Turbulence in the "Open Skies": The Deregulation of International Air Transport*

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I. INTRODUCTION

United States foreign policy was characterized by consensus and cooperation on matters involving economic regulation during the first three decades following World War II. But such peaceful coexistence came to an abrupt end during the administration of Jimmy Carter, when confrontation was substituted for diplomacy as a catalyst for injecting free market economic theory into international aviation.

In the late 1970s, domestic airline deregulation had lowered fares for many consumers, and increased load factors and profits for carriers. To the Carter administration, what had been good for domestic markets was perceived as desirable for international markets as well. The policy of the U.S. government quickly became one of exporting deregulation.

That policy met fierce resistance abroad, for most governments emphasize the important role that their air carriers play in facilitating communications, trade, tourism, and national pride and prestige, as they "show the flag" around the world.[1] As a consequence, most foreign airlines

1. Many factors have shaped the history of mankind. Among these factors have been transportation and communications—not causes, but certainly essential conditions of human progress.

> The existence of facilities for human migrations has made possible the expansion of the more highly developed races, tribes and nationalities, and the submergence of the less advanced ones. . . .
>
> Improved means of world intercourse have also facilitated the dissemination and migration of cultural, as distinguished from biological forms. . . .
>
> Adequate means of communication and transportation are an essential condition of the progressive economic and political integration of mankind.

O. LISSITZYN, INTERNATIONAL AIR TRANSPORT AND NATIONAL POLICY 18-19 (1942 [hereinafter cited as O. LISSITZYN].

> Rapid communications and transportation facilitate commercial intercourse between the various parts of a single nation and between nations. Hence, the possession of a

have long been viewed as "public utility" types of enterprises, with several obligations beyond those which would be provided in a "free" market. Hence, foreign air carriers have long been governmentally regulated, owned or subsidized.

Many U.S.-flag carriers also opposed their government's policy on grounds that, whatever the benefits of domestic deregulation, they were not likely to be realized in an environment in which government ownership and subsidization dominated the economic environment. Many criticized the Carter administration's "open skies" policy as naive, in giving foreign airlines access to interior U.S. cities in exchange for vague guarantees of pricing flexibility, free competition, and non-discrimination. And by the early 1980s, many were reeling from the economic turbulence created by the new regime.

And so began the most intensive international conflict in the history of aviation. Foreign governments objected both to ends and means. U.S. airlines objected on grounds that the Carter administration was giving away the store, in order to export an ideological belief in free market economics to an environment which was hardly "free".

The Reagan administration has since retreated somewhat from these ambitious beginnings. And paradoxically, resistance to market theory in some nations has since weakened. This article will trace the metamorphosis of economic regulation in international aviation from its origins to the contemporary environment.

II. GENESIS OF THE INTERNATIONAL AVIATION REGULATORY INFRASTRUCTURE

A. *THE CONVENTION ON INTERNATIONAL CIVIL AVIATION OF 1944*

From its inception, commercial air transport has relied on the support of national governments; in the years following World War I, only government subsidies and mail contracts sustained the economic viability of commercial aviation.[2] In order to establish and define a basic legal

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rapid means of communications such as air transport may prove an important competitive asset in international trade.

Id. at 38.

Transportation is the most important industry in the United States so far as employment, investment and impact on other industries is concerned. It is the fundamental infrastructure which facilitates the free flow of commerce.

P. DEMPSEY & W. THOMS, LAW AND ECONOMIC REGULATION IN TRANSPORTATION ix (1986) [hereinafter cited as P. DEMPSEY & W. THOMS].

2. [T]he pilots and entrepreneurs soon discovered that they could not fly without their government's support, and that even within their own country they could not make their airline pay without subsidies or the air mail contracts which governments awarded. In every country the soaring ambitions of the aviators and their financiers came up against the controls and military designs of their governments. . . . [T]he European governments were determined from the beginning to harnass aviation to their own needs, and

framework for international aviation, the Peace Conference of 1919 produced the Convention Relating to the Regulation of Aerial Navigation, more commonly known as the Paris Convention.[3]

The first article of the Paris Convention declared that each state enjoys "complete and exclusive sovereignty over the airspace above its territory."[4] The homo sapien is a territorial beast, and this notion seemed to satisfy a powerful primordial imperative. In so proclaiming exclusivity of national territorial rights, the world community rejected the older concept of international maritime law which allowed "freedom of the seas", or unencumbered commercial use of the oceans during peacetime by vessels flying the flag of any nation and owned by citizens of any country.[5]

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particularly to bind their colonies and overseas settlements more closely to the home country. The new "airlines" could not avoid being dependent on the governments which subsidized them, merged them or controlled their routes.

A. SAMPSON, EMPIRES OF THE SKY: THE POLITICS, CONTESTS AND CARTELS OF WORLD AIRLINES 24 (1984) [hereinafter cited as A. SAMPSON]. International civil aviation enjoyed robust growth after the end of World War I. The cessation of hostilities provided the impetus for the development of aviation for transport purposes; large numbers of military aircraft and pilots were available for conversion to civilian use, governments and businesses realized the potential of aviation for expeditious transport and communications, and postwar conferences generated a need for official travel. B. GIDWITZ, THE POLITICS OF INTERNATIONAL AIR TRANSPORT 37 (1980) [hereinafter cited as B. GIDWITZ]. *See generally*, P. DEMPSEY & W. THOMS, *supra* note 1, at 26-27.

3. Convention Relating to the Regulation of Aerial Navigation, signed, Oct. 13, 1919, 11 L.N.T.S. 173 (hereinafter cited as Paris Convention). *See generally*, N. MATTE, TREATISE ON AIR-AERONAUTICAL LAW 125-27 (1981) [hereinafter cited as N. MATTE]; O. LISSITZYN, *supra* note 1, at 366-73; W. WAGNER, INTERNATIONAL AIR TRANSPORTATION AS AFFECTED BY STATE SOVEREIGNTY 39-61 (1970) [hereinafter cited as W. WAGNER].

4. *Id.*, art. 1. *See generally*, L. MCNAIR, THE LAW OF THE AIR 407 (3d ed. 1964).

> [The Convention of Paris] repudiated the notion of freedom of the air and jealously guarded the new notion of air sovereignty, which limited planes more than ships; for nations were naturally far more worried by aircraft flying over their territory—whence they could spy, bomb, or secretly land—than by ships which under the law of the sea were allowed in theory to call at any port they wish.

A. SAMPSON, *supra* note 2, at 24. *See id.* at 91. "We were once told that the aeroplane had 'abolished frontiers,' " observed George Orwell in 1945. "Actually it is only since the aeroplane became a serious weapon that frontiers have become definitely impassable." *Id.* at 191. *See id.* at 62.

5. A. LOWENFELD, AVIATION LAW II-3 (1972) [hereinafter cited as A. LOWENFELD]. The notion that an ocean vessel may be owned by citizens other than those of the flag it flies has not been without controversy. *See* Dempsey & Helling, *Oil Pollution by Ocean Vessels—An Environmental Tragedy: The Legal Regime of Flags of Convenience, Multilateral Conventions and Coastal States*, 10 DEN. J. INT'L L. & POL'Y 37, 50-65 (1980); Herman, *Flags of Convenience—New Dimensions of an Old Problem*, 24 MCGILL L.J. 1 (1978); McDougal, Burke & Vlassic, *The Maintenance of Public Order at Sea and the Nationality of Ships*, 54 AM. J. INT'L L. 25 (1960); P. DEMPSEY & W. THOMS, *supra* note 1, at 29-33; W. WAGNER, *supra* note 3, at 1-8. Professor Lowenfeld predicted in 1975 that "Airlines would not be multilateral corporations . . . in terms of ownership and organization, but would be owned by the states or citizens of the state whose flag they flew." Lowenfeld, *A New Take-Off for International Air Transport*, 54 FOREIGN AFF. 36 (1975) [hereinafter cited as *A New Takeoff*]. Professor Bin Cheng has pointed out that the requirement of "substantial ownership or effective control" of an airline by nationals of the state whose flag it flies, widely incorporated into bilateral air transport agreements, has essentially

Henceforth, transit and landing rights for airlines would be largely defined by the explicit or tacit approval of the national governments in or above whose territory they would operate.[6] This principle of air sovereignty insured that national governments would play a dominant role in the economic and political development of international civil aviation.[7]

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banned the notion of flags of convenience from international air transport. However, Dr. Gertler has pointed out three examples of multilateral airline ownership: SAS, Air Afrique, and the failed East Africa Airways. Gertler, *Nationality of Airlines: A Hidden Force in the International Air Regulation Equation*, 48 J. AIR L. & COM. 51, 65-66 (1982) [hereinafter cited as *Nationality of Airlines*]. He also emphasizes that the Chicago Convention does not impose such a "genuine link" requirement. *Id.* at 59, 66.

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> The legal and diplomatic framework within which international air transport has thus far developed is based upon three simple, yet fundamental principles: (1) Each state has sovereignty and jurisdiction over the air space directly above its territory (including territorial waters). (2) Each state has complete discretion as to the admission or non-admission of any aircraft to the air space under its sovereignty. (3) Air space over the high seas, and over other parts of the earth's surface not subject to any state's jurisdiction, is free to the aircraft of all states. Although of recent origin, these principles are now among the least disputed in international law.

O. LISSITZYN, *supra* note 1, at 365.

7. Salacuse, *The Little Prince and the Businessman: Conflicts and Tensions in Public International Law*, 45 J. AIR L. & COM. 807, 814 (1980). Professor Lowenfeld points out that, unlike most other industries, "aviation directly engages the prestige, the fascination, and the national interest of almost all countries. . . [and] is a serious problem in international relations." *A New Takeoff*, *supra* note 5, at 36. Another commentator concurred: "We shall have a false idea of air transport history . . . if we think of it as purely a commercial enterprise, or neglect the extent to which political considerations have been controlling in shaping its course." O. LISSITZYN, *supra* note 1, at vi.

In the 1920s and early 1930s, the European governments realized the potential of international air transport in linking their overseas colonies to the home country. A number of colonial powers, including France, Great Britain, Germany, Belgium and the Netherlands, opted to concentrate their respective resources in the development of a single national carrier. These national carriers, owned and/or heavily subsidized by their respective governments, provided a sense of security in a rapidly changing international environment. *See* A. SAMPSON, *supra* note 2, at 23-39.

Across the Atlantic, a number of private airlines were prospering. Like their European counterparts, many were initially dependent upon government subsidies and mail contracts for their survival. The government of the United States, however, was not interested in the development of a single national carrier; by 1930, the "Big Four" private carriers—United Air Lines, Eastern Airlines, American Airlines, and Trans World Airlines—were firmly established as the dominant domestic airlines, all flying transcontinental routes. Another U.S. carrier, Pan American World Airways, had no domestic routes but had already developed a monopoly on rapidly expanding international routes.

By the mid-1930s, passenger traffic on the world's commercial airlines had grown substantially, replacing mail contracts as the primary source of carrier revenues. In Europe, however, the major civil aviation powers had repeatedly failed in their attempts to formulate a uniform aviation policy, which might have increased the efficiency of air travel on the continent. The emergence of the Nazis in Germany in 1933 sent shock waves through the civil aviation industries of Europe as governments once again began to give priority to the production of military aircraft.

In the United States, however, commercial carriers and manufacturers continued to prosper.

As World War II entered its final stages, several prominent members of the international community expressed concern over the postwar development of international civil aviation, realizing that this brave new world would require multilaterally negotiated solutions to a growing number of political, economic and technical problems. In response to these concerns, the United States agreed to sponsor an international conference in the hope that it would lay the foundation for the future growth of the industry.

Fifty-two nations attended the International Civil Aviation Conference in Chicago in November of 1944. Virtually all of the civil aviation powers of the prewar era were represented.[8] Initial optimism for a comprehensive multilateral agreement soon faded, however, as economic and political rivalries emerged between a number of the Conference's more prominent members, particularly the United States and Great Britain.[9]

The Roosevelt Administration created a Civil Aeronautics Authority—later re-formed as the Civil Aeronautics Board [CAB]—to allocate and supervise air routes and rates. The American system continued to be one of "controlled competition," in which the airlines, while remaining privately owned, were nonetheless dependent on the government for approval of existing and proposed routes. The Big Four domestic airlines were awarded certificates or "grandfather rights," to the important and profitable domestic routes, while Pan American's monopoly of international routes was allowed to continue for a time. In another important decision which would have far-reaching implications, American aircraft manufacturers were prohibited form owning or exercising control over any U.S. carriers.

The nightmare of World War II and the ensuing German occupation of most of Europe wreaked havoc upon the international civil aviation system. The German national carrier, Lufthansa, while denied most of its overseas routes, emerged as Europe's dominant commercial carrier, taking over the fleets of several other prominent European carriers. Britain's commercial carriers virtually ceased to exist, as its aviation industry was converted to the production of military aircraft, particularly fighter aircraft.

The outbreak of hostilities also had a profound effect on the American aviation industry, particularly after the entry of the United States into the war in 1941. The Big Four domestic carriers and Pan American were pressed into military service, some of the ferrying supplies to Allied forces in Europe and around the globe.

8. The Soviet Union was invited, but declined to attend, the Chicago Convention, presumably because the pro-fascist governments of Spain and Portugal were present. The Axis nations (*i.e.*, Germany, Italy, and Japan) were not invited. *See* A. SAMPSON, *supra* note 2, at 65-66.

9. A. SAMPSON, *supra* note 2, at 62-69.

> The second World War not only transformed the scope of the airlines but produced two contradictory political attitudes to the air. The horrors of air warfare, culminating in the atomic bomb on Hiroshima, generated a new insistence that both military and civil aircraft should be separated from national ambitions and put under international control. Yet every government was more convinced that it must protect and advance its own airlines, as the lifeline to its trade and security.

Id. at 57.

> The system, whereby all over the world international air services are performed on the basis of bilateral air transport agreements is a result of the failure of the 1944 Chicago Conference and the subsequent failure of P.I.C.A.O. and I.C.A.O. to reach a *Multilateral* exchange of traffic rights for scheduled international air services. A multilateral agreement in the exchange of traffic rights was impossible in 1944 because of the widely divergent views of the two key aviation powers at the time, the U.S.A. and the

The United States entered the Chicago negotiations as the world's dominant aviation power, both in terms of aircraft production and technological expertise. It would emerge from the war with a tremendous fleet of long-range transport planes readily convertible to civilian use, as well as a massive industrial infrastructure which, when fully converted to civilian production, would be capable of producing large numbers of commercial aircraft. In addition to this obvious advantage in production capability, the American aircraft industry had achieved a number of important technological breakthroughs during the war years which would insure its supremacy for decades to come. Other nations represented at Chicago, particularly the United Kingdom, feared the prospect of unrestrained competition with the American civil aviation industry.[10]

Following World War II, the United States embarked on a crusade to encourage freer trade and economic cooperation between nations in the belief that the American people and, indeed, the Western World, would prosper only if obstacles to the free flow of commerce were eliminated. By eliminating tariff and nontariff barriers, it was believed that free trade would be encouraged, and the law of comparative advantage would dictate which nations were best suited for producing various commodities. Essentially, it was argued that each nation would produce the manufactured product, agricultural commodity, or raw material for which it was best suited (*i.e.*, each would export that which it could produce most economically and most efficiently).[11]

In Chicago, the United States promoted a free-market philosophy in which airlines of all nations would have relatively unrestricted operating rights on international routes.[12] In pursuit of this policy, American negotia-

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U.K., on the economics of international air transport. The U.K. was then champion of strict intergovernmental regulation of international air transport, whereas the U.S. advocated a system of free competition between international air carriers. MCGILL CENTER FOR RESEARCH OF AIR & SPACE LAW, LEGAL, ECONOMIC AND SOCIO-POLITICAL IMPLICATIONS OF CANADIAN AIR TRANSPORT 521-22 (1980) [citations omitted and emphasis in original] [hereinafter cited as MCGILL STUDY ON CANADIAN AIR TRANSPORT].

10. In the last stages of the war, U.S. carriers had captured almost 72% of world air commerce, compared to about 12% by British carriers. N. TANEJA, U.S. INTERNATIONAL AVIATION POLICY (1980) [hereinafter cited as N. TANEJA]. The European nations had devoted their full resources to the war effort; their civil aviation industries, either nonexistent or ill-equipped for the production of commercial aircraft, would require large expenditures of time and capital before they could realistically compete with their American counterparts. *See generally*, A. SAMPSON, *supra* note 2, at 64. W. WAGNER, *supra* note 3, at 80-82. "Before the war, there were in the whole world 2,388 airplanes flying on regular air lines, 1,200 of which served on international routes; in 1944, the United States alone had 20,000 transport planes and five million skilled workmen in aeronautical industry." *Id.* at 81 [citations omitted]. "As no country in the whole world was able to compete, in the last period of the war, with American aeronautical equipment and personnel, it seemed certain that the proclamation of air freedom, parallel to the freedom of the high seas, would be advantageous to the interests of the United States." *Id.* at 81-82.

11. M. WILLRICH, ENERGY AND WORLD POLITICS 11-13 (1975).

12. Actually, early U.S. drafts of the Chicago Convention included elaborate provisions for

tors called for a multilateral granting of all five freedoms[13] and insisted that the determination of capacities,[14] frequencies,[15] and fares should be left to market forces rather than delegated to an international regulatory body.[16] In the American view, reliance on commercial air carriers to provide the quantity and quality of transport services demanded by consumers was preferable to economic regulation by government fiat.[17]

The British delegation in Chicago proposed that an international regulatory body be established to distribute international routes and determine capacities, frequencies and fares.[18] Such a system, the British believed, would provide their aviation industry with a much-needed period of recovery, one which would allow it to survive direct competition with its American counterpart.[19]

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the limitation of carrier capacity. *See* UNION, REPORT OF THE CHICAGO CONVENTION ON INTERNATIONAL CIVIL AVIATION 31 (1944). the United States also called for the strict recognition of cabotage in international aviation, thereby restricting foreign access to domestic traffic. *See id.* at 1, 4. Hence, the U.S. negotiating posture at Chicago was not as laissez faire as some historians have suggested. *But see* A. SAMPSON, *supra* note 2, at 66-67.

13. The "five freedoms" are universally applicable working rules for bilateral air transportation relations. They are:

1) A civil aircraft has the right to fly over the territory of another country without landing, provided the overflown country is notified in advance and approval is given.
2) A civil aircraft of one country has the right to land in another country for technical reasons, such as refueling or maintenance, without offering any commercial service to or from that point.
3) An airline has the right to carry traffic from its country of registry to another country.
4) An airline has the right to carry traffic from another country to its own country of registry.
5) An airline has the right to carry traffic between two countries outside its own country of registry as long as the flight originates or terminates in its own country of registry.

B. GIDWITZ, *supra* note 2, at 49-50; Azzie, *Specific Problems Solved by the Negotiation of Bilateral Air Agreements*, 13 MCGILL L.J. 303 (1967) [hereinafter cited as Azzie].

14. Capacity refers to the available number of commercial seats on a specific aircraft-type multiplied by the flight frequency of that aircraft-type during a specific time period (usually one week) over a specific route.

15. Frequency refers to the number of flights during a specific time period (usually one week) over a specific route.

16. *See* A. LOWENFELD, *supra* note 5, at II-5.

17. *See generally*, A. SAMPSON, *supra* note 2, at 63-67; N. MATTE, *supra* note 3, at 128.

18. Britain urged establishment of an "International Air Authority" which would "(i) control routes and frequencies in accordance with agreed criteria designed to 'avoid wasteful competition on the one hand [but to] give ample facilities on the other'; (ii) allocate quotas to countries' carriers for services over the assigned routes; and (iii) set rates to 'avoid waste' and get rid of subsidies." A. LOWENFELD, *supra* note 5, at II-6 to II-7.

19. A. SAMPSON, *supra* note 2, at 67-68, N. MATTE, *supra* note 3, at 129. Neither American nor British proposals gained significant support, however. Of the five proposed freedoms, only the first two "technical" freedoms were adopted by the majority of the nations attending the Chicago Conference. The United States, which viewed a multilateral granting of all five freedoms with no capacity of frequency restrictions as consistent with its stated goal of open competition in the marketplace, was once again opposed by the British and others who maintained that such a system would confer upon the United States a near-monopoly on a number of major international

The dominant civil aviation powers were unable to reach a meaningful compromise, and the attending nations were unwilling to surrender their sovereignty to an international regulatory body having he power to formulate and enforce a uniform aviation policy. Although the Chicago Conference failed in its attempt to formulate a comprehensive economic policy for international civil aviation or to effectuate an exchange of traffic rights, it laid the foundation for the postwar establishment of the International Civil Aviation Organization [ICAO].[20]

Established in 1947, ICAO was given responsibility for regulating the many technical aspects of international civil aviation.[21] The nations attending the Chicago Conference were in agreement as to the need for uniform technical standards; consequently, the jurisdiction of the ICAO was extended to such matters as aircraft licensing, airworthiness certification, registration of aircraft, international operating standards, and airways and communications controls.[22] Today, ICAO is one of the largest and the most successful specialized agencies in the United Nations family, with 156 member nations.[23]

A second institution which has played an important role in the post-World War II development of civil aviation is the International Air Transport

routes. The multilateral granting of fifth-freedom rights in itself was not totally unacceptable to the Europeans; early all nations at the Conference agreed that a certain amount of fifth-freedom traffic was essential to the profitability of many international air routes. Rather, the crucial disagreement concerned the degree to which capacity in relation to fifth-freedom rights should be regulated. Having little domestic traffic, the Europeans feared that a multilateral granting of fifth-freedom rights with no limitations on capacity would provide U.S. carriers with unlimited access to the European carriers' most valuable traffic. Thus, the nations represented at Chicago were unable to reach agreement on the economic structure of postwar civil aviation.

20. The participants in the Chicago Conference hoped to reach agreement with respect to both (a) safety, communications and technology, and (b) economic regulatory issues of entry, rates, frequency and capacity. The Convention created ICAO and gave it important responsibilities over the former questions, which it has performed quite well. But ICAO was given only limited general policy directions over the more controversial economic issues, and until relatively recently, the organization steered clear of them. *See* A. LOWENFELD, *supra* note 5, at II-5.

21. ICAO's Legal Director, Dr. Michael Milde, has pointed out that the Chicago Convention established ICAO as "an international organization with wide quasi-legislative and executive powers in the technical regulatory field and with only consultative and advisory functions in the economic sphere." Milde, *The Chicago Convention—After Forty Years*, 9 ANNALS OF AIR & SPACE L. 119,112 (1984) [hereinafter cited as Milde]. *See also*, FitzGerald, *ICAO Now and in the Coming Decades*, in INTERNATIONAL AIR TRANSPORT: LAW ORGANIZATION AND POLICIES FOR THE FUTURE 47, 52 (N. Matte ed. 1976) [hereinafter cited as FitzGerald].

22. R. THORNTON, INTERNATIONAL AIRLINES AND POLITICS 32 (1970) [hereinafter cited as R. THORNTON]. In addition to the role it has played in regulating the technical aspects of international civil aviation, the ICAO has also succeeded in simplifying numerous economic aspects of the industry as well, such as customs procedures and visas. *Id.* at 34. The ICAO also assists the aviation industry by serving as a center for the collection and standardization of statistical data. *Id.*

23. INT'L CIVIL AVIATION ORG., MEMORANDUM ON ICAO, Addendum (1984).

Association [IATA].[24] IATA, whose membership consists of airlines companies certificated for scheduled operations by governments eligible to participate in ICAO, has had as its principal focus the setting of fares for international routes. IATA also addresses the financial, legal and technical aspects of international civil aviation.[25]

B. BERMUDA I—THE MODEL FOR BILATERAL AIR TRANSPORT AGREEMENTS

With the failure of the nations attending the Chicago Conference to agree upon a comprehensive multilateral solution to the economic regulatory aspects of the international civil aviation industry, it became clear that bilateral negotiations between individual pairs of nations remained the only viable option for determining route assignments, frequencies, capacities, and fares.[26] The Chicago Convention,[27] the formal agreement executed at the conclusion of the Chicago Conference, reaffirmed the international legal principles embraced by the Paris Convention twenty-five years earlier, stating that "every state has complete and exclusive sovereignty over the airspace above its territory",[28] and therefore "[n]o scheduled international air service may be operated over or into the territory of a contracting State, except with the special permission or authorization of that State, and in accordance with the terms of such permission or authorization."[29] Accordingly, the United States entered into a series

24. *See generally* Note, *The Ins and Outs of IATA: Improving the Role of the United States in the Regulation of International Air Fares*, 81 YALE L.J. 1102 (1972) [hereinafter cited as *The Ins and Outs of IATA*]. IATA was founded in Havana, Cuba, in 1945, as a successor to another IATA, the International Air Traffic Association, an international organization of airline companies which established many navigational and technical standards from its formation in 1919 until the outbreak of World War II. *See generally*, A. SAMPSON, *supra* note 2, at 38.

25. *See* A. LOWENFELD, *supra* note 5, at III-1 to III-30.

26. *Id.* at II-7 to II-8.

27. Convention on International Civil Aviation, 61 Stat. 1180 (1944) [hereinafter cited as Chicago Convention].

28. Chicago Convention, *id.* art. 1. B. CHENG, THE LAW OF INTERNATIONAL AIR TRANSPORT 3 (1962) [hereinafter cited as B. CHENG]. *See* A. SAMPSON, *supra* note 2, at 69-70. Dr. Michael Milde, Director of the Legal Bureau of the ICAO, summarized the principle of sovereignty as embraced by the Chicago Convention:

> The Convention on International Civil Aviation—the cornerstone of legal regulation of international civil aviation for the past forty years—is based on the principle of complete exclusive sovereignty of States over their territory, except with special permission or authorization. Consequently, the granting of the economic rights to carry traffic remains a sovereign prerogative of each contracting State and is dealt with in bilateral agreements on air services which take into consideration mutual economic benefits of the States concerned and the proper balance of interest between such states.

Milde, *supra* note 21, at 121-22 (citation omitted).

29. Chicago Convention, *supra* note 19, art. 6. *See* Diamond, *The Bermuda Agreement Revisited: A Look At the Past, Present and Future of Bilateral Air Transport Agreements*, 41 J. AIR L. & COM. 412, 419-22 (1975) [hereinafter cited as Diamond].

of bilateral negotiations with a number of foreign governments with the objective of concluding air transport agreements which would secure important landing rights abroad for their international carriers.

American and British officials met in Bermuda in 1946 in an attempt to reconcile their respective aviation policies.[30] The ensuing negotiations, while not the first of their kind in the postwar era, were nonetheless particularly significant in that they were the first between two nations each hoping to develop strong, long-haul trunk routes.[31]

Both nations entered the talks with significant bargaining strengths. The principal British advantage was geographic in nature; by controlling numerous strategic landing and refueling locations around the globe, Britain, with its vast Empire upon which the Sun never set, could restrict American access to a number of important trunk routes. The primary U.S. advantage was its much-publicized domination in aircraft production and aviation technology.[32]

Despite the difficulties encountered at Chicago, the two nations succeeded in reaching a compromise acceptable to both. With respect to fares, the United States retreated from its earlier opposition to any form of international control. It was agreed that IATA would bear primary responsibility for designating fares, subject to the approval of the governments affected by the IATA decision.[33] If a government objected to an IATA-established fare, IATA would reconsider its decision until a solution acceptable to all parties was reached.[34] It was also agreed that the designated carriers of each nation would be free to institute at their discretion capacity and designated fifty-freedom traffic arrangements, subject to the general principle that the primary objective of each nation's carriers should be the provision of capacity adequate to the traffic demands between the country of which such air carrier is a national and the country of ultimate destination of the traffic, and subject to *ex post facto* review of these carrier decisions by the involved governments.[35]

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30. The Bermuda Conference has since been described as "one of the most important events in international aviation history." Diamond, *supra* note 29, at 443. The agreement which it produced, *Bermuda I*, has been characterized as the "Magna Carta of international aviation." Comment, *Bermuda II: The British Revolution of 1976*, 44 J. AIR LAW & COM. 111, 112 (1978) [hereinafter referred to as *British Revolution*]. *See* A. SAMPSON, *supra* note 2, at 72.

31. R. THORNTON, *supra* note 22, at 35.

32. *See* Diamond, *supra* note 29, at 438-43; A. SAMPSON, *supra* note 2, at 72.

33. A. SAMPSON, *supra* note 2, at 73-5.

34. Prior to 1978, the United States routinely exempted the IATA ratemaking process from U.S. antitrust laws.

35. Jones, *The Equation of Aviation Policy*, 27 J. AIR L. & COM. 221, 231 (1960). Should one nation have reason to believe that a carrier of the other had instituted capacity or fifth-freedom arrangements in excess of the relevant traffic demands, it could request an *ex post facto* review by both governments of the carrier's actions. *Id. See* Diamond, *supra* note 29, at 444-47; and Azzie, *supra* note 13, at 205-06.

The *Bermuda I* agreement, as it came to be known, would become the prototype for bilateral air transport agreements throughout the world over the next thirty years.[36] In addition to representing an essential compromise between the world's two leading civil aviation powers, *Bermuda I* reinforced the role of national governments in formulating international civil aviation policy.[37]

During the ensuing three decades, the United States entered into *Bermuda I*-type agreements with most of the 75 nations with which it had aviation relations.[38] Most have been concluded as "executive agreements" rather than "treaties" submitted for the advice and consent of the U.S. Senate.[39] A large number of third-party nations have also employed

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> The original *Bermuda Agreement* . . . left the determination of capacity and frequency of services in the first instance to the designated airlines, which were to act in accordance with predetermined guidelines. The guidelines obliged airlines to take into account each other's interests so as not to affect unduly each other's services; capacity was primarily to be related to traffic demand between the territories of the Contracting Parties and only secondarily to the requirements of fifth-freedom traffic (and traffic picked up or discharged at intermediate points). In the event of dissatisfaction with capacity and frequency of services, *ex post facto* review by governmental authorities might lead to negotiations or, eventually arbitration.

MCGILL STUDY ON CANADIAN AIR TRANSPORT, *supra* note 9, at 545 [citation omitted]; *see id.* at 522. One commentator has succinctly summarized the comprehensive results of the Bermuda negotiations:

> The Bermuda principles were, in brief, the following: the *routes* to be operated between two countries and agreed in bilateral negotiations with individual government control over the designation of carriers to operate these routes; *capacity* and *frequency* levels (how big an aircraft is to operate a route and how frequently) are, in the first instance, to be left to the judgment of the operators themselves, subject to deliberately vague guidelines and *ex post facto* review if one party feels that its interests are being unduly affected; *fares* are negotiated by the airlines within the International Air Transport Association (IATA) framework.

Jonsson, *Sphere of Flying: The Politics of International Aviation*, 35 INT'L ORG. 273, 282 (1981) [hereinafter cited as Jonsson].

36. Haanappel, *Bilateral Air Transport Agreements—1913-1980*, 5 INT'L TRADE L.J. 241 (1980) [hereinafter cited as Haanappel].

> Prior to 1946, the *Chicago Conference* had already drafted a *Form of Standard Agreement*, for provisional air routes. Most of the world's bilateral air transport agreements are not, however, patterned on this latter *Form of Standard Agreement*, however, but rather on the 1946 *Bermuda Agreement*.

MCGILL STUDY ON CANADIAN AIR TRANSPORT, *supra* note 9, at 522 [citation omitted and emphasis in original]. "The Anglo-American agreement at Bermuda became the prototype for all other countries over the next thirty years, and it was followed by a 'vast cobweb of bilateral international agreements'. . . ." A. SAMPSON, *supra* note 2, at 72.

37. *See generally*, N. MATTE, *supra* note 3, at 229-50. International civil aviation grew rapidly in the immediate postwar years as military aircraft and personnel were converted to civilian use. Rapid advances in technology made during the war years led to the development of commercial aircraft of increasing size and range.

38. *Bermuda* was entered into by the United States as an "executive agreement" rather than a "treaty" requiring the Constitutional advice and consent of the U.S. Senate, and became effective upon its signature on February 11, 1946. A. LOWENFELD, *supra* note 5 at II-11. However, it was subsequently submitted to the Senate, on June 11, 1946. *Id.* at II-17.

