Article

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

Robert M. Hardaway*†

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* Professor of Law, University of Denver Sturm College of Law.

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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-

1. *See, e.g.,* 49 U.S.C. § 40102(a)(15) (2003); 49 U.S.C. § 41102(a) (2000); U.S. GEN. ACCOUNTING OFFICE, GAO-04-34R, FOREIGN INVESTMENT IN U.S. AIRLINES 1-4 (2003).

2. GENERAL ACCOUNTING OFFICE, *supra* note 1, at 7-9.

3. ANN F. FRIEDLAENDER, THE DILEMMA OF FREIGHT TRANSPORT REGULATION 2 (1969) (citing generally SOLON JUSTUS BUCK, THE GRANGER MOVEMENT: A STUDY OF AGRICULTURAL ORGANIZATION AND ITS POLITICAL, ECONOMIC AND SOCIAL MANIFESTATIONS 1870-1880 (2nd impression 1933); LEE BENSON, MERCHANTS, FARMERS, & RAILROADS: RAILROAD REGULATION AND NEW YORK POLITICS 1850-1887 (1955); IDA M. TARBELL, THE HISTORY OF THE STANDARD OIL COMPANY (1904)).

4. *See* GABRIEL KOLKO, RAILROADS AND REGULATION 1877-1916 7 (Norton Library 1970) (1965).

5. *See id.* at 7-11.

6. *See generally* Robert M. Hardaway, *Transportation Deregulation (1976-1984): Turning the Tide*, 14 TRANSP. L.J. 101, 112-118 (1985) (discussing the politics of railroad regulation).

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.[7] The result was the Interstate Commerce Act (ICC Act),[8] and the founding of the Interstate Commerce Commission (ICC), under which the government itself set prices on behalf of the railroad cartels.[9] 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.[10]

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."[11] 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.[12] 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."[13] 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."[14] 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.[15] 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.)).

8. Interstate Commerce Act, ch. 104, 24 Stat. 879 (1887) (codified as amended in scattered sections of 49 U.S.C.).

9. *Id.* at 529-30.

10. *Id.* at 529.

11. George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3, 5 (1971).

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.

13. KOLKO, *supra* note 4, at 148.

14. KOLKO, *supra* note 4, at 139 (quoting N.Y. PRESS, Mar. 16, 1906).

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,"[16] 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).[17] 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[18] - this despite the fact that the airline industry itself expanded by 23,800 percentage points during this same period.[19]

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."[20] 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,[21] thereby costing consumers up to $3.5 billion in excess fares.[22] The government's end to sponsored price fixing and exclusion of competition was the Airline Deregulation Act of 1978 (ADA)[23] which placed "maximum reliance on competitive market forces."[24] 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).

16. *See* Dempsey, *supra* note 15, at 93.

17. Dempsey, *supra* note 15, at 115.

18. Dempsey, *supra* note 15, at 109, 115, 131, 173, 174.

19. STEPHEN BREYER, REGULATION AND ITS REFORM 206 (1982).

20. FRIEDLAENDER, *supra* note 3, at vii:

> 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.

21. *Oversight of the CAB Practices and Procedures: Hearings Before the Subcomm. On Administrative Practice and Procedure of the S. Comm. on the Judiciary*, 94th Cong. 454 (1975) [hereinafter *Kennedy Hearings*] (statement of Dr. William A. Jordan, Professor of Managerial Economics, York University).

22. *Id.* at 457.

23. Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705 (1978) (codified as amended in scattered sections of 49 U.S.C.).

24. PAUL BIEDERMAN, THE U.S. AIRLINE INDUSTRY: END OF AN ERA 80 (1982).

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.[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.[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.[27]

Since I testified before Congress on September 10, 1985[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

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

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*].

27. *Id.* at 4-7, 9-10.

28. *Government Policies on the Transfer of Operating Rights Granted by the Federal Government, Particularly Certificates of Public Convenience and Necessity and Airport Slots: Hearings Before the Subcomm. On Aviation of the H. Comm. on Public Works and Transportation*, 99th Cong. 175-82 (1985) (statement of Robert M. Hardaway, Acting Director of the Transportation Law Journal, College of Law Denver University).

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 comprehensive analysis. Proposed herein is the adoption of "cabotage," defined by the Standard Dictionary of the English language as "air transport of passengers and goods within the same national territory."[29] The definition adopted by International Civil Aviation Organization (ICAO) at the Chicago Convention[30] is, "Each state shall have the right to refuse permission to the aircraft of other contracting states to take on its territory passengers, mail, and cargo destined for another point within its territory."[31] Current international agreements, often misleadingly described as "open skies" agreements," provide only for reciprocal rights of U.S. and foreign governments to share international routes.[32] Under such an agreement a carrier is permitted to carry passengers from country X to city A in country Y, and to carry some of those same passengers from city A to city B in country Y. These agreements do not permit a foreign carrier to pick up passengers in city A and carry them to city B.

