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# EXCLUSIVE PATRONAGE CONTRACTS IN INTERNATIONAL AIR TRANSPORTATION

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**A** GREEMENTS between rate conferences and shippers, whereby the shippers in return for specially reduced cargo rates use only conference services, known as "exclusive patronage," "contract-non contract" or "dual-rate" contracts, are not employed in international air transportation today. They are, however, extensively used by ocean liner conferences. Since they have proved themselves most useful in protecting the established maritime rate structure<sup>1</sup>, the question arises, can such contracts be made part of the conference machinery of the scheduled international air cargo operators<sup>2</sup>?

With a view to answering this question it is proposed to consider, first, the status of exclusive patronage contracts in maritime usage today and, second, the legality of such contracts if put to similar use by the scheduled international air cargo operators. Maritime usage is considered first because the legality of exclusive patronage contracts has been more fully explored in that sphere and the result is bound to have a strong, although not necessarily conclusive, effect on ultimate usage in international air transportation.

## MARITIME TRANSPORTATION

Of approximately 100 shipping conferences concerned with the foreign commerce of the United States, more than 80% have incorporated some sort of exclusive patronage contract into their rate structure<sup>3</sup>. This is done by including in the basic conference agreement<sup>4</sup> a provision authorizing the dual rate system in conjunction with exclusive patronage contracts.

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\*Opinions are the author's and do not necessarily reflect views of the International Air Transport Association.

<sup>1</sup> See Inter-American Maritime Conference, Report of Delegates of the United States, Washington, 1941, where at p. 7 it is said:

"It is the judgment of the Maritime Commission that the conference system is necessary to the successful conduct of water-borne foreign trade which is of an international character but that conferences cannot continue to exist in foreign trade without some means of protection such as the conference contract system." See also Rept. of U.S. Mar. Comm. p. 17-18 (1946).

<sup>2</sup> Scheduled international air rates for both passengers and cargo are established by the three traffic conferences of the International Air Transport Association. See Sheehan, *The IATA Traffic Conferences*, 7 *Southwestern Law Journal* 135 (1953).

<sup>3</sup> Marx *International Shipping Cartels*, p. 207, (1950) Professor Marx's treatise is an excellent study of the current shipping conference situation and has been most useful in the preparation of this article.

<sup>4</sup> Each conference has a basic agreement in the nature of a charter or articles of association setting out the rights and obligations of members.

The form of exclusive patronage contract differs from conference to conference, depending on the nature of the trade and the particular requirements of the operators and shippers concerned. But generally they are alike. The one in use between members of the North Atlantic Continental Freight Conference<sup>5</sup> and their shippers is fairly typical and will serve as an example.

That contract<sup>6</sup> provides that the shipper will forward by vessels of conference carriers all commodities which he may ship during specific periods, excluding bulk cargoes, household goods, explosives, hay, live-stock, precious metals or human remains. The carrier agrees that the rate to be paid by the shipper will be 10% below the applicable conference rate existing when the contract is signed, with benefit to the shipper of any reductions subsequently made by the conference. The contract is to run for an initial period of not exceeding three months and continue in force for successive periods of six months, unless either party gives 60 days' prior notice of termination. The carrier agrees not to increase the contract rates in any contract period, except in accordance with certain notice provisions, to transport all commodities which the shipper tenders and to maintain adequate service. If the carrier is unable to reserve space within 3 days after application by the shipper on a vessel sailing within 15 days of the desired time, the shipper is free to make other arrangements, including forwarding by non-conference vessels.

Although in use for a great many years<sup>7</sup>, only recently has any serious question been raised as to the legality under American law of exclusive patronage contracts. In October, 1948, Isbrandtsen Company, Inc., a prominent American non-conference steamship operator, brought suit in the U.S. District Court for the Southern District of New York to enjoin the North Atlantic Continental Freight and the Continental North Atlantic Westbound Freight Conferences from using such contracts and to have set aside certain rulings of the U.S. Maritime Commission which authorized the dual rate system. The District Court temporarily restrained the Conferences from using the contracts and directed Isbrandtsen to file a complaint before the U.S. Maritime Commission challenging the validity of the dual rate practice. The complaint was filed. After due proceedings, in December, 1950, the Federal Maritime Board (which had succeeded the U.S. Maritime Commission) upheld the contracts and dismissed Isbrandtsen's com-

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<sup>5</sup> A voluntary association of some 13 lines operating between U.S. North Atlantic and North Continental European ports. It and its predecessors on the trade route have been in existence for about one hundred years.

<sup>6</sup> This contract was approved by the Federal Maritime Board in January 1954. See *Contract Rates, North Atlantic Continental Freight Conference et al*, FMB Case No. 724.

