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Comment

AIR CARRIER DIVERSIFICATION

MERRICK C. WALTON

We have no preconceived notions of whether any particular type of diversification, including the holding-company approach, is either good or bad. Our intention is . . . to prevent a reoccurrence of the Penn Central bankruptcy in the field of aviation.¹

I. INTRODUCTION

The 1969 reorganization of United Air Lines² initiated a period of airline interest in diversified business activity that may ultimately eclipse the airlines' enchantment with mergers as a panacea for financial difficulties.³ United's lead was quickly followed by two cargo carriers, Flying Tiger Line⁴ and Airlift International.⁵ Two years later, when Braniff Airways filed its application⁶ with the Civil Aeronautics Board for approval of a plan of reorganization, however, the CAB's response was an order⁷ instituting a full-scale investigation of air carrier diversification.⁸ This investigation was precipitated by two events that had occurred during the interval

¹ Statement of Civil Aeronautics Board Chairman Robert D. Timm Before the Subcomm. for Dep't of Transportation and Related Agencies of the House Committee on Appropriations, April 17, 1973 (emphasis added).

² See CAB Order No. 69-4-67 (April 15, 1969); CAB Order No. 69-7-172 (July 31, 1969).

³ On the extent, success and regulation of airline mergers, see Keyes, *Notes on the History of Federal Regulation of Airline Mergers*, 37 J. AIR L. & COM. 357 (1971); Crooker, *Airline Mergers in the 1970's*, 39 J. AIR L. & COM. 143 (1973); Reid & Mohrfeld, *Airline Size, Profitability, Mergers and Regulation*, 39 J. AIR L. & COM. 167 (1973).

⁴ See CAB Order No. 69-12-121 (Dec. 29, 1969); CAB Order No. 70-6-119 (May 5, 1970).

⁵ See CAB Order No. 70-6-120 (June 19, 1970); CAB Order No. 70-9-8 (July 15, 1970).

⁶ CAB Docket No. 24048 (filed Dec. 8, 1971).

⁷ CAB Order No. 72-3-27 (March 10, 1972).

⁸ Air Carrier Reorganization Investigation, CAB Docket Nos. 21508, 21223, 24048, and 24283 [hereinafter cited in text as "Reorganization Investigation"]. The investigation was instituted by CAB Order No. 72-3-27 (March 10, 1972).

between the United reorganization and the Braniff application. First, the Penn Central bankruptcy⁹ had raised questions about the stability of highly diversified corporate conglomerates and the desirability of these corporate forms in regulated transportation industries. Although the collapse of the Penn Central rail system was not demonstrably caused by diversification alone, there was a clear possibility that complex corporate structures like that of the Penn Central might conceal financial maneuvering that stripped a regulated carrier of its resources and rendered it incapable of fulfilling its function of providing adequate transportation. The Interstate Commerce Commission had expressed misgivings about "the growing influence over regulated carriers by conglomerates having little or no concern for the public interest in transportation,"¹⁰ and the CAB recognized that this influence might extend to air as well as surface carriers. Secondly, a 1969 amendment¹¹ to the Federal Aviation Act of 1958¹² broadened CAB power to regulate acquisition of control of air carriers. These two events led the CAB to question the wisdom of permitting unhindered diversification on the one hand, and to place strict conditions on its approval of air carrier reorganizations on the other.¹³

In the *Reorganization Investigation*,¹⁴ airline predictions that diversification would result in improved fiscal health for the carriers, through better utilization of management talent and "dampening" of cyclical earnings patterns,¹⁵ were subjected to close scrutiny. Administrative Law Judge E. Robert Seaver concluded

⁹ In re Penn Central Transp. Co., Civil No. 70-347 (E.D.Pa.) (filed June 21, 1970).

¹⁰ See CAB Order No. 72-3-27, at 4 (March 10, 1972); cf. ICC, DIVERSIFICATION AND CONGLOMERATES (1971) (pamphlet) reproduced in Initial Decision of Administrative Law Judge, Air Carrier Reorganization Investigation, CAB Docket 24283 *et al.*, Appendix G (served Aug. 27, 1973).

¹¹ Pub. L. No. 91-62, 83 Stat. 103 (Aug. 20, 1969), 49 U.S.C. §§ 1377, 1378 (Supp. V., 1969), amending 49 U.S.C. §§ 1377, 1378 (1964) [codified at 49 U.S.C. §§ 1377, 1378 (1970)].

¹² Federal Aviation Act of 1958, 72 Stat. 731, as amended, 49 U.S.C. §§ 1301 *et seq.* (1970), formerly Civil Aeronautics Act of 1938, ch. 601, 52 Stat. 973 [hereinafter sometimes cited in text as "the Act"].

¹³ See CAB Order No. 70-9-8 (July 15, 1970); CAB Order No. 71-6-106 (June 21, 1971); CAB Order No. 72-3-27 (March 10, 1972).

¹⁴ CAB Docket No. 24283 (filed March 10, 1972).

¹⁵ Initial Decision of Administrative Law Judge E. Robert Seaver, Air Carrier Reorganization Investigation, CAB Docket No. 24283 *et al.*, at 5, 15 (served Aug. 23, 1973). [hereinafter cited as *Initial Decision*].

that reorganization and diversification were not necessarily inconsistent with the public interest.¹⁶ He recommended, however, that a system of rules be prescribed for the regulation of these reorganizations finding that, without this regulation, serious abuses "would occur or they would be so likely to occur that such diversification . . . would have to be prohibited."¹⁷ Judge Seaver's recommended "transaction agreements" raise compelling questions that must be carefully analyzed both in the context of the basic positions of the parties to the *Reorganization Investigation* and the scope of CAB regulatory power over the economic activities of air carriers. For example, assuming that the Board's regulatory power is essentially unlimited, might not the exercise of this power result in substitution of CAB judgment for that of airline management? Furthermore, is there a danger that the benefits of diversification will be denied to carriers who prefer to abandon¹⁸ their reorganization plans rather than proceed encumbered by a morass of strict and burdensome controls on virtually every aspect of corporate financial activity?

II. CIVIL AERONAUTICS BOARD POWER OVER AIR CARRIER CONTROL

The basic grant of statutory authority for Civil Aeronautics Board control of the corporate relationships of air carriers is found in Section 408 of the Federal Aviation Act of 1958.¹⁹ That

¹⁶ *Initial Decision* at 218.

¹⁷ *Id.*

¹⁸ After the CAB made its approval of the reorganization of Airlift International, Inc., subject to "fairly strict conditions," Airlift, for unspecified reasons, abandoned its reorganization plans and was dismissed as a party to the Reorganization Investigation. *Initial Decision* at 2; see CAB Order No. 70-9-8 (July 15, 1970); CAB Order No. 72-5-51 (May 12, 1972).

¹⁹ Federal Aviation Act of 1958, § 408, *as amended*, 49 U.S.C. § 1378 (1970), provides in pertinent part: Sec. 408(a) It shall be unlawful, unless approved by order of the Board as provided in this section:

(5) For any air carrier or person controlling an air carrier, any other common carrier, any person engaged in any other phase of aeronautics, or any other person to acquire control of any air carrier in any manner whatsoever. . . .

