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Casenotes and Statute Notes

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INSURANCE — IMMUNITY FROM SUBROGATION — A creditor under a conditional sales agreement, for whose benefit the debtor obtains insurance on the property sold, is not considered a named insured under the policy for purposes of immunity from subrogation under Texas law. Rocky Mountain Helicopters, Inc. v. Bell Helicopters Textron, 805 F.2d 907 (10th Cir. 1986).

On April 19, 1979, a helicopter owned and operated by Rocky Mountain Helicopters, Inc. (Rocky Mountain) crashed near Darby, Montana, killing both the pilot and copilot. The accident occurred as the helicopter hauled logs attached to the belly of the helicopter by a cable. The helicopter was destroyed.

Rocky Mountain first leased the destroyed helicopter from Bell Helicopters Textron (Bell), then four months before the crash, exercised an option to purchase the equipment. The conditional sales agreement used by Bell required the purchaser to obtain insurance. In ac-
cordance with the conditional sales agreement, Rocky Mountain added the new helicopter to an existing hull loss insurance contract with Southeastern Aviation (Southeastern) for the benefit of both Rocky Mountain and Bell.6

The parties' dispute involved the interpretation of two endorsements included in the insurance policy.7 Endorsement 13 included a breach of warranty clause that covered Bell, as lienholder loss payee, for losses even if Rocky Mountain's coverage became void due to some negligent act.8 Under this provision, and based on this loss payee coverage, Bell claimed to be insured under the policy for purposes of immunity from subrogation.9 Bell reasoned that as an insured under the breach of warranty clause, it was immune from a subrogation suit by Southeastern.10 Endorsement 30, added at a later date, reserved for Southeastern the right of subrogation against requiring the purchase of insurance "acceptable to Bell and naming both Lessee and Bell as full insureds to the extent of their respective interests in the helicopter with a breach of warranty clause in favor of Lessor. . . ." Id. at 7.

6 Rocky Mountain Helicopters, 805 F.2d at 909.

7 Id. at 910. "[M]atter may be added to, and become a part of, a contract of insurance by way of indorsements . . . ." 1 M. Rhodes, Couch on Insurance 2d § 4:32 (rev. ed. 1984). "The policy and its indorsements . . . together form the contract of insurance, and are to be read together to determine the contract actually intended by the parties." Id. at § 4:36.

8 Rocky Mountain Helicopters, 805 F.2d at 910. The breach of warranty endorsement stated that "no subrogation shall impair the right of the Lienholder to recover the full amount of his claim." Appellant's Opening Brief, supra note 2, at 5. "A breach of warranty endorsement creates an independent contract of insurance between the lienholder and the insurer. . . . The primary purpose of the endorsement is to protect the lienholder's interests against the breach of conditions of the policy by the acts of the mortgagor." Avemco Ins. Co. v. Jefferson Bank & Trust Co., 613 S.W.2d 436, 438 (Mo. Ct. App. 1980).

9 Rocky Mountain Helicopters, 805 F.2d at 910. Bell argued that the breach of warranty clause was like a Standard or Union Mortgage Clause which "creates an independent contract of insurance between the lienholder and the insurer." Appellant's Opening Brief, supra note 2, at 22. (quoting Avemco Ins., 613 S.W.2d at 438).

10 Rocky Mountain Helicopters, 805 F.2d at 910. "No right of subrogation can arise in favor of the insurer against its own insured, since by definition subrogation arises only with respect to the rights of the insured against third persons to whom the insurer owes no duty." 16 M. Rhodes, Couch on Insurance 2d. § 61:136 (rev. ed. 1983).
Based on this provision, Rocky Mountain and Southeastern claimed that Bell waived its right to immunity from subrogation.

Rocky Mountain and Southeastern sued Bell (as the manufacturer) in the United States District Court for the District of Utah for damages resulting from the crash. They alleged that a cracked trunnion caused the accident. Bell responded by claiming that an inexperienced pilot caused the accident. The trial court submitted the

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1 Rocky Mountain Helicopters, 805 F.2d at 910. During the time Rocky Mountain leased the helicopter, insurance policy 613 covered the helicopter. In October 1976, Southeastern unilaterally amended the policy with a subrogation reservation in endorsement 33. Policy 865 was the policy which covered the helicopter at the time of the crash. Policy 865 included a subrogation reservation in endorsement 30 which was identical to endorsement 33. The Southeastern employee responsible for Rocky Mountain testified that the subrogation endorsement was not included in any of Rocky Mountain's previous policies. In addition, "no memorandum notice was sent to any of the manufacturer-mortgagees whose interests were affected by the endorsement." Appellant's Opening Brief, supra note 2, at 7.

2 Rocky Mountain Helicopters, 805 F.2d at 910. Endorsement 30 stated that "[T]he provisions... are for the convenience of all concerned and not for the purpose of insuring the following against any loss for which the following would have been liable as manufacturer [or] vendor... had the aircraft or any part thereof been sold by the following free of any security interest prior to loss.

Brief for Appellee, supra note 3, at 5.

3 Rocky Mountain Helicopters, 805 F.2d at 910. This was a diversity action and Texas law controlled. Id. at 909.

4 Id. at 910. The trunnion is the part of the helicopter which connects the mast to the rotor blades. Id.

5 Id.

[S]oon after installation of this trunnion the normal operating loads encountered during logging caused the initiation of the fatigue crack which progressively got larger. On the day of the accident the crack was approaching a critical size and the condition in which the remaining good portions of the trunnion were no longer capable of supporting the loads that were imposed upon it. On the final flight either just prior to the log release, or just after the log release, the trunnion split open causing a loss of the main rotor system, control of the aircraft and it impacted with the ground.

Brief for Appellee, supra note 3, at 16 (testimony of Appellee's expert witness).

6 Rocky Mountain Helicopters, 805 F.2d at 910. Bell attempted, but was not permitted, to show that Rocky MTN [sic] knew or should have known not only that [the pilot] was a reckless pilot, which explains the pick-up of the overweight load and failure to immediately release it, but also that [the pilot] was undertrained and not yet qualified as a command pilot, which would have explained the pilots' inability to handle the forces generated in the he-
case to a jury, which returned a special verdict finding Rocky Mountain forty-five percent negligent and Bell fifty-five percent negligent.\textsuperscript{17}

The district court accepted Bell's argument that under the breach of warranty clause, Bell, as loss payee, was an insured for purposes of immunity from subrogation.\textsuperscript{18} The court, however, also accepted Rocky Mountain and Southeastern's argument that even if Bell was an insured under the policy, Bell waived its right to immunity from suit in Endorsement 30.\textsuperscript{19} The district court ruled in favor of Rocky Mountain and Southeastern based on a finding that Southeastern successfully reserved the right of subrogation against Bell.\textsuperscript{20}

Bell appealed to the Tenth Circuit Court of Appeals stating that the district court erred in holding that Bell waived its right to immunity from subrogation through Endorsement 30.\textsuperscript{21} Rocky Mountain and Southeastern cross-appealed on the basis that the district court erred in holding that Bell, as loss payee, was an insured under the policy.\textsuperscript{22} Although the Tenth Circuit affirmed the lower court's ruling in favor of Rocky Mountain and Southeastern, they overruled the lower court's holding that Bell qualified as an insured under the breach of warranty endorsement.\textsuperscript{23} \textit{Held, affirmed:} A creditor under a conditional sales agreement, for whose benefit the debtor

\textsuperscript{17} Rocky Mountain Helicopters, 805 F.2d at 910. “In an action to recover damages for negligence resulting in personal injury, property damage or death... a claimant may recover damages only if his percentage of responsibility is less than or equal to 50 percent.” TEX. CIV. PRAC. & REM. CODE ANN. art 33.001(a) (Vernon Supp. 1988).
\textsuperscript{18} Rocky Mountain Helicopters, 805 F.2d at 910.
\textsuperscript{19} \textit{Id.}
\textsuperscript{20} \textit{Id.}
\textsuperscript{21} \textit{Id.}
\textsuperscript{22} \textit{Id. at 911.}
\textsuperscript{23} \textit{Id.} “We need not reach Bell’s argument that it did not waive its immunity because, while we agree with the trial court that Bell was covered by Endorsement 13, we agree with Rocky Mountain and Southeastern that Bell was not an immune insured party under Texas law.” \textit{Id.}
obtains insurance on the property sold, is not considered a named insured under the policy for purposes of immunity from subrogation under Texas law. *Rocky Mountain Helicopters, Inc. v. Bell Helicopters Textron*, 805 F.2d 907 (10th Cir. 1986).

**I. LEGAL BACKGROUND**

**A. The Doctrine of Subrogation**

The doctrine of subrogation first developed in equity courts as a means to reimburse an innocent party who paid the debt of another.\(^{24}\) The origin of the word “subrogation” is believed derived from the Latin term *subrogare*, which translated is “to put in place of another” or “to substitute.”\(^{25}\) The doctrine became a legal fiction by which equity courts treated an extinguished debt as still existing for purposes of repaying an innocent party.\(^{26}\) Subrogation in the insurance field serves as a means of preventing an insured from recovering money from both an insurer and a negligent third party\(^{27}\) for a property loss.\(^{28}\) After paying proceeds to the insured, the insurance company acquires any cause of action the insured has against a negligent party and can sue the negligent party for reimbursement.\(^{29}\)

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\(^{24}\) 16 M. Rhodes, *Couch on Insurance* 2d, *supra* note 10, at § 61:20. “Subrogation is an established branch of equitable jurisprudence, being a creature of the courts of equity, and having for its basis the doing of complete and perfect justice, without regard to form, in all cases where the equities demand it.” *Id.*


\(^{26}\) I. Taylor, *The Law of Insurance* 20 (3d ed. 1983). “At common law, it was necessary that an insurer, who had become subrogated to the rights of its insured, sue the wrong-doing third person in the name of its insured.” *Id.*

\(^{27}\) 16 M. Rhodes, *supra* note 10, at § 61:18. “A sounder approach to the problem is that a wrongdoer who is legally responsible for the harm should not receive the windfall of being absolved from liability because the insured . . . had the foresight to obtain . . . insurance. . . .” *Id.*

\(^{28}\) I. Taylor, *supra* note 26, at 21. “Subrogation is found only in insurance affecting property losses. Life and accident insurance are not . . . contracts of indemnification but rather of investment. . . .” *Id.*

\(^{29}\) *Id.* at 20.

Let us suppose that Smith’s automobile is damaged to the extent of $600.00 as a result of a collision with another automobile negligently operated by Brown. If Smith is insured by a collision insurer,
subrogee (the party to whom the insured’s right of action against the negligent party passes), and the insured is the subrogor (the party whose rights are taken by the subrogee).30

B. Limitations on the Doctrine of Subrogation

An insurer can claim subrogation only against third parties to whom it owes no contractual duty.31 As a result, there can be no subrogation action against a named insured who causes his or her own negligent loss.32 When a negligent party (insured by Company A) causes his or her own loss, or when a negligent party (insured by Company A) causes loss to another party (also insured by Company A under a completely separate contract) the insurance company has no right to a subrogation claim.33 To allow an insurer to subrogate itself against its named insured would permit the insurer to secure a judgment with funds collected through premium payments, and would pass the risk of loss to the insured.34 This would constitute judicial approval of a breach of the insurer’s contractual duty to the insured.35

The policy reasons behind granting immunity from subrogation to insureds is explained in Stafford Metal Works, Inc. v. Cook Paint and Varnish Co..36 Stafford Metal involves

he will be paid by it the amount of his damage.... The insurer in turn will have the right to sue Brown.

Id. R. HORN, supra note 25, at 14.

Hecker, Subrogation-Potential Defenses, 18 FORUM 615, 621 (1983).


Royal Exch. Assurance of Am. v. SS President Adams, 510 F. Supp. 581 (W.D. Wash. 1981) (insurer could not be subrogated to the rights of its insured against a negligent carrier because the insurer also insured the negligent carrier under an unrelated policy); see also Truck Ins. Exch. v. Transport Indem. Co., 180 Mont. 419, 591 P.2d 188 (1979). “[A]n additional insured is entitled to the same protection as a named insured.” Id. 591 P.2d at 193.

Home Ins., 500 P.2d at 949.

Id. Subrogation against an insured would also “permit an insurer, in effect, to pass the incidence of the loss, either partially or totally, from itself to its own insured and thus avoid the coverage which its insured purchased.” Id.

an insurer's attempt to defend an insured in a liability suit, and later sue the same insured in a subrogation action to recoup the settlement payment. Continental (the insurer), through two separate policies, insured Stafford for fire damage and Cook for liability resulting from property damage. Stafford bought some defective urethane foam insulation from Cook which caused a fire in their plant. Stafford sued Cook for $145,228.47 in property damage caused by the fire. Under the terms of Cook's contract, the insurer undertook Cook's defense against Stafford and settled out of court for $163,774.36. After resigning from Cook's defense, the insurer filed a subrogation suit against Cook for the excess $63,774.36 of the settlement which exceeded Cook's policy limits of $100,000.00.

The court held that to allow subrogation in this case would create severe conflicts of interest which would destroy the insurer and insured relationship. The court noted, for example, that the insurer's attorneys did not conduct any discovery during their defense of Cook, and that the insurer settled for the full amount of Stafford's claim with no attempt to negotiate a lesser amount. If the subrogation suit was successful, the insurer would be in the position to "play favorites" among its insureds. The risk of loss, as represented by the excess settlement payment over the limits of the policy, fell on the insurer.

\[\text{Id. at 57.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Id.}\]
\[\text{Id. at 62. "The situation where an insurer attempts to subrogate and sue his own insured, whom he is obligated to defend, gives rise to so many opportunities for conflict of interests or misrepresentation of the insured that public policy commands that the insurer be denied the right to do so." Id.}\]
\[\text{Id. at 63.}\]
\[\text{Id.}\]
\[\text{Id. "Such subrogation creates administrative costs in shifting the loss between insurance carriers, which costs must be borne by the public in the form of increased insurance rates . . . . Clearly, minimizing such costs is in the public interest." Id. at 62.}\]
Identifying an insured for purposes of immunity from subrogation is not always as straightforward as identifying a company's named insureds. For example, many auto insurance policies cover additional parties driving a car with the consent of the named insured. Additional insureds are granted the same protection as a named insured. No right of subrogation exists, therefore, against a negligent unnamed driver with the status of an additional insured under the policy. Determining whether an additional party is an insured for purposes of immunity from subrogation becomes even less clear in situations where the named insured gives the benefit of the insurance coverage to a third party. Two common examples are insurance contracts which include a standard mortgage or loss payee clause, and builder's risk insurance.

1. The Standard Mortgage Or Loss Payee Clause

A standard mortgage clause defines the rights of beneficiaries under the policy. An insurance contract with a standard mortgage clause provides that the proceeds are paid first to the mortgagee (the lender) to protect the lender's interest in the insured property. The standard mortgage clause also provides that the lender's interest will not be invalidated by any negligent act or omission by the insured borrower. The clause creates a separate and independent contract between the lender and the in-

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40 I. TAYLOR, supra note 26, at 74. "This clause insures third persons operating a vehicle with the consent of the insured and as a result, protection is given not only to the named insured but also to these 'additional insured.'" Id.

47 See cases cited supra note 33.

48 See supra note 46.

49 Hecker, supra note 31, at 621. "The issue is whether the party receiving the benefit of another's insurance becomes an "insured" so that the subrogated carrier is precluded from proceeding against it to recover for losses sustained by the named insured." Id.

50 Nelson v. Consumers County Mut. Ins. Co., 326 S.W.2d 535 (Tex. Civ. App. 1959). "The proceeds of [the] policy [become] the property of the mortgagee and [are] payable to it to the extent of the amount due on the mortgage. The expression 'as its interest may appear' is defined as the indebtedness the mortgagor owes under his note and mortgage." Id. at 538.

51 I. TAYLOR, supra note 26, at 57.
A lender’s interest in insured property under a standard mortgage clause is similar to a vendor’s interest under a conditional sales contract which requires the purchaser to obtain insurance for the benefit of the vendor. When a policy is made payable to a conditional vendor “as his interests may appear”, the vendor’s interests are protected because the proceeds apply first to discharge the remaining debt.

