Carter Administration Stumbles at Bermuda

A Setback for U.S. International Aviation Policy

John W. Barnum

Paradoxically Bermuda II, the new U.S.-U.K. agreement on commercial air transport, increases government regulation in international air markets at the very time when Congress, at the urging of the President, is moving toward a more competitive regime for domestic air markets. Even more paradoxically, in Bermuda II the executive branch itself has—in the name of foreign policy—limited competition by executive agreement rather than left economic regulation to the appropriate regulatory agency, the Civil Aeronautics Board.

LAST JULY IN BERMUDA the United States and the United Kingdom signed an agreement governing commercial air transportation between the two countries. President Carter proclaimed the agreement's fairness and its benefits to consumers and airlines, saying it should "last as long as the original 1946 Bermuda Agreement." (The 1946 agreement is now called Bermuda I, the new agreement Bermuda II.)

By October, however, President Carter's new Civil Aeronautics Board chairman, Alfred E. Kahn, was telling the Aviation Subcommittee of the House of Representatives that the July agreement inadequately protects consumer interests, limits the possibilities for low-fare scheduled services, increases government interference in airline operations, and should not be adopted as a precedent for other bilateral air transport agreements. Witnesses from the Department of State and Department of Transportation were agreeing that important parts of Bermuda II should not become a precedent. Right after the hearings, President Carter stated that the bilateral talks with Japan then in process should include certain benefits for U.S. airlines and consumers that the U.S. negotiators had given away in Bermuda II.[1] To anyone familiar with the context, the President's letters amounted to a repudiation of the agreement he had praised back in July.

What caused the President to reverse himself on the new Bermuda agreement? Why was it that the only witnesses defending that agreement before the House Aviation Subcommittee in October and the Senate Aviation Subcommittee in November were those who had negotiated it?

The shortcomings of Bermuda II can be summarized in three categories:

- Bermuda II specifically limits the number of scheduled airlines that can serve particular routes, establishes restrictive standards and procedures for authorizing additional service, and in other respects gives up more than the United States received in exchange.
- Bermuda II leaves unresolved the major issues concerning charter air service and probably prejudices their later satisfactory resolution.
- Bermuda II raises far-reaching questions concerning the regulation of international air transportation and the role of the executive

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[1] Letters to Chairman Alfred Kahn, Secretary of State Cyrus Vance, Secretary of Transportation Brock Adams, and Attorney General Griffin Bell, October 6, 1977.

branch in restraining competition in the name of foreign policy.

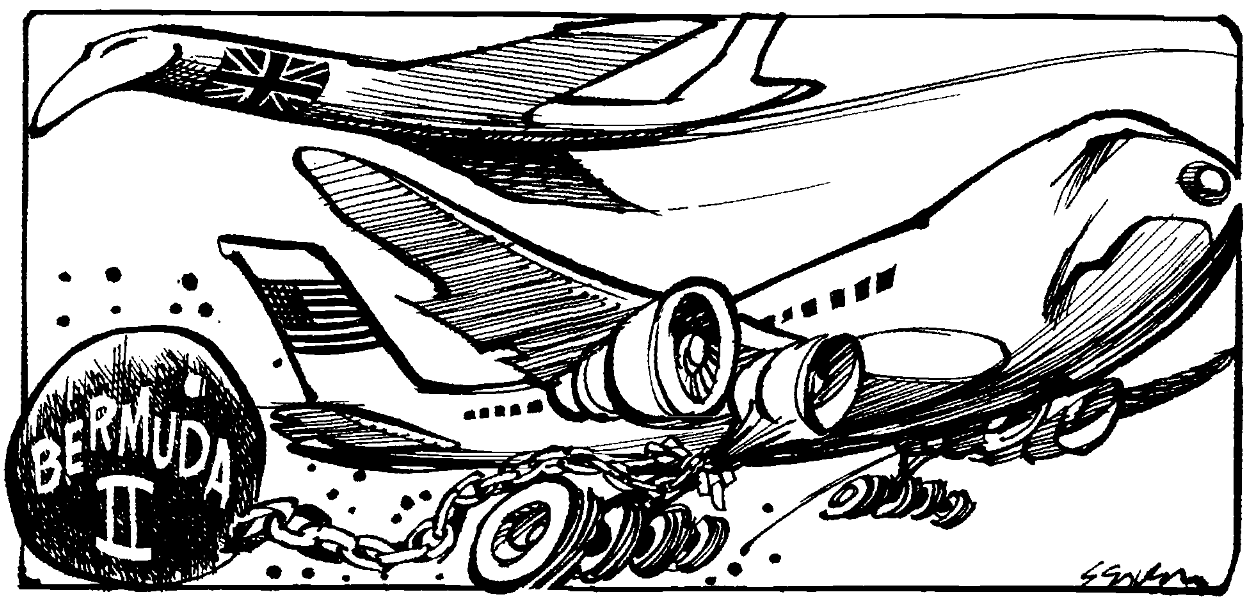
Widespread concern with Bermuda II also reflects the fact that other nations, particularly Japan and Italy, want many of Bermuda II's objectionable provisions to be included in their bilateral air transport agreements with the United States. Economic regulation of international air transportation is governed primarily by a network of bilateral agreements between governments, with some seventy current bilateral agreements between the United States and foreign governments being modeled on Bermuda I. Now that we have a new "Bermuda" agreement with the United Kingdom, it is difficult to sustain logically the argument that this agreement is not an appropriate precedent and that the 1946 agreement still is. And the Japanese are in a particularly strong economic position to argue that they are entitled to the same favorable treatment given the British in Bermuda II.

