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A COMPARISON OF TWO PROPOSALS FOR REGULATORY CHANGE

LUCILE SHEPPARD KEYES*

ACCORDING TO the Presidential message transmitting to the Congress the text of the proposed Aviation Act of 1975 (the Act), this legislation is intended to "replace the present promotional and protectionist regulatory system with one which serves the needs of the public by allowing the naturally competitive nature of the industry to operate."¹ It can fairly be said that this same fundamental objective underlies the recommendations of the CAB's Special Staff on Regulatory Reform (the *Report*).²

The two sets of proposals are also similar in contemplating the prompt institution of measures designed to liberalize regulation during an interim period, followed by further relaxation of controls after a period of several years. The next two sections of this study will outline the major similarities and differences in the short- and long-term regulatory programs respectively. Only the principal regulatory proposals are dealt with; no attempt is made at a comprehensive statement of either program.

In connection with the *Report*, the long term is to be understood as meaning "after a period of three to five years"; for the Act, the long term means "beginning January 1, 1981." As will be seen, three of the short-term proposals would go into effect only after a certain delay: *i.e.*, the Special Staff's plan for open entry into all-cargo markets after two years, the Act's provision for change in the treatment of airline mergers after thirty months, and the Act's liberalization of control over route transfers on January

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¹ Message from the President to the Congress of the United States transmitting the proposed Aviation Act of 1975 (Oct. 8, 1975).

² CAB, REGULATORY REFORM: REPORT OF SPECIAL STAFF ON REGULATORY REFORM (1975) (hereinafter cited as REPORT).

1, 1978. In addition, the Act allows suspension of rate reductions of twenty percent and forty percent below existing levels in the first and second years, respectively, of the effectiveness of the legislation (if the Board believes that the proposed reduced rates will be found to be illegal), after which suspension will be subject to a more restrictive legislative rule. These provisions are dealt with in more detail below.

A succeeding section will analyze the reasons for the differences, and attempt to evaluate the economic consequences of each program and its capacity to achieve the basic purpose common to both.

I. COMPARISON OF INTERIM PROGRAMS

In general, each interim program contemplates the liberalization of charter rules, increased flexibility of pricing on the part of the carriers, the lifting of operating restrictions contained in certificates of convenience and necessity, the broadening of authority to operate noncertificated service with small aircraft, and the elimination of any uneconomic services which may at present be required by law. With regard to mergers, the differences of substance between the Act and the Staff's recommendation seem to be more apparent than real, although there is a substantial difference in the treatment of anticompetitive agreements. The only really significant difference on entry policy, despite appearances to the contrary, is the *Report's* proposal—not shared by the Act—that open entry be provided for supplemental and all-cargo carriers. The following presents a brief, but detailed treatment of each of these areas of liberalization.

A. Charter policy

Though the *Report* and the Act both contemplate liberalization of charter rules, only the Act provides that these rules be liberalized "*permanently and by statute*"³ (emphasis supplied). For example, under the proposed legislation the Board could not require purchase of "advance-purchase charter trip" tickets more than thirty days in advance or prevent the tour organizer from selling up to twenty-five percent of the tickets at any time before departure,

³ Section-by-Section Analysis accompanying the text of the Aviation Act of 1975 transmitted October 8, 1975, p. 1.

and minimum stay requirements would be similarly limited by law.⁴ The *Report*, on the other hand, takes the view that expanded charter authority should be accomplished through rule-making,⁵ i.e., with the Board retaining the power to alter this authority and to limit its applicability when necessary to protect "the corporate existence of individual scheduled carriers."⁶

B. Price policy

The basic difference between the *Report* and the Act regarding price regulation in the short term is to be found in the latter's provision that "a rate above direct costs may not be found to be unjust or unreasonable on the basis that it is too low, and the Board may or require an air carrier to charge, demand, collect, or receive compensation in excess of that carrier's direct costs for the service at issue."⁷ The actual price flexibility provided under the Act is in a range between a (somewhat modified) normal public utility-type reasonable maximum and a "direct cost" floor. Its additional provisions for ten percent "flexibility" per year upward and twenty percent "flexibility" per year downward in the first two years of its effectiveness apply only to *suspensions* and not to actual regulatory ceilings or floors. The *Report* likewise retains a (similarly modified) normal regulatory maximum⁸ for the interim

⁴ S. 2551, 94th Cong., 1st Sess. § 3 (1975) (hereinafter cited as Aviation Act of 1975).