39. The term "executive agreement" has been defined as any agreement, other than a

Bermuda I as a model for their own bilateral air transport agreements.[40]

Under the U.S. standard from bilateral provisions, the United States was free to designate an unlimited number of gateway city pairs by virtue of language which read "from the United States. . . ."[41] The U.S. was also free to designate an unlimited number of carriers, by virtue of provisions which granted each nation the right to authorize service on each route by "an airline or airlines."[42] *Bermuda I*-type agreements also gave carriers the right to determine capacity, although there were vague provisions requiring that: (a) air services should be closely related to traffic demand; (b) there should be a fair and equal opportunity for the air carriers of the two nations to operate over the designated routes; and (c) the "interest of the air carriers of the other government shall be taken into consideration so as not to affect unduly the services which the latter provides on all or part of the same route."[43] Moreover, each nation enjoys

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treaty, which intends to bind the United States and any other government to any rights, privileges, and/or obligations. M. MCDOUGAL, STUDIES IN WORLD PUBLIC ORDER 424-26 (1960). A "treaty", on the other hand, is any agreement which, prior to Presidential ratification, receives the consent of two-thirds of the Senate. *Id.* at 425, 485, 503, 540, 561, 565. *See* L. HENKIN, FOREIGN AFFAIRS AND THE CONSTITUTION 176-84 (1972). *See generally*, W. WAGNER, *supra* note 3, at 149; Wagner, *The Colonial Airlines Case: Treaties and Executive Agreements Relating to Aviation*, WASH. U.L.Q. 211 (1952); Wagner, *Treaties and Executive Agreements: Historical Development and Constitutional Interpretation*, 4 CATH. U.L. REV. 3 (1954).

Federal Courts traditionally have not required that agreements of this nature be submitted to the Senate as treaties. Opposition to the characterization of such agreements as treaties rests partially on the argument that flexibility is an essential prerequisite to workable international agreements, for they must be regularly altered and amended subsequent to their implementation. Hence, if we are to retain this essential flexibility, perhaps only the fundamental provisions of the agreement should be submitted to the Senate for its advice and consent as a treaty (e.g., terms concerning capacity, rates, charter carriage, fifth freedom rights, and initially designated points), with subsequent modifications of less important issues to be concluded with an exchange of diplomatic notes.

40. *See* Comment, *Bermuda 2: New Model for International Air Services Agreements*, 9 L. & POL'Y INT'L BUS. 1259 (1979) [hereinafter cited as *Bermuda 2 Model*]. In fact, the student who authored the piece chose a particularly inappropriate title, inasmuch as *Bermuda II* has by no means become the new model for bilateral air transport agreements. *See* Lowenfeld, *The Future Determines the Past: Bermuda I in the Light of Bermuda II*, 3 AIR L. 2 (1978) [hereinafter cited as Lowenfeld]. While a number of nations adopted the *Bermuda* bilateral as a model for their own air transport negotiations, many modified it to include pooling or more restrictive capacity clauses. *See* A. LOWENFELD, *supra* note 5, at II-11.

41. *See* Haanappel, *supra* note 36, at 252.

42. United States Standard Form of Bilateral Air Transport Agreement, Art. 3 (1953). *See* Haanappel, *supra* note 36, at 252.

43. United States Standard Form of Bilateral Air Transport Agreement Art. 8, 9, 10 (1953). *See* Haanappel, *supra* note 36, at 250. Similarly, section 6 of the Agreement insists that the provision of fifth-freedom services shall not become the primary objective of capacity placed in the market. Indeed, it requires that capacity shall be related to (a) the traffic requirements between the countries of origin and destination, (b) the requirements of through airline operations, and (c) the traffic requirements of the area through which the airline passes after taking account

the right of *ex post facto* review of capacity.[44] As to ratemaking, prior to 1960 most *Bermuda I*-type agreements contained an explicit endorsement of the IATA rate-making machinery, identifying procedures to be followed upon a failure of IATA to reach a consensus.[45] In 1960, the United States revised its standard-rate article to eliminate specific endorsement of IATA. However, the *Bermuda I*-type bilaterals ordinarily allowed the aviation authorities of each nation to suspend filed tariffs prior to their effective date.[46]

The airlines of pre-war Europe, most of them state-owned, and/or heavily subsidized, prospered during the post war years as routes rapidly expanded throughout the continent, as well as to the Americas, Africa and Asia. With the reemergence of European airlines in the late 1940s and early 1950s and the rapid growth in the number of bilateral transport agreements based on the *Bermuda* model, the strong dominance of U.S. carriers on international routes came to an end.

C. The U.S. Civil Aeronautics Board

In the 1930's, the U.S. airline industry was in its infancy, subsidized and heavily dependent on Government funding. Payment for the carriage of mail was a primary source of income. In foreign nations, air transport was tied directly to government objectives as European colonial powers utilized the air industry to link empires. However, as the viability of private airlines increased, the demand for regulation of the industry also grew proportionally. While the perils of allowing the airline industry to operate in an unrestrained market were not as pressing in most of the world due to the fact that airlines were owned and controlled by national governments, in the United States, where private airline ownership was most prevalent, there existed a widespread national ambivalence towards competition[47] in the aftermath of the Great Depression. As one commentator has remarked, "the nation was leery of relying on restrained competition to spur firms to satisfy the public's needs".[48] Although the Post Office opposed regulation of the airlines on the grounds that it would reduce innovation and efficiency, Congress overwhelmingly passed the Civil Aviation Act in 1938.

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of local and regional air services. *See generally* Gertler, *Bermuda Air Transport Agreements: Non Bermuda Reflections*, 42 J. Air L. & Com. 779, 803 (1976) [hereinafter cited as Gertler].

44. *Bermuda 2 Model*, *supra* note 40, at 1262.

45. United States Standard Form of Bilateral Air Transport Agreement, Art. 11 (1953). *See* Gertler, *supra* note 43, at 800; Haanappel, *supra* note 36, at 255-57; *Bermuda 2 Model*, *supra* note 40, at 1262.

46. *Id.* For a comprehensive discussion of the *Bermuda I* provisions, *see* Haanappel, *supra* note 36, at 246-50.

47. Behrman, *Civil Aeronautics Board*, in The Politics of Regulation 75-120 (1890).

48. *Id.* at 81.

The legislation established the Civil Aeronautics Board [CAB], to regulate the economic and commercial aspects of U.S. air transport. The legislative history of the Civil Aeronautics Act of 1938, the predecessor of the Federal Aviation Act of 1958, reveals that Congress recognized the air transport industry to be in its infancy[49] and believed that the existing competitive environment could, in the absence of regulation, inhibit or impede its sound development.[50] Congress sought to establish a regulatory structure similar to that which had been devised for other industries perceived to be "public utility" types of enterprises, in order to enhance their economic stability, avoid excessive competition, and thereby contribute to the sound economic growth and development of air transportation.[51]

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49. *See Regulation of Interstate Transportation of Passengers, Mail and Property By Aircraft: Hearings on S.3187 by the Senate Comm. on Commerce*, 73rd Cong., 2nd Sess. 1 (1934). Among the primary proponents of air transport regulation, and the author of the original bills, was Senator Patrick McCarran, who emphasized the significance of the pending legislation by stating that, "there was never anything before this country more vital from the standpoint of national development . . . than the legislation which is now pending before this subcommittee, because we are dealing with an infant industry, and we are dealing with it from the standpoint of what it can do for this country commercially, industrially, and as an arm of national defense. *Civil Aviation and Air Transport: Hearings of S.3659 Before a Subcomm. of the Senate Comm. on Interstate Commerce*, 75th Cong., 3rd Sess. 7 (1983) [hereinafter cited as *Senate Hearings on S.3659*].

50. Congress believed that air carriers were engaged in "intensive," "extreme" and "destructive" competition both among themselves and with carriers of other modes of transportation, and that such an economic environment was having injurious effects upon the industry and its ability adequately to provide the service required to satisfy the needs of commerce, the public interest, and the national defense. By establishing a system for the orderly development of air transportation, it was believed that these deleterious consequences could be avoided. *See Senate Comm. on Interstate Commerce, Air Transport Act, 1937*, S. Rep. No. 686, 75th Cong., 1st Sess. [hereinafter cited as *Senate Committee Report on ATA*]. Virtually identical language was expressed in the subsequent Senate Report of *Senate Comm. on Interstate Commerce, Air Safety Act, 1937*, S. Rep. No. 687, 75th Cong., 1st Sess. 2 (1937) [hereinafter cited as *Senate Committee Report on ASA*].

One difficulty faced by air carriers prior to 1938 was an inability to attract sufficient investment capital. See SENATE SUBCOMM. ON ADMINISTRATIVE PRACTICE AND PROCEDURE OF THE JUDICIARY COMMISSION, 94TH CONG., 1ST SESS. CIVIL AERONAUTICS BOARD PRACTICES AND PROCEDURES, 207-08 (Comm. Print 1976) [hereinafter cited as KENNEDY REPORT]. It was argued that the order and stability insured by public regulation would create an economic environment in which this inability to attract capital would be diminished. *See Senate Hearings on S. 3659*, *supra* note 49, at 30-31; *Civil Aeronautics Authority: Hearings on S. 3760 Before the Senate Commerce Comm.*, 75th Cong., 3rd Sess. 338-39 (1938) [hereinafter cited as *Senate Hearings on S. 3760*]; and HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, CIVIL AERONAUTICS BILL, H.R. DOC. NO. 2254, 75TH CONG., 3RD SESS. 2 (1938) [hereinafter cited as HOUSE COMMITTEE REPORT ON CAB]. P. DEMPSEY & W. THOMS, *supra* note 1, at 26-29.

51. The underlying purposes of the Civil Aeronautics Act have been summarized as follows:

> The leading argument for protective certification of air transportation services in 1938 was the assertion that uncontrolled entry would result in destructive competition, which, in turn, would prevent the attraction of adequate capital to the industry, as well as possibly threatening the maintenance of proper labor standards and adequate safety of operations. The attraction of adequate investment was also seen as an indirect

The CAB instituted broad policy changes in the post-war years.[52] In the international sphere, the most important of these reflected a belief on the part of the U.S. government that regulated competition between privately owned U.S. carriers in both the domestic and international markets would insure reliable and affordable air transportation.[53]

Prior to World War II and the establishment of the Civil Aeronautics Board, international air commerce of the United States was the almost exclusive domain of Pan American Airways and its affiliate Pan American-Grace Airways.[54] Led by resourceful Juan Trippe, Pan American flew routes to the Caribbean, South America, across the Pacific to the Far East, and across the Atlantic to Europe. The authority under which Pan Am operated to those foreign destinations had been granted by private agreements between the airline and the governments of the foreign nations to which it flew. As the war wound down, the CAB announced that the negotiation of routes and other operating authority would henceforth be performed by the U.S. Department of State and the Board.[55] The era of private arrangements between airlines and nations had ended with the dawn of an era of CAB regulation and international negotiation of air transportation agreements between governments.

In 1945, the CAB issued the *North American Routes Case*,[56] which allocated transatlantic service to Europe among three U.S. carriers.[57]

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means of promoting the national defense through supporting equipment and personnel which would be available to the nation in wartime. . . . [L]ess emphasized, but also popular . . . were arguments . . . that air transportation should be treated as a "public utility;" . . . that, in common with all forms of transportation, air carriage was a field in which competition would result in needless duplication and waste. . . .

REPORT OF THE CAB SPECIAL STAFF ON REGULATORY REFORM 20 (1975).

52. *See* Dempsey, *The Rise and Fall of the Civil Aeronautics Board—Opening Wide the Floodgates of Entry*, 11 TRANSP. L.J. 91 (1979) [hereinafter cited as *The Rise & Fall of the Civil Aeronautics Board*].

53. B. GIDWITZ, *supra* note 2, at 60.

> U.S. flag carriers in the international market compete with a plethora of foreign-flag carriers enabled by government subsidy to maintain uneconomic operations immune from the rigors of the free market system. In the face of this competition, the CAB . . . regularly supported the concept of duplicative services by U.S.-flag carriers over a number of international routes negotiated under bilateral air transport agreements, rejecting the contention that the designation of a single U.S. flag entrant would foster that carrier's capability to withstand foreign competition.

Dempsey, *The International Rate and Route Revolution in North Atlantic Passenger Transportation*, 17 COLUM. J. TRANSNAT'L L. 393, 416 (1978) [hereinafter cited as Dempsey].

54. Barnes, *The Economic Role of Air Transportation*, 10 L. & CONTEMP. PROBS. 431, 434 (1946).

55. A. SAMPSON, *supra* note 2, at 62. As Sampson pointed out: "[T]he C.A.B., under its new chairman Welch Pogue, had announced in October 1943 that the State Department and the CAB, not the airlines, would in future negotiate overseas air routes. It rang up the curtain, as Pogue put it, for action between governments on the international state." *Id.*

56. 6 C.A.B. 319 (1945).

57. The three carriers were Pan American, TWA and American Export Airlines. The latter

Nevertheless, while continuing to encourage regulated competition among U.S. carriers, the Board existed to ameliorate the vicissitudes of the marketplace and the impact of excessive competition between carriers. For example, in the late 1960s, overly optimistic government and industry demand projections led the airline industry to invest in large numbers of the new generation wide-bodied aircraft. But passenger demand is always dampened when disposable income is squeezed by economic recession, as it was in the early 1970s. That, coupled with radically increased fuel costs after the Arab Oil embargo of 1973,[58] caused airline profit margins to plummet into oceans of red ink.

Hence, the economic recession of the late 1960s, excessive investment in wide-body aircraft (induced by anticipation that the economic "boom" of the mid-1960s would continue into the 1970s), and enormous increases in the cost of aviation fuel (stimulated by the OPEC decision to

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was subsequently merged into American Airlines. 6 C.A.B. 371 (1945). However, except for service to London and Lisbon, the routes issued by the Board in 1945 were not duplicative. President Truman urged still greater competition between U.S.-flag international carriers: "My objective is to accomplish a route pattern in which our nation may have the benefit of competition to the principal traffic points in Europe, and to avoid a monopoly on the part of either of the United States carriers." North Atlantic Route Transfer Case, 11 C.A.B. 676, 678-79 (1950). Beginning in 1950, both Pan Am and TWA served the four most important European gateways: London, Paris, Rome and Frankfurt. A. LOWENFELD, *supra* note 5, at II-48. National Air Lines received authority to serve London in 1969. Miami-London Service Investigation, 51 C.A.B. 100 (1969).

It was recognized as early as 1935 by the Federal Aviation Commission that European nations were enthusiastically developing their commercial aviation capability in foreign markets for reasons of national pride and prestige. *See* SENATE COMM. ON INTERSTATE COMMERCE, FEDERAL AVIATION COMMISSION, S. DOC. NO. 15, 74TH CONG., 1ST SESS. 82 (1935) [hereinafter cited as REPORT OF THE FAC]. However, Recommendation 25 of the FAC's Report, which is part of the legislative history of the Civil Aeronautics Act of 1938, 52 Stat. 937 (1938)—the predecessor of the Federal Aviation Act of 1958—urged that "the status of American air transport in foreign fields competing with foreign-owned lines should in general not be one of competition between American lines, but of carefully-controlled regional monopoly." REPORT OF THE FAC, *supra* at 88. The rationale for this position was essentially that "[i]f American air lines are to compete with lines under foreign direction it would be an obvious absurdity to divide the American strength by competition among a multiplicity of american flag enterprises." *Id.* Consequently, this portion of the legislative history of the Civil Aeronautics Act of 1938 is inconsistent with the post World War II approach of the CAB and DOT in promoting U.S.-flag competition on international routes by awarding parallel grants of authority to more than one U.S.-flag carrier. *Cf.* Westwood & Bennett, *A Footnote to the Legislative History of the Civil Aeronautics Act of 1938 and Afterward*, 42 NOTRE DAME LAW. 309, 314-19 (1967) (on the role of Federal Aviation Commission in the legislative process in this area); *see generally* H. KNOWLTON, AIR TRANSPORTATION IN THE UNITED STATES 1-18 (1941); C. PUFFER, AIR TRANSPORTATION 193-255 (1941). *But see* S. RICHMOND, REGULATION AND COMPETITION IN AIR TRANSPORTATION 152, 205 (1961) (on President Eisenhower's policy in favor of competition between U.S.-flag carriers on internation routes). Dempsey, *supra* note 53, at 416-17.

58. *See* Dempsey, *Economic Aggression & Self-Defense in International Law: The Arab Oil Weapon and Alternative Responses Thereto*, 9 CASE W. RES. J. INT'L L. 253 (1977) [hereinafter cited as *Economic Aggression in International Law*].

escalate drastically the price of oil)[59] placed the traditionally dominant U.S. carriers, Pan Am and TWA, in severe jeopardy.[60] As a response to this crisis, in the early 1970s the carriers proposed, and the CAB authorized, two measures that departed from the established policy of fostering competition among U.S.-flag carriers in the international market.

The first consisted of capacity-reduction agreements among carriers. Submitted to the CAB by Pan Am, TWA, British Airways, and British Caledonian Airways, the agreements called for reduction in the number of flights between London and New York, Chicago, Boston, and Washington, D.C.[61] The carriers contended that the flight reductions would enable them to decrease fuel consumption substantially and, consequently, to reduce expenditures and thereby ensure their continued economic viability.[62] Given the peculiar competitive disadvantages of U.S.-flag carriers vis-a-vis subsidized foreign carriers, the Board approved the capacity-reduction agreements, although it had generally rejected such agreements in domestic markets, finding them adverse to the public interest.[63]

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59. Although Pan Am reduced its fuel consumption during 1974, its fuel costs for that year increased by $169,000,000. The operating losses sustained by Pan Am and TWA during the first five months of 1975 were partially attributable to the overwhelming increase in the price of oil. Pan American World Airways, Inc., CAB Order 75-9-11 (1975). *See The Rise and Fall of the Civil Aeronautics Board*, *supra* note 52, at 117.

60. Although the U.S. share of the U.S.-Europe passenger market fell to a record low of 38% in 1967, the reduction did not produce deleterious economic consequences for Pan Am and TWA, for the growth of transatlantic traffic had allowed them to enjoy increased revenues through the mid-1960's, despite their declining traffic shares. The relative position of U.S.-flag carriers in international markets dropped from a peak of 70% in 1951 to less than 50% in 1961. In the transatlantic market the U.S. share dropped to 37% against the eighteen foreign flat competitors in the market. *See* F. THAYER, AIR TRANSPORT POLICY AND NATIONAL SECURITY 273-74 (1965).

However, the last years of the decade saw both carriers suffer hemorrhaging. In 1969 Pan Am suffered an operating loss of $16,000,000. Transatlantic Route Proceeding, CAB Order 77-1-98, at app. II, 4-5 (1977). Subsequent to 1969 it enjoyed no net profits, and its net losses totaled $316,000,000 by the end of 1975. Pan AM-TWA Route Agreement, CAB Order 77-1-7, at 7 (1977). TWA's combined losses in its Atlantic and Pacific operations exceeded $54,000,000. *Id.*

61. Approval was sought pursuant to 49 U.S.C. § 1382. It is well established that the federal government may approve agreements which, by their terms, violate the letter and spirit of the antitrust laws, provided that such agreements are required to satisfy a serious transportation need or to secure important public benefits. National Air Carrier Ass'n v. CAB, 442 F.2d 862 (D.C. Cir. 1971); National Air Carrier Ass'n v. CAB, 436 F.2d 185 (D.C. Cir. 1970); FMC v. Svenska Amerika Linien, 390 U.S. 283 (1968). Agreements otherwise violative of the antitrust laws might also be approved where the diminution in competition, when weighed against other public interest objectives, will assist in the effectuation of overall statutory policy. *See* Seaboard Air Line R.R. Co. v. United States, 382 U.S. 154 (1965); Minneapolis and St. Louis R.R. Co. v. United States, 361 U.S. 173 (1959); P. DEMPSEY & W. THOMS, *supra* note 1, at 241-245.

62. Capacity Reduction Agreements Case, CAB Order 75-10-77, at 2 (1977).

63. Capacity Reduction Agreements Case, CAB Order 75-7-98, at 15 (1975):

> The views expressed by the Board . . . relating to domestic capacity agreements, cannot be applied to international capacity agreements without taking into account the

The second measure taken to forestall further worsening of the carriers' economic condition involved a route-transfer agreement between Pan Am and TWA.[64] "Although the realignment plan resulted in a significant reduction of direct competition between the two participating airlines,"[65] the CAB authorized it for a limited time[66] as a step "necessary

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often decisively different circumstances which prevail in the international arena. Although the United States Government has sought to promote a regime of regulated commercial competition in international air transportation, many other governments do not share this competitive philosophy, and the United States is not always able to make its views prevail. Moreover, many foreign air carriers are state enterprises not subject to the economic forces upon which this Board relies to assure rational economic behavior in domestic air transportation.

In particular, such carriers may be inclined to operate at excess capacity in important markets for reasons of national prestige or national policy, without regard to the economic losses suffered or inflicted by such action. Furthermore, the Board does not have the same effective powers over rates in the international arena as it does domestically. There thus may well arise situations where capacity agreements between carriers are essential to protect U.S.-flag carriers against unwarranted harm, and where the only feasible alternative may be reduction of capacity by government order, with all the potential for international confrontation which this can involve. Thus international capacity agreements may well continue to be acceptable . . . even where a parallel domestic agreement would not be [footnotes omitted].

For a summary of the circumstances under which the capacity limitation agreements were approved, and a recommendation that they be supported under similar, extraordinary circumstances, *see* INTERAGENCY TASK FORCE OF THE U.S. INT'L AIR TRANSPORTATION POLICY OF THE U.S. 18-19 (1976). Despite a challenge by the Justice Department to CAB approval of limited term capacity reduction agreements consummated by the carriers in 1973, as an emergency response to the fuel crisis precipitated by the Arab oil embargo, the Federal courts upheld the Board's action, notwithstanding certain procedure irregularities, finding it necessary under the unusual circumstances.

However, the courts disapproved similar Board action with respect to an analogous 1974 carrier agreement, on the ground that the Board had failed to conduct full hearings and an investigation on all controverted issues. United States v. CAB, 511 F.2d 1315 (D.C. Cir. 1975). *But see* Air Line Pilots Ass'n Int'l v. CAB, 509 F.2d 964 (D.C. Cir. 1975).

64. CAB Order 75-1-133 (1975). The Board's policy regarding route exchange agreements during the early part of the 1970's has been summarized as follows:

> Route transfer agreements were encouraged during the early 1970's as a useful device for pursuing economic efficiency during a period when slumping traffic and excess capacity made the consideration of route expansion appear inopportune. Importantly, during this time period route transfer application were accorded priority treatment and other carriers were not permitted to file competitive applications. To ensure procedural fairness in view of this expedited and exclusive treatment, and mindful of the limited purposes for which the "transfer" process was created, the Board focused upon one narrow question: whether the exchange would improve the efficiency of the air transportation system as a whole without major detriment to any of its parties. See, for example, *American-Airwest Route Exchange Agreement*, Orders 75-8-93, August 18, 1975 and 76-8-133, August 25, 1976.

Eastern Airlines, Inc. & Piedmont Aviation, Inc., CAB Order 77-11-45 (1977); *see id.*, CAB Order 77-12-76 (1977).

65. Pan Am-TWA Route Agreement, CAB order 77-1-7, at 2 (1977). As a result of the route transfer, Pan Am and TWA temporarily discontinued nonstop competitive operations between London and Washington, D.C., Los Angeles, and Chicago, points previously served by both carriers. Pan Am assumed sole nonstop responsibility at Washington and retained authority in the Baltimore to London market; TWA assumed the obligation at the remaining points and Phila-

. . . to avoid a clear danger of a major cessation [of the carriers' international operations] with greater attendant public disruption."[67] As a result of the route transfer, both carriers enjoyed increased load factors and enhanced profitability, but the U.S. share of transatlantic traffic suffered a sizeable reduction.[68]

Although the United States sought to promote a certain degree of competition among its privately owned carriers, nearly all other major aviation powers promoted the growth and expansion of a single national carrier. As in the post-World War I era, these nations continued to view their carriers as instruments of national political and economic policy. As economic instruments, the national carriers took on even greater importance in the post-World War II era, relied upon by their governments to earn foreign exchange and promote tourism.[69]

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delphia. CAB Order 78-3-8, at 1 n.1 (1978). Both carriers retained the opportunity to provide competitive service in the London to New York, Boston, and San Francisco markets. *United States International Aviation Negotiations: Hearings Before the Subcomm. on Aviation of the House Comm. on Public Works and Transportation*, 95th Cong., 1st Sess. 277-81 (statement of Mahlon R. Straszheim). Pan Am served San Francisco via Seattle and assumed sole responsibility in the Detroit-to-London market, which it served via Boston. *Id.* Pan Am also retained authority in the Baltimore to London market. *See* CAB Order 78-3-8 (1978).

66. Approval pursuant to section 412 of the Federal Aviation Act was limited to a period of two years or 90 days after a final decision in the Transatlantic Route Proceeding, whichever transpired first. CAB Order 75-1-133 (1975). *See also* CAB Order 76-9-42 (1976); CAB Order 76-7-40 (1976); Pan Am-TWA Route Agreement, CAB Order 77-1-7 (1977). The agreement was subsequently extended for an additional two-year period by CAB Order 78-3-8 (1978). By the date of the extension (Mar. 1, 1978), the carriers had modified their original agreements so as to eliminate the more objectionable anticompetitive features. *Id.* at 4.

67. Pan Am-TWA Route Agreement, CAB Order 77-1-7 (1977).

68. *See* CAB Order 77-1-98 (1977), for an objection to the concomitant balance of payments outflow. Dempsey, *supra* note 53, at 417-19.

69. The development of jet aircraft in the 1950s truly revolutionized the aviation industry, particularly at the international level. Aircraft manufacturers, especially those in the United States were soon mass-producing commercial airliners which made air travel safer, more efficient, and much faster. As aircraft increased in size and greater economies of scale were achieved, air travel became affordable to millions of consumers. A tremendous explosion in passenger traffic ensued, particularly on transatlantic routes, leading to rapid growth rates among international carriers.

These growth rates were not limited to American and European carriers. Throughout the post-war period, new airlines sprang up in Asia, Latin America and Africa, many owned and/or heavily subsidized by the governments of newly independent nations. Unlike U.S. carriers whose survival depended upon their ability to adjust to economic forces prevailing in the marketplace, the vast majority of these newly formed airlines were analogous to the European national carriers in that they were formed for reasons other than profitmaking, such as increasing tourism, earning foreign exchange, and enhancing international security and prestige. Supported financially by governments seeking access to prestigious markets, these new carriers increased competition in a number of key regions. In 1947, for example, TWA and Pan American carried more than 80% of all transatlantic passengers; fifteen years later, their share had fallen to just 32%,

III. The Route and Rate Revolution in International Aviation

A. *The Route Revolution: Liberal Bilaterals and Multiple Permissive Entry*

The stability which had characterized the *Bermuda*-ICAO-IATA regime since World War II came to an abrupt end in the late 1970s. With the election of Jimmy Carter as President, the nation had a firm disciple of transportation deregulation in the White House.[70] He appointed a Cornell University economics professor, Alfred E. Kahn, to serve as Chairman of the U.S. Civil Aeronautics Board.[71] Kahn believed that the airline industry, both domestically and internationally, was fertile for unregulated com-

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while 19 airlines were now providing service between the United States and Europe. A. SAMPSON, *supra* note 2, at 109-110.

The rapid technological advances of the 1950s and 1960s culminated in the development of wide-bodied or "jumbo" jets. The Lockheed L-1011, Boeing 747, and McDonnell Douglas DC-10, huge aircraft, capable of carrying several hundred passengers, were extremely expensive to purchase and maintain. Yet many international carriers viewed them as essential investments to insure their survival in an increasingly competitive marketplace.

While many international carriers grew at impressive rates during the 1950s, 1960s, and 1970s, the profits of individual carriers remained relatively low for several reasons. Intense competition on many routes undoubtedly contributed to the problem. The rapid technological advances of the post-war era have forced many carriers to raise or borrow billions of dollars to finance the purchase of new aircraft which, in turn, often became obsolete within a relatively short period of time.

By 1973, numerous international carriers had invested billions of dollars in entire fleets of wide-bodied aircraft. Unfortunately, their massive expenditures coincided with the Arab oil embargo of the same year. Cheap and abundant supplies of aviation fuel had made the tremendous expansion of the industry possible; the skyrocketing price of oil, coupled with one of the worst recessions of the twentieth century, brought many international and domestic carriers to the brink of financial collapse by the mid-1970s.

70. Although president Ford had begun the legislative call for deregulation, it was Jimmy Carter who became the "ultimate deregulator." A. SAMPSON, *supra* note 2, at 136.

71. Dempsey, *Transportation Deregulation—On a Collision Course?*, 13 TRANSP. L.J. 329 (1984) [hereinafter cited as *Transportation Deregulation*].

> The high priest of deregulation was Alfred Kahn, a quick-firing Professor of Economics at Cornell University, who had regulated energy industries in New York State. Like Milton Friedman, he was both an economist and an evangelist: a witty talker with a long nose and a sharp chin, he popped up like an irreverent imp determined to unlease new forces; and he had no great respect for the giant airlines.

A. SAMPSON, *supra* note 2, at 135. Professor Lowenfeld put it this way:

> President Carter—I suspect not fully aware of what he was doing—named Kahn Chairman of the Civil Aeronautics Board. . . . I am convinced that the arrival of Alfred Kahn in Washington—more than any given event—changed the environment for civil aviation in the United States, and (I venture to predict) in Europe as well. Kahn had not only immense energy and charm—a king of anti-pompousness (if there is such a word); he had complete confidence in this own analysis, he had little patience with precedents, less with lawyers, and still less with administrative procedures that to some appeared as due process of law but to him appeared as a major line of defense of the 'ins' against the 'outs'. A person with any other combination of qualities—even if on substance he agreed with Kahn—might have decided that his first priority was to persuade the Congress to move on the deregulation legislation which had been pending in Committee for over two years. Kahn, however, decided to do it the other way around: first

petition, because in theory: (1) demand is price-elastic (so that a moderate fare reduction will significantly fill unused capacity); (2) few economies of scale exist (so that costs are similar for fully loaded small or large aircraft); and (3) resources are mobile (so that aircraft can be shifted between markets as demand changes).[72] The system of economic

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demonstrate that deregulation can work, and then, if Congress had not done so in the mean time, it will fall into line eventually.

Lowenfeld, *Deregulation—Is It Contageous?*, INTERNATIONAL AIR TRANSPORT IN THE EIGHTIES 26 (H. Wassenberg & H. Fenera ed. 1981) [citation omitted]. For a more flattering view of Dr. Kahn's vast accomplishments *see* T. MCCRAW, PROPHETS OF DEREGULATION 208-99 (1984).

72. A. KAHN, THE ECONOMICS OF REGULATION 209-20 (1970). Further, Kahn argued that governmental regulation had made carriers inefficient, while denying passengers the range of price and service options which flow from a competitive environment. *See* Kahn, *The Changing Environment of International Air Commerce*, 3 AIR L. 163 (1978) [hereinafter cited as Kahn].

Kahn believed that, "Wherever competition is feasible it is for all its imperfections, superior to regulation as a means of serving the public interest." A. SAMPSON, *supra* note 2, at 133. Before the Senate Judiciary Committee hearings chaired by Edward Kennedy, Kahn testified:

> The objection [to regulation] is not necessarily that airlines have been forced by their competition to incur greater costs for denser schedules, more advertising, meals, and in-flight entertainment than they would if they were able to get together and restrict such expenditures. The objection is, rather, that those cost-inflating service improvements have not been subjected to the test of having to compete with lower-cost alternatives.

Oversite of Civil Aeronautics Board Practices and Procedures, Hearings before the Subcomm. on Administrative Practice and Procedure of Sen. Comm. on the Judiciary, 94th Cong., 1st Sess. 93 (1975). Professor Lowenfeld succinctly summarized the principal arguments against economic regulation in these terms:

> [R]egulation or cartelization breeds inefficiency, shelters waste, and deprives the consumer of free choice. It isn't, as we have seen in the American experience, that regulation or cartelization results in huge monopoly profits. . . . The point is only that when both price and market entry are controlled, whether by the CAB or under IATA plus national governments, costs go up, prices go up, and passengers pay for services they don't want and can't pay for services they do want.