Bermuda I

The 1946 bilateral air transport agreement between the United States and the United Kingdom designated air routes between the two countries which listed the cities to be served, established procedures for setting fares and reviewing the capacity that airlines offer, and covered a number of "housekeeping" details for facilitating air commerce between the two signatories. It espoused "a fair and equal opportunity [for each country's airlines] to compete." The guts of the agreement were, however, the provisions that determined who would fly where and the voice or veto each government would have on such decisions by the other government or its airlines.

Bermuda I came about after the failure to reach multilateral agreement on these issues at the international aviation conference held in Chicago in 1944. Although both Bermuda I and the "Bermuda principles" model for U.S. air transport bilaterals were amended from time to time, the "Bermuda principles"—especially the "fair and equal opportunity to compete"—remained a cornerstone of our policy for *scheduled* international air transportation for thirty years and were expressly approved in successive presidential policy statements in 1963, 1970, and 1976.

On the other hand, *nonscheduled* air transportation — charter service — between the United States and other countries has been governed by a series of bilateral memoranda of understanding or exchanges of letters. Charter service was not even on the horizon in 1946 and only began its rapid growth after the introduction of jets in the late 1950s. Since then the United States has given more encouragement to charter service than has the United Kingdom, which has been more concerned with protecting the revenues of its government-owned airline than with promoting low-cost air travel for its citizens.



This was the situation on June 22, 1976, when the United Kingdom, acting within its rights under Bermuda I, terminated that agreement effective one year later. The reasons given were (1) to gain for British carriers a greater share of the revenue from air service between the two countries, (2) to eliminate excess passenger capacity, on the North Atlantic in particular, and (3) thereby to improve the profitability of the government-owned British Airways, and of the other British carriers as well.

Bermuda II

The last six months of President Ford's administration and the first six months of President Carter's obviously were difficult times for negotiating an entirely new air transport agreement. But President Carter did appoint a special representative to conduct the negotiations: Alan S. Boyd, former CAB chairman, the first secretary of transportation, and transportation advisor to candidate and President-elect Carter. And Ambassador Boyd did negotiate an agreement: on June 22, 1977, the negotiators initialed an outline and thirty-one days later the formal agreement was signed in Bermuda and hailed by both governments.

In commenting on Bermuda II it is appropriate to acknowledge that Monday morning quarterbacking is the only thing that is easy about negotiating an agreement with a foreign sovereign whose posture and policies are substantially different from our own. It is nevertheless useful to focus on the principal problems and innovations in Bermuda II for three reasons.

First, there is still much to be done in gaining full government agreement on air services between the United States and the United Kingdom—much to be done by way of implementing those provisions of Bermuda II that specifically contemplate government consultation (such as the provisions on capacity and fares) and much to be done on unresolved issues (such as charter services).

Second, bilateral negotiations with other countries are in progress or impending. Since Bermuda II has obvious implications for the current Japanese and Italian talks (among others), we should be clear about its strengths and weaknesses before these various negotiations reach a point of no return.

And third, there is the broader question of the interrelationship between domestic and international commercial aviation. The U.S. debate on airline regulation reform has been limited largely to the domestic scene, the assumptions being that international aviation is a different ballgame and that, in any event, the Congress cannot legislate the result. While this is true in some respects, we must not lose sight of two equally basic propositions: (1) that we seek the same objectives in both arenas—viable and efficient carriers free to offer (and offering) a variety of price-service trade-offs to both existing and developing markets—and (2) that the same U.S. airlines are already in both arenas (Braniff, Northwest, and TWA in particular) and that the scope of the international operations of many U.S. airlines is increasing.

More needs to be said on this last point. Bermuda II authorizes direct service to London, Bermuda, or Hong Kong from a total of seventeen U.S. "gateways" and to the British Caribbean from any point in the United States.[2] Last fall the CAB, in its *Transatlantic Route Proceeding*, authorized direct service from most of those gateways and through service from certain other cities, substantially expanding the international route structure of several domestic carriers. On December 21 President Carter approved that decision in part and modified certain of its other aspects. The result will be to accelerate the growth of international operations by several U.S. carriers. Our domestic and international aviation will be further improved if carriers are able not only to carry passengers from non-gateway cities through the gateways to a foreign city, but also to carry domestic passengers to the gateways. The CAB has already granted Braniff, Northwest, and Pan American the right to carry some such local traffic ("fill-up rights"), a significant and wise step in this direction. And if, as a result of Bermuda II, we have to live with only one U.S. carrier authorized to provide service from each of thirteen U.S. gateways to London, both the designated carrier and the international traveler will benefit from the granting of domestic service rights.

[2] A "gateway" is a city from which an airline may fly directly to a city in the other country. The market for the traffic between the two cities is called a "city-pair."

For example, if a U.S. carrier with authority to serve a particular gateway were relatively free under relaxed domestic regulations to institute domestic service behind that gateway, it would be in a position to offer additional through or connecting flights, as well as through service from additional cities. Moreover, such coordination between the domestic and international regimes would assist our balance of payments more effectively than "jawboning" American travelers to fly the U.S. flag carrier once they get to the U.S. gateway. In any case, to optimize the efficiency of the total system—and to avoid creating schizophrenic managements operating under two contradictory sets of rules—we should relate domestic and international problems and solutions as best we can.

