I. The Disintegration of the U.S. Airline Industry

Paul Stephen Dempsey*

The airline industry is in an unprecedented crisis, one that was not entirely unforeseen, but one which was nonetheless, unfortunate and avoidable. As 1991 dawned, five major airlines, accounting for nearly one-fourth of the nation's aviation passenger capacity, found themselves in some stage of liquidation, desperately selling off operating assets to raise enough cash to stay aloft. Five have also stumbled into bankruptcy, and one of those died. The U.S. fleet of aircraft is now the oldest in the developed world. The entire U.S. publicly-traded passenger airline industry could be purchased today for about $14 billion,[1] less than the value of either Japan Air Lines or All Nippon Airways individually — despite the fact that the U.S. market is the largest in the world. These are the proud legacies of airline deregulation.

Before deregulation, many industry analysts warned that after a binge of destructive competition, only a handful of airlines would survive.[2] These warnings were dismissed by deregulation proponents who saw nearly textbook levels of competition everywhere they looked.[3] Alfred

* Paul Stephen Dempsey is a Professor of Law and Director of the Transportation Law Program at the University of Denver College of Law. He holds the following degrees: A.B.J., J.D., University of Georgia; LL.M., George Washington University; and D.C.L., McGill University.

1. AVIATION DAILY, July 8, 1991, at 24.

2. Dempsey, *The Rise and Fall of the Civil Aeronautics Board-Opening Wide the Floodgates of Entry*, 11 TRANSP. L.J. 91 (1979).

3. *See generally*, P. DEMPSEY, FLYING BLIND: THE FAILURE OF AIRLINE DEREGULATION (1990).

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Kahn, the architect of airline deregulation, recently confessed, "We thought an airplane was nothing but a marginal cost with wings."[4]

Deregulation was supposed to produce lots of new airlines. Congress was told that barriers to entry and economies of scale were insignificant; new entrants would emerge to prevent the industry from becoming concentrated; even if new entrants didn't materialize, the threat of new entry would discipline the market, for aviation markets were, in theory, "contestable."[5]

In deregulation's inaugural years, new airlines appeared; but most couldn't survive. Many, like People Express, were consumed in mergers and acquisitions or, like Air Florida and nearly 200 other airlines, fell into the abyss of bankruptcy.[6] Although they sent ticket prices spiraling downward, new entrants never accounted for more than about 5% of the passenger market. New entry is highly unlikely today.

The magnitude of the crisis with which the airlines are now confronted is unparalleled in the history of commercial aviation. In January 1991, after a prolonged illness, Eastern Air Lines was laid to rest. The tragedy that was Eastern's could be dismissed as an aberration were it not for the fact that four other major U.S. airlines — Continental, Pan Am, TWA and Midway — are liquidating major operating assets to stay aloft. Pan Am, Continental, Midway and America West have also stumbled into bankruptcy, Continental for the second time (some call it Chapter 22 bankruptcy). TWA has announced its intention to enter bankruptcy. More will likely follow. Take a closer look at the disintegrating airlines:

A year after closing its Kansas City hub, Eastern entered bankruptcy and sold its Washington-New York-Boston shuttle (to Donald Trump for $365 million) as well as the Latin American routes it picked up a few years earlier at Braniff's fire sale (to American Airlines for $310 million). After running out of cash, it ceased operations in January, 1991. Delta and United were the highest bidders in the Eastern liquidation of gates, landing slots and routes.[7]

Pan Am sold its trans-Atlantic routes to London and beyond to United for $400 million.[8] Pan Am has also agreed to sell its Washington-New

4. Passell, *Why Only a Few Big Airlines Prosper in a Deregulated Sky*, N.Y. TIMES, Jan 2, 1991 at A1, C8 col. 1.

5. See Dempsey, *The Rise and Fall of the Civil Aeronautics Board: Opening Wide the Floodgates of Entry*, 11 TRANSP. L.J. 91 (1979).

6. Uchitelle, *Off Course*, N.Y. TIMES MAGAZINE (Sept. 1, 1991), at 12, 14.

7. Delta purchased Eastern's Atlanta gates for $41 million. Delta Moves Quickly to Purchase Major Eastern Assets, Aviation Daily, Jan. 22, 1991, at 133; Eastern Asset Distribution February 5, 1991, Aviation Daily, Feb. 7, 1991, at 258. However, the U.S. Department of Justice has objected to United's acquisition of Eastern's landing slots and gates at Washington National Airport. United is already the dominant airline at Washington Dulles Airport.

8. *Losses Color 1990 Red for U.S. Airlines*, AVIATION DAILY, Jan. 2, 1991, at 5.

York-Boston shuttle and remaining transatlantic routes to Delta for $621 million cash and $668 million in assumed liabilities.[9] The 1980s was a decade of dismemberment for anemic Pan Am, during which it sold off its trans-Pacific routes (again to United, for $750 million), its Intercontinental Hotel chain, and the Manhattan skyscraper which still bears its name. The 1990s look even worse for this once proud pioneer of international aviation, now in bankruptcy. Deregulation brought us Market Darwinism, a product of the Jeffrey Dahmer school of economics, pursuant to which the stronger airlines tear off the arms and legs of the weaker carriers and consumed them. With Pan Am, only the heart (its Latin American operations, which is where it began in the 1920s) remains. The larger airlines are saving that, to eat later.

TWA is selling off international routes, gates and landing slots at Chicago and Washington, D.C. American is spending $445 million for TWA's Heathrow authority as well as other domestic airport and landing slot assets.[10]

Midway sold the Philadelphia gates it picked up at Eastern's fire sale, to USAir, at a $32 million loss, then entered bankruptcy.[11] The airline lost $139 million in 1990, a tremendous loss for a carrier that size.[12]

In bankruptcy for the second time in a decade, Continental sold its lucrative Seattle-Tokyo route to American Airlines, for $150 million.[13] Continental lost more than $400 million in the first six months of 1991. Recently, it has explored buy-outs with Marvin Davis, H. Ross Perot, Jr., Northwest Airlines and USAir.

Other U.S. airlines are having serious problems. USAir lost nearly half a billion dollars in 1990.[14] It has tightened its belt significantly by reducing flights, withdrawing from markets (including the California routes it acquired in its acquisition of PSA only five years ago), and furloughing thousands of workers.[15]

Of course, a few gargantuan airlines will survive. The healthiest three, United, American and Delta, already control more than half the mar-

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9. O'Brian, *Delta, Despite Victory in Pan Am Bid, Faces Some Big Challenges*, WALL ST. J., Aug. 13, 1991, at 1, col. 1.

10. *Losses Color 1990 Red for U.S. Airlines*, AVIATION DAILY, Jan. 2, 1991, at 5.

11. *Losses Color 1990 Red for U.S. Airlines*, AVIATION DAILY, Jan. 2, 1991, at 5; *Midway-USAir Deal Anti-Trust Implications Under Review*, AVIATION DAILY, Oct. 22, 1990, at 143.

12. Schellhardt, *Midway Air Posts Big Loss for Period, Suspends Payments*, WALL ST. J., Feb. 8, 1991, at B4.

13. *DOT Approves Continental Tokyo Route Transfer to American*, AVIATION DAILY, Jan. 10, 1991, at 60.

14. *USAir 1990 Loss $500 Million; Reducing Capacity 4-5 Percent*, AVIATION DAILY, Jan. 28, 1991, at 173.

15. *USAir Furloughs More Employees, Slates Several Facilities for Closing*, AVIATION DAILY, Feb. 12, 1991, at 280.

ket.[16] All three are on a buying binge, gobbling up the dismembered parts of the disintegrating airlines.

The airline industry suffered recessions and sharply increased fuel costs before deregulation. Fuel prices shot up 300% in the 1970s, after the Arab oil embargo of 1973, and there was recession in the early 1970s as well.[17] But never before have major airlines collapsed.

All the world's airlines are paying the sharply higher fuel prices inspired by the Persian Gulf crisis, and all are suffering from the early pangs of global recession. But only America's are in bankruptcy, only America's have died, and only America's are selling off operating assets — despite the fact that international aviation fuel costs more than domestic fuel. Why are America's airlines having such difficulty in today's marketplace?

II. DOT Secretary Skinner's Observations on the Contemporary Crisis in the Airline Industry

In early 1991, the Secretary of Transportation, Samuel Skinner, delivered a speech before the National Press Club and testified before two Congressional committees in which he addressed the contemporary crisis in the airline industry. Distilled to its essence, Secretary Skinner made the following points:

1. The contemporary shakeout will leave air passenger transportation dominated by "more than three and less than seven" airlines over the next few years and, as a consequence, "some of the lowest fares will disappear."[18]
2. The deregulation experiment is not the cause of the industry's problems. It is instead a profound success, and the deregulation debate is proclaimed over.[19]
3. While deregulation is not the cause of the industry's problems, labor costs are.[20]
4. Foreign ownership is the cure for the industry's ills.[21]

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16. *American, United and Delta account for 47% of the revenue passenger miles flown by U.S. carriers in 1990*, AVIATION DAILY, Jan. 29, 1991, at 189. The five disintegrating airlines — Continental, TWA, Pan Am, Eastern and Midway — together accounted for 28% of the revenue passenger miles in 1990. *Id.*

17. P. DEMPSEY, FLYING BLIND: THE FAILURE OF AIRLINE DEREGULATION (1990).

18. *Five Major Airlines Enough for Competition, Secretary Says*, AVIATION DAILY, Feb. 6, 1991, at 241.

19. *DOT Secretary, Labor Differ On Blame for Industry's Ills*, AVIATION DAILY, Feb. 11, 1991, at 273.

20. *See* Statement of Secretary of Transportation Samuel K. Skinner Before the Subcomm. on Aviation of the House Comm. on Public Works and Transportation (Feb. 5, 1991).

21. *DOT Secretary Opens Door for Increased Foreign Ownership of U.S. Airlines*, AVIATION DAILY, Jan. 24, 1991, at 151; McGinley, *Transport Aide Backs Raising Limit On Foreign Holdings in U.S. Airlines*, WALL ST. J., Feb. 20, 1991, at A8.

Only Skinner's first conclusion is probably correct. The industry will achieve even higher levels of concentration than the unprecedented levels it has already reached. Before deregulation, the eight largest airlines controlled eighty percent of the domestic passenger market. They now control ninety-four percent. The five disintegrating airlines accounted for about twenty-five percent of the domestic market, which if Secretary Skinner is right, will likely be distributed among four to six surviving airlines. The three largest airlines (American, United and Delta) already account for more than half the domestic market.

A growing number of industry experts and concerned citizens dispute Secretary Skinner's second point. Eastern Airlines trustee Marty Shugrue observed, "Deregulation is simply not working out as anticipated. There are far fewer airlines than when deregulation began. Of the remaining carriers, more than half are struggling and several may well go the way of Eastern."[22]

Aviation fuel costs soared 300% during the 1970s, and the industry was plagued by recession then as well; but not a single airline folded, entered bankruptcy, or liquidated operating assets. Then of course, the industry was regulated; today it is not.

Today, aviation fuel is cheaper than before Saddam Hussein invaded Kuwait. While fuel costs rose significantly during the crisis, they were nonetheless lower in actual and real terms than they were a decade ago. Between 1981 and 1984, the actual cost per gallon of aviation fuel ranged between $0.79 and $1.04 per gallon, while in real terms (adjusted for inflation) it ranged between $1.04 and $1.47. In 1990, aviation fuel sold for only $0.80 per gallon.[23] Despite the fact that fuel is cheaper, today five airlines are liquidating operating assets.