<sup>7</sup> Investigations by the British Government in 1909 (Report of Royal Commission on Shipping Rings (London) and by the United States in 1914 (Report of House Committee on Merchant Marine and Fisheries (Alexander Report) H.R. Doc. 805, 63 Cong., 2nd Sess) recognized the general existence of exclusive patronage contracts and expressly or implicitly approved their use.

plaint<sup>8</sup>. Isbrandtsen then appealed to the District Court and asked that Court to enjoin and set aside so much of the Federal Maritime Board order as approved the dual rate practice. The United States, by its Attorney General, appeared and the Secretary of Agriculture was permitted to intervene<sup>9</sup>, both in support of the injunction. The District Court declined to rule on the validity of the dual rate system, but granted a permanent injunction<sup>10</sup> against use of the contracts on a point not argued, that is, that the differential between the contract and non-contract rates offered to shippers was arbitrarily determined and unreasonable, therefore unjustly discriminatory and unlawful. This decision was affirmed without opinion by the U.S. Supreme Court, by a 4 to 4 vote, in March, 1952<sup>11</sup>.

It is unfortunate that neither the District Court nor the Supreme Court ruled on the validity of the exclusive patronage plan per se. The Federal Maritime Board subsequently promulgated a rule of procedure to provide for securing information from ocean carriers as to the necessity and justification of using dual rates,<sup>12</sup> presumably with a view to approving them if the differential between contract and non-contract rates were found to be not arbitrary and not unreasonable. Isbrandtsen, by advertisements in newspapers and otherwise, has indicated its dissatisfaction with this action and its determination that the validity of exclusive patronage contracts per se should be dealt with by the courts. Since the Federal Maritime Board has primary jurisdiction in such matters, it is necessary for the issue to be presented to and settled initially by that body<sup>13</sup>. A proceeding for that purpose, is now pending<sup>14</sup>. But the ruling of the Federal Maritime Board, when obtained, will have to be reviewed by the Federal Courts and a final decision may not be reached for years. Meanwhile, consideration of the arguments against validity of exclusive patronage contracts per se, which were appended without comment to the District Court opinion<sup>15</sup>, may be useful in attempting to foresee what the ultimate decision on that important issue will be.

The position of plaintiffs in the Isbrandtsen case was that in no circumstances could an exclusive patronage contract based on dual rates in a conference agreement be valid under the U.S. Shipping Act of

<sup>8</sup> *Isbrandtsen Co. Inc. v. North Atlantic Continental Freight Conference et al*, 3 F.M.B. 235 (1950).

<sup>9</sup> It should be noted that the Department of Agriculture, while arguing for open competition of ocean freights, favored fixed international prices for key agricultural commodities.

<sup>10</sup> *Isbrandtsen Co. Inc. v. U.S. et al*, 96 F. Supp. 883 (1951).

<sup>11</sup> *A/S J. Ludwig Mowinckles Rederi et al v. Isbrandtsen Co. Inc. et al*, 72 S.Ct. 623, 312 U.S. 950, 96 L. Ed. (1952).

<sup>12</sup> F.M.B. General Order 76, 10 November 1952.

<sup>13</sup> See *U.S. Navigation Co. v. Cunard S.S. Co.*, 284 U.S. 474; and *Swayne and Hoyt Ltd. v. U.S.* 300 U.S. 297; also *U.S. et al v. Far Eastern Conference et al*, 94 F. Supp. 900, reversed on writ of certiorari to Supreme Court, 10 March, 1952.

<sup>14</sup> F.M.B. Docket 725.

<sup>15</sup> See *Isbrandtsen Co. Inc. v. U. S. et al* op cit. Judge Frank attached the arguments without expressing an opinion as to their cogency.

1916, as amended,<sup>16</sup> (hereinafter the Shipping Act), particularly the third sub-division of Section 812 thereof, which reads:

"No common carrier by water shall, directly or indirectly . . . Third. Retaliate against any shipper by refusing, or threatening to refuse, space accommodations when such are available, or resort to other discriminating or unfair methods, because such shipper has patronized any other carrier or has filed a complaint charging unfair treatment, or for any other reason . . ."

The Federal Maritime Board and the conferences maintained that the above statute must be read in the light of the paramount purpose of Section 814 of the Shipping Act, which provides:

"That every common carrier by water, or other person subject to this Act, shall file immediately with the board a true copy . . . of every agreement with another such carrier or other person subject to this Act . . . to which it may be a party or conform in whole or in part, fixing or regulating transportation rates or fares; giving or receiving special rates, accommodations, or other special privileges or advantages; controlling, regulating, preventing, or destroying competition . . .

"The board may by order disapprove, cancel, or modify any agreement, or any modification or cancellation thereof, whether or not previously approved by it, that it finds to be unjustly discriminatory or unfair as between carriers, shippers, exporters, importers, or ports, or between exporters from the United States and their foreign competitors, or to operate to the detriment of the commerce of the United States, or to be in violation of this Act, and shall approve all other agreements, modifications, or cancellations . . .

"Every agreement, modification, or cancellation lawful under this section shall be excepted from the provisions of the Act approved July second, eighteen hundred and ninety, entitled 'An Act to protect trade and commerce against unlawful restraints and monopolies,' and amendments and acts supplementary thereto . . ."