Although a loss payee is deemed to have a separate and independent contract with the insurer, it is unclear whether the loss payee is considered an insured for all purposes under the policy. In Dalrymple v. Royal-Globe Insurance Co., the court held that a lender, named as loss payee in an insurance policy, is not as a matter of law an insured under the policy for purposes of immunity from subrogation. In Dalrymple, the builder of an apartment complex became a lender when he financed and sold the complex. To protect the builder/lender’s interest, the sales agreement required the purchaser to obtain insurance on the complex naming the builder/lender as loss

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52 10A M. RODES, COUCH ON INSURANCE 2D § 42:736 (rev. ed. 1982). The standard mortgage clause “constitutes two separate contracts of indemnity which relate to the same subject matter, but cover distinct interests therein, and it effects a new and independent insurance which protects the mortgagee... and which cannot be destroyed or impaired by the mortgagor’s acts...” Id.; see Federal Ins. Co. v. Tamiami Trail Tours, 117 F.2d 794 (5th Cir. 1941) (a mortgage clause created a separate contract between the insurer and the mortgagee, and the insurer must assume the risk of mortgagee’s negligence).


54 5 M. RHODES, COUCH ON INSURANCE 2d, § 29:109 (rev. ed. 1984). Where the conditional vendor is entitled to the proceeds he must apply them to the discharge of the purchase price, as the risk of loss as between the parties to the sales contract is on the vendee. Where title has passed to the buyers but part of the purchase price remains unpaid, the proceeds should first be applied on the unpaid purchase price and the remainder should be turned over. Id.

55 280 Ark. 514, 659 S.W.2d 938 (1983).

56 659 S.W.2d at 940. “A loss payee is not an insured in the usual sense of the word but simply a loss payee who is entitled to payment for loss of his property...” Id.

57 Id. at 939.
payee.\textsuperscript{58} After a fire in an occupied apartment, the insurer paid the builder/lender, as loss payee, for damage caused by the fire.\textsuperscript{59} The apparent cause of the fire was faulty wiring near a water heater.\textsuperscript{60}

The party renting the apartment at the time of the fire later brought suit against the owner of the complex for damage due to the fire.\textsuperscript{61} The insurer, acting under its right of subrogation in the owner's policy, filed a third party suit against the builder/lender based on negligent construction due to faulty wiring.\textsuperscript{62} The builder/lender defended with a suit against the insurance company for breach of contract.\textsuperscript{63} The builder/lender, as loss payee under the policy, claimed to be an insured who was immune from subrogation.\textsuperscript{64}

The court's analysis focused on the difference between coverage under property insurance and coverage under liability insurance.\textsuperscript{65} The court reasoned that although a loss payee clause creates a separate contract between the insurer and the lender, the lender's rights under a property insurance policy are limited to payment for loss of property.\textsuperscript{66} The loss payee provision, according to the court, did not make the lender an insured for purposes of immunity from subrogation.\textsuperscript{67} The court concluded that a party seeking protection from liability must pay for that

\textsuperscript{58} Id.
\textsuperscript{59} Id.
\textsuperscript{60} Id.
\textsuperscript{61} Id. At a later date, the renters amended their complaint to seek punitive damages against the builder/lender. A jury awarded the renters $6,000.00 compensatory damages and $7,500.00 punitive damages, finding 85% attributable to the builder/lender and 15% attributable to the purchaser. Id.
\textsuperscript{62} Id.
\textsuperscript{63} Id.
\textsuperscript{64} Id.
\textsuperscript{65} Id. at 940. "A loss payee is entitled to enforce his right to payment for property loss against the insurer, but there the right ends; it does not grant immunity to a loss payee that causes the loss." Id.
\textsuperscript{66} Id. The builder/lender "did not buy the insurance, he was simply a named loss payee, and there is no provision in the policy that provides that a loss payee is given any liability protection." Id. at 939.
\textsuperscript{67} Id. at 940. The dissent argued that "[t]o allow the . . . insurance company to recover by subrogation against its own insured is but to encourage all insurers to
protection.\textsuperscript{68}

In General Insurance Co. of America \textit{v.} Stoddard Wendle Ford Motors,\textsuperscript{69} the court reached a different result by holding that a loss payee under a property insurance policy is a "coinsured" and is immune from subrogation.\textsuperscript{70} Stoddard Wendle Ford Motors (Stoddard) financed and sold a truck to Findley under a conditional sales agreement.\textsuperscript{71} Findley, in accordance with the terms of the sales agreement, procured insurance from General Insurance Company of America (General) with Stoddard named as loss payee.\textsuperscript{72} Because Findley planned to use the truck in a logging operation, Stoddard lengthened the truck's wheel base by cutting the body and welding in an additional section.\textsuperscript{73}

When Findley later used his truck to haul a tractor, the welded section of the truck separated, causing the truck and tractor to go over an embankment.\textsuperscript{74} General paid the $6,874.00 required to repair the truck.\textsuperscript{75} Later General, as subrogee of Findley, brought suit against Stoddard for the $6,874.00 in damages caused by defective welding.\textsuperscript{76} The court noted that an insurer can only be subrogated to the rights of the insured against a negligent third party, not a negligent coinsured.\textsuperscript{77}

Because the insurance was maintained for Stoddard’s benefit, Stoddard became a "party beneficially interested

\begin{itemize}
  \item look for negligence on the part of their insureds and, if found, refuse to pay a claim otherwise covered by the contract." \textit{Id.}
  \item \textit{Id.}
  \item 67 Wash. 2d 973, 410 P.2d 904 (1966).
  \item \textit{Id.} 410 P.2d at 908.
  \item \textit{Id.} at 905.
  \item \textit{Id.} Stoddard assigned its interest to Pacific Finance Corp., who later reassigned the interest back to Stoddard. The insurance actually named Pacific as loss payee, but the court held that Pacific was a mere agent of Stoddard. The insurance policy was for the benefit of Stoddard. \textit{Id.} at 905, 907.
  \item \textit{Id.} The original wheel base of 191 inches was lengthened to 212 inches. \textit{Id.}
  \item \textit{Id.} at 905-06.
  \item \textit{Id.}
  \item \textit{Id.}
  \item \textit{Id.} at 906, 908.
\end{itemize}
in the insurance" and not a "third party."\textsuperscript{78} Stoddard's sales contract required Findley to purchase the insurance for which Stoddard received the benefit of the insurance proceeds.\textsuperscript{79} Although Stoddard's negligent welding caused the damage, the insurance was for Stoddard's benefit and made Stoddard a coinsured who was immune from subrogation.\textsuperscript{80}

2. Builder's Risk Insurance

The issue of immunity from subrogation also arises in the field of builder risk insurance.\textsuperscript{81} Under this type of policy, a general contractor purchases insurance to protect against losses which may occur during construction.\textsuperscript{82} These policies usually extend coverage to unnamed subcontractor's property "as their interests may appear."\textsuperscript{83} A dispute can arise when an insurance company compensates a named insured general contractor for a loss, and then tries to recover under a theory of subrogation against a negligent subcontractor.\textsuperscript{84} There is disagreement among courts on the issue of whether the negligent subcontractor is an insured for purposes of immunity from subrogation.\textsuperscript{85} The court's interpretation of a builder's risk policy determines whether a subcontractor is considered an insured.\textsuperscript{86}

a. Majority View: Immunity From Subrogation

A majority of courts hold that a subcontractor is an in-

\textsuperscript{78} Id. at 908.
\textsuperscript{79} Id.
\textsuperscript{80} Id.
\textsuperscript{81} Id. The court noted, "Cases in which an insurance company attempts to recover as a subrogee, against a party for whose benefit the insurance was written and whose negligence has occasioned the loss, are concededly rare, but there are some (mostly in the field of builder's risk insurance)." Id.
\textsuperscript{82} Comment, Conflicts Regarding the "No Subrogation Against Insured" Rule, 29 Drake L. Rev. 811, 812 (1979).
\textsuperscript{83} Id.
\textsuperscript{84} Hecker, supra note 31, at 623.
\textsuperscript{85} Id. at 624.
\textsuperscript{86} Comment, supra note 82, at 812.
sured for purposes of immunity from subrogation. Under this reasoning, the insurer cannot seek recovery from a negligent subcontractor who causes a loss. In *Transamerica Insurance Co. v. Gage Plumbing*, the Tenth Circuit affirmed the district court's holding that the unnamed subcontractor was an insured for purposes of immunity from subrogation. In *Transamerica*, the general contractor, who was building a motel complex, purchased an insurance policy that covered all temporary structures, materials, and equipment on the site for which the general contractor was liable. During construction a fire destroyed one of the buildings which held a subcontractor's supplies and equipment. After paying out proceeds for the damage caused by the fire, the insurer brought a subrogation suit against the subcontractor alleging that the subcontractor's negligence caused the fire.

In their analysis, the court looked to the customs and practices of the building trade and determined that the parties intended the subcontractor to be a coinsured under the policy. The court interpreted the policy to be a single contract covering all the property on the premises. The insurer assumed the risk that one of the insured subcontractors might cause negligent damage. The court put the burden of limiting the subcontractor's coverage on the insurer through the use of "clear and

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87 *Id.* at 817; see also Frank Briscoe Co. v. Georgia Sprinkler Co., 713 F.2d 1500, 1504 (11th Cir. 1983) (builders risk insurer could not maintain a subrogation against a negligent subcontractor for damage caused by a leaking fire sprinkler system); Baugh-Belarde Constr. v. College Util., 561 P.2d 1211, 1216 (Alaska 1977) (builder's risk policy is viewed as one policy which protects both the insured contractor and any insured subcontractors against their own negligence).

88 433 F.2d 1051 (10th Cir. 1970).

89 *Id.* at 1053.

90 *Id.*

91 *Id.* at 1052.

92 *Id.* at 1053-54.

93 *Id.* at 1055. "[T]he beneficiaries of the policy could collect only the amount of their losses, but this does not change the policy from being a single policy covering all the property on the premises in which the insurance company assumed the risk that one of its insureds might cause damage to the insured property through negligence." *Id.*

94 *Id.*
Because no language limiting liability appeared in the policy, the court held that the parties intended that the policy cover the subcontractor as an insured with immunity from subrogation.96

b. *Minority View: No Immunity From Subrogation*

A minority of courts allows an insurer to seek a subrogation action against a negligent subcontractor.97 The minority view admits that the subcontractor can be a limited insured under the policy. The result depends on the courts' analysis of whether the subcontractor is insured for property damage only, and therefore not immune from subrogation, or whether the subcontractor is also insured against liability for negligence.98 Under the minority view, if the subcontractor is insured for property damage only, the insurer can recover from a negligent subcontractor any amounts paid to an insured general contractor.99

_McBroome-Bennett Plumbing, Inc. v. Villa France, Inc._,100 is representative of the minority view.101 This was a case of first impression in Texas on the issue of subrogation rights of an insurer against a negligent subcontractor.102 In _McBroome_, the insurance company issued builder's risk

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95 _Id._ "A limitation of coverage can be accomplished only by the use of clear and concise language." _Id._

96 _Id._

97 Comment, _supra_ note 82, at 824.

98 _Id._

99 _Id._ By automatically labeling the subcontractor as an insured and thereby strictly construing the contract against the insurance company, the contract changes from one covering the general contractor's liability for the subcontractor's property to one covering the subcontractor's negligence to others. This process does violence to the rule which prohibits courts from making a new contract for the parties. _Id._ at 826-27.

100 _Id._ at 827. "The subcontractor should not be permitted immunity from subrogation actions because of its limited interest in a portion of the property which was destroyed because of the subcontractor's admitted negligence." _Id._

101 Comment, _supra_ note 82, at 824.

102 _McBroome_, 515 S.W.2d at 35.
insurance to the owner-general contractor on a construction project. The contractor hired a plumbing subcontractor. During construction, fire damaged the building.

The general contractor filed a claim under its insurance policy. The insurer paid $15,719.37 to cover the loss. The insurer then sued the plumbing subcontractor, as subrogee to the general contractor's cause of action, alleging the subcontractor's negligence caused the fire. The subcontractor defended by claiming immunity from suit as an unnamed coinsured under the insurance contract.

The court focused its analysis on the "realities" of the situation. The disputed provision provided coverage for "property of the [insured] or property for which the [insured] is liable." The court noted that the subcontractor paid no premiums, was not hired when the policy was issued, and was not a party to the contract between the general contractor and the insurer. The subcontractor's only right under the policy was to receive payment for loss of its property where the general contractor was liable for the loss. In addition, the general contrac-

103 Id.
104 Id.
105 Id. Damages caused by the fire amounted to $15,719.37. Id.
106 Id.
107 Id.
108 Id.
109 Id.
110 Id. The case was submitted to the court without a jury . . . and the court rendered judgment against the subcontractor and in favor of [the insurer] for the amount of the loss, denied the subcontractor's claim for its tools, but allowed the counterclaim against [the general contractor] for the balance due for plumbing services.
111 Id.
112 Id. at 37. "The true relationship of the parties should be carefully examined in the light of the foregoing rules of law." Id.
113 Id.
114 Id. at 39. "It must be borne in mind that any possible nexus between the subcontractor and the insurer under this policy is his tools and property at the site for which [the general contractor] is liable, while the nexus in the subrogation action is his negligence to the property of another." Id. at 38.
115 Id. at 37.
tor required the subcontractor to carry "sufficient insurance to fully protect his work." The court found that the "realities of the case" indicated that the parties did not intend for the subcontractor to be a coinsured under the builder's risk policy.

The dissent interpreted the language of the policy differently. According to the dissent, the language "property for which the [insured] is liable" did not refer to liability for loss, but rather property for which the general contractor was responsible. The general contractor was responsible for equipment and supplies present at the construction site, including the equipment of the negligent subcontractor. The subcontractor, insured under the policy, became a coinsured for purposes of immunity from subrogation.

II. *Rocky Mountain Helicopters, Inc. v. Bell Helicopters Textron*

The district court decision held that Bell, as loss payee, was an insured for purposes of immunity from subrogation. The district court, however, did not rule in favor of Bell's arguments.

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114 Id. at 39. "[T]he subcontract ... seems to provide ample evidence that [the general contractor] was not going to insure the subcontractor's interest and it was not intended that the subcontractor would automatically become a full-fledged insured under the original policy." Id.

115 Id.; Cf Stafford Metal Works, Inc. v. Cook Paint and Varnish Co., 418 F. Supp. 56 (N.D. Tex. 1976). "McBroome is a limited decision dealing with a particular type of insurance policy. There are no Texas cases in point that lead this Court to believe that a Texas court would abandon the traditional prohibition against an insurer suing his own insured ...." Id. at 61.

116 *McBroome*, 515 S.W.2d at 42.

117 Id. "[T]he subcontractor's property ... including their tools located on the premises, was covered regardless of whether or not [the general contractor] was 'liable', in the strict legal sense for this particular loss." Id.

118 Id. at 45.

The insurer, which has accepted one premium covering the entire property and has assumed the risk of the negligence of each insured party, ought not to be allowed to shift the risk to any one of them. The entire loss should be borne by the insurer, just as if all the property covered by the contract were owned by a single insured party whose negligence caused the loss.

Id. at 44.

119 Rocky Mountain Helicopters, Inc. v. Bell Helicopters Textron, 805 F.2d
of Bell because it believed Bell contractually waived its right to immunity from subrogation through endorsement 30 of the policy. On appeal Bell argued that the district court erred in holding Bell waived its right to immunity. Bell claimed that endorsement 30 was void due to lack of consideration and mutuality. Rocky Mountain argued on appeal that the district court erred in finding Bell an insured for purposes of immunity from subrogation. The Court of Appeals for the Tenth Circuit never addressed Bell's claimed nonwaiver of immunity because the court ruled that Bell, as loss payee under Texas law, was not an insured for purposes of immunity from subrogation.

