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DEREGULATION AND THE PRACTICING ATTORNEY

HERBERT D. KELLEHER*

WITHIN the next month Congress will probably enact legislation substantially changing federal economic regulation of the domestic air transport industry for the first time since such regulation was imposed in 1938. While there is still considerable debate concerning the substance and form of the final bill, some measure of regulatory reform appears inevitable. All the available economic evidence demonstrates that the artificial suppression of competitive market forces by predecessors to the present Civil Aeronautics Board, acting within the latitude afforded by the Federal Aviation Act, has encouraged unnecessarily high fares; carrier inefficiency; excess capacity; undue concentration in the industry; and has denied passengers a choice of price and service options that would be available to them in a less regulated environment.¹

The popular term for reform proposals—"deregulation"—is actually somewhat of a misnomer. What is contemplated by the proponents of regulatory change is basically a redirection of government policy toward allowing greater competition through partial relaxation of entry and pricing controls. Deregulation, *i.e.*, the immediate abolition of all restraints on entry and pricing, unfortunately does not appear to be "in the cards."

The purpose of this article is to survey the history of the existing regulatory scheme, the reasons for the present impetus for reform, and the major arguments for and against amending the 1938 Act (as carried over into the 1958 Act). Finally, some com-

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¹ The present CAB, under the leadership of Chairman Alfred Kahn, has been

ments will be offered on the possible impact of regulatory change on matters such as airline safety, airport financing, administrative law, and consumer protection which may be of particular interest to the practicing attorney not directly involved in the controversy.

Origins of the CAB and Economic Regulation

Federal economic regulation of the airline industry originated during the New Deal, and the essential statutory basis for CAB authority has not changed since the adoption of the Civil Aeronautics Act of 1938.² Congress altered the regulatory framework somewhat in 1958 when it separated safety regulation from economic regulation. The new statute, the Federal Aviation Act of 1958,³ transferred safety functions to an independent agency, the Federal Aviation Agency (now reorganized as the Federal Aviation Administration), but it carried forward unchanged the sections of the 1938 statute dealing with economic regulation.

At the time federal economic regulation was first considered, the principal business of commercial aviation was not passenger service, but the transportation of mail. Most airlines believed that they could not afford to operate substantial routes without a subsidized mail contract. However, neither the government nor the airline industry was satisfied with the manner in which mail contracts were awarded and administered. In 1934, Postmaster General Farley cancelled all existing contracts, charging the airlines with collusion in the competitive bidding process when the routes had been awarded earlier by the Hoover Administration. For a brief period, Army pilots carried the mail, but their operations were plagued by numerous accidents, and new legislation returned mail transportation to private carriers under a revised competitive bidding process. Three separate agencies supervised the carriers at

promoting competition by expediting and favorably considering new route applications and reduced fare proposals. This contrasts starkly with a new route "moratorium" imposed by the CAB some years ago. The mere fact that widely divergent attitudes and decisions on "competition" are reachable under the same statutory guidelines argues that Congress must reform and refine the Federal Aviation Act if it, and not the agency, is to control policies respecting the economic aspects of domestic aviation. Ironically, the anticipated regulatory reform bill may well embody less pricing flexibility and more route protection than is available under the recently inaugurated administrative policies of the Kahn CAB.

² Civil Aeronautics Act of 1938, Pub. L. No. 706, 52 Stat. 973.

³ Federal Aviation Act of 1958, 72 Stat. 731, as amended, 49 U.S.C. §§ 1301 et seq. (1976), formerly Civil Aeronautics Act of 1938, ch. 601, 52 Stat. 973.

the time: the Post Office Department awarded mail contracts and determined the routes and schedules to be flown; the Interstate Commerce Commission set rates for mail pay; and a bureau in the Commerce Department regulated safety. Part of the impetus behind the 1938 Act was therefore a desire to rationalize the regulation of mail contracts and combine the functions of the three agencies in a single body.⁴

The principal purposes of the resulting legislation, however, were to control the degree of competition in the industry and thus to provide route security for the existing carriers.⁵ By the late 1930's, many airlines were in serious financial difficulty; some were on the verge of bankruptcy. Although their economic problems were due in large part to absurdly low competitive bids for mail carriage, substantial startup costs, and a general downturn in business conditions during the Depression, the contract carriers blamed "destructive competition" from smaller carriers. As a Congressional committee was to observe twenty years later:

The scheduled air mail carriers were haunted by visions of a mass invasion of unsubsidized operators, flying secondhand equipment and employing flying personnel at wages less than the minimum statutorily prescribed for air mail carriers. With their lower costs and their utilization of the pioneering efforts of their air mail predecessors, the newcomers, it was feared, might provide a low-cost service which would attract substantial patronage from the established, subsidized airlines. The new service, while safe, would be "inferior" to the existing service because it would be less modern and less reliable. But the new entrants, and the cutthroat competition which was to be their hallmark, clearly were more of a threat than a reality. While there was some price competition among the established carriers, the sorry financial plight of the airlines had not been caused by the "irresponsible" and "scatter-brained" unsubsidized competitors which the new legislation was

⁴ The background to adoption of the Civil Aeronautics Act of 1938 and the statute's legislative history are treated extensively in C. RHYNE, *THE CIVIL AERONAUTICS ACT ANNOTATED* (1939); L. KEYES, *FEDERAL CONTROL OF ENTRY IN AIR TRANSPORTATION* (1951) [hereinafter cited as KEYES]; *Report of the Anti-trust Subcomm. of the House Comm. on the Judiciary on Airlines*, 85th Cong., 1st Sess. (1957) reprinted in W. JONES, *CASES AND MATERIALS ON REGULATED INDUSTRIES* 727-732 (1967); and Westwood and Bennett, *A Footnote to the Legislative History of the Civil Aeronautics Act of 1938 and Afterward*, 42 *NOTRE DAME LAW.* 309 (1967) [hereinafter cited as Westwood and Bennett].

⁵ See *CAB v. Delta Air Lines, Inc.*, 367 U.S. 316 (1961).

designed to exclude, for in fact there were virtually no such operators in existence in 1938.⁶

Nevertheless, the established carriers argued that unless uncontrolled entry and "overcompetition" were curbed, they would be unable to attract the capital necessary to survive, thereby threatening the existence of the entire air transportation system.

In 1936, the major carriers formed a trade association—the Air Transport Association (ATA)—whose officers decided the industry needed a protective statute similar to the Interstate Commerce Act. Several of the bills first considered by Congress in fact provide for regulation by the Interstate Commerce Commission (ICC), although they were abandoned in favor of proposals to create an independent agency concerned only with aviation.