⁵ REPORT at 311-12. Under this proposal, the authority of the Board to effect further liberalization would be clarified by a statutory change already proposed by the Board.

⁶ *Id.* at 312.

⁷ Aviation Act of 1975 § 14(a). Section 14e adds the following definition of direct costs: "'Direct costs' means the direct operating cost of providing service to which a rate, fare, or charge applies, and shall not include such items as general and administrative expenses; depreciation; interest payments; amortization; capital expenses, costs associated with the development of a new route or service; and other fixed costs or costs which do not vary immediately and directly as a result of the service at issue."

⁸ The Staff's recommendation is that the Board consider "through an appropriate proceeding, the [formal] adoption of a ceiling approach to rate-making" REPORT, at 354, especially in view of the fact that "a commendable *de facto* flexibility has been adopted [by the Board] with respect to discount fares." *Id.* at 351. The ceiling is to be calculated by "perfecting those standards set in the DPFI," *Id.* at 360 (i.e., the recently concluded Domestic Passenger Fare Investigation, CAB Docket No. 21866), so as to "bring about closer conformity to the price/quality mix desired by consumers, to discourage dissipation of profits by wasteful practices, and to tailor the ceiling fare structure more closely to cost relationships." REPORT at 361 (*emphasis supplied*). The new rule of rate-making

period, but the contemplated "floor" includes the possible use of the minimum rate power to protect the finances of an existing carrier.⁹

C. Restrictions in certificates

Both the Act¹⁰ and the *Report* contemplate the removal of operating restrictions contained in certificates of convenience and necessity over a five-year period. Though the Staff's interim program calls merely for an "attempt to remove restrictions inhibiting carrier operations by developing a systematic program of Board-instituted proceedings or hearing carrier applications meeting specified criteria,"¹¹ its basic reform program calls for the abandonment of protective certification—and thus *a fortiori* the elimination of certificate restrictions—after a period of three to five years.

D. Elimination of uneconomic service

The *Report* and the Act agree on an abandonment policy which would assure the carriers "that they would not be required to provide non-compensatory service."¹² Since this policy involves no essential departure from the Board's present practice, it does not receive great emphasis in the *Report*; however, it is recommended that the Board accord priority "to proceedings that would eliminate uneconomic service."¹³

E. Mergers and agreements

Neither the *Report* nor the Act contemplates any major substantive change in merger regulation as compared with the Board's past and current practice. As the *Report* notes, "The Board has generally discouraged mergers that would significantly further concentrate the industry by refusing to approve mergers between large

in the Act points to a similar modification of accepted public utility rate-making principles in requiring the Board to consider as being in the public interest "the quality and type of service required by the public in each market" and "the desirability of a variety of price and service options such as peak and off-peak pricing to improve economic efficiency." Aviation Act of 1975, § 14(b).

⁹ REPORT at 360.

¹⁰ Aviation Act of 1975 §§ 6(c) and 9.

¹¹ REPORT at 378.

¹² *Id.* at 9.

¹³ *Id.* at 377.

carriers, and between viable carriers,"¹⁴ and there is good reason to believe that most, if not all, of the Board-approved mergers would have passed the legal test prescribed in the Act.¹⁵ The Staff's only recommendation for change in the interim period was that the Board "seriously consider the disapproval of merger applications within the industry if a failing carrier can be reasonably expected to be purchased or otherwise rescued by outside interests."¹⁶ The expanded role which the Act would prescribe for the Department of Justice, because based on the same substantive rule that would govern the actions of the Board, would presumably not make any appreciable difference in the operative meaning of the law.

With respect to intercarrier agreements, a substantial difference is the Act's categorical prohibition of the approval of agreements controlling capacity, providing for pooling, or fixing prices.¹⁷ The Special Staff expressly endorsed the "short-term approval of capacity agreements [that] can forestall a merger or bankruptcy of a major carrier"¹⁸ during the interim period, and did not expressly recommend disapproval of other forms of anticompetitive agreement for such a purpose during this period.

F. Entry

Both the Staff *Report* and the Act provide for promptly expanding commuter carrier exempt authority to accommodate aircraft of approximately fifty-five revenue seats (up from the present thirty).¹⁹ The *Report*, however, proposes a further opening up of zones

¹⁴ *Id.* at 388.

