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DEREGULATION OF THE UNITED STATES SYSTEM OF GOVERNMENT REGULATION OF DOMESTIC CIVIL AVIATION SEEN IN LIGHT OF THE OVERALL STRUCTURE OF INTERNATIONAL CIVIL AVIATION

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INTRODUCTION

THE PRIMARY aim of this article is focused on a published report submitted by a specially appointed staff of the Civil Aeronautics Board (CAB) in July, 1975.¹ The Report examined the necessity of, and submitted certain detailed proposals for, regulatory reform of the United States system of governmental regulation of domestic civil aviation. Some of these regulatory proposals have taken the form of legislation submitted to Congress by President Gerald Ford.² When one considers the impact of the CAB special staff Report on the overall structure of international civil aviation, it should be kept in mind that the report, in principle, only applies to United States *domestic* civil aviation; for, it states explicitly: "The study has not focused on international air transportation, where the institutional and legal framework is of an entirely different nature."³

The United States policy solely with respect to *international* civil aviation forms the subject of a separate study which is currently being conducted by the Departments of State and Transportation.

First, this article will attempt to provide a survey of the presently existing system of government regulation of international civil aviation. This survey will be followed by an analysis of a possible application of the main regulatory proposals as suggested by the CAB Report to the field of *international* civil aviation. More specifically, a study will be made of how the deregulation proposals of the CAB Report might be applied to or influence two fields of government regulation of international civil aviation, *i.e.*, international capacity reduction agreements and international rate-making.

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¹ CAB, REGULATORY REFORM: REPORT OF THE CAB SPECIAL STAFF (1975) [hereinafter cited in text and notation as REPORT]. The Report was never formally endorsed by the entire Board.

² Aviation Act of 1975, H.R.10261, 94th Cong., 1st Sess. (1975). Similar deregulation measures were proposed by President Gerald Ford to Congress with respect to interstate trucking and bus transportation. N.Y. Times, Nov. 14, 1975.

³ REPORT, *supra* note 1, at 17.

THE PRESENT SYSTEM OF GOVERNMENT REGULATION

The present system of government regulation of international civil aviation is the result of historic events which took place at Chicago in 1944, and at Bermuda in 1946.⁴ At the invitation of the late President Franklin D. Roosevelt, an International Civil Aviation Conference was held at Chicago from November 1 through December 7, 1944. The purpose of the Chicago Conference was to draw up a "blueprint" for the regulation of postwar international civil aviation, and produced sufficient results to be termed a tremendous success in the technical field of international civil aviation. In the economic field of international civil aviation, however, the Chicago Conference produced very little. The key civil aviation powers at the end of World War II, the United States and the United Kingdom, represented two widely separated and extremely adverse viewpoints as to the economic operation of such proposals, making compromise almost an impossibility, at least at that time.

However, it was possible to achieve a certain amount of progress in other satellite areas resulting in the production of a few main documents by the Chicago Conference: the Convention on International Civil Aviation, commonly called the Chicago Convention, the International Air Services Transit Agreement and the International Air Transport Agreement.⁵ The International Civil Aviation Organization (ICAO) was also created by the Conference.

The central economic provisions produced by the Chicago Conference are contained in Articles 5 and 6 of the Chicago Convention and further in the Transit and Transport Agreements. In Article 5(1) of the Chicago Convention, contracting parties agree to exchange on a multilateral basis the rights of overflight and technical stops for nonscheduled international air services. These rights of overflight and technical stops are generally known as the first and second freedoms of the air.⁶ In Article 5(2), States exchange the rights to carry traffic in nonscheduled international air services between their respective territories, and beyond that from the territory of a third State to the territory of a contracting Party and *vice versa*

⁴ See Baker, *The Bermuda Plan as the Basis for a Multilateral Agreement*, in I. CHAYES, T. EHRlich, & A. LOWENFELD, *INTERNATIONAL LEGAL PROCESS*, 498 (1968). See also 1 McGill University, *THE PUBLIC INTERNATIONAL LAW OF AIR TRANSPORT, MATERIALS AND DOCUMENTS* 245 (1974).