Part II briefly reviews the regulatory history of the U.S. domestic airline industry. Part III reviews the causes of the current trend to reconsolidation of the domestic airline industry, including the contribution of antitrust and bankruptcy policies. Part IV describes the current state of cabotage and examines the political and geopolitical reasons most often posited for resisting its adoption, including the resistance of labor—paradoxically the resistance of both domestic as well as foreign labor. Finally, part V applies basic economic principles to show that that adoption of cabotage would lower fares, increase productivity as well as the GNP of countries participating in cabotage agreements, foster competition, and achieve the goals set forth in the ADA.

29. The International Flight Information Manual, Appendix 4: Terminology (2004), http://www.faa.gove/ats/aat/ifim/ac91-70a04.htm.

30. Chicago Convention on International Civil Aviation, Dec. 7, 1944, 61 Stat. 1180, T.I.A.S. 1591, 15 U.N.T.S. 295.

31. International Flight Information Manual, *supra* note 29.

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, scheduling, 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),[33] on the theory that strict regulation was necessary to protect airlines from "excessive competition."[34] The CAB's chief tool of regulation was to sanction and indeed sponsor the practice of price-fixing,[35] a practice that is criminal when done by private enterprises,[36] and difficult in any case to carry out when businesses attempt to engage in it on their own without the benefit of government enforcement.[37] The CAB also tightly restricted rates, routes, and, most notably, entry into the market.[38] 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.[39] This virtual "Berlin Wall" to entry was enforced even as the industry itself grew by 23,800 percentage points.[40] 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,[42] proponents of the CAB felt that the policies were justified to allow the airlines to reap oligopoly profits.[43] 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).

35. GENERAL ACCOUNTING OFFICE, *supra* note 33, at 21.

36. PAUL S. DEMPSEY & LAURENCE E. GESELL, AIR TRANSPORTATION: FOUNDATIONS FOR THE 21ST CENTURY 275-85 (1997).

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).

39. Michael E. Levine, *Airline Competition in Deregulated Markets: Theory, Firm Strategy, & Public Policy*, 4 YALE J. ON REG. 393, 425 (1987).

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.[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.[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.[46] Shielded from competitive pressures, and secure in their cozy regulated environment, the airlines had no incentive to resist cost inflation.[47] The CAB's policies allowed the airlines to simply use cost increases as the basis for requesting fare increases.[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.[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.[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.

B. Deregulation

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

44. CAB Report, *supra* note 25.

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.

46. Levine, *supra* note 39, at 405.

47. Levine, *supra* note 39, at 405.

48. *See* Hendricks, *Regulation, Deregulation, and Collective Bargaining in Airlines*, 34 Indus. & Lab. Rel. Rev. 67 (1980).

49. U.S. Gen. Accounting Office, GAO/RCED-96-79, Airline Deregulation: Changes in Airfares, Service & Safety at Small, Medium-Sized and Large Communities 12 (Apr. 1996).

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."[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,[52] and that airline regulation had effectively bilked consumers out of $3.5 billion in excess fares.[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.[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.[55] Congress passed the Airline Deregulation Act of 1978 sixteen years after President Kennedy's first call for deregulation.[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.[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[58] - not on its political influence.[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.[60] Instead, fares in real terms declined dramatically during this period[61] despite staggering 105% fuel increases during the period of March 1979-March 1980 alone.[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.[63]

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51. FRIEDLAENDER, *supra* note 3, at vii; *see also supra* text accompanying note 20.

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).

53. *Kennedy Hearings, supra* note 21, at 457 (testimony of Dr. William A. Jordan).

54. STAFF OF S. SUBCOMM. ON ADMINISTRATIVE PRACTICE AND PROCEDURE OF THE COMM. ON THE JUDICIARY, 94TH CONG., REPORT ON CIVIL AERONATUTICS BOARD PRACTICES AND PROCEDURES 452 (Comm. Print 1975); *See also* Hardaway *supra* note 6, at 136.

55. DEMPSEY & GESELL, *supra* note 36, at 275-80.

56. *See* Hardaway *supra* note 6, at 136-37.

57. *See* Hardaway *supra* note 6, at 137.

58. *See* Hardaway *supra* note 6, at 137.

59. *See* Hardaway *supra* note 6, at 137.

60. *See* Hardaway *supra* note 6, at 143-44.

61. Hardaway *supra* note 6, at 144.

62. Hardaway *supra* note 6, at 144.

63. *See* Hardaway *supra* note 6, at 138.

In addition to deceasing fares, deregulation allowed many new airlines to begin service throughout the country.[64] By 1981 more than eleven newly formed airlines had entered the industry.[65] Market share of new entrants more than tripled between 1978 and 1983,[66] while that of the major carriers decreased proportionately. By 1984, airline productivity had skyrocketed, the number of passenger miles almost doubled[67] and in the first two years of deregulation the number of employees in the industry increased by over 30,000.[68] Over the first five years of deregulation local service employment even increased by 13,000.[69] 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.[70]

But consumers were the greatest beneficiaries of deregulation. By eliminating costly and inefficient cross-subsidization,[71] deregulation gave airlines the incentive to use appropriately sized aircraft for service to small communities,[72] while at the same time increasing service to those communities.[73] 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.[74] Between 1970 and 1975, airlines cut small community flights by over twenty-five percent.[75] By 1983, however, after five years of deregulation, there were more city-pair markets receiving non-stop service than in 1978.[76] 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

64. Hardaway *supra* note 6, at 141.

65. Hardaway *supra* note 6, at 141

66. *See* Hardaway *supra* note 6, at 143.

