8-1-1961

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LEGISLATION AND ADMINISTRATION

ADMINISTRATIVE LAW — DOMESTIC AIRLINE SERVICE TO COMMUNITIES — CAB “INADEQUACY OF SERVICE” RULINGS — On November 10, 1959, a significant change in Civil Aeronautics Board policy, apt to have far-reaching effects on airline flight scheduling, was announced. For the first time, the Board issued an opinion finding a certified carrier’s service to be inadequate and ordering it to provide additional flights.1 Thus began a trend in the Board’s approach which represents an attempt to make a significant extension of regulatory power. Since its creation by the Civil Aeronautics Act of 1938,2 the CAB had never, prior to this, invoked its statutory powers to require the domestic trunklines to meet their “adequate service” obligations.3 Rather, it relied on its function of certification of new routes to regulate the availability of airline service throughout the country.4

Inquiry into the section 404(a)5 “adequacy” cases necessarily begins with the Fort Worth Investigation.6 It is through a close analysis of these cases that the development of the widely divergent views of the air carriers and the CAB can most readily be appreciated. Though its initial Board ruling has been severely modified in later, more significant proceedings, the Fort Worth Investigation had a profound impact in that it was the first time in the history of the Board7 that the latter was faced with the problem of resolving, solely with reference to the requirements of section 404(a), the thorny issue of the nature and extent of a carrier’s legal obligations to provide air transportation. However, the Board was not completely without guidance regarding the interpretation and application of section 404(a). A most illuminating discussion of the kinds of considerations inherently involved in adequate service determinations was found in an analogous Supreme Court decision of over fifty years ago.8 The Court recognized that “adequate facilities” defied rigid definition:

It is a relative expression and has to be considered as calling for such facilities as might be fairly demanded, regard being had, among other things, to the size of the place, the extent of the demand for transportation, the cost of furnishing the additional accommodations asked for, and to all other facts which would have a bearing upon the question of convenience and cost. . . . That the inhabitants of a place

1 Toledo Adequacy of Service Investigation, Order No. E-14629, November 10, 1959.
2 The Civil Aeronautics Act of 1938, 52 Stat. 973, 49 U.S.C. §§ 401-705, has been incorporated into and superseded by the Federal Aviation Act of 1958, 72 Stat. 731, 49 U.S.C. §§ 1301-1542. With respect to the statutory provisions pertinent to the issues in the proceedings discussed, the two statutes are identical. Reference, when made, will be to the section number of the 1958 enactment.
3 The portion of section 404-(a), 72 Stat. 760, 49 U.S.C. § 1374, relevant to this discussion provides that:

It shall be the duty of every carrier to provide and furnish interstate and overseas air transportation, as authorized by its certificate, upon reasonable request therefore and to provide reasonable through service in such air transportation in connection with other air carriers; to provide safe and adequate service, equipment, and facilities in connection with such transportation.

4 Federal Aviation Act of 1958, § 401(a) (1), 72 Stat. 731, 49 U.S.C. § 1371, confers the power and duty upon the CAB to issue certificates if it finds the applicant qualified to provide the service requested and if the transportation “is required by the public convenience and necessity.”
5 See note 3 supra.
6 Docket No. 7382.
7 However, the Board on several occasions had acknowledged its power and authority under section 404(a). United A.L., Consolidation of Routes 1 and 12, 3 C.A.B. 72, 76 (1941); Pennsylvania-Central Air., Service to Atlantic City, 3 C.A.B. 144 (1941); Continental A. L., et al., Texas Air Service, 4 C.A.B. 215 239 (1943).
8 Atlantic Coast Line v. Wharton, 207 U.S. 328 (1907), in which the issue was whether an order of a state railroad commission requiring an interstate railroad to stop at specified local stations amounted to an unreasonable restraint on interstate commerce. The Supreme Court, in holding that such an order did unreasonably burden interstate commerce, analyzed the problem by considering the adequacy of local facilities at the stops ordered by the state commission.
American Airlines was named a party along with all other carriers certificated to serve Fort Worth. Prior to 1953, virtually all trunkline air service to and from the Dallas/Fort Worth area was provided through Dallas' Love Field. Fort Worth's airport was incapable of handling large four-engine equipment, though in the days of the DC-3 it had handled a considerable portion of the trunkline services to the area. In April, 1953, Fort Worth opened its new and modern airport, Amon Carter Field, located midway between Dallas and Fort Worth. At that time the Dallas/Fort Worth airline service pattern was divided between the two airports. A substantial number of flights were switched to Amon Carter Field, but more were left at Love Field. The ensuing years saw a tug-of-war taking place between the two cities for more service. The culmination of this was the complaint filed by Fort Worth in 1955. Three years later the Board issued its opinion rejecting the charges of inadequacy on all counts. The Board retained jurisdiction of the proceeding in order to take further action "in the event reasonable grounds should hereafter occur for believing that the air carriers serving Fort Worth may no longer be providing adequate service. . . ."

Fort Worth sought reconsideration and modification of the opinion, but this was denied. The issue was not long at rest. Less than six months later, Fort Worth renewed its efforts, filing a motion, pursuant to the terms of Order E-12996, to re-open the case. It submitted criticism of up-to-date schedules as new proof of inadequacy and complained primarily that American had downgraded its Fort Worth-Washington/New York service since the Board's decision, and that Braniff Airways had consistently failed to provide service between these communities.

American Airlines, Braniff Airways, Continental Airlines, and the City and Chamber of Dallas filed answers opposing Fort Worth's motion on the grounds, inter alia, that the matters alleged were repetitious and had been fully considered and disposed of in the Board's prior holding. Specifically, American urged that the CAB should not allow itself to become a "top scheduling committee" for the airlines, arguing that:

Scheduling is perhaps the most difficult, intricate and delicate task in managing an airline, is most demanding in terms of time required, is terribly dependent upon intimate, first-hand acquaintance with myriad problems and facts maintained on a continuing and comprehensive basis, and is almost completely concerned with what needs to be done in the

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9 Id. at 335. The Atlantic Coast Line case was cited with approval by the Board in Additional North-South California Service, 4 C.A.B. 373, 375 (1943), a route proceeding, wherein the Board noted that "adequate service is a relative expression which has been construed to mean only that such facilities must be supplied as might be fairly demanded." Board references to the meaning of adequate service had not been limited to proceedings involving questions as to the need to provide competitive service over existing routes such as were present in the Additional North-South California Service case, supra. Other situations confronting the Board on the occasions where it alluded to the term "adequate service" ran the gamut from an application for a certificate under the "grandfather" clause, Marquette Air. Grandfather Certificate. 1 C.A.A. 301, 309 (1939), (§ 401(e)(i), 52 Stat. 973, 49 U.S.C. § 401 et seq.), to a complaint by a passenger whose flight was cancelled, Adler v. Chi. & Southern A. L., 4 C.A.B. 113, 117 (1943).

10 The Act provides that "any person may file with the Administrator or the Board . . . a complaint in writing with respect to anything . . . omitted to be done . . . in contravention of any provision of this Act." § 1002(a), 72 Stat. 731, 49 U.S.C. § 1482. Alternatively, the Board may, on its own initiative, undertake an investigation "as though it had been appealed to by complaint." § 1002(b), 72 Stat. 731, 49 U.S.C. § 1482.

11 Order No. E-12996, September 23, 1958. Two members dissented with respect to various parts of this opinion.

future rather than what has been done or might have been done in the past. It is the heart of management's function in this industry. The Board was not established to participate in such work and supervise it on a day-to-day basis, and it is not equipped or staffed to do so.\(^{13}\)

Furthermore, it argued that the form of the law made it a virtually impossible task for the Board, inasmuch as the Board's duty to consider complaints regarding adequacy of service is a judicial function which must follow formal hearing procedures and cannot, therefore, be adapted to day-to-day supervision of scheduling. It felt that the sets of schedules submitted would be past history before the Board could reasonably be expected to act.

Taking a strictly legal approach, the carrier suggested a significant point. A proposal, which would have given sweeping power to the proposed Board, was made during the time when Congress was contemplating the nature of the Board, subsequently created by the enactment of the Civil Aeronautics Act in 1938. This proposal was designed to give the Board the broad duty to promote the development of efficient interstate, overseas, and foreign air transportation by prescribing, and revising from time to time, general standards respecting the character and quality of service to be rendered in such transportation, and to make such standards effective on such dates as it may determine after due consideration of the time required to conform to such standards.\(^{14}\)

This was rejected by Congress in enacting the legislation, and, instead, section 401(e)\(^{15}\) was passed. In an analogous case, where a specific proposal to give the Board authority to regulate depreciation for air carriers had been rejected,\(^{16}\) the United States Court of Appeals for the District of Columbia recently held that the Board may not exercise powers or functions that Congress has expressly considered and withheld, even though the Board has been charged with general regulatory responsibilities from which such specifics might otherwise be thought implied. Thus, the airline contended that the Board, in acting as a "perpetual schedule standard-setting body," was performing a function described in the rejected legislative proposal which it could not assume or exercise, even though such could conceivably be implied from section 404(a).\(^{17}\)

Finally, American urged the dismissal of the motion to reopen the investigation on the ground that it raised the same matters considered and resolved in the first Board order. Current schedules were the only new factors involved. It was asserted that even these were outmoded and even if they were not, they would be by the time the CAB acted.

The Board, finding that the service offered between Fort Worth and Washington/New York was no longer adequate\(^{18}\) within the meaning of section 404(a)
of the Act and that appropriate action should be taken to remedy this situation, directed American and Braniff, respectively, to show cause why an order should not be issued pursuant to section 404(a), requiring the two carriers to provide increased service in those areas. American countered with the argument that, in light of the old schedule patterns and the radical change wrought by jet service, the request for re-inauguration of certain services was not a "reasonable" one within the meaning of 404(a) and that the show cause order violated the cardinal principle that adequacy determinations should be made only upon full consideration of present facts and circumstances. 19

Procedurally, the airline invoked the argument that the proposed order could not issue without American's being afforded an appropriate evidentiary hearing at the time of the reopening. This was based upon section 1002(c) of the Federal Aviation Act, which provides that an order to compel compliance "with any provision of this Act or other requirement established pursuant there-to" may issue only upon findings made "after notice and hearing." These words were said to be such as to "connote a hearing appropriate to adjudicatory action, not to legislation or rule making, i.e., an evidentiary hearing, not mere written submissions and oral argument." 20 Section 7(c) of the Administrative Procedure Act states that "the proponent of a rule or order shall have the burden of proof" and its opponent "shall have the right to present his case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts." These statutory safeguards against arbitrary administrative action, the airline concluded, plainly prescribe the due process of law guaranteed by the Fifth Amendment, and the notice and hearing provisions are a continuing safeguard which cannot be dispensed with by the fact that the Board has "retained jurisdiction" of the proceeding.

Despite these arguments, the CAB issued its first order directing provisions of services under its theory of "retained jurisdiction" in adequacy cases. 20 The tentative finding of the show cause order that service provided to Fort Worth was no longer adequate was affirmed and the Board, in a highly specific ruling which went beyond bureau counsel's recommendations, 21 directed American to provide one nonstop daily round trip service with jet equipment in the Fort Worth-New York market and required one nonstop daily trip by American with turboprop equipment in the Fort Worth-Washington market. Both services were ordered for a period of one year, provision of service to be begun 60 days from the date of service of the order. This marked the first time the CAB specified plane types, frequency of flights, en route stops and the time span over which service must be provided, in a single package. The Board apparently felt that legal strictures of 401(e) against specifying aircraft types in adequacy of service cases do not apply when a common market containing two rival cities is involved.

The CAB pointed out that Fort Worth had grown between 1956 and 1959 in general economic strength and in such customary indicia of traffic potential as population, buying power, and retail sales. It found from the evidence that, with daily New York passengers ranging from 55 to 93, and daily Washington passengers ranging from 29 to 43, Fort Worth was entitled to at least one effective daily round trip in the Washington and New York markets and that such service

19 In its original opinion, the Board declared the fundamental principle that
The question whether a given service satisfies the adequacy standard is . . . a question of fact, and it is important that all the circumstances affecting its provisions by the carrier and use by the public be examined.


21 These were that American and Braniff provide four round trips weekly from Fort Worth to Washington and New York in four-engine, pressurized aircraft.
could only be provided in the form of nonstop jet service. It noted the public's willingness to cross over to Dallas, but felt the Fort Worth passengers should not be forced to make the additional ground trip and that comparable jet service at Carter Field would be economically supportable in itself. Underlying the Board's thinking was the idea that if Fort Worth's ability to support a daily flight to the East Coast were to be tested, the service must be at least equal to that offered 35 miles away at Dallas, which, by contrast, had 4 daily non-stop jet trips to New York and 4 daily Washington nonstops. While recognizing the wide latitude given the airlines by the Act with regard to scheduling, the Board said "... there comes a point where Section 404 must come into play to protect a community's right to effective air service."

In overcoming the complaint of American that the schedule patterns were obsolete, the CAB felt that it was appropriate, since the most recent survey data covered only 1958, to project that survey to 1960 levels by applying a 10% growth factor for 1959 and 1960. Furthermore, a 10% jet stimulation factor was added in the New York market.

In response to the demand for a new evidentiary hearing, the agency concluded that, as a practical matter, the complexities of the assessment of adequacy of service issues warranted the "retaining jurisdiction" theory whereby the record developed may be utilized along with new developments in later considerations of inadequacy charges. In such streamlining of further procedures, protection is afforded the carriers as well as the complaining communities. The usual time period during which service must be provided in those cases where inadequacy has been found by the Board has been one year and it may well be that actual experience may cause a carrier to seek prompt modification of the order before the limited period for which service was ordered has in fact run, so that this Board policy works both ways in its protective measure. It would appear that this approach is reasonable and necessary for the effective administration of section 404(a), but this cannot hide the fact that substantial loss may still be incurred by the carriers in whatever amount of time they are forced to operate the various runs dictated by the Board's policy.