¹⁵ Section 11 of the Aviation Act of 1975 provides that, after a 30-month period, the Board is not to approve any consolidation, merger, or acquisition of control "(1) if it would result in a monopoly or would be in furtherance of any combination or conspiracy to monopolize the business of air transportation in any part of the United States, or (2) whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless the Board finds that the anticompetitive effects of the proposed transaction are outweighed in the public interest by the probable effect of the transaction in meeting the transportation convenience and needs of the community or communities to be served, and unless it finds that such transportation convenience and needs may not be satisfied by any less anticompetitive alternative." On the Board's past policy, see Keyes, *Notes on the History of Federal Regulation of Airline Mergers*, 37 J. AIR L. & COM. 357 (1971).

¹⁶ REPORT at 389.

¹⁷ Aviation Act of 1975 § 12.

¹⁸ REPORT at 393.

¹⁹ Aviation Act of 1975 § 6(b); REPORT at 333-36. The Report recommends

of air transport service not to be subject to protective regulation—that is, supplemental air transportation and all-cargo air carriage.²⁰ Assuming that section 6(b) of the Act is amended to reflect more closely the intent of its authors, the open zones proposal constitutes the only really significant substantive difference between the *Report* and the Act as regards entry control in the short term. The Act does indeed contain a provision for procedural reform in the treatment of route applications²¹ which has no parallel in the *Report*. The set of general principles for the treatment of such applications which is recommended in the *Report*,²² however, if publicly adopted after notice and hearing, could form an appropriate basis for a reformed procedure such as is envisaged in the Act.

Although the Act at first reading appears to embody further significant relaxation of controls over entry in the immediate future, a closer look at the legislation reveals that it would not accomplish this result. The features of the Act which seem to offer hospitality to new competition are threefold: (1) Section 6(b), which provides that any one who is “fit, willing, and able” will be permitted to provide air transportation “between any two cities not receiving nonstop air transportation by an air carrier holding a certificate of convenience and necessity”; (2) section 7, which provides that beginning on January 1, 1978, transfers of authority to engage in interstate scheduled air transportation to any air carrier will be similarly subject only to a “fitness, willingness, and ability” test (plus procompetitive standards of section 408 of the Federal Aviation Act); and (3) section 4, which embodies a new declaration of policy.

In connection with section 6(b), it should be pointed out that a recent study by the CAB's Bureau of Operating Rights shows that by 1973, eighty-eight percent of the 210 forty-eight state city pairs involving all combinations of the nation's twenty-one large hubs were already receiving nonstop service, and only one such

that larger aircraft be authorized only in city-pair markets not served by a local service carrier with the same class of aircraft.

²⁰ REPORT at 311-33. As is brought out below, the Staff's recommendations with respect to all-cargo carriage would consist of two steps, a more limited liberalization to be undertaken immediately, and completely open entry after two years.

²¹ Aviation Act of 1975 § 5.

²² REPORT at 374-86.

city pair did not have single-plane service.²³ In this study, a city-pair market is defined to include service to satellite airports as well as principal terminals. Presumably the drafters of the Act had a similar definition in mind, since very important trunkline markets would otherwise have been opened up at once to new competition under the proposed law.

The Act should—and presumably will—be changed to clarify this point and to prevent other circumventions of its intent by such means as combinations of nonstop services to provide single-plane, through, or connecting service between large hubs. For this purpose, a case-by-case assessment of possible competitive impact on existing services would apparently be required; any prospective service appearing to involve the possibility of significant competitive impact would then be subjected to the ordinary certification process.

The Bureau further estimated that among city pairs *not* receiving nonstop service in 1972, there were 372 “in which traffic might be expected to grow sufficiently to warrant nonstop service by 1985.”²⁴ In 247 of these, or sixty-six percent of the total, the Bureau found that *unrestricted nonstop authority already existed at the time of the study*.²⁵ In these markets the incumbent carrier could preempt new competition by instituting nonstop service without the necessity for any further administrative action at all. Of the remaining thirty-four percent, single plane service was found to be authorized in all but two cases. With these two exceptions, therefore, authorization of nonstop service by the incumbents required only the removal of certificate restrictions. Under the proposed legislation, these restrictions would be eliminated by 1981 in any case, so that here again the incumbents would be able to preempt competition without administrative action. Meanwhile, it is unreasonable to suppose that the Board would often refuse to eliminate an existing restriction on an incumbent in a market “threatened” by new nonstop competition. Some of this preemptive nonstop service might well be premature and therefore temporarily unprofitable.

²³ CAB, THE DOMESTIC ROUTE SYSTEM: ANALYSIS AND POLICY RECOMMENDATIONS, at 21-25 (1975).