Sponsors of the proposed legislation analogized the airlines to railroads and other industries traditionally regarded as "natural monopolies," despite the fact that airlines did not operate on tracks or utilize power lines and, indeed, had a much different pattern of costs and operating practices. The bill, which eventually became the Civil Aeronautics Act (drafted initially by counsel for the ICC, ATA, and the major airlines),⁷ borrowed heavily from the railroad and motor carrier sections of the Interstate Commerce Act. Senator Pat McCarran and Congressman Clarence F. Lea, major proponents of the legislation in Congress, apparently regarded the requirement of a certificate of public convenience and necessity in the Interstate Commerce Act as reason in itself for imposing such a requirement on airlines, thus furnishing "an outstanding example of how institutional history fixes an idea which in turn becomes determinative of future policy."⁸

The committee hearings, reports, and floor debates in both houses were filled with denunciations of "cutthroat competition," "chaos," and "destructive tactics" in the industry, predictions of "rate wars," and pleas for route protection so that the financial position of the established carriers and the entire air transport

⁶ *Report of the Antitrust Subcommittee*, *supra* note 4, at 736.

⁷ J. GOULD, *THE SUPER LAWYERS* 33-34 (1972); *Regulation of the Carriage of Passenger and Property by Aircraft*, *Subcomm. of the Senate Comm. on Interstate Commerce*, 75th Cong., 1st Sess. 515 (1937). *See also* Westwood and Bennett, *supra* note 4, at 329.

⁸ E. REDFORD, *THE REGULATORY PROCESS* 28 (1969) [hereinafter cited as REDFORD].

system would not collapse.⁹ Congressman Lea told his colleagues in the House of Representatives:

One hundred and twenty million dollars has already been invested in commercial aviation in the United States. It is the information of the committee that \$60,000,000 of this sum has been wiped out. The fact that so much money has been put into commercial aviation shows the faith, the genius, and the courage of the American people in that they are willing to invest as they have in aviation up to this date. However, in the absence of legislation such as we have now before us, these lines are going to find it very difficult if not impossible to finance their operations because of the lack of stability and assurance in their operations. You would not want to invest \$200 to \$2,000 a mile in a line that has no assurance of security of its route and no protection against cutthroat competition.

Part of the proposal here is that the regulatory body created by the bill will have authority to issue certificates of convenience and necessity to the operators. This will give assurance of security of route. The authority will also exercise rate control, requiring that rates be reasonable and giving power to protect against cutthroat competition. In my judgment, those two things are the fundamental and essential needs of aviation at this time, security and stability in the route and protection against cutthroat competition.

These are the two economic fundamentals presented and it is this necessity that the bill seeks to meet. We want to give financial stability to these companies so they can finance their operations and finance them to advantage.¹⁰

The industry's pleas for controls on entry and price competition simply repeated a pattern recurring throughout the history of economic regulation in the United States. In the late nineteenth century, the railroads supported the Interstate Commerce Act as a device for protecting their market position. Large truckers and barge operators used similar arguments to limit price competition and obtain route protection in the 1930's. The legislative history of the Civil Aeronautics Act simply comports with one of the major theories of economic regulation: that, as a rule, restrictive legislation is secured by the affected industry and is designed and administered primarily for its benefit.¹¹ The fact that regulation by

⁹ H.R. Rep. No. 2254, 75th Cong., 3d Sess. (1938); Sen. Rep. No. 1661, 75th Cong., 3d Sess. (1938).

¹⁰ 83 CONG. REC. 6406-6407 (1938).

¹¹ Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGT. SCI.

the CAB has produced only mixed benefits for the airline industry does not defeat the hypothesis.

Although the principal impetus for creation of the Civil Aeronautics Board was the industry's desire for protection and financial stability, other factors were at work which have often been overlooked in discussions of the Act's legislative history. Aviation was an infant but technologically significant industry, and many congressional proponents of the Act believed the government should take steps to promote its "orderly development." More important, passage of the Civil Aeronautics Act was undoubtedly influenced by the general pessimism about free enterprise and the faith in government controls which accompanied much New Deal legislation. This profound mistrust of competition played a significant role in the extension of regulation to a number of other naturally competitive industries and in the creation of such agencies as the National Recovery Administration. As Richard Posner has observed, government supervision was promoted because the "Great Depression seemed to many to reveal the bankruptcy of the market as an economic regulator," despite the fact that it was "primarily the inadequacy of [government] fiscal, monetary and welfare policy that made the depression so painful and prolonged."¹² Finally, creation of the CAB was founded on assumptions that the airline industry was a business "affected with the public interest" and that any business affected with the public interest should be subject to public utility controls.¹³

All of these influences merged to result in passage of the Civil Aeronautics Act in June 1938. "If not united with one another as to the cause for concern, the proponents of more comprehensive

3 (1971). George Stigler argues that in seeking economic regulation, an industry strives for four principal contributions from the government: a direct subsidy of money; control over entry by new firms; powers affecting substitutes or complements (e.g., federal aid for airport construction); and price fixing. All four such elements have been present, at one time or another, in the policies advocated by the airlines.

¹² Posner, *Natural Monopoly and its Regulation*, 21 STAN. L. REV. 548, 621-622 (1969).

¹³ REDFORD, *supra* note 8, at 32. It is suspected that the financial institutions which dominated the infant American airline industry also may have played a significant role in shaping the legislation which emerged. Unlike traditional utility legislation, the 1938 Act and its 1958 successor do not give the CAB any direct control over such matters as airline financing and equipment and facilities acquisition and disposal.

air carrier regulation at least found unity in their fear of an uncharted future."¹⁴ The fragmented basis for Congressional support of the Act is reflected in the unusual policy statement contained in Section 102:¹⁵

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:

(a) The encouragement and development of an air-transportation system properly adapted to the present and future needs of the foreign and domestic commerce of the United States, of the United States 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 United States Postal Service, and of the national defense;

(e) The promotion of safety in air commerce; and

(f) The promotion, encouragement, and development of civil aeronautics.¹⁶

The Board not only is to regulate, but it also is to "promote," "encourage," and "develop" commercial aviation. It is also to foster "(c)ompetition to the extent necessary to assure the sound development of an air-transportation system"—a provision not contained in any previous regulatory statute. The six objectives quoted above are both ambiguous and contradictory. As Richard Caves has noted: "Taken literally, [they require] an impossibility by suggesting the simultaneous maximization of things that probably

¹⁴ Jones, *Licensing of Domestic Air Transportation, Part I*, 30 J. AIR L. & COM. 113, 115 (1965).

¹⁵ Federal Aviation Act of 1958 § 102, 49 U.S.C. § 1302 (1976).