Sec. 408(d) Whenever, after the effective date of this section, a person, not an air carrier, is authorized, pursuant to this section, to acquire control of an air carrier, such person thereafter shall, to the extent found by the Board to be reasonably necessary for the administration of this Act, be subject, in the same manner as if such person were an air carrier, to the provisions of this Act relating to accounts,

section, recently expanded by a 1969 amendment,²⁰ provides, *inter alia*, that it shall be unlawful for any person whatsoever to acquire control of an air carrier without CAB approval.²¹ Additionally, subsection 408(f) creates a presumption of control by any person beneficially owning ten percent or more of the combined voting stock (or its equivalent) of an air carrier.²² The section thus gives the CAB extensive regulatory power over acquisitions of air carriers by unrelated parties. The CAB also considers that section 408(a)(5) gives the Board control over acquisitions "from within,"²³ as in the reorganizations to date, in which an air carrier itself creates a holding company that "acquires" the carrier.

A close examination of section 408, however, reveals some troublesome features of that section as currently interpreted by the CAB. First, while the section prohibits acquisition of an air carrier by "any other person" without CAB approval, there is no mention of acquisition of "any other person" by an air carrier. Public Law 91-62,²⁴ signed by President Nixon on August 20, 1969, supposedly closed a "loophole"²⁵ by adding the words "or any other person" to section 408(a)(5). This amendment undoubtedly had the effect of broadening the scope of CAB regulatory power:

records, and reports, and the inspection of facilities and records, including the penalties applicable in the case of violations thereof.

Sec. 408(f) *For the purposes of this section, any person owning beneficially 10 per centum or more of the voting securities or capital, as the case may be, of an air carrier shall be presumed to be in control of such air carrier unless the Board finds otherwise. As used herein, beneficial ownership of 10 per centum of the voting securities of a carrier means ownership of such amount of its outstanding voting securities as entitles the holder thereof to cast 10 per centum of the aggregate votes which the holders of all the outstanding voting securities of such carrier are entitled to cast.* [emphasis added to portions inserted by Pub. L. No. 91-62, 83 Stat. 103 (Aug. 20, 1969)].

²⁰ See note 11 *supra*.

²¹ 49 U.S.C. § 1378(a)(5) (1970).

²² 49 U.S.C. § 1378(f) (1970).

²³ *Initial Decision* at 150-51.

²⁴ Pub. L. No. 91-62, 83 Stat. 103 (Aug. 20, 1969), 49 U.S.C. §§ 1377, 1378 (Supp. V., 1969), amending 49 U.S.C. §§ 1377, 1378 (1964) [codified at 49 U.S.C. §§ 1377, 1378 (1970)].

²⁵ See *Hearings on H.R. 8261, 8322, 8323 Before the Subcomm. on Transp. and Aeronautics of the House Comm. on Interstate and Foreign Commerce*, 91st Cong., 1st Sess., 5 (1969); *Hearings on S.1373 Before the Senate Comm. on Interstate and Foreign Commerce*, 91st Cong., 1st Sess., 63 (1969).

Although described as merely "closing a loophole," these changes do substantially more. Prior to Public Law 91-62, the statute did not conceive of air transportation as an exception to the ordinary right of persons to engage in lawful businesses of their own choosing. Only in the case of control by related businesses or other carriers, when anticompetitive activities might threaten the [Federal Aviation] Act's broad developmental objectives, did Congress assert a regulatory interest. The new language makes the exception into the rule. *No one* is free to acquire control of an air carrier without the scrutiny of the CAB. In addition, under a broad "public interest" test, the Board may assert the power to determine what types of people will be allowed to control airlines, and to examine whatever factors, including business ability, character, motives, and personal habits, it deems pertinent.²⁶

Although this grant of power to the CAB may have closed one loophole, another gap, at least as large, remains. Since there is no mention in section 408 (or elsewhere) of acquisition of "any other person" by an air carrier, there is no express statutory restriction on diversification of air carriers by direct acquisition or creation of non-air carrier subsidiaries.²⁷ Presumably, therefore, CAB regulation of these transactions is limited to indirect control through the Board's other regulatory powers over the parent airline.²⁸ The only conceivable escape from this limitation would be to give section 408(a)(5) a "bilateral" reading with respect to the words "any other person" so as to extend the force of the section by implication to cover acquisitions of subsidiaries by air carriers as well as acquisitions of air carriers by other parties.²⁹ The CAB has not interpreted the statute in this way,³⁰ but Admin-

²⁶ Rasenberger, *Control of an Air Carrier by "Any Other Person"—Flying Blind Under the Federal Aviation Act*, 37 J. AIR L. & COM. 65, 68-69 (1971) (emphasis in original). Mr. Rasenberger's article is an extremely cogent analysis of CAB regulatory power under section 408 as originally enacted and as amended by Public Law 91-62. A good discussion of the history of section 408 as originally enacted in the Federal Aviation Act of 1958 is found in Allen, *Section 408 of the Federal Aviation Act: A Study in Agency Law-Making*, 45 VA. L. REV. 1073 (1959).

²⁷ This would, of course, be strictly true only of subsidiaries not "engaged in any phase of aeronautics." Section 408(a)(6) of the Act, 49 U.S.C. § 1378(a)(6) (1970), makes it unlawful, unless approved by the Board:

(6) For any air carrier or person controlling an air carrier to acquire control, in any manner whatsoever, of any person engaged in any phase of aeronautics otherwise than as an air carrier

²⁸ Cf. *Initial Decision* at 154-55.

²⁹ *Id.* n.27.

³⁰ *Id.* The CAB has, however, given such a "bilateral" construction to the lan-

istrative Law Judge Seaver recommended, in his Initial Decision in the *Reorganization Investigation*, that Congress enact legislation giving the CAB this power.³¹

A second flaw in section 408 is the presumption created by subsection (f)³² that a ten per cent ownership of voting stock constitutes control for the purposes of section 408(a)(5). Since the CAB thereby obtains considerable powers³³ over persons acquiring a relatively small interest in an air carrier, even though other persons already hold much larger interests, it is entirely possible that potential investors will decline to invest this heavily in air carrier securities. Ironically, this provision can be viewed as encouraging the holding-company form of reorganization. For example, UAL, Inc., which owns all the stock of United Air Lines, Inc., is the only "person" in "control" of United. The owners of UAL are thereby insulated from CAB regulation through the use of the holding-company device.³⁴

Another provision of the Federal Aviation Act having great potential effect on air carrier diversification is section 414,³⁵ which

guage concerning common carrier acquisition of control of an air carrier, interpreting the policy behind section 408(a)(5) to apply equally to air carrier acquisition of control of another common carrier. *See, e.g.*, Freight Forwarder Case, 9 C.A.B. 473 (1948); *Initial Decision* at 154-55 n.28. *See also* Rasenberger, *supra* note 26, 37 J. AIR L. & COM. at 81-2.

³¹ *Initial Decision* at 180-81. Judge Seaver's recommendation is the deletion of the phrase "engaged in any other phase of aeronautics" from section 408(a)(1) of the Act, 49 U.S.C. § 1378(a)(1) (1970) which makes it unlawful, unless approved by the Board:

(1) For two or more air carriers, or for any air carrier and any other common carrier or any person engaged in any other phase of aeronautics, to consolidate or merge their properties, or any part thereof, into one person for the ownership, management, or operation of the properties theretofore in separate ownerships. [emphasis added to proposed deletion].

Judge Seaver admits that this "would require Board approval of all air carrier acquisitions," but does not feel that it would be "excessively burdensome." *Initial Decision* at 180-81. It is not clear that such an amendment would have the desired effect since a merger of properties "into one person" is not necessarily the same thing as acquiring a subsidiary.

³² 49 U.S.C. § 1378(f) (1970). The text of subsection (f) appears in note 19 *supra*.

³³ These powers would include, *inter alia*, the power to require disclosures under section 408(d), 49 U.S.C. § 1378(d). The text of subsection (d) appears in note 19 *supra*.

³⁴ The CAB is reportedly attempting, however, to obtain more information about the ownership of the parent companies. AIRLINE MANAGEMENT AND MARKETING, May 1971, at 31.

