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AN EXAMINATION OF TRADITIONAL ARGUMENTS ON REGULATION OF DOMESTIC AIR TRANSPORT

BRUCE KEPLINGER*

Economic regulation of private industry by independent national commissions has been a part of the American way of life since the 1880's. Recently, the continuing discussion over the desirability and effectiveness of this regulation has been intensified by presidential proposals to move toward economic deregulation of commercial aviation. One such proposal is to deregulate the powers of the Civil Aeronautics Board (CAB), which has regulated the domestic airline industry since 1938. The CAB was created as an experiment to aid the growth of the infant commercial airline industry emerging from the Depression of the 1930's. Government regulation was imposed on the airline industry because the market forces of private industry were thought to hinder development of commercial air transport. To eliminate or severely curtail this regulation is a radical step which should not be taken without careful consideration of the reasons for CAB regulation.

This comment will demonstrate that past arguments made by proponents of regulation do not support retention of the framework in domestic air transport in the late 1970's. First, the grounds for creating the CAB were spurious. Secondly, even if the founding

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1 In this paper the term "deregulation" refers to any program that removes the government's economic controls over the airline industry, returning the industry to private economic forces. As will be seen, deregulation does not mean abandoning safety regulations, antitrust laws, or any of the common law rules against unfair competition.

2 H.R. 10261, S. 2551, 94th Cong., 1st Sess. (1975). This bill would not end all CAB regulation, but would place a greater emphasis on encouraging competition.

3 The CAB was established by the Civil Aeronautics Act of 1938, ch. 601, 52 Stat. 973 (1938).

of the CAB were an appropriate response to the conditions of 1938, when an infant industry was trying to develop under depressed economic conditions, the present state of the airline industry dictates that the justifications of 1938 are no longer applicable. Since World War II commercial air transport has developed into the dominant source of transportation over long distance markets in the United States. In this dominant position, the airlines may no longer require government protection. Moreover, opponents of regulation have asserted that regulation of commercial air transport is today costing the American consumer several billion dollars each year in the administrative costs of satisfying the CAB regulations, the artificially high rates, and excessive service quality, and if these assertions of economic waste are correct, prompt decisions concerning the desirability of continued regulation are needed; if past arguments do not support retention of the federal regulatory framework, new justifications showing that regulation is needed in the modern air transport industry should be presented for evaluation. The future of air transport regulation must rest on the strength of these contemporary arguments.

I. BACKGROUND OF THE 1938 ACT

Although Congressional investigations of aviation began as early


 CIVIL AERONAUTICS BOARD, THE DOMESTIC ROUTE SYSTEM: ANALYSIS AND POLICY RECOMMENDATIONS 122-34 (1974). This report projects continued growth in the industry. Even during the period of 1968-1972, which was considered a slump in airline growth, the growth rate was six percent per year. Id. at 123.

 The proponents of regulation have pointed to this growth as proof of the correctness of federal regulatory policies. Tipton & Gerwitz, The Effect of Regulated Competition on the Air Transport Industry, 22 J. AIR L. & COM. 157 (1955). There is, however, no proof that the industry's growth is not more attributable to the massive technological improvements that have occurred during the regulatory period. Perhaps the growth would have been even more rapid and innovative without federal regulation.

 Green and Nader, Economic Regulation vs. Competition: Uncle Sam the Monopoly Man, 82 Yale L. J. 871 (1973). The estimate is that the cost was $2-4 billion in 1972. Id. at 882. In 1975 the minimum estimate was one billion dollars per year. Hearings on Oversight of CAB Practices and Procedures Before the Subcomm. on Administrative Practice and Procedure of the Senate Comm. on the Judiciary, 94th Cong., 1st Sess., vol. 2, at 1153 (1975) [hereinafter referred to as Kennedy Hearings, 1975].

 The contemporary arguments are presented in 41 J. AIR L. & COM. Vol. 4 (1975).
as 1918, the first comprehensive legislation on the subject did not appear for twenty years.\textsuperscript{10} The initial interest in air transport was in the field of mail delivery. In 1925 Congress began subsidizing air commerce by paying airlines more than the cost of carrying the mail.\textsuperscript{11} In 1930 the major mail route holders conducted a series of collusive meetings\textsuperscript{12} in which the lucrative routes were divided among those present. Because these meetings were inconsistent with the Congressional goal of maintaining competition, when the abuses were discovered in 1934, the routes were taken from the carriers and the Army was charged with carrying air mail. Poor equipment and a lack of planning led to the deaths of twelve Army pilots\textsuperscript{13} which shocked the public and prompted the passage of the Air Mail Act of 1934\textsuperscript{14} which put commercial air transport on a competitive bidding basis and imposed safety regulations upon the carriers.\textsuperscript{15} The plan failed because the competitive bidding mechanism allowed the Interstate Commerce Commission (ICC) to revise the rates annually,\textsuperscript{16} permitting airlines to make ridiculously low bids for the first year and then recoup their losses in later years when the ICC adjusted the rates.\textsuperscript{17}

Even though the administrative burden of this plan was large, the government had not yet developed a complete system of route regulation. Under the 1934 Act carriers could begin making "off-the-route"\textsuperscript{18} operations without governmental permission, but if such

\textsuperscript{10} R. Caves, \textit{Air Transport and Its Regulators} 125 (1962).
\textsuperscript{11} For a detailed discussion of these early mail acts see A. Thomas, \textit{Economic Regulation of Scheduled Air Transport}, ch. 2 (1952).
\textsuperscript{12} S. Richmond, \textit{Regulation and Competition in Air Transportation} 5 (1961).
\textsuperscript{14} The Air Mail Act of 1934, 48 Stat. 433 (1934).
\textsuperscript{15} One proposal for deregulation involves returning to a competitive bidding basis. \textit{See} L. Keyes, \textit{Federal Control of Entry into Air Transportation} 66-72 (1951).
\textsuperscript{16} Civil Aeronautics Board, \textit{Regulatory Reform: Report of the CAB Special Staff} 31 (1975) [hereinafter cited as \textit{Regulatory Reform}].
\textsuperscript{17} The plan also failed because it divided authority over the industry among three separate departments: the Post Office, the Interstate Commerce Commission, and the Bureau of Air Commerce. This precluded effective control of the industry.
\textsuperscript{18} "Off-the-route" refers to operations in areas where no regulatory certificates have been granted. No off-the-route operations are permitted under the present system.
service proved harmful to the industry, the government could enjoin a carrier from continuing operations. Also, an independent non-mail carrier could inaugurate service competition against an air mail contractor at any time. During the period of 1934-1936, the government regulated safety under the Bureau of Air Commerce, and subsidized mail carriers through the Post Office, but did not require that a carrier obtain a certificate from the government in order to enter the business of transporting air passengers or cargo. During this period of free entry into competition, the passenger and air express business of the industry increased threefold while rates were substantially reduced. The existence of this strong growth refutes the argument that the regulatory system imposed in 1938 brought growth to an industry that was previously unhealthy and chaotic.

