DePaul University

From the SelectedWorks of Brian Havel

2004

The Approach of Re-Regulation: The Airline Industry After September 11, 2001

Brian F Havel
Michael G Whitaker

Available at: https://works.bepress.com/brian-havel/56/

HEINONLINE

Citation:
Brian F. Havel; Michael G. Whitaker, The Approach of Re-Regulation: The Airline Industry after September 11, 2001, 2001 Issues Aviation L. & Pol'y 4101 (2001-2004)
Provided by:
Rinn Law Library

Content downloaded/printed from *HeinOnline*

Tue Apr 9 14:00:54 2019

-- Your use of this HeinOnline PDF indicates your acceptance of HeinOnline's Terms and Conditions of the license agreement available at https://heinonline.org/HOL/License

-- The search text of this PDF is generated from uncorrected OCR text.

-- To obtain permission to use this article beyond the scope of your HeinOnline license, please use:

Copyright Information

Use QR Code reader to send PDF to your smartphone or tablet device

[¶ 10,051]

The Approach of Re-Regulation: The Airline Industry After September 11, 2001

by Brian F. Havel and Michael G. Whitaker

On the morning of September 11, 2001, terrorists hijacked four commercial passenger airliners. Two of the planes crashed into the World Trade Center in New York City, killing over 5000 people and causing the collapse of both towers. A third plane crashed into the Pentagon in Washington, D.C., killing nearly 200 people. The fourth plane, likely heading to another target, crashed in western Pennsylvania, killing its crew and dozens of passengers. Responding to these attacks, the Federal Aviation Administration issued a Federal ground stop order on September 11, 2001, prohibiting all flights to, from, and within the United States. Airports did not re-open until September 13 (except for Ronald Reagan National Airport, which partially re-opened on October 4). Consumer demand for airline services, already in apparent recession, plummeted dramatically after the attacks. To address the financial survival of U.S. airline carriers in the aftermath of September 11, Congress passed and President Bush signed into law a package of measures to assist the airline industry to recover. What this assistance, and the conditions which attach to it, may portend for a deregulated airline industry is the subject of the following discussion.

Introduction

The terse wording of the statutory preamble to the new Air Transportation Safety and System Stabilization Act is chilling: the purpose of the legislation, signed by President Bush on September 22, 2001, is "[t]o preserve the continued viability of the United States air transportation system."[1] Barely more than two decades since the passage of the Airline Deregulation Act,[2] the paradigm of free market control of the U.S. airline industry has been visibly fractured. The purpose of this essay is to inspect the fault-lines of the fracture, evaluate their severity, and assess what these new manifestations of governmental regulation augur for the future of the industry. The analysis is inevitably synchronic, a necessary reaction to the suddenness of events. A longer perspective will tell how much of the industry's commercial agenda before September 11, 2001, including imaginative market-driven objectives like the new common transatlantic aviation area,[3] will survive America's new day of infamy.

Before inspecting the details of the new regulatory activity, we begin with a retrospective on the economic performance of deregulation and efforts in the last few years to ratchet back some of the discretionary freedoms awarded to the airlines under the original legislation. Having examined the Federal Government's legislative and administrative responses to the September 11, 2001 attacks, we then reflect on the implications of this recent and sudden burst of government intervention for the competing paradigms of free market deregulation and a priori governmental economic control.

Objectives and Achievements of Airline Deregulation: An Overview

While one should guard against hyperbole when recounting the economic performance of U.S. airline deregulation, the statistical evidence of a successful experiment is persuasive. Rather than a narrative retread of deregulation's history, we offer a capsule summary of the available evidence as it stood in 1998, the twentieth anniversary of deregulation:

- *Airline ticket prices were almost 40 percent lower than in 1978;*
- *The average fare per passenger mile was about 9 percent lower at small community airports, 11 percent lower at medium-sized airports, and 8 percent lower at large community airports;*

 ©2001, CCH INCORPORATED

- *Air carriers logged more than 5.7 billion passenger miles, more than twice the roughly 2.5 billion miles they flew in 1978;*
- *Airlines served approximately 600 million passengers, two and a half times as many as the 250 million carried in 1978; and*
- *Overall number of airline departures rose to over 8 million, a 63 percent increase in two decades.*[4]

The core legal principles of this "democratization" of airline travel can be simply expressed. The Airline Deregulation Act of 1978, signed into law by President Jimmy Carter on October 24, 1978, together with a number of later enactments,[5] provided for the complete deregulation of the nation's airline marketplace (but not of the international marketplace[6]) through the decontrol of prices, freedom of entry into and exit from the marketplace, freedom of mergers and alliances (subject to antitrust review), elimination of regulated service standards and requirements, and an end to a *priori* route authorization. Since 1978, the Federal Government's most significant regulatory role in the airline market-other than *ex post facto* antitrust supervision by the Departments of Justice and Transportation-has been to establish and monitor safety and security standards through the Federal Aviation Administration. Meanwhile, the aviation infrastructure, including airports and air traffic control, has remained under government control.[7]

In scoring the latest report card on deregulation, however, two additional factors should inform our assessment. These factors show the incompleteness of the deregulation experiment and the abnormality of the airline industry, and may indeed explain why the industry runs the constant risk of re-regulation. First, as the recent tragedy has magnified, the consumer price benefits of deregulation have not been matched by a record of industry economic success. Profitability in the U.S. airline industry has been at best marginal. In the last cyclical recession in the early 1990s U.S. airlines lost more money than the entire industry had earned collectively since the era of the Wright brothers.[8] The reasons for the airlines' economic frailty, including the particular difficulties of the major network carriers, have been canvassed elsewhere.[9]

