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THE ECONOMICS OF POST-SEPTEMBER 11 FINANCIAL AID TO AIRLINES

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INTRODUCTION

In one of the first legislative responses to the terrorist attacks of September 11, 2001, Congress passed the Air Transportation Safety and System Stabilization Act¹ (ATSSSA), and President Bush signed it into law on September 23, 2001.² The ATSSSA provided \$5 billion in immediate and direct payments to airlines to compensate them for losses resulting from the federal ground stop order during the first four days after the attack, and for further losses that the airlines were expected to incur as a result of reduced air traffic from September 23 through December 31, 2001.³ The ATSSSA also created the Air Transportation Stabilization Board (ATSB)⁴ and authorized it to issue federal credit instruments, such as direct loans or loan guarantees, totaling up to \$10 billion,⁵ to assist air carriers whose financial survival was put at risk by the terrorist attacks and the subsequent collapse in air traffic.⁶

The ATSSSA also caps the aggregate liability of each airline arising from the September 11 incidents or other terrorist acts at \$100 million⁷ and expands the existing authority for the government to provide war-risk liability insurance for aircraft operating on certain foreign routes⁸ to cover domestic routes as well.⁹ The new authority authorizes the Department of Transportation to subsidize insurance costs for at least 180 days after passage of the ATSSSA.¹⁰

As of early November 2002, the ATSB had closed on a loan guarantee of

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1. Air Transportation Safety and System Stabilization Act, Pub. L. No. 107-42, 115 Stat. 230 (2001) [hereinafter ATSSSA].

2. James D. Tussing & Stewart B. Herman, *Government Acts to Bail Out U.S. Airlines*, 226 N.Y. L.J. 1 (2001).

3. ATSSSA § 101.

4. *Id.* § 102(b).

5. See U.S. Dep't of the Treasury, Office of Domestic Finance, Air Transportation Stabilization Board, *Mission*, at <http://www.ustreas.gov/offices/domestic-finance/atsb> ("The Board may issue up to \$10 billion in Federal credit instruments, e.g. (loan guarantees).") (last visited Nov. 11, 2002).

6. ATSSSA § 102(c).

7. *Id.* § 201(b)(1)(B)(2).

8. 49 U.S.C. §§ 44301-44310 (2001).

9. ATSSSA § 201(a); Tussing & Herman, *supra* note 2, at 4.

10. ATSSSA § 201(b)(1)(B)(4).

\$390 million for America West Airline (backing a loan of \$429 million)¹¹ and had conditionally approved a loan guarantee of \$900 million for US Airways.¹² Despite the offer of restructuring assistance from the ATSB, however, US Airways was unable to secure sufficient concessions from creditors, suppliers and labor quickly enough to prevent it from having to seek protection from the bankruptcy courts, which it did on August 11, 2002.¹³ The ATSB did not rescind its loan guarantee, but on August 12, 2002, issued a letter confirming that the offer was still open, "subject to the conditions set forth in the Board's July 10 letter to US Airways and to the bankruptcy court's confirmation of a plan of reorganization."¹⁴ As of early December 2002, US Airways was still in bankruptcy negotiations.¹⁵ United Airlines' request for a \$1.8 billion loan guarantee was rejected on December 4, 2002,¹⁶ and on December 9, UAL Corp., the parent company of United Airlines, also sought protection from the bankruptcy court while it continued to negotiate with creditors and unions to restructure.¹⁷

Meanwhile, the ATSB had denied Vanguard Airlines its requested loan guarantee on July 29, 2002,¹⁸ and had denied National Airlines, Inc. and Spirit

11. See U.S. Dep't of the Treasury, Office of Domestic Finance, Air Transportation Stabilization Board, *Recent Activity*, at <http://www.ustreas.gov/offices/domestic-finance/atsb/recent-activity.html> [hereinafter ATSB, *Recent Activity*] (chronology of significant events) (last visited Nov. 11, 2002). The loan guarantee for America West was subject to stringent restructuring provisions, including a grant of America West stock options sufficient to give the government up to a one-third interest in the company if exercised. See *infra* notes 102-07 and accompanying text.

12. Frank Reeves & Jim McKay, *US Airways Loan Plan Given Key Approval*, PITT. POST-GAZETTE, July 11, 2002, at A1. The loan guarantee for US Airways was subject to the airline receiving further concessions from its employees and lenders, and offering a larger equity stake to the government. See *id.*; see also Keith L. Alexander, *Airlines Wait for Word from Board*, WASH. POST, July 27, 2002, at E1; Caroline Daniel, *Companies & Finance International—US Airways Given Extra Loan Conditions*, FIN. TIMES, July 12, 2002.

13. See Susan Carey, *US Airways, Hit Hard by Terror, Files Chapter 11; United May Be Next as Bid for Emergency Aid Snags; Carriers Wrestle With Costs*, WALL ST. J., Aug. 12, 2002, at A1.

14. *Air Transportation Stabilization Board's Statement on US Airways' Plan for Chapter 11 Reorganization*, Air Transportation Stabilization Board press release, Aug. 12, 2002, available at <http://www.ustreas.gov/press/releases/po3342.htm>.

15. *US Airways Posts \$335 Million Loss*, WASH. POST, Nov. 2, 2002, at E3.

16. Susan Carey & Scott McCartney, *Charting United's Turbulent Future: Near Bankruptcy, Airline Boasts Coveted Routes That Could Save It; Labor Pacts Face an Overhaul*, WALL ST. J., Dec. 6, 2002, at A1.

17. Susan Carey & Thomas M. Burton, *UAL Files for Bankruptcy Protection*, WALL ST. J., Dec. 10, 2002, at A3.

18. See ATSB, *Recent Activity*, *supra* note 11. Vanguard Airlines had actually been denied a loan guarantee three times by the end of May, and had reapplied a fourth time on June 27, 2002. See Eric Palmer, *Vanguard Airlines' Future Up in Air*, MYRTLE BEACH SUN-NEWS, June 29, 2002, at D2.

Airlines, Inc., federal loan guarantees on Aug. 14, 2002.¹⁹ On the other hand, it conditionally approved an application by American Trans Air, Inc. for a loan guarantee on September 26, 2002,²⁰ and conditionally approved guarantees for Frontier Airlines and Aloha Airlines in early November.²¹ The remaining applications (by Corporate Airlines, Evergreen International Airline, Gemini Air Cargo, Great Plains Airlines, MEDjet International, and World Airways) were apparently still pending.²²

Throughout this year, the Department of Transportation has also continued to subsidize airline insurance, according to authorization in ATSSSA.²³ The original legislation provided only that insurance be subsidized for the first 180 days after September 11, 2001, but DOT extended the authority in March, May, and June²⁴ and sought to extend it again in October.²⁵

The idea of the federal government occasionally providing loan guarantees or other financial assistance to individual companies at risk of failure is not new. In fact, the list of federally financed or orchestrated “bailouts” of private corporations during the last few decades—including Lockheed (in 1971), Conrail (in 1976), Chrysler (in 1979), Continental-Illinois Bank (in 1984),²⁶ the restructuring of the Savings & Loan industry in the 1980s,²⁷ Long-Term Capital

19. ATSB, *Recent Activity*, *supra* note 11. National Airlines ceased operations in early November, after two years in bankruptcy court. See *National Airlines*, WASH. POST, Nov. 7, 2002, at E2.

20. ATSB, *Recent Activity*, *supra* note 11.

21. *Frontier Airlines, Aloha Receive Approval for Loan Guarantee*, WALL ST. J., Nov. 6, 2002, at A2.

22. See *List of Airlines Seeking Aid*, ASSOCIATED PRESS, June 29, 2002; see also David Bailey, *ATA Files for Loan Guarantees from U.S.*, WALL ST. J., July 1, 2002, at B8; *Three Small Airlines Apply for Guarantees on Federal Deadline*, WALL ST. J., July 9, 2002.

23. See *supra* note 9 and accompanying text.

24. See *Airlines' War Insurance Is Extended by 60 Days*, WALL ST. J., Mar. 14, 2002; Stephen Power & Christopher Oster, *U.S. Extends Insurance Coverage Again for Airlines After Sept. 11*, WALL ST. J., May 16, 2002, at D6; *U.S. Government Extends War Risk Insurance*, COMMUTER/REGIONAL AIRLINE NEWS, June 24, 2002.

25. See *FAA APO Third Party War Risk Liability Insurance*, at <http://insurance.faa.gov>. (noting that “The FAA will offer an Amendment to the current Third Party War Risk Liability Insurance Policy which terminates on Wednesday, October 16, 2002. This Amendment will extend the coverage from October 16, 2002, to December 15, 2002.”)

26. Robert B. Reich, *Bailout: A Comparative Study in Law and Industrial Structure*, 2 YALE J. ON REG., 163, 164 (1985) (listing all of the “bailouts” noted except the restructuring of the savings and loan industry, Long Term Capital Management, and Amtrak, but discussing only the Chrysler bailout at length, comparing the policy implications of government orchestrated bailouts of similar industrial companies in United States, Great Britain, Germany and Japan).

27. See Alane Moysich, *The Savings and Loan Crisis and Its Relationship to Banking*, in 1 FDIC, HISTORY OF THE EIGHTIES—LESSONS FOR THE FUTURE 167 (1997), available at www.fdic.gov/bank/historical/history/167_188.pdf (describing the federal restructuring of the savings and loan industry in the 1980s).

Management (in 1998),²⁸ and the ongoing subsidy of Amtrak²⁹—suggests that, if a company is large enough, and the impact of its failure potentially catastrophic enough, the federal government can be expected to get involved somehow in the financial restructuring of the company.³⁰

Yet while the idea of occasional federal bailouts of large and economically important corporations which find themselves in serious financial distress is not new, it is unusual for legislation to be passed in anticipation of financial distress in an entire industry, offering the possibility of federal financial support to any and all comers from the industry.³¹

This Article considers the economic and policy merits of this unusual piece of legislation, the rules issued to implement the legislation, the industry response, and the implications of the actions taken so far by the ATSB under the ATSSSA.

