

1966

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John William Snow

Recommended Citation

John William Snow, *Air Freight Forwarding: A Legal and Economic Analysis*, 32 J. AIR L. & COM. 485 (1966)
<https://scholar.smu.edu/jalc/vol32/iss4/1>

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AIR FREIGHT FORWARDING: A LEGAL AND ECONOMIC ANALYSIS

BY JOHN WILLIAM SNOW†

I. INTRODUCTION

THE DEVELOPMENT OF an efficient and economically sound national transportation system is the congressional adjuration to the transportation regulatory agencies, the Interstate Commerce Commission (ICC) and the Civil Aeronautics Board (CAB).¹ This congressional objective is complicated by the fact that the CAB serves the dual function of regulating and promoting air transportation while the ICC's function is the more limited one of regulation.²

It appears clear that this dual function of the Board has had a significant influence on the policies it has adopted. Some transportation authorities see a basic inconsistency between the Board's dual function and the objective of a national transportation policy.³ The air freight forwarding industry illustrates some of the difficulties associated with this apparent inconsistency.⁴

Perhaps a more difficult regulatory problem is that if regulation is to be rational, it must be consistent with underlying economic realities and take account of the continuing vagaries of economic life. The problem is difficult because economic reality is characteristically intractable and economic life in a market is constantly changing. Continual pressure to adjust to the changing circumstances is a basic fact of economic life in a

† B.A., University of Toledo; Ph.D. in Economics, University of Virginia; Assistant Professor of Economics, University of Maryland.

¹ Federal Aviation Act of 1958, 72 Stat. 731, 49 U.S.C. §§ 1301-1542 (1964); Interstate Commerce Act, 49 Stat. 543 (1935), 49 U.S.C. §§ 301-27 (1964).

² Interstate Commerce Act, 49 Stat. 546 (1935), 49 U.S.C. § 304 (1964); Federal Aviation Act of 1958, § 102, 72 Stat. 740, 49 U.S.C. § 1302 (1964).

³ Sawyer, *A Report to the President from the Secretary of Commerce, Unified and Coordinated Federal Program for Transportation* 46-49 (1949).

⁴ CAB Economic Regs., 14 C.F.R. § 296.1-296.2 (1966).

§ 296.1 Definitions.

- (a) "Indirect Air Carrier" means any citizen of the United States which engages indirectly in interstate air transportation of property only, and which:
 - (1) Does not engage directly in the operation of aircraft in air transportation.
- (b) "Direct Air Carrier" means any air carrier directly engaged in the operation of aircraft, pursuant to a certificate of public convenience and necessity issued under section 401 of the Civil Aeronautics Act of 1938, as amended, or under the authority conferred by any applicable regulation or order of the Board.

§ 296.2 Classification.

- (a) "Air Freight Forwarder" means any indirect air carrier which, in the ordinary and usual course of its undertaking, assembles and consolidates or provides for assembling and consolidating such property or performs or provides for the performance of break-bulk and distributing operations with respect to consolidated shipments, and is responsible for the transportation of property from the point of receipt to point of destination and utilizes for the whole or any part of such transportation the services of a direct air carrier.

market economy. Noting this characteristic of a market economy, Joseph Schumpeter remarked,

[A] capitalistic economy is not and cannot be stationary. Nor is it expanding in a steady manner. It is incessantly being revolutionized from within by new enterprise, *i.e.*, by the intrusion of new commodities or new methods of production or new commercial opportunities into the industrial structure as it exists at any moment. Any existing structure and all the conditions of doing business are always in a process of change.⁸

If proper regulation presupposes a knowledge of economic realities and economic realities are continually changing, the regulation must take into account these changing conditions. The regulator must of necessity look to the long run consequences of the regulatory policy if the congressional goals are to be rationally attained. At the same time, however, the regulatory agency must also provide immediate answers to concrete and pressing problems which are continually coming before it. The luxury of time is rarely available, and the problems often require immediate answers. The result can be that a decision designed to meet a present need becomes, in time, a general and inflexible rule. Rules once established tend to become inert. A determination adequate for the exigency of the moment is rarely the best available solution for the future. Indeed, it would be odd if it were. Therefore, a basic problem the regulatory agency faces is providing rules adequate to meet current exigencies but not so categorical that adequate treatment of future problems is prevented. This is the basic problem of reconciling the values of needed regulation—predicability and flexibility. The regulation of air freight forwarding illustrates these problems.