According to this view, the Federal Maritime Board may authorize exclusive patronage contracts under Section 814, unless it finds that such contracts are unjustly discriminatory or unfair, operate to the detriment of the commerce of the United States or are in violation of the Shipping Act.

The Plaintiff's position is supported by five arguments. These, together with an analysis of each, are set out briefly below.

*First Argument* — The purpose of Section 814 was merely to exempt from the anti-trust laws agreements destroying, or substantially reducing, competition among those carriers who choose to join a conference. The first three sub-divisions<sup>17</sup> of Section 812

<sup>16</sup> 39 Stat. 728 (1917), 40 Stat. 900 (1919), 46 U.S.C. Secs. 801-842 (1940).

<sup>17</sup> The third sub-division is quoted in the text supra. The first two sub-divisions read: "First. Pay or allow, or enter into any combination, agreement, or understanding, express or implied, to pay or allow a deferred rebate to any shipper. The term 'deferred rebate' in this chapter means a return of any portion of the freight money by a carrier to any shipper as a consideration for the giving of all or any portion of his shipments to the same or any other carrier, or for any other purpose, the payment of which is deferred beyond the completion of the

were intended to prohibit the use of any method which would coerce an independent carrier, under threat of financial ruin, to become a member of a conference, thereby destroying rate competition between independents and conference members to the injury of American shippers. Since the tendency or effect of exclusive patronage contracts is fully as deadly as deferred rebates<sup>18</sup> or fighting ships<sup>19</sup> in wiping out competition between a conference and independents, Congress could not have intended to authorize a conference to use such contracts. Such an interpretation would work a repeal, by mere implication, of the anti-trust laws, far beyond the express and limited repeal contained in Section 814.

Analysis—Repeal of the anti-trust laws by implication certainly is not favored. But the exemption from those laws authorized by Section 814 is specific and is sufficiently broad to justify approval by the Federal Maritime Board of the exclusive patronage contracts. Congress clearly contemplated that the Federal Maritime Board would in some cases approve agreements, whether between conference members only or between conference members and independents, giving or receiving "special rates, accommodations, or other special privileges or advantages."

It is true that, notwithstanding the foregoing exemption, Congress, in the first and second sub-divisions of Section 812, outlawed "deferred rebates" and "fighting ships," and by the third sub-division of that Section forbid carriers to "retaliate" against shippers or to "resort to other discriminating or unfair methods." But exclusive patronage contracts are not in essence retaliatory. They are merely an arrangement whereby those shippers, whose undertaking to use regularly conference vessels makes possible the establishment and maintenance of regular service, receive the monetary benefit which results from the more efficient use of that service<sup>20</sup>. Superficially the contracts may seem unfair because of the lower rates accorded to contract shippers. In fact they are not, because the undertaking to use only conference vessels puts contract shippers at a distinct disadvantage vis-a-vis shippers who have

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service for which it is paid, and is made only if, during both the period for which computed and the period of deferment, the shipper has complied with the terms of the rebate agreement or arrangement.

"Second. Use a fighting ship either separately or in conjunction with any other carrier, through agreement or otherwise. The term 'fighting ship' in this chapter means a vessel used in a particular trade by a carrier or group of carriers for the purpose of excluding, preventing, or reducing competition by driving another carrier out of said trade."

<sup>18</sup> The deferred rebate contract is similar to the exclusive patronage contract, except that the shipper, to qualify for the discount, must have given all his business to conference carriers not only for the contract period but for a subsequent period as well.

<sup>19</sup> A fighting ship is one operated at low rates to shippers for the sole purpose of destroying competition.

<sup>20</sup> The Inter-American Maritime Conference Report, op cit. at p. 7 states: ". . . when a shipper signs a contract the conference carriers are assured of the shipper's support, which results in a more regular and dependable flow of freight traffic. This enables the steamship carriers to plan their schedules and conduct their operations to better advantage and makes possible certain economies in the solicitation of cargoes and the loading of vessels."

not so contracted and for that voluntarily assumed disadvantage they are entitled to a reasonable compensatory advantage ratewise.

The Alexander Report, upon which the Shipping Act largely was based, condemned fighting ships and deferred rebates<sup>21</sup>. It also dealt at length and not unfavorably with exclusive patronage contracts. Congress took occasion in Section 812 to prohibit the former specifically. It is reasonable to suppose that had Congress intended to disagree with the recommendation of its committee by prohibiting exclusive patronage contracts, it would have said so with at least equal force.

The Supreme Court's analysis of the dual rate arrangement in *Swayne & Hoyt, Ltd. v United States*, 300 U.S. 297 (1937) would appear to belie the argument of plaintiff stated above. In that case the view that under *some* circumstances and with *some* percentage differential a dual rate plan may be valid was implicit. Moreover the argument of the Federal Maritime Board to this effect in the *Isbrandtsen* case appears to have impressed the District Court, for in its opinion the same assumption was expressly adopted.