³⁵ 49 U.S.C. § 1384 (1970):

confers antitrust immunity on persons affected by Board orders made pursuant to specified provisions of the Act, including section 408. Once the CAB approves a transaction under section 408, section 414 exempts the parties to that transaction from the operation of the antitrust laws to the extent necessary to do anything contemplated by the order granting approval. Since section 414 applies to all orders made under section 408, the breadth of the Board's antitrust exemption power is therefore limited only by the scope of section 408. If section 408 were read as giving the CAB broad regulatory powers over all corporate affiliations of air carriers, the corresponding section 414 immunity could have substantial impact on the existing scheme of antitrust regulation outside the airline industry. It is unlikely, however, that the drafters of the 1969 amendment to section 408 intended to expand the scope of section 414 to confer antitrust immunity on any corporation which became affiliated with an air carrier in a transaction subject to CAB approval. Since section 414 was intended only to prevent destructive competition within the air transportation industry, its extension to transactions involving members of other industries as well as air carriers would seem to be unwarranted absent a more explicit expression of congressional intent than an amendment of a related section.

III. CAB REGULATION OF REORGANIZATIONS TO DATE

One frequent air carrier response to adverse financial conditions has been the merger, a procedure justified primarily as an attempt to increase the scope of operations and thereby increase market share.³⁶ Since these transactions involve only air carriers, however, there has been no question of CAB regulatory power even under section 408 prior to the 1969 amendment. The only issue in air carrier mergers is the advisability of the merger itself; the CAB has not had to consider, in this context, the weakening of air carriers by interests outside the aviation industry. Mergers are evaluat-

Any person affected by any order made under section 1378, 1379, or 1382 of this title shall be, and is hereby, relieved from the operations of the "antitrust laws" as designated in section 12 of title 15, and of all other restraints or prohibitions of . . . law, insofar as may be necessary to enable such person to do anything authorized, approved, or required by such order.

³⁶ See note 3 *supra*.

ed largely on the basis of anticipated benefit or detriment to service and competition within the industry,³⁷ rather than potential interference from or with outside interests.

Another transaction clearly subject to CAB regulation, even before the amendment of section 408, was acquisition of control of air carriers or persons engaged in "any other phase of aeronautics."³⁸ While this type of arrangement is not necessarily a "reorganization" of an air carrier, it resembles to a certain degree the acquisition of an air carrier by a holding company. Possibly the most celebrated case involving an acquisition of an air carrier by a common carrier is *Pan American World Airways, Inc., v. United States*,³⁹ which involved the creation ("acquisition") by Pan American and W. R. Grace & Co.⁴⁰ of a jointly-owned subsidiary, Pan American-Grace Airways (Panagra). In response to allegations that non-competition agreements between Pan American and Panagra violated the antitrust laws, the United States Supreme Court held that primary jurisdiction over the issues raised by the complaint was vested in the CAB by virtue of the Board's powers under sections 408 and 414 and ordered the complaint dismissed.⁴¹ With respect to persons "engaged in any other phase of aeronautics," an illustrative example is the acquisition of control of Trans World Airlines by Hughes Tool Company, over which the CAB exercised considerable supervision.⁴² This degree of regulatory supervision was approved by the Supreme Court in the recent case of *Hughes Tool Co. v. Trans World Airlines*,⁴³ where the Court stated that "the parent company which controls an air carrier is subject to pervasive control by the CAB."⁴⁴

The transactions triggering the CAB's current concern, however, have taken another form, known as the "holding-company" reor-

³⁷ Cf. Crooker, *supra* note 3, 39 J. AIR L. & COM. at 154, 158-59.

³⁸ See note 19 *supra*.

³⁹ 371 U.S. 296 (1963).

⁴⁰ W.R. Grace & Co. was a common carrier by water.

⁴¹ 371 U.S. at 309, 313.

⁴² See, e.g., *Transcontinental & Western Air, Inc., Control by Hughes Tool Company*, 6 C.A.B. 153 (1944) (Transcontinental & Western was the predecessor of TWA); *Trans World Airlines, Inc., Further Control by Hughes Tool Company*, 12 C.A.B. 192 (1950).

⁴³ 409 U.S. 363 (1973).

⁴⁴ *Id.* at 387.

ganization. Under this arrangement, the air carrier itself creates a holding company to acquire the air carrier by distributing the stock of the holding company to the air carrier's stockholders in exchange for their stock interest in the air carrier.⁴⁵ This type of transaction was utilized in the 1969 reorganization of United Air Lines whereby United was acquired by UAL, Inc., a holding company created for that purpose. The CAB, believing that section 408 as then written did not give it power over this transaction, disclaimed jurisdiction.⁴⁶ Following the amendment of section 408 by Public Law 91-62,⁴⁷ however, the Board concluded that it had jurisdiction over these transactions and exercised that jurisdiction by imposing "fairly strict conditions" on similar reorganization plans of Flying Tiger Lines and Airlift International.⁴⁸

Braniff's application,⁴⁹ however, for permission to embark on a similar plan of holding-company reorganization, brought about the *Reorganization Investigation*.⁵⁰ The CAB, now convinced that it had jurisdiction, decided that the time had come to examine what seemed to be developing as a clear trend toward air carrier diversification.⁵¹ The Board did not limit the scope of the inquiry to the holding-company variant, but rather extended it to "all aspects of diversification by any air carriers,"⁵² and to an inquiry into the need for regulation and legislation with regard to these activities. The Board's primary concern was diversification "from within," *i.e.*, reorganizations instigated by air carriers themselves. These trans-

⁴⁵ There are, of course, other variations of the transaction, but the net effect is essentially the same. One goal in planning such a reorganization is to ensure that it will be a "tax-free" reorganization under the federal tax laws, primarily INT. REV. CODE of 1954, §§ 354, 361, 368.

⁴⁶ CAB Order No. 69-4-67 (April 15, 1969).

⁴⁷ See notes 11, 19 *supra* and accompanying text.

⁴⁸ *Initial Decision* at 2. See CAB Order No. 71-6-106 (June 21, 1971); CAB Order No. 70-9-8 (July 15, 1970). The Airlift plan was later abandoned. See note 18 *supra*. For extensive discussion of the United and Flying Tiger reorganizations, the proposed Braniff reorganization and other airline diversification in general, see the *Initial Decision* at 24-72.

⁴⁹ CAB Docket No. 24048 (filed Dec. 8, 1971). Docket No. 24048 was consolidated for hearing with Docket Nos. 21508, 21223, and 24283. See note 8 *supra*.

⁵⁰ *Initial Decision* at 3; CAB Order No. 72-3-27 (March 10, 1972). Braniff's application was severed and conditionally approved, pending final determination of the Reorganization Investigation, in October, 1973. CAB Order No. 73-11-8 (Oct. 23, 1973).

⁵¹ CAB Order No. 72-3-27, at 4-5 (March 10, 1972).

⁵² *Initial Decision* at 3.

actions include: (i) the carrier-created holding company that acquires the air carrier that created it, (ii) the divisive reorganization whereby a single carrier is divided into two or more new corporations and (iii) the acquisition of subsidiaries by an air carrier that becomes the parent of a diversified group. The Board also considered, however, the problems of continued supervision of diversification "from without," *i.e.*, when the carrier is acquired as a subsidiary by a parent corporation not otherwise subject to CAB regulation.⁵³ This latter form of diversification is subject to CAB approval regarding the acquisition itself, but the Board's power to exert continuing supervision by conditioning its approval is not as clear. Additionally, while amended section 408 requires CAB approval for acquisition of a carrier, even by a holding company created by the carrier for that purpose, the statute does not explicitly apply to other acquisitions either by air carriers as parents or by holding companies with air carrier subsidiaries. One of the purposes of the investigation was to determine which of these variations were already subject to CAB approval and which, if any, required additional legislation to ensure adequate regulation.