¹⁶ *Id.*

cannot be simultaneously maximized."¹⁷ More realistically, the Declaration of Policy gives the Board "sufficiently broad discretion that any one of a wide variety of results is either legally justifiable or at least not subject to meaningful judicial review."¹⁸

The Act created a five-member independent agency known as the Civil Aeronautics Authority (later renamed the Civil Aeronautics Board) and gave it the power (a) to control entry into interstate and foreign commerce by requiring entrants to obtain certificates of public convenience and necessity prescribed by the agency; (b) to control exits by requiring approval before abandoning a route or ceasing service to a point; (c) to exempt carriers from certain provisions of the Act; (d) to regulate fares on the basis of rate-making provisions adopted from sections of the Interstate Commerce Act; (e) to award direct subsidies to air carriers; (f) to control mergers and intercarrier agreements, thus immunizing them from the antitrust laws; and (g) to investigate deceptive trade practices and unfair methods of competition.¹⁹ A bureau within the Authority was also given authority to regulate safety of all civil aviation, both private and commercial. And under a grandfather clause, the Board was directed to issue certificates of public convenience and necessity to the sixteen established airlines operating scheduled service. As one writer has described it:

The resulting Civil Aeronautics Act of 1938 gave the airlines almost all they desired. The routes of the then existing . . . airlines were protected, and the threat of outside competition was practically eliminated. Furthermore, a generous subsidy was provided, in effect a blank check. The carriage of Air Mail need no longer be on a contract basis, subject to competitive bids. Instead, government mail pay was to be awarded to a carrier on the basis of "need." Unless a carrier could be shown to be willfully fraudulent or inefficient in his management, he no longer had to fear losses. The government stood ready not only to make up any deficit, but

¹⁷ R. CAVES, *AIR TRANSPORT AND ITS REGULATORS* 127 (1962) [hereinafter cited as CAVES]. Moreover, even if one believes in the efficacy of economic regulation of naturally competitive industries, the CAB was not given the requisite "tools" to do this job, as it was deprived of control over schedules, financing, and equipment acquisition and disposal.

¹⁸ Jones, *Licensing of Domestic Air Transportation, Part II*, 31 J. AIR L. & COM. 89, 91 (1965). See also *United Air Lines v. CAB*, 371 F.2d 221, 224 (7th Cir. 1967); *Frontier Airlines, Inc. v. CAB*, 439 F.2d 634, 637 n.4 (1971).

¹⁹ 49 U.S.C. §§ 1371-1387 (1976).

also to insure a return on his investment. All in all, the Act seemed to be a bonanza for the airlines, and the major figures in the industry greeted its passage enthusiastically.²⁰

Life Under the 1938 Act

During its forty year existence, the Civil Aeronautics Board has, on the whole, faithfully and competently carried out its vision of the basic statutory directives of the 1938 Act. It has succeeded in expanding scheduled service to every city of appreciable size in the United States, encouraged route and service competition among the existing carriers, and promoted the growth of the industry. With few exceptions, the defects in the present regulatory scheme are not the result of erroneous Board policy, but are instead inevitable products of the Act itself and the Board's difficulties in reconciling the conflicting mandates imposed on it by Congress.

One of the most obvious products of life under the statute has been the total exclusion of new entrants into domestic trunkline service. Although the Board received more than seventy-nine applications for trunkline authority from outsiders between 1950 and 1974, it did not approve one of them.²¹ The most apparent reason for its refusal to do so has been the inherent tendency of the certification process to favor the past operating performance of existing carriers, rather than any bias or express policy of exclusion on the part of the CAB.²² The Board has authorized new entry by additional categories of carriers, permitting them to provide "specialized" types of service. Yet none has been allowed to compete with the trunklines on dense long-haul routes between major cities. After World War II, the Board authorized a group of "local service" carriers to provide subsidized feeder service to small communities on an experimental basis; in 1955 their certificates were made permanent by statute and they are now known as "regional" airlines. The Board has also granted authority to classes of carriers providing supplemental (or charter) service, all-

²⁰ KELLY, *THE SKY'S THE LIMIT* 102 (1963).

²¹ *Airline Regulation by the Civil Aeronautics Board, Summary of Report of the Senate Subcommittee on Administrative Practice and Procedure*, reprinted in 41 J. AIR L. & COM. 607, 614 (1975).

²² REPORT OF THE CAB SPECIAL STAFF ON REGULATORY REFORM 49 (July 1975) [hereinafter cited as REPORT OF THE CAB SPECIAL STAFF].

cargo service, metropolitan helicopter service, and service within Alaska and Hawaii. It has also established a category of carriers exempt from economic regulation under Part 298 of the Board's Rules—air taxi or commuter operators utilizing aircraft with a maximum seating capacity of thirty and payload of 7,500 pounds.

Richard Caves, in his classic study of air transportation, suggested that "a new carrier will never be picked to supply a standard (trunkline) service, but will always be chosen for a completely novel and risky one."²³ This tendency apparently results from the Board's desire to use route awards as a vehicle for improving the profitability of existing carriers or to reduce the disparity in size among them. In instances in which a new applicant proposes an innovative service which threatens an existing carrier with serious competition, the Board always has struggled with the problem until it found a way to resolve it in favor of the established carrier. This has occurred on a number of occasions, most prominently in the attempts by nonscheduled carriers to obtain authority to provide low-cost scheduled service in competition with the trunks.

Immediately after World War II a number of nonscheduled airlines entered the industry under a general exemption granted previously by the CAB, using surplus transport aircraft available at the end of the war.²⁴ Several made application for scheduled authority to provide low cost coach service—a class of passenger service not then offered by any of the trunks. In rejecting the applications, the Board admitted that "the extension of low-fare, or coach transportation would bring into existence an additional market, a substantial part of which would be made up of persons who previously have not traveled by air," but it concluded that awarding the "nonskeds" route authority was still not justified. The market for transcontinental air coach service should be reserved for eventual penetration by the certificated incumbents in order to produce excess revenues for support of coach service on their weaker routes. "We cannot escape the conclusion . . . that the introduction of new carriers, operating unlimited air coach services

²³ CAVES, *supra* note 17, at 171.