*Second Argument*—Nowhere in the Shipping Act is there an express delegation of authority to the regulatory agency to fix maximum rates for foreign commerce. Whereas the Alexander Report had recommended that the proposed regulatory agency have power to order just and reasonable maximum rates with respect to both domestic and foreign commerce, Congress granted such power merely for domestic commerce. As to foreign commerce, Congress delegated authority only to forbid unjustly discriminatory rates. This failure to delegate complete authority over foreign rates indicates an intent that shipping conferences should not act as complete monopolies and therefore should not have the right to use any such monopolistic device as the exclusive patronage contract.

*Analysis*—Although Congress has not vested in the Federal Maritime Board express authority to prescribe maximum foreign rates, it has vested in that body *indirect* authority over such rates. Common carriers by water are required to file with the Federal Maritime Board agreements fixing rates in the U.S. foreign trades within 30 days of the date of their becoming effective. If the Federal Maritime Board regards any rate in an agreement filed with it as unreasonably high, it can disapprove either the specific rate agreement of the pertinent basic conference agreement as operating "to the detriment of the commerce of the United States." The Federal Maritime Board and its predecessors have so construed their powers<sup>22</sup>. To be sure this authority does not

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<sup>21</sup> See Note (7) *supra*.

<sup>22</sup> Thus in *Edmond Weil v. Italian Line "Italia"*, 1 U.S.S.B. 395, 398 (1935) it is said: "An unreasonably high rate is clearly detrimental to the commerce of the United States, and upon a showing that a conference rate in foreign commerce is unreasonably high the Department (of Commerce) will require its reduction to a proper level. If necessary, approval of the conference agreement will be withdrawn."

See also *Rawleigh v. Stoomvaart et al*, 1 U.S.S.B. (1933); *In the Matter of*

appear to have been exercised. But it seems clear from the language used in Section 814 that the Board could do so if it saw fit<sup>23</sup>.

It does not necessarily follow that because Congress was explicit in granting authority over domestic rates to the regulatory authority, Congress would have been explicit if it had intended the regulatory authority to have control over foreign rates. The United States has complete jurisdiction over domestic rates but not over foreign rates. Congress may have deemed it more appropriate in the case of foreign rates to vest control indirectly in the regulatory authority because of the multiplicity of jurisdictions to which such rates may be subject. Furthermore, since no one State can effectively exercise unilateral jurisdiction over foreign rates, Congress may have intended that only occasional, rather than continual, active control of such rates would be exercised by the U.S. regulatory body.

*Third Argument* — The usual basic conference agreement provides that rates cannot be changed, up or down, without the consent of every member, and a considerable majority of members of shipping conferences are foreign owned. Consequently, shipping conferences, backed by an exclusive patronage contract system, might put American shippers to a disadvantage because of their ability to maintain rates, no matter how unreasonably high.

*Analysis* — American shippers are not necessarily at the mercy of foreign shippers because of the conference rule which prevents rates from being altered unless all members concur. Should any operator or combination of operators seek to maintain conference rates at an unreasonably high level by refusing to vote for lower rates and thereby detrimentally affect the commerce of the United States, the Federal Maritime Board, through its power under Section 814 to disapprove, cancel or modify the basic conference agreement, could force reconsideration of such rates. For if the conference were dissolved, its members then would be unable to make any agreement affecting U.S. commerce without risking violation of the anti-trust laws. In other words, conference operators would be confronted with the choice either of eliminating the unreasonable rates or of having no agreement whatsoever<sup>24</sup>.

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*Rates, Charges, Rules, Regulations, and Practices of the Common Carriers Parties to the Pacific Coast River Plate Brazil Conference Agreement*, 2 U.S.M.C. 28 (1939); *Pacific Forest Industries v. Blue Star Line, Ltd.*, 2 U.S.M.C. 54 (1939). In *Isbrandtsen Co. Inc. v. U. S. et al*, op cit. the Federal Maritime Board reaffirmed this view.

<sup>23</sup> In acting upon resolutions of the IATA Traffic Conferences under a statute similarly silent as to the power of the regulatory agency, the Civil Aeronautics Board has withheld approval, or threatened to do so, where agreed foreign rates were deemed too low or too high. See for example, CAB Orders E-5623, 17 Aug. 1951, and E-8103, 15 February, 1954. For statute, see text II International Air Cargo Transportation, *infra*.

<sup>24</sup> It is of interest that the Civil Aeronautics Board in its approval of the basic conference agreement of the International Air Transport Association traffic conferences (which has always been limited to a period of one, two or three years) has invariably included a condition that no collateral agreement fixing rates, fares or charges will be approved if it provides an effectiveness period of more than one year. For example, see CAB Order No. E-6390, 1 May, 1952.



*Fourth Argument*—Section 814 of the Shipping Act makes it necessary for the Federal Maritime Board to withhold approval from any conference agreement which is in violation of the Act. The third sub-division of Section 812 prohibits “discriminating” methods. Exclusive patronage contracts discriminate between contract and non-contract shippers. When used elsewhere in the Shipping Act “discriminating,” “discriminatory” or “discrimination” are invariably modified by some term such as “unjustly” or “unreasonable”<sup>25</sup>. Therefore, the omission of any such qualification in the third sub-division of Section 812 is significant and has the effect of outlawing, not only *unreasonable* discrimination, but *all* discrimination. It should be noted with respect to this sub-division that, whereas the Alexander Report recommended that all carriers should be prohibited from resorting to “other unfair methods of discrimination,” the Act which finally resulted used instead the words “other discriminating or unfair methods.”