IV. THE AIR CARRIER REORGANIZATION INVESTIGATION

The Civil Aeronautics Board framed four broad issues to be considered in the *Reorganization Investigation*:

(a) whether Braniff's application should be approved and if so subject to what conditions;

(b) what further terms, conditions, or limitations should be placed on the Board's approval of the Flying Tiger and Airlift reorganizations, and as to Airlift whether the Board's approval should be rescinded;

(c) what terms, conditions, or limitations, if any, is the Board authorized to impose in respect to the relationship between United Air Lines, Inc., on the one hand, and UAL, Inc., and any other affiliates, on the other, and what terms, conditions, or limitations which the Board is authorized to impose should be adopted;

(d) in addition to the Board's present powers as derived from its regulations and the Federal Aviation Act, *inter alia*, what further regulations and/or legislation would be necessary to deal effectively with air carrier diversification.⁵⁴

⁵³ CAB Order No. 72-3-27, at 4 (March 10, 1972).

⁵⁴ *Id.* at 5.

In searching for the answers to these questions, Administrative Law Judge E. Robert Seaver had to assess widely divergent viewpoints on both the legal and economic aspects of air carrier diversification. Whereas the airlines were almost unanimously optimistic regarding the economic benefits to be derived from diversification, the CAB was skeptical and even alarmed at the prospect that uncontrolled diversification could cripple the air transportation industry by creating another economic tragedy like the Penn Central collapse. There was a similar conflict concerning the extent of CAB regulatory power over these activities and the advisability and necessity of its exercise. The parties also disagreed concerning the antitrust problems which might arise through the exercise of the Board's section 414 immunization power.

A. Positions of the Parties

1. The Air Carriers

United, Flying Tiger, Braniff and Airlift were made parties to the investigation, although Airlift was subsequently dismissed.⁵⁵ Additionally, National Airlines was allowed to intervene, but participated only to the extent of filing a statement of position.⁵⁶ The airlines were quite optimistic about the economic benefits to be derived from diversification, in general, and indicated several ways in which diversification could lead to increased carrier prosperity. The most significant advantage seen by the airlines was the potential for "dampening" the cyclical nature of earnings in the air transportation industry, thus providing increased financial stability and an increased ability to provide adequate and efficient service. According to United, the question was:

Whether certificated air carriers should be non-diversified, single-minded companies whose performance is inexorably tied to the peaks and valleys of the air transportation business . . . [or] be allowed to be a part of larger, diversified entities.⁵⁷

⁵⁵ See note 18 *supra*.

⁵⁶ *Initial Decision* at 3. National's statement of position indicated its agreement with the position of the CAB's Bureau of Operating Rights, discussed in Section IV. World Airways, which also intervened, but later withdrew as an intervenor, "presented testimony which supported . . . diversification either through the use of subsidiaries . . . or by means of the formation of a holding company." *Id.* at 5-6.

⁵⁷ *Id.* at 132 (from testimony of expert witness Charles D. Barker).

While diversification cannot completely eliminate economic ups and downs, since "all business activities tend to follow the same economic trends,"⁵⁸ the potential offset between fluctuations in different industries should have a salutary effect on the earnings stability of a corporate family engaged in diversified activities.⁵⁹ Presumably, the effect of a "dampened" earnings cycle would be to lower investor risk and therefore lower the cost of equity capital; at the same time, resources of the entire corporate group would be available to combat temporary reverses, eliminating the need for short-term financing from outside sources.⁶⁰ The air carriers conceded, however, that diversification would not fundamentally alter the economics of air transportation, but would merely render the diversified group "less susceptible" to fluctuations in earnings.⁶¹

Other advantages of diversification claimed by the air carriers include economy of scale, leveling of labor costs and tax benefits. With respect to labor costs, the airlines had seen their profits increasingly reduced by the rising cost of labor. By combining a carrier with a less labor-intensive business, the effect of high labor costs would be leveled across the entire enterprise, while the high profits of the affiliated corporation might be partially shielded by the investment tax credit and net operating loss carryovers accumulated by the airline.⁶² An additional advantage seen by the advocates of the holding-company type of reorganization was the potential for shielding non-air carrier subsidiaries from CAB interference. United and Flying Tiger both presented testimony that their holding-company diversifications have permitted activities that would have been impossible in an organization having an air carrier as the parent.⁶³ This rationale is founded on the premise that the CAB can exert considerable influence over the financial activities of the subsidiaries by virtue of its clear jurisdiction over the parent airline. When the parent is a holding company and the air carrier merely one of many subsidiaries, however, the potential for CAB influence is not as great.

⁵⁸ *Id.* at 133.

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.* at 137.

⁶² *Id.* at 134.

⁶³ *Id.* at 135.

Concerning the scope of CAB jurisdiction, the air carriers themselves were divided. Braniff conceded that the Board should exercise reasonable regulation over air carrier diversification programs, but Flying Tiger asserted that the Board had "neither the power nor the expertise to regulate broadly all acquisitions by air carriers and their affiliates."⁶⁴ Furthermore, Flying Tiger was of the opinion that most of the controls proposed by the CAB's Bureau of Operating Rights exceeded the Board's statutory powers.⁶⁵ United took a middle position, asserting that the public interest would be adequately protected by reasonable reporting requirements, without any need for restrictive conditions on approval of proposed reorganizations.⁶⁶

2. *The Civil Aeronautics Board—Bureau of Operating Rights*

The position of the CAB was represented by the Board's Bureau of Operating Rights (BOR), which offered evidence on the merits and also proposed a set of controls⁶⁷ to be placed on air carrier diversification activities. While the Bureau ultimately took the position that diversification should be permitted under an adequate regulatory scheme, it felt that the evidence of the asserted benefits of diversification was inconclusive and that the advantages were in many ways offset by equally obvious disadvantages.⁶⁸

On the merits of diversification, the Bureau argued that in the reorganizations that had occurred to date, there had been no noticeable elimination of cyclical earnings, and that any benefits that did occur accrued to the entire group of affiliated corporations and not to the air carrier individually.⁶⁹ The ultimate concern of the BOR, and therefore of the CAB, is the financial stability and well-being of the air carriers; benefits accruing to other members of a corporate family are significant only insofar as they also contribute

⁶⁴ *Id.* at 18.

⁶⁵ *Id.* at 17.

⁶⁶ *Id.* at 18. With respect to its own reorganization, however, United questioned the power of the CAB to impose conditions at this stage since the United reorganization was a *fait accompli* before the amendment of section 408. In addition, the Board had expressly disclaimed jurisdiction. See CAB Order No. 69-4-67 (April 15, 1969).

⁶⁷ See *Initial Decision* at 8-10.

⁶⁸ *Id.* at 6-7, 138-41.