²⁴ *Id.* at 139.

²⁵ *Id.* at 142.

Section 7 of the Act would appear to be similarly unpromising as an avenue to new competition. In the first place, a carrier would be unlikely to sell off (unless at an exorbitant price) an important market except under extreme financial duress. In addition, if such a sale were made, it would necessarily involve a commitment by the seller not to serve the market in question—a commitment which would constitute a restriction (by contract) similar to those which the legislation seeks to eliminate in the carrier's certificates, and would obviously make it impossible for the transfer mechanism to result in any net new competition on any route. Moreover, if such a sale were made, the effect would be capitalization of a monopoly right, the financing of which the purchaser would have to add to his costs of operation. It may also be noted that the opportunity to purchase a route is expressly limited to those who already enjoy the status of "air carrier," which means those who either already enjoy the status of "air carrier," which means those who either already possess Federal certification (the certificated route air carriers and supplementals) or have been exempted by the Board from the certification requirement (indirect air carriers, air commuters, and air taxis).

As 1981 approaches, the attractiveness of the section 6(b) avenue to non-air carriers as well as certificated and exempt carriers, and the attractiveness of the section 7 avenue to the latter two, as a means of getting a foot into the door of scheduled service, will increase somewhat as a result of the automatic expansion provisions which become operative in 1981 under the Act. As will be noted in the following section of this discussion, however, the quantative impact of this possibility will apparently be minor.

The provision of the Act which at first appears to offer the greatest opportunity for opening up entry within and into the industry is the amended declaration of policy,²⁶ a straightforward interpretation of which would require immediate abandonment of the protection of carrier profits as an objective for regulatory action. This requirement would, of course, put a prompt end to the practice of protective entry control. A brief discussion of the significant changes embodied in the amended policy declaration will serve to bring out this point.

²⁶ Aviation Act of 1975, § 4.

There are three changes in the policy declaration which have an important bearing on the administration of entry control. First, the removal of the mandate to regulate air transportation as to "foster sound economic conditions . . . in such transportation."²⁷ Secondly, the removal of "promotion" of air carrier services and of civil aeronautics in general as one of the aims of regulation.²⁸ Thirdly, the replacement of the statutory endorsement of "competition to the extent necessary to assure the sound development of an air-transportation system properly adapted to the needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense"²⁹ (emphasis added) by two new provisions directing the Board to consider "maximum reliance on competitive market forces and on actual and potential competition to provide the needed air transportation system" and "the encouragement of new air carriers" as being "in the public interest and in accordance with the public convenience and necessity. The new references to responsiveness to the needs of the public and "the provision of a *variety* of adequate, economic, efficient and *low-cost* services" (emphasis supplied) might also be construed as favoring new entrants proposing to provide innovative forms of service, especially at bargain prices.

Both "sound economic conditions" and "promotion" as regulatory aims can be and have been interpreted as implying protection of the finances of particular airline companies by deliberate restriction of new competition. The elimination of these terms, especially in light of the Presidential Message cited above, might therefore plausibly be interpreted as implying that such protection is no longer to be provided. Moreover, such protection is certainly incompatible with "maximum reliance on competitive market forces and on actual and potential competition," and has historically played a major (but largely indirect) role in discouraging entry of new carriers into the trunkline industry.

Adoption of this interpretation would radically alter the operative meaning of the "public convenience and necessity" and elimi-

²⁷ Federal Aviation Act of 1958 § 102(b), 72 Stat. 731, *as amended*, 49 U.S.C. § 1302(b), *formerly*, Civil Aeronautics Act of 1938, ch. 601, 52 Stat. 973.

²⁸ Federal Aviation Act of 1958 §§ 102(c), (f), 49 U.S.C. §§ 1302(c), (f) (1970).

²⁹ Federal Aviation Act of 1958 § 102(d), 49 U.S.C. § 1302(d) (1970).

nate the whole process of carrier selection as it is now understood. Whether a market could be expected to support an additional carrier would be irrelevant to public policy if it were not necessary to protect the profitability of the applicant or of the current incumbent, and there would be no need to reject any qualified (fit, willing, and able) applicant. "Choice of carrier," in the sense of selection among qualified applicants on the basis of (probable) relative performance, would be left to the market.