A second additional factor also exposes one of the great ironies of the industry's latest twist of fortune. As noted above, the airline/airport security systems remain fully regulated by the Federal Government. The terrorist penetration of these systems has given the government an opportunity to resume some degree of economic intervention even though the airlines themselves committed no security breaches under Federal regulations. As John Nance ob-

serves in an accompanying essay, the airlines fully discharged their Federal mandate to resist a "designer enemy."[10]

Recent (Foiled) Attempts at Economic Re-Regulation

In recent years, there have been sporadic efforts to erode some of the liberties enjoyed by the airlines under economic deregulation. Various reasons and agendas have animated these efforts, but they spring from a concern that certain features of deregulation have led to higher ticket prices at hub airports and compromise or elimination of low-cost competition. The invention of the hub-and-spoke system, for example, which allowed U.S. air travel to move from linear routing to more efficient network systems,[11] has raised concerns about monopolistic pricing at hubs where only a single carrier provides most of the service.[12] Critics also claim that hubbing has also allowed large carriers to impose price and route pressure on start-up and smaller competitors.[13] Indeed, in response to complaints by smaller competitors, the Department of Transportation issued draft "guidelines" (which were subsequently withdrawn) that sought to inhibit an airline's competitive response to new entry by monitoring price and capacity ratios on certain routes with a view to possible enforcement action for anti-competitive (including predatory) behavior.[14] Associated with these attempts at limited price regulation, the quality of carrier service has also come under threat of regulatory scrutiny. For example, there have been several Federal legislative attempts to enact a so-called "passenger bill of rights."[15]

The airline industry, economically deregulated and yet flying on the public way, has found itself in an incongruous position. The government is now less likely than ever to cede its responsibility for regulating safety and security and for managing sky traffic. Accordingly, the industry will remain in uneasy equipoise between what it supposedly does control-the economic incidents of flying-and what it cannot. The pervasiveness of government, and the repeated pressures to restrict their economic liberties, make it hardly surprising that airlines have a strong lobbying presence in Washington, D.C. (a "mighty" lobby, in the tendentious epithet of a recent *New York Times* headline[16]). And there is no doubt that airline lobbying efforts to repel re-regulation have been largely successful.[17]

Public choice theory provides at least one paradigm to help explain this outcome.[18] As Gary Libecap has written, "all things being equal, those interest groups with great wealth, size, and homogeneity will have more resources to influence politicians regarding the assignment of property rights, more votes to attract attention to their demands, and more cohesion to be effective lobbyists."[19] Diffuse interests (individual consumers, for example)

 ©2001, CCH INCORPORATED

have little incentive to spend time and money to organize or become informed and therefore have very limited effective influence.[20] Concentrated interests (that is, producers or service providers), on the other hand, face lower organizational costs and have larger incentives to become organized and informed about regulations and therefore tend to have much higher effective influence.[21] Before September 11, 2001, the airlines, and more specifically the major carriers that comprise the Air Transport Association, clearly held the concentrated producer/provider advantage. Neither the smaller, lower-cost carriers nor the disparate elements of the passenger rights lobby, nor for that matter any motivated and cohesive group of legislators, presented a sufficiently persistent countervailing influence in favor of (some) economic re-regulation.

If the airlines have built their lobbying efforts to resist re-regulation, then their pitch for federal assistance was a conspicuous defeat for those efforts.

—Brian F. Havel and Michael G. Whitaker

The severely weakened financial condition of the airlines after September 11, 2001, has probably shifted the balance of influence for the foreseeable future. It is not enough to make the glib assertion, as some commentators have done, that securing an assistance package in the immediate backwash of the terrorist attack was itself an awesome demonstration of the power of the airlines' lobbyists.[22] If the airlines have built their lobbying efforts to resist re-regulation, then their pitch for federal assistance was a conspicuous defeat for those efforts. To succeed as a concentrated set of interests, the airlines needed at least the appearance of financial stability; without that, they faced a newly-concentrated Federal Government and could not expect to wield their former preponderance of influence. In these circumstances, even if winning the assistance package was a "master stroke,"[23] the outcome of the stabilization package carried the inevitable risk of invading the industry's zones of regulatory freedom. The industry pried open the federal purse, but certain re-regulatory encroachments could be expected in response. Given the short time available to craft the legislation, the encroachments were necessarily limited. But their presence signals concerns for the future of a deregulated industry. We turn now to consider the recent assistance package in greater detail.