Lowenfeld, *Deregulation—Is It Contageous?* in INTERNATIONAL AIR TRANSPORT IN THE EIGHTIES 31 (H. Wassenbergh & H. Fenema ed. 1981). Conversely, other commentators have questioned the underlying premises of deregulation:

> Another unchallenged assumption characterizing the thinking of the leaders of airline deregulation—mostly economists—was that regulation and efficiency were antithetical. Although regulation can work to promote inefficiency, the fault lies more within the purview of the agency and its management practices than within the principle of regulation itself. A glance at the highly regulated yet extremely efficient transportation systems of some Western European countries bears out this point.
>
> Those who maintain their allegiance to deregulation argue that it is better for the industry and for the public in the long run; but no one seems to know how long that will be, and who else will suffer in the process. Deregulation proponents foresaw neither the extent of the upheaval in the airline industry, nor the inability of management to cope with sudden change. Deregulation was a high-risk venture, with the costs far higher than even its proponents predicted.
>
> Airline deregulation was typical of the radical approach for getting government out of the marketplace. It is conceivable that it may eventually result in more efficient, less costly service, but that remains an open question. In the meantime, the landscape is still being littered with corporate wreckage, the result of uncertainty and the high risks of such radical surgery.

S. TOLCHIN & M. TOLCHIN, DISMANTLING AMERICA 248 (1983) [hereinafter cited as S. TOLCHIN & M. TOLCHIN].

regulation which had been embraced by the Civil Aeronautics Board prior to Kahn was criticized as having "(a) caused air fares to be considerably higher than they otherwise would be; (b) resulted in a serious misallocation of resources; (c) encouraged carrier inefficiency; (d) denied consumers the range of price/service options they would prefer, and; (e) created a chronic tendency toward excess capacity in the industry."[73]

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73. Professor Alfred Kahn argued that because the airline industry is inherently competitive, the effort of the CAB in the four decades following its creation to restrain pricing competition led to "irrational service inflation." In Kahn's words, airlines had a tendency to compete not only "in adopting the most modern and attractive equipment and in the frequency with which they schedule flights, but also in providing comfort, attractive hostesses, in-flight entertainment, food and drink." A. KAHN, 2 THE ECONOMICS OF REGULATION 212 (1966). By excessive scheduling and otherwise offering wastefully higher levels of service, marginal costs began to rise to the level of passenger fares. The upward pressure on costs squeezed profit margins and led to the industry to ask the CAB for a repeated series of additional fare increases, as ticket prices spiraled upward. While a high level of service might be desirable to some, Dr. Kahn would prefer the test of the competitive market place:

> That test requires that customers be provided with a sufficient variety of price-quality combinations—consistent with efficient production—so that each can register a free and tolerably well-informed monetary appraisal of the quality differentials that are offered. . . . The reason why it is questionable that the service improvements produced by competition in the airline industry have been worth the cost is that the [CAB's] restrictions on *price* competition have denied consumers the alternative of less sumptuous service at prices reflecting its lower cost. They have therefore not had the opportunity to determine whether the better quality is in their collective judgment worth the higher cost of providing it. . . .

Id. at 220. A subcommittee chaired by Senator Edward Kennedy (D-Mass.) agreed. It concluded that although the airline industry was potentially highly competitive, the CAB had restricted pricing competition and stifled new entry. Although consumer fares were high, airline profits were low, because excessive service competition exacerbated costs. It argued that with pricing and entry freedom, carriers could provide service with higher load factors at significantly reduced ticket prices. CIVIL AERONAUTICS BOARD PRACTICES AND PROCEDURES, A REPORT OF THE SUBCOMMITTEE ON ADMINISTRATIVE PRACTICE AND PROCEDURE OF THE SENATE COMMITTEE ON THE JUDICIARY, 94th Cong., 1st Sess. (1975). *See The Rise and Fall of the Civil Aeronautics Board*, *supra* note 52, at 116-117. The competition unleashed by deregulation did lead to lower ticket prices for consumers and higher load factors in the late 1970s. *See generally*, E. BAILEY, D. GRAHAM & D. KAPLAN, DEREGULATING THE AIRLINES: AN ECONOMIC ANALYSIS 55-56 (1983); S. BRYER & R. STEWART, ADMINISTRATIVE LAW AND REGULATORY POLICY 674-697 (1985); and S. BREYER, REGULATION AND ITS REFORM 197-221 (1982); Levine, *Revisionism Revisited? Airline Deregulation and the Public Interest*, 44 L. & CONTEMP. PROBS. 179 (1981); *The Rise and Fall of the Civil Aeronautics Board*, *supra* note 52, at 118. With the promulgation of the Airline Deregulation Act of 1978, Kahn was appointed Jimmy Carter's "Inflation Czar," and aviation novice Marvin Cohen, was elevated to fill the shoes of the CAB Chairmanship. As CAB Chairman Cohen himself said, "I came into this job from a law practice, where I didn't know much about aviation." *A Review of U.S. International Aviation Policy, Hearings Before the House Comm. on Public Works and Transportation*, 97th Cong., 1st and 2nd Sess. 755 (1981-82) [hereinafter cited as *House Hearings on International Aviation*].

For a general criticism of the existing structure of air transport regulation, *see* SENATE SUBCOMM. ON ADMINISTRATIVE PRACTICE AND PROCEDURE OF THE JUDICIARY COMM., 94th Cong., 1st Sess., Civil Aeronautics Board Practices and Procedures (Comm. Print 1976); REPORT OF THE CAB SPECIAL STAFF ON REGULATORY REFORM (1975); *Hearings on S.689 Before the Subcomm. on Aviation of Senate Commerce Comm.*, 94th Cong., 1st Sess. (1977) (testimony of Senator

As CAB Chairman, Kahn began to encourage pricing and service competition in domestic aviation, policies which were generally embraced by Congress in the Air Cargo Deregulation Act of 1977,[74] and the Airline Deregulation Act of 1978.[75] By lowering their rates, domestic airlines were able to tap the price elasticities of the market to encourage discretionary travelers to fill seats which might otherwise have flown empty. Consumers, who had been deprived of competitive fares under regulation, applauded the new regime.[76] By 1978 the airlines industry, which

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Edward Kennedy); 123 CONG. REC. S6199-6201 (Apr. 21, 1977) (remarks of Sen. Kennedy); and L. KEYES, FEDERAL CONTROL OF ENTRY INTO AIR TRANSPORTATION (1951). Under regulation, the absence of rate and route competition encouraged airlines to compete in the only area in which they were not generally restricted: service. The carriers scheduled an increased number of flights, thereby decreasing their load factors. The resulting high-cost service led to a diminution of revenues. CAB Order 78-9-38, at 3 (1978). The carriers also offered competitive in-flight amenities and a high level of ground services, (*e.g.* elaborate advertising, plush terminal facilities). This, too, produced less than satisfactory profits. *Cf.* Dempsey, *Entry Control Under the Interstate Commerce Act: A Comparative Analysis of the Statutory Criteria Governing entry in Transportation*, 13 WAKE FOREST L. REV. 729, 770 (1977) (although no real rate competition existed in the several modes of regulated surface transportation, service competition was pervasive).

74. Pub. L. No. 95-163, 91 Stat. 1278 (1977). P. DEMPSEY & W. THOMS, *supra* note 1, at 28, 191-198.

75. Pub. L. No. 95-504, 92 Stat. 1705 (1978). The promulgation of the Airline Deregulation Act of 1978 was the "culmination, not the start, of a period of freer entry and more competitive fares." M. BRENNER, J. LEET & E. SCHOTT, AIRLINE DEREGULATION 107 n.78 (1985) (quoting Stelzer, a paper delivered at Institute of Air Transport Symposium, Paris, May 1984) [hereinafter cited as M. BRENNER]. *See generally*, Levine, *Revisionism Revisited? Airline Deregulation and the Public Interest*, 44 L. & CONTEMP. PROBS. 179 (1981); P. DEMPSEY & W. THOMS, *supra* note 1, at 29-30.

It is clear that Congress did not take into account the issue of international transportation in promulgating much, if not most, of the Airline Deregulation Act, and left many of the most significant provisions of the Federal Aviation Act unchanged insofar as they apply to foreign air transportation. Thus, although it amended the declaration of policy set forth in section 102 of the Act, 49 U.S.C. § 1302, insofar as this provision affects domestic and overseas transportation, Congress left the section intact for foreign transport purposes, admitting that it had not considered the liberalization of international service. *See* H.R. REP. NO. 95-1779, 95th Cong., 2d Sess. 55 (1978); S. REP. NO. 95-631, 95th Cong., 2d Sess, 51-52, 61 (1978). Similarly, although Congress amended section 401 of the Act to liberalize significantly the entry criterion applicable to domestic transportation (by eliminating the requirement that such transportation be shown to be "required" by the public convenience and necessity, and substituting therefor a requirement that such movements be demonstrated to be "consistent": with that standard, and by shifting the burden of proof to opponents of new entry, 49 U.S.C. § 1371(d)(i)(A) & (d)(9)(B), respectively), it left unchanged the entry criteria and the burden of proof applicable in the field of foreign transit. S. REP. NO. 95-631, 95th Cong., 2d Sess. 58 (1978). The Report of the Kennedy Subcommittee, which was the first major congressional effort in our contemporary era to examine the regulation of air transportation, emphasized that its record and conclusions were inapplicable to international aviation, for the subject had not been considered by the Subcommittee. *Subcomm. on Admin. Practice & Procedure of the Sen. Comm. on the Judiciary, Civil Aeronautics Board Practices and Procedures*, 94th Cong., 1st Sess. 26 (1976).

76. *See* Hardaway, *Transportation Deregulation (1978-84): Turning the Tide*, 14 TRANSP. L.J. 101 (1985) [hereinafter cited as Hardaway].

was now able to fill unused capacity, enjoyed the largest profits in the history of domestic aviation.[77]

These initial successes with domestic airline deregulation led the Carter Administration to begin to export its policies into international markets. In the years preceding the Carter Administration, only two major U.S.-flag carriers served the major routes in the U.S.-Asia market (*i.e.*, Pan American and Northwest Orient), the U.S.-Latin America market (*i.e.*, Pan American and Braniff), and the U.S.-Europe market (*i.e.*, Pan American and TWA).[78] *Bermuda I* and its progeny had not specifically limited the number of carriers which could be designated to serve the routes specified in their annexes.[79] However, prior administrations has been reluctant to certificate a significantly larger number of U.S.-flat vis-à-vis

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77. *The Rise & Fall of the Civil Aeronautics Board*, *supra* note 52, at 119. Several industry analysts pointed out the catalytic impact these profits had upon the U.S. government's decision to export deregulation:

> It is probable that this short spurt of strong growth, in this very cyclical industry, contributed to the fervor of the Carter Administration deregulators. The CAB and other U.S. air transport policymakers have typically exhibited short memories, and have acted to expand competition during (or just after) the intermittent periods of industry growth and prosperity.

M. BRENNER, *supra* note 71, at 108, n.80.

78. Prior to 1969, only two U.S.-flag carriers (*i.e.*, Pan Am and TWA) were designated to serve the North Atlantic. That year, a third carrier, National Air Lines, was authorized to provide service between Miami, its domestic hub, and London. Miami-London Service Investigation, 51 C.A.B. 100 (1969). Dempsey, *supra* note 53, at 415-34. National Air Lines was acquired by Pan Am in the late 1970s. *See* Note, *The Airline Merger Cases: CAB Application of Clayton & 7 After Deregulation*, 12 TRANSP. L.J. 139, 149-53 (1981).

Before the beginning of World War II, Pan Am had enjoyed the exclusive opportunity to serve as the United States "chosen instrument" in most international markets. *See* A. SAMPSON, *supra* note 2, at 62, 77-83. That privilege began to be diluted after the end of the war:

> In 1946 Braniff, Chicago and Southern, Western, Eastern, National, Colonial and American Airlines all obtained rights to fly to various parts of Central America, the Caribbean islands and South America. United Airlines was granted a route extension from San Francisco to Hawaii. Northwest Airlines began its services through Alaska to the Far East. And, finally, Transcontinental and Western Air (later Trans-World Airlines), which had already received authority to fly across the Atlantic in 1945, was granted Pacific routes as well in 1946 and thus became America's second worldwide airline.

D. CORBETT, POLITICS AND THE AIRLINES 288 (1965). Northwest Orient recently filed an application to merge with Republic. Joint Application of NWA, Inc. and Republic Airlines, Inc., Jan. 28, 1986, on file with the U.S. Dept. of Transportation in Docket 43754. This merger will create the nation's third largest air carrier.

79. CAB Chairman Marvin Cohen described the Carter Administration's approach on this issue as follows:

> In terms of multiple designations under the Bermuda I standard form, we have multiple designation. The agreement says airline or airlines, with an "s". When we negotiate, recently in the past 3 or 4 years, we have been negotiating for more market flexibility.
>
> The right of multiple designation was already there in the agreement. Some countries have not been very happy with it and have limited it somewhat or tried to and we have fought down the line. . . .

House Hearings on International Aviation, *supra* note 73, at 760.

foreign-flag carriers in any particular market, thereby retaining a rough parity, or a general *quid-pro-quo* balance.[80] But beginning in the late 1970s, the CAB began to designate a large number of new U.S.-flag entrants to provide service between several interior U.S. points and London—markets which had therefore lain dormant under *Bermuda I*.[81] In the *Transatlantic Route Proceeding*, several additional U.S.-flag carriers were authorized to compete in the transatlantic market, including Delta Air Lines (Atlanta-London), Braniff Air Lines (Dallas/Ft. Worth-London), and Northwest Airlines (to serve points in Scotland, Denmark, Norway, Sweden and Iceland), while the operating rights of Pan Am, TWA and National in this market were expanded.[82] The U.S. Civil Aeronautics Board took other actions which offended the British government, including its refusal to approve capacity limitation agreements proposed by the United Kingdom in 1976 as an attempt to "shore up" the deteriorating shares of its airlines in the U.S.-U.K. market.[83]

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80. Although the typical bilateral air transport agreement, patterned after the *Bermuda I* model, Air Services Agreement, United States-United Kingdom, February 11, 1946, 60 Stat. 1499, T.I.A.S. No. 1507, permits designation of "an air carrier or carriers" by each signatory state, *id.* art. 2(1), governments have remained conservative in their construction of the rights and obligations arising thereunder. For the three decades following World War II, most nations of the world, including the United States, implicitly construed such agreements as limiting the number of domestic carriers that could properly be designated on international routes. Hence, each nation typically selected only one of its domestic carriers to compete over these routes, except in certain more heavily traveled markets (*e.g.*, New York-London). Yet, notwithstanding thirty years of international practice, the liberal language of the *Bermuda I* type agreements may be interpreted as not explicitly limiting the numbers of carriers which might be designated on international routes.

81. Dempsey, *supra* note 53, at 415-34.

82. *Id.* at 419-23. Five new U.S.-flag carriers were certificated between 1978 and 1980 in the transatlantic market: Air Florida, Braniff, Delta, Northwest, and Western. *House Hearings on International Aviation*, *supra* note 73, at 973.

83. *See* Comment, *Aviation Law—Air Services Agreement Between the United States and the United Kingdom*, 8 GA. J. INT'L & COMP. L. 211 (1978); *British Revolution*, *supra* note 30, at 114.

> The thrust of the British complaint was that Bermuda I resulted in an imbalance of benefits in favor of the United States and that competition under Bermuda I had allowed U.S. carriers to seize too large a share of the market. U.S. carries accounted for 58 percent of the total airline traffic between the United States and Britain, compared to Britain's share of 38 percent, the remaining 4 percent went to other carriers. Moreover, British carriers were flying the Atlantic at only 30 to 62 percent of capacity, whereas U.S. flights were generally operating at 48 to 62 percent of capacity. By British accounts, this resulted in combined U.S. airline revenues of $512.8 million, as compared with British airline revenues of $227.5 million.

Bermuda 2 Model, *supra* note 40, at 1263 (citations omitted). The British were also concerned about U.S. carrier profits on fifth-freedom routes between London and Continental European points. *Id.* at 1263-64. Other grievances included "the manner in which the CAB exercised authority over rates and, although never made explicit, probably a high degree of irritation at U.S. public resistance to the proposed institution of supersonic Concorde service." M. BRENNER, *supra* note 75, at 13.

Dissatisfaction with these efforts led the British government to renounce *Bermuda I* in 1976, which under the terms of the bilateral began a one-year count down to termination. Vigorous negotiations between the two governments resulted in the signing of a new bilateral air transport agreement, *Bermuda II*, shortly prior to the expiration of its predecessor.[84] In many ways, the new agreement was considerably more restrictive than *Bermuda I*, *inter alia*, limiting the number of carriers which may be designated to serve specific routes, imposing capacity controls, and curtailing U.S. carriers' fifth-freedom rights.[85]

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84. U.S.-U.K. Air Transport Agreement, 28 U.S.T. 5367, T.I.A.S. No. 8641 (1977); Dempsey, *supra* note 53, at 421-22, 429-31, 436-38.

> The negotiations were extremely difficult, particularly for the U.S. negotiating team, whose task was made more difficult by a change in Administrations (Ford to Carter) midway in the 12-month negotiating period. The British held firm to their basic position and it was not until the very last minute that a new, and more restrictive, agreement was reached. Among other things, it limited the number of permissible scheduled carriers, enabled greater government control over capacity, and significantly reduced U.S. carrier "Fifth Freedom" traffic rights.

M. BRENNER, *supra* note 75, at 13.

85. Sion, *Multilateral Air Transport Agreements: The Possibility of a Regional Agreement Among North Atlantic States*, 22 VA. J. INT'L L. 155, 162-64 (1981) [hereinafter cited as Sion]; Schaffer & Lachter, *Developments in United States International Air Transportation Policy*, 12 LAWYER OF THE AMERICAS 585, 586-87 (1980) [hereinafter cited as Schaffer & Lachter]. Under *Bermuda I*, both Pan Am and TWA had been authorized to serve the markets between London on the one hand, and Boston, New York and San Francisco, on the other. *Bermuda II* permitted dual U.S.-flag designations at only two points (New York and Los Angeles were ultimately selected by the CAB). The single designation points authorized under *Bermuda I* to enjoy nonstop service to London were Atlanta, Cleveland, Dallas/Ft. Worth, Denver, Houston, Kansas City, Minneapolis/St. Paul, New Orleans, Pittsburgh, St. Louis, and Tampa. *Bermuda II* reduced the number of new points for which U.S.-flag carriers could be authorized to two in 1978 (Atlanta and Dallas/Ft. Worth) and two in 1980 (Houston and a "wild card" city, to be subsequently named). *Bermuda II* also diminished the fifth-freedom opportunities of U.S.-flag carriers. They lost the right to carry local traffic on flights beyond London and Prestwick/Glasglow and Austria and Belgium (in 1980), and the Netherlands, Norway and Sweden (in 1982). Although *Bermuda I* placed no capacity or frequency restrictions on carriers other than *ex post facto* governmental review, *Bermuda II* allows the two governments to challenge carrier schedules prior to their implementation. Dempsey, *supra* note 53, at 436-38.

One commentator noted that *Bermuda II* "was a very restrictive undertaking between the United States and the United Kingdom, [because it] restricted capacity, eliminated fifth freedom beyond [rights], recognized restrictive charter roles, and . . . provided greater benefits to the United Kingdom than to the United States." *House Hearings on International Aviation*, *supra* note 73, at 508 (testimony of Edward V. Driscoll). One of the principal benefits to U.S. carriers arising from the new agreement is the opportunity to engage in unlimited blind-sector operations beyond London to points in Europe. This essentially allows U.S. carriers to carry passengers originating in the United States to their continental European destinations via London. *See British Revolution*, *supra* note 30, at 117. *See generally*, Haanappel, *Bermuda 2: A First Impression*, 2 ANNALS OF AIR & SPACE L. 139 (1977). Another major transatlantic revolution was born in 1977 when Britain's Freddie Laker was given operating authority to inaugurate low-fare "Skytrain" service between London and New York. Schaffer & Lachter, *supra* at 591. "Perhaps the most extraordinary contemporary development in scheduled transatlantic air transportation has been the inauguration of Skytrain by Laker Airways Limited [Laker] in the fall of 1977." Dempsey,

However, *Bermuda II* was not to become the new model for U.S. bilateral air transport agreements that *Bermuda I* had been for more than three decades. *Bermuda II* was described by Senate Commerce Committee Chairman Howard Cannon (D-Nev.) as "the greatest step backward in forty years of attempting to bring market-oriented competition to international aviation."[86] CAB Chairman Alfred E. Kahn concurred, saying "there is now a consensus that the agreement represented a substantial departure from this kind of system envisioned by Congress and generally incorporated in other bilateral agreements."[87] In the Summer of 1978, President Carter issued a Statement of International Air Transport Policy which established the objectives of multiple-carrier entry in international markets and increased pricing competition.[88] Alfred Kahn described the

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supra note 53, at 399. For an analysis of Laker's acquisition of operating authority from the British government, *see* Bradley, *Licensing of International Air Services in Britain*, 2 ANNALS OF AIR & SPACE L. 31 (1977).

86. 124 CONG. REC. S12264 (daily ed. Aug. 1, 1978) (remarks of Sen. Cannon).

87. *International Aviation: Hearings Before the Subcomm. on Aviation of the Senate Comm. on Commerce*, 95th Cong., 1st Sess. 6 (1977).

88. Statement Concerning United States Policy on the Conduct of International Air Transport Negotiations, 14 WEEKLY COMP. OF PRES. DOC. 1462 (Aug. 28, 1978). In negotiating new aviation bilaterals, the U.S. objectives were henceforth to be:

(1) Creation of new and greater opportunities for innovation and competitive pricing that will encourage and permit the use of new price and service options to meet the needs of different travelers and shippers.
(2) Liberalization of charter rules and elimination of restrictions on charter operations.
(3) Expansion of scheduled service through elimination of restrictions on capacity, frequency, and route and operating rights.
(4) Elimination of discrimination and unfair competitive practices faced by U.S. airlines in international transportation.
(5) Flexibility to designate multiple U.S. airlines in international air markets.
(6) Encouragement of maximum traveler and shipper access to international markets by authorizing more cities for nonstop or direct service, and by improving the integration of domestic and international airline services.
(7) Flexibility to permit the development and facilitation of competitive air cargo services.

Id. CAB Chairman Alfred Kahn stated the U.S. negotiation objectives somewhat differently:

(1) Eliminate anticompetitive restrictions on charters and supplemental carriers;
(2) Expand opportunities for new low-fare scheduled service;
(3) Obtain maxium access to markets by expansion of the number of nonstop U.S. gateways;
(4) Secure an adequate number of multiple-carrier designations;
(5) Avoid restrictions on capacity and frequency; and
(6) Acquire maximum flexibility for U.S.-flag carriers to operate to intermediate and beyond points.

See United States International Aviation Negotiations: Hearings Before the Subcomm. on Aviation of the House Comm. on Public Works and Transportation, 95th Cong., 1st Sess. 95 (1977). In the Ford Administration, U.S. international aviation policy was guided by the following six objectives:

(1) Promotion of an international economic environment and aviation structure that would be conducive to competition among carriers;
(2) reliance on market forces to the greatest extent possible, realizing that the views of other nations may differ from our own policies;

negotiating strategy of the Carter Administration in these terms:

> We had something to offer foreign governments willing to expose their carriers to free competition—additional access to the rich American market. And we offered to do so, if in turn they would admit competing American carriers into their cities, accept our increasingly liberal charter rules, renounce limitations on the number of permissible flights, and accept limitations on their unrestricted right to disallow competitive fares.[89]

In the three decades following World War II, the United States had pursued a bilateral negotiating policy which emphasized an equitable exchange of economic benefits (*i.e.*, a trading of operating rights having approximately equal market value).[90] There had been occasions, particularly in the period 1955-1957, where it was alleged that the United States had "given away" valuable route opportunities to Germany and the Netherlands for policy and political considerations unrelated to international aviation.[91] But these gifts pale in insignificance when compared with the indiscriminate generosity of the Carter administration.

Under Carter, the traditional U.S. negotiating objective of obtaining an equality of operating opportunity for the carriers of both nations and a fair exchange of traffic rights was abandoned, in favor of a strategy aimed at enhancing consumer benefits. In essence, this was something of a *deja vu* of the approach the United States had advocated decades earlier at Chicago. Initial successes with the exportation of the pro-competitive policies were achieved in the transatlantic market, "where there was already so much competition in fares and service that a number of European governments believed their airlines would gain more from increased

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(3) maintenance of a system that can transport people, and goods whenever the need exists at as low a price as can be economically justified;
(4) U.S. government support for a U.S. international air transportation industry that can generate sufficient earnings to attract private capital and job opportunities and remain economically viable and efficient;
(5) maintenance of a safe and efficient system of airport facilities and protection of U.S. environment; and
(6) an appropriate contribution by U.S. international aviation policy to U.S. defense, security, foreign policy and international commerce objectives.

INTERNATIONAL AIR TRANSPORTATION POLICY OF THE UNITED STATES (1976). Note that the Ford Administration policy, although emphasizing the need to promote a competitive economic environment, also recognized the desirability of keeping U.S.-flag carriers economically healthy and safe, and perceived the industry as important to the national defense. In contrast, the Carter-Kahn policies seemed to emphasize increased competition as the only salient policy objective.

89. *House Hearings on International Aviation*, *supra* note 73, at 943.

90. Loy, *Bilateral Air Transport Agreements: Some Problems of Finding a Fair Route Exchange*, in THE FREEDOM OF THE AIR (E. McWinney & M. Bradley ed. 1968).

91. *See* Lissitzyn, *Bilateral Agreements on Air Transport*, 30 J. AIR L. & COM. 248 (1964). "The conclusion of the agreement with Germany coincided with a visit of Chancellor Adenauer to Washington, lending strength to the suspicion that high policy considerations contributed to the decision to grant to the German airline what appeared to be rather liberal treatment with respect to the route exchange." *Id.* "The Netherlands had little to offer as a *quid pro quo* in the way of air transport privileges, but good relatives with a NATO ally seemed to be at stake." *Id.*

access to the U.S. market than they would lose from a little more competition."[92]

The major Benelux nations (*i.e.*, Belgium and the Netherlands) were the first to embrace the pro-competitive approach by entering into liberal bilateral air transport agreements which surrendered restrictions on numbers of carriers, capacity and rates in exchange for access to lucrative interior U.S. markets.[93] By expeditiously authorizing multiple U.S.-flag entrants, the Board hoped to put pressure on other European governments in close geographic proximity to jump abroad the competition bandwagon so as to avoid to the loss of tourists and business travelers to Brussels and Amsterdam.[94] Liberal bilateral air transport agreements were concluded during 1978 between the United States and the Netherlands,[95] Belgium,[96] and Israel.[97] IATA Director General Knut Ham-

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92. M. BRENNER, *supra* note 75, at 106.

> The U.S.-Europe market had already been extremely competitive for many years. while historically there had been only three U.S. scheduled passenger airlines (principally Pan American and TWA), there were large numbers of charter airlines (both U.S. and foreign) competing for shares of the U.S.-Europe market, as well as many foreign scheduled airlines. Every major Western European country had its "flag" carrier (with the three Scandanavian countries forming the SAS consortium) and several Eastern European airlines flew to the United States as well. Non-European airlines also flew the North Atlantic to the United States via Europe from India, Pakistan, Iran and Israel. While most of the European airlines theoretically served only their homelands, in practice many of them used their home port as funnels and transfer points to serve all of Europe, the Middle East, and Africa. Carriers such as Air France, British Airways, KLM, Lufthansa, Sabena and Swissair, in particular, provided extensive geographic competition. In addition, the transatlantic services were subject to severe price competition from the charter airlines. By 1977 more than 25 percent of all U.S.-Europe passengers flew on charter flights including those operated by scheduled airlines.

Id. at 105. By 1978, the North Atlantic was already the most highly competitive international aviation market with 34 U.S. and foreign-flag carriers performing scheduled service over some of the most heavily traveled international routes on the planet. CAB Order 78-9-38, at 3 (1978).

93. CAB Order 78-9-2 (1978), at 6.

94. "Because of the proximity of Brussels and Amsterdam to the other major gateways on the continent, these new services may encourage them to consider allowing equivalent attractive service to their major airports in order to avoid losses of traffic." *Id.* at 7. CAB Chairman Marvin Cohen subsequently noted the success of this approach:

> The bleed-off of traffic from Scandinavia, Germany, and France to Belgium and Holland was a catalyst to the Germans to enter a more liberal agreement and forced France and the Scandanavians to introduce and accept low-fare offerings. In addition, the British desire for low-fare service by Laker led to acceptance of a de facto open-pricing regime.

House Hearings on International Aviation, *supra* note 73, at 574.

95. Protocol Amending the Air Transport Agreement of 1957, as amended, Mar. 31, 1978, United States-Netherlands, T.I.A.S. No. 1507.

96. Agreement Amending the Air Transport Agreement of 1946, as amended, Dec. 12-Dec. 14, 1978, United States-Belgium, T.I.A.S. No. 9207.

97. Protocol Amending the Air Transport Agreement of 1950, as amended, Aug. 16, 1978, United States-Israel, T.I.A.S. No. 9902. *See generally*, *The New Protocol Relating to United States-Israel Air Transport Agreement of 1950*, 13 INT'L LAWYER 356 (1979). The Israeli pricing provision permits third-country carriers to match fares in the U.S.-Israel market. *See* Comment,

marskjold predicted that "1978 will no doubt go down in history as the year of the most intensive regulatory changes since the time of the Chicago Convention."[98] But there was a significant difference: Chicago had been a multilateral consensual resolution of conflicting national political and economic interests; the Carter Administration's approach was one of unilateral insistence of pro-competitive ideology upon a world acclimated to the existing legal and economic order of regulated competition.

The negotiating strategy of the United States was essentially one of "divide and conquer."[99] As deregulation magnate Alfred Kahn responded to British refusal to embrace the United States' "open skies" ideology, "let's stick it to the Brits—let's put pressure on the Germans through Amsterdam."[100] With the opportunity to engage in pricing competition and serve interior U.S. points, Sabena and KLM began to draw traffic away from their neighbors and obtain significant increases in mar-

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Liberal Bilateral Air Transport Services Agreement and Sixth Freedom Traffic Carriage and Pricing, 14 INT'L LAWYER 281 (1980).

98. *Cited in* Majid, *Impact of Current U.S. Policy on International Civil Aviation*, 32 ZEITSCHRIFT FUR LUFT-UND WELTRAUMRECHT 295 (1983) [hereinafter cited as *Impact of Current U.S. Policy*].

99. In 1978, this author suggested a U.S. negotiating strategy designed to remedy the anti-competitive consequences of *Bermuda II*:

> The United States has come strong bargaining weapons to secure a significantly more favorable position than achieved in *Bermuda II*. It is the largest passenger market in the world, the leading source of tourists, and maintains the largest fleet of aircraft on the planet. In order to secure competitive opportunities for its carriers, the United States must be willing to trade the competitive opportunities necessary to enhance the posture of foreign air carriers. It may be necessary to offer unlimited access to interior U.S. gateways in exchange for unlimited designation of U.S.-flag carriers and downward pricing flexibility.
>
> There remains the possibility of rectifying the deleterious effects of *Bermuda II* upon competition in the transatlantic market by seeking competitive opportunities elsewhere. Much of the traffic that flows through the London gateway merely employs that point as a conduit through which it acquires access to the European continent; many passengers who have traditionally flown the New York-London route are part of the greater U.S.-European market, and would settle for a point other than London in order to secure access to the continent. Hence, the U.S. may well be able to exploit this phenomenon in order to persuade the British to reevaluate their position. Competitive opportunities stimulated in one market may have a ripple effect that may diminish a neighboring market's initially obstinate negotiating posture.

Dempsey, *supra* note 53, at 444 (citations omitted).