The very broadness of the new policy declaration makes it virtually certain, however, that a straightforward interpretation of it will not be accepted by the Board or by the courts, if only for the reason that immediate adoption of such an interpretation (and the law provides for no delay in its effectiveness) would be manifestly inconsistent with the program of limited liberalization which is clearly contemplated in the rest of the Act. For example, there would be no reason to single out markets not now receiving non-stop service as subject to open entry by the fit, willing, and able if the same condition were intended to prevail with respect to *all* markets.

It may be concluded that passage of the Act, assuming that it is changed to reflect the intent of its authors, would result in no significant changes in entry conditions in the interim period, apart from the expansion of commuter carrier authority. The same observation applies to the recommendations of the Special Staff, with the additional exceptions of the opening up of supplemental and air cargo transportation.³⁰

II. COMPARISON OF LONG-TERM PROGRAMS

In contrast to the situation in the short term, very pronounced and basic differences exist between the Act's long-term program and that out-lined in the Staff *Report*. These differences pertain es-

³⁰ Certain additional recommendations of the Staff with respect to entry policy would appear to be of little practical importance. At least in the absence of extraordinary political pressure, it seems very unlikely that granting priority to applications such as that of World Airways to provide low-fare service in the trans-continent market (Docket 27693) would bring about a reversal of the Board's long-term and consistent practice of denying new entry in trunkline markets. REPORT at 383-86. Moreover, the introduction of Board-estimated "comparative economic efficiency" of carriers into the existing list of selection factors, REPORT at 388, would probably have a minor effect on the ultimate outcome of new route proceedings.

pecially to entry control, charter policy, public utility-type maximum price regulation, and, to a lesser extent, merger regulation. Despite some differences in administration, it would appear that the substantive treatment of minimum prices, exit, and intercarrier agreements would not differ very greatly under the two proposed regimes.

A. Entry Control and Charter Policy

The Special Staff recommended the abandonment of protective entry control throughout the airline business in the long term, "together with the adoption of a procedure to insure continuing financial fitness, and observance of insurance and bonding requirements, on the part of air carriers, whether existing or newly entering the field."³¹ Such a regime would imply the absence of restrictive charter rules, although regulation of the use of the term to avoid deception of the public might conceivably prove to be necessary.³² The Act, on the other hand, would permit retention of restrictive charter rules subject to the limits it prescribes, and provide for continuation of the same controls (substantially unchanged) over entry as existed in the short-term period, plus the permission of an essentially arbitrary yearly route expansion for existing scheduled carriers with very limited opportunity for new competition from outside the scheduled industry.³³

³¹ The "financial fitness" and insurance and bonding requirements are intended to supplement safety regulation by the Federal Aviation Administration, which regulation appears to require strengthening at the present time, whether or not economic regulation is reformed. Although the "financial fitness" requirement has been in force for some years with respect to the supplemental carriers, it has never, so far as the present writer has been able to determine, resulted in the grounding of any supplemental airline, despite the fact that a number of these have experienced large and continuing losses and passed from the scene. The requirement appears to be useful only in screening out the (admittedly unlikely) entrant or the (even more unlikely) existing operator who could meet FAA technical requirements but possessed insufficient working capital to cover maintenance expenses.

³² The Special Staff was unable, during the time allowed, to develop detailed recommendations for the regulatory apparatus which would be appropriate in the long term. It therefore recommended further study of several aspects of this apparatus, including "[e]xamination of the tariff provisions of Title IV [of the Federal Aviation Act of 1958] to determine whether they are adequate to assure continued publication of, availability of, and adherence to tariffs and schedules, to provide the necessary information to establish a market, to facilitate interline ticketing . . . , and to provide ample notice for the alteration, commencement, or termination of schedules." REPORT at 304.

³³ Aviation Act of 1975 § 9.

Beginning in 1981, large (trunkline size) and medium-sized unsubsidized passenger carriers would be permitted to expand their route systems every year without administrative control, to the tune of five percent of the average ASM's operated by this type of carrier in the preceding year. Smaller carriers would be permitted to expand by ten percent of the average ASM's of the carriers in their class, or ten percent of their own ASM's, whichever was larger. There would be two such smaller-carrier classes, one comprising carriers of the size of the subsidized local service airlines and the other made up of smaller operators. All-cargo carriers would be permitted to expand yearly by ten percent of the average available ton-miles in this class. Both intrastate and interstate carriers would be eligible for "free" expansion, but those not engaged in *scheduled* service would not be so eligible, and only scheduled mileage would be counted in computing the basis for expansion. Moreover, the Board would be required to issue a permanent certificate for any new route served under this provision when it had been operated for a period of twelve consecutive months with a minimum of five round trips per week. Thus, after a year, there would be no effective limit on the amount of capacity which can be provided on the freely "occupied" new routes.