²⁴ For a discussion of the Board's treatment of the nonscheduled carriers, see CAVES, *supra* note 17, at 171-174, 272-279; and Maclay & Burt, *Entry of New Carriers into Domestic Trunkline Air Transportation*, 22 J. AIR L. & COM. 131 (1955).

as here proposed, would constitute a serious threat to the future orderly progression toward cheaper air transportation for the Nation as a whole."²⁵

In 1967, World Airways, another nonscheduled airline (regulated by the Board as a supplemental carrier), applied for a certificate to provide regular transcontinental service between major cities on the East and West coasts at fares as low as \$79. The CAB "sat" on World's application for several years and then dismissed it as "stale."²⁶ When World refiled in a supposedly more "hospitable" atmosphere, the CAB used various procedural devices to avoid dealing with the application and eventually again dismissed it on the erroneous ground that the Act prevented a supplemental carrier from holding scheduled authority.²⁷

Besides being identified as a closed market, the domestic industry is also characterized by its concentration. Although forty years have elapsed since they were granted grandfather rights in 1938, the trunklines (now reduced from sixteen to ten through mergers) today carry approximately eighty-eight percent of the domestic passenger market.²⁸ The Board has attempted to reduce the size variance between the trunks through additional route awards to smaller carriers; nevertheless, the four companies which dominated the domestic industry in 1938—American Airlines, United Air Lines, Transcontinental & Western Air (now TWA), and Eastern Air Lines—still remain the "Big Four."²⁹ The local service industry, now composed of nine regional airlines,³⁰ has been permitted to compete with the trunks on a number of short- and medium-haul routes; still it accounts for less than nine percent of the domestic market. Such concentration is not a natural product of the air transport industry, since the available evidence suggests that the optimum size of an airline is certainly no greater than that

²⁵ Transcontinental Coach-Type Service Case, 14 C.A.B. 720, 724 (1951).

²⁶ CAB Order No. 73-11-101 (Nov. 21, 1973).

²⁷ The Board was reversed in *World Airways, Inc. v. CAB*, 547 F.2d 695 (D.C. Cir. 1976).

²⁸ CAB AIR CARRIER TRAFFIC STATISTICS (1938-1977).

²⁹ The other six are Braniff Airways, Continental Airlines, Delta Air Lines, National Airlines, Northwest Orient Airlines, and Western Airlines.

³⁰ Air New England, Allegheny Airlines, Frontier Airlines, Hughes Airwest, North Central Airlines, Ozark Airlines, Piedmont Airlines, Southern Airways, and Texas International Airlines.

of the smallest trunk carrier.³¹

Finally, past CAB regulation has produced a form of competition between carriers which differs dramatically from the competitive practices of most other major industries. Restrictions on route selection and pricing have largely prevented carrier management from making the two major decisions made by most other businesses: what markets should we enter and how much should we charge for our goods and services? As a result, these controls severely limit a carrier's ability to determine its own profitability. A study by William Fruhan contends that the CAB actually exercises more direct control over a carrier's competitive position and relative profitability than management does.³² With pricing removed as a competitive tool, the carriers have been forced to compete in terms of scheduling and inflight amenities, such as meals, movies, and onboard pubs.

Previous Attempts at Deregulation

Although deregulation of the industry had never been seriously considered by Congress until three years ago, the problems resulting from the system under the 1938 Act have been discussed since the Truman Administration. A study by Lucille Keyes in 1951 concluded that there was no available evidence of any need, or valid argument, for federal control over entry, or for government protection of individual carrier revenues.³³ She was later to write that protective regulation was no more essential to assure "the provision of an adequate supply of air transport services . . . than it is necessary to secure an adequate supply of soaps, doorknobs, or automobiles."³⁴

³¹ REPORT OF THE CAB SPECIAL STAFF, *supra* note 22, at 102-04.

³² W. FRUHAN, *THE FIGHT FOR A COMPETITIVE ADVANTAGE* 51-67 (1972). Fruhan identifies nine specific profit variables in the industry: (1) the degree of competition on the carrier's routes; (2) the distribution of haul lengths on the carrier's routes; (3) the density distribution of passenger traffic on the carrier's routes; (4) the reasonability of traffic flows on the carrier's routes; (5) the yields (by haul length segments) received by the carrier; (6) the intensity (in hours per day) of productive aircraft utilization; (7) the quality (or passenger appeal) of the carrier's equipment; (8) the carrier's capacity aggressiveness in trying to seize market share; and (9) the overall quality of carrier management. His study concluded that the CAB controls the first five, leaving management with authority only over the last four variables.

³³ KEYES, *supra* note 4.

³⁴ Keyes, *A Reconsideration of Federal Control of Entry into Air Transportation*, 22 J. AIR L. & COM. 192, 197 (1955).

Suggestions, however, for relaxing controls on entry have always brought a strong protest from the industry. During the course of the fight by the "nonskeds" to obtain scheduled authority during the early Fifties, two officers of the Air Transport Association predicted doom if the Board were to open the industry to outsiders:

On the day that concept was introduced, every airline would tear up its time tables, disregard its certificates, forget that it has franchise responsibilities and do what business it pleased in the interest of greater profits *and not public convenience*. Airlines who had filed applications for particular routes would just start flying those routes and not wait Board action. Carriers who had sought for years to eliminate restrictions would just fly over the cities to which they have been restricted. The industry, in such a chaotic struggle for survival, would then have to abandon service to roughly some 500 of the cities to which it is now certificated, and operate only between the 50 most profitable pairs of points.

Acceptance of the "freedom of entry" thesis expounded in pending applications before the Civil Aeronautics Board would be tantamount to urging the creation of one or a number of new systems, draining the rich juice of the air transport network from trunkline carriers who would be forced to continue to serve thin segments. This would create an extremely unfair and uneconomic competitive situation and would dislocate the country's air transport network. It would not represent any new or additional competitive opportunity, reflecting itself in public good, but only a chance for a favored few really to enjoy excessive profits.³⁵

Such prophecies have always seemed to carry the day. The Board was severely criticized by several Congressional committees during the Eisenhower years for its treatment of nonscheduled carriers,³⁶ and executive recommendations to Presidents Kennedy and Nixon proposed either reorganizing or abolishing the CAB.³⁷ But until Congress enacted legislation last November deregulating the all-cargo industry,³⁸ not one of the more than thirty amendments

³⁵ Tipton and Gerwitz, *The Effect of Regulated Competition on the Air Transport Industry*, 22 J. AIR L. & COM. 157, 190-191 (1955).

³⁶ See *Monopoly Problems in Regulated Industries (Airlines)*, Hearings before Antitrust Subcomm. of House Judiciary Comm., 84th Cong., 2d Sess. (1956).

³⁷ See LANDIS, REPORT ON REGULATORY AGENCIES TO THE PRESIDENT-ELECT (1960); PRESIDENT'S ADVISORY COUNCIL ON EXECUTIVE ORGANIZATION (ASH COMMITTEE), A NEW REGULATORY FRAMEWORK: REPORT ON SELECTED INDEPENDENT REGULATORY AGENCIES (1971).

³⁸ Act of Nov. 9, 1977, Pub. L. No. 95-163. The act amends the Federal Aviation Act of 1958 by adding a new section 418 requiring the Board to award

to the economic provisions of the Federal Aviation Act has manifested any congressional intent to loosen restrictions on entry and pricing.

The Impetus for Regulatory Change

What then are the reasons for the present drive to reform the CAB's authority? There are several. First, there has been a growing public reaction against regulation of all kinds, manifested by sunset legislation, hostility against such agencies as the FDA and OSHA, and disgust at the debacle which the ICC has made of the railroads. The economic recession, during the Nixon and Ford administrations, and persistent problems with inflation have also created public concern over the enormous costs of government regulation.