This article is an examination of the CAB's regulatory policy toward the air freight forwarder industry. The article focuses on two economic questions, the answers to which have formed the basis for CAB attitude toward the industry: first, the effect on the total demand for air freight resulting from the activities of the air freight forwarders, and second, the effect on the air freight forwarders' competitive position resulting from the so-called twenty-five mile rule-of-thumb. Under this rule, air freight forwarders are generally prohibited from accepting through responsibility for a shipment which originates or has a destination at a point more than twenty-five miles from the forwarder's air terminal. The air freight forwarder can accept responsibility only for that portion of the surface transportation which occurs within twenty-five miles of its terminal area. Within this zone the forwarder's surface transportation is exempt from ICC regulation.

Answers to the questions posed in the preceeding paragraph are critical to an evaluation of the Board's policy toward the industry. If air freight forwarding plays an important role in the demand for air freight, then under its congressional directive the Board should encourage air freight forwarding. If the relationship exists, the rationale of the twenty-five mile limitation on surface transportation must also be examined. If the

⁸ SCHUMPETER, *TEN GREAT ECONOMISTS* 38-39 (1951).

relationship is nonexistent, however, the second question becomes less meaningful.

A questionnaire survey of air freight forwarders was used to obtain most of the empirical evidence on the operations of forwarders. The questionnaire was mailed to the president of each of the eighty-nine air freight forwarders holding domestic authorization as of February, 1966, and responses were received from forty-one. This is an unusually good return and is no doubt accounted for by the forwarders' intense interest in their industry and in its economic and regulatory problems.

II. AIR FREIGHT FORWARDERS

Pursuant to a rule-making proceeding in the late 1940's,⁶ freight forwarders were defined as indirect air carriers subject to the CAB's jurisdiction but exempt from the certificate and other provisions of the Civil Aeronautics Act of 1938. However, forwarders are subject to the tariff, reporting, control and interlocking relationship provisions of the act.⁷

The Board's policy has been to promote air freight forwarding and to impose, therefore, few restrictions. Consistent with this policy, air freight forwarders have been afforded substantial freedom in the conduct of their operations. Over the years the CAB has developed a rule-of-thumb providing that the forwarders' terminal areas constituted the area within a radius of twenty-five miles from the center of the points served.⁸ In some instances, this twenty-five mile area is measured from the city limits rather than from the center of the city and in other instances forwarders have been permitted to extend their terminal areas to points more than twenty-five miles from the city limits. Within these terminal areas, the CAB has permitted air freight forwarders to contract with either common carriers or contract carriers.

A. Agency Rulings

The ICC is quite naturally interested in restricting the development of surface transportation by other than certified carriers, undoubtedly feeling pressure from their constituency on this issue but also apparently genuinely fearful that inroads are being made into its ability to effectively regulate the motor carrier industry.

Accordingly, the question of the extent of terminal areas of air carriers, both direct and indirect, has been the subject of litigation which produced in its wake rule-making proceedings by both the ICC and the CAB. Section 203 (b) (7a) of the Interstate Commerce Act provides that "transportation of persons or property by motor vehicle incidental to transportation by aircraft" is exempt from the provisions of Part 2 of the act (except for the safety and service provisions). The authority to determine

⁶ Air Freight Forwarders Case, 9 C.A.B. 473 (1948).

⁷ Federal Aviation Act of 1958, § 403 (a) & (b), 72 Stat. 758-59, 49 U.S.C. § 1373 (a) & (b) (1964).

⁸ This rule-of-thumb was codified in 49 C.F.R. §§ 210.40, 404.1 (1966), and 14 C.F.R. § 222 (1966).

what surface transportation is "incidental to air transportation" rests with the ICC.

