

When is aviation reform not really reform?

The Wright Stuff

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Path dependence is one of the most powerful notions in modern economic theory. Its initial sense was quite literal: the paved road follows the earlier deer path. Unfortunately, some paths that worked for the deer may not do so well for people who follow. In principle, therefore, we prefer the operation of competitive markets, which have the desirable feature of getting us to the optimal position through a series of incremental adjustments that end up in the same place no matter where we begin.

Politics, however, follows a different set of imperatives. What is true of deer paths unfortunately can also be true of airline routes, as Congress's most recent fiasco known as the Wright Amendment Reform Act so amply illustrates.

DEREGULATION AND JIM WRIGHT

The setting for this misadventure is the North Texas airline market, home to the key players in this latest saga: American Airlines, Southwest Airlines, the Dallas/Fort Worth International Airport (DFW), the cities of Dallas and Fort Worth, and yes — full disclosure — my clients, Love Terminal Partners and Virginia Aerospace, who own the North Concourse, or Lemmon Avenue, gates at Love Field Airport in Dallas.

Under last year's Wright Amendment Reform Act, these gates are marked for condemnation and demolition. Their sin: the competitive threat they pose to American and Southwest — the two dominant players in the North Texas air market.

The law not only shapes activities in the Dallas/Fort Worth area, but everywhere else on the airline grid. The entire nation should take notice of what Congress has wrought.

THE AMENDMENT The background retraces familiar ground. Before 1978, the Civil Aeronautics Board (CAB) had comprehensive authority to regulate the routes and the rates of all airline carriers operating in the United States. That system was subjected to fierce and justified criticism for its restrictions on

entry and price competition. In a rare burst of bipartisan unity, the Airline Deregulation Act of 1978 junked the old system in favor of the current regime that introduces total flexibility on both dimensions.

Deregulation led to the immense shakeup within the industry, as once-coddled carriers faced low-cost competition from upstart rivals. Unfortunately, one notable dissenter to the new competitive regime was Jim Wright, then-speaker of the House of Representatives and Democratic congressman from Fort Worth. Wright was not powerful enough to stop deregulation, but he was able to lend his name to the statute that blocked open competition at home in the North Texas market.

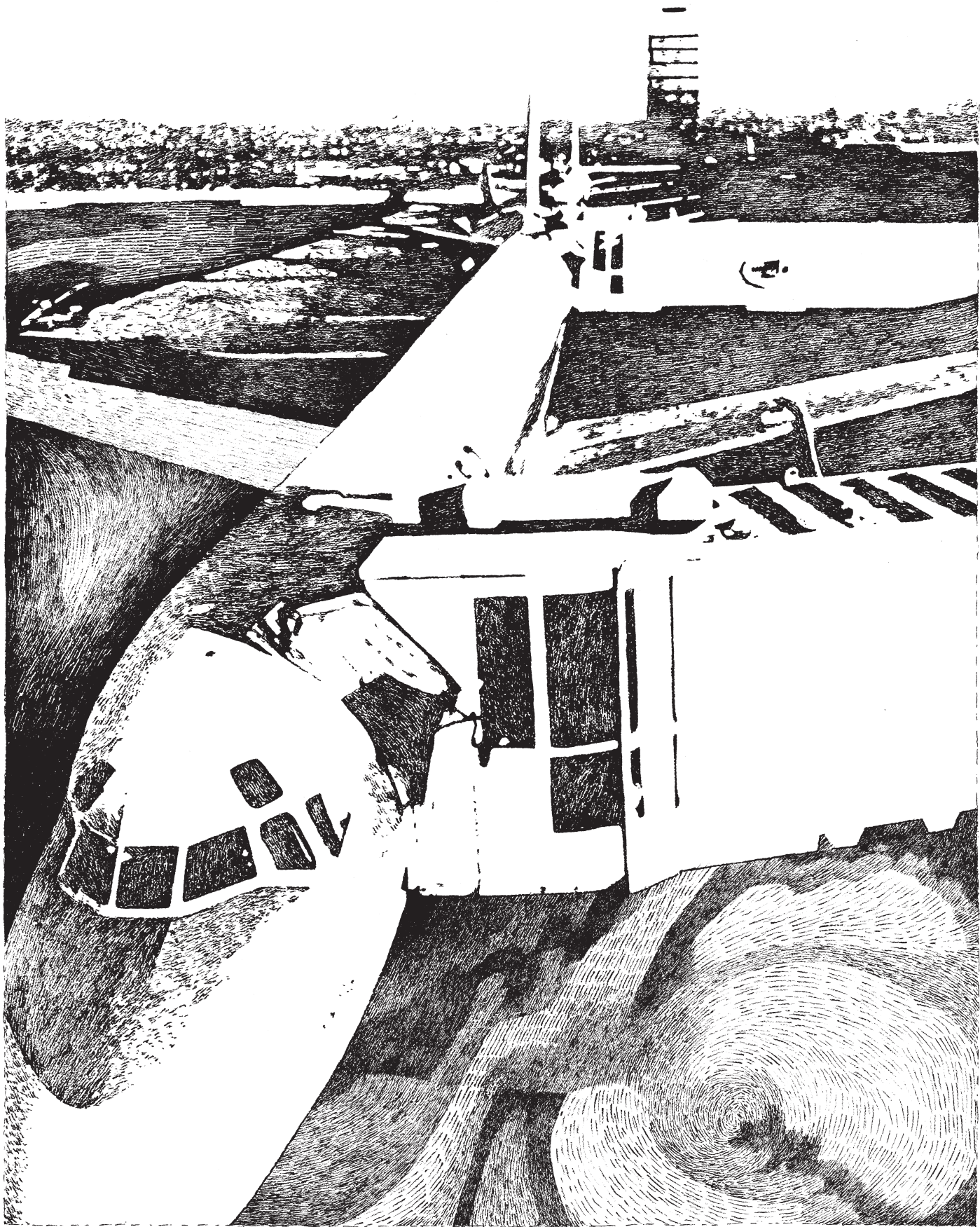
His case was highly particularistic. During the early 1960s, the Federal Aviation Administration determined that Dallas's existing local facilities, including Love Field, were not large enough to handle the expected increase in traffic for the growing North Texas market. Its recommendation was to construct a major new international airport to handle the anticipated rise in traffic.