⁵ See INTERNATIONAL CIVIL AVIATION CONFERENCE, *FINAL ACTS AND APPENDICES*, ICAO Doc. 2187 (Chicago, 1944).

⁶ The terminology "freedoms of the air" seems to have originated with the Canadian delegation at the Chicago Conference. For State A, "freedom 1" is the privilege of flying over the territory of State B without landing; whereas "freedom 2" is the privilege of landing in State B for technical purposes only.

on a multilateral basis. These latter rights, the true *traffic* rights, are generally known as the third, fourth and fifth freedoms of the air.⁷ Article 5(2), however, contains so many restrictions and exceptions that it has become for all practical purposes an entirely dead letter. Therefore, it can be said that Article 5 of the Chicago Convention remains limited to a multilateral exchange of the first two freedoms of the air for nonscheduled international air services.

Article 6 of the Chicago Convention expressly denies any multilateral grant of commercial rights for scheduled international air services. For scheduled international air services the first two freedoms of the air are exchanged on a multilateral basis in the above-mentioned Transit Agreement. Both the Chicago Convention and the Transit Agreement have been very widely ratified and, read together, they form a multilateral exchange of the first two freedoms of the air for both scheduled and nonscheduled international air services. The Transport Agreement produced at Chicago was meant to give multilateral exchange of the third, fourth and fifth freedoms of the air for *scheduled* international air services. Due to lack of ratification, however, the Transport Agreement, like Article 5(2) of the Convention, has been rendered useless and of little effect.

In the economic field, the end result of the Chicago Conference can thus be said to be limited to a multilateral exchange of the first two freedoms of the air, the freedoms of overflight and stops for technical purposes. No agreement was reached with respect to the exchange of the much more important third, fourth and fifth freedom traffic rights. Also, the issues of tariffs and capacity—the amount of traffic to be carried between States—found no solution at Chicago.

The above-mentioned diametrically opposed economic views of the United States and the United Kingdom were the main reason for the failure to reach an agreement. At the time of the Chicago Conference, the United States strongly favored a system of free competition for international air transport, with no capacity and tariff controls or limitations in international air transport. The United Kingdom on the other hand, was of the opinion that there should be strict governmental economic regulation of international air transport through an intergovernmental organization, the so-called International Air Authority. That authority would have been empowered, *inter alia*, to determine international air routes, capacity

⁷ For State A, "Freedoms 3, 4 and 5" are: (3) the privilege to set down in State B traffic picked up in State A; (4) the privilege of picking up in State B traffic destined for State A; (5) the privilege of picking up or setting down in State B traffic which is destined for or has come from State C.

and tariffs. The British and American viewpoints accurately reflected the economic situation of the airline industry in the United Kingdom and the United States at the end of the Second World War. The British airline industry, like that of most other European countries, had been almost completely destroyed during the war, whereas the American airline industry could at the end of the war dispose of large numbers of readily available aircraft. Under those circumstances, a system of free competition was definitely more favorable to the United States' airline industry, and it was exactly this competition from the United States' airlines industry from which the British sought protection. They intended to protect their weakened airline industry through international regulatory machinery which would give each country a "fair share" of the international air traffic.

A way out of the impasse was not found until early 1946, when American and British authorities met at Bermuda for bilateral aviation negotiations. As a result of these negotiations, the Bermuda Agreement⁸ was concluded between the two countries. Among other items, the Agreement exchanges third, fourth and fifth freedom traffic rights for *scheduled* air services on a bilateral basis. Without any doubt the most significant feature of the Agreement is the *quid pro quo* compromise which was reached with respect to the questions of capacity and tariffs. Instead of adopting a system of *a priori* determination of capacity, the Bermuda Agreement adopts a system of *ex post facto* review of capacity. Initially the airlines designated under the Agreement determine the capacity to be offered, and if one or both governments are dissatisfied with the capacity as offered, they can require intergovernmental consultations on the subject to rectify the situation.