⁶⁹ *Id.* at 136, 138-41.

to the health of the air carrier involved.⁷⁰ The Bureau also pointed to several other potential disadvantages, like the siphoning-off of carrier assets and profits and distraction of management from full attention to air transportation activities.⁷¹ Indeed, Judge Seaver noted in his Initial Decision:

Even offsetting the fact that the hearing herein was directed to diversification activities, the testimony of the principal officers of the three carrier parties left the strong impression that much of their time is now taken up with diversified business activities.⁷²

Concerning asset and profit drain, the record indicated that Flying Tiger and United had both been required to pay considerable amounts to their parent holding companies,⁷³ either as dividends or in other ways. Additionally, the BOR emphasized that the parent could further damage the air carrier subsidiary by denying equity capital to the carrier in times of poor business conditions, investing its available capital instead in other subsidiaries that were currently showing a better return.⁷⁴

The CAB was also alarmed at the prospect that an air carrier might suffer the same fate as the Penn Central railroad, sometimes characterized as being a victim of excessive diversification.⁷⁵ The CAB did not take a position of opposition to mergers and acquisitions *per se*, as CAB chairman, Timm has indicated:

What I am suggesting is that the airline industry should be afforded the same economic tools that other mature industries have, including a healthy and nondestructive competitive climate; responsible mergers, acquisitions, and diversification.⁷⁶

On the other hand, the order instituting the *Reorganization Investigation* makes it clear that the Board is cognizant of "the information flowing from the various investigations of Penn Central's

⁷⁰ *Id.*

⁷¹ *Id.* at 142-45.

⁷² *Id.* at 144.

⁷³ *Id.* at 140-41.

⁷⁴ *Id.* at 142-43.

⁷⁵ *Cf.* Reid & Mohrfeld, *supra* note 3, 39 J. AIR L. & COM. at 168: "The classic example in the transportation industry is the infamous Penn-Central merger which has become the largest single economic failure in the history of business and commercial affairs."

⁷⁶ Statement of Chairman Robert D. Timm, *supra* note 1.

many problems.”⁷⁷ Although no attempt was made to probe deeply into that matter, and Judge Seaver apparently concluded that the Penn Central situation was not “sufficiently analogous to be of direct assistance,”⁷⁸ official notice⁷⁹ was taken of a report by the special staff of the Senate Commerce Committee, which concluded that the Penn Central collapse was not caused by diversification *per se*, but, *inter alia*, by an “improvident dividend policy” and management problems.⁸⁰ Profit drain, through payment of excessive dividends, and management distraction and inefficiency are, as previously mentioned, among the potential drawbacks of diversification seen by the CAB.

Concerning its authority over reorganizations, the Board asserted that its regulatory power extends at least to the holding-company form of reorganization under amended section 408.⁸¹ Judge Seaver apparently concluded, however, that legislation was needed to give the CAB direct jurisdiction over acquisitions of subsidiaries by an air carrier parent.⁸² He dismissed as without support in the legislative record a contention by Flying Tiger that the amendment to section 408 only covered acquisition of an air carrier from without,⁸³ stating that the phrase “any other person” as used in section 408(a)(5) “manifestly includes the acquisition by a holding company formed by the carrier.”⁸⁴ The gaps in CAB authority under current law, therefore, would leave the Board without direct control over two types of acquisitions: (i) those in which an air carrier acquires subsidiaries, and (ii) those in which a holding company owning an air carrier subsidiary acquires other

⁷⁷ CAB Order No. 72-3-27, at 4 (March 10, 1972). The Board noted that approval of the Flying Tiger and Airlift reorganizations was granted shortly before Penn Central went into bankruptcy reorganization.

⁷⁸ *Initial Decision* at 95.

⁷⁹ *Id.* n.23.

⁸⁰ See SPECIAL STAFF OF THE SENATE COMMITTEE ON COMMERCE, 92d Cong., 2d Sess., *THE PENN CENTRAL AND OTHER RAILROADS* (1972). Cf. STAFF REPORT OF THE SEC TO THE HOUSE SPECIAL SUBCOM. ON INVESTIGATIONS, 92d Cong., 1st Sess., *THE FINANCIAL COLLAPSE OF THE PENN-CENTRAL COMPANY* (1972). The Bureau of Operating Rights introduced in evidence a number of other documents concerning diversification in regulated industries. A list of these documents appears in the *Initial Decision* at 79-80.

⁸¹ See CAB Order No. 72-3-17, at 3 (March 10, 1973).

⁸² *Initial Decision* at 180-81.

⁸³ *Id.* at 150-51.

⁸⁴ *Id.* at 151.

subsidiaries.⁸⁵ Whatever control the CAB could exert in these situations would be indirect, by virtue of its jurisdiction over the air carrier itself; presumably, the Board's leverage would be considerably greater in the former instance than in the latter. If the CAB adopted a "bilateral" reading of "any other person" in section 408(a)(5),⁸⁶ it could then reach the first transaction, though not the second. This bilateral reading of "any other person" would certainly be quickly challenged by those air carriers already controlling subsidiaries.⁸⁷ Concerning the holding-company approach, it is not clear whether Congress, in enacting the 1969 amendment to section 408, intended only to reach the initial acquisition, or to give the CAB further authority over those subsequent acquisitions by the same parent which might affect the carrier, albeit indirectly.

It is at least arguable that the kind of regulation contemplated by Congress to protect the airline industry would require a continuing jurisdiction by the CAB. This concept was suggested in the House debate on the amendment to section 408:

The question is, do we want people going in on regulated industries who are going to have interests other than the interests of providing the kinds of service the regulated industry is going to provide? The answer is "No." Then the question is, how do we devolve a mechanism for preventing these kinds of circumstances from taking place? The answer is very simple. We have given the regulatory agency concerned a specific statutory direction to direct itself to this point and to see to it that these regulated industries not only function in the public interest but also that they are manned by boards of directors and by control which will assure that fact.⁸⁸

Since Congress did not expressly make these transactions subject to CAB control, however, presumably any attempt by the Board

⁸⁵ This assumes that the acquired subsidiary is neither an air carrier nor engaged in another phase of aeronautics. The acquisition of an air carrier is the section 408(a)(5) situation; the acquisition of a person engaged in another phase of aeronautics is covered by section 408(a)(6), 49 U.S.C. § 1378(a)(6) (1970) which makes it unlawful unless approved by the Board:

For any air carrier or *person controlling an air carrier* to acquire control, in any manner whatsoever, of any person engaged in any phase of aeronautics otherwise than as an air carrier . . . [emphasis added].

⁸⁶ See note 30 *supra* and accompanying text.

⁸⁷ A partial list of air carrier-subsidiary control relationships of this type is contained in the *Initial Decision* at 70-71.

⁸⁸ 115 CONG. REC. 6042 (1969) (remarks of Congressman Dingell).

to assert jurisdiction over them would be strongly contested by the air carriers and other interested parties.⁸⁹ Whether further legislation will be forthcoming is uncertain; congressional response to this particular "loophole" may depend largely upon the performance of diversified carriers and CAB reaction.⁹⁰

3. *Other Parties*

The Departments of Justice (Antitrust Division) and Transportation (DOT) were also parties to the *Reorganization Investigation*. The Justice Department took no firm position on the advisability of diversification itself, but agreed that both the advantages and disadvantages were real.⁹¹ On the regulatory issues, however, the Antitrust Division did express an opinion concerning the anti-trust aspects, and suggested a regulatory approach that the CAB might adopt.⁹² The Department of Transportation, while cautioning of serious problems that might result from financial manipulation, conceded that diversification might prove beneficial if properly regulated. The DOT also proposed a regulatory scheme.⁹³

⁸⁹ Cf. Rasenberger, *supra* note 26, 37 J. AIR L. & COM. at 81-82.

⁹⁰ That the trend may be toward increasingly close scrutiny, and possibly more comprehensive regulation, of diversification of transportation companies in general is suggested in the SEC study mentioned *supra* note 80, *Foreword* at IV:

Transportation carriers in their function as utilities operating under a public license are in a position to monopolize a segment of the national economy and thereby ensure a guaranteed source of funds. Diversion of those guaranteed funds out of the transportation business and into other endeavors offering a more attractive investment return is increasing. . . .

