is deemed “maritime in nature,” is there any way, after The Isla Nena, that the “dead ship” doctrine can extinguish a specific performance action brought in personam under a maritime service contract? No, as long as the contract in question is for the removal of an obstruction to navigation.107

In a line of cases during the late nineteenth century,108 courts disagreed over whether it matters that the ship to be salvaged is “live” or “dead.” In Maltby v. Steam Derrick Boat,109 the court found admiralty jurisdiction over a sunken derrick boat that lacked sails and means for propulsion, but had a mast for hoisting objects from the river that were obstructing navigation.110 The court declared that it did not matter whether the object to be salvaged was maritime in nature, so long as the object to be saved was a piece of property found in navigable waters.111 The opposing view is illustrated by Cope v. Vallette Dry-Dock Co.,112 decided seven years later in 1887. In Cope, the Supreme Court declined admiralty jurisdiction over a claim for salvage of a piece of dry dock, having been saved just before it would have sunk as a result of a collision with a vessel.113 The Court held that a dry dock is not used for navigation, and is not a ship or a vessel.114

Ten years later in 1897, the Circuit Court of Appeals for the Seventh Circuit decided In re Hydraulic Steam Dredge No. 1.115 This case involved a dispute over a contract to furnish coal to a dredge that sucked mud from the bottom of a lake and transported it in pipes to areas that needed the material as
a fill for railroad purposes.\footnote{116} Although not a salvage case like many of the aforementioned cases, this case looked to the nature of the contract to determine whether it was maritime, just as the court did in *The Isla Nena*. The court determined that although the dredge dug up materials from the bottom of a lake, its purpose was to effectuate construction on land.\footnote{117} "It is not suggested that vessels engaged in navigation frequented the place," the court noted.\footnote{118} While this last statement is dicta, it is important because it foreshadowed what later became a focus on whether a particular location is heavily navigated.

This same reasoning led a court to find that a dredge, whose work is to remove obstructions to the navigation of rivers, harbors, and channels, may be subject to a maritime lien in order to satisfy a dredging contract debt.\footnote{119} Additionally, the Supreme Court recently held in *Stewart v. Dutra Construction Co.*\footnote{120} that a giant dredge that removed silt from the ocean floor and dumped it into adjacent scows was a "vessel" within the meaning of the Longshore and Harbor Workers’ Compensation Act.\footnote{121}

The courts eventually sided with *Maltby* in their admiralty analysis, concluding that the salvaged objects need not be ships or distinctly maritime, but must simply be a piece of property found in navigable waters cognizable under admiralty jurisdiction.\footnote{122} This was not necessarily a repudiation of *Cope*; many courts simply distinguished that case on the facts.\footnote{123} Additionally, a good explanation for why courts once restricted salvage claims to ships and their cargo exists in *Cheeseman v. Two Ferry Boats*.\footnote{124} In that case, the court explained that the distinction originates in the outdated rule that maritime jurisdiction only extended to the "ebb and flow of the tide."\footnote{125} At the time, ships were one of the only things that existed in the seas.

The importance that admiralty law places on removing obstructions to navigation might also be traced to cases involving derelict vessels and floating objects that constitute a marine peril. Derelict vessels, or vessels floating along without anyone controlling them, are considered by courts to be obstructions to navigation and a danger to commerce.\footnote{126} Even floating objects

\begin{thebibliography}{9}
\footnotesize
\item \footnote{116} Id. at 546-547.
\item \footnote{117} See id. at 557.
\item \footnote{118} Id.
\item \footnote{119} McRae v. Bowers Dredging Co., 86 F. 344, 348 (C.C.W.D. Wash. 1898).
\item \footnote{120} Stewart v. Dutra Constr. Co., 543 U.S. 481 (2005).
\item \footnote{121} Id. at 484, 497.
\item \footnote{122} See, e.g., Colby v. Todd Packing Co., 77 F. Supp. 956, 958-59 (D. Alaska 1948).
\item \footnote{123} Id. at 958.
\item \footnote{124} Cheeseman v. Two Ferryboats, 5 F. Cas. 528 (S.D. Ohio 1870) (No. 2633).
\item \footnote{125} Id. at 532.
\item \footnote{126} See Tracor Marine Inc. v. M/V Margoth, 403 F. Supp. 392, 394 (D.C.Z. 1975); Henry R. Tilton, 214 F. 165, 167 (D. Mass. 1913); Flora Rodgers, 152 F. 286, 288-89 (D.S.C. 1907); Anna, 1 F.
such as logs can be considered a danger to navigation, and their salvage thus considered maritime in nature.\textsuperscript{127}

It is clear then that the “dead ship” doctrine has no role in maritime contract cases when the contract involves the removal of an obstruction from navigable waters. This reasoning is in line with the holdings in the aforementioned decisions relating to salvage, derelict vessels, and objects constituting marine peril. It reflects the continued importance that admiralty law places on the free flow of vessels in navigable waters and the “protection of maritime commerce.”\textsuperscript{128}

\textbf{C. THE “DEAD SHIP” DOCTRINE CAN STILL REMOVE A CASE FROM ADMIRALTY JURISDICTION WHEN OBSTRUCTION TO NAVIGATION IS NOT AT ISSUE}

Despite the emphasis admiralty courts place on the nature of maritime contracts and the furtherance of navigation (versus the maritime status of the object obstructing navigation), \textit{The Isla Nena} shows that the “dead ship” doctrine is not dead. The doctrine can still remove a case from the reach of federal admiralty jurisdiction, so long as obstructions to navigation are not involved.\textsuperscript{129}

The plaintiff’s argument in \textit{The Isla Nena} was that the ship was no longer engaged in navigation, and that because it was to be given a deep water burial, the ship was no longer intended to be used in navigation.\textsuperscript{130} The argument seemed to acknowledge the weakness in the plaintiff’s case: the fact that the ship was obstructing navigation at the time of the suit for specific performance of the contract. The plaintiff’s strategy, and the First Circuit’s emphasis on the fact that the \textit{Isla Nena} was obstructing navigation, indicates the “dead ship” doctrine’s vitality in cases not involving such obstructions.

The cases cited by the plaintiffs in \textit{The Isla Nena} are evidence of the doctrine’s continued use. The First Circuit decided a case only three years earlier that provided the concise definition of the “dead ship” doctrine relied on by the plaintiffs.\textsuperscript{131} Other cases cited by the plaintiffs indicate the doctrine is still alive, when the facts so allow.\textsuperscript{132} Many of these “dead ship” cases involve

\begin{itemize}
\item Cas. 931, 932 (C.C.E.D.N.Y. 1873) (No. 401).
\item See Tidewater Salvage, Inc. v. Weyerhaeuser Co., 633 F.2d 1304, 1306 (9th Cir. 1980).
\item P.R. Ports Auth. v. Umpierre-Solares (\textit{The Isla Nena}), 456 F.3d 220, 225-26 (1st Cir. 2006).
\item Appellant’s Brief, supra note 35, at 22.
\item Mullane v. Chambers, 333 F.3d 322, 328 (1st Cir. 2003) (“[A] ship loses its status as a vessel when its ‘function is so changed that it has no further navigation function.’” (quoting Goodman v. 1973 26 Foot Trojan Vessel, Ark. Registration No. AR1439SN, 859 F.2d 71, 73 (8th Cir. 1988))).
\item See, e.g., Robert E. Blake Inc. v. Excel Envtl., 104 F.3d 1158, 1160-61 (9th Cir. 1997) (citing Goodman, 859 F.2d at 73) (holding that a contract to reactivate a “laid up” ship which had been
\end{itemize}
ships not touching water. For example, in *Hanna v. The Meteor*, the District Court for the Eastern District of New York held that a ship that is part of an out-of-service fleet is a “dead ship” to which a party cannot attach a lien for repairs. In *Robert E. Blake Inc. v. Excel Environmental*, the Ninth Circuit held that admiralty law did not reach a contract to reactivate a ship that had been mothballed and unused for years, because the ship was “dead.”

The “dead ship” doctrine after *The Isla Nena* does not appear to be effete. It influences decisions on cases in which a finding of admiralty jurisdiction turns on the status of the vessel. After this case, though the doctrine appears to be powerless to remove from admiralty jurisdiction a maritime services contract to raise and dispose of a vessel posing an obstruction to navigation. The courts have reiterated the interest of admiralty jurisdiction in the protection of navigation and maritime commerce. It does not matter whether the object obstructing navigation is a ship or its cargo or otherwise. Thus, when it comes to contracts for removal of such objects, the “dead ship” doctrine cannot place the contract beyond the reach of admiralty jurisdiction.

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*Note:* Mothballed and inactive for several years was not cognizable under the admiralty jurisdiction; AMOCO Oil v. M/V Montclair, 766 F.2d 473, 477 (11th Cir. 1985) (holding that dead ships are ships that have been completely removed from commerce and navigation); Marina Entm’t Complex, Inc. v. Hammond Port Auth., 842 F. Supp. 367, 370-71 (N.D. Ind. 1994) (holding that a contract to lease a barge did not fall under admiralty jurisdiction because the *res* was a dead ship).  
134. See id. at 532. 
135. 104 F.3d 1158 (9th Cir. 1997). 
136. Id. at 1160-61. 
Investing in Air Transport – A Prudent Move?

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I. INTRODUCTION

The Air Transport Action Group (ATAG) of the International Air transport Association (IATA) reports that aviation transports globally 2 billion passengers every year and 40 percent of the inter-regional goods by value.1 Forty percent of tourists now travel by air and the air transport industry generates a total of 29 million jobs annually through direct, indirect, and

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1. Air Transport Action Group, Facts & figures, at http://www.atag.org/content/showfacts.asp?folderid=430&level1=2&level2=430&.
catalytic impacts. Aviation’s global economic impact is valued at $2.960 billion, which is equivalent to 8 percent of the world’s gross domestic product.

In addition to its total output and employment impacts, civil aviation has a broader influence on overall economic growth, deriving from non-quantifiable benefits for the users of air transport, businesses, and individuals alike. Air transport acts as a facilitator for the development of markets and trading of goods as well as services. In 2005, airline scheduled services carried 2.022 billion passengers (at an annual increase of 7.1 percent over 2004) and 37.7 million tons of freight worldwide (at an annual increase of 2.5 percent). Approximately 45 percent of some 714 million international tourists and some 40 percent by value of the world’s manufactured exports were transported by air that year.

In the immediate aftermath of the events of September 11, 2001, where civil aircraft were used as weapons of destruction, aviation insurers gave seven days notice that on September 17, war risk third party liability coverage according to policy terms applying to the write back coverage for war, hijacking, and other perils would be withdrawn. The most compelling reason for the cancellations was the emergence of an exposure in terms of third party bodily injury and property damage that was seemingly unquantifiable. The International Union of Aviation Underwriters (IUAU) assessed that the total losses in respect to third party bodily injury and property damage caused by these events could exceed the previous greatest single catastrophic loss of $20 billion caused by Hurricane Andrew in 1992 by a significant margin.

In general terms, it was assessed that the price to be paid to revive or reinstate adequate coverage for third party war risk coverage would cost the airlines an additional premium of $1.25 per passenger carried. If airlines were to purchase coverage for limits of $950 million in excess of the already available $50 million they would have to pay $1.85 per passenger carried. In view of the fact that the airports, refuellers, ground handlers, and other service providers in the aviation industry contribute to an accumulation of risk, and

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2. Id.
3. Id.
5. Id.
6. Id.
7. See SGWA/1-I-IP/4, SPECIAL GROUP ON AVIATION WAR RISK (SGW1) (International Civil Aviation Organization), Dec. 2001, at i-1.
8. Id.
9. Id.
10. Id.
11. Id.
since many of them may serve a particular airline at one location, underwriters were disinclined to offer coverage for these providers.\(^{12}\) However, many insurers showed willingness to extend coverage for an additional $100 million over the $50 million coverage already provided.\(^{13}\)

Many States stepped in to address issues regarding cancellation of insurance and assumed responsibility for the operation of air services by their national carriers and the circumstances, rules, and regulations under which they are carried out.\(^{14}\) Most provided immediate relief in the nature of concessions and guarantees for their airlines.\(^{15}\) The unity displayed by the community of nations and the global aviation community is evidence enough that, irrespective of the absence of empirical data supporting the importance of the economic contribution of civil aviation to the world, there is implicit recognition of the indispensability of air transport as a critical driver of the world economy.

The most fundamental premise in investment is that an investor applies resources to an enterprise expecting returns on investment. The issue, therefore, is whether investing in civil aviation\(^{16}\) would provide the investor, whether a State or private entity, with worthwhile returns to justify investment in the first place and to continue so doing. In order to determine this, it is necessary to look into the investment climate of the world, the investment climate of the air transport industry, and the economic benefits brought about by civil aviation. In a global investment climate, where in the developing world alone 1.2 billion people survive on less than $1 a day, where 53 percent

12. Id.
13. Id.
14. See generally RUWANTISSA I.R. ABYEYRATNE, AVIATION IN CRISIS 2-7 (Ashgate 2004) (providing additional information on action taken by States as a result of the insurance crisis, where States guaranteed the continued operation of their air carriers).
15. Some notable examples were found in the United States, where the administration proposed a plan to have taxpayers cover most of the losses that insurance companies would suffer in future terrorist attacks. The European Commission announced, on 10 October 2001, that it would allow member states to help European airlines recover from the turmoil after the attacks on September 11. The Commission, which in the past was critical of government assistance to airlines, urged governments to extend compensation to cover the rise in premiums until the end of the year, and proposed setting up a fund to cover the higher premiums. Japan’s government stepped in to help the struggling airline industry as companies tried to cope with rising insurance costs and falling demand in the aftermath of the suicide attacks on the United States. The Ministry of Land, Infrastructure and Transport announced that the government would guarantee third-party insurance up to $2 billion for Japan’s airline carriers to cover any shortfall in claims after insurers reduced coverage to $50 million following the September 11 attack. Hong Kong’s Civil Aviation Department on 4 October 2001 gave the green light for 15 airlines to levy insurance surcharges on passengers on Hong Kong Routes. See Abeyratne, supra note 14.
16. Throughout this book, civil aviation is meant to refer collectively to air transport representing the airline industry, airports, aircraft manufacturers and other support industries providing services to air transport.
of the entire world live on less than $2 a day,\textsuperscript{17} and where youths have more than double the unemployment rate as others, a good investment climate should, as of necessity, foster productive private investment as the engine of growth and poverty reduction.\textsuperscript{18} As will be discussed later in this chapter, in civil aviation in particular, investments create jobs and opportunities for people and expand the variety of goods and services available, while reducing their cost. This in turn benefits the consumer and supports a sustainable source of tax revenues to fund other important social goals.

The World Bank has reported that a robust global investment climate is central to growth and poverty reduction.\textsuperscript{19} In this regard, the preeminent goal of governments should be to create opportunities for the private sector for investment while at the same time creating expansion and employment within the State sector. In other words, the goal should be to create a sound investment environment for everyone so that society as a whole would benefit. Of course, this is easier said than done, as developing nations have their own internal concerns and pressing needs brought to bear by both social and natural factors. It calls for a certain symbiosis between the developed and developing world as well as an enduring commitment from the international community to assist the developing world in three main areas: removing distortions in developed countries that harm the investment climates of developing countries; providing increased and effective assistance; and sharing knowledge and experience. These three areas of contribution from the international community have to be applied to the basic axiom that economic development requires adequate and effective transportation. Each country has a theoretically optimum amount of transport capacity. Transportation plays a multifaceted role in the pursuit of development objectives of a nation as well as the need to maintain international communication networks.\textsuperscript{20} Air transport enables goods and passengers to be transferred between and within production and consumption centres. Therefore, it could be argued that investment is vital to air transport.

The largest investment in air transport lies in the procurement of aircraft, which is usually done by the airlines themselves.\textsuperscript{21} In 2003, 861 turbo jet aircraft were ordered, compared with 497 in 2002.\textsuperscript{22} The financial commitment of airlines for jet aircraft orders in 2003 was about $60 billion, up

\begin{itemize}
\item[18.] Id.
\item[19.] World Development Report 2005, supra note 17.
\item[20.] Id.
\item[22.] Id.
\end{itemize}
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from $40 billion in the previous year. ICAO records that at the end of 2003, there were 1151 western built commercial jets in storage, compared with 1182 at the end of the previous year. It is quite clear that there is overcapacity of aircraft seats and freight capacity. Compared to investments being made in aircraft purchases, other aviation investments are relatively small, because airports and other aspects of infrastructure are funded by the States or instrumentalities of State and pertain to finite resources. Airport real estate is leased, although parts of a terminal may be built by airlines for their exclusive use. In air transport, total costs rise in direct proportion with output, which means that unit costs do not decline radically with expanding sales. One of the most burdensome expenses regarding airports concerns rents which have been excessively high, reducing the margin of profit in this usually gainful industry. These onerous financial burdens on the air transport industry do not detract from the fact that civil aviation was meant to perform an indispensable service to humanity. For example, the 1958 Federal Aviation Act of the United States stipulated the following:

It shall be the duty of every air carrier to provide and furnish interstate and overseas air transportation, as authorized by its certificate, upon reasonable request therefor and to provide reasonable through service in such air transportation in connection with other air carriers.

Travel and tourism, the largest combination of industries and the largest creator of wealth, is estimated to generate $3.5 trillion a year in activity and

23. Id. In 2003, 917 turbo jet aircraft were delivered, compared with 999 in 2002. The backlog of unfilled aircraft orders at the end of 2003 was 3,272 aircraft, compared with 3,407 at the end of 2002.


27. RUWANTISSA ABEYRATNE, AIR LAW AND POLICY 50 (PublishAmerica 2007).


30. Walter Robinson, Let Air Canada Heal Self Inflicted Wounds, HAMILTON SPECTATOR, Apr. 2, 2003, at A11. Developing countries are said to invest almost $200 billion per year in infrastructure, which is about 4 percent of the global outlook and 20 percent of the total investment in the developing world. See, e.g., H.S. Bhatia, Private Sector Investment, Management and Expertise Important to Airport Development, ICAO JOURNAL, Sept. 1996, at 17. Canada’s eight largest airports pay more than $250 million a year to the federal government in rent which is passed through to airlines and their passengers as a hidden tax. Id.


potentially provides employment to 130 million people worldwide. This accounts for 10 percent of the world GDP, 10.3 percent of the world wages, 9.8 percent of the profits, and 11.7 percent of indirect and direct taxes.

Be that as it may, there are some factors which effectively preclude air carriers from operating profitably. One factor is the restriction placed on ownership and control of airlines, which in some instances permit only 25 percent of foreign ownership and control. The International Air Services Transit Agreement Article 1, Section 5, provides that:

Each contracting State reserves the right to withhold or revoke a certificate or permit to an air transport enterprise of another State in any case where it is not satisfied that substantial ownership and effective control are vested in nationals of a Contracting State, or in case of failure of such air transport enterprise to comply with the laws of the State over which it operates, or to perform its obligations under this Agreement.

In the period since the 1950s, however, international civil aviation grew in breadth and scope and States increasingly used the right to withhold or revoke a foreign airline’s certificate, or in the alternative, permitted it to operate in their national airspace as a means of regulating international air transport. Specifically, States limited foreign investment in their flag carriers by requiring a nationality clause based on Article 1(5) of the IASTA in each of their bilateral agreements on air traffic rights. In this way, States prevented airlines from third countries from benefiting from a bilateral exchange of traffic rights. The requirement for airlines to seek permission to land in or take off from a territory of a State is another feature unique to the airline industry in terms of trade and competition. This requirement has its genesis in the Charter of International Civil Aviation—the Chicago Convention of

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33. Id.
34. H.S. Bhatia, supra note 30, at 17.
37. International Air Services Transit Agreement art. 1, § 5, Dec. 7, 1944, 59 Stat. 1693, 84 U.N.T.S. 389 [hereinafter IASTA] (IASTA has been ratified as of May 2005 by 122 States, 17 of which have ratified during the last five years). See also International Air Transport Agreement art. 16, Dec. 7, 1994, 59 Stat. 1701, 171 U.N.T.S. 387 (article 16 addresses the same issue; however, because very few States signed the Agreement (12 States), it did not go into effect).
38. Id.
41. Id.
42. Id.
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1944\textsuperscript{43}—which sets the regulation for the conduct of international civil aviation, Article 6 of which provides as follows:

No scheduled international air service may be operated over or into the territory of a Contracting State, except with the special permission or other authorization of that State, and in accordance with the terms of such permission or authorization.\textsuperscript{44}

Commencing in the early 1950s, States responded, both through the Chicago Convention, and through IASTA, to the growth of civil aviation by availing themselves of the prerogative given by IASTA to withhold or revoke an airline operational permit to enter into their territories for purposes of landing and takeoff on a commercial basis.\textsuperscript{45} By the same token, States used this right to restrict foreign investment in their own airlines or flag carriers by including a clause with specific conditions on nationality of their aircraft in the bilateral air services agreements, which they signed with other States in conformity with Article 6 of the Chicago Convention.\textsuperscript{46}

There is no documented definition of, or agreed meaning to the term substantial ownership and effective control.\textsuperscript{47} This \textit{in limine} creates certain ambivalence in the field of trade and competition in the airline industry, particularly for an airline that is not fully owned and operated by a State or instrumentality of State.\textsuperscript{48} The real difficulty in arriving at a conclusive definition of the term arises when an airline is privatized and the government no longer holds the majority of the shares and there is no demonstrable evidence of national ownership.\textsuperscript{49} The international community has, as a practice, got used to identifying ownership of an airline with the voting shares of the company, often equating substantial ownership to more than 50 percent of the voting shares.\textsuperscript{50} However, it can no longer be viewed in this simplistic manner, particularly owing to the wave of privatization experienced by the airline industry.\textsuperscript{51} For example, 45 percent of voting shares held by a private entity in a national airline may arguably be termed substantial ownership even though 55 percent of such voting shares may be held by nationals of the State which designates the airline as its national carrier.\textsuperscript{52}


\textsuperscript{44} Id.

\textsuperscript{45} Alexandrakis, supra note 39, at 75.

\textsuperscript{46} Id.


\textsuperscript{48} Id.

\textsuperscript{49} Id.

\textsuperscript{50} Id.


\textsuperscript{52} Commission Decision 95/404/EC on a Procedure Relating to the Application of Council
The issue of effective control on the other hand, is a more complex issue than ownership as it is no longer a question of percentages, but rather relates to who controls the airline concerned. In broad terms, this may mean who directs policies of the airline and hires and fires personnel. An indicative definition of control can be found in the United States where legislation concludes that control is “possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.”

There is a distinct variance in characteristics and effect between substantial ownership on the one hand, and effective control on the other. The former may often be established through a presumption of nationality, while the latter may involve complications brought to bear by nationality issues, such as the nationality of members of a supervisory board, and nationality and rights of directors of a board. Furthermore, the nationality criterion pertaining to ownership may even be obviated with some ease, as in the case of the European Union, which, in 1997, introduced legislation recognizing a community air carrier could operate air services anywhere within the fifteen member States of the Union, Norway, Iceland, and Liechtenstein. The European Union effectively replaced the national carrier with a community carrier by this legislation.