I. ECONOMIC RATIONALES FOR SUBSIDIES AND BAILOUTS

Under what circumstances should government provide subsidies or other aid to support a particular kind of economic or other activity? As a general rule, economic theory tells us that private sector businesses will allocate resources efficiently in response to prices determined in free markets. This theory suggests

28. See Tom Herman, *The Long-Term Capital Bailout: Historians Marvel at Rescue's Size, Twists*, WALL ST. J., Sept. 25, 1998, at A8 (describing the bailout); see also Matt Murray, *Fed Tells Banks to Tighten Standards for Loans They Extend to Hedge Funds*, WALL ST. J., Feb. 2, 1999, at A4.

29. See Don Phillips, *Agreement Reached on Aid to Amtrak*, WASH. POST, June 29, 2002, at E1.

30. Whether each of the named instances of federally-coordinated bailout was good policy or not, or whether it is generally good policy occasionally—but not predictably—to rescue a company from bankruptcy proceedings, are obvious questions for debate. This Article will not address these general questions, though it will offer some comparisons between the rationale for, and process by which previous bailouts worked, and rationale and processes envisioned in the airline bailout legislation.

31. To be sure, agricultural support legislation has been a regular staple of congressional action since the Depression. Some scholars have wondered why the federal government has been so willing for so long to grant huge subsidies to this industry. See, e.g., David S. Bullock & Jay S. Coggins, *Do Farmers Receive Huge Government Transfers in Return for Small Lobbying Efforts?*, Mar. 2, 2001 (manuscript on file with author). I have not tried to figure out whether there is an economic difference between agricultural subsidies, and subsidies and bailouts of industrial companies, but clearly there is a political difference. One could also argue that the Federal Savings and Loan Insurance Corporation (FSLIC) was a vehicle put in place to make federal involvement in restructuring an entire industry inevitable, but it was not contemplated when the FSLIC was created that virtually all of the savings and loans in the industry would have to be bailed out at the same time. The Regional Rail Reorganization Act of 1982, 45 U.S.C. §§ 701-797 (1982), by which the federal government reorganized and combined several failing northeastern and midwestern railroads, may be the clearest precedent for the ATSSSA, although railroad reorganization was not precipitated by a war or other catastrophic event.

that government should not impose taxes or provide subsidies that distort the signal provided by these market prices. Nonetheless, it is widely appreciated that in the presence of certain “market failures,” government regulation or subsidies may be necessary for markets to reach an efficient outcome.³²

One type of market failure that might call for government intervention in the form of taxes or subsidies occurs when an activity generates “externalities.”³³ For example, smoking is believed to cause harm to parties who do not themselves smoke—from second-hand smoke, for example, and also from the costs to society of additional burdens on the health care system. These are negative externalities whose costs are not automatically internalized in the price of cigarettes. Hence it is widely accepted that cigarette smoking should be taxed rather heavily to raise the price of smoking to smokers and thereby encourage them to kick the habit.

Similarly, scientific research often produces positive “externalities”—benefits that vastly exceed those that can be captured (through salaries, patent rights, etc.) by the researchers. So federal and state governments provide substantial ongoing subsidies to support scientific research.³⁴

“Public goods” are special cases of goods with positive externalities.³⁵ A public good is a commodity that benefits everyone within a given country or community regardless of whether they have paid for the good.³⁶ Moreover, it costs no more to provide the good for everyone than it does to provide it for one person.³⁷ A common example of a public good, and one that may be of particular relevance to this discussion, is national defense. Economists generally agree that efficiency can be enhanced by taxing citizens to provide government subsidies for public goods and for other goods or activities that have positive externalities.

Another situation in which government subsidy or regulation might sometimes be needed to achieve economic efficiency is a natural monopoly, in

32. See, e.g., JOHN B. TAYLOR, *PRINCIPLES OF MICROECONOMICS* 453 (Denise Clinton ed., 1995) (defining market failure as “any situation in which the market does not lead to an efficient economic outcome and in which there is a potential role for government”).

33. *Id.* at 516 (defining an externality as a situation in which “the costs of producing a good or the benefits from consuming a good spill over to individuals who are not producing or consuming the good.”).

34. Author’s calculations from National Science Board data indicate that, in 2000, federal, state and local government funding for research and development totaled more than \$67 billion, or about 27% of total R&D expenditures by government, industry, universities and colleges, and other nonprofit institutions. See *National Science Board*, Appendix, Table 4-4, at http://www.nsf.gov/sbe/srs/seind02/pdf_v2.htm#c4.

35. TAYLOR, *supra* note 32, at 511 (defining “public good” as “a good or service having two characteristics, *nonrivalry in consumption* and *nonexcludability*,” “nonrivalry” is further defined as a situation in which increased consumption by one person does not reduce the availability of the good for consumption by another; “nonexcludability” is defined as a situation in which it is impossible to prevent people from consuming a good).

36. This is due to the “nonexcludability” characteristic of the good.

37. This is due to the “nonrivalry” characteristic.

which there are very high fixed costs to provide some good or service, so that the average cost of providing the good always exceeds the marginal cost.³⁸ In such a situation, private sector providers of the good would have to charge at least the average cost for each unit of their products to avoid financial ruin, but would be under pressure in a competitive market to charge only the marginal cost. In such industries, price wars tend to squeeze smaller players out, and the industry tends toward monopoly, with all of its pathologies.³⁹ Government might be able to help solve this problem by providing or subsidizing the construction of the fixed assets that are the source of declining average cost structure.

A fourth reason that government regulation or subsidy might be justified is simply that society may have goals other than efficiency that will not be met in a pure free market economy. For example, U.S. society places a very high value on education, which is expressed by providing free public education through high school for all U.S. residents under the age of eighteen, and by heavily subsidizing post-secondary education.⁴⁰

Thus, in analyzing Congress's decision to offer financial support to airlines in the wake of the September 11 terrorist attacks we should ask whether the attacks created a market failure in the air transportation system that was not there before or exacerbated an existing one. In particular, we will ask whether some new or enhanced market failure threatened the continued operation and financial health of individual airlines, or of the airline industry as a whole, or whether the industry provides some kind of public good or produces some other positive externality that justifies subsidy, or whether financial health of the airlines serves some other social goal whose value exceeds the cost of the financial support given.

There are several possible reasons why subsidies to the airline industry in the wake of the September 11 terrorist attacks might be economically efficient.

38. TAYLOR, *supra* note 32, at 314 (defining natural monopoly as an industry in which average total cost is declining over the entire range of demand and the minimum efficient scale is larger than the size of the market).

39. In an industry that is a natural monopoly it is generally more operationally efficient for the market to be served by a single provider. But if that single provider is not regulated, it will tend to "over charge" customers by charging the revenue maximizing price. For a monopolist, this price is higher than the price at which the marginal cost of supplying the next unit is equal to the marginal value of the next unit to customers. *Id.* at 547.

40. Economic analysis generally indicates that the private benefits of education exceed the costs, and so one might think that people would have an incentive to get an education even without public subsidies. But liquidity constraints may prevent a large proportion of the population from getting an education, despite the long-term expected benefits. Moreover, some scholars argue that having an educated population produces economic benefits to a society that exceeds the sum of the private benefits—in other words, education has positive externalities. *Id.* at 518. Both possibilities would provide purely economic rationales for public subsidies to education, in addition to the social value rationale.

A. The Air Transportation System as a Whole is a Natural Monopoly

The reason is that there are huge fixed costs associated with constructing and maintaining airports, in providing an air traffic control system, and, of special relevance since September 11, in providing security.⁴¹ Hence the government (at federal, state and local levels) has long been heavily involved in financing the air transportation system by providing (and subsidizing) airports, the air traffic control system, and now airport security. Given that these facilities and systems were in place prior to September 11 and are not easily redeployed, efficiency is generally enhanced the more the facilities are used.⁴² If usage falls off suddenly, as it did in the aftermath of the September 11 attacks, the overall efficiency of the air transportation system might be enhanced by some sort of stimulant to additional travel.

This argument might provide a rationale for the government to stimulate travel by subsidizing travelers (for example, by providing tax deductions for personal travel as well as business travel, suspending federal aviation taxes,⁴³ or buying and distributing the equivalent of frequent flyer miles to taxpayers (e.g., like the \$300 advances on 2001 tax cuts distributed to many taxpayers during the summer of 2001). While subsidizing travelers might be expected to boost travel in ordinary times, in the first few months after September 11, travel was probably more likely to be increased by increasing travelers' confidence that air travel would be safe and convenient. As discussed below, the quick passage of the ATSSSA by Congress may have had significant value as a reassurance to travelers.⁴⁴ In any case, the natural monopoly argument only translates into an argument for directly subsidizing individual airlines if the subsidies to airlines

41. One could also argue that there are substantial fixed costs involved in providing hotel, restaurant, and rental car services to people who use the air transportation system. But these costs, while large in the aggregate, may be less "fixed" in the sense that they are more easily broken up into small units that can be provided incrementally (or redeployed to other uses) in response to changes in demand. Nonetheless, one might reasonably ask why, if it is regarded as a federal responsibility to subsidize the losses incurred by airlines in the wake of September 11, it should not also be a federal responsibility to subsidize the entire travel sector. I will not attempt to address this question in this Article.

42. This is because the marginal cost of adding one more passenger or one more flight is very small when the system is not operating at full capacity. At some point, however, increased usage of the air transportation system by travelers would begin to have a negative externality cost in increased congestion, but those costs can usually be internalized through some type of "peak-load" pricing by the airlines in selling seats on their various flights. The analysis above assumes that, in the aftermath of September 11, the system as a whole has operated well below maximum capacity for an extended period of time, so that the cost at the margin of an additional traveler flying an additional flight is well below the average cost of providing that seat to that flyer.

43. Federal aviation taxes include both a ticket tax and a fuel tax. This solution is recommended in Steven A. Morrison & Clifford Winston, *Bailing Out the Airlines*, BOSTON GLOBE, Sept. 24, 2001, at 19.

44. See Conclusion, *infra*.

are passed through to travelers in the form of reduced ticket costs.

B. Each Link in the Air Transportation System Produces Positive Externalities

The idea here is that each functioning link in the transportation system has a value as part of the network that exceeds the value of that link in isolation. The idea of such network externalities has been applied to such things as telephone service and computer software: having access to telephone service increases in value when more people have telephone service; likewise, some software programs become more valuable with more users.⁴⁵ Yet the idea of network externalities in air transportation is less obvious.