The Agreement further provides that tariffs shall be subject to government approval and in determining such tariffs, use may be made of the rate-making machinery of the International Air Transport Association (IATA). This Association was created in April, 1945, and is a private association of scheduled international air carriers.⁹ One of the reasons to equip IATA with a rate-making machinery resided precisely in the fact that the Chicago Conference had been unable to find a solution to the question of international airline tariffs. Through the IATA rate-making or Traffic Conference machinery, the IATA member airlines are able to reach agreements on uniform fares and rates for scheduled international air

⁸ Air Service Agreement between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland, Feb. 11, 1946, 60 Stat. 1499, T.I.A.S. No. 1507.

⁹ IATA was created at the International Air Transport Operators Conference, held at Havana, Cuba, from April 16-19, 1945. Negotiations leading to its creation began immediately after the close of the Chicago Conference.

services. Membership of the world's scheduled international air carriers in IATA has become almost universal as a necessity of operation.

The Bermuda Agreement has served as an example for the majority of bilateral air transport agreements concluded subsequent to 1946. At the present time, the world is covered with a network of bilateral air transport agreements exchanging traffic rights for scheduled international air services on a bilateral basis. Most of these agreements, and certainly most of those concluded by the United States, are of the "classical" Bermuda type: no predetermination of capacity and a system whereby tariffs for scheduled international air services are originally determined through the IATA rate-making machinery and are then subject to government approval.

Until recently most international nonscheduled or charter flights were performed outside the framework of bilateral air transport agreements, on the basis of unilaterally issued government permits. At the present time, however, there are a few bilateral air charter agreements in force between the United States and other countries.¹⁰ Nevertheless, in the total field of international charter air transportation, bilateral agreements remain the exception and unilaterally issued government permits the rule.

APPLICATION OF THE PRIMARY REGULATORY PROPOSALS OF THE CAB REPORT

In essence, the above-mentioned Bermuda Agreement consisted of a unilateral compromise on the part of the British with respect to their wish to predetermine the capacity to be offered in international air services, coupled with similar action on the part of the Americans with respect to their opposition against international tariff control. It is remarkable how much this international compromise as to capacity and tariffs was in harmony with the then existing United States' system of government regulation of *domestic* civil aviation. That system, as set forth in the Civil Aeronautics Act of 1938,¹¹ and as still in force under the Federal Aviation Act of 1958,¹² leaves the determination of capacity in domestic air transport to the initiative of the individual domestic airlines, whereas in the field of domestic tariffs it gives the CAB the power to reject filed tariffs and to prescribe lawful ones instead.¹³ Paradoxically, in the field of *international* tariffs, until 1972, the CAB only had the power to reject discriminatory international

¹⁰ *E.g.*, Air Transportation Services Agreement with Canada, January 17, 1966, [1967] 17 U.S.T. 201, T.I.A.S. No. 5972, *as amended* May 8, 1974, T.I.A.S. No. 7824; Nonscheduled Air Services Agreement with Yugoslavia, September 27, 1973, [1975] 25 U.S.T. 659, T.I.A.S. No. 7819.

¹¹ Civil Aeronautics Act, 52 Stat. 973 (1938).

¹² Federal Aviation Act, 72 Stat. 731 (1958).

¹³ Federal Aviation Act, 49 U.S.C. §1482(d) (1964).

tariffs.¹⁴ The CAB's power to reject and suspend international tariffs in a more general way was not granted until 1972.¹⁵ The CAB still does not have the power to prescribe international tariffs. The power to reject IATA agreed international fares and rates, however, has been exercised by the CAB since the Bermuda Agreement through the provisions of Section 412 of the Federal Aviation Act.¹⁶ This section makes inter-carrier agreements subject to CAB approval. IATA has agreed that international air fares and rates are such inter-carrier agreements, and thus need CAB approval under Section 412.¹⁷