LET US NOW consider how some of the provisions of Bermuda II will affect our international aviation and how they relate to our total commercial aviation policy.

The Airline Designation Provisions

In Bermuda II the question of whose airlines may fly where between the two countries is addressed in several related provisions:

(1) Annex 1 specifies twenty-seven "routes" on which the airlines of one country or the other are authorized to offer combined passenger-and-cargo service or all-cargo service. On each U.S. route, for example, there is at least one U.S. gateway city and one U.K. point between which a U.S. airline may offer direct air service.

(2) As a general rule each country may designate one or more of its airlines to serve a particular city-pair, such as Los Angeles-Hong Kong.

(3) On the passenger routes across the North Atlantic, however, each country has the right to designate only one airline at each U.S. gateway, except that two carriers may be designated by each country for two of the U.S. gateways. (Thus Pan American and TWA, along with British Airways and Laker, will be serving New York-London.)

(4) At the thirteen U.S. gateways to London for which each country may now designate only one airline, each country has the right to designate an additional airline when the number of passengers in the market reaches certain levels.

What this means is that we have acceded (except at two gateways) to the British demand that the number of U.S. airlines eligible to operate scheduled service from particular U.S. gateways be limited to one. We have also acceded to the demand that British carriers be eligible to operate to every U.S. gateway from which U.S. carriers can operate. One U.S. gateway not yet determined and in any event not to be opened for three years will be an exception. On the other side, the United Kingdom has reserved Manchester, England, as an exclusive gateway for a U.K. airline, effective immediately. We have even gone so far as to give the United Kingdom the right to operate to and from one U.S. city (Houston) for three years before any U.S. carrier can inaugurate Houston-London service, albeit in exchange for three-year headstarts for a U.S. airline at Atlanta and Dallas/Fort Worth.

In order to appreciate the implications of all this for other bilateral negotiations, we must note a key difference between Bermuda I and Bermuda II. Although Bermuda I authorized U.K. airlines to operate to particular U.S. cities, and although the schedule attached to the typical bilateral likewise lists the U.S. cities at which the airline or airlines designated by the foreign government may make scheduled landings, Bermuda I did not, and the typical bilateral does not, limit the number of airlines that either government may designate to land in the other country. And while it is true that in several cases there is an understanding—or unpublished exchange of letters—that restricts our unilateral right to designate additional carriers, Bermuda II purports to legitimize this significant additional limitation on competition by including it in a bilateral agreement.

To be sure, Bermuda II permits the designation of additional airlines to serve a city-pair when traffic reaches certain levels, or "thresholds." At the thirteen single-designation gateways to London, either country may designate a second airline when the traffic during each of two successive twelve-month periods is 600,000 one-way revenue passengers for both carriers operating, or 450,000 one-way passengers for its carrier, or if the other country's carrier operates less than 100 flights a year. (The United States does not have any right to designate a third U.S. airline at the two gateways to London where two U.S. carriers are authorized initially.) But in the case of the U.S.-London markets now limited to one scheduled airline from each side, estimates indicate that we will be well into the next century before traffic reaches the thresholds required to permit unilateral designation of a third scheduled airline.

What do those thresholds really mean? A Boeing 747 configured for 405 passengers and operating daily at an average load factor of 65 percent carries 200,000 one-way passengers a year.[3] A DC-10 carries approximately 25 percent fewer passengers and a narrow-body aircraft substantially fewer again. Thus a gateway would have to attain sufficient traffic to justify three daily 747s (or the equivalent capacity) before a second U.S. carrier could be designated. Should we seek to designate a second carrier because the U.K.-designated carrier was not providing sufficient capacity (or service) to develop the market, we could not do so either until the U.K. airline's frequencies were less than 100 for a twelve-month period (two flights a week) or until the first U.S. airline had carried 450,000 one-way passengers for two years (two daily 747s plus). And if the first U.S. airline were falling down on the job, the United States could not simply designate an additional carrier to restore competition: it would have to withdraw the first airline's authorization before designating another.

It is, of course, possible that a future British government will agree to designating more U.S. airlines or will accept more capacity than allowed by the strictest interpretation of Bermuda II. But that possibility is too remote to be relevant to any analysis of the agreement. In July 1975 and again in February 1976 the British secretary of state for trade announced a British policy of limiting to one the number of British airlines on individual North Atlantic markets, New York included. Laker is flying to New York primarily because the British courts overruled the government's withdrawal of its authority. The British goal of dividing the revenues equally makes it highly unlikely that the United Kingdom will permit a second U.S. airline to enter a market before the Bermuda II thresholds are achieved.

While I am concerned with the idea of limiting to one the number of U.S. airlines authorized to fly all but two of the U.S.-London markets, the limitation has some benefits. First, except for New York-London and Los Angeles-London, the London markets are relatively thin —that is, few (if any) of them could today provide traffic for viable operations by more than two carriers. Second, it is desirable in my judgment to authorize direct service to London, for example, from as many U.S. gateways as can sustain viable service. The dispersion of gateway service to a dozen U.S. cities benefits the residents and businesses of those cities, helps introduce more U.S. carriers to the international arena, and relieves airport congestion at the historic gateways like New York. (There is a limit, however, on the number of gateways that should be opened, not only to avoid inviting a money-losing operation but also to protect the traffic at existing gateways so that the passengers who must go through those gateways can enjoy better service options.) Third, daily service by one carrier is usually better than sporadic service by two carriers, as Lufthansa showed when it was competing in Chicago against both Pan American and TWA.