II. CIVIL AVIATION AND THE ALLEVIATION OF POVERTY

Apart from estimates, the world community has no way of quantifying the economic contribution of the aviation industry to global economic growth. The reason for this is that the aviation industry is only the fuel which drives the world trade machine. Therefore, although world trade can be quantified, it is impossible to determine what part of that trade was driven by aviation. Aviation moves people across boundaries, thereby contributing to the tourism industry, which some argue is the largest industry in the world.

53. The Securities Exchange Act, 17C.F.R. 240.12b-2 (1988 & Supp. 1995). The European Union, by Council Regulation No. 2407/92 of July 23, 1992, identifies effective control as a relationship constituted by rights, contracts, or other means. This relationship grants, inter alia, the right to exercise a decisive influence on an undertaking, in particular, the right to use all or part of the assets of an undertaking and determine the composition, voting, or decisions relating to the running of the business or undertaking. Id.
56. Id.
57. Tourism: World's Largest Industry- From Zero To A Trillion $ In 100 Years (Lessons From
moves goods and services around the world, from the fish caught in the lakes of Uganda and the horticultural products of Kenya to Europe to the Asian worker to the Middle East. Without international aviation, the poor fisherman and horticulturist of Africa will not be able to sustain their professions and the unemployed worker would not find employment overseas. Therefore, it can be argued that aviation greatly assists in poverty alleviation, which is one of the main objectives of the International Bank for Reconstruction and Development, otherwise known as the World Bank.58

Another facet to aviation is that it moves people and goods across borders, thus facilitating global business. For instance, when an aircraft carries business people from Europe to Asia, aviation plays the seminal role of being the first link in the chain that might trigger any business transactions emanating from such travel.

At best, the current approach adopted by the world community to world trade regarding aviation is unfortunate for the aviation industry and in particular the air transport industry, which is relegated to a back seat in the face of other priorities such as poverty alleviation, health, and education. Although no rational argument exists to promote aviation over the other priorities mentioned (although it is a fact that institutions such as the World Bank must, as they correctly do, set their priorities towards eradicating poverty, ensuring health, and providing education),59 it should not necessarily follow that aviation should be treated as inconsequential when it comes to support. If aviation is to be treated as a driver of the global economy, then the sustainability, safety, and security of the industry must, as of necessity, be treated with some degree of priority.

The irony in the above situation is that in Africa, and some parts of Asia and South America, air transport is one of the solutions to the problem of poverty. In the African continent in particular, which accounts for just 2 percent of the world GDP but hosts 13 percent of its population, the aviation industry has a vital role to play in achieving sustainable development.60 Africa, being the smallest region for air services in the world, accounts only for 4.1 percent of the global passenger traffic and approximately 2 percent of the freight traffic of the world.61 The tourism sector too is negligible in Africa compared to other regions of the world.62 In 2001, tourism represented 3.4

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59. Id.
61. Id. at 1.
62. Id. at 38.
percent of the GDP, although it has the fastest growth rate of tourist arrivals.\textsuperscript{63} Therefore, the major potential contribution of air transport to Africa and its poverty alleviation program would be through air transport contribution to tourism. “Tourism contributes to poverty reduction by generating economic growth, providing employment opportunities and increasing [incomes generated through taxes and other levies].”\textsuperscript{64} Tourism also serves as a major contributor to the trade balance in many African countries.\textsuperscript{65}

Traditionally, the air transport industry fortunes have been irregular.\textsuperscript{66} The airline industry, despite its glamour and perceived commercial power, has experienced marginal profitability and cyclical fiscal growth in the long term, with periods of growth and profit being watered down by less successful periods to follow.\textsuperscript{67} One of the reasons for this fluctuating pattern is that the airline industry is driven by variable factors, such as operational and technological changes as well as regulatory control.\textsuperscript{68}

To clearly view the aviation industry’s ability to cope with the difficulties faced by the air transport industry, it is necessary to examine the dimensions of air transport, which are the only means through which one can glean the extent of its contribution to the world economy. Two things have to be done if the air transport industry is to be recognized as a major contributor to the world economy and trading process. The first is to treat air transport as a trading tool and not as a luxury. A liberalized trading process must be applied in the context of air transport. It is incontrovertible that liberalization of air transport is a global trend that is irreversible and has been ongoing since the 1980s.\textsuperscript{69} In the liberalization process, fluctuations of global economic factors, as well as the national approaches to market access, continue to be the most critical elements in air services agreements between States. These factors remain integral to substantive regulatory liberalization should a State decide to radically alter its stance toward opening the skies. In considering liberalization of market access, States invariably face two basic issues: the extent of liberalization, i.e., how open the market access should be in terms of the grant of traffic rights; and the approach to liberalization, i.e., whether liberalization should be national, bilateral, regional, plurilateral, or multilateral, and the pace with which liberalization should be pursued.

The first step to poverty alleviation through aviation is liberalization of

\begin{itemize}
  \item \textsuperscript{63} Id. at 38.
  \item \textsuperscript{64} Id. at 37.
  \item \textsuperscript{65} Id. at 36.
  \item \textsuperscript{66} Abeyratne, supra note 14, at 1.
  \item \textsuperscript{67} Id.
  \item \textsuperscript{68} Id.
\end{itemize}
market access. Liberalization is realized when carriers are not fettered with unduly restrictive bilateral air services agreements. It would be largely up to each State to decide on the parameters of the air service agreements, depending of course, on its national and economic interest. Although basic third and fourth freedom traffic rights are provided in most bilateral air transport arrangements as a starting point, most arrangements go beyond to cover a whole range of traffic rights, as well as other market access considerations.

The extent of market access being available to air carriers could vary widely because of such determinants as the competitive advantages and disadvantages of both States and carriers. Other factors affecting market access include size, location, and stage of development of States, and the competitive strategies open to particular economies driven by national policy. As for the approach to liberalization, the experience of the last two decades seems to suggest that States will endeavor as much as possible to utilize all the existing avenues in pursuing liberalization. This is assuming that States do not face an overt or covert threat to their economies.

A case in point is a State depending heavily upon tourism, where it will be in the interest of that particular State not to depend entirely on market decisions of air carriers bringing in tourist traffic to its territory. “[M]any States have unilaterally introduced liberal air transport policies,” frequently taking to consideration “a broader perspective of national interest including economic development and trade benefits.” It would be surprising if a State were to advocate and pursue liberalization without reservation, purely in order to promote a liberal global air transport industry to the detriment of its own economy and industry. The bilateral approach continues to offer flexibility and viability through which States can expand air services while retaining the control over the pace and direction of liberalization. However, the serious disadvantage of bilateralism is that it may also be a constraint toward any attempt at achieving liberalization on a wide scale. This is because of the inherent inflexibility of the system in not being able to facilitate accord between a large number of involved States.

The underlying objective for liberalization in the long run should be to optimize efficient and economical trade and communication links among States, and to promote to the fullest possible extent national and regional growth and development. Simultaneously, each State should be ensured a

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70. Third freedom traffic rights are rights of an air carrier to operate point-to-point air services from its country of origin to another country carrying passengers and freight for hire., Freedoms of the Air, http://www.icao.int/icao/en/trivia/freedoms_air.htm. Fourth freedom traffic is the exact reverse of third freedom. Id.


72. Id. at 2.8.

73. Id.

74. Id.
meaningful participation in international air transport in accordance with the Chicago Convention. In the meantime, States can be expected to continue to pursue liberalization in market access at their own choice and pace, taking into account the related benefits and risks, using bilateral, regional and/or multilateral avenues as appropriate. Liberalization may also be gradual with phased introduction or by blocks of market access such as air cargo.

Second, air transport has to be linked to poverty alleviation. One must recognize that both big businesses and poor industrialists depend on air transport for the export of their goods and services. It is incontrovertible that tourism and aviation could pave the way for a new export-led trading structure that could, in turn, create sustainable development structures within lesser-developed countries.

III. THE ECONOMIC CONTRIBUTION OF CIVIL AVIATION

ICAO records that in the year 2003, airlines of the world carried 1,657 million passengers and some 35 million tons of freight.\(^75\) During that year the world gross domestic product (GDP) grew approximately 3.9 percent in real terms, almost one percent higher than in the previous year.\(^76\) While air transport is the main mode of business travel, and, therefore, contributes significantly to global commercial activity, there is no empirical study to compare the contribution made by the air transport industry to the world gross domestic product in real and quantifiable terms. ICAO has estimated that in the year 1998, the direct contribution of civil aviation, in terms of the consolidated output of air carriers, other commercial operators, and their affiliates, was $370 billion.\(^77\) Direct on site employment at airports and air navigation services providers generated 1.9 million jobs, while production by aerospace and other manufacturing industries employed another 1.8 million people.\(^78\) Overall, the aviation industry directly employed no less than 6 million persons in 1998.\(^79\)

These direct economic activities have multiplier effects upon industries providing either consumer products or aviation-specific and other inputs.\(^80\) In simple terms, “every $100 of output produced and every 100 jobs created by air transport trigger additional demand of some $325 and in turn 610 jobs in other industries.”\(^81\) For example, the total economic contribution of air transport, consisting of the direct economic activities and the multiplier effects,

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76. *Id.*
78. *Id.*
79. *Id.*
80. *Id.*
81. *Id.* at 3.
was estimated to generate $1,360 billion output and 27.7 million jobs worldwide in 1998.\textsuperscript{82} The total output result suggests that about 4.5 percent of the world output (in terms of real gross domestic product) may be attributed to air transport and its multiplier effects.\textsuperscript{83} The findings on the direct contribution and multiplier effects remain generally relevant beyond the assessment year, particularly in view of the steep demand contractions of air travel in 2001, followed by two years of stagnation.\textsuperscript{84} The ramifications of these preceding years for the entire civil aviation business testify of its importance for the local, regional, and national economies in which they are embedded.

In addition to its total output and employment impacts, civil aviation has a broader influence on overall economic growth, deriving from non-quantifiable benefits for the users of air transport, businesses, and individuals alike. Air transport acts as a facilitator for the development of markets and trading of goods as well as services.\textsuperscript{85} In 2001, airline scheduled services carried more than 1.6 billion passengers and 30 million tonnes of freight worldwide.\textsuperscript{86} Approximately 45 percent of some 714 million international tourists and some 40 percent by value of the world manufactured exports were transported by air that year.\textsuperscript{87}

Measuring the economic contribution of civil aviation gives an account of the impact that air transport, aerospace, and other affected industries have in generating output and creating employment throughout a given economy. Furthermore, air carriers and other operators purchase a wide range of products (goods and services) from primarily airports, air navigation services providers, governmental agencies, public corporations as well as aerospace manufacturing and other industries.\textsuperscript{88}

At the national level, the stimulating economic impact of civil aviation as job creator and contributor to economic growth is evident when airlines, airports, air navigation services providers, aerospace industries, and their respective affiliates meet a growing direct demand for air transport services. This is accomplished by expanding operations and fleets, ordering more goods and services from suppliers, and by hiring more employees. These direct economic activities have multiplier effects upon other industries throughout an

\begin{thebibliography}{88}
\bibitem{82} Id.
\bibitem{83} Id.
\bibitem{84} Ruwantissa Abeyratne, \textit{Sustainability of Air Carriers and Assurance of Services}, 68 J. AIR L. & COM. 3, 3 (2003).
\bibitem{85} ICAO, \textit{supra} note 77, at 2.
\bibitem{86} Id.
\bibitem{87} Id.
\bibitem{88} Id.
\end{thebibliography}
A wider or narrower spread of these multipliers will depend on the circumstances, notably the size of the industries associated with civil aviation and the assessment approach taken. For example, countries with significant aerospace manufacturing will show a wide spread, while those with limited air transport services may have a relatively narrow spread. Non-aviation travel and tourism businesses, such as hotels and restaurants, travel agencies, tour operators, and retailers greatly benefit from trip-related expenses of airline passengers.

The United States has shown exponential growth in the aviation industry and, as such, ICAO considers “the impetus of civil aviation in the United States economy . . . a good case study to demonstrate the procedural steps of the assessment phases” of the ICAO study on the economic contribution of civil aviation.

It has been evaluated over a number of years by Wilbur Smith Associates on behalf of the U.S. Federal Aviation Administration. In 2000 (the most recent year for which data is available), the provision of airline services, general aviation activities, airport operations, and acquisition of aircraft totalled an output value of $177.3 billion and created more than 1.2 million jobs. Expenditures associated with business and leisure trips by air totalled $176.3 billion and created over 3.1 million jobs. These direct and catalytic expenditures generated additional expenditures of $654.6 billion and over 5.5 million jobs through the indirect demand of suppliers and induced demand effects.

These results for the U.S. economy can also be expressed as multiplier effects of the direct demand: every $100 of output produced and every 100 jobs created by civil aviation in 2000 trigger another U.S. $469 of output and 717 jobs in many different industries. The value of all economic activities of civil aviation and air travel-related expenses, plus indirect and induced multiplier effects, totalled U.S. $1,008.2 billion and employed 10 million people who earned $310.1 billion in 2000.

Finally, compared to 1987, total output increased by 27.4 percent, while the number of jobs increased by 23.7 percent, and income rose by 31.8 percent.

The fragile nature of the air transport industry calls for stringent measures to sustain the economic contribution of civil aviation to the world. At best, the air transport industry fortunes have been irregular. The airline industry has
experienced marginal profitability and cyclical fiscal growth in the long term, with periods of growth and profit being watered down by less successful periods to follow. One of the reasons for this fluctuating pattern is that variable factors such as operational and technological changes, as well as regulatory control, drive the industry. Overcoming the challenges ahead would essentially require a balance between these areas.

The shift in focus that confronts competition in commercial aviation largely lies in the compelling need for measures that would enable airlines to maximize on the potential available in the market. This would prevent the industry from falling apart. Since the beginning of regulated civil aviation in 1944, and until recently, competition was rigidly regulated and often based on predetermined capacity as a determinant of a carrier entitlement to enter a market. This stultified the global air transportation system. The transition from a somewhat smoothly running, but cumbersome aviation industry was not easy because the air transport industry was comfortable and languid with established legacy carriers dominating a vastly untapped market. However, the air transport system of the past had its advantages. Granted, there were not large aircrafts, there were not as many connections, and airline tickets could not be purchased online. In the past, a passenger almost anywhere in the world could purchase a ticket to fly seamlessly to almost any part of the world through a complex but reasonably efficient set of working relationships between hundreds of individual air carriers. Transaction costs were low, where a single call to a travel agent at the corner of the street could finalize a transcontinental flight. This was mostly possible because individual airlines themselves ensured the provision of all their services, infrastructure, and procedures to connect passengers and freight both within their own networks and those of connecting carriers. At the airport, the passenger did not encounter heat sensitive monitors that sought to establish that he was the carrier of a communicable disease, nor were there physical checks of passengers and baggage. Industry standards and facilitation measures were in place through ICAO and the International Air Transport Association (IATA).

97. Id.
98. Id.
100. Id. at 224-26.
101. Id. at 222-23.
103. Id.
Furthermore, procedures and clearance at the airport were hassle free and not subject to color coded security alerts.

Today, the story is somewhat different. Things have become more sophisticated. It was inevitable that they had to because market conditions changed and the demand for air transportation grew, (and keeps growing), at roughly double the rate of the growth in the general economy.\footnote{Id.} The exponential infusion of capacity to meet this demand requires costly systems and infrastructure to serve the consumer.\footnote{Id.} An inevitable corollary was that air transport became more expensive.\footnote{Id.} However, if only this were the issue, things would have been easily manageable. The prolific use of air travel by the public made air transport an easy target for terrorism and the free movement of disease causing vectors.\footnote{Ruwantissa Abeyratne, *Forensic Aspects of the Aerotoxic Syndrome*, 21 Med. & L. 179, 179-88 (2002).} The threat of terror brought its own problems, requiring more expensive aviation insurance and the necessity to cancel flights every now and then.\footnote{Id. at 223.} Additionally, the proliferation of air travel brought in environmental concerns of aircraft noise and engine emissions,\footnote{See World Trade Report 2005, *supra* note 104, at 224.} problems of airport congestion, and slot allocation.\footnote{Id. at 223.} Worst still, competition between carriers to offer capacity made some of the carriers expand with the only objective being to provide services at any cost.\footnote{Id.} Critical services required for aviation safety, such as efficient ground handling and precise engineering were outsourced, with no guarantee of one hundred percent safety of a flight.\footnote{Id.}

The above notwithstanding, neither a single nation nor the global aviation community ever deregulated safety and security.\footnote{Abeyratne, *supra* note 102, at 32.} Responsibility still continues to devolve upon governments to provide additional capacity, find the money to fund safety and security inspectors, and ensure that their carriers operate air services with full insurance coverage, however expensive. This responsibility is in place so that the world economy will not run aground for lack of international air services.\footnote{Id.} Fortunately, all 188 States who are signatories to the Convention on International Civil Aviation (Chicago Convention) signed at Chicago on December 7, 1944, can rely on ICAO to find regulatory solutions that would keep the crisis from becoming
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In the recent past, ICAO has regulated safety and security, established and conducted security and safety audits on Contracting States, adopted much needed principles of guidance on facilitation, assisted in preventing the spread of disease by air carriage, and even developed a global aviation insurance scheme in case things go wrong in the insurance industry the way they did immediately after September 11, 2001.

“Since its inception as a regulated industry, the overriding theme of international civil aviation has been, and continues to be, the pursuit of friendship and understanding among the people of the world,” with the ultimate objective of ensuring global peace.

Toward this end both the principles of air navigation and aviation economics have to ensure that aviation is developed in a manner that would make sure the world has a safe, reliable, economical, and efficient civil aviation system. An inherent characteristic of aviation is its ability to forge inroads into human affairs and promote international discourse. It also promotes international goodwill and develops a feeling of brotherhood among the people of the world. Therefore, it has been claimed that problems of international civil aviation constitute an integral part of the universal political problems of world organization, and, therefore, aviation problems cannot be solved without involving the world political and diplomatic machinery. It is at this crossroads that one encounters the profound involvement of the International Civil Aviation Organization.

At present, the most critical challenge facing international civil aviation is to sustain the air transport industry and assure the consumer continuity of air transport services. The initial setback suffered by the industry as a result of the events of September 11, 2001, and the combined impact of the economic downturn and precipitous decline in air travel during the period that immediately followed, portended an inevitable gloom for the air transport industry, which resulted in the abrupt downfall of air traffic globally during 2001. The retaliation by the world community against terrorism increased the airline passenger’s fear and reluctance to use air transport. Increasing

115. Id.
117. Taieb Cherif, *Foreward to KOSTAS IATROU & MAURO ORETTI, AIRLINE CHOICES FOR THE FUTURE: FROM ALLIANCES TO MERGERS* (Ashgate 2007).
118. Id.
120. Markus Franke, *Competition Between Network Carriers and Low Cost Carriers—Retreat Battle or Breakthrough to a New Level of Efficiency?*, 10 J. AIR TRANSP. MGMT. 15, 16 (2004).
121. *2001 Annual Review of Civil Aviation 2003, 57 INT’L CIVIL AVIATION J. 12 (July/Aug. 2002)* (The International Civil Aviation Organization recorded that following the events of September 11, 2001, total passenger traffic decreased by 3.9 percent over the previous year and international freight tonnes kilometers by approximately 5 percent).
costs of security enforcement and insurance prompted air carriers to cancel or postpone their new aircraft requisition orders. Many carriers, particularly in developing countries, were compelled to revisit their cost structures and downsize their human resource bases.

In the years that followed, the build up to the war in Iraq in 2002, the war in 2003, and the outbreak of Severe Acute Respiratory Syndrome (SARS) all added to the initial setback of September 2001. These unfortunate historical landmarks indeed proved to be the four horsemen of the Apocalypse resulting in serious ramifications for air carriers. Their ill effects were seen in the rising costs of security and insurance, massive layoffs of employees, drastic reduction of non-profitable routes, closure of facilities, and cessation of aircraft operations. In the manufacturing industry, previously ordered aircraft delivery was deferred, resulting in significant cutbacks in employment in the aerospace industry and a colossal loss to the industry in 2002. Airports and air navigation service providers suffered a similar fate, losing income from user charges and non-aeronautical revenues, while simultaneously facing enhanced insurance and security costs.

These setbacks notwithstanding, current trends dictate that the world economy will remain moderately stable and healthy in the near future, despite a slowdown in economic growth. In the short term, inflation may hold steady and inflation rates will probably decrease gradually. The continuing upward trend in fuel prices is likely to increase airline fixed costs, and aviation will increasingly be defined in trade terms, whilst being a strong candidate for trade liberalization with a firm focus on services. In the years ahead, individual airlines will be compelled to remain competitive. They will need to

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122. Abeyratne, supra note 102, at 31 (citing Yann Cochennec, What goes up... Aircraft orders and deliveries slid dramatically in 2002, but 2003 will be even tougher, INTERAVIA BUS. & TECH., Jan. 1, 2003).


126. Abeyratne, supra note 102, at 31 (citing Cochennec, supra note 122).

127. Id. at 29, 30.

128. Id. at 31 (citing 2001 Annual Review, supra note 127, at 24).


130. Abeyratne, supra note 102.

flow with the tide of emergent and future commercial trends such as
privatization, the use of information technology, and removing infrastructure
constraints and governmental restraints.

Air travel has several determinants in regard to demand. Primarily, it is
determined by income levels and demographics and the cost of air travel.132
With regard to the cost of air travel, world energy demand, supply, and prices
are key factors which drive both the profitability of the air carrier and the cost
factor involving the use of travel offered by the carrier to the consumer.133

All the above indicators incontrovertibly point to one central driver of
future air transport competition, which will help the increasing influence of
global alliances and partnerships between carriers to be a key element in
industry strategic development where more groups of airlines will provide
direction and focus. Airline management, geared towards competition, will be
called upon to improve coordination, and provide integration and stability to
the air transport industry, calculated to result in the inevitable corollary of cost
reduction.

The outsourcing of non-core activities will continue among airlines,
encouraging fledgling carriers to emerge in a liberalized market. Larger
airlines will seek franchising and code sharing agreements with other airlines
to the furthest extent possible, and will not disregard the importance of creating
low cost subsidiaries, while also looking to consolidate their services with
other carriers. In the process, existing distinctions between scheduled and
nonscheduled (charter) carriers will be minimalized. In terms of service
distribution, airlines will invest in e-commerce, concentrating as much as
possible on selling their services directly online.