Second, Congress and the public have become aware of the performance of intrastate airlines in Texas and California whose operations are beyond the jurisdiction of the CAB. Pacific Southwest Airlines (PSA) and Air California (both certificated by the California Public Utilities Commission (CPUC) and Southwest Airlines (certified by the Texas Aeronautics Commission (TAC)) charges fares substantially below the interstate fares historically charged by CAB carriers in the identical, as well as comparable city-pair markets, while still maintaining reasonable profits, high levels of service, and excellent safety records. Their fares average two-thirds, or less, of interstate fares for comparable distances, yet they offer a large number of flights in short-haul density markets, using modern 727 and 737 jet equipment. High load factors and efficient operating practices have resulted in productivity more than double that of some interstate carriers. Studies have shown that "they are

grandfather rights to any certificated carrier which provided scheduled interstate all-cargo service within the continental United States sometime during the period between January 1 and November 9, 1977; commuter carriers must have operated continuously during the 12-month period preceding November 9, 1977, to qualify for grandfather rights. Thereafter, the Board is required to award all-cargo certificates to any applicant who demonstrates that it is fit, willing, and able to provide the proposed service, and no certificate may contain restrictions limiting the points to be served or the rates to be charged. In addition, the bill amends section 1002 of the Act to limit the Board's authority to regulate cargo rates to those cases where the Board finds, after notice and hearing, that the rates are discriminatory, preferential, prejudicial, or predatory. In general, all-cargo transportation involving the states of Hawaii and Alaska will continue to be regulated under existing law. The Board is permitted to exempt holders of all-cargo certificates from any section of the Act.

carrying almost twice as many revenue ton-miles per employee and boarding 1.7 and 2.2 times as many passengers per employee as the average short-haul [CAB] carrier."³⁹

Much of this success—and the resulting benefits to the public—has been due to the regulatory environment in which these airlines have operated. PSA inaugurated service during a period in which there was complete freedom of entry and pricing in California.⁴⁰ For nearly two decades PSA and a number of other airlines freely entered intrastate markets, offering low fares and building the Los Angeles-San Francisco corridor into the most heavily traveled air market in the world. The low fares which prevailed in California required carriers to minimize their costs; many carriers could not do so, but, because of its high productivity, PSA succeeded—offering frequent service and earning excellent profits. But like the mail contract carriers in 1938, PSA believed it could preserve its market position more effectively in a regulated environment. In 1965, apparently at its behest, the California legislature granted the CPUC authority to control airline entry and exit.⁴¹ Since that time California regulation has become as restrictive as federal regulation. Air California began operations in 1967 under a certificate authorizing service from Santa Anna to the Bay Area, but in 1967 the CPUC refused to certificate another new carrier, Pacific Air Transport, to provide service between Long Beach and San Francisco, on the grounds that it had failed to make a satisfactory showing of financial stability or experience in scheduled operations. In the last twelve years, the CPUC has also clearly sheltered Air California from direct competition by PSA, refusing to permit the two carriers to compete against one another from the same airports except in several minor markets.⁴²

The Texas regulatory statute also has its deficiencies,⁴³ most of which the Texas Aeronautics Commission has wisely surmounted

³⁹ SIMAT, HELLIESEN AND EICHNER, INC., AN ANALYSIS OF THE INTRASTATE AIR CARRIER REGULATORY FORUM, SUMMARY REPORT 23 (1976) [hereinafter cited as SIMAT, HELLIESEN AND EICHNER, INC.].

⁴⁰ See generally W. JORDAN, AIRLINE REGULATION IN AMERICA (1970) [hereinafter cited as JORDAN]; and Comment, *Is Regulation Necessary? California Air Transportation and National Regulatory Policy*, 74 YALE L. J. 1415 (1965).

⁴¹ CAL. PUB. UTIL. CODE §§ 2750-2769 (West 1975).

⁴² LaMond, *An Evaluation of Intrastate Airline Regulation in California*, 7 BELL J. ECON. & MGT. SCI. 641 (1976).

⁴³ For an analysis of the TAC, see Means & Chasnoff, *State Regulation of Air Transportation: The Texas Aeronautics Commission*, 53 TEX. L. REV. 653 (1975).

through implementation at the Commission level of liberal entry and pricing policies. The success achieved by Southwest Airlines under these entry and pricing policies provides the primary current example and impetus for federal reform. The Texas Aeronautics Act itself, however, requires potential new entrants to obtain a certificate of public convenience and necessity and requires the TAC, before granting intrastate authority, to consider "the effect, if any, upon existing air carriers and CAB certificated carriers."⁴⁴ As a result of vigorous opposition by Braniff and Texas International, the authorization of Southwest's new routes in the state has required lengthy administrative proceedings and court appearances. On the other hand, the TAC has fought to maintain Southwest's right to use close-in airports and has allowed it considerable pricing flexibility and experimentation. The latter has led to the development of a unique two-tier, peak-offpeak pricing structure which has produced the lowest generally available off-peak fares in the country for scheduled short-haul airline service.⁴⁵

Although neither the California nor Texas statutes are perfect models for regulatory reform, both states, at different times, have allowed the creation and growth of low fare service not possible under the prior federal regulatory regime. The CPUC and TAC have given their carriers the flexibility to pursue pricing strategies which dramatically increased traffic and resulted in profitable, efficient systems in a highly competitive environment. Most important, their low fares and high productivity have furnished excellent examples of the benefits which could be achieved by a less-regulated industry.

A third factor which has contributed to the current impetus for reform of the 1958 Act is the nearly unanimous opinion of economists that CAB regulation results in greater technical inefficiency and higher fares than would exist if restraints were removed. Using intrastate fares as a model, studies have demonstrated that in the absence of federal regulation airline fares would be forty to eighty percent lower than those actually charged in major domestic markets.⁴⁶ Without regulation, the passenger also would be afforded

⁴⁴ TEX. REV. CIV. STAT. ANN. art. 46c-6, § 3(b) (Vernon Supp. 1978).

⁴⁵ SIMAT, HELLIESEN AND EICHNER, INC., *supra* note 39, at 6.

⁴⁶ JORDAN, *supra* note 40, at 100-114; Keeler, *Airline Regulation and Market Performance*, 3 BELL J. ECON. & MGT. SCI. 399 (1972); and G. DOUGLAS and

greater variety in the range of prices and services offered in particular markets. Moreover, it is contemplated that the efficiency of the industry would improve as a result of higher load factors, more sensible route alignment, and carrier specialization.