It is not easy to predict the effect of this odd (to say the least) form of controlled entry. It appears, however, to have no plausible justification in terms of basic reform, continued protection, or transitional gradualism. Since the allocation of new route opportunities among carriers is essentially arbitrary, and the opportunities are in any event limited to those who already have a foothold in the scheduled industry, the procedure certainly cannot be called basic reform. On the other hand, the expansion opportunities (especially in view of the unlimited amount of capacity which can be offered after a year) are entirely sufficient to permit weaker existing carriers to be progressively eliminated. The scheme evidently does not represent a gradual transition to a basically reformed system, with free entry and free pricing, since such a system would never be arrived at. On the contrary, it appears to involve the effective continuation of the present closed system with ultimately an even greater tendency to concentration and non-aggressiveness.

The attractiveness of the sections 6(b) and 7 avenues to entry will be somewhat increased by the availability to entrants of "free" or "automatic" expansion under Section 9 beginning in 1981. Although there is no reason to believe that these avenues would offer any broader opportunity for profitable new services in the long term than in the short, some uneconomic services might conceivably be initiated under these sections as stepping stones to greener pastures; similarly, some new firms might be tempted to try to initiate intrastate operations with large aircraft,³⁴ or air commuter operations, with a view to becoming eligible for expansion. Because all of these avenues would permit initial operations only at a very small scale, however, and the opportunity for "free" growth would hence be limited to that available to the smallest class of carrier, the potential expansion of any new entrant would be effectively limited.

B. Maximum and Minimum Price Regulation

In keeping with its recommendation of open entry, the Special Staff also recommended the abandonment of public utility-type price regulation, including both ceilings and floors. The Act, on the other hand, would permit the continuation of traditional (but, as has been noted, somewhat modified) maximum price regulation and would provide for a direct-cost floor administered by the Board. Since the antitrust laws can presumably be relied on to prevent price cuts for the purpose of knocking out a competitor, which result in short-term losses, there should be little effective difference in *minimum* price regulation under the two long-term regimes.

C. Merger Policy

As was indicated above, the Act provides for continuing control over mergers by the CAB, which could grant antitrust immunity on the basis of a finding that a transaction's anticompetitive

³⁴ Opportunities for entry into intrastate operations with large aircraft will be limited by protective regulation by State governments, unless some action is taken to prevent this. In this connection, the Special Staff recommended that a qualified body "consider the question of whether action will be needed to forestall restrictive State regulation by establishing Federal jurisdiction to the boundaries of the present air commerce definition under the Federal Aviation Act, thus preempting State regulation, or at least to the jurisdictional limits of present Federal economic regulation, so as to avoid litigation based on Constitutional grounds of burdening interstate commerce." REPORT at 306.

effects are outweighed by its contribution to transportation convenience and needs, which contribution could not be secured by a less anticompetitive method. This standard is generally regarded as more permissive than that utilized under the antitrust laws; to the extent that this is really the case, the *Special Staff Report* provides a more stringent control over airline mergers than does the Act. The *Report* recommends the application of straight antitrust standards, with any special administrative agency which may remain or be set up over the airline industry limited to receiving pre-merger notification and informing and advising the Attorney General on such cases.³⁵

D. Exit

The long, as well as the short-term recommendations, of both the drafters of the Act and the Special Staff are in general agreement that no carrier shall be compelled to continue to provide any uneconomic service; and each contemplates that service shall be terminated only after due notice.

E. Inter-carrier Agreements

While the long-term treatment of inter-carrier agreements, like some other aspects of reformed regulation, was believed by the Staff to warrant further study,³⁶ it foresaw no justification, under the reformed regime, for anticompetitive agreements designed merely to protect individual carrier finances. This position appears to be basically similar to that embodied in the Act.

F. Recommendations Regarding Subsidization of Service to Small Communities

In addition to the major long- and short-term regulatory recommendations just discussed, the Special Staff proposed a plan for replacement of the present program of subsidization of the local-ser-

³⁵ REPORT at 305-06.