When the carriers without mail contracts began to compete on the most profitable routes, the established carriers saw a threat to their extensive capital investments, which had been made in the cartel atmosphere of 1930-1934. They also saw a threat to their share in the growth of the industry. These established carriers banded together to form the Air Transport Association (ATA), raised the cry of "cutthroat competition," and lobbied intensively for protective legislation. The main protection sought was governmental restriction upon entry into the industry. To support its objective of stricter regulation, the ATA presented four major arguments: that regulation was needed to bring the economic stability that was essential for safety in air travel; that regulation was needed to end the chaotic conditions produced by "cutthroat

20 Hearings on H.R. 5234 and H.R. 4652 Before the House Comm. on Foreign and Interstate Commerce, 75th Cong., 1st Sess., at 15-17 (1937) [hereinafter cited as Hearings on H.R. 5234].
21 Id. at 26.
22 A cartel is a combination of producers of any product joined together to control its production, sale, and price and to obtain a monopoly in any particular industry or commodity. H. BLACK, BLACK'S LAW DICTIONARY (4th Ed.) 270 (1968). During this period three holding companies received 84% of all air mail contracts and did 90% of the business.
23 Comment, Is Regulation Necessary? California Air Transportation and National Regulatory Policy, 74 YALE L. J. 1419 (1965) [hereinafter cited as Is Regulation Necessary?]
24 Id.
competition;" that the airlines were a natural monopoly, making regulation essential; and that regulation was necessary for the development of a national air system that served as many communities as possible. None of the ATA's arguments supported the regulatory system that Congress adopted in the Civil Aeronautics Act of 1938. That Act relied on a certificate of public convenience and necessity to limit entry into the industry and to shield the established carriers from competition by requiring that the certificate be granted by the government before a carrier could compete in any air transport market.

The first argument presented by the ATA in favor of regulation was that governmental control would bring economic stability to the industry and that this stability was essential for safe air travel. The ATA leadership emphasized the connection between economic stability and safety. While it was undisputed that governmental regulation in the field of air safety was essential, the connection between the salutary effects of regulation on safety and the impact of regulation on the economic situation was tenuous. Defining safety standards is an activity of a different order than setting prices and limiting markets.

25 This device had already been used by states and by other federal agencies to control certain industries.

a) state—New State Ice Co. v. Liebman, 285 U.S. 262 (1932);


27 S. RICHMOND, REGULATION AND COMPETITION IN AIR TRANSPORTATION 8 (1961). The attention of Congress had been focused on air safety by such events as the loss of Will Rogers and the death of Senator Cutting in an air crash in 1936.

28 Col. Edgar S. Gorrell of the ATA stated that: "This condition of financial starvation not only makes it impossible for these lines to take advantage of possible technological improvements, but could lead to traffic competition of such intensity that the accident ratio might accelerate instead of decline." Quoted in R. KELLY, THE SKY'S THE LIMIT 109 (1963).

29 Such regulation would include air traffic control and establishing safety standards for the construction and operation of aircraft. These safety regulations are under the jurisdiction of the Federal Aviation Administration (FAA).

30 Kennedy Hearings, 1975 at 56 (testimony of James C. Miller III, Chief Economist to the Council of Economic Advisors).

31 The FAA has the power to ensure that the airlines are of sufficient economic strength to adhere to its safety standards. 14 C.F.R. §§ 248, 249 (1975).
In addition to the allegations that competition would prevent expenditures to insure the adequate safety of operations, the airlines argued that competition would prevent the attraction of adequate capital into the industry and would threaten the maintenance of proper labor standards. These arguments seem to have been based on a general anti-competitive theory which became popular in government circles in the late 1930's and suggested that undesirable conditions such as bad labor conditions, instability, and uncertainty were inevitable when a firm was subjected to unrestrained competitive pressure. The actions of the American economy since the Depression have shown that predictions of the dire consequences of competition were overstated. In any case, large scale economic regulation was not a reasonable or efficient means of achieving air safety. The connection between economic stability and safety is valid only to the extent that a desperate airline might cut corners on safety-related expenses. If safety is the goal, direct regulation of airline practices is more sensible than indirect economic regulation. The assertion that safety decreases when competition increases is not persuasive.

The second argument advanced by the proponents of regulation was that a regulatory system was needed to assure security and stability in the air routes and to protect the carriers against "cutthroat competition" that occurs when carriers in an over-capitalized market (i.e. too many sellers) cut fares to the point that the increase in market demand created by lower fares will not

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34 Healy, Workable Competition in Air Transportation, 35 AM. ECON. REV. 239 (1945).

35 The predictions that unrestrained competition would be unsafe were disproved by the unregulated California intrastate carriers. The safety regulations of the FAA applied equally to both intrastate and interstate carriers. In fact, even though many carriers failed economically, there were fewer fatal accidents per passenger mile on the California intrastates than on the regulated trunks over the same period. Is Regulation Necessary? at 1444.

36 The ATA pointed to the Army crashes of 1934 as an example of what competition could produce, but the Army was not under the civil safety standards at that time. In any case, the Army was not competing with anyone.

37 REGULATORY REFORM at 29.
compensate for reduced unit revenues (i.e. dilution of revenues). In such a market a seller must cut his prices so low to keep his customers that he cannot make a profit. The cost of production to the seller becomes higher than the price the product can command. It is far from clear, however, that a condition of cutthroat competition existed in the air transport industry prior to 1938. The phenomenon of cutthroat competition occurs when members of the industry are attempting to minimize their losses by recouping as much of their fixed costs as possible. In other words, due to the high fixed costs, it is better to sell at a substantial loss than not to sell at all. But the airline industry is characterized by high variable costs, rather than high fixed costs. This makes the model of cutthroat competition inapplicable.