In the latest developments of this case, before the effective date of the order directing jet service, American voluntarily inaugurated nonstop service between Fort Worth and Washington and one-stop service between Fort Worth and New York with Lockheed Electra turboprop equipment. This flight had been planned as an experimental and developmental service before the Board's order. In a letter to the CAB on December 13, 1960, American advised the Board of the unsuccessful operation of the one-stop turbojet flight between Fort Worth and New York and notified it of its planned discontinuance effective the beginning of January, 1961. It claimed that this flight was one of the most publicized flights ever inaugurated by American, with vigorous promotion rendered by Fort Worth as well as American. During the first weeks of its operations, it averaged only 14 passengers per operation, for a load factor of 21%. This indicated a total loss of approximately one million dollars annually. The purpose of submitting this in-

22 The Board felt the best way to accomplish this was by the supposed simple expediency of merely "shifting one B-707 and one Electra flight from Love to Carter Field. . . ." Order No. E-15770, September 14, 1960, p. 13.
24 E.g., Toledo Adequacy of Service case, Docket 8851, Petition of Capital Airlines filed July 20, 1960, for rescission of Order No. E-14629.
25 The load factor is the percentage of seats occupied or the number of seats occupied versus those available. It is considered to be the true measure of an airline's earning power.
formation was to supplement American’s petition for reconsideration\(^{26}\) in the hope of convincing the Board of the economic infeasibility of continuing the service directed by its order. If this petition for reconsideration is denied, American will likely test how far the CAB can go in monitoring schedules by challenging the decision in court, relying particularly on the contention that the whole record of a once-tried case must be brought up to date by formal hearing before additional service legally can be directed by the Board, as well as the challenge of the Board’s power to prescribe “adequacy” standards.

While the second Board decision in the *Fort Worth Investigation* is basically in line with the tone of CAB decisions\(^{27}\) rendered between the two Board holdings in the case, it is particularly significant in pointing up, by comparison with the first holding, the fact that the Board, in the two years since the original decision, has changed its views regarding the obligations of an airline to provide adequate service. It is perhaps true that there has been a “radical upgrading” of the standards, as the airlines charge. Just one indication of this is reflected in the Board’s ruling in its original opinion that 38 daily passengers each way with a 60 seat DC-7, which represents a 63 per cent load factor, would not be sufficient to support nonstop service to New York.\(^{28}\) This is to be compared with the determination in the subsequent consideration that the increased traffic number of 51.5 passengers is sufficient to require a provision of nonstop service with a 112 seat jet; this representing a mere 46 per cent load factor.\(^{29}\)

The *Toledo Adequacy of Service Investigation* was initiated by the CAB, upon a joint complaint filed by the City government and the Chamber of Commerce of Toledo, Ohio, to determine whether Capital Airlines had failed to provide adequate service between Toledo and Chicago, Philadelphia and New York, and whether a remedial order should be issued under section 404(a). Consolidated with this proceeding was an investigation, directed by the Board upon its own motion\(^{30}\) to determine whether United Air Lines was providing adequate air coach service\(^{31}\) in the same markets.

The Board’s Examiner issued an Initial Decision\(^{32}\) in which he found that Capital had violated section 404(a) of the Act by failing to provide any through service, either first-class or coach, in the Toledo-Chicago, Toledo-Philadelphia, and Toledo-New York markets. To remedy this inadequacy, the Examiner recommended that Capital should be ordered to provide two daily round trip coach flights in those markets where inadequacy of service was found, for a period of one year.\(^{33}\)

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\(^{26}\) Petition of American Airlines for Reconsideration of Order No. E-15770, October 10, 1960. At the time of this letter, the petition was still under consideration by the Board. See Order No. E-15944 staying the effectiveness of Order No. E-15770.


\(^{28}\) Order No. E-12996, p.7.

\(^{29}\) Order No. E-15770.

\(^{30}\) Order E-12748, dated July 3, 1958.

\(^{31}\) Air coach service sells at approximately 25 per cent lower than first-class accommodation. Its lesser convenience and value to the traveler result chiefly from the installation of additional seats in the aircraft and the absence of free full-course meals. Coach service must be operated in either high seating density equipment or, if operated with first-class seating equipment, be scheduled during less convenient, off-traffic hours. This type of service was begun in 1949 and has taken on more and more meaning since 1951, when United announced plans to vastly increase its air-coach program. Naturally, in this highly competitive industry, other airlines were forced to follow suit, some with even greater expansion. It has grown phenomenally to the point where it now accounts for over 40 per cent of the air market.

\(^{32}\) Docket No. 8851, June 18, 1959.

\(^{33}\) The Examiner found that the only planes which Capital had available were older, fully depreciated, and not suitable for first-class service. Rather than force Capital to compete for first-class fares against United’s newer equipment, he ordered the coach flights.
For the purpose of evaluating the operating results during this trial period, he further recommended that the proceeding remain open.

With respect to United, the Examiner decided that the proceeding should be dismissed, finding that the first-class service provided by United in the markets in issue was adequate *per se*, that Capital had assumed the primary obligation to compete in these markets, and that United's failure to render coach service between the relevant markets did not constitute inadequate service within the meaning of section 404(a) of the Act.

The CAB adopted as its own the findings and conclusions of the Examiner. Thus appeared the beginning of a trend which is likely to see more and more inadequacy of service cases now that the Board has seen fit to exercise its powers to order increased service. This is especially so because of the greater concentration of the airlines industry in long-haul markets, produced by the innovation of jet service.

This case is unique insofar as it directs Capital, the principal defendant, to provide increased service *in competition with* United in the named markets, based upon a finding that the *potential demand* between the four cities involved was not being fulfilled. The Board reasoned that an increase of Capital's service would create competition that would improve United's service and thus “generate the demand necessary to sustain Capital's new flights.” In answer to Capital's contention that such an approach violated the fundamental principle that “adequate service” is a minimum standard of service, the Board looked to the purpose in initially certificating Capital to serve in the markets in dispute. It determined that Capital was selected, in exclusion of all other applicants, for the purpose of providing a competitive service between Toledo and the major population centers of New York, Chicago, and Washington and that “the Board clearly intended that Capital would provide a competitive spur to United, would promote coach service in that area, and would improve regional service in the New York-Philadelphia-Cleveland-Toledo-Detroit-Chicago markets.” Thus, it was felt that Capital's acceptance of this award carried with it the requirement, at the very least, to attempt to provide such service.

The Board found no difficulty in passing upon the remedial order suggested by the Examiner, *i.e.*, that aircoach service would satisfy Capital's minimum competitive obligation. Though there had been no specific finding of a deficiency in

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35 Because of their size, the DC-8 and the 707 cannot be used extensively on routes less than 1,000 miles. Under this range, operating costs of the big jets rise sharply.
36 The carrier relied on the statement in the Fort Worth Service Investigation, Order No. E-12996, Opinion, p. 20, wherein it was said that *adequacy of service under section 404(a) of the Act represents a minimum standard of service which an air carrier is legally obligated to provide and which the Board will undertake to enforce. As such, the adequacy requirement, although part of a statute with strongly promotional objectives, is itself basically a protective more than a promotional provision, designed as a shield to safeguard the public from poor service rather than as a major vehicle for the attainment of maximum service benefits. This does not mean, of course, that an actual deterioration of service is an essential part of a showing of inadequacy, for adequacy is necessarily a relative concept, and therefore changes in local needs, in the conditions affecting a carrier, or in general standards of air service may be such that a formerly adequate service becomes inadequate through failure to provide the required degree of improvement. (Emphasis added.)
38 The result in the 1958 Fort Worth holding was distinguished since, in that decision, the Board recognized that Braniff had “attempted to provide effective competition in the market.”
coach service, but merely a general finding that Capital's over-all service was inadequate in violation of section 404(a), it resolved that the manner in which compliance shall be achieved lay within its sound discretion and that the Examiner's proposed remedy properly balanced the conflicting needs of the carrier and the travelling public. Furthermore, though the Board was convinced of the economic feasibility of aircoach operation in competition with United's first-class service, it would appear to have taken a rather abrupt stand when it countered flatly that any losses resulting from such services constitute the price a carrier must pay in fulfilling the obligations of its certificate. It must be recognized, aside from any ultimate conclusion regarding the Board's new policy, that such an attitude of forced institution of service could easily result in substantial loss to an airline.

It was argued in dissent—that the test in such proceedings should be whether the aggregate of services offered by all carriers in the markets involved constitutes adequate service. This, it was asserted, was the doctrine enunciated by the Board in the Fort Worth Investigation. One Board member maintained that United's Toledo service was not fully adequate per se inasmuch as United offered no coach service. He felt that an inadequacy finding, even assuming that Toledo coach service was in fact inadequate, would have to be made against both carriers. It was further pointed out that, by the majority holding, section 404(a) becomes a promotional and competitive provision, contrary to the Fort Worth doctrine. Even if the reason for a carrier's original certification was to provide competition, the mere fact that competition was lacking would not necessarily require an "inadequacy of service" finding.

On appeal to the Court of Appeals for the District of Columbia Circuit, Capital, apart from its persistent claim that the findings were not supported by substantial evidence, submitted that the Board's order was unlawful for the following reasons: that its requirement of a specific type of service, i.e., coach service, with specific type of equipment, i.e., high density seating equipment, at specific times of the day, i.e., daylight hours, was in excess of the authority granted by the Federal Aviation Act; that its direction of Capital alone to provide coach service in markets which Capital was authorized to serve on an equal competitive basis with United unjustly and unlawfully discriminated against Capital; that its order, by the direction that specified reduced-rate coach services be provided, purported to prescribe passenger rates without the necessary findings of fact required by the Act having been made and without consideration of certain factors prescribed by the Act; and that a requirement to provide uneconomic service constituted a deprivation of property without due process of law.

The argument most strongly urged upon the court by the carrier was based upon section 401(e) of the Act, which provides that "No term, condition, or limitation of a certificate shall restrict the right of an air carrier to add to or change schedules, equipment, accommodation, and facilities...." This, Capital reasoned, prevented the Board from issuing a certificate explicitly limited to first-

39 "However, even if the proposed service should fail to prove economical in this trial period, the rendition by Capital of the minimum service pattern is required under its certificate and section 404(a) of the Act.” Opinion, p. 8. In response to this, Capital stated that "it is obvious that subsidy will be required to support these required operations." This statement was contained in a petition for subsidy which has since been withdrawn. Aviation Week, April 4, 1960, p.47.

40 "The question is not why the Board certificated Capital to serve particular markets. The question is whether the service in the markets is now legally adequate." Brief for Petitioner Capital Airlines in the United States Court of Appeals, March 9, 1960, p.12.

41 Section 1002(d) of the Federal Aviation Act of 1958, 72 Stat. 788, 49 U.S.C. § 1482, specifies the requirements for a direct rate-making proceeding.

42 Section 1002(e), 72 Stat. 788, 49 U.S.C. § 1482 lists a number of considerations to be taken into account in a direct rate-making proceeding.

class or coach service, even if it desired to do so. Since a carrier's "adequate service" obligation must naturally be considered in connection with the authority granted by its certificate, it was said to logically follow that the Board could not legally require this specific coach service since such had not and could not be prescribed in the certificate. The very most the airline would concede to the Board under 404(a) was the authority, after making proper findings based upon substantial evidence, to order a carrier to provide "air transportation."

This and the airline's other arguments, however, failed to persuade the court. The court viewed with favor the holding of the Board that when a carrier is authorized for the purpose of providing competition and never attempts to compete, the fact that other authorized airlines provide minimally adequate service does not discharge the deficient carrier's duties under its certificate. The court upheld the agency's position that the Act must be read as a whole and that the purposes for which an airline is certificated are relevant to the duty to provide adequate service imposed by section 404(a).

In disposing of the contention of Capital that section 401(e) severely limits the Board's authority in issuing an order upon a finding of inadequacy, the court, in what certainly appears to be the most sensible and workable approach, stated: That provision must be read in harmony with the rest of the Act. Section 404(a) requires a carrier to provide "safe and adequate service, equipment and facilities" and section 1002(c) authorizes the Board to issue "an appropriate order" of compliance if it finds that any carrier has failed to observe the requirements of the Act. Capital's argument would emasculate section 404(a), and we are bound to avoid such an absurd result. The Board can not effectively order a delinquent carrier to provide more adequate service unless it can specify in detail what constitutes minimally adequate service.

Of course, this raises the question, "Doesn't section 401(e) thereby become emasculated?" However, the explanation of the function of this provision was given in a subsequent Board holding.

The court rejected the other contentions without discussion. No further court action has been taken in this case.

Another of the significant 404(a) cases decided by the CAB adversely to the airlines is the Washington-Baltimore Adequacy of Service Investigation. The Greater Baltimore Committee filed a petition with the Board requesting investigation of the adequacy of service at Baltimore. Subsequently, the Board itself instituted an investigation to determine (1) whether the domestic certificated carriers were providing safe and adequate service at Washington; (2) if not, whether the Board should compel any such carriers to make use of Friendship International Airport at Baltimore in addition to the Washington National Airport; and (3) whether the certificates of air carriers authorized to serve Washington should be modified to provide that Washington shall be served through Friendship in addition to National Airport. These two investigations were consolidated.

Baltimore's primary allegation was that its air service was inadequate with respect to volume, with respect to equipment, and with respect to amount of single-plane service provided in 77 markets.

The Examiner found inadequacies in only nine of these markets, but the Board found that substantial remedial action beyond that recommended was re-

44 See also, § 1002(a) of the Act, directing the Board to "issue an appropriate order to compel such person (anyone violating other provisions of the Act) to comply therewith."
46 Id. at 52.
48 Petition of the Greater Baltimore Committee, Docket 7978.
quired and ordered improved single-plane service in a total of 23 markets.\textsuperscript{50} While not specifying that service was to be provided with jet, turboprop, or any other particular type of aircraft, the order directed that pressurized equipment be employed on first-class flights.