In one sense, the conclusion was hardly exceptional. New York City had already outgrown LaGuardia; ditto Chicago with Midway. But in both cases, the old airports remained free to offer unlimited service even as new and larger fields were brought on line. That practice seemed to hold when Dallas/Fort Worth International opened its gates in 1974 — three years after Southwest had made its home at Love Field, close to downtown Dallas.

In its inception, Southwest flew only inside Texas and thus below CAB radar, which allowed it to offer unregulated low prices. With the 1978 repeal of the CAB restrictions, Southwest quickly made a powerful mark in the interstate market, undercutting the prices of the established airlines, including American Airlines, which had, and still has, the dominant position at DFW with around 80 percent of the gates.

The 1979 Wright Amendment stipulated that "public convenience and necessity" required a unique, ad hoc limitation on the Southwest flights out of Love Field. It forbade the use of any planes holding more than 56 passengers for flights outside Texas or its four contiguous states: Arkansas, Louisiana, New Mexico, and Oklahoma — small markets all. The 1997 Shelby Amendment added Alabama, Kansas, and Mississippi

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to the list of unregulated states. Missouri joined the group in 2005. The major markets, including California, Florida, Illinois, and New York, remain subject to the prohibition of the original Wright Amendment to this day.

No small plane is viable on longer routes, so the Wright Amendment, by design, locked Southwest out of the interstate market. The short-term justification for this maneuver was to help DFW recover its extensive costs, an enviable break never afforded to any player, wise or foolish, who places big bets in competitive markets. The Wright Amendment has long been excoriated as a regrettable hangover from the earlier CAB era — another black eye for the “public convenience and necessity” to which it paid lip service.

AGREEMENT AND ‘REFORM’

The loudest voice in the anti-Wright chorus was Southwest, which was denied the full and effective use of its home base. For years, travelers on Southwest were greeted with refrains to “Free Love Field” — until Southwest had a better idea, which

importantly, it does not take a detailed agreement to remove existing restrictions — simple legislation could do that. But the agreement is strictly necessary for the five contracting parties to put into place potent substitute restrictions that will both operate immediately and survive the repeal of the Wright Amendment, potentially in perpetuity.

GATE GAMES As its first restrictive practice, the five-party contract explicitly divides the market for flights to or from the Dallas/Fort Worth area into two segments. All nonstop international commercial passenger service will take place only at DFW Airport. No direct flights or through ticketing to locations outside the 50 states and the District of Columbia can be booked through Love Field; the flights must still stop within either Texas or within the eight exempt states under the Wright Amendment.