Suppose that Point One is a "hub" in an air transportation system (a major airport through which passengers are routed and regrouped to be carried to their destinations on connecting flights). Airline A provides service on a route between Point One and Point Two, which not only benefits travelers who want to travel from One to Two, or from Two to One, but may also benefit travelers who want to go from Two to Three, or from Two to Four, if they can get to those other destinations from Two by going through Point One. Thus, each route serving an additional destination from Point One increases in value due to the existence of the other destinations already served from that hub. If Airline A provides service to and from two dozen cities (Two through Twenty-five) from the airport at Point One, then if Airline B provides service between some other city (Twenty-six) and Point One, the value of that single link is enhanced by the existence of the links that Airline A offers from the airport at Point One to places Two through Twenty-five.

The existence of network externalities achieved through a "hub-and-spoke" system design suggests that Airline B benefits from the fact that Airline A provides service from Point One to cities Two through Twenty-five. In other words, A's hub system generates positive externalities for Airline B. The link provided by B to destination Twenty-six also adds some value to Airline A's hub.⁴⁶ To the extent that there are network externalities in hub-and-spoke systems, a decline in service into and out of a hub by one airline may have spillover costs to other airlines that serve that hub. On the other hand, if Airline A cuts back its service out of Point One, this might create an opportunity for airline B to profitably expand its service out of that hub,⁴⁷ so it is not clear

45. See Michael L. Katz & Carl Shapiro, *Network Externalities, Competition, and Compatibility*, 75 AM. ECON. REV. 424, 424 (1985) (defining the concept); Michael L. Katz & Carl Shapiro, *Systems Competition and Network Effects*, 8 J. ECON. PERSP., 93, 93-115 (1994) (discussing network effects in communications systems and in software systems).

46. "Everyone benefits by consolidated routes and more cross-country and transcontinental travel. And having these large national airlines aids that network effect," Yale law professor George L. Priest told the *New York Times* in the fall of 2001. Stephen Labaton, *Airlines and Antitrust: A New World. Or Not*, N.Y. TIMES, Nov. 18, 2001, at C1.

47. As will be discussed below, there is evidence that small regional carriers have been taking

whether the net effect on B is positive or negative. Hence it is unclear whether the general collapse in demand for air travel after September 11, combined with the existence of network externalities associated with airlines that operate with hub-and-spoke configurations, implies any role for government action.

The analysis is complicated, however, by the fact that hub-and-spoke systems have some of the characteristics of a natural monopoly. The establishment of a hub involves substantial fixed costs, and the marginal cost to a hub-and-spoke operator of operating an additional route that connects that hub to another destination point will generally be lower than the average cost of operating all the routes into and out of that hub.⁴⁸

The unusual economics of hub-and-spoke operations may help explain several recurring patterns in the airline industry since the industry was deregulated in 1978. First, the major airlines that operate hub-and-spoke systems have had trouble maintaining profitability, especially during recessions or widespread economic slowdowns⁴⁹. Meanwhile, some regional carriers that do not operate hub-and-spoke systems have managed to be profitable even in down cycles (Southwest Airlines has established the most successful of the low-fare non hub-and-spoke business models, but other regional airlines such as JetBlue and Frontier have lately begun pursuing the same model⁵⁰). Finally, hub-and-

advantage of cutbacks by major carriers in the current market to attract business travelers, who have traditionally tended to give their business to the major airlines that operate hub-and-spoke operations. *See infra* notes 120-26, 150-53 and surrounding text.

48. Economists and airline analysts have argued that hub-and-spoke operations produce “economies of scale” that save the operator costs by “centralizing maintenance and allowing the use of larger planes that are filled closer to capacity because people can be gathered from many places, sorted out at the hub with timely connecting flights, and sent on to many other places.” Steven A. Morrison & Clifford Winston, *The Remaining Role for Government Policy in the Deregulated Airline Industry*, in DEREGULATION OF NETWORK INDUSTRIES: WHAT’S NEXT?, 4 (Sam Peltzman & Clifford Winston eds., 2000). But because the upfront costs of establishing a hub can be high, hub operations have generally been assumed to create barriers to entry to other airlines, which some economists believe make it possible for hub-and-spoke operators to charge a “hub premium,”—a ticket price for trips routed through the hub that is higher than it otherwise would be because of lack of adequate competition by non hub-and-spoke operators serving that same origin and destination point. But lately, economists have begun to question the “hub premium” argument, as well as the notion that hub-and-spoke operations have lower operating costs, noting that Southwest Airlines has managed to successfully underprice many hub-and-spoke operators because its costs per mile are consistently lower than the larger hub-and-spoke airlines’ costs. *See id.* at 5-6.; *see also* discussion, *infra* Part VII.

49. Steven A. Morrison & Clifford Winston, *Causes and Consequences of Airline Fare Wars*, in BROOKINGS PAPERS ON MICROECONOMIC ACTIVITY 85, 85 (1996) (noting that “[s]ince the airline industry was deregulated, its financial performance has continued to be extremely volatile.”). They estimate, for example, that from 1990 to 1993, a period which included a mild recession and the Gulf War, the industry lost nearly \$13 billion. *Id.* *See also* Rodney Ward, *September 11 and the Restructuring of the Airline Industry*, DOLLARS & SENSE, May 1, 2002, at 16.

50. *See, e.g.*, Melanie Trotman & Scott McCartney, *Executive Flight: The Age of “Wal-*

spoke operators are frequently accused of predatory behavior such as initiating fare wars in hopes that they can outlast and drive out of business the regional carrier competing with them on routes that would otherwise be quite profitable for the hub operator.⁵¹ While these fare wars are good for travelers, they leave the airline industry as a whole continually struggling for profitability.⁵²

One of the implications of this analysis is that, if all other factors are equal,⁵³ hub-and-spoke systems should be able to operate at a lower average cost than non-hub-and-spoke operators during periods of high demand, but they may be less able to cut costs during periods of slow demand. Meanwhile, to the extent that hub-and-spoke operations provide positive externalities to other airlines that operate individual routes into and out of that hub, there may be a valid economic reason for subsidizing hub-and-spoke operators at least enough to prevent them from failing during slow times and closing down their hub operations. However, this would only be true if the hub operators could be prevented from using the subsidy to sustain them through a fare war designed to drive a competing regional carrier out of some market.

Applying these arguments to the specific policy questions that arose in the

Mart” Airlines Crunches the Biggest Carriers, WALL ST. J., June 18, 2002, at A1.

51. Morrison & Winston, *supra* note 48, at 7 (noting that “[c]ritics have been accusing [major] airlines of predatory practices for more than a decade.”). In the spring of 1998, a Transportation Department report found that

[i]n recent years, when small, new-entrant carriers have instituted new low-fare service in major carriers’ local hub markets, the major carriers have increasingly responded with strategies of price reductions and capacity increases designed not to maximize their own profits but rather to deprive the new entrants of vital traffic and revenues.

Id. (citing U.S. Department of Transportation, Office of the Secretary, Docket No. OST-98-3713, Notice 98-16). Morrison and Winston find evidence that the entry into a market by a low cost carrier such as Southwest or ValuJet increased the probability of a fare war in that market, but they did not find evidence that the established carriers initiated the wars or acted in a predatory manner. Morrison & Winston, *supra* note 49, at 108-16. *See also* Morrison & Winston, *supra* note 48, at 8 (noting that large changes in fares or in capacity by large airlines in response to entry by nonmajors are unusual).

52. Morrison & Winston, *supra* note 49, at 120 (estimating that from 1979 through 1995, fare wars reduced airline industry profits by \$7.8 billion). *See also* Samuel Buttrick et al., *Airlines: Industry Update; Estimates Reduced Further*, UBS WARBURG GLOBAL EQUITY RESEARCH, June 20, 2002, at 6 (“Trading airline stocks may be hazardous to your wealth. Over the long-term, a diversified portfolio of airline stocks has reliably underperformed broader market averages.”).

53. Other costs are not equal, of course. The major airlines which typically operate hub-and-spoke systems are also more likely to have unionized workforces and older average workers, which raises their costs relative to small regional carriers. Southwest and other low-fare carriers, for example, tend to have younger fleets, which require less maintenance, and have younger labor forces that aren’t tied to complicated, inefficient labor contracts. Labor costs at AirTran Airways, Frontier, and JetBlue represent only 25% of revenue, while at Southwest, they represent 30% of revenue, and at United and Delta, labor costs are 40% of revenue. *See* Trottman & McCartney, *supra* note 50, at A8.

weeks and months after September 11 suggests that any effort by the federal government to provide financial support to individual airlines will, almost inevitably, involve the government in the complex question of determining which (if any) airlines are generating positive externalities by their operations, and how those airlines can be subsidized without encouraging them to engage in predatory practices against actual and potential competitors.

C. Transportation Systems That Provide Many Links in General Provide Positive Externalities

Shippers, travelers, and potential shippers and travelers benefit from having a richer opportunity set of routes through which they can fly or ship goods. This is simply an extension of the network externalities argument. A case can probably be made that the more functioning links there are in an air transportation system, the more valuable the system as a whole is to society. This line of argument suggests that there are positive externalities to each link in a smoothly functioning air transportation system that provides links to many locations, and that if government action is required to maintain each link, it might be efficient to take such actions.

The ATSSSA responds directly to this possible market failure by assigning to the Secretary of Transportation the responsibility to “take appropriate action to ensure that all communities that had scheduled air service before September 11, 2001, continue to receive adequate air transportation service and that essential air service to small communities continues without interruption.”⁵⁴

Although some airlines might have to be subsidized to keep the whole system functioning,⁵⁵ it does not follow from this analysis that any specific airline should be subsidized.

D. Relatedly, Having a Well-functioning Transportation System That Can Move People and Goods Smoothly and Quickly to Wherever They Are Valued More Provides a Type of Public Good

In what sense are transportation systems “public goods?” While most of the trips that individual travelers take when they use that system are private goods for which they pay at least the marginal cost,⁵⁶ note that if a well-functioning and

54. Air Transportation Safety and System Stabilization Act, Pub. L. No. 107-42, § 105(a), 115 Stat. 230 (2001). There are, of course, compelling political reasons for Congress to attempt to ensure continued air service to all communities, but the purpose of this section of the Article is to examine the economic reasons that might justify the provisions of the Act.