These points provide some justification for having agreed to designate only two carriers in the thinner markets initially. It does not follow, however, that we should have agreed that a third carrier cannot be designated until the market has supported the equivalent of three daily 747s each way for two years. Nor does it follow that we should have agreed to limit the larger U.S.-London markets for scheduled service to four carriers forever.

The Provisions for Limiting Capacity

A second troublesome aspect of Bermuda II is the provision for governmental control over airline capacity. The British renounced Bermuda I on the grounds that it had led to excess capacity, to an unacceptable division of the revenues, and to unsatisfactory operating results for British Airways. In their view the solution to all three problems was more stringent allocation and control of capacity. They were not so much interested in "a fair and equal opportunity to compete," to use the lan-

[3] "Load factor" is the percentage of seats sold, and a 65 percent average load factor is considered an excellent result for scheduled service.

guage of Bermuda I, as in obtaining equal results. And they were not interested in using reduced fares to cure the excess capacity they observed.

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Measures of Capacity. Bermuda I left each airline free to decide how much capacity it would offer on scheduled flights and involved the governments only to the extent of consultation after the fact—if one government or the other felt that too much capacity was being offered. Under Bermuda II, the route schedules for U.S. airlines offering Pacific and round-the-world combination air service contain limitations on the numbers of flights that may be operated, and capacity on the North Atlantic routes is subject to specific constraints and an elaborate mechanism for government clearance before additional service may be offered. The agreement provides (Annex 2—Capacity on the North Atlantic):

(1) Six months before the summer and winter seasons, each airline will file its proposed schedule with both governments.

(2) An airline may offer the same number of flights that were authorized for the previous corresponding season, or at least 120 round-trip flights from a gateway in summer and 88 in winter.

(3) Any larger number may be protested by the other government, and the governments then exchange *their* forecasts of the traffic increase in the disputed markets.

(4) The airlines may then fly either (a) the number of flights ("frequencies") that the governments agree upon or, failing agreement, (b) the total allowed in the previous corresponding season plus an increase corresponding to the average of the two governments' traffic forecasts, but in any event not less than twenty additional frequencies in a summer season or fifteen in a winter season. (These automatic increases do not appear to be available if governments agree on a lower number.)

In this connection it is helpful to note the distinction in the terminology of Bermuda II's provisions on capacity. Some provisions refer merely to "capacity," without any indication of how capacity is to be measured; others refer to numbers of revenue passengers and others to frequencies of flights. Thus, the hortatory language in Article 11 speaks merely of capacity adequate to the "traffic demands" and "excess capacity" running "counter to the interests of the travelling public." On the other hand, the provisions for authorizing designation of an additional airline (Article 3) and for government forecasting of increases in traffic (Annex 2) are couched in numbers of revenue passengers. In these instances the abstract issue of capacity is reduced to its most specific measurement—number of passengers.

But the operative, or cutting-edge, provisions speak in terms of "frequencies." The frequencies during the last comparable season are protected and the minimum ceilings on levels of service and the minimum seasonal increments to which a designated carrier is entitled (if the governments do not agree on a lower number) are both specified in terms of frequencies.

Frequencies of scheduled service are, to be sure, a way of measuring and regulating capacity. But they provide a fairly flexible measure compared, for example, to available seats. Bermuda II gives airline managements some freedom to adjust capacity even if the other government invokes the restrictions on frequencies. An airline could increase capacity by moving from a narrow-body aircraft to a wide-body aircraft (or to a larger wide-body) without violating limits of capacity written in terms of frequencies. Moreover, the capacity provisions expressly authorize the operation (but not the advertising) of extra sections of scheduled flights and exclude these from the calculation of the number of authorized frequencies. Thus the capacity limitation provisions of Bermuda II are more relaxed than might appear at first blush.

A Capitulation to the Cartel Approach? In analyzing Bermuda II and its implications for other bilateral agreements we must take into account a fundamental difference between the international aviation policies of the United States and those of virtually every other nation.

Whereas the United States prefers to rely entirely on a number of privately owned airlines, other countries look principally if not entirely to one government-owned airline, and their interests are primarily on the producer side of the market because a relatively small percentage of the international passengers involved is made up of local citizens. Whereas U.S. international airlines are not subsidized by the government in any significant respect, airlines operated by foreign governments are subsidized in a variety of ways. Whereas our international airlines are generally able to operate at a profit, albeit in most cases at long-term profit margins that are less than desirable if these airlines are to meet their enormous capital needs, foreign carriers are usually less efficient and therefore less profitable. And whereas we stress the benefits to be obtained from competition, virtually every foreign government with which we have air transport relations is inclined to control or regulate international aviation as much as it can.

The result elsewhere is a network of pooling agreements whereby governments divide up markets in a variety of ways. The rates for scheduled service between foreign points are established for the most part by the international carriers acting in concert through the International Air Transport Association (IATA), a trade association for international scheduled airlines, and the rates established are invariably more (in many instances two and three times more) than the rates for scheduled service over comparable distances within the United States.

The basic problem for the United States, when negotiating a bilateral air transport agreement, is to reconcile our preferences and posture with those of the other country. It is true that some U.S. airlines have been comfortable with the more cartel-like regimes that obtain abroad, just as some domestic airlines prefer the status quo of excessive domestic regulation. On the other hand, other U.S. airlines criticize Bermuda II not only because too many rights were traded away but also because it represents an undesirable and unnecessary capitulation to the cartel approach, to the detriment of U.S. airlines' competitive opportunities.