In the *Hazel Kenny Extension—Air Freight Case*,⁹ the ICC established the general rule that motor transportation is "incidental" to transportation by aircraft within the meaning of section 203 (b) (7a),

when the motor transportation is limited to a bonafide collection, delivery, or transfer service within a reasonable terminal area of the air carrier as distinguished from a connecting carrier line-haul service, and that a reasonable terminal area of the air carrier was found to be that established by the air carriers in their tariffs filed with the CAB.¹⁰

The Commission's finding was based on the assumption that the CAB would refuse to accept any tariffs of either air carriers or indirect air carriers (*i.e.*, air freight forwarders) which prescribed an unreasonable terminal area. Normally, this constitutes a twenty-five mile zone around the city served.

In its rule-making proceeding, the CAB indicated its strong belief that maximum effective development of the air transportation industry depended upon the existence of efficient surface transportation which,

can best be guaranteed when it is under the control of the direct air carrier or the air freight forwarder . . . and a reasonable amount of freedom for the direct air carriers and air freight forwarders to establish pick-up and delivery service and to test their adequacy and economy is vital to prevent stifling of the potential of air cargo transportation.¹¹

The Board found that there were some major air cargo generating points which required pick-up and delivery service well beyond the twenty-five mile limit. For these points, pick-up and delivery authorization was granted where the service was provided in "relatively small cars or straight trucks and geared to air carrier schedules."¹²

The CAB was concerned that air freight transportation would suffer unless the air carriers were free to make the necessary provision for surface transportation in connection with the air transportation. Acknowledging the ICC's responsibility for determining what constituted service "incidental to transportation by aircraft," the CAB expressed the belief that the ICC would "give due appropriate weight to the Board's findings that the contemplated services are truly air cargo pick-up and delivery in nature, as it does today."¹³

In its rule-making proceeding the ICC affirmed the general rule established in the *Kenny* case for determining the geographical limit of the section 203 (b) (7a) exemption.¹⁴ But the Commission decided that since the CAB had provided an application procedure for air carriers to obtain operating authority for pick-up and delivery service outside the twenty-

⁹ 61 M.C.C. 587 (1953). See generally, Note, 32 J. AIR L. & COM. 273 (1966).

¹⁰ 61 M.C.C. at 594.

¹¹ 14 C.F.R. § 222 (1966).

¹² *Ibid.*

¹³ *Ibid.*

¹⁴ MC-C-3437 (1963).

five mile limit,¹⁵ a complimentary procedure to challenge such extension must be established. The Commission stated that in a proceeding to challenge extensions of pick-up and delivery operating authority, its findings would be determinative, not the CAB's.

The possibility, and indeed likelihood, of conflict between the ICC and the CAB over what constitutes motor service incidental to air transportation is clear. The CAB, operating under congressional adjuration, is committed to promoting the growth and development of air transportation. To achieve these ends, the CAB believes that development of better surface transportation is essential and that such surface transportation is most effective when under the control of the air freight forwarder.

III. AIR FREIGHT FORWARDING AND DEMAND FOR AIR FREIGHT TRANSPORTATION

Air freight forwarders accounted for approximately one-fourth of all air freight tonnage in 1964.¹⁶ The percentage of total air freight tonnage originated by air freight forwarders or indirect air carriers has risen steadily since 1953 when air freight forwarders accounted for eight and one-third percent of all air freight tonnage. Since then, the air freight forwarders' contribution to total air freight tonnage has increased faster than the total volume of air freight, so that by 1964, they accounted for over twenty-two percent of air freight tonnage.¹⁷ (See Table 1, *infra*.)

TABLE 1*

PERCENTAGE OF DOMESTIC AIR FREIGHT TONNAGE ON CERTIFICATED
ROUTES ORIGINATED BY FREIGHT FORWARDERS**

Year	Percentage
1953	8.3
1954	11.2
1955	10.9
1956	11.9
1957	13.5
1958	15.0
1959	14.6
1960	16.7
1961	17.8
1962	20.0
1963	21.5
1964	22.2

* SOURCE: Data given to me by Mr. Clifford Currier of the CAB, Freight Forwarding Division.

** Does not include supplemental air carriers.

The question which these figures raise is why the air freight forwarders' position has improved relative to the air freight industry. The question is

¹⁵ 14 C.F.R. § 222.3 (1966).