The September 11, 2001 Legislative and Administrative Response

The Air Transportation Safety and System Stabilization Act of 2001 (hereinafter the "Stabilization Act" or the "Act") was an intensive and occasionally highly confidential collaborative effort among Congress, the Bush Administration, and airline executives.[24] Cobbled together in less than two weeks after September 11, 2001, the Act demonstrated a reactive resilience that many did not expect of the Federal Government, but also exposed the cancerous pathology of U.S. airline finances even before the attacks.[25] Crippled by airport closures, flight standstills, and a massive sapping of public confidence, the already weakened condition of the airlines prevented them from subsidizing their own economic model of flying above break-even capacity. Compounded by insurance woes and the likelihood of multi-billion dollar tort claims many times the value of even the largest airlines, a resurgence of the statist philosophy of *l'état capitaliste* seemed necessary to maintain the integrity of the mobile air transport system.[26]

The Stabilization Act

The Stabilization Act, coupled with two derivative orders of the Department of Transportation (DOT) and one derivative order of the Office of Management and Budget (OMB), form the (current) core of the Federal Government's regulatory response to the airline industry's financial woes in the wake of September 11, 2001. The Act has five titles, each responsive to a particular dimension of the prevailing crisis: disaster relief to support the industry, aviation insurance assistance, certain taxation adjustments, victim compensation measures, and a brief closing title (to be developed in subsequent legislation) committing the government to enhancing airline safety and security.[27] The opening title, providing for disaster relief, has attracted the most notoriety. Because it touches most directly on the future regrouping of the airlines, and (with the accompanying DOT and OMB orders) contains the most interesting features of a nascent re-regulation, the title on aviation disaster relief will be the principal focus of the present discussion.

Aviation Disaster Relief

The Act's financial assistance is a two-pronged instrument: five billion dollars is to be disbursed as aid for "direct losses" incurred as a result of the federal ground stop order (issued September 11, 2001) and for any incremental losses to December 31, 2001 that are the result of the terror attacks; an aggregate of ten billion dollars will be furnished in the form of federal credit instruments "subject

 ©2001, CCH INCORPORATED

to such terms and conditions as the President deems necessary."[28] The direct aid is being dispensed mechanically, allocating the monies according to recorded available seat miles for August 2001.[29] The two-thirds of the aid that is being allocated in the form of federal credit instruments will be administered through a newly-created Air Transportation Stabilization Board (the "Board") comprising the voting triumvirate of the Secretary of Transportation (or his designee), the Chairman of the Board of Governors of the Federal Reserve (or his designee), the Secretary of the Treasury (or his designee), with the nonvoting addition of the Comptroller General of the United States (or his designee).[30]

To qualify for federal credit assistance, an airline must convince the Board that credit is "not reasonably available" at the time of the proposed "transaction", the intended "obligation" (presumably the "transaction") is one that is "prudently incurred," and that the proposed "agreement" (presumably the "transaction" or "obligation") is "a necessary part of maintaining a safe, efficient, and viable commercial aviation system in the United States."[31] The drawbacks of hasty draftsmanship are manifest in statutory writing that uses three distinct terms (transaction, obligation, and agreement) to capture whatever it is, within the bounds of "prudent" spending, that airlines will be doing with the borrowed money. Moreover, the use of these terms suggests specific commercial events such as aircraft leasing or purchase; in reality, the aid will probably be used merely to sustain daily operations.[32]

The creation of an official financial oversight council, even one with a limited and specific mandate, is obviously a dramatic turnabout in the long march to a fully-deregulated free-market airline industry. It would hardly be surprising, in the political context of a desperate and unloved industry making a Chrysler-esque appeal to the coffers of the central government, that members of Congress would make intrusive re-regulatory demands on the industry. In the days preceding the final version of the Act, Congressional hearings were filled with siren calls for "de-monopolization" of hub airports and price caps on hub airport tickets, and the rhetoric of the stalled passenger rights campaign once again took the airlines to task for their perceived past arrogance.[33] In the end, time prevented the kind of detailed trade-offs that normal political lobbying produces. The intervention of New Jersey freshman Democratic Senator Jon Corzine, a former partner in Goldman, Sachs, did, however, spark a reprise of one of the key elements of the Chrysler rescue of 1979: in return for credit assistance, airlines may be required to enter contracts with the Board under which the government, contingent on the financial success of the assisted airlines, would "participate

in the gains of the participating [airlines] through the use of such instruments as warrants, stock options, common or preferred stock, or other appropriate equity instruments."[34]

Salary Caps and Route Oversight

As well as making the government a potential stakeholder in private airline corporations, the first title of the Stabilization Act features two other harbingers of a new paradigm of official intrusiveness. The first, contained in Section 104 of the Act, conditions Federal credit arrangements to airlines on a "legally binding agreement with the President" that, for the two years beginning September 11, 2001, caps the compensation (or severance pay) of officers or employees of the recipient carriers at 2000 levels if their total compensation package was in excess of $300,000 during that year.

The second signal of a tilt toward re-regulation is potentially more intrusive and unsettling. Economic deregulation, as conceived by the architects of the 1978 legislation, removed government control of prices, capacity, and route selection. Carriers, which previously had to apply for permission to serve all domestic routes and competed primarily on the basis of in-flight service, could now choose which routes to fly, how often, and at what fare.[35] If a route proved unprofitable, inefficient, or otherwise fell outside a matrix for successful business operations, the airline could discontinue service unilaterally and without the former regulatory precondition of an official certificate of discontinuance from the Civil Aeronautics Board.[36] Route flexibility could be said to be the core of deregulation, since complex and expensive route proceedings were so much the heart of the old regulatory apparatus.[37] If a carrier wanted Federal aid to serve smaller underserved communities, it could opt into the Essential Air Services (EAS) program established under the Airline Deregulation Act. As a program participant, the carrier would then subject itself to certain continuing restrictions on entry and exit.[38]