100. A. SAMPSON, *supra* note 2, at 145.

> [T]he U.S. government saw [the new liberal pro-competitive bilaterals] as a means of putting pressure on recalcitrant governments in the same geographic area. Thus, under this "encirclement" theory, the United Kingdom was to be pressured by expansion of air service to and via Belgium and The Netherlands. Not too much later a new agreement with South Korea was intended to put pressure on Japan. This campaign for "Open Skies", as it was quickly dubbed, was further stimulated by strong criticism within the United States of the restrictive terms of *Bermuda II*.

M. BRENNER, *supra* note 75, at 13 (citations omitted).

ket shares and tourist revenue.[101]

During the ensuing years the approach has succeeded in breaking down some of the restrictions on competition, particularly in northern Europe, although not without meeting serious resistance in southern Europe, much of Asia,[102] and most of Latin America.[103] Between 1978 and 1980, the United States signed eleven new "open skies" *Benelux*-type bilaterals or amendments to existing bilateral air transport agreements.[104] Today,

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101. As Alfred Kahn, in characteristic candor, described his response to *Bermuda II* in these terms:

> Let's stick to the British. Let's go and open up competition with the Low Countries who are eager to have competitive opportunities with us, precisely in order to impose leverage on these protectionist countries.
>
> * * *
>
> Our doing so, in turn, puts pressure on the Germans, for example. It is clearly putting pressure not merely on our carriers but the French and Italians. . . . [T]hey are coming to us and talking about zones of pricing discretion. Then we say we are going to hang tough, we want genuine opportunities for competition.

House Hearings on International Aviation, *supra* note 73, at 961. *See id.* at 100, n.1. In 1977, Sabena was given the right to fly to Atlanta. No British carriers could begin service under *Bermuda II* to this important sunbelt city until 1980. Gray, *The Impact of Bermuda II on Future Bilateral Agreements*, 3 AIR L. 17, 21 (1978). One prominent attorney of the era predicted that "a goal of U.S. policy will be to try to create an alternative low-fare gateway to London and use the new U.S. approach of trading 'liberalization for liberalization' in the bilateral field." *Id.*

102. While Liberal agreements (not always fully honored by the foreign governments) have been negotiated with the Philippines, the Republic of China, Singapore, and South Korea, access to Japan is the key to the major portion of the U.S.-Far East market. Not only is Japan extremely important in its own right, but most visitors to the area do not want to bypass it. Furthermore, it is strategically located, and distances in the Far East are too great to permit sidetrips to Japan as casual "backhauls." The Japanese government has always been conservative in its civil aviation policies, but has gradually been persuaded to accept more service to and from the United States.

M. BRENNER, *supra* note 75, at 107. *See id.* at 13-15.

> With the exception of U.S.-Philippines and U.S.-People's Republic of China, Central Pacific routes are the subject of liberal bilateral agreements. As a result, at least as a technical matter, any U.S. carrier is free to institute service. . . . Apparently as an economic matter, however, most U.S. carriers have not instituted such service. Currently, approximately one-half of the service to Central Pacific points is provided through Japan. . . .
>
> The South Pacific routes to Australia and New Zealand are entry limited.

Pacific Division Transfer Case, DOT Order 85-11-67 (1985).

103.

> South American governments . . . always have been and continue to be, highly restrictive, and firmly rejected the Carter Administration's policy. One probable reason for this, over and above basic philosophy, is concern that their national carriers would be overrun by freely competing U.S. airlines.

M. BRENNER, *supra* note 75, at 106-07.

> In Latin America, particularly South America, the Carter policy was rejected. There currently remains very little movement away from historic control of competition, capacity, and fares in this market.

Id. at 15.

104. Haanappel, *supra* note 36, at 261. Professor Haanappel has summarized the essential characteristics of these new agreements:

1. Unlimited multiple designation of airlines;

among the more than 70 nations with which the United States has a bilateral air transport agreement, the following nations are among the members of the world community with which the United States has concluded the most liberal of such bilaterals: Belgium, Costa Rica, Finland, Israel, Jordan, Jamaica, South Korea, Thailand, Taiwan, and Singapore.[105] Even the U.S.-U.K. bilateral, *Bermuda II,* has since been liberalized.[106] It

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2. a liberal route structure, *i.e.*, U.S. airlines may serve foreign countries from any point in the U.S., via any intermediate point and to any beyond point;
3. free determination by the designated airlines of capacity, frequencies and types of aircraft to be used unhindered by Bermuda I capacity clauses;
4. no limitation on the carriage of sixth-freedom traffic;
5. encouragement of low tariffs, set by individual airlines on the basis of forces of the marketplace without reference to the rate-making machinery of IATA;
6. minimal governmental interference in tariff matters; and
7. inclusion of provisions on charter flights, *i.e.*, the availability of cheap charter air services is encouraged and charterworthiness is governed by the country of origin rule.

Id. at 262 (citations omitted).

> By 27th August 1981 the U.S. concluded 19 Liberal Bilateral Agreements with Phillippine [sic], Fiji, Paupua New Guinea, Republic of Korea, Switzerland, Jamaica, Antilles, Thailand, Israel, Jordan, Federal Republic of Germany, Scandinavian Countries, etc. Varying liberal content was injected in the agreements with Holland, Signapore, United Kingdom, New Zealand, Australia and Japan.

Impact of Current U.S. Policy, *supra* note 98, at 299.

105. Letter from Matthew V. Scocozza to Paul Stephen Dempsey (Aug. 5, 1985). However, since late 1982, no bilateral as liberal as *Benelux* has been consummated. Professor Hannappel has identified several reasons to explain the receding tide:

> It may be becoming increasingly difficult for the U.S.A. to find bilateral air transport agreement "partners" willing to enter into "liberal" agreements. There also seems to have been a U.S. negotiating policy shift away from concluding full-scale "liberal" bilateral air transport agreements and towards more limited agreements taking care of immediate problems. In bilateral negotiations, the financial interests of U.S. air carriers seem to be taken into account now much more than in the late seventies. . . . Increased access for foreign air carriers to U.S. gateways is therefore no longer automatically exchanged for acceptance by foreign air carriers of liberal pricing and charter regimes. There remains, however, considerable concern in the U.S.A. about discriminatory practices against U.S. air carriers abroad, especially in respect of ground handling facilities at foreign airports and access to computer reservation and agency systems abroad.

P. HAANAPPEL, AN ANALYSIS OF U.S. DEREGULATION OF AIR TRANSPORT AND ITS INFERENCES FOR A MORE LIBERAL AIR TRANSPORT POLICY IN EUROPE 52 (1984) [hereinafter cited as P. HAANAPPEL].

However, under the recently concluded United States-Canada Experimental Transborder Air Services Agreement pertaining to Mirabel, both the U.S. and Canada may designate an unlimited number of carriers to provide combination services between Mirabel International Airport near Montreal and all but seven specified points in the United States. The agreement also includes liberalized pricing provisions. See DOT Order 85-7-1 (1955); DOT Order 86-1-25 (1986).

106. *See* Agreement on Air Transport Services, Nov. 2-9, 1978, United States-United Kingdom, T.I.A.S., No. 9231; Agreement on Air Transport Services, Apr. 15-25, 1978, United States-United Kingdom, T.I.A.S. No. 8965; Agreement on Air Transport Services, Mar. 17, 1978, United States-United Kingdom, T.I.A.S. No. 8964. As Michael Levine, one of airline deregulation's principal architects, eloquently remarked, "while the international changes, taken as a whole, are less complete and less consistent in their application than those within the United States, they have evolved in a much less homogeneous environment under a regime of multiple sovereigns and evolved at a rate and to an extent which, compared to the norm for change in that environ-

has been suggested that some nations may have been persuaded to accept the U.S. insistence of liberalization of the bilaterals even against their better judgment:

> A network of over 2500 such Bilateral Air Services Agreements currently regulates and ensures the continuance of air transport between different parts of various countries of the world. The ease with which these bilateral arrangements can be unilaterally dissolved by one state party hangs heavily above them like "Damocles Sword." Due to the fragility of these Agreements, a state which is indispensably interested in the preservation of an Air Service may find itself under pressure to accept terms offered by the other party which may otherwise be categorised [sic] as onerous or unfair.[107]

The new liberal bilaterals are characterized by their opportunities for pricing flexibility,[108] unrestricted capacity,[109] multiple designations,[110] access to interior U.S. markets for foreign-flag carriers,[111] some new fifth-

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ment, has been breathtaking." *Quoted in* Levine, Book Review, 32 STAN L. REV. 1061, 1063 n.17 (1980).

107. *Impact of Current U.S. Policy*, *supra* note 98, at 297-98 [citation omitted].

108. The new bilaterals typically provide for either country-of-origin pricing (under which a fare may be unilaterally disapproved only by the state from which the flight originates), or mutual disapproval pricing (under which new fares may be freely inaugurated unless both states disapprove them), the latter being the most liberal of the two. *See* Rosenfield, *United States Government-Industry Partnership*, 16 INT'L LAWYER 473, 478 (1982) [hereinafter cited as Rosenfield]; Klem & Leister, *The Struggle for a Competitive Market Structure in International Aviation: The Benelux Protocols Take United States Policies a Step Forward*, 11 L. & POL'Y INT'L BUS. 557, 573-74 (1979) [hereinafter cited as Klem & Leister]. Under a country-of-origin pricing provision, a nation's right to take unilateral action suspending fares proposed by a carrier is limited to those situations where the the first point in its itinerary is located within its territory. Hence, the foreign government may protect its airline by rejecting a U.S. carrier's low fare proposals for traffic originating in that nation's territory. Country-of-origin clauses were incorporated into the new bilaterals and protocols signed with the Federal Republic of Germany, Peru, and Poland in 1978, and the Netherlands in 1979.

Mutual disapproval pricing provisions differ in that neither nation may disapprove tariffs for traffic originating in its territory unless the other concurs in the disapproval. If the two nations cannot agree, the air carrier's proposed rates go into effect. Such provisions were incorporated into bilaterals signed by the United States with Israel, Belgium, and Korea.

109. "The right to fly any number of seats on any number of frequencies would be determined by the carrier, based solely on market conditions." Rosenfield, *supra* note 108, at 478.

> Liberal Agreements make capacity provisions flexible by removing restrictions from the number of airlines to be designated, frequency of flights and the size of aircraft. For example, Art. 3 of the [1980] Air Transport Services Agreement between the U.S. and [Jordan], provides that subject to some conditions "Each party shall have the right to designate as many airlines as it wishes to conduct international air transportation in accordance with this Agreement or alter such designations."

Impact of Current U.S. Policy, *supra* note 98, at 299.

110. Multiple designation involves the ability of a state to name more than a single of its flag carriers to serve a particular route.

111. For example, direct access to Miami, Atlanta, Dallas/Ft. Worth, San Juan, Anchorage, and San Francisco was given to Germany; Atlanta and three additional cities were conferred to Belgium; and rights between Korea-New York, Korea-Los Angeles, and Tokyo-Los Angeles were given to South Korea. *House Hearings on International Aviation*, *supra* note 73, at 108 (statement of William T. Seawell). Another commentator summarized examples of foreign access to

freedom rights for U.S.-flag carriers,[112] country of origin charter rules,[113] and elimination of discrimination and unfair methods of competition.[114]

During the Carter Presidency, the U.S. Civil Aeronautics Board also issued a series of route decisions which contributed to the growing turbulence in international aviation relations. For example, in 1978, the CAB concluded the *Seattle/Portland-Japan Service Investigation*[115] which authorized a new U.S.-flag carrier, United Airlines, to inaugurate low-fare transpacific service, despite assurances by both the U.S. Departments of State and Transportation that the Japanese governments vigorously opposed the entry of new U.S.-flag entrants or fare decreases in the market.[116] Later that year, the Board finalized the *Philadelphia-Bermuda Nonstop Proceeding*,[117] in which it issued permissive operating authority in the Philadelphia-Bermuda market to each of the five U.S.-flag carriers which had applied for it, notwithstanding the market's small size (it only generated 47,000 origination and destination passengers),[118] and vehement objections by the British government.[119] In spite of a history of

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interior U.S. points even more generously, by saying that "Germany has rights to 12 U.S. cities and has named 10 thus far, the United Kingdom has rights to name 20 U.S. cities and has listed 17 so far on their major route." *Id.* at 424 (testimony of Donald C. Comish).

112. Rosenfield, *supra* note 108, at 479.

113. Under this provision, charter flights are governed by the rules of the nation in which the flight originates.

114. Klem & Leister, *supra* note 108, at 575-76; Dempsey, *supra* note 53, at 411-15; *Impact of Current U.S. Policy*, *supra* note 98, at 299-300.

115. CAB Order 78-10-42 (1978).

116. *Id.*, dissent of Member O'Melia, at 6-7. The majority opinion noted, paradoxically, that "certain constraints in international markets—arising out of the inescapable role of foreign governments—whose attitude toward competition often differs markedly from ours—prevent us from relying on entry as a means of achieving our goals to the same extent as in domestic markets; nevertheless, competition remains the best means of assuring that, on a continuing basis, fares reflect costs and passengers are offered the most desired combination of service and price." *Id.* at 10. The majority went on to dismiss the foreign policy implications of its decision in these terms:

> We are fully aware of the various diplomatic implications of our decision. However, we are optimistic that the Japanese government will eventually see the mutual benefits that can be derived from fare reductions and more freely competitive international air service. Moreover, in our judgment, it would be undesirable to allow diplomatic uncertainties to prevent our authorizing service that is clearly to the benefit of the public.

Id. at 14. This optimism was misplaced, however. By the mid 1980's the Japanese government had still not been fully convinced of the wisdom of following the CAB's enlightened pro-competitive aviation policy.

117. CAB Order 78-12-192 (1978).

118. *Id.* dissent of Member O'Melia, at 3.

119. *Id.* at 9. In a sense, the Board seemed determined to capitalize on the absence of restraint required by *Bermuda II*:

> This is an international route subject to a recently negotiated bilateral agreement which permits the multiple designation of U.S. carriers, and therefore presents a valuable opportunity to implement international aviation policy which should not be lost. We have noted our disagreement with the restrictive covenants in Bermuda II, but in this case,

stormy aviation relations with Peru, the CAB in 1979 inaugurated the *United States-Peru Case*,[120] in which it determined that new competitive U.S-flag carriers should be authorized to serve the market.[121] In the *France Show Cause Order*, the CAB invited all interested parties to be certificated to serve France, despite that government's strong opposition to multiple entry.[122] And in a number of other international route proceedings, the CAB Expanded its domestic policy[123] of issuing multiple permissive awards of operating authority to all carriers which requested it to a wide variety of international aviation markets, irrespective of their size or foreign opposition.[124] The Board criticized the traditional regime of economic regulation as reflecting "mercantilism," where a *quid-pro-quo* balance of airline interests in international aviation had been promoted over the interests of consumers, who had been allegedly denied the benefits of pricing and service competition, while airlines had grown increasingly lethargic and inefficient.[125] The modern approach of the U.S. government

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Bermuda II gives us the latitude to use more competitive tools to shape the system of U.S.-U.K. air service.

Id. at 8 (citation omitted). CAB Member O'Melia filed a vigorous dissent, which began by stating, "This *Philadelphia-Bermuda* case may well come to represent in the eyes of the international aviation community the classic case study of how an agency's fixation with a notion—hoisted to the status of a doctrine—can cause it to cast away all considerations of statutory constraints, intergovernmental sensitivities, procedural orderlines, and practical consequences." *Id.* dissent of Member O'Melia, at 1.

The opposition of the British government to multiple awards was turned on its head with the Board, in a subsequent proceeding, cited *Philadelphia-Bermuda* as reflecting the notion that the Board would grant "the broadest possible international authority when foreign governments were receptive to our multiple-award philosophy." U.S.-Bahamas Service Investigation, CAB Order 79-8-68 (1979)), at 4. In still another proceeding, the CAB reasserted its alleged devotion to harmony in foreign relations by saying, "Naturally, we must consider foreign policy questions, particularly the aviation attitudes of other nations, in deciding international licensing cases." United States-Central American Show Cause Proceeding, CAB Order 79-11-87 (1979), at 9.

120. CAB Order 79-11-89 (1979).

121. The majority opinion revealed the temerity of the CAB's pro-competitive policy: "[W]e cannot ignore the turbulent history of our aviation relations with Peru. . . . [W]e cannot assume that the Peruvian authorities will be receptive to a multiple-entry policy for U.S.-flag carriers, notwithstanding that multiple designations are permissible under the bilateral agreement." *Id.* at 4.

122. *House Hearings on International Aviation*, *supra* note 73, at 37 (statement of C.E. Meyer, Jr.).

123. *See* Las Vegas-Dallas/Fort Worth Nonstop Service Investigation, CAB Order 78-7-116 (1978); P. DEMPSEY & W. THOMS, *supra* note 1, at 121-127.

124. *See, e.g.*, United States-Costa Rica Show Cause Proceeding, CAB Order 79-10-6 (1970); U.S.-Europe Exemptions, CAB Order 78-9-2 (1978); U.S.-Guam/Pacific Exemptions, CAB Order 79-4-87 (1979); U.S.-Korea Exemptions, CAB Order 79-6-1117 (1979); United States-Benelux Low-Fare Route Proceeding, CAB Order 79-10-16 (1979); United States-Bermuda Show Cause Proceeding, CAB Order 79-11-185 (1979).

125. In the *Benelux Exemptions Case*, CAB Order 78-9-2 (1978), the Board eloquently expressed its criticism of the existing regulation regime by noting that:

The prevailing attitude and practice abroad is protection from competition. As a conse-

was to be quite different:

> The policy of our government is to trade liberalizations rather than restrictions, offering access to U.S. markets in return for guarantees of pro-competitive rates with respect to pricing, capacity, and other economic decisions by the carriers of all states. The underlying premise is that expansion of competitive opportunities for all carriers—foreign as well as U.S.—benefits everyone, particularly the consumer. This has been the domestic experience, and it is equally applicable internationally, if governments will allow.[126]

Needless to say, many nations not only opposed the "open skies" policy on philosophical grounds but resented the means by which the United States unilaterally foisted it upon them.[127] One commentator sum-

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quence, international air transportation is characterized, with few exceptions, by strict limits on entry and cartel pricing. The exchange of air transport rights has for the most part been conducted in an atmosphere of mercantilism, with countries attempting to gain as much as possible for their carriers while giving up as little as possible to the carriers of the other. The result has been, and continues to be in too many instances, a strict bilateral balance of accounts. The big loser has been the consumer, whose choice of airlines and prices has been artificially restricted, and who has all too often in consequence had to pay monopolistic prices or, at best, to conform to complex and vexatious restrictions—*e.g.*, on length of stay—in order to qualify for fares closer to the cost of providing the service efficiently. By insulating the carriers from the pressures of competition, these policies have also sheltered and encouraged inefficient operations, thereby increasing the pressure for further government protection or subsidization.

Id. at 6. However, where the bilateral air transport agreement prohibited multiple designations, the CAB engaged in its traditional carrier selection criteria. *See* The Spokane-Vancouver Route Proceeding, CAB Order 79-5-17 (1979).

126. CAB Order 78-9-2 (1978), at 6.

127. For example, Michael E. Levine, Director of the CAB's Bureau of Pricing and Domestic Aviation during the Carter Administration, wrote a confidential memorandum in 1979 in which he proposed the following negotiating strategy for imposing the "open skies" ideology upon Europe:

> [W]e are not particularly anxious to achieve a written agreement with Holland or Italy until the timing is correct and our leverage allows us to assure their acquiescence in a liberal agreement. We believe that additional pressure can be placed upon Italy and France through whatever increased competition may be negotiated with Greece, Spain, Portugal, and possibly Yugoslavia. It seems clear that France intends to protect its gateway and will continue to "play" to some extent . . . but that further market pressure is required to get France to permit (either de facto or in writing) the emergence of a competitive environment.
>
> [The Summer of 1979] will be the first market test of a meaningful level of new competition on the North Atlantic, and we believe that if it succeeds the summer experience alone may provide the necessary economic incentives for recalcitrant countries to become less protectionist. . . .
>
> We believe that denunciation can be a useful strategic tool which should be used where advantageous. For example, we should consider denunciation very seriously if no further progress is forthcoming on the removal of Bermuda 2 restrictions or our problems with the Italian bilateral. Such steps would assist us in our negotiations in other parts of the world, such as Australia, New Zealand and Japan. There is political merit in the argument advanced by DOS that the U.S. might be successfully charged with racism or imperialism if the first bilateral the U.S. denounces is with a country without a predominantly European background or one which is very much less economically developed than we are. If we first denounce an agreement without European brethren, other nations more remotely related to the U.S. should correctly interpret this as a signal that the U.S. is now willing to denounce bilateral civil aviation agreements.

marized the undiplomatic implementation of U.S. policy and the strong resistance these efforts generated abroad:

> It was, indeed, nothing but arrogance on the part of U.S. policymakers who seriously planned to coerce, albeit by passive means, other nations of the world into the adoption of the U.S. policy. Preference of this approach, instead of . . . striving for a coordinated international aviation policy through discussions with other nations and with due respect to their rational, reasonable and legitimate proposals and concerns, seems to have its inspiration in the fact that the United States is the strongest aviation nation in the world, a criterion which is devoid of a core of legitimacy to any rational jurist. A confidential memorandum of the CAB discloses the negotiating strategy in the Carter era whereby . . . it was assumed that if a "broad authority" was conferred on small aviation countries which were not able to grant reciprocal trade or other commensurate aviation benefits to American firms, it would result in major countries changing their aviation policies and "surrendering to the U.S."[128]

B. The Rate Revolution: Pricing Competition, IATA and Antitrust Immunity

Prior to deregulation, most of the pricing competition over the North Atlantic was stimulated by charter or supplemental carriers[129] (with their

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> The symbolism of the first act, of and in itself, should be helpful to other negotiations in progress in other parts of the globe, especially Japan.
>
> The decision whether or not to denounce Bermuda 2 is a close call. . . . There is reason to believe that a favorable trend will develop as other more liberal regimes we have negotiated on the Continent force the British to liberalize to protect their premier gateway, London. . . .
>
> [I]f this summer's operations to the Continent are a success, the U.S. may have the maximum bargaining leverage and most favorable political climate to orchestrate a denunciation, followed by successful negotiations resulting in a competitive agreement.

Memorandum from Michael E. Levine to Members of the [Civil Aeronautics] Board, *et al* (Feb. 26, 1979) at 1-2.

128. Majid, *Recent U.S. Aviation Policy: Need for Multilaterlism Emphasized*, 1984 City of London L. Rev. 51, 62 (1984) [hereinafter cited as Majid].

129. This study does not emphasize supplemental or charter air transportation. The term "supplemental air transportation" is defined by 49 U.S.C. § 1301(34), as charter trips performed in air transportation pursuant to a certificate of public convenience and necessity authorized 49 U.S.C. § 1471(d)(3), to supplement the scheduled air transport services of carriers holding certificates of public convenience and necessary under 49 U.S.C. § 1371(d)(1) & (2). *See also* 49 U.S.C. § 1371(n).

Charter organizers and operators are considered "indirect" air carriers (*i.e.*, they are engaged in air transportation but not in the operation of aircraft), 14 C.F.R. § 296.1(e) (1977), and, as such, are under the jurisdiction of the CAB. *Id.*; 14 C.F.R. § 373.2 (1977). *Compare* Dempsey, *The Contemporary Evolution of Intermodal and International Transport Regulation Under the Interstate Commerce Act; Land, Sea and Air Coordination of Foreign Commerce Movements*, 10 Vand. J. Transnat'l L. 505 (1977), *with* Dempsey, *Foreign Commerce Regulation Under the Interstate Commerce Act: An Analysis of Intermodal Coordination of International Transportation in the United States*, 5 Syracuse J. Int'l L. & Com. 53 (1977). *See generally* Diederich, *Protection of Consumer Interests Under the Federal Aviation Act*, 40 J. Air L. & Com. 1 (1974). Supple-

frequently ignored affinity group and travel restrictions),[130] and Loftleidir Icelandic (a non-IATA carrier which flew from the United States to tiny Luxembourg via frigid Keflavik Airport in Iceland).[131] With the United States' unilateral insistence on pricing competition and the CAB's assault on IATA (to be discussed momentarily), the competitive pricing innovators initially became Britain's Laker Skytrain (the product of flamboyant Sir Freddie Laker)[132] and America's Air Florida (which had the unfortunate

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mental and charter operations have become much less significant in U.S. international aviation in recent years.

Hence, "direct" air carriers (*i.e.*, those engaged in the operation of aircraft, 14 C.F.R. § 296.1(d) performing scheduled operations in foreign commerce in the transportation of passengers pursuant to a certificate of public convenience and necessity, issued under 49 U.S.C. § 1371(d)(1) (1970), or pursuant to a permit issued under 49 U.S.C. § 1372(b) (1970), will be emphasized herein.

130. At first, beginning in 1953, IATA had enforced a rule that charter or non-sked flights across the Atlantic could only be permitted for groups and clubs with an authentic "affinity"—whether ethnic relationships, hobbies or staff associations. . . . But a whole industry sprang up to devise and advertise debious clubs which could qualify for bargain fares, and the game reached a farcical climax in 1971 when an American group called the Left Hand Club was raided on their aircraft, and a quarter of them were found to be spurious members and taken off the plane. The public still insisted on any kind of charter, the affinity rules proved impossible to enforce and were abandoned, and the scheduled airlines competed with their own advanced booking fares.

A. SAMPSON, *supra* note 2, at 11-12.

The authorized discount travel plans that had theretofore existed included various restrictions that made them relatively less attractive to certain travellers: low-cost air transportation frequently required (a) advance booking and ticket purchases, (b) participation in an organized tour program, (c) round-trip ticket purchases with inflexible minimum and maximum lengths of stay, or (d) membership in a particular affinity group. Dempsey, *supra* note 53, at 403.

131. A. SAMPSON, *supra* note 2, at 108.

132. *Id.* at 147-62. Skytrain was a single-class air shuttle charging the lowest scheduled New York to London air fares ever offered. Laker offered no "frills" on the Skytrain service: tickets were sold at the airport six hours prior to departure on a first-come-first-served basis; meals were not included in the ticket price, but were provided at a supplementary charge. There were numberous obstacles to approval of this revolutionary concept on both sides of the Atlantic.

In 1972 the British Civil Aviation Authority [BCAA]—the counterpart of the CAB—issued a license to Laker to operate the Skytrain service between London and New York. BCAA License No. A. 14011, published in the CAN Serial No. 30 part III A (Oct. 18, 1972); BCAA Air Operators Certificate No. 348/5/1 (Nov. 26, 1972); both are on file with the U.S. Department of Transportation in Docket 25427 (Laker Exhibits). The license issuance was in response to Laker's application No. A 12449 filed with the British Authorities on June 15, 1971. *Id.* The British authorities denied the application on February 19, 1971. *Id.* Laker's appeal was heard by Sir Dennis Proctor, KCB, on February 9, 1972, who recommended that the appeal be allowed. Commissioner's Report dated February, 1972. *Id.* But the British Secretary of State concluded that the appeal should be dismissed so that issues raised by Laker's proposals could be considered by the BCAA. Secretary of State letter to BCAA dated March 30, 1972. *Id.* The BCAA, on September 26, 1972, granted Laker a ten year license. The British government then formally notified the United States of its designation of Laker to operate the London-New York route specified under the 1946 Air Service Agreement Between the United States and the United Kingdom [*Bermuda I*].

In 1973 Laker applied to the CAB for a scheduled foreign air carrier permit, pursuant to section 402 of the Federal Aviation Act of 1958. But while the application was awaiting disposi-

fate of crashing into a bridge in the heart of the world's media mecca, Washington, D.C.).[133] In the early 1980s, these two discount leaders met their unhappy demise in bankruptcy, only to be replaced with a new generation of bargain basement carriers: America's short-lived People Express[134] and Britain's Virgin Atlantic.[135]

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tion by the CAB, the British government postponed the effectiveness of the Skytrain license. In 1975, Britain's Board of Trade issued a policy statement that would have indefinitely precluded Laker's Skytrain services. *See* Laker Airways Limited—"Skytrain" Service, CAB order 77-6-68 (1977). Essentially, the British government established a "spheres of influence" policy, providing that only one scheduled British carrier would be permitted to serve any long-haul international route. This action was taken in response to the decrease in passenger demand experienced by the industry in 1974, when British airline traffic dropped 10% and profits fell from $85 Million in 1973 to $4.5 million in 1974. *Freddie Laker's Shuttle Is Alive Again*, BUS. WEEK, Nov. 3, 1975, at 85.

In the proceeding before the BCAA in which British Airways sought the revocation of Laker's Skytrain license on the grounds that it would create a substantial diversion of traffic from established scheduled carriers, it was argued that: (1) transatlantic air traffic between the United States and the United Kingdom was steadily decreasing; (2) operating costs, particularly fuel costs, had increased so signficantly that transatlantic operators were faced with substantial pecuniary losses; as a consequence, they had, with inter-governmental support, reduced capacity between New York and London; and (3) given this economic environment, it was doubtful that the market for which Skytrain was initially licensed in 1972 still existed. In response, Laker argued that no man may be deprived of its property without due process of law, and contended that a depressed economic environment on the North Atlantic did not constitute due process. Coleman, *Laker Warns of Huge Losses in Skytrain Permit Dispute*, AVIATION WEEK & SPACE TECHNOLOGY, Jan. 27, 1975, at 27.

Laker successfully challenged the action of the Board of Trade in the British courts. On December 15, 1976, the Court of Appeal rendered a judgment in favor of Laker, effectively revalidating its U.K. license to operate the Skytrain service. The British civil aviation policy of establishing "spheres of influence" to eliminate competition between British air carriers was directly challenged by the ruling, which declared that the British Trade Minister could not lawfully cancel the Skytrain license held by Laker Airways. *U.K. Court Rules in Favor of Skytrain*, AVIATION WEEK & SPACE TECHNOLOGY, Aug. 9, 1976, at 32. Britain's Labour government decided not to appeal the decision to the House of Lords, thereby removing the final legal impediment on the European side of the Atlantic to the institution of Laker's Skytrain service. *British Government Not to Appeal Laker Ruling*, AVIATION WEEK AND SPACE TECHNOLOGY, Feb. 21, 1977, at 25. *See* Memorandum from British Embassy, Washington, D.C. (Feb. 18, 1977), in appendix to CAB Order 77-3-40 (1977). *See also* Statement by the Secretary of State for Trade (Mr. Edmund Den) in the House of Commons (Feb. 14, 1977), *Id.* Dempsey, *supra* note 53, at 400-401.

President Carter approved Laker's plan in June of 1977, and scheduled service began on September 27, 1977. *Id.* at 406. *London for Only $236*, TIME, June 27, 1977, at 63; Parke, *Transatlantic Shuttle*, FLYING, Apr. 1975, at 5.

133. A. SAMPSON, *supra* note 2, at 137, 143, 211, 215.

134. *Id.* at 16, 137-40, 214-17. In 1985, People Express was given authority to operate between a point or points in the United States and Shannon, Ireland, and a point or points in Belgium, the Federal Republic of Germany, Luxembourg, the Netherlands and Switzerland. DOT Order 86-1-52 (1986). It had previously been granted temporary authority to operate between Newark, N.J., and London, between Newark and Zurich and Brussels, and between San Francisco and Brussels. DOT Order 83-5-60 (1983); DOT Order 85-7-9 (1985); DOT Order 85-8-76 (1985); DOT Order 85-11-26 (1985).

135. A. SAMPSON, *supra* note 2, at 209, 217, 223.

The advent of deeply discounted air fares owes its stimulus to the policy initiatives of the U.S. Civil Aeronautics Board. As CAB Chairman Alfred Kahn remarked, "I have only to open my mouth, and the fares come tumbling down."[136] The CAB inaugurated a general policy of pricing flexibility and of favoring low-fare proposals:

> It is our policy—both domestically and internationally—to develop a system of air transportation that places principal reliance on actual and potential competition to determine the variety, quality and price of air service. Essential components of this policy are greater competitive opportunities for airlines and the promotion of low-fare transportation options for travelers and shippers.[137]

The Board favored a plethora of low-fare proposals establishing a labyrinth of discount possibilities for both domestic and international travelers.[138] Its general policy of encouraging low-fare experimentation[139] was based upon the theory that carriers should be given freedom from regulatory constraints in exercising their commercial judgment to improve their competitive positions.[140] The Board was strongly committed to the encouragement of innovative low fares and welcomed proposals offering different price/quality options.[141] The CAB's philosophy was "that com-

136. *Id.* at 136.