The growth in commercial air services has continued to outstrip the
available capacity at more and more airports.134 Although many airports with
congestion problems are located in Europe, a growing number of airports in
other regions are reaching capacity limits.135 Moreover, because of the
interconnected operations of the international air transport system, capacity
constraints at some airports impact other airports.136 This is becoming an
increasing challenge to the continued growth of air transport and is having an
impact on further liberalization with respect to market access, requiring, in
some instances, airports to enter into alliances with one another.137

Governments, airlines, and airports have each developed measures to

132. Hanlon, supra note 131, at 12.
133. Abeyratne, supra note 102, at 32 (citing Hanlon, supra note 131, at 22).
134. See World Trade Report 2005, supra note 137, at 223.
135. Id.
136. See Hanlon, supra note 131, at 140-41.
137. Id. at 148.
overcome or ameliorate situations of insufficient airport capacity. Many States have either expanded existing airports, built new ones, paved new runways or added terminals. However, environmental, economic, political, and physical constraints have, in some instances, prevented physical expansions to increase airport capacity. At least one inter-governmental body and a regional body have taken action to improve air traffic control systems designed to increase the capacity of air traffic management at airports. Airports and air carriers have been able to enhance airport capacity by improved facilitation at existing facilities, despite increased security requirements after the events of September 11, 2001, which have limited capacity enhancements in this area.

Revenue and investment management is a key concept, which has pervaded the air transport industry, particularly in the wake of trends in privatization of airports and air navigation services. Both airports and air navigation services need to consider issues involved in privatization in order to manage their revenues and investments. Along with the burgeoning need for an increase in airport capacity, to accommodate the demand for increasing air transport capacity, comes the issue of proper fiscal management of income derived by airports and air navigation services providers. Intrinsic to the issue of revenue and investment management are considerations of cost pricing, liability, and duties imposed upon a privatized entity. These aspects have to be managed if successful revenue and investment management are to be accomplished. Intrinsically, an examination of appropriate cost pricing and revenue allocation will be a significant item on the agenda of both airport and

138. Abeyratne, supra note 102, at 34.
139. As was noted by the WTO: A number of high growth international ports, such as Hong Kong, China (1998), Osaka (1994), Kuala Lumpur (1998) and Shanghai (2002) have built new airports to deal with the [capacity] problem ... London's Heathrow airport is particularly notable for the capacity constraint problem. After decades of struggling to deal with congestion, the authorities have decided to build a new terminal and a short runway.
World Trade Report 2005, supra note 137, at 223.
World Trade Report 2005, supra note 137, at 223.
140. Id.
141. For example, in April 2001, the Federal Aviation Administration (FAA) announced a set of initiatives in its Operational Evolution Plan, which is designed to increase capacity within the United States national air space. See Air Traffic Control: Role of FAA's Modernization Program in Reducing Delays and Congestion: Testimony Before the Subcommittee of Aviation, Committee of Commerce, Science, and Transportation, U.S. Senate, GAO-01-725, 5 (2001) (statement of Gerald L. Dillingham, Director of Physical Infrastructure Issues).
143. Abeyratne, supra note 102.
144. Gunnar Finnsson, Move to Privatization of Airports Requires Careful Consideration of Numerous Factors, 48 Int'l Civil Aviation J. 18 (Jan./Feb. 1993).
145. Abeyratne, supra note 102.
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The preeminent regulatory challenge confronting air transport is to update policies, guidelines and other regulatory instruments to address changes in the aviation environment. Competition, when coupled with liberalization of air services taking place on an international scale, inevitably calls for a more open and free approach. However, it is not prudent to consider air transport services as being just another normal economic activity. The overarching objective of ICAO, as contained in Article 44 of the Convention on International Civil Aviation, is for ICAO to foster the planning and development of international air transport so as to meet the needs of the people for safe, regular, efficient, and economical air transport. This is a most fundamental challenge, which not only draws the inference that air transport is a public utility, but also issues a challenge to ICAO, its Contracting States, and their carriers to ensure the provision of a safe service satisfying fixed standards of continuity, regularity, capacity, and pricing.

The inherent characteristics of air transport, of being a public utility on the one hand and of being confronted with the danger of over regulation on the other, admit of the need for a delicate balance between untrammeled competition and suffocative regulation. While the first approach may give rise to the usual free market inhibitors such as airport, airway, and runway congestion, the other approach may ground to a halt the services that may provide air transport commensurate with the demand.

In order to face the exponential growth of the air transport industry, it is inevitable that competition and liberalization should be given serious consideration as a current and future trend in the aviation field. What is needed foremost, in order to improve international cooperation toward achieving a well meshed and overall competitive policy, is to consider the various possible options available. One of the options to promote competition and facilitate trade in air transport lies indisputably in combating and eliminating anti-competitive practices. State responsibility toward achieving this goal is a key factor. One way of ensuring collective State action in this regard, might be for States to enter into understandings or agreements toward combating restrictive trade practices, either bilaterally or plurilaterally. Along with a plurilateral framework of competitive policy, there also should be a

146. Id.
147. Id. at 33.
148. Chicago Convention, supra note 104, at art. 44.
150. Abeyratne, supra note 102.
151. Id. at 34-35.
concomitant bilateral structure of individual agreement between States to stringently monitor anticompetitive conduct. This can only be achieved with a robust and effective international legislative structure. The important role played by public international law in this regard cannot be denied.

As for liberalization of air transport, there has so far been no indication that any State favors total liberalization, calculated to open out its domestic market. Strategic alliances between airlines, whether through mergers or other arrangements, will be viewed with caution and objectivity by individual airlines and States. This will act to preclude the total overrunning of local interests. It is this consideration that would make liberalized ownership and control criteria less attractive to local entrepreneurs who would not encourage foreign ownership to encroach on local control airlines have of their own markets.

The two integral areas that will carry the sustainability of air carriers and assurance of air services in the years to come will be regulatory control and economic strategy. From an economic perspective, it is inevitable that competition will be between airline alliances rather than individual carriers. Markets will be unstable, and in the case of individual airlines, only those who go back to basics to offer the consumer a service as value for money will survive. Ethical and moral consideration of economics, in terms of strategic airline management that provides for quality customer service, will play a major role in airline sustenance and will be the bottom line for the years to come.

From a trading perspective, both States and carriers must share equal responsibility to ensure continuity of air transport services. The uniqueness of the operation of air transport services as a trading practice lies in the symbiosis required for its sustenance between States and carriers. This peculiar relationship requires that a certain responsibility devolves upon States to ensure the prosperity of its air transport industry and to prevent the industry from collapsing. Although air transport may be heavily privatized in some instances, particularly in the developed world, it does not take away the overall regulatory supervisory role of the State and its obligation to support its

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152. Id.
153. Abeyratne, supra note 102.
154. Id.
155. Abeyratne, supra note 84, at *37.
156. Id.
157. Id.
158. Id.
159. Id.
160. Id.
2007] Investing in Air Transport – A Prudent Move? 23 carriers.161

From a regulatory perspective, the challenges faced in the economic field are to update and promote ICAO policies and guidelines to meet the demands of a changing environment, and to seek a balance between promoting economic growth in the industry, advancing civil aviation, and strengthening security measures and facilitation. In order to address these challenges, all players involved need to seek a harmonious relationship between a liberalized economic regulatory framework and proper safety, security, social, and labor standards.

Economic activity in air transport, particularly in the movement of aircraft between States, should be viewed in the context of sustainable development, where environmental protection would play a key role. Although air transport does not pose catastrophic environmental consequences on a short-term basis,162 it has become opportune to address trade in air transport and its effect on global environmental welfare as a composite whole, rather than within a fragmented framework. The economic aspects of environmental protection, particularly in the areas of noise charges and emissions trading as a market based option, is an inevitable challenge, particularly when it concerns global consensus on criteria for levying such charges and their quantification.

A compelling feature in any investment policy concerning air transport must include policies encouraging foreign investment in civil aviation, including investment in airports and general aviation. Airline ownership and control provisions in local legislation and bilateral air services agreements must be relaxed to encourage foreign equity in the air transport industry. A moderate rental policy should also be adopted by the State to preclude undue burden on the airports. The supply of seat and freight capacity must be realistic and consistent with demand, compelling a reduction in aircraft orders.

Despite the past forecast of a substantial loss to the air transport industry in the five years ending in 2005, ICAO forecasted that scheduled passenger traffic would grow by 5.2 percent in 2006.163 This brings to bear the need for investment, to ensure that the necessary air transport services will be available to the public, while also making sure that overinvestment in aircraft capacity is avoided at all cost.

IV. INVESTING IN AIRPORTS

Airports, particularly in developing nations, have attracted significant private sector investment in the past 20 years, in spite of the grave financial

161. Id.
163. The World of Civil Aviation 2003-2006, supra note 21, at 84.
risks involved.\textsuperscript{164} However, in the 1990s, a growing trend emerged, which increasingly encouraged governments to turn to the private sector for assistance in strengthening and stabilizing efficiencies in the provision of airport infrastructure services.\textsuperscript{165} Other interests in the private sector were spurred on by its expertise in raising revenues and eradicating mismanagement and neglect that had alienated assets under governmental control.\textsuperscript{166} The overall objective of governments when leaning toward the private sector was to salvage assets, provide a more efficient service, and obviate governmental interference in tariff and investment policy decisions.\textsuperscript{167} At present, the trend toward private investment in airports is facilitated by the globalization and liberalization of the world economies, which have resulted in the ownership and management of airports to undergo significant changes.\textsuperscript{168} Of course, each model of privatization and investment in airports and their infrastructure have different variants which are applied diversely to suit individual business and political models.\textsuperscript{169}

It is noteworthy, that at its incipient stage, international civil aviation relegated to the airport the status of a terminus,\textsuperscript{170} much the same as a bus terminus of that time, assigning it as the focal geographical point at which people gathered to embark on a plane for a journey by air, or disembark after an air journey.\textsuperscript{171} However, airports are now complex industrial enterprises.\textsuperscript{172} Quite apart from the essential airside support given by airports to landing and departing aircraft, there are commercial facilities provided for both passengers and the public within the terminal building by concessionaires who are specialists in their own fields of business.\textsuperscript{173} The airport authorities collect concession fees (non-aeronautical revenues) from the concessionaires. In numerous airports around the world, the income derived from such resources is significant, often exceeding traditional income derived through the provision of airport and air navigation services (aeronautical revenues) to incoming and outgoing aircraft.\textsuperscript{174}

The paradigm shift which changed the nature of an airport from being a

\textsuperscript{164} Ruwantissa Abeyratne, \textit{Towards a SAARC Common Aviation Policy}, ASIAN LAW, March, 2005 [hereinafter \textit{Towards}].

\textsuperscript{165} \textit{Id}.

\textsuperscript{166} \textit{Id}.

\textsuperscript{167} \textit{Id}.

\textsuperscript{168} \textit{Id}.

\textsuperscript{169} \textit{Id}.

\textsuperscript{170} See ICAO, \textit{CIRCULAR 3-AT/1: AIRPORT ECONOMICS} 9 (1948) (Giving an early definition of airports).

\textsuperscript{171} \textit{Towards, supra} note 170.

\textsuperscript{172} \textsc{Rigas Doganis}, \textit{The Airport Business} 7 (Routeledge 1992).

\textsuperscript{173} \textit{Towards, supra} note 170.

\textsuperscript{174} \textit{Id}.
place where a person enplaned to travel to another country, to also being a complex entrepreneurial enterprise, has compelled governments to view airports as being of significant commercial potential.\textsuperscript{175} The conventional practice of investment by States in airports is becoming increasingly unpopular and difficult because of pressure to finance other more pressing and high-priority services, e.g., public health, education, and social services.\textsuperscript{176} From an economic perspective, it is incontrovertible that most States that have privatized their infrastructure have stood to gain financially, particularly when the revenue from privatization is injected to the government coffers.\textsuperscript{177} Cases-in-point are airports under the British Airports Authority, the largest group of privatized airports in the United Kingdom and Australia.\textsuperscript{178} In the case of the United Kingdom, several airports have been subject to long-term leases for upfront payments.\textsuperscript{179} The role of government at the post-privatization stage is substantially different from the role played when an airport is under government control. After privatization, governments are no longer responsible for management and development of airports.\textsuperscript{180} Management of facilities of the airport is transferred to the new administration, as well as the collection of airport charges and other revenues.\textsuperscript{181}

Usually, apart from the basic advantage of attracting more finances to the government treasury, there are three reasons that impel a government to open an airport for public issue: lack of government funds to expand airport capacity to meet the demands of air transport, increase of efficiency of the airport and its services through private sector involvement, and the opening of a wider choice for airlines operating into the airport in terms of hub operations.\textsuperscript{182}

The United Nations introduced a global perspective on privatization by endorsing the practice, particularly by a General Assembly Resolution in 1992,\textsuperscript{183} which, while recognizing the sovereign right of each State to decide on the development of its private and public sectors, notes that “the private sector plays a positive role in mobilizing resources and promoting economic growth and sustainable development.”\textsuperscript{184} The Resolution goes on to urge all concerned to support “national efforts of countries in implementing
privatization, de-monopolization, administrative deregulation and other relevant policies in the context of their economic regions and the opening of their economies.\textsuperscript{185}

Privatization of an airport brings to bear a certain focus on the changed status of the airport, particularly in terms of ownership and management, and the inevitable corollaries of legal liabilities and fiscal responsibility, which change hands.

V. CONCLUSION

A compelling feature in any investment policy concerning air transport must include policies encouraging foreign investment in civil aviation, including investment in airports and general aviation. Airline ownership and control provisions in local legislation and bilateral air services agreements must be relaxed to encourage foreign equity in the air transport industry, and a moderate rental policy should be adopted by the State to preclude undue burden on the airports. The supply of seat and freight capacity must be realistic and consistent with demand, compelling a reduction in aircraft orders.

Despite the forecast of a substantial loss to the air transport industry in the five years ending in 2005,\textsuperscript{186} ICAO forecasted that scheduled passenger traffic will grow by 5.2 percent in 2006.\textsuperscript{187} This brings to bear the need for investment, to ensure that the necessary air transport services will be available to the public, while also making sure that overinvestment in aircraft capacity is avoided at all cost.

Investment in air transport will also have a beneficial effect on the robust synergy between aviation and tourism, particularly because of the overarching dependence by the tourism industry on aviation for the carriage of tourists to their destinations. The growing interdependence between the two industries has resulted in a significant increase in the combined contribution of aviation and tourism to the gross domestic product, generating employment and investment opportunities.

The World Bank has reported that a robust global investment climate is central to growth and poverty reduction. In this regard, the pre-eminent goal of governments should be to create opportunities for the private sector for investment, while simultaneously creating expansion and employment within the State sector. In other words, the goal should be to create a sound investment environment for everyone so that society as a whole will benefit.

\textsuperscript{185} Id.
\textsuperscript{187} Id.
Of course, this is easier said than done, as developing nations have their own internal concerns and pressing needs brought to bear by both social and natural factors. It calls for a certain symbiosis between the developed and developing world, as well as an enduring commitment from the international community to assist the developing world in three main areas: removing distortions in developed countries that harm the investment climates of developing countries, providing increased and effective assistance, and sharing knowledge and experience. These three areas of contribution from the international community have to be applied to the basic axiom that economic development requires adequate and effective transportation. Each country has a theoretically optimum amount of transport capacity. Transportation plays a multifaceted role in the pursuit of development objectives of a nation as well as the need to maintain international communication networks. Air transport enables goods and passengers to be transferred between and within production and consumption centres. Therefore, it could be argued that investment is vital to air transport.
Gaining Command & Control of the Northwest Passage: Strait Talk on Sovereignty

Christopher Mark Macneill*

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I. INTRODUCTION

The Arctic Ocean remains one of the last frontier regions on earth to be explored and exploited. However, due to global warming, technological advances, and declining stocks of global resources, increasing interest and activity in the Arctic is underway. This renewed interest in the Arctic has sparked a new vigor by Canada and the United States to promote their State interests in the region.

The fabled Northwest Passage (hereinafter “NWP”) runs through the Canadian territory known as the Arctic Archipelago, which is adjacent to the northern mainland Canadian coastline. It is the most direct, albeit seldom navigable, route for the United States to Alaska from its eastern population bases. Canada has historically claimed the constituent lands and waters of the NWP as its sovereign territory, whereas the United States has consistently referred to the NWP as an international strait to which they claim an unfettered right of passage of the freedom of the seas.

Canada, in contrast, has reactively grasped for every sovereign justification it can for establishing and maintaining arctic sovereignty. To support its claim, Canada cites its historic association through cession of its lands from the Indigenous people and the British Crown sovereign. Canada has also relied on the sector theory to lay claim to all the waters and lands within its sector to the North Pole. The country has most strongly relied on the setting of straight baselines around its arctic archipelago to assert that all constituent waters within the baselines are Canadian internal waters.

To ameliorate and respond to American demands for an undeterred right of passage, Canada has enacted environmental protectionist legislation for the arctic environment1 and, in 1988, entered into a landmark arctic agreement with the U.S.2 Under this agreement, the United States promises to notify Canada of any planned excursions by sea into the waters of the NWP. In return, Canada promises to grant blessings to all such endeavors as they are announced.

The ultimate problem involving the access and sovereignty rights to the Northwest Passage is one of ‘command and control.’ Namely, who should control the NWP and the important shipping access it allows to the Arctic Ocean? The United States, on one hand, sees the Canadian position as encroaching on the United States’ right of innocent passage3 and as violating the law of the sea as set out in the Corfu Channel case.4 Canada, on the other

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hand, believes that the waters of the NWP are internal to Canada based on equity concerns and particularly because of the uniqueness of the NWP archipelago. Canada also claims that there is insufficient shipping traffic history to satisfy the ‘functionality test’ as set out in the Corfu Channel case.

In response to the unannounced excursion of the Polar Sea through the NWP without prior Canadian approval, the Canadian government set out a course to embed its sovereignty in the region. Primarily, Canada looked to the Fisheries Case and the supporting archipelago principles for establishing extended straight baselines for including these island formations where the ecology is sensitive and vital needs are established. Canada has also attempted to influence the policy-making efforts of the UNCLOS, which had adopted Article 234 to allow for special state powers for ice-covered regions in order to protect the environment, health, and safety of these fragile regions.

II. STATEMENT OF CLAIM

This note explores the substantive merit of Canada’s position on its sovereignty claims over the Northwest Passage and the waters of the Arctic Archipelago. In particular, the issue is whether Canada’s claims are justified

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5. Id. at *28-29.
6. The Polar Sea is a U.S. Coast Guard heavy icebreaker, which circumnavigated the Northwest Passage in the summer of 1985. Whatever the motive - a challenge to Canada’s claim to the Northwest Passage or simply a quick and inexpensive way to get the Polar Sea from Greenland to Alaska - the U.S. government was careful not to make a request for permission to make the crossing and thereby imply in any way recognition of Canada’s claim to the strait. Instead, the United States made clear that the voyage was without prejudice to the legal position of the other side. J. M. Simard & T. Hockin, A Northern Dimension for Canada’s Foreign Policy, Independence and Internationalism: Report of the Special Joint Committee of the Senate and of the House of Commons on Canada’s International Relations (1986), available at http://www.carc.org/pubs/v14no4/6.htm. Ottawa, to save face, made a point of granting permission; it even asked to place several ‘observers’ on board the Polar Sea. See Michael Byers, The Need to Defend Our Northwest Passage, The Tyee, Jan. 30, 2006, http://thetyee.ca/Views/2006/01/30/DefendNorthwestPassage/. “Washington acceded to the request, strengthening Canada’s argument that the transit was consensual and even promised to provide advance notice of any future transits by its Coastguard vessels.” Id. “The voyage of the Polar Sea caused a rush of popular anxiety in Canada. Pressure built quickly, and on September 10, 1985, the government responded in a statement in the House of Commons by the Secretary of State for External Affairs. Mr. Clark announced a number of measures intended to strengthen Canada’s claim, including notification that Canada was drawing straight baselines around the arctic archipelago to delineate its claim, the removal of the 1970 reservation to the jurisdiction of the International Court of Justice, increased aerial surveillance, naval activities in Canada’s eastern arctic waters, and construction of a class 8 polar icebreaker. Taken together these measures have the potential significantly to strengthen Canada’s claim to sovereignty over the waters of the arctic archipelago.” J. M. Simard & T. Hockin, A Northern Dimension for Canada’s Foreign Policy, Independence and Internationalism: Report of the Special Joint Committee of the Senate and of the House of Commons on Canada’s International Relations (1986), available at http://www.carc.org/pubs/v14no4/6.htm.
8. UNCLOS, supra note 3, at art. 234.
and what legal premises support its position? In view of the claim of the United States to a right of innocent passage through an international strait, this note also attempts to identify potential alternatives for amicably resolving this dispute.

III. HISTORY OF THE NWP

The Northwest Passage is an ice-laded sea route linking the North Atlantic and North Pacific Oceans via the Canadian archipelago. This archipelago, also known as the Arctic Archipelago, is a group of 36,563 islands and contains ninety-four islands greater than 130 square kilometers, including three of the world’s largest islands.9 With the exception of Greenland, the Arctic Archipelago is the world’s largest high-arctic land area and extends some 2400 kilometers longitudinally and 1900 kilometers from the mainland of Canada to its northern most point on Ellesmere Island.10 It is bounded on the south by the Hudson Bay and the Canadian mainland; on the east by Greenland, Baffin Bay, and Davis Strait; on the north by the Arctic Ocean; and on the west by the Beaufort Sea. The various islands of the archipelago are separated from the mainland and from one another by a shallow myriad maze of narrow ice-blocked straits that are typically frozen throughout the year. To the north, these islands open into the frozen Arctic Sea.11

10. Id.
11. Id.
The NWP was alternatively known as the Strait of Anián, which was a sixteenth century Spanish name for a passage that was believed to connect the Pacific Ocean and the Atlantic Ocean in the temperate regions of North America. Such a strait does not in fact exist, but for centuries European explorers searched for such a route while at the same time attempting to find an eastern bound passage north of Russia such as a Northeast Passage.

12. Id.
In recent years, amidst global warming and rapid melting in the Arctic, many reports on the subject of the NWP have declared that the NWP may soon be a viable option for circumpolar shipping. Ice-free access to the NWP could shave five thousand miles off circumpolar sea voyages that otherwise would have to go through the Panama Canal to circumnavigate the Americas. However, these predictions need to be met with cautious optimism according to John Falkingham, Chief of Forecast Operations at the Canadian Ice Service. “Currently the Canadian Arctic’s shipping season, such as it is, lasts only about four to six weeks, and that’s not going to change anytime soon. We don’t expect the [NWP] to be free of ice for an extended period of the summer until much later in the century.” Peter Tyson, in a report on the future of the NWP, suggests that the summer shipping season will remain treacherous for even the most well-equipped icebreaking vessels and that the alternative Russian Northeast Passage (also known as the Northern Sea Route) is currently utilized and recognized as “a more straightforward path than the labyrinthine Canadian archipelago.” According to Tyson,

[R]ather than Canada’s thicket of islands, Russia’s route has just several straits for ships to pass through. And its summertime ice conditions are often better. The Northern Sea Route is already open up to eight weeks a year, with at least a million and half tons of shipping going through.