The Tenth Circuit examined several lines of reasoning to reach their conclusion that Bell was not an insured. First, the court reviewed Bell's argument that a standard mortgage or breach of warranty clause creates a separate and independent contract between the lender and the insurer. Bell claimed, as loss payee of a standard mortgage clause, that a separate contract of insurance existed between Southeastern and Bell. The court responded there were limits to the "fiction" that a standard mortgage clause operates as an independent contract. The court

\begin{enumerate}
\item[(170)] Id. at 910; see supra notes 11-12 and accompanying text for a discussion of Rock Mountain's insurance policy.
\item[(171)] Rocky Mountain Helicopters, 805 F.2d at 910. Bell also appealed an evidentiary ruling which excluded evidence that Rocky Mountain's pilot was untrained and reckless. Id.
\item[(172)] Appellant's Opening Brief, supra note 2, at 25-26. "[T]here was absolutely no consideration ever given by Southeastern for End. 30 [sic] . . . such as a reduction in premium, which would have been appropriate since the ultimate risk of loss would be reduced by the purported right to sue the financing manufacturer in subrogation." Id. at 27.
\item[(173)] Rocky Mountain Helicopters, 805 F.2d at 911.
\item[(174)] Id.
\item[(175)] Id. at 911-13.
\item[(176)] Id. at 911; see supra notes 50-68 and accompanying text.
\item[(177)] Rocky Mountain Helicopters, 805 F.2d at 911.
\item[(178)] Id.
\end{enumerate}
cited Dalrymple as authority that at least one court limited the "fiction" of the separate contract. In addition, the court stated that Bell did not cite any cases where this "fiction" frustrated the right of subrogation.

Bell argued, in its brief, that Stoddard Wendle represented a case where a court held that a standard mortgage clause created a separate contract and frustrated the insurer's right of subrogation. The court gives no indication of why it dismissed this argument. By citing only to Dalrymple, the court dismissed a line of reasoning and presentation of facts surprisingly similar to those presented by Bell. Like the lender in Stoddard Wendle, Bell required the purchase of insurance under a sales contract, and at all times the insurance was maintained for Bell's benefit. Under the Stoddard Wendle court, these facts make the lender an immune insured for purposes of subrogation.

The Tenth Circuit next examined the analogous "builder's risk cases." Although these cases were "instructive," the court noted there is disagreement as to the

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129 280 Ark. 514, 659 S.W.2d 938 (1983); see supra notes 55-68 and accompanying text for a discussion of Dalrymple.
130 Id.; see supra notes 55-68 and accompanying text.
131 Rocky Mountain Helicopters, 805 F.2d at 911. "It is nowhere clearly established and we find no examples in the cases cited by Bell that this fiction of an independent contract has been applied to facilitate or frustrate a right of subrogation." Id.
132 67 Wash. 2d 973, 410 P.2d 904 (1966); see supra notes 68-80 and accompanying text for a discussion of Stoddard Wendle.
134 Rocky Mountain Helicopters, 805 F.2d at 911. The court merely stated it found no examples in Bell's cited cases. Id.
135 Appellant's Reply Brief, supra note 133, at 9. "Stoddard Wendle is significant because, of the many cases precluding subrogation against an insured, its facts most closely parallel those of the instant case." Id.
136 See supra notes 5-6 and accompanying text.
137 General Ins. Co. of Am. v. Stoddard Wendle Ford Motors, 67 Wash. 2d 973, 410 P.2d 904, 908 (1966). "'Co-insured,'... does not apply only to named insureds, but to all for whose benefit the insurance was written." Id.
138 Rocky Mountain Helicopters, 805 F.2d at 912; see supra notes 81-118 and accompanying text.
outcome of this issue between jurisdictions. The Tenth Circuit acknowledged that in Transamerica it held that a subcontractor under a builder's risk policy is an insured for purposes of immunity from subrogation. This decision, however, represented Louisiana and Kansas law, not Texas law. The court erroneously cited Dalrymple as an example of a builder's risk case where a court found there was no immunity from subrogation. The insurance policy in Dalrymple was not a builder's risk policy which covered unnamed subcontractors, but rather a property insurance policy purchased as a requirement of a conditional sale contract. This blurring of loss payee and builder risk cases is a determinative factor in the court's decision.

In applying Texas law to the case, the court uses McBroom, a builder's risk case, as authority for the holding that a loss payee is not immune from subrogation. For a second time, the court blurs the distinction between loss payee and builder risk cases. The court admitted its decision was a "close call". A builder's risk policy is a specific type of insurance which defines the insured interests of a subcontractor's work and tools. This is vastly dif-

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139 Rocky Mountain Helicopters, 805 F.2d at 912.
140 433 F.2d 1051 (10th Cir. 1970); see supra notes 88-96 and accompanying text for a discussion of Transamerica.
141 Id.; see supra notes 87-96 and accompanying text.
142 Rocky Mountain Helicopters, 805 F.2d at 912.
143 Id. "[T]he court in Dalrymple recognized a distinction between property coverage and liability insurance. It found that while the builder's risk policy insured the contractor's property on the premises, it did not insure the contractor against all damages to the building that might result from his negligence." Id.
144 Dalrymple, 659 S.W. 2d at 939. "The contract for sale required that the purchaser obtain insurance on the property for 'loss by fire and other hazards and contingencies.'" Id.
145 515 S.W.2d 32 (Tex. Civ. App. 1974); see supra notes 100-118 and accompanying text.
146 Rocky Mountain Helicopters, 805 F.2d at 914. "As to Bell's interest in the helicopter, such interest is analogous to the contractor's interest in its lost tools in McBroom. This interest does not make it an insured party under Texas law." Id.
147 Id. at 913. "Applying the McBroom approach to our facts to determine if Bell is an insured party, we believe that the 'realities' present something of a double image lending support to both sides." Id.
ifferent from a loss payee's interest under an insurance policy, which is written for the benefit of the loss payee. In summary, the Court of Appeals for the Tenth Circuit held that under Texas law, the loss payee of an insurance policy which is purchased as a requirement of a sales agreement, is not an insured for purposes of immunity from subrogation. The Tenth Circuit, however, did not adequately resolve the issue when it based its decision on the holding of a builder's risk case.

III. Practical Implications

Rocky Mountain stands as authority in Texas for the proposition that a lienholder, or loss payee, under an insurance policy is not an insured for purposes of immunity from subrogation. The Tenth Circuit based its decision on the holding in McBroome. The McBroome court emphasized the "realities" of the case by focusing on the intent of the parties. There were two types of property covered in McBroome, the general contractor's property and property, such as the subcontractor's tools, for which the general contractor was liable. The court reasoned that because the general contractor required the subcontractor to purchase separate insurance, the parties did not intend the general contractor's insurance to cover the subcontractor.

In Rocky Mountain, the helicopter represented the only property covered under the policy. Both Rocky Mountain and Bell had insurable interests in the same property. Since Bell required Rocky Mountain to purchase insurance for the benefit of both parties, the parties appear to have intended that Bell be an insured under the policy. If McBroome controls, the "realities" of the case in-

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149 See supra notes 119-148 and accompanying text.
150 Id.
151 McBroome, 515 S.W.2d at 37.
152 Id.
153 Id. at 39.
154 See supra notes 1-12 and accompanying text.
155 Id.
icate that Bell is an insured under the policy for purposes of immunity from subrogation.

The Tenth Circuit did not use other Texas authority as a guide to understanding the limits of the McBroome case. In *Stafford Metal*, a different Texas court interpreted *McBroome* as a "limited decision" dealing only with an analysis of builder's risk policies. The "realities" of the *McBroome* decision were that a subcontractor's property was not covered under the general contractor's insurance policy. This is vastly different from the facts of *Rocky Mountain* where Bell's interest in the helicopter was insured. The *Stafford Metal* court concluded there were no Texas cases that indicate a willingness, on the part of Texas courts, to allow an insurer to sue an insured.

The holding in *Rocky Mountain* affects any lender in Texas who is named loss payee under an insurance policy. Apparently, neither the intent of the parties, nor the reasons for which the insurance was purchased control. One result is that in order to protect their interests, lenders will be forced not only to require that a purchaser obtain insurance, but also that under the policy the lender is named as an additional insured. This will significantly raise the cost of insurance for the purchaser based on the increased risk of insuring the loss payee.

When a lender requires the purchase of insurance with a standard mortgage, or loss payee, clause the insurer is put on notice that the insurance is being purchased for the benefit of a third party. If the insurer is in a jurisdiction that grants immunity from subrogation to a loss-payee, the insurer can adjust the premium payments accordingly to reflect any added risk it may incur. The amount of risk would probably vary depending on the type of property that is insured.

With the differing interpretations between jurisdictions

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156 *See supra* notes 36-45 and accompanying text.
158 *Id.* at 60.
159 *Id.* at 61; *see supra* note 115.
of whether a loss payee is an insured for purposes of immunity from subrogation, statutory guidance is needed. For example, in a jurisdiction which recognizes a loss payee as an immune insured, the insured's cost for obtaining insurance can increase. This result will pass the cost of subrogation onto the public. Insurers are in the business of risk distribution. Insurers should be responsible for the added risk of a loss payee clause.

**Conclusion**

The issue presented in Rocky Mountain is whether a loss payee, for whose benefit insurance is purchased, is an insured for purposes of immunity from subrogation. The scarce authority on this issue is divided over the outcome. The basic issue is whether the risk of loss should fall on the loss payee, or on the insurer. A line of cases that involve a similar issue are builder risk cases. In these cases, an insurer of a builder's risk policy attempts to recover for damage caused by a negligent subcontractor. The outcome turns on a factual determination of whether the subcontractor's tools and work are insured under the general contractor's blanket policy. In Texas, based on the holding in McBroome, a negligent subcontractor is not immune from subrogation unless specifically named as an insured under the general contractor's policy. The Tenth circuit used McBroome as authority for holding that a loss payee of an insurance policy is also not immune from subrogation. Under Texas law, therefore, the loss payee of an insurance policy, purchased as a requirement of a sales agreement, is not an insured for purposes of immunity from subrogation.

*Catherine Stone Bowe*
ADMINISTRATIVE LAW — CAB POLICIES CONCERNING CLASSIFICATION AND COMPETITIVE STATUS OF FOREIGN AIR CARRIERS — The Civil Aeronautics Board may, with appropriate explanation, alter its prior policies to encourage competition between foreign and domestic airlines, without fear of judicial interference. *Japan Air Lines Co. v. Dole*, 801 F.2d 483 (D.C. Cir. 1986).

Discount passenger fares and freight rates form the substantive basis of this dispute.\(^1\) On October 27, 1980, Japan Air Lines Company (JAL), Lufthansga German Airlines (Lufthansa), and Swissair, Swiss Air Transport Company (Swissair) filed a complaint with the Civil Aeronautics Board (CAB or the Board)\(^2\) challenging a system of discount fares marketed by several domestic airlines as Visit USA (VUSA).\(^3\) The complaint involved the restrictive nature of the fares that were available only to passengers who flew to and from the United States on the carrier offering the discount fare.\(^4\)

In May of the following year, JAL filed a second complaint, challenging a discount freight offer by Northwest Airlines, Inc. (Northwest).\(^5\) Northwest’s Export Inland Contract Rate (ExIn rate) gave a discount for freight

\(^{1}\) Japan Air Lines Co. v. Dole, 801 F.2d 483, 483-84 (D.C. Cir. 1986).

\(^{2}\) While the CAB ceased to exist on January 1, 1985, its orders remain in effect and are administered by the Secretary of Transportation. Legal actions concerning the orders continue with the Secretary substituted as the respondent. See CAB Sunset Act of 1984, Pub. L. No. 98-443, § 12(e), 98 Stat. 1703, 1711 (1984).

\(^{3}\) *Japan Air Lines*, 801 F.2d at 484. The VUSA fares provided passengers visiting the United States from a foreign country with a discount on their travel to various points within this country. *Id.* at 484-85. Domestic airlines which intervened in the action included Pan American World Airways, TransWorld Airlines, and Northwest Airlines. *Id.* at 483.

\(^{4}\) *Id.* at 485. “Unrestricted” VUSA fare systems, which allowed a passenger to choose different carriers for his foreign and domestic travel, were not challenged. *Id.*

\(^{5}\) *Id.* There were no restrictions imposed as to carrier or tariff rate for the Seattle to Far East leg of the shipment. *Id.*
flown from Chicago's O'Hare airport to Seattle, so long as the freight was ultimately shipped to Hong Kong, Japan, South Korea, the Philippines, or Taiwan.6

The complaints were consolidated, and three major issues took shape.7 The VUSA fares and ExIn rate were challenged first on the theory that they involved foreign air transportation and should therefore be filed in the domestic carriers' international tariffs. Secondly, the foreign carriers alleged that the discounts were contrary to bilateral treaty guarantees of a fair and equal opportunity to compete with domestic carriers.8 Finally, the complaints charged that the fares were unjustly discriminatory because they gave undue or unreasonable preference to domestic carriers in the foreign leg of travel.9 Taken together, the three charges expressed the foreign carriers' concern that unregulated discounts could force foreign carriers, unable to match rates, out of a lucrative market.10

An Administrative Law Judge held the initial hearing and determined that the discounts did involve foreign air transportation, but that they did not deny the foreign car-

6 Id.
7 Id. A carrier must file a tariff, a public document announcing rate ceilings, for any through fare representing foreign air transportation. See infra notes 43-45 and accompanying text for the definition of foreign air transportation for tariff filing purposes.
8 Japan Air Lines, 801 F.2d at 485. The guarantees of fair and equal opportunities to compete are found in the applicable Civil Air Transport Agreements. See, e.g., Agreement on Air Transport Services, Aug. 11, 1952, United States-Japan, art. 10, 4 U.S.T. 1948, 1953, T.I.A.S. No. 2854, at 7 (stating, "there shall be fair and equal opportunity for the airlines of both Contracting Parties to operate the agreed services on the specified routes between their respective territories.").
9 Japan Air Lines, 801 F.2d at 485. The foreign carriers charged unjust discrimination under the Federal Aviation Act, 49 U.S.C. § 1374(b) (1982), which provides in pertinent part:

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 . . . to any unjust discrimination or any undue or unreasonable prejudice or disadvantage in any respect whatsoever.

10 Visit USA Fare/Export Inland Contract Rate Investigation, Order 84-8-55 (CAB Aug. 10, 1984) (opinion and order on discretionary review) [hereinafter CAB Order]. Foreign carriers viewed the discounts as examples of below-cost pricing and cross-subsidization by domestic carriers. Id. at 33.
riers a fair and equal opportunity to compete and were not unjustly discriminatory. On requests by both parties, the CAB reviewed the Administrative Law Judge's decision in its order of August 10, 1984. The Board upheld the initial findings with one exception, ruling that the ExIn rate involved only domestic and not foreign transportation. The foreign carriers petitioned for further review in the District of Columbia Circuit, challenging each ruling in the CAB order except the VUSA foreign classification, and charging that the CAB by this order had unfairly modified its policies. Held, affirmed: The Civil Aeronautics Board may, with appropriate explanation, alter its policies to encourage competition between foreign and domestic airlines, without fear of judicial interference.

I. Legal Background

A petition challenging an administrative order that restates an agency policy triggers procedural and substantive questions for the reviewing court. It must determine whether the agency has met its statutory mandate to change policies in a way that is not arbitrary and capricious, and that is supported by substantial evidence. To make the determination, the court must substantively investigate the agency's policy as it was, and as it has changed.

A. Judicial Review of Agency Policies or Rulings

The Administrative Procedure Act authorizes federal
courts of appeal to review administrative orders. This statute allows the reviewing court to decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. In particular, the statute outlines the circumstances under which a court shall set aside agency actions.

1. The Arbitrary and Capricious Standard

A court will set aside agency actions, first, if they are arbitrary or capricious. The courts have defined a narrow scope of review under the arbitrary and capricious standard because of the deference traditionally given to an agency in interpreting its own rules. A court will not simply substitute its own judgment for the agency's.