137. United States-Benelux Low-Fare Proceeding, CAB Order 78-6-97, at 5 (1978). Conversely, the CAB was aggressive in suspending, investigation and disapproving proposed increases in international fares. *See, e.g.*, CAB Order 78-10-143 (1978), and CAB Order 78-9-38 (1978).

138. For example, the CAB permitted the institution of "super-jackpot" fares, CAB Order 78-3-70 (1978), and CAB order 77-11-123, "super saver" fares, CAB Order 78-4-71 (1978), and CAB Order 78-6-159 (1978), "senior saver" fares, CAB Order 78-4-102 (1978), "inclusive tour" fares, CAB Order 78-1-79 (1978), "home free" fares, CAB Order 78-1-133 (1978), "no strings" fares, CAB Order 78-6-98 (1978) and CAB Order 78-3-106 (1978), "new low" fares, CAB Order 78-2-59 (1978), and various other low-fare proposals. *See e.g.*, CAB Order 78-4-84, at 3 (1978), and cases cited therein. It also instituted various route proceedings in which low-fare proposals were determinative. *See, e.g.*, Chicago-Albany/Syracuse-Boston Competitive Service Investigation, CAB Order 77-12-50 (1977); Baltimore/Washington-Houston Low Fare Route Case, CAB Order 77-12-115 (1977); and California-Nevada Low Fare Route Proceeding, CAB Order 77-10-136 (1977).

In the Miami-Los Angeles Competitive Nonstop case, CAB Order 78-1-35 (1978), and in the Twin Cities-Las Vagas/Phoenix/San Diego Route Proceeding, CAB Order 78-1-20 (1978), the Board explicitly indicated that "the offer or failure to offer lower prices will be taken into account in determining whether the public convenience and necessity require the award of new or additional authority and, if so, which carrier[s] should be selected." *Id.* at 5. The Board however, recognized the unnecessary complexity of transatlantic fares and the fact that passengers may pay different fares for essentially similar transportation. See CAB Order 77-11-78 (1977), and CAB Order 77-3-54 (1977).

139. *See* CAB Order 78-1-48 (1978).

140. *Cf.* CAB Order 78-2-19 (1978) (involving a U.S.-Mexico APEX fare proposal by Western Air Lines, Inc.); CAB Order 78-1-15 (1978) (involving Pan Am's budget fare proposal to various points in the Far East and South Pacific).

141. CAB Order 77-12-14 (1977). This policy was specifically extended to international markets. *See* CAB Order 77-12-148, at 4 (1977). The CAB encouraged the submission of low-fare proposals designed to stimulate traffic in markets where low load factors predominate. CAB

petition is a more efficient price regulator than government, and that excessively high prices can be inhibited effectively by the presence of aggressive competitors or the threat of entry."[142]

The Carter Administration and its Civil Aeronautics Board implemented several means of stimulating pricing competition in international markets:

- O Bilateral negotiations attempted to reduce the authority of governments to interfere in pricing.
- O Charters, which typically offered lower prices, were made more accessible to the general public by easing restrictive charter regulations.
- O In selecting U.S.-carrier applicants to serve routes where foreign governments limited the number of U.S. carriers, there was a strong bias in favor of the applicant proposing the lowest fare package.
- b In mid-1978, the CAB started an investigation into its continued approval of the very concept of IATA rate-making, by proposing to withdraw antitrust immunity.[143]

While decisions to open wide the floodgates of entry[144] caused certain foreign governments some measure of consternation,[145] nothing in

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Order 78-6-99, at 2 (1978). The Board appeared unwilling to suspend or investigate decreased fares in international markets despite the complaints of competing carriers that such low fares were predatory. *See e.g.*, CAB Order 78-4-98 (1978); CAB Order 78-3-39 (1978).

142. North Altantic Fares Investigation, CAB Order 78-5-157, at 1-2 (1978). *See Pay, Now, Go Later—and Cheaper*, TIME, Jan. 31, 1977, at 37.

143. M. BRENNER, *supra* note 75, at 15. Specifically, the objectives of the United States in international air transport agreement negotiations were summarized by CAB Chairman Alfred E. Kahn as follows: (1) eliminate anticompetitive restrictions on charters and supplemental carriers; (2) expand opportunities for new low-fare scheduled service; (3) obtain maximum access to markets by expansion of the number of nonstop U.S. gateways; (4) secure an adequate number of multiple carrier designations; (5) avoid restrictions on capacity and frequency; and (6) acquire maximum flexibility for U.S.-flag air carriers to operate in intermediate and beyond points. *Int'l Aviation Negotiation, supra* note 65, at 95. *See also* INTERAGENCY COMMITTEE ON INT'L AIR TRNASPORTATION POLICY, U.S. POLICY FOR THE CONDUCT OF INT'L AIR TRANSPORT NEGOTIATIONS (1978). These policies have been described by IATA as "a strong call for international deregulation, emphasizing increased competition, multiple designation of carriers, liberalization of charter operations, no capacity constraints and 'marketplace pricing' with minimum governmental involvement," and have been characterized as a "bewildering blend of liberal idealism and commercial market share policy." INT'L AIR TRANSPORT ASS'N, THE STATE OF THE AIR TRANSPORT INDUSTRY 5 (1978). Dempsey, *supra* note 53, at 442.

144. For a comprehensive summary of the deregulation of airline entry in the domestic context, *see The Rise & Fall of the Civil Aeronautics Board, supra* note 52.

145. The prevailing attitude of foreign governments has been to restrict competition through means of regulated pricing and limitations on carrier entry.

> The exchange of air transport rights has for the most part been conducted in an atmosphere of mercantilism, with countries attempting to gain as much as possible for their carriers while giving up as little as possible to the carriers of the other. The air has been, and continues to be in too many instances, a strict bilateral balance of accounts. The big loser has been the consumer, whose choice of airlines and prices has been artificially restricted, and who has all too often in consequence had to pay monopolistic prices or, at best, to conform to complex and vexatious restrictions—e.g., on length of stay—in order to qualify for fares closer to the cost of providing the service efficiently.

the history of international aviation generated more vehement opposition than the CAB's tentative decision in 1978 to strip the International Air Transport Association[146] of its antitrust immunity.[147]

The inability of the world's aviation community to achieve a multilateral regime of economic regulation after World War II led to the *Bermuda I* abdication of ratemaking to the conference rate machinery of the airline consortium: IATA. In the negotiations, Britain dropped its insistence that the number of flights be limited, and the U.S. accepted the IATA Collective ratemaking mechanism.[148] The first antitrust exemption was granted to

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> By insulating the carriers from the pressures of competition, these policies have also sheltered and encouraged inefficient operations, thereby increasing the pressure for further government protection and subsidization.

CAB Order 78-9-2, at 6 (1978).

146. IATA is the world organization of scheduled air carriers that transport the bulk of the scheduled domestic and international air traffic under the flags of some 85 nations. IATA is also the forum for the negotiation of international fare and rate agreements. INTERNATIONAL AIR TRANSPORT ASSOCIATION, WORLD AIRLINE COOPERATION 3 (1977). Representatives of six airlines met in the Hague, the Netherlands, on August 25, 1919, to establish the International Air Transport Traffic Association, forerunner of the present IATA. IATA, 50 YEARS OF WORLD AIRLINE COOPERATION 2 (1969). A. SAMPSON, *supra* note 2, at 38. During its first decades, the Association made decisions regarding safety, standardization of aircraft design and construction, inflight communications and navigation. IATA, WORLD AIRLINE COOPERATION 3 (1981). By the mid-1930s, it had grown to an organization of 29 carriers. IATA, TRENDS IN INTERNATIONAL AVIATION AND GOVERNMENTAL POLICIES 6-7 (1979). The association lay dormant during World War II until, in April 1945, its successor, the International Air Transport Association, was born in Havana, Cuba. Today, IATA is comprised of more than 100 member airlines, and has headquarters in Montreal and Geneva.

IATA performs a number of functions on behalf of its members, including *inter alia*, handling interline accounts among carriers, lobbying for lower taxes, urging international security standards, compiling and disseminating information, providing data processing equipment and programs, and disseminating public relations materials. IATA, WORLD AIRLINE CORPORATION 5-14 (1981). By the late 1970s, IATA was comprised of 112 scheduled airlines form 90 nations. *House Hearings on International Aviation*, *supra* note 73, at 905. IATA Director General Knut Hammarskjold described the organization's principal contributions to cooperation in international aviation in these terms:

> [C]omplex interline facilities have been established which permit travelers to buy one ticket in one currency at one time for any number of connecting flights on different airlines. IATA also establishes standards and procedures for the appointment of travel agents and their relations with airlines, thus saving the costs of each airline doing this individually and giving travelers the assurance of dealing with qualified travel professionals. As one integral part of these activities, IATA provides member airlines a multilateral forum in which their individual tariff proposals are coordinated for presentation to governments.

Id. at 867-68.

147. For a general discussion of IATA's role in international aviation and the potential effect of withdrawing its antitrust immunity, *see* Haanappel, *International Air Transport Association: Quo Vadis?*, in INTERNATIONAL AIR TRANSPORT: LAW, ORGANIZATION, AND POLICIES FOR THE FUTURE 67 (N. Matte ed. 1976). For a succinct discussion of the political opposition the CAB's action engendered, *see* A. SAMPSON, *supra* note 2, at 144-45.

148. *The Ins and Outs of IATA*, *supra* note 24, at 1115.

IATA by the CAB under section 412 of the Federal Aviation Act[149] in 1946.[150] At that time, the Board sought to avoid unilateral control by foreign governments over the rates charged by U.S.-flag carriers operating in international transportation.[151] Yet the only statutory power it then held over such rates was certain limited authority to remove discrimination[152] and to approve or disapprove agreements between carriers affecting air transportation.[153] It was not until 1972 that Congress conferred to the CAB jurisdiction over the investigation, suspension, and cancellation of tariffs containing an unlawful fare or rate in foreign air transportation.[154] The earlier inability to suspend the investigation of international tariffs led the Board, in 1946, to approve the IATA rate mechanism.[155] Approval was extended on numerous occasions,[156] and the temporal limitations were ultimately lifted in 1955.[157]

Governmental approval of an agreement under the Federal Aviation Act section 412[158] may confer antitrust immunity thereto by virtue of section 414 of the Act.[159] Consequently, although price-fixing is a *per se* violation of the Sherman Act,[160] the continued approval of IATA agreements by the CAB excluded air carriers that engage in such anticompetitive practices from antitrust scrutiny. The expansion of the Board's jurisdiction in 1972[161] enabled it to exert much the same ratemaking authority over international aviation it had theretofore exercised domestically.[162] The CAB belatedly perceived this statutory change to eliminate the necessity of continuing the immunity which had for more than three

149. 49 U.S.C. § 1382. *See* P. DEMPSEY & W. THOMS, *supra* note 1, at 243-245.

150. IATA Tariff Conference Resolution 6 C.A.B. 639 (1946). The Board, at that time, believed that conference of immunity to IATA was "the only opportunity available to it under existing legislation." *Id.* at 645.

151. IATA Conference Resolution, 6 C.A.B. 639, 642 (1946). *See generally*, A. LOWENFELD, *supra* note 5, § 2 (1972).

152. 49 U.S.C. § 1482(f).

153. 49 U.S.C. § 1382.

154. 49 U.S.C. § 1482(j).

155. 6 C.A.B. at 646. In granting the approval, the CAB requested that Congress amended the Federal Aviation Act to give the Board expanded jurisdiction over international fares and rates. *Id.*

156. *See* CAB Order 78-6-78, at 1, n.1.

157. *Id. See also*, Edles, IATA, *The Bilaterals and International Aviation Policy*, 27 FED. B.J. 291, 293 (1967) [hereinafter cited as Edles].

158. 49 U.S.C. § 1382. P. DEMPSEY & W. THOMS, *supra* note 1, at 243-244.

159. 49 U.S.C. § 1384. Congress amended section 414 in the Airline Deregulation Act of 1978, Pub. L. No. 95-504, 49 U.S.C. § 1601(b)(1)(B) to permit the Board to confer antitrust immunity on an agreement approved under section 412, only where such immunity is "required in the public interest." P. DEMPSEY & W. THOMS, *supra* note 1, at 244-245.

160. *See, e.g.*, United States v. Trenton Potteries Co., 273 U.S. 392 (1927). Dempsey, *supra* note 53, at 412.

161. CAB Order 80-4-113 (1980).

162. IATA, AIRLINE DEREGULATION 16-17 (1985). The following governments, governmental

decades shielded IATA's consensual decisionmaking activities from *per se* review under the Sherman Act.[163]

Without advance notice or consultation with foreign governments, the U.S. Civil Aeronautics Board in June of 1978 tentatively decided to withdraw antitrust immunity from IATA Traffic Conference Resolutions and related agreements, and issued an Order to Show Cause why that decision should not be made final.[164] Alfred Kahn described IATA as a "smoothly

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organizations, and governmental agencies opposed the CAB's proposed removal of IATA's antitrust immunity:

GOVERNMENTS

Argentina	Ghana	Pakistan
Australia	Greece	Philippines
Austria	Iraq	Portugal
Belgium	Ireland	Saudia Arabia
Benin	Israel	Sudan
Brazil	Italy	Sweden
Cameroon	Ivory Coast	Switzerland
Canada	Japan	Taiwan
Colombia	Kenya	Tanzania
Congo	Kuwait	Togo
Denmark	Lebanon	Tunisia
Egypt	Malta	United Kingdom
Ethiopia	Mauritania	Upper Volta
Finland	Mexico	Yugoslavia
France	New Zealand	Zambia
Germany, F.R.	Norway	

GOVERNMENTAL ORGANIZATIONS

Arab Civil Aviation Council
European Civil Aviation Conference
African Civil Aviation Commission
Latin American Civil Aviation Commission
International Civil Aviation Organization

U.S. EXECUTIVE DEPARTMENTS

Department of State
Department of Transportation

House Hearings on International Aviation, supra note 73, at 903.

163. *See generally*, Hammarskjold, *One World or Fragmentation: The Toll of Evolution in International Air Transport*, 9 ANNALS OF AIR & SPACE L. 79 (1984). There was also European concern over "the chaotic position of huge over-capacity on the North Atlantic marked by cut-throat competition involving marginal or even below-cost pricing and the consequent financial losses on a scale which threatened the survival of many airlines and the loss of public investment." McMahon, *Air Transport Regulatory Developments*, ITA MAGAZINE, March 1985, at 7, 8.

164. IATA Director General Knut Hammarskjold described the international response to the CAB's Show Cause Order as "the strongest outcry from governments in the world's aviation history." *House Hearings on International Aviation, supra* note 73, at 871-72. "Foreign governments objected not only to the substance of the order but to the fact that the CAB was proposing a fundamental change in the structure of international aviation without seeking to negotiate that change with other sovereign powers." These unilateral actions of the CAB caused foreign governments to claim ". . . breaches of sovereignty, comity, and custom." *Id.* at 872. Ham-

oiled price-fixing cartel" and labeled IATA's participants as "protectionists and cartelizers."[165] Others cursed it as "one of the most hated car-

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marskjold continued: "My concern—and I believe that of most other governments—relates to the failure of the [Carter] Administration to acknowledge that other countries have legitimate differences of view and that the accepted way of resolving differences—particularly for a major aviation country—is through cooperation, consultation, and negotiation." *Id.* at 875.

165. *House Hearings on International Aviation*, *supra* note 73, at 870-71. Turning his comments to the IATA Show Cause Order, Hammarskjold noted:

> Other actions of the U.S. were directly confrontational, because they sought *unilaterally* to set new rules of the game.
>
> The prime example is the well-known show-cause order of the Civil Aeronautics Board issued in June 1978. Without advance warning or attempt to discuss with foreign governments, the Board demanded that IATA show cause why the CAB should not withdraw approval and antitrust immunity from a substantial portion of IATA's activities, which the CAB had sanctioned since 1946. The order, even though subsequently narrowed in scope and despite later attempts to consult with foreign governments, elicited the strongest outcry from governments in the world's aviation history.

Id. at 871-72. "Much of the rest of the world perceives that the U.S. acted irresponsibly in implementing its procompetitive international aviation policy". *Id.* at 877. British Airways echoed these sentiments in very strong language:

> [T]here has been a sharp international reaction against the U.S. policy of promoting competition on international air routes, at least as it has been administered in the recent past. Foreign countries understandably have resented being preached to and reproached by U.S. officials about their lack of enthusiasm for unrestrained competition with the U.S. airline behemoths. . . .
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> Many other nations hold different perspectives which, of course, are equally valid in their eyes. It is therefore important to preserve, not destroy, an institution like [IATA] which has been the principal forum in which pragmatic compromises have been reached to enable competing philosophies to coexist. To the extent that there is a coherent worldwide system of international air transportation, it is primarily the result of agreements reached within IATA. In the absence of a substitute for IATA—some sort of GATT of the international airways—the attacks upon this institution by a number of U.S. officials must be viewed as one of the more perverse excesses of U.S. competition policy.

Id. at 1237-39.

IATA has generally opposed unilateral U.S. efforts to export its deregulation philosophy. As IATA Director George R. Besse said, "In many countries, airlines are not only economic tools . . . they are tools of prestige, of privilege. There is a social and political order connected with running an airline, and like it or not, that's the way it is. Although what the U.S. does affects nearly everyone else, they have to learn that their way is not everybody's way." *Deregulation Drive Stalls Out at IATA General Meeting*, TRAFFIC WORLD, Nov. 12, 1984, at 44.

IATA Director General Knut Hammarskjold echoed these sentiments, warning against "the trend toward fragmentation of the world-wide, integrated, multilateral system." *Id.* He noted that "we should never lose signt of the fact that a global air transport system is an interwoven, interdependent network. If so, the result will be a decline in the cohesion of the system, with serious implications in many respects for international travelers and shippers." *Id.* For a comprehensive summary of the arguments in favor of and opposed to the IATA Show Cause Order, *see* Magdelenat, *The Story of the Life and Death of the CAB Show Cause Order*, 2 AIR L. 83 (1980) [hereinafter cited as Magdelenat].

Many domestic commentators have also complained of the arrogance exhibited by governmental officials during the Carter Administration's implementation of U.S. international aviation policy. Rep. Bill McEwen (R-Ohio) remarked of CAB Chairman Marvin Cohen's attitude toward U.S.-flag carriers, "I have never before witnessed such expressions of contempt or utter disdain for American job providers, [and] American carriers by any agency of the Federal bureau-

tels in the world."[166]

By 1980, IATA had reorganized itself into a two-tier structure, designed to ameliorate the wrath of the CAB. Henceforth, it would be comprised of a Trade Association for activities other than ratemaking and a Traffic Conference for ratemaking activities.[167] Membership in the former would be mandatory; participation in the activities of the latter would be discretionary. Carriers choosing to participate in the Tariff Conference would be free to introduce unilateral fares. The reorganization removed two of the most troublesome aspects of the IATA Conference machinery: compulsory participation in the price-fixing conferences and the traditional unanimity rule of the decisional process. The CAB seemed unimpressed by the changes and proceeded to threaten revocation of the antitrust immunity shield.

A thundering storm of protests was filed by 46 governments individually, by 65 nations through international organizations, the U.S. Departments of State and Transportation, and several international organizations, including the ICAO.[168] Essentially, these parties objected to the potential extraterritorial application of U.S. antitrust laws should the Show Cause Order become final.[169] The harsh criticism leveled by IATA Director General Knut Hammarskjold was typical of the emotional rhetoric of the time:

> Foreign attitudes about aviation competition differed from those of the U.S. before 1978, but the divergence was radical after that.[170]
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> * * *
>
> [O]ne might have expected the U.S. . . . to have pursued its goals with some caution in order not to scare off the rest of the world. However, the new U.S. policy was pursued internationally with what can only be described as messianic fervor. U.S. officials proclaimed that deregulation was best for *all* countries and *all* consumers. They implied that foreign resistance arose

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caracy." *House Hearings on international Aviation, supra* note 73, at 781. Former U.S. Secretary of Transportation and Congressman Brock Adams characterized Alfred Kahn's views with disbelief: "I get the impression from Professor Kahn that he really just doesn't care if our airlines are gone. If they can't compete, you know, that is too bad." *Id.* at 997.

166. CAB Order 8-4-113 (1980). *See* Sion, *supra* note 85, at 185-186; Schaffer & Lachter, *supra* note 85, at 589-94; Rosenfield, *supra* note 108, at 477; Magdelenat, *supra* note 171, at 85-86; Tompkins, *The North Atlantic—Competition or Confrontation*, 7 J. AIR L. 48, 49-50 (1982) [hereinafter cited as Tompkins].

167. H.R. 4209.

168. Letter from Judith T. Connor to Norman Mineta, Nov. 9, 1981, reproduced in *House Hearings on International Aviation, supra* note 73, at 970. *See* Kahn, *Protecting Airlines From Freedom*, Wash. Post, Nov. 5, 1981, at A29.

169. CAB Order 81-9-68 (1981); *see* CAB order 81-5-27 (1981).

170. ECAC was formed in Strasbourg in 1954 to coordinate intra-European air services. *See* A. SAMPSON, *supra* note 2, at 98. Today, it is headquartered in Paris. It represents the civil aviation administrations of the governments of 22 West European nations. McMahon, *Air Transport Regulatory Developments*, ITA MAGAZINE, Mar. 1985, at 7, 8.

> for selfish, protectionist reasons or—worse—from lack of intellectual capacity to understand the issues. Whether true or not, these are not messages designed to endear others to one's point of view. Additionally, a carrot-and-stick approach was used for seeking agreements with foreign countries. The carrot was route rights in the U.S. in exchange for acceptance of U.S. philosophies. The stick was the threat of refusal of cost-related fare increases or geographic leverage on countries.
>
> There has also been a suspicion abroad—as paradoxical as it may seem—that the U.S. was indifferent to the welfare of its own industry and hence could hardly be expected to be concerned about the welfare of any other nation's industry.
>
> The inevitable result of messianic fervor is confrontation, and the implementation of U.S. aviation policies internationally from 1978 until recently created such confrontation.[171]

The intensity of the diplomatic pressure eventually led the CAB to narrow its investigation to the ratemaking activities of U.S.-flag carriers in the North Atlantic market.[172]

Opposition to the Board's temerity was growing domestically as well. Congressman Elliott Levitas (D-Ga.), an influential member of the House Committee on Public Works and Transportation, succeeded in attaching an amendment to the Transportation Appropriations Bill for fiscal year 1982[173] prohibiting the CAB's implementation of its IATA Show Cause Order. And President Reagan in mid-1981 informed the CAB that, "it would be appropriate and in the best interest of our foreign policy that the Board extend the effective date of its decision . . . so that our continuing efforts to maintain foreign government cooperation as we rebuild our Air Traffic Control System will not be adversely affected."[174]

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171. CAB Order 82-1-31 (1982). *House Hearings on International Aviation*, *supra* note 73, at 1207-08.

172. Thoms, *The Deregulated Skies—The United States "Sunset" Legislation and International Air Travel*, 31 NETHERLANDS INT'L L. REV. 398, 414-15 (1984).

173. Born in 1938, the Civil Aeronautics Board died (under the terms of the Airline Deregulation Act of 1978) on midnight December 31, 1984. *See text accompanying notes 631-32, infra.* The final gasp of air for the Civil Aeronautics Board as it laid on its deathbed was its Press Release of December 31, 1984, in which it quoted an appropriate poem:

> Do not stand at my grave and weep; I am not there, I do not sleep. I am a thousand winds that blow; I the sunlight on ripened grain; I am the gentle autumn's rain. When you awaken in the morning's hush, I am the swiftly passing rush of quiet birds in circle flight. I am the soft stars that shine at night. Do not stand at my grave and cry;
> I am not there. . . Goodbye.
>
> Unknown.

Reprinted in Air Transport World, Feb. 1985, at 9.

174. Nations signing the agreement have agreed not to reject transatlantic fares which fall within the "zone of reasonableness," a specified percentage above and below a referenced rate. *U.S., ECAC Sign Atlantic Fare Pact*, AVIATION WEEK & SPACE TECHNOLOGY, Oct. 22, 1984, at 33. The MOU was signed by Belgium, Denmark, France, West Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, the U.K., the U.S., and Yugoslavia. *U.S.-European Carriers Extend Agreement on North Atlantic Fares*, AVIATION WEEK

With this unparalleled uproar, the Board thrice postponed the effective date of its final order in the IATA Show Cause proceeding. The first was ostensibly prompted by the Air Traffic Controller Strike of 1981;[175] the second, by the consummation of A Memorandum of Understanding [MOU] between the U.S. and the European Civil Aviation Conference [ECAC][176] which established a zone of pricing flexibility for transatlantic fares.[177] In 1982, the Board issued an order postponing its tentative conclusions indefinitely.[178] The United States was spared further embarrassment when the CAB submitted to euthenasia by sunsetting at midnight on December 31, 1984,[179] chronically constipated by the IATA Show Cause Order. By the Spring of 1985, the United States and ECAC signed an agreement extending the MOU for another two years,[180] thereby postponing once again the final day of reckoning. And in May of 1985, the U.S. Department of Transportation brought this ugly saga to a graceful conclusion (not with a bang, but with a whimper) by simply terminating the seven

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& SPACE TECHNOLOGY, April 8, 1985, at 31; *U.S.-ECAC Talks May Expand in Scope*, AVIATION WEEK & SPACE TECHNOLOGY, April 29, 1985, at 72.

Although the issue of antitrust liability on the North Atlantic may have been abated for the immediate future, two U.S. rate schemes continue to irritate the Europeans and the Israelis: barter fares and Visit USA fares. Barter fares involve giving discounts on air tickets for purchases of non-airline products or services. For example, TWA offers purchasers of Polaroid cameras a 25% air ticket discount through March 14, 1986; Pan Am has an agreement with Hertz providing car rentals with a discount or free air ticket. *U.S. Firms' Value Added Programs Spur Airline Clash with Europeans*, AVIATION WEEK & SPACE TECHNOLOGY, April 1, 1985, at 36. Visit USA fares are U.S. carrier offerings of special discounts for travel within the United States to Europeans who purchase a transatlantic ticket on the airline. *CAB Settles Complaints on International Fares*, TRAFFIC WORLD, Sept. 3, 1984, at 40.

175. DOT Order 85-5-32 (1985). The U.S. Department of Transportation has since pointed out that the ability of IATA to control pricing behavior of airlines is extremely limited:

> It is difficult for IATA, through its price fixing activities, to affect capacity and achieve joint profit maximimization, since differences exist among firms in objective economic factors (*e.g.* unit cost differences) and subjective and behavioral criteria (*e.g.* uncertainty about the level of the future demand or corporate objectives besides profit maximization). W. Gellner, *Competition Among the Few*, pp. 142-174 (1965). For more recent discussions of these issues, *see* F.M. Scherer, *Industrial Market Structure and Economic Performance*, pp. 199-228 (second edition 1980); and Richard A. Posner, *Antitrust Law, An Economic Perspective*, pp. 39-77 (1976).

Pacific Division Transfer Case, DOT Order 85-11-67 (1985), at 53, n.137.

176. Pub. L. No. 96-192, 94 Stat. 35 (1980).

177. 49 U.S.C. § 1482(j). *See* Callison, *Airline Deregulation Only Partially A Hoax: The Current Status of the Airline Deregulation Movement*, 45 J. AIR L. & COM. 961, 997-98 (1980).

178. 49 U.S.C. § 1302(1).

179. *Id.* § 1502(b). The new legislation also created a zone of pricing flexibility permitting virtually unregulated pricing in a range from 5% above to 50% below an annually designated standard.

180. M. BRENNER, *supra* note 75, at 15. "In extending the pro-competitive policy statement of the 1978 domestic Deregulation Act to international service, Congress recognized that the existence of a free and open international marketplace could not be assumed, and added new protective language." *Id.*

year old proceeding.[181]

C. *The International Air Transportation Competition Act of 1979*

Congress had joined the fray in 1980 by promulgating the International Air Transportation Competition Act of 1979 [IATCA].[182] The legislation establishes a zone of pricing flexibility for international rates, pursuant to which carrier pricing may freely range from 5% above to 50% below the Standard Foreign Fare Level with limited regulatory supervision.[183] The principal policies IATCA espouses include *inter alia*, "[t]he placement of maximum reliance on competitive market forces and on actual and potential competition (A) to provide the needed air transportation system. . . (B) to encourage efficient and well-managed carriers to earn adequate profits and to attract capital . . . to provide efficiency, innovation, and low prices, and to determine the variety, quality, and price of air transportation services."[184] The international negotiating objectives of the United States are declared by Section 17 of the IATCA to include, *inter alia*, "freedom of air carriers . . . to offer fares and rates which correspond with consumer demand . . . [and] the maximum degree of multiple and permissive international authority of United States air carriers so that they will be able to respond quickly to shifts in market demand."[185] These particular policies seem to support the Carter Administration's negotiating endeavors begun two years before under the *Benelux* model.

But pro-competitive provisions are by no means the exclusive statutory instruments for effectuating U.S. international aviation policy. As several industry analysts have noted, "the legislation was more cautious and realistic than the Administration's policy."[186] Indeed, the opening provi-

181. 49 U.S.C. § 1302(a)(4). P. Dempsey & W. Thoms, *supra* note 1, at 199.

182. *Id.* § 1302(a)(12). *See Conference Report on the International Air Transportation Competition Act of 1979*, Rep. No. 96-716, 96th Cong., 1st Sess. 17 (1979). Section 17 of IATCA, which sets forth the goals for formulating international air transportation policy, includes virtually identical language in its opening paragraph. 49 U.S.c. § 1502(b)(1).

183. 49 U.S.C. § 1304(a)(3).

184. *Id.* § 1034(a)(7).

185. *Id.* § 1502(b)(9).

186. Bilateral air transport agreements may be concluded as treaties, inter-governmental agreements, executive agreements, conventions, protocols and exchanges of diplomatic notes. One commentator has noted that such agreements need not, however, be of a formal character and that international law imposes no requirement that such an agreement be in writing. B. Cheng, *supra* note 28, at 465. An excellent resource tool for the study of U.S. bilaterals is Provisions in U.S. International Transport Agreements (1985), a 3-volume compilation published by the Air Transport Association [hereinafter cited as ATA U.S. Provisions]. Dr. Gertler has succinctly summarized the purposes of bilateral air transport agreements:

> The presnt objective of the agreements seems to be not only an exchange of routes and traffic rights, but also the establishment of a broad spectrum of administrative, legal, economic and operational conditions considered necessary for the operation of air

sions of IATCA emphasize that to the extent that competition is employed to allow prudently managed and efficient carriers "to earn adequate profits and to attract capital," account must nevertheless be taken of the "material differences, if any, which may exist between interstate and overseas air transportation, on the one hand, and foreign air transportation, on the other."[187] This distinction had been lost by the Carter CAB under the Chairmanships of Alfred Kahn and Marvin Cohen. Moreover, at the insistence of the U.S. House of Representatives, the bill was specifically amended to incorporate a requirement that the economic health of U.S. carriers be protected, by requiring "[t]he strengthening of the competitive position of United States air carriers to at least assure equality with foreign air carriers, including the attainment of opportunities for United States air carriers to maintain and increase their profitability in foreign air transportation."[188]

Other significant policy imperatives of IATCA insist that the government avoid "unjust discrimination, undue preferences or advantages, or unfair and deceptive practices. . ."[189] and prevent "unfair, deceptive, predatory, or anticompetitive practices in air transportation. . . ."[190] Sec-

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services and for the related commercial and other activities of airlines in the territory of the other party.

Gertler, *supra* note 43, at 781.

187. Most U.S. bilateral air transport agreements define territory as ". . . the land areas under the sovereignty, suzerainty, protection, jurisdiction or trusteeship of that State, and territorial waters adjacent thereto."

188. The 'and beyond" refers to bilaterals which provide for an exchange of so-called "fifth freedom" rights. *See infra,* note 28.