The first decade of deregulation produced a blood bath of ruinous competition. The industry as a whole enjoyed a average profit margin on less than one percent during the 1980s (compared with an average of between three percent and six percent for manufacturers).[24] Excessive losses produced nearly 200 bankruptcies and fifty mergers during deregulation's first decade. The DOT never met a merger it didn't like, approv-

22. Shugrue, Jr., *More Airlines Will Share Eastern's Fate Unless We Act Now to Save Them*, *USA Today*, Jan. 31, 1991 at 8A. *DOT Secretary Opens Door for Increased Foreign Ownership of U.S. Airlines*, AVIATION DAILY, Jan. 24, 1991, at 151; McGinley, *Transport Aide Backs Raising Limit On Foreign Holdings in U.S. Airlines*, WALL ST. J., Feb. 20, 1991, at A8.

23. Flint, *Don't Blame It All On Fuel*, AIR TRANSPORT WORLD, Feb. 1991, at 32.

24. *See Testimony of Philip Baggaley (vice president, Standard & Poor's) Before the Aviation Subcomm. of the House Comm. on Public Works and Transportation* (Feb. 6, 1991), at 3. Baggaley says the industry's profit margin was 1% during this period. As we shall see below, other sources suggest the profit margin was only .6%.

ing all twenty-one submitted to it.[25] Deregulation also freed corporate raiders like Carl Icahn and Frank Lorenzo to strip airlines of assets. Debt service is now crushing the operating profits of the disintegrating airlines. DOT could have stopped it, but chose not to intervene.

The economic anemia unleashed by deregulation forced airlines to defer new equipment purchases. Sadly, U.S. airlines today fly the oldest fleet of aircraft in the developed world. The geriatric jets burn more fuel.[26] They are also less safe.

Deregulation created the fuel-guzzling hub-and-spoke phenomenon, which requires flying passengers more miles, with more takeoffs and landings, and creating more airway congestion than before. Flying older jets more miles necessarily consumes more fuel. So when fuel costs rise even modestly, as they did during the Persian Gulf crisis, the profit margin disappears.

Secretary Skinner is therefore wrong. Deregulation must shoulder at least part of the blame for the industry's disintegration and unprecedented concentration. The same is true in the savings and loan industry, and the trucking and bus industries.

We will address Secretary Skinners other conclusions in greater detail below. First, let us examine the principal survival characteristics of airlines in these unfriendly skies.

III. Survival Characteristics of U.S. Airlines

After more than a decade of deregulation, several survival characteristics appear essential for survival of airlines. Listed below are nine:[27]

1. MULTIPLE HUBS, STRATEGICALLY LOCATED
2. FREQUENT FLYER PROGRAMS
3. COMPUTER RESERVATIONS SYSTEMS
4. SOPHISTICATED YIELD MANAGEMENT
5. FUEL EFFICIENT FLEET OF STANDARDIZED AIRCRAFT
6. LOW DEBT (CONSERVATIVE GROWTH)
7. LOW WAGES/FLEXIBLE WORK RULES
8. SUPERIOR SERVICE
9. INTERNATIONAL ROUTES

These survival criteria are neither listed in order of importance, nor are they of equal value. But generally speaking, the more of them an

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25. See Dempsey, *Antitrust Law and Policy in Transportation: Monopoly I$ the Name of the Game*, 21 Ga. L. Rev. 505 (1987).

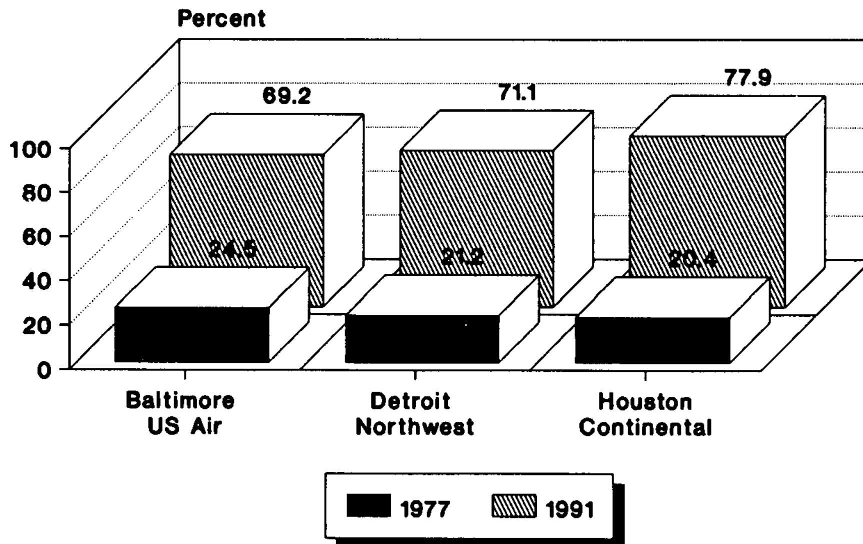
26. "[T]he decline in fuel prices [of 31% between 1985 and 1986] encouraged airlines to continue to operate fuel-inefficient aircraft beyond the point at which they would have been retired . . . ." Flint, *Don't Blame It All On Fuel*, Air Transport World (Feb. 1991), at 32.

27. Not to take all the credit, several of these characteristics, or derivations of them, have been identified by other sources, including work done on the subject by Airline Economics, Inc.

airline possesses, the better its chances for survival. Let us examine each:

1. MULTIPLE HUBS, STRATEGICALLY LOCATED — Before deregulation, while Atlanta (for Delta) and Pittsburgh (for Allegheny, now USAir), were moderately concentrated, no airline dominated more than fifty percent of the market (measured by gates, passengers, or takeoffs and landings) at any major airport in the nation. Today, dominant airlines control more than sixty percent of the market (sometimes more than ninety percent) at about eighteen major airports; none were so dominated before deregulation. The infrastructure of gates and landing slots at the major airports has been consumed by the megacarriers, leaving little room for new entry.[28] Charts I through III reveal the growth in concentration at several of the nation's largest airports.

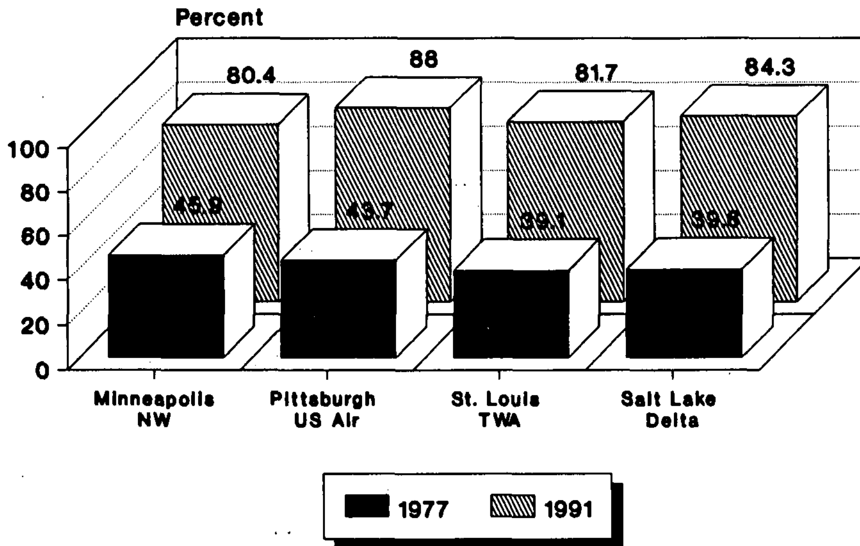
Chart I — Single Carrier Market Share at Concentrated Airports



Strategically located hubs are designated to allow the carriers to blanket the nation with service. For example, United has hubs at Chicago, Denver, San Francisco, and Washington, D.C. (Dulles). American Airlines has expanded its traditional hubs at Chicago and Dallas/Ft. Worth, and established new ones at San Jose, Nashville, Raleigh/Durham, and

28. *Intelligence*, AVIATION DAILY, Aug. 20, 1990, at 323 (88% of the gates at the nation's 66 largest airports are leased to airlines, and 85% of the leases are for exclusive use.)

Chart II — Single Carrier Market Share at Concentrated Airports



San Juan. Delta has hubs at Atlanta, Dallas/Ft. Worth, Salt Lake City, and Cincinnati.

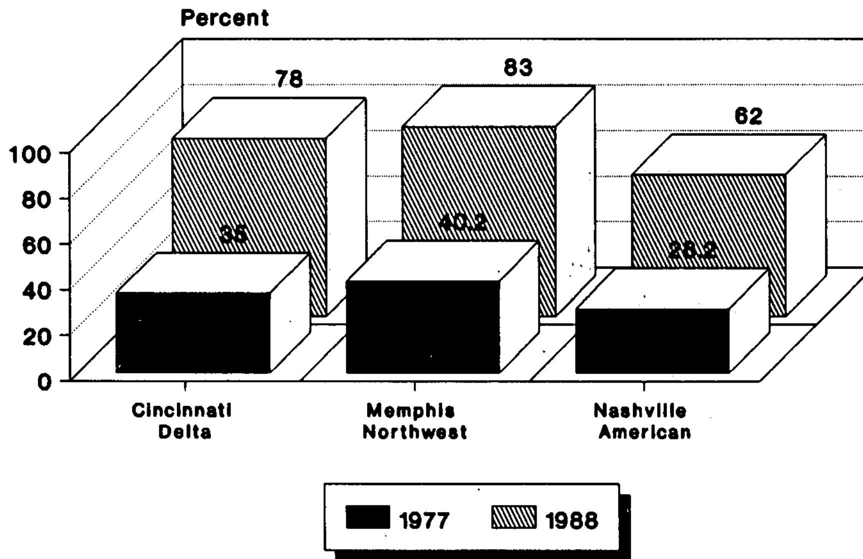
In contrast, TWA has a domestic hub only at St. Louis (and an international hub at New York-Kennedy). Pan Am dominates no domestic airport. America West is hubbed at Phoenix. Midway has a hub at Chicago's Midway Airport. Among the troubled airlines, only Continental has multiple strategically located hubs — at Houston, Denver, Cleveland and Newark (the latter it acquired from People Express on its death bed).

Moreover, consumption of airport infrastructure can translate into higher yields. Yields at concentrated airports are twenty-seven percent higher per mile for passengers who begin or end their trips there than at unconcentrated airports.[29] Airlines with more gates, takeoff and landing slots (at capacity constrained airports), and/or code sharing agreements charge significantly higher prices than those without, according to the U.S. General Accounting Office [GAO].

For example, as of 1988, the eight largest airlines owned ninety-six percent of the landing and takeoff slots at the four slot-constrained airports (i.e., Chicago O'Hare, Washington National, and New York's Kennedy and LaGuardia). In 1985, before the Department of Transportation decreed they could be bought and sold in the market, the eight largest

29. General Accounting Office, Airline Competition: Higher Fares and Reduced Competition at Concentrated Airports (1990).

Chart III — Single Carrier Market Share at Concentrated Airports



airlines controlled only seventy percent of the slots.[30] Fares are seven percent higher, on average, at slot constrained airports.[31] Moreover, an airline which doubles the number of its gates enjoys a 3.5% increase in fares.[32]

2. FREQUENT FLYER PROGRAMS — The widespread service permitted by multiple hubs allows airlines to enjoy economies of density, and better market their product to the most lucrative customer, the business traveler. For example, United Airlines serves all fifty states, not because each is profitable, but because it can offer to fill all the geographic needs of business travelers.