Section 105(a) of the 2001 Stabilization Act, *as least as it is written*, represents another apparent regulatory turnabout. The Section prescribes that the DOT Secretary "should take appropriate action to ensure that all communities that had scheduled air service before September 11, 2001, continue to receive adequate air transportation service and that essential air service to small communities continues without interruption." At the very least, the draftsmanship here is confusing. The statutory language is either an attempt to preserve the operating terms of the existing EAS program,[39] in which case it is a complete redundancy, or it is a poorly-written conflation of a *general* restriction on route exit with the specific (and statutory) restriction on route exit that has always character-

 ©2002, CCH INCORPORATED

ized the EAS. That the latter may be the correct reading is apparent from subsection (c) of Section 105, which states that, "[n]otwithstanding any other provision of law, the Secretary is authorized to require an air carrier receiving direct financial assistance under this Act to maintain scheduled service to any point served by that carrier before September 11, 2001," and to enter into agreements to ensure that outcome. Discretionary route exit, in other words, will be foreclosed to U.S. airlines if they accept "direct" financial assistance under the Stabilization Act (which means, presumably, only assistance granted under the first prong of the Federal Government's relief instrument), *regardless of whether any given route is part of the EAS infrastructure.* Moreover, the generality of the Secretary's power to "ensure that all communities" continue to have air service, *regardless of whether any given airline has received "direct" financial assistance under the Act,* appears to be conferred without restriction. On its face, this is re-regulation.

The DOT/OMB Orders

As Columbia's Peter Strauss has so tellingly elucidated, there is a fourth branch of the U.S. federal government, unmentioned in the Constitution, namely, the administrative or bureaucratic branch.[40] Congress worked quickly to finalize the Stabilization Act, but the interpretation and implementation of the Act's provisions (some of which, as noted above, are distinguished by inelegant and ambiguous drafting) rests initially, before any future court challenge, with quasi-independent agencies of government (*in situ,* the DOT, the DOT Office of Aviation Analysis, and the OMB).

The DOT issued Order 2001-9-18, *Airline Industry Conditions* (hereinafter "Airline Industry Conditions Order"), on September 28, 2001.[41] This Order directs the airlines to furnish detailed financial and operations data to the DOT's Office of Aviation Analysis; as we will see, the Order is a clear example of regulatory overreaching, since it is not grounded in any specific provision of the Stabilization Act. (As of the time of writing, it appears that the Order is under reconsideration by the DOT and may be formally rescinded and replaced by more conventional reporting requirements agreed between the DOT and the airlines; its relevance to the present essay is that it reveals a notable re-regulatory "instinct.") In an associated announcement, on October 5, 2001 the OMB issued Regulations for the Air Carrier Guarantee Loan Program under Section 101(a)(1) of the Stabilization Act (hereinafter "OMB Regulations"), which will take effect on October 11, 2001.[42] The OMB Regulations spell out in much more detail, and much more dramatically, how the Air Transportation Stabilization Board will discharge its au-

thority. Finally, the DOT issued Order 2001-9-20, *Reports on Significant Airline Service Reductions* (hereinafter "Service Reductions Order"), on September 27, 2001.[43] This second DOT Order seeks to implement the exit restrictions of Section 105 of the Stabilization Act; it reflects the apparent (and confusing) conflation of EAS and general exit standards that we noticed in its parent statute. We propose to consider each of these statutory instruments in turn.

DOT Airline Industry Conditions Order

The premise for this Order is not anything contained explicitly in the Stabilization Act. It is a *sua sponte* exercise of general administrative authority justified on the ground that "[the DOT] must be able to monitor industry developments and to use [its] authority as appropriate to alleviate recent industry problems, to provide advice and analysis to Congress, and to implement legislation enacted by Congress." To apply a categorical imperative of the U.S. Supreme Court, the Order is derived from the "penumbra" of the Stabilization Act. The Order does cite to earlier statutory authorization that allows the DOT Secretary to require air carriers to file periodic reports with his Office.[44]

The data required under this Order is broader than required under existing legislative and administrative reporting requirements, and is subject to a real-time requirement that is not present under existing periodic reporting obligations.[45] Moreover, some of the information being requested has not been previously solicited, for example, details of salary and compensation packages for executives and advance notice and information concerning potential employee furloughs. What is manifestly absent in these requirements is a reasoned demonstration of the connection between the onerous quantity of data demanded and the conditions of the disaster relief set forth in the Stabilization Act. In the Act, for example, the first of the two prongs of relief (the $5 billion direct grant) is conditioned only on calculation of a mechanical ratio of available seat miles. If, on the other hand, the Order applies solely only to the credit guarantee program (which cannot be gleaned from its text), the text does not explain whether the information demanded will be cross-referenced in any way with the separate reporting requirements of the Air Transportation Stabilization Board. Indeed, it is not stated in the Order whether the collection of data by the DOT Office of Aviation Analysis is in any way to be coordinated with the information that the Board will demand.