55. The ATSSSA also authorizes the Secretary of Transportation “to require an air carrier receiving direct financial assistance under this Act to maintain scheduled air service to any point served by that carrier before September 11, 2001.” *Id.* §105(c)(1). Thus, the ATSSSA makes it possible to use subsidies of specific airlines as a mechanism to ensure that all the links in the system are maintained.

56. Air fares are notoriously variable, even for seats on the same row of the same flight. See Keith L. Alexander, *The Price Is Different: Complaints Are Up as Passengers Learn There Can*

complete air transportation system is in place, everyone has the *option* to travel, even if only a few people take advantage of that possibility on any given day.⁵⁷ The value of that option is a public good in the sense that having the system in place gives the option to everyone at the cost of providing it to the subset of people who actually use it on any given day, and one traveler's decision to use the system does not, for all practical purposes, diminish the option value for other potential travelers.⁵⁸ "People want assurances that the airlines will keep flying, just as they want water companies to keep providing their resources," noted

Be Dozens of Fares for a Flight, WASH. POST, Apr. 6, 2002, at E1. The variation results from tactics airlines use to price discriminate, which allows them to charge higher prices to travelers with a high marginal benefit of flying. This tactic fills some of the seats with people who pay the average cost or even more, while charging the lowest prices to travelers with the lowest marginal benefit of traveling. The airlines use this tactic in hopes of filling the last few seats on the plane (which have a very low marginal cost to the airline).

57. Airlines have long tried to take advantage of the fact that the travel option is valuable, and especially that it is more valuable to some travelers (generally business travelers) than to others, by charging higher fares for tickets that come with fewer restrictions and/or are refundable.

58. Professor Ed Kitch suggested to me that this argument might be extended to a wide variety of goods and services, raising the question of whether there is something special about transportation systems in this regard. Although I have not seen this argument made elsewhere and have not worked through all of its implications, it seems to me that transportation is different. Unlike food, or apparel, or housing options, for example, transportation options have the effect of expanding the set of transaction options of all other types that are available to individual actors in an economy. Communication systems have a similar effect as do public marketplaces (including financial markets and virtual marketplaces). Thus, transportation systems have an especially enriching impact on economic activity. Transportation "is crucial to the rest of the economy, like electric power," observes Alfred E. Kahn, a professor of political economy at Cornell who oversaw deregulation as president of the Civil Aeronautics Board. Edward Wong, *The Impossible Demands on America's Airlines*, N.Y. TIMES, June 16, 2002, at 4. This may explain why, throughout history and across countries, governments often heavily subsidize the internal transportation systems of their countries. See, e.g., Sylvia de Leon, *No Way to Run a Railroad*, WASH. POST, June 24, 2002, at A19 ("Not a passenger rail system in the world runs without some form of government investment. Nor is there any system of domestic transportation that does not rely on direct or indirect subsidy."). Government subsidization includes roads, canals, and railroads, as well as airlines.

Governments built public roads, highways and expressways. Private companies built railroads and streetcar lines, but on rights-of-way owned by governments or confiscated by them for the public good, and frequently with generous helpings of public money for construction. The federal government nurtured private airline companies with air-mail fees and still owns and operates the air traffic-control system. Local governments build most airports.

Thomas G. Donlan, *Plane Arriving on Track 3: The Airline Industry May Replicate the Sorry Fate of the Railroads*, BARRONS, July 1, 2002; see also Don Phillips, *Agreement Reached on Aid to Amtrak*, WASH. POST, June 29, 2002, at E1. A full development of this idea will have to await future work.

Edward Wong recently in the *New York Times*.⁵⁹

E. The Existence of a Well-functioning and Complete Air Transportation System May also Serve a Non-economic Social Goal

For example, ease of travel may help to tie together a diverse and widely-scattered population into a unified nation. Both of the latter two possibilities provide an argument for subsidizing the air transportation system as a whole. Indeed, the regulations implementing the ATSSSA issued by the Office of Management and Budget assert that the purpose of the federal credit instruments authorized under the Act to assist financially struggling airlines is “to facilitate a safe, efficient, and viable commercial aviation system in the United States.”⁶⁰

But here again, while there are potentially legitimate arguments for federal involvement of some sort to ensure the continued existence of a smoothly functioning, safe, and efficient air transportation system, it is not obvious that subsidizing individual airlines, either by directly reimbursing their costs or by providing loan guarantees to them, is the best way to achieve this goal.

II. ECONOMIC PROBLEMS FACING AIR CARRIERS SINCE SEPTEMBER 11

By almost any measure, the airline industry suffered a huge economic cost in the wake of the events of September 11. First, all air travel was stopped entirely in the United States for four days, and then resumed very gradually. By the end of September 2001, domestic enplanements were down 34% from September 2000, and international enplanements were down about 23%.⁶¹ In late September, airline analysts estimated that airlines would be forced to reduce their output in 2001 by about 20%, or \$20 billion.⁶² With the spillover effect that the drop in air travel would have on hotels, restaurants, and tourism in general, the net loss to the economy was expected to represent as much as a one percent decline in gross domestic product, representing a significant worsening of the recession which was already under way.⁶³ Six months later, domestic enplanements were still down significantly, off by 14% from the previous year’s level,⁶⁴ and by the end of September 2002, were down 8.7% for the first three quarters of the year compared with the comparable period in 2001, a period weakened by recession and the events of September 11.⁶⁵

Although airline analysts are predicting an eventual full recovery of airline

59. Wong, *supra* note 58, at 4.

60. Regulations for Air Carrier Guarantee Loan Program Under Section 101(a)(1) of the Air Transportation Safety and System Stabilization Act, 14 C.F.R. pt. 1300 (2001).

61. Stephen Power, *FAA Expects Fares to Decline This Year but Forecasts a Sharp Increase for 2003*, WALL ST. J., Mar. 12, 2002, at A2.

62. Morrison & Winston, *supra* note 43, at 19.

63. *Id.*

64. Power, *supra* note 61, at A2.

65. Air Transport Association Monthly Passenger Traffic Report, available at <http://www.airlines.org/public/industry>.

traffic to pre-September 11 levels by 2004, the collapse in travel in 2001 and 2002 has been devastating to corporate profitability. The industry lost \$7.5 billion in 2001 (even after accounting for the \$5 billion in cash grants given airlines last fall under the ATSSSA),⁶⁶ and is expected to lose another \$8 billion in 2002⁶⁷ and at least another \$1 billion to \$1.5 billion in 2003.⁶⁸

Major financial losses in most industries are generally a signal that the industry has too much capacity in place relative to demand, and that some capacity must be shut down. Indeed, this is exactly the case in the airline industry for the years 2001 and 2002. Yet, unlike the situation of excess supply in the steel industry, for example, no one expects the decline in air traffic to be permanent, so the losses are not regarded as a signal that capacity should be permanently reduced. Nonetheless, some capacity had to be taken out of service for a while, and the losses associated with the furloughed capacity must be absorbed somehow.⁶⁹ One goal of the ATSSSA was to mitigate the transaction costs associated with temporary capacity reductions.⁷⁰

The immediate financial impact on the airlines of the collapse in traffic was offset to some degree by cash payouts provided by the ATSSSA. By October 5, 2001, just twenty-four days after September 11, the government had already paid out over \$2 billion to the ten largest airlines. These initial payments, plus the additional \$3 billion in payments paid out over the next few months, prevented the cash flow crisis from turning into a rash of bankruptcies at a number of small airlines and even a few large airlines. But for airlines that were already weak, the cash grants only postponed the need for dramatic restructuring and refinancing.

III. COMPARISON TO EARLIER CORPORATE BAILOUTS

Although political pressure to bail out large corporations in the past has often come from labor organizations that wanted to save jobs, Robert Reich has argued that the role played by government bailouts of corporations in the past has not, ultimately, been to preserve jobs or to avoid needed restructuring.⁷¹ In the bailouts that he studied, all of the corporations ultimately shrank substantially and redeployed many assets. The bailouts, in fact, accomplished many of the same things that might have been accomplished more quickly in a bankruptcy proceeding or private workout. Government involvement, he argued, does little

66. John Schmeltzer, *Airlines in Push for Credit Lines; Immediate Loans Less Attractive*, CHI. TRIB., Mar. 29, 2002.

67. *US Airways Posts \$335 Million Loss*, *supra* note 15.

68. Buttrick et. al., *supra* note 52, at 2.

69. Air Transport Association, *State of the U.S. Airline Industry: A Report on Recent Trends for U.S. Air Carriers* (2002), at 3 (noting that at the end of 2001, U.S. airlines had parked or retired some 350 aircraft).

70. Regulations for Air Carrier Guarantee Loan Program Under Section 101(a)(1) of the Air Transportation Safety and System Stabilization Act, 14 C.F.R. Pt. 1300 (2001).