³⁶ REPORT at 303-04. The Staff recommended that a qualified body undertake to consider "the question whether antitrust immunity actually is necessary to permit carriers to achieve otherwise unavailable cost reductions and product improvements, including action to meet special semi-emergency situations, and, if such immunity is necessary, [the formulation of] an exact rule to make sure that the agency empowered to grant immunity does not do so for other purposes." The Staff also recommended that this body develop "a statutory rule directing the agency supervising inter-carrier relations to make sure that any cooperative agreements or arrangements facilitating the efficient operation of the air transport system are administered in a nonexclusionary and nondiscriminatory fashion."

vice airlines under the Federal Aviation Act with a less costly low-bid contract system better designed to secure needed service at isolated small communities,³⁷ a program which had previously been submitted to Congress on the basis of a definitive study of the problem by the Board's staff.³⁸ The *Report* also proposed certain less comprehensive reforms which should be undertaken in this area if the contract system were not adopted.³⁹ On this subject, the Act merely recommended that the Secretary of Transportation undertake a year-long study of the subsidization program, including identification of "the cost of local service subsidy involved in providing service at each city,"⁴⁰ and recommend any necessary changes to Congress. Further discussion of these proposals would take us too far away from the central topic of this study, which has to do with regulation rather than subsidization.

III. ANALYSIS OF DIFFERENCES AND EVALUATION OF CONSEQUENCES

To recapitulate: On the assumption that section 6(b) is amended as suggested above, the chief differences between the *short-term* regulatory programs of the *Report* and the Act are (1) the *Report's* more conservative approach to charter rules, pricing and inter-carrier agreements; and (2) the Staff's recommendation that open entry be promptly provided in supplemental and all-cargo air transportation. For the *long term*, the Staff suggests a far more liberal approach to entry, charters, and maximum price control, and (probably) a somewhat less permissive approach to the treatment of mergers. Other differences are of relatively minor import.

The chief reason for the Staff's relative conservatism in certain areas in the short run was its belief that expectations built up over a period of thirty-seven years should not be abruptly disappointed, a consideration which was thought to necessitate the continuation of the established policy of protective regulation for a generous time period, estimated by the Staff at three to five years. It was believed that such a period would also provide ample time

³⁷ REPORT at 336-39.

³⁸ CAB, STAFF STUDY OF THE BUREAU OF OPERATING, SERVICE TO SMALL COMMUNITIES RIGHTS (1972).

³⁹ REPORT at 372-74.

⁴⁰ Aviation Act of 1975, § 16.

for studying some as yet unresolved questions regarding the precise substantive and administrative make-up of a reformed regulatory scheme. A second reason for conservatism was the belief that, given the maintenance of the policy of protective entry control, any major uncontrolled or irreversible relaxation of other controls over competition within the closed group of certificated scheduled carriers could lead to further artificial concentration of the industry in the transitional period, which might in turn tend to inhibit competition in the long run.

It would then become necessary to provide an adequate period of time for preparation of a more open regulatory framework. Such preparation, possibly including reshaping of route systems, revision of capital structures, pruning of unnecessary expenses, formation of subsidiaries to take over homogeneous subsets of a carrier's present system (and thus possibly reaping the economic advantages of specialization), was considered to be far more acceptable than direct indemnification of the affected interests. As the *Report* stated:

Abrupt change could be objected to as tending unjustly to upset expectations built up over a long period of years. This consideration does not, of course, justify indefinite continuation of the *status quo*; otherwise, an industry subjected to protective regulation would be forever foreclosed from the institution of a more competitive regulatory framework. It cannot be accepted that protective regulation, or other governmentally-conferred privilege, should be preserved intact forever because of the expectations of special sectors of the economy, in disregard of the basic rights and interest of the nation as a whole.

Other than a suitable amount of time to prepare for the new dispensation, it does not appear that considerations of equity or practicality require that any special aid or indemnity be provided for the affected interests. Suggestions for compensation for the value of the route certificates, offers for government purchase of aircraft, or special subsidies to "cushion" possible losses all amount either to the recognition of a non-existent property right in the certificates or to a means of buying off potential opposition.⁴¹

Within a closed group, uncontrolled price competition may well lead to undesirable results: the prevailing pattern of nonaggressive

⁴¹ REPORT at 293.

equilibrium among interdependents may be broken from time to time by a campaign of predation, since a notably weak airline would present a tempting target for such a campaign in a situation in which a defeated firm could be expected not to be replaced from outside. Given the apparent differences in the efficiency of various carriers, a direct-cost price floor might prove insufficient to prevent such a development.