At the same time, the number of gates, and hence the number of flights for scheduled airline service from Love Field, must be reduced, as soon as is practicable, under the agree-

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was to team up with DFW and American Airlines to divide the monopoly spoils of the North Texas market.

Splitting monopoly power is no easy task because it requires that the parties win a two-front war. First, they have to allocate the gains between them in a stable fashion that guards against cheating by either player. Second, they have to find a way to block new entry by savvy competitors that otherwise would find a comfortable home underneath the monopoly umbrella.

Both airlines were highly aware of those difficulties. In conjunction with DFW and the cities of Dallas and Fort Worth, they crafted an agreement that achieved those goals. The five parties finalized their detailed contract on July 11, 2006, and received congressional blessing with the Wright Amendment Reform Act later in October.

One stated objective of the agreement is beyond reproach: to eliminate all restrictions found in the Wright Amendment in eight years. In addition, the contract has the added immediate benefit of allowing travelers who fly from Love Field to book “through tickets” from Texas to a domestic or international destination, with a layover in one of the exempt states. The Wright Amendment previously required separate booking for the second leg of any trip outside the protected area, as an added irritation to travelers.

So far so good — but not good enough. The most obvious rejoinder is that no obstacle prevents the Wright prohibition’s immediate removal, so that North Texas could, like other major markets, be served by two or more airports. More

ment, from today’s 32 gates to only 20 gates. To make sure that this 20-gate restriction limits the number of available gates, no airline is permitted to “subdivide” a gate in order to increase the number of departing flights from Love Field. Thereafter, the five-party agreement explicitly allocates 16 of the 20 Love Field gates to Southwest Airlines, two to American Airlines, and two to Continental Airlines. (For the first four years after the Wright Amendment Reform Act is enacted, the allocation is slightly different.) Love Field is tied up like a drum.

To enforce these prohibitions, the contracting parties had to neutralize the six North Concourse (or Lemmon Avenue) gates, owned by Love Terminal Partners and Virginia Aerospace, that none of the three preferred airlines were slated to use. No problem: the five-party agreement calls for the City of Dallas to take any and all steps, up to and including condemnation and demolition, to ensure that the North Concourse gates are never used for passenger service. Additional provision is made for capital expenditures to modernize the main terminal where the remaining 20 gates are located.

To implement their gate restrictions, both Dallas and Fort Worth agreed to oppose any efforts to initiate passenger air service at any local airport except DFW. Dallas mayor Laura Miller has pointedly stated on numerous occasions that new carriers are not welcome. Pinnacle Airlines — a rapidly growing discount carrier that concentrates on markets in the Southeast United States — took heed and, in June 2006, backed off its deal for the Lemmon Avenue gates, which precipitated

the suit for interference with prospective advantage that Love Terminal Partners and Virginia Aerospace filed against the mayor and the City of Dallas.

The five-party agreement understands that both Love Field and DFW are regional, not just local, airports. Accordingly, the agreement contains provisions requiring both American and Southwest to forfeit one gate at Love Field and DFW for each new gate that opens within an 80-mile radius of Love Field, up to a maximum of eight gates for Southwest and 1.5 gates for American. If other carriers do not want to take the foregone gates, then each airline can continue using the gates it otherwise would have forfeited on a common-use basis. This provision remains in effect until 2025 for both airlines. The provision reduces the prospect of third parties entering the North Texas market, for neither American nor Southwest is likely to sacrifice one gate of proven quality for a second of unknown worth. The evident purpose of these provisions is to prevent both airlines from opening new gates for the next 19 years.

THE ANTITRUST CRITIQUE

On its face, the 2006 five-party agreement violates the core antitrust prohibition against horizontal price fixing and division of territories and markets. Why then should Congress have passed the Wright Amendment Reform Act and given assistance to an agreement that is in blatant violation of the standard prohibitions of the antitrust law?

The agreement itself is a classic horizontal division of territories with a division of the spoils. The two airlines get the benefit of higher prices from reduced entry, and they share the gains with DFW in the form of higher user fees sufficient to cover the cost of demolishing the Lemmon Avenue gates.