While much of what was said in this Board ruling is merely a reiteration of the principles discussed above, several significant contributions to the development of the new Board policy may be noted. With respect to the burden of proof in these proceedings, the carriers demanded that the complaining party definitely and affirmatively establish that additional or improved service would be financially successful. Recognizing economic feasibility to be the paramount factor, the Board, nevertheless declared that, because of "special problems,"\textsuperscript{51} the obligation rests upon the carriers to come forward and show that providing additional service would not be economically feasible and that adverse effects would result if the relief were granted.\textsuperscript{52} It was not asking the carriers to sustain the full burden of proof, but was merely imposing the reasonable requirement that the carriers adduce the direct information and facts peculiarly within their knowledge to show adverse impact. Otherwise, it would be a virtual impossibility for the party charging inadequacy to maintain its case.\textsuperscript{53}

Another source of dispute was the so-called "ten-a-day" guideline. Briefly, Bureau Counsel recommended adoption of the suggestion of Baltimore’s economic witness that ten daily passengers was the point at which a carrier should provide a single-plane service. The Examiner’s independent study of 172 city pairs receiving single-plane service over a 28-day period in 1957 showed that approximately two-thirds of these markets generated an average of ten or fewer daily passengers in both directions. In view of the fact that the carriers had found it feasible to provide single-plane service in these markets, the Examiner concluded that the ten passengers a day guide was of major importance in evaluating adequacy of single-plane service. The Board adopted this guideline for purposes of the proceeding, although this was only one of many relevant factors. It regarded the ten-pasengers-a-day test as a general and flexible guide indicating that single-plane service should be provided in a market if other factors are favorable.\textsuperscript{54}

It appears that the Board has converted the fact of what the industry is actually doing into a standard of adequacy for the application of section 404(a).

Subsequent to the Board order, National Airlines, one of the many airlines made party to the proceeding, petitioned the District of Columbia Court of Appeals

\textsuperscript{50} Order E-15162, April 29, 1960. Taking into account markets in which more than one carrier was ordered to provide service, a total of 27 specified additional services were ordered. Scheduling deficiencies were found in four markets.

\textsuperscript{51} The Board listed such factors as the timing of schedules for connections, overnighting problems pertaining to both aircraft and crew, routing of aircraft so they are in the appropriate location for maintenance service and the competing demands of different points and different route segments. Supplemental Opinion and Order on Reconsideration. Order No. E-16061, November 22, 1960, p. 29.

\textsuperscript{52} Several bases were invoked in support of this requirement. First, analogously, in an ordinary route proceeding, it is customary practice for the carrier opposing a proposed route award to come forward with evidence to show undue diversion or other adverse effects upon its existing system. Also, § 7(c) of the Administrative Procedure Act provides in part, "Except as statutes otherwise provide, the proponent of a rule or order shall have the burden of proof." In S. REP. No. 752, 79th Congress, 2d Sess. 22, it is stated, "That the proponent of a rule or order has the burden of proof means not only that the party initiating the proceeding has the general burden of coming forward with a prima facie case but that other parties, who are proponents of some different result, also for that purpose have a burden to maintain." (Emphasis added) Supplemental Opinion and Order on Reconsideration. Order No. E-16061, November 22, 1960, p. 30.


\textsuperscript{54} Order E-15162, April 29, 1960, pp. 17-19.
for review of the Board holding, attacking the ten-a-day test and the two-stop requirement and contending a lack of adequate findings of fact. At this writing, the Prehearing Conference had not yet been held, but was expected shortly.

In the Flint-Grand Rapids Adequacy of Service Investigation, the complaining parties, the Cities and Chambers of Commerce of Flint and Grand Rapids, Michigan, charged Capital Airlines with failing to measure up to its "adequacy of service" obligations. The Board determined that specific deficiencies existed in regard to quality of equipment, dependability of schedules, and amount of single-plane service.

By its failure to use modern pressurized equipment on a reasonable number of flights to the complaining cities, Capital was deemed to have deprived them of adequate service within the meaning of 404(a). The Board took note of the present advanced developmental stage of air travel and concluded that, in light thereof, unpressurized DC-3 and DC-4 equipment could no longer be considered appropriate first-class service.

The agency pointed to the necessity for dependable scheduling and on-time performance, especially in the air transportation industry where speed and saving in time is the primary concern to passengers, in commanding improvement in performance of scheduled flights.

Again relying on the speed factor, the Board ordered single-plane flights with no more than two intermediate stops between Flint or Grand Rapids and the various individual cities involved, finding this necessary for effective transportation.

The CAB took the opportunity at this time to further define the "minimum standard of service" concept of the 1958 Fort Worth holding. It stated that this is "a standard requiring that the public's reasonable needs for service be met in quantity and quality" and that adequacy be "evaluated primarily in relation to normal, recurrent traffic needs, and not on the basis of unusual peak demands."

The role of section 401(e) was clarified and its apparent contradiction with the terms of section 404(a) was sensibly reconciled when it was stated:

That provision [section 401(e)] generally leaves to the discretion of management the choice of schedules, equipment, and facilities until such time as the exercise of that discretion results in denying the public adequate service. It does not, in any way, limit the Board's power to order a carrier to perform additional service, and at whatever times of the day necessary, to meet the public's need for, and right to, adequate service. If we were to follow Capital's argument to its obvious conclusion, the provisions of section 404(a) would not be susceptible to enforcement, and the Board would be powerless to order additional flights in an inadequately served market because they necessarily involve some scheduling changes or adjustments. Plainly, this is not the result intended or stated by the Act.

In what may ultimately be the most important "adequacy" case thus far, the question of how much freedom airline managements should be allowed in establishing coach service on a large-scale basis appears ready for resolution. In the New York Short-Haul Coach Investigation, a CAB ruling is soon to come. It could well be the showdown case which the carriers may see fit to appeal to the Supreme Court.

56 Flights involving more than this, the Board ruled, could not provide usable service and are inadequate if viewed from the standpoint of effective single-plane service. Order E-15162, April 29, 1960, at 24.
58 This was particularly justifiable in this proceeding where the nonstop distances ranged from only approximately 400-600 miles.
60 Docket No. 9973.
The adequacy of the volume of air coach service being operated between nine pairs of points radiating out of New York City, ranging from 150 to 725 miles in distance, is the subject of this latest § 404(a) case. In instituting this action the Board noted that\(^{61}\) the major concentration of coach service was in the long-haul, high traffic density markets, but that there was little or no coach service being rendered some short-haul, top passenger-generating markets. Thus, in the only Board-initiated section 404(a) action, this investigation was instituted for the immediate purpose of ruling on adequacy of service in the specific markets mentioned. In addition, however, the Board declared its intention to consider general standards for the carriers’ guidance in providing such adequate service as may be required in all markets. This, unquestionably, constitutes the most complex and difficult task which the Board has established for itself thus far in dealing with 404(a).

The various trunklines involved adopted the same general approach in opposing the action of the agency.\(^{62}\) Primarily, they asserted that there are no standards which are applicable to all markets under all operating conditions and that an adequacy determination could only be made with respect to one market by specific reference to “all the circumstances” surrounding that particular market. This is especially true since consideration of coach service adequacy entails such great complexity.\(^{63}\) As another reason for their position that the formulation of any coach adequacy standard of general applicability was impracticable, the carriers pointed to the economic infeasibility and inconvenience of coach service in many short-haul markets. It was maintained that, based on actual experience, short-haul coach service does not generate new traffic, especially among the business travelers, because of the relatively insignificant dollar saving which it permits over first-class service and the small time saving over the private automobile with its door-to-door convenience and low cost on trips between nearby cities. It was also advanced that, since coach service makes its strongest appeal to vacation and pleasure travelers, the fact that such passengers frequently travel as families and can fly first-class at reduced family plan fares further undermines the coach-first-class fare differential in short-haul markets. Passengers prefer, the carriers asserted, frequent service to lower fares. Since air coach service, by reason of its lower yield, necessarily requires more passengers per flight to break even than does first-class, it cannot support frequent flights, particularly in short-haul markets where the generating effect of coach service is almost nil. The Examiner, however, disputed the validity of these specific factual contentions and pointed out that the contrary is shown by virtue of the equality of over-all percentages of coach service and use, especially since coach service presently amounts to almost one-half of the total.\(^{64}\) He also found that short-haul coach service is as economically feasible by the use of high density DC-6 and DC-6B aircraft, along with elimination of frills and reduction of expenses by foregoing meals in the short-haul flights, as first-class service, if not more so.\(^{65}\)

On this basis, then, the Examiner determined that a proper standard of adequate service would necessarily have to provide for adequate coach service, if

\(^{61}\) Orders E-13125, October 31, 1958, E-14269, July 27, 1959. Ten of the twelve trunklines and one local “feeder” line were the reluctant parties named to the proceeding.


\(^{63}\) See further, Brief of United Air Lines Submitted to Examiner Paul N. Pfeiffer, September 14, 1960, p. 21, citing the first holding of the Fort Worth Investigation, Order No. E-12996, September 23, 1958, wherein the Board laid down the principle that “Adequacy . . . must be evaluated by a market-by-market appraisal” and that “transportation services and transportation needs inherently pertain to movements of traffic between specific pairs of points, and adequacy must ultimately be determined accordingly.”

\(^{64}\) Initial Decision, December 14, 1960, p. 38.

\(^{65}\) Id. at 49.
the carriers' scheduling policies were to be for public convenience and necessity.\textsuperscript{66} Employing this rationale, the standard of adequacy was given an expanded definition to include not merely a bare minimum of need, but to allow for the requirements of the public for growth and welfare\textsuperscript{67} and to include convenience of facilities offered as well as volume of service.\textsuperscript{68} The standard of adequate, economical, and efficient service was held to require that carriers provide the passenger with the opportunity to make a fair selection between travelling in coach or in first-class service. Moreover, "whether it shall be an even choice or some larger or lesser percentage depends upon the volume of segment traffic flow in the particular market under consideration."\textsuperscript{69}

The Examiner found that the standard required a reasonable round trip frequency, depending upon the volume of traffic in the specific market, during convenient arrival and departure times for commuter business travel. The Examiner then went on to apply this standard to the pairs of points involved in the proceeding, finding various specific inadequacies.\textsuperscript{70}

A Board decision in the \textit{New York Short-Haul Coach Investigation} sustaining, essentially, the views of the Examiner would result in a substantial increase in coach service in short-haul markets, thus making ripe for resolution, perhaps by the Supreme Court, the two widely divergent views. This case, in which the CAB is likely to adopt substantially all of what has been determined, would represent the greatest inroad yet upon management prerogatives. It is doubtful that the Toledo controversy\textsuperscript{71} was sufficiently important for the airlines to press beyond the Court of Appeals, thereby risking an adverse legal precedent. Here, however, the "ruinous intrusion," as the trunklines would call it, is of greater magnitude and reaches into a more complex area of scheduling policy.

One possible alternative to requiring certificated carriers to improve the quality of their air transportation service to smaller communities and short-haul markets, especially in view of the desires of the airlines for long hauls, awakened by the jet age, is substituting local service carriers or "feeder" lines for trunklines at many points, thereby avoiding or remedying adequacy of service problems in many cases. However, this remedy has its limitations, for the Board has recognized that such substitution would, in certain markets, dilute the traffic to such an extent as to interfere with economical service.\textsuperscript{72}

While impressive arguments are advanced on both sides in answer to the question of the extent to which the CAB should regulate, it is evident that the agency has been granted the power to pursue the course it has adopted, charges that the airline scheduling policy is being determined by "administrative fiat" resulting in a "deterioration of CAB efficiency" notwithstanding. Experience thus far indicates there will be much haggling and delay in putting into effect the orders of the Board;\textsuperscript{73} it is probable that a number of complaints will ensue as the Board's policy becomes more clearly formulated.

\textsuperscript{66} In performing its functions, the Board is required by \$102 to consider . . . as being in the public interest, and in accordance with the public convenience and necessity: . . . (c) "The promotion of adequate, economical, and efficient service by air carriers at reasonable charges, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices."

\textsuperscript{67} See also, \textit{Mulcahy v. Public Service Commission}, 117 P.2d 298, 301 (Utah 1941).


\textsuperscript{69} Initial Decision, December 14, 1960, pp. 44-46.

\textsuperscript{70} \textit{Id.} at 49-79.

\textsuperscript{71} \textit{Capital Airlines v. CAB}, 281 F.2d 48 (D.C. Cir. 1960).

\textsuperscript{72} See cases cited, \textit{Flint-Grand Rapids Adequacy of Service Examination}, Order No. E-15161, April 29, 1960, p. 13, n.25.

\textsuperscript{73} The latest developments in the \textit{Fort Worth} case are an example. Petitions for reconsideration before the Board's one-year operating period has expired are likely to cause numerous delays.
Presuming that it is within the power of the CAB to arrange schedules, the question remains whether that power ought to be exercised. While the operating efficiencies and economic factors involved in a systemwide scheduling program may very well result in some costly experiences for air carriers, as a result of the Board's direction of increased service, the needs of the communities involved are also important. The economic impact of air service on cities today is considerable. The airlines are continuously carving themselves a bigger and bigger chunk of intercity passenger traffic, at the expense of railroads and bus companies. Air travel plays an important role in the stimulation of local commerce and in the attraction of new business. The CAB is apparently ready to render the airline industry subservient to the community's objective of promoting traffic potential. Yet it is difficult to determine with whom the balance lies. The jet age has already put airline hopes more than ever at the tender mercies of the CAB and has caused serious financial strain upon the airline industry. Ideally, the resolution of the problem could be effected in guaranteeing recognition of the smaller communities' needs by modification of CAB policy in another area, i.e., by increase of airline fares, if need be.

An interesting sidelight to the CAB's recent policies has been the deep concern expressed by a special study group in a report prepared for the Senate Committee on Interstate and Foreign Commerce, in which an extensive analysis of the various facets of the national transportation policy was made. Inquiry into the recent exercise of power under section 404(a) for purposes of determining whether that regulatory power should be shorn was deemed imperative. It was recognized that "the possibilities are legion" and that regulation through service standards could increase Government regulation of the airline industry "to an extent, when coupled with other regulatory powers...", as to result in virtual Government management of the [air transportation] system." The report said that "we ought not blindly stumble into such a situation" without carefully considering the available alternatives, such as substitution of a stronger carrier, encouragement of mergers to insure adequacy, or substitution of subsidized local service carriers. Thus, the airlines can hope for Congressional action to halt what appears to be "Government assumption of managerial reins as well as regulation."