There was harmful competition in the airline industry prior to 1938. This competition was evidenced by the absurdly low bids the carriers made to force out new competition. In industries where high fixed costs make entry into competition difficult, such low bidding might occur in an unregulated market; but this was not the case in the airline industry. The harmful competition that did exist was inspired by governmental regulation under the Mail Act. These low bids served as examples in the ATA's argument that cutthroat competition existed, but they were actually brought about by the carriers' knowledge that any loss they sustained would be covered by government subsidy, that the rates could be adjusted upward annually, and that protective legislation would soon be

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25 *Is Regulation Necessary?* at 1423.

26 One may speculate whether there has ever been cutthroat competition in the airline industry. The evidence of the intrastate carriers in California and Texas, and of the unregulated commuter airlines shows that unrestrained competition would lead to neither chaos nor unsafe conditions. *See Kennedy Hearings, 1975* at 464-90 (presentation of William Jordan).


28 For example, a large airline bid one mill per mile for a new route at a time when it had a petition before the ICC claiming that twenty-four cents per mile was not a fair and reasonable rate. 83 CONG. REC. 6406 (1938) (remarks of Congressman Boren).

29 See the discussion of the natural monopoly argument, notes 49-62, *infra* and accompanying text.
enacted. If cutthroat competition did exist, perhaps it was aggravated if not actually caused by governmental regulation.

It appears that Congress accepted the allegation that chaotic economic conditions existed at the time. On closer examination, however, it seems that this chaos was more a fiction of ATA lobbyists than a reality. The president of the ATA admitted in 1937 that cutthroat competition and chaos were not present in the industry; he could only state his fear that these conditions would develop. In fact, over the period preceding 1938, the relatively free economic conditions had resulted in a great increase in traffic volume accompanied by a decrease in rates. The below cost pricing that existed was due to the low bidding practices of the ATA members in the expectation that present subsidies and future entry control would protect them.

A third argument advanced for regulation by the ATA was that the airlines had the characteristics of a natural monopoly and could be analogized to the railroads, which the government had regulated for over fifty years. This analogy is faulty in several respects. First, even if the analogy were valid, the development of the antitrust laws since 1890 has reduced the potential for abuse which the first railroad regulators had to combat.

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43 Congressman Lyle H. Boren referred to these abuses as "this final banquet that they may gorge themselves before we put them on a diet of public convenience and necessity." 83 CONG. REC. 6406 (1938) (remarks of Congressman Boren).

44 See Westwood & Bennett, A Footnote to the Legislative History of the Civil Aeronautics Act of 1938 and Afterward, 42 NOTRE DAME L. REV. 309 (1967).

45 "Although the Board in support of its restrictive policies has repeatedly relied on allegedly chaotic conditions in the industry at the time in seeking justification for the policies it has adopted, the record fails to disclose that such conditions existed." Memorandum Submitted by Senator Joseph C. O'Mahoney with Respect to the Right of Entry in Air Transportation Under the Civil Aeronautics Act, in Hearings Before the Antitrust Subcomm. of the House Comm. on the Judiciary, 84th Cong., 2d Sess., at 926 (1956) [hereinafter cited as O'Mahoney Memorandum].

46 Hearings on H.R. 5234, at 76.

47 See notes 20-21 supra and accompanying text.

48 83 CONG. REC. 6406 (1938) (remarks of Congressman Boren).

49 Hearings on H.R. 5234, at 66; S. RICHMOND, REGULATION AND COMPETITION IN AIR TRANSPORTATION 7 (1961).

50 Section 414 of the Federal Aviation Act of 1958. This section allows the CAB to sanction airline practices that might otherwise be antitrust violations. See Kennedy Hearings, 1975 at 41-42 (testimony of Thomas E. Kauper).
can industry. The development of such restraints has reduced the need for direct economic regulation. Indeed, the antitrust division of the Department of Justice has called for relaxation of price and route regulation in the airline industry. More importantly, the economic conditions of the railroads are far different from those of the airlines. The justification for the regulation of railroads was that the initial investment needed to operate a railroad had to be protected. The company had to purchase rights of way, lay down tracks, survey and tunnel through mountainous districts, etc. In contrast, the airlines operate above other persons' terrain between airports furnished by governments. In 1935 it was pointed out that airlines operate "on a far smaller initial expenditure and a far smaller upkeep," and are in no need of this type of protection. The airline industry has high variable costs, rather than high fixed costs, which makes entry and exit in the industry easier. There is not a great need to minimize losses by selling the product at any cost, however low.

In the Congressional investigations that preceded the Act of 1938 the proponents of regulation claimed that the airline industry was a "natural monopoly." In a natural monopoly the cost of entering the market is very high and the product offered is necessarily uniform. Examples of natural monopolies are the telephone system and power utilities. In these natural monopolies the marginal cost of growth is lower when the company is larger, there is a high ratio of fixed to variable costs, the product is uniform, and capital, once acquired, is immobile. The largest producer makes the largest profits in a natural monopoly. The market forces cause smaller firms to merge in order to attain economies of scale. Eventually, only one huge producer remains. A natural monopoly requires regulation because without outside controls one company would be able to force out all competition and raise its prices arbitrarily, knowing that the public had no alternative source for its product.