One motor carrier . . . exceeded its standard for an acceptable working capital ratio and unreasonably mortgaged [its] operating equipment. The experience of the Penn Central with diversification profits on acquired . . . operations are often illusory while the out-of-pocket costs. . . are quite real. In the same vein the increasing diversification by air carriers may result in unreasonably encumbering airline operating equipment while the costs of acquisition exceed the real benefits thereof.

The record is not clear that diversification is absolutely bad Until a thorough analysis is made of the public interest benefits for diversification . . . a proper conclusion may not be reached. In order to make this analysis, . . . the staff of the Special Subcommittee on Investigations [has been instructed] to collect and study all the available data on diversified transportation companies. . . .

One solution considered in the study was federal incorporation of companies regulated by the ICC and the CAB.

⁹¹ *Initial Decision* at 10-11.

⁹² *Id.* at 12.

⁹³ *Id.* at 13-15.

B. *The Proposed System of Regulation*

Administrative Law Judge Seaver was persuaded that diversification was not so inherently hazardous that it should be prohibited to air carriers.⁹⁴ He was convinced, however, that there was sufficient danger of abuse that the CAB should undertake a relatively strict program of regulation of air carrier diversification of whatever type, although the holding-company pattern was considered to be more fraught with peril than the air carrier-parent arrangement.⁹⁵ According to Judge Seaver, the primary concern of the CAB is the well-being of the air carrier itself and its ability to provide adequate service, and other factors are of only secondary importance. Any benefit conferred on a non-air carrier member of a diversified group is immaterial unless the air carrier is helped, directly or indirectly, as well.⁹⁶ Furthermore, no arrangement should be allowed that might work to the detriment of an air carrier. Judge Seaver concluded that the CAB had the power to regulate such activities.⁹⁷ He recommended, however, additional legislation to close the existing gaps in the Board's authority.⁹⁸ The CAB's power, as Judge Seaver saw it, is not limited to approval or disapproval of the initial acquisition, but is sufficient to reach other activities by the conglomerate which might affect the air carrier;⁹⁹ Congress surely did not intend to limit the Board's power in this area, but "must have intended to give it authority that was ample to deal with the evil at hand."¹⁰⁰

The regulatory scheme proposed by Judge Seaver¹⁰¹ consists of three basic measures.¹⁰² First, intercompany transactions between a

⁹⁴ *Id.* at 218.

⁹⁵ *Id.*

⁹⁶ *Id.* at 128-29.

⁹⁷ *Id.* at 150-67.

⁹⁸ See notes 30, 31 *supra* and accompanying text.

⁹⁹ *Initial Decision* at 150-67, citing *Foreign Study League v. CAB*, 475 F.2d 865 (10th Cir. 1973); *Pan American World Airways v. United States*, 371 U.S. 296 (1963). See also *Hughes Tool Co. v. Trans World Airlines*, 409 U.S. 363 (1973).

¹⁰⁰ *Pan American World Airways v. United States*, 371 U.S. 296, 312 (1963). See *Initial Decision* at 164.

¹⁰¹ The proposed controls are based primarily on those suggested by the Bureau of Operating Rights. *Initial Decision* at 197.

¹⁰² The proposed regulations and guidelines are fully described in the *Initial Decision*, at 184-207 and Appendix H.

carrier¹⁰³ and its affiliates would be limited to those described in "transaction agreements" drafted under guidelines established by the CAB. The transaction agreements would be subject to the prior approval of the Board.¹⁰⁴ Secondly, quarterly reports would be required, describing transactions in the quarter just completed, to enable the Board to assess compliance with the transaction agreements. Thirdly, "performance monitoring reports" would be submitted to the CAB for continuous monitoring of the effects of diversification on the air carrier,¹⁰⁵ resulting from the reported transactions. The transactions to be described in the transaction agreements and reported quarterly would include:¹⁰⁶ dividends,¹⁰⁷ intercompany management services, joint use of employee time, joint marketing, transfers of goods and services, joint purchasing or leasing, intercompany loans and advances,¹⁰⁸ intercompany transfers of assets other than funds,¹⁰⁹ leases of property and equipment, joint use of assets and facilities, tax allocations,¹¹⁰ tour packages with affiliated hotels, and guarantees, pledges, and other credit support.

The air carriers expressed general acquiescence¹¹¹ to these proposed regulations, but raised two specific objections. First, they in-

¹⁰³ The regulatory plan would only apply to scheduled carriers, at least at first, since the public interest "would not be affected as adversely and immediately" if other elements of the air transportation industry suffered ill effects as a result of diversification. *Initial Decision* at 212.

¹⁰⁴ The Transaction Agreements could be amended at any time, whereupon the Board could modify or withdraw its approval. *Id.* at 198.

¹⁰⁵ Factors to be monitored would include relative size of the air carrier in comparison to its affiliates, current status of debt restrictions, intercompany distribution of funds, and type and extent of non-air-transportation business carried on by the corporate group. *Id.* at 199-203.

¹⁰⁶ *Id.* at 197, Appendix H at 1-11.

¹⁰⁷ Guidelines: Cash dividends paid on common stock could be paid only out of unappropriated earned surplus plus current net income, not to exceed 50% of previous year's net income. *Initial Decision*, Appendix H at 2.

¹⁰⁸ Guidelines: Interest charges would be limited to interest rates available in arm's-length transactions with outsiders. Interest at a floating prime rate would be *prima facie* evidence that this standard had been met. *Id.* at 6.

¹⁰⁹ Guidelines: All such transfers should be at fair market value, except that transfers to air carriers could be at less than FMV. *Id.* at 8.

¹¹⁰ Guidelines: The air carrier would be entitled to receive the full benefit of tax credits generated by it when used by the holding company, without regard to whether or not the airline could later use the credit if filing a separate return. *Id.* at 9.

¹¹¹ *Initial Decision* at 186.

sisted that CAB approval of the transaction agreements was unnecessary and that mere reporting requirements would suffice.¹¹² Judge Seaver rejected this contention, expressing the opinion that if carriers' and affiliates' goodwill could be relied on, regulation would never be necessary.¹¹³ Secondly, objections were raised to the dividend restrictions. Judge Seaver, however, responded that fairly stringent restrictions were essential to prevent depletion of working capital through payment of excessive dividends.¹¹⁴

The proposed controls, even though somewhat strict, seem reasonably well adapted to serve the intended purpose. Nevertheless, criticisms of the CAB plan are justified. The requirement of CAB approval could easily result in a situation wherein management will be forced to tailor its action to what is perceived to be the Board's preference; the alternatives being either to take no action because other options appeared unlikely to receive CAB approval, or to transact with an outsider so that no approval would be required, which would defeat the purpose of diversification. The possibility of effectively substituting CAB judgement for that of management should be resolutely guarded against¹¹⁵ since the Board's familiarity with the particular business exigencies necessitating one of the regulated transactions would almost inevitably be less than that of management. Additionally, since there has been so little experience with airline diversification, considerable flexibility of regulation should be maintained so that proper adjustments can be made as experience accrues and other variables become pertinent. Judge Seaver indicated that the governing standard should be one of fundamental fairness to the air carrier.¹¹⁶ This standard is clearly preferable to dollar or frequency limits.

V. ANTITRUST PROBLEMS

An additional problem, assuming the CAB adopts Judge Seaver's proposed controls, is the extent to which the Board might by exercise of its powers affect competitive patterns outside the air transportation industry, either intentionally or inadvertently. Since

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ *Id.* at 202.

¹¹⁵ *Cf. Initial Decision* at 190.