That point is hardly novel, and when the obvious was raised by an analyst in the Justice Department, a sternly worded letter from Sen. Kay Bailey Hutchinson (R-Texas) demanded that Justice recuse itself from evaluating the Wright Amendment legislation because of its utter lack of understanding of the supposedly unique circumstances of the North Texas market. She also claimed that the matter was better handled through the Department of Transportation, which enforces the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (AIR 21). However, the senator failed to note that AIR 21 also promotes competitive policies that are at odds with the basic contract. Worse still, on close examination, the purported justifications she offers turn out to be just another dubious form of special pleading.

LOCALISM Senator Hutchinson and Mayor Miller's first claim is that the Wright Amendment Reform Act constitutes a good faith local solution to an important local transportation problem. Unfortunately, this agreement is anything but a complete local solution. It benefits the five signatories but shuts out all other local parties who are not privy to the deal. That local solution is no better than any other contract that purports to bind strangers.

Nor is there any reason to treat the proper arrangements for gates and landing fees in the Dallas/Fort Worth market sole-

ly as a local issue, comparable to the siting of a new City Hall or sports stadium. Airport routes are always and inevitably a national or international issue because airline travel is of necessity a network business. It is for that reason that the FAA has often insisted that the competitive policies promoted under AIR 21 are for the entire traveling population, not just one segment of it. The passengers who use DFW and Love Field are not all Dallas/Fort Worth residents, but come from all over the nation, some traveling to Dallas/Fort Worth and others using it as a hub for travel to other destinations. Right now, the fare premium for American Airlines from DFW has been estimated at around 22 percent. This "local" arrangement not only gouges local citizens, but it is a form of predation from regions of the country and from overseas to aid two airlines and some, but by no means all, Dallas/Fort Worth residents.

No special conditions in the Dallas/Fort Worth market justify either the travel restrictions from Love Field or the major gate reduction. It is the worst form of bootstrapping to insist the indefensible practice under the Wright Amendment justifies a further departure from the open entry regimes now in force everywhere else. Nor are the restrictions justified as means to protect the investments that DFW has made in upgrading its facilities. Of course, many pre-1979 investments in DFW were undertaken in an age when the CAB sheltered established airlines by enforcing entry barriers. Yet the 1978 Airline Deregulation Act removed those barriers in order to provoke the realignment in the airline industry from which DFW seeks a special immunity. By its twisted logic, no protective tariff, however blatant, could ever be repealed. One unearned windfall for DFW is quite enough.

At present, it makes no sense to keep planes from flying out of Love Field solely because Dallas and Fort Worth built a large airport less convenient to many users. Thirty-two years of protection are enough for an "infant" firm that is now the third largest airport in the world, as measured by its operations.

SAFETY AND ENVIRONMENT The defenders of the Wright Amendment Reform Act also claim that the flight restrictions are justified by legitimate environmental concerns about noise, pollution, and air safety. This argument fails, not because the ends are somehow illegitimate, but because the means are utterly inappropriate to the ends.

As an initial matter, no other airport has seen fit to invoke these interests to justify *prima facie* violations of the antitrust laws. And for good reason: it is easy to identify more direct ways to attack these problems without distorting the competitive process. The two airports need only set appropriate noise, pollution, and safety requirements for all flights, regardless of their destination.

Within these caps, the social objective is to maximize traffic flow as a rough proxy for consumer surplus, for each unit of noise or pollution. One counterproductive means to that end is to limit the size of planes, which keeps out high-capacity aircraft that generate less noise and pollution and fewer takeoffs and landings per passenger mile. By all means, deal with pollution through the direct regulation of noise or by setting times and locations for landing and takeoffs. But the flight restric-

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tions at Love Field have adverse, not positive, environmental consequences. The same arguments apply to congestion and collision risks. Direct safety regulation is imperative. The Wright Amendment is a dangerous distraction.

Nor does any health or safety consideration justify reducing the number of gates operating at Love Field from 32 to 20. Thirty-two gates worked just fine under the earlier 2001 master plan for Love Field. Technology on all dimensions always gets better with time so that we should expect more, not fewer, flights to work within any constant set of safety and environmental restraints.

Moreover, even if some capacity reduction is needed, why is it necessary to close the six gates of the North Concourse? These planes do not contribute more to congestion or pollution than the gates assigned to Southwest, American, or Continental. As the North Concourse gates are clearly superior to the main terminal in convenience and service, they should be the last taken out of service, not the first. Why place the full burden of this gate reduction on the nonsignatories to the 2006 five-party agreement, while giving Southwest Airlines and American Airlines a complete pass? It is far better to allow the holders of different gates to bid for the gate rights or, at the very least, to force a pro rata reduction so that those who support the restriction bear a fair share of its costs. Any allocative constraint does not justify this distributional skew in favor of the insiders, which should be condemned for its anti-competitive role.