61 Kennedy Hearings, 1975 at 35.
62 Id. at 102.
63 Id.
64 Id. at 42-43.
Studies have shown, however, that the theories of natural monopoly do not neatly analogize to the airlines. Once an airline has reached the size to operate approximately five modern aircraft, costs do not decline as further growth occurs. Because of differences in scheduling and aircraft, the product is not completely uniform. Finally, the capital is not immobile and financing is available. Because the airline industry is not a natural monopoly, market competition would function to lower prices, increase output, and tailor production to suit customer preferences. An airline could not arbitrarily raise its prices to gain an unreasonable profit, because other companies could then obtain start-up capital, enter the market, charge a reasonable rate, and attain healthy profits. Conversely, an industry member could never cut prices so low as to force out competition; it could never recoup its losses by charging super-competitive prices because others could quickly re-enter the market and charge at the competitive rate. But for regulation this relative ease of entry would keep the airline industry from being monopolized by a few carriers. Rather than protecting the public

60 This is because the airline industry is characterized by high variable costs, rather than by high fixed costs. This is admitted even by proponents of regulation. Bluestone, The Problem of Competition Among Domestic Trunk Airlines—Part II, 21 J. Air L. & Com. 57-68 (1954). A recent article has asserted that fixed costs (overhaul bases, rent for terminal space, and the reservation system) constitute 40% of industry costs, and that this amount constitutes high fixed costs. Brenner, Need for Continued Economic Regulation of Air Transport, 41 J. Air L. & Com. 793 (1975).
61 An antitrust lawyer from the Justice Department has testified that the airline industry lacks the characteristics of a natural monopoly. Kennedy Hearings, 1975, at 38 (testimony of Thomas E. Kauper).
62 The ease of entry should keep the number of producers in the industry high enough to avoid the problems of oligopoly. The Assistant Attorney General, Antitrust Division has called for a relaxation in regulation, indicating that no unmanageable antitrust problems should arise. Id. at 35; cf. the assertion that deregulation would indeed lead to a monopoly in D. Locklin, Economics of Transportation 827 (1966).
against a natural monopoly, CAB regulation prevents competition that otherwise would be economically feasible.\(^63\)

The fourth argument for regulation is based not on economics, but on public policy. The ATA asserted that regulation was needed to ensure the development of a national air system, linking as many communities as possible. The key to this argument is the concept of internal subsidies (also known as cross subsidies). The airlines argued that their predominance on lucrative routes should be protected in order to ensure profits to compensate for the losses the airlines incurred serving smaller communities.\(^64\) In other words, the airlines claimed that if they had to charge competitive prices on all routes, they could not afford to serve smaller communities.\(^65\) The ATA has used this argument to predict that deregulation would force a sharp reduction in the number of communities served, but this argument has been widely assailed.\(^66\)

This policy argument rests on the assumption that a large amount of internal subsidization exists in the airline industry.\(^67\) Studies have shown, however, that the extent of internal subsidization presently existing is miniscule.\(^68\) In any case, the use of internal subsidies is inefficient and inequitable. John W. Barnum, Acting Secretary of Transportation, testified to a Senate Subcommittee that: “Carriers should not be forced to lose money or operate on the assumption that other routes will subsidize those producing inadequate rev-

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\(^63\) Jordan, Producer Protection, Prior Market Structure and the Effects of Government Regulation, 15 J. OF LAW & Econ. 151 (1972). This writer’s conclusion is that: “The CAB is an institutionalized restraint on the citizen’s freedom to travel at reasonable prices, and an unnecessary burden on the nation’s taxpayers. Its regulation is permeated by a penchant for secrecy and unbridled bias for the industry.”

The economic feasibility of competition upon deregulation is not conceded by the proponents of regulation. A recent article takes the position that the airline industry would become more wasteful and less competitive upon deregulation. Brenner, Need for Continued Economic Regulation of Air Transport, 41 J. AIR L. & COM. 793 (1975).

\(^64\) The proponents of regulation argument that internal subsidies are needed to keep the national air service system intact. Brenner, Need for Continued Economic Regulation of Air Transport, 41 J. AIR L. & COM. 793 (1975); Lloyd-Jones, Deregulation and Its Potential Effect on Airline Operations, 41 J. AIR L. & COM. 815 (1975).

\(^65\) Id.

\(^66\) See the series of papers in Kennedy Hearings, 1975 at 410-36.

\(^67\) Id. at 57 (testimony of James C. Miller III).

\(^68\) Id. at 392 (letter from James C. Miller III).
The inequities of internal subsidies arise from requiring a traveler on a heavy route to pay for part of the ticket of a traveler on a light route. Such subsidies are hidden and, according to the CAB itself, contrary to the public interest. A more equitable way to achieve this public policy goal would be to have the community that benefits from the service directly and openly subsidize that service. In some areas, subsidies may not be needed at all under a free entry system. While small town service is not as profitable as other routes, this does not mean that an efficient and adaptable local carrier could not survive in these markets.

II. THE 1938 ACT AND COMPETITION

While the ATA's arguments for regulation were not convincing, the fact remains that the Congress passed a broad measure regulating the commercial air transport industry in 1938. The actions of the CAB, however, have not been consistent with the intent expressed by Congress in passing the bill. The early Congressional discussions of regulation emphasized the need to preserve competition and to assure that new carriers be allowed to enter the market. In 1935 the Federal Aviation Commission reported, after careful study, that:

[T]here must be no policy of a permanent freezing of the present air transport map, with respect either to the location of its routes or the identity of their operators. The present operators of airlines have no inherent right to a monopoly of the routes they serve.

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69 Id. at 13 (testimony of John W. Barnum).
70 Id. at 26 (testimony of Lewis Engman).
71 Id. at 393 (letter from James C. Miller III).
72 CAB Order No. 74-3-82 (March 18, 1974). See DOUGLAS AND MILLER at 118.
75 Kennedy Hearings, 1975 at 38.
It was the Senate's understanding that if a carrier demonstrated the ability to serve a needed new route, it would be granted a certificate.\(^7\)

Despite Congressional claims that competition would be preserved, some observers perceived the threat of regulation to competition. An expert in the field detected a pattern in Congressional actions in 1936 that indicated "an attempt, intentional or otherwise, to freeze the picture of air transportation in the U.S."\(^8\) The Department of Commerce also noted this pattern and in 1937 sent to Congress a prescient warning of the impact of the contemplated regulations.\(^9\) Despite these warnings, Congress proceeded with the legislation, continually assuring itself that freedom of entry and healthy competition would be maintained under the new system.\(^8^0\) Any applicant who demonstrated that it met the safety rules would be able to enter the industry.\(^8^1\) Senator Patrick A. McCarren stated

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\(^7\) Hearings on S. 3027 Before a Subcomm. of the Senate Comm. on Interstate Commerce, 74th Cong., 1st Sess., at 105 (1935). Senator King stated if the bill would have the effect of freezing the number of companies in the industry, it should not be passed. The Senator's view was that:

> If it authorizes their activities to the exclusion of others who may desire to enter this field, then I think there should be some amendments that would fully protect those who are interested in the development of this great act.