¹⁶ Motor Carrier Air Freight Forwarder Investigation, CAB Docket No. 16850 (Information Response, Bureau of Operating Rights, 1965).

¹⁷ It is not possible at this time to determine the air freight revenue ton miles originated by the air freight forwarders so the discussion is limited to total tonnage generated.

all the more vexing when account is taken of the large promotional expenditures made by the truck carriers and all-cargo carriers. Table 2, *infra*, shows that between 1958 and 1964, promotional expenditures made by the all-cargo carriers almost doubled, increasing from \$1,670,000 in 1958 to \$3,245,000 in 1964.¹⁸

TABLE 2
TOTAL ANNUAL PROMOTIONAL EXPENDITURES OF
THE ALL-CARGO CARRIERS 1958-1964*

Year	Expenditures
1958	\$1,670,000
1959	1,500,000
1960	1,874,000
1961	2,100,000
1962	2,169,000
1963	2,342,000
1964	3,245,000

* SOURCE: Data taken from HANDBOOK OF AVIATION STATISTICS (1965), U. S. Government Printing Office, Table 12, p. 238.

A possible explanation of this question is that the direct air carriers have been promoting a different freight market than the air freight forwarders. If this be the case, the air freight forwarder market appears to have been expanding more rapidly than the airlines' direct freight market.

My air freight forwarder survey indicates that the air freight forwarders do, by and large, operate in a different transportation market than the major airlines.¹⁹ The difference, however, is less a matter of geography than shipper attitudes or preferences. This is illustrated by the fact that while the greatest portion of air freight forwarders' business came from relatively small firms (under \$500,000 annual sales), the forwarders' business was concentrated in the large urban centers. (See Tables 3 and 4, *infra*.) Eighty-one percent of the respondents indicated that cities of 1,000,000 or more inhabitants accounted for the largest portion of their shipping business while seventy-seven percent indicated that the larger cities were the designation point for the greatest portion of their business. Twenty-seven percent of the respondents answered that one-fourth or more of their shipping business originated in communities of less than 50,000, which indicates that air freight forwarders are active in these markets also. However, there appears to be a specialization by community size within the industry. All but one of the respondents who indicated that cities of 1,000,000 or more did not account for the greatest portion of their shipping business were in the category of forwarders for whom cities of less than 50,000 population accounted for one-fourth of their shipping business.

¹⁸ CAB, HANDBOOK OF AVIATION STATISTICS 238 (1956).

¹⁹ While little data exists on the subject, the uncontradicted impression one gains from observing the air freight industry is that the direct air carriers have developed the large shipper market and focus attention almost exclusively on this market.

TABLE 3

AIR FREIGHT FORWARDERS' RESPONSES TO THE QUESTION,
"FROM WHAT SIZE COMMUNITY IS THE LARGEST PORTION OF
YOUR BUSINESS ORIGINATED AND DESIGNATED?"

<i>Size of City</i>	<i>Freight Origination</i>	<i>Freight Destination</i>
Under 50,000	1%	3%
50,000 to 250,000	4%	4%
250,000 to 500,000	6%	6%
500,000 to 1,000,000	8%	10%
over 1,000,000	81%	77%
	100%	100%

TABLE 4

AIR FREIGHT FORWARDERS' RESPONSES TO THE QUESTION,
"FROM WHICH SIZE CATEGORY OF FIRM DOES THE GREATEST
PORTION OF YOUR SHIPPING BUSINESS COME?"

<i>Firm Size</i>	<i>Percentage of Respondents</i>
Under \$100,000 annual sales	2%
\$100,000 to \$500,000	22%
\$500,000 to \$1,000,000	54%
\$1,000,000 to \$5,000,000	14%
Over \$5,000,000	8%
	100%

One suspects that air freight forwarders' relative position in the air freight industry has improved because the market in which the forwarders are selling air freight transportation has historically been the underdeveloped segment of the air freight market. The problem of underdevelopment may stem from the difficulty of selling the relatively small size firm on the advantages of air freight transportation. The major airlines have apparently exhibited little interest in this segment of the market and it has fallen, almost by default, to the air freight forwarders; at least this seems to be a good working hypothesis. The uncontradicted impression one obtains from even the most cursory observation of the air freight industry is that the major air freight carriers have focused their attention on the large shipper market which has been the large volume market.