In 1975, the Board itself appointed a special staff to undertake a comprehensive study of air transport controls and proposals for regulatory reform. The staff returned to the Board recommending that all protective entry and public utility-type price controls in domestic air transportation be eliminated within three to five years by amendment to the Federal Aviation Act.⁴⁷ According to the Special Staff, such controls

are not justified by the underlying cost and demand characteristics of commercial air transportation. The industry is naturally competitive, not monopolistic. In the absence of economic regulation, it is clear that monopoly abuses would not occur. Service quality and price would be highly responsive to demand because of the immediate threat of new entry even in markets served by a single carrier. Most important for the long term, the possibility of new entry will assure that the system will be composed of highly efficient carriers able to adapt readily to changing conditions.

The present system of regulation causes higher than necessary costs and prices (which in turn suppress demand), weakens the ability of carriers to respond to market demand and other constantly changing conditions, narrows the range of price/quality choices to the user, and thus produces a misallocation of the nation's economic resources.⁴⁸

The conclusions reached by these studies have been reinforced by the CAB's past inability to cope with the growing economic problems in the industry—a fourth influence in the drive for regulatory change. During the first half of the 1970's, airline profits all but disappeared; at the same time the industry was faced with enormous commitments for new flight equipment. Yet as profits plummeted and the CAB struggled to adjust to changes in industry costs and market conditions, external capital to finance new equipment all but dried up. Investors began to realize that the airlines, once one of the glamour industries of the stock market, were now

J. MILLER, *ECONOMIC REGULATION OF DOMESTIC AIR TRANSPORT* 172 (1974).

⁴⁷ REPORT OF THE CAB SPECIAL STAFF, *supra* note 22.

⁴⁸ CAB SPECIAL STAFF, *EXECUTIVE SUMMARY OF REPORT OF THE CAB SPECIAL STAFF ON REGULATORY REFORM* 1 (July 22, 1975).

very poor investments. In fact, during the period from 1964 to 1974 investors in the air transport industry earned lower returns and accepted greater risks than did investors in almost any other industry.⁴⁹ With profits low and fares high, what did economic regulation have to commend it?

The final important factor spurring the reform movement was the reaction against certain policies pursued by the Board during the Nixon Administration: in particular, its route moratorium; capacity reduction; and pricing policies. Concerned with what it considered to be overcapacity and excessive competition in the industry, the CAB informally decided to refuse to award any new route authority during the years 1969-1974.⁵⁰ This "route moratorium" was accomplished by delaying decisions in pending route cases for years and refusing to set down new applications for a hearing. Applications were seldom denied on their merits and the policy was never formally adopted in accordance with the rule-making provisions of the Administrative Procedure Act, so that it became effectively impossible for a carrier or other affected party to seek judicial review of the moratorium.⁵¹

The Board was also criticized for another policy it used in an attempt to deal with the industry's financial problems: its approval of agreements between airlines to reduce schedules in several trans-continental markets. Between 1971 and 1975, the Board sanctioned a number of these capacity reduction agreements between the Big Four, despite their blatantly anti-competitive character. Several of the temporary agreements were sustained by the courts on

⁴⁹ Gritta, *Profitability and Risk in Air Transport*, 7 TRANSP. L. J. 197 (1975).

⁵⁰ *Report on Civil Aeronautics Board Practices and Procedures, Subcomm. on Administrative Practice and Procedure of the Senate Judiciary Comm.*, 94th Cong., 1st Sess. 77-102 (1975).

⁵¹ See, e.g., *Utah Agencies v. CAB*, 504 F.2d 1232 (10th Cir. 1974), holding that refusal to grant an immediate or expedited hearing on a request for competitive service between Los Angeles and Salt Lake City was not an abuse of discretion. The Board had less success when it attempted to dismiss such applications on their merits. In 1974, it refused to grant competitive authority in the Denver-San Diego market saying that while additional authority was perhaps justified, the industry's financial difficulties and the fuel shortage overrode the benefits of competition. On appeal, the Board was reversed on the grounds its decision conflicted with the mandate to promote competition contained in the Act. *Continental Air Lines, Inc. v. CAB*, 519 F.2d 944 (D.C. Cir. 1975). The deliberate delay used to effectuate the "moratorium" was, of course, a designed accentuation of the normal and endemic regulatory "lag," which constitutes yet another spur for CAB reform in the procedural area.

appeal,⁵² but in 1975 a more permanent agreement was found illegal because of the Board's refusal to consider its antitrust implications.⁵³

The Board's pricing policies also generated considerable concern. In 1970, it initiated a massive public investigation of the domestic passenger fare structure, apparently in response to criticism of its prior policy of establishing fares through closed meetings with carrier representatives. The decisions in the nine phases of that investigation have resulted in the setting of standard seating configurations, imposition of uniform rates (between city pairs of equal distance) on the basis of average industry costs, disapproval of many discount fares, a requirement that fares be based on fully allocated costs, a maximum discount for economy from coach fares, and the refusal to permit individual carriers to raise or lower fares within a "zone of reasonableness."⁵⁴ Although the Domestic Passenger Fare Investigation (DPFI) may have represented an improvement over the manner in which the Board had earlier set fares, it also introduced much more rigidity into the fare structure than was necessary under the Act. Use of industry average costs, for example, dampens the incentive of an individual carrier to improve its efficiency. By insisting that airlines charge uniform rates, based on a "cost-related" fare taper (the shorter the distance the higher the yield per mile), the Board has substantially raised the price of short-haul travel above the level at which it is competitive with surface modes of transportation; and it has effectively prevented individual carriers from experimenting with selective price cutting in particular markets. As pointed out by the CAB Special Staff, "the logic of DPFI requires that the rate regulation be made more restrictive to protect the carriers from themselves and the public from the effects of carrier extravagance."⁵⁵

⁵² *E.g.*, *Air Line Pilots Association International v. CAB*, 475 F.2d 900 (D.C. Cir. 1973), *cert. denied*, 420 U.S. 972 (1975).

⁵³ *United States v. CAB*, 511 F.2d 1315 (D.C. Cir. 1975).

⁵⁴ For analyses of the DPFI see REPORT OF THE CAB SPECIAL STAFF, *supra* note 22, at 62-76; Douglas and Miller, *The CAB's Domestic Passenger Fare Investigation*, 5 BELL J. ECON. & MGT. SCI. 205 (1974). See also *Continental Air Lines, Inc. v. CAB*, 522 F.2d 107 (D.C. Cir. 1974) and *Continental Air Lines, Inc. v. CAB*, 551 F.2d 1293 (D.C. Cir. 1977). The present CAB is eliminating these artificial and anti-competitive pricing constraints. CAB Regulation PS-80, Amendment No. 59 to Part 399, Dockets 31290 & 30891 (August 25, 1978).

⁵⁵ REPORT OF THE CAB SPECIAL STAFF, *supra* note 22, at 74.