\(^8\) 83 CONG. REC. 6851 (1938) (remarks of Senator King).

Senator Truman assured the Senate that the bill would have no such effect.

\(^8^0\) Id. at 923.

There was nothing in the debates in either House to give the slightest ground for believing that anybody in Congress, or indeed in the industry, whatever his secret designs, if any, may have been, to establish a system which would give to any bureau of the Government the power, on its own discretion, to restrict the development of aviation and to drive out of the business of air transportation any individual or any group willing to risk its capital is the pioneering of this industry, while at the same time obeying all the necessary rules to maintain the maximum degree of safety in the air.
that the first object of any act should be to ensure that the airlines comply with the antitrust laws of the country so as to provide the greatest protection for competition. Senator Harry S. Truman, then the chairman of the subcommittee considering the bill, stated that any provision that would effectively limit the number of major carriers to those presently in existence “ought to be changed.”

Truman stated on the Senate floor that the Act of 1938 would not have the effect of freezing the present routes or allowing only the existing major carriers to develop new routes. Finally, the general tenor of the debate was that the CAB would be an instrument to get the airline industry out of its present crisis (if one existed); no one mentioned that the CAB would still function after the industry had matured.

It may be concluded that the Congress intended to maintain free entry of new competition into the airline industry. The existing airlines were to receive no undue preference in the granting of new routes. The most worthy applicant, based on the facts of the route proposals, was to be chosen, whether it was a new or old carrier.

Unfortunately, the clear intent that arose from the debates was not carried over into the statute. In the Civil Aeronautics Act of 1938 the mandate to preserve competition was softened by the phrase “to the extent necessary.” Further, Congress stated other goals, such as improving relations among air carriers that were potentially inconsistent with the goal of encouraging competition.

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82 83 CONG. REC. 6731 (1938) (remarks of Senator McCarren).
84 83 CONG. REC. 6727 (1938) (remarks of Senator Truman).
85 83 CONG. REC. 6507 (1938) (remarks of Congressman Randolph). Legislation is needed due to the “present disorderly financial situation.” (emphasis added)
86 Colonel Gorrell emphasized that the Act would bring in a number of new companies and produce additional air lines on many routes. He agreed that these effects would be desirable. Hearings on H.R. 5234 at 85,344.
87 While opponents of regulation think this language as unwieldy and vague, proponents praise it as being “remarkably flexible.” Callison, Airline Regulation—A Hoax?, 41 J. AIR L. & COM. 747 (1975).
88 Section 102 of the Federal Aviation Act of 1958 provides:
In the exercise and performance of its powers and duties under this chapter, the Board shall consider the following, among other things, as being in the public interest, and in accordance with the public convenience and necessity:
Much of the inconsistency that has appeared in the CAB decisions concerning competition might be traced to the vague guidance provided by the Act.88

III. THE CAB AND COMPETITION

The CAB was entrusted by Congress with the task of eco-

(a) The encouragement and development of an air-transportation system properly adapted to the present and future need of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense;
(b) The regulation of air transportation in such manner as to recognize and preserve the inherent advantages of, assure the highest degree of safety in, and foster sound economic conditions in, such transportation, and to improve the relations between, and coordinate transportation by, air carriers;
(c) The promotion of adequate, economical, and efficient service by air carriers at reasonable charges, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices;
(d) 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;
(e) The promotion of safety in air commerce; and

H.R. 10521, S. 2551, 94th Cong., 1st Sess. (1975) would change this section to make the mandate to foster competition more clear:

Sec. 4. Section 102 is amended to read as follows:

DECLARATION OF POLICY: THE BOARD

Sec. 102. In the exercise and performance of its powers and duties under the Act, the Board shall consider the following, among other things, as being in the public interest, and in accordance with the public convenience and necessity:

(a) The encouragement and development of an air transportation system which is responsive to the needs of the public and is adapted to the present and future needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense;
(b) The provision of a variety of adequate, economic, efficient and low-cost services by air carriers without unjust discriminations, undue preferences or advantages, or unfair or deceptive practices; and the need to improve relations among and coordinate transportation by air carriers;
(c) Maximum reliance on competitive market forces and on actual and potential competition to provide the needed air transportation system;
(d) The encouragement of new air carriers; and
(e) The importance of this highest degree of safety in air commerce.

nomically regulating air commerce for the public good. The Civil Aeronautics Act of 1938 set out six standards to guide the Board's determination of what is in the public interest, including encouraging and developing an air transport system, fostering a high degree of safety and sound economic conditions, and promoting reasonable fare charges and competition to the extent necessary to ensure full development of the system. The tool with which the CAB attempts to implement these policy guidelines is the certificate of public convenience and necessity which all interstate carriers of any substantial size must obtain in order to operate. These certificates cannot be abandoned or transferred without permission of the Board.

At its inception the purpose of economic regulation was to achieve the stabilization and development of the industry by regulating mail compensation and transport tariffs and through control of business structures and practices. This purpose indicates that the CAB was intended to differ from the older federal regulatory agencies that were created to prevent abuses by industry. The CAB was a "New Deal" commission, paternalistic in concept, and was conceived to promote, aid, and control the industry. In keeping
with its control function, the CAB may not issue a certificate for a route to an applicant unless it is "fit, willing and able to perform air transportation properly." The Board has interpreted its mandate from Congress to include an additional inquiry: even if the applicant is fit, willing and able, the Board will not grant the certificate if it determines that the present carriers on the route will be damaged by the new entry. In making this inquiry, the CAB is following its interpretation of the Act, rather than the pro-competition intent expressed by Congress.

According to the 1938 statements of Congress, the key declaration of policy which the Board must interpret and follow is the one concerning maintenance of competition. It would therefore be instructive, in an inquiry into the functioning of the CAB, to see how this clause has been interpreted. The Board first interpreted the Congressional mandate to mean that competition was to be allowed to the extent necessary to carry out the other policy goals of the Act. Three years later the same clause was interpreted to provide a presumption in favor of competition. An airline already on a route had the burden of proving that the proposed competition would be destructive of the other ends of regulation. This interpretation appears to be consistent with the Congressional intent. The conclusion appears to be that the Act itself was inartfully drafted.

expressed goal of fostering competition. The conclusion appears to be that the Act itself was inartfully drafted.