When the agency's action reflects a change in policy, however, the reviewing court's deference becomes conditional. The Supreme Court described this conditional deference in *Motor Vehicle Manufacturers Association v. State Farm Mutual*, a case involving the National Highway Safety and Transportation Administration (NHSTA) decision to rescind the requirement that new cars produced after September, 1982, include passive restraints. In *Motor Vehicle*, the Court acknowledged the deference due an agency, but outlined the agency's responsibility to sup-

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16 Id.
17 Id. Subsection (2) of 5 U.S.C. § 706 in relevant part mandates the reviewing court to "hold unlawful and set aside agency action, findings, and conclusions found to be (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law, or . . . (E) unsupported by substantial evidence in a case . . . reviewed on the record of an agency hearing provided by statute." Id.
18 Id. § 706(2)(A).
20 See *Motor Vehicle*, 463 U.S. at 43.
21 Id.
22 Id. at 34. The court held that NHSTA's rescission of passive restraint requirements was arbitrary and capricious. Id. at 56-57.
ply a "reasoned analysis" for a changed policy. This justification must be sufficient to enable the reviewing court to conclude that the agency has examined the relevant data and articulated a satisfactory explanation for its action. To affirm a policy change under the arbitrary and capricious standard, the court must have confidence that the change is the product of reasoned decision-making by the agency. In *Motor Vehicle*, the Court said NHSTA's failure to justify fully one abandoned alternative meant that the agency had failed to give sufficient explanation for its changed policy.

This requirement that an agency provide a reasoned analysis for changing its course forms the basis of the arbitrary and capricious test. In *Airmark Corp. v. FAA*, a review of a Federal Aviation Administration procedure, the District of Columbia Court of Appeals said that analysis was the minimum requirement of an agency failing to adhere to its own precedents. Similarly, in *American Financial Services v. FTC*, a review of the Federal Trade Commission's credit practice rules, the same court said that before it could affirm an agency's decision, the agency must show that its decision was based on a consideration of the relevant factors and that there had been no

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23 Id. at 42. The analysis required is "beyond that which may be required when an agency does not act in the first instance." Id.
24 Id. at 43. A satisfactory explanation must include a "rational connection between the facts found and the choice made." Id.
25 Id. at 52.
26 Id. The Supreme Court disallowed NHTSA's recession of the passive restraint requirement because the agency had not sufficiently explained its abandonment of the continuous passive safety belt as a required safety feature. Id. at 56. For an analysis of the *Motor Vehicle* decision as a significant reaffirmation of the "hard look" approach to reviewing agency actions, see *The Supreme Court, 1982 Term*, 97 HARV. L. REV. 1, 230-38 (1983).
27 758 F.2d 685 (D.C. Cir. 1985) (calling for an analysis which indicates "that prior policies and standards are being deliberately changed, not casually ignored." (quoting Greater Boston Television Corp. v. FCC, 444 F.2d 841, 852 (D.C. Cir. 1970); cert. denied, 403 U.S. 923 (1971))).
28 Id. at 692. The FAA procedure at issue involved granting exceptions to regulations imposing noise standards on four-engine jet aircraft in commercial operations. Id. at 687.
29 767 F.2d 957 (D.C. Cir. 1985).
clear error of judgment by the agency.\textsuperscript{30}

2. The Substantial Evidence Test

Along with the arbitrary and capricious standard, the Administrative Procedure Act requires the reviewing court to apply a substantial evidence test when an agency changes its prior policies.\textsuperscript{31} In \textit{Universal Camera Corp. v. NLRB},\textsuperscript{32} the Supreme Court defined substantial evidence as "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion."\textsuperscript{33} The Court stressed that substantial evidence must be more than a scintilla.\textsuperscript{34} Offering a veritable treatise on the substantial evidence rule, \textit{Universal Camera} deals with an attempt by the NLRB to force Universal Camera to reinstate an employee terminated for filing charges under the Wagner Act.\textsuperscript{35} Courts reviewing agency actions have consistently relied on these definitions for more than thirty years.\textsuperscript{36}

The Supreme Court added procedural clarity to \textit{Universal Camera}'s definitions in \textit{American Textile Manufacturers Ind}-

\textsuperscript{30} Id. at 985. The Supreme Court addressed the issue of what factors are relevant in \textit{Motor Vehicle}:

Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to difference in view or the product of agency expertise.

\textsuperscript{31} See supra note 17 for text of the statutory mandate of a reviewing court.

\textsuperscript{32} 340 U.S. 474 (1951).

\textsuperscript{33} Id. at 477. The Court said that substantial evidence: must do more than create a suspicion of the existence of the fact to be established . . . It must be enough to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn from it is one of fact for the jury.

\textsuperscript{34} Id. (quoting Consolidated Edison v. NLRB, 305 U.S. 199, 229 (1938)).

\textsuperscript{35} Id.

\textsuperscript{36} Id. Writing for the majority, Justice Frankfurter identified the "essential issue" as the procedural one of determining "the effect of the Administrative Procedure Act . . . on the duty of the Courts of Appeals when called upon to review orders of [an agency.]" Id. at 476.

stitute Inc. v. Donovan. American Textile encompassed the cotton industry’s challenge to the Occupational Safety and Health Administrations’ Cotton Dust Standard, which limited occupational exposure to the dust which induces brown lung disease. This decision requires the reviewing court to take into account contradictory evidence in the record. The possibility of drawing two inconsistent conclusions from that record, however, does not prevent an agency’s finding from being supported by substantial evidence. The court will intervene only in what ought to be the rare instance when the substantial evidence test appears to have been misapprehended or misapplied. The proper inquiry for a reviewing court, then, is not whether it would find the results the agency did on its own. Rather, the court must ask whether there is substantial evidence to support the agency’s results. When there is substantial evidence, the agency’s decision will stand.

B. CAB Policies and Rulings

Within this procedural framework, the court reviewing new administrative policies must analyze the policies substantively. The questions here include what law has governed agency action for each issue, and what test has been used to measure actions against the law. Changes in either the law or the test will result in judicial scrutiny.

1. Classification as Foreign Transportation

Generally, the Federal Aviation Act of 1958 governs the classification of a carrier’s activity as foreign air transpor-

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37 452 U.S. 490, 541 (1981) (holding that the Court of Appeals did not misapprehend or grossly misapply the substantial evidence test when it upheld the Occupational Safety and Health Administration’s Cotton Dust Standard).
38 Id. at 500.
39 Id. at 523.
40 Id. The Supreme Court had previously allowed such inconsistent conclusions to support a substantial evidence finding in Consolo v. Federal Maritime Comm’n, 383 U.S. 607, 620 (1966).
41 American Textile, 452 U.S. at 523.
42 Greater Boston Television, 444 F.2d at 853 (upholding FCC criteria used for renewal of a television station’s license).
This act defines foreign air transportation as "carriage by aircraft of persons or property as a common carrier for compensation or hire or the carriage of mail by aircraft, in commerce between . . . a place in the United States and any place outside thereof." Once transportation has been classified as foreign, the carrier must file a tariff disclosing its rate ceilings publicly so that the rates can be scrutinized by the governments involved.

Traditionally, the CAB determined which rates were to be filed using a "flow of commerce" test. This test distinguishes between kinds of transportation by considering the essential character of the movement. The subjective intent of the airline user, whether passenger or cargo shipper, is determinative. If the user aims his movement at a foreign destination, then the trip is properly characterized as foreign air travel.

One of the first official retreats from this traditional test appears in the CAB's Tariff Flexibility Rulemaking. Answering challenges from foreign carriers concerning revised domestic fare filing procedures, the Board stated that the carriers were seeking too broad an interpretation of foreign transportation. Tests of foreign status must comply, the Board said, with the intent of Congress and Federal Aviation Act, 49 U.S.C. § 1301 (1976). 49 U.S.C. § 1301(24) (Supp. 1987). See CAB Order, supra note 10, at 28, explaining that the basic purpose of the bilateral tariff-filing requirement is "to provide formal review and approval procedures in the case of essentially international fares." Id. See, e.g., Canadian Colonial Airways, Inc. - Investigation, 2 C.A.B. 752, 755 (1941) (holding that one U.S. stopover between non-U.S. stops did not remove the flight from foreign classification when the stop was merely an incidental part of the whole trip to the ultimate destination).

See Eastern Air Lines Inc., Enforcement Proceeding, 40 C.A.B. 745, 747 (1964), in which the Board states, "as a general rule, the destination which was intended by the passenger when he begins the journey and which was known to the carrier and for which he purchased a ticket determines the character of the trip."


46 Id. at 46,792 (stating that origin-destination criteria have been rejected when necessary to preserve a fundamental policy of the Federal Aviation Act).
when classification is not clear, it is best resolved on a case-by-case basis.\footnote{Id. at 46,791.}

2. \textit{Equal Opportunity to Compete}

The foundation of relationships between foreign and domestic airlines are the Bilateral Air Transport Service Agreements between our government and those of the foreign carriers. These agreements usually include a negotiated guarantee to the foreign carrier of an equal opportunity to compete with domestic carriers.\footnote{Each of these treaties was negotiated by the CAB and a foreign power in anticipation of air traffic between the two countries. \textit{See supra} note 8 and accompanying text for equal opportunity provisions. For a discussion of the rule of bilateral agreements after deregulation, see McConnell, \textit{The Big Picture}, 32 Fed. B. News & J. 28 (1985).} Such a guarantee protects the competitor from the possibility of an overly protective home government. Ideally, all carriers stand on an equal footing when preparing rates.

Because the treaty power in the United States lies with the executive branch, the CAB, an executive agency, was an integral party to these bilateral agreements. As a rule, therefore, the courts defer to CAB interpretation of treaty language.\footnote{Sumitomo Shoji America, Inc. v. Avagliano, 457 U.S. 176, 185 (1982) (holding that a U.S. subsidiary of a Japanese company is not covered by the Friendship, Commerce and Navigation Treaty); \textit{see also} Collins v. Weinberger, 707 F.2d 1518, 1522 (D.C. Cir. 1983) (acknowledging that: \textit{[n]o treaty can determine all its own applications. Interpretation, clarification and implementation are always necessary, and it is the executive branch, in agreement with the other party to the treaty, which bears primary responsibility for that function. Courts should defer to such executive actions provided they are not inconsistent with or outside the scope of the treaty. \textit{Id.})}} The test the CAB traditionally applied in its interpretation was whether the foreign carrier is able to match fares and rates with its domestic counterparts.\footnote{\textit{See, e.g.}, Air India, Discriminatory Fares, 92 C.A.B. 753 (1981) (holding certain Air India fares discriminatory because the government of India prevented a domestic carrier from offering matching fares on a voluntary basis). The matching fare is sufficiently “equal” if carriers can construct it on an interline basis between themselves. \textit{Id.}}
3. Unjust Discrimination

Charges of unjust discrimination are, like determination of foreign statutes discussed above, determined under the Federal Aviation Act. Prior to the period of airline deregulation, the test for discriminatory behavior was a strict "rule of equality." In 1980, the CAB's adoption of the pricing policy set forth in PS-93 substantially liberalized the "rule of equality" test. Under this statement, unjust discrimination is an unreasonable preference or prejudice within domestic air transportation. The policy limits this unreasonable preference, however, to situations in which four factors are present, including an inability of "actual and potential competitive forces" to correct the discrimination on their own. The authors clearly believed that the competitive forces unleashed by domestic deregulation of the airline industry would eliminate discrimination problems. Legislative history of the policy hints at the compatibility of this competitive approach with foreign transportation, but the policy as writ-

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57 CAB Order, supra note 10, at 45-46.
58 PS-93, 14 C.F.R. § 399.36 (1980) provides in pertinent part:

(b) Except in unusual circumstances or as provided in paragraph (c) of this section, the Board will find a rate for domestic air transportation to constitute unreasonable discrimination only if: (1) There is a reasonable probability that the rate will result in significant long-run economic injury to passengers or shippers; (2) The rate is in fact discriminatory according to a reasonable cost allocation or other rational basis; (3) The rate does not provide transportation or other recognized benefits that justify the discrimination; and (4) Actual and competitive forces cannot reliably be expected to eliminate the undesirable effects of the discrimination within a reasonable period.

(c) A rate that discriminates on the basis of the status of the traffic carried will not be presumed to be unreasonably discriminatory, unless the use of the status categories in question is contrary to established national anti-discrimination policy.

Id.
50 Id. § 399.36(a)(1).
51 Id. § 399.36(b)(1-4).
52 Id. § 399.36(b)(4).
ten is limited to domestic transportation.  

While most courts believed these areas of law were well settled before 1982, the deregulation of the American airline industry would challenge the underpinnings of each of the traditional tests. In 1982, Congress issued a mandate to the Board to consider maximum reliance on competitive market forces as a matter of public interest. This policy of regulating in a pro-competitive fashion formed the basis for the CAB’s policy restatements and the court’s affirmance of those restatements in this case.

II. *Japan Air Lines Co. v. Dole*

The decision of the District of Columbia Court of Appeals in *Japan Air Lines Co. v. Dole* was a complete victory for the CAB. The court held that the Board had decided all three issues correctly. the ExIn rate was properly classified as domestic transportation, and the discounts did not deny the foreign carriers an equal opportunity to compete or unjustly discriminate against the foreign carriers.

A. *Classification of ExIn Rates*

The CAB held that the ExIn rate did not involve foreign transportation. In reaching this decision, however, the

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64 International Air Transportation Competition Act, 49 U.S.C. § 1302 (Supp. 1987). The section states in part:
   In the exercise and performance of its powers and duties under this act, the Board shall consider the following ... as being in the public interest, and in accordance with the public convenience and necessity: ... (4) The placement of maximum reliance on competitive market forces and on actual and potential competition (A) to provide the needed air transportation system, and (B) to encourage efficient and well-managed carriers to earn adequate profits and to attract capital, taking account, nevertheless, of material differences, if any, which may exist between interstate and overseas transportation, on the one hand, and foreign air transportation on the other.
65 *Japan Air Lines*, 801 F.2d at 484.
66 Id. at 485.
CAB rejected the traditional "flow of commerce" test, which relied on the tie to separately ticketed foreign travel.\textsuperscript{67} The CAB stated that this test is insufficient, on its own, to justify international classification for tariff filing purposes.\textsuperscript{68} Such a mechanistic approach is too limited in its scope of inquiry,\textsuperscript{69} and would require, if strictly applied, the filing of any domestic fare which could possibly be combined with a foreign one.\textsuperscript{70}

Instead, the CAB relied on what it called a "carrier restricted" standard.\textsuperscript{71} Rather than the destination of the user, this test focuses on restrictions the airline imposes on the fare. If a rate is only available when combined with another trip on the same carrier, it will have to be filed in that carrier's tariff.\textsuperscript{72} But if any airline can offer the rate on equal terms then it must be economically independent of the international travel to which it is joined for marketing purposes.\textsuperscript{73} Because the ExIn rate in this case did not involve any restrictive combinations with any one carrier on the Far East leg of the shipping excursion, the CAB found it to be independent, and therefore, not foreign transportation.\textsuperscript{74}

JAL, Lufthansa and Swissair charged that this turn from the traditional "flow of commerce" test represented inconsistent behavior by the CAB and was unaccompanied by adequate explanation.\textsuperscript{75} The foreign carriers relied on Motor Vehicle, in which the Supreme Court imposed the "reasoned analysis" requirement on an agency changing

\textsuperscript{67} See supra notes 46-47 and accompanying text for a discussion of the "flow of commerce" test.
\textsuperscript{68} CAB Order, supra note 10, at 28.
\textsuperscript{69} Id. at 12.
\textsuperscript{70} Id. at 24.
\textsuperscript{71} Id. at 29. The Board chose the "carrier restricted" test as the one most able to "harmonize" the considerations of domestic deregulation and bilateral tariff-filing requirements. Id.
\textsuperscript{72} Id. at 49.
\textsuperscript{73} Id. at 29.
\textsuperscript{74} Id. at 48-49.
\textsuperscript{75} Japan Air Lines, 801 F.2d at 486.
its policies or regulations.\footnote{See supra notes 21-30 and accompanying text for a discussion of the requirement of a reasoned analysis.}

The court acknowledged this agency obligation, quoting Airmark, with its reminder that an agency which "glosses over or swerves from prior precedents without discussion . . . may cross the line from tolerably terse to intolerably mute."\footnote{Japan Air Lines, 801 F.2d at 486 (quoting Airmark Corp., 758 F.2d at 692.)} The court held, however, that the adoption of the "carrier restricted" test was not an intolerable swerve from its own precedents.\footnote{Id. at 487. The court summarized six CAB cases cited by the foreign carriers in support of the "flow of commerce" test, and determined that none of them stated that test was the only applicable test. Id. at 486-87 n.2.} Indeed, the court said the CAB had never given "unqualified acceptance" to the "flow of commerce" test,\footnote{46 Fed. Reg. 46,787 (1981); see supra notes 48-51 and accompanying text for a discussion of Tariff Flexibility Rulemaking.} and found support for the proposition in the Board's Tariff Flexibility Rulemaking.\footnote{46 Fed. Reg. 46,791 (1981). The Board acknowledged that within the spectrum between purely foreign tariffs and purely domestic fares, "there may be fares that raise uncertainties: These are best analyzed on a case-by-case basis and in a specific factual context." Id.} There, the Board had set out a limited view of foreign air transportation, and called for classification on a case-by-case, fact sensitive basis.\footnote{Japan Air Lines, 801 F.2d at 488.} Because of this support for alternate standards in prior CAB procedures, the court found that the agency had provided sufficient explanation for its "not so inconsistent" decision.\footnote{CAB Order, supra note 10, at 49; see supra note 8 and accompanying text for a discussion of bilateral agreements.}

B. Equal Opportunity to Compete

The CAB next determined that the VUSA fares and the ExIn rate were consistent with bilateral agreements guaranteeing foreign carriers a fair and equal opportunity to compete.\footnote{CAB Order, supra note 10, at 49; see supra note 8 and accompanying text for a discussion of bilateral agreements.} Again, the Board rejected the traditional test of a foreign carrier's ability to match fares and rates with the domestic carrier. Instead, the CAB applied a new
standard, which it called "reasonably competitive." The Board said this standard requires that "foreign carriers have the opportunity to offer reasonably competitive alternatives to particular inner point fares." The "reasonably competitive" standard hinges, as does the "carrier restricted" test, on the facts involved. The Board admitted that no simple formula for identifying a violation of the bilateral provision for fair competition exists.