Airlines offer to fill business persons' needs, while luring them with rewards of free travel to exotic destinations. In essence, airlines encourage business fraud. Suppose, for example, a distributor of copying paper offered to sell paper to a business executive at a price twenty-five percent higher than his competitors, but promised him two free first class airline tickets to Hawaii if he bought the paper all year long. Wouldn't the business executive be defrauding his company if he purchased the higher-priced paper? Yet that is precisely the type of inducement that

30. GENERAL ACCOUNTING OFFICE, AIRLINE COMPETITION: INDUSTRY OPERATING AND MARKETING PRACTICES LIMIT MARKET ENTRY 4 (1990).

31. GENERAL ACCOUNTING OFFICE, TESTIMONY OF KENNETH MEAD BEFORE THE AVIATION SUBCOMM. OF THE U.S. SENATE COMMERCE COMM. 6 (Apr. 5, 1990).

32. Id. at 6.

airlines offer business travelers addicted to their frequent flyer programs. Once addicted, many business travelers select, and bill their companies for, the higher-priced flight on the airline, satiating their desire for free travel. Indeed, seventy-five percent of travel agents report that their business customers chose to fly a particular airline more than half the time because of their membership in a frequent flyer program.[33]

3. COMPUTER RESERVATIONS SYSTEMS — Eighty percent of flights are booked through travel agents, and ninety-five percent of agents use one of the airline-owned computer reservations systems.[34] According to the GAO, an airline which owns its own computer reservations system stands between a thirteen-eighteen percent better chance of selling its product through its system than does a competitor.[35] American Airlines pioneered them, with SABRE. United owns APOLLO. Continental owns SYSTEM ONE, which it took from Eastern for a good deal less than its fair market value. TWA, Northwest and Delta share the combination of PARS and DATAS II (now named WORLDSPAN).

Computer reservations systems have created a sophisticated and expedient means of exchanging pricing proposals, and have facilitated implicit price fixing.[36] They also produce extraordinary profits for their owners, far beyond the rents which could be exacted in a fully competitive market.

4. SOPHISTICATED YIELD MANAGEMENT — Airlines have learned that by watching passenger demand carefully, they can shrewdly manipulate the number of seats for which restricted discounts are offered on an hourly basis, and fill seats with passengers paying the maximum price. That explains the phenomenon of thousands (40,000 to 80,000) of rate changes each day.[37]

Consumer groups complain that by offering cut-rate fares for only a relatively small number of seats, airlines are engaging in "bait-and-switch" advertising.[38] The bewildering array of fares has also increased transactions costs for consumers.

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33. GENERAL ACCOUTING OFFICE, AIRLINE COMPETITION: INDUSTRY OPERATING AND MARKETING PRACTICES LIMIT MARKET ENTRY 4 (1990).

34. GENERAL ACCOUNTING OFFICE, AIRLINE COMPETITION: HIGHER FARES AND REDUCED COMPETITION AT CONCENTRATED AIRPORTS 27 (1990). Airlines attempt to induce travel agents to book flights with them by offering commission overrides, which offer economic inducements for exceeding quotas. A poll of travel agents reveals that more than half of them "usually" of "sometimes" select a carrier in order to obtain override commissions. *Id.* at 29.

35. GENERAL ACCOUNTING OFFICE, AIRLINE COMPETITION: IMPACT OF COMPUTERIZED RESERVATION SYSTEMS (1986).

36. *See* Nomani, *Fare Warning: How Airlines Trade Price Plans*, WALL ST. J., Oct. 9, 1990, at B1.

37. Uchitelle, *Off Course*, N.Y. TIMES MAGAZINE (Sept. 1, 1991), at 12, 16.

38. *See* Cowan & Gargan, *Mirage of Discount Air Fares Is Frustrating to Many Fliers*, N.Y. TIMES, Apr. 22, 1991, at 1.

Yield management is actually a euphemism for pricing discrimination and market segmentation. Pricing discrimination can be divided in two categories, based upon the demand characteristics of the passenger and the supply characteristics of the market. On the demand side, passengers fall into three categories: (1) discretionary travelers; (2) large business travelers; and (3) small and medium business travelers. Airlines have learned that by offering discounts, they can tap the elasticities of demand and encourage individuals to fly who might not otherwise and, thereby, fill seats which otherwise would go empty. However, the airlines don't want to sell these discounted seats to passengers who otherwise would fly, particularly business travelers, who often need to fly on short notice and would prefer to be home with their families on weekends. Thus, the discounted fares are loaded with restrictions. They require advance purchase (up to three weeks before travel), are wholly or partially nonrefundable, and require that the passenger stay over a Saturday night. Business travelers are divided into two broad categories: those who work for large corporations; and those who work for small and medium size businesses. A Fortune 500 corporation (or indeed, any corporation which does more than half a million dollars in travel annually) can negotiate a contract rate with the airlines allowing its employees to travel at a rate nearly as low as the discretionary price, but without the onerous restrictions. However, small and medium size businesses and professionals do not have the oligopsony power to negotiate a fair price for service, and are forced to pay the full Y fare, or something close to it.

During the first decade of deregulation, the full unrestricted coach fare shot up 156%, a level double the inflation rate.[39] While most passengers (in fact, some ninety percent) travel on some sort of a discount, the range of discounts are taken off a reference rate which is much higher than it was before deregulation. Thus, many passengers, particularly professionals and those who work for small and medium size businesses, pay a rate well above pre-deregulation levels. This should be of some public policy concern in light of the fact that small businesses create ninety percent of America's jobs. If a small firm cannot get its sales force out to market its product at a fair price, it cannot compete as effectively with large firms selling similar products.

Transportation is an infrastructure industry essential for commerce, communications and national defense. It is the veins and arteries through which commerce flows. Distortions here will result in distortions in the

39. Ott, *Industry Officials Praise Deregulation*, But Cite Flaws, AV. WEEK & SPACE TECH. (Oct. 31, 1988), at 88; P. DEMPSEY, FLYING BLIND: THE FAILURE OF AIRLINE DEREGULATION 33 (1990).

broader market for the purchase and sale of products in the national distribution market.

The second plane along which airlines have segmented the market is geographic in nature. Trips of more than a thousand miles usually have multiple hub competition to drive down prices to competitive levels. But prices for passengers who begin or end their trips at a concentrated hub airport are some twenty-seven percent higher than in competitive markets. Also, passengers who live in small communities served by only a single airline pay higher prices for airline service.

Of course, widespread pricing discrimination is driven by the chronic propensity of airlines to engage in below-cost pricing when they compete head-to-head. They do so for two reasons. First, airlines sell what is, in effect, an instantly perishable commodity. Once a scheduled flight pulls away from the jetway, any empty seats are lost forever. They cannot be warehoused and sold another day. Second, the short term marginal costs of production are nil. Adding another bottom to fill an empty seat costs the airline only a bag of peanuts, a cup of Coca-Cola, and a few drops of fuel. These two characteristics tend to result in a pricing structure which, in competitive markets, fails to cover the full costs of production. Before regulation in 1938, this phenomenon was labeled "destructive competition."[40]

Today, it might be called the "death spiral," the consequences of which meant bankruptcy for about 200 airlines. These economic characteristics encourage airlines to compete to the death in competitive markets, hoping to establish market dominance if they are lucky enough to survive, and to look to those markets in which they already enjoy dominance to cross-subsidize losses in competitive markets. This has, of course, produced an unprecedented number of mergers, consolidations, bankruptcies, and widespread pricing discrimination (a/k/a "yield management").

5. FUEL EFFICIENT FLEET OF STANDARDIZED AIRCRAFT — The economic anemia created by the destructive competition unleashed by deregulation left airlines with inadequate resources to buy new planes, causing the U.S. fleet to degenerate into the oldest in the developed world. Thirty-one percent of the U.S. fleet now exceeds the economic design goals originally set by the manufacturers.[41] Older generation aircraft gulp more fuel. TWA and Pan Am fly the oldest jets in our geriatric U.S. fleet.

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40. *See generally*, Dempsey, *Running On Empty: Trucking Deregulation and Economic Theory*, 43 ADMIN. L. REV. 253, 299-311 (1991).

41. GENERAL ACCOUNTING OFFICE, TESTIMONY OF KENNETH MEAD BEFORE THE SUBCOMM. ON AVIATION OF THE HOUSE COMM. ON PUBLIC WORKS AND TRANSPORTATION: MEETING THE AGING AIRCRAFT CHALLENGE (Oct. 10, 1989).

Merged airlines have been forced to deal with the problems of consolidating huge fleets of aircraft of inconsistent types from several manufacturers, which increase the cost of maintenance and require multiple inventories of spare parts. As Chart IV reveals, deregulation led to an unprecedented number of mergers and acquisitions during its first decade.

As a consequence, Continental, which flies the fleets of former carriers like Texas International, New York Air, People Express and Frontier, experiences this problem. Northwest flies the fleets of North Central, Southern and Hughes Airwest, which merged to form Republic, which Northwest acquired. In contrast, airlines which grow from within (such as, for the most part, American and United) save maintenance cost and aircraft downtime by growing incrementally with relatively standardized fleets. United has placed orders for new aircraft which will expand its fleet by between forty percent and ninety percent, all with a single manufacturer, Boeing, "promoting commonality within the fleet which assures significant long-term operational efficiencies."[42] Moreover, because of the oligopsony power wielded by the larger airlines, they buy aircraft at a unit price significantly lower than that paid by smaller airlines.

Incidentally, the largest airlines now control the order books at the major aircraft manufacturers. Both American and United are taking delivery of new jets every week (and will through the middle of this decade), while the collapsing airlines are not. As noted above, newer generation aircraft are relatively fuel efficient. This will matter more as the decade proceeds toward the statutory retirement of Stage 2 aircraft on December 31, 1999. As of May 1990, the airlines with the highest percentage of aging Stage 2 aircraft were: Eastern (seventy percent), Northwest (sixty-five percent), Pan Am (fifty-eight percent), USAir (fifty-five percent), TWA (fifty-five percent), Continental (fifty-two percent), and Midway (eighty-five percent).[43] In contrast, only thirty-one percent of American's fleet consists of Stage 2 aircraft.[44]

As noted above, deregulation also produced the fuel guzzling hub-and-spoke phenomenon — the dominant megatrend on the deregulation landscape. Hubbing requires that airlines fly passengers more miles in smaller aircraft with more takeoffs and landings. Indeed, hubbing led many airlines to cancel orders for wide-body aircraft in the early 1980s, and either fly their existing jets or place orders for narrow-bodied planes. The average seat mile costs for a wide-bodied aircraft like a Boeing 747 are about half that of a narrow-bodied plane like a Boeing 737 or 727.