100 § 401(d)(1), Civil Aeronautics Act of 1938. One writer has asserted that the granting of these broad discretionary powers to the Board is an unconstitutional delegation of authority by Congress. Jones, The Anomaly of the Civil Aeronautics Board in American Government, 20 J. AIR L. & COM. 149 (1953).


102 See note 88 supra for the text of this section. This comment uses "competition" mainly to mean the entry of new carriers into routes with the trunklines. If "competition" means two or more existing trunklines serving city-pairs, competition has increased under the CAB. See Callison, Airline Regulations—A Hoax?, 41 J. AIR L. & COM. 747 (1975).

103 Mid-Continent Airlines, Inc., Twin Cities-Des Moines-Kansas City-St. Louis Operation, 2 C.A.B. 63 (1940).

104 Transcontinental & Western Air, Inc., Additional North-South California Services, 4 C.A.B. 373 (1943).

105 Id.

106 During this period the CAB made a clear statement on the advantages of competition:
The greatest gain from competition, whether actual or potential, is the stimulus to devise and experiment with new operating tech-
Within a few years, however, the Board completely reversed itself and held that there should be a presumption against competition. Rather than maintaining an established interpretation of the mandate to allow competition, the CAB has been remarkably inconsistent. One writer asserts that the Board's attitude toward competition changes according to the ebb and flow of the economy. In prosperous times competition is encouraged, while in times of recession, additional competition is not allowed. These shifts in interpretation leave no comprehensible criteria for predicting Board actions in one of its most important activities.

The CAB is not always to blame for anti-competitive governmental decisions in the air transport industry. At times the CAB has sought to encourage competition and has been blocked by the trunklines in the courts. In 1955 the CAB sought to grant permanent authority to supplemental air carriers by exempting them from the certification requirement. The Circuit Court for the District of Columbia disallowed this action. In response, the CAB sought to issue "supplemental certificates" to twenty-six applicants, but this, too, was blocked. The fate of these Board actions may help to explain the general anti-competitive tone of CAB decisions.

The fact of CAB inconsistency remains. Neither the ATA nor aspiring applicants can easily predict the CAB decisions in particular cases. There are several reasons for this inconsistency.


See Comment, CAB Regulation of Supplemental Air Carriers, 76 Harv. L. Rev. 1450 (1963).
First, there are the varying interpretations of statutory standards and methods caused by economic and political fluctuations. There also is the problem that the CAB's goals are not clearly defined. The only clear goal Congress provided was to nurture the growth of an infant industry. This goal has been accomplished. Now that airlines are the dominant passenger carriers over long distances, this goal is not helpful in defining policy. The CAB appears to have adopted a new goal to maintain the position of present air carriers, regardless of their shortcomings. The CAB has not admitted that this is its goal, however, since it is inconsistent with the Congressional charge to the Board.

A third problem arises because the mechanical function of the Board precludes long range planning of air route patterns. The CAB regulates the airline industry by deciding those cases that are brought before it. This case by case approach, coupled with a steady turnover in the membership of the Board, makes effective planning difficult. Further, the Board fills three inconsistent roles in approaching each case; it is at once the promoter of the airline industry, the regulator of the same industry, and the judge weighing private interests and property rights against the public interest. Since the Board is filling inconsistent roles and decides only the cases brought before it, the decisions of the Board are less predictable.

A former member of the CAB has pointed out that independent national regulatory commissions are an anomaly in the political structure of the United States. Our governmental system is based generally on the separation of powers among the three branches.

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114 See notes 98-101 supra and accompanying text.
116 Whether or not the goal would have been accomplished more quickly without regulation is unknown.
117 See note 6 supra.
118 Section 102(c), (d), Civil Aeronautics Act of 1938.
121 Id. at 147. "It is well nigh impossible that all three can be successfully combined in the same proceeding and substantial justice be done to all concerned."
122 Id. at 140.
of the government, but in these independent agencies the legislative, executive and judicial powers are united.\(^{123}\) Because the initiative to develop routes is delegated to the applying airlines, the CAB is unable to formulate a consistent route policy. These factors, when joined with the CAB's changing interpretation of fostering competition,\(^ {124}\) help explain the inconsistencies in the actions of the CAB.

Generally the CAB has not allowed the degree of competition that Congress anticipated.\(^ {125}\) Vagueness in the terms of the Act is a partial explanation. Moreover, the Act allows the Board to approve such anti-competitive practices as mergers, pooling agreements, and interlocking directorates if they are judged to be in the "public interest."\(^ {126}\) Such measures could be in the public interest, but they are more likely to be only in the interest of the airlines involved.\(^ {127}\)

An examination of the results of the CAB's rulings over the years leads to the conclusion that competition has been less important to the CAB than maintaining the existing carriers.\(^ {128}\) The impact of the CAB's attitude toward the entry of new carriers into competition with existing carriers is plain. No new trunk service

\(^{123}\) J. Frederick, Commercial Air Transportation 198 (1946).

\(^{124}\) See note 79 supra. An ideal membership for the Board could hypothetically reach results consistent with the charge of Congress. But such a membership is unlikely and unrealistic.

\(^{125}\) While the economic state of the airlines remains less than robust, the following will probably accurately reflect the CAB's attitude: "[T]he authorization of multiple competition at a time of economic stringency such as this calls in our judgment for both a clear showing of feasibility and a substantial justification in terms of public benefits to be received." CAB Order No. 70-7-24 (July 6, 1970). See note 79 supra.

\(^{126}\) See L. Keyes, Federal Control of Entry Into Air Transportation 108 (1951). These provisions encourage non-aggressiveness in the industry. The phenomenon of "conscious parallelism" could allow this non-aggressiveness to continue even after deregulation. "Conscious parallelism" occurs when the members of an industry adjust their prices and production so that all members make a profit, even though no overt agreement has been made. The larger the number of producers, however, the less likely conscious parallelism becomes. The relatively low entry costs of the airline industry could keep the number of producers sufficiently large to avoid this phenomenon.