JAL and Lufthansa challenged this "reasonably competitive" standard as another example of inconsistent behavior on the part of the CAB. The carriers claimed that the agency had, in the past, consistently required that carriers be able to match fares and rates offered by their competitors.

The court rejected this claim. First, the court acknowledged the deference owed an agency that has helped negotiate an agreement, when that agreement requires interpretation. The court then noted that the governments of the petitioning carriers had not lodged an objection to the CAB's interpretation of their treaties. Next, the court dismissed the carriers' reliance on prior decisions alleged to support matching fares and rates under all circumstances. The "reasonably competitive" standard, it said, was merely an application of the tradi-

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84 CAB Order, supra note 10, at 36.
85 Id.
86 Id.
87 Id. The Board affirmed the Administrative Law Judge's finding that any price disadvantage suffered by the foreign airlines was "of their own making because they have not attempted to negotiate prorate agreements to equalize the price for their passengers." Id. at 34.
88 Japan Air Lines, 801 F.2d at 488.
89 Id.
90 Id. at 489.
91 Id. at 488; see also supra note 53 and accompanying text describing the deference generally given to the CAB's interpretation of its own agreements.
92 Japan Air Lines, 801 F.2d at 489. For the court, the silence of foreign governments apparently implied their recent consent with the Board's treaty interpretation.
93 Id.; see, e.g., Air India, 92 C.A.B. 753 (establishing that carriers must be able to match fares on an interline basis).
tional rule of interline arrangements rather than an adoption of some new test.

Finally, the carriers protested that they could not find reasonably competitive alternatives to the VUSA fares and ExIn rate. If such alternatives did not in fact exist, the court could not uphold the new standard. However, the court held that substantial evidence indicated that competitive alternatives existed, and affirmed the CAB order.

C. Unjust Discrimination

In determining that the VUSA fares and ExIn rate were not unjustly discriminatory, the CAB relied heavily on its 1985 policy statement, PS-93. This statement refers explicitly to discrimination in domestic transportation. The CAB justified extending its criteria to foreign transportation by referring to the discussion of international fares in the CAB statement adopting PS-93. In that statement the agency asserted that many of the fundamental policy considerations that led to the domestic policy applied equally to foreign air transportation.

The petitioning carriers argued against this extension of domestic policy to an international dispute, calling this

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94 Japan Air Lines, 801 F.2d at 489. Interline agreements require that foreign carriers can construct competitive rate structures for the entire journey, not simply for the leg ending at a U.S. point. Id.
95 Id.
96 See supra notes 31-42 and accompanying text for a discussion of substantial evidence standards and procedures.
97 See supra notes 58-63 and accompanying text for a discussion of PS-93.
98 See supra note 58.
99 CAB Order, supra note 10, at 44-45; see 45 Fed. Reg. 36,058, 36,062 (1980), stating that "[i]n many pertinent respects, the framework [of international pricing] is now similar — if not identical — to the domestic area."
100 45 Fed. Reg. 36,058, 36,062. The CAB went on to say that it was studying this issue, and that it would address the issue in more detail soon. Id.
use of PS-93 standards arbitrary and capricious. The court, however, upheld the agency's right to change policy by rule or, as here, by adjudication. In doing so, it cited the legislative history of PS-93 and the willingness the authors showed to embrace foreign transportation as well as domestic. Perhaps more significantly, the court also cited the congressional directive to the CAB to regulate with a pro-competitive outlook. PS-93 represents this strong pro-competitive view, and the court decided the single reference to possible expansion was sufficient to extend the market's forces to discrimination in foreign air travel.

Finally, the court rejected the carriers' claim that this use of PS-93 was yet another unexplained departure from precedent. The carriers reminded the court that Congress had earlier expressed approval of the state of foreign air regulation. The court said, however, that such precedent was not intended to remain untouched throughout the deregulation process, and the CAB determination was affirmed.

103 Japan Air Lines, 801 F.2d at 490.
104 Id.; see 1 K.C. Davis, Administrative Law Treatise § 5.01 (1958):
   Just as agencies, for developing law on a subject, often have a choice between proceeding by rule making or by adjudication, agencies also have a choice, for clarifying the meaning of rules, between amending the rules and interpreting them. The interpretation may be made in an adjudication or it may be a mere announcement.
105 Japan Air Lines, 801 F.2d at 490.
106 Id. at 491; see 49 U.S.C. § 1302(a) (Supp. 1987), requiring the Board in the public interest, to place "maximum reliance on competitive market forces and on actual and potential competition."
107 Japan Air Lines, 801 F.2d at 491.
108 Id.
110 Japan Air Lines, 801 F.2d at 492.
III. PRACTICAL IMPLICATIONS

*Japan Air Lines Co. v. Dole* is significant for its substantive and procedural implications. Substantively, each of the three issues addressed by the court represents a new statement of (or at least a new way of stating) CAB policy toward foreign air transportation. Procedurally, the court, in reviewing a CAB order, appears to have reworked its frame of reference for evaluating agency changes in policy.

The classification of VUSA fares as foreign, accomplished through the use of the new "carrier restricted" test,\(^{111}\) means that airlines must now file those fares under tariff regulations with the CAB and foreign governments.\(^{112}\) Airlines will not need to file ExIn rates.\(^{113}\) As a result, airlines may expect to open their fares to public scrutiny whenever they restrict those fares to combination with particular carriers.

By affirming that these rates did not prevent the foreign airlines' right to compete, the court clearly stated that what is promised by the bilateral agreements is not equal rates. Instead, they promise the reasonable ability to enter into competition, the results of which are not guaranteed to be favorable to the foreign carrier.\(^{114}\) Bilateral treaties will now prevent protection of domestic and foreign airlines. Indeed, stress has moved from the word "equal" to the word "opportunity" in the concept of equal opportu-

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\(^{111}\) See *supra* notes 66-82 for a discussion of the classification of rates as foreign or domestic transportation.

\(^{112}\) CAB Order, *supra* note 10, at 49. The order directs this filing be done: within 30 days of the date of service of this order, setting forth the terms and conditions of all fares and rates for transportation between or among domestic (or foreign) points which are available only in conjunction with the purchase and use of air transportation to and/or from the United States on a specified carrier or carriers.

\(^{113}\) *Id.* One former CAB member cites foreign interpretation of these classifications as attempts by the U.S. to apply its law extraterritorially. She sees this as a major issue of the deregulation period. McConnell, *supra* note 52, at 31.

\(^{114}\) See *supra* notes 52-54 and accompanying text for a discussion of the equal opportunity to compete.
nity to compete. If it costs the foreign carriers more to exercise that opportunity, they will have no recourse under the treaties.

Finally, the extension of PS-93 to international carriers significantly limits the situations in which those carriers can claim unjust discrimination. Only in cases in which the market cannot correct discrimination will the CAB step in and restrain the offensive practice. This means foreign carriers desiring to compete with domestic carriers will have to weigh opportunities for success on each route, knowing that unrestrained competition will provide the framework for those opportunities.

The fact that such expansive changes in CAB policy were given blanket approval may well indicate a new perception of the court’s role in reviewing the agency’s decisions. The traditional law on judicial review of an agency’s action is sprinkled throughout the opinion. The court does not appear to weaken the general presumption against unexplained agency changes in policy. However, the court’s deference to the pro-competitive changes embodied in these issues may signal a more free rein for the interpretation of aviation regulations across the board. The natural outgrowth of such novel interpretations is uncertainty. The effect of that uncertainty in the airline industry remains to be seen. But in the extreme, if foreign carriers are unable to compete profitably in the unrestrained market of discount passenger fares

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117 See, e.g., id. at 490. The court stated that, even if the extension of PS-93 to foreign air transportation may be said to establish a novel rule, inconsistent with prior precedent, we may not upset such changes unless we are convinced that the agency has changed course without carefully considering the reasons for, and consequences of, such a change.

Id. (emphasis added).
and freight rates, many trans-Atlantic routes may be abandoned.

It was, perhaps, inevitable that the deregulation of the domestic airline industry would have a rippling effect upon its foreign counterpart. The pro-competition spirit can hardly be fostered completely at home and be shackled abroad. Discounts like the VUSA fares and ExIn rates, in which lines between domestic and foreign aviation are blurred, were areas ripe for challenges to the traditional rules. Pointing to the dramatic shift in agency regulation required by Congress' alteration of the statutory framework within which the Board now operates, this court allowed the CAB to outline sweeping changes in policy. Despite the uncertainty in international aviation that may well follow, the court's decision to affirm was consistent with the congressional mandate for competition. If the interim period of change does not destroy foreign carriers' business, airline users can look for more consistency between domestic and foreign airlines' operations, and an even wider scope of benefits from deregulation.

IV. Conclusion

In *Japan Air Lines Co. v. Dole*, foreign airlines failed in three challenges to CAB policy restatements. The Court of Appeals for the District of Columbia held that ExIn rates, unlike restricted VUSA fares, were not foreign transportation because the rates were not restricted to any particular carrier in the international leg of the shipping excursion. The court also ruled that neither of these discounts denied foreign carriers an equal opportunity to compete. Finally, the court determined that neither discount unjustly discriminated against the foreign carriers. The court's deference to the CAB's rulings opens the door to extension of the deregulation process to areas of the airline industry that touch on foreign transportation. Airlines will have to expect future Board rulings that en-
courage the spread of competition throughout the industry, and affirmation of those rulings by the courts.

Linda Althoff
PROPERTY TAX — CONGRESSIONAL LIMITATIONS ON STATE TAXATION OF AIR TRANSPORTATION — An airline property tax that is wholly utilized for airport and aeronautical purposes does not violate the antidiscrimination provisions of section 1513(d)(3) of the Airport and Airway Improvement Act. Western Air Lines, Inc. v. Board of Equalization of South Dakota, 107 S. Ct. 1038 (1987).

Prior to 1978, South Dakota taxed all commercial and business personal property. In 1978, South Dakota revised its personal property tax system and exempted from taxation almost all personal property. South Dakota continued to tax airplanes because they fell in the category of centrally taxed property.

In May 1983, five airlines operating in South Dakota paid their 1982 flight property taxes under protest. The airlines subsequently sued the appropriate county treasurers for a refund of their 1982 property taxes. In a separate action, the airlines petitioned the State Board of Equalization to exempt the airlines’ flight property from their 1983 taxes. In both actions the airlines alleged that

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2 S.D. CODIFIED LAWS ANN. § 10-4-6.1 (1982); see infra note 26 for text of this section.
3 See S.D. CODIFIED LAWS ANN. § 10-29-2 (1982); see infra note 20 for text of this statute.
5 Brief for Appellant at 6-7, Western Air Lines, Inc. v. Board of Equalization of S.D., 107 S. Ct. 1038 (No. 85-732) (1987) [hereinafter Appellant’s Brief]. In April 1983, each airline requested that the board of commissioners of each of seven counties abate and refund property taxes after September 3, 1982, the effective date of the federal statute. Joint Appendix at 17, Western Air Lines, Inc. v. Board
the South Dakota law violated the Airport and Airline Improvement Act of 1982 (AAIA) which prohibits assessing air carrier transportation property at a higher percentage than other commercial property. The various county commissioners voted unanimously to deny the airlines’ appeal for refund of their 1982 property taxes after they were advised that the South Dakota tax is an in lieu tax and therefore not covered by the AAIA. Similarly, the State Board of Equalization denied the airlines’ petition of Equalization of S.D., 107 S. Ct. 1038 (No. 85-732) (1987) [hereinafter Joint Appendix]. The suits were commenced pursuant to S.D. CODIFIED LAWS ANN. § 10-27-2 (1982) which provides that “[a]ny person against whom any tax is levied . . . , who pays the same under protest . . . may . . . commence an action against such treasurer for recovery thereof.” Id. at 7. Each complaint alleged that the defendant county had “attempted to levy and collect tax upon the Plaintiff’s air carrier transportation property, and to treat the same differently than similar property which is otherwise exempt from taxation pursuant to South Dakota statute, thereby violating the federal statutes . . . .” Joint Appendix at 8, Western.

Appellant’s Brief, supra note 5, at 6-7. Each county answered that the disputed tax “is utilized wholly for airport and aeronautical purposes and is in lieu of property taxes and is therefore permitted by 49 U.S.C. § 1513(d)(3) (sic).” Joint Appendix, supra note 5, at 11.

Appellant’s Brief, supra note 5, at 6-7. The AAIA forbids a state from assessing or taxing air carrier transportation property at ratios or rates higher than those imposed on other commercial and industrial property. 49 U.S.C. app. § 1513(d) (1982).

Section 1513(d) reads as follows:

(1) The following acts unreasonably burden and discriminate against interstate commerce and a State, subdivision of a State, or authority acting for a State or subdivision of a State may not do any of them:

(A) assess air carrier transportation property at a value that has a higher ratio to the true market value of the air carrier transportation property than the ratio that the assessed value of other commercial and industrial property of the same type in the same assessment jurisdiction has to the true market value of the other commercial and industrial property;

(B) levy or collect a tax on an assessment that may not be made under subparagraph (A) of this paragraph; or

(C) levy or collect an ad valorem property tax on air carrier transportation property at a tax rate that exceeds the tax rate applicable to commercial and industrial property in the same assessment jurisdiction.

(2) in this subsection . . .

(D) “commercial and industrial property” means property, other than transportation property and land used primarily for agricultural purposes or timber growing, devoted to commercial or industrial use and subject to a property tax levy; . . .
to exempt their airplanes from 1983 taxes, agreeing with the county commissioners that the South Dakota tax did not violate federal law.\(^8\)

The airlines appealed these decisions to the South Dakota Circuit Court.\(^9\) The court consolidated the actions\(^10\) and held that the state tax was permissible under the AAIA.\(^11\) The airlines appealed the decision to the South Dakota Supreme Court.\(^12\) Although it disagreed with the lower court’s reasoning, the Supreme Court affirmed the decision based on its interpretation of other AAIA provisions.\(^13\) The airlines applied for and received a writ of certiorari for review by the United States Supreme Court.\(^14\) Held, affirmed: An airline property tax that is wholly utilized for airport and aeronautical purposes does

(9) This subsection shall not apply to any in lieu tax which is wholly utilized for airport and aeronautical purposes.