189. As economic instruments, airlines are expected to contribute to the expansion of a country's industrial base, spur the development of remote regions, earn foreign currency, and, in some countries, help to support an indigenous aircraft industry. As political instruments, airlines are perceived by some as conferring prestige upon their country of registry and are used as tools of foreign policy implementation. Inauguration of air service between two historically hostile or even remote states may be viewed as a symbol of detente, desire for expansion of bilateral ties, or some other foreign policy objective. In pursuit of such symbolism, government agencies concerned with foreign policy may urge the establishment of specific air routes which have limited commercial viability.

B. GIDWITZ, *supra* note 2, at 32. *See generally, Nationality of Airlines, supra* note 5.

190. As the international route structure has grown and the number of airlines operating international routes has proliferated, conflict in the international air transport industry has intensified. Issues of contention—especially the degree of regulation in the industry—stem from the diverse nature of the more than one hundred carriers involved in international air transport. . . . The evolution of international air transport is less a function of aviation technology or conventional commercial traffic than an expression of political forces in specific historical periods. It has been the politics of expansionism, war preparation, diplomacy, economic doctrine, or other conditions not intrinsically related to air transport itself that have defined the development of international air transport more than the nature of available aircraft or the amount of traffic actually carried on world airlines. The size and scope of a particular airline's network do not always accurately reflect the commercial strength of that airline's individual routes or of its entire route network.

tion 17 of IATCA, which specifies U.S. negotiating objectives, is more specific in its requirement for "the elimination of discrimination and unfair competitive practices faced by United States airlines in foreign air transportation, including excessive landing and user fees, unreasonable ground handling requirements, undue restrictions on operations, prohibitions against change of gauge, and similar restrictive practices. . . ."[191] It was an exaggerated emphasis upon the pro-competitive provisions of IATCA, coupled with an inadequate implementation of its economic health imperatives and anticompetitive prohibitions, that led to vigorous objectives by many U.S.-flag carriers in the early 1980s.

IV. The Impact of the "Open Skies" on the U.S. Airline Industry

Numerous representatives of U.S.-flag carriers vehemently objected to the Carter Administration's policy of trading "hard rights" (access to major United States interior markets) for "soft rights" (theoretical access to foreign markets, imprecise promises for liberal pricing opportunities, and prohibitions against discrimination and unfair competitive practices) in the new rounds of *Benelux*-type bilateral air transport negotiations.[192]

B. Gidwitz, *supra* note 2, at 72-73.

191. Fundamental to the process of bilateral air transport negotiations are the general air-transport policies of the negotiation states. Most countries adhere to certain positions on readiness to exchange various traffic rights, capacity control, pricing, user fees and charges, and other aspects of commercial transport. These positions are usually well known among international civil-aviation authoritiies and may even be published as formal policy statements. What is frequently less well known and even more rarely admitted is the intrusion in air-transport negotiations of partisan domestic politics or foreign relations issuer irrelevant to the aviation questions at hand. Although the practice of using non-aviation quid prop quos to obtain air traffic rights is fairly widespread, govenments seem loath to admit it and rarely acknowledge in public such trade-offs.

Id.

192. C.E. Meyer, Jr., former CEO of Trans World Airlines, criticized the Carter Administration's approach in these terms:

> The prior administration was so enamored with the theory of free competition that they failed to recognize the realities of the marketplace. They attempted to sell the economic theory with a religious commitment and insentivity to the point where foreign countries and their carriers frequently concluded that their only defense was to retaliate against their U.S. competitors.
>
> The extent of damage caused by the prior administration's philosophy, strategy, and zealous commitment to what they perceived to be a free market environment has been clearly counterproductive to a number of explicit and implicit objectives of international aviation policy. . . .

House Hearings on International Aviation, *supra* note 73, at 195-96. Similarly, the former CEO of Pan American World Airways, Inc., William T. Seawell, echoed these sentiments:

> The "open skies" policy was administered by the C.A.B. as if [no] market structure problems or discriminatory practices existed, and virtually no attention was paid to them in bilateral negotiations. The implicit assumption was that the international marketplace did not differ meaningfully from the domestic arena. Thus, the CAB assumed that competition would be enhanced by certificating the maximum number of carriers, irrespective of nationality. It was assumed that in a competitive market U.S. carriers could hold their own—that if they are aggressive and productive, profits would naturally follow.

The Carter Administration's "open skies" policy of giving access to

Thus, U.S. policy has been administered without any consideration of impact on trade balance or the effect on U.S. carrier profitability. The only objectives pursued were the authorization of the maximum number of U.S. and foreign-flag carriers, and low fares at any cost to U.S. carriers. Routes were freely given to the foreign operators in exchange for the "right" of U.S. carriers to serve the country in question, and for vague guarantees that the foreign countries would permit pricing freedom. . . .

In practice, these policies have proven disastrous for the U.S. flag. Because the foreign carriers are given free access to the U.S. market, and superior access to their own, they were able to capitalize on the valuable rights which were ceded by the U.S. But U.S. carriers often found that the new agreements were a one-way street. Foreign government support of their own carriers, and denial of market access to U.S. carriers, made it difficult and often impossible for the U.S. carriers to compete.

Id. at 81-82. He continued:

During the past four years, the U.S. carriers have been in the unfortunate position of standing in a virtual adversarial position with respect to their own aviation regulatory authorities. If the U.S. is to hold its own economically in the 1980s, the U.S. government cannot be the foe of U.S. industry. The goal of the U.S. government should be the preservation and strengthening of its own carrier system, rather than its fragmentation and disintegration.

Id. at 189. And, Thomas F. Grojean, President of the Flying Tigers Line, Inc., noted:

In the past, the U.S. has recognized competitive disadvantages suffered by its international-flag carriers and sought to maintain competitive advantages to balance the advantages enjoyed by foreign carriers. Since entry is the most significant restriction controlled in the U.S., it was the most common device for offsetting the restrictions faced by U.S. carriers. In recent years, however, this device has been placed on the trading block at wholesale prices.

Id. at 319-20. Even Monte Lazarus, Senior Vice President of United Airlines, one of the initial authors of airline deregulation bills ultimately promulgated into law, eloquently observed that "it does take two to tango internationally and you can't willy-nilly just transfer over domestic policy internationally." *Id.* at 473.

Congressman Barry Goldwater, Jr. (R-Ariz.), summarized the complaints of U.S.-flag carriers against their government's international aviation policy, by noting the "[s]evere allegations that our government, which does the negotiating for our flag carriers are not truly aggressive enough, that they are giving away the stores, that they are not looking out after our best interests, but in fact are more interested, seemingly, in improving the lot of our foreign competition." *Id.* at 771. And Ronald L. Danielian, Executive Vice President of the International Economic Policy Association, concluded that "in international aviation, the United States has offered open and unrestricted access to its market far in excess of what our carriers receive in foreign countries." *Id.* at 1035. Former CAB Chairman Secore D. Browne was particularly critical of the Carter Administration's approach: "The proponents and defenders of open skies [have] almost evangelistic faith in the curative powers of a free market over the passage of time for the real world problems of a market that never has been, and never will be, free—international civil air transportation." *Id.* at 1188. The Reagan Administration's State Department seemed to recognize these failures. Assistant Secretary Judith T. Connor noted:

Rarely a week goes by now that the U.S. Government does not have to intercede for our carriers with some of our partners to remind them of their obligation under the bilaterals. Clearly, in those markets characterized by such environment, it may have been naive for the U.S. government to believe that a liberal bilateral agreement would truly present U.S. carriers with full opportunity to compete for a fair share of the market. . . .

In the future we will negotiate with the awareness that the letter of our international agreements can in fact be ignored, and that such violations seriously compromise the benefits we believe we are obtaining. In this way we hope and intend to strike better bargains.

Id. at 1223. M. BRENNER, *supra* note 75, at 113.

the world's most lucrative international aviation markets[193] to foreign-flag carriers and opening the floodgates of entry to an unlimited number of U.S.-flag carriers caused the passenger market pie to be sliced into thinner and thinner pieces, without appreciably increasingly its size.[194] Under many of the *Bermuda I* agreements which were in effect prior to the *Benelux* rounds, the United States already possessed jurisdiction to authorize multiple U.S.-flag carriers to fly to foreign cities from interior U.S. points.[195] U.S. policy traditionally had chosen to funnel domestic traffic into international hubs such as New York, Chicago, San Francisco, Los Angeles, or Miami, where the interior flow could be aggregated to fill the capacity of the transcontinental wide-bodies—the L-1011s, B-747s, and DC-10s.[196] Cabotage legislation has long given local airlines the exclusive opportunity to carry domestic traffic,[197] allowing U.S.-flag carriers to

193. Of the 250 million individuals in the United States, approximately 50 to 60 million have the economic ability to fly internationally. In contrast, the top four or five European markets have only 26 million people who fall into this category. *House Hearings on International Aviation*, *supra* note 73, at 108 (testimony of Ronald L. Danielian).

194.

> Trends in total traffic volumes suggest little correlation between the extent of competition and traffic growth. The slowest rate of growth was in the European market where competition was most intense. The fastest traffic growth, by far, until the 1982/1983 economic collapse, was in South America, the least competitive market.

M. BRENNER, *supra* note 75, at 113.

195. For example, the U.S.-Netherlands bilateral air transport agreement authorized U.S.-flag service "from the United States" rather than from specified points. *House Hearings On International Aviation*, *supra* note 73, at 440 (testimony of Donald C. Comlish).

196. *Id.* at 105-107 (statement of William T. Seawell).

197. *See generally*, N. MATTE, *supra* note 3, at 171-72; B. CHENG, *supra* note 28, at 314-26. Section 1108(b) of the Federal Aviation Act of 1958, as amended, prohibits foreign carriers from transporting persons, property and mail for compensation between two points in the United States. Section 401 allows only "air carriers" to engage in air transportation within the United States. "Air carriers" are defined as citizens of the United States in Section 101(c). Noncitizens may only engage in foreign air transportation as "foreign air carriers" pursuant to section 402 of the Act.

The International Law Section of the American Bar Association has succinctly summarized the origins of cabotage:

> Cabotage—the carriage of local traffic between two domestic points for compensation or hire—has a long-standing status in international law, originally in maritime and subsequently in aeronautical. Such traffic has traditionally been reserved for a nation's own carriers. In maritime law, cabotage resulted from a recognition of a nation's right to control its own internal trade and had both economic and military overtones. . . .
>
> Cabotage in aviation matters was apparently first recognized in 1910. The French, who became concerned with German free balloons flying over French territory, convened what was probably the first diplomatic conference to consider flight regulation. While nothing came of the Conference at that time, the later Paris Convention of 1919 provided (Article 16) that contracting states could establish restrictions in favor of their national aircraft "in connection with the carriage of person and goods for hire between two points in its territory."

Subcomm. on Aviation, Sen. Comm. on Commerce, Science and Transportation, Hearings on S.1300, International Air Transportation Competition Act of 1979, 96th Cong., 1st Sess. 244-45 (1979) (statement of ABA section on International Law). Cabotage was reaffirmed by Article 7 of

fill unused capacity into the international hub by attracting local passengers. For example, in 1957 Korean Air Lines was given authority to serve only Alaska and Seattle. Interior flow to the Seattle gateway was, by virtue of cabotage legislation, the exclusive domain of U.S.-flag carriers. Moreover, U.S. passengers who began their trip abroad a U.S. carrier were generally unlikely to switch to a foreign carrier at the international hub for the remainder of the flight.

By giving foreign carriers direct access to lucrative interior markets,[198] these traditional advantages were diluted.[199] For example, KLM, the dominant carrier in the U.S.-Netherlands market,[200] began new service to Miami, Boston, Houston, Atlanta, and Los Angeles. By 1981, KLM

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the Chicago Convention, which also prohibited it from being granted to a foreign airline except on a nondiscriminatory basis:

> 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. 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 any airline of any other State, and not to obtain any such exclusive privilege from any other State.

Convention on International Civil Aviation, *opened for signature*, Art. 7, Dec. 7, 1944, 61 Stat. 1180, T.I.A.S. No. 1591. *See generally*, Comment, *Air Cabotage: Historical and Modern-Day Perspectives*, 45 J. AIR L. & COM. 1059 (1980).

The cabotage reservation first appeared in U.S. legislation with the promulgation of Section 6(e) of the Air Commerce Act of 1926, 67 Stat. 489, and was subsequently incorporated into section 416(b) of the Federal Aviation Act of 1958, 49 U.S.C. § 1386. It was amended by section 21 of the international Air Transportation Competition Act of 1979 to allow foreign air carriers to transport domestic passengers and freight during periods of emergency. 49 U.S.C. § 1386(b)(7).

198. As one commentator has noted, "The richest international air routes in the world are those between the United States and other developed nations." *House Hearings on International Aviation*, *supra* note 73, at 1236 (statement of British Airways).

199. The debate as to whether U.S.-flag carriers are jeopardized because interior U.S. markets are opened to nonstop international service is not without controversy. Indeed, a strong argument can be made that it is to the benefit of U.S. carriers that their hubs be opened for international service because of the beyond-market flow they will be able to funnel into the international route, and protection that cabotage legislation (discussed above) affords them to fill up capacity on feeder routes—an opportunity foreign carriers do not enjoy. Thus, U.S. carriers may have a competitive advantage in providing international service from their domestic hubs, such as Atlanta (Delta and Eastern), Chicago (American and United), Dallas (American and Delta), Denver (Continental, Frontier, and United), Houston (Continental), Pittsburgh (U.S. Air), and St. Louis (TWA and Ozark). *See generally*, A. SAMPSON, *supra* note 2, at 140-41. Single-plane advantages from beyond points cannot be duplicated by most foreign carriers on this side of the Atlantic, just as fifth-freedom opportunities beyond London, Paris, and Amsterdam are circumscribed by restrictive bilaterals, pooling agreements and analogous foreign-carrier market strength. For a rather strongly worded criticism of the U.S. carrier complaints of the unfairness of the *Benelux*-type bilaterals on this issue, *see* Wassenbergh, *Aspects of the Exchange of International Air Transportation Rights*, 6 ANNALS OF AIR & SPACE L. 235 (1981).

200. The U.S.-flag share of the U.S.-Netherlands market ranged from 9% in 1977, to 12% in 1978, 23% in 1979, and 12% in 1980. Both Braniff and National withdrew from the market. *House Hearings on International Aviation*, *supra* note 73, at 735, 975.

was operating 36 wide-body flights to the United States—sufficient capacity to carry all of Holland to America in a single summer.[201] The United States was given the right to designate an unlimited number of U.S.-flag carriers to serve Amsterdam, a privilege which already existed under the language of the preexisting *Bermuda I*-type agreement between the two nations. As a result of KLM's strength in its Amsterdam hub, as well as its ability to marshall sixth-freedom, beyond-segment traffic into it, (because of pooling arrangements,[202] market identity, and local traffic fill-up), U.S.

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201. *Id.* at 209 (testimony of C.E. Meyer, Jr.).

202. "Under a typical pooling agreement, the carriers serving a given route agreed that they will 'pool' the revenues earned by each carrier into a common 'pot' which is the divided between the carriers according to an agreed formula. The carriers usually mesh their schedules, pricing, reservations and sales promotion." *Id.* at 79-80 (statement of William T. Seawell). *See generally* A. SAMPSON, *supra* note 2, at 92-93. Between 75-80% of the tonne-kilometers moved in intra-European air transportation is controlled through pooling arrangements. Professor Haanappel has defined these agreements as follows:

> In its simplest form a pooling agreement can be described as an agreement for the sharing of revenues derived from the joint operation of an air route or air routes by two or (exceptionally) more airlines. At the head of every pooling agreement there is a capacity (and often frequency and scheduling) agreement between airlines. On the basis of that capacity agreement, it is then further agreed between the participating airlines that they will put revenues derived from the joint operation of an air route or air routes into one and the same fund, to be divided between the carriers in accordance with a predetermined formula.

P. HAANAPPEL, *supra* note 105, at 57-58. Such agreements would likely violate the U.S. antitrust laws if they occurred within the United States. The "five freedoms" may be defined as follows:

1) A civil aircraft of one country has the right to fly over the territory of another country without landing, provided the overflown country is notified in advance and approval is given.
2) A civil aircraft of one country has the right to land in another country for technical reasons, such as refueling or maintenance, without offering any commercial service to or from that point.
3) An airline has the right to carry traffic from its country of registry to another country.
4) An airline has the right to carry from another country to its own country of registry.
5) An airline has the right to carry traffic between two countries outside its own country of registry as long as the flight originates or terminates in its own country of registry.

B. GIDWITZ, *supra* note 2, at 49-50. In the years since the Chicago Conference, three other "freedoms" have been identified:

6) An airline has the right to carry traffic between two foreign countries via its own country of registry. Sixth freedom can also be viewed as a combination of third and fourth freedoms secured by the country of registry from two different countries producing the same effect as the fifth freedom vis-a-vis both foreign countries.
7) An airline operating entirely outside one territory of its country of registry, has the right to fly into the territory of another country and there discharge, or take on, traffic coming from, or destined for, a third country or third countries.
8) An airline has the right to carry traffic from one point in the territory of a country to another point in the same country. More commonly known as "cabotage," this practice is forbidden by many bilaterals, including those concluded by the United States.

B. CHENG, *supra* note 28, at 13-17. Professor Cheng has noted that "the more refined these distinctions become the more restrictive is the policy pursued; for every newborn 'freedom of the air' is in reality an additional shackle on the right to fly of foreign carriers, to be removed only at a price." *Id.* at 17.

carriers were unable to make significant inroads into the U.S.-Netherlands market, one which had traditionally been dominated by the Dutch. Indeed, multiple designations of U.S.-flag carriers had the tendency merely to dilute each carrier's segment of the market, although the overall pie may have grown somewhat larger as a result of increased pricing competition.[203]

Similarly, in the Belgium/Luxembourg-United States market, U.S.-flag carriers earned only $28 million in passenger fares, while American passengers spent $73 million on foreign-flag carriers.[204] During the same period, German carriers were given the opportunity to serve 12 U.S. cities, and the United Kingdom was given access to 20.[205] Several industry analysts have concluded that "the U.S. airline share of [the international] market is reduced by significantly increased foreign airline access to the U.S. market."[206]

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203. There are several markets in which U.S. carriers enjoy less than 50% of the traffic despite multiple designations of U.S.-flag carriers, and the existence of liberal bilaterals, including Belgium, Costa Rica, West Germany, Korea, and the Netherlands. *House Hearings on International Aviation*, *supra* note 73, at 856. In 1980, Professor Haanappel pointed out that "The Dutch carrier KLM has close to ninety percent of the total U.S.-Netherlands market and that the remaining ten percent is shared between several U.S. carriers." Haanappel, *supra* note 36, at 262. As one government official has noted:

> When we introduce new U.S. carriers in the market, we must at least realize the possibility that they may end up competing among themselves and with the incumbent U.S. carrier for a share of the market. Unquestionably, the overall size of the traffic "pie" increases through new entry and lower promotional fares. However, the [Reagan] Department of Transportation is concerned that the pie may not increase enough to give any one U.S. carrier a large enough slice to produce profitable operations.

House Hearings on International Aviation, *supra* note 73, at 751 (testimony of Judith Connor). Between 1977 and 1980, seven U.S.-flag carriers received new or expanded authority in the transatlantic market. *Id.* at 973 (statement of Rep. Norman Y. Mineta (D-Calif.)).

204. *Id.* at 1023. To obtain a balanced picture, one should examine Alfred Kahn's defense of this negotiating strategy. *See id.* at 943-44, and Kahn, *supra* note 72.

The existing powers of the CAB/DOT to impose and invoke license and fare suspension and service restrictions have had a sound prophylactic effect on the occasional intransigence of foreign governments to comply with their obligations under bilateral air transport agreements. Moreover, the mere presence of such unilateral remedies makes compliance with the international responsibilties arising there under a prudent course of action. The existence of effective sanctions under bilateral agreements or multi-lateral conventions assures that the principles of international law established thereby will prevail as national obligations, and that adherence to the provisions thereof will be assured.

205. *Id.* at 424 (testimony of Donald C. Comlish). *See id.*, at 108, 110.

As of the summer of 1986, British Airways was served London from the following U.S. points: Anchorage, Baltimore, Boston, Chicago, Detroit, Los Angeles, Miami, New York, Orlando, Philadelphia, Pittsburgh, San Francisco, Seattle, Tampa, and Washington, D.C.

206. M. BRENNER, *supra* note 75, at 113.

> [I]t can be tentatively concluded that the advance of procompetitive policies in international air transportation has neither served as a market stimulus nor benefitted the U.S.-flag airline system in terms of market share. Indeed, the Far East experience indicates that increased foreign airline access is inimical to U.S. airline market participation.

Id.

Moreover, there are significant structual differences between U.S. and foreign-flag carriers which may place the former at a competitive disadvantage. United States carriers are privately owned; those which continuously fail to make satisfactory profits will eventually find themselves in bankruptcy—a victim of the Darwinian economic process of weeding out the weak and inefficient. In contrast, most foreign airlines are owned or heavily subsidized by their governments;[207] the profit imperative is a less critical factor for their survival.[208] Many foreign-flag carriers are operated

207. Indeed, one source estimates that 75% of foreign air carriers are owned, in whole or part, by their governments. *Subcomm. on Aviation, Senate Comm. on Commerce, Science and Transportation, Hearings on S.1300, International Air Transportation Competition Act of 1979*, 96th Cong., 1st Sess. 166 (1979) (testimony of C.E. Meyer, Jr.) [hereinafter cited as *Senate Hearings on IATCA*]. The principal airlines of western Europe had the following levels of government ownership in 1979:

Air France	98.80%
Air Inter	49.90%
Alitalia	99.00%
British Airways	100.00%
KLM	78.00%
Aer Lingus	100.00%
Lufthansa	82.16%
Luxair	25.57%
Sabena	100.00%

Comment, *Introducing Competition to the European Economic Community Airline Industry*, 13 CALIF. W. INT'L L.J. 364, 365 n.7 (1985). The only major European airlines that are wholly privately owned are the U.K.'s British Caledonian, and Frances' UTA. *See* note 214, *infra*.

208. As William T. Seawell, former CEO of Pan American World Airways, Inc., has noted:

> Most governments—unlike the U.S. government—own a substantial share of their national flag carriers and provide them with direct or indirect subsidies and other financial assistance. Such assistance can take many forms, including direct capital grants, loans at below-market interest rates, and government loans which are subsequently "forgiven".

House Hearings on International Aviation, *supra* note 73, at 124-25 (citations omitted). He also pointed to the significant differences between the U.S. and foreign-flag economic environment:

> The market structure in most foreign countries bears little resemblance to the U.S. market; instead, these markets are characterized by a pervasive pattern of state involvement in the economy—an involvement directed toward promoting the success of national enterprise, including the national airline, against foreign rivals. In contrast to privately owned U.S. airlines, foreign air carriers are generally established and preserved by their foreign governments for reasons such as national prestige, development of tourism, employment, and national defense capability. *They do not need to make money to survive*. While profitability is an ostensible goal, it is only one of a number of objectives, and the lack of profits will almost never be permitted to result in the failure of the airline, or even a contraction of operations. Government ownership, in and of itself, creates significant incentives to ensure that the flag carrier will not only survive, but will also maintain and even expand its operations regardless of financial results.
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> In this environment, competition alone does *not* ensure that the most efficient producers prosper. An inefficient, government-subsidized carrier can drive an efficient, privately owned American carrier out of a market—and under Open Skies this has in fact occurred.

for purposes of enhancing prestige,[209] national security,[210] tourism, or earning foreign exchange,[211] rather than for reasons which inspire capitalist efficiency.[212]

Id. at 1222-23 [emphasis in original and citation omitted]. *See id.* at 756 (testimony of Judith Connor), who noted that foreign airlines borrow money at lower increase rates because their governments stand behind the debt incurred.

209. International aviation offers a rather unique opportunity to "show the flag" around the world, for many of the same reasons which inspired President Theodore Roosevelt to send the U.S. navel fleet around the world. Air transportation also facilitates propaganda distribution and cultural penetrations between nations. *See* Jonsson, *supra* note 35. *See also*, A. SAMPSON, *supra* note 2, at 26, 115-116. Anthony Sampson has noted the heavy dependence of national airlines upon their governments for routes and economic assistance. In return, the governments derive some benefit in terms of national prestige. "The plans painted in their national colors and the glossy showrooms and advertising in the foreign capitals were becoming more visible representatives than embassies or sports teams," observed Sampson. "And the airlines were all appealing to their countrymen—in the words of British Airways' crude slogan—to 'fly the flag.' " *Id.* at 91.

210. The importance of aviation to national defense became manifest during the two World Wars. Civil aviation aircraft can undoubtedly be of importance in transporting troops, armaments, and munitions to the fields of battle. *House Hearings on International Aviation*, *supra* note 73, at 122-23. This has also been recognized by the United States government, which established the Civil Reserve Air Fleet [CRAF] program after World War II. CRAF calls for the rapid mobilization of designated civil aircraft for military use during times of national emergency. Many U.S.-flag carriers have designated passenger and cargo aircraft to the CRAF program. *Id.* at 1014-19 (statement of Ronald L. Danielian).

211. Most nations have economic priorities which include the need to earn foreign exchange and improve balance of payments. Industries such as transportation are important to achievement of these economic objectives in ways which are both direct, defined in terms of wealth earned from ticket sales, and indirect, principally defined in terms of tourist revenues. Moreover, airlines create employment opportunities within their countries. As was noted by Thomas F. Grojean, President of the Flying Tigers Line, Inc., "a country may have a political interest in encouraging industrial development or internal employment, and it may deem a low import or export air rate to be more important to the national interest than the airline's short-term profitability." *House Hearings on International Aviation*, *supra* note 73, at 313. And, Under Secretary of State, Judith Connor, noted that the domestic employment imperative of foreign carriers gave them a competitive advantage: "The numbers of people that foreign carriers hire as a result of their government's social policy also permits the carriers in many cases to provide superior services over a continued period of time, even during economic downturns, because they are able to continue with substantial numbers of in-flight personnel and ground personnel, while our carriers cut back during those periods of economic difficulty." *Id.* at 768. *See also*, *id.* at 861-62 (statement of Powell A. Moore).

212. These rationales were the same which had prompted initial governmental intervention in civil aviation. As one commentator has noted:

> In brief, the reasons for the original government interest and intervention in civil aviation can be grouped under four rubrics. *National defense*. World War I demonstrated beyond doubt the military value of aviation. . . . *Economic considerations*. Means of communication and transportation have always been considered as "public services", offering economic advantages to a state even if they may not be particularly profitable. . . . In the case of international aviation, foreign exchange earnings and balance-of-payments considerations provided additional economic incentives for government engagement. *Safety*. Governments everywhere regarded the safety of air transport operations to be their special concern and responsibility. . . . *Foreign policy considerations*. Since international aviation provides ample opportunities to "show the

International aviation, where many of the foreign actors owe their continued existence to their federal treasuries, and where strict territorial sovereignty over a state's airspace has been universally recognized since the Paris Convention of 1919, has always flown in the shadows of a strong governmental presence.[213] Hence, there is a significant question as to whether the free market economic model is appropriate in a politically charged environment in which many of the foreign competitors do not need to make a profit in order to survive, and in which many markets have never been truly "Free".[214] One commentator succinctly summa-

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flag" around the world, it has from the outset been viewed as enhancing the prestige of States.

Jonsson, *supra* note 35, at 278-79. The airlines, though they seem to defy geography, are among the most national of industries, inextricably bound up with their home country's ambitions and security. A. SAMPSON, *supra* note 2, at 19. *See* Capacity-Reduction Agreements, CAB Order 75-10-77, at 2 (1975): "In international markets, the desire of several nations to maximize . . . tourism spending . . . has fostered a willingness and ability among foreign nations to allow their subsidized flag carriers to sustain the huge operating losses occasioned by the operation of excess capacity. . . ."

213. One commentator has pointed out that a full spectrum of policies in international air transport may motivate a state vis-à-vis the airline industry. As to European nations alone he has categorized their policies as:

a. States want to guaranted the existence of what they call the national airline.
b. States want to ensure that the network of services offered to the public generally has a reasonable constancy and durability.
c. States want their airlines to be profitable.
d. States want to serve other national interests outside air transport, such as tourism, the balance of payments, defence [sic], which may be dependent on the existence of air routes into their country.
e. States want to offer the public low fares. And perhaps one should add:
f. States want everyone to be happy, especially their parliamentaries.

Raben, *Deregulation: A Critical Interrogation*, in INTERNATIONAL AIR TRANSPORT IN THE EIGHTIES 15-16 (H. Wassenberg & H. Fenerna eds. 1981).

214. P. DEMPSEY & W. THOMS, *supra* note 1, at 199. Although most foreign carriers are largely owned or heavily subsidized by their governments, one must recognize that there is an emerging trend toward "privatization" of state-owned airlines, as governments are beginning to sell their ownership interests to private investors. Perhaps the most notable of the recent announcements regarding this movement is the decision of the Thatcher government to sell the United Kingdom's ownership interest in British Airways. Lufthansa, Sabena, KLM, Air Signapore, Air Malaysia, and Japan Air Lines also appear to be joining the march toward privatization.

Moreover, as to airlines which remain largely state-owned, although the profit imperative is a less significant factor for their survival vis-a-vis privately owned carriers, nevertheless management has several rather good reasons to make profits. First, they measure their success or failure with the performance standard of the private carriers. Hence, they have a psychological incentive to do as well as their private rivals. Second, to the extent they can reduce their dependence on government subsidies they increase management freedom. Subsidies always come with strings attached as to when, where, and how the money shall be spent, and management decisionmaking can become ensnarled in the red tape of the entrenched government bureaucrat. These burdens may themselves contribute to less efficient operations. In contrast, healthy profits can be invested in new equipment or expanded markets largely at the discretion of management.

Third, state ownership may itself cause less economical or efficient operations, by govern-

rized the reasons for foreign anticompetitive behavior:

> The air above a nation is as sovereign as its soul, penetrated only by express permission. Add to that the prestige which many nations attach to their national airlines, and you have a recipe for permanent protectionism. A third-world nation will limit competition from efficient airlines, because it wants to keep its own national airline aloft. A nation like Switzerland also turns protectionist, not because Swissair is inefficient, but because Swiss labor costs are too high for Switzerland ot be an economic country to run an airline from.[215]

Nevertheless, the Carter Administration pursued the exportation of its policy of deregulation into foreign markets intoxicated by its limited success with the approach in the U.S. domestic market.[216] Several commentators have criticized the naive assumptions upon which the internationalizing of that policy was based.[217] As Anthony Sampson has aptly noted:

> After the United States deregulated the airlines in 1978 the economists could test out their theories and arguments between controls and free entry, between open skies and protection, in the great laboratory of the sky, and the arguments extended round the world. Yet, however bright and clear the economists looked inside their own airspace, they became overclouded as

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ment policies which seek to encourage other public interest imperatives such as reduced unemployment (which would require an airline to hire more employees than it really needs), increased tourism (which may require an airline to serve markets from which it derives insufficient passenger revenues because rates are depressed to artifically low levels), or spurring the economic health of domestic manufacturers (which may cause it to purchase domestic aircraft of other operational equipment at a higher price and/or lower quality than can be obtained abroad). Hence, a lethargic and anemic state-owned carrier may not be as innovative as its private competitor, and may not be the market threat that some maintain.

Nevertheless, state-owned carriers will continue to take some share of the air transport pie, and no matter how inefficient, their governments are not likely to allow them to go bankrupt. Therefore, to suggest that privately owned carriers have the same opportunities or burdens as publicly owned carriers is to fail to recognize the differences between apples and oranges. The international air transport environment is not haunted by the ghost of Adam Smith and his invisible hands as is the domestic U.S. economic environment.

215. *Free Trade in the Sky*, THE ECONOMIST, June 4, 1983, at 14; *quoted in* Bentil, *Attempt to Regulate Restrictive Commercial Practices In the Field of Air Transportation Within a Transnational Antitrust Framework*, 50 J.AIR L. & COM., 60, 73-75 (1984).

216. For an 18 month period in the late 1970s, the airline industry enjoyed the highest profits in its history. *The Rise and Fall of the Civil Aeronautics Board*, *supra* note 52, at 119. *See* Hardaway, *supra* note 76, at 137-41.