Is Bermuda II a capitulation to the cartel approach? To answer this question we must consider the combined effects of its provisions on route schedules, designations, and capacity. Taken together, these provisions say that British carriers have the same rights to the same city-pair markets as we do, that each country may (with minor exceptions) have the same number of scheduled airlines in each market in which each is interested, and that, in the absence of agreement to increase capacity in a particular market, the designated U.K. airline or airlines can increase frequencies by the same amount as our carriers—twenty in the summer, fifteen in the winter. The result is essentially a detailed division of markets and severe governmental constraints on competition among the chosen few. (The open-ended provisions for further government consultation and agreement on scheduled airline fares, which are discussed below, also have ominous overtones of the cartel approach.)

The result is essentially a detailed division of markets and severe governmental constraints on competition among the chosen few.

Bermuda II has the potential for undesirably stringent capacity controls, the regulation of capacity in terms of "frequencies" notwithstanding. It also involves the government—both governments—in the affairs of airline management more than seems desirable. Whether Bermuda II will prove to restrict scheduled service between the two countries as much as it appears it will or whether it will be better than some of the alternative schemes available, only time will tell. The answer will depend upon both the receptiveness of the British government to the U.S. airlines' plans and the extent to which the U.S. government presses for maximum reliance on market forces.

Other Provisions of Bermuda II

Among Bermuda II's other new provisions several clearly benefit both airlines and travelers. There is express recognition of a U.S. airline's right to originate a flight from any U.S. city, fly to a U.S. gateway and then on to the U.K. point, without changing the flight number. And the aircraft can stop at any point in any third country either before or after it lands in the United Kingdom (subject of course to agreement with the third country). Moreover a U.S. airline can bring travelers from different U.S. interior cities or gateways to London and there transfer them to its ongoing flights to third countries. Thus a TWA passenger from Pittsburgh could transfer in London to a TWA flight to Tel Aviv that may have originated in Chicago, while the Chicago passenger could switch to the continuation of a Pittsburgh-Boston-London flight to Athens. There is also no longer any dispute about the carriers' being able to switch the flight beyond London to a smaller aircraft if the continuing traffic does not warrant the larger equipment justified by the traffic on the transatlantic leg. In those respects and in others, Bermuda II gives airline managements more flexibility than did Bermuda I. (See Annex 1, Section 5, Notes Applicable to All Routes.)

We have also agreed, however, that these several rights and benefits are not to be available for passengers who stop over in London or some other U.K. point for more than three hours in some cases, for more than a day in others. More important, in Bermuda II we gave up many rights that U.S. airlines previously enjoyed to carry local traffic beyond U.K. points. This is the so-called fifth freedom: the right of country A's airline to fly to country B and there to pick up new passengers (or travelers from A who had been stopping over in B) and to carry them to country C. We did retain some "fifth freedom" rights, including the round-the-world service, but the rights we gave up were extremely beneficial to U.S. airlines and to the U.S. balance of payments.

The eventual elimination of "fifth freedom" rights is consistent with the European approach to international aviation: divide local traffic among the carriers of the two countries involved, with freedom to fix prices accordingly. Combined with the opening of new U.S. gateways for international aviation, however, it may also lead to the development of more direct service from more U.S. cities to more foreign cities. Both airlines and aircraft manufacturers are giving thought to this possibility as they consider future equipment needs, and there obviously could be benefits for all concerned if those longer and thinner markets can be operated profitably. It is less desirable, however, when such a development is induced by restraints on competition, such as the elimination of fifth freedom rights, rather than results from normal competitive forces—the efforts of several airlines competing more freely for the travelers' dollar or pound.

The United States already permits a number of foreign airlines to carry fifth freedom traffic to and from U.S. gateways. Air India, El Al, and Iran Air carry approximately 4 percent of the traffic between New York and London, for example. And in Bermuda II we have given the British additional rights to pick up Tokyo passengers at Anchorage, Mexico City passengers at five East Coast cities, and passengers for some South American cities at Atlanta and Houston. These several services are beneficial to the traveler, if not to the U.S. airlines that now have additional competition, and it is unfortunate that American carriers' fifth freedom rights are being contracted even as those of the British carriers are being expanded.

The other critical area of economic regulation of international air transportation is tariffs—the fares charged for passengers and the rates charged for air cargo and baggage. Historically tariffs for scheduled air services have been set by agreement among the international carriers at IATA and submitted to the aeronautical authorities of the countries involved for approval. Of late, however, there has been growing dissatisfaction with the IATA mechanism. Bermuda II contemplates continued use of this mechanism, but it also expressly provides for early filing of tariffs with the CAB and the corresponding British agency and for the exchange of information between those authorities before and during the IATA meetings.

It is premature to say what effect the tariff provisions of Bermuda II will have. The principles enunciated are good: "Each tariff shall, to the extent feasible, be based on the cost of providing such service assuming reasonable load factors" and "individual airlines should be encouraged to initiate innovative, cost-based tariffs." Moreover the recent inauguration of Laker's Skytrain ($238 roundtrip, New York-London) and sharply reduced fares for certain types of service offered by the other scheduled carriers bode well for the consumer. The unknowns are the impact on charter services (including the continued existence of some of the supplementals—the airlines which do not have scheduled service authority) and the practical results of further consultations on both specific tariffs and general issues. On its face, however, Bermuda II involves both governments more deeply in the tariff-setting business.