-Raymond W. Brown, Jr.

Contracts — National Defense Loan Program — Minors' Ability to Disaffirm Educational Loan Contracts Under State Legislation. — In the summer of 1958, as a result of greatly increased concern with the nation's educational system, intensified by public clamor at the launching of Sputnik, the 85th Congress passed the National Defense Education Act. The purpose of the act was to assist in the improvement of the educational system and to encourage capable students to continue their education beyond high school, in order that there might be an adequate number of trained people to meet the defense needs of the nation. Among its features was a provision for establishing a federal loan

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75 Id. at 708.
76 Id. at 698.
77 Id. at 720.
program for capable but needy college students. The act provided for appropriations of $47,500,000, $75,000,000, $87,500,000, and $90,000,000 for the fiscal years ending in June of 1959, 1960, 1961, and 1962, respectively, to be distributed to colleges and universities throughout the several states for the purpose of extending loans to students. For the fiscal years ending in June of 1963, 1964, 1965, and 1966, the appropriations are to be whatever amount is necessary to maintain loans outstanding to students for the completion of their education, or in the words of the House Committee, "to phase out" the program. The loans are to be repaid by installment beginning one year after the student completes college, and are to bear interest at the rate of three per cent, after the commencement of the repayment period. Complete repayment need not be made until the end of the 11th year after the student's graduation. The loans are to be unsecured, although in the case of borrowers who have not yet reached their majority, the administering college may require either security or a co-signer. Loans to any student are not to exceed $1,000 for any one year, nor an aggregate sum of $5,000 for all years. All other terms are left to be set by the participating colleges.

Thus Congress has established an extensive program of financial aid for the furtherance of higher education. However, in doing so, it may have overlooked or underestimated a considerable problem. A very great number of college students are less than 21 years old. This raises the question of what effect the traditional right of minors to disaffirm and avoid their contractual obligations will have upon the National Defense Loan program. Since the collection of such loans will be the responsibility of the colleges and universities involved, an examination of the law of the various states is necessary to determine whether an action could be maintained against a defaulting obligor.

The Right of Disaffirmance at Common Law

The common law, since as early as the 13th Century, has shown a concern for the protection of minors in their contractual dealings with adults. By the 15th Century, it was well settled that minors could, for the most part, free themselves of contractual burdens. The policy behind this legal protection is easily understood and needs no more explanation than to point out that minors, because of their tender years and lack of worldly wisdom, may fall prey to the more experienced and less innocent. Thus the common law provided the safeguard of disaffirmance for minors threatened by enforcement of oppressive bargains.

It was obviously necessary to allow some degree of contractual capacity to enable minors to provide for their basic needs. Therefore, rather than categorically declaring all minors' contracts void, the early common law adopted three classifications. Infants' contracts were to be either void, voidable, or valid. Contracts which were obviously prejudicial to the minor were void ab initio; those clearly advantageous were valid and binding; and those which could not easily be classed as either beneficial or detrimental were voidable by the minor when he reached majority.

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10 2 WILLISTON, CONTRACTS § 223 (3d ed. 1959).
11 Examples: penal bonds, Beam v. Beatty, 4 Ont. L.R. 554 (1902); gifts or deeds without consideration, Robinson v. Coulter, 90 Tenn. 705, 18 S.W. 250 (1891).
12 Tucker v. Moreland, 10 Pet. 58, 9 L. Ed. 345 (1836).
The modern rule is simpler. The earlier attempts to classify contracts as beneficial, detrimental, or indifferent proved confusing and have been discarded. The rule today is that the minor is to decide for himself, upon reaching the age of 21, whether to honor or avoid any of his contracts. Contrary to the earlier rule, he may fulfill even prejudicial contracts if he so chooses or if he feels a moral obligation to do so. Conversely, he is not bound to fulfill all contracts even though they may be fair and reasonable.14

Thus minors’ contracts, as a general rule, are now deemed voidable rather than void.16 They are subject to the minor’s election either to fulfill or disaffirm them. There are cases in which the term “void” is often used for “voidable” but it is well resolved today that infant's contractual obligations, including loan agreements,16 are voidable rather than void.17

The doctrine of disaffirmance and avoidance does not apply to all minors’ contracts. An infant may not avoid his contracts for the acquisition of necessities of life, or, more precisely, he has a duty to pay a reasonable price for necessaries with which he has been supplied.18 Although the liability for value of necessaries is regarded as arising from the contract, it seems that the minor’s liability to pay is quasi-contractual, rather than strictly contractual, since the duty is to pay a reasonable price rather than the agreed price.19

There seems to be only a very general principle for determining whether a given contract is for “necessaries.” The courts uniformly hold that whether any particular thing is a necessary for which the minor must pay depends upon the peculiar facts of each case. The facts which are said to be determinative are the minor’s social position and situation in life20 and his or her parents’ fortune.21 This is indeed a nebulous standard, difficult of application, but it is at least clear that the term “necessaries” is not limited solely to those things indispensable to the minor’s personal support or comfort.22 At the same time, items are not “necessaries” merely because they are useful or beneficial.23

Some sort of education was deemed a “necessary” as early as Lord Coke's time,24 but the extent of this education has also been keyed to the infant’s station in life and this has been generally limited to an elementary or “common school” education.25 The principle that higher education is not a “necessary” may have lost some of its vigor with the passage of time, but it cannot yet be termed dead.26 The extent of its survival will be explored later in this article.

That the right to disaffirm can give rise to serious hardship for persons dealing with minors is recognized. The possibility of this hardship is apparently considered as a necessary, even though unfortunate, aspect of this protective policy of the law. This has been explained by a former assistant attorney general and county judge of Illinois in the following manner:

14 Id. § 12.
16 C.T.S. Infants, § 84 (1943). In re Ferguson’s Guardianship, 41 N.Y.S.2d 862, aff’d
473, 30 N.E. 1119 (1892).
19 Trainer v. Trumbull, 141 Mass. 527, 6 N.E. 761 (1886).
21 International Text Book Co. v. Connelly, supra note 20.
23 Rhodes v. Frazier’s Estate, 204 S.W. 547 (Mo. 1918).
24 Co. LIT. 172, a.
25 St. John’s Parish v. Bronsen, 40 Conn. 75 (1873).
It is well known that the policy of the law is to discourage adults from entering into contracts with minors... and an adult cannot well complain if he violates what he knows, or should know, is an accepted rule of long standing... If the adult loses, it is the penalty for having dealt with an infant.

However, it should be noted that, because there are situations in which the intention to protect minors would not be defeated by requiring them to honor their agreements, the law provides exceptions to the general power of disaffirmance. Already noted in this regard were contracts for necessaries, binding in order that minors might not find themselves unable to acquire essential items. In addition, minors are bound to perform contracts authorized by statute (e.g., marriage, antenuptial agreements, apprenticeship), and contracts in performance of a duty which can be enforced by suits in law or equity. Statutes in some states provide that a minor is bound by contracts entered into in connection with his business. There is also a growing trend to apply principles of estoppel to prevent a minor from disaffirming, particularly in cases involving misrepresentation of age.

Other avenues of relief are open to persons seeking to escape the hardships of the disaffirmance doctrine, among which is the principle of ratification. A minor upon reaching maturity (i.e., majority), but not earlier, may ratify a contract entered into during his infancy. Any manifestation which indicates his intention to be bound will serve as a ratification and destroy his ability to thereafter avoid the agreement.

As a recognition of a principle that a minor should not be allowed to use the law's protection as a means of inflicting injury upon others, the law requires that a minor cannot disaffirm a contract without restoring the consideration which he has received, if it is still in his hands. This does not imply that restoration is a condition precedent to the minor's disaffirming, but it does mean that the other party is allowed a means, the use of which he must himself instigate, by which he can regain possession of what he has given to the minor under the agreement.

Thus it appears that there is a problem with respect to borrowers who are under the age of 21 years. If the contracts of such borrowers are going to be enforcable at their election, there is a possibility of a considerable loss of federal monies. There is no federal law to cover this situation, and the Congress, in its deliberations prior to the passage of the National Defense Education Act, dealt chiefly with questions of the advisability of a federal loan program in general, and only slightly with the question of repayment of loans. Little more was mentioned on the question of default than the comment of Representative Ayres of Ohio to the effect that college students were good loan risks, and of Representative Haskell of Delaware that, "The best guess we can get is that the worst loss would be around 3 or 4 per cent. So the Federal Government, in the long pull, does not stand to lose a great deal of money under the loan program." It may be that

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28 27 AM. JUR. INFANTS § 14 (1940).
29 Id. § 15.
30 For discussion of statutory inroads on infant's power to disaffirm, see 48 COLUM. L.R. 272 (1948).
31 See comment: 36 NOTRE DAME LAWYER 419 (1961).
32 Sanger v. Hibbard, 104 Fed. 455 (8th Cir. 1900).
34 2 WILLISTON, CONTRACTS § 238 (3d ed. 1959).
36 104 CONG. REC. 16712 (1958).
37 104 CONG. REC. 16588 (1958).
Mr. Haskell's conclusion is unwarranted. The appropriations for loans total a definite sum of $300 million, with provision for whatever more is needed to continue loans until the program is "phased out." (House Report No. 2157 contained an estimate that a total of $310 million would be loaned to students in institutions of higher learning under this program.\(^3\)) Should four per cent of these loans prove uncollectible, the total loss would be at least $12 million. This is not a small amount.

**National Defense Loans and The Right of Disaffirmance**

Since minors are invested with the power to avoid their contracts (which, of course, applies to loan contracts as well as others), the next question to examine is whether, in attempting to enforce National Defense Loan contracts, the exceptions to the rule of disaffirmance, such as liability for necessaries, the principle of ratification, or the necessity to restore consideration, are available.

National Defense Loans are given in order that a student may obtain a college education. As a rule, any student obtaining one believes, of course, that he needs it. Yet, is it such a "necessary" as will bind a minor to a contract for its acquisition? Lord Coke defined these "necessaries" as "necessary meat, drink, apparel, necessary physicke, and such other necessaries, and likewise for his good teaching or instruction, whereby he may profit himself afterwards."\(^9\) Obviously some education is considered in the law to be "necessary," but how much? As has been said above, in dealing with questions of necessaries, the courts consistently and uniformly hold that whether a particular thing is a necessary or not depends upon the facts of the individual case.\(^40\) The criteria are the "state, station, and degree in life" of the infant; the standard is often said to be flexible and adaptable to fit the state in life of the infant.\(^42\) As was said in *McLean v. Jackson*,\(^43\) it is nearly impossible to set forth a definition which will be applicable in all cases because of the changes in living habits. What today is considered a luxury may tomorrow be termed a necessity. The Missouri Supreme Court has said that items are not necessaries merely because they are useful.\(^44\) On the other hand, as stated by the highest court of Vermont,\(^45\) the term "necessaries" is not confined to things actually required for subsistence but includes also such things as are useful for the support and comfort of the infant, and for the improvement of his body and mind. *Breed v. Judd*, an 1854 Massachusetts case,\(^46\) did not deal with education, but resolved in passing that a minor's bargain to obtain an outfit to go prospecting in California was enforceable because it provided him with the materials necessary to embark on a new field of labor. This line of reasoning occurs later in the case of *Cory v. Cook*,\(^47\) where the Supreme Court of Rhode Island held that such education as will fit a person for the duties of life in the sphere in which he moves and enable him to earn a respectable living in his chosen vocation is a necessary. This does not seem too far from saying that a college education can be a necessary, but there is a paucity of decisions on the matter. Although there have been several cases dealing with minors' contracts for instruction from correspondence schools,\(^48\) there

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\(^{41}\) Jordan v. Coffield, 70 N.C. 110 (1874).
\(^{42}\) Rhodes v. Frazier's Estate, 204 S.W. 547 (Mo. 1918).
\(^{43}\) 12 Ga. App. 51, 76 S.E. 792 (1912).
\(^{44}\) Rhodes v. Frazier's Estate, 204 S.W. 547 (Mo. 1918).
\(^{46}\) 67 Mass. 455 (1954).
\(^{47}\) 24 R.I. 421, 53 Atl. 315 (1902).
\(^{48}\) LaSalle Extension Univ. v. Campbell, 131 N.J.L. 343, 36 A.2d 397 (1944); International Text Book Co. v. Connelly, 206 N.Y. 188, 99 N.E. 722 (1912); International Text Book Co. v. Doran, 80 Conn. 307, 68 A. 258 (1907).
have been very few dealing with an actual college education. The most prominently cited case of the latter type is Middlebury College v. Chandler.\textsuperscript{49} In that 1844 case, a minor had contracted for his board bill while attending school and was thereafter seeking to avoid the debt. The court held that though a "common school" education is a necessary, a college education in such things as literature and science is not, even though it is undeniably beneficial both to the individual and to the public. It must, of course, be noted that the Middlebury College case was decided nearly 120 years ago. That it was partly attributable to the general uncommonness of college education must be admitted. A more recent holding is that of Moskow v. Marshall,\textsuperscript{50} to the effect that a college education was not a necessary, and, therefore, a dormitory lease contract was not binding on two Harvard students who had moved from a private dormitory to a university lodging. Again, it must be pointed out that even in 1930, fewer people went to college than go today. Nevertheless, it is still not clear that the prevalence of college education has made it a "necessary" for all those attending colleges or universities.

Other cases, which have been concerned with education or business training, show further extension of the reluctance, at least until the present, to include any more than elementary or secondary education in the class of "necessaries." As mentioned earlier, there have been decisions on the question of whether a course of instruction from a correspondence school is a necessary. The decisions in these cases have been uniform in their refusal to give such a status to this type of education. In International Text Book Co. v. Connelly,\textsuperscript{51} it was held that a five year course in steam engineering was not a necessary. Similarly, tuition contracts with correspondence schools were held voidable in La Salle Extension Univ. v. Campbell\textsuperscript{52} and International Text Book Co. v. Doran.\textsuperscript{53} Similar holdings are seen in regard to minors' contracts for instruction at trade or business schools. In Mauldin v. Southern Shorthand and Business Univ.,\textsuperscript{54} involving a contract for a course in stenography, it was held that the evidence did not show that such a course was a necessary, and in Crandall v. Coyne Elec. School,\textsuperscript{55} a minor was held able to avoid a contract for a course of instruction in electricity. It should again be pointed out that in these cases the courts stress the importance of the circumstances of each individual case. The question to be decided is not "What is a necessary in general," but "What is a necessary for the infant in question," in view of his station, capabilities, and circumstances.