18. Id.
19. Id.
EXHIBIT 2: DECREASE IN THE EXTENT OF SEA-ICE

Similarly, experts also increasingly believe that a shipping route may become available in this century straight across the top of the northern hemisphere via a direct route through the thinning ice of the North Pole. As John Falkingham argues, “since the oldest and thickest ice in the Arctic Ocean is that which is driven against the western flank of the Canadian Archipelago . . . this will likely be the last multi-year ice to remain” in the Arctic.


“Despite the reported widespread thinning of Arctic ice, even the Swedish icebreaker Oden had trouble negotiating the Northwest Passage when it muscled through in mid-July 2005.” Source: Tyson, supra note 17.

With the summer seasonal melt and clearing of ice at the North Pole, it is now being asserted that the Arctic Polar Route (APR) straight over the North Pole alternatively represents a more navigable and ice manageable Arctic shipping route, which would shorten circumpolar shipping by 8000 miles versus 5000 miles saved by NWP and NEP.24

23. Tyson, supra note 17.
24. Id.
Presumably, if both the NEP and APR, currently and in the future, represent more viable routes for circumpolar navigation, then why does the marine industry and the governments of the United States and Canada seem so interested in the NWP? Essentially, as Bob Gorman notes,

[T]he marine industry is focused on the Arctic as a destination and not a short-cut between the Atlantic and the Pacific either now or in the next 10 to 20 years. Oil and gas activity is restricted to the on-shore MacKenzie Delta at the moment with plans by the Aboriginal Pipeline Group to build a gas pipeline to the delta during the next 10 years. Once the pipeline is in place offshore oil and gas activity in the Canadian Beaufort Sea will likely pick-up once again.

While the NWP dispute between the United States and Canada is a global issue

25. Id.
26. CONTEXTS - GEOGRAPHY - NORTHERN PASSAGE, http://www.english.upenn.edu/projects/knarf/contextspassage.html (“The 900-mile east-west water route runs from Baffin Island to the Beaufort Sea through a field of thousands of icebergs, and thence into the Pacific through the Bering Strait, which separates Siberia from Alaska.”).
27. Arctic Marine Transport Workshop, supra note 22, at 5.
in the context that it will affect the trading activity of many countries, it is however, essentially a bilateral issue between two neighboring Arctic nations, the United States (Alaska) and Canada.\(^\text{28}\)

Commercially, the importance of the passage lies in the future possibilities for its use. Up through the present, navigation of the [NWP] has been extremely limited, consisting mainly of research and Arctic area community re-supply vessels. However, technical advances [and global warming] could make the [NWP] a viable international commercial sea route by the end of this century. . . . The existence of vast amounts of oil and natural gas on Alaska’s North Slope and the Beaufort Sea will likely provide an impetus for international commercial usage of the [NWP].\(^\text{29}\)

IV. INTERNATIONAL STRAIT – THE UNITED STATES’ POSITION ON THE NWP

As the world’s largest trading nation, the United States has generally and consistently espoused the principle of the freedom of the seas.\(^\text{30}\) Whereas Canada, who’s territorial lands the frozen waterway zigzags through, has consistently claimed the NWP is sovereign to Canada. Until recently, the decades old dispute between the United States and Canada has been largely academic. But as global temperatures rise and polar ice caps melt, and as oil and gas commodity prices rise, the energy import dependant United States and the Canadian government have begun to envision the value and viability of the NWP as a control and access route to the abundant supply of under exploited natural resources of the Arctic. According to Robert Huebert, Associate Director of the Centre for Military and Strategic Studies at the University of Calgary, “[t]he heart of the dispute is the transit of international shipping, and who gets to set rules.”\(^\text{31}\) Canada considers the NWP as its internal waters and wishes to control and regulate emergent shipping traffic through this navigationally poor and environmentally risky zone located within its territorial lands.

\(^{28}\) ZORZETTO, supra note 13.

\(^{29}\) A. Perrin, Crashing Through the Ice: Legal Control of the Northwest Passage or Who Shall by ‘Emperor of the North’, 13 TUL. MAR. L.J. 139, 141 (1988).

\(^{30}\) Rebecca Dube, Tiff over Northwest Passage Heats up as Ice Melts, USA TODAY, Apr. 4, 2006 (“The United States generally supports maximum freedom of the seas. U.S. officials worry about what sort of precedent the Northwest Passage could set for international straits in global hot spots, such as the Strait of Hormuz near Iran and the Strait of Malacca between Malaysia and Indonesia.”); But see Norwegian Fisheries Case, supra note 7 (refuting this theory).

Gaining Command & Control of the Northwest Passage

V. MISSISSIPPI RIVER WATERWAY – A COMPARATIVE VIEW: AN INTERNAL WATERWAY OR INTERNATIONAL PASSAGE OF TRANSNATIONAL ORIGIN, WITH PASSAGE BETWEEN TWO MAJOR GULFS?

As a useful comparative analysis of the U.S. position on the NWP, an analogy can be drawn with the Mississippi River. The Mississippi River originates in Canada and is arguably part of an integrated waterway connected with the Great Lakes and the St. Lawrence River. The Mississippi River has the potential to provide a semi-navigable watercourse of passage from the St. Lawrence Bay and North Atlantic, to the Gulf of Mexico, if developed for improved navigation.

Jus Cogens, which is a Latin term representing fundamental international legal principles, suggests that ‘good neighborliness’ is paramount for harmonious international relations. This principle is the very root of the U.S. position that the NWP is an international strait. Presumably then, without invoking double standards and hypocrisy among nearest neighbors, the same theory would suggest that if the United States is justified in exclusive control and access to the Mississippi River as an internal waterway for their exclusive use, then ‘what is good for the goose should also be good for the gander.’ As such, if the United States considers the great Mississippi River as internal waters, despite its international dimensions of origin and shipping potential between two distinct and distant Gulfs, then so too on similar grounds it can be reasonably argued that the NWP is a Canadian internal waterway despite exogenous notions of freedom of the seas under the United Nations Convention of the Law of the Sea. In essence, if as a good neighbor Canada, Mexico, and other nations who would stand to benefit from shorter shipping routes to internal American markets (or other proximate markets) accept or acquiesce with the notion that the Mississippi River is an internal U.S. waterway, then on the same principal, the United States should cooperate with Canada in recognizing the uniqueness of the NWP and its sovereignty within the baselines of the Canadian Arctic Archipelago.

VI. GLOBAL INTERESTS IN THE NWP DISPUTE

Not entirely unlike the potential community of interest for Canada, Mexico, and other nations’ freedom to use the Mississippi River system as discussed above, I see the NWP as a dispute where all countries involved (neighboring Arctic nations of Greenland, Denmark, Norway, Russia, Iceland, and others) have significant economic and legal interests at stake. Furthermore, beyond trade development and efficiencies, and besides the importance of the immense hydrocarbon reserves in the Canadian Arctic (especially in the context of increasing political instability in the Middle

32. Dube, supra note 30.
East), the central proximity of the Canadian Arctic Archipelago to the [former] Soviet Union and the United States makes this an area of vital strategic interest. Indeed, the shortest distance between the two super powers is across the Arctic Circle.\(^{33}\)

While the European Union, led by the influence of the United Kingdom, in recognizing its economic interest has supported\(^{34}\) the United States position that the NWP is an international strait\(^{35}\) (although the support is qualified in the context of environmental concerns), Russia (Former Soviet Union - FSU) has in contrast expressed its support for Canada’s claim of complete control over the passage.\(^{36}\) The FSU’s position may have seemed surprising at the time in view of their strategic interest during the cold war in using the NWP for nuclear submarine defense, security, and potential warfare. However, of a kindred sovereign character, the NEP similarly links the Atlantic and Pacific, and is located in the Russian Arctic. The FSU has claimed this passage through the Arctic by enacting legislation establishing ‘straight baseline’ boundaries around the waters, and classifying them as internal waters subject to complete [Russian] control. Thus, the [FSU] has an interest in establishing complete legal sovereignty over the [NEP] through the Arctic waters which is identical\(^{37}\) to Canada’s interest in establishing sovereignty over the [NWP] through the Arctic.\(^{38}\)

This position by Russia seems broadly accepted as international commercial shipping through the NEP has been compliant with Russian statutory regulations and guidelines, which include both fees and supervision through the route.

The United States as the sole remaining world super power has to approach this dispute delicately as it has in contemporary years garnered a reputation internationally for taking what is in its best interest e.g. oil fields in Iraq and the Middle East. According to Bob Huebert, the best solution to the dispute would be to “negotiate a joint management scheme for the Beaufort Sea without necessarily saying that one side was right and the other wrong.”\(^{39}\)

35. Presumably every nation that wants to potentially use the NWP for international shipping and prospective resource access and/or exploration will skew their expressed interpretation and application of international law to promote their own national and/or regional domestic needs and economic growth.
37. The NEP is comprised of only a few straits and a small number of scattered islands over an otherwise open northern Russian Arctic coastline and sea, versus the extensive ice laden island waterway archipelago network of the Canadian Arctic.
Due to the high need for North American security measures in the wake of 9/11, and the Bush led war on terror across the world, it is obviously beneficial socio-politically, environmentally, and fiscally efficient for Canada to patrol and supervise the NWP. Effectively this also would ensure that the ecologically fragile arctic waterway will not be open to all and any global users. Whereas the United States can without an inherent right of innocent passage or freedom of seas transit, confidently rely on the 1988 Arctic Agreement signed by both nations and the North American Free Trade Agreement to ensure its continued use and access of the NWP route through Canadian territory.

EXHIBIT 5: ARTIC OCEAN MARINE ROUTES

Furthermore, in recommending U.S. acquiescence that NWP is Canadian internal waters, the United States would exclusively qualify as a neighboring

40. Arctic Marine Transport Workshop, supra note 22.
land-locked state with a right of “traffic in transit” as a transit state under UNCLOS Article 124 (1)(b).\(^{41}\) UNCLOS Article 124 (1)(b) provides a neighboring land-locked state is a state “with or without a sea coast, situated between a land-locked State and the sea, through whose territory traffic in transit passes.”\(^{42}\) For example, Alaska is effectively land-locked from convenient and effective land based access to the continental U.S. and, therefore, stands to benefit from transit passes through the Canadian Arctic coastline.

Practically, the legal consequences of water course classification differ significantly according to whether the NWP is deemed an international strait as the United States claims, or as Canada claims, an internal waters or a territorial sea strait. As one commentator has noted:

If [the NWP] is considered an international strait, then the more liberal right of ‘transit passage’ would exist for foreign vessels transiting through the waters of the Passage, as envisaged by the 1982 Convention on the Law of the Sea. . . . Nevertheless, even if the transit passage regime lacked prerequisites to enable it to be considered binding under international law, the legal regime of non-suspensive innocent passage would exist, as enunciated in the 1958 Geneva Convention. However, if the [NWP] is considered to be merely a territorial seas strait, which is not used for international navigation, then the narrower right of suspensive-innocent passage would apply to foreign vessels transiting through its waters, as enunciated in both the 1958 and the 1982 conventions (significantly, this right does not allow a foreign vessel to travel in a submerged state), although the latter convention appears to limit the situations where a littoral state may suspend such innocent passage.\(^{43}\)

Ultimately, the distinction between international straits, territorial seas, and internal waters is an important one, as the classification triggers the interpretation of the applicable laws of the sea as set out in UNCLOS.

Internal waters are viewed as part of a state’s land domain and are thus subject to the complete sovereignty of the coastal state. In the territorial waters of a coastal state (waters seaward of the baseline), foreign states have the right of innocent passage. Under both multilateral maritime conventions, when waters not previously considered to be internal are subsequently enclosed by baselines, the same right of innocent passage exists for foreign states. If the waters are classified as an international strait, a coastal state’s powers are restricted to an even greater degree. The right of passage through an international strait is not suspendable by the coastal state. The rights of passage through international straits also include the right of overflight by aircraft, and the right of submarines to traverse in a submerged mode.\(^{44}\)

In arguing the NWP is an international strait, the U.S. has relied primarily

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41. UNCLOS, supra note 3, at art. 124.
42. Id. at art. 124(b).
43. Kettunen, supra note 33, at 977.
44. Perrin, supra note 29, at 155-156.
on the criteria established in the *Corfu Channel* case. The test applied for determining if a body of water is considered an international strait consists of two elements: (a) a geographic test and (b) a functional (or use) test.\(^{45}\) In the first instance, the NWP clearly meets the geographic test; it is indeed a body of water joining two oceans or two areas of high seas.\(^{46}\) Similarly, applying this definition literally to the Mississippi River it could arguably be identified as a body or course of navigable water that joins two areas of high seas (as a conduit watercourse of the Great Lakes/St. Lawrence river system emanating at the Gulf of St. Lawrence in the North Atlantic, with a nexus to the Gulf of Mexico). Regardless of the potential for international transit between the Gulf of St. Lawrence and Gulf of Mexico, the United States understandably prefers to recognize the Mississippi as internal waters for its sovereign control and security purposes. And whereas the navigability of Mississippi River in its full length from the Great Lakes to the Gulf of Mexico is impractically questionable, it as such fails the functionality test. Likewise, the NWP does not meet the functionality test due to adverse navigability, as the shipping traffic historically has been minimal (and almost exclusively Canadian or with Canadian permission and supervision). No established route among uncertain branch routes exists, and the traffic is subject to seasonality and advanced ice breaking technology (see Exhibits 12 and 13).\(^{47}\) As such, and from a functional perspective, the NWP does not have an established international usage. The natural geography encompassing diverse networks of shallow and ice laden passages with adverse weather do not lend to ready navigability. Thus, it is not an international strait because there is no established viable use as an international strait.

Whether we are hypothetically speaking of the Mississippi River or of the NWP and their navigational potential to serve as international waterways, the fact that a body of water could potentially be used for navigation does not necessarily constitute it an international waterway.\(^{48}\) The voyage of the Polar Sea is the only known transit of the NWP undertaken without consent of the Canadian government, and the U.S. government made it clear to the Canadian government that, in taking the expeditious short cut through the NWP, it did not regard the voyage as establishing a precedent that would challenge the Canadian claim of sovereignty over the NWP waters.\(^{49}\) In response, the Canadian government formally sanctioned the Polar Sea’s voyage. Moreover,
the subsequent 1988 Arctic Cooperation Agreement, signed between the United States and Canada, suggests there will be no more Polar Sea voyages—that is, no more American navy icebreakers transiting the NWP without Canadian consent.\footnote{Arctic Cooperation Agreement cite Agreement on Arctic Cooperation and Exchange of Notes Concerning Transit of Northwest Passage, U.S.-Can., Jan. 11, 1988, 28 I.L.M 141, 143.} So, even if the Polar Sea was a precedent, it is no more than an isolated, single instance. Thus, the conclusion remains: the NWP is not a strait that is “used for international navigation” and hence cannot constitute in law an international strait.\footnote{McRae, supra note 45, at 435.}

Whereas Alaska is not a land-locked state and has a coastline on the Pacific Ocean, Bering Sea, and Beaufort Sea, there are numerous non-coastal U.S. states that have only land-locked based access to their fellow state of Alaska. For instance, Vermont, which is a long distance from both the Alaskan highway and pipeline, will greatly benefit from an Atlantic seaboard access to the North Atlantic and the NWP for expedient commercial shipment of trade goods between Alaska and the New England region via its neighboring New England states. Similarly New York and the South Eastern U.S. seaboard would also greatly benefit from efficient access to the prospective energy and mineral resources in Alaska, the Beaufort Sea, and the broader Arctic region in general.

Generally, it would be in the best interest of the U.S. for the sake of good relations with Canada, Canadian sovereignty, North American sovereignty, security, environmental, and trade purposes to establish a co-operative strategic Arctic framework which would effectively provide the U.S. with exclusive transit access for shipping and a right of innocent passage, but would exclude other nations doing so without express permission, because they would be unable to qualify as either a riparian or affected land-locked state status. Furthermore, under UNCLOS Part VIII & IX:

The terms and modalities for exercising freedom of transit shall be agreed between the land-locked States and transit States concerned through bilateral, subregional or regional agreements. Transit States, in the exercise of their full sovereignty over their territory, shall have the right to take all measures necessary to ensure that the rights and facilities provided for in this Part for land-locked States shall in no way infringe their legitimate interests.\footnote{LAKSHMAN GURUSWAMY ET AL, SUPPLEMENT OF BASIC DOCUMENTS TO INTERNATIONAL ENVIRONMENTAL LAW AND WORLD ORDER 776-778 (2d ed. Supp. 1999).}

This essentially means that the U.S. and Canada are obliged to arrive at a bilateral agreement providing a right of transit to the U.S. through the NWP, which by its nature and application, does not infringe on Canada’s sovereign interests in the NWP.
VII. THE CANADIAN POSITION ON THE NWP – INTERNAL CANADIAN WATERS

The position of the Canadian Government with respect to the NWP is oxymoronically both firm and soft. In the first instance, Canada has consistently claimed sovereignty over the NWP and, in contemporary years, has taken to strategically referring to the waters as Canadian internal waters. In 1986, after having signed the 1982 UNCLOS in a reaction to challenges by the U.S. to its sovereignty over the NWP, Canada declared straight baselines premised on the outer shores of its arctic archipelago, to which the U.S. protested.53

In contrast, while Canada has at least been firmly consistent in defense of their claim to sovereignty of the NWP, it has in fact by its own conciliatory nature, arguably eroded the Canadian projection of sovereignty. This occurred through declarations that while Canada considers the waters of the NWP internal, they also support international shipping through the passage, provided Canadian regulations are followed.54 Albeit gracious diplomacy, the implicit legal intent is an offer to accommodate the U.S. right of transit through the NWP on Canada’s terms with the belief that the U.S. really does not want an international channel, which would be an additional threat to their security and would erode their comparative shipping advantage in the area.

Canada’s claim to sovereignty over the waters of the Arctic Archipelago55 stands or falls on whether the drawing of straight baselines enclosing the waters as internal waters can be justified in law, and on whether the waters of the NWP constitute an international strait. The argument supporting the use of “straight baselines” in the context of the Arctic Archipelago derives from the decision of the International Court of Justice (ICJ) in the 1951 Norwegian Fisheries Case.56 Professor Donald Pharand maintains that “the preponderant view of legal authorities is that the waters of the Canadian Arctic Archipelago are properly enclosed by straight baselines and are the internal waters of Canada.”57

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53. “The weakness of this argument lies in the timing of the Canadian declaration. Canada implemented straight baselines around the Arctic on January 1, 1986. However, in 1982, it had signed the [UNCLOS], in which article 8(2) states that a State cannot close an international strait by declaring straight baselines.” Rob Heubert, Climate Change and Canadian Sovereignty in the Northwest Passage, CAN. J. POL’Y RES. 2, no. 4, 2001, available at http://www.isuma.net/v02n04/huebert/huebert_e.shtml. Although the likely Canadian counter argument to this is that the NWP fails the Corfu Channel test for functionality as there has been no established historical use of the passage as an international strait prior to establishing the baselines. Furthermore, reference can be made to the Norwegian Fisheries case where similar baselines declared by Norway around their coastal archipelago was recognized by the ICJ.

54. Heubert, supra note 53.

55. The Archipelago concept in international law was established under part IV (Articles 46-54) of UNCLOS 1982. See UNCLOS, supra note 3, at pt. IV.

56. Norwegian Fisheries Case, supra note 7.

57. McRae, supra note 45, at 434.
Norwegian *skjaergaard* writ large.\textsuperscript{58} Professor Donald McRae also points out that the geographic nexus between the Canadian mainland, its arctic archipelago, and the archipelago islands themselves; the use of the frozen waters by Canadian Inuit for land premised passage and their dependence on the whole of the archipelago (interrelationship between the land, ice, and water of the area for indigenous people);\textsuperscript{59} and the uncertainty of “the highly irregular and indented nature of the coastline and islands lead to the conclusion that this is almost a classic case for departure from the low-water line rule.”\textsuperscript{60}

In the 1951 *Norwegian Fisheries Case*, the issue before the ICJ concerned the west coast of Norway, a coastline similar to the Canadian Arctic coastline. It is cut into by fjords and a series of many small coastal islands (known as “skjaergaard”). In the ICJ’s decision, instead of following the rule of low-water line, which would follow the mainland coastline, straight baselines were allowed to be drawn seaward from the mainland to the island coasts and from island coast to island coast. The effect was a linkage of baselines drawn along the outer shores of the coastal islands that linked on each end to the mainland, enclosing significant areas of water between the islands and between the islands and mainland. Effectively, by the ICJ allowing these baselines to be drawn along the outer shores of the skjaergaard, it provided that the waters behind them would be ‘internal waters.’\textsuperscript{61}

\textsuperscript{58} *Id.* at 433.

\textsuperscript{59} As the result of a 1951 decision by the International Court of Justice, straight baselines became a legally accepted means for determining the extent of coastal state control along fragmented coastlines, or “coastal archipelagos.” See *Norwegian Fisheries Case*, supra note 8, at 131. Canada has also invoked its prior argument of historic internal waters in support of its straight baselines claim, arguing that its title to the waters within the baselines—which by definition are internal waters—was consolidated by historic usage. The historic usage argument was reinforced in 1993 by the Nunavut Land Claims Agreement, whereby the Canadian government and Inuit affirmed that “Canada’s sovereignty over the waters of the arctic archipelago is supported by Inuit use and occupancy.” Nunavut Land Claims Agreement Act, 1993 S.C., Art. 15.1.1(c) (Can.).

\textsuperscript{60} McRae, *supra* note 45, at 433.

\textsuperscript{61} *Id.* at 432.
As previously noted, a paradox results when straight baselines are applied enclosing waters as inland waters where an existing strait used for international navigation exists.

In such straits, vessels have a right of passage equivalent to the right of innocent passage in the territorial sea or, where the regime of ‘transit passage’ applies, a right even greater than that of innocent passage. Although the extent of use necessary to constitute a strait as ‘international’ is a matter of controversy, there must be some evidence that foreign shipping does in fact use the route for navigation.

Inherently, Canada’s claim of sovereignty over the waters of the NWP is

63. McRae, supra note 45, at 429.
supported by the fact there is no established history of international shipping through the NWP and, as a result, it fails the functionality test of an ‘international strait.’ This, by default, implies that Canada’s application of straight baselines in 1986 will adhere to international legal scrutiny as there are no grounds to recognize a pre-existing international shipping use of the waterway.

Further in support of Canada’s straight baseline application to the outer shores of its arctic archipelago, and in addition to citing the Norwegian Fisheries Case, it is useful to note that there are an abundance of other nations who have similarly applied straight baselines out from their mainland coastline and along their coastal islands, effectively enclosing adjoining seas behind the baselines. For instance, in Exhibit 7 below, note the extension of straight baselines by the United Kingdom to outer coastlines of the Outer and Inner Hebrides of the Western Isles,64 which effectively enclosed the Hebridean Sea and the Sea of Minch within national boundaries, albeit a navigational short cut historically used by many maritime nations for circumnavigating the British Isles.