The Question of Charters

Article 14 of Bermuda II proclaims the importance of charters and even recognizes "the relationship of scheduled and charter air services and the need for a total air service system."[4] It then says that charter air service shall be governed by Annex 4. That annex is short. It extends for one year a bilateral memorandum of understanding on charters which the governments executed in April 1977. It makes most of the "boilerplate" and "housekeeping" provisions of Bermuda II applicable to charter services—although not the aviation security article (Article 7), apparently because of an oversight. And it states that the two parties have agreed to discuss, on both a multilateral and bilateral basis, a variety of basic issues, some of which are in fact catalogued—"charterworthiness" conditions (meaning the basis on which charter service may be offered), freedom of market access, and designation of charter airlines, for example. But that is all Annex 4 does.

When Bermuda I was negotiated in 1946, it was undoubtedly appropriate that it should cover only scheduled service, because as a practical matter that was all there was at the time. By 1977, however, the charter activities of the scheduled airlines (Pan American, TWA) and of the supplementals (Capitol, Overseas National, Trans International, World, for example) were big business—providing 25 percent of the U.S.-U.K. passenger traffic. Charter service also has a major impact on scheduled service, particularly on fares.

[4] It should be noted that neither "scheduled air service" nor "charter air service" is defined in the agreement, and "air service" is defined as meaning "scheduled air service or charter air service or both, as the context requires. . . ." (Article 1). If it is desirable to maintain the distinction between scheduled and charter services—and for a number of reasons I think it is best to do so for the time being—definitions of both should be included in bilateral air service agreements, so that when we come to consider how to treat Laker's "Skytrain," other low-fare scheduled services, and "part charters" and charter transfers (both involve the use of scheduled flights for charter passengers), we can know what rights and limitations are applicable.

This being the case, it was a mistake for us to lock up our policy on scheduled air service when we had only an interim—and unsatisfactory—memorandum of understanding on charters. A bilateral agreement on air services should be just that—an agreement that establishes rights and limitations for all activities within an interrelated market.

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Yet Ambassador Boyd testified before the Congress that he did not want to jeopardize a satisfactory agreement on, and the continuity of, U.S.-U.K. scheduled service (which provides 75 percent of the traffic) for the sake of an agreement that covered both scheduled and nonscheduled service. This three birds-in-the-hand and one in-the-bush logic has a fatal flaw: we do not yet know what we have in the hand. It is impossible to know how good an agreement we have on the 75 percent—the scheduled business—until we know how the other part is going to be treated. Will one, two, or four designated scheduled airlines be adequate at a particular gateway? Are the ceilings on frequencies or the thresholds for additional designations appropriate? Should additional gateways have been authorized?

These questions cannot be answered until we know what freedom charters will have to serve the area, and indeed whether the ratio of scheduled to nonscheduled service will still be 75:25. If the British were now to insist on limiting charter operations substantially, we might want to be able to authorize both scheduled and supplemental carriers to combine "part charters" with regular scheduled service, or to transfer charter passengers to scheduled flights, or to offer Skytrain, standby, or other budget fare options.

But Bermuda II has locked us into precise limitations on the number of scheduled airlines that may serve particular markets and the number of frequencies they may operate. Whatever may be said about the apparent desirability of some of these limitations, at the least it must be admitted that we cannot conclude they are beneficial until we know the whole story—how *all* the business will be treated. Similarly, it is not desirable to agree on scheduled fares until we know how much freedom the carriers will have to set charter fares. This is, of course, the area where charter operations have had the most significant impact on scheduled service. And fortunately it is an area that Bermuda II expressly recognizes as needing more work.

Ambassador Boyd also argued that the British were insisting upon a restrictive regime for scheduled services and that he wanted to avoid the risk of a similar regime's being applied to charters. Now that we have signed an agreement on scheduled service sufficiently restrictive to be acceptable to the British, we can expect to achieve a liberal, pro-competitive agreement on charters—or so the ambassador's logic seemed to run. But this assumes the British want a new agreement on charters, whereas in fact there is little evidence they do—unless, of course, they dictate its terms. The evidence is more to the effect that the British would like not only to have U.S. charter carriers blocked by the absence of a new and liberal U.S.-U.K. agreement on charters, but also to have some kind of multilateral agreement to protect their airlines and their tourist trade by preventing U.S. carriers from diverting charter traffic to other European gateways. Given British antipathy toward charters and British success in obtaining President Carter's approval (overruling the CAB) of low-cost scheduled fares aimed more at charter service than at Laker, satisfactory agreement on charters is likely to be a long time coming, as indeed the first rounds of charter discussions have already shown.

In arguing for simultaneous resolution of scheduled and charter issues I do not overlook the possibility that other circumstances may have argued for separate agreement at Bermuda. If the British had been prepared to sign an agreement for scheduled services that met our objectives, there would have been at least some justification for the three birds-in-the-hand theory. But for the reasons summarized above, this argument cannot be made for Bermuda II.

As a matter of negotiating tactics it would certainly have been preferable to delay final agreement on scheduled service, or at least to make it contingent on the resolution of the charter issues. The task before us in 1977 was to write a comprehensive agreement for commercial aviation between the United States and the United Kingdom, not merely a better agreement for scheduled service than we wrote in 1946. To be sure, we wanted solutions for the scheduled service problems that had surfaced during thirty years. But one of those problems was—and is—finding the appropriate relationship between scheduled and charter services, and the new agreement therefore should have covered both.