\(\text{Id.}\)

\(^8\) **Western**, 107 S. Ct. at 1042. The Board of Equalization unanimously concluded that the state flight property tax was utilized wholly for airport and aeronautical purposes and is in lieu of property taxes and is therefore permitted under 49 U.S.C. app. § 1513(d)(3) (1982). \(\text{Id.}\)

\(^9\) **Id.**

\(^10\) **Hughes County**, 372 N.W. 2d at 107. In all, 42 cases were consolidated from Brown, Beadle, Davison, Hughes, Pennington, Minnehaha, Codington, and Yankton counties. \(\text{Id.}\) The lawsuits were consolidated in the Sixth Judicial Circuit in Hughes County, South Dakota. **Western**, 107 S. Ct. at 1042. In February 1984, the circuit court issued a single memorandum decision disposing of these cases. Jurisdictional Statement, Appendix B at 18a, **Western**. The circuit court stated that it was "not required to delve into the issue of whether this tax is burdensome or discriminatory . . . ." Jurisdictional Statement, Appendix B at 21a, **Western**. Instead, the circuit court upheld the tax as an in lieu tax permitted under the AAIA. Jurisdictional Statement, Appendix B at 20a, 21a, **Western**.

\(^11\) Jurisdictional Statement, Appendix B at 20a, 21a, **Western**. The trial court affirmed the Department on the appeal, entered judgment for the counties on the suits for rebate, and dismissed the airlines' actions on their merits. \(\text{Id.}\) The trial court determined that the South Dakota tax is an in lieu tax used solely for aeronautical purposes under 49 U.S.C. app. § 1513(d)(3) (1982). \(\text{Id.}\)

\(^12\) **Hughes County**, 372 N.W.2d at 107. The airlines raised two issues on their appeal. \(\text{Id.}\) at 108. First, is the South Dakota tax imposed in lieu of another valid tax so as to be authorized under 49 U.S.C. app. § 1513(d)(3) (1982)? \(\text{Id.}\) Second, does the tax on airplanes discriminate against the airlines in violation of 49 U.S.C. app. § 1513(d)(1) (1982)? \(\text{Id.}\)

\(^13\) **Hughes County**, 372 N.W.2d at 109; see infra notes 100-108 and accompanying text for a discussion of this decision.


I. SOUTH DAKOTA FLIGHT PROPERTY TAXATION

South Dakota's personal property tax system is not unique. While most personal property is completely exempt from taxation, South Dakota singles out certain classes of property for taxation. This method of taxing certain personal property while not taxing most other property is at the heart of the airlines' discriminatory taxation claim.

The South Dakota Constitution authorizes the legislature to classify property for taxation purposes. Each county is an assessment district which assesses all property subject to taxation in that district, except property the Department of Revenue centrally assesses. The South Dakota statutes provide ten different systems of centrally-assessed taxation with respect to ten different types of industries. These industries include railroads, private car-line companies, express companies, telephone companies, telegraph companies, electric, heating, water and gas companies, rural electric and water supply companies, and pipeline companies.

In 1961 South Dakota imposed a centrally-assessed tax

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15 S.D. CODIFIED LAWS ANN. § 10-4-6.1 (1982); see infra note 26 for text of this statute.
16 S.D. Const. art. XI, § 2. "[T]he Legislature is empowered to divide all property . . . into classes and to determine what class or classes of property shall be subject to taxation and what property, if any, shall not be subject to taxation." Id.
17 S.D. CODIFIED LAWS ANN. § 10-3-16 (1982). "The director of equalization . . . shall assess for taxation all property subject to taxation, except property which the secretary of revenue has been directed to assess. . . ." Id. Therefore, property is centrally assessed when the secretary of revenue assesses the property rather than having each county tax assessor assess the property locally. Id.
18 Id. §§ 10-28 to 10-37.
19 Id. Each centrally-assessed taxation system operates independently. Id. For example, some measure the value of property by partial reference to stocks and bonds. Id. §§ 10-28-13, 10-34-3. Others measure the value of property by reference to gross receipts. See, e.g., id. §§ 10-31-2, 10-33-11, 10-35-9.
upon the flight property of all airline companies operating in South Dakota.\textsuperscript{20} For property tax purposes, airplanes are assessed at their "true and full value in money."\textsuperscript{21} A percentage of value allocable to the state is determined through a complicated formula that apportions the assessed value of aircraft according to use within and without the state.\textsuperscript{22} The aircraft is then taxed at up to 60 percent of its state allocated value\textsuperscript{23} and taxed at the rate paid on all property, both real and personal, within the state.\textsuperscript{24} The tax proceeds are allocated to the airports where the airlines make regularly scheduled landings. The airports must use these proceeds only for airport purposes.\textsuperscript{25}

When the South Dakota legislature enacted this tax on airplanes in 1961, South Dakota also taxed all other busi-

\textsuperscript{20} Id. §§ 10-29-2, 10-29-8. Section 10-29-2 provides: "Flight property of airline companies operating in the state shall be assessed for the purpose of taxation by the department of revenue and not otherwise." The South Dakota Flight Property Tax was enacted in 1961. Id. §§ 10-29-1 to 10-29-17. Also in 1961 Congress introduced the first antidiscrimination tax legislation, making certain property tax assessments on common carrier property unlawful. See infra note 41 and accompanying text for a discussion of this legislation.

\textsuperscript{21} S.D. Codified Laws Ann. §§ 10-6-33, 10-6-1(5), 10-29-9 (1982).

\textsuperscript{22} Id. § 10-29-10. The allocation is based on the use for the preceding calendar year of air flight property in the state. The complex equation used to determine the allocation includes: (1) the ratio of the total tonnage of passengers, express, and freight received or discharged in the state to the total tonnage of passengers, express, and freight received or discharged by the company as a whole, both within and without the state; (2) the ratio of aircraft flight time within the state to the total aircraft flight time within and without the state; and (3) the ratio of revenue ton miles of passengers, mail, express, and freight flown by the company within the state compared to the total flown by the company within and without the state for the preceding calendar year. Id.

\textsuperscript{23} Id. § 10-6-33. In 1957 the South Dakota Legislature determined that the Commissioner of Revenue should not use more than 60% of the property's true value to compute taxes. Id.

\textsuperscript{24} Id. § 10-29-14. The property is actually taxed at the average mill rate which is determined by dividing the total of all state and local taxes levied within the state for the present year by the total taxable valuation of all property in South Dakota for the preceding year. Id. The South Dakota Constitution requires uniform taxes on all property of the same class. See S.D. Const. art. XI, § 2.

\textsuperscript{25} S.D. CODIFIED LAWS ANN. § 10-29-15 (1982). "The taxes imposed by this chapter shall be allocated by the secretary of revenue to the airports where such airline companies make regularly scheduled landings and shall be used exclusively by such airports for airport purposes . . . ." Id.
ness-related personal property. In 1978 South Dakota revised its personal property tax system and exempted from taxation all personal property not centrally assessed. Airline flight property remains taxable because it is centrally assessed by the Department of Revenue. Since South Dakota taxes aircraft and does not tax all other personal property, the airlines contend that the South Dakota tax violates the antidiscrimination provisions of the AAIA. To understand fully the AAIA's purpose and scope, one needs to have a working understanding of the antidiscrimination statutes which preceeded AAIA.

II. FEDERAL TAX DISCRIMINATION LAWS — A TROUBLED HISTORY

A. Legislative History

Pursuant to its Commerce Clause powers, Congress passed legislation protecting rail, motor, and air carriers
against discriminatory state and local property taxation.\textsuperscript{29} Congress sought protection for the interstate carriers by enacting the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act),\textsuperscript{30} section 31 of the Motor Carrier Act of 1980 (Motor Carrier Act),\textsuperscript{31} and section 532(b) of the Airport and Airway Improvement Act of 1982 (AAIA).\textsuperscript{32} These statutes had a common purpose and were identical in many of their significant provisions.\textsuperscript{33} Congress wanted to protect the rail, motor, and air carrier industries from states that were placing an unfair tax burden upon them.\textsuperscript{34}


\textsuperscript{30} 49 U.S.C. § 11503 (1982); see infra note 44 for the text of this statute.

\textsuperscript{31} 49 U.S.C. § 1503a (1982); see infra note 45 for the text of this statute.

\textsuperscript{32} 49 U.S.C. app. § 1513(d) (1982); see supra note 7 for the text of this statute.

\textsuperscript{33} Note, Discriminatory Demands and Divided Decisions: State and Local Taxation of Rail, Motor, and Air Carrier Property, 39 Vand. L. Rev. 1107, 1108 (1986). By prohibiting state and local discriminatory property taxes Congress hoped to revitalize the rail, motor, and air carrier industries. Id. at 1110.

Congress developed most of the legislative history during the fifteen years prior to the statutes' enactment. The bulk of the legislative history relates to the railroad industry. Legislative history on antidiscrimination tax laws for motor carriers and air carriers is minimal. The 4-R Act's legislative history reveals that congressional concern regarding discriminatory state property taxes began as early as 1944. This concern primarily arose due to the in-


During the 1920s and 1930s the railroad industry suffered greatly due to the combined effects of the depression and the growth in the trucking and barge industries. Comment, supra note 34, at 576. Congress enacted the 4-R Act first because tax discrimination against rail carriers was the most blatant. See S. REP. No. 630, 91st Cong., 1st Sess. 3 (1969). Congress passed the 4-R Act to promote competition among the railroads and between railroads and other forms of transportation. Comment, supra note 34, at 575. The goal of this legislation was "to eliminate the long-standing burden on interstate commerce resulting from discriminatory State and local taxation of common and contract carrier transportation property." S. REP. No. 1483, 90th Cong., 2d Sess. 1 (1968); see S. REP. No. 630, 91st Cong., 1st Sess. 1 (1969). Both of these bills dealt solely with the taxation issue, which was later made a part of the 4-R Act. Id.

96 See H.R. REP. No. 1069, 96th Cong., 2d Sess. 45, reprinted in 1980 U.S. CODE CONG. & ADMIN. NEWS 2283, 2327. The legislative history of the AAIA is even more limited than that of the Motor Carrier Act. Congress merely stated that the AAIA has the same purpose and scope as the Motor Carrier Act. See S. REP. No. 494, 97th Cong., 2d Sess. 37, reprinted in 1982 U.S. CODE CONG. & ADMIN. NEWS 781, 1188.

97 See H.R. Doc. No. 160, 78th Cong., 2d Sess. 124-25 (1944). In 1944 approximately half the states admitted to Congress that they taxed railroads at a higher rate than other personal and commercial property. Id. The legislative history indicates that states discriminated against rail carriers through variations in assessment or tax rates. S. REP. No. 630, 91st Cong., 1st Sess. 4 (1969).

State and local governments also took advantage of certain economic changes that occurred after World War II to discriminate against railroad carriers. Note,
creasingly heavy tax burden borne by the railroads, and the consequently higher costs to consumers.38

During 1959-60 Congress asked a special study group for recommendations on means to eliminate state and local discriminatory taxation of various common carriers.39 The resulting Doyle Report noted that despite state laws requiring uniform tax treatment, states still discriminated against common carrier property as compared to other business property in the same jurisdiction.40 The Doyle Report recommended that Congress forbid discriminatory assessments against property owned or used by interstate carriers.41

Over the fifteen years following the Doyle Report, Con-

supra note 33, at 1110-11. At this time market values of most residential and commercial property increased substantially, while carrier property values remained constant. Id. Nevertheless, neither the residential and commercial property nor the carrier property increased in assessed value. Id. Therefore, interstate carriers experienced unfavorable tax consequences. Id.; see also S. Rep. No. 445, 87th Cong., 1st Sess. 458 (1961).

38 Note, supra note 33, at 1110-11. Congress determined that consumers paid higher prices for transportation because carriers necessarily passed the cost of discriminatory taxes on to the consumer. See S. Rep. No. 1085, 92nd Cong., 2d Sess. 3-4 (1972). Congress anticipated that both the carriers and the consumer would benefit from laws protecting carriers from discriminatory taxes. See generally, Comment, supra note 34 (arguing that the 4-R Act restores competition to the rail carriers).

39 S. Res. 29, 151, 244, 86th Cong., 2d Sess. (1960).


"A table was submitted by the Association of American Railroads . . . showing the extent of overpayment of railroad ad valorem taxes resulting from the assessment of railroad property at a percent of its value that is higher than the percent which the assessment of other taxpayer property is to the value of such other property. This confirmed the findings of this committee that there is a studied and deliberate practice of assessing railroad property at a proportion of full value substantially higher than other property subject to the same tax rates."

Id.

41 Id. The Report noted that adoption of such a proposal "would mark the assumption of control by Congress in the field of taxation of interstate commerce so vital to unhampered commerce between the States." Id. at 466.

The Doyle Report actually proposed two methods to help alleviate the tax burden on railroads. Id. at 463-66. The first proposal suggested a right-of-way exemption. Id. at 463-65. The Association of American Railroads made the second
gress considered a series of legislative proposals that would have forbidden state tax discrimination, not only against railroads and pipelines, but against all common and contract carriers regulated by the Interstate Commerce Commission.\(^{42}\) Congress ultimately determined railroad carriers bore the biggest burden resulting from discriminatory tax practices.\(^{43}\) In response to these dis-

\[\text{proposal, which was the basis of section 306 of the 4-R Act which Congress enacted fifteen years later. Id. at 465-66.}\]

The Doyle Report indicates that the Association of American Railroads: proposed Federal law would declare the following action by any State, or governmental subdivision or agency thereof, whether such action be taken pursuant to a State constitutional provision, a statute, an administrative practice, or otherwise, to constitute an unreasonable and unjust burden upon interstate commerce and thereby forbidden and declared to be unlawful:

(a) The assessment, for the purposes of a property tax levied by any taxing district, of property owned or used by any common carrier engaged in interstate commerce at a value which bears a higher ratio to the true market value of such property than to the assessed value of all other property in the taxing district subject to the same property tax levy bears to the true market value of all such property.

(b) The collection of any tax on the portion of said assessment so declared to be unlawful.

To provide a forum other than at the State level to decide such unlawful assessment and collection of taxes it was further proposed that, notwithstanding the provisions of 28 U.S.C. § 1341, or of the constitution or laws of any State, jurisdiction is to be conferred upon the Federal district courts to enjoin after full hearing, any action declared under the preceding section to be unlawful, such jurisdiction not to be exclusive of that which any Federal or State Court may otherwise have.

This proposed antidiscrimination tax bill, which would be available to all common carriers engaged in interstate commerce, has the obvious merit of insuring that such carriers would receive equal treatment with other taxpayers subject to the same tax rates in accordance with applicable State law. The proposal in no way alters the freedom of the State to tax its taxpayers as in its discretion it deems best, so long as such carriers are accorded equal tax treatment with other taxpayers.


\(^{43}\) Note, supra note 33, at 1111. Railroads accounted for ninety percent of the
criminatory taxes, Congress passed the 4-R Act of 1976.\textsuperscript{44} Next Congress similarly protected motor carriers from discriminatory taxation when it passed the Motor Carrier Act of 1980.\textsuperscript{45} The Motor Carrier Act is essentially identical to the 4-R act.\textsuperscript{46}


\textsuperscript{44} 49 U.S.C. § 11503 (1982). The portion of the 4-R Act which prohibits the states from discriminatorily taxing transportation property reads as follows:
   (b) The following acts unreasonably burden and discriminate against interstate commerce, and a State, subdivision of a State, or authority acting for a State or subdivision of a State may not do any of them: (1) assess rail transportation property at a value that has a higher ratio to the true market value of the rail transportation property than the ratio that the assessed value of other commercial and industrial property in the same assessment jurisdiction has to the true market value of the other commercial and industrial property. (2) levy or collect a tax on an assessment that may not be made under clause (1) of this subsection. (3) levy or collect an ad valorem property tax on rail transportation property at a tax rate that exceeds the tax rate applicable to commercial and industrial property in the same assessment jurisdiction. (4) impose another tax that discriminates against a rail carrier providing transportation subject to the jurisdiction of the Commission . . . .