OMB Regulations

The OMB Regulations have been issued pursuant to Section 102(c)(2)(B) of the Stabilization Act, and are intended to implement the three conditions of eligibility for federal credit assistance

 ©2001, CCH INCORPORATED

prescribed in that subsection (the airline must not have similar credit reasonably available, the obligation must be prudently incurred, and the obligation must be a necessary part of maintaining a safe, efficient, and viable commercial aviation system).[46]

The OMB Regulations are, as might be expected, considerably more detailed than the originating legislation. Viewed through the prism of re-regulation, some aspects of the Regulations are especially pertinent. An applicant carrier must submit itself to intensive financial scrutiny by an independent auditor; but this scrutiny will persist not only during the period when the loan is outstanding but for three years *after* payment in full of the guaranteed loan as the Board deems appropriate (potentially a period of a decade, given the seven-year loan payback period included in the Regulations).[47] Strict scrutiny includes untrammeled access to the financial and operational affairs of the applicant to the extent considered "necessary" by the Board or the Comptroller General.[48] More specifically, an application must be accompanied by copies of financial evaluations and forecasts concerning air service operations that were prepared by or for the air carrier within the three months prior to September 11, 2001.[49]

The notion of a government-mandated stakeholding in exchange for credit assistance is clarified under Section 1300.10 of the Regulations, which provides that "the Board shall not accept an equity interest in an air carrier that gives the Federal Government voting rights." This apparent reluctance to have blocks of voting stock in the hands of the government, however, does not vitiate the Act's explicit expectation that the Board may participate in the financial success of the air carrier through warrants, stock options, common or preferred stock, or other equity instruments. Nowhere in the Regulations is there any indication as to how the Board might configure the government's expectation of participation nor, indeed, is there any signal that the Board will typically *require* carriers to meet that expectation. Although, for example, the OMB Regulations state the required elements of a carrier's business plan which must support the request for credit assistance,[50] there is no mention among these elements of any prerequisite of government participation. Nonetheless, among the Board's preferred evaluative criteria for loan guarantee approval is a demonstration that the proposed loan instruments would ensure that the Federal Government would participate in the gains of the air carrier and its security holders.[51] The Regulations, therefore, are more circumspect than the legislation; while the Act confers a general permissive authority on the Board to seek Federal Government participation, the Regulations are structured to place the onus on the carriers, rather than on the

Board, to initiate any such proposal. The OMB, in this reading, strikes a small clawback victory for deregulation.

The drafting of the OMB Regulations played out as a mini-drama among the major airlines. A *samizdat* version of the Regulations, in fact, leaked from the OMB and circulated on the Internet a day prior to the final version. The unauthorized version contains several examples of bracketed unfinalized terms (for example, payback terms to be either three or seven years; Board guarantees not to exceed a range of between 80 and 95 percent of the amount of principal and accrued interest on loans to air carriers[52]), and an eligibility criterion that excluded bankrupt carriers. If one reflects that the final Regulations uniformly favored the more lenient options (a seven-year loan payback period, Board guarantees to be less than 100 percent of principal and interest,[53] bankrupt carriers to be eligible provided that the underlying financial obligation were part of a court-certified reorganization plan[54]), then one can easily surmise which carriers prevailed. Delta, for example, insisted publicly that there should be tight restrictions and a short repayment period, so that the credits would be seen as "transitional" rather than "a long-term underpinning for the industry."[55] Less financially confident airlines like Continental and Northwest clearly sought (and won) more lenient terms. Amidst all the recent turmoil, it appears, some of the spirit of competition still persisted.

Service Reductions Order

As airlines began to cut capacity and eliminate routes to cope with the aftermath of September 11, 2001, the Federal Government used its financial resources to impose new leverage over airline route choices. As noted earlier, the Stabilization Act on its face appears to recapture for the government some of the discretionary route exit authority that the airlines have enjoyed under deregulation. Given the absence of any sunset proviso in the Act, this intrusion of the Secretary of Transportation into route entry and exit may be the most significant re-regulatory action taken after the September 11, 2001 attacks. Moreover, the confusion spawned by the new Act, as we have seen, results from conflation of the objectives of the small community services program, the EAS, with a broader attempt to check the play of market forces in the national air transport system as a whole. As we noted, also, the Secretary's authority to maintain pre-existing air services appears to be linked to, although is not absolutely determined by, the receipt of direct financial aid.

The DOT's Services Reduction Order, however, resists these ambiguities of the statute and instead rests most of its entire regulatory authority on the scope of the small community service

 ©2001, CCH INCORPORATED

program created by 49 U.S.C. 41731 *et seq.*[56] Although the statute envisages that the DOT Secretary will ensure that all scheduled air services before September 11, 2001, are maintained, the Order is less definitive and seems designed to have an informational and advisory focus, requiring airlines to supply advance notice (as well as notice of changes announced or implemented since September 11, 2001) on plans "to substantially reduce or end a community's domestic scheduled passenger service."[57] It is not stated what the DOT will do with the information supplied, but presumably it is in support of some further, undetermined action by the Secretary to use his general statutory power to continue or maintain service (including entering into agreements with the airlines to continue or maintain service). Further, and again in variance from the open-ended term of the Stabilization Act, the "reporting requirement," as the Order characterizes this obligation, will expire as of December 31, 2001 (although it may be renewed "if that appears necessary").

It seems, therefore, that the powers claimed in the Stabilization Act to restrict route exit have only been contingently exercised through the Order. Nonetheless, the text of the Order suggests that the DOT believes that it is carrying out its conventional and circumscribed functions under the EAS program, while Congress, which enacted the Secretary's general exit power "notwithstanding any other provision of law," evidently contemplated a broader (and more intrusive) mandate. Whatever the legislative provenance, airlines no doubt will cooperate in good faith with the reporting requirements in order to claim the awarded assistance. But they will do so under cloudy statutory language that (should the DOT so interpret it) holds the potential for much more invasive governmental supervision of their route and capacity choices.