71. Reich, *supra* note 26, at 222.

more than “slow the pace of shrinkage.”⁷²

Consider the Chrysler bailout, for example. Chrysler had been performing poorly throughout the 1970s, and in 1978, it lost \$204.6 million on sales of somewhat less than \$13 billion.⁷³ Debts were mounting, and in the second quarter of 1979, Chrysler lost \$207 million on \$3 billion in sales.⁷⁴ At the time, Chrysler employed 140,000 people, and hundreds of thousands more worked for suppliers. John Riccardo, then president of Chrysler, hoped that the new Democratic administration might be sympathetic to the idea of federal help to avoid massive layoffs.⁷⁵

By August 1979, the Carter administration had decided to help Chrysler, but not through tax waivers or other direct subsidies as Riccardo had hoped. Instead, G. William Miller, the new Secretary of the Treasury, proposed to introduce legislation to provide up to \$750 million in loan guarantees, but only if Chrysler came up with an acceptable restructuring plan that included financial concessions from lenders, wage concessions from employees, and other concessions from suppliers, dealers, and state governments. Moreover, Riccardo would have to step down as Chrysler president.⁷⁶ Chrysler lost \$450 million in its third quarter—a record loss at the time for a single company in a single quarter. Congress held hearings at which John McGillicuddy of Manufacturers Hanover (Chrysler’s lead bank) said that Chrysler executives had “substantially exhausted their remedies in the private sector.”⁷⁷

By early November, the Carter administration had decided that it would take at least \$1.5 billion in loan guarantees to help Chrysler recover. Although there was no organized opposition to a bailout, a number of members of Congress pressed for certain provisions, including greater concessions by employees. The bill that was finally enacted on December 20 provided guidelines for \$2 billion worth of concessions from banks, employees, dealers, and suppliers, and \$1.5 billion worth of federal loan guarantees to be doled out in several pieces, as the other restructuring moves were accomplished. It also established a loan guarantee board, which consisted of the Secretary of the Treasury, the Chairman of the Federal Reserve Board, and the Comptroller General.⁷⁸ Finally, the legislation gave the federal government 14.4 million warrants to buy Chrysler stock.⁷⁹

With the federal legislation in place, Chrysler was able to get the necessary

72. *Id.* at 224. See also Noam Scheiber, *The Airlines Sure Needed a Lift. Or Did They?*, WASH. POST, Jan. 13, 2002, at B2 (“[T]he average federal bailout has traditionally been a Chapter 11-style bankruptcy in all but name. And that goes for the loan guarantee portion of this most recent ‘bailout’ [the loan guarantee part of the ATSSSA] as well.”).

73. Reich, *supra* note 26, at 181.

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.* at 183.

78. *Id.* at 183-84.

79. *Id.* at 185.

concessions, though with considerable difficulty. During the next year Chrysler got out of the full-sized car business and concentrated its production on compacts and subcompacts. It also closed a number of plants. Still the company's fortunes did not improve. At the end of 1980, Chrysler went back to the board for more money. In January 1981, in a last desperate attempt to make the bailout work, Miller called the relevant parties to a meeting and demanded even more concessions. With those in place, the board approved a final \$400 million in loan guarantees.⁸⁰

Chrysler's fortunes finally turned, and by 1983, the company made a profit of \$700 million. Its long-term debt had been slashed, and total employment was down to about 70,000 people. Chrysler had not failed to pay any of the debts that had been guaranteed by the government, and in fact, the federal government was able to redeem its warrants for \$311 million.⁸¹

Although many economists and free-market advocates remain unconvinced that saving Chrysler produced greater economic efficiencies than would have been achieved by letting Chrysler be restructured in bankruptcy, the fact that the company did ultimately recover, and that the government not only did not lose money, but actually made money on the deal, helped to make this bailout something of a model. The terms of the ATSSSA, discussed below, seem to require that loan guarantees to any airline pursuant to the ATSSSA follow the Chrysler model.

IV. STRUCTURE OF THE BOARD AND TERMS OF THE ACT

In many respects, the "bailouts" contemplated by the ATSSSA follow the model established by the Chrysler Corporation bailout. First, the ATSSSA created a special board, the Air Transportation Stabilization Board (ATSB), to review each application for federal credit guarantees, and to monitor the companies that are given any such support.⁸² The make-up of this Board strongly resembles the board that oversaw the Chrysler rescue. In particular, the Board consists of the Secretary of Transportation (or his designee), the Chairman of the Board of Governors of the Federal Reserve System (or his designee), and the Comptroller General of the United States (or his designee), who serves as a non-voting member. The Federal Reserve Board Chairman serves as Chair of the Board.⁸³ The board established by the Chrysler Loan Guarantee Act consisted of the Secretary of Treasury, the Chairman of the Federal Reserve Board, and the Comptroller General.⁸⁴

Second, the ATSSSA designates that the ATSB can issue federal credit instruments only to firms "for which credit is not reasonably available at the time

80. *Id.* at 186.

81. *Id.* at 186-87.

82. Air Transportation Safety and System Stabilization Act, Pub. L. No. 107-42, § 102(b)(1), 115 Stat. 230 (2001).

83. *Id.* § 102(b)(2).

84. *See Reich, supra* note 26, at 183-84.

of the transaction.”⁸⁵ Likewise, Congress only became willing to seriously consider providing loan guarantees to Chrysler after Chrysler’s lead banker came before them and pleaded that Chrysler had exhausted all other options in the private credit markets.

Third, any airline seeking federal support must be of such substantial importance to the overall air transportation system that provision of financial support is determined by the Board to be “necessary” to the maintenance of a “safe, efficient, and viable commercial aviation system in the United States.”⁸⁶ Similarly, the rescue of Chrysler was believed to be critically important to the health of the U.S. economy and to the viability of U.S. automakers in international markets.

Fourth, to qualify for assistance under the ATSSSA, airlines must demonstrate that they have a viable business plan that, in practice, extracts substantial concessions from other stakeholders, just as Chrysler had to extract painful concessions from its bankers, its employees, and its suppliers. ATSSSA section 104(a) in particular requires that senior executives of any airline seeking a loan guarantee (including anyone whose total compensation exceeded \$300,000 in 2000) not receive any increases in compensation before September 11, 2003.⁸⁷

Finally, as was done in the Chrysler rescue plan, the Act requires that the federal government be “compensated for the risk assumed in making guarantees” to airlines or their creditors to “the extent feasible and practicable,”⁸⁸ and that the terms of the transaction ensure that the government will participate in any subsequent financial success of the rescued airline.⁸⁹ As will be discussed in the next section, this has so far meant that the government has demanded warrants or options to buy stock of the “bailed out” airline in exchange for loan guarantees.

The ATSSSA model differs from the Chrysler bailout model in two very important respects, however. First, is the fact that the ATSSSA also offered a total of \$5 billion worth of no-strings-attached cash payments to be paid out to every airline that applied, in proportion to that airline’s share of the “available seat miles” market. These payments were meant to prevent a widespread cash flow crisis from devastating the industry in the immediate aftermath of September 11, and they were justified as compensation to the airlines for the losses they suffered as a result of U.S. government orders to curtail flights. Second, the ATSSSA limits the liability of airlines for damages caused by any terrorist act or act of war and provides that the ATSB can subsidize the purchase of liability insurance to cover the period from October 1, 2001 through September 30, 2002, for any airline, to the extent that insurance costs rise in response to the events of September 11. Like the cash payments, the insurance subsidies are available to any airline with no strings attached. The fact that these

85. ATSSSA § 102(c)(1)(A).

86. *Id.* § 102(c)(1)(C).

87. *Id.* § 104(a).

88. *Id.* § 102(d)(1).

89. *Id.* § 102(d)(2).

two forms of subsidy were provided proportionately to all airlines means that they have not had the effect of distorting competition in the airline market by favoring one airline over any other. Hence, they have generally not been as controversial as the loan guarantee part of the ATSSSA program.⁹⁰

V. INITIAL INDUSTRY RESPONSE

The first airline to step forward and ask for federal loan guarantees after the Act was passed and the rules were promulgated explaining the application requirements was America West Airlines, the eighth largest U.S. airline. America West submitted its application on November 13, 2001.⁹¹ America West had been struggling financially before September 11 because of the softening of the economy and decline in business travel. It had been forced into bankruptcy during the Gulf War in 1991, when the airline industry had previously taken a serious war-related hit. Although America West had largely recovered from that episode and now has one of the lowest cost structures in the industry, it had management problems in 2000 and 2001 that it was trying to correct. Furthermore, America West had lost \$55 million in the first half of 2001 as a result of declining traffic in the early months of the recession.⁹² The collapse in traffic after September 11 sent it reeling. The company's cash reserves began shrinking at the rate of more than \$1 million per day, and it could not raise more money.⁹³ Although America West received \$98 million of the total \$5 billion in immediate cash payments to air carriers under the Act, some analysts were predicting that, without further federal aid, the airline would run out of cash and have to seek bankruptcy protection before the end of the year.

America West's precarious financial position, ironically, made it even harder

90. The subsidization and direct provision of war-risk liability insurance under the ATSSSA has been controversial for a different reason, however, because insurance carriers who would like to sell insurance to the airlines have complained that the federal government ought not to be in this business. Since two other papers in this special issue deal with the economics of war-risk insurance, I will not consider that debate in this Article. See Anne Gron & Alan O. Sykes, *Terrorism and Insurance Markets: A Role for the Government as Insurer?*, 36 IND. L. REV. 447 (2003); Jeffrey E. Thomas, *Exclusion of Terrorist-Related Harms from Insurance Coverage: Do the Costs Justify the Benefits?*, 36 IND. L. REV. 397 (2003). Curiously, the limits on liability established under the ATSSSA have also not been controversial, even though these limits are worth much more to the larger airlines than to small airlines.

91. Air Transportation Stabilization Board, *What's New?*, at <http://www.ustreas.gov/atsb/whatsnew.html> (last visited Oct. 17, 2002).

92. A new president had taken the helm of America West on September 1, 2001, and by September 10 the airline had negotiated, but not yet closed, on a \$200 million financing package. After September 11, the financing fell through. See Hal Mattern, *America West at Crossroads*, GANNETT NEWS SERV., Dec. 30, 2001; Melanie Trotman, *Credit Lifeline: Still Wobbling a Bit, America West Tests Plan to Help Airlines*, WALL ST. J., April 4, 2002, at A1.