*Analysis*—It must be conceded that the third sub-division of Section 812 of the Shipping Act forbids “discriminating” methods and that the exclusive patronage contract is in a literal sense a “discriminating” method. But it is difficult to conceive that the recommendation of the Alexander Report, which would have vested in the Federal Maritime Board the same administrative control over discriminating methods as is vested over other discriminations (that is, forbid them only where they are found to be unfairly, unreasonably or unjustly discriminatory) was deliberately rejected by Congress. An absolute prohibition of discrimination in rate methods is impracticable. Virtually every rate structure approved by regulatory authorities admits and has to admit of some degree of discrimination. Thus, it is an accepted tariff practice to accord a lower rate per ton-mile of service for larger shipments than for smaller shipments. Strictly speaking, this is a discriminating method as between shippers of large consignments and shippers of small shipments. But it is economically desirable to encourage large shipments. Again, commodity rates, for example, \$10 per ton for nitrates, \$5 per ton for lumber, etc., are an obvious discrimination as between shippers. But this discrimination is universally regarded as necessary and desirable to develop full traffic potential. It is inconceivable that such discriminating methods were meant to be prohibited by the Shipping Act: such a construction has never been suggested. It must be assumed, therefore, that Congress’ failure to accept the language recommended by the Alexander Report was unintentional, and that Congress in the third sub-division of Section 812 must have intended to outlaw only unfair, unreasonable or unjust methods of discrimination.

Plaintiff argued that in *Baltimore & O.R. Co. v. United States*, 22 F. Supp. 533, 538, Judge Learned Hand in interpreting the unmodified

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<sup>25</sup> For example, fourth sub-division of Sec. 812, also Secs. 814, 815 and 816 of the Shipping Act.

term "discriminating" in the third sub-division of 49 U.S.C.A. Sect. 226 concluded that the term must be interpreted *peremptorily*. However in that case the discrimination clearly referred to rates, fares and charges between connecting lines, where the Congressional intent could well have been to make the prohibition absolute. That statute relates for example, to the situation where there are a number of interline routings between two points and it is desired that a shipper shall be charged *exactly* the same by one route as by another. In the third sub-division of Section 812, "discriminating" refers to "methods" resorted to by a carrier against a shipper and the context in which these two words are used is so broad as to have possible application to the general rate structure; therefore, "discriminating" must have been intended in its usual relative sense.

*Fifth Argument* — A law which permits the Federal Maritime Board to approve exclusive patronage contracts is of doubtful constitutionality because it is the same as granting to a conference the power to include or exclude independent enterprise from a trade. Such a statute is tantamount to giving a private cartel the power to issue certificates of convenience and necessity with no statutory criteria to guide their issuance.

*Analysis* — Although shipping conferences are monopolistic in character, they are not and cannot be complete monopolies. In the first place, they lack that common ownership and control which is essential to true monopoly: they are in fact associations of independent enterprises with important conflicting interest and loyalties, for example, national flag rivalries<sup>27</sup>. Second, to a large degree conferences are comprised of government owned or controlled shipping concerns and to

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<sup>26</sup> Which reads: (underlining supplied) "(1) It shall be unlawful for any common carrier subject to the provisions of this Act to make, give, or cause any undue or unreasonable preference or advantage to any particular person, company, firm, corporation, association, locality, port, port district, gateway, transit point, or any particular description of traffic to any undue or unreasonable prejudice or disadvantage in any respect whatsoever.

"(2) No carrier by railroad subject to the provisions of this Act shall deliver or relinquish possession at destination of any freight transported by it until all traffic rates and charges thereon have been paid, except under such rules and regulations as the commission may from time to time prescribe to govern the settlement of all such rates and charges and to prevent unjust discrimination: Provided, That the provisions of this paragraph shall not be construed to prohibit any carrier from extending credit in connection with rates and charges on freight transported for the United States, for any department, bureau, or agency thereof, or for the District of Columbia.

"(3) All carriers, engaged in the transportation of passengers or property, subject to the provisions of this chapter, shall, according to their respective powers, afford all reasonable, proper, and equal facilities for the interchange of traffic between their respective lines, and for the receiving, forwarding, and delivering of passengers or property to and from their several lines and those connecting therewith, and *shall not discriminate in their rates, fares and charges between such connecting lines*, or unduly prejudice any such connecting line in the distribution of traffic that is not specifically routed by the shipper. . . ."