THE POLITICAL RESPONSE

In light of the lopsided merits of this case, it is grim testimony to the degraded state of American politics and the Republican Party that this misguided agreement met with such easy success in Congress.

The legislation itself did attract some attention, but did not receive a committee hearing. The Justice Department steered clear of the deal, and the guarded opposition came chiefly from Sen. Patrick Leahy (D-Vt.) and other Senate Democrats who wondered out loud why this anticompetitive agreement should be afforded senatorial immunity. More specifically, Leahy observed: "I appreciate the changes we have been able to agree to, stripping the explicit antitrust exemption from the bill, and speaking only to the obligations of the city of Dallas, rather than blessing the agreement among the cities, the airport authority, and two airlines."

There was much glowing praise for the legislation from Senator Hutchinson, backed more cautiously by Sen. John Cornyn (R-Texas).

THE PRESENT LITIGATION

The drama itself has not come to its final resting place. The litigation continues, notwithstanding the passage of the Wright Amendment Reform Act. Center stage at present is the antitrust suit, in which the signatories to the 2006 five-party agreement have moved for dismissal. Their motion, however, does not purport to speak to the underlying social justifications for the act, but rather raise the familiar set of procedural issues that typically occupy so much of the general terrain.

I will comment only briefly on the merits of their various contentions, as the issue is very much in litigation. But it is instructive that none of the issues now in litigation go to the substantive merits of this plan under the antitrust laws, or for that matter AIR 2I.

STANDING The first point of contention goes to the question of standing, which is whether the owners of the gate are in a position to challenge the defendants' behavior at all. There is some antitrust authority that holds that only competitors and consumers should be able to claim that they have sustained antitrust injury, not parties such as the two owners of the North Concourse. The argument is that the potential demolition of the terminals is not a type of injury against which the antitrust laws are meant to guard.

The telling response is that Pinnacle Airlines has pulled out because it would rather have a gate than a lawsuit, which leaves only the owners of the gate in a position to contest the restrictive influence in the case, given their immense stake in the outcome. We know that it is highly unlikely that the Justice Department will intervene now that it has been rebuked. If these plaintiffs do not have standing, then no private party will be in a position to raise the antitrust issues that the Wright Amendment Reform Act squarely presents.

NOERR-PENNINGTON The second defense in this case deals with the scope of the so-called *Noerr-Pennington* immunity from antitrust liability. According to this doctrine, parties cannot be held liable for violations of federal antitrust laws when they petition Congress for protection against competition, because their lobbying activities are protected by the First Amendment.

This doctrine was of far less importance in the pre-New Deal era when the Court showed some spine by striking down laws that resulted in state-created monopolies. But on economic and constitutional issues, the hallmark of the New Deal is the Progressive insistence that Congress is wise enough to determine which cartels to favor and which ones to reject. At this point, there is something to be gained from petitioning the Congress, which is then the source of this implied immunity from the antitrust act. But the question remains whether that doctrine is broad enough to cover all the pre-petition activity that led to the formation of the agreement itself.

ANTITRUST IMMUNITY These two doctrines are in large measure the preliminary canter, for it is most likely that the outcome of the case will turn on the question of whether the agreement is entitled to receive protection under the state immunity doctrine that was read into the Sherman Act in the famous 1943 decision in *Parker v. Brown*. *Parker* is best understood as a decision that respects the ability of state governments and local municipalities to choose between cartels and competition, free of the effect of the federal antitrust laws. Its central proposition is that unless Congress speaks on these matters, the states should have the same power as Congress to choose between competition and cartel.

In my view, *Parker* represents the New Deal's worst in

antitrust policy. National cartels are bad enough, but at least in Congress the domestic opponents are able to rally against them. But state cartels, such as the raisin cartel whose actions were blessed in *Parker*, are not even subject to this imperfect legal check. Rather, the local political forces will push hard for cartels that enrich the state, or some segment of it, but impoverish the nation, which is what is happening here.