67. Melvin A. Brenner, James O. Leet & Elihu Schott, 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.

68. *See* Hardaway *supra* note 6, at 140.

69. *See id.* at 140.

70. *Id.*

71. *Id.* at 146- 47.

72. *See* Hardaway *supra* note 6, at 147.

73. *See id.*

74. *Id.* at 146.

75. *Id.*

76. *Id.* at 147.

deregulation)."[77]

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.[78] 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.[79] 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.[80] 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."[81] 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."[82] 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.[83] 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, AEI J. Gov't & Soc., 26-27 (May-June 1982)).

78. *Id.* at 148.

79. Rob O'Dell, *Hub Airports Stifle Competition, Panel Told*, Atlanta J. Const. June 15, 2000, *available at* http://archives.californiaaviation.org/airport/msg08824.html.

80. Jan K. Brueckner, *Reducing Airport Congestion: A partially self-correcting problem?*, 25 U. Ill. Inst. of Gov't & Pub. Aff. Pol'y F. 5 (2002).

81. *Aviation Competition Enhancement Act of 1997: Hearing Before the Subcomm. on Commerce, Sci. and Transp.* 105th Cong. (1997) (statement of Edward P. Faberman, Executive Director, Air Carrier Association of America) at http://commerce.senate.gov/hearings/1028fabe.htm.

82. Paul S. Dempsey, *Predation, Competition & Antitrust Law: Turbulence in the Airline Industry*, 67 J. Air L. & Com. 685, 690 (2002).

83. *Airline Mergers and their Effect on American Consumers: Hearing before the Subcomm. on Comm., Trade and Consumer Prot.*, 107th Cong. 14-16 (2001) (statement of Rep. Peter Peter A. DeFazio, Member, House Aviation Subcomm.).

FARE COMPARISON: COMPARABLE MARKETS WITH AND WITHOUT LOW-FARE COMPETITION[84]

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

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.[85] Northwest Airlines dominated Detroit, and Minneapolis-St. Paul.[86] Northwest's average hub market share was the highest average of any other U.S. major carrier.[87] The correlation between dominance and higher fares is demonstrated with Northwest's Detroit-Boston city pair.[88] 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%.[89] Altogether, on twenty-five routes with the largest average fares, Northwest was the dominant carrier on seven of them.[90] 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."[91] Delta Airlines also has three hubs, one of which is Cincinnati, another airport identified by the GAO as being highly dominated with increased

84. U.S. DEP'T. OF TRANSP., OFF. OF THE ASSISTANT SEC'Y FOR AVIATION AND INT'L AFFAIRS, DOMESTIC AVIATION SERIES, DOMINATED HUB FARES (2001).

85. *Barriers to Entry Continue in Key Markets*, *supra* note 26.

86. Paul S. Dempsey, *Antitrust Law and Policy in Transportation: Monopoly is the Name of the Game*, 21 GA. L. REV. 505, 512 (1987).

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.

88. Donna Rosato, *Flying Into Pockets of Pain: How Hub Airports Keep Fares High*, USA TODAY, Feb. 23, 1998 at 01B.

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.*

91. Paul S. Dempsey, *Predatory Practices & Monopolization in the Airline Industry: A Case Study of Minneapolis/St. Paul*, 29 TRANSP. L. J. 129, 163 (2002).

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 hub[97] 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-

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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 Boisseau, *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.

101. George Williams, The Airline Industry and the Impact of Deregulation 18 (Revised ed., Ashgate Publishing Limited 1996) (1993).

spoke network,[102] whereby "feeder traffic" could be brought in through regional spokes to a large central hub airport.[103] Such a network allowed more connections between cities than would have been possible with the linear route structure.[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.[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.[106]

Despite its apparent advantages, the hub-and-spoke network has not been shown to be more efficient than the linear route system.[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.[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."[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,[110] and even to establish exclusive use rights to a terminal.[111] Employing such strategies at the hubs as long-term leases,[112] majority-in-interest

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102. Robert M. Hardaway & Paul S. Dempsey, *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. GENERAL ACCOUNTING OFFICE, *supra* note 33, at 24.

103. CONSUMER UNION, *The big trouble with air travel (Why fares are headed up and service down.)* CONSUMER REP. 53, 3 (June 1988).

104. WILLIAMS, *supra* note 101, at 14-15, 19.

105. WILLIAMS, *supra* note 101, at 18.

106. WILLIAMS, *supra* note 101, at 18.

107. CONG. OF THE U.S., CONG. BUDGET OFFICE, FIN. U.S. AIRPORTS IN THE 1980's 8-11 (Apr. 1984).

108. Paul S. Dempsey, *Airlines in Turbulence: Strategies for Survival*, 23 TRANSP. L.J. 15, 33-38 (1995).

109. Hardaway & Dempsey, *supra* note 102, at 471.

110. GENERAL ACCOUNTING OFFICE, *supra* note 33, at 12.

111. *Id.* at 25. This is due to limits on airport capacity and the size of the air travel market. *Id.*

112. Hardaway, *supra* note 38, at 20. Many long term airline gate leases were, to a large

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.