¹¹⁶ *Initial Decision*, Appendix H at 12.

section 414¹¹⁷ of the Federal Aviation Act of 1958 confers immunity from the antitrust laws to the extent necessary to comply with an order made under section 408, presumably any transaction approved by the Board in connection with an acquisition governed by section 408 would not result in antitrust liability. The Justice Department, articulating a principle which impliedly limits CAB jurisdiction over all activities outside the air transportation industry, asserted that the Board's statutory authority cannot extend to a non-air carrier when antitrust matters are at issue simply because the non-carrier and an air carrier are members of the same corporate group.¹¹⁸ The Justice Department contended that while

under the doctrine of *Pan American World Airways v. United States* . . . and *Hughes Tool Co. v. TWA*, . . . the Board's economic jurisdiction "extends beyond these areas specifically enumerated in the Federal Aviation Act to include those activities and relationships of an air carrier that directly affect its ability to provide air transportation" . . . this jurisdiction does not extend to the activities of air carriers or persons controlling air carriers which are unrelated to air transportation or have "only an incidental effect" on air transportation.¹¹⁹

The Department of Justice asserted that it and the Federal Trade Commission have "primary responsibility" for antitrust matters outside the air transportation industry, and that the CAB cannot acquire jurisdiction (to immunize, nor by implication, to regulate) over "non-air lines of commerce simply because they are owned by a holding company which also controls an airline."¹²⁰ Although Judge Seaver conceded that there were numerous anticompetitive problems that arise in diversified businesses, such as reciprocal dealing

¹¹⁷ 49 U.S.C. § 1384 (1970). The text of this provision is set out in note 35 *supra*.

¹¹⁸ *Initial Decision* at 10.

¹¹⁹ *Id.* at 11. See *Pan American World Airways v. United States*, 341 U.S. 296 (1963); *Hughes Tool Co. v. TWA*, 409 U.S. 363 (1963). Cf. *Breen Air Freight, Ltd. v. Air Cargo, Inc.*, 470 F.2d 767 (2d Cir. 1972), *cert. denied*, 411 U.S. 932 (1973), *noted in* 39 J. Air L. & Com. 453 (1973), where the Second Circuit held that the Civil Aeronautics Board's power to immunize from antitrust liability was limited by the statutory definition of "air carrier" in section 101(3) of the Act, 49 U.S.C. § 1301(3) (1970). The court in *Breen* concluded that despite close relationships to air carriers, persons outside the statutory definition could not be immunized from antitrust liability by the CAB.

¹²⁰ *Initial Decision* at 10.

and vertical foreclosure of competing suppliers,¹²¹ he rejected the strict antitrust controls advocated by the Department of Justice.¹²² Noting that diversification often results in pro-competitive effects,¹²³ Judge Seaver concluded that the Board's discretion and the availability of judicial review would be adequate to prevent interference with established competitive patterns in other industries.¹²⁴

VI. SPECIAL PROBLEMS IN AIR CARRIER REORGANIZATIONS

Aside from certain difficulties introduced by the existence of CAB regulation of air carriers, the reorganization of an air carrier, by whatever method, does not present problems essentially different from those incident to a similar transaction involving any other corporation. Certain specific objectives, including the search for profit centers that will offset the cyclical nature of airline revenues and the need for new sources of financing, will inevitably play a part in the selection and mode of acquisition or creation of subsidiaries and affiliates. Similar objectives are applicable to most industries, however, as are antitrust considerations and the necessity of fashioning the particular transaction to derive maximum benefit from the applicable federal tax laws.¹²⁵ The juxtaposition of these general objectives with the CAB's regulatory interests and policies can cause certain problems that would not ordinarily accompany a reorganization in a non-regulated industry.

The consequences of CAB regulation are quite apparent in the area of allocation of tax benefits. For example, an obvious tax advantage of a diversified corporate family is the filing of a consolidated income tax return.¹²⁶ This procedure would permit, *inter alia*, the losses generated by one entity to be offset against the profits of another, a consequence clearly desirable when an objective is to dampen the cyclical profit-and-loss patterns of indi-

¹²¹ *Id.* at 170.

¹²² *Id.* at 175-77.

¹²³ *Id.* at 173-74.

¹²⁴ *Id.* at 178-80.

¹²⁵ The applicable federal tax laws are among the most complicated provisions of the Internal Revenue Code. *See* INT. REV. CODE of 1954, §§ 38, 46-50 (relating to the investment credit); §§ 351-68 (relating to corporate organizations and reorganizations); §§ 381-83 (carryovers); §§ 1501-05, 1551-52, 1561-64 (consolidated returns).

¹²⁶ INT. REV. CODE of 1954, §§ 1501-05, 1551-52, 1561-64.

vidual members of the group. Additionally, the consolidated return permits certain otherwise unusable tax credits, loss carryovers and deductions attributable to one corporation to inure to the benefit of the other corporations that compose the diversified family.¹²⁷ Normally, the allocation of the benefits thus derived would be a matter of contract or agreement among the parties. Judge Seaver's proposed guidelines, however, would require that the air carrier member of an affiliated group receive the entire benefit of a tax credit generated by it whether or not the credit would later benefit the carrier if it were filing a separate return.¹²⁸ This arrangement is, of course, not inherently unreasonable, but neither is it totally realistic in terms of the myriad possibilities for other allocations within good business judgment not necessarily prejudicial to the air carrier. This requirement, while consonant with a policy engendering the fiscal stability of air carriers, could in practice operate as an arbitrary restriction on the ability of the corporate group to allocate available funds among its members as dictated by business exigencies and thereby serve to dilute the benefit of filing the consolidated return. Similar restrictions have been applied to intercorporate tax benefit allocations among the members of the Flying Tiger group, but their effect is not yet apparent.¹²⁹

Another area of uncertainty traceable to CAB influence, pending the outcome of the *Reorganization Investigation*, is the prospect of forced divestiture if the Board ultimately determines that certain types of air carrier reorganization are not in the public interest. In approving the Braniff reorganization,¹³⁰ the Board emphasized that it was granting only interim approval, and ordered Braniff to be prepared to "readily return to a non-holding company form of structure" until final resolution of the issues in the *Reorganization Investigation*.¹³¹ A similar condition was annexed to CAB approval of certain of Flying Tiger's financial arrangements with subsidiaries; this condition would not necessarily require anything as drastic as divestiture, but could require Flying

¹²⁷ INT. REV. CODE of 1954, §§ 38, 46-50, 381-83.

¹²⁸ *Initial Decision*, Appendix H at 9. See note 110 *supra*.

¹²⁹ See CAB Order No. 73-12-105 (Dec. 26, 1973); CAB Order No. 73-12-106 (Dec. 26, 1973).

¹³⁰ CAB Order No. 73-11-8 (Oct. 23, 1973). See note 50 *supra*.

¹³¹ CAB Order No. 73-11-8 (Oct. 23, 1973).

Tiger to "undo" certain financial arrangements.¹³² While the CAB advances what it considers good policy reasons for these conditions,¹³³ the hardship thus imposed on those responsible for conducting corporate affairs is apparent. The prospects of operating a diversified corporate enterprise under a threat of forced divestiture are not encouraging and must inevitably have the effect of discouraging certain transactions, particularly those involving long-term financing. Obviously, a parent would be reluctant to guarantee the long-term obligations of a subsidiary that might be stripped from it at any moment; nor would the parent corporation be willing to commit its own funds in this atmosphere of uncertainty. On the other hand, any advances from the subsidiary to the parent, or payment of a large dividend, might be considered a "raid" if divestiture were ordered and repayment compelled even if initially motivated by good business reasons. Admittedly, the threat of forced divestiture under the antitrust laws is present, at least theoretically, in any acquisition. The operation of the antitrust laws, however, is somewhat predictable, whereas the standards to be applied by the CAB are as yet unsettled. Until the Board prescribes ascertainable standards, there will inevitably be some hesitation on the part of the air carriers to enter into transactions that might result in a later order of divestiture. This temporary uncertainty might be tolerable if there were any assurance that the CAB would refrain from conditioning its approval of each transaction. There is, however, no guarantee that the Board will not reserve the right in every instance to order divestiture if it subsequently determines that the transaction was unwise. If the Board continues to take this approach, the result may be to discourage diversification involving air carriers except at times when the carriers are financially solvent and not in need of infusions of capital from other sources, but to discourage diversification, because of the threat of divesti-

¹³² CAB Order No. 73-12-105 (Dec. 26, 1973); CAB Order No. 73-12-106 (Dec. 26, 1973).