\textsuperscript{Id.}

\textsuperscript{45} Id. § 11503a. The portion of the Motor Carrier Act which prohibits states from discriminatorily taxing motor carrier transportation property reads as follows:
   (b) The following acts unreasonably burden and discriminate against interstate commerce and a State, subdivision of a State, or authority acting for a State or subdivision of a State may not do any of them: (1) assess motor carrier transportation property at a value that has a higher ratio to the true market value of the motor carrier transportation property than the ratio that the assessed value of other commercial and industrial property in the same assessment jurisdiction has to the true market value of the other commercial and industrial property; (2) levy or collect a tax on an assessment that may not be made under paragraph (1) of this subsection; (3) levy or collect an ad valorem property tax on motor carrier transportation property at a tax rate that exceeds the tax rate applicable to commercial and industrial property in the same assessment jurisdiction;

\textsuperscript{Id.}

\textsuperscript{46} Compare 49 U.S.C. § 11503 (1982) with 49 U.S.C. § 11503a (1982). The Motor Carrier Act lacks a provision equivalent to the "catch-all" section found in section 11503(b)(4). This subsection provides that "a State, subdivision of a State, or authority acting for a State or subdivision of a State may not . . . impose
Finally, Congress gradually began to see the need to similarly protect airline carriers. First, Congress began recognizing the need to expand the airport and airway system. In 1970 Congress requested that the Secretary of Transportation prepare a plan to develop public airports. Then Congress adopted the Airport and Airway Development Act of 1970 (AADA), authorizing the Secretary to make grants to states and localities for airport development. Congress also established an Airport and Airway Trust Fund to finance airport expansion and im-


This "catch-all" phrase may indicate that Congress did not intend to limit the 4-R Act only to property taxes. Despite the fact that the Motor Carrier Act lacks this "catch-all" phrase, Congress also may not have intended to limit the Motor Carrier Act to property taxes. See H.R. REP. No. 1069, 96th Cong., 2d Sess. 45, reprinted in 1980 U.S. CODE CONG. & ADMIN. NEWS 2283, 2327. "The prohibition in this section against different tax rates is intended to apply to taxes such as those on real or personal property, general sales taxes, or other levies that are parts of the general tax structure applicable to a variety of commodities, operations, and commercial activities." Id.

Despite the conflict between this legislative history and the language of the Motor Carrier Act as codified, no court has resolved this issue. See American Trucking Ass'ns v. O'Neill, 522 F. Supp. 49 (D. Conn. 1981) (concerning the amendment of a Connecticut statute which required each interstate motor carrier to pay a forty dollar annual registration fee while other motorists only paid a five dollar annual fee); American Trucking Ass'ns v. Conway, 514 F. Supp. 1341 (D. Vt. 1981) (Vermont amended its statutes to require interstate motor carriers to pay increased permit fees).

Both courts based their decisions on the Tax Injunction Act, 28 U.S.C. § 1341 (1982). O'Neill, 522 F. Supp. at 54; Conway, 514 F. Supp. at 1343. The courts held that permit fees are taxes within the meaning of the Tax Injunction Act, but federal laws do not apply if a state's remedy is adequate. O'Neill, 522 F. Supp. at 54; Conway, 514 F. Supp. at 1343. The courts never addressed whether the Motor Carrier Act prohibits discrimination. The decisions did not provide any reason for their failure to apply the Motor Carrier Act to these situations. O'Neill, 522 F. Supp. at 54; Conway, 514 F. Supp. at 1343. See generally Note, supra note 33, at 1124-25.

47 H.R. CONF. REP. NO. 1074, 91st Cong., 2d Sess. 29, reprinted in 1970 U.S. CODE CONG. & ADMIN. NEWS, 3047, 3101. Congress found that "substantial expansion and improvement [of the airport and airway system] is required to meet the demands of civil aviation, the postal service, and the national defense." Id.

After passage of the AADA and the establishment of the Trust Fund, states and municipalities questioned whether they could impose taxes on airlines and air travelers. In *Evansville-Vanderburgh Airport v. Delta Airlines, Inc.*,, the Supreme Court ruled that neither the Commerce Clause nor the AADA prevented state and local authorities from assessing head taxes on passenger flights at state and local airports. Following this decision, Congress determined that the combination of Trust Fund levies and local taxes unfairly burdened interstate air carriers. Therefore, Congress adopted the Airport Development Acceleration Act of 1973 (ADAA) in order to limit state taxation of air carriers. This statute conferred the same protection to airlines as previous statutes had conferred to railroads and motor carriers.

In the Airport and Airway Improvement Act of 1982 (AAIA), Congress added section 7(d) to the ADAA. Section 7(d) forbids a state from assessing or taxing air carrier transportation property at ratios or rates higher than those imposed on other commercial and industrial property. In tax systems similar to the South Dakota tax scheme, states discriminated by either taxing air carrier property while not taxing other commercial property, or

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50 495 U.S. 707 (1972).

51 *Id.* at 720-721.

52 *See S. REP. No. 12, 93rd Cong., 2d Sess. 20-21 (1973); H.R. REP. No. 157, 93rd Cong., 2d Sess. 4 (1973).*


(a) No State... shall levy or collect a tax, fee, head charge, or other charge, directly or indirectly, on persons traveling in air commerce or on the carriage of persons traveling in air commerce or on the sale of air transportation or on the gross receipts derived therefrom.

(b) Nothing in this section shall prohibit a State... from the levy or collection of taxes other than those enumerated in subsection (a) of this section, including property taxes, net income taxes, franchise taxes, and sales or use taxes on the sale of goods or services.

*Id.*

54 *See supra* notes 44-45 for a text of these statutes.

55 49 U.S.C. app. § 1513(d) (1982); *see supra* note 7 for text of this statute.

by varying the tax rates applicable to other commercial and industrial property.57

B. Interpretation of the Statutes

In all three statutes, Congress specifically prohibited discriminatory state and local property taxation.58 The substantive provisions of the Motor Carrier Act and the AAIA are based upon the language of the 4-R Act.59 Interpretation of this legislation requires consideration of some definitional problems as well as use of established rules of statutory construction.

1. Commercial and Industrial Property

The statutes forbid states from taxing carrier transportation property at rates higher than those imposed on other “commercial and industrial property of the same type.”60 Therefore, the interpretation of the phrase “commercial and industrial property” is central to many discriminatory tax claims.

The definition of “commercial and industrial property” contained in the statutes has received varying interpretations from courts construing the statutes.61 In all three

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57 See Tatarowicz & Mims-Velarde, supra note 28, at 905-06. Congress declared that these discriminatory tax practices “unreasonably burden and discriminate against interstate commerce.” Id.; see also S. REP. No. 630, 91st Cong., 1st Sess. 3 (1969). Congress determined that interstate carriers are “easy prey for State and local tax assessors” since they are “non-voting, often non-resident targets for local taxation, and cannot easily remove their right-of-way and terminals.” Id.

58 See supra notes 28-57 and accompanying text for a discussion of these statutes.

59 See supra note 33, at 1119. De jure discrimination against carriers occurs when a state fails to include various types of property in the assessment ratio. Id. This results in an assessment rate for a carrier that exceeds the average assessment rate of all other commercial and industrial property in the assessment jurisdiction. Id.; see also Burlington N. R.R. v. Lennen, 715 F.2d 494, 497 (10th Cir. 1983) (discussing de jure discrimination). In order to violate the 4-R Act and the Motor Carrier Act, the assessment rate for a carrier must exceed the average assessment rate by five percent. 49 U.S.C. §§ 11503, 11503a (1982).

60 See infra notes 63-86 and accompanying text for a discussion of these cases.
statutes, commercial and industrial property is defined as "property, other than transportation property and land used primarily for agricultural purposes or timber growing, devoted to a commercial or industrial use and subject to a property tax levy." Much of the confusion centers on when property is "subject to a property tax levy."

In Ogilvie v. State Board of Equalization of North Dakota, interstate railroads contended that imposition of a state ad valorem tax upon their personal property and not upon other business taxpayers violated the 4-R Act. Specifically, the railroads argued that inclusion of their personal property in the assessed value of their rail transportation property, while personal property was not included in the assessed value of the locally assessed business property, was discriminatory. The state contended, however, that the 4-R Act did not deny the state the power to classify property and to exempt certain classes of property from taxation.

The North Dakota district court held that the inclusion of personal property in the assessed value of railroad property does not violate section 11503(b)(1) of the 4-R Act. The court held that business personal property is not subject to a property tax levy and therefore is not commercial and industrial property for purposes of the 4-R Act.

Both the district court and the Eighth Circuit, however,

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64 Ogilvie, 657 F.2d at 205.
66 Ogilvie, 492 F. Supp. at 453.
67 Id. The court agreed with the state which argued that the 4-R Act "does not deny to the state the power to classify property and to exempt certain classes of property from taxation." Id.
68 Id. As stated earlier, the 4-R Act defines "commercial and industrial property" as property devoted to a commercial or industrial use and subject to a property tax levy. 49 U.S.C. § 11503(a)(4) (1982).
held that the 4-R Act was intended to prohibit tax discrimination against rail transportation property in any form whatsoever. Therefore, North Dakota could not tax railroad personal property when it exempted all other commercial and industrial property. The courts found the tax invalid solely due to the catch-all provision in section 11503(b)(4) of the 4-R Act which prohibits "any other tax which results in discriminatory treatment of a common carrier by railroad . . . ." The court of appeals did not, however, specifically address the question of whether section 11503(b)(1) prohibits North Dakota from taxing railroad personalty when it exempts other business personalty.

In *Northwest Airlines, Inc. v. State Board of Equalization of North Dakota*, three airlines sought relief from property tax assessments against them. The airlines alleged that the state tax scheme, which taxed airline personal property while exempting other commercial and industrial personal property from taxation, was invalid under the AAIA. The North Dakota Supreme Court held that the

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6. *Ogilvie*, 657 F.2d at 210. The Eighth Circuit agreed with the district court when it concluded:

The intent of Congress in enacting § 306 was to protect interstate rail carriers from discriminatory property taxation. The most obvious form of tax discrimination is to impose a tax on a class of rail transportation property that is not imposed on other nonrailroad property of the same class. The inclusion of personal property in the assessed value of railroad property and other centrally assessed businesses imposes a personal property tax on centrally assessed businesses that is not imposed on locally assessed businesses.

7. *Id.*

8. *Id.* The Eighth Circuit found that North Dakota had a long history of tax discrimination against railroads. *Id.* The court also found that the state had ample time to remedy its situation before the 4-R Act became effective. *Id.* "Not having done so, the district court . . . correctly determined that personal property of the railroads was exempt from taxation, the same as all other commercial and industrial property. . . ." *Id.*

9. *Id.* at 209; see supra note 46 for a discussion of the "catch-all" provision of the 4-R Act.


11. 358 N.W.2d 515 (N.D. 1984).

12. *Id.* at 515.

13. *Id.* at 516. With certain exceptions, commercial and industrial personal property in North Dakota is exempt from personal property taxation. N.D. Cent.
AAIA prohibits North Dakota from taxing airline person- 
ality while exempting other business personalty.\textsuperscript{76}

In \textit{Arkansas-Best Freight System, Inc. v. Cochran},\textsuperscript{77} motor carriers brought an action challenging Tennessee tax as-
se ssments.\textsuperscript{78} The motor carriers sought relief because 
their motor carrier property was assessed at one hundred 
percent of value while other commercial and industrial 
property was presumed not to have value.\textsuperscript{79} The district 
court found \textit{Ogilvie} controlling.\textsuperscript{80} The court interpreted 
the Motor Carrier Act to prohibit discrimination against 
motor carrier property resulting from the exemption of 
"commercial and industrial" personalty owned by other 
locally assessed business taxpayers in Tennessee.\textsuperscript{81} Ten-
nessee argued that the Motor Carrier Act did not interfere 
with the state's power to classify property for purposes of 
ad valorem taxation, but the court held that the failure to 
tax other commercial and industrial property violated the 
provisions of the Motor Carrier Act.\textsuperscript{82}
In *Atchison, Topeka & San Francisco Railway v. Arizona,* railroad companies sought relief from Arizona’s allegedly discriminatory tax practices. The railroads argued that Arizona must consider manufacturers’ inventories, exempt from taxation under the Arizona Constitution, within the category of “commercial and industrial property . . . subject to a property tax levy” since Arizona could tax the property if the Arizona citizens amended their constitution. The court held that “[p]roperty which is for any reason tax-exempt is excluded as a form of commercial and industrial property.”

As these cases demonstrate, no clear consensus on the meaning of “commercial and industrial property” currently exists. It remains unclear whether a state may tax airplanes while exempting all other business personal property without violating the tax antidiscrimination laws. Similarly, no clear definition of in lieu tax currently exists.

2. *In Lieu Tax*

Section 1513(d)(3) states that it “shall not apply to any in lieu tax which is wholly utilized for airport and aeronautical purposes.” The meaning of the term “in lieu tax” is uncertain. Congress apparently decided to exclude a certain class of in lieu taxes, those “wholly utilized for air-

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*Id.* at 1240. For years railroads have contended that Arizona placed a heavier tax burden on them than on other property owners. *Id.* In 1971, the railroads unsuccessfully challenged the system that placed them in the category with the highest rate of assessment. *See* *Apache County v. Atchison, T. & S.F. Ry.*, 106 Ariz. 356, 476 P.2d 657 (1970), *appeal dismissed*, 401 U.S. 1005 (1971).

599 F. Supp. at 1245. The court found the railroad’s interpretation “simply unreasonable.” *Id.* “Property ‘subject to’ a tax levy is property which is presently taxed.” *Id.*

*Id.; see also* ACF Indus., Inc. *v. Arizona*, 714 F.2d 93, 94 (9th Cir. 1983) (no authority requires that untaxed property be included in an average of assessed value for taxed property); Trailer Train Co. *v. State Bd. of Equalization of Cal.*, 687 F.2d 860 (9th Cir. 1983) (in determining base rate for comparison, crucial issue is whether tax roll contains majority of state’s commercial and industrial property).

port and aeronautical purposes,” from the comparison standard of the AAIA.  

The supreme courts of North Dakota and South Dakota have been the only courts to consider this portion of the AAIA.  North Dakota adopted an amendment to the air carrier tax one year after the enactment of the AAIA.  The amendment declared the tax to be in lieu of aircraft registration fees and sales and use taxes.  In *Northwest Airlines*, the trial court held that regardless of the “in lieu” label, this new tax was not a substitute for another tax previously imposed on the airlines.  Therefore, by definition the tax could not be an in lieu tax.  The North Dakota Supreme Court upheld the lower court finding that North Dakota’s air carrier transportation property tax was not an in lieu tax under section 1513(d)(3).  

In *Western Air Lines, Inc. v. Hughes County*, the South Dakota Supreme Court upheld a lower court holding regarding the validity of the South Dakota tax, but rejected the circuit court’s definition of in lieu tax.  According to the circuit court, the South Dakota tax met the two prong test of the AAIA.  First, the circuit court found that an in lieu tax determines the exclusive method of taxing a particular type of property, to the exclusion of all other methods actually or potentially applicable.  According to the circuit

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88 Id.  
89 See *Northwest Airlines*, 358 N.W.2d at 515; *Hughes County*, 372 N.W.2d at 106.  
91 Id.  “The taxes imposed by . . . this chapter on air carrier transportation property are in lieu of the registration fees imposed by section 2-05-11 and are in lieu of sales and use taxes which would otherwise be imposed on the sale, storage, use or consumption of air carrier transportation property . . . .”  
92 *Northwest Airlines*, 358 N.W.2d at 518.  
93 Id.  
95 Id. at 109.  
96 Jurisdictional Statement, Appendix B at 20a, *Western*.  
97 Id. at 19a-20a. The court based this conclusion on S.D. CODIFIED LAWS ANN. § 10-4-6.1 (1982).  Id.; see supra note 26 for text of this statute. The statute specifically states that the exemption of personal property from ad valorem taxation “shall not impair or repeal any tax or fee authorized to be levied or imposed in lieu of personal property.”  