113. Hardaway, *supra* note 38, at 19-20.

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.

116. Paul S. Dempsey, *Predation, Competition, & Antitrust Law: Turbulence in the Airline Industry*; 52 J. AIR L. & COM. 685, 697 (2002).

117. *Id.* at 695.

118. Scott McCartney, *Why Travelers Benefit When an Airline Hub Closes*, WALL ST. J., Nov. 1, 2005, at D1.

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]

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

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.[126] For instance, at Chicago O'Hare airport, two airlines control approximately eighty-five percent of the takeoff and landing slots;[127] and a few carriers dominate the majority of slots at Reagan National, LaGuardia, and Kennedy.[128] The established carriers continued to increase their control.[129] The following table indicates this trend from 1990 - 1999.

Increase in Slot and Gate Control[130]

Airport/Holding Entity	Percentage Held		
	1991	1996	1999
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
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
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
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

126. *Barriers to Entry Continue in Key Markets*, *supra* note 26, at 5.

127. *Barriers to Entry Continue in Key Markets*, *supra* note 26, at 5.

128. *Barriers to Entry Continue in Some Domestic Markets*: *Testimony Before the Subcommittee on Consumer and Environ. Affairs, Comm. on Government Affairs, U.S. Senate,* GAO/RCED-98-112 (Mar. 5, 1998) (statement by John H. Anderson, Jr., Ass'n Director Transp. Issues Resources, Community, & Econ. Dev. Division) [hereinafter *Barriers Continue in Markets*].

129. *See, e.g., Barriers to Entry Continue in Key Markets*, *supra* note 26, at 5.

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.[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.[132] The fixed number of slots has resulted in a sellers market;[133] and slots are costly with prices exceeding $2 million for peak period slots and off peak slots selling for about $500,000.[134] Not only do the airlines consider the slots private assets for sale, but they also use them as collateral in securing loans.[135]

A new entrant experiences extreme difficulty in buying slots because established carriers rarely put the slots up for sale.[136] A new entrant requires about six slots to be competitive, with three in the peak periods.[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.[138]

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

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U. of Technology, Workgroup for Infrastructure Policy 2002), http://www.imprint-eu.org/public/Papers/IMPRINT_Czerny&Tegner.pdf.

131. *Id.* at 2 & 5.

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.

133. Hardaway, *supra* note 132, at 63.

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.

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.

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.

137. *Barriers to Entry Continue in Key Markets*, *supra* note 26, at 6.

138. *Barriers to Entry Continue in Key Markets*, *supra* note 26, at 6.

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.

or forfeit.[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.[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.[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.[143] Frontier, AirTran Airlines and AirTran Airways obtained slots into LaGuardia, Reno Air and Trans States Airlines into O'Hare.[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."[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.[146] Development of these facilities is complicated financially.

Concentration at hubs tends to create substantial investment requirements.[147] The investment capital can be raised through general obligation bonds and/or revenue bonds.[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.[149] Most investment capital is currently raised through revenue bonds and may impact the terms and conditions of an airline's airport use agreement.[150] An airport use agreement is a contract identifying the rights and privileges between the airport operator and the airline.[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.[152]

The airport practice of entering into long term lease agreements with

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140. *Barriers to Entry Continue in Key Markets*, *supra* note 26, at 6.

141. *Barriers to Entry Continue in Key Markets*, *supra* note 26, at 6.

142. *Barriers to Entry Continue in Key Markets*, *supra* note 26, at 6.

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.

144. Barriers Continue in Markets, *supra* note 128, at 5; *Barriers to Entry Continue in Key Markets*, *supra* note 26, at 5.

145. Barriers Continue in Markets, *supra* note 128, at 5; The FAA Authorization Act of 1994 (P.L. 103-305, sec. 206).

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).

147. Congressional Budget Office, Financing U.S. Airports in the 1980's 9 (1984).

148. *Id.* at 17.

149. *Id.*

150. Dempsey & Gesell, *supra* note 36, at 450.

151. Financing U.S. Airports in the 1980's, *supra* note 147 at 18 (1984).

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.[153] The subleases frequently restrict use of the gates to non-preferred times and at higher costs than paid by the incumbent.[154] For instance, Southwest leased space at Detroit from Northwest and paid nineteen times what Northwest paid for the space.[155] Northwest also sublets one gate to Frontier at Minneapolis, telling Frontier when the gate can be used.[156] 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.[157]

Exclusive use agreements also present the potential for an airline to hold more gates than necessary for currently scheduled operations.[158] The nature of these agreements prevents the airport operator from offering underused or unused gates to another airline.[159]

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.[160] This arrangement still allows the lessee to seize the space if they later decide to schedule operations during those times.[161] Another solution is recapture provisions, allowing the operator to require the incumbent to forfeit or share gates not being used,[162]; however only seven percent of concentrated airports have such provisions.[163]

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

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153. UNITED STATES GENERAL ACCOUNTING OFFICE, AIRLINE COMPETITION: INDUSTRY OPERATING AND MARKETING PRACTICES LIMIT MARKET ENTRY, 42 (1990) [hereinafter *Operating and Marketing Practices*].