¹³³ The Board felt that it would be unfair to delay ultimate decision on these matters until it handed down its final decision in the *Reorganization Investigation*, but emphasized that it could only grant approval conditionally since the transactions it currently approves may be disapproved later in the final determination of the issues in the *Investigation*. CAB Order No. 73-11-8 (Oct. 23, 1973). Presumably the Board felt that it did not yet have enough information to make a decision on the broader issues, but the result of its conditional approval may be to impose a greater hardship than if decision on Braniff's application had been postponed.

ture, when the airlines are most in need of long-term financing. The CAB could order divestiture, for example, at the point when the carrier became profitable once more, reasoning that other members of the group were siphoning off its profits. Parties contemplating diversification transactions involving an air carrier are well advised therefore to proceed with some caution at present.

There are other restrictions contained in Judge Seaver's guidelines that create pitfalls for the unwary. These, however, are of a more speculative nature. For example, the guideline concerning intercorporate transfers would require that transfers from an air carrier be at fair market value or greater, while transfers to an air carrier might be at less than fair market value.¹³⁴ While this provision seems unduly slanted in favor of the air carrier, it may not prove too great a problem even if adopted by the Board since these transactions have tax consequences in many instances that nullify the benefit of the bargain price and are therefore avoided anyway.¹³⁵ A more subtle problem is involved in the provision restricting interest charges to air carriers to the maximum rate obtainable by arms-length bargaining.¹³⁶ This requirement, though objectively fair, could cause difficulty if CAB notions of an equitable interest rate did not coincide with those of the parties involved. The restriction is eased somewhat by a recommendation that a floating prime rate will be *prima facie* evidence of compliance.¹³⁷

These are, of course, just a few of the many intricacies that may be introduced into an already complicated area of the law, that of corporate reorganizations and corporate taxation, if extensive CAB regulation is overlaid onto the existing statutory scheme. Corporate counsel and tax advisers will conceivably be required to master a multitude of regulations and principles applicable only to transactions involving air carriers and which will entail restrictions on

¹³⁴ *Initial Decision*, Appendix H at 8. See note 109 *supra*.

¹³⁵ Cf. INT. REV. CODE of 1954, § 482.

¹³⁶ *Initial Decision*, Appendix H at 6. See note 108 *supra*.

¹³⁷ *Id.* This is an example also of a more general problem. The CAB's expertise in regulating, or prescribing guidelines for, such intercorporate transactions may or may not be adequate. But even assuming that the CAB is competent to prescribe such guidelines, its regulations may be so slanted in favor of the air carriers, if Judge Seaver's opinion is any indication, as to preclude many transactions which would otherwise be sound and accepted practice. The result would be, in some cases, to substitute the Board's judgment for that of experienced corporate executives who are more familiar with the needs of the business.

corporate action not consonant with ordinary notions of good business judgment absent a need for protection, imposed by CAB regulatory policy, of one member of an affiliated group. Until the Board issues a definitive statement concerning its intentions in this area, a certain degree of caution is essential.

VII. CONCLUSION

The airline industry has in fact had more experience with diversified business activity than the preceding discussion may indicate. A number of local service and supplemental carriers have been operated for some time as subsidiaries of companies engaged to a greater or lesser degree in activities unrelated to air transport.¹³⁸ Additionally, many carriers, including several of the large trunk carriers, have subsidiaries in both related and unrelated industries.¹³⁹ Most of these arrangements, however, either arose prior to the amendment of section 408 of the Federal Aviation Act, or, to the extent that they were subject to CAB regulation, were not of sufficient impact to warrant the degree of concern that triggered the *Air Carrier Reorganization Investigation*.¹⁴⁰ More recently, however, the applications of industry giants like Braniff for permission to reorganize have indicated that despite problems of diversified companies in other industries, the certificated air carriers have perceived that one remedy for the financial problems of the air transportation industry may be vertical reorganization, through creation of subsidiaries and holding companies, rather than horizontal reorganization, or merger, which has met with indifferent success.¹⁴¹ Diversification has been successful in many instances and many airlines are apparently eager to experiment with this device. Unless the CAB adopts a more flexible regulatory approach, however, it is likely that many of the benefits of diversification will be denied to the air transportation industry.

Although the Board's concern for air carrier stability is legitimate and probably justified by the potential for abuse of diversified cor-

¹³⁸ *Initial Decision* at 66-72.

¹³⁹ *Id.* at 70-71.

¹⁴⁰ *But see* *Foreign Study League v. C.A.B.*, 475 F.2d 865 (10th Cir. 1973); CAB Order No. 71-7-119 (July 21, 1971) (affirmed in *Foreign Study League v. C.A.B.*).

¹⁴¹ *See* note 3 *supra*.

porate structures, the projected plan of regulation is too restrictive. Many of the guidelines proposed by the Bureau of Operating Rights could in practice virtually preclude any exercise of independent business judgment in transactions subject to Board approval. Although the CAB clearly will have a regulatory interest in many intercorporate transactions to which an air carrier is a party, this interest is adequately served by existing regulatory mechanisms. The economic balance between air carrier and non-air carrier members of diversified groups does not require closer supervision than is already provided under the tax laws since many of the transactions that would be prohibited or discouraged under the proposed regulatory scheme have tax consequences which are generally sufficient to prevent their occurrence. Antitrust regulation by the Justice Department and the Federal Trade Commission is adequate, and the public interest in free competition would not be served by expanding CAB power to confer antitrust immunity. Furthermore, many of the dangers sought to be avoided by the proposed plan may be more apparent than real; the mere possibility of their occurrence does not justify such stringent regulation.

The Civil Aeronautics Board has ample power under section 408 to approve or disapprove acquisitions of control of air carriers. The Board's authority to condition its approval should be adequate to insure continuing supervision in those rare instances when it is warranted. Additionally, the Board's regulatory power over the air carriers themselves is sufficient to provide indirect control over relationships with subsidiaries that might weaken the parent air carrier. The possibility that excessive diversification contributed to the Penn Central collapse has not been sufficiently substantiated to justify restrictive CAB regulation or new legislation that would expand the Board's already considerable powers, especially since the result might be to discourage utilization of apparently valuable economic tools by the air carriers.

The Initial Decision is now before the Civil Aeronautics Board. The Board may decide that further legislation is needed and make an appropriate request to the Congress. It is more likely, however, that the CAB will conclude that it has the power to regulate air carrier diversification and will proceed to do so, either according to Judge Seaver's proposals or, hopefully, by some less stringent scheme of its own. The economic questions are largely a matter of

time and experience; the regulatory issues and the scope of CAB power may ultimately be decided in the courts, perhaps in the context of air carrier defiance of CAB regulation. Whatever the outcome, the Civil Aeronautics Board has been presented with a real challenge to its ingenuity and regulatory expertise; its reaction may well have profound influence on the economics of the air transportation industry.