These various factors—hostility to excessive government regulation, the example of intrastate carriers, economic studies of the airline industry, carrier financial problems, and reaction against previous Board policies—have merged during the last three years to provide bipartisan support for regulatory change. The hearings by Senator Kennedy's Subcommittee on Administrative Practice and Procedure were key to generating this support.⁵⁶ Various other congressional committees, the Ford and Carter administrations, and the CAB itself have each recommended substantial revisions to the Act. In October 1975, President Ford sent to Congress a comprehensive program of reform, entitled the Aviation Act of 1975, which was designed to allow greater pricing flexibility and freedom of entry.⁵⁷ During the next two years, a number of other reform bills were introduced by various Congressmen.⁵⁸ As this is being updated, the Senate and House are about to convene a conference committee on their differing versions of regulatory reform, S. 2493 and H.R. 12611.⁵⁹

Under the leadership of Chairman Alfred Kahn, the Board itself has begun to ease pricing and entry restrictions within the framework of the existing Act. It has approved discount fare proposals submitted by individual carriers, such as "Peanuts" and "Super Saver" fares, and it has reworked the Domestic Passenger Fare Investigation so as to liberalize many of the more stringent DPFI findings which restricted individual carrier pricing flexibility.⁶⁰ Moreover, the Board has recently announced that as a matter of general policy it will now consider the offer of (or failure to offer) low fares as a major factor in all future route proceedings. In determining the need for new authority and the choice of a carrier to serve the market, the Board stated that it will consider proposals for new price options (reduced normal fares, promotional fares, and off-peak pricing), and service options (reduced

⁵⁶ See note 21 *supra*.

⁵⁷ S. 2551, 94th Cong., 1st Sess. (1975).

⁵⁸ *E.g.*, S. 3364, 94th Cong., 2d Sess. (1976); S. 3536, 94th Cong., 2d Sess. (1976); S. 3830, 94th Cong., 2d Sess. (1976).

⁵⁹ 95th Cong., 2d Sess. (1978). The Senate bill is a product of committee hearings on the Air Transportation Regulatory Reform Act of 1977, S. 689, 95th Cong., 1st Sess. (1977), introduced by Senators Cannon and Kennedy, and the Commercial Aviation Regulatory Reform Act of 1977, S. 292, 95th Cong., 1st Sess. (1977), introduced by Senators Pearson and Baker.

⁶⁰ See note 54 *supra*.

amenities, improved aircraft utilization, higher density seating, and load factors).⁶¹ In addition, the CAB has already set for expedited hearing, or decided favorably, a number of applications for low-fare route authority by proposed new entrants, such as intrastate carriers, supplemental carriers, and companies not presently operating airline service, and has adopted a policy of granting all applicants permissive, rather than mandatory authority to serve.⁶² The members of the Board, however, recognize that by attempting to encourage competition, lessen entry barriers, and promote low fares, they may be taking "calculated legal risks" involving possible reversal of the Board's actions as contrary to the mandates of the present Act. They have pleaded with Congress to enact regulatory reform legislation that will emphasize competition and eliminate ambiguity and conflict in policy goals; produce procedural expedition; and grant greater flexibility in the areas of ratemaking and exemption from the Act's requirements.⁶³

Although the Senate and House reform proposals now proceeding to conference committee are by no means uniform, the legislation under consideration would basically do the following:

(a) amend the policy declaration in Section 102 to place greater emphasis on competition, efficient and low-cost transportation, entry by new carriers, and prevention of undue concentration in the industry;

(b) redefine standards for obtaining new route authority by ultimately requiring opponents to prove that proposed service is inconsistent with the public convenience and necessity;

(c) provide a vehicle for automatic entry by which existing CAB carriers and large intrastate carriers could initiate non-stop service in one or two markets of their choice each year;

(d) allow automatic exit from markets without the necessity to obtain Board approval;

(e) create a new class of federally-subsidized carriers using

⁶¹ Chicago-Albany/Syracuse-Boston Competitive Service Investigation, CAB Order No. 77-12-50 at 3 (Dec. 9, 1977).

⁶² *E.g.*, Chicago Midway Low-Fare Route Proceeding (CAB Docket 30,277); California-Nevada Low-Fare Route Proceeding (CAB Docket 30,659); and the Transcontinental Low-Fare Route Proceeding (CAB Docket 30,536).

⁶³ AVIATION DAILY, February 9, 1978, at 220; AVIATION DAILY, February 10, 1978, at 228.

thirty-fifty seat aircraft to provide service to small communities;

(f) allow carriers the freedom to raise or lower fares within a zone of reasonableness without Board approval;

(g) open the charter industry to any applicant the Board determined was fit, willing, and able;

(h) remove regulation of charter fares;

(i) deprive the Board of its power to approve and immunize from the antitrust laws certain capacity reduction, pooling, or fare-fixing agreements between carriers;

(j) impose procedural time limits on Board actions to reduce regulatory lag and prevent the Board from sitting on applications for new service; direct the Board to streamline its hearing process and make greater use of show cause proceedings; and

(k) preempt state regulation of carriers operating under a CAB license (except, possibly, large intrastate carriers).

What are the major arguments for and against such legislation?

The Arguments for Regulatory Reform

The proponents of regulatory reform⁶⁴ argue that air transportation is as naturally competitive as any other industry and should not be subject to public utility regulation; high variable costs, rather than the high fixed costs associated with public utilities, characterize the industry. Restrictions on pricing flexibility have eliminated beneficial competition, causing carriers to compete largely with increased flight schedules. This has resulted in excess equipment capacity, has led to unnecessarily high costs and passenger fares, and has driven down carrier profits. Restrictions on entry by new carriers have insulated the industry from normal economic pressures to reduce costs and improve productivity and have deprived the public of low fares and new, innovative services. In addition, say the proponents, controls on entry and exit have encouraged inefficient route structures and fostered undesirable attempts to cross subsidized low density routes with profits from high density markets. For example, there is no sound reason to force people traveling between New York and Chicago to subsidize passengers

⁶⁴ See generally Snow, *Aviation Regulation: A Time for Change*, 41 J. AIR L. & COM. 637 (1975); Miller, *A Perspective on Airline Regulatory Reform*, 41 J. AIR L. & COM. 679 (1975); Levine, *Alternatives to Regulation: Competition in Air Transportation and the Aviation Act of 1976*, 41 J. AIR L. & COM. 703 (1975).

traveling between Dubuque and Des Moines. If it costs more to provide adequate service to small cities, then travelers actually using that service should pay for it.