The system, whereby both in United States' domestic civil aviation and in international civil aviation the determination of capacity is left to the initiative of individual airlines, has in recent years been heavily undermined by "capacity reduction agreements." Capacity reduction agreements can be defined as inter-carrier agreements for the purpose of reciprocal and proportionate reduction of capacity offered on one or more specific air routes. The first domestic capacity reduction agreement which was approved by the CAB under Section 412 of the Federal Aviation Act was the transcontinental markets capacity agreement between Trans World Airlines (TWA), American Airlines (AA) and United Airlines. It was filed with the CAB on June 23, 1971, and subsequently approved on August 19, 1971.¹⁸ The first such international agreement, one between British Overseas Airways Corporation (BOAC), Pan American World Airways and Trans World Airlines (TWA) for the Philadelphia-London markets, was filed with the CAB on April 12, 1973, and approved on January 23, 1974.¹⁹ The rationale behind the conclusion of capacity reduction agreements and approvals thereof by the CAB is to be found in the problem of overcapacity. The introduction of wide-bodied jets in the late 1960s and the early 1970s resulted in an enormous increase in potential capacity. With the weakening economy and the worldwide fuel crisis came a more drastic reduction in growth in air traffic than had been initially anticipated, and a general upward trend in air tariffs. As a consequence of these developments airlines were faced with an increase in capacity and a stagnating growth in traffic. Capacity reduction agreements surfaced at that time as a response to the

¹⁴ *Id.* at §1482(f).

¹⁵ *Id.* §1482(j).

¹⁶ *Id.* at §1382.

¹⁷ The exact extent of the CAB's powers over international air tariffs in accordance with the Bermuda Agreement and the relevant provisions of the Federal Aviation Act was examined in detail during the so-called *Chandler Fare Controversy* in 1962-1963. See 3 A. LOWENFELD, AVIATION LAW 31-78 (1972).

¹⁸ CAB Docket No. 22908 (1971).

¹⁹ CAB Docket No. 26057 (1974).

economic realities of the situation and offered what seemed to be an immediate solution to the problem.

The main proposals for the reformation of the system of governmental regulation of domestic civil aviation in the United States emphasized by the Report are at least two-fold in number: the elimination of protective entry control and elimination of price control.²⁰ Another important proposal made by the Report purports to end the practice of the CAB to approve capacity reduction agreements.²¹ Without a thorough examination and analysis of the merits of these particular proposals at this time, it seems fairly clear that the ultimate goal remains one of stimulating more competition in the domestic airline industry of the United States.

Through entry control, which is now a feature of most systems of government regulation of civil aviation, governmental authorities seek to manipulate the number of carriers operating in different markets.²² The elimination of entry control, as proposed by the CAB Report, to the realm of international civil aviation probably would not have a disruptive effect upon the existing system of government regulation of international civil aviation. Under most bilateral air transport agreements, the designation of air carriers to serve the air routes covered by such bilateral agreements is left to the discretion of the State of which such air carriers are nationals. If the United States liberalized its system of entry control of the American air carriers into the international air transport markets, this would not be contrary to the relevant provisions of most bilateral air transport agreements concluded by the United States, and would not have a drastically disruptive effect upon the existing system of government regulation of international civil aviation. The situation with regard to the elimination of price control and capacity reduction agreements, however, is quite different and should be separately examined.

CAPACITY REDUCTION AGREEMENTS

With respect to capacity reduction agreements the Report states as follows:

It is generally agreed that the capacity reduction agreements first approved in 1971 were justified (at least in the beginning) to meet a financial crisis brought about by the failure of traffic growth to meet expectations, and that similar agreements since late 1973 facilitated the reduction of fuel consumption in line with FEA²³ objectives. However,

²⁰ See, REPORT, *supra* note 1, at 285.

²¹ *Id.* at 95.

²² See, e.g., Federal Aviation Act, 49 U.S.C. §§1371, 1372, 1461 (1958).