<sup>27</sup> A British view is that "A shipping conference is a meeting in which competitors face one another with the object of achieving that minimum of co-operation which will suffice to prevent such chaotic competition as might render impracticable the liner system of working ships." Thirty-eighth Report of the Imperial Shipping Committee (1939) p. 51.

the extent that they are, they tend to be endowed with a public, rather than a private, consciousness. Third, shipping conferences are subject to whatever authority any government concerned may see fit to exercise, and, in the case of American foreign commerce, they are subject to a considerable degree of supervision and regulation by the Federal Maritime Board. Finally, a crucial factor in determining the degree of monopoly a conference may enjoy is the ability to exclude potential competitors from its membership. It is the announced policy of the U.S. regulatory authority, in passing upon basic conference agreements, to require a clause permitting the admission as a conference member of any line seeking admission on equal terms with existing members<sup>28</sup>. It seems clear, therefore, that the authority vested in the Federal Maritime Board to approve exclusive patronage contracts is not the equivalent of giving to a private cartel the power to issue certificates of convenience and necessity and that the statute is entirely constitutional.

#### Practical Considerations

Overriding any of the five arguments mentioned above is a practical consideration which of itself could justify a decision upholding the power of the Federal Maritime Board to approve exclusive patronage contracts. Since there is no international governmental regulatory body, shipping conferences must be recognized as the legitimate means whereby the shipping industry can establish and preserve a stable rate structure for the good, not only of the ship operators, but of shippers and the general public of many States as well. The Federal Maritime Board, and its predecessors, whose opinion should carry great weight, have maintained consistently that the successful functioning of shipping conferences is essential to the maintenance of good international shipping services<sup>29</sup>. But without some protective device such as the exclusive patronage contract, shippers would have no inducement to deal with conference members, and independent shipping operators offering rates slightly below those of the conference operators could and would tend to draw trade to their lines. Non-conference operators, which usually maintain irregular schedules, could offer such lower rates because they would be free to sail at will and, if it suited their purpose best, only after they had accumulated full loads. Conference members would be obliged to give service on regular routes, whereas non-conference operators could adjust their services to tap trade wherever it was most profitable to them. No conference operator could afford to suffer such disadvantages for long, and so conferences would cease to function. For this reason, if for no other, it would seem that the Shipping Act should be so construed as to permit the Federal Maritime Board within its administrative discretion, and subject to the particular contracts not

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<sup>28</sup> Inter-American Maritime Conference op. cit. at 175. See also *Pacific Coast European Conference*, J.U.S.C.M. 11, 14 (1948).

<sup>29</sup> See Note (1) supra.

being arbitrary, unreasonable or discriminatory, to approve or disapprove exclusive patronage contracts.

It is to be expected, then, that the validity of exclusive patronage contracts per se under the U.S. Shipping Act ultimately will be upheld.

#### INTERNATIONAL AIR CARGO TRANSPORTATION

So much for the status of exclusive patronage contracts in foreign water transportation under the Shipping Act. Now to consider the validity of such contracts in foreign air transportation, under the governing United States statute, the Civil Aeronautics Act of 1938, as amended<sup>30</sup> (hereinafter the Civil Aeronautics Act).

The Civil Aeronautics Act in many respects is similar to the Shipping Act. Both are based on the same philosophy of regulated competition, provide for similar semi-judicial administrative bodies and have evolved from the same statutory model, the Interstate Commerce Act of 1887.

Section 412<sup>31</sup> of the Civil Aeronautics Act, setting up machinery for approval or disapproval of agreements is similar to Section 814 of the Shipping Act, the chief difference (of minor consequence here) being that the Federal Maritime Board may disapprove, cancel or modify any agreements it deems to be unjustly discriminatory or unfair or to operate to the detriment of the commerce of the United States or to be in violation of the Shipping Act and shall approve all others, whereas the Civil Aeronautics Board shall disapprove any agreement it finds to be adverse to the public interest or in violation of the Civil Aeronautics Act and shall approve all others.

Section 404 (b) of the Civil Aeronautics Act which deals with discrimination and which is almost identical to the first sub-division of Section 815<sup>32</sup> of the Shipping Act, states that:

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<sup>30</sup> Act of June 23, 1938 (Public No. 706, 75th Congress 52 Stat. 977; 49 U.S. Code 401) as amended by Act of July 2, 1940.

<sup>31</sup> It reads: "(a) Every carrier shall file with the Authority a true copy, or, if oral, a true and complete memorandum of every contract or agreement (whether enforceable by provisions for liquidated damages, penalties, bonds, or otherwise) affecting air transportation and in force on the effective date of this section or hereafter entered into, or any modification or cancellation thereof, between such air carrier and any other air carrier, foreign air carrier, or other carrier for pooling or apportioning earnings, losses, traffic, service, or equipment, or relating to the establishment of transportation rates, fares, charges, or classifications, or for preserving and improving safety, economy, and efficiency of operation, or for controlling, regulating, preventing, or otherwise eliminating destructive, oppressive, or wasteful competition, or for regulating stops, schedules, and character of service, or for other cooperative working arrangements.

"(b) The Authority shall by order disapprove any such contract or agreement, whether or not previously approved by it, that it finds to be adverse to the public interest, or in violation of this Act, and shall by order approve any such contract or agreement, or any modification or cancellation thereof, that it does not find to be adverse to the public interest, or in violation of this Act. . . ."