93. Caroline E. Mayer & Frank Swoboda, *Airline Agrees to Offer U.S. a Stake for Aid; America West Bid May Set Industry Pattern*, WASH. POST, Dec. 11, 2001, at A1.

for it to get financial aid under the terms of the ATSSSA and associated rules. These terms and rules, somewhat contradictorily, were supposed to provide financial assistance to airlines that could not get sufficient financing in the private markets. However, the financial assistance was not supposed to apply to firms that were already in bankruptcy as of September 11, 2001, or that would probably have gone into bankruptcy proceedings even if the terrorist attacks had not occurred.⁹⁴ There is some evidence that larger, healthier airlines may have been quietly lobbying the ATSB to let America West fail.⁹⁵

In its initial application, America West sought \$400 million in credit guarantees (which it hoped would form the basis of a total new financing package of \$1 billion), but it soon became clear the members of the ATSB were not eager to issue a loan guarantee⁹⁶ and would make stringent demands on any airline that sought them.⁹⁷ On December 7, 2001, America West filed an amended application that increased from \$426 million to \$445 million the amount of the loan it was trying to get, but still sought a guarantee for only \$400 million (just under 90%) of that loan. The revised application also used more conservative assumptions about future business conditions and increased the amount of other financing it pledged to get from others, the amount of concessions it promised to get from other stakeholders, and the compensation it would pay to the government (in the form of cash, fees, and warrants) in exchange for the loan guarantees.⁹⁸ The application also included warrants that would give the U.S. government the right to buy up to 10% of America West's outstanding stock at \$6 per share.⁹⁹ "The message was: You need to prove you have a viable business plan and need to be willing to pay taxpayers for the risk they are taking," America West's chairman, W. Douglas Parker, told *The Washington Post*.¹⁰⁰

The ATSB was still not satisfied.¹⁰¹ The company then reduced to \$380 million the amount it was asking the government to guarantee, representing 85%

94. Mark Moran, *American West Airline Offers Government Part Ownership in Return for Federal Loan Guaranty*, NAT'L PUB. RADIO, Dec. 11, 2001. Of course, US Airways did go into bankruptcy proceedings as of Aug. 11, 2002, but the ATSB has continued to negotiate with the company throughout the bankruptcy proceedings. See *supra* notes 14-15 and accompanying text.

95. Trotman, *supra* note 92, at A1.

96. Aviation Daily reported that two of the three ATSB members—the Federal Reserve representative and the U.S. Treasury Dept. representative—opposed giving America West any aid. *America West Submits Amended Loan Guarantee Application*, AVIATION DAILY, Dec. 11, 2001, at 3.

97. Mayer & Swoboda, *supra* note 93, at A1.

98. *America West Submits Amended Loan Guarantee Application*, *supra* note 96, at 3. Aviation Daily also reported that an America West negotiator claimed that the "fee structure mirrors a private commercial loan it negotiated just prior to Sept. 11." *Id.*

99. Mayer & Swoboda, *supra* note 93, at A1.

100. *Id.*

101. Caroline E. Mayer, *America West Again Revises Bid for Aid; Airline's Action Is Focus of Fight Over U.S. Role*, WASH. POST, Dec. 19, 2001, at E1.

rather than 90% of the financing it was seeking, and found another outside lender that would supply an additional \$20 million.¹⁰² It also increased the amount of concessions it was seeking from aircraft manufacturers and lessors, offering to give these companies convertible debt securities and warrants that together could give them the rights to up to 40% of America West's Class B common stock.

The seven-year business plan laid out in the application, and in filings made with the SEC in connection with the issuance of the convertible debt and warrants, indicated that America West had negotiated with lessors to immediately retire fourteen aircraft, or 9.3% of its fleet, and to defer deliveries of twenty-five new aircraft the company had ordered for delivery between 2001 and 2004, in order to spread out receipt of those planes through 2007.¹⁰³ Under the plan, the loans, which America West was hoping the government would guarantee, would be paid off between 2005 and 2008.

Finally, on the evening of December 28, 2001, the ATSB announced that it had approved America West's loan guarantee, conditioned on the airline further increasing the compensation the government would receive in the form of additional "warrants that represent [thirty-three] percent of AWA's common stock on a fully diluted basis, with a strike price, expiry date, anti-dilution provisions, and other provisions protective of the taxpayers' interest, acceptable to the Board."¹⁰⁴ (The warrants ultimately issued were for America West Class B common stock, which had a \$3 exercise price and an exercise period of ten years.)¹⁰⁵ The guarantee was also conditional on America West committing to keeping its labor costs under control.¹⁰⁶ Even with this additional compensation, the guarantee had been approved by only a two-to-one vote, with the Treasury representative opposing the deal. Treasury Undersecretary Peter R. Fisher, who served as the Treasury representative on the Board, issued a prepared statement saying, "I fear that the board's decision is likely to impede, rather than promote, real progress toward a safe, efficient, and viable air transportation system for our country."¹⁰⁷

102. Caroline E. Mayer, *America West Trims Request for U.S. Aid; Loan-Guarantee Bid Cut by \$20 Million*, WASH. POST, Dec. 20, 2001, at E3.

103. Mary Schlangenstein, *America West Details Concessions for Loan Guarantees*, BLOOMBERG NEWS, Dec. 20, 2001.

104. Letter from Roger Kodat, Acting Executive Director of the ATSB, to W. Douglas Parker, Chairman, President and CEO of America West (Dec. 28, 2001), Off. of Pub. Aff. News Release PO-890 (Dec. 28, 2001) (announcing the conditional approval).

105. America West also has a small quantity of Class A common stock, nearly all of which is in the hands of a private investment company. Class A common stock are entitled to fifty votes per share; therefore, voting control of the company lies with this investment company. See Press Release, America West Holdings Corp., *America West Satisfies Loan Guarantee Conditions*, (Jan. 14, 2002) (on file with author).

106. *Id.* America West pilots were already the lowest paid among major carriers. Mattern, *supra* note 92.

107. Michele Heller, *Citi Takes Lion's Share of Loan for America West*, AMERICAN BANKER, Jan. 2, 2002, at 4.

By that time, America West had only five days until it was due to make debt payments, totaling an estimated \$87 million,¹⁰⁸ which it would be unable to make without the new financing that the guarantee would secure. With its back against the wall, and facing bankruptcy proceedings unless it accepted the terms, America West agreed.

As part of the financing package, the airline had also negotiated about \$600 million worth of concessions and contributions, including reduced or stretched-out payments to aircraft lessors, creditors and vendors, and tax breaks from state and local authorities.¹⁰⁹ Including all the fees and other conditions, the terms of the financing package provide a total return to U.S. taxpayers that, according to America West president Parker, are well in excess of the terms of a private commercial loan that America West had negotiated in August 2001, but which it had never closed due to the terrorist attacks.¹¹⁰

Other airline companies had been watching America West's experience closely, and in the first few days after the ATSB issued its letter conditionally promising a loan guarantee, press reports indicated they were rethinking plans to apply for financial assistance. "Most airlines are looking at this as a rough guide, and they don't like what they saw," the *New York Times* quoted aviation analyst Raymond Neidl as saying about the America West agreement.¹¹¹ As of late spring 2002, only three other airlines—all of them small—had bothered to apply for loan guarantees. These airlines included Kansas City-based Vanguard Airlines Inc., Frontier Flying Service, Inc., a commuter carrier that serves Alaska, and Miami-based Spirit Airlines. The major airlines, it seemed, had come to the conclusion that going through the effort of trying to get the ATSB to approve a loan guarantee did not have significant advantages for any of the parties involved in the airlines (management, employees, creditors, and shareholders) relative to a trip through Chapter 11 bankruptcy proceedings or even a private restructuring outside of bankruptcy court.¹¹²

VI. PICKING WINNERS AND LOSERS

Of the major airlines, both US Airways, the sixth largest U.S. carrier, and United Airlines, the second largest, had been mentioned regularly by the media during the fall and winter as likely candidates for financial support,¹¹³ although

108. Lou Whiteman, *America West Pays Dearly for Loan Guarantees*, DAILY DEAL, Dec. 31, 2001.

109. Caroline E. Mayer & Frank Swoboda, *U.S. to Back Loans to Struggling Airline*, WASH. POST, Dec. 29, 2001, at A1.

110. *New Labor Clause in Bailout Hard to Find*, AIRLINE FIN. NEWS, Jan. 7, 2002.

111. Micheline Maynard, *Airlines Shy Away From Loan Guarantees by U.S.*, N.Y. TIMES, Jan. 3, 2002, at C1.

112. One industry analyst called the terms "a pact with the devil." See Whiteman, *supra* note 108 (quoting Michael Boyd, an Evergreen, Colorado-based aviation consultant).

113. See, e.g., Keith L. Alexander, *Airline May Seek Loan Guarantee: US Airways CEO Hints at Hope That Employees Will Take Pay Cuts*, WASH. POST, Mar. 27, 2002, at E3; Keith L.

throughout the spring neither airline filed any official request for financial help with the ATSB. Of these two, US Airways was in a far weaker immediate cash flow position. The airline lost nearly \$2 billion in fiscal year 2001,¹¹⁴ had only \$561 million in cash available to it at the end of March 2002, and was losing about \$3.5 million per day.¹¹⁵ The airline also had virtually no assets that could be used for collateral.¹¹⁶ United, by contrast, ended the first quarter with \$2.9 billion in liquidity and had \$2.5 billion to \$3 billion in unencumbered modern aircraft that could be used as collateral for loans.¹¹⁷ It was burning through about \$5 million a day in expenses in excess of revenues.¹¹⁸ United, however, faces about \$1 billion in debt repayments due at year-end 2002, and in early 2003. Both airlines talked publicly of filing for a loan guarantee as part of their negotiations with unions to get labor costs down.¹¹⁹ However, neither airline actually filed. Perhaps both were hoping that air travel would pick up again, as evidence appeared that the economy had moved out of recession, and thereby rescue them from having to restructure to suit the ATSB.

Nevertheless, while air travel in general did increase somewhat during the spring, the nature of the market appeared to have changed. Business travelers had traditionally provided the bulk of revenues for the major airlines because they had been willing to pay higher fares to avoid overnight Saturdays or other restrictions.¹²⁰ But as business and leisure travel began increasing in the spring,

Alexander, *United Expected to Seek U.S. Aid*, WASH. POST, Feb. 2, 2002, at E1 [hereinafter Alexander, *United Expected to See U.S. Aid*].

114. Keith L. Alexander, *US Airways to Defer Payments; Debt Move Called a Step in Carrier's Restructuring Effort*, WASH., POST, July 2, 2002, at E2.

115. Keith L. Alexander, *US Airways Applies for Federal Assistance*, WASH. POST, June 11, 2002, at E1.

116. *Id.*

117. *United Airline Mechanics Key to Loan Guarantee Quest*, AIRLINE FIN. NEWS, July 1, 2002; see also Eric Torbenson, *D.C. Test for Airlines*, ST. PAUL PIONEER PRESS, June 30, 2002, at 1D.