²³ Federal Energy Administration, 15 U.S.C.A. §761 *et. seq.* (Supp. 1976).

the approval of such agreements in non-emergency situations, as a continuing feature of the regulatory apparatus, would represent a radical departure from the Board's previous pro-competitive policies and from generally accepted antitrust principles.²⁴

The Report does not seem to distinguish between domestic and international capacity reduction agreements; yet, in view of the fact that it purports to deal only with the United States' domestic air transportation it can be fairly concluded that the Report neither condones nor recommends the termination of any international capacity reduction agreements. This conclusion seems to be in accordance with the decision of the CAB in the Capacity Reduction Agreements Case.²⁵ In its decision, the CAB rejected capacity reduction agreements in general; however, it stated clearly and unequivocally with respect to *international* capacity agreements:

The views expressed by the Board . . . relating to domestic capacity agreements, cannot be applied in international capacity agreements without taking into account the often decisively different circumstances which prevail in the international arena.²⁶

It is certainly true that the international airline industry has been much more severely hit by the fuel crisis, inflation and depression than the domestic airline industry of the United States. Under these circumstances, continuing CAB approval of international capacity reduction agreements, at least for the time being, seems warranted. In approving these agreements, the CAB should continue to protect the interests of the airline user, and in particular, it should guard against those agreements which are basically anti-competitive or which have become too burdensome for the airline user with respect to the scheduling of flights. Furthermore, the CAB should make sure that with the reduction in capacity resulting from the capacity agreements, the standard of service offered to the user will nevertheless remain unchanged.

INTERNATIONAL RATE-MAKING

The elimination of price controls may be acceptable in the future regulation of the United States' domestic civil aviation, but it remains highly unacceptable in the field of scheduled international air transportation.²⁷ The often criticized system whereby scheduled international fares and rates are determined on an inter-carrier basis through IATA, subject to government approval, may not be ideal, but it is the best which currently is available

²⁴ See, REPORT, *supra* note 1, at 95.

²⁵ CAB Docket No. 22908 (1975). See also CAB Order No. 75-7-98 (1975).

²⁶ CAB Order No. 75-7-98, at 15 (1975).

²⁷ Cf. Comment, *A New Era in International Aviation: CAB Regulation, Rationalization and Restrictionism on the North Atlantic*, 7 N.Y.U.J. INT'L L. & POL. 317 (1974).

or can be attained in practice. Most nations seem firmly committed to this system as set forth in the Bermuda-type, bilateral, air transport agreements. These agreements state explicitly that all fares and rates shall be subject to government approval. Therefore, these agreements prevent the United States from eliminating control in international air transport without the concurrence of other States.

Not only would elimination of price control in international air transport be contrary to the majority of the bilateral air transport agreements entered into by the United States, but such action would surely put an end to the participation of United States' international air carriers and foreign air carriers serving the United States in the IATA rate-making machinery. Once CAB international price control has been abolished, the IATA agreed inter-carrier tariff agreements become illegal under the antitrust laws²⁸ of the United States.

At the present time it is very unlikely that the United States would denounce the IATA system of international rate-making. It appears that the CAB has not retracted its position of April, 1973, when it concluded rather succinctly:

We reiterate our conviction that IATA should promptly and effectively resume its historically accepted role in the arena of international rates. It is axiomatic that the pricing of international air services cannot be done unilaterally.²⁹

The above considerations as to the elimination of price control in scheduled international air transport do not of course apply with the same force to international charter tariffs. Unless there are provisions to the contrary in the few bilateral air charter agreements which exist at the present time, the United States could indeed do away with price control for international charter air services, although it is difficult to perceive the motivation for such action at this time.

CONCLUSION

It seems fairly evident to this observer that the universal application of all the aspects presented in the Report to the international civil aviation system would produce unfeasible, impractical and highly unlikely results. However, the elimination of entry control to international air transport would meet few objections from the point of view of the bilateral air trans-

²⁸ At the present time, once IATA tariff agreements have been approved by the CAB under Section 412 of the Federal Aviation Act, they are exempt from the operation of the United States antitrust laws under 49 U.S.C. §1384.

²⁹ CAB Order No. 73-4-64 (1973).

port agreements and its implementation would not present any substantial difficulties. However, the elimination of price control to international air transportation in order to promote a greater degree of competition brings an entirely contrary response at least as far as scheduled international air transportation is concerned. The smoothness with which international rates have been established through the IATA provides additional incentive for the rejection of this concept. Finally, the continuation of the necessity of CAB approval of international capacity reduction agreements seems, at least for the present, warranted and should continue as it is currently being conducted.