It is not clear whether the air freight forwarders' market share has been rising because the shipping volume of their traditional shipper has been rising, or because the air freight forwarders have been attracting new shippers to air freight transportation.²⁰ The investigation shows clearly that air freight forwarders serve more shippers today than was the case five years ago. Ninety-eight percent of the respondents indicated that they did business with more shippers today than five years ago. On the other hand, seventy-eight percent of the respondents indicated that the average

²⁰ An additional possibility not discussed here is that the new shippers have had larger shipping volumes than the air freight forwarders' traditional shippers and this has caused the average shipping volume to rise.

volume per shipper was larger today than five years ago. It appears then, that the explanation of the air freight forwarders' increased volume and relative share of air freight is twofold: a larger average volume of shipments handled per shipper and the increased number of shippers served.

IV. THE TWENTY-FIVE MILE LIMITATION

The air freight forwarder respondents were unanimous in their opinion that the twenty-five mile limitation on pick-up and delivery service had a detrimental competitive effect upon them. In addition, ninety-seven percent of the respondents knew of shippers who could ship through air freight forwarders if the twenty-five mile limitation did not exist. The study clearly indicates that forwarders feel the limitation has put them at a significant competitive disadvantage and that their business volume would be greater if the limitation was extended to some greater distance. The motor carrier was the mode of transportation which the great majority of respondents felt benefited most from the twenty-five mile limitation. Only two respondents answered that direct air carriers were the mode benefiting most from the limitation on forwarders which strongly reinforces the earlier suggestion that the forwarders are not in competition with air carriers for the shippers' business. Since the forwarders serve a somewhat different market, they should be regarded as basically complimentary to direct air carriers rather than as a competitive mode siphoning off air freight business.

If this be the case, a competitive limitation on air freight forwarders is a limitation on the entire air freight business. The question then becomes twofold: (1) how great is the burden of the limitation, and (2) is this limitation or detriment to air freight offset or justified by other interests or considerations.

It is not possible from my investigation to determine quantitatively the loss in total air freight resulting from the current twenty-five mile limitation on the forwarders' pick-up and delivery service. That some loss results there can be little doubt. There is evidence of loss proffered by the air freight forwarders which undoubtedly involves some element of bias since they are likely to be overly optimistic about the effects of removing the limitation. The evidence that some loss results is not wholly vitiated, however, even though the extent of the loss is probably overstated in the forwarders' minds. Perhaps more persuasive evidence comes from the fact that the forwarders are performing a function with which the twenty-five mile limitation on pick-up and delivery service interferes directly. Table 5, *infra*, presents the respondents' answers to the question, "What do you consider to be your primary business function?" Their answers indicate that forwarders regard provision of a through service as an extremely important function. Sixty-one percent of the respondents answered that this was their most important function, while twenty-three percent regarded it as second in importance. If the forwarders are correct in appraising the importance of providing a through service for the shipper, then the likeli-

hood that the twenty-five mile limitation adversely affects the total volume of air freight in some significant way becomes more creditable.²¹

TABLE 5

RESPONDENTS' ANSWERS TO THE QUESTION,
"WHAT DO YOU CONSIDER TO BE YOUR PRIMARY BUSINESS FUNCTION?
PLEASE NUMBER IN TERMS OF IMPORTANCE."

	<i>First</i>	<i>Second</i>	<i>Third</i>	<i>Fourth</i>
A. Freight consolidation	3%	7%	11%	79%
B. Provide complete through shipping service	61%	23%	11%	5%
C. Information to shippers	26%	45%	24%	5%
D. Expediting function for shipper	10%	25%	54%	11%

Assuming this appraisal to be correct, the critical question becomes the extent to which there exists potential air freight shippers outside the limitation. We have seen that the air freight forwarders are convinced that shippers do exist who would be using air transportation if a through service could be provided beyond the present twenty-five mile limit.