There are a number of divorce and support cases which treat the question of whether a college education is a necessary, but these cases are not entirely germane to this inquiry, since they are concerned with the propriety and fitness of a given father supplying a given item to a given child. The element of the father's ability to support is relevant to deciding whether the particular item of support is a "necessary." This element is not present in minors' contracts cases. Moreover, the policy of the law in the latter area is one of protection. For these reasons it is suggested that the definitions of "necessary" made in child-support cases are of limited relevance here.

Cases in which a father was ordered to pay the cost of a child's college education on the basis of its being necessary are not infrequent. In Esteb v. Esteb,\textsuperscript{56} an order requiring a father to pay for the college education of a daughter in the wife's custody was upheld where the facts showed such an order to be justified.

\textsuperscript{49} 16 Vt. 683, 42 Am. Dec. 537 (1844).
\textsuperscript{50} 271 Mass. 302, 171 N.E. 477 (1930).
\textsuperscript{51} 206 N.Y. 188, 99 N.E. 722 (1912).
\textsuperscript{52} 131 N.J.L. 343, 36 A.2d 397 (1944).
\textsuperscript{53} 80 Conn. 307, 65 A. 255 (1907).
\textsuperscript{54} 126 Ga. App. 681, 55 S.E. 922 (1906).
\textsuperscript{55} 256 Ill. App. 322 (1930).
\textsuperscript{56} 138 Wash. 174, 244 Pac. 264 (1926).
desired to be a teacher, was apparently fit to be one, and had little aptitude for business or commercial work. In *Feek v. Feek*, an order to a father to pay for his son's college education was upheld on the basis that the son desired the education in order to "fit himself for a vocation." The court, in each of these cases, pointed out the importance of the facts and circumstances of every case.

On the other hand, it has been held that a college education, no matter how desirable, was not a necessary. Further, in *Halsted v. Halsted*, it was said that "Unlike the furnishing of a common school education to an infant, the furnishing of a classical or professional education is not a 'necessary,' within the meaning of that term in law. . . . It may be that unusual circumstances might make the furnishing of a professional or classical education to an infant a necessary. . . ." Further, in *Haag v. Haag*, it was held that a college education was not a necessary, the court pointing out that in those recent cases in which a father was ordered to pay for college expenses, specific circumstances were considered, such as financial ability, talents of children, nearness of the child to maturity, and the father's willingness to pay, which warranted those results. In *Cohen v. Cohen*, it was said: "It is true that a college education is not a 'necessary,' within the meaning of that term, for which a parent may be held liable in an action instituted by a third party."

It is apparent that the question of what degree of education is necessary is no more settled in divorce and separation cases than it is in the field of minors' contracts. However, because of the recurrent references to the situation and status of the child and to the changing times as determining the necessity of a college education, it is probably not unsafe to say that courts might today be more receptive to the contention that a college education in a given case is a necessity. As an indication that courts may enlarge the scope of the "necessaries" area, the case of *Siegel & Hodges v. Hodges* should be considered. That case involved a suit by a theatrical manager-tutor against a child entertainer for the services rendered by the tutor in training the child for the stage and television. The child proved to be very talented and very successful (although the greater part of his success came after this suit). An attempt was made to avoid the contract with the tutor through the doctrine of infant's disaffirmance. However, the court refused to allow the infant to invoke this doctrine, saying:

Retaining, as we should, the sound policy of great solicitude for the rights of minors who are sought to be saddled with a financial obligation, there may be circumstances where the rendition of services for such a minor are so palpably in his interest, and their withholding would be so detrimental to the development of his proper potentials and growth ability, as to render him liable—in his own best interests—for their fair value.

Thus it must in fairness be said that, although there is a strong possibility that the courts will come to embrace a college education as a necessity, the present state of the law gives no guarantee that such a decision will be reached in any given case. The continual reiteration of the principle that the circumstances of each case will determine whether any item is necessary and the fact that the burden of proof of necessity is on the one seeking to bind the minor lead to the conclu-

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57 187 Wash. 573, 60 P.2d 686 (1936).
58 See, e.g., Calogeras v. Calogeras, 163 N.E.2d 713 (Ohio Juv. Ct. 1959), in which the court pointed out the drastic changes in modern living which demand widespread education; Jackman v. Short, 165 Ore. 626, 109 P.2d 860 (1941); Underwood v. Underwood, 162 Wash. 204, 286 Pac. 318 (1931); Payette v. Payette, 85 N.M. 297, 157 Atl. 531 (1930).
64 *Id.* at 989. (Complaint dismissed on other grounds).
tion that prediction of the outcome of any case involving attempted avoidance of a minor's loan contract is impossible.

Even supposing that it were established that a college education for a student was a "necessary," there would be an additional difficulty in preventing his avoidance, should he attempt it. The common law has differentiated between contracts for necessaries and loans to purchase necessaries, holding that the latter are not binding on minors. An exception was sometimes made if the minor actually used the money to purchase necessities, on the ground that the lender could then, through the application of equitable principles, be subrogated to the rights of the supplier of the necessaries. Since the joinder of law and equity, the minor borrower can generally be bound, but it is noteworthy that the text writers still carefully point out that those who lend money to a minor may not have the same protection as one who actually supplies the necessaries.

Could a student who sought to avoid a National Defense Loan agreement be bound on his note under the doctrine of ratification? Probably not. It is quite true that a ratification of his contract by a minor after reaching maturity will prevent his further avoidance, but this principle will probably be of little or no help in this situation. Under the National Defense Loan program, a student borrower has a year after graduation before repayment must begin. In the usual case of an attempted disaffirmance, no overt act of disavowal would likely take place before the time for repayment arrived. If, at that time, the borrower sought to disaffirm his loan and avoid his note, the sole argument regarding ratification would have to be that his silence from the time he turned 21 until the time of default constituted an implied affirmance of his contract. However, the law allows a reasonable time after attaining maturity in which to disaffirm, and there is a considerable question as to whether mere silence can, in a situation of this kind, amount to a ratification.

What about the payment of installments on the loan? Could a borrower still disaffirm the loan after making partial repayment? The courts hold that any act performed after attaining the age of majority which is inconsistent with the non-existence of a contract amounts to a ratification, although part payment has been held insufficient to constitute a ratification in the absence of a specific promise. It was said, in Kendrick v. Neisz, that "payment of interest or part of the principal after reaching maturity does not constitute a legal affirmance." Nevertheless, if the circumstances surrounding the part payment support an inference of an intention to affirm, a ratification will be found. Therefore, it can only be said that whether a National Defense Loan borrower could be found on the basis of ratification is an open question, impossible of prediction.

Another exception to the ability of a minor to escape from his obligations is reflected in the principle that requires his returning the consideration which he has received when he disaffirms a contract. By the weight of authority, however, when the minor no longer has the consideration which he has received, he has no

66 Randall v. Sweet, 1 Denio. 460 (N.Y. 1845).
67 Hickman v. Hall's Adm., 5 Litt. 338 (Ky. 1824).
68 Price v. Sanders, 60 Ind. 310 (1878).
71 SIMPSON, CONTRACTS § 72 (3d ed. 1954).
74 17 Colo. 506, 30 Pac. 245 (1892).
75 1 WILLISTON, CONTRACTS § 153 (3d ed. 1957).
duty to return it in order to take advantage of the power of disaffirmance. Therefore, since a student borrower would not retain the loan which he received under the National Defense Loan program (he will have immediately used it for his schooling), this doctrine will be of no avail in seeking to prevent his escape without repayment.

The conclusion seems to be, after an examination of the common law, that it is highly questionable whether minors can be bound to their contracts for National Defense Loans. Any benefit in this regard to be gotten from the various exceptions to the rule of disaffirmance must be considered as unpredictable. In no given case can it be known beforehand whether a loan will be enforceable or not—this determination will, of necessity, await the attempts to enforce the note, because of the importance of the circumstances of each case.

State Legislation and Educational Loans

If case law provides no guarantees of enforceability of notes for the educational loans, is there any legislation which will protect the government loan funds? The answer to this question is that, with the exception of eight or nine states, present legislation will not guarantee enforceability of educational loans. There is some recent legislation which will protect the loan program and which may have been intended specifically to deal with the problem of federal loan funds, since these new statutes were passed after the establishment of the National Defense Loan program. New statutes in Indiana, New York, and Virginia specifically provide that minors contracting for educational loans will be bound thereby as if they were adults. Indiana's statute is a good example, since it, in no uncertain terms, provides that minors are to be bound. It reads:

28-5174. Legal disability of minors removed when borrowing money for educational purposes—Students who enter into contracts for loans to finance a college education, or who borrow money to defray the expenses of attending any institution of higher education, notwithstanding that they are under 21 years of age, shall have full contractual capacity to act in their own behalf in the matter of such contracts, and with respect thereto, shall have all the rights, powers, and privileges and be subject to the obligations of persons of full age.

New York's new statute is equally clear and states that no infant who has obtained an educational loan from any institution of higher learning can disaffirm it on the ground of infancy. Virginia's statute provides that any student obtaining a loan to attend any college approved by specified educational associations shall have adult contractual status and shall not be allowed to avoid his contract by reason of infancy.

In addition, statutes of four other states may well have the same effect. The Illinois statute provides that any student who has been accepted in an institution of higher learning in the state "shall be permitted to execute a legally binding promissory note for a loan . . . subject to approval by the institution of higher education attended." Just what effect the terminology of this statute will have (i.e., that the student will be "permitted" to bind himself) is open to doubt, but the intent of the statute seems plain, and on that basis it is likely that the courts would bind the borrowing student.

Georgia has a statute making any note given for an educational loan "from any trust fund" binding. Whether the funds obtained under the federal loan program would be considered as coming from a "trust fund" is the question here.

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77 Lemon v. Beeman, 45 Ohio St. 505, 15 N.E. 476 (1888); Chandler v. Simmons, 97 Mass. 508, 93 Am. Dec. 117 (1861).
78 IND. ANN. STAT. § 28-5174 (1959).
79 N.Y. EDUC. LAWS § 281.
81 ILL. ANN. STAT. ch. 29 § 43 (Smith-Hurd 1959).
82 GA. CODE ANN. § 20-205 (1953).
Strictly speaking, of course, the funds in the hands of the colleges are not in a trust fund.

Oklahoma's statute seems nearly adequate, except for some troublesome terms. It provides that any loan made by, or guaranteed by, a "Federal or State official, body, agency, or instrumentality" shall be binding.\(^8\) Does this cover loans administered through private schools? Or for that matter, is any school the agency or instrumentality of the state? If these questions are answered in the affirmative, the loans will be protected.

By statute in South Carolina, minors are bound to honor notes given in exchange for loans if the loan is for an educational purpose or if it was made with the written consent of the parents or guardian.\(^8^4\) It is interesting that this provision has been on the books in South Carolina since 1923.

These are the only states in which specific statutory provisions seem capable of preventing disaffirmance of educational loans. However, in the states of Iowa, Kansas, Montana, Idaho, and North Dakota, a minor over the age of 18 must restore the consideration in order to disaffirm his contracts. In some of these states he is released from this duty if he no longer has the consideration; in others he is not.\(^8^5\)

Delaware has an interesting provision which, if utilized, would unquestionably safeguard federal loan funds in that state. It provides that the signature, seal, and acknowledgment of any minor over 18 will bind him to an obligation.\(^8^6\)

Other than a few states which reduce the age of majority for girls from 21 to 18, this seems to be the extent of the statutory protection available. To summarize, it appears that in three states, NDEA loans are enforceable; in four more it is quite probable that they are; and in a few more there is a chance for restoration of the loaned funds in case of disaffirmance. This means that in the great majority of the states, there is no more protection against disaffirmance than is offered by the common law.

A subsidiary question arises in considering those states (like Indiana, New York, and Virginia) where a statute clearly makes loan contracts enforceable. Today, great numbers of students attend a college or university in a state other than that of their domicile. What will result for example, in the case of a student from Kentucky, where the common law prevails, who attempts to disaffirm a loan which he obtained from a university in Indiana, where he is statutorily prevented from disaffirming? Can the law of Indiana be used to bind this student even if enforcement must be sought in the Kentucky courts?

It is justifiably said that no area of the law of conflict of laws is more confused than that of the validity of contracts. "Validity" here is used to mean "essential validity" as spoken of by Judge Goodrich\(^8^7\) rather than formal validity (i.e., formalities, proof, authentication, etc.). The confusion is due to the fact that, although there are at least three definite rules pertaining to choice of law as to validity, the courts seem to accept all three rather than select one of them as the accepted principle.\(^8^8\)

The three leading theories for determining the law applicable to validity of contracts are: (1) that the law of the place of making governs;\(^8^9\) (2) that the law of the place where performance is to occur governs;\(^9^0\) and (3) that the inten-

\(^8^4\) S.C. Code § 11-151 (1923).
\(^8^7\) Goodrich, Conflict of Laws § 110 (3d ed. 1949).
\(^8^8\) Ibid.
\(^8^9\) Scudder v. Union Nat'l Bank, 91 U.S. 406 (1875).
\(^9^0\) Hall v. Cordell, 142 U.S. 116 (1891).
tion of the parties controls. In addition, there is growing acceptance of a fourth principle — the "center of gravity" theory set forth in Barber v. Hughes. Under this theory, the law of the state which has "the most significant contacts with the matter in dispute" will apply.