The U.S. Airline Industry After September 11, 2001: Whither Deregulation?

According to correspondent Laurence Zuckerman of *The New York Times*, the perceived impact of the Stabilization Act, and particularly of the creation of the Stabilization Board, is that "the federal government is taking on its biggest role in shaping the nation's airlines since the industry was deregulated a generation ago."[58] The creation of the new Stabilization Board, for however limited a duration and however defined a purpose, does appear to permit the Federal Government to become involved in a task that advocates of deregulation assigned solely to the marketplace: to pick winners and losers.[59] On the strength of the evaluative criteria in the OMB Regulations (including, as we have seen, indications of

how closely the government can benefit from future airline gains through stock or warrant participation), the Board can help a weakened carrier to survive or doom its prospects in the near-term. The Comptroller General of the United States, David M. Walker, a nonvoting Board member, stated that it was "clear" that "the Board will have a considerable amount of discretion"[60] If this is a kind of postmodern industrial policy, it is highly unpredictable in its implications. The government, through its sudden largesse, can assert itself as an industry "czar," in the characterization used by former Secretary of Labor Robert Reich,[61] making endless numbers of big and small decisions that will affect the financial and operational destiny of all of the airlines.[62] As discussed above, just the reporting requirements imposed by administrative fiat are exponentially different, because of their real-time effect, from the periodic and limited reporting previously required.

Some commentators deny that the post-September 11, 2001 assistance package prefigures any economic re-regulation of the industry. In this view, the psychology of Congress, although plainly containing an element of irritation with perceived past arrogance, has not evolved into a new regulatory mind-set that would undo the accomplishments of the 1978 Act and its subsequent history. That is certainly the optimistic view. The psychological consequences could also cut the other way: the industry is in thrall to federal beneficence, and Congress (and the administrators) may feel that other interventions to "correct" the perceived imbalances of deregulation may be warranted before the government again departs the stage. If the result of the Stabilization Board's performance is to cause further consolidation in the industry, one or more of the earlier re-regulatory efforts (including capping of prices and market shares at hub airports) could gain a stronger Congressional foothold. The airlines' Washington presence, which in the past has persuaded Congress (for example) to favor private codes of conduct in place of official regulation of passenger rights, may not hold the same sway when the airlines have been dependent on the federal treasury for their very survival.

The Board is the most conspicuous re-regulatory feature of the new legislation, but its specific duration and purpose means that it is not necessarily the most threatening for deregulation. Our close inspection of the "rescue" instruments has revealed the more persistent intrusion to be the new and open-ended discretion apparently enjoyed by the Secretary of Transportation with respect to route exit. Flexibility of route entry and exit, together with pricing and capacity freedom, comprise the triad of economic liberties that have sustained airline deregulation. However diluted the DOT's Airline

 ©2001, CCH INCORPORATED

Service Conditions Order may appear (its present reach, as we noted, extends only to reporting requirements), it cannot disguise the sweeping authority claimed in its originating legislation. Given the applicability of the venerable "last-in-time" doctrine, under which the Supreme Court has ruled that the most recent legislation prevails over any prior enactments in the event of inconsistency,[63] the Stabilization Act manifestly trumps the 1978 Deregulation Act on the subject of route exit. To us, this seems the most unsettling fault-line in the fracturing of deregulation that we have been discussing in this essay. And it is the one that holds the most potential to expand.

Brian F. Havel is Associate Professor of Law and Vice President of the International Human Rights Law Institute at DePaul University College of Law. Since 1998, he has served as chair of the CCH Aviation Law Advisory Council. Michael G. Whitaker is Vice President for International and Regulatory Affairs with United Airlines, Chicago and is also a member of the CCH Aviation Law Advisory Council. The views expressed in this essay are those of the authors and do not necessarily reflect the corporate opinion of United Airlines. *The authors are very grateful to Andrew C. Eastmond, J.D. (DePaul 2000) for his assistance in researching and editing this essay.*

[The next page is 4117.]

Endnotes

[1] H.R. 2926, 107th Cong. (2001)(enacted).

[2] *See generally* LEGISLATIVE HISTORY OF THE AIRLINE DEREGULATION ACT OF 1978, compiled by the Committee on Public Works and Transportation, U.S. House of Representatives, May 1979.

[3] *See generally* Association of European Airlines, TOWARDS A TRANSATLANTIC COMMON AVIATION AREA, AEA Policy Statement (Sept. 1999).

[4] *Source:* Adam D. Thierer, HERITAGE FOUNDATION, 20TH ANNIVERSARY OF AIRLINE DEREGULATION: CAUSE FOR CELEBRATION, NOT RE-REGULATION 5-10 (1998). A number of studies confirm the findings of the Heritage Foundation Report: see, *e.g.*, U.S. General Accounting Office, *Airline Deregulation: Changes in Airfares, Service and Safety at Small, Medium-sized and Large Communities*, GAO/RECD-96-79, April 1996, and Steven A. Morrison and Clifford Winston, THE EVOLUTION OF THE AIRLINE INDUSTRY (1995).

[5] *See supra* note 3.

[6] *See* Havel, IN SEARCH OF OPEN SKIES: LAW AND POLICY FOR A NEW ERA IN INTERNATIONAL AVIATION 154 (1997)(discussing Congressional attempts to export some of the principles of domestic airline deregulation to the international market).