118. Keith L. Alexander, *United Asks U.S. for Loan Guarantee*, WASH. POST, June 25, 2002, at E1.

119. See Alexander, *United Expected to Seek U.S. Aid*, *supra* note 113, at E1 (noting that United's attempt to regain financial health without going to the government has faltered, and its efforts to win major union concessions stalled); Susan Carey, *US Air Chief Unveils Recovery Plan*, WALL ST. J., May 17, 2002, at A2 (describing US Airways' plans to cut labor costs by \$1 billion per year, obtain \$200 million per year in annual concessions from lenders and suppliers, and secure a \$1 billion federal loan guarantee); Susan Carey, *US Airways Signals It May Ask Workers to Accept Pay Cuts*, WALL ST. J., Mar. 26, 2002, at A2 (noting that both US Airways and United Airlines were asking workers to take pay cuts as part of their decisions about whether to seek federal loan guarantees); Edward Wong, *US Airways Ready to Test Federal Program*, N.Y. TIMES, April 27 (2002) (noting analysts' opinions that US Airways needs to apply for a loan guarantee to use as a negotiating tool to bring down labor costs).

120. Unrestricted fares at the big airlines are typically about four times as much as restricted fares. See Trotman & McCartney, *supra* note 50, at A1.

it became clear that business travelers had learned to shop for low fares on the Internet and had become unwilling to pay substantially more than leisure travelers.¹²¹ The old price discrimination revenue model, in which the major airlines captured the business travelers at high fares by offering reliability and a wide range of departure and route options, as compared to the regionals, which operated by offering lower fares but fewer time and route options to leisure travelers, had broken down.¹²² The major airlines continued to hemorrhage cash through the third quarter of 2002,¹²³ with total losses for the industry of nearly \$2.5 billion in the third quarter, a period that is usually the season of strongest demand for air travel. Losses for the industry as a whole exceeded industry losses of the third quarter of 2001, which included the immediate aftermath of September 11.¹²⁴ Nonetheless, Southwest Airlines had returned to profitability, and several other small airlines were aggressively gaining market share.¹²⁵ By mid June, in fact, at least one airlines analyst had estimated that Southwest Airlines, dubbed “the king of the discounters,” had “surpassed Northwest Airlines, Continental Airlines and US Airways Group in terms of revenue passenger miles flown domestically.”¹²⁶

Then, on June 7, just three weeks before the June 28 application deadline for financial assistance, and less than two weeks after the ATSB had turned away Vanguard Airlines and Frontier Flying Service, US Airways filed an application with the ATSB for a \$900 million loan guarantee, to be part of a restructuring package that would include \$1 billion in new financing, plus \$1.3 billion in cost concessions from employees and vendors.¹²⁷ The package also offered an undisclosed equity stake to the government. US Airways’ action appeared to

121. *Id.*

122. The *Wall Street Journal* noted that “American business has changed its flying habits, possibly forever.” *Id.*

123. See Scott McCartney, *Big Three Airlines Face Tough Tasks*, WALL ST. J., Oct. 24, 2002, at D5 (noting that the three largest airlines, American, United, and Delta, lost a total of \$2.14 billion in the third quarter of 2002).

124. See John Heimlich, *U.S. Airlines: The Road to Resuscitation*, Air Transport Association, Oct. 31, 2002, fourth slide, headed “Heavy Losses Continuing in 2002,” available at <http://www.airlines.org/public/industry/bin/Econ102.pdf>.

125. In May, for example, the nation’s largest airlines reported that traffic was still down by about 10% compared with the prior May. But a number of smaller airlines were reporting increased traffic, including Southwest (up 4.4%), ATA (up 5.9%), JetBlue (up 106.4%), AirTran (up 19.2%) and Frontier (up 16.2%). See *The Air Transportation Stabilization Board Will Get Its First Test of the Federal Bailout Law When It Decides Whether United Airlines Deserves a Federal Loan Guarantee*, DETROIT NEWS, June 30, 2002; see also Melanie Trottman, *Southwest Airlines Turns More Aggressive: Moves Follow the Successful Outcome of Gamble on Continued Growth After Sept. 11*, WALL ST. J., July 15, 2002, at B6.

126. See Trottman & McCartney, *supra* note 50, at A1 (citing UBS Warburg airline analyst Samuel Buttrick).

127. See Alexander, *supra* note 115, at E1; Susan Carey & Stephen Power, *Air Loan Board Isn’t Afraid to Say No*, WALL ST. J., June 26, 2002, at A2.

spur action by a number of other airlines. On June 24, United Airlines followed, requesting a \$1.8 billion loan guarantee as part of \$2 billion in new financing.¹²⁸ The filing came after United pilots tentatively agreed to a pay-cut agreement worth \$520 million over three years if United would apply for federal help, and United management agreed to \$430 million in concessions.¹²⁹

US Airways' and United's filings, in turn, spurred a number of regional carriers to file. On June 13, American Trans Air applied. On June 27, Aloha Airlines and Great Plains Airlines applied. Moreover, on June 28, at the last possible moment, Frontier Airlines, World Airways, Corporate Airlines, MEDjet International Inc, and Gemini Air Cargo applied.¹³⁰ Frontier officials said they applied for a \$59.5 million loan guarantee partly to "ensure that the playing field is level."¹³¹

The last-minute rash of filings, especially by airlines that appeared to have access to other sources of capital in the capital markets, raised serious questions in the minds of many critics about the role that the airlines seemed to think loan guarantees under the ATSSSA should play.¹³² Coming nine-and-one-half months after September 11, with no further terrorist attacks having occurred and the economy apparently recovering, it was hard to make the case that providing loan guarantees to a self-selected subset of the airline industry was "a necessary part of maintaining a safe, efficient, and viable commercial aviation system in the United States."¹³³ While the promise of financial assistance to prevent airlines from being forced into bankruptcy in the immediate aftermath of September 11 may have been important symbolically to help restore confidence on the part of travelers that the system as a whole would not be allowed to fail, by the summer of 2002 it began to appear that the implicit ability of the ATSB to pick winners and losers could have a substantial impact on the future structure of the airline industry. To selectively award financial aid to some airlines, the government would be "playing God in shaping the future of what the industry looks like," argued Doug Steenland, president of Northwest Airlines, at an industry conference in May.¹³⁴ Samuel Buttrick, UBS Warburg analyst, noted that providing financial assistance to some airlines would mean that "winners [would] lose at the margin so losers can win."¹³⁵ "What the hell does the taxpayer need

128. See Dave Carpenter, *United Seeks \$1.8B Federal Loan*, ASSOCIATED PRESS, June 24, 2002.

129. *Id.* See also *U.S. Loan for United Airlines Premature*, DETROIT NEWS, June 30, 2002.

130. See *List of Airlines Seeking Aid*, *supra* note 22; *Three Small Airlines Apply for Guarantees on Federal Deadline*, *supra* note 22.

131. Stephen Power, *Four More Airlines Request Loan Guarantees from U.S.*, WALL ST. J., July 1, 2002, at B8.

132. For example, United Airlines had raised \$775 million in a private secured financing in January 2002. See Carey & Power, *supra* note 127, at A2.

133. General Standards for Board Issuance of Federal Credit Instruments, 14 C.F.R. § 1300.10(a)(3) (2001).

134. Carey & Power, *supra* note 127, at A2.

135. Buttrick et al., *supra* note 52, at 4.

to subsidize (an airline) for if the company can go out and get [financing] in capital markets,” asked Continental Airlines CEO Gordon Bethune.¹³⁶ On the other hand, others complained that if a company cannot get credit in the public capital markets, perhaps that company should not be saved by government subsidy.¹³⁷ The head of an association that represents small airlines complained that by keeping the big carriers with high cost structures alive, the ATSB is crowding out smaller new competitors that have more efficient costs.¹³⁸

Clearly the terrain had shifted, so that by the summer of 2002 the issue at stake in decisions by the ATSB to provide financial assistance to airlines was no longer about keeping the whole airline industry going through a major crisis. The issue had become about how to restructure the airline industry in the face of what appeared to be a significant change in the airline competition model, away from the historic model in which the cost advantage was held by hub-and-spoke operators. Meanwhile, some members of Congress were testing the idea of delaying or cutting the funding available for loan guarantees under the ATSSSA in order to reallocate the funds toward other budget priorities.¹³⁹

The ATSB could have sidestepped the controversy by simply refusing to grant any more loan guarantees, on the grounds that the crisis had passed, and that none of the guarantees were now “necessary” for “maintaining a safe, efficient, and viable commercial aviation system in the United States.”¹⁴⁰ However, on July 10, 2002, the ATSB gave conditional approval to US Airways’ request, as discussed above,¹⁴¹ but with stringent conditions demanding more concessions in the form of legally binding agreements with unions, suppliers, and lenders. US Airways was also required to increase the equity stake offered to the government (the amount of which has not been released, but which has been reported to be well below the 33% stake given by America West); resolve outstanding issues surrounding airport slots and gates; and conclude final loan documents,¹⁴² and after August 11, 2002, win approval of the bankruptcy court for its plan of reorganization.¹⁴³ By contrast with America West’s experience, the rapid approval of US Airways’ loan guarantee request suggests that the airline had been in negotiations with ATSB staff for several months leading up to its June 7 filing,¹⁴⁴ so that many of the conditions it would have to meet were

136. See Carpenter, *supra* note 128.

137. Carey & Power, *supra* note 127, at A2.

138. Torbenson, *supra* note 117, at 1D.

139. See Carey & Power, *supra* note 127, at A2; see also Torbenson, *supra* note 117, at 1D; *House Chairman Fighting to Preserve Loan Guarantees*, AIRLINE FIN. NEWS, July 1, 2002.

140. General Standards for Board Issuance of Federal Credit Instruments, 14 C.F.R. § 1300.10(a)(3) (2001).

141. See *supra* note 15 and accompanying text.

142. Reeves & McKay, *supra* note 12, at A1. See also Daniel, *supra* note 12, at 25.

143. See *Air Transportation Stabilization Board’s Statement on US Airways’ Plan for Chapter 11 Reorganization*, Aug. 12, 2002, at <http://www.ustreas.gov/press/releases/po3342.htm>.