42. UAL CORPORATION, ANNUAL REPORT 7 (1990).

43. Memorandum from Samuel K. Skinner to Congressman James Oberstar, Oct. 25, 1990.

44. AMR CORPORATION, ANNUAL REPORT 27 (1990).

Chart IV — Major Air Carrier Mergers, Acquisitions, Purchases and Consolidations Since Progulgation of the Airlines Deregulation Act of 1978

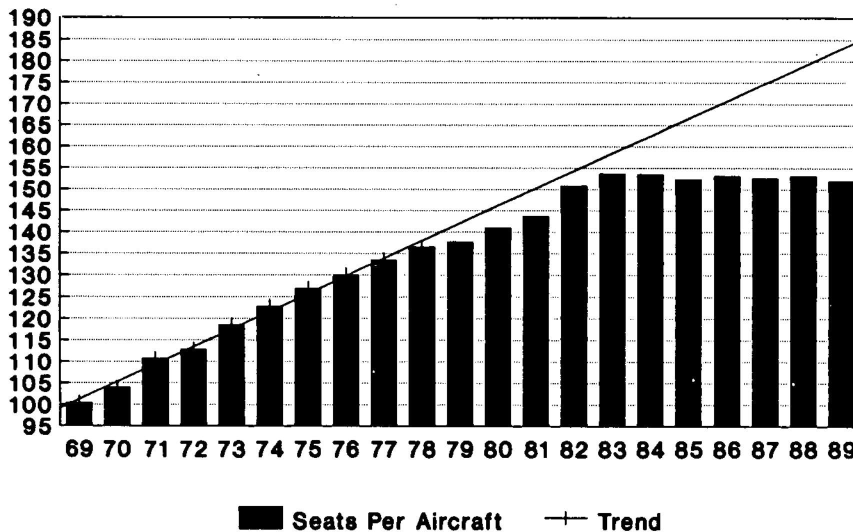
Carriers merged / acquired	Resulting carrier	Market Share 1987	1988	1989	1990	1991
American; Air Cal; TWA (London routes); Eastern (Latin American routes)	AMERICAN	13.8	15.2	17.8	17.5	17.0
United; Pan Am (Transpacific, Latin American, & London Routes); Air Wisconsin	UNITED	16.9	16.4	16.9	17.2	16.8
Delta; Western; Pan Am (European routes and N.Y. shuttle)	DELTA	12.2	12.0	14.4	13.4	13.0
Northwest; North Central — Republic; Southern; Hughes Airwest	NORTHWEST	10.3	8.9	11.1	11.7	11.5
Texas International; Continental; New York Air; Frontier — People Express; Britt; PBA; Braniff (Latin America) — Eastern; Rocky Mountain	TEXAS AIR*	19.0	19.3	12.2	12.7	8.7
USAIR; PSA; Empire — Piedmont; Henson; Midway (Philadelphia gates and Canadian routes)	USAIR	7.1	7.2	8.2	8.1	7.9
TWA; Ozark	TWA	8.2	7.4	8.5	7.8	7.9
Pan Am; National; Ransome	PAN AM	6.3	7.1	7.0	7.0	5.9

Sources: 1987 statistics, *Business Week*, Oct. 5, 1987, at 40.
1988-89 statistics, *Wall Street Journal*, Mar. 10, 1989, at A8.
1990 statistics, *Aviation Daily*, Jan. 29, 1991, at 189.
1991 statistics (First Ten Months only), *Aviation Daily*, Nov. 26, 1991, at 859.

* Renamed Continental Airline Holdings

Chart V reveals the pre-deregulation trend toward larger capacity (and lower seat mile cost) aircraft, compared with its reversal in the post-deregulation period.

Chart V — Average Seats Per Aircraft Fiscal Years 1969-1989



Trend shown 1969-1978

Funnelling passengers through constipated hub-and-choke bottlenecks not only squanders billions of dollars of business traveler time and productivity, it burns fuel wastefully. Smaller, older jets flying more miles with more takeoffs and landings necessarily cause their airlines to suffer increased costs during a period of ascending fuel prices.

6. LOW DEBT (CONSERVATIVE GROWTH) — The operating losses engendered by deregulation created enormous debt. Despite reduced wages, airline operating expenses increased ninety-four percent during deregulation's first six years.[45] During deregulation's first decade, the industry suffered a seventy-four percent decline in its profit margin to a mere point six percent — until now, the worst financial period in the industry's history.[46] The industry became an economic basket case, prompting the rash of mergers in the mid-1980s, and bankruptcies, which continue to the present.

Deregulation also freed corporate raiders, like Frank Lorenzo (at Continental and Eastern) and Carl Icahn (at TWA), to loot airlines, leaving

45. GENERAL ACCOUNTING OFFICE, COMPETITION: HIGHER FARES AND REDUCED COMPETITION AT CONCENTRATED AIRPORTS 24 (1990).

46. *US Airline Deregulation a Financial Disaster*, AFN Study Shows, COMMUTER REGIONAL AIRLINE NEWS (Apr. 8, 1991), at 8.

them with suffocating debt. Frank Lorenzo is the only man in history to have bankrupted two airlines (one of them twice).

TWA owes $3.2 billion in long term debt, lease obligations and unfunded pension liability.[47] Continental suffers from about $2.2 billion in debt.[48] Eastern's collapse could expose parent Continental to an additional billion dollars of liability for Eastern's unfunded pension obligations and the transfer of assets into the Texas Air empire at less than fair market value. Interest payments recently exceeded 8% of operating expenses at both TWA and Eastern — the highest in the industry.[49]

As a percentage of total capitalization, Pan Am's debt soared from sixty-two percent in 1980 to 273% in 1989.[50] Pan Am has $3 billion in long-term debt, lease obligations, and unfunded pension liability.[51] Eastern's debt climbed from seventy-nine percent of total capitalization in 1980 to 473% in 1988, its last year before bankruptcy.[52] TWA's debt soared from sixty-two percent in 1980 to 115% in 1989.[53] Continental's rose from sixty-two percent in 1980 to ninety-six percent in 1989.[54] It is no wonder the anemic airlines are cannibalizing assets to stave off extinction. Chart VI reveals this distressing trend.

Representative Byron Dorgan aptly noted, "I'm not so alarmed if they load up a lipstick company with debt and it fails. But if you do that to an airline, it's a real blow to the public interest."[55] Indeed it is. A collapsing infrastructure industry sends shock waves throughout the economy.

The Department of Transportation has long held jurisdiction to investigate the "fitness" of airlines plagued with debt. Here, like with respect to so many of its other statutory responsibilities, DOT has shown no enthusiasm for protecting the public interest.

The enormous debt assumed by Pan Am and Eastern (to shore up declining revenues) and Continental and TWA (to pay off exorbitant debt put on by corporate raiders) appears to be dragging these airlines down a black hole.

Unfortunately, low debt has subjected some airlines to leveraged

47. Smith, *Pan Am Stock Soars As Icahn Makes New Bid*, WALL ST. J., Dec. 18, 1990, at A4.

48. Mahoney, *Financial Fog Still Dogs Continental Airlines*, DENVER POST, Aug. 12, 1990, at G-1.

49. AVIATION DAILY, July 30, 1990, at 192; AVIATION DAILY, Feb. 19; 1991, at 326.

50. AVIATION DAILY, Feb. 13, 1991, at 297.

51. Smith, *Pan Am Stock Soars As Icahn Makes New Bid*, WALL ST. J., Dec. 18, 1990, at A4.

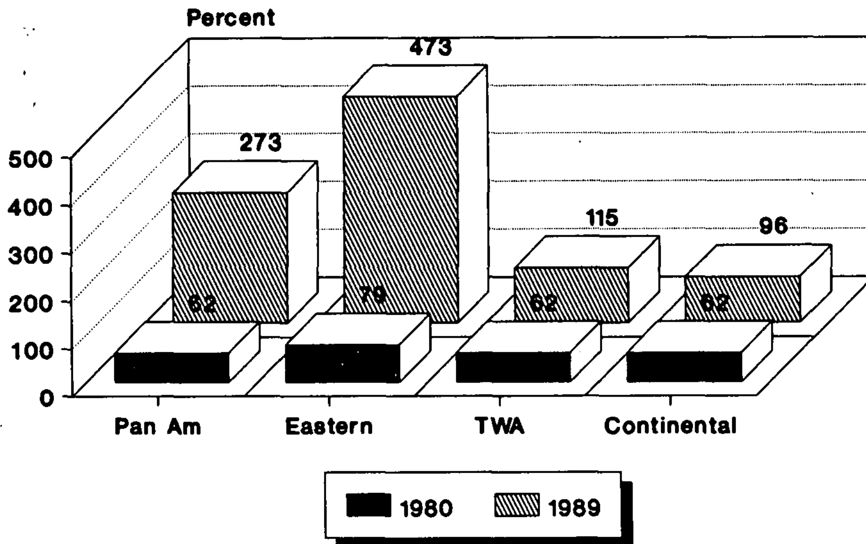
52. AVIATION DAILY, Feb. 13, 1991, at 297.

53. AVIATION DAILY, Feb. 13, 1991, at 297.

54. AVIATION DAILY, Feb. 13, 1991, at 297.

55. Smith, *Trump Bid $7.54 Billion to Acquire American Air*, WALL ST. J., Oct. 6, 1989, at A3.

Chart VI — Debt As a Percentage of Total Capitalization 1980/1989



buy-outs. Low debt suggests there are a lot of assets owned which can be sold to re-pay the debt assumed during the acquisition. For example, Northwest had one of the lowest percentage of aircraft leased (four percent) in the industry prior to its leveraged buy-out.[56] In order to thwart potential LBOs, some airlines have sold aircraft and leased them back, a strategy which reduces the inventory of aircraft which could finance an LBO, but nonetheless increases the long-term costs of doing business, whether the debt shows up on the books of the airline or not. In fact, during the last decade, rental fees (primarily aircraft lease expenses) grew 781%, more than any other operating expense.[57]

Some claim that wealth transfers (from owners and labor) to consumers have totalled billions of dollars per year, and that this savings is overwhelming proof of the success of deregulation as a masterpiece of public policy. Even if it were true that consumers were savings billions (and for reasons expressed below, this is dubious), the cannibalization of assets, the deferment in equipment investment, and the crushing debt is in the long run resulting in an anemic and highly concentrated industry incapable of preserving the competition of which deregulation proponents have been so proud. Moreover, no less an economic scholar than W. Edwards Deming, the single individual most responsible for post-War Japanese

56. AVIATION DAILY, Nov. 6, 1986.

57. *Salaries Have Doubled Since 1980; Other Expenses Grew Faster*, AVIATION DAILY, July 29, 1991, at 173.

prosperity, has observed, "The policy of forever trying to drive down the price of anything purchased with no regard to quality and service, can drive good vendors and good service out of business."[58] Hence, raping an essential infrastructure industry in order to provide alleged short-term consumer benefits is inimical to longer term public policy and national economic interests.

7. LOW WAGES/FLEXIBLE WORK RULES — Some airlines have broken unions and thereby reduced costs. Continental and TWA are prime examples. Although Continental has lower labor costs than any other major airline, not even that has kept it out of bankruptcy. Labor acrimony, perhaps enhanced by the tactics of its former chairman, Frank Lorenzo, cost it dearly in the 1980s.

The airline industry is a service industry. Happy employees can give passengers a lovely trip, and lure them back for another, and another. Angry, embittered employees can do the opposite. For example, the tremendous acrimony between TWA's workers and owner Carl Icahn, has resulted in that airline repeatedly being ranked among the worst among the major airlines in terms of consumer complaints.[59]

Other airlines have convinced unions to settle for two-tier wage rates, with the "B" scale at entry grade. American, United, and Delta are examples. More than half of the present pilots and flight attendants at American, for example, are on the "B" scale. Some of the flight attendants at the two-tier airlines, earning between $950 and $1,220 a month,[60] qualify for food stamps.