154. *Barriers to Entry Continue in Key Markets*, *supra* note 26, at 9.

155. Hardaway, *supra* note 132, at 54

156. *Low Fare Carriers Demand Access to Major Airports*, WORLD AIRLINE NEWS, Jul. 24, 1998.

157. *Operating and Marketing Practices*, *supra* note 153, at 42.

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 Schmickle & 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.[164] 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.[165]

At some airports, all gates were governed by exclusive use leases.[166] 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.[167] The larger the share of gates leased under the agreements, the higher the fares.[168] The following lists the airports where post-deregulation airlines reported difficulty gaining competitive access to gates.

EXCLUSIVE GATE LEASES[169]

Airport	Total Number of Gates	Gates Under Exclusive Leases	Major Lease Holder and Date of Lease Expiration
Charlotte	48	43	34 gates leased to USAir until 2007
Cincinnati	67	67	50 gates leased to Delta with 9 leases expiring in 2015 and 41 expiring in 2023
Detroit	86	76	64 gates leased to Northwest until the end of 2008, with all but 10 under exclusive use terms
Minneapolis	65	65	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.
Newark	94	79	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.
Pittsburgh	75	66	50 gates leased to USAir until 2018.

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.[170] 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.[171]

Agreements often provide airlines with significant power over air-

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.
167. Barriers Continue in Markets, *supra* note 128, at 6.
168. *Operating and Marketing Practices*, *supra* note 153, at 18.
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.
171. *Operating and Marketing Practices*, *supra* note 153, at 32.

port ventures and pricing policy.[172] 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.[173] 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.[174]

Thus airport operators rarely proceed with major projects without conferring with the airlines operating at the airports.[175] This is mostly due to wary investors who might hesitate in a bond issue for a project lacking approval of the airlines.[176]

Long-term agreements negatively affect competition if used to prevent expansion of facilities for new-entrant airlines.[177]

The GAO found that airlines and airports have different perceptions of the timing of projects.[178] 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.[179] The GAO found that the airlines' position may restrict capacity at these airports, possibly discouraging entry.[180] Airline officials claim signatory airline actions under majority-in-interest agreements have never directly precluded new entrants from initiating service.[181] 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.[182] Therefore, the resulting delays may discourage competitive entry.[183]

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172. FINANCING U.S. AIRPORTS IN THE 1980's, *supra* note 147, at 24.

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.

174. FINANCING U.S. AIRPORTS IN THE 1980's, *supra* note 147, at 25.

175. FINANCING U.S. AIRPORTS IN THE 1980's, *supra* note 147, at 25.

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.

177. *Operating and Marketing Practices*, *supra* note 153, at 48.

178. *Operating and Marketing Practices*, *supra* note 153, at 49.

179. *Operating and Marketing Practices*, *supra* note 153, at 49.

180. *Operating and Marketing Practices*, *supra* note 153, at 49.

181. *Operating and Marketing Practices*, *supra* note 153, at 49.

182. *Operating and Marketing Practices*, *supra* note 153, at 48

183. *Operating and Marketing Practices*, *supra* note 153, at 49.

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.[184] Thus, a philosophy borrowed from the FDIC's experience with savings and loans was adopted: allow failing and inefficient airlines to merge.[185] 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.[186] 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).[187] ACA was based at Washington Dulles International Airport and operated under the United logo and codes.[188] Another United Airlines partner, Mesa Air, made a bid to purchase ACA.[189] United solved this problem by merging with Mesa Air.[190]

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."[191] Even still, the merged company became the largest airline in Europe, and one of the largest in the world.[192] US Airways and America West merged in September of 2005 creating the United States' "largest full-service, low-cost, low-fare airline."[193] In 1990, America West was the first start-up airline since industry deregulation to reach major-airline

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).

187. *Aviation*, 2004 A.B.A. Sec. Pub. Util., Comm., & Transp. L. Ann. Rep. 59, 71.

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.

193. Press Release, US Airways, Reorganized US Airways Group, Inc. Completes Merger with America West Airlines (Sept. 27, 2005).

status.[194]

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[195] and SkyTeam was initiated by Air France and Delta Airlines in 1999.[196] Star Alliance evolved from an agreement in 1992 between Air Canada and United Airlines.[197] 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.[198]

Entry into the industry by new competitors is already difficult, based on present barriers that exist at major airports.[199] The alliances can sometimes intensify concentration;[200] 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.[201]

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 -

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194. *US Airways, America West Complete Merger*, Consumer Affairs, Sept. 27, 2005, *available at* http://www.consumeraffairs.com/news04/2005/usair_americawest6.html.

195. Oneworld.com, Oneworld Fact Sheets, http://www.oneworld.com/ow/news-and-information/fact-sheets/details?objectID=21&tempURLParam (last visited Nov. 7, 2006).

196. SkyTeam.com, About SkyTeam: History, http://www.skyteam.com/EN/aboutSkyteam/history.jsp#2000 (last visited Nov. 7, 2006).