It will not be necessary, for present purposes, to examine the differences in these four theories since it seems that in application to the hypothetical problem above they all reach the same result — namely, that the law of Indiana will apply. The place of making (i.e., where the last act necessary to make the contract binding takes place) will be the university. The negotiations, application, interviews, etc., will be at the university's loan office. A note will be given in return for the loan, and that note will most likely be signed at the same office. This would undoubtedly, then, be the "place of making."

The notes as a matter of course are payable at the university. This would mean that the university is also the "place of performance." As for the "intention of the parties," there is little basis for prediction, since in most cases it is unlikely that the parties would even think about the question of applicable law. Any such intention would be difficult to show in the absence of an express declaration; the inference would probably be that they contemplated the law of the place where they were dealing, Indiana.

It would also seem likely that Indiana would have the most significant contacts with the transaction, under the usual circumstances, so that the "center of gravity" theory would also direct the selection of Indiana law.

There is further basis for the contention that the law of Indiana would apply. Professor Ehrenzweig has explained what he calls the "Rule of Validation," under which, in choice of law problems involving contracts, that law will be applied which will validate the contract. The basis for this rule is the hypothesis that equal parties to a contract intended to be bound and therefore the courts will apply the law which will have that effect. He contends that there is no reason why the "Rule of Validation" should not be applied to married women's and infants' contracts, absent contrary public policy in the forum state.

Thus it seems that where a student obtains a loan from a college or university in a state where such contract would be enforceable (such as Indiana) he will be bound under the contract by the laws of that state, even though his domiciliary state would allow disaffirmance.

Loan Procedures In Use at the Colleges

Since, as has been seen, there are in most states no guarantees against disaffirmance, it would seem that any insurance against loss must be provided by the lending colleges themselves. One such means, which is immediately apparent and which is authorized by the National Defense Education Act, is the requiring of co-signers in extending loans to minor students. With a view toward discovering the procedures currently in use at the universities, a questionnaire was sent to a sampling of institutions throughout the country. Of the 23 universities from which replies were received, 17 stated that they require co-signers on loans to minor students. Six colleges replied that they do not require such indorsement.

91 Andrews v. Pond, 13 Pet. 64, 10 L. Ed. 61 (1839).
92 223 Ind. 570, 63 N.E.2d 417 (1945).
93 1 Williston, Contracts § 97 (3d ed. 1957).
94 Ehrenzweig, Contractual Capacity of Married Women and Infants in the Conflict of Laws, 43 Minn. L.R. 899 (1959).
96 These universities are: Pennsylvania, California (Berkeley), U.C.L.A., Arkansas, Texas, John Carroll, Kansas, St. Mary's (Texas), North Carolina, Yale, Miami (Florida), Kentucky, Ohio State, Oregon, Washington, Wisconsin, and Creighton.
97 These universities are: Minnesota, Colorado, Saint Louis, Iowa State, Notre Dame, and Illinois.
It is interesting to note that the University of Colorado, in granting loans to minors without a co-signer, does so on the assumption that tuition and college living expenses will be deemed "necessaries" by the courts of that state.98 Interesting also is the reply of Saint Louis University that "In accordance with the spirit and advice of the federal officials connected with the National Defense Loans, we have not been requiring a co-signature for these loans even though the student is a minor."99

Iowa State University replied that it does require co-signers, but the form used for the student's note reveals that the required parental signature is only an acknowledgement that the student is applying for a loan with the parent's knowledge.100 The University of Illinois has in the past, required co-signers for National Defense Loans to minors, but since the passage of the 1959 statute mentioned above such indorsement is no longer required. However, for reasons not explained, the university still requires co-signatures for loans from other than federal funds, even though the terms of the statute upon which they rely indicate no basis for the distinction.101

On the whole, the repayment experience of university loan programs has been good. Of course, there as yet has been no experience in regard to repayment of National Defense loans. A good portion of the collection success is probably attributable to the energetic measures used to stimulate repayment. Such things as follow-up letters, refusal to allow registration for subsequent semesters, and threats of notations on students' academic records have been used to persuade payment of overdue loans. In some cases, loans are put in the hands of collection agencies, or with state officers for purposes of instigating legal action. Many universities, however, are reluctant to resort to suit.102

Conclusion

Judging from the generally cautious administration by college officials of their loan programs, it may well be that the chance of serious loss of federal money through defaults or disaffirmance on National Defense Loans will be avoided. Yet it is not amiss to suggest that additional safeguards be erected. In view of the questionable enforcability of minors' loan contracts, and the fact that security or indorsement is by no means universally required, it would appear that a statutory remedy would be of value. There is no reason why the National Defense Education Act itself could not contain a requirement that loans to minors be given only on indorsed notes. An amendment to cover this would very probably do away with the question of unenforcability of minors' contracts in this area. Further state legislation of the type seen in the Indiana, New York, and Virginia statutes would solve the problem quite satisfactorily, but this would have to await the action of the individual state legislatures. Further, the colleges participating in the program could, without the need of legislation, require co-signers for all loans to minors. It is suggested that one or more of these solutions be adopted.

Arthur L. Roule, Jr.

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98 Letter of Apr. 17, 1961, from Ronald M. Brown, Director of Financial Aid, Univ. of Colorado, on file at Notre Dame Law Library.
100 Letter of Apr. 10, 1961, and promissory note form from Edgar P. Swanson, Secretary, Scholarship Awards Committee, Iowa State Univ., on file at Notre Dame Law Library.
MUTUAL STRIKE INSURANCE — POOLING AGREEMENTS — ANTITRUST ASPECTS OF MUTUAL INSURANCE PLANS.—Members of the Association of American Railroads (virtually all of the nation's major rail carriers), recently contracted for strike insurance with the Imperial Insurance Company, Ltd., of the Bahamas. Under the terms of the insurance agreement each policy holder is to be indemnified for specified fixed expenses which must be met during a strike. The insured is entitled to compensation if the strike is illegal under the Railway Labor Act or was begun to enforce demands contrary to the recommendations of an Emergency Board appointed by the President of the United States pursuant to the Railway Labor Act. For this coverage each policy holder pays a yearly premium equalling one day's fixed costs. According to one source this mutual insurance plan was devised by the railroads in anticipation of difficulty in their national campaign to curb "feather-bedding" through the elimination of wasteful work practices.

Another program of reciprocal strike loss payments was recently inaugurated by the airlines. Clearly, these plans reflect growing employer interest in mutual action against financially injurious strikes.

The railroad plan differs from that of the airlines in that the former involves an insurance policy issued by an independent insurance company, while the airlines' plan provides for direct payments to struck airlines by their non-struck associates. The refinements of the "outsider insurer" plan for strike assistance make this the more attractive of the two programs. If the mutual assistance idea spreads to other industries it will probably take this form.

However, the fact that a mutual assistance program is cast in the form of insurance does not insulate it from attack. Labor spokesmen have charged that the plan of the Association of American Railroads would tend to frustrate collective bargaining and prolong strikes. Labor seems to view such insurance plans as powerful employer weapons for curbing union collective bargaining power. For instance, the Brotherhood of Railroad Trainmen recently brought a civil action

2 Losses for which indemnification is provided include: (a) ad valorem and other taxes on carrier property not based on revenues or income; (b) fixed interest on debts less the part apportionable to non-carrier property; (c) mandatory payment to sinking funds provided for in mortgages on the carrier property; (d) interest or dividends on equipment trust certificates or conditional sales agreements; (e) payments on the principal of equipment trust certificates or conditional sales agreements, or rents under leases or trackage agreements covering property used by the carrier in its operations; (f) insurance on carrier property or operations exclusive of this insurance; (g) pensions and payments into pension funds; (h) contractual or fixed obligations incurred in connection with its operations; (i) cost of supervisory, official and other forces necessary in its opinion to preserve carrier's properties in a standby condition and effect resumption of services at the end of a work stoppage. Application for Service Interruption Policy, The Imperial Insurance Company, Limited, Bayparl Building, Parliament Street, Nassau, Bahamas.
3 Benefits are payable during "work stoppages" which include:
   a cessation of work by a part or all of the employees of the Insured for the purposes of enforcing demands made by one or more labor organizations on, or of resisting proposals of, a common carrier by railroad in instances where such cessation of work (a) is contrary to the provisions of the Railway Labor Act or (b) is to enforce demands contrary to the recommendations of an Emergency Board appointed by the President of the United States, pursuant to the Railway Labor Act or (c) is in resistance to the application of recommendations of such an Emergency Board, or (2) where the demands or proposals (a) are directed to or may then or thereafter affect or (b) are made by, Insured Railroads representing more than 50% of the aggregate of Insured Railroads' Daily Indemnities and such an Emergency Board has not been appointed or, if appointed, such Board has failed to make definite findings or recommendations on the merits thereof. (Ibid.)
against the Association of American Railroads charging illegal activity under the insurance program.\textsuperscript{7} The complaint in that case challenged the insurance plan on several grounds; undoubtedly, other plans would be open to still further claims of invalidity. However, this note will consider only the restraint of trade aspects of such programs.

The "strike insurance" plans might be found to be illegal in two ways: as "conspiracies" prohibited by the Sherman Act, or as unlawful pooling agreements under the Interstate Commerce Act or the Federal Aviation Act. These two are closely related. However, Congress has chosen to single out pooling agreements (as particular types of agreements affecting trade) to be put under the control of the Interstate Commerce Commission and the Civil Aeronautics Board. Thus, if strike insurance violates federal law, members of certain industries may violate the Interstate Commerce Act or the Federal Aviation Act as well as the Sherman Act.

\textbf{Strike Insurance Plans as Pooling Agreements}

At the present time section 5(1) of the Interstate Commerce Act requires every common carrier within the jurisdiction of the act to submit for approval every "... contract, agreement, or combination with any other such common carrier or carriers for the pooling or division of traffic, or of service, or of gross or net earnings, or any portion thereof."\textsuperscript{8} Failure to submit any "pooling agreement" for Commission approval is unlawful,\textsuperscript{9} each day of its continuance is a separate offense,\textsuperscript{10} and a carrier guilty of an "unlawful act" will be liable to persons injured as a result thereof for the full amount of damages sustained.\textsuperscript{11} Approval by the Commission of "pooling agreements" follows when, after hearing, either upon request of a carrier or on its own initiative, the Commission is of the opinion that "[T]he pooling or division ... of their traffic, service, or gross or net earnings, or of any portion thereof, will be in the interest of better service to the public or of economy in operation, and will not unduly restrain competition. ..."\textsuperscript{12}

Congress has never defined just what constitutes a "pooling" agreement within the meaning of the Interstate Commerce Act. However, section 5 of the original Act of 1887 was directed at the prevention of specific evils recognized at common law which, when spelled out along with cases decided under this section, describe, define, and limit the meaning of "pooling" as used throughout the Commerce Act.

At common law the distinction was drawn between pooling contracts and contracts for the maintenance of fair rates and the prevention of ruinous competition:

If a contract is simply one wherein provision is made for preventing ruinous competition and is neither intended to nor does limit or suppress fair competition and is neither intended to nor does fix or maintain unreasonable rates of fare, then it cannot be regarded as an illegal pooling contract, but must be regarded as a valid traffic contract. If there is no restraint placed upon any one of the contracting companies, if all are left free to perform their duties, and if there is no incentive or inducement to any one of them to neglect or refuse to perform its duty there is not, as it seems to us, any illegal element in the contract. But if the contract either in terms or in effect disables any one of the contracting companies for performing its duty or makes it to its interest not to perform its duty the contract should, as we believe, be held void as against public policy.\textsuperscript{13}

\begin{footnotes}
\item[9] Ibid.
\item[10] Ibid.
\end{footnotes}
In *Chicago, M. & St. P. R.R. v. Wabash, St. L. & P. R.R.*,\(^{14}\) decided after but arising before the enactment of the Interstate Commerce Act, seven railroad companies had entered into contracts to integrate traffic of each party into the railway systems of the other parties. Rates charged were to be the additive rates of the parties over whose lines traffic moved. Rates could be reduced by a party when necessary to meet outside competition from rail carriers not parties to the agreement. Rate reduction was not permitted longer than necessary to meet competition, and permission to reduce rates could be withheld if the other parties to the contract considered such action unnecessary. All revenue received pursuant to traffic over the lines in accordance with the agreements was to be pooled in a common fund. The money in the common fund was to be divided among the parties to the contract. This set of contracts contemplated the physical division of traffic (where possible) according to fixed proportions; when this could not be done the objective was to be accomplished by the pooling and division of gross earnings of parties according to the same proportions.

The court held that the purpose of these contracts was not to facilitate carrying freight at reasonable rates, but to stifle all competition so that rates could be raised. The seven companies were operated as one. Between them there could be no competition; the carriers lost every incentive to afford the public proper facilities. The court noted that the necessary result of such contracts is poorer service and higher rates, and declared the agreement void as against public policy. The court refused to enforce any party's claim under the contract.

This is the type of contract at which section 5 of the Interstate Commerce Act is aimed.\(^{15}\) It is typical of those contracts and combinations labeled “pooling agreements” at common law.

In the case of *Central Trust Co. v. Ohio Cent. R.R.*,\(^{16}\) three railroads contracted to divide their total business among themselves at 54\(\frac{1}{2}\)%, 27, and 18\(\frac{1}{2}\)% per cent. Any party receiving more than its share of the business was to pay over excess revenue to a party receiving less than its share. In a suit to enforce payment the court readily labeled the agreement a “pooling” contract but did not decide its validity. The court ordered payment on the grounds that the petitioner had performed his part of the contract, and defendant had not rescinded earlier; thus good faith required that the proceeds arising from operation under the contract be paid over without regard to the validity of the original contract. The decision was condemned in a subsequent case.\(^{17}\) The railroads involved in *Denver & N. O. R. Co. v. Atchison, T. & S. F. R. Co.*\(^{18}\) had entered into an agreement to divide traffic in a certain section of the country. The court held the agreement to be “pooling” and void as against public policy.

A close analysis of the foregoing cases reveals that each contract voided as “pooling” actually involved a “pool,” that is, a division of traffic or revenue according to fixed proportions. Secondly, in each case where an agreement was labeled a pool, the parties to the agreement were competitors as to the subject matter of the agreement. That competition is an essential element of “pooling” is borne out by *Ex Parte Koehler*,\(^{19}\) in which the contract involved was held valid as against a charge that it constituted a “pooling agreement.”