<sup>32</sup> It reads: "That it shall be unlawful for any common carrier by water, or other person subject to this chapter, either alone or in conjunction with any other person, directly or indirectly—First. To make or give any undue or unreasonable preference or advantage to any particular person, locality, or description of traffic in any respect whatsoever, or to subject any particular person, locality, or description of traffic to any undue or unreasonable prejudice or disadvantage in any respect whatsoever. . . ."

"No air carrier or foreign air carrier shall make, give, or cause any undue or unreasonable preference or advantage to any particular person, port, locality, or description of traffic in air transportation in any respect whatsoever or subject any particular person, port, locality, or description of traffic in air transportation to any unjust discrimination or any undue or unreasonable prejudice or disadvantage in any respect whatsoever."

Section 404(b) in conjunction with Section 411<sup>33</sup> of the Civil Aeronautics Act has the same general effect with respect to discrimination affecting foreign commerce, as Sections 812, 815 and 816<sup>34</sup> of the Shipping Act. However, the Civil Aeronautics Act contains no language specifically forbidding deferred rebates, fighting ships or retaliatory practices, as are dealt with in Section 812 of the Shipping Act, and in particular omits any wording similar to that in the third sub-division of Section 812 outlawing "discriminating" methods, upon which the *Isbrandtsen* case has largely been based. Therefore use by scheduled international air cargo operators of exclusive patronage contracts does not have to get over the legal hurdle of peremptory discrimination. On this issue, it should be sufficient, in accordance with Section 404(b), above, merely for it to be shown that such contracts do not result in "unjust" discrimination or in "undue or unreasonable" prejudice or disadvantage.

The failure of Congress to vest in the regulatory body direct control over foreign rates, which concerned the court in the *Isbrandtsen* case (see *SECOND ARGUMENT* above), does not seem so formidable with respect to control of foreign air rates. As previously noted,<sup>35</sup> the Civil Aeronautics Board appears to have no difficulty in construing that it is empowered under Section 412(b) of the Civil Aeronautics Act to disapprove agreements providing for unreasonable foreign rates on the ground that they are adverse to the public interest.

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<sup>33</sup> It reads: "The Authority may, upon its own initiative or upon complaint by any air carrier or foreign air carrier, if it considers that such action by it would be in the interest of the public, investigate and determine whether any air carrier or foreign air carrier has been or is engaged in unfair or deceptive practices or unfair methods of competition in air transportation. If the Authority shall find, after notice and hearing, that such air carrier or foreign air carrier is engaged in such unfair or deceptive practices or unfair methods of competition, it shall order such air carrier or foreign air carrier to cease and desist from such practices or methods of competition."

<sup>34</sup> Section 816 reads: "No common carrier by water in foreign commerce shall demand, charge, or collect any rate, fare or charge which is unjustly discriminatory between shippers or ports, or unjustly prejudicial to exporters of the United States as compared with their foreign competitors. Whenever the commission finds that any such rate, fare, or charge is demanded, charged or collected it may alter the same to the extent necessary to correct such unjust discrimination or prejudice and make an order that the carrier shall discontinue demanding, charging, or collecting any such unjustly discriminatory or prejudicial rate, fare, or charge."

"Every such carrier and every other person subject to this chapter shall establish, observe, and enforce just and reasonable regulations and practices relating to or connected with the receiving, handling, storing, or delivering of property. Whenever the commission finds that any such regulation or practice is unjust or unreasonable it may determine, prescribe, and order enforced a just and reasonable regulation or practice."

<sup>35</sup> See Note (23) *supra*.

Assuming therefore that the Civil Aeronautics Board has the statutory power to approve exclusive patronage contracts, it remains to consider whether the Board would exercise its authority so as to approve such contracts, and whether on an appeal from such a decision the courts would be likely to support that decision.

Taking the second of these points first, although the courts could as a matter of law upset a decision reached by the Civil Aeronautics Board, it is clear that they would be greatly influenced by the ruling of the regulatory body charged with administering air transportation under the Civil Aeronautics Act, particularly insofar as any material question of fact is concerned. The Supreme Court has stated consistently in reviewing decisions of semi-judicial regulatory agencies that it will, because of the agency's greater closeness to and preoccupation with the industry regulated, support such decisions as much as possible<sup>36</sup>.

In accordance with Section 412 (b) of the Civil Aeronautics Act the Civil Aeronautics Board is bound to ask itself two things:

- (i) are exclusive patronage contracts in violation of the Act, that is, are they unjust or unreasonable in the sense of Section 404 (b), or unfair in the sense of Section 411 or,
- (ii) are such contracts adverse to the public interest?

To justify approval, the Board must find negatively on both counts.

Whether the contracts would be deemed to be unjust, unreasonable or unfair in the sense of Sections 404 (b) and 411 would probably depend upon the particular facts of the dual rate structure. For example, how great a differential exists in the rates actually charged to contracting shippers on the one hand and to non-contracting shippers on the other. But, as in the *Isbrandtsen* case, it does not seem likely that the exclusive patronage contracts would be found to be invalid per se. In line with the reasoning of the Supreme Court in *Swayne & Hoyt Ltd. v. U.S.*, as applied or implied by the Federal Maritime Board and the Federal District Court, it is to be expected that under *some* circumstances, and with *some* percentage differential, the Civil Aeronautics Board would be willing to approve such contracts.