There is no doubt that if the Wright Amendment Reform Act had explicitly removed any and all antitrust immunity, then the question would be resolved because the *Parker* rule is confined only to cases of congressional silence. But the interplay between the explicit authorization of actions pursuant to the contract and Senator Leahy's observation, quoted above, that the courts should decide the merits of the issue leave the case in antitrust limbo. A further complication arises from the possible application of Congress's 1984 Local Government Antitrust Act, which on its face prevents damage suits against local governments, and which has been read to extend its protection in at least some cases to the private parties who have cooperated with state and local governments.

A simple decision to enjoin the implementation of the agreement is in the cards, without an award of damages. Owing to the manifest antitrust violations, hefty damages against American and Southwest remain a live possibility. We can hope to avoid all of those consequences. The Democrats who control the current Congress can certainly prove themselves to be greater friends of competitive markets than the Republicans from whom they wrested congressional control. All that remains is for them to gather their wits and repeal this misnamed "reform" legislation. Only time will tell.

EMINENT DOMAIN The litigation frontier is clouded by two other developments. The first is whether Dallas is able to knock the North Concourse gates out of commission.

One initial response is that the Supreme Court's *Kelo* decision confers broad power on state and local governments to condemn property to implement their version of the public good. But in fact, matters are not so simple because the one caveat in *Kelo* with some bite holds that naked or pretextual transfers from one party to another are still blocked by the constitutional prohibition that requires all takings to be for public use. In this case, the inference seems irresistible that the condemnation and demolition has as prime beneficiaries the two airlines that stand to gain explicitly from the transaction. The inevitable response will come in two forms. The first of these is that the public benefits from the participation of Dallas and Fort Worth. Yet in this case, the use of monopoly power should scotch that claim, for otherwise all cases with direct private beneficiaries are saved by the inevitable claim that some members of the public gain indirect benefits from the operation, even when most have to pay monopoly premia. It remains to be seen whether the articulation of this limitation in *Kelo* has legs.

The plot thickens, moreover, if Dallas tries to switch strategies by deciding to abandon demolition in favor of the lesser approach of refusing to allow any flights out of the North Concourse gates. In all likelihood, that approach will not

work because of the Supreme Court's holding that a complete loss of all use is tantamount to a physical taking, for which just compensation is required. If the complete wipeout is a taking for just compensation purposes, then it should be for public use purposes as well, so we are back to the same inquiry about the scope of the *Kelo* doctrine. It would be quite wonderful for some court to break the pattern of shameless deference to local connivances by breathing life back into some traditional constitutional limitations.

PROSPECTIVE ADVANTAGE The second unresolved issue has to do with the suits for interference with prospective advantage for scaring away Pinnacle Airlines prior to the passage of the Wright Amendment Reform Act.

Here there seems little doubt that the basic elements of this tort have been satisfied. Thus, as early as the Schoolmaster's Case of 1410, English Common Law courts knew the difference between competition and coercion. It was all right to win over the pupils of a rival schoolmaster by offering them better services. Yet to shoot at the children would be a wrong not only to them, but to the schoolmaster who lost their business when the young scholars were frightened away.

The war of resemblances seems pretty clear in this contest. The threat of Mayor Miller to pull the rug out from under the terminal is a threat to use force in violation of the general obligation to treat airports as common carriers, whose function under AIR 2I is to facilitate competition between potential users.

The usual issues of sovereign and official immunity remain in play. But as the entire government effort is to subvert the operation of competitive markets, it is hard to see why any legitimate government protects these actions. Speaking generally, ordinary principles of private law allow, at the very least, the owners of the gates to enjoin all threats of illegal conduct. And if somehow the condemnation is allowed to go forward, then the economic losses from the use of the gates should be compensable as well, both before and after the condemnation takes place.

DEFERENCE VS. PRINCIPLE

It is evident that the legal issues will be hotly contested and the outcome is hard to predict owing to the systematic tension. But every first principle of law cries out against the use of state power to aid private division of territories by blowing up the facilities of ordinary business competitors.

Any court that fastens on to the enormity of the underlying behavior will not be impressed by the strained arguments used to support this deviation from the principles of fair play in open markets. At this point, they might decide that the usual rules that give enormous deference to actions done pursuant to federal and state law just do not fit this situation.

The *Dallas Business Journal*, which wrote often and well about this sorry saga, on passage of the law concluded simply that "The Fix Was In." Dead on. There is nothing about the sad history of the Wright Amendment that justifies its follow-on reform act on dubious path-dependent grounds. The case is so egregious that any and all courts should use all the tools of the antitrust law, the constitutional law, and the tort law to bring this long-running horror show to its merciful end. **R**