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Two other legal premises for Canada’s claim of sovereignty over the waters of the Canadian Arctic Archipelago are historic title and the ‘sector theory.’


66. McRae, supra note 45, at 430.
argument implicit in its sovereignty claim to the NWP, as the United States does not seem to have issues with Canada’s land based claims to the Arctic Archipelago. However, U.S. dissention arises from Canada’s claim to sovereignty of the associated waterway. Furthermore, I suspect that historical claims often prove difficult to argue when it comes to proving that other states have recognized or acquiesced in any claim to historic title by Canada to all the waters of its arctic archipelago. Although, the time immemorial presence of the Inuit people, indigenous to Canada on these lands and ice fields, is a strong inherent supporting historical element to Canada’s (or its Inuit peoples’) claim to the waters of the NWP.

An earlier tenet which Canada has also employed in its claim of sovereignty over its adjoining arctic and polar region is the sector theory. “According to the sector theory, polar states are entitled to exercise sovereignty between their mainland territory and the North Pole in an area of longitude running from their east and west coasts to the Pole.” This theory is associated with the famous resolution asserting Canadian sovereignty up to the North Pole, introduced into the Canadian Senate in 1907 by Senator Poirier.

Canada may also assert its claim for sovereignty on the principle of acquired title (cession from a sovereign); equity with respect to Canada’s distinct interest in using the NWP for national security, protection of the environment, and Inuit people and culture; or finally, as in the Norwegian and Iceland Fisheries cases, Canada may assert that the archipelago waters are vital to traditional Inuit community for hunting and fishing to sustain their needs.

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67. “The historic consolidation argument is also supported by judgments of international courts. In 1975, in a dispute between Spain and Morocco over the Western Sahara, the International Court of Justice held that the historic presence of nomadic peoples can help to establish sovereignty. And in 1933, in a dispute between Norway and Denmark over Eastern Greenland, the predecessor to the International Court of Justice, the Permanent Court of International Justice, held that the degree of presence necessary to establish title over territory is lower in inhospitable regions than in more temperate climes.” Michael Byers, The Need to Defend Our Northwest Passage, THE TYEE, Jan. 30, 2006, http://thetyee.ca/Views/2006/01/30/DefendNorthwestPassage/.

68. McRae, supra note 45, at 430.

69. Fisheries Jurisdiction Case (U.K. v. Icle), 1974 I.C.J. 3 (July 25) (finding that the Icelandic Regulations of 1972, which established a zone of exclusive fisheries jurisdiction extending to 50 nautical miles from baselines around the coast of Iceland, were not opposable to the United Kingdom).

70. Perrin, supra note 29 at 148-49.
“[T]he fact of the existence of the coastal state is the backbone of all legal regimes in the law of the sea where the state exercises some degree of legal power based on its territory.”\textsuperscript{72} This notion provides the basis for delimitation of different legal regimes for the marine and submarine areas, with their respective disparate statuses. While the coastal state possesses a certain degree of legal power over the marine and submarine areas situated relatively close to its coast (the internal waters, the territorial sea, the contiguous zone, the exclusive economic zone and the continental shelf), such legal power is not recognized by the law of the sea rules for the marine and submarine areas situated relatively distant from its coast (the high seas, the seabed outside the limits of national jurisdiction).\textsuperscript{73}

\textsuperscript{71} Arctic Marine Transport Workshop, \textit{supra} at note 22, at 7.
\textsuperscript{72} LAKSHMAN D. GURUSWAMY ET AL., \textit{INTERNATIONAL ENVIRONMENTAL LAW AND WORLD ORDER: A PROBLEM ORIENTED CASEBOOK} 415 (2d ed. 1999).
\textsuperscript{73} Id.
Furthermore, Section 603 (State Responsibility for Marine Pollution) of the Restatement (Third) of the Foreign Relations Law of the United States, as adopted by the American Law Institute, provides that,

A coastal state also has the right to adopt and enforce nondiscriminatory laws and regulations for the prevention, reduction, and control of marine pollution from vessels in ice-covered areas within the limits of its exclusive economic zone, where particularly severe climatic conditions and the presence of ice for most of the year create obstructions or exceptional hazards to navigation, and where pollution of the marine environment could cause major harm to, or irreversible disturbances of, the ecological balance. The coastal state is obligated to base such laws and regulations on the best available scientific evidence and to have due regard to navigation. Article 234.

Author Guruswamy, referencing Article 19(2)(h), 21(1)(f), 27, and 220(2) of the United Nations Convention on the Law of the Sea, also states that,

Where there are clear grounds for believing that a foreign ship, while passing through the territorial sea of the coastal state, violated laws and regulations of that state adopted in accordance with applicable international rules and standards, the coastal state may, subject to certain procedural safeguards (see Article 226), undertake physical inspection of the vessel in the territorial sea in order to ascertain the facts relating to the violation. Where evidence so warrants, the coastal state may institute proceedings against the ship, in accordance with its

74. Arctic Marine Transport Workshop, supra at note 22, at 5.
75. See also UNCLOS, supra note 3, at pt. XII.
76. GURUSWAMY, SUPPLEMENT OF BASIC DOCUMENTS, supra note 52 at 145.
laws, and may detain the ship pending such proceedings.\footnote{See UNCLOS, supra note 3.}

Alicia Zorzetto, in her American University Ice Case Study on \textit{Canadian Sovereignty at the Northwest Passage}, provides in her conflict environment scan that “the conflict should not be considered a ‘yield’ or ‘stalemate’ because it is unique. This issue may be in the midst of being amicably resolved. Therefore, it is too early in this situation to determine an outcome.”\footnote{Alicia Zorzetto, supra at note 13.} For a synoptic overview of the dynamics of the US-Canada NWP dispute, note Exhibit 10 below. The problem identification in the NWP conflict is described as having its core origin rooted with “Warming in the Polar Region.”

\textbf{EXHIBIT 10: US/CANADA NWP CONFLICT ENVIRONMENT\footnote{Id.}}

This exhibit, interestingly enough, shows that global warming and environmental changes can have extensive geo-political effects, such as changing water and ice dynamics placing new pressures on demands for new international shipping routes, sovereignty claims, environmental concerns and resource control.

\footnote{\footnotetext{77. See UNCLOS, supra note 3.} \footnotetext{78. ALICIA ZORZETTO, supra at note 13.} \footnotetext{79. Id.}}
VIII. CONCLUSION

The NWP is a strategic route from the Atlantic Ocean to the Pacific Ocean through a myriad of northern Canadian Arctic Archipelago islands. The NWP was not traditionally a commercially viable trading route due to shallow waters and, in particular, ice blockades. Global warming has now altered this reality! Because of climate change, the Canadian government is experiencing new challenges from multiple national governments, especially the United States, concerning the feasibility of international transit through the NWP.

The Canadian perspective is that they have full sovereignty encompassing the islands/waterways and thereby will assert complete control over all activity in that specific region. However, many countries perceive the NWP to be an international waterway between the Atlantic and Pacific Oceans. In response, the Canadian government has continually stated that it does support international shipping through the NWP, as long as Canadian awareness and regulations, within the guidelines of international law, are followed.

International law under the United Nations requires that disputing nations seek in the first instance to cooperatively resolve their differences. In fact, the United Nations International Court of Justice has no general jurisdiction to hear applications from complainant states submitted unilaterally, with few exceptions. Furthermore, “states often do not want to risk losing a case when the stakes are high or be troubled with litigation in minor matters.”

Given the changing environment and the obvious elevating interest in the NWP, a more vigorous search for resolution palatable for both the United States and Canada is required. Primary to the U.S. claim is the fundamental law of the sea espousing “freedom of the sea,” and the right of innocent passage through international waters and territorial seas. Primary to the Canadian claim is its desire to prevent diminution of sovereignty over its arctic. In customary international law, the U.S. claim is supported by the Corfu Channel case and the Canadian claim is founded on the I.C.J.’s decision in the Norwegian Fisheries Case (straight baseline use by numerous other States with coastal archipelago’s, such as the United Kingdom’s extension of baselines to the outer shores of the Outer Hebrides of its Western Isles off the Sea of Minch).

The arguments in favor and contra for both the U.S. and Canadian positions are numerous and the law is inconclusive. Although the author favors the Canadian legal argument, he recognizes that in the end, even if Canada were to have the NWP recognized as its internal waterway, there would still remain a very basic obligation of good neighborliness to allow passage on a non-discriminatory basis when and where navigation could be executed with due care and sensitivity for the region. Alternatively, if a hard line were to be drawn, it would be readily noted that the alternative NEP and Polar Route remain logistically viable routes. Those routes could be used, consistent with the concept of equity where the practice is one of what a reasonable prudent person would do, except that exclusionary provisions are indeed acceptable where the situation merits and alternative options are comparatively more favorable.

I believe that the most contentious issue that Canada has with the U.S. position is that, although the U.S. has declared they recognize Canada’s ownership of the maze of islands through which the NWP flows, as a sovereign nation, they feel violated when the U.S. does not feel compelled to seek consent, or at least to give notice that they will be passing through Canadian territory. It has been readily seen throughout history that one

82. Id.
person’s liberties can be another’s intrusions. As ‘self’ and ‘mutually’ respecting nations, Canada and the United States must begin to earnestly work together toward building a strategic approach to resolving the NWP dispute which synergistically may be broadened to include a framework for a joint plan dealing with not only passage to and through the NWP, but as well the ongoing management and protection needs for the area.

EXHIBIT 12: MARINE TRAFFIC IN THE CANADIAN ARCTIC
JUNE – NOVEMBER 2004

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Canadian Government Vessels</strong></td>
<td>8</td>
</tr>
<tr>
<td><strong>Commercial Traffic</strong></td>
<td></td>
</tr>
<tr>
<td>Canadian Vessel Voyages</td>
<td>62</td>
</tr>
<tr>
<td>Foreign Vessel Voyages</td>
<td>18</td>
</tr>
<tr>
<td>(14 to Churchill)</td>
<td></td>
</tr>
<tr>
<td>Foreign Cruise Ships</td>
<td>7</td>
</tr>
<tr>
<td>Foreign Research Vessels</td>
<td>2</td>
</tr>
<tr>
<td>Foreign Pleasure Craft</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total = 94</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Northwest Passage Transits</strong></td>
<td>5</td>
</tr>
<tr>
<td>Canadian Coast Guard</td>
<td>2</td>
</tr>
<tr>
<td>Canadian Commercial Vessels</td>
<td>0</td>
</tr>
<tr>
<td>Foreign Cargo Vessels</td>
<td>0</td>
</tr>
<tr>
<td>Foreign Cruise Ships</td>
<td>1</td>
</tr>
<tr>
<td>Foreign Pleasure Craft</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total = 5</strong></td>
<td></td>
</tr>
</tbody>
</table>

\[ \sum \text{Total Voyages} = 107 \]

Note: Listing prepared from responses to the Canadian Coast Guard voluntary reporting system.

Source: Canadian Coast Guard

2007]  

**Gaining Command & Control of the Northwest Passage**

EXHIBIT 13: TRANSITS OF THE NORTHWEST PASSAGE

Seven routes have been used for transits of the Northwest Passage between the Atlantic Ocean (Labrador Sea) and Pacific Ocean (Bering Sea) or in the opposite direction. Several minor variations have also been used (for example through Pond Inlet and Navy Board Inlet, Jones Sound, etc.). These routes are:

**Route 1:** Labrador Sea, Davis Strait, Lancaster Sound, Barrow Strait, Viscount Melville Sound, McClure Strait, Beaufort Sea, Chukchi Sea, Bering Strait, Bering Sea.

The shortest and deepest, but most difficult way owing to the severe ice of McClure Strait; the route could be used by submarines because of its depth.

**Route 2:** Labrador Sea, Davis Strait, Lancaster Sound, Barrow Strait, Viscount Melville Sound, Prince of Wales Strait, Amundsen Gulf, Beaufort Sea, Chukchi Sea, Bering Strait, Bering Sea.

An easier variant of route 1 which may avoid severe ice in McClure Strait, suitable for deep draft vessels.

**Route 3:** Labrador Sea, Davis Strait, Lancaster Sound, Barrow Strait, Peel Sound, Franklin Strait, Victoria Strait, Coronation Gulf, Amundsen Gulf, Beaufort Sea, Chukchi Sea, Bering Strait, Bering Sea.

This is route used by most vessels of draft less than 10 m.

**Route 4:** Labrador Sea, Davis Strait, Lancaster Sound, Barrow Strait, Peel Sound, Rae Strait, Simpson Strait, Coronation Gulf, Amundsen Gulf, Beaufort Sea, Chukchi Sea, Bering Strait, Bering Sea.

A variant of route 3 for small vessels if ice from McClintock Channel has blocked Victoria Strait; Simpson Strait is only 6.4 m deep and has difficult currents.

**Route 5:** Labrador Sea, Davis Strait, Lancaster Sound, Prince Regent Inlet, Bellot Strait, Franklin Strait, Victoria Strait, Coronation Gulf, Amundsen Gulf, Beaufort Sea, Chukchi Sea, Bering Strait, Bering Sea.

This route is dependent on ice conditions in Bellot Strait which has difficult currents, mainly used by eastbound vessels.

**Route 6:** Labrador Sea, Davis Strait, Lancaster Sound, Prince Regent Inlet, Bellot Strait, Rae Strait, Simpson Strait, Coronation Gulf, Amundsen Gulf, Beaufort Sea, Chukchi Sea, Bering Strait, Bering Sea.

A variant of route 5 for small vessels if ice from McClintock Channel has blocked Victoria Strait, Simpson Strait is only 6.4 m deep, difficult currents run in Bellot and Simpson Straits.

**Route 7:** Labrador Sea, Hudson Strait, Foxe Basin, Fury and Hecla Strait, Bellot Strait, Franklin Strait, Victoria Strait, Coronation Gulf, Amundsen Gulf, Beaufort Sea, Chukchi Sea, Bering Strait, Bering Sea.

A difficult route owing to severe ice usually at the west of Fury and Hecla Strait and the currents of Bellot Strait. Transits of the Northwest Passage (continued)

Until the 2004-05, winter 99 complete transits of the Northwest Passage (Atlantic to Pacific waters or vice versa) have been made. Including these are 175 partial transits recorded through waters of the Canadian Arctic Archipelago. An analysis of these routes shows:

**Complete transits of the Northwest Passage**

<table>
<thead>
<tr>
<th>Route</th>
<th>west</th>
<th>east</th>
<th>total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Route 1</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Route 2</td>
<td>7</td>
<td>3</td>
<td>10</td>
</tr>
<tr>
<td>Route 3</td>
<td>16</td>
<td>29</td>
<td>45</td>
</tr>
<tr>
<td>Route 4</td>
<td>6</td>
<td>5</td>
<td>11</td>
</tr>
<tr>
<td>Route 5</td>
<td>4</td>
<td>10</td>
<td>14</td>
</tr>
<tr>
<td>Route 6</td>
<td>3</td>
<td>10</td>
<td>13</td>
</tr>
<tr>
<td>Route 7</td>
<td>0</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>All Routes</td>
<td>37</td>
<td>62</td>
<td>99</td>
</tr>
</tbody>
</table>

**Partial transits through the Canadian Arctic Archipelago**

<table>
<thead>
<tr>
<th>Route</th>
<th>west</th>
<th>east</th>
<th>total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Route 1</td>
<td>2</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Route 2</td>
<td>10</td>
<td>6</td>
<td>16</td>
</tr>
<tr>
<td>Route 3</td>
<td>50</td>
<td>58</td>
<td>108</td>
</tr>
<tr>
<td>Route 4</td>
<td>6</td>
<td>6</td>
<td>12</td>
</tr>
<tr>
<td>Route 5</td>
<td>5</td>
<td>12</td>
<td>17</td>
</tr>
<tr>
<td>Route 6</td>
<td>3</td>
<td>10</td>
<td>13</td>
</tr>
<tr>
<td>Route 7</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>All Routes</td>
<td>77</td>
<td>98</td>
<td>175</td>
</tr>
</tbody>
</table>

Source: Robert Heslewood, Scott Polar Research Institute, United Kingdom

84. *Id.* at A-20-25.
58

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TRANSITS OF THE NORTHWEST PASSAGE CONT.

The following 99 voyages, by 67 vessels, carrying 17 different flags, have made complete transits of the Northwest Passage to September 2004. These transits proceeded to or from the Atlantic Ocean (Labrador Sea) in or out of the eastern approaches of the Canadian Arctic archipelago (Lancaster Sound or Foxe Basin), then the western approaches (McClure Strait or Amundsen Gulf), across the Beaufort Sea and Chukchi Sea of the Arctic Ocean, from or to the Pacific Ocean (Bering Sea). The seven routes which have been used are indicated, with any significant variations listed. Some voyages are discontinuous because the complement left the vessel during a winter. Details of submarine transits are not included because only two of them (USS Seadragon in 1960 and USS Skate in 1962) have been reported and they do not navigate through ice.

<table>
<thead>
<tr>
<th>Year</th>
<th>Vessel</th>
<th>Registry</th>
<th>Master</th>
<th>Route</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1903-06</td>
<td>Qajaq (21 m auxiliary sloop)</td>
<td>Norway</td>
<td>Roald E. G. Amundsen</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Wintem twice in Qajaq Haven and once off King Point</td>
</tr>
<tr>
<td>2</td>
<td>1948-42</td>
<td>St Roch (29.7 m Coastal Command ship)</td>
<td>Canada</td>
<td>Henry Ashjorn Larsen</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Wintem at Walker Bay and Peary Bay, traversed Pond Inlet</td>
</tr>
<tr>
<td>3</td>
<td>1944</td>
<td>St Roch (ROMP auxiliary schooner)</td>
<td>Canada</td>
<td>Henry Ashjorn Larsen</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Return voyage, first transit in one season, traversed Pond Inlet</td>
</tr>
<tr>
<td>4</td>
<td>1952</td>
<td>HMCS Labrador (icebreaker)</td>
<td>Canada</td>
<td>Owen Corson S. Robertson</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>First continuous circumnavigation of North America</td>
</tr>
<tr>
<td>5</td>
<td>1957</td>
<td>USCGC Storis (icebreaker)</td>
<td>United States</td>
<td>Harold L. Wood</td>
</tr>
<tr>
<td>6</td>
<td>1957</td>
<td>USCGC Bramble (buoy tender)</td>
<td>United States</td>
<td>H. H. Carter</td>
</tr>
<tr>
<td>7</td>
<td>1957</td>
<td>USCGC Spar (buoy tender)</td>
<td>United States</td>
<td>C. V. Crewing</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>USCGC Storis escorted convoy with Bramble and Spar</td>
</tr>
<tr>
<td>8</td>
<td>1967</td>
<td>CCGS John A McDonald</td>
<td>Canada</td>
<td>Paul M. Fournier</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Distibuted to assist USCGC Northwest coast 900 km off Point Barrow with damaged propeller, circumnavigated North America</td>
</tr>
<tr>
<td>9</td>
<td>1969</td>
<td>USCGC Stater Island (icebreaker)</td>
<td>United States</td>
<td>Eugene F. Walsh</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Escorted oil tanker Montreal on return voyage from Point Barrow</td>
</tr>
<tr>
<td>10</td>
<td>1970</td>
<td>CSS Baffin (research icebreaker)</td>
<td>Canada</td>
<td>P. Black</td>
</tr>
<tr>
<td>11</td>
<td>1970</td>
<td>CSS Hudson (research icebreaker)</td>
<td>Canada</td>
<td>David W. Butler</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>First circumnavigation of the Americas</td>
</tr>
<tr>
<td>12</td>
<td>1975</td>
<td>Pandora II (hydrographic research vessel)</td>
<td>Canada</td>
<td>R. Dickison</td>
</tr>
<tr>
<td>13</td>
<td>1975</td>
<td>Theta (research vessel)</td>
<td>Canada</td>
<td>K. Moro</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Traveled in company</td>
</tr>
<tr>
<td>14</td>
<td>1975</td>
<td>CSS Skidgate (buoy tender)</td>
<td>Canada</td>
<td>Peter Kallis</td>
</tr>
</tbody>
</table>
### Gaining Command & Control of the Northwest Passage