Whether the contracts would be regarded as contrary to the public interest is dependent upon the Board's general attitude toward air traffic conferences and the need and desirability of protecting them vis-a-vis non-conference competition. In the opinion of this writer, a strong case can be made in behalf of a policy of protection.

In the first place, some sort of conference machinery is indispensable to a just and reasonable air rate structure throughout the world. Without it the tens of thousands of international rates which must be applied by more than 100 air transport enterprises cannot be established and maintained. As previously related, shipping conferences have learned by experience, costly to carriers, shippers and public alike, that the alternative to rate conferences is cut-throat competition, unreliable

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<sup>36</sup> See Note (13) *supra*.

schedules and unpredictable tariffs. The U. S. agencies responsible for regulating sea transportation, the Federal Maritime Board and its predecessors, have stated repeatedly their conviction that such a machinery is essential for the proper functioning of foreign sea commerce. The need of it for international air transportation is, if anything, greater. Maritime rates can, generally speaking, be isolated to a given set of points, because sea routes begin at the port of embarkation and terminate at the port of debarkation. Air rates, on the other hand, are inter-dependent the world over, because air routes in a very real and practical sense, have no beginning or end. The rate between New York and Singapore via India not only has an effect on the rate between New York and a point beyond, say, Manila, but it also has an important effect on the rate between New York and Singapore the opposite way around the world, via the Pacific. In other words international air rates simply cannot be established piece-meal. Each one must be determined in relation to hundreds or even thousands of others, some of which may be geographically quite remote.

Secondly, there is an established conference machinery. The air traffic conferences of the International Air Transport Association are the recognized mechanism for establishment and maintenance of international air rates. Of the vast network of bilateral governmental agreements regulating the right of commercial flight between States<sup>37</sup> a large number recognize the rate machinery of the International Air Transport Association as the appropriate agency for agreeing international air rates. To be sure these agreed rates are subject to the approval of the governments concerned, and in the event of failure to agree, the governments undertake to arrange settlement either by mutual negotiation or by mediation<sup>38</sup>. But it is unlikely that the entire world rate structure could be established in the first instance by governments themselves. For the latter would then have to establish departments of technicians and experts, duplicating the large staffs which in any case are required by the transport companies. Moreover the existing bilateral machinery is obviously not designed for establishment of rates on a multi-national basis.

Thirdly, without some sort of device similar to that which the U.S. regulatory authorities have considered necessary for protection of the shipping conferences, successful functioning of the air traffic conferences will be jeopardized. Non-conference operators cannot, of course, be bound by conference agreed rates. If they exercise their freedom — as some are doing and many would do — to set rates below those of the conferences, they will tend to draw to their aircraft all the traffic available. Not being bound to regular schedules, as are conference operators, they can if necessary wait for full loads and so operate at a lower cost per unit of service rendered than conference operators. Moreover

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<sup>37</sup> For a detailed description of the bilateral machinery, see Cooper *Right to Fly*. (1947) pp. 178-188.

<sup>38</sup> See Annex to Air Services Agreement between U.S. and U.K., signed at Bermuda 11 Feb. 1946.

they are free to vary their routes to tap markets which are temporarily attractive, and so skim off the most desirable traffic. Conference members will therefore withdraw from the conferences, and eventually the latter will lose their ability to discharge the responsibility with which governments have charged them. As a matter of experience, before this happens some off-setting advantage should be accorded to conference operators. There may be a more suitable arrangement: but the device, approved by the maritime regulatory authorities and long used by shipping conferences, an arrangement which *tend to tie* shippers to regular conference operators, and which has proved itself generally useful and acceptable in its own transport sphere, merits careful consideration by the U.S. air regulatory authorities.

What degree of protection may be justified is, of course, within the province of the governments concerned. It is conceivable that under some circumstances, for example, along certain routes, no protection may be warranted. Along others, protection may be needed and the degree can be controlled, if an exclusive patronage arrangement is employed, by varying the differential between the contract and non-contract rates. In some cases a 5% differential may be required to put non-conference and conference operators on an equally competitive basis. In other cases a 15% or 20% differential may be necessary. Insofar as air traffic into or out of the United States is concerned, it would be up to the Civil Aeronautics Board, by continual supervision and control, to ensure that the differential employed by the conferences is just and fair to all concerned and in the public interest.

#### CONCLUSION

In conclusion it is considered likely that the exclusive patronage system currently employed by the shipping industry will be held valid under the U.S. Shipping Act, that a similar arrangement for the benefit of international air cargo transportation should be held valid under the Civil Aeronautics Act and that such an arrangement prudently applied by the IATA Traffic Conferences and carefully supervised by the Civil Aeronautics Board could be a sound and desirable development in international air cargo transportation.