[7] *See* Thierer, *supra* note 5, at 5.

[8] See Air Transport Association, Earnings Summary 1938-2000 (last modified July 12, 2000), <http://www.air-transport.org/public/industry/display1.asp?nid=1034>

[9] In 1993, the industry's economic and structural frailties were thoroughly examined by a blue-ribbon commission appointed by President Bill Clinton when the airline industry was struggling to resist a cyclical downturn. *See Change, Challenge and Competition: The National Commission to Ensure a Strong and Competitive Airline Industry*, Aug. 1993.

[10] John J. Nance, *Denial of Access: Hardening Our Defenses Against Terrorist Manipulation of Commercial Aircraft*, ISSUES IN AVIATION LAW AND POLICY (CCH), ¶ 5051 (Oct. 2001).

[11] *See* Havel, *supra* note 7, at 201 *et seq.*

[12] *See generally* Office of the Assistant Secretary for Aviation and International Affairs, Domestic Aviation Competition Series, *Dominated Hub Fares* (Jan. 2001).

[13] *See generally* DOT, ENFORCEMENT POLICY REGARDING UNFAIR EXCLUSIONARY CONDUCT (63 Fed. Reg. 17919 (1998): FINDINGS AND CONCLUSIONS ON THE ECONOMIC, POLICY, AND LEGAL ISSUES, Dkt. OST-98-3713 (Jan. 17, 2001).

[14] *See id.* (withdrawing proposed guidelines).

[15] *See, e.g., Fair Treatment of Airline Passengers: Hearing on S. 383 Before the Subcomm. on Aviation of the Senate Comm. on Commerce, Science and Transp.* (1999) (statement of Nancy E. McFadden, General Counsel, U.S. Department of Transportation)(discussing the Clinton Administration's Airline Passenger Fair Treatment Act), and Air Transport Association, *ATA Airlines Announce Customer Service Plan, <http://www.airlines.org/public/news/display2.asp?nid=268>* (setting forth a compromise proposal adopted by the ATA in place of Federal intervention).

[16] See Leslie Wayne & Michael Moss, *Bailout for Airlines Showed the Weight of a Mighty Lobby,* N.Y. TIMES, Oct. 10, 2001, at A1.

[17] A glance at the opensecrets.org website, which monitors political campaign financing, reveals that airlines are not among the top ten industries engaged in Congressional lobbying activities. This is curious; the top of the list is dominated by utility industries that have historically attracted intense public regulation (electricity, oil and gas, telecommunications). The airlines, as this essay emphasizes, have had the complex status of a deregulated "public utility" still cocooned in a giant web of regulation.

[18] James Buchanan (winner of the Nobel Prize in Economic Science (1986)) and Gordon Tullock are credited as the primary architects of public choice theory. Their book, THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF A CONSTITUTIONAL DEMOCRACY (1962), is still considered the seminal work in this field.

[19] John E. Richards, *Toward a Positive Theory of International Institutions: Regulating International Aviation Markets,* INT'L ORG., Winter 1999, at 10.

[20] *See id..*

[21] *See id.*

[22] *See* Wayne & Moss, *supra* note 17 (quoting commentators).

[23] Wayne & Moss, *supra* note 17.

[24] Organized labor played no part in the negotiations once it became clear that the assistance package would not extend to protection for airline employees. *See* Wayne & Moss, *supra* note 17.

[25] See Michael Arndt et. al., *Suddenly Carriers Can't Get off the Ground,* BUS. WK., Sept. 3, 2001, at 36 (discussing the precarious state of airline finances before the attacks).

[26] The irony of these developments has not been lost in Europe. The European airlines have made their own requests for public financial support, citing the U.S. experience to show that the American antitrust philosophy of supporting "competition" but not competitors (borrowed by the European Union in its airline liberalization program) has been sidelined by a European-style statist industrial policy of subsidization and bailout. National government airline subsidies, which had been subject to strict scrutiny and progressive elimination by the European Commission, have resurfaced as several EU carriers, including Aer Lingus,

©2001, CCH INCORPORATED

Olympic, and Sabena, face imminent financial collapse. Sabena declared bankruptcy on October 3, 2001, the Belgian government provided a $115 million bridge facility for one month to salvage at least part of the stricken flag carrier. For the general public in Europe, the most startling casualty of recent events has been Swissair, Switzerland's prestige flag carrier and often regarded as setting the gold standard in international airline travel. Switzerland is not an EU member, and is not yet bound by the EU's subsidy rules. On October 3, 2001, the Swiss government agreed to lend Swissair $280 million to pay back fuel bills, airport charges, and other costs, allowing the airline to resume flying after a deeply embarrassing total shutdown of services a few days previously. Elizabeth Olson & Paul Meller, *Governments Intervene to Prop Up Ailing Airlines*, N.Y. TIMES, Oct. 4, 2001, at W1. On October 10, 2001, the European Commission decided to allow EU member states to compensate carriers for revenue lost immediately after the September 11 terrorist attacks. However, Transport and Energy Commissioner Loyola de Palacio explicitly rejected any other government aid to carriers within the EU and expressed her disapproval of the Swiss government's decision. Paulo Prada *et al.*, *Airlines Praise EU Opposition To Financial Aid For the Industry*, WALL ST. J., Oct. 11, 2001, at A14.