Pooling freights or dividing earnings is resorted to by rival and competing lines of railway as a means of avoiding the cutting of rates, which, if persisted in, must result in corporate suicide. It is not apparent how a division of the earnings of two such roads can concern or affect the public, so long as the rate of transportation on them is reasonable. But assuming,

\(^{14}\) 61 Fed. 993 (8th Cir. 1894).
\(^{15}\) 5 ELLIOT, RAILROADS § 2556 at 431 (3d ed. 1921).
\(^{16}\) 23 Fed. 306 (C.C.N.D. Ohio 1883).
\(^{17}\) *Chicago, M. & St. P.R.R. v. Wabash, St. L. & P.R.R.*, 61 Fed. 993, 999 (8th Cir. 1894).
\(^{19}\) *Ex Parte Koehler*, 23 Fed. 529 (C.C.D. Ore. 1885).
what is not admitted, that the legislature has the power to prohibit the
practice, the Oregon & California and the Oregonian railways do not
appear to be competing ones,—the latter serving as a feeder, branch,
or continuation of the former. Nor is the arrangement between them a
pooling one, but simply one by which each carries for the other at a fixed
price, per ton per mile.\textsuperscript{20}

In 1887 the Interstate Commerce Act was passed.\textsuperscript{21} Its purpose was to assure
proper transportation service to the public at reasonable rates by requiring carriers
to conduct their business in competitive fashion. Competition was still viewed as
the means to the most efficient transportation system, and it was recognized that
in the absence of government control carriers refused to compete. Instead, they
combined in various ways to restrict competition and to raise prices. Among the
means used to restrict competition was the “pooling” agreement discussed above,
wherein competitors made physical divisions of traffic or revenue. To curb this
anti-competitive tactic the Interstate Commerce Act provided:

\begin{quote}
[It shall be unlawful for any common carrier subject to the provisions of
this act to enter into any contract, agreement, or combination with any
other common carrier or carriers for the pooling of freights of different
and competing railroads, or to divide between them the aggregate or net
proceeds of the earnings of such railroads, or any portion thereof; and in
any case of an agreement for the pooling of freight as aforesaid each day
of its continuance shall be deemed a separate offense.\textsuperscript{22}
\end{quote}

That “pooling” as condemned by the Act was the same offense regarded as
“pooling” at common law and embodying the same essential elements is borne
out in cases decided subsequent to the passage of the Act.

The fifth section prohibits what is termed “pooling”... Prior to the
passage of the act the companies had sometimes endeavored to regulate
competition and to maintain rates by pooling arrangements, and in the
act that kind of an arrangement was forbidden.\textsuperscript{23}

The agreement involved in that case was not held to be a pooling agreement be-
cause while it established rates among competing carriers, it did not involve any
actual division of traffic or revenue among the various lines.\textsuperscript{24} That “division of
traffic or revenue” was an element of “statutory pooling,” as it was of “common
law pooling,” is further shown in the leading case of \emph{In re Pooling Freights}.\textsuperscript{25}

The statute contemplates two methods of pooling, both of which are
prohibited: First, a physical pool, which means a distribution by the car-
riers of property offered for transportation among different and com-
peting railroads in proportions and on percentages previously agreed upon;
and, secondly, a money pool, which is described best in the language of the
statute, “to divide between them (different and competing railroads) the
aggregate or net proceeds of the earnings of such railroads, or any portion
thereof.”\textsuperscript{26}

Likewise, statutory pooling contemplated divisions of traffic or revenue between
competitors as to the subject matter of the pooling agreement. In a case\textsuperscript{27} involving
the Southern Pacific railroad, which had established legal joint through rates with
its eastern connections but was losing business because connecting carriers were
diverting traffic by an elaborate system of rebates, the Supreme Court approved a
contract whereby the initial carrier had the right to prescribe the routing of freight
continuously to the terminal point. The Court held that there was no rate com-
petition among connecting carriers because of the previously established through
rates. Thus freights were not being pooled within the meaning of the pooling pro-
visions of the Commerce Act.

\begin{footnotes}
\item[20] Id. at 534.
\item[21] 24 Stat. 379 (1887).
\item[22] 24 Stat. 380 (1887).
\item[23] United States v. Trans-Missouri Freight Association, 166 U.S. 290, 315 (1896).
\item[24] Ibid.
\item[25] 115 Feb. (D.G. Tenn. 1902).
\item[26] Id. at 589.
\item[27] Southern Pacific Co. v. ICC, 200 U.S. 536 (1906).
\end{footnotes}
The Circuit Court, in order to arrive at its result, necessarily treated the connecting carriers as rival and competing transportation lines for this freight, and assumed that between these lines there would exist, but for the routing agreement, a competition for the fruit transportation which could not be extinguished by any agreement as to routing, as a condition for making through tariff rates; that as competition was destroyed by this rule, it was idle to say that such result was not intended by the defendant, and so it was held that the carrying out of the routing agreement violated the act.

We think these various roads were really not competing roads within the meaning of the fifth section of the Commerce Act, when the facts are carefully examined.\(^\text{28}\)

Against this background of cases Congress passed the Transportation Act of 1920.\(^\text{29}\) A new national transportation policy was thereby enacted, best described in the words of the Supreme Court in \(\text{McLean Trucking Co. v. United States;}^{\text{30}}\)

The national transportation policy is the product of a long history of trial and error by Congress attempting to regulate the nation's transportation facilities beginning with the Interstate Commerce Act of 1887. For present purposes it is not necessary to trace the history of those attempts in detail other than to note that the Transportation Act of 1920 marked a sharp change in the policies and objectives embodied in those efforts.\(^\text{31}\) Thereafter, the effort of Congress had been directed mainly to the prevention of abuses; particularly, those arising from excessive or discriminatory rates; and emphasis on the preservation of free competition among carriers was part of that effort. The Act of 1920 added "a new and important object to previous interstate commerce legislation." It sought "affirmatively to build up a system of railways prepared to handle promptly all the interstate traffic of the country."\(^\text{32}\) And in administering it, the Commission was to be guided primarily by consideration for "adequacy of transportation service . . . its essential conditions of economy and efficiency, and . . . appropriate provision and best use of transportation facilities. . . ."\(^\text{33}\)

Congress wanted the national transportation system to be freed of cutthroat competition.\(^\text{34}\) Consistent with this new policy, Congress amended section 5(1) of the original Interstate Commerce Act to permit approval of "pooling" agreements if they were in the interest of better services to the public, or resulted in economy of operation, and did not unduly restrain competition. This is substantially the form in which section 5(1) exists today. Subsequent amendments of

\(^{28}\) Id. at 559.
\(^{29}\) 41 Stat. 480 (1920).
\(^{30}\) 321 U.S. 67 (1943).
\(^{31}\) Id. at 80-81.
\(^{32}\) Drayton, \textit{TRANSPORTATION UNDER TWO MASTERS,} 15 (1946).
the Act have been in accordance with this first major change.\textsuperscript{33}

While the 1920 amendment gave the Interstate Commerce Commission power to approve certain “pooling” agreements, Commission jurisdiction over “pooling” agreements remained essentially unchanged. That is, every pooling agreement, whether approvable or not, was required by law to be submitted to the ICC for consideration. The determination of “pooling” was made in accordance with the common law definition, an agreement for division of traffic or revenue between competitors as to the subject matter of the agreement.

In \textit{Boston \\& Maine Railroad Pooling Etc., Application}, \textsuperscript{34} the ICC, citing common law and pre-1920 authorities, emphasized that a competitive relationship between the parties is necessary to a finding that a contract constitutes “pooling.”\textsuperscript{3}\textsuperscript{5} The agreement involved in the case was held to be a pooling agreement only after extensive consideration of the facts wherein the Commission showed that two of the parties to the agreement competed with each other for business which the agreement sought to regulate.

An important case of this point is \textit{Petition of Dining Car Employees}.\textsuperscript{3}\textsuperscript{5} The Dixie Flyer trains between Chicago and Jacksonville, Florida, operated over the lines of four railroads. Between Evansville, Indiana, and Nashville they used the Louisville \\& N. R.R. lines, and between Nashville and Atlanta the Nashville, C. \\& St. L. R.R. lines. The Nashville, C. \\& St. L., having abandoned all dining car service save that required to serve the Dixie Flyer trains, and wishing to end dining car service completely, entered into an agreement with the Louisville \\& N. whereby that line would handle the dining car service for the Dixie Flyer trains for the entire route between Evansville and Atlanta. The dining car employees of the Nashville, C. \\& St. L. maintained that this amounted to a pooling agreement. The ICC held otherwise on the grounds that there was “no element of competition between the two railroads so far as dining car service is concerned.”\textsuperscript{3}\textsuperscript{6}

A pooling agreement was found in \textit{Express Contract}, 1929.\textsuperscript{3}7 It was urged that section 5(1) did not apply to the express business because “there was an absence of competition between the carriers involved insofar as the express business was concerned.” Jurisdiction of the Commission was founded upon a showing that, historically, railroads and other carriers had competed in the business of transporting small parcels.

In \textit{Application of Pullman},\textsuperscript{3}8 decided after a change in section 5(1) in the Transportation Act of 1940, the Interstate Commerce Commission stated:

\textit{There is nothing in the legislative history of the 1940 Act to evince an intention on the part of Congress to depart from the long-continued provision limiting the effect of the prohibition to competing carriers and to bring under the control of the Commission any contract dealing with the subject matter of the section regardless of a competitive relation between the parties. . . . The word “pooling” itself contemplates a competitive relationship between the parties to the pool.}\textsuperscript{3}9

As these cases demonstrate, statutory “pooling” occurs and Commission approval is required only when agreements provide for a division of traffic or earnings among competitors.

The question arises whether a system of insurance would constitute a “division of earnings,” and thus a “pool.” There are no cases directly on point. However, pooling has been found in agreements which, at first glance, indicated no division of traffic or revenue. Perhaps the most significant case was \textit{Proposed

\textsuperscript{33} Emergency Transportation Act of 1933, 48 Stat. 211 (1933); Transportation Act of 1940, 54 Stat. 898 (1940).
\textsuperscript{34} 298 I.C.C. 703 (1956).
\textsuperscript{35} 292 I.C.C. 783 (1954).
\textsuperscript{36} Id. at 786 (emphasis added).
\textsuperscript{37} 275 I.C.C. 799 (1951).
\textsuperscript{38} 259 I.C.C. 41 (1944).
\textsuperscript{39} Id. at 45.
Pooling of Railroad Earnings. The railroads which used Pullman sleeping cars had entered into an agreement to purchase the stock of the Pullman Company. The Commission determined that competition existed among the railroads as to sleeping car service because in the absence of a company such as Pullman the railroads might undertake to furnish their own sleeping car service. It found a pooling of revenues, also:

Where earnings from sleeping-car traffic in the case of a given railroad were large enough to afford a surplus for equal division between the railroad and Pullman under this contract, they would constitute pooled earnings, for the amount would be determined by agreed percentage of Pullman operating expenses, and Pullman's half would be available for distribution to all stockholder railroads as dividends, which, if declared, would be payable without regard to the profitableness of the sleeping-car business on the line of any particular recipient of the dividends.

The Southern Railway & Steamship Association, as part of an agreement to control traffic and maintain rates in a common market, provided for fines and penalties for violation of agreement provisions. The Interstate Commerce Commission decided that these fines and penalties were substitutes for balances which would be due under a regular pooling agreement.

In response to the contention that insurance premiums and payments constitute a division of earnings and thus “pooling” it quickly appears that strike insurance simply does not fit the traditional concept of “pooling.” “Pooling” at common law and under the statutes has always involved division of profits or divisions of control, matters as to which the parties to agreements compete. Strike insurance involves cooperative action at another level. It involves divisions of risk. Every business is subject to the possibility of strike loss. Only through cooperative action can the amount of loss be reduced. Only by means of an annual premium payment can the loss be spread so that each unit of production, whether marketed prior or subsequent to the occurrence of the contingency, be required to bear a proportional part of the cost. Parties do not compete as to risk reduction in the same sense that they compete as to profits and control.

Admittedly, risk is related to profit. The relationship, however, seems analogous to the relationship of expense to profit. Indeed, risk is a form of expense, fortuitous expense. The cases indicate that collective action for the purpose of reducing expenses does not constitute “pooling.” In Transco Sys. Inc.-Pooling, interstate freight carriers formed a cooperative organization to handle the routing and interlining of freight among them. Routing and interlining were necessary operations in the business and contributed to efficient service. The expenses of the organization were paid by the carriers. No “pooling” of traffic or services, or gross or net earnings was found.

In Pacific Greyhound Lines-Pooling, an agreement under which one busline rented the facilities of a competitor was held to be cooperation, but not pooling. The agreement left the competitors free to operate as they saw fit.

In Greyhound Corp.-Purchase-B.C. Motor Trans., competitors sought to reduce costs by using coordinated schedules and common terminals and garages, as well as otherwise cooperatively performing services, but retained all revenue from their separate operations. The Interstate Commerce Commission held:

In a number of proceedings involving somewhat similar circumstances as those here presented, it has been found that an arrangement amounting only to a measure of cooperation between carriers principally for the purpose of facilitating their services without a division of traffic to which each

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40 268 I.C.C. 473 (1947).
41 Id. at 479.
43 39 M.C.C. 501 (1943).
44 57 M.C.C. 185 (1950).
45 60 M.C.C. 643 (1954).
contributes, or a pooling of the revenues in which it shares according to some agreed formula otherwise than according to individual performance, does not constitute "pooling" within the meaning of the act.\(^{46}\)

These cases seem to bear out the distinction which has been made. Direct divisions of profits, direct divisions of control constitute "pooling." Cooperative agreements to reduce expenditures, not immediately related to profits and at a level at which competition is not imperative, do not constitute "pooling." It is submitted that agreements to divide risks, being in the nature of expenditure reduction agreements, should not be regarded as "pooling" agreements.