The 1975 Report of the House Committee on Interstate and Foreign Com-
court, the second prong merely requires that any tax imposed be wholly utilized for airport and aeronautical purposes. The South Dakota statute also met this requirement because it specifically provided that all proceeds should be wholly used for airport purposes.

The South Dakota Supreme Court held that the circuit court had erred in sustaining the tax as an in lieu tax. The court defined the term “in lieu tax” to mean a tax that is “instead of, or, a substitute for, and it is not an additional tax.” The tax in question was the first imposition of a personal property tax on flight property in South Dakota. Therefore, the South Dakota tax was not a substitute for an ad valorem personal property tax.

Nevertheless, the South Dakota Supreme Court affirmed on an alternative ground. The court found the tax valid under the balancing test found in section 1513(d)(1). Under this section, a tax is found discriminatory by comparing the tax rates assessed on aircraft to the rates applied to other commercial and industrial property. The AAIA defines “commercial and industrial property” as property “devoted to commercial or industrial use and subject to a property tax levy.” Because South Dakota exempted locally assessed business property from taxation, the court reasoned that this property was not “subject to a property tax levy,” and therefore

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98 Jurisdictional Statement Appendix B at 20a, Western.
99 Id.
100 Hughes County, 372 N.W.2d at 109.
101 Id. (citing BLACK'S LAW DICTIONARY 832 (5th ed. 1979)).
102 Id. The court also found that the tax is an additional tax to the personal property taxes already existing. Id. The court was not persuaded by the reference in S.D. CODIFIED LAWS ANN. § 10-4-6.1 (1982) to “in lieu”. Id.
103 Id.
104 Id.
105 Id.
could not be included as commercial or industrial property for comparison purposes under section 1513(d)(1). 108

When defining "in lieu tax" the South Dakota Supreme Court relied upon Lebeck v. State. 109 In Lebeck, an Arizona court refused to enforce a license tax on motor vehicles purportedly imposed "in lieu of all ad valorem property taxes on any vehicle subject to such license tax." 110 The court held that because plaintiffs' vehicles were engaged exclusively in interstate commerce, they were not subject to the ad valorem tax. 111 The Lebeck court defined "in lieu tax" to mean instead of or a substitute for, and not an additional tax. 112 Therefore, in order to be subject to the in lieu tax, the property must have been subject to the previous tax. 113 The court found that the motor vehicles were not subject to a tax in lieu of the ad valorem tax. 114

3. General Rules for the Statutory Construction of the AAIA

As stated earlier, Congress provided little guidance as to their intent in enacting the AAIA. 115 According to established rules of statutory construction, Congress intends legislation enacted to remedy an existing problem construed in order to effectuate its purpose. 116 Where a provision is susceptible to alternative interpretations, the alternative which best serves that purpose is applied. 117 Therefore, the obvious purpose for a law should not be

108 Hughes County, 372 N.W.2d at 110.
110 Id. at 721. "[A] license tax is hereby imposed on vehicles registered for operation upon highways of Arizona, which license tax shall be in lieu of all ad valorem property taxes on any vehicle subject to such license tax." ARIZ. CONST. art. 9, § 11.
111 Lebeck, 156 P.2d at 721.
112 Id.
113 Id.
114 Id.
115 See supra notes 47-57 and accompanying text for a discussion of the legislative history for the AAIA.
sacrificed to a literal interpretation of its words. The law favors a rational and sensible construction.

The purpose of section 7 of the ADAA was to "[make] current law which prohibits the assessment, levying or collecting of taxes on motor carrier property in a manner different from that of other commercial and industrial property, applicable to air carriers." Congress undoubtedly had this purpose in mind when it amended the Act and added section 1513(d). Clearly, the purpose was to protect airlines from discriminatory local taxes on interstate transportation services. Overall, the purpose of the Act as a whole, and of section 1513(d) in particular, is to protect airlines operating in interstate commerce from burdensome and discriminatory taxes.

III. Western Air Lines, Inc. v. Board of Equalization of South Dakota — The Supreme Court’s Analysis

In their appeal to the United States Supreme Court, the airlines challenged the South Dakota Supreme Court’s interpretation of “commercial and industrial property” under section 1513(d). Following oral argument, the Supreme Court requested supplemental briefing from the parties and the Solicitor General on the following questions: (1) is the question whether a state tax is an "in lieu

121 49 U.S.C. app. § 1513(d) (1982); see supra note 7 for full text of section 1513(d).
124 Western, 107 S. Ct. at 1042.
tax which is wholly utilized for airport and aeronautical purposes," one of state or federal law, and (2) if federal law governs the question whether a tax is an in lieu tax under section 1513(d)(3), is the South Dakota Airline Flight Property Tax an in lieu tax under section 1513(d)(3)?

The parties and the Solicitor General agreed that federal law governs the interpretation of the state tax. Although the appellants urged that the South Dakota Supreme Court had incorrectly interpreted "commercial and industrial property" under the AAIA, the Court did not address this issue because it resolved the case based on its interpretation of in lieu tax under the AAIA.

The Court admitted that little legislative history specifically discussing the in lieu tax provision exists. The court specifically rejected an affidavit by John L. Zorack, an attorney supposedly involved in the passage of the legislation which ultimately became section 1513(d). The appellant submitted this affidavit to lend weight to its ar-

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126 Western, 107 S. Ct. at 1043. Generally, "absent a clear indication to the contrary, the meaning of words in a federal statute is a question of federal law . . . ." Id. This is especially true when the federal statute aims to eliminate state discrimination against interstate commerce. Id.; see, e.g., Aloha Airlines, 464 U.S. at 13-14 (holding that state legislature's characterization of a tax could not shield the tax from application of another subsection of section 1513).

127 Western, 107 S. Ct. at 1042. "Had the South Dakota court paid even the slightest attention to the legislative history of § 1513(d) . . . that court would have discovered that . . . the statutory phrase 'subject to a property tax levy,' was not intended to allow the sort of wholesale discrimination practiced by South Dakota, but rather to allow for exclusion from the comparison class of 'commercial and industrial property' only those limited classes of property which had traditionally been exempt from state taxation." Appellant's Brief, supra note 5, at 13-14; see supra notes 60-86 and accompanying text for a discussion of the various interpretations of "commercial and industrial property."

128 Western, 107 S. Ct. at 1043.

129 Id.; see supra note 97 for the small amount of legislative history that does exist. The court states that this "sliver of legislative history" supports its interpretation of in lieu tax. Western, 107 S. Ct. at 1043.

130 Western, 107 S. Ct. at 1043. Zorack is described as an attorney who "represent(s) clients in a variety of legislative matters before the United States Congress." Id. Zorack was apparently involved, in an unexplained capacity, in the passage of this legislation. Id.
argument that in order to qualify as an in lieu tax the tax must be a substitute for other property taxes previously imposed on airlines.\textsuperscript{151} Although the Court recognized this as a possible interpretation of Section 1513(d), the Court stated that "the attempt at the creation of legislative history through the post-hoc statements of interested onlookers is entitled to no weight" in the interpretation process.\textsuperscript{152}

Therefore, in keeping with established rules of statutory construction, the Court focused on the "'purpose and effect' of the state tax in light of the policy embodied in the federal provision."\textsuperscript{153} The Court acknowledged that section 1513(d) is historically related to similar provisions in the 4-R Act and the Motor Carrier Act of 1980.\textsuperscript{154} The \textit{Western} Court found the major purpose of these statutes is to prevent states from excessively taxing "nonvoting, nonresident businesses in order to subsidize general welfare services for state residents."\textsuperscript{155}

Finally, the Supreme Court determined that the "language and logic" of the AAIA indicate that the South Dakota Airline Flight Property Tax falls under the in lieu exemption.\textsuperscript{156} The Court analyzed section 1513(d)(3) in

\textsuperscript{151} \textit{Id.} According to Zorack, the in lieu provision "was intended to ensure that the Act would not invalidate state taxes which are a legitimate substitute for other taxes on air carrier transportation property and which are not imposed in an effort to tax such property at rates higher than those imposed on other comparable commercial and industrial property." \textit{Id.} Zorack added that the provision was added in direct response to Minnesota's objection to an earlier version. \textit{Id.} Minnesota's air flight property tax was a substitute for other property taxes previously imposed on airlines. \textit{Id.}

\textsuperscript{152} \textit{Id.}; see \textit{supra} notes 115-123 and accompanying text for a discussion of rules of statutory construction.

\textsuperscript{153} \textit{Western,} 107 S. Ct. at 1043-44. "The legislative history of the antidiscrimination provision in the 4-R Act demonstrates Congress' awareness that interstate carriers 'are easy prey for State and local tax assessors.'" \textit{Id.} at 1044. (quoting S. \textit{Rep.} No. 630, 91st Cong., 1st Sess. 3 (1969)); see \textit{supra} notes 28-46 and accompanying text for a discussion of the legislative purpose behind these statutes.

\textsuperscript{154} \textit{Western,} 107 S. Ct. at 1044; see \textit{supra} notes 28-46 and accompanying text for a discussion of the legislative purpose behind these statutes.

\textsuperscript{155} \textit{Western,} 107 S. Ct. at 1044. The South Dakota tax stands in lieu of the generally applicable ad valorem property tax assessed on most other commercial and industrial property in the state at the time the airline flight property tax was estab-
two parts. First, the tax must be "wholly utilized for airport and aeronautical purposes." The South Dakota tax meets this requirement because section 10-29-15 requires that the taxes collected under this chapter shall be allocated "to the airports where such airline companies make regularly scheduled landings and shall be used exclusively by such airports for airport purposes . . . ."

Secondly, the tax must be applied to the exclusion of any other property tax. South Dakota also meets this requirement because it only assesses the flight property of airline companies once for taxation purposes. The Court reasoned that if the revenues collected pursuant to the South Dakota tax were specifically used to benefit those from which the tax is collected, then the tax does not discriminatorily take from some in order to benefit others. Therefore, the South Dakota tax satisfies the overall purpose of this antidiscrimination tax legislation.

The Supreme Court ultimately rejected the position taken by the airlines and the South Dakota Supreme Court that an in lieu tax means that the tax is a substitute for an ad valorem personal property tax. The Court reasoned that if the only criteria for an in lieu tax is that

lished. Id. at 1045; see supra notes 96-99 and accompanying text for a discussion of the circuit court's reasoning.

137 Western, 107 S. Ct. at 1043.


139 Western, 107 S. Ct. at 1044.

140 S.D. Codified Laws Ann. § 10-29-2 (1982); see supra note 20 for the text of this statute.

141 Western, 107 S. Ct. at 1044.

142 Id. at 1045. "[T]he language of § 1513(d)(3), while at first glance ambiguous, should be interpreted in a manner that comports with the policies of the Airport and Airline Improvement Act. That interpretation is that § 1513(d)(3) exempts from the antidiscrimination provisions of § 1513(d)(1) a tax on airline flight property . . . the proceeds of which are wholly utilized for airport and aeronautical purposes." Id.

143 Id.; see supra note 100-108 and accompanying text for a discussion of the South Dakota Supreme Court's interpretation of the phrase "in lieu tax." The United States Supreme Court stated, "[t]he illogical results of applying such an interpretation, however, argue strongly against the conclusion that Congress intended these results when it drafted § 1513(d)(3)." Western, 107 S. Ct. at 1044.
one tax replaces another tax, then all a state legislature would have to do is amend its tax code one session, and then the following session replace that tax with another tax.  

IV. THE IMPLICATIONS OF WESTERN

Despite the unanswered questions left by the Western opinion, some observations can be made about the possible effects of the Western holding. First, Western admittedly provides some concrete guidelines for interpreting Section 1513(d)(3) of the AAIA. Before this decision, the phrase “in lieu tax” had been construed narrowly. Now an in lieu tax can mean any tax that determines the exclusive method of taxing a particular type of property, to the exclusion of all other methods actually or potentially applicable.

Secondly, the Western decision did nothing to remove the confusion surrounding the interpretation of “commercial and industrial property” under the AAIA. It is still unclear whether a state can totally exempt all business inventories from ad valorem taxation and continue to tax centrally assessed business taxpayers protected by the 4-R Act, the Motor Carrier Act, and the AAIA.

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144 Id. at 1045. “At worst, the appellant’s interpretation of § 1513(d)(3) would do no more than place a meaningless hurdle before state legislatures seeking to conform their tax scheme to the requirements of this provision.” Id. According to the court, there is no reason that an in lieu tax must have replaced some other tax by the effective date of the federal provision. Id. “This exercise of replacing one tax with another, while contributing somewhat to a state legislature’s workload, would contribute nothing to the policies of the [AAIA].” Id.

145 See supra note 128 and accompanying text. The Court never addressed the question of the interpretation of “commercial and industrial property.” Western, 107 S. Ct. at 1045.

147 See supra notes 87-114 and accompanying text for a discussion of the different interpretations of “in lieu tax.”

146 See supra note 139 and accompanying text.

149 See supra notes 60-86 and accompanying text for a discussion of the different interpretations of “commercial and industrial property.”

150 See supra notes 60-86 for a discussion of this problem. Rail car companies which operate in Florida are currently facing this sort of discrimination. Amici Curiae Brief of Railway Progress Institute & Association of American Railroads at
If other states act upon this interpretation of AAIA, it could significantly impact an air carriers’ ability to operate within a state. This decision undoubtedly increases the amount of taxes states may impose upon air carriers. By the same token, it opens up new ways of financing new (and old) public airports. This will be particularly significant in smaller cities and states whose airports are not self-supporting.

Finally, Western’s overall impact on state and local taxation schemes remains uncertain. Since the court only dealt with one small exception to the federal antidiscrimination laws, it is still unclear whether or not states may totally exempt certain property from ad valorem taxation and continue to tax interstate carriers. On the other hand, it does expose one loophole in the federal statutory scheme.

V. Conclusion

Arguably, the Supreme Court may have gutted a major provision of the AAIA and thereby defeated well-established Congressional intent. Congress clearly stated a desire to protect interstate carriers from state discriminatory taxation. The Court’s opinion generally provides that air carriers are fair targets for state property taxation as long as the tax is applied to the exclusion of any other property tax and the proceeds are used exclusively for airport or aeronautical purposes.

14, Western. Effective January 1, 1982, Florida totally exempted all business inventories from ad valorem taxation. Id. The Florida Department of Revenue refused to account for the effect of these totally exempt business inventories upon the overall level of assessment of business personalty when calculating the average level of assessment of commercial and industrial property for the 1982 tax year. Id.

151 Western, 107 S. Ct. at 1043-1045.

152 See supra notes 87-114 and accompanying text for a discussion of this loophole, the in lieu tax.

153 See supra note 139 and accompanying text.

154 See supra note 137 and accompanying text.
Nevertheless, the Court’s reasoning is logical. Realistically, the airlines are not at risk of harm when the aircraft tax proceeds are wholly used for airport purposes. The opinion serves as a reminder that statutory interpretation is far from a science. Courts must always look to the policy embodied in the statute. Western also illustrates that courts must apply common sense when testing possible meanings of a phrase or section of a statute.

For these reasons, Western represents a notable opinion. Nonetheless, the case does have some weaknesses. The Court completely sidesteps the question of whether or not a state may totally exempt most commercial and industrial property and continue to tax interstate carriers. Hopefully, the Western decision will prompt new guidance from Congress and will not be viewed merely as one narrow exception to the federal scheme prohibiting discriminatory taxation of interstate carriers.

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155 See supra notes 141-142 and accompanying text for a discussion of the Court’s reasoning.
156 Western, 107 S. Ct. at 1043.
157 Id. at 1044.
154 Id. at 1043; see supra notes 60-86 and accompanying text for a discussion of the various interpretations of “commercial and industrial property.”
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