In most service industries, salaries account for a disproportionate share of operating costs. But low wages do not guarantee survival. People Express collapsed despite its rock bottom wages. Continental, America West and Midway, also with relatively low wages, are struggling in the contemporary environment.[61]

As a percentage of operating expenses, Delta has among the highest labor costs of any major airline, and Continental the lowest.[62] Yet Delta has thrived under deregulation, and most analysts predict it to be one of the few surviving airlines. There seems to be a rather poor correlation between low wages and survival, despite Secretary Skinner's allegations to the contrary. In fact, as a percentage of operating expenses, employee

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58. W. EDWARDS DEMING, QUALITY, PRODUCTIVITY AND COMPETITIVE POSITION 23 (1982).

59. *See e.g.*, *Rankings of U.S. Carriers Consumer Complaints*, AVIATION DAILY, July 9, 1991, at 45.

60. *Flight Attendant Work Force Grows 10 Percent, Salaries Mostly Unchanged*, AVIATION DAILY, Feb. 12, 1991, at 285.

61. *Continental has the lowest labor costs, as a percentage of operating expenses, of any major U.S. airline.* AVIATION DAILY, Feb. 11, 1991, at 276.

62. AVIATION DAILY, Feb. 11, 1991, at 276.

salaries and benefits *declined* significantly during the 1980s.[63]

8. SUPERIOR SERVICE — Airline service has degenerated universally under deregulation, so consumers have been taught not to expect much. Consumer polls reveal they rate foreign airlines higher than our domestic ones (one showed the highest-ranking U.S. airline as an embarrassing 17th among the world's major airlines).[64] It is no wonder. When USAir consumed Piedmont, its loyal customers were most concerned with whether USAir would continue Piedmont's practice of giving passengers the full can of Coke, rather than just a cup. That one example reflects how far consumer expectations have fallen.

To pose an analogy, before deregulation, we enjoyed chicken fried steak. Now we are relegated to a diet of ground horse meat. Consumers save billions of dollars eating horse meat, but it just doesn't taste the same.

The point is, today, it doesn't take a lot of service to stand out as being better. Consumers can be, and too often are, turned off by late arrivals and departures, dirty planes, inedible food, and embittered employees. The three largest airlines — Delta, United and American — typically are rated higher than other domestic airlines in terms of service.

9. INTERNATIONAL ROUTES — The global air transport market is growing, and many international markets are quite lucrative. Although traffic is temporarily down on the North Atlantic, airlines which serve the North Pacific market enjoy the most attractive yields. Both Northwest and United earn a disproportionate share of their total income from international markets. Between 1987 and 1989, Northwest earned between sixty-eight percent and ninety-one percent of its total operating profit from international markets, while United earned between twenty-four percent and thirty-four percent.[65] Many industry analysts predict international markets will grow faster than domestic markets during this decade.

IV. CONCENTRATION IN THE TRANSPORTATION INDUSTRY

Collapsing airlines means more concentration. Already, the eight largest airlines account for more than ninety percent of the domestic market (up from eighty percent prior to deregulation). Sadly, additional concentration will send ticket prices soaring into the ionosphere.

The Brookings Institution alleges that consumers save $6 billion a

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63. In 1980, labor costs accounted for 37.3% of operating expenses; a decade later, they accounted for only 33.8%. *Salaries Have Doubled Since 1980; Other Expenses Grew Faster*, AVIATION DAILY, July 29, 1991, at 173.

64. CONDE NAST TRAVELER, Nov. 1988, at 26.

65. M. Jedel, *Post Deregulation Strategic Employment Relations Response of the Successful, Surviving Major Domestic Airlines: A Story Not Fully Told* 42 (unpublished monograph).

year because of airline deregulation. Not so. Fuel adjusted real air fares fell at a significantly faster rate during the decade *before* deregulation than in the decade after it. Except for a brief spate of sharply lower fares in the 1977-79 period, post-deregulation fuel and inflation adjusted fares fell at a thirty percent slower rate per mile than in the pre-deregulation period.[66]

The Brookings studies wholly ignore the pre-deregulation trend of falling ticket prices (which for four decades, was driven by technological improvements) and attribute all price savings since promulgation of the Airline Deregulation Act of 1978 to its favorite ideology, deregulation. Brookings also ignores the post-deregulation increased unit costs of operation created by the smaller aircraft mandated by hubbing, the increased labor and fuel costs attributable to circuitous hub connections, the billions of dollars of opportunity costs wasted by business travelers resulting therefrom, as well as the decline the pre-deregulation trend in productivity improvements attainable by new technology (which the U.S. industry has largely been unable to acquire because of inadequate profits and crushing debt). Yet the Brookings studies have been relied on heavily by the U.S. Department of Transportation and other deregulation proponents as proving the splendid success of this masterpiece of public policy.

Paradoxically, while deregulation was supposed to produce more competition, lower prices and better service, it has instead produced more concentration, higher prices and miserable service. Every major prediction made by the textbook economists has proven wrong.

The airline story could itself be considered a curious aberration if the concentration epidemic was not also plaguing every other mode of transport. But under deregulation, the number of major railroads dwindled from twelve to seven, with no significant new entry. Two thirds of the general freight trucking companies collapsed, with no significant new entry. And with the merger of Greyhound and Trailways, the bus duopoly became a monopoly, and is now in bankruptcy; here too, there has been no significant new entry.[67]

V. Cabotage, Foreign Ownership and International Aviation

A. *Cabotage*

The legal concept of cabotage has its origin in maritime law. It is thought to have originated from either the French word "cabot," meaning a small vessel, or the Spanish word "cabo," or "cape," which described

66. P. Dempsey, Flying Blind: The Failure of Airline Deregulation (1990).
67. P. Dempsey, The Social and Economic Consequences of Deregulation (1989).

navigation from cape to cape along the coast without entering the high seas.[68]

In aviation law, cabotage is essentially defined as the transportation of passengers, cargo or mail by a foreign airline between two points in the same nation — the foreign carriage of domestic traffic. It was first articulated in aviation law in 1910, as the French objected to German balloons flying entering French air space.[69] The Paris Convention of 1919 recognized cabotage formally, providing in Article 16 that nations could favor its airlines "in connection with the carriage of persons and goods for hire between two points in its territory."

Article 7 of the Chicago Convention of 1944 addressed the issue in two sentences.[70] The first provides: "Each contracting State shall have the right to refuse permission to the aircraft of other contracting States to take on in its territory passengers, mail and cargo carried for remuneration or hire and destined for another point within its territory." Thus, each nation has exclusive sovereignty over its airspace, and may reserve its domestic traffic to its domestic carriers.

The second sentence of Article 7 provides: "Each contracting State undertakes not to enter into any arrangements which specifically grant any such privilege on an exclusive basis to any other State or an airline of any other State, and not to obtain any such exclusive privilege from any other State." The literal language strongly suggests that if a nation gives away cabotage rights to another state's airline(s), it must give them to all nations on a nondiscriminatory basis.

In the United States, cabotage prohibitions originated in the Air Commerce Act of 1926.[71] Cabotage is generally prohibited under section 1108(b) of the Federal Aviation Act. Under section 401 of the Act, only air carriers (defined as U.S. citizens) may ply the domestic trade.[72] Noncitizens may operate as "foreign air carriers" under section 402, but they must acquire a section 402 permit and their transport rights are limited to foreign air transportation.[73]

In 1991, negotiations between Canada and the United States on a new bilateral air transport agreement included discussions of a partial ex-

68. Schraft & Rosen, *Cabotage Or Sabotage?*, AIRLINE PILOT (Oct. 1987), at 27 [hereinafter Schraft & Rosen].

69. *International Air Transportation Competition Act of 1979: Hearings on S. 2400 Before the Subcomm on Aviation of the Sen. Comm. on Commerce, Science and Transportation*, 96th Cong. 1st Sess. 244-45 (1980) (Statement of ABA Section in Intl. Law)

70. Convention on International Civil Aviation, Opened for signature, Dec. 7, 1944, 61 Stat. 1180, T.I.A.S. No. 1591, Art. 7.

71. 67 Stat. 489.

72. See 49 U.S.C. sec. 1301(3), 1371 (1991).

73. 49 U.S.C. sec. 1301(19), 1372. (1991) P. DEMPSEY, LAW & FOREIGN POLICY IN INTERNATIONAL AVIATION 78 (1987).

change of cabotage rights. In defining negotiating objectives, Congress in 1979 amended the Federal Aviation Act to include a provision requiring "opportunities for carriers of foreign countries to increase their access to United States points if exchanged for benefits of similar magnitude of United States carriers or the traveling public with permanent linkage between rights granted and rights given away."[74] Canada has a larger land mass than the United States, and therefore potentially offers more destinations than would most other nations. But the United States has twenty-four city-pairs that generate more than one million passengers annually, while Canada has but one. The domestic passenger and cargo market in the United States is so many times larger and richer than any other domestic market (even that of a combined European Community) that an exchange of equal rights of "similar magnitude" would be a practical impossibility. As Duane Woerth, vice president of the Air Line Pilots Association, noted, "It's like exchanging gold for tin. Only a zealot who believed in trade for trade's sake could support such an imbalance as fair or astute."[75]

Exchanging cabotage rights would require a statutory change, and therefore could not be negotiated without Congressional approval. Moreover, as noted above, Article 7 of the Chicago Convention insists that giving cabotage rights to one nation requires that it be given to all under a kind of most favored nation basis.

However, an exemption from the cabotage restrictions is available under certain emergency conditions. In 1979, Congress promulgated the International Air Transportation Competition Act, which amended the Federal Aviation Act to allow the U.S. Department of Transportation to confer a thirty-day exemption from the cabotage prohibition if it finds the "public interest" so requires, and ". . . because of an emergency created by unusual circumstances not arising in the normal course of business, traffic in such markets cannot be accommodated by . . ." U.S.-flag carriers, all efforts have been made to accommodate such traffic needs using U.S. airlines (including their lease of foreign aircraft), and the exemption is necessary to avoid undue hardship for the traffic in the market. Where the traffic inconvenience results from a labor dispute, such exemption must not result in an undue advantage to any party thereto.[76]

The Department of Transportation (DOT) has found that these requirements were satisfied in several emergency situations. For example, DOT granted an emergency cabotage exemption to allow Heavylift (a

74. 49 U.S.C. sec 1502(b)(8) (1991).

75. Letter from Captain Duane E. Woerth to Paul Stephen Dempsey (July 24, 1991).

76. 49 U.S.C. sec. 1386(b)(7) (1991). DOT may renew the exemption for periods of up to 30 days. However, the exemption terminates not more than five days after the unusual circumstances that created its need end. *Id.*

U.K.-flag carrier) to provide one-way cargo charter flights between Houston, Texas, and St. Thomas, U.S. Virgin Islands, to support recovery operations in the Virgin Islands in the aftermath of Hurricane Hugo.[77] In order to support oil spill clean-up operations at Valdez, Alaska, the DOT granted North West Territorial Airways Ltd. (a Canadian-flag carrier) an emergency cabotage exemption to provide one-way cargo charter operations between Los Angeles and Anchorage.[78]

The DOT has granted such exemptions by telephone. For example, on April 28, 1987, Qantas Airways (an Australian-flag carrier) requested an emergency cabotage exemption by telephone to transport a single passenger from Honolulu to San Francisco. The passenger was the father of an injured boy being transported from Hadi, Fiji, to the United States on a scheduled Qantas Australia-Nadi-Honolulu-San Francisco flight. DOT concluded that the waiver was clearly required on humanitarian grounds, constituted unusual circumstances, and could not have been accommodated by U.S. carriers since the son was already aboard a Qantas flight and his physical transfer to a U.S. carrier was not practical.[79]

But, when U.S. airlines have been available to provide the service, the DOT has declined to grant the exemption. For example, the DOT denied the application of Lineas Aereas Del Caribe (a Columbian-flag carrier) to transport cattle from Miami to San Juan, Puerto Rico, when it was advised that two U.S. carriers were available to provide the proposed service.[80]

Cabotage restrictions may be avoided in various ways, including "sharing codes, making 'blocked space' arrangements for both passengers and cargo, obtaining an ownership interest in a U.S. carrier, making arrangements between U.S. and foreign carriers covering computer reservations systems, and setting up joint frequent flier and marketing programs."[81]

"Blocked space" arrangements involve the leasing or reservation of a specific number of seats by one passenger airline for its passengers to be flown in aircraft operated by another airline. For example, Northwest might enter into a blocked space agreement with KLM whereby Northwest would sell up to a specified number of seats on the KLM Minneapolis-Amsterdam flight to Northwest's customers. "Code share" arrangements involve the listing in the computer reservation systems of the connecting flights of two airlines as a single through flight number.