\(^{128}\) See notes 123-27 supra and 137-51 infra.
carriers have been admitted into domestic air transportation since 1938.29 Since 1950 there have been ninety-four serious applications for trunkline authority; the CAB has approved none of them.29 The Act contained a "grandfather clause" that gave certification to those trunk carriers already in existence in 1938.30 Sixteen trunklines were certificated in this manner. Of these, ten remain in operation.31 This reduction resulted from mergers approved by the CAB. Similarly, the Board admitted nineteen local service carriers in 1950. These carriers absorbed the influx of equipment and trained pilots into the industry following World War II. They generally flew smaller aircraft over shorter routes and did not compete with the "grandfather" trunklines. No local service carriers have been admitted since 1950, and their number has shrunk to nine32 as the less successful carriers merged with the more successful ones.33

An original motive of the CAB for protecting the trunk carriers from outside competition34—to reduce the government subsidy payments to the existing carriers35—is no longer valid since no trunk carrier has received a subsidy since 1959.36 Even when this motive had validity Congress was worried about the CAB allowing the grandfather trunklines to dominate the industry. In 1942 the Senate passed a resolution encouraging the Board to report as soon as possible on

29 CIVIL AERONAUTICS BOARD, HANDBOOK OF AIRLINE STATISTICS, 1973 10 (1974). The proponents of regulation admit this but attempt to ameliorate the impact of the exclusion by stating that many modern non-trunk carriers are now larger than the trunklines were themselves in 1939, Callison, Airline Regulation—A Hoax?, 41 J. AIR L. & COM. 747 (1975). But trunklines carry ninety-two percent of domestic scheduled revenue passenger miles. The non-trunk carriers are not a major source of competition. Heymsfeld, An Introduction to Regulatory Reform for Air Transportation, 41 J. AIR L. & COM. 665 (1975).

30 REGULATORY REFORM 49.
31 Section 401(c) Civil Aeronautics Act of 1938.
32 DOUGLAS AND MILLER 110.
33 REGULATORY REFORM 53.
34 Another great cause of reduction of the number of carriers was due to the courts, not the CAB. See notes 106-08 supra. In California failing airlines simply went out of business; no mergers took place. W. JORDAN, AIRLINE REGULATION IN AMERICA 24 (1970).
35 DOUGLAS AND MILLER 110-12.
37 Id.
the steps the Board contemplates taking with respect to the issuance, under Sec. 401 of the Civil Aeronautics Act of 1938, of certificates to air carriers who were not engaged in air transportation on the date of enactment of such Act.\textsuperscript{138}

The Board responded by promising to foster the entry of new trunk carriers when the propitious time arose.\textsuperscript{139} Thirty-four years later, the propitious time has not yet arisen.

When an aspiring trunkline approaches the CAB, it faces a conundrum. All that a new applicant can offer to the CAB is a lower rate schedule; it cannot prove its capability until it begins to operate, and it cannot operate without permission. Unfortunately, the CAB tends to characterize price proposals from new applicants as "unrealistic."\textsuperscript{140} By dismissing these proposals almost out of hand the CAB has aborted potential price competition\textsuperscript{141} and has maintained the stability of the existing trunklines. Such actions seem to reveal a CAB assumption that the interest of the trunklines and the interest of the traveling public coincide.

The dearth of new trunkline carriers is evidence that the CAB does not encourage competition. An examination of the decisions handed down by the CAB also supports the hypothesis that the CAB is industry oriented and does not regulate domestic air transport in the public interest.\textsuperscript{142} In 1954 the CAB refused to allow an airline to extend its service from San Diego to Tijuana at rates significantly lower that those prevailing at the time.\textsuperscript{143} In 1963 the CAB ruled that California airlines, whose intrastate rates were far below those of the CAB regulated carriers, could not carry passengers who were connecting from an interstate flight.\textsuperscript{144} These are cases when the public clearly is penalized in order to maintain an inefficient airline system. In 1965 the CAB further attacked the efficient\textsuperscript{145} California carriers by ruling that they could not carry

\textsuperscript{138} S. Res. 228, 77th Cong., 2d Sess., 88 Cong., Rec. 3173 (1942).
\textsuperscript{139} S. Doc. 206, 77th Cong., 2d Sess. (1942).
\textsuperscript{140} \textit{Regulatory Reform} 53.
\textsuperscript{141} W. JORDAN, \textit{Airline Regulation in America} 226 (1970).
\textsuperscript{144} CAB Order No. E-19655 (adopted June 6, 1963).
\textsuperscript{145} The efficiency of the intra-state airlines has been used by the opponents of regulation. \textit{See W. JORDAN, Airline Regulation in America} (1970); \textit{Is Regula-
passengers to the California side of Lake Tahoe on the grounds that some of those on board would probably be destined for Nevada and would, therefore, be interstate passengers.\textsuperscript{146} Another attack against intrastate carriers occurred in 1964 when the CAB brought an intra-Hawaii airline under its regulations on the ground that the routes were over international waters and within federal jurisdiction.\textsuperscript{147} In 1967 World Airways, a non-trunk airline, offered to establish transcontinental scheduled service with very substantial fare reductions.\textsuperscript{148} For years the Board consistently refused to act upon the petition and, through a technicality, eventually dismissed it from the docket as "stale."\textsuperscript{149} In 1976 a similar World Airways proposal was also rejected.\textsuperscript{150} By denying these attempts to compete with the regulated carriers, the CAB blunts the competitive forces that would produce lower fares for the traveling public. In 1970 the Circuit Court for the District of Columbia openly recognized that the CAB was dominated by a pro-industry bias. The public's interest in competition is not being fully served.

Another example of a CAB action which prevented competition is the Board's treatment of the non-scheduled irregular airlines that developed after World War II. When the irregulars applied for certificates to provide scheduled service over their routes, the trunk carriers intervened. Even though the irregulars offered lower rates and a proven willingness to develop rapidly untapped markets, the CAB granted all of the routes to the trunklines\textsuperscript{151} by using an internal subsidy theory.\textsuperscript{152} A final illustration of the CAB's anti-