Establishing comparable and complementary regimes for scheduled and charter air services is an objective we should keep in mind in other bilateral negotiations. Many other countries share the British opposition to charter operations. Every effort should be made, therefore, to resolve the problems that have frustrated our charter operations in Japan, for example, before we and the Japanese come to any new bilateral agreement on scheduled services.

Regulation by Executive Agreement: A General Problem

By the terms of Bermuda II, the executive branch undertakes substantial regulation of interstate and foreign commerce without any express statutory authority. Admittedly the President is generally regarded as having the authority to conduct the foreign affairs of the nation (although in fact his express powers in the Constitution are limited to appointing and receiving ambassadors), but the power to regulate commerce is vested in the Congress. In the absence of express statutory authority, is it appropriate for the President to limit competition in international aviation? Can an executive agreement, *as distinguished from a treaty ratified by the Senate,* supersede the antitrust

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laws? Is Bermuda II consistent even with the Federal Aviation Act?

There are not any clear answers to these questions. Bilateral air transport agreements appear to have mushroomed in a dark and empty statutory closet, nurtured by congressional neglect.

The Federal Aviation Act contains four references to such agreements. Section 802 reads:

> The Secretary of State shall advise the Secretary of Transportation, the Board, and the Secretary of Commerce, and consult with the Secretary of Transportation, Board, or Secretary [of Commerce], as appropriate, concerning the negotiations of any agreement with foreign governments for the establishment or development of air navigation, including air routes and services.

Section 1102 provides that the board and the secretary of transportation, in performing their duties under the act, "shall do so consistently with any obligation assumed by the United States in any treaty, convention, or agreement that may be in force between the United States and any foreign country. . . ." Section 1108 contains language to the same effect. Section 1115 imposes on the secretary of state and secretary of transportation certain duties related to aviation security involving nations "with which the United States has a bilateral air transport agreement." (This is in fact the only specific statutory reference to bilaterals.)

Those four sections (and congressional acceptance of the practice) argue that Congress has in fact contemplated executive agreements for international air services.[5] But it does not follow that the executive, without express statutory authority, has the power to require airlines to act in a manner inconsistent with the antitrust laws or to limit competition without reference to the independent regulatory agency where that power resides initially. Let me indicate how Bermuda II does both.

(1) Bermuda II provides that a U.S. airline designated to serve one city-pair on the North Atlantic, for example, "shall take into consideration the interests" of all the U.K. airlines operating there "so as not to affect [their services] unduly" (Article 11, paragraph (2)). The U.S. airline operates under this constraint in all its London markets, even if it does not compete with a particular U.K. carrier in any one of them, because the phrase "on all or part of the same routes" is used to modify the "services" that a U.S. carrier may not affect "unduly." Thus TWA, in seeking to develop traffic originating in the Southwest for its Chicago-London service, must not unduly affect British Caledonian's Houston-London service.

The obligation to pull punches against the foreign carriers necessarily means that the U.S. carrier will also be pulling its punches against other U.S. carriers with which it is competing elsewhere head-to-head—carriers with which it should be competing vigorously. Since each airline will be competing under the same constraint, with full knowledge that the other designated carriers have accepted the constraint, it does not require a radical antitrust analysis to conclude that the airlines have entered into an understanding in restraint of competition. If, for example, distributors of television sets agreed with the manufacturer not to compete with other distributors, they could be deemed to have conspired among themselves not to compete and they would be in trouble.

Where did the executive get the authority to impose that restraint? The CAB is authorized to remove from operation of the antitrust laws specific airline actions which the board expressly approves, such as mergers, interlocking relationships, and even certain agreements among airlines. But there is nothing in the Federal Aviation Act or elsewhere that suggests the board should "approve" bilateral agreements, and in view of the limited scope of the antitrust immunity provision (Section 412), it would be going too far to argue that, in authorizing airlines to provide service pursuant to an executive agreement, it is authorizing the airlines to act in an anticompetitive manner.

It could be argued that the sentence in question only prevents predatory practices that themselves violate our antitrust laws. Ambiguous agreements must, of course, be given a legal rather than an illegal construction, but this is a weak defense here. The sentence in question is not expressly limited to predatory practices.

[5] Compare this vaguest of authority, however, with the express authority of the secretary of state, in collaboration with the CAB, to negotiate with a foreign country to reduce or eliminate excessive or discriminatory landing fees, et cetera. (International Air Transportation Fair Competitive Practices Act of 1974, Section 3, 88 Stat. 2103, amending the International Aviation Facilities Act, 49 U.S.C. 1151-60.)

Moreover, the next sentences, which illustrate the meaning of the first, say what airlines may not do in a particular situation: when another airline begins service, any airline already serving that city-pair may not increase its frequencies for two years or until the second airline attains the same number of frequencies as the incumbent, whichever is sooner.

Increasing frequencies by one a week (or one a year) twelve months after an airline has entered the market might or might not be predatory: judgment would depend on the particular circumstances. Yet here the executive has adopted a firm rule, and the rule indicates that the first sentence of Article 11, paragraph (2), can best be read as going far beyond a mere prohibition of predatory practices.

The evolution of that first sentence is important. In Bermuda I the governments agreed:

> That, in the operation by the air carriers of either Government of the trunk services described in the Annex . . . 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 routes. [Resolution paragraph(5)].