[27] *See* H.R. 2926, *supra* note 1.

[28] *Id.* at tit. 1 § 101(a).

[29] *See id.* at § 103(b).

[30] *See id.* at § 102.

[31] *Id.* at § 102(c)(1).

[32] *But see* Office of Management and Budget, *Regulations For Air Carrier Guarantee Loan Program under Section 101(a)(1) of the Air Transportation Safety and System Stabilization Act*, to be codified at 14 CFR Part 1300 (2001), at § 1300.17 (b)(indicating that continuing debt service will not qualify for Federal credit assistance).

[33] *See* David Phinney, *Airlines Plead for Billion [sic] Relief Package*, STATES NEWS SERV., Sept. 19, 2001 (noting that Senator Fritz Hollings (D-S.C.) was a particularly vocal proponent of these re-regulatory issues).

[34] H.R. 2926, *supra* note 1, at tit. 1 § 102(d). *See also* Greg Hitt *et al.*, *Airline Bailout May Become Boon for U.S.*, WALL ST. J., Oct. 9, 2001, at A2.

[35] *See generally* Havel, *supra* note 7 at 89 *et seq.*

[36] The requirement for CAB permission to abandon or exit a route was formally abolished when the agency's route authority sunsetted on December 31, 1981. *See* 49 U.S.C. app. 1551(a)(1)(D)(1979).

[37] *See* Havel, *supra* note 7, at 136 (discussing lengthy CAB route proceedings).

[38] For the legislative details of the EAS program, *see* 49 U.S.C. § 41731-41742.

[39] But there is no reference in Section 105(a) to the formal title of the program. Section 105(b) of the Stabilization Act does, however, appropriate an additional

$120 million to the EAS program (using its correct statutory reference) for fiscal year 2002, evincing a clear understanding that the EAS program is indeed implicated in the Act's arrangements.

[40] *See* Peter L. Strauss, *The Place of Agencies in Government: Separation of Powers and the Fourth Branch*, 84 COLUM. L. REV. 573 (1984).

[41] DOT Dkt. No. OST-2001-10709 (Sept. 28, 2001).

[42] For a complete citation to the Regulations, *see supra* note 33.

[43] DOT Dkt. No. OST-2001-10711-1 (Sept. 27, 2001).

[44] *See* 49 U.S.C. 41708.

[45] *See, e.g.*, Attachment B to the Order, which calls for production of "any routine report already being prepared by an airline . . ."

[46] The OMB Regulations have been issued without the typical administrative law due process precaution of a prior period of public comment. Section 553(a) of the Administrative Procedure Act exempts from its rule-making requirements those agency actions that concern "loans, grants, benefits, or contracts." 5 U.S.C. § 553(a). According to the OMB, the Stabilization Act loan guarantee program "falls squarely within this exception to the requirements otherwise imposed by section 553." OMB Regulations, *supra* note 33, at 2-3.

[47] *See* OMB Regulations, *supra* note 33, § 1300.11(4).

[48] *See id.* at § 1300.11(5).

[49] *See id.* at § 1300.16(7).

[50] *See id.* at § 1300.16(b)(8).

[51] *See id.* at § 1300.17(b)(4)(iv).

[52] An editorial note in the unauthorized version of the regulations comments that the "steel loan regulations have an 85 percent ceiling."

[53] *See* OMB Regulations, *supra* note 33, at § 1300.14.

[54] *See id.* at § 1300.11(2).

[55] Statement of Leo F. Mullin, chairman, Delta Air Lines; *see* Laurence Zuckerman, *U.S. Takes Big Role in Airlines Crisis*, N.Y. TIMES, Oct. 4, 2001, at A1.

[56] *See supra* note 39 for appropriate statutory references. The Order also speaks in vague terms of the DOT's "overall responsibility to monitor industry conditions, advise [C]ongress on industry developments, and implement Congressional legislation [including the Stabilization Act]." No specific provision of the Stabilization Act is cited.

[57] In particular, a carrier must give fifteen days notice before 1) a termination of all scheduled service by a U.S. airline at a U.S. community; 2) a termination of the last nonstop service in a domestic market, or 3) a reduction of service at a U.S. community if the total available seats or flights linking that community with FAA-designated hubs will be reduced by 33 per cent or more during a ninety-day period.

[58] Zuckerman, *supra* note 56.

©2001, CCH INCORPORATED

[59] This is almost certainly going to happen. The OMB Regulations, for example, clearly discourage a condition of bankruptcy protection or receivership and put pressure on airlines in bankruptcy to ensure that the Board's guarantee and the underlying financial obligation are part of a bankruptcy court-certified reorganization plan. *See* OMB Regulations, *supra* note 56, at § 1300.11(a)(2). The eligibility criteria, and the obvious disfavor of insolvency, may prompt some carriers to forego bankruptcy in the hope of using the credit assistance program to preserve their viability. That fact alone, if it happens, distorts the play of market forces.

[60] Zuckerman, *supra* note 56.

[61] Zuckerman, *supra* note 56, at C5.

[62] Congress did, however, make clear that it did not intend the rescue package to act as a lifeline for carriers that were already in financial jeopardy before September 11, 2001. *See* Zuckerman, *supra* note 56.

[63] *See, e.g.*, The Head Money Cases, 112 U.S. 580 (1884).

[The next page is 4151.]