**Transits of the Northwest Passage cont.**

<table>
<thead>
<tr>
<th>Year</th>
<th>Vessel</th>
<th>Registry</th>
<th>Master</th>
<th>Route</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>CGS J. E. Berrafdo&lt;sup&gt;2&lt;/sup&gt; (icebreaker)</td>
<td>Canada&lt;sup&gt;5&lt;/sup&gt;</td>
<td>Paul Pelland</td>
<td>East 3</td>
</tr>
<tr>
<td>1977</td>
<td>Williwaw (13 m ketch)</td>
<td>Netherlands</td>
<td>Willy de Roo</td>
<td>West 4</td>
</tr>
<tr>
<td>1978</td>
<td>CGS Pierre Radisson (icebreaker)</td>
<td>Canada&lt;sup&gt;6&lt;/sup&gt;</td>
<td>Patrick M. R. Toomey</td>
<td>East 2</td>
</tr>
<tr>
<td>1978-79</td>
<td>J. E. Berrafdo II (10 m ketch)</td>
<td>Canada&lt;sup&gt;7&lt;/sup&gt;</td>
<td>Real Bourier</td>
<td>West 4</td>
</tr>
<tr>
<td>1979</td>
<td>Conner Kigurak (icebreaker)</td>
<td>Canada&lt;sup&gt;8&lt;/sup&gt;</td>
<td>C. Cunningham</td>
<td>West 2</td>
</tr>
<tr>
<td>1979</td>
<td>CGS Louis S. St. Laurent (icebreaker)</td>
<td>Canada&lt;sup&gt;9&lt;/sup&gt;</td>
<td>George Budock</td>
<td>West 2</td>
</tr>
<tr>
<td>1980</td>
<td>CGS J. E. Berrafdo&lt;sup&gt;2&lt;/sup&gt; (icebreaker)</td>
<td>Canada&lt;sup&gt;10&lt;/sup&gt;</td>
<td>E. Chasse</td>
<td>East 4</td>
</tr>
<tr>
<td>1980</td>
<td>Pandora II (hydrographic survey vessel)</td>
<td>Canada&lt;sup&gt;11&lt;/sup&gt;</td>
<td>R. A. Jones</td>
<td>East 4</td>
</tr>
<tr>
<td>1981</td>
<td>CSS Hudson&lt;sup&gt;2&lt;/sup&gt; (research icebreaker)</td>
<td>Canada&lt;sup&gt;12&lt;/sup&gt;</td>
<td>F. Cazier</td>
<td>East 3</td>
</tr>
<tr>
<td>1982-83</td>
<td>Mermaid (15 m ketch)</td>
<td>Japan</td>
<td>Kenichi Horie</td>
<td>West 6</td>
</tr>
<tr>
<td>1983</td>
<td>Arctic Shilo (tug)</td>
<td>Canada&lt;sup&gt;13&lt;/sup&gt;</td>
<td>S. Dool</td>
<td>East 3</td>
</tr>
<tr>
<td>1983</td>
<td>Polar Circle (research vessel)</td>
<td>Canada&lt;sup&gt;14&lt;/sup&gt;</td>
<td>J. A. Strand</td>
<td>East 4</td>
</tr>
<tr>
<td>1983-88</td>
<td>Belvedere (18 m yacht)</td>
<td>United States&lt;sup&gt;5&lt;/sup&gt;</td>
<td>John Blokstra</td>
<td>East 6</td>
</tr>
<tr>
<td>1983-88</td>
<td>Belvedere (18 m yacht)</td>
<td>United States&lt;sup&gt;5&lt;/sup&gt;</td>
<td>John Blokstra</td>
<td>East 6</td>
</tr>
<tr>
<td>1983-88</td>
<td>St白领 (18 m yacht)</td>
<td>United States&lt;sup&gt;5&lt;/sup&gt;</td>
<td>John Blokstra</td>
<td>East 6</td>
</tr>
<tr>
<td>1984</td>
<td>Lindblad Explorer&lt;sup&gt;2&lt;/sup&gt; (ice strengthened ship)</td>
<td>Sweden</td>
<td>Hassa Nilsson</td>
<td>West 4</td>
</tr>
<tr>
<td>1984-85</td>
<td>Vagabond II (23.1 m yacht)</td>
<td>France</td>
<td>W. Jacobsen&lt;sup&gt;1&lt;/sup&gt;</td>
<td>West 6</td>
</tr>
<tr>
<td>1985</td>
<td>USCGC Polar Sea&lt;sup&gt;2&lt;/sup&gt; (icebreaker)</td>
<td>United States&lt;sup&gt;5&lt;/sup&gt;</td>
<td>John T. Powell</td>
<td>West 2</td>
</tr>
<tr>
<td>1985</td>
<td>World Discoverer (Ice-strengthened ship)</td>
<td>Singapore</td>
<td>Heinz Aye 1&lt;sup&gt;2&lt;/sup&gt;</td>
<td>East 4</td>
</tr>
<tr>
<td>1976-88</td>
<td>Conner Explorer II (drilling ship)</td>
<td>Canada&lt;sup&gt;15&lt;/sup&gt;</td>
<td>Ronald Colby</td>
<td>West 3</td>
</tr>
<tr>
<td>1986-88</td>
<td>Vagabond&lt;sup&gt;2&lt;/sup&gt; (23.1 m yacht)</td>
<td>France</td>
<td>W. Jacobsen&lt;sup&gt;2&lt;/sup&gt;</td>
<td>East 6</td>
</tr>
<tr>
<td>1986-89</td>
<td>Mabel E. Holland (12.8 m lifeboat)</td>
<td>Britain</td>
<td>David Scott Denyer</td>
<td>East 6</td>
</tr>
<tr>
<td>1988</td>
<td>CGS Henry A. Larsen (Icebreaker)</td>
<td>Canada&lt;sup&gt;16&lt;/sup&gt;</td>
<td>Stephen Gomes</td>
<td>East 3</td>
</tr>
<tr>
<td>1988</td>
<td>Society Explorer&lt;sup&gt;2&lt;/sup&gt; (Ice-strengthened ship)</td>
<td>Bahamas</td>
<td>Heinz Aye 2&lt;sup&gt;2&lt;/sup&gt;</td>
<td>East 3</td>
</tr>
<tr>
<td>1988</td>
<td>CGS Martha L. Black (Icebreaker)</td>
<td>Canada&lt;sup&gt;17&lt;/sup&gt;</td>
<td>Robert Mellis</td>
<td>East 3</td>
</tr>
<tr>
<td>Year</td>
<td>Vessel</td>
<td>Registry</td>
<td>Master</td>
<td>Route</td>
</tr>
<tr>
<td>------</td>
<td>--------</td>
<td>----------</td>
<td>--------</td>
<td>-------</td>
</tr>
<tr>
<td>1988</td>
<td>USCGC Polar Star(^2) (Icebreaker)</td>
<td>United States(^2)</td>
<td>Paul A. Taylor</td>
<td>East 3</td>
</tr>
<tr>
<td>1988-89</td>
<td>Northanger (15 m ketch)</td>
<td>Britain(^2)</td>
<td>Richard Thomas</td>
<td>West 4</td>
</tr>
<tr>
<td>1989</td>
<td>USCGC Polar Star(^2) (Icebreaker)</td>
<td>United States(^2)</td>
<td>Robert Hammond</td>
<td>West 3</td>
</tr>
<tr>
<td>1990</td>
<td>USCGC Polar Star(^2) (Icebreaker)</td>
<td>United States(^2)</td>
<td>Joseph J. McClanahan</td>
<td>West 3</td>
</tr>
<tr>
<td>1990</td>
<td>Terry Fox (Icebreaker)</td>
<td>Canada(^24)</td>
<td>P. Kimmerley</td>
<td>East 3</td>
</tr>
<tr>
<td>1991</td>
<td>Cannmar Tagger (Tug)</td>
<td>Canada(^25)</td>
<td>L. Lenneluk</td>
<td>East 3</td>
</tr>
<tr>
<td>1992</td>
<td>Frontier Spirit(^1) (Ice-strengthened ship)</td>
<td>Bahamas(^2)</td>
<td>Heinz Ams(^2)</td>
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<tr>
<td>1992</td>
<td>Kapitan Khodobnikov(^1) (Icebreaker)</td>
<td>Russia (^1)</td>
<td>Piotr Galkov(^1)</td>
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<tr>
<td>1993</td>
<td>Kapitan Khodobnikov(^2) (Icebreaker)</td>
<td>Russia (^2)</td>
<td>Piotr Galkov(^2)</td>
<td>East 3</td>
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<tr>
<td>1993</td>
<td>Frontier Spirit(^2) (Ice-strengthened ship)</td>
<td>Bahamas(^3), Heinz Ams(^3)</td>
<td>West 3</td>
<td></td>
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<tr>
<td>1993</td>
<td>Dagmar Anne(^2) (27 m yacht)</td>
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<td>Arvid Fuchs</td>
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<tr>
<td>1994</td>
<td>Kapitan Khodobnikov(^2) (Icebreaker)</td>
<td>Russia (^3)</td>
<td>Piotr Galkov(^3)</td>
<td>East 3</td>
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<tr>
<td>1994</td>
<td>Kapitan Khodobnikov(^2) (Icebreaker)</td>
<td>Russia (^4), Piotr Galkov(^4)</td>
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<tr>
<td>1994</td>
<td>Hanseatic(^1) (Ice-strengthened ship)</td>
<td>Bahamas(^4), Hartheg van Harting(^4)</td>
<td>West 3</td>
<td></td>
</tr>
<tr>
<td>1994</td>
<td>Itasca (converted tug)</td>
<td>Britain(^3)</td>
<td>Allan Jening</td>
<td>East 4</td>
</tr>
<tr>
<td>1995</td>
<td>Kapitan Khodobnikov(^2) (Icebreaker)</td>
<td>Russia (^5), Włodek Vasileiko(^5)</td>
<td>East 5</td>
<td></td>
</tr>
<tr>
<td>1995</td>
<td>CCGS Arctic II(^1) (Icebreaker)</td>
<td>Canada(^27)</td>
<td>Norman Thomas</td>
<td>East 5</td>
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<tr>
<td>1995</td>
<td>CCGS Arctic II(^2) (Icebreaker)</td>
<td>Canada(^28)</td>
<td>Robert Mollis</td>
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<tr>
<td>1995</td>
<td>CCGS Arctic II(^2) (Icebreaker) (formerly Khodobnikov)</td>
<td>Canada(^29)</td>
<td>D. Connolly</td>
<td>East 3</td>
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<tr>
<td>1995</td>
<td>Dove II (8.2 m yacht)</td>
<td>Canada(^20), Winston Bushweil</td>
<td>The smallest vessel to have completed the transit</td>
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<tr>
<td>1995</td>
<td>Cannmar Mosconne (Icebreaker)</td>
<td>Canada(^31)</td>
<td>D. W. Harris</td>
<td>East 3</td>
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<tr>
<td>1995</td>
<td>Hrvatska Ciga (Croatian Trim) (19.8 m yacht)</td>
<td>Croatia</td>
<td>Mladen Sutej</td>
<td>West 5</td>
</tr>
<tr>
<td>1996</td>
<td>Kapitan Donihtry(^2) (Icebreaker)</td>
<td>Russia (^6), Oleg Agafonov</td>
<td>Carried passengers</td>
<td>East 5</td>
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## Gaining Command & Control of the Northwest Passage

### TRANSITS OF THE NORTHWEST PASSAGE CONT.

<table>
<thead>
<tr>
<th>Year</th>
<th>Vessel</th>
<th>Registry</th>
<th>Master</th>
<th>Route</th>
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<tbody>
<tr>
<td>63</td>
<td>1996</td>
<td>CGGS Sir Wilfrid Laurier (Icebreaker)</td>
<td>Canada</td>
<td>Norman Thomas</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Escorted by CGGS Louis S. St. Laurent for part of voyage, traversed Pond Inlet</td>
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<tr>
<td>64</td>
<td>1996</td>
<td>Hausarctic(^2) (Ice-strengthened ship)</td>
<td>Bahamas</td>
<td>Hartwig van Harling(^2)</td>
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<tr>
<td></td>
<td></td>
<td>Carried passengers(^3) until proceed in Simpson Strait, escorted by CGGS Henry A. Larsen to Victoria Strait, traversed Pond Inlet</td>
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<td></td>
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<tr>
<td>65</td>
<td>1996</td>
<td>Canadian Supplier II (Cargo vessel)</td>
<td>Canada</td>
<td>P. Bundenale</td>
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<tr>
<td>66</td>
<td>1996</td>
<td>Arctic Circle (Tug)</td>
<td>Canada</td>
<td>J. McCormick</td>
</tr>
<tr>
<td>67</td>
<td>1997</td>
<td>Hausarctic(^2) (Ice-strengthened ship)</td>
<td>Bahamas</td>
<td>Hans Aas(^5)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Carried passengers(^4), escorted to Victoria Strait by CGGS Henry A. Larsen, traversed Pond Inlet</td>
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<td></td>
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<td>68</td>
<td>1997</td>
<td>Kapitan Khlebnikov(^2) (Icebreaker)</td>
<td>Russia</td>
<td>Viktor Vasilev(^2)</td>
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<td>Carried passengers(^3)</td>
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<td></td>
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<tr>
<td>69</td>
<td>1997</td>
<td>Alex Gordon (Tug)</td>
<td>Canada</td>
<td>Paul Misata</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Escorted by CGGS Sir Wilfrid Laurier to Franklin Strait and then CGGS Pierre Radisson</td>
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<td>70</td>
<td>1997</td>
<td>Suppliant (Tug)</td>
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<td>Alan Gutter</td>
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<td>Escorted by CGGS Terry Fox to Victoria Strait</td>
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<td>71</td>
<td>1998</td>
<td>Kapitan Khlebnikov(^2) (Icebreaker)</td>
<td>Russia</td>
<td>Pieti Golikov(^3)</td>
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<td>Carried passengers(^5)</td>
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<td>72</td>
<td>1998</td>
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<td>Hans Aas(^5)</td>
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<td>Carried passengers(^4), escorted to Victoria Strait by CGGS Sir John Franklin, traversed Pond Inlet</td>
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<tr>
<td>73</td>
<td>1999</td>
<td>Admiral Makarov (Icebreaker, dock in tow)</td>
<td>Russia</td>
<td>Vitaly Khloplev(^6)</td>
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<tr>
<td>74</td>
<td>1999</td>
<td>Irdis (Tug, dock in tow)</td>
<td>Russia</td>
<td>Aleksandr Aleksandrov</td>
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<tr>
<td></td>
<td></td>
<td>Traveled in convoy each bering a component of a steel floating dock, Korea to Caribbeas</td>
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<tr>
<td>75</td>
<td>1999</td>
<td>Kapitan Dranitski(^2) (Icebreaker)</td>
<td>Russia</td>
<td>Viktor Tonkovich(^4)</td>
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<td>Carried passengers(^6), circumnavigated the Arctic</td>
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<td>2000</td>
<td>USCGC Healy(^1) (Icebreaker)</td>
<td>United States</td>
<td>Jeffery M. Garrett</td>
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<tr>
<td>77</td>
<td>2000</td>
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<td>Thilo Netbe</td>
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<tr>
<td></td>
<td></td>
<td>Carried passengers(^4), traversed Pond Inlet</td>
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<td></td>
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<td>78</td>
<td>2000</td>
<td>Kapitan Dranitski(^2) (Icebreaker)</td>
<td>Russia</td>
<td>Victor Tonkovich(^2)</td>
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<td>Carried passengers(^2), circumnavigated the Arctic</td>
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<td>79</td>
<td>2000</td>
<td>Naden (Star Class)</td>
<td>Canada</td>
<td>Kenneth Burton</td>
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<tr>
<td></td>
<td>(17.7 m icebreaker)</td>
<td>Voyage to commemorate St. Roch 1940-42 transit</td>
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<tr>
<td>80</td>
<td>2000</td>
<td>Stater Fraser (Icebreaker, formerly CGGS)</td>
<td>Canada</td>
<td>Robert Mells</td>
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<td></td>
<td></td>
<td>Escorted Madam</td>
<td></td>
<td></td>
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<tr>
<td>81</td>
<td>2000</td>
<td>Exche (25 m yacht)</td>
<td>New Zealand</td>
<td>Stephen Kafka</td>
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<tr>
<td>82</td>
<td>2001</td>
<td>Kapitan Khlebnikov(^2) (Icebreaker)</td>
<td>Russia</td>
<td>Viktor Vasilev(^3)</td>
</tr>
<tr>
<td>83</td>
<td>2001</td>
<td>Kapitan Khlebnikov(^2) (Icebreaker)</td>
<td>Russia</td>
<td>Viktor Vasilev(^4)</td>
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<td></td>
<td></td>
<td>Return voyage, carried passengers(^2)</td>
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<td>84</td>
<td>2001</td>
<td>Turmoil (46 m yacht)</td>
<td>Cayman Islands</td>
<td>Philip Walsh</td>
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<td>Year</td>
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<td>85</td>
<td>Northeasterf (14.9 m yacht)</td>
<td>Ireland</td>
<td>Patrick Barry</td>
<td>West 3</td>
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<tr>
<td>86</td>
<td>Le Nager (12.8 m yacht)</td>
<td>France</td>
<td>Michele Deroy</td>
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<td>87</td>
<td>Kapitan Kptznov (Icebreaker)</td>
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<td>Pietr Gallivier</td>
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<td>88</td>
<td>Sayha IV (51 m yacht)</td>
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<td>Stephan Gay</td>
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<td>89</td>
<td>Apostle Andrew (16.2 m yacht)</td>
<td>Russia</td>
<td>Nikoly Lihvu</td>
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<tr>
<td>90</td>
<td>Arctic Kulik (Icebreaker tug)</td>
<td>Barbados</td>
<td>Sanjeev Kumar</td>
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<tr>
<td>91</td>
<td>Hanseatic2 (Ice-strengthened ship)</td>
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<td>Daniel Fogno</td>
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<td>Norwegian Blue (52.9 m yacht)</td>
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<td>Vagaflold (7 m yacht)</td>
<td>France</td>
<td>Eric Brinsier</td>
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<td>USCGC Masyf (Icebreaker)</td>
<td>United States</td>
<td>Daniel Oliver</td>
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<tr>
<td>97</td>
<td>Polar Bear (14.6 m motorboat)</td>
<td>Britain</td>
<td>David Scott Cowper</td>
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<td>Dargan Amerf (27 m yacht)</td>
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<td>Arwed Focks</td>
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<td>Kapitan Kptznov (Icebreaker)</td>
<td>Russia</td>
<td>Pavel Anudinov</td>
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</tbody>
</table>
The Effects of Transportation Regulation on the Transborder Metropolitan Areas of the U.S.-Mexico Border Region: NAFTA and the Mexican Truck Plan – Where Do We Go From Here?

Brent E. Butzin*

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* J.D. expected 2008, University of Denver Sturm College of Law; M.S./B.S. in Civil Engineering, University of Colorado; B.Envd. in Planning, University of Colorado. Special thanks go to Mark Andrews of Strasburger & Price, L.L.P. of Washington, D.C., whose reviews and comments made this paper possible.
XIV. Transborder Cities – Port Cities: So What About the Cross-Border Trucks?

I. INTRODUCTION

The North American Free Trade Agreement (NAFTA), entered into between the United States, Canada, and Mexico in December 1992, has transformed relations between these countries, and nowhere are the changes more evident than in cities and towns straddling the border. The U.S.-Mexico border region, as defined by the La Paz Agreement of 1983 to include areas within 100 kilometers on either side of the border, is home to over 12 million people, 90% of whom live in 15 interdependent sister cities along the border. The cities along the U.S.-Mexico border are tightly interconnected through their history, people, and especially their economies, which had become co-dependent long before the advent of NAFTA. The border has come to define a region that for decades has been the fastest growing in both the United States and Mexico.

One of the most contentious portions of NAFTA has always been the provision to allow direct trucking between the United States and Mexico by carriers of both nations. The cross-border trucking plan has been repeatedly delayed and to date all of its planned milestones have been missed. Despite expectations that the deadlock might finally be broken in 2007, recent Congressional actions and new lawsuits appear once again to have stalled the inauguration of the cross-border trucking program.

With the United States again dragging its feet on the implementation of the Mexican truck program, now is a prudent time to review the history of

4. INDICATORS REPORT, supra note 2, at 4.
7. See 153 CONG. REC. S11350, SA 2797 (daily ed. Sept. 10, 2007). On September 10, 2007, the United States Senate voted to prohibit funding a pilot program announced days prior by President Bush that would grant 100 Mexican motor carriers access to U.S. roadways. The measure followed a similar one passed by the House of Representatives.
NAFTA, its evolution, and its impacts on transborder metropolitan economies, which are most directly impacted by the NAFTA-related decisions made far away in Washington D.C. and Mexico’s Distrito Federal (Mexico City). Importantly, the time is right to review whether the cross-border trucking program will ever be implemented, and especially whether its delay could actually benefit the purported beneficiaries of increased free trade: the border regions.

This note will review the status of trade between the United States and Mexico leading up to the implementation of NAFTA, with particular focus on the development of the border economy. It will then review the NAFTA agreement, its promises, and its performance looking back at its first ten years. The note then will analyze the criticisms of NAFTA and the reasons given on each side for the failure to implement the trucking plan. Finally, the note will review the nature of transborder cities on the U.S.-Mexico border, their economies, their future prospects, and the primary question concerning these cities – for whom cross-border trucking is as much a local issue as an international one – namely, what are the potential impacts of the cross-border trucking provisions of NAFTA and do they stand to benefit border cities; or, alternatively, would advocates of a prosperous border region be well advised to join the ranks of the firmly entrenched opposition to the cross-border trucking program?

II. TRANSBORDER URBAN INTEGRATION: AN OVERVIEW

The border region’s common history predates the industrial development of the border in the 20th Century. El Paso-Juárez was founded in 1598 by Don Juan de Oñate Salazar, who claimed the area for Spain and renamed the area El Paso del Norte. Today, though an international border splits El Paso del Norte, the combined agglomeration is home to nearly 3 million people in what is, by all conventional measures, a single city. Estimates in the 1990’s indicated that up to 40% of El Paso’s sales tax revenue came from Mexicans crossing the border, and with thousands of El Pasoans commuting to jobs in Mexico, undoubtedly revenues travel the opposite direction as well. Further, though undoubtedly a “U.S.” city, El Paso’s population is 78% Hispanic and trending upward, with two-thirds of the city’s population being of Mexican origin. The border cities show clear demographic convergence – El Paso’s

10. See Id.
11. Id.
12. Roberto Coronado & Lucinda Vargas, Economic Update on El Paso del Norte, Business
literacy rate is well below U.S. averages, while Juárez’ is well above Mexico’s mean.13

Some authors contend that the cities of the U.S.-Mexico border regions are not true “binational” cities, but rather more simply akin to border-crossing cities because of disparities in current local conditions, historical backgrounds, and a general lack of institutional integration and cooperation – cross-border relations exist primarily for economic opportunity rather than friendship, trust, or any “sense of belonging together.”14 Other authors, however, have noted that the U.S.-Mexico border is “unique for what it unites, not what it divides.”15 Regardless of how these urban “borderplexes” are viewed, the cities of the U.S.-Mexico border are united both demographically and economically, and likely will share destinies as much as they share histories.

Perhaps not surprisingly, the U.S. Department of Transportation estimates that 80% of cross-border passenger vehicle trips are for same-day travel, including commuting, shopping, and visiting family and friends.16 NAFTA, combined with the December 1994 peso crash that overnight left a starker economic divide in everything from wages to electricity costs, created an entire class of fronterizos (border dwellers) for whom crossing the border is a part of daily life.17 Mexican citizens living in border towns are given three-day passes to enter the United States. These individuals have not only picked up American goods during their time in the U.S., but many of the United States’ political values as well, transforming Mexican politics in the process.18 These changes and their significance will be considered later.

As the border region is a dynamic, growing region with strong cultural ties and a historic dominance of the U.S.-Mexico trade relationship, it is worth considering the extent to which the urban systems that dominate this vast, otherwise sparsely populated region function as integrated cities. A better understanding of these metropolitan economies may provide insight into how these areas can remain competitive in this era of cheap imports from Asia, tight border security, immigration fears, static cross-border trucking arrangements, and the continuing exodus of people from Mexico’s south and interior to its northern states in search of better paying jobs.