**Strike Insurance and the Anti-Trust laws**

It has been asserted that strike insurance programs violate the anti-trust provisions of the Sherman Act. Section 1 of that Act makes illegal "[E]very contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce among the several states, or with foreign nations. . . .\(^{47}\) Restraints of trade were recognized well before the passage of the Sherman Act in 1890.\(^{48}\) One of the earliest restraints of trade was that imposed by the covenant not to compete.\(^{49}\) In the latter half of the nineteenth century new devices were formed to restrict competition. These in the main took the form of agreements or combinations among competitors, fixing prices, pooling profits, dividing territories, or limiting output.\(^{50}\) All were held void and unenforceable at common law. The Supreme Court has repeatedly interpreted the Sherman Act as aimed at preventing trade abuses illegal at common law.\(^{51}\)

In conjunction with an examination of the pertinent common law prior to enactment of the Sherman Act examination of the legislative history of the act is important. As Chief Justice White stated in the *Standard Oil* case, "The unanimity with which foes and supporters of the bill spoke of its aims as the protection of free competition, permit use of the debates in interpreting the purpose of the act.\(^{52}\) The legislative process began in 1888, when offered by Senator Sherman to investigate "such measures as it may deem expedient to set aside, control, restrain, or prohibit all arrangements, contracts, agreements, trusts or combinations between persons or corporations, made with a view, or which tend to prevent free and full competition. . . .\(^{53}\) In the Senate debates the evils aimed at were combinations which "control prices,"\(^{54}\) "limit production," and "destroy competition."\(^{55}\) In the House the bill was interpreted as intended to prevent arrangements having a tendency to drive out competition.\(^{56}\)

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\(^{46}\) *Id.* at 653.


\(^{48}\) Apex Hosiery Co. v. Leader, 310 U.S. 469, 497 (1940).

\(^{49}\) 32 Col. L. Rev. 291, 293 (1960).

\(^{50}\) *Ibid.*

\(^{51}\) The United States Supreme Court said in *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 497, 98 (1940):

> The common law doctrines relating to contracts and combinations in restraint of trade were well understood long before the enactment of the Sherman law. They were contracts for the restriction or suppression of competition in the market, agreements to fix prices, divide marketing territories, apportion customers, restrict production and the like practices, which tend to raise prices or otherwise take from buyers or consumers the advantages which accrue to them from free competition in the market. Such contracts were deemed illegal and were unenforceable at common law. . . . In enacting the Sherman law they (legislators) took over that concept by condemning such restraints wherever they occur in or affect commerce between the states.

\(^{52}\) Standard Oil Co. v. United States, 221 U.S. 1, 50 (1911).

\(^{53}\) 19 Cong. Rec. 6041 (1888).

\(^{54}\) 21 Cong. Rec. 2471 (1889).

\(^{55}\) *Id.* at 2558.

\(^{56}\) *Id.* at 4089.
Summing up the legislative and common law background of the Sherman Act the Supreme Court said in 1940:

The legislative history of the Sherman Act, as well as the decisions of this Court interpreting it, show that it was not aimed at policing interstate transportation or movements of goods or property. The legislative history and the voluminous literature which was generated in the course of the enactment and during the fifty years of litigation of the Sherman Act give no hint that such was its purpose. It was another and quite a different evil at which the Sherman Act was aimed. It was enacted in the area of "trusts" and of "combinations of businesses and of capital organized and directed to control of the market by suppression of competition in the marketing of goods and services by the monopolistic tendency of which had become a matter of public concern. The end sought was the prevention of restraints to free competition in business and commercial transactions which tended to restrict production, raise prices or otherwise control the market to the detriment of purchasers or consumers of goods and services, all of which had come to be regarded as a special form of public injury.

For that reason the phrase "restraint of trade" which . . . had a well-understood meaning at common law was made the means of defining the activities prohibited. The addition of the words "or commerce among the several states" was not an additional kind of restraint to be prohibited by the Sherman Act but was the means used to relate the prohibited restraint of trade to interstate commerce for constitutional purposes. . . . A second significant circumstance is that this Court has never applied the Sherman Act in any case, whether or not involving labor organization or activity, unless the Court was of opinion that there was some form of restraint upon commercial competition in the marketing of goods or services.57

Until 1911 it had generally been conceded that the Sherman Act applied to every restraint, reasonable or unreasonable. That year, in Standard Oil Co. v. United States,58 the Supreme Court set forth the famous "rule of reason":

Thus not specifying but indubitably contemplating and requiring a standard, it follows that it was intended that the standard of reason which had been applied at the common law and in this country in dealing with subjects of the charter embraced by the statute, was intended to be the measure used for the purpose of determining whether in a given case a particular act had or had not brought about the wrong against which the statute provided.59

According to this interpretation placed upon the Sherman Act, the Supreme Court seems to have created a supplementary rule of per se violation. Fashion Originators Guild of America, Inc. v. FTC60 is a notable case. The fashion designers wished to protect themselves against persons who copied their styles and sold low priced imitations. They worked out an agreement whereby no manufacturer who made or retailer who sold imitations could make or market the originals. The designers argued that this plan was reasonable and necessary for their protection. But the Supreme Court held: "[T]he reasonableness of the methods pursued by the combination to accomplish its unlawful object is no more material than would be the reasonableness of the prices fixed by unlawful combination."61

Despite this and other per se violation cases,62 the "rule of reason" retains vitality.63 Indeed one authority asserts that the rule is applied even in the per se cases.64 The above quoted passage from the Fashion Originators opinion may indicate only that the "reasonableness" under consideration is not the reasonableness of the method in relation to its purpose, but the reasonableness in relation to the effect upon competition and the flow of goods.

57 Apex Hosiery Co. v. Leader, 310 U.S. 469, 495 (1940).
58 221 U.S. 1 (1911).
59 Id. at 60.
60 321 U.S. 457 (1941).
61 Id. at 468.
No formula can be stated which will in all cases mechanically decide what constitutes a “restraint of trade” within the Sherman Act. In such a complex area there are definite evils at which legislation is aimed, but any attempt to specify and enumerate particular acts constituting violation must fail. Any statute or decision which made such an exclusive enumeration would promote its own avoidance. The facts of each particular case must be analyzed to determine whether there is a violation of the Act. The Supreme Court recognized this in 1916 when it decided that the “call” rule of the Chicago Board of Trade did not violate section 1 of the Sherman Act. The Court stated:

But the legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider facts peculiar to the business to which the restraint was imposed; the nature of the restraint, and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.

Thus where a group of bituminous coal producers formed a corporation to act as the common selling agent for the whole group the Court held the agreement outside the scope of the Sherman Act provision. The Court saw fit to consider the economic condition of the defendant coal producers in order to be able to fairly judge the case:

It is therefore necessary in this instance to consider the economic conditions peculiar to the coal industry, the practices which have obtained, the nature of defendant’s plan of making sales, the reasons which led to its adoption, and the probable consequences of the carrying out of that plan in relation to market prices and other matters affecting the public interest in interstate commerce in bituminous coal.

At this time the economic condition of the coal industry was poor. Coal was losing markets to oil, natural gas, and water power and greater efficiency in use of coal was cutting down demand. The Supreme Court felt that if existing evils could not be corrected they could at least be alleviated. It was convinced that the plan was an honest effort to remove abuses, to make competition fairer, and promote the interests of commerce. Consequently, the Court held:

Voluntary action to rescue and preserve these opportunities, and thus to add in relieving a depressed industry and in reviving commerce by placing competition on a sounder basis, may be more efficacious than an attempt to provide remedies through legal processes. The fact that the correction of abuses may tend to stabilize a business, or to produce fairer price levels, does not mean that the abuses should go uncorrected or that cooperative endeavor to correct them necessarily constitutes restraint of trade. The intelligent conduct of commerce through the acquisition of full information of all relevant facts may properly be sought by the cooperation of those engaged in trade, although stabilization of trade and more reasonable prices may be the result.

The Court also found that there would still be sufficient competition for the members of the association from producers not parties to the plan.

The situation in the railroad industry and presumably in other industries which might adopt strike insurance pacts is analogous to the situation in the coal industry in 1933. Strike insurance, like the joint selling plan of the coal operators, is a voluntary cooperative undertaking to eliminate financial difficulties. Yet

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65 Chicago Board of Trade v. United States, 246 U.S. 231, 238-39 (1917).
66 Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933).
67 Id. at 361.
68 Id. at 374.
Appalachian Coal is not precedent for subjecting strike insurance to judicial inspection under the anti-trust laws, much less for a similar holding, because the natures of the plans are basically different. The coal operators' plan provided for a combination of competitors in the matter of selling. That is a classic area of anti-trust violations. Strike insurance has no immediate relationship to the selling function of business. It is most closely associated with the hiring of labor and two cases dealing with employment practices and the anti-trust laws must be considered.

In Anderson v. Shipowners Association,69 a seaman, a member of the seamen's union, sued an association of shipowners. The members of the association had entered into an agreement to regulate employment under which every seaman was required to register with the association and be employed in turn according to number. He could not be employed at the will of an individual shipowner, nor could he choose his ship or the job which he would perform. The Court held that the effect of the combination, both as to seamen and owners was precisely what the Sherman Act condemned. The Court continued, "These ship owners and operators having thus put themselves into a situation of restraint upon their freedom to carry on interstate and foreign commerce according to their own choice and discretion, it follows as the case now stands, that the combination is in violation of the Anti-Trust Act."70

Strike insurance is distinguishable from this sort of case in at least two respects. First of all, the shipowners' agreement was directed specifically at regulating employment; strike insurance is not so directed. Secondly, the shipowners' combination placed the association in control of the individual owners. Thus the association could effectively prevent any shipper from competing. This is not true of strike insurance. A business can settle its labor difference and resume operations without any approval of the insurer or the other insured parties.

Union Circulation Company v. FTC71 involved another group plan relating to employment practices. Magazine subscription agencies had been continually defrauded by solicitors. In order to induce solicitors to accept agency discipline the agencies agreed not to hire any solicitor who had been employed by another agency within a certain period of time. This agreement was held to violate section 1 of the Sherman Act. The court noted that an agreement regarding hiring practices was distinguishable from the ordinary contract in restraint of trade which was directly concerned with manufacturing and merchandising. Yet the Court found unreasonable restraints in that

[T]he reasonably foreseeable effect of the "no-switching" agreements will be to impair or diminish competition between existing subscription agencies, and to prevent would-be competitors from engaging in similar activity. . . .

The tendency of the "no-switching" agreements is to discourage labor mobility, and thereby the magazine-selling industry may well become static in its composition to the obvious advantage of the large, well-established signatory agencies and to the disadvantage of infant organizations.72

Once again strike insurance contracts are distinguishable in that they do not purport to place any controls on the activities of the individual employer.

Anderson, Union Circulation, and cases dealing with cooperation in purchasing do suggest one basis for holding that strike insurance places restraints on trade. Strike insurance has two functions. It reduces the cost of a strike because all who are subject to strikes pay a part of the cost although only a certain number ever sustain losses. Secondly, it stabilizes the cost, in that it is paid annually in the form of premiums. Thus each unit sold bears a proportional part of the cost. In the absence of insurance the total cost of a strike falls upon the party suffering

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69 272 U.S. 359 (1926).
70 Id. at 365.
71 241 F.2d 652 (1957).
72 Id. at 658.
the loss in an amount probably in excess of the premiums paid for insurance. Further, only units sold subsequent to the strike bear its cost. When a strike occurs, insurance prevents competitors from gaining an advantage. The struck employer is reimbursed, and thus he need not raise his prices, which have regularly reflected the cost of the contingency. Thus, since other members of the industry are denied the advantage which would otherwise accrue to them in the event a competitor should suffer a strike, insurance "lessens competition." The difficulty with this argument is that it proves too much. If strike insurance, because it eases the burdens of a strike by reducing and spreading costs, deprives competitors of a rightful advantage, then every commercial insurance program violates the anti-trust laws. No reasonable person would contend that the type of competitive advantage which accrues when a company suffers fire or flood loss and is uninsured, is or should be protected by the anti-trust laws. Yet what is the difference between business interruption losses resulting from fire and flood, and those attributable to strikes?

There is no difference between the losses, it is submitted, and it is in failing to distinguish between the losses and the activities which give rise to them that the error of viewing strike insurance as a violation of the anti-trust laws may be committed. The occurrence of fire and flood is not encouraged by an insured person and is beyond his control. Likewise, the occurrence of strikes is not encouraged by employers and, so long as they bargain in good faith, is legally beyond their control. Thus the losses in all cases are attributable to undesired and uncontrollable contingencies. If the losses in one case are insurable, they should be insurable in all cases. The difficulty arises in that strike insurance is seen as related, not to the recouping of losses, but to the prolonging of strikes. However, such relationship is in no way demanded by the insurance agreement. Nothing in the insurance agreement makes the group rather than the individual employer the party involved in the wage negotiations. The employer remains under a duty to bargain in good faith. If, as a matter of practice, signatories to a mutual insurance pact do act unreasonably in bargaining, the labor laws are presumably adequate to deal with the practice.

It is submitted that it is unnecessary and unwise to extend the anti-trust laws into this area. This would not be so if strike insurance pacts, like the agreements in Anderson and Union Circulation, were by their very nature restraints on trade. As has been demonstrated, they are not. If the strike insurance policyholders should engage in unfair labor practices, restraints on trade might arise, but such restraints are not the product of the insurance agreement itself. Rather they stem from agreements among the insured parties collateral thereto. It would seem the better procedure to root out such collateral agreements by firm enforcement of the labor law, leaving the insurance programs to fulfill their proper function. This would suffice to keep collective bargaining on a good faith basis. It would also leave the insurance program in operation. Thus the inevitable strike losses could be soundly distributed to the benefit of the consumer, the industry, and, in the long run, the employees themselves.

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74 See decision of the Civil Aeronautics Board in Six Carrier Mutual Aid Pact, supra note 5. The application of the labor laws to mutual assistance plans was also considered in Note, 60 Col. L. Rev. 205 (1960) and Note, 35 Ind. L. J. 491 (1960).