217. The last Chairman of Civil Aeronautics Board, C. Dan McKinnon, a Reagan appointee, criticized the Carter Administration for giving away access to interior U.S. points on the incorrect assumption that a competitive marketplace could be created abroad. "[The Carter Administration] policy ignored some of the cold, hard facts of economic life," said McKinnon. "Foreign countries don't want competition that would force their less efficient carriers [out of business] or cut into the revenues." He also announced that under the Reagan administration, access to lucrative interior U.S. points would not be given away for free. "U.S. aviation policy has stiffened with demands of a balanced *quid pro quo* in all future agreements." *CAB Chief Blames Unfair Bilateral Pacts on Carter Administration Policies*, TRAFFIC WORLD, May 21, 1984, at 60.

> they crossed the frontiers into the international arena. For they came up against the obstacles of sovereignty and national price, and no nation would allow its airline to go bankrupt.[218]

International aviation markets are not subject to the same sort of antitrust prohibitions against unfair methods of competition that police competitive behavior in domestic U.S. markets.[219] Since the inauguration of the U.S. "open skies" policy, a number of United States carriers have complained about discriminatory and anticompetitive practices by foreign governments and their airlines.[220] Many foreign carriers are vertically integrated; they frequently are affiliated with corporations which own the airport or reservations systems in their respective nations. And most foreign governments have a strong incentive to protect their local airline and its domestic market. The foreign transport minister frequently wears two hats: he is not only an officer of the government, but he also plays a paternalistic role, attempting to enhance the competitive posture of the local-flag carrier and thereby reduce the cost of subsidy to the national treasury.[221] Among the examples of discriminatory practices are higher costs for landing fees and fuel than are charged the local-flag carrier; less desirable gate and ticket agent locations; requirements that local passenger and baggage handling personnel be employed; bias in the computer reservations system; and currency conversion and remittance problems.[222] As a consequence, U.S. carriers have generally been less successful than their foreign counterparts in attracting foreign travelers.[223]

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218. A. SAMPSON, *supra* note 2, at 19.

219. *See House Hearings on International Aviation*, *supra* note 73, at 753 (statement of Rep. Elliott Levitas).

220. *Pan Am, Tiger Slam Past U.S. Bilateral Pacts as "Giveaways"*, TRAFFIC WORLD, Mar. 26, 1985, at 44. These difficulties will be discussed in greater detail in Chapter X.

221.

> This attitude reflects more than simple chauvinism. Many foreign governments have financial interests in their airlines. But there are other factors as well. International air transportation is generally recognized abroad as an important foreign trade item, and a means for earning hard currencies; it is widely regarded as an aid in attracting tourism; it can provide significant employment; in an emergency, the civil aircraft and infrastructure (personnel and facilities) become part of the national defense forces; it is often used for diplomatic communication and presence abroad; and many governments consider their national airlines instruments and symbols of prestige. The Carter Administration policy makers subordinated all of these consideration to "consumer" benefits.

M. BRENNER, *supra* note 75, at 109, n.84.

222. Rosenfield, *supra* note 108, at 485-87; *Bilateral Focus*, AV. WEEK & SPACE TECH., June 3, 1985, at 57.

223. Between 1972 and 1983, U.S.-flag carriers were able to attract 55-60% of U.S. citizens, but only 40% of aliens who travel to or from the United States.

> [A]lthough the U.S. airlines have consistently attained the 50 percent overall share that foreign governments consider to be "fair", that level of participation results from the stronger than average showing of U.S. airlines in the heavy-traffic Carribean, Mexican, and Central American areas. U.S. citizens have consistently accounted for more than

> There are many explanations for this. In many foreign countries, there are motivations of patriotism and security (language, type of food, etc.) to use the national airline. Beyond that, however, there are other influences: government regulations requiring government employees and many business travelers to use the national airline; national airline control over the distribution system; bias in computer reservations systems owned by national airlines; currency exchange controls; among others. Government ownership of airlines provides a strong incentive for government to help airlines to be successful. Without being judgmental of the merits of the "open skies" policy, it is certainly a fair criticism of its advocates that they either ignored or downplayed the pervasive absence of a "fair marketplace" abroad.[224]

The objective of the Civil Aeronautics Board was to provide the consumer—the international traveler—with improved service at reduced fares. The theory was essentially that increased competition among air carriers would lead to a proliferation of services available to the traveling public at competitive costs reasonably related thereto, and that the price elasticity of the passenger market will ensure increased capacity for the carriers and, consequently, improved revenues.[225]

Nevertheless, the Carter Administration's policy of giving foreign-flag carriers access to interior U.S. points and certificating additional U.S.-flag carriers to compete in international markets,[226] coupled with a decade-long decline in U.S. passenger share of the international market,[227]

> 60 percent of the total traffic to and from these areas; and U.S. airlines have consistently captured more than 60 percent of the U.S. citizens and more than 50 percent of the aliens. If these nearby regions are eliminated, U.S. airlines are carrying less than half the long-haul international air traffic to and from the United States.

M. BRENNER, *supra* note 75, at 109 [citations omitted].

224. *Id.*

225. Dempsey, *supra* note 53, at 441.

226.

> The crisis facing the American airlines came not just from the recession and the surplus of jumbos, but from a fundamental change in the political weather. The politicians began demanding that Washington withdraw its protection ad regulation, and the airlines became the most spectacular test in the crusade to deregulate America, which soon affected airlines around the world.

A. SAMPSON, *supra* note 2, at 133. Another commentator has affirmed this conclusion:

> Regretably, the airlines were the first to suffer the pains of liberalisation. They have sustained serious operational and commercial losses; losses which are likely to continue for a considerable time even if rationality is injected into the system of international civil aviation without any delay.
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> While it is fully appreciated that a substantial responsibility lies with the present recessionary trends in the world economy, it can also not be denied that the U.S. deregulation policy was fully involved in aggravating the bad results of the airline industry. If the results were solely caused by the downturn in the economy and decline in traffic demand then results of all airlines should have been consistent; on the contrary, the airlines were placed disadvantageously in the deregulated environment (i.e., the major and privately-owned airlines) incurred considerably more deficits than the other airlines.

Impact of Current U.S. Policy, *supra* note 98, at 301, 304 [citations omitted].

227. The percentage of US. citizens of the international aviation market declined from 63.2% in 1972 to 46.2% in 1981, rising to 49.5% in 1982. In the U.S.-Europe market, the figure fell

sharply increased fuel prices,[228] the recession of the late 1970s and early 1980s,[229] and a surge in anticompetitive and discriminatory nontariff barriers, contributed to a deterioration in market share and to a serious economic decline for several U.S.-flag carriers.[230] Between 1975 and 1984, North American carriers' share of the world total fell from 22.1% to

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from 66.8% in 1972 to 46.9% in 1981, rising to 51.9% in 1982. CAB, REPORT TO CONGRESS 95 (1977); CAB, REPORT TO CONGRESS 83 (1982). CAB Chairman Marvin Cohen refused to attribute any significant position of air carrier economic losses to the "open skies" policy, arguing that there were no material differences between the domestic and international aviation market and that essentially the same pro-competitive deregulatory approach was appropriate for both. *See House Hearings on International Aviation*, *supra* note 73, at 568-69. For a strong criticism of Chairman Cohen's reasoning, *see id.* at 474, 998 (statements of Rep. Elliott Levitas). Congressman Levitas noted:

> For the life of me, I cannot understand how you can take the position that where a competitor has his losses subsidized, that you have a competitive situation. . . . No foreign government wants to put its tax resources into financing an airline. But you can make management decisions that you know are uneconomical if you don't bear the price of not turning a profit on those decisions, or, alternatively, you don't have to worry about taking a loss.
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> * * *
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> Free enterprise requires not only flexibility in pricing, but it requires the opportunity to make a profit and the risk of failure.

Id. at 801.

228. *See* A. SAMPSON, *supra* note 2, at 126-27.

229. "The world recession, made crueller by the extension of deregulation, brought the long air boom to an abrupt halt; and while 1984 brought an upturn in American passengers, the combination of deregulation, the high dollar and the Asian competition still threatened the American airlines." A. SAMPSON, *supra* note 2, at 227.

230. Ronald L. Danielian of the International Economic Policy Association noted the causes of deterioration of U.S. market share as follows:

> As airlines were beginning to control their losses from the heavy fuel payments, 1979 brought another price increase so that one fuel can represent over one-third of operating costs. Add to this the reduction in U.S. market shares and increased nontariff barriers, and U.S. carrier survival is threatened. From a competitive standpoint, our carriers are at a disadvantage, because their losses dictate that they must pare down their route structure in search of healthier balance sheets. On the other hand, the foreign airlines with large losses, are not pressured into cutting back routes to the same degree.
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> Foreign carriers for the most part are owned, controlled, or supported financially by their governments, and their operating losses are offset by various government actions. U.S. carriers, on the other hand, must bear the losses from reduced schedules while giving up revenue paying passengers to foreign airlines as their penetration into our much larger market gives them major opportunities.

House Hearings on International Aviation, *supra* note 73, at 1026-27 (citation omitted). Melvin Brenner and his colleagues had these observations:

> The airline seat is a perishable commodity. It is inherent in a highly competitive environment that there will continue to be strong pressures against adequate pricing. These pressures are intensified by ease of entry. While this offers great bargains to today's travelers, it raised very troublesome questions for the U.S. airlines, and their continuing ability to compete effectively against foreign government-supported airlines.

M. BRENNER, *supra* note 75, at 121.

The economic losses of the early 1980s were not restricted to U.S. carriers. Anthony Sampson noted that the world's airline industry is "technically close to being bankrupt." A. SAMPSON, *supra* note 2, at 16. He quoted Umberto Nordio of Alitalia who provided the rationale.

> We're selling a product which is not stockable. It's as if a car dealers were told that all

20%.[231] Between 1977 and 1981, the U.S. share of the international aviation market dropped from 45.4% to 41.3% in the transatlantic sphere, and from 45.0% to 41.8% in the transpacific.[232] For every percentage point U.S.-flag carriers lose in the U.S.-Europe market, they forfeit revenues of $47 million;[233] for every percentage-point decrease in the U.S.-Asia market, U.S. airlines lose $25 million.[234]

The aviation industry is an important contributor to the United States' balance of payments. In 1980, all U.S. service industries, including transportation and tourism, contributed a net $35 billion to the U.S. balance of payments. Of that, U.S.-flag carriers earned $2.6 billion carrying 49.1% of total international passenger traffic, or 18.9 million of the 39.5 million passengers who flew to the United States that year; foreign tourists spent

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his cars would be worth nothing tomorrow morning. Naturally he would rush to sell them, even at a dollar each.

Id. at 18. "Worldwide industry losses for 1982 were $900 million, despite the fact that the industry carried 7 million more passengers than it did the preceding year." *Transportation Deregulation*, *supra* note 71, at 342 [citations omitted]. However, not all commentators paint the impact of deregulation so grimly. In a rather succinct summary of international air deregulation, two commentators note:

> The airline experience . . . casts doubt on the . . . argument . . . that other countries might successfully engage in unfair competition against U.S. firms. Although the evidence is too limited to permit a firm conclusion, research suggests that U.S. airlines generally have benefited from open skies policy through increased market shares and improved profitability.
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> * * *
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> Liberal agreements also appear to have helped, or at least not hurt, the profitability of U.S. airlines.

Gomez-Ibanez & Morgan, *Deregulating International Markets: The Examples of Aviation and Ocean Shipping*, 2 YALE J. REG. 107, 120-21 (1984).

231. *Passenger, Freight Traffic Upturn Passes 1980 Record*, AV. WEEK & SPACE TECH., May 6, 1985, at 30. During the same period, the European carrier share fell from 43.% to 36.9%; the Asian and Pacific carrier share grew from 18.7% in 1975 to 26.5% in 1984; Middle East airlines rose from 4.6% to 6.5%; and Latin American and Caribbean air carriers dropped from 6.6% to 5.6%. *Id.*

232. *House Hearings on International Aviation*, *supra* note 73, at 73. Between 1973 and 1981, and U.S.-flag share of the U.S. international aviation market fell from 54.2% to 48.6%. The following year, it increased by one percentage point. In the U.S.-Europe market, it fell from 49.2% in 1973 to 41% in 1981, increasing to 44.9% in 1982. *See* CAB REPORT TO CONGRESS 95 (1977), and CAB REPORT TO CONGRESS 83 (1983).

> [C]ompetition was constantly heating up, from airlines which were owned by their governments and which could therefore often afford to lose money on prestigious routes. The North Atlantic was the most competitive of all, as foreign airlines cut into the American share—first the Europeans and then the others beginning with El Al, Air India and Pakistan International. In 1947 TWA and Pan Am had carried over eighty percent of transatlantic travellers; by 1962 they were carrying only thirty-two percent, with nineteen airlines competing between the United States and Europe. IATA did what it could to maintain fares, but it could not prevent the pressure from new intruders and from the growing charter flights.

A. SAMPSON, *supra* note 2, at 109-110.

233. *House Hearings on International Aviation*, *supra* note 73, at 114.

234. *Id.* at 73. *See id.* at 184, 1225, 1305.

an additional $10.1 billion in the United States.[235] Nevertheless, the balance of payments generated by international aviation is becoming a matter of increased concern in the United States. The "passenger fare deficit",[236] ranging between $1 billion and $1.7 billion during the 1970s, shot up to $3 billion in 1983; the "travel spending gap"[237] rose to $2.6 billion that year.[238]

The turmoil experienced by U.S.-flag carriers in the years immediately following adoption of the "open skies" policy has been profound.[239] The nation's major Latin American carrier, Braniff, flew into bankruptcy,[240] selling off its South American routes to Eastern,[241] which has

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235. *Id.* at 1005. If foreign-flag carriers were to capture the U.S. portion of the international passenger market, "because of insufficient revenues owing to competitive reasons and possible saturation of the market", the U.S. would lose $8.69 billion, "a heavy burden for our balance of payments to absorb." *Id.* at 1010 (statement of Ronald L. Danielian).

236. The passenger fare account is the difference between the U.S. citizen share of the international aviation market vis-a-vis the U.S. carrier market share, weighted by average fare payments. The United States experiences a "fare deficit" when the U.S. citizen share of travel exceeds its flag carriers' share of travel. M. BRENNER, *supra* note 75, a 114.

237. The "travel spending gap" is the difference between what foreign travelers spend in the U.S. vis-a-vis what U.S. citizens spend abroad. In the early 1970s, the gap exceeded $2 billion a year. There was a surplus of $1.5 billion in favor of the United States in 1982, dropping sharply to a $2.6 billion deficit in the following year. *Id.*

238. *Id. See generally*, Schott, *Consequences of U.S. International Aviation Policies*, 24 TRANSP. Q. 182, 184 (1985).

239. "The deregulation measure taken unilaterally by the United States, in view of the . . . evidence, have seemed to have caused substantially more damage to the international civil aviation than any reform brought about them." *Impact of Current U.S. Policy*, *supra* note 98, at 321.

> The damage was caused by the very nature of the airline product—its perishability. Unlike manufactured good, airline journeys have to be consumed at the moment of production, they cannot be stocked for resale tomorrow if there is no purchaser today.
>
> * * *
>
> It was the expanding of . . . domestic de-regulation package into the international arena that led to a worsening of the problems we were already facing.

Thomson, *The North Atlantic: Survival of the Fittest?*, 27 ITA WEEKLY BULL. 677, 679-80 (1981).

> The recent financial crisis among United States airlines, as well as radical changes in policy by the United States government, now places the future of international air transportation in question. Many U.S. airlines which were once powerful forces for international commerce have been forced to restrict their operations and withdraw from the markets previously served successfully. . . . A once efficient and highly organized system of transporting passengers, mail, and cargo has been engulfed in confusion.

Hall, *Development of the International Framework of Air Transportation*, 5 NORTHRUP. U.L.J. AEROSPACE ENERGY & ENV'T 1, 10 (1984).

240. "The biggest victim of deregulation was Braniff. . . ." A. SAMPSON, *supra* note 2, 138-140.

> Fearing competition from its major competitors, Braniff chose to expand quickly, opening up dozens of new routes within the United States, Europe, and Asia, and slashing fares by an average of 40 percent. During the same period, other airlines were also moving fast to beat out the competition. Close at Braniff's heels was American Airlines, which had moved its headquarters from New York to Dallas, Braniff's home base; American soon matched Braniff's fare cuts on domestic routes.
>
> The rate war between American and Braniff was described by the Wall Street Journal as a "bleeding contest," destructive to both airlines, and disastrous for Braniff,

itself suffered chronic economic pains and was ultimately consumed by Texas Air. An anemic Trans World Airlines, the dominant U.S. transatlantic carrier, was sieged in a takeover battle between Texas Air maverick Frank Lorenzo and corporate raider Carl Ichan, with the latter ultimately victorious.[242] By 1985, TWA was suffering the worst economic losses in its history.[243] And a hemorrhaging Pan Am, the premiere U.S.-flag international carrier, cannibalized virtually all of its non-airline assets to stay aloft until 1985, when it announced the sale of all its Pacific aircraft and

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which filed for bankruptcy in May 1982. Braniff followed only by a few months the demise of Laker Airways, a British company also known for its fare cuts and rate wars.

S. TOLCHIN & M. TOLCHIN, *supra* note 72, at 243.

> For Braniff, freedom to enter new international markets contribute to bankruptcy. In two years of transpacific service it lost (before interest) $26.7 million on $43.9 million of revenues. In the Atlantic, from 1978 to 1982, Braniff lost (before interest) $61.8 million on revenues of $312 million.
>
> At the opposite end of the spectrum, so far as the quality of management, efficiency of operation, and financial strength are concerned, is Northwest Airlines. Yet Northwest, which has almost always reported good profits in the Pacific, lost money in the first four years of its U.S.-Europe operations, for an operating loss from 1979 to 1982 of $80.9 million. Even in the spectacular peak profit year of 1983, Northwest earned only $4 million on revenues of $157 million. This would suggest that "freedom to enter" international markets has proved to be very costly for both conservative and speculative-oriented airline managements.

M. BRENNER, *supra* note 75, at 117. In fairness, Braniff's bankruptcy was more attributable to its intemperate expansion than to "open skies." Its primary international market was Latin America, which has largely rejected "open skies." Braniff did expand its route structure wildly to the Benelux, Korean and Hong Kong markets with the opportunities for additional entry available under the new liberal bilaterals, but it was doing a great deal more of that domestically. Certainly, these opportunities would have been largely foreclosed had deregulation not occurred. But few other carriers have made such imprudent managerial decisions in the deregulation era as did Braniff.

241. *See* Braniff—South American Route Transfer Case, CAB Order 83-6-74 (1983). In the first quarter of 1986, Eastern posted its heaviest losses in its history—a record $110.6 million. *Eastern's Record Loss*, TRAFFIC WORLD, May 12, 1986, at 45.

242. *A Daring New Flying Machine*, TIME, June 24, 1985, at 36; *TWA Gloomily Weighs Its Options*, BUS. WEEK, April 2, 1984, at 37. Here again, the empirical evidence does not support a hypthesis that TWA's problems are directly attributable to "open skies." TWA's transatlantic operations concentrate on southern European markets, most of whose nations have refused to conclude liberal bilaterals with the United States. Indeed, prior to 1986, TWA's transatlantic operations were profitable, but its domestic losses (based on hub-and-spoke operations radiating from St. Louis) frequently consumed these international profits.

243. TWA lost $208.4 million in 1985, making the year the carrier's worst ever. Since 1980, it suffered net losses of almost $250 million, showing a net profit of nearly $30 million only in 1984. Part of its economic problem is attributed to the age of its fleet; although its labor costs are close to the industry average, its older aircraft are less fuel efficient than those of its competitors. *How to Lose by Winning*, NEWSWEEK, Jan. 20, 1986, at 44-46. Fueled by a flight attendants' strike and the Athens terrorist bombing of TWA jet, its losses soared to $169.6 million in the first quarter of 1986, despite a radical drop in fuel prices. Carroll, *TWA Silent On Number of Fliers, Denies Continuing Strike Hurts*, USA TODAY (May 19, 1986), at 5B. Pan Am and TWA traditionally transported the lion's share of U.S. passengers flying in international markets. During 1974 the former was responsible for 44% of the aggregate scheduled international miles flown by U.S.

corresponding routes to the U.S. behemoth, United Airlines.[244]

Since 1980, Pan Am's operating losses have exceeded $1 billion.[245] As a consequence, it flies one of the oldest fleets of transcontinental aircraft of any international carrier. In 1984, it was the only major U.S. carrier to incur operating losses, which amounted to $135.2 million.[246] Pan Am's problems in the Pacific market may have been exacerbated by the U.S. "open skies" policy.[247] As Pan Am explained its decision to abandon Asia:

> With the advent of U.S. policies to open up international markets, many new U.S. and foreign carriers have initiated international service, in many cases concentrating on markets in which they have well-established hub and feeder systems. In 1979-80, major new transpacific services were instituted to the United States by Signapore Airline, Korean Air, Philippine Airlines, Thai

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244. *A Recovered Pan Am Faces Tomorrow's Hurdles*, BUS. WEEK, June 4, 1984, at 60. *See generally*, A. SAMPSON, *supra* note 2, at 126.

> In 1980 and 1981 Pan Am suffered total operating losses of $415 million. By selling certain assets, such as its hotel chain, at a profit, Pan Am was able to show a net profit of about $61 million, but in the process, it virtually exhausted its credit. Today, it is doubtful that it could raise a very significant amount of money. Certainly its ability to finance new aircraft is seriously constrained.
>
> During the same period, British Airways and Air France also suffered very large losses. But no one contemplates that either of these carriers might go out of business or be denied credit. . . . A government guarantee will cure any misgivings that potential security holders have, and one can be confident that their capital needs will be met.
>
> Due to this circumstance, we have witnessed for several years the phenomenon of foreign airlines, many of which have been chronically unprofitable, replacing the older models in their fleets with newer and more efficient aircraft and selling their old planes to U.S. carriers. . . . [T]hose who like to pretend that we have, or can have, a free market in international aviation are dreadfully naive.

Tillinghast, Jr., *Financing of International Carriers*, 5 NORTHRUP U.L.J. AEROSPACE ENERGY & ENV'T 25, 29 (1984).

Prior to the sale of its transpacific routes and corresponding aircraft to United, Pan Am served the U.S.-Latin America, U.S.-Asia, and U.S.-European markets. The former is the least liberalized, the latter is the most liberalized, and U.S.-Asia is mixed. Curiously, Pan Am sold the U.S.-Asia market to United not only to raise badly needed capital and retire some of its overwhelming debt, but also so that it could expand its transatlantic operations. Pan Am still retains the highly profitable routes to Latin America, an area which has largely rejected "open skies."

245. Joint Application of Pan American World Airways, Inc., and United Airlines, Inc., April 22, 1985, on file at the U.S. Dep't of Transportation in Docket 43065, at 19 [hereinafter cited as Pan Am-United Application].

246. *Id.* at 19.

247. The U.S. Department of Transportation found to the contrary:

> Pan American's loss of market share in the psat ten years has not been to foreign-flag competition. In fact, the U.S.-flag share of U.S.-Pacific traffic has held steady at 44 percent, and the U.S.-flag share of the U.S.-North Central Pacific traffic has actually increased three percent to 45 percent.

Pacific Division Transfer Case, DOT Order 85-11-67 (1985).

Airlines and China Airlines.[248]

* * *

Ten other airlines provide direct scheduled service between the United States and Japan, and two or three new U.S. carriers could be added under proposed amendments to the bilateral agreement. United States-Hong Kong is also served by nine other carriers, and in addition more than a dozen U.S. carriers have been authorized to serve that multiple-designation market.[249]

PAN AM'S SYSTEM FINANCIAL RESULTS
1970-1984
Operating
Profit
(Loss)

(000)

Calendar Year	Operating Profit	Net Profit
1970	$(29,866)	$(48,458)
1971	(16,240)	(46,501)
1972	(1,938)	(33,181)
1973	(1,699)	(26,252)
1974	(98,598)	(81,744)
1970-1974	$(148,341)	$236,166
1975	$(35,118)	$(53,952)
1976	14,200	94,593
1977	90,213	45,004
1978	143,729	118,801
1979	72,052	76,128
1976-1979	$285,076	$280,574
1980	$(129,614)	80,266[1]
1981	(377,431)	(18,875)[2]
1982	(372,736)	(485,331)
1983	13,131	(51,025)
1984	(135,216)	(206,836)
1980-1984	$(1,001,866)	$(681,801)
1970-1984	$(865,131)	$(637,393)

[1] Includes $294.4 million from sale of Pam Am Building.
[2] Includes $222.1 million from sale of Intercontinental Hotel

Pam-United Application, *supra* note 245, Exhibit C.

248. Pan Am-United Application, *supra* note 245, at 19.

249. *Id.* at 22 [citations omitted]. The followig carriers are authorized to serve the U.S.-Japan market:

Northwest, Continental (Air Micronesia), Flying Tiger (cargo only), JAL, China Airlines, Korean Air, Signapore Airlines, Philippine Airlines, Thai International, and Varig. The list includes European Airlines which carry passengers between Toyky and Anchorage (British Airways, Air France, Sabena, etc.) and connecting service through Vancouver available from CP Air. Also excluded are charter services, now available to Japan on a limited basis.

Id. at 22, n.1 The following carriers sreve the U.S.-Hong Kong market:

Northwest, Continental, Flying Tiger (cargo only), JAL, Korean Air (connections), CP Air (connections), and Philippine Airlines (connections). Excluded from this list are Cathay

Pan Am's share of the Pacific market fell from 29.9% in 1978 to 13.7% in the first ten months of 1984.[250] Between 1960 and 1984, foreign-flag carriers increased their share of the transpacific market by 23 percentage points.[251] In response to the economic difficulties faced by the U.S. airline industry, social Darwinist Alfed Kahn said, "It's destructive and it's

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Pacific's nonstop operations to Vancouver, where connections to U.S. points are available.

Id. at 22, n.2.

250. See table on next page.

251.

	Total Industry	U.S. Flag Passenger	U.S. Flag Share	Foreign Flag Passenger	Foreign Flag Share
1960[1]	291	205	70%	86	30%
1965[1]	687	406	59	281	41
1970[1]	1,840	1,018	55	822	45
1975	2,522	1,061	42	1,461	58
1980	4,567	1,885	41	2,682	59
1984[2]	5,061	2,208	44	2,853	56
Percentage Point Change 1960-1984			−26		+26
U.S. - South Pacific					
1960[1]	71	36	51%	35	49%
1965[1]	172	87	51	85	49
1970[1]	425	242	57	183	43
1975	687	342	50	345	50
1980	1,154	554	48	600	52
1984[2]	1,104	492	42	612	55
Percentage Point Change 1960-1984			− 6		+ 6
U.S. - Total Pacific					
1960[1]	362	241	67%	121	33%
1965[1]	859	493	57	366	43
1970[1]	2,265	1,260	56	1,005	44
1975	3,209	1,402	44	1,806	56
1980	5,721	2,439	43	3,282	57
1984[2]	6,165	2,700	44	3,465	56
Percentage Point Change 1960-1984			−23		+23

[1] Includes charter traffic.
[2] January-October 1984.
Source: DOT/INS-U.S. International Air Travel Statistics reduced 5% to exclude industry discount and non-revenue passengers.
Pan Am-United Application, *supra* note 245, Exhibit I.

Pan Am provided the following summary of the growth of foreign-flag carriers in the transpacific market:

> JAL, the predominant carrier in the United States-Pacific market overall, has consistently been the major force in service between the United States and Japan; its 40-percent-plus share has been unshakable, consisting as it does, not only of local Japanese originating traffic, but also of tremendous flows of traffic through its Tokyo hub. With two new U.S. points added in 1983 (Seattle and Chicago), JAL now operates 9

PAN AM'S SHARE OF PACIFIC TRAFFIC

	1976	1977	1978	1979	1980	1981	1982	1983	1984
Pan Am Percentage Share of Japan Traffic	23.2	25.6	30.1	27.3	25.0	22.0	19.9	21.0	16.7
Pan Am Percentage Share of North Central Pacific Traffic	24.2	26.2	30.1	26.6	23.4	21.5	19.3	18.1	14.3
Pan Am Percentage Share of All Pacific Traffic	24.8	26.9	29.9	26.7	22.9	20.7	18.3	17.3	13.7

Source: INS data. Percentage shares for 1984 are based on data for the first ten months of 1984. Pan Am-United Application, *supra* note 248, Exhibit G.

cruel, but that's the way the market functions."[252]

By the early 1980s, the average age of the U.S.-flag fleet had grown to 8 years; in contrast, their foreign-flag competitors had a fleet average age of only 4.6 years. Of the 750 fuel-efficient intercontinental aircraft in operation, 74% were flown by foreign carriers.[253] Only 10% of the 200 intercontinental aircraft on order was placed by U.S. carriers; the remaining 90% was designated for foreign fleets.[254]

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daily frequencies to the United States, and more are planned. The carrier also recently announced an expansion and modernization of its fleet. . . .

In addition to JAL, U.S. carriers have had to face a new group of competitors in service between the United States and Japan in 1980. Philippine Airlines started service in this market in 1983, and China Airlines and Korean Air have added new frequencies with modern, widebody equipment. [In February of 1985] the Malaysian Airline System (MAS) obtained fifth-freedom rights betweeen Tokyo and the U.S. West Coast and, more recently, announced joint operations and JAL and Northwest and the operation of independent services between Tokyo and the United States in 1986.

* * *

Strong foreign competition exists throughout the North Central Pacific. Starting in 1957 with rights to serve only Alaska and Seattle, Korean Air now has rights to serve Los Angeles and Honolulu (with fifth-freedom rights from Japan), New York, and Chicago and Oakland. China Airlines' U.S. routes were substantially expanded in 1980, and Singapore Airlines has emerged as a significnt competitor from Singapore, Taipei, and Hong Kong, as well as Tokyo. Cathay Pacific initiated nonstop 747 service from Hong Kong to Vancouver in 1983, an operation that has been expanded from two to three weekly flights. CAAC initiated service to the United States in 1981, and Philippine Airlines now serves three U.S. Gateways (Los Angeles, San Francisco, and Honolulu).

In the South Pacific, Quantas, the Australian national carrier, and Air New Zealand have consistently held large shares of that market since the late 1970s. Pan Am's market share has declined considerably because of growing operations by UTA and CP Air, and most importantly, by Continental's growth in the market.

Id. at 23-26 [citations and references omitted].

252. *Transportation Deregluation*, *supra* note 71, at 371.

253. *House Hearings on International Aviation*, *supra* note 73, at 135-36 (statement of William T. Seawell). Pan American flew the world's *oldest* fleet of wide-bodied aircraft. *Id.* at 135. And because of serious economic losses, capital did not exist for fleet modernization and expansion. The cost of a single 747 with spare parts was $75 million. *Id.* at 136. "If present trends continue, we will confront modern, efficient, expanding foreign fleets while saddled with absolescent, less fuel-efficient equipment—and the prospect of inevitable, continuing operating deficits and further system shrinkage which use of these models will entail." *Id.* at 137. Similar sentiments were expressed by TWA's CEO, C.E. Meyer, Jr., *id.* at 207. These difficulties are exacerbated by the fact that foreign carriers are able to secure low-interest loans on aircraft manufactured in the United States from the U.S. Export-Import Bank (Eximbank). During 1980, Eximbank loaned 27 nations $1.7 billion to purchase aircraft at interest rates ranging from 8% to 9.25%—substantially below the 20-21% rates available from private financial sources to U.S.-flag carriers, inflated by their poor credit rating. *Id.* at 190, 236 (statement of William T. Seawell). On many of these loans, the foreign airlines have no interest payments for the first 5-to-12 years after they are made. *Id.* at 235 (statement of Rep. Bob McEwen (R-Ohio).

254. *Id.* at 37-38 (statement of C.E. Meyer, Jr.). By the end of 1983, the picture was even more dismal. Of the 38 long-range intercontinental wide-bodied aircraft on order, only 4 were designated for U.S. carriers. The average age of the U.S.-flag intercontinental fleet had grown to 9.4 years, compared to 6.2 yeers for foreign carriers. M. BRENNER, *supra* note 75, at 118. The long-term implications are dire, for "fleet composition is important to cost efficiency and the ability to operate profitably at prices that the competitive market will permit." *Id.* at 117.