77. Application of Heavylift Cargo Airlines Ltd., DOT Order 89-10-7 (1989), at 2.
78. Application of North West Territorial Airways Ltd., DOT Order 89-4-1 (1989), at 2.
79. Application of Qantas Airways Ltd., DOT Order 87-6-63 (1987), at 2.
80. Application of Lineas Aereas Del Caribe, S.A., DOT Order 86-8-37 (1986), at 1.
81. Schraft & Rosen, *supra* at 29.

For example, Continental might show a through Continental flight number from Houston to Stockholm via Newark, although the passengers would fly via Continental from Houston to Newark, and via SAS from Newark to Stockholm.

In considering whether blocked space or code sharing arrangements are in the public interest, the DOT considers such issues as the extent to which the authority involved is consistent with applicable bilateral air transport agreements, whether reciprocity exists on the part of the nation whose flag the foreign carrier flies, and what benefits would accrue to U.S. carriers, passengers and shippers under the proposed arrangements.[82]

B. Foreign Ownership

Almost all bilateral air transport agreements require that carriers designated thereunder be owned and controlled by citizens of the nation from which they originate. Hence, there is no concept of "flags of convenience" in aviation as there is in maritime law.

Foreign ownership restrictions have long been imposed in a number of infrastructure industries in the United States, including telecommunication, broadcasting,[83] electric power production,[84] nuclear power productions,[85] inland and intercoastal shipping,[86] mining on federal lands,[87] and

82. Joint Application of American Airlines, Inc. and Lufthansa German Airlines, DOT Order 91-4-13 (1991), at 2.

83. Foreign owned or controlled corporations are prohibited from receiving licenses to operate as instruments for the transmission of communications. A corporation is defined as foreign-owned if any director or officer is an alien, or if more than one-fifth of its capital stock is owned by aliens, a foreign government, or a corporation organized under the laws of a foreign country. Additionally, a corporation is generally considered as foreign-controlled if it is directly or indirectly controlled by any other corporation, at least one-fourth of whose capital stock is owned by foreign interests. 47 U.S.C. sec. 310(b). (1991)

84. Hydroelectric power sites on navigable streams located within the United States may be developed only by U.S. citizens or domestically organized corporations. 16 U.S.C. sec. 797(e) (1991).

85. No licenses for the operation of atomic energy utilization or production facilities may be issued to aliens or to foreign-owned or foreign-controlled corporations. 42 U.S.C. sec. 2133 (1991).

86. The Jones Act of 1920 requires that any shipping of passengers or property between points in the United States or its territories must be accomplished in vessels constructed and registered in the United States and owned by U.S. citizens. A ship may not be registered in the United States unless the corporation's principal officers are U.S. citizens and 75% of the stock is owned by U.S. citizens. Any vessel that is at any time registered in a foreign country permanently loses these United States shipping rights. Moreover, any eligible vessel weighing more than 500 gross tons that is later rebuilt outside the United States also forfeits these privileges. However, vessels registered in foreign nations granting reciprocal privileges to U.S.-flag vessels may perform intercoastal transportation of empty items, such as cargo vans, barges, shipping tanks, and equipment utilized therewith. 46 U.S.C sec 883 (1991).

87. 30 U.S.C. secs. 22, 24, 71, 181, 352 (1986).

aviation. These requirements reflect the importance these infrastructure industries have in supporting national defense.

Essentially, eligibility to register an airline in the United States is limited to: (a) United States citizens; (b) partnerships in which all partners are United States citizens; or (c) U.S. corporations in which at least two-thirds of the board of directors are U.S. citizens and at least seventy-five percent of the voting stock is owned by U.S. citizens. Moreover, the right to enter into cabotage (trade or transport between two points within the United States) is limited to domestically registered aircraft.[88]

Section 408(a)(4) of the Federal Aviation Act makes it unlawful "for any foreign air carrier or person controlling a foreign air carrier to acquire control in any manner whatsoever of any citizen of the United States substantially engaged in the business of aeronautics."[89] Historically, a presumption of control existed where ownership exceeded 10% of the airline.[90] Securities and Exchange Commission reporting requirements are triggered by the acquisition of five percent. In reality, ownership of substantially lesser percentages of widely held corporations can result in effective "control" (although, as we shall see, the current view of the DOT is that foreign control of U.S. airlines almost never exists). Moreover, it is unlikely that a foreign investor would be interested in investing substantial capital in an airline he could not effectively control.[91] But in the unlikely event a foreign citizen should be deemed by DOT to have "control" of a U.S. airline, it would no longer be deemed a U.S.-flag carrier, and hence prohibited under the cabotage restrictions (described above) from plying the domestic trade.

Another statutory provision provides that in order to qualify as a U.S. citizen (i.e., a U.S.-flag carrier), the airline must have as its ". . . president and two-thirds or more of the board of directors and other managing officers thereof . . . [U.S. citizens and] at least seventy-five per centum of the voting interest is owned or controlled by persons who are citizens of the United States . . . ."[92]

These are, then, separate requirements — that no foreign citizen or airline "control" a U.S.-flag carrier, and that no foreign citizens serve as president, hold more than two-thirds of the seats on the board of directors, or more than twenty-five percent of the voting stock of a U.S. airline.

DOT has also employed its fitness requirements under section 401(r)

88. 49 U.S.C. secs. 1378, 1401, 1508 (1991).

89. 49 U.S.C. sec. 1378(a)(4). The authority of the Department of Transportation under this provision was terminated as of January 1, 1989. 49 U.S.C. sec. 1551(a)(7) (1991).

90. 49 U.S.C. sec. 1378(f) (1991).

91. Feldman, *What Are the Chances of Foreign Ownership of U.S. Airlines?*, AIR TRANSPORT WORLD (Nov. 1987).

92. 49 U.S.C. sec. 1301(16) (1991).

of the Act to monitor foreign control issues.[93]

As to control generally, DOT said this:

> [F]oreign influence may be concentrated or diffuse. It need not be identified with any particular nationality. It need not be shown to have sinister intent. It need not be continually exercisable on a day-to-day basis. If persons other than U.S. citizens, individually or collectively, can significantly influence the affairs of [the U.S. carrier], it is not a U.S. citizen.[94]

The most important case addressing the issue of foreign control of a U.S. airline involved KLM's acquisition of a significant interest in the holding company of Northwest Airlines. In a transaction which increased Northwest's debt-to-equity ratio from 0.42/1 to 5.85/1, in August 1989, Wings Holdings, Inc., acquired control of Northwest with eighty-one and five tenths percent debt and eighteen and five tenths percent equity.

Wings' debt was $3.1 billion, almost two-thirds of which was put up by Japanese banks. Equity was $705 million, of which Alfred Checchi, Gary Wilson and Frederic Malek put up only $40 million (for which they received about half the voting and nonvoting common stock), KLM (a Netherlands airline) put up $400 million (or fifty-seven percent of the equity, for which KLM received seventy percent of Wings' nonvoting preferred stock, thirty-one percent of its nonvoting common stock, and four and nine tenths percent of its voting common stock, as well as a warrant allowing it to convert up to $50 million of its preferred stock into common stock, some of which could be voting), and Elders IXL (an Australian company) put up $80 million (or eleven and three tenths percent of the equity, for which it received ten percent of Wings' nonvoting preferred stock, sixteen percent of its nonvoting common stock, and fifteen and four tenths percent of its voting stock).[95]

Both KLM and Elders had the right to name one representative to the twelve-member Wings' Board of Directors. KLM had the right to name a three-person committee to advise Wings on financial matters, and to enter into a variety of cooperative agreements with Northwest and preclude such agreements with other airlines.[96]

In its first order, issued September 29, 1989, the DOT concluded that unless KLM reduced its equity interest to twenty-five percent, KLM could be in a position to exert actual control over Wings.[97] DOT expressed con-

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93. 49 U.S.C. sec. 1372(r) (1991). Carriers undertaking significant changes in their operations must provide DOT with information relevant to their citizenship and fitness. 14 C.F.R. § 204.4.

94. In the matter of Intera Arctic Services, Inc., DOT Order 87-8-43 (1987), at 5.

95. In the matter of the Acquisition of Northwest Airlines by Wings Holdings, Inc., DOT Order 91-1-41 (1991), at 2.

96. Id.

97. In the matter of the Acquisition of Northwest Airlines by Wings Holdings, Inc., DOT Order 89-9-51 (1989) at 3.

cern about the size of KLM's equity interest, both in absolute and proportional terms, its ability to exert influence on Wings, and the fact that it was an actual competitor with Northwest in a number of markets.

DOT acknowledged that determining whether foreign "control" exists is a complex matter:

> Analysis in this area has always necessarily been on a case-by-case basis, as there are myriad potential avenues of control. The control standard is a *de facto* one — we seek to discover whether a foreign interest may be in a position to exercise actual control over the airline, *i.e.*, whether it will have a substantial ability to influence the carrier's activities.[98]

DOT observed that "it is clear from our precedent that a large share in a carrier's equity poses citizenship problems, even where the interest does not take the form of voting stock, particularly if there are other ties to the foreign entity."[99] DOT noted that the incentive for the foreign airline to exert control was much enhanced where it is also an actual or potential competitor. The interest of Elders in Wings appeared to be no more than a pecuniary interest, not rising to the level of concern about control.[100] However, KLM's large equity interest, its right to sit on Wings' Board and name a financial committee, and the working arrangements between the two airlines caused the DOT to conclude that KLM could be in a position to exert control over Northwest, thereby jeopardizing its status as a U.S. citizen. DOT and Northwest entered into a consent order whereby KLM's equity interest in Wings would be reduced to twenty-five percent, its power to establish a financial advisory committee would be revoked, and Northwest would fulfill certain reporting requirements.[101]

The disintegration of the economic position of a number of U.S. airlines in late 1990, precipitated by the War with Iraq, escalating fuel prices, fear of terrorism by the traveling public, and a global recession which diminished passenger demand, led the DOT to reverse its position on foreign ownership. The DOT was now willing to take another look at Wings and Northwest. It concluded that Messrs. Checchi, Wilson and Malek were firmly in control of Wings, holding two-thirds of its voting stock and having the power to appoint most of its directors.[102] The DOT announced that it was adopting a new policy:

> [W]e have reexamined our application of the control test in order to reflect more accurately today's complex, global corporate and financial environment, consistent with the requirement for U.S. citizen control. Specifically, we have reviewed the relationship between voting equity, on the one hand,

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98. Id. at 4-5.
99. Id. at 6.
100. Id. at 5.
101. Id. at 8.
102. DOT Order 91-1-41 (1991), at 8.

and nonvoting equity and debt, on the other.[103]

The DOT concluded that foreign equity ownership of up to forty-nine percent would be allowed, although foreign voting equity would be limited, as the statute required, to twenty-five percent. Foreign debt would not be treated as a control issue.[104] The DOT also indicated that it would not ordinarily allow a foreigner to serve as Chairman of the Board.[105] It had earlier approved the placement of three representatives of SAS on the Continental Airline Holdings' board.[106] KLM could have three seats on the fifteen member Wings' board.[107] DOT warned, "the naming of a disproportionate number of foreign director representatives to important committees, such as the executive committee, nominating committee, or finance committee, may be taken as an indication of control and would be cause for us to review the citizenship of the affected air carrier."[108]

The truth is, with ownership, code sharing and marketing alliances, a foreign airline can effectively control a U.S. carrier, reducing competition in the international market while creating domestic U.S. feed for its international operations. Foreign ownership is the back door to cabotage. With ownership, foreign airlines do not need cabotage rights.