144. Sources inside the ATSB have indicated that “US Airways presented the strongest case of all the airlines that have applied” and “US Airways executives also worked with ATSB staff

already incorporated in the initial filing. In fact, throughout the spring, newspaper articles noted on a number of occasions that US Airways was using the promise (or threat?) of either a loan guarantee filing, or a Chapter 11 filing, or both, in its negotiations with labor over concessions.¹⁴⁵ Moreover, one could argue that US Airways had a stronger case than other major airlines that its devastating losses (more than \$2 billion worth) in the previous year were attributable to the terrorist attacks of September 11, because Reagan National Airport in Washington, D.C. is a major hub for US Airways. Reagan National was shut down completely for three weeks after September 11.¹⁴⁶ Moreover, the company reportedly offered the government its valuable landing and arriving slots at New York's LaGuardia Airport and Washington's Reagan National Airport as collateral, as well as its gates at several East Coast airports—all of which can probably be sold easily if US Airways defaults.¹⁴⁷

Nonetheless, as of the writing of this Article, the ATSB had rejected the applications of United Airlines and four small airlines,¹⁴⁸ and given approval of loan guarantees for two airlines (in addition to American West).¹⁴⁹ So its award of a guarantee to US Airways suggested that, whether it had intended to or not, the ATSB has gone into the business of picking winners and losers in the airline industry restructuring wars.

VII. HAVE AIRLINE ECONOMICS FUNDAMENTALLY CHANGED?

In Part I above we noted that the hub-and-spoke operational structure of the major airlines resulted in complicated economic dynamics for the airline industry. To the extent that hub-and-spoke operations reduce average costs by centralizing maintenance operations and make it possible to coordinate traffic better to keep more planes full, the large hub-and-spoke operators ought to be the low-cost operators, at least when operating at close to full capacity, with all other costs being equal.¹⁵⁰ Moreover, to the extent that hub-and-spoke operations provide positive externalities that enhance the value of other airlines serving the

members for several months prior to submitting their application last month and even used some of the same financial advisors as America West.”). Alexander, *supra* note 12, at E1.

145. See *supra* note 119 and accompanying text.

146. Alexander, *supra* note 117, at E1; see also Alexander, *supra* note 12, at E1 (noting that US Airways did make this argument in its application).

147. Alexander, *supra* note 12, at E1.

148. The airlines whose loan guarantee requests have been denied include Frontier Flying Service, Inc. (denied May 31, 2002); Vanguard Airlines, Inc. (denied for the fourth time July 29, 2002); National Airlines, Inc., and Spirit Airlines, Inc. (both denied August 14, 2002). See ATSB, *Recent Activity*, *supra* note 11. United Airlines loan guarantee request was denied December 4. See

149. Conditional approvals have gone to US Airways, American Trans Air, Aloha Airlines, and Frontier Airlines. See *supra* notes 12, 19-20 and accompanying text.

150. Of course, *supra* note 53 and surrounding text, all other costs are not equal, and the industry as a whole is still operating well-below full capacity.

same hubs, it might be economically efficient to make sure those operators stay in business.

The events of the past year, combined with other factors that have been coming together over the last two decades, have turned airline economics upside down. Smaller, regional carriers and discount operators, such as Southwest, Frontier, and JetBlue, as well as the restructured America West, are now clearly the low-cost operators. Discount operators have long had labor cost advantages relative to the big seven.¹⁵¹ However, the big airlines have had the cost savings presumably provided by hub-and-spoke operations, and they have been able to attract the high marginal value travelers (especially business travelers) by offering more flight times and more destination options. Hence there has been room in the market for both kinds of operators during periods of air travel expansion, such as much of the 1990s.

Since early 2001, however, air travel has fallen off more so than in any of the previous recessions.¹⁵² The effect has been particularly hard on hub-and-spoke operators because the high fixed costs associated with their operations have turned into a major cost disadvantage relative to non-hub-and-spoke operators. When these high fixed costs have been combined with the long-standing labor cost disadvantages of the big airlines, the major carriers have simply been unable to meet the price discounts offered by the smaller regional carriers. The price wars now are being initiated by the “wannabes,” rather than by the established carriers trying to protect their turf.¹⁵³

151. American, United, Delta, Northwest, Continental and US Airways have all been in existence since before deregulation in 1978, have older fleets, and older employees who are more likely to be unionized. Only a few of the regional carriers, including Southwest, have been in business that long. As of the third quarter of 2001, Southwest had surpassed US Airways in revenue passenger miles to become the sixth largest carrier. Labaton, *supra* note 46, at C1 (accompanying chart, entitled “Big Airlines, Big Trouble”). Out of fifty-eight new carriers that started operations after deregulation in 1978 and before 1990, only America West is still operating. Morrison & Winston, *supra* note 48, at 9. America West went through bankruptcy restructuring in the early 1990s, and now has one of the lowest labor cost structures in the business. Trottman, *supra* note 92, at A8 (noting that the carrier has “a low cost structure that most other major carriers would envy.”).

152. Air Transport Association, *supra* note 69 (comparing percentage decline in traffic in 2001-2002 to percentage declines in previous recessions).

153. The major carriers tried several times in the spring of 2002 to increase their prices, but lost volume so fast that they quickly dropped their prices again. Melanie Trottman, *America West Sparks Airfare War*, WALL ST. J., Apr. 22, 2002, at A3 (noting that the larger airlines had tried twice in the previous two weeks to raise domestic fares). Meanwhile, America West is using the liquidity its new government-backed financing has given it to revamp its business model by dropping fares on the last-minute, unrestricted tickets long preferred by business travelers. See Melanie Trottman, *Small Airlines Gain by Cutting Business Fares*, WALL ST. J., July 29, 2002, at B1. The company reports that its business travel revenue trends are improving as a result. “In the first quarter, its revenue per available seat mile from business travelers was down 16% from a year earlier, but narrowed to a drop of only 3% in the second quarter, including a 1% increase in June.”

Some substantial part of the overall decline in air traffic is probably still attributable to fear of terrorist attacks and to the increased air travel hassles resulting from enhanced security measures. What is unclear, however, and which cannot be resolved in this Article, is whether there has been a permanent shift in taste and habits of the traveling public—especially business travelers—that works against the business model of the traditional hub-and-spoke operators, or whether the industry is merely still working out the shock waves of the post-September 11 collapse in traffic. The ATSSSA was designed to address the latter, not the former. If the shift in traveler habits is permanent, the industry will have to reorganize itself in response, and it is not at all obvious that it is useful for the ATSB to help some companies make the needed adjustments without providing even-handed help to all companies.

CONCLUSION

Part I above reviewed a number of possible rationales for providing government subsidies to the airline transportation system as a whole, but most of these did not translate into rationales for providing assistance to specific airlines. The exception was the argument that hub-and-spoke operations might be natural monopolies and that they may provide positive externalities to other carriers. However, the events of the last year have called into question whether hub-and-spoke operations are really lower cost in the long run (through both expansions and contractions in air travel), and whether they really provide positive externalities. Absent the hub-and-spoke arguments, there appear to be few, if any, compelling reasons to subsidize selected airlines.

The problem, however, is that the airline transportation system is made up of individual airlines. So any decision to subsidize or shore up the industry as a whole must either grapple with the question of how to subsidize the industry in a way that is neutral as to which airlines get the benefit of the subsidy, or it must pick “winners and losers” by subsidizing some more than others.

The ATSSSA proposed to do some of both. The cash grants and the insurance subsidies probably operated in a neutral way because they were available to all airlines on the same terms, and on a more-or-less pro rata basis according to the volume of business each airline did prior to September 11. Yet the loan guarantee part of the Act required case-by-case negotiations over terms, which inevitably forced the ATSB into the role of deciding which airlines were worth saving, and on what terms. For this reason, the loan guarantee part of the Act was the most controversial from the beginning, and the Bush Administration, which was called upon by Congress to administer the ATSSSA, actively resisted playing the role of banker.

So far, the loan guarantees actually approved by the ATSB suggest that the policy of the Board is to demand terms that are nearly as stringent as (and maybe more stringent than) the airline would face in the private financial markets. The guarantee granted to America West required a restructuring of claims against the

Id. at B4. Frontier, National, AirTran, and American Trans Air are all taking similar actions.

company comparable to what might have been required in a Chapter 11 restructuring. The offer of a loan guarantee for US Airways did not keep this airline out of bankruptcy, and it remained unclear as of early November whether the airline would be able to re-emerge from bankruptcy, even with a federal loan guarantee. Meanwhile, United Airlines was unable to muster a sufficient amount of concessions from its unions and creditors to satisfy the ATSB and was compelled to file for bankruptcy after the ATSB denied its loan guarantee request.

However, if an ATSB-negotiated restructuring and loan guarantee is simply an alternative to Chapter 11, what is the point? Is it really good public policy for a federal agency to be acting like a banker for the airline industry? In normal times, the answer would clearly be no. But the first few weeks after September 11, 2001, when the ATSSSA was passed, were not ordinary times. They were times that called for real and symbolic acts on the part of the government to increase security and restore the public's confidence in our ability to go on with our lives. Just as it is appropriate for bank regulators to take steps to prevent a run on a troubled bank, it was appropriate for Congress to step in with a few real and symbolic acts to reassure the traveling public that the air transportation system was not going to collapse. The immediate no-strings-attached cash doled out to the airlines can be compared to sending the National Guard in to help clean up after a hurricane; the promise of loan guarantees can be compared to declaring the communities in the path of the hurricane to be Disaster Areas, making the individuals and businesses in the area eligible for federal disaster relief loans. Such decisions are primarily about showing solidarity with the victims, and declaring to ourselves that, as a society, we will not let disaster stop us.

So far, the loan guarantees that have actually been provided by the ATSB appear to have been little more than substitutes for Chapter 11. Thus, in practice, they have mostly provided a symbolic subsidy, not a real one. Yet the cash payments doled out last fall were real, and the promise made last fall of further subsidies, though perhaps only symbolic, probably had real effects. Given the negative connotations and sense of failure associated with reorganization through the bankruptcy courts, it was probably useful symbolically last fall to offer airlines an alternative approach to restructuring that does not carry the stigma of bankruptcy. The ATSSSA has done that. It remains to be seen whether the ATSB can respond to the applications it has received, and still manage to get out of the way and let the airlines reorganize themselves to serve a more cautious, price-conscious market in a way that allows them to make a profit and stay in business.