197. StarAlliance.com, Media Room: History, http://www.staralliance.com/star_alliance/star/frame/main_10.html (last visited Nov. 7, 2006).

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.).

200. *Proposed Alliances, supra* note 199, at 11.

201. *Proposed Alliances, supra* note 199, at 2.

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.[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.[203] However, the U.S. Government has traditionally been reluctant to allow airlines to fail.[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.[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.[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.[207]

Currently, Delta and Northwest have Chapter 11 status.[208] American has threatened to file bankruptcy,[209] United recently emerged from bankruptcy[210] and US Airways has done the same through a merger.[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-

202. *Proposed Alliances, supra* note 199, at 15

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).

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

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*].

206. *Id.* at 9, 10, 19.

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.

208. Press Release, Delta Airlines, *Delta Air Lines Files for Chapter 11 Reorganization to Address Fin. Challenges* (Sept. 14, 2005); Press Release, Northwest Airlines, *Northwest Airlines Restructuring* (Sept. 14, 2005).

209. Aviation, *supra* note 187, at 59.

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

211. *Pension Problems, supra* note 205, at 17.

penses and liability while under Chapter 11 bankruptcy status.[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."[213] Low-cost carriers benefit most from major airline bankruptcies as they rush in to fill the lost capacity space.[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.[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.[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."[217] The current U.S. cabotage rules stem from the 1920s Jones Act,[218] which requires that goods shipped between U.S. ports must travel on vessels owned and staffed by Americans.[219] The Jones Act restrictions were expanded to include all forms of transportation, including aircraft.[220] Generally, cabotage rights are only granted if the country requesting cabotage rights grants a similar privilege to U.S. carriers, and if

212. *Pension Problems*, *supra* note 205, at 1, 17, 37, 53.

213. Subcomm. on Aviation, *Hearing on Current Situation and Future Outlook of U.S. Commercial Airline Industry*, Sept. 28, 2005, at 2, http://www.house.gov/transportation/aviation/09-28-05/09-28-05memo.html.

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.

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).

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).

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.

218. 46 U.S.C.S. § 883 (Matthew Bender & Co., Inc. 2006)(commonly referred to as the Jones Act).

219. *Id.*

220. *See* Eric V. Hull, *Through the Looking Glass: Judicial Interpretation of Vessel Status Leaves Injured Workers Adrift in Unchanged Territory*, 16 U.S.F. Mar. L.J. 321, 341 (2003-2004).

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

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221. *See* 49 U.S.C.S. § 41703 (a)-(b) (West 2006); U.S. DEP'T OF TRANSP., *supra* note 217.

222. Federal Aviation Act of 1958, §§ 402, 416(b), *amended by* 49 U.S.C.A. § 1372 (current version at 49 U.S.C.A. § 41301-41302 (1994), 1386(b) (current version at 49 U.S.C.A. 40109 (1994)); Air N.Z. Limited v. Civil Aeronautics Bd., 726 F.2d 832, 834 (D.C. Cir. 1984).

223. Federal Aviation Act of 1958, §§ 416(b), 1006, *amended by* 49 U.S.C.A. § 1372 (current version at 49 U.S.C.A. § 41301-41302 (1994)), 49 U.S.C.A. §§ 1386(b), 1486 (current version at 49 U.S.C.A. § 40109 (1994)); Island Airlines, Inc. v. Civil Aeronautics Bd., 363 F.2d 120, 125 (9th Cir. 1966).

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

225. U.S. DEP'T OF TRANSP., *supra* note 217.

226. *See* U.S. DEP'T OF STATE, BUREAU OF ECONOMIC AND BUSINESS AFFAIRS, *Open Skies Agreements*, Aug. 29, 2006, http://www.state.gov/e/eb/tra/c661.htm; THE JOURNAL OF COMMERCE ONLINE, *EU Urged to Accept Partial Air Pact*, AIR CARGO WORLD, 2003, http://www.aircargoworld.com/break_news/04122004a.htm.

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.[228] 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.[229] 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%.[230]

In 2002, the European Court struck down the draft Open Skies agreement, saying it violated the laws of the 15-nation EU common market.[231] 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.[232] 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.[233] 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.[234] 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.[235]

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.[236] 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

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NOMIC AND BUSINESS AFFAIRS, Apr. 13, 2004, at Article 3, *available at* http://www.state.gov/e/eb/rls/othr/19514.htm.

228. *See* U.S. DEP'T OF STATE, *Open Skies Partners*, BUREAU OF ECONOMIC AND BUSINESS AFFAIRS, Oct. 19, 2006, at 2, *available at* http://www.state.gov/e/eb/rls/othr/2006/22281.htm.

229. *See* THE JOURNAL OF COMMERCE ONLINE, *EU Urged to Accept Partial Air Pact*, AIR CARGO WORLD, 2003, http://www.aircargoworld.com/break_news/04122004a.htm.

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]

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237. *Northwest, Delta Look Overseas for Profits*, *supra* note 215, at 2.