Much of this language is retained in Bermuda II, but there is a significant change. Bermuda I does not specify *who* is meant to take the other country's carriers' services into consideration: it merely says they "shall be taken into consideration." The best legal interpretation would seem to be that the CAB, in implementing the agreement by regulating the operations of the carriers, should consider the effect of U.S. carrier operations on U.K. carrier operations. In Bermuda II, however, it is *the U.S. carriers* that are expressly required to be solicitous of the U.K. carriers' services. That, along with the fact that the conduct required is inconsistent with our antitrust laws, is the nub of the problem.

(2) The other legal problem with Bermuda II lies in the fact that the executive has agreed to limit the number of carriers in particular markets. Under Bermuda I *the CAB* could authorize one, two, three, or more U.S. airlines to operate on any route. A decision by the board to designate only one carrier would have its anticompetitive aspects, but independent regulatory agencies have generally been entitled to limit competition when they find such limitation to be in the public interest. What constitutes the public interest is, of course, debatable, but no one to my knowledge has argued that the CAB does not have the power to limit competition, antitrust laws notwithstanding. Under Bermuda II, however, *the executive branch* has agreed to limit the number of competitors in any one market. It is not clear to me that the Congress intended to give the executive branch such authority without reference to the independent regulatory agency.

The Congress has in fact given the President the power to approve, modify, or reject a CAB decision on international routes. Section 801(a) of the Federal Aviation Act requires that such decisions be submitted for his approval. But the existence of one *and only one* express statutory authority argues that the President cannot act in this area except in compliance with that provision. The express limited authority codifies and thereby limits what might otherwise be the President's general authority in this area of mixed commerce and foreign affairs.

The antitrust laws protect competition (not competitors) in both the foreign and domestic commerce of the United States. When Congress wants to sanction a different standard for competition in foreign commerce it does so expressly, as it did when it authorized Webb-Pomerene export associations. Moreover, bilateral agreements like Bermuda II affect the interstate as well as the foreign commerce of the United States.

If it is true as a legal matter that the President does not have authority to limit competition except through his review of CAB decisions, the result is a practical absurdity. For example, whatever may be the President's authority, we must acknowledge that it is not within his practical power to require the British to permit more than one U.S. airline to operate from Washington to London. If the British say they will permit only one airline to land and disembark passengers, that is that. Under the circumstances we cannot say that in acquiescing to such a limitation in Bermuda II the President has limited competition, though he has enabled others to limit it. On the other hand, it is within the President's power to permit more than one British carrier to land in Washington. Section 801(a) says the CAB issuance or denial of a permit to a foreign air carrier "shall be subject to the approval of the President." His decision not to authorize a permit does limit competition in the foreign commerce of the United States.

Passing for the moment the fact that in Bermuda II the executive branch limited the number of authorized U.K. airlines without reference to any CAB decision, this analysis suggests that the infirmity in Bermuda II lies not in the limits imposed on U.S. airlines' rights but in the limits imposed on the U.K. carriers, and that insofar as the antitrust laws are concerned any number of foreign carriers should be allowed into the United States even though the foreign government limits the number of U.S. carriers to one—or none. This *reductio ad absurdum* analysis should underline the need for filling the statutory void.

There is the further question whether Bermuda II's provisions for limiting capacity are legal in light of Section 401(e)(4) of the Federal Aviation Act. That section prohibits the CAB from restricting the right of a carrier "to add to or change schedules." Thus in domestic aviation the board, once having authorized an airline to serve a particular route, may not interfere with the airline's capacity and scheduling decisions, except by withdrawing the authorization. Internationally, however, the revulsion of foreign governments against increases in capacity and competition has led to numerous cases in which the executive branch has had to agree to limit capacity and to interfere with U.S. airlines' schedules in order to obtain or ensure landing rights in the foreign country.

Bermuda II elevates this practice to the formality of an executive agreement. Again it is at least arguable that the restrictions on the carriers are being imposed not by the U.S. government but by the foreign government, and therefore do not violate Section 401(e)(4). But in any event we have the executive regulating competition and in this case regulating in a manner expressly forbidden to the regulatory agency. And again we have a void where there ought to be a statute granting—or denying—express executive authority.

Concluding Note

In Bermuda II the executive has limited competition in foreign commerce (1) without regard to the statutory role of the independent regulatory agency, (2) in several instances in a manner that is inconsistent with the antitrust laws, and (3) in at least one instance in a manner that Congress has expressly forbidden to the regulatory agency.

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It may of course be noted that Congress has from time to time provided the executive with authority to limit competition in other areas of interstate and foreign commerce—"anti-dumping" authority, for example. And of late the executive has sought to protect domestic industries by persuading foreign governments to limit their exports to this country—steel, shoes, television sets, next (perhaps) automobiles. Whatever the benefits to the protected industry, the consumer loses. But President Carter has expressed a dedication to helping the consumer of international aviation, and apparently he now realizes that Bermuda II took us in the opposite direction. The present problem is therefore not only to obtain a satisfactory charter agreement with the United Kingdom (if necessary by renouncing Bermuda II) but also to avoid a repetition of Bermuda II in the Japanese and other negotiations.

The Congress must consider whether the executive should continue to be free to limit competition in international aviation without resort to the formal recommendation or administrative proceedings of the regulatory agency. And whatever role is determined to be appropriate for the CAB, the President's hand would be strengthened in bilateral negotiations if the Congress would codify his authority to negotiate and provide the negotiators with criteria that are more compatible with competitive markets—and with the emerging regime for domestic aviation—than are the criteria suggested by Bermuda II. ■