It is doubtful that the air freight forwarder would feel so strongly about the adverse effects of the limitation unless they were actually being harmed. The question that cannot presently be answered is the extent to which potential freight is being diverted from the forwarder to other modes of transportation because of the twenty-five mile limit. However, it is clear that whatever the extent of diversion, it is not picked up by the airlines. Consequently, the total volume of air freight is necessarily smaller than it would otherwise be. The economic problem which the limitation produces is the misallocation of resources. The shipper is prevented from obtaining the transportation service which, in the absence of the limitation, he would utilize and the producer of the preferable service is not encouraged to expand that service in accordance with the true preference of consumers. In short, the market is prevented from operating to produce the best economic allocation of resources in the transportation industry.

However, the day is long past (if, indeed, it ever existed) when the economic optimum was thought to be the social optimum and as such, inviolable. Nevertheless, we still tend to give the market solution a presumption of correctness which is to be overturned only when some inherent failure of the market exists (natural monopoly, cut-throat competition, etc.) or upon a persuasive showing that some non-market interest requires a higher priority (public education, national defense, etc.). If the twenty-five mile limitation is to be defended, it must overcome the presumption in favor of letting a free market determine the allocation of the transportation business.

²¹ Of course, this question involves a subjective determination by the respondent and the additional problem that the functions are inter-related and not capable of being separated out. However, the purpose of the question was to provide a general appraisal rather than a carefully weighted valuation of the forwarder function.

The basic argument advanced in support of the twenty-five mile limitation on the pick-up and delivery service of air freight forwarders is that the rule is necessary to assure proper control and regulation of motor transportation. The ICC's capacity to regulate motor transportation would be seriously impaired and undermined by any extension of the limitation because it would put a basic motor carrier service outside ICC jurisdiction.

This argument is suspect on several grounds. It makes preservation of regulatory control, rather than quality of the transportation service, the "good" to be attained. Regulation has merit only if it produces a better result than would otherwise occur. Therefore, to argue that a service should be restricted because it interferes with the capacity to regulate implies that the regulated service is better than the non-regulated service since no one would argue regulation for regulation's sake. The difficulty, however, is that we are dealing with a service which regulation makes less efficient and less desirable.

Air freight forwarders are prevented from providing a service which they are ready, willing, and able to offer. Shippers are prevented from obtaining a transportation service which they desire. The gains from trade are lost to both the public and to the superior mode of transportation for this particular service. If we have properly assessed the function of regulation, then the argument against extending the surface authority of air freight forwarders, based on the ground that it interferes with the regulatory power of the ICC, has little merit. Regulation should serve the public, not the regulators' constituency nor the regulators themselves.

Another basic weakness in the argument against extension of the air freight forwarders' surface authority is the historic problem of regulation of pick-up and delivery service. Shippers complain bitterly about the low quality and high cost of this service. Regulation of pick-up and delivery service has produced much dissatisfaction and it is questionable whether pick-up and delivery service is suited to effective regulation. If this be the case, less regulation would be in the public interest. The air freight forwarders' surface transportation consists of the small package pick-up and delivery service. It has been pointed out that the forwarders' shipments come predominantly from the relatively small shipper, whose interest is in an origin-to-destination service—the through service which the air freight forwarders are particularly well-qualified to handle. Since this is the type of service that has not fared well under current regulation, the argument for removing this restriction is much stronger.

V. CONCLUSION

This investigation indicates that the CAB's basic approach toward air freight forwarding has been justified. Air freight forwarders have become an important element in the air freight industry, attracting shippers to air freight and promoting the demand for air freight by serving a shipping market that would otherwise have been seriously underdeveloped. The twenty-five mile limitation on the pick-up and delivery service puts the

forwarders at a competitive disadvantage for which little justification can be found. This disadvantage is also a burden on the shipper and serves to reduce the total demand for air freight since the direct air carriers and air freight forwarders serve basically different shipping markets. The problem of the twenty-five mile limitation stems from a basic discoordination of our national transportation regulation in which the ICC and the CAB, each serving different constituencies, are constrained to determine policy which is often too narrow in perspective to fully serve the public interest.