In accordance with the same desire to avoid the abrupt disappointment of expectations, the Staff's proposals for opening up entry into all-cargo and supplemental air transportation (as well as its recommendation that the size limitation on exempt commuter aircraft be raised) were believed to involve no loss of presently valuable rights to those directly affected and no severe financial impact on any other air carriers outside the group.⁴² The benefits anticipated as a result of opening up entry for supplementals included the maintenance of "the already high efficiency level attained by these firms" and consequent insurance "that the low-price, low-quality option they offer will continue to be provided at minimum cost." It was also believed that charter services would be extended under this dispensation to "markets that would not otherwise be served" and that the Board, the Congress and others would be provided "with continuous objective evidence on labor and other costs associated with large aircraft operations not conducted under a monopoly license."⁴³ Open entry into the all-cargo field (together with the also recommended elimination of cargo rate regulation) was expected to "(1) maintain or enhance the current quality of service, and possibly lead to lower rates than otherwise would be charged; [and] (2) offer the potential for long-run improvements in carrier efficiency, rates and service, as well as the penetration of markets that are now served primarily by surface transport."⁴⁴

The liberality of the regulatory framework recommended by the Special Staff for the long term is justified by an analysis of the

⁴² *Id.* at 321-22, 324, 325. With respect to the all-cargo market, entry was to become entirely open after a two-year period. Meanwhile, entry was to be opened for carriage of high-density cargo and in markets receiving only a small amount of all-cargo service during a specified base period. *Id.* at 323.

⁴³ *Id.* at 313.

⁴⁴ *Id.* at 322-23.

basic economic characteristics of the airline industry and by examination of the historic performance of that industry under regulation. For these underlying arguments, the reader must be referred to the text of the *Report* of the Special Staff. The recommended treatment of mergers in accordance with general antitrust principles rests on the belief that the airline industry does not require some specially higher degree of monopoly in order to function efficiently. Elimination of maximum price control similarly seems appropriate because of the expected efficacy of actual and potential competition in limiting airline pricing. The abandonment of protective entry control is essential in order that actual and potential competition be fully effective in limiting price, promoting quality and efficiency, and spurring innovation.

For the industry to achieve maximum service of public needs through competition, it seems to be of crucial importance that airline markets be opened up to competition from outside the presently certificated industry. If the industry remains effectively closed to outsiders, the interdependent in-group will be likely as a rule to continue the typical nonaggressive pattern which has characterized its behavior in the past. It is a fact of the highest significance that both of the major marketing innovations in the history of the industry—air coach and charters—received their impetus from outside the protected group.⁴⁵ Without open access from the outside, then, the industry under the proposed Act might well continue in essentially the same pattern as it has done in the past, with the steady attrition in numbers aggravated by uncontrolled, arbitrarily distributed competition from within and by a policy towards mergers which appears to be at least as permissive as that followed by the Board in the past. In the supplemental field, maintenance of closed entry as the charter market expands would be likely to result in a decrease in efficiency, accompanied by an increase in the value (now at or near zero) of the existing license; consequently, far greater difficulty would be experienced in opening up the market

⁴⁵ See, for example, Jones & Davis, *The 'Air Coach' Experiment and National Air Transport Policy*, 17 J. AIR L. & COM. 1, 3 (1950), and the testimony of Secor D. Browne (then Chairman of the Civil Aeronautics Board) in the Hearings before the Subcommittee on Aviation of the U.S. Senate Commerce Committee, *amending the Federal Aviation Act of 1958*, Serial No. 92-105 (1973).

at a future date.⁴⁶ A similar development might well occur in the all-cargo industry.

At the same time, the continuation of maximum price control by the Board, in a period when inflationary cost increases are not expected to be offset (as in most of the past) by the results of technological advance,⁴⁷ will bring about a strong possibility that carrier earnings will be held artificially low because of political pressures, that the debt-equity ratios of the carriers will deteriorate further, and that the decline in industry numbers will be further accelerated.⁴⁸ It would seem that contemplation of these possible consequences should persuade the sponsors of the Aviation Act of 1975 to consider reformulation of its major provisions.⁴⁹

⁴⁶ On this point, see the REPORT at 319-21.

⁴⁷ See note 23 *supra* at 122-29.

⁴⁸ REPORT at 257-66.

⁴⁹ Such a reconsideration appears to be especially appropriate in view of the fact that the Secretary of Transportation in a recent major policy statement has joined the Board and practically all serious students of transportation economics in repudiating the policy and practice of cross-subsidization, thus undermining the principal argument now in use by proponents of protective regulation. SECRETARY OF TRANSPORTATION, STATEMENT OF NATIONAL TRANSPORTATION POLICY at 12, 14 (1975).