238. *Id.*

239. Christopher Elliott, *Let Foreign Airlines Fly Inside USA*, USA Today, Dec. 18, 2002, at 13A.

240. *Id.*

241. *See* Edward Hasbrouck, *Airline Subsidies, Alliances, and Code-sharing*, The Practical Nomad, Jan. 30, 2006, *available at* http://www.hasbrouck.org/articles/alliances.html.

242. *See generally* George Raine, *Taking to the Air Low-fare Startup Virgin America Says it Has the Funding to Fly*, San Francisco Chronicle, Dec. 9, 2005, at 2, *available at* http://www.sfgate.com/cgi-bin/article.cgi?f=/C/a/2005/12/09/BUGA2G58LF1.DTL&hw=virgin&sn=003&sc=934.

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-

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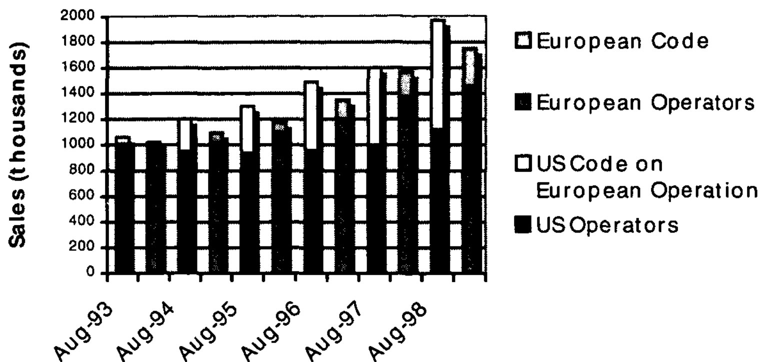
2003), *in* COMPETITIVE ENTER. INST., at 6-7, *available at* http://www.cei.org/gencon/023,03641 .cfm.

245. *See* ALPA'S GLOBAL AVIATION STRATEGY GROUP, *The Global Airline Market Heats Up,* AIR LINE PILOT, Oct. 2000, at 4, *available at* http://cf.alpa.org/internet/alp/2000/oct00p18 .htm.

246. *See* Duane E. Woerth, *Airline Labor Law in the Era of Globalization: The Need to Correct a Misreading of the Railway Labor Act,* ISSUES IN AVIATION L. AND POL'Y, 16,013 (Oct. 2001).

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).

248. Charles A. Hunnicutt, *US and EU: New Era, New Agreement? Opportunity to Build a Global System,* 18 AIR & SPACE LAW. 1, 14-15 (2003).



rialize for U.S. carriers because U.S. airline labor costs were cheaper than their European counterparts.[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.[250] The results can be seen in the following chart covering growth from 1993 through 1998.[251]

Airline Code-Share Growth between 1993 and 1998[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.[253] A similar event took place involving Atlas Air with the opening of a domicile in the United Kingdom.[254] FedEx and Atlas claimed that the Railway Labor Act[255] (RLA) did not apply to the pilots who were based in a foreign domicile, and therefore the wages and work-

249. Captain Duane Woerth, *Liberalization of the International Air-Transportation Industry: How Will US Pilots Fare?*, ALPA.Org, *available at* http://cf.alpa.org/internet/prescorner/codeshare/index.htm.

250. *Id.*

251. Woerth, *supra* note 249, at figure 2.

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* 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).

253. Woerth, *supra* note 249.

254. Woerth, *supra* note 249.

255. Woerth, *supra* note 249.

ing conditions for those pilots would be negotiated separately from the agreement applicable to pilots based in the United States.[256]

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.[257] 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.[258] This shell game leaves the employee with virtually no means of protest for any disputes with the airline.[259]

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.[260] 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.[261]

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 US city while operating under that foreign carrier's native laws and regulations pertaining to safety and security, labor and the environment.[262] 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.[263] In essence the EU operation flying within the U.S. would become a U.S. carrier. Therefore, the EU operation within

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).

257. Dodd, *supra*, note 243.

258. *Id.*

259. *Id.*.

260. Bob Davis & Anita Raghavan, *Competing Views: GE-Honeywell Deal Gets Caught Up in Diverging Histories*, WALL ST. J., Jul. 3, 2001, at A1.

261. *Id.*

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.

263. *Id.*

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."[272] New-entry carriers such as JetBlue do not compete with the major carriers on most international flights.[273] 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."[274] Another obstacle is that these flights require larger aircraft than most discounters fly.[275]

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.[276] Northwest's Chief Financial Officer went so far as to say that his airline's future viability depends on foreign operations.[277] 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.[278] Because profits are never guaranteed, the major carriers may not survive even if they do

272. *Northwest, Delta Look Overseas for Profits, supra* note 215, at 1.
273. *Northwest, Delta Look Overseas for Profits, supra* note 215, at 1.
274. *Northwest, Delta Look Overseas for Profits, supra* note 215, at 1.
275. *Northwest, Delta Look Overseas for Profits, supra* note 215, at 1.
276. *Northwest, Delta Look Overseas for Profits, supra* note 215, at 1.
277. *Northwest, Delta Look Overseas for Profits, supra* note 215, at 1.
278. *Northwest, Delta Look Overseas for Profits, supra* note 215, at 2.