VI. THE PUBLIC POLICY IMPLICATIONS OF FOREIGN CONTROL OF THE U.S. AIRLINE INDUSTRY

Now that deregulation has failed to produce the near perfect model of textbook competition the *laissez faire* economists predicted, the deregulationists are proposing to sell our domestic industry off to foreign airlines. Already Northwest, Delta, Continental, America West and Hawaiian Airlines have significant foreign equity. DOT has suggested that, insofar as foreign ownership is concerned, the sky is the limit.

In 1989, Secretary of Transportation Samuel Skinner expressed legitimate concern over the Checchi group acquisition of Northwest Airlines, not only because the LBO would increase Northwest's debt fourfold, but also because the $400 million equity participation by KLM Royal Dutch Airlines would give it about fifty-seven percent of total equity.[109] Secretary Skinner appeared to interpret section 101(16) of the

103. Id. at 9.
104. Id.
105. Id. at 11.
106. DOT Order 90-9-15 (1990), at 6.
107. DOT Order 91-1-41 (1991), at 11.
108. Id.
109. *Statement of Samuel Skinner Before the Aviation Subcomm. of the House Comm. on Public Works and Transportation* (Oct. 4, 1989), at 4. Had the management/pilot deal for United not fallen through, British Airways was prepared to supply $570 million, or 78% of the total $965 million equity. Valente & McGinley, *UAL Machinists Refuse to Back Buy-Out Plan*, WALL ST. J., Oct. 5, 1989, at A6.

Federal Aviation Act to limit foreign equity to twenty-five percent. As Skinner said,

> While KLM's voting share technically fell within the statute's numerical limits [which requires that the airline's President and two-thirds of its Board and other managing officers be U.S. citizens, and that not less than 75% of voting interest be owned and controlled by U.S. citizens], we concluded that KLM's ownership of 57 percent of NWA Inc.'s total equity, together with the existence of other links between the carriers and KLM's position as a competitor, could create the potential for the exercise of influence and control over the carrier's decisions. This would be inconsistent with the law.[110]

Remarkably, that which Secretary Skinner then declared would be, in his words, "inconsistent with the law", he now proclaims to be well within the law.

The statute has not been amended since Secretary Skinner found that KLM's gargantuan ownership was inconsistent with the law. The U.S. Department of Transportation continues to hold jurisdiction under section 401 of the Federal Aviation Act to scrutinize the fitness of airlines (which includes safety and compliance fitness), and under section 101(16) to review foreign ownership. Under present law, foreign ownership is limited to twenty-five percent of the voting stock of U.S. airlines, and no foreign airline can ply the domestic trade.

In a radical departure from precedent and a tortuous interpretation of law, DOT announced recently that it will allow foreign equity ownership of up to fifty percent. Secretary Skinner has also proposed that statutory limits on voting ownership be increased to forty-nine percent.[111] DOT has even proposed to put the exchange of cabotage rights (the opportunity for foreign airlines to serve domestic routes) on the table in negotiations with the government of Canada, despite the legislative prohibition. Actually, foreign airlines don't need cabotage rights if they can buy access to the U.S. market.

Foreign alliances with U.S. airlines began in the 1980s with shared frequent flyer programs, then entered computer reservations systems, and now have turned to outright equity ownership. Chart VII reveals the alliances of the two dominant European computer reservations systems.

International airline alliances have been stimulated by the prospect for liberalizing European transport in 1992.[112] Having witnessed the in-

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110. Statement of Skinner, *supra* at 4-5. In September 1 989, Skinner jawboned Checchi and Northwest into agreeing, inter alia, to limit KLM's voting stock to 25%, and to limit KLM's representation on Northwest's Board of Directors to "matters relevant to KLM's pecuniary interest, recusing himself or herself when the board is dealing with certain matters, such as bilateral negotiations and competitive issues." Id. at 6.

111. McGinley, *Transport Aide Backs Raising Limit On Foreign holdings in U.S. Airlines*, WALL ST. J., Feb. 20, 1991, at A8.

112. Dempsey, *Aerial Dogfights Over Europe: The Liberalization of EEC Air Transport*, 53 J.

CHART VII — EUROPEAN COMPUTER RESERVATIONS SYSTEMS PARTNERS

Covia	Amadeus
United	Texas Air
British Airways	Air France
KLM	Lufthansa
Swissair	Iberia
Alitalia	SAS
USAir	

tense shakeout deregulation produced in America, foreign management believes that the liberalization of competition rules will result in extreme concentration. The conventional wisdom is that, when the dust settles from U.S. deregulation and international aviation liberalization, only a handful of global megacarriers will dominate air transport. Several industry experts predict that the world's air transport system will eventually be dominated by just eight to ten global megacarriers.

Wanting to be among the survivors motivated the contemporary surge in international combinations and alliances. Moreover, with Europe's aviation infrastructure even more saturated than America's, opportunities for growth are largely limited to acquiring or affiliating with existing airlines.

Foreign airlines are deeply interested in penetrating the U.S. passenger market — a market larger than that of the rest of the world combined. In the last few years, KLM bought a huge piece of Northwest, SAS purchased a chunk of Continental, Singapore Airlines and Swissair each acquired a slice of Delta, and British Airways (which gobbled up British Caledonian) sought a share of United Airlines. Chart VIII depicts the substantial foreign airline interests in U.S. flag carriers:

CHART VIII — FOREIGN AIRLINE OWNERSHIP OF U.S. AIRLINES

Foreign Airline	Percentage Ownership	U.S. Airline
SAS	18.4%	Continental
Swissair	5%	Delta
Singapore Airlines	5%	Delta
Ansett Airlines	17%	America West
Japan Air Lines	20%	Hawaiian Airlines
KLM	49%	Northwest
British Air	15%*	United

* proposed; later withdrawn

The equity interests by Scandinavian Airline System [SAS] in

AIR L. & COM. 615 (1988); P. DEMPSEY, LAW & FOREIGN POLICY IN INTERNATIONAL AVIATION 93-108, 241-56 (1987).

Continental Airline Holdings was inspired by the American carriers' need for a substantial infusion of new capital. From SAS's perspective, the Texas Air alliance gave it new feed into its transatlantic routes; SAS moved its international hub from New York Kennedy Airport to Newark, where Texas Air's Continental and Eastern could provide domestic feed.[113] (However, SAS may have over-extended itself, and is now retrenching). Swissair's and Singapore Airlines' interest in Delta appears to have been inspired by different reasons — the desire of Delta to have a friendly partners poised to fend off LBOs.

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

Not only are foreign airlines affiliating with U.S. carriers. Other international aviation alliances are emerging, including British Airway's acquisition of British Caledonian, and Air France's purchase of UTA. Chart IX reveals the major ownership interests of foreign airlines.

CHART IX — CROSS OWNERSHIP AGREEMENTS BETWEEN FOREIGN AIRLINES[114]

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

113. *Repeating Mistakes*, JOURNAL OF COMMERCE, Aug. 30, 1989, at 8A.

114. *Testimony of Helane Becker (vice president, Lehman Brothers) Before the Subcomm. on Aviation of the House Comm. on Public Works and Transportation* (Feb. 6, 1991), at 5. *Going*

Here's a college board exam question: if Delta owns five percent of Swissair, and Swissair owns five percent of SAS, and SAS owns eighteen and four tenths percent of Continental, how much of Continental does Delta control?

Foreign ownership raises serious anti-competitive concerns. Many international markets are already among the highest priced, fastest growing, most lucrative and least competitive. As noted above, United and Northwest both earn a disproportionate share of their profits from the trans-Pacific market. How vigorous a competitor would they be if Japan Air Lines (or for that matter, Korean Air Lines, or Cathay Pacific) owned a significant chunk of either?

KLM now owns forty-nine percent of Northwest. Both airlines serve Amsterdam and Minneapolis (their respective hubs), as well as interior European and U.S. cities. How can we expect vigorous competition between an airline (Northwest) and its owner (KLM)? We didn't see it between Continental and Eastern once Frank Lorenzo's Texas Air subdued both.

Further, most foreign airlines are owned, in whole or part, by their governments. Monopoly is not the antithesis of competition; socialism is. A government owned or subsidized airline need not make a profit to stay alive, and therefore lacks a proper competitive discipline. Their presence in a "free market" creates an unlevel playing field. Government treasuries have financial resources beyond the wildest dreams of privately owned companies. Foreign governments can subsidize losses or underwrite the capital requirements necessary to develop monopoly positions.

At the outset of deregulation, some predicted that ultimately only a handful of airlines would survive, and that they would be nationalized as wards of the state. Never could they have imagined that the few surviving airlines would be wards of foreign governments.

Today, about eight percent of Northwest is owned by the government of the Netherlands. About eight percent of Continental and Eastern are owned by the Scandinavian governments. We have now embarked upon a regime of partial nationalization, not by our government, but by foreign governments.

Foreign ownership restrictions have long existed for many of our essential infrastructure industries — airlines, intercoastal and inland shipping, telecommunications, broadcasting, electric power production, and nuclear energy. These restrictions were added to our law not

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Steady, ECONOMIST (July 22, 1989), at 39; *and Overlapping Airlines: Recent Investments*, WALL ST. J., July 23, 1991, at A6.

because of blind xenophobia, but because of legitimate national security considerations.

Aviation is essential to national security. As operation Desert Shield confirms, the nation depends on the aircraft of our domestic airlines committed to the Civil Reserve Aviation Fleet [CRAF] as the essential logistical means to ferry troops and supplies to distant battlefields. We need the CRAF fleet for airlift capacity in time of war. Foreign ownership may jeopardize access to it. The Air Force simply doesn't have enough C-5As to do the job.

On August 2, 1990, Iraq invaded Kuwait. Two weeks later, the CRAF fleet was activated — the first time since its creation in 1951. Calling up the CRAF fleet was essential in order to meet the demands of the most massive airlift since the Berlin Airlift in 1948. During the first two months of activation, CRAF planes flew more than 500 missions, carried 66,000 passengers (mostly soldiers) and 22,000 tons of cargo. In the recent Persian Gulf crisis, we relied upon our domestic civil reserve aviation fleet [CRAF] to ferry sixty percent of the soldiers and twenty-three percent of the supplies to the battlefield. Yet Secretary Skinner would have foreign governments sit on the boards of directors of U.S. airlines.

Similarly, we maintain a federally subsidized U.S.-flag fleet of ocean carriers because of the lesson we learned in World War I — when we looked around for essential ships to ferry troops and supplies across the Atlantic, there were nearly none. Not that long ago, the federal government bailed out a collapsing Conrail and Lockheed, in part, because of their importance to national security. Transportation is essential to our national defense.