Interestingly, the United Nations already forecasts that the border region will fail in its effort to remain competitive. Despite decades of unrelenting growth, the UN Population Division forecasts 1.8% annual growth in Tijuana

13. Id.
15. Brown, supra note 8, at 110.
18. Id.
between 2010 and 2015, down from 4.8% between 2000 and 2005.\textsuperscript{19} The U.N. reports a similar drop from 4.3% to 1.7% in Ciudad Juárez.\textsuperscript{20} With the growth of these cities having been historically driven by an economic boom and the correspondent influx of job seekers, such dire population predictions equate to dire economic forecasts. Proper planning and strategizing for a successful "transfrontier metropolis" may be the best opportunity to head off potential disaster.\textsuperscript{21}

III. THE EARLY BORDER ECONOMY & MANUFACTURING

The cornerstone of the border economy and the primary driver of its growth both before and after the implementation of NAFTA has been the maquiladora (maquila) industry.\textsuperscript{22} Maquiladoras developed as a result of the United States’ decision in 1964 to eliminate the Bracero Program, which had drawn thousands of Mexicans to the border region between 1942 and 1964 to provide temporary labor, primarily in the agricultural sector.\textsuperscript{23} When the U.S. unilaterally terminated the program, some 180,000 Mexicans were left unemployed.\textsuperscript{24} As a result, in 1965 the Mexican government initiated the Programa de Industrialización de la Frontera Norte de México, or Border Industrialization Program (BIP), which through various financial incentives was meant to draw labor-intensive U.S. industries to the border region to build plants, called maquilas, and provide employment for those left unemployed by the termination of the Bracero Program.\textsuperscript{25}

A maquila is an in-bond manufacturing facility, primarily for American, Asian, or European companies that provide consumer goods for sale in the U.S. market.\textsuperscript{26} Typically, raw materials, parts, and components are imported from these countries, assembled using less-expensive Mexican labor, and re-exported to their destination market. Prior to NAFTA, maquiladoras generally afforded significant benefits to manufacturers because they were permitted to temporarily import these intermediate inputs into Mexico without paying duties.\textsuperscript{27} As intended, these duty drawbacks granted by Mexico created a great


\textsuperscript{20} Id.


\textsuperscript{23} Robert B. South, Transnational "Maquiladora" Location, 80 ANNALS ASS’N. AM. GEOGRAPHERS. 549, 551 (1990).

\textsuperscript{24} Id.

\textsuperscript{25} Id.

\textsuperscript{26} Id.

\textsuperscript{27} See Eaton, supra note 22, at 750.
incentive for the development of maquiladoras, and by 1988, 1,400 had been constructed.\(^{28}\)

Initially, geographic limits were imposed by the Mexican government on plant locations to draw industrial development away from the established centers of Mexico City, Guadalajara, and Monterrey, limiting plants to within 20 kilometers of the U.S. border.\(^{29}\) As such, maquiladoras were initially located in Tijuana and Ciudad Juárez, fueling population and economic booms in these cities.\(^ {30}\) Today, the policy on geographic restriction has been reversed, and the Mexican government sets minimum wages lower in inland areas to encourage maquiladoras to locate in poorer, interior locations.\(^ {31}\)

Studies have indicated that the three primary factors in locating maquiladoras are wage rates, proximity to parent companies in the U.S. (for management personnel), and proximity to U.S. markets (to minimize transportation costs).\(^ {32}\) Many top executives, including those of several large Japanese electronics firms, choose to locate satellite headquarters and live in the United States, while commuting to plants in Mexico.\(^ {33}\) With increasing competition from overseas manufacturers, it is unclear whether reduced wages in inland areas of Mexico will be sufficient to overcome the significant structural advantages that the border cities enjoy today, namely, an established manufacturing and labor base, as well as the obvious advantage of proximity to the U.S. – the one advantage that overseas manufacturers cannot compete with.

IV. CROSS-BORDER PLANNING AND COLLABORATION

Past efforts at coordinated planning between local governments in border areas have had mixed success.\(^ {34}\) As critics of the historically unequal relationship between border cities have pointed out, “there has been no shortage of rhetoric calling for trans-frontier cooperation in the areas of transportation management, land use planning, and environmental regulation.”\(^ {35}\) Chief among these efforts are the work that has been done in the San Diego-Tijuana area in the fields of transportation and environmental controls. In the early 1980’s, San Diego connected its downtown to the San Ysidro border crossing with a light rail line, but Tijuana was never able to

\(^ {28}\) South, supra note 23, at 549.
\(^ {29}\) Id. at 551.
\(^ {30}\) See Eaton, supra note 22, at 757-8.
\(^ {31}\) South, supra note 23, at 558.
\(^ {32}\) See South, supra note 23, at 556-58.
\(^ {33}\) Eaton, supra note 22, at 760.
\(^ {34}\) See Herzog, supra note 21, at 606 (illustrating various efforts at transborder cooperation efforts).
\(^ {35}\) Id. at 604.
muster the funding to construct the planned connector system. Similarly, an effort in 1991 by the San Diego Association of Governments to construct a joint international airport was rejected. The “TwinPorts” concept would have replaced San Diego’s aging airport with a modern facility on the U.S.-Mexico border that would have shared runways with Tijuana’s existing Gen. Abelardo Rodriguez International Airport. The project never got off the ground, and in 1991 fell victim to political tensions and San Diego’s unease with its neighbor.

Most joint planning efforts have been plagued by strategies imposed at the national level, though local efforts, especially recently, have been more successful at meeting local needs. Mexican municipalities are constitutionally restricted from borrowing internationally, and long-term financing for municipal projects is difficult to obtain. As such, Mexican cities have historically had to rely on unreliable federal funding or commercial lending to meet local needs. Recently, newer innovations at the local level (wholly apart from NAFTA) have brought marked success in those areas where planning and implementation on a regional basis are most critical. Construction of the International Wastewater Treatment Plant in California to treat wastewater from Tijuana is one such example. Along similar lines, police in the San Diego-Tijuana and El Paso-Juárez metropolitan areas have both experimented with joint policing efforts with considerable success, and the Tijuana and San Diego police departments keep in close touch by radio (in Spanish).

In a 1998 article discussing shared policing in El Paso, local officials said what people in the transborder cities had long thought: “You’re better off keeping Washington and Mexico City out of things, because [then] all bets are off … Keep it local, keep it simple.”

Even shopping does not respect international borders in the transborder economies. The greater availability and variety of consumer goods in U.S. cities has led U.S. retailers to actively promote cross-border shopping by

36. Id.
40. Id. at 13.
41. Id.
42. Id. at 12.
43. See Geri Smith and Elisabeth Malkin, The Border, BUSINESS WEEK, May 12, 1997, at 64 (describing the “$400 million sewage treatment plant that will serve both cities”).
44. Id.
Mexicans, while more affordable medical goods and services have been used to lure American shoppers into Mexico.\textsuperscript{46} This contrast is evident in Laredo and Nuevo Laredo, where a 1993 survey counted 35 electronics stores on the U.S. side and virtually none on the Mexican side, but found that medical offices in Nuevo Laredo outnumbered those on the Laredo side 28-to-3.\textsuperscript{47} Cross-border complementarity is evident in other areas as well. As a matter of course, downtown Laredo merchants flatten truckloads of cardboard boxes on to specially designed tricycles, which are then taken across the border to a recycling facility in Nuevo Laredo.\textsuperscript{48} The dynamic cross-border consumer market provided Laredo, a relatively poor city by U.S. standards, with over $11,000 in per capita retail sales in 1991.\textsuperscript{49}

V. ENTER NAFTA: THE NORTH AMERICAN FREE TRADE AGREEMENT

Negotiated in 1992, NAFTA is a trilateral agreement between the United States, Mexico, and Canada that is comprised of twenty-two chapters primarily addressing trade in goods, services, and investment.\textsuperscript{50} NAFTA’s stated goals include the facilitation of cross-border movement in goods and services, promotion of increased investment opportunities, and perhaps most critically, the elimination of barriers to trade.\textsuperscript{51}

NAFTA Chapter 12 addresses cross-border trade in services, and in Article 1202 provides that each party to the agreement shall accord the service providers of the other party treatment no less favorable than it would provide its own service providers.\textsuperscript{52} This Article applies to the free movement of trucking companies across borders, except insofar as Article 2101(2) applies to protect inconsistencies with local laws intended to ensure the health and safety of consumers.\textsuperscript{53} NAFTA Annex I established the timetable for enacting the liberalization of cross-border transportation services described in Article 1202. Annex I set December 18, 1995, as the implementation date for access of Mexican carriers to the border states of California, Arizona, New Mexico, and Texas, with access throughout the United States to take effect on January 1, 2000.\textsuperscript{54}

\begin{itemize}
\item \textsuperscript{46} See Curtis, supra note 3, at 59-61.
\item \textsuperscript{47} Id. at 61.
\item \textsuperscript{48} Id. at 62.
\item \textsuperscript{49} Curtis, supra note 3, at 55.
\item \textsuperscript{50} See NAFTA, supra note 1, at chs. 1–9, 32 I.L.M. 605 (chs. 10–22); see also NAFTA Implementation Act of 1993, 19 U.S.C. § 3301 (2000).
\item \textsuperscript{52} Id. at 571.
\item \textsuperscript{53} Id. at 572.
\item \textsuperscript{54} Id. at 568.
\end{itemize}
Interestingly, prior to 1982, Canadian and Mexican truck and passenger bus carriers already had operated freely within the United States after deregulation of its trucking industry in 1980 by the Motor Carrier Act.55 In 1982, however, Congress passed the Bus Regulatory Reform Act of 1982 (the “Bus Act”), which placed a moratorium on the entry of Mexican trucks into the United States.56 The 1982 legislation grandfathered in the five Mexican carriers that were already operating within the United States, but otherwise instructed the Interstate Commerce Commission (ICC) to deny permits to all Mexican carriers until it had determined that American carriers wishing to operate in Mexico were treated “at least as favorably” by Mexico as its native carriers.57 Facing a presidential veto, the proposed legislation was modified to give the President authority to extend the moratorium as needed and – after first notifying Congress of the proposed change – to lift the moratorium if he found it to be in the national interest.58

NAFTA Annex I permitted the Bus Act status quo to remain in effect until the scheduled implementation dates for greater access as provided for in NAFTA, at which time the President would presumably lift the moratorium. Except for those Mexican carriers grandfathered in by virtue of their pre-1982 U.S. operations, and another 160 or so Mexican carriers that were specifically exempted, Mexican carriers were restricted to operating in “commercial zones” associated with municipalities along the U.S.-Mexico border until the moratorium was lifted.59

The commercial zones were originally defined by the ICC for economic regulation purposes, and are often described as a 20-mile-wide swath along the border from the Pacific to the Gulf of Mexico.60 However, the actual area encompassed by the commercial zones varies from a 2-mile-wide strip in some areas to as much as a 75-mile-deep expanse in others. The commercial zones encompass nearly all of the urbanized areas in the border region, including a four-county area of the Rio Grande Valley in Texas and the entire San Diego metropolitan area, extending over fifty miles north of the U.S.-Mexico Border, and nearly to the southern suburbs of Los Angeles.61 By 1996, over 11,000

56. Id. at 147.
59. Burgess, supra note 5, at 296.
60. See Townsend, supra note 55, at 149; see Burgess, supra note 5, at 283 (citing the C.F.R. formula used in determining the width of commercial zones proportionate to the size of municipalities).
61. NAFTA Safey Stats, Commercial Zones United States/Mexico Ports of Entry, http://ai.fmcsa.dot.gov/International/border.asp?redirect=commzone.asp (last visited Nov. 1 2007) (Per the C.F.R. formula, the commercial zone of the San Diego metropolitan region extends to the farthest
Mexican carriers operated within the commercial zones.62 Meanwhile, long after the passage of NAFTA, the Interstate Commerce Commission Termination Act of 1995 (ICCTA) modified the moratorium language of the Bus Act so that the President could lift the moratorium on movements beyond the commercial zones if removal “[was] consistent with the obligations of the United States under a trade agreement or with United States transportation policy.”63 The changes in ICCTA appeared to give the President explicit authority to implement the provisions of NAFTA Annex I. But to date, the barriers to cross-border trucking have not been lifted, despite attempts by President George W. Bush to do so.64

VI. LEGAL STATUS OF NAFTA: THE LAW OF THE LAND?

The United States Constitution affords treaties the full force and effect of law.65 Strictly speaking, NAFTA is not a treaty in constitutional terms because it did not pass the Senate by a two-thirds vote.66 NAFTA was negotiated using the “fast-track authority” given to the President in the Omnibus Trade and Competitiveness Act of 1988, which permitted the President to negotiate a trade agreement with Congressional participation and guaranteed that subsequent enabling legislation would be acted upon by Congress, without amendment, within 60 days of being submitted for Congressional approval.67 The NAFTA enabling legislation – the NAFTA Implementation Act – was passed by Congress in 1993, and though only approved by a simple majority in both houses of Congress, it nonetheless affords NAFTA status as “the supreme Law of the Land,” and in terms of U.S. law is treated the same as an international agreement reached by other means.68

The U.S. recognizes the customary international law principle of pacta sunt servanda, or “agreements must be kept,” so the failure of the United States to abide by the terms of NAFTA is a clear abrogation of its legal duty to

65. U.S. CONST., art. VI, cl. 2.
67. Id. at 987
68. Id. at 979-80.
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the agreement’s other signatories. 69 On the other hand, according to other established principles of U.S. domestic law, congressional legislation later in time takes precedence over earlier legislation, including international obligations. 70 Under this theory, any later conditions imposed by Congress take precedence over NAFTA obligations and are legally binding on the DOT under U.S. law. This obvious tension between domestic and international law has not been resolved, despite the determination of the NAFTA Chapter 20 panel, which will be discussed later. Ultimately political channels seem likely to dictate the outcome of the trucking dispute – more so than any legal mechanism currently available.

VII. CROSS-BORDER TRUCKING UNDER NAFTA

The debate about whether to allow Mexican trucks into the United States has raged for over two decades and predated NAFTA. 71 However, when the December 18, 1995, NAFTA Annex I deadline passed and Mexican carriers were still not permitted to operate outside the commercial zones within the United States, Mexico initiated a Chapter 20 procedure against the United States. NAFTA Chapter 20 provides a dispute resolution mechanism for disputes between party nations. 72 Despite U.S. arguments that the language contained in Annex I was suggestive rather than mandatory, the arbitration panel agreed with Mexico that the U.S. was obligated to afford Mexico’s carriers equal access to U.S. roads. 73 Language in NAFTA Article 1202 limits the requirement of equal treatment to “like circumstances,” but the arbitral panel made clear that mere differences in regulatory systems were not sufficient to support the general moratorium on Mexican trucking in the U.S. 74 The panel did recognize, however, that equal treatment in all senses was not necessary required, and that NAFTA Article 904 allowed the U.S. to impose legitimate safety requirements. 75 Mexico’s decision to bring a NAFTA case against the United States was the result of a politically motivated delay within the Clinton Administration. 76

On December 4, 1995, only weeks before the border states were to be opened, Secretary of Transportation Federico Peña issued a press release announcing that regulations were in place for a smooth transition to cross-

69. Id. at 983.
71. Townsend, supra note 55, at 132.
72. Id. at 139.
73. See Id. at 140.
74. See Id. at 141–42
75. Id. at 144–45.
76. See Id. at 153 (illustrating the Teamsters involvement with the Clinton administration).
border trucking. On December 12, 1995, President Clinton received a letter from the Teamsters and other labor groups about safety concerns with the cross-border trucking program. Only three days later, Secretary Peña issued a second press release announcing that the border would remain closed. The next day, Mexico filed its NAFTA case against the U.S.

Despite the clear mandate of NAFTA Annex I and the arbitral panel decision, the border remains closed to trucks from Mexico outside of the commercial zones. Still, the failure of the parties to implement the findings of the arbitral report is not conclusive evidence that the dispute resolution procedures contained within NAFTA are faulty or inadequate. If Mexico had chosen to do so, NAFTA permitted it to retaliate against the United States if no suitable resolution could be reached within 30 days of the NAFTA Chapter 20 panel report being issued. Following the arbitral panel’s decision against the United States, action permitted under NAFTA articles 2018 and 2019 would have entitled Mexico to approximately $5 billion in sanctions in the form of protective tariffs against the United States. However, repeated assurances from President George W. Bush that the U.S. would comply with its NAFTA obligations have so far stalled any further action from the Mexican government.

VIII. NAFTA AND TRADE: THE FOURTH NAFTA PARTY

Meanwhile, as the cross-border trucking debate rages on, so does the cross-border economy. In the end, international boundaries are merely lines drawn by men on a map and they have seldom been able to constrain the more organic development of urban areas and economies. The border economy flourished in the second half of the 20th Century and many cities that would probably not even exist without the border became dynamic urban areas of their own. Tijuana, San Diego’s border twin, grew from a hamlet of 16,500 people in 1940 to a bustling city of over 1.3 million in 2005. Similarly,
Ciudad Juárez grew from 20,000 to 1.3 million (and by some estimates, as high as 1.8 million) over the same time period. And though, like most border towns, Juárez’ population greatly exceeds its northern counterpart, El Paso, the interconnectedness of the U.S.-Mexico border region has led to the development of some of the world’s premier binational metropolitan economies. NAFTA has transformed this transnational economy and still has the potential to do so further.

In 2001, NAFTA Article 303 eliminated the duty drawbacks for taxes paid on inputs from non-American sources. The elimination of the duty drawback was intended to encourage greater use of North American manufacturing inputs in the maquiladoras. When Article 303 came into force, it had the effect of increasing costs for some Asian and European-owned maquiladoras by 20% overnight, which resulted in some shutting down altogether. Mexico’s subsidy of the maquilas is now subject to NAFTA’s “rule of origin,” which only allows preferential treatment for goods of North American origin. Nevertheless, the maquilas retain some benefits for manufacturers. First, import duties on intermediaries are deferred until the final product is exported to the United States. Also, maquilas have traditionally been exempted from paying Mexico’s value added tax. Most importantly, companies utilizing maquilas can still benefit from the duty drawbacks for products exported to non-NAFTA countries, and can similarly benefit from free-trade agreements between Mexico and other Latin American nations. As such, it is unlikely that the maquiladoras will be phased out in the immediate future.

However, while total maquiladora employment (primarily in the border region) grew from 540,000 in 1993 to 1.35 million in 2000, that figure had dropped to 1.14 million by 2004. While most economists attribute the loss to the post-September 11 recession in the United States and note that employment has since stabilized, stiff competition from overseas producers, particularly

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89. Brown, supra note 8, at 110-112 (discussing population growth in Juárez’).
90. Id. at 112. (attributing the economic growth in Juárez’ to cross-border trade and the maquila industry).
91. NAFTA supra note 1, art. 303.
92. See Eaton, supra note 22, at 750.
93. Id. at 749-50
94. Id.
95. Id. at 747-48
96. See Id at 750.
98. Id. at 104.
China, should prompt the border regions to evaluate current developments related to NAFTA and the cross-border trucking program in light of how best to continue the economic growth they have enjoyed in the last half century. Particularly, the border region should consider whether there may be regional advantages that can be capitalized upon by further delaying implementation of some portions of NAFTA because, as some authors have suggested in reference to the disparate benefits of free trade agreements across regions, a “more level and compact landscape is not an advantage to everyone.”

Few question that NAFTA has greatly stimulated trade between the U.S. and Mexico since its inception in 1993, but the growth in trade has been surprisingly localized, leading some to comment that the border region itself is the “Fourth Party” to the NAFTA agreement. Overall, U.S. merchandise trade with Mexico, approximately 80% of which is truck trade, increased from $38.6 billion in 1993 to $161.5 billion in 2002. However, the majority of this trade is confined to the border region. In 2002, nearly 60% of cargo shipments between the U.S. and Mexico did not leave the border state region of the two countries. This is not surprising because many trade sectors are acutely distance-sensitive and wage differentials between border and non-border locations have been too small to offset other border advantages. This fact led some experts to predict, even before NAFTA was enacted, that it would have spillover effects on the Southern California-Baja California urban system and would increase trade and transborder labor mobility. In effect, as one author correctly predicted, NAFTA so far has been “primarily a free trade agreement between Northern Mexico, California, and Texas.” The macroeconomic benefits of NAFTA have effectively filtered down to the border region, while at the same time, the commercial zones may have absorbed much of the immediate benefit and slowed its spread to the wider U.S. and Mexican economies.

100. Brown, supra note 8 at 105.
104. Id.
105. Id.
IX. MEXICAN TRUCKING TODAY

Because the majority of Mexican trucks currently are not permitted outside of the commercial zones, a complicated “drayage” system has evolved at the border for goods destined in the United States beyond the confines of the commercial zones.\footnote{106} Goods are shipped first from their Mexican point of origin using Mexican long-haul carriers.\footnote{107} At a drayage yard near the border, trailers are then transferred to a short-haul Mexican drayage truck.\footnote{108} These trucks are typically older and are used solely for the time-consuming border crossing, where Mexican carriers are loath to use their best equipment.\footnote{109} Drayage trucks are often forced to stop as many as eight times during the border crossing: first, by Mexican customs brokers; second, at the toll station of the international bridges; third, at the U.S. Customs/Immigration and Naturalization Service (INS) station; fourth, for the primary inspection; fifth, for a secondary inspection; sixth, supplemental vehicle or drug inspections by U.S. federal, state, or local authorities; seventh, exit review of final papers; and eighth, for random safety inspections within the commercial zones.\footnote{110}

Ultimately, when the drayage trucks finally reach the U.S. side the trailers are again transferred, this time to a U.S. long-haul carrier that will transport the goods to their final destination in the U.S.\footnote{111} Drayage trucks return to Mexico empty, and contribute greatly to the congestion at the border, especially in Laredo, where the majority of cargo destined for points beyond the commercial zone crosses the border.

The Mexican drayage trucks are also notorious for their failure rates at U.S. inspection stations, which ranged anywhere from 36-to-50% between 1996 and 1999.\footnote{112} However, contrary to the contentions of many who would argue against cross-border trucking, the drayage trucks are not representative of the overall Mexican trucking fleet, and many safety violations are in fact only minor shortcomings. Indeed, Mexican trucks that were “grandfathered” in because they received operating permission prior to the Bus Regulatory Reform Act of 1982 are already operating within the U.S., as are trucks using U.S. roads as a “land bridge” to Canada and those with U.S. citizens as majority owners (despite the fact that the carriers themselves are domiciled in

\begin{footnotesize}
\begin{enumerate}
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\item Id.
\item Id.
\item Id.
\item Id.
\item Sheppard, supra note 104, at 158.
\item Id.
\end{enumerate}
\end{footnotesize}
Mexico). There is no evidence to indicate that these carriers and their vehicles, which are more representative of the Mexican long-haul trucking fleet than the much maligned drayage trucks, have worse safety records than those of U.S. long-haul carriers.

X. WHY IS THE BORDER NOT OPEN? THE CONTINUING SAGA

Many justifications are given by the U.S. Congress for refusing to allow the border to open. After the NAFTA panel’s decision against the U.S., the Department of Transportation’s Federal Motor Carrier Safety Administration (FMCSA) went back to the drawing board to develop rules to govern the safety of Mexican trucks crossing the border. Following the decision of the arbitral panel, Congress had conditioned DOT funding for carrying out the panel’s mandate on the promulgation of rules for Mexican trucks to operate safely within the United States. The panel decision only forbade a blanket exclusion of all Mexican trucks pursuant to NAFTA, but allowed the U.S. to determine on a case-by-case basis whether the trucks were suitable to meet applicable U.S. safety standards.