\textsuperscript{146} CAB Order No. E-22387 (adopted June 30, 1965).
\textsuperscript{148} Application of World Airways, CAB Docket No. 18468.
\textsuperscript{149} DOUGLAS AND MILLER 113.
\textsuperscript{150} In 1976 World Airways' offer to provide transcontinental service for less than half of the fare charged by trunkline carriers was rejected by the CAB. CAB Docket No. 27693 (Decided Jan. 23, 1976). For the World Airways proposal see Kennedy Hearings, 1975 at 565-70.
\textsuperscript{151} Moss v. CAB, 430 F.2d 891 (D.C. Cir. 1970).
\textsuperscript{152} Transcontinental Coach-Type Service Case, 14 C.A.B. 720, 724 (1951). A third type of unregulated carrier is the small commuter airline. This type of line is excused from regulation by § 416(b) of the Federal Aviation Act of 1958.
\textsuperscript{153} REGULATORY REFORM 36.
competitive decisions is found in *Continental Air Lines, Inc. v. CAB*. In this case the CAB three times rejected Continental's application to enter the Denver-San Diego route in competition against Western Airlines, even though an administrative law judge had specifically found that Western's service on the route was inadequate and that the route could easily support two carriers. On appeal to the Circuit Court of the District of Columbia, the issue was the CAB's interpretation of the Congressional mandate concerning competition. After examining the evidence of legislative intent the court concluded that: "When sufficient traffic exists to support competition, certification of competing carriers is mandated by the Act as providing the best means of effectuating the other public interest goals contained in Sec. 102." On considering the record in the case, the court found that the CAB was erroneous as a matter of law in rejecting the administrative law judge's finding that there was sufficient traffic to support competition.

The result of the CAB route granting procedures has been a strict control upon the entry of new carriers into the industry. Without the threat of competition posed by new entrants, the market structure has tended to become static. The lack of new entries and the natural attrition by which the less efficient carriers are absorbed by the more efficient have caused the number of operating trunklines to decrease steadily. The scarcity of entrants encourages inefficiency in the existing carriers because the threat of

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154 519 F.2d 944 (D.C. Cir. 1975).
155 By this time, the route was carrying 130,000 passengers a year more than many other routes where competition was allowed. Continental Airlines, Inc. v. CAB, 519 F.2d 944 (D.C. Cir. 1975).
156 *Id.* at 947. That Continental is exceptional among the trunk carriers is illustrated by the fact that it is the only trunk to call for an end to the freeze on new entries into the industry. Continental's president stated: "[W]e believe that new entrants maintain vitality in the industry. They bring innovation, which means public benefits. Moreover the mere threat of new entrants being permitted into the industry spurs incumbents to better serve the public." *Regulatory Reform* 13.
157 Continental Airlines, Inc. v. CAB, 519 F.2d 954 (D.C. Cir. 1975).
158 *Id.* at 959.
159 *Regulatory Reform* 126.
160 See note 126 supra.
new competition is not present to goad the airline to perform at their best level.\footnote{\textit{Green and Nader, Economic Regulation vs. Competition: Uncle Sam the Monopoly Man}, 82 YALE L.J. 879 (1973).}

Another result of the regulatory system is that it focuses competition on service quality and thereby encourages excess capacity\footnote{Excess capacity exists when there is a continual number of empty seats on aircraft servicing a certain route. The percentage of seats filled on each flight is called the "load factor." A recent article has asserted that excess capacity would increase in a deregulated environment. Brenner, \textit{Need for Continued Economic Regulation of Air Transport}, 41 J. AIR L. & COM. 793 (1975). The article claims that price competition is impossible among airlines, leaving service quality as the only area for competition.} and a level of service that is higher than the traveling public would demand. The trunklines are unable to compete for a larger share of the industry's traffic by offering lower rates or new routes. Consequently, their only area of competition is service quality.\footnote{W. JORDAN, AIRLINE REGULATION IN AMERICA 229 (1970).} By offering larger, more glamorous aircraft and more flights per day than the market justifies, the airlines increase their capacity to an excess.\footnote{\textit{Council of Economic Advisors, Annual Report} 154 (1975).} This forces an increase in the cost of each occupied seat. The resulting service might be better than the average consumer would choose in a trade-off between price and service.\footnote{\textit{Regulatory Reform 2.}}

These factors combine to produce a lack of competition. By restricting the entry of new carriers, regulation may have produced higher fares than the quality of service justifies.\footnote{\textit{Council of Economic Advisors, Annual Report} 155 (1975).} The CAB policy tends to insulate the existing carriers from the potential new competition that would be a check on any tendency toward inefficiency.\footnote{\textit{Regulatory Reform} 54. The only area where competition is open is in the quality of services offered. \textit{Id.} at 47.}

**IV. Conclusion**

This comment does not call for deregulation; it is only meant to clarify the discussion concerning regulation by presenting the past arguments for adopting regulation and by examining the past record of the regulatory system. The arguments made for regulation at the time of the passage of the Civil Aeronautics Act...
of 1938 are not persuasive. First, the connection between economic stability and air safety is not strong enough to support economic regulation. Secondly, chaos and cutthroat competition did not exist in the industry prior to 1938. The fluctuations that did exist were the products of the Mail Act of 1934, the infant stage of the industry, and the generally depressed economy. Thirdly, the airline industry is not a natural monopoly and need not be regulated as such. Finally, the maintenance of a national air system would be more fairly and efficiently achieved by direct subsidies rather than by internal subsidies.

The intent of Congress in passing the Act was to preserve competition and free entry into the industry. Although the language of the Act is vague, this intent was sufficiently clear for the court in *Continental* to hold that an anti-competitive decision of the Board was erroneous as a matter of law. The empirical evidence suggests that the existing airlines have been protected at the expense of aspiring applicants and of consumers. Unless the proponents of regulation can demonstrate that these decisions are actually in the public interest, it would appear that the Congressional intent would be better served by a relaxation of economic regulations.

The decision to adopt a plan of deregulation or to retain the present system should be made on the basis of arguments applicable to the present and future state of the industry. The arguments advanced in the past did not justify the adoption of regulation, and the record of the CAB in controlling the domestic air transport industry does not seem to justify its retention.

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168 A recent article has asserted that, although the airlines are not a natural monopoly, there are sufficient similarities to natural monopolies to justify regulation. Lloyd-Jones, *De-regulation and Its Potential Effect on Airline Operations*, 41 J. AIR L. & COM. 815 (1975).

169 Two examples of such modern arguments are: 1) that deregulation would threaten the attraction of investment capital that is vital to the industry; 2) that deregulation would cause a lack of flow in the interconnecting network of the domestic air route system. See Rasenberger, *Deregulation and Local Airline Service—An Assessment of Risks*, 41 J. AIR L. & COM. 843 (1975).