Of course, we could commandeer the aircraft of foreign airlines if we needed them — seize the property of foreign companies as other nations have done to American firms. But acquisition of capacity is not the only problem.

Those who argue for foreign ownership of domestic airlines forget that most of the technological breakthroughs of aviation were inspired by its military applications — its proficiency in delivering troops and bombs. Imagine a world where we had never prohibited foreign ownership or foreign airline competition. How many Pearl Harbors would we have suffered if the dominant domestic airlines in 1940 had been Lufthansa and Japan Air Lines?

Although we fought wars with Britain in two centuries, British Airways doesn't look like much of a national security threat these days. But our alliances are constantly shifting, so that an Aeroflot looks more or less threatening depending upon the point in history at which you ask the question. We embraced Stalin to fight Hitler, and Syria's Assad to

destroy Saddam Hussein. Today, would we want Donald Trump to sell the Trump shuttle to Iraqi Airways?

In 1974, the Shah of Iran proposed to buy Pan American World Airways. Had Secretary of Transportation Skinner been calling the shots then, he might well have allowed it. After all, Iran was then our closest ally in that part of the world.

We all know the tragic events which transpired in Iran after the fall of the Shah. If the foreign ownership rules adopted by DOT in 1991 had been in effect in 1974, would Iranian President Rafsanjani today be Chairman of Pan Am's Board, and would Pan Am's CRAF 747s be parked on Iranian military airfields next to Iraqi jet fighters?

We need to keep our essential infrastructure industries out of foreign hands so that we don't wake up one day in the midst of a global crisis wondering why we were so short sighted as to allow them to be crippled by our adversaries. We don't want foreign owners sabotaging, disrupting or delaying the free movement of commerce, or communications, or electric power, or indeed, putting their grubby hands on nuclear fuel rods. We need a healthy domestic infrastructure capable of serving the nation loyally in times of crisis.

Moreover, foreign ownership jeopardizes the integrity of bilateral air transport negotiations between the United States and foreign governments. International routes are traded by nations on a bilateral basis, usually with candid input from their carriers.[115] Multiple allegiances may well jeopardize the integrity of that process.

VII. Conclusion and Recommendations

Foreign ownership restrictions didn't cause the disintegration of our domestic airline industry. Neither did the fuel crisis of 1991-92.

Look around the world. No foreign airline is in as sorry shape as ours — none are liquidating operating assets, none are in bankruptcy, and none have died — despite the fact that international aviation fuel costs more than domestic fuel, and the entire world is feeling the pangs of recession.

Surely, we need to alleviate the economic crisis plaguing the airline industry and threatening healthy competition. To do that, we best get on tackling its true cause rather than hastily grasping for radical alternatives which might endanger our national security.

There are more than two temperatures at which to cook a pot of stew. In the 1970s, the competitive dial was set on LOW. The stew wasn't warm enough, so Congress turned the dial up to HIGH by promul-

115. *See generally*, P. Dempsey, Law & Foreign Policy in International Aviation (1987).

gating the Airline Deregulation Act of 1978. The competitive bubbles began to boil, causing stew to splatter over the side of the pot. The aroma was sweet for a short while, until it turned foul with smoke. Before the stew burns a charcoal black, Congress should turn the dial down to MEDIUM, so that we can have stew the public can eat.

The public owns the trillion dollar airport and airway infrastructure. Common sense suggests that it ought to have some say in how the airlines use that public system. Consider that all the stock of all the airlines could be purchased on Wall Street for less than $15 billion, or a mere one and five tenths percent the value of the public investment.

Unlike the highways, where people have direct access in their privately owned automobiles, the only access for the great majority of citizens to the airport and airway system they own is via the commercial airlines. Yet the destinations, the terms, conditions and prices of services are all dictated by private monopolists and oligopolists, with no input from the public which owns ninety-eight and five tenths percent of the system.

Deregulation gave away the public system to private monopolists. It replaced the U.S. Civil Aeronautics Board, which protected the public interest, with the chief executive officers of a handful of airlines, who treat the public system as their private Monopoly board, buying and selling properties while charging the public exorbitant rents. They are allowed to turn a profit by selling assets owned by the nation — landing slots and international routes. Deregulation transformed the air transport system from a public utility into segmented and shared regional and city-pair monopolies, and a national oligopoly.

It would be the equivalent of deregulating the trucking industry, and giving the Interstate Highways to the trucking companies — letting them set the rates and service conditions of public access, and allowing the trucking companies to sell these monopoly rights to the Dutch government.

The tyranny of monopoly gave birth to economic and antitrust regulation in the nineteenth Century. (Congress regulated the monopoly railroads in 1887, and passed the Sherman Antitrust Act just three years later). A nation which fails to learn from its history is doomed to repeat it.

The Wall Street Journal asked Americans to identify the industries in which they have most, or least, confidence. The largest number by far, forty-three percent, said they had no confidence in the airline industry. The disapproval rating for the industries which followed — insurance (twenty-seven percent), banking (twenty-three percent), oil and gas (twenty-two percent), and stockbrokers (twenty-two percent) — was not

nearly as high as that for airlines.[116]

Note the common denominator of each of these five industries. Insurance has never been regulated by the federal government, and airlines, banks, oil and gas companies and securities have all experienced significant deregulation during the last decade.

Before deregulation, our transportation system was universally acclaimed to be the world's finest. But since then, the deterioration in our transportation infrastructure, public and private, would embarrass a third world nation. The potholes we dodge on the highways and the aging jets in which we fly are symptoms of a malignant illness.

The failure of deregulation disproves the implicit thesis of the theology of *laissez faire* — that unconstrained human greed will produce a better society. It is time for a spoonful of regulatory medicine, while there is still some modicum of competition to preserve. It is time to roll back deregulation, not to the strict regime of the early 1970s, but to an enlightened regime of responsible government oversight. It is time for regulatory reform.

Several bills have been introduced by Congressmen genuinely concerned about the disintegration of the airline industry. Unfortunately, these proposals do not go far enough. They are designed to give the patient a few aspirin and band-aids, while the doctor fails to recognize that the patient has a chronic disease and needs major surgery. The disease is deregulation, and it is time to take the airline industry to the operating room.

What, specifically, should reform legislation include? The DOT has proffered foreign investment as a panacea for the deteriorating economic condition of U.S. airlines, and the elimination of cabotage restriction as a panacea for the demise of competition. These proposals are dangerous. For the reasons expressed above, if adopted, they would jeopardize national security.

If Congress does nothing, we will likely see an airline industry more highly concentrated than it now is. Because airline managers are rational wealth maximizers, prices will rise and grow even more discriminatory. Transportation, like many public utilities, is a necessity. Distortions in its service and the extraction of monopoly rents cannot long be tolerated. Eventually, Congress may be faced with the prospect of introducing public utility regulation to the few surviving firms.

Neither of the extremes of public utility regulation nor the contemporary environment of economic anarchy and Market Darwinism are desirable. Public policy in this essential infrastructure industry would best be

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116. Winans & Dahl, *Airlines Skid On Bad Moves, Bad News*, WALL ST. J., Sept. 2, 1989, at B1.

enhanced by preserving the level of competition which now exists and imposing light-handed regulation upon it, while there is still competition to preserve.[117] How might that be accomplished?

1. Indirect Subsidies. Recognizing the importance of transportation to commerce, communications and national defense, in earlier periods of American history direct federal subsidies were given to bail out transportation firms such as Conrail, Chrysler, Lockheed, and Amtrak. But the contemporary realities of a $3 trillion federal debt preclude direct subsidies to ameliorate the contemporary crisis in the transportation industry. Nonetheless, weaker carriers, new entrants, and carriers which can best enhance the competitive environment ought to be favored in distributing postal subsidies, international routes and landing slots. However, these franchises ought not be allowed to be sold for profit, for they generally end up in the hands of the megacarriers when sold. They should be issued on a limited term basis, and issued to whatever carrier fulfills public needs best at their expiration or upon their surrender. The sale of carriers piecemeal (as is being done at TWA and Pan Am, for example) only makes these carriers less attractive for acquisition as a whole property, and makes them less viable long-term.

2. Nonstop Route Certificates. Hubbing-and-spoking, the dominant megatrend on the deregulation landscape, is choking the air transport system, causing flight schedules to regress back to the DC-3 era and burning fuel unmercifully. New nonstop service overflying hubs might be inaugurated if airlines could receive a protected franchise for a term of years. A franchise to serve any city-pair not now receiving nonstop service ought to be available to an airline promising to provide at least one round-trip a day. It would receive an exclusive franchise to serve the market for say, three to five years. If necessary, designated carriers would receive access to congested airport gates and slots, perhaps through use of federal eminent domain power, to condemn the necessary property at fair market value and sell it to the franchisee. Preference would again be given to weak airlines, new entrants, and carriers best able to enhance competition. To protect consumers, average yields in the market could be no higher than industry average yields for similar stage lengths.

3. Price Ceilings and Floors. Carriers should be prohibited from extracting monopoly or oligopoly rents by raising prices, or driving smaller carriers out by lowering them. Average fares per mile in any market should not exceed, say fifteen percent of industry average fares, unless the airline can show good cause why they should, usually in the form of extraordinary costs attributable to serving the market in question. As to

117. *See* P. Dempsey, Flying Blind: The Failure of Airline Deregulation 46-59 (1990).

predatory conduct, a smaller aggrieved airline should be able to object to a larger competitor's price or service war poised to drive it out.

4. *Consumer Protection.* Something must be done about the myriad of abusive practices such "bait and switch" advertising, unrealistic scheduling, deliberate overbooking, nonrefundable tickets, misleading code-sharing and change-of-gauge, and demand based flight cancellations. Perhaps Congress should pass a law requiring DOT to promulgate regulations addressing such problems within, say 120 days. If the rules aren't tough enough, Congress can fine tune with legislation. Alternatively, Congress could eliminate federal preemption over such questions, letting the state Attorney Generals lose.

5. *Financial Fitness.* The DOT had ample jurisdiction to prevent the airlines from being loaded with onerous debt or stripped of assets in leveraged buy-outs. It chose to do nothing while our airline industry was crippled. Congress should pass legislation prohibiting any future LBO of an airline, force existing owners to wean them of debt over a period of time, and prohibit public assets (such as international routes, landing slots and gates) to be sold off to enhance the personal wealth of the corporate raiders.

6. *U.S. Transportation Commission.* During the past decade, the DOT has shown absolutely no enthusiasm for protecting the public interest or performing its statutory obligations in a responsible way. That is because the DOT is an executive branch agency, with policy dictated by the White House. Yet Article I section 8 of the U.S. Constitution vests in Congress the power to regulate interstate and foreign commerce. Hence, regulatory power over transportation should be extricated from the executive branch and vested in an independent agency.

Two alternatives come to mind. One is that of splitting off the Federal Aviation Administration from DOT, making it an independent agency and enhancing its jurisdiction over economic matters. Another is to strip the economic regulation function from DOT and consolidate them with the jurisdiction now held by the Interstate Commerce Commission and the Federal Maritime Commission into a new "U.S. Transportation Commission" with broad jurisdiction over all modes of transport (after all, transportation is increasingly multimodal). Under either alternative, the agency should be headed by a collegial body of, say seven or nine commissioners having terms of office and appointed in a manner similar to the governing members of the Federal Reserve Board, an agency which performs major economic policy functions without much of the political degeneration of most other federal agencies.