In May 2001, FMCSA published three proposed rules, including two to directly regulate Mexican motor carriers – the “Application Rule” and the “Safety Rule” – for public comment. The Application Rule required proof of ability to meet safety regulations, insurance, audits, registration as a certified Mexican carrier, and regular inspections. The Safety Rule provided further intensive inspections for the first 18 months of provisional authority to operate within the U.S. and guaranteed that Mexican trucks would meet the same safety requirements as U.S. carriers. The third proposed rule – the “Certification Rule” – outlined procedures for the certification of auditors, investigators, and inspectors conducting inspections of vehicles, carriers, and drivers. With the necessary controls set for implementation, President Bush announced his intention to open the border by early 2002 and requested funding from Congress to implement the FMCSA’s proposed inspection program. Acknowledging its action was in direct violation of
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NAFTA, on June 26, 2001, the U.S. House of Representatives nonetheless voted to prevent the Bush Administration from using any funds in 2002 to process applications from Mexican trucking firms.122 An agreement was later reached on November 30, 2001, which led to a compromise funding solution for border safety.123 By March 22, 2002, President Bush announced a twenty-two point “Smart Border” plan, leading to the President finally lifting the moratorium on November 27, 2002, ordering the DOT to process Mexican carrier applications.124 The Teamsters and environmental groups immediately requested and received an emergency stay from the Ninth Circuit Court of appeals, citing the DOT’s alleged failure to conduct an Environmental Impact Assessment (EIS) pursuant to the National Environmental Policy Act (NEPA).125 On June 7, 2004, a unanimous Supreme Court reversed the Ninth Circuit, paving the way for the eventual revival of the cross-border trucking program, two years after it appeared the border might finally open.126

XI. MEXICAN OPPOSITION

Despite the perpetual delays on the U.S. side to allowing Mexican trucking on U.S. roads, perhaps in part because of the misperception that goods traffic is largely a one-way Mexico-to-U.S. flow, discussion is muted about the likelihood of U.S. carriers being given reciprocal access within Mexico. Indeed, cross-border trucking is “extremely unattractive” for many established interests on the Mexican side of the border as well.127 Mexican truckers argue that it will never be economical for them to operate long-distance routes to the United States.128 Mexican carriers are significantly smaller and are handicapped by disadvantageous financing availability. Further, Mexican truckers spend up to 30% of earnings on maintenance, far in excess of their U.S. counterparts.129 Fearing direct competition with U.S. carriers, the Mexican trucking organization Cámara Nacional De Autotransporte De Carga (CANACAR), which represents 78% of commercial rigs in Mexico, has successfully lobbied to prevent opening the border to U.S. carriers operating in Mexico and has threatened to strike if the border is opened.130

122. Id. at 165.
123. Id. at 174.
124. See id. at 173-78.
125. Public Citizen v. Dep’t. of Transp., 316 F.3d 1002, 1009 (9th Cir. 2003).
127. Sheppard, supra note 104, at 271.
128. Id. at 272.
129. Id.
130. See id. (discussing requests by Mexican organizations to keep the border closed for a period of five years).
has gone so far as to suggest abandoning the cross-border trucking provisions of NAFTA altogether – an idea this note will consider further.\textsuperscript{131}

CANACAR’s official comment on the FMSCA’s proposed safety rules in 2001, however, complained that “consciously or unconsciously, all three of FMCSA’s [proposed rules] unfortunately are permeated with anti-Mexican sentiments . . . disguised in the form of concern for highway safety [and] based on false assumptions.”\textsuperscript{132} CANACAR’s concern about unfair treatment and discrimination against Mexican nationals has parallels – and finds some justification – on the U.S. side of the debate. Some authors have written of the “nativistic racism” that pervades over the NAFTA debate.\textsuperscript{133} Indeed, there is an inherent tension between U.S. border policy related to immigration, which seeks to restrict cross-border movement, and NAFTA’s goal of easing cross-border movement.\textsuperscript{134} Further, there is some evidence that NAFTA-related trucking may in fact be an increasingly preferred vehicle for human trafficking across the U.S.-Mexico border.\textsuperscript{135} While it is outside the scope of this note, there can be no denying that nationalistic feelings will play a major role in the political destiny of the cross-border trucking program.

In considering the mixed feelings within Mexico about the cross-border trucking provisions of NAFTA, it is important to also consider that the vibrant north of Mexico has transformed Mexican politics. Probably led in part by border communities that had tired of the “viceroys” of Mexico City and the political dynasty of the Institutional Revolutionary Party (PRI), the right wing National Action Party (PAN) won the Mexican presidency in 2000 after 71 years of PRI rule.\textsuperscript{136} In the 2006 presidential election, Felipe Calderón and the PAN won a second consecutive presidential victory by the slimmest of margins over Andrés Manuel López Obrador, the former mayor of Mexico City, and his Party of the Democratic Revolution (PRD). The border states and their ever-changing demographics, influenced by strong connections to the United States, were the driving force behind the right-wing PAN’s victory; the PAN won every border state by significant margins, while losing the Distrito Federal and most of the poorer southern states by similarly large margins. The shift to conservative rule in Mexico may harden the positions of organized labor

\begin{footnotes}
\item[131] Townsend, supra note 55, at 186.
\item[134] Id. at 1751.
\item[135] Id.
\item[136] See Mexico’s New Frontier, THE ECONOMIST, Feb. 8, 1997, at 41 (speculating prior to the election on demographic shifts in Mexico’s northern states and the PAN’s electoral prospects as a result); see Instituto Federal Electoral, 2000 Election Results, http://www.ife.org.mx/documentos/RESELEC/esta2000/comp_test/reportes/centrales/Presidente.html
\end{footnotes}
interests – as it has done in the U.S. – and make cross-border trucking more difficult to implement, despite the subtle ideological shift that continued migration toward the U.S. border region seems to foster within the Mexican electorate.

XII. ONGOING U.S. OPPOSITION

Many commentators have speculated that if the border was ever likely to open, it would happen under the George W. Bush administration. President Bush, a former Governor of Texas, has been a consistent advocate of free trade generally and cross-border trucking in particular and has tried on multiple occasions to lift the moratorium on cross-border trucking and honor the United States’ obligations under NAFTA Annex I.

The USDOT announced on February 22, 2007, that it had come to an agreement with Mexico that would allow on-site inspections of Mexican carriers to verify compliance with a 37-point compliance program DOT developed in response to Congressional concerns about safety. On February 23, 2007, DOT announced that procedures had been implemented to meet all 22 safety requirements set forth by Congress in 2001 and that it would initiate a pilot program for 100 Mexican trucking companies to enter the United States, with reciprocal rights planned for 100 American carriers. An article in the Washington Post the following day contained criticism of the move, with the Teamsters claiming that the DOT was “playing a game of Russian roulette on America’s highways.” Even so, in an editorial on March 8, 2007 entitled “Let the Trucks Roll,” the Washington Post stated its support for the pilot program. The following week, Teamsters President James Hoffa penned a response, again railing against the government’s “dangerous experiment” with Mexican trucking.

Not surprisingly, by March 22, 2007, a Senate committee had halted the program to open the border to Mexican trucks, and on March 29, 2007, U.S.

137. See Blackmore, supra note 83, at 710.
138. See Id. at 709.
Representative James Oberstar (D-MN) gave testimony in the House to support his proposed Safe American Roads Act of 2007, which would further delay the cross-border trucking program by restating the DOT safety requirements, adding a public comment period, and permanently delaying the program until Mexico is prepared to grant immediate reciprocal access to U.S. companies. Oberstar noted that Mexico is currently unable to grant licenses to U.S. carriers and needs at least 6 more months before it will be prepared to do so.

After President Bush vetoed the supplemental funding bill for the Iraq war containing Oberstar’s additional criteria for initiating the pilot program – importantly, including the requirement that Mexico concurrently grant equal access to U.S. carriers – the House Transportation and Infrastructure Committee on May 2, 2007, proceeded to vote 66-0 in favor of opening the border to a maximum of 1,000 trucks for the pilot program. In the meantime, however, on April 23, 2007, the Teamsters and a coalition of environmental and labor groups filed suit against the DOT and FMCSA seeking an injunction for DOT’s alleged failure to provide the requisite public notice of the proposed pilot program. At this point, it is unclear whether cross-border trucking may be in sight for 2007. Still, with the next presidential election looming and opposition to the program as fierce as ever, it seems unlikely that either party will “rock the boat” and initiate this controversial program in the foreseeable future.

XIII. MEANWHILE, BACK ON THE BORDER: MEASURED PROGRESS IN BORDER LOGISTICS

Unsurprisingly, the largest barrier to the full integration of transborder cities is not the lack of a cross-border trucking program, but rather the logistical nightmare of crossing the border. Following September 11, 2001, total trade with Mexico by land modes decreased by over $11 billion, due in large part to excessive delays at the border. Wait times in excess of two hours were commonplace in late 2001, bringing trade almost to a halt. Fortunately, with the advent of technological innovations there is hope that a more efficient border crossing procedure can take the place of constructing...
ever greater border crossing facilities and infrastructure, for which funding has thus far been scarce. Furthermore, if elimination of the costly drayage system is the primarily rationale for implementing the contentious provisions of NAFTA Annex I, perhaps technological innovations for border crossing can reduce the incentive to use an intermediary vehicle and reduce border transactions to a single exchange between Mexican and U.S. long-haul carriers – no more onerous than the intermodal exchanges used in the transport of nearly every other good imported into the United States.

The main strategies being employed by Customs and Border Protection (CBP) to increase the speed and efficiency of processing incoming trucks at the U.S.-Mexico border are a forced transition to electronic automation and advance inspections. First, trucks are now required to submit manifests electronically before reaching the border. Further, as part of the Free and Secure Trade (FAST) program, trucks are being outfitted with electronic transponders that allow instant identification of the vehicle and link it to a manifest the carrier must submit ahead of time. The Customs Trade Partnership Against Terrorism (CTPAT) program purports to secure the supply chain, and includes CBP inspectors at manufacturing facilities in foreign countries ensuring that proper security measures are in place before trucks reach the border. Manufacturers who are part of the CTPAT and FAST programs receive expedited services at the border, fewer inspections, and according to CBP, will normally face waits at the border of less than 5 minutes. These improvements provide cause for hope that border delays will soon no longer be major burdens to cross-border freight movement and infrastructure constraints can be disregarded as major considerations in selecting appropriate border policies.

XIV. TRANSBORDER CITIES – PORT CITIES: SO WHAT ABOUT THE CROSS-BORDER TRUCKS?

So what does the future of the cross-border trucking program mean for the cities of the border region? So far, NAFTA seems to have benefited the border regions greatly, and the continued use of commercial zones seems to do the same. The City of Laredo has expressed direct concern that the cross-border trucking program could diminish the city’s importance as a trade hub and major port.149 Is Laredo’s fear of being bypassed rational? The Free Trade Alliance San Antonio has already successfully lobbied to be the first non-border city to receive a prototype of the North American Trade Automation Protocol (NATAP), which facilitates the electronic transmission of standardized import-export information via the Internet.150 However, others

150. Michael R. Skahan, Comment, The NAFTA Trucking Dispute with Mexico: Problem? What
have argued that existing infrastructure and established business relationships with customs brokers protect the status quo in Laredo and other border towns, despite the additional costs the drayage system imposes on carriers.151 American drivers also frequently get paid by the mile, and so have a strong motivation to carry loads to Laredo152, for example, rather than unloading to a Mexican carrier in Dallas, even if Dallas is a more strategic transfer point and logical site for a regional distribution center.

Port cities have always been some of the most dynamic on earth, and while a traditional port could not be disconnected from its city, the cross-border trucking program presents that very possibility for many of the cities on the U.S.-Mexico border – cities whose very existence has been defined by the border for decades. Even within the border region, however, there are differences of priority. For example, Laredo, the top gateway into the U.S. for Mexican trucks, is more port than city. This is distinguishable from Tijuana, which primarily serves the Southern California market with its industries, and otherwise is an integral player in the San Diego metropolitan area. Juárez’ interests probably lie somewhere in between Laredo’s and Tijuana’s. While it is part of a vital interconnected metropolitan area, its industries also depend on distribution of goods to a much broader area than Tijuana’s. So, while the border region as an identifiable, unique area certainly has interests that differ from those of the national governments, each metropolitan area, in looking out for itself, should have somewhat different goals in mind.

Even so, better cross-border integration, vital to all trans-border metropolitan areas, should be a goal of both parties to the NAFTA agreement because, with the vast majority of U.S.-Mexico trade beginning and ending in the border region, it goes without saying that stronger cities will make for a stronger international economy. Hopes of more integrated transportation networks have long been one of the great promises of the NAFTA cross-border trucking program.153 However, given the entrenched political opposition on both sides to the cross-border trucking program and the promise of better technology alleviating delays at the border – delays that provided much of the incentive for the program in the first place – it is worth questioning whether NAFTA Annex I is even necessary.

If lesser measures – for example, eliminating border delays enough that utilizing drayage trucks no longer becomes necessary – can reduce transportation costs and provide reliable “just in time” deliveries to the U.S. side, perhaps the existing border zone commercial areas are adequate. Eliminating the commercial zones in favor of free trucking could weaken the

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151. Id. at 610.
152. Id.
153. See Eaton, supra note 22, at 808.
cities that are the foundation of the border economy. And while there is
certainly a need to reduce costs so that the maquiladora sector can remain
competitive, the cross-border trucking program may not be the answer. In the
grand scheme of things, one expert noted, it may not “matter a great deal to the
U.S. economy whether [Mexicans] in Juarez or Nogales come across the
border [to their sister cities] on a regular basis … but for [the border] economies these things are very important.”\(^{154}\) And, as one Laredo official
commented on the current system, “It’s not just what is most efficient, it’s
what makes everybody politically happy.”\(^{155}\) With opposition against the
program firmly entrenched, technological solutions in sight, and the weakening
of border communities a real possibility if cross-border direct trucking is fully
implemented – a prospect already prophesied by credible U.N. population
forecasts – the trucking program of NAFTA Annex I may be a solution where
no real problem exists. In the end, cross-border trucking may not be in the best
interests of the flourishing cities of the U.S.-Mexico border region.\(^{156}\)

\(^{155}\) Skahan, supra note 148 at 610.
\(^{156}\) As of the time of printing, November of 2007, a Cross Border Demonstration Project for Mexican trucking has been implemented, with five Mexican-domiciled carriers and three U.S.-domiciled carriers currently operating throughout both countries. FMCSA, http://www.fmcsa.dot.gov/cross-border/cross-border-carriers.htm. Time will tell whether this demonstration project leads to wholesale acceptance of Mexican trucking on U.S. roadways.
Case Comment:
Rent-a-Defendant: Current Developments Concerning Vicarious Liability Statutes in the Motor Vehicle Rental and Leasing Industry

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On August 10, 2005, President Bush signed into law the Transportation Equity Act of 2005, 49 USC § 30106, which effectively provided that in the absence of negligence or criminal wrongdoing, motor vehicle rental and leasing companies would no longer be liable for the negligence of their customers.1 At the time 49 USC § 30106 went into effect, 15 states had laws that threatened non-negligent companies with unlimited vicarious liability for the negligence of their customers.2

In Graham v. Dunkley, the New York State Supreme Court, Queens County, addressed the constitutionality of 49 USC § 30106, and whether it preempted a New York state law that provided that the owner of a motor vehicle was liable for the negligence of any person using the vehicle with the owner’s permission.3 The court held that Congress had exceeded its commerce power by passing 49 USC § 30106, and therefore the New York state law was not preempted.

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2. Id.
In *Graham*, the plaintiff alleged that she was injured in an automobile accident and filed suit against the driver, Rayon S. Dunkley, and “Nissan Infinity, LT,” the registered owner and lessor of the vehicle at the time of the accident. The plaintiff’s suit against NILT, Inc. was based on New York State Vehicle and Traffic Law § 388 (“§ 388”), which provides that a motor vehicle owner will be liable for the negligence of any person who operates the vehicle with the implied or express permission of the owner. NILT, Inc. filed a pre-answer motion for dismissal for failure to state a cause of action. NILT, Inc. argued that Article VI of the Constitution (“the Supremacy Clause”) declares that federal law “shall be the supreme law of the land,” and therefore dictated that 49 USC § 30106 preempted § 388, and the plaintiff was left with no state cause of action.4

Pursuant to the Supremacy Clause, federal law may preempt state law when: 1) a federal law contains express preemption language; 2) federal law completely occupies a field leaving no room for state law to supplement it; and 3) state law conflicts with a federal law. For federal law to preempt a state law, the federal law must be constitutional. 49 USC § 30106 contained express statutory language declaring that the owner of a motor vehicle who rents or leases the vehicle shall not be liable under “the law of any State or political subdivision thereof” for the damages to persons or property during the period of the rental or lease, directly conflicting with New York State Vehicle and Traffic Act § 388.5

Prior to the *Graham* decision, the case law concerning 49 USC § 30106 had not looked beyond the Supremacy Clause in its analysis, leaving unaddressed the issue of whether Congress had exceeded its commerce power in passing the law. Only months before the *Graham* decision, in *Infante v. U-Haul*, the New York State Supreme Court, Queens County, held that 49 USC § 30106 preempted § 388.6 The *Graham* court went beyond the Supremacy Clause, however, declaring that there is a strong presumption against preemption, especially when a federal law affects “the States’ historic police powers over the health, safety and welfare of its residents.”7 If a federal law is unconstitutional, a preemption analysis becomes unnecessary.

State and federal courts have concurrent jurisdiction on federal constitutional issues unless Congress expressly precludes jurisdiction for state courts. The *Graham* court determined that since no federal legislation had withdrawn its power to do so, it had jurisdiction to pass upon the constitutionality of 49 USC § 30106. The court also noted that the plaintiff’s case did not fall within the exclusive federal question jurisdiction of the federal

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4. Id. at 517.
5. Id. at 516.
courts because NILT, Inc. had merely raised a federal defense to a state cause of action. For a case to arise under federal law, a right or immunity created by a federal law must be an essential element of the plaintiff’s cause of action, and here the plaintiff was pursuing a state cause of action.

The Tenth Amendment provides that “the powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.”8 In order for Congress to pass a law, the Constitution must give it the power to do so.

The power of Congress to pass 49 USC § 30106 was ostensibly based on its power under Article I, § 8 of the Constitution (the “Commerce Clause”). The Commerce Clause gives Congress the ability to “regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.”9 The Supreme Court has held that in regards to commerce “among the several States,” Congress may regulate: 1) the channels of interstate commerce; 2) the instrumentalities (persons or things) of interstate commerce; and 3) activities that “substantially affect” interstate commerce. Since the removal of vicarious liability for those in the business of renting or leasing vehicles is neither a channel nor instrumentality of interstate commerce, the discussion focused on Congress’s ability to regulate activities “substantially affecting” interstate commerce.10

The Graham decision refers to three “guiding principles” of contemporary Commerce Clause jurisprudence: 1) Congress can regulate all activities, including intrastate activities, which have a “substantial effect” on interstate commerce; 2) effects on commerce that seem individually trivial may be deemed “substantial” when aggregated; and 3) courts should defer to a congressional finding that an activity “substantially affects” interstate commerce if there is any “rational basis” for such a finding.11

Recent Supreme Court interpretation of Congress’s power to regulate “activities that substantially affect” interstate commerce was addressed by the Graham court, most notably the Supreme Court’s decisions in United States v. Lopez and Gonzalez v. Raich.12 In Lopez, the Supreme Court found that Congress had exceeded its commerce power by passing a law that made the possession of a firearm in a school zone a federal offense. The Court rejected as too attenuated the government’s argument that crime “substantially affected” the functioning of the national economy, noting that if it were to accept the government’s position, there would be little activity that Congress could not regulate.

8. Id. at 519-20 (quoting U.S. CONST. amend. X).
9. Id. at 520 (quoting U.S. CONST. art. I, § 8).
10. Id. at 521.
11. Id. at 522 (citing United States v. Lopez, 514 U.S. 549, 558 (1995)).
12. Gonzales v. Raich, 545 U.S. 1 (2005); Lopez, 514 U.S. 549.
Likewise, in *Gonzalez*, the Court rejected the government’s argument that gender violence had a “substantial effect” on interstate commerce. The Court held that congressional findings that led to the passage of a law that provided a federal civil remedy for the victims of gender-motivated violence were based on a “but-for causal chain from initial occurrence of violent crime . . . to every attenuated effect upon interstate commerce.” The Court held that if such reasoning were accepted, Congress would soon be able to venture into realms traditionally controlled by the States, such as using the aggregate effects of divorce and marriage to be able to regulate family law.

The *Graham* decision employed similar reasoning in holding that 49 USC § 30601 exceeded Congress’s commerce power. The court found that since § 388 is a statute that defines the scope of *vicarious liability*, it was not an activity that had a substantial effect on interstate commerce, nor was there any “rational basis” for 49 USC § 30106. The court reasoned that like the effects of gender violence on the national economy, the effects of imposing vicarious liability on the rental car industry were too attenuated to “substantially affect” interstate commerce. The court declared that finding a rational basis for 49 USC § 30106 would require piling “inference upon inference in a manner that would bid fair to convert congressional authority under the Commerce Clause to a general police power of the sort retained by the states.”

Furthermore, like family law, the substantive law of torts has traditionally been regarded as an area left to the determination of the respective States. In *Erie R. Co. v. Tompkins*, the Supreme Court held that Congress had “no power to declare substantive rules of common law be they a commercial law or part of the law of torts,” and since then federal courts have looked to the States for the substantive law of torts. The *Graham* court found that Vehicle and Traffic Law § 388 was part of New York State’s substantive law of torts, codifying the imputed liability substantive tort doctrine of vicarious liability attributable to motor vehicle owners. The court pointed to three instances in which the Court of Appeals for the Second Circuit certified questions to the New York State Court of Appeals concerning § 388, speaking to its recognition as an important part of New York State’s substantive law of torts.

While the *Graham* decision arguably overlooks the contention that the threat of vicarious liability may lead to higher costs in areas such as the transportation of goods, which might therefore “substantially affect interstate commerce,” it does provide an interesting model for jurisdictions that wish to retain their imputed liability statutes. The constitutionality of 49 USC § 30106 remains far from settled, however, as evidenced by a recent decision.

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14. *Id.* at 523 (quoting *Lopez*, 514 U.S. at 567).
15. *Id.* at 522 (quoting *Erie R. R. v. Tompkins*, 304 U.S. 64, 78 (1938)).
subsequent to *Graham* in which 49 USC § 30106 was held to be a permissive exercise of Congress’ commerce power.\(^{16}\) It is apparent that this issue will continue to be litigated, and it may be some time before the reach of preemption and the validity of 49 USC § 30106 is finally determined.

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\(^{16}\) In *Garcia v. Vanguard Car Rental USA, Inc.*, a federal district court judge found 49 USC § 30106 to be within Congress’ commerce power, and that it therefore preempted vicarious liability claims under the relevant Florida state statute. *Garcia v. Vanguard Car Rental USA, Inc.*, 2007 WL 686625 (M.D. Fla. March 5, 2007).