The strength of the U.S. dollar in the mid-1980s sent an unprecedented flow of U.S. tourists abroad, somewhat ameliorating these financial woes.[255] Growth in traffic, the end of recession, declining fuel prices, the demise of transatlantic loss leaders Laker and Air Florida, and management maturity in avoiding disastrous fares wars led to improved carrier economic health by the mid-1980s.[256] Moreover, the squeeze on profits engendered by the increased competition unleashed by deregulation has strongly motivated airline management to insist on higher levels of efficiency, enhanced productivity, and lower labor costs. The confrontation between management and labor in this industry since deregulation began has been fierce. Nevertheless, it must be admitted that the industry as a whole had become lethargic under regulation. Hence, the disciplines imposed by the Darwinian marketplace have led to higher levels of carrier efficiency, an improved allocation of resources, and lower prices for many consumers. And indeed, freedom to lower (and raise) prices has enabled carriers to tap the price elasticities of the marketplace to maximize profits the non-discretionary (*e.g.*, business) traveler, and fill seats which might otherwise have flown empty with the discretionary (*e.g.*, vacation) traveler. In less competitive markets, prices have generally been set higher than those in highly competitive markets. As a result, a number of U.S.-flag carriers have enjoyed healthier profits in some years since deregulation. Nevertheless, the usual profits recently enjoyed by some U.S. carriers tend to obscure their unsatisfactory long-term economic position,[257] and problems of discrimination and unfair methods of

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255. While general economic conditions significantly influence the total amount of travel, the nationality of travelers is strongly affected by relative currency values (rates of exchange). There has been an unanticipated surge in the value of the dollar.

M. BRENNER, *supra* note 75, at 108.

> A strong dollar makes it more expensive for foreigners to visit the United States; a weak dollar serves as a magnet. Conversely, a strong dollar reduces the cost of foreign travel for Americans. In 1983/1984 the dollar was at historic peaks against many other major currencies.

Id. at 106.

> It is likely that if European currencies strengthen, or the world adjusts to the 1983/1984 strength of the dollar, the U.S. citizen percentage of U.S.-Europe travel will diminish and the overall U.S. airline share will drop to 45 percent or less—the situation that prevailed before the drive for "Open Skies."

Id. at 110.

256. 1984 was projected to be the first year that the world's airlines would be in the black since 1978. IATA projected a net profit for 1984 of approximately $800 million. It also noted that member airlines would have to send about $200 billion over the next decade to purchase new equipment. *Airlines Back in the Black*, New York Times, Dec. 31, 1984, at A39, col. 3.

257. M. BRENNER, *supra* note 75, at 114. Melvin Brenner and his colleagues made a comprehensive economic study of the U.S. airline industry during the period 1972-1983. They explained why they chose this time frame for analysis:

> Not only does this provide almost the same number of years before and after the 1978 "swing" year, but 1972 is a reasonably "normal" year and which to begin. The 1970/71 recession was past, and 1972 was a good recovery year; the recession of

competition in foreign markets persist.

V. A Critique of the Implementation of U.S. International Aviation Policy

A. *Industry Criticism of "Open Skies"*

Many U.S.-flag carriers vehemently criticized their government's "open skies" policy of giving foreign airlines access to lucrative interior U.S. points ("hard rights") for imprecisely defined promises of pricing flexibility and prohibitions against anticompetitive behaviour ("soft rights").[258] As Lawrence Nagin, Vice President of the Flying Tiger Line, Inc., noted:

> In drafting the Federal Aviation Act, Congress concluded that aviation policy should follow a course designed to promote, encourage, and develop a viable privately owned U.S. air transport industry as a vehicle for U.S. aviation policy, and to strengthen the competitive position of U.S. air carriers to at least equality with that of foreign air carriers.
>
> There is no question that in the late 1970s and early 1980s our negotiators had lost sight of these objectives in their zeal to export deregulation.[259]

Similarly, William A. Kutzke, Vice President of Northwest Airlines, found himself disagreeing with the merits of the "open skies" policy, and the pragmatic difficulties its implementation has created:

> [T]he concept of liberal bilaterals is good in theory but in practical effect is not realistic in the context of international aviation. To obtain these agreements, the U.S. must trade hard rights including valuable U.S. routes to a foreign country to obtain a fundamentally different approach to aviation policy. This approach just did not work.
>
> * * *
>
> Not uncommonly the liberal bilaterals require repeated rounds of consultation and repeated discussions in order to reach any resolution [of disputes

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1974/75 was still to come. Also, 1972 was the last full year that preceded the 1973 Arab oil embargo, and the beginning of sharp fuel price increases.

Id. at 107 (citation omitted). When discussing the long-term profitability of U.S. carriers, their conclusions were pessimistic:

> On an overall basis, despite extremely good, recent experience, long-haul international air transportation is not a business in which to get rich. Over the entire 12-year period, operating profit in [U.S.-Europe, U.S.-Asia and U.S.-South America] aggregated only $927 million on total revenues of $43 billion—an operating profit margin of little over 2 percent. Operating profit failed to cover interest expense, which amounted to a total of $1,152 million.

Id. at 116.

258. Such criticism was particularly robust during the early 1980s, when the economic impact of "open skies" was initially being felt.

259. *Difficulties in Implementing United States-Korean Aviation Bilateral Agreements Hearing Before the Subcomm. on Investigations and Oversight of the House Comm. on Public Works and Transportation*, 98th Cong., 2d sess. 7 (1984) (testimony of Lawrence M. Nagin) [hereinafter cited as *House Hearings on U.S.-Korean Aviation*].

involving foreign anticompetitive conduct].[260]

The focus of U.S. negotiators has been significantly different from that of foreign negotiators. During the Carter Administration, U.S. negotiating strategy shifted away from discrete operating problems, to one of employing the complaints as a catalyst for altering the fundamental structure of the agreement—in other words, as another opportunity for expanding the "open skies" philosophy to additional markets.[261] Many industry executives complained of the apparent inability of their government to engage in effective negotiations to reduce non-tariff barriers in international aviation.[262] As C.E. Meyer, Jr., President of TWA, remarked, "Foreign governments often negotiate with the primary goal of providing economic advantages for their flag-carriers, while the United States frequently concentrates exclusively on obtaining liberal agreements."[263]

B. Congressional Criticism of "Open Skies"

Congressman Elliott Leviates (D-Ga.), who chaired extensive hearings on the subject in the early 1980s, concluded that U.S. negotiators

260. *Id.* at 64, 67 (statement of William A. Kutzke).

261. The rationale for this approach has been summarized as follows:

> [I]f the underlying policy differences can be resolved, not only will the specific operating problem be eliminated, but also the framework to avoid future confrontations on the same issue will have been constructed. In addition, by this expansion, some of the emotionalism surrounding individual issues can be dissipated, and a more dispassionate atmosphere created that may foster compromise and accommodation.

House Hearings on International Aviation, *supra* note 73, at 25 (statement of Frank C. Conahan).

262. Thomas F. Grojean, President of the Flying Tiger Lines, Inc., came close to calling U.S. negotiators "wimps":

> The foreign governments . . . are very perceptive as to how strong the U.S. government is going to react, and I think in the last several years they have perceived a weakness on the part of our Government in not really putting any teeth in the negotiations. So they feel they can get away . . . with disregard of any of the provisions of the original agreements that they so choose. . . . We need to convey a statement of, "we are not going to be easily regarded in our negotiations" and just get tough and show some teeth and foreign governments will recognize this change in attitude and there will be little need for any legislative changes.

House Hearings on International Aviation, *supra* note 73, at 417.

263. No. 96-56. Senate Comm. on Commerce, Science, and Transportation, Hearings on International Air Transportation Competition Act of 1979, 96th Cong., 1st Sess. 167 (statement of C.E. Meyer, Jr.). The Civil Aeronautics Board admitted as much in its *Benelux Exemptions Case*:

> [I]nternational air transportation is characterized with few exceptions, by strict limits on entry and cartel pricing. The exchange of air transportation rights has for the most part been conducted in an atmosphere of mercantilism, with countries attempting to gain as much as possible for their causes while giving up as little as possible to the carriers of the other. The air has been . . . a strict bilateral balance of accounts. . . .
>
> [D]uring the past the principles of free competition have clearly been reaffirmed in the U.S. negotiating strategy. The policy of our government is to trade liberalizations rather than restrictions, offering access to U.S. markets in return for guarantees of pro-competitive rules with respect to pricing, capacity, and other economic decisions by the carriers of all states.

CAB Order 78-9-2, at 6 (1978).

were often less prepared and more disorganized than their foreign counterparts and had frequently failed even to discuss their agenda with American industry and consumer representatives.[264] With respect to unfair competitive practices, the U.S. General Accounting Office found that the government had no system for receiving, monitoring, or processing the informal complaints of U.S.-flag carriers and that the industry was reluctant to file formal complaints because of inordinate time consumed by their processing and the potential for retaliation by foreign governments.[265] Moreover, there seemed to be a widely held consensus that the United States was pursuing its zealous dedication to "open skies" irrespective of its direct or indirect effects upon the economic health of U.S.-flag carriers. And having irritated so many foreign governments with its persistent insistence on an ideology most found ill-conceived, the United States appeared by many to shy away from further jeopardizing the "open skies" movement by acting forcefully to resolve U.S. carrier complaints of discrimination and anti-competitive behavior by foreign governments and their airlines. Signing another pro-competitive bilateral seemed to some to take higher priority than enforcing the fair opportunity to compete clauses in the ones which had already been concluded.

In August 1983, the Subcommittee on Investigations and Oversight of the House Committee on Public Works and Transportation issued a report which was sharply critical of U.S. implementation of international aviation policy. As to the "open skies" policy, the Subcommittee agreed with the U.S. airline industry that "we have been giving up routes and schedules of greater economic value than we have been getting. . . ."[266] It concluded that the United States should no longer "trade hard rights for soft rights."[267]

The Oversight Subcommittee also criticized the administration's attack on the International Air Transport Association:

> The IATA has been a multilateral forum for establishing airline fare structures for many years. Although it has its limitations, it still has the strengths of airline involvement in a multilateral forum to develop fare schedules subject to approval by the governments involved. the CAB show-cause order and the open skies policies have seriously undermined IATA and possibly caused the airlines and foreign governments to pursue nationalistic policies with respect to the United States—such as escalation in unfair and discriminatory

264. *House Hearings on International Aviation*, *supra* note 73.

265. *Id.* at 565.

266. Rep. No. 98-19, *Subcomm. on Investigations and Oversight of the House Comm. on Public Works & Transportation, Report on the Improvement Needed in the Implementation of the United States International Aviation Policy*, 98th Cong., 1st Sess. 14 (1983).

267. *Id.* at 17. The Committee also believed that the U.S. government should not "negotiate aviation rights for benefits in other economic sectors". *Id.*

practices.[268]

It therefore urged "a return to active participation in IATA and other international forums."[269]

But the Subcommittee's most pointed criticism was directed at the inability of U.S. negotiators to respond forcefully to problems of discriminatory and unfair competition practices in foreign markets.[270] It reminded the Administration of IATCA's insistence that such anticompetitive conduct not be tolerated and urged a firmer implementation of its mandate, including the imposition of unilateral sanctions where appropriate.[271] It also offered specific suggestions as to how U.S. negotiations might be more effectively conducted:

> It is clear that a much firmer position needs to be taken in international negotiations to insure that discriminatory practices are eliminated and valuable economic routes are not traded away. Our examination of these issues demonstrates that the agencies must improve the negotiating process through earlier and more intensive involvement of our flag carriers, improved agency technical capability, continuation of personnel and policy over time, and closer interagency coordination.[272]

In 1984, the ranking minority member of that Subcommittee, Congressman Guy Molinari (R-N.Y.), criticized the implementation of U.S. international aviation policy in still stronger language:

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268. *Id.* at 16.

269. *Id.* at 18.

270. The Committee found the implementation of U.S. aviation policy with respect to non-tariff barriers in international markets as virtually a failure in carrying out legislatively mandated policy:

> Our most obvious and most fully documented deficiency is in our failure to respond forcefully to foreign discriminatory and unfair competitive practices. As a result, there is not a fair and equitable market for our carriers in international transport. Airlines often pay higher prices for fuel. They often pay excessive user charges for landing fees, navigational fees, and comparable services that are either free or cost foreign airlines much less in the United States. They are denied full access to computer reservations systems in some countries. They must use inefficient and indigenous groundhandling crews in some countries. In several Asian countries, they can't get their revenues converted from foreign currenct to U.S. currency in a reasonable period of time.

Id. at 15.

271. Said the Committee:

> The Act is clear that discriminatory practices are not to be condoned and that our government is to develop firm policies to deal with them—including taking action against the other country's airline if such problems persist. [We believe] that a much firmer implementation of the Act is needed.

Id. at 16.

272. *Id.* at 17. *See* A. SAMPSON, *supra* note 2, at 46. Dr. Gertler summarized carrier participation in international aviation negotiations as follows:

> [Professor Lowenfeld points out that] "U.S. carriers are not parties to the negotiations, and indeed, often have disagreements among themselves." The industry is, of course, as a rule consulted and the representatives of its association may have observer status at negotiations. In the practice of other countries the situation as to consultations with the industry is similar with the notable difference that representatives of a national airline are usually full-fledged members of the delegation.

Gertler, *supra* note 43, at 797 [citation omitted].

> The international aviation negotiations conducted by the United States . . . have been terrible, to put it mildly. It appeared that we would give away anything in exchange for a signature on a piece of paper and even at that we were unconcerned about whether the other side lived up to the agreement that they had signed.
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> * * *
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> The hearings which took place in 1981 and 1982 held by this subcommittee made it abundantly clear that the United States was being viewed as a patsy by many foreign governments and that the attitude on the part of some of our negotiators was less than what could be desired.[273]

C. *The Emerging Role of the U.S. Department of Transportation*

There is some evidence, at least, that the Reagan Administration is taking a tougher stance on negotiating bilaterals and in ensuring a competitive environment free of discrimination and unfair methods of competition. The last Chairman of the Civil Aeronautics Board, Dan McKinnon, a Reagan appointee, noted the policy shift:

> [T]here is today, I believe, much greater concern within the U.S. Government for the long-term health of the U.S. aviation industry. We are now insisting [that] foreign governments live up to agreements they made in return for access to lucrative U.S. markets. U.S. aviation policy has stiffened with demands of a balanced quid pro quo in all future agreements.
>
> I feel confident in saying that the MOU with Korea signed in 1980, as well as several other agreements signed about that time with other countries in Asia could not have been negotiated or agreed to under U.S. aviation policy as it is being implemented today.[274]

With the sunset of the Civil Aeronautics Board on January 1, 1985, the remaining regulatory functions over aviation were transferred to the U.S. Department of Transportation, a cabinet-level Executive branch agency. Jurisdiction over international aviation was vested in DOT's Office of Policy and International Affairs, headed by Assistant Secretary of Transportation Matthew V. Scocozza. In addressing the American Bar Association in April 1984, Secretary Scocozza indicated that the Reagan policies in this area would differ from its predecessors:

> Over the past four and one-half years of the Reagan Administration, we have been facing reality—that is, dealing with the fact that most of our foreign trading partners are unwilling to lower constraints and allow competition to flourish. As a result, U.S. aviation negotiators have become very stingy with handing out or trading new economic rights to foreign airlines.[275]

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273. *House Hearings on U.S.-Korea Aviation*, *supra* note 259, at 5-6 (testimony of Rep. Guy Molinari).

274. *Id.* at 1256 (testimony of Dan McKinnon).

275. *DOT's Policy Leader Says U.S. Will Swap Rights for Less Foreign Regulation*, TRAFFIC WORLD, Apr. 29, 1985, at 45. He continued:

> There are several foreign governments wishing to obtain authority for their-flag airline to

While the United States may no longer be trading access to interior U.S. markets for pricing and operational flexibility, one negotiator noted that the reason may be simply that there are few new routes left to trade, all feasible markets having been given away to foreign carriers during the Carter Administration; "We can't just create a new Chicago-Zurich route."[276]

Prior to 1985, initial licensing, ratemaking and antitrust decisionmaking was vested in the U.S. Civil Aeronautics Board, an independent regulatory commission established in 1938 and comprised of five members, no more than a simple majority of whom could be members of a single political party.[277] Each was appointed by the President, with the advice and consent of the Senate, for multi-year overlapping terms, and none could be removed prior to the expiration of his term without cause. Congress intentionally placed the agency outside the Executive Branch of government to shield it from the political winds that blow down Pennsylvania Avenue.[278]

During the Watergate Hearings in 1973, evidence came to light of surreptitious airline contributions to Presidential candidates, and questionably motivated Presidential influence over the issue of lucrative international air routes. Senator Sam Ervin (D-N.C.) asked, "Is it not fair to say that if there is any industry in the United States which is peculiarly susceptible to express or implied pressure from people exercising governmental powers, it is the airlines?" George Spater, whose American Airlines had donated $75,000 cash to Nixon's Committee to Re-Elect the President [CREEP], admitted the truth of Sen. Ervin's hypothesis.[279] Shortly thereafter, Congress amended the Administrative Procedure Act with the Sunshine Act, which insists that federal administrative agencies

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operate to new U.S. cities, particularly in the south and southwest. Their desires to inaugurate service to Atlanta, Dallas/Forth Worth, and other points fit nicely with the desires of these communities to increase their access to the international marketplace and stimulate local economic growth. Their desires also dovetail with the DOT's view that international air service expansion should occur at cities other than the traditional gateways. We would like to promote inter-gateway competition, increase convenience for travelers and shippers while, at the same time, hopefully relieving congestion at JFK, Chicago, and Los Angeles. The only obstacle standing in the way to these developments is the unwillingness of foreign governments to loosen their regulation of U.S. airlines and provide a more flexible operating environment. The bottom line is simple: The U.S. Government is willing to deal when there is a real deal to be made.

Id.

276. Gordon, *U.S. Negotiators Face Complex Schedule of Bilateral Talks*, AV. WEEK & SPACE TECH., Feb. 11, 1985, at 43, 46.

277. *See The Rise and Fall of the Civil Aeronautics Board*, *supra* note 52.

278. For a discussion of the rationale for segregating the independent regulatory commissions away from the Executive Branch of federal government, *see generally*, Dempsey, *The Interstate Commerce Commission: Disintegration of an American Legal Institution*, 34 AM. U.L. REV. 1, 49-50 (1984).

279. A. SAMPSON, *supra* note 2, at 134.

hold virtually all their decisional meetings in public view.[280] And, in the Airline Deregulation Act of 1978, Congress sought to diminish Presidential influence over international operating authority cases by reducing his veto powers under section 80-1 of the Federal Aviation Act to disapproval "solely upon the basis of foreign relations or national defense considerations which are within the President's jurisdiction, but not upon the basis of economic or carrier selection considerations."[281]

With the execution of the Civil Aeronautics Board in 1985, its remaining responsiblities were vested in the U.S. Department of Transportation, a cabinet-level Executive branch agency quite close to the President. The agency's Secretary, and its Assistant Secretary for Policy and International Affairs are appointed by, and serve at the discretion of the President. Also, under the Reagan Administration, DOT, rather than the State Department, has been given the lead role in negotiating international aviation issues with foreign governments. The advantage of centralizing most of the nation's jurisdiction over international civil aviation in a single administrative agency is that pursuit of national policy can be effectuated more expeditiously, efficiently, and economically. While the agency's small staff was widely recognized as among the most talented and efficient in Washington, the five-member Civil Aeronautics Board rarely spoke with a single voice, and often collectively mumbled or stuttered. But centralization of vast power over an important infrastructure industry leads one to ask the rhetorical question: if power corrupts, does absolute power corrupt absolutely?

In promulgating the Civil Aeronautic Sunset Act of 1984, the House Committee on Public Works and Transportation expressed strong reservations about whether DOT would be properly shielded from Presidential political influence:

> Our concern has been that a Secretary of Transportation or a high-level political official in the Department would find it difficult to limit his or her focus on the statutory criteria. DOT Secretaries and Assistant Secretaries are high ranking political officials of the Executive Branch and have an interest in furthering their Administration's legislative and political programs.[282]

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280. 5 U.S.C. § 5526.

281. 49 U.S.C. § 1461. *See* Dempsey, *supra* note 53 at 434-36. Under the U.S. Supreme Court's doctrine announced in Chicago & Southern Air Lines, Inc. v. Waterman Steamship Corp., 333 U.S. 103 (1948), Presidential decisions under Section 801 are not subject to judicial review. *Waterman* has been criticized in Miller, *The Waterman Doctrine Revisited*, 54 GEO. L.J. 5 (1965); Whitney, *Integrity of Agency Judicial Process Under the Federal Aviation Act: The Special Problem Presented by International Route Awards*, 14 WM & MARY L. REV. 787 (1973); and Levitt, *Judicial Review of Foreign Route Orders Under the Federal Aviation Act*, 12 TRANSP. L.J. 102 (1980). The author adds his voice in opposition to the judiciary's self-imposed quarantine.

282. HOUSE COMM. ON PUBLC WORKS & TRANSPORTATION, CIVIL AERONAUTICS BOARD SUNSET ACT OF 1984, H. REP. NO. 793, 98th Cong., 2nd Sess. 9 (1984).

The U.S. Department of Transportation has responded to these concerns by promulgating rules seeking to vest initial decisionmaking on international aviation cases in semi-autonomous Administrative Law Judges (who must hold formal on-the-record hearings) and senior career officials, with review thereof by the Assistant Secretary for Policy and International Affairs and the President, either of whom may veto and remand the lower-level determination.[283]

Prior to 1978, section 801(a) of the Federal Aviation Act provided that the issuance of operating authority "to engage in overseas or foreign air transportation . . . shall be subject to the approval of the President."[284] Section 801(b) of the Act[285] provided that the President could disapprove action taken by the CAB under section 1002(j) thereof,[286] (*i.e.*, in the suspension, cancellation or rejection of rates governing foreign air transportation), provided that his "disapproval is required for reasons of the national defense or the foreign policy of the United States . . . ."[287] The differences in the statutory language concerning Presidential discretion over entry, on the one hand, and over rate determinations, on the other, suggested that the President held virtually unlimited discretion to reject the former, but that he could only reject the latter for reasons of national defense of foreign policy.

The United States Supreme Court, in *Chicago & Southern Air Lines, Inc. v. Waterman Steamship Cor.*,[288] concluded that Presidential decisions under section 801 were exempt from judicial review.[289] Although the *Waterman* doctrine has been criticized by numerous commentators,[290] Congress has not seen fit to amend the Act to rectify the problems arising as a result of this exemption from judicial scrutiny,[291] and the fed-

283. 50 Fed. Reg. 2374-80 (Jan. 10, 1985); 14 CFR Parts 300-326 (1985). *See generally*, D. SWEENEY, C. MCCARTHY, S. KALISH & J. CUTLER, JR., TRANSPORTATION DEREGULATION: WHAT'S DEREGULATED AND WHAT ISN'T 251 (1986).

284. 49 U.S.C. § 1461(a).

285. 49 U.S.C. § 1461(b).

286. 49 U.S.C. § 1482(j).

287. Section 801(b) was added as an amendment to section 801 in 1972. Pub. L. No. 92-259, § 2, 86 Stat. 95, 96 (1972).

288. 333 U.S. 103 (1948).

289. *Id.* This interpretation was based upon a construction of Section 1006(a) of the Civil Aeronautics Act, 49 U.S.C. § 646 (now 49 U.S.C. § 1486(a)), which provides for judicial review of any CAB order that is administratively final, "except any order in respect of any foreign air carrier subject to the approval of the President as provided in section 801 of this Act. . . ." Hence, it does not explicitly shield presidential decision under section 801 concerning U.S.-flag carriers engaged in foreign commerce.

290. *See, e.g.*, Miller, *The Waterman Doctrine Revisited*, 54 GEO. L.J. 5 (1965); and Whitney, *Integrity of Agency Judicial Process Under the Federal Aviation Act: The Special Problem Posed by International Airline Route Awards*, 14 WM. & MARY L. REV. 787 (1973). *See generally*, A. LOWENFELD, *supra* note 5, § 2.2 (1972).

291. However, Senator Howard Cannon proposed legislation in 1976 that would have re-

eral courts have consistently upheld the doctrine's applicability. The absence of "checks and balances" provided by judicial oversight in effect means that the real limits to Presidential discretion under section 801 are few: political pressure; the remote likelihood of Congressional action via statutory amendment; and the conscience of the Chief Executive.

In the Airline Deregulation Act of 1978, however, Congress amended section 801(a) to constrict the President's theretofore virtually unlimited discretion in route proceedings.[292] As a result of this amendment, he may now disapprove action in entry proceedings "solely upon the basis of foreign relations or national defense considerations which are within the President's jurisdiction, but not upon the basis of economic or carrier selection considerations."[293] To the extent that the amendment limits Presidential review to those instances in which overriding reasons of foreign policy or national defense require his intervention, it is to be applauded; it does not, however, explicitly permit judicial review to determine whether a Presidential decision of such a prescribed nature is in fact legitimate. Hence, the *Waterman* doctrine lives, and the judicial branch will presumably continue its unfortunate self-imposed quarantine.

Centralizing power over international aviation in a single agency may well enhance the ability of the U.S. government to respond promptly and more effectively to problems of discrimination and anticompetitive conduct in foreign markets. Let us so hope. But the lucrative value of many of the operating route, ratemaking, and merger decisions may one day tempt carriers to exploit their political leverage or the pecuniary appetite of weaker men in government to seduce favorable consideration. From the early days when Juan Trippe was building infant Pan American World Airways into a global empire, prudent corporate executives of U.S.-flag carriers have recognized that their fate would largely be dictated in Wash-

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pealed section 801 of the Federal Aviation Act. Citing the international arena as one of the primary areas of disappointment in airline regulation, he said:

> One need look no further than the disastrous meddling of the Nixon Administration in the Transpacific Route Proceeding to indicate that politics rather than U.S. air transport interests influenced key executive decisions. In the area of international negotiations, it took Congressional passage of the Fair Competitive Practices Act before the Executive exercised its duty to go to bat against outrageous discrimination against U.S. international airlines.
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> Even with enactment of that statute, the State Department has not dealt vigorously with the governments of Japan, the Soviet Union, the United Kingdom and the Netherlands in protecting U.S. air transport interests.

Henzey, *Cannon Vows Effort to Restore Confidence in Air Transport System*, Airline Rep., Dec. 6, 1976, at 1, 2.

292. Airline Deregulation Act of 1978, Pub. L. No. 95-504, 49 U.S.C. § 1461 (Supp. 1978).

293. *Id. See generally* HOUSE COMM. ON PUB. WORKS & TRANSP., AIR SERVICES IMPROVEMENT ACT OF 1978, H.R. REP. NO. 1211, 95th Cong., 2d Sess. 19 (1978); SENATE COMM. ON COMMERCE, SCIENCE & TRANSP., AMENDING THE FEDERAL AVIATION ACT OF 1958, S. REP. NO. 631, 95th Cong., 2d Sess. 227 (1978), Dempsey, *supra* note 53, at 434-36.

ington.[294] Even in an era of partial deregulation, government can ameliorate the pain of the downward curve of the market cycle when it so chooses, and must continue to dispense scarce resources among multiple applicants. While the *Benelux* model and the "open skies" ideology seek to reduce the government's role, it must be remembered that the overwhelming majority of nations still have rejected U.S. free-market initiatives and refused to consummate a *Benelux*-type bilateral. And many which would permit multiple entry simply lack the traffic base to support it. Hence, selection of one over another applicant remains a regulatory responsibility of the U.S. government in international aviation, and one which confers potentially vast pecuniary rewards.

So long as so many nations are unwilling to permit designation of more than a single U.S.-flag carrier on international routes, some administrative body will be required to designate which single carrier shall serve those routes. It is hoped that such decisions will remain free from the influences of partisan politics. The decisional body must remain semi-autonomous if political influences are to be avoided. If the integrity of such autonomy can be maintained, then the existence of such responsibilities over international transportation within the Executive Branch may not be wholly objectionable.[295]

VI. Conclusion

"Open skies" was implemented with the best of intentions. Its proponents insisted that increased competition would inure to the benefit of consumers by giving them the range of price and service options reflecting their votes of dollar approval in the marketplace; carriers would become more efficient as they responded to consumer needs; and the world's resources would be more efficiently allocated.[296]

Nevertheless, its method of implementation in the international arena was abrupt, brazen and wholly undiplomatic. The means chosen generated unnecessary hostility in an area of our foreign policy which had long been characterized by warm and friendly relations.[297] And "open skies" may have contributed to the severe economic injury suffered by many airlines operating in international markets.

Deregulation may have had positive effects during its initial years in domestic markets. But to assume that the same free market principles would work as well internationally, in an industry so dominated by govern-

294. *See* A. Sampson, *supra* note 2, at 44-45.

295. Dempsey, *supra* note 53, at 449.

296. *See* Hardaway, *Transportation Deregulation (1976-1984): Turning the Tide*, 14 Transp. L.J. 101 (1985).

297. *See* Dempsey, *The Role of the International Civil Aviation Organization on Deregulation, Discrimination, and Dispute Resolution*, 52 J. Air L. & Com. 529, 533-39 (1987).

ment ownership and subsidization, was to foster theory at the expense of reality. Moreover, even the initial successes of domestic airline deregulation have been called into question as it has matured, with the industry becoming increasingly concentrated,[298] and with levels of service and margins of safety deteriorating.[299]

The more cautious approach to liberalization of the Reagan administration is a welcome respite from the days of belligerent international economic policy. But one cannot help but be concerned that with the demise of the independent Civil Aeronautics Board on January 1, 1985, such vast powers over an industry so important to the national economy as international aviation is now centralized in an executive branch agency—the U.S. Department of Transportation.[300] One of the reasons the domestic industry has become so concentrated in such a remarkably short period of time is that DOT appears simply to have decided to abdicate its regulatory responsibilities, thereby fostering the Reagan administration's policy of less government.[301]

With such fanfare, we have entered this brave new world of liberalization in international aviation. But the metamorphosis is not yet complete. We must continue to weigh and balance the costs and benefits of this policy, and adjust its application to serve the public interest. The invisible hands of Adam Smith create one set of imperatives. The hand of government on the dial of regulation create another; if prudently employed, it can accentuate the benefits of market theory, while diminishing its costs, and foster public policy objectives beyond allocative efficiency. The international dimensions of aviation make it inevitable that government will continue to play a role, turning the dial to more regulation, or less, as public needs demand.

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298. *See* Moore, *U.S. Airline Deregulation: Its Effect On Passengers, Capital and Labor*, 24 J.L. & ECON. 1 (1986).

299. *See* Dempsey, *Transportation Deregulation—On a Collision Course?*, 13 TRANSP. L.J. 329 (1984); Dempsey, *Airline Deregulation's Hostile Skies*, Denver Post, Oct. 17, 1983, at 3B, col. 3; Dempsey, *Stormy Skies of Deregulation*, Chicago Tribune, Oct. 14, 1983, at 19, col. 1; Dempsey, *Affordability, Safety of Airlines May Suffer*, Los Angeles Times, Oct. 11, 1983, at 7, col. 1.

300. In creating independent regulatory agencies, it was the intent of Congress to establish a "body of experts . . . independent of executive authority, except in its selection, and free to exercise its judgment without the leave or hindrance of any other official or any department of the government." Humphrey's Executor v. United States, 295 U.S. 602 (1935). *See* Dempsey, *The Interstate Commerce Commission—Disintegration of An American Legal Institution*, 34 AM. U.L. REV. 1, 49-50 (1984).

301. Dempsey, *Consolidation a Destructive Trend*, Denver Post, Dec. 6, 1986, at 4B, col. 1; Dempsey, *Birth of the Monster Airlines*, TRAFFIC WORLD (Dec. 1, 1986), at 77; Dempsey, *Deregulation's Toll Is Rising*, Denver Post, Sept. 4, 1986, at 5B, col. 4; Dempsey, *Deregulated Skies Unfriendly to Small Airlines*, Rocky Mountain News, May 25, 1986, at 77, col. 1. *See also*, Dempsey, *Antitrust Law & Policy in Transportation: Concentration Is the Name of the Game*, 21 GA. L. REV. 1 (1987).