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]

279. *Northwest, Delta Look Overseas for Profits*, *supra* note 215, at 2.

280. Paul A. Samuelson & William D. Nordhaus, Economics 688 (Irwin McGraw Hill, 6th ed. 1998) (1948).

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

Necessary Labor for Production		
Product	In the U.S.	In Europe
1 unit of food	1	3
1 unit of clothing	2	4

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 ¾ 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 ½ unit of clothing. The European worker earns only 1/3 unit of food or ¼ 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 ½ for food to clothing and the European price ratio of ¾ 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 2/3 (a number between the previous U.S. ratio of ½ and the Europe ratio of ¾) 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.[289] 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.[290] They "affect world prices the least and therefore can trade at world prices that are very different from domestic prices."[291]

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.'"[292] The more countries involved, the more efficient the trade. Thus, multilateral trade is more efficient than bilateral trade.[293]

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.[294] 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.[295] The first is that the theory "assumes a smoothly working competitive economy with flexible prices and wages and no involuntary unemployment."[296] 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.[297] This creates inefficiencies. The changes that the theory brings often cause "underutilized labor and capital" to lobby to protect their interests from foreign competitors.[298] As a result, the theory is not very popular during down times, such as when "high tariff walls" were erected during the Great Depression.[299] 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."[300]

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."[301] "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."[302] 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."[303] 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."[304]

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.[305] 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."[306] 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."[307]

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.[308] 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.[309]

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.[310]

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

305. *See* Alfred E. Kahn, *Change, Challenge, and Competition: A Review of the Airline Commission Report*, REG.: THE CATO REV. OF BUS. & GOV'T, Fall 1993.

306. Daniel P. Rollman, *Flying Low: Chapter 11's Contribution to the Self-Destructive Nature of Airline Industry Economics*, 21 EMORY BANKR. DEV. J. 381, 404 (2004).

307. *Id.* at 413.

308. *See Pension Problems*, *supra* note 205, at 3.

309. *See Pension Problems*, *supra* note 205, at 3.

310. Severin Borenstein & Nancy L. Rose, *Do Airlines in Chapter 11 Harm Their Rivals?* 20 (Nat'l Bureau of Econ. Research, Working Paper No. 5047, 1995).

Benefit Guaranty Company (PBGC).[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.[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.[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."[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.[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.[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.[317] But the ability of low-cost carriers in the U.S. to succeed and profit amidst these and other significant obstacles[318] are an indication of U.S. potential for success in open domestic competition against foreign carriers.

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311. *Commercial Aviation: Preliminary Observations on Legacy Airlines' Financial Conditions, Bankruptcy, and Pension Issues, Before the Comm. on Transportation and Infrastructure, Subcomm. on Aviation*, 3 (2005) [hereinafter *Hearings*] (statement of JayEtta Z. Hecker, Director, Physical Infrastructure Issues & Barbara D. Bovjberg, Director, Education, Workforce, and Income Security Issues).

312. *See Pension Problems*, *supra* note 205, at 37.

313. *See Pension Problems*, *supra* note 205, at 37.

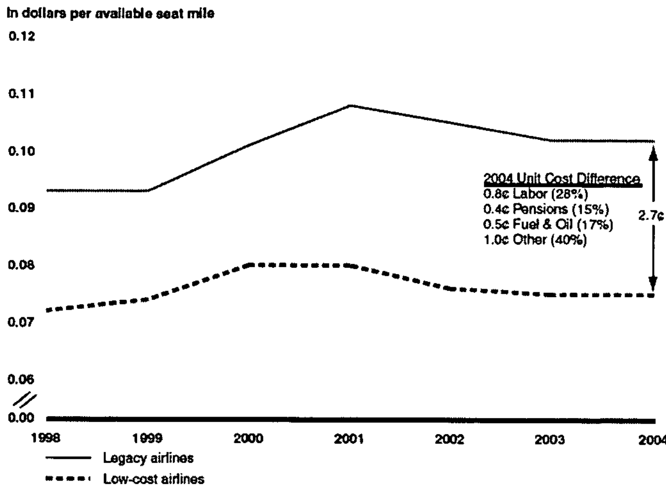
314. *See Pension Problems*, *supra* note 205, at 3.

315. *See Pension Problems*, *supra* note 205, at 57.

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)).

317. *See generally* Press Release, Lufthansa, *Lufthansa Lifts Nine-Month Operating Result to 471 Million Euros*, Lufthansa, Nov. 11, 2005, http://konzern.lufthansa.com/en/html/presse/pressemeldungen/index.html?c=nachrichten/app/show/en/2005/11/514/HOM&s=0 (discussing Lufthansa's operating results and positive financial forecast).

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.

324. *See* Press Release, THE INT'L AIR TRANSP. ASSOC., *IATA Challenges EU on Flawed Regulation Airlines Can't Make the Sunshine*, 8IATA, Apr. 21, 2004, *available at* http://www.iata.org/pressroom/pr/2004/2004-04-21-01.htm (discussing IATA's application for judicial review challenging new EU Regulation 261/2004).

legislation, which would increase liability and costs.[325]

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 deeded necessary under Homeland Security laws.

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325. *See id.*