The paramount goals of CAB regulation should be to encourage efficiency and competition within the industry. Relaxation of entry restrictions would lead to new service and price options being offered to the public, would promote carrier specialization in services and haul lengths, and would force incumbent airlines to reduce costs. Because, above a certain level, there are no significant economies of scale in the industry, a less-regulated industry would consist of many small carriers rather than several large ones; therefore, concentration would diminish. Classic rate-making principles should be rejected in favor of allowing prices to be established by market forces. Competition between carriers then would lead to a reduction in fares in dense markets and more attractive choices being offered the price-sensitive traveler. As the public responded to lower fares, load factors would increase and equipment utilization would improve.

The Arguments Against Regulatory Reform

The opponents of regulatory reform include not only many scheduled CAB carriers, but also airline labor, holders of airline debt, and some airport operators. Their principal arguments⁶⁸ against amending the Act may be summarized as follows:

Economic regulation under the 1938 act has produced the finest air transportation system in the world, with rates significantly lower than those for comparable service in any other country. Airline fares have increased much less than the cost of other goods and services, and are cost-related. Fares must be set on a system-wide basis to permit cross-subsidization of weak routes, which would not receive service in a free market; such service to small communities is critical to an adequate national transportation system.

The industry is presently highly competitive—if anything, too

⁶⁸ See generally Tillinghast, *The Practicalities of "Deregulation,"* 45 ABA ANTITRUST L. J. 236 (1976); Callison, *Airline Deregulation—A Hoax?*, 41 J. AIR L. & COM. 747 (1975); 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) [hereinafter cited as Lloyd-Jones]; and Rasenberger, *Deregulation and Local Airline Service—An Assessment of Risks*, 41 J. AIR L. & COM. 843 (1975) [hereinafter cited as Rasenberger].

much so. Dense markets are served by as many as three or four carriers with excellent service levels and numerous flights throughout the day. Moreover, it is not a closed system. There has been substantial new entry by local service (regional) airlines, charter operators, and commuter carriers, and the Board has continually increased competition with new route awards.

It is illogical to expect pricing variety in a deregulated environment because carriers would be forced to match every fare decrease made by a competitor. Since airlines offer a substantially identical product, no airline could afford to concede the marketing advantage created by even a minor fare reduction. Large carriers would simply use low fares as a predatory tactic to increase their market share and drive competitors from routes. The result would be mass bankruptcy for weaker or smaller airlines and even greater concentration in the industry. In addition, because of the resulting financial uncertainty, banks and insurance companies would refuse to lend to airlines, depriving them of needed capital to finance new equipment purchases.

If carriers were free to enter and exit markets at will, many marginal markets would lose certificated service entirely, either depriving isolated communities of access to the airline network or else forcing the government to replace such service through offering greater direct subsidies. The simple result of the entire concept of regulatory reform would be chaos and instability, loss of jobs, widespread carrier failure, dog-eat-dog competition, carrier refusal to finance new airport construction, a degradation in safety, and a loss in consumer confidence in the entire industry.

The Consequences of the Proposed Legislation

The opponents of deregulation obviously paint a very gloomy picture of a "deregulated" future. For many airline managers, strict economic regulation has become a narcotic. Even the thought of reducing the dose or switching to methadone sends them into cold sweats. Simple resistance to change from the familiar accounts for much of the opposition to loosening the reins on the industry.

Most of the arguments advanced by the opponents of regulatory reform are simply echoes of the rationale advanced by their predecessors for adoption of the original Act, and are neither intellectually convincing nor borne out by the experience of intrastate

operations under more liberal entry and pricing policies. The logic behind some is predicated on an assumption "that airline managements would act irrationally by foregoing profitable operations in small markets and engaging in loss operations in large markets to the point of bankruptcy—a view contradicted by general business experience and empirical evidence in the field of air transportation."⁶⁶

There undoubtedly would be some "shake-out" or adjustment period, but the results should not be traumatic. The gradual relaxation of entry controls provided for in most reform proposals would minimize almost all conceivable dislocations. Through trial and error and greater reliance on simple supply and demand, the system would move toward the equilibriums experienced by any other major industry. The end result would undoubtedly be lower fares, increased volumes of traffic, and improved carrier profits. Any discontinuance of small community service by large carriers would be redressed quickly by commuter carriers at every point where it is economically justified; present commuter operations prove this.

Unfortunately we have few actual examples of the effects of deregulating an industry. Australia and England, however, each has eliminated regulation of its trucking industry, and in neither case has there been the chaos, destructive competition, or the financial instability which had been predicted beforehand.⁶⁷ Although the profits of individual airlines would not be guaranteed, it is doubted that any present air carrier would be forced into bankruptcy. For example, competition in Texas during the last six years has forced one carrier to improve its productivity and reorient its management philosophy, inducing it to offer an innovative program of traffic-generating low fares over most of its interstate routes; in the process it has moved from the brink of insolvency to earning healthy profits.

Under an amended statute, the Board will be under both statutory and political pressure to certificate new carriers, in addition to granting new route authority to CAB and large intrastate carriers. It has been suggested that there will be a stampede by inexperienced

⁶⁶ REPORT OF THE CAB SPECIAL STAFF, *supra* note 22, at 170 n.1.

⁶⁷ Joy, *Unregulated Road Haulage: The Australian Experience*, 16 OXFORD ECON. PAPERS 275 (1964), cited in Demory, *Deregulation, The Adjustment Process*, 41 J. AIR L. & COM. 873, 882-883 (1975).

operators to form companies and apply for new route authority since "there is an allure to running an airline that seems to drive otherwise sensible people toward economic self destruction."⁶⁸ Economic realities mitigate against such a result. Start-up costs for Southwest Airlines' initial operations in 1971, including three new jet aircraft operating between only three cities, required a total investment of \$20 million. The CAB Special Staff estimated that entry into transcontinental markets with new wide-bodied equipment would require as much as \$150 million, although start-up costs could be reduced significantly by leasing equipment or purchasing used aircraft.⁶⁹ No investor or lender would commit millions of dollars in funds to such a project unless he were convinced that the applicant's management was experienced and totally competent and that the business stood a reasonable chance of success. Moreover, the Board could not certificate such a carrier under any of the reform proposals unless it first found it "fit, willing, and able."⁷⁰

The economic implications obviously dominate discussions of regulatory reform. Yet there are other, less publicized issues which may be of practical or philosophical interest to practicing lawyers not directly involved in this controversy. They include the consequences for airline safety, airport financing and construction, consumer protection, and administrative law and procedure.

Airline Safety. One of the concerns most often voiced about easing restrictions on entry into the airline industry involves the maintenance of adequate safety standards. Will there be an influx of under-capitalized "scarf and goggles" operators whose marginal profits will force them to compromise on maintenance and flight standards? Although it is believed this fear is totally unfounded, there is some superficial basis for concern. William Jordan, in his study of the California industry, found that during the 1949 through 1965 period of open entry in California intrastate carriers did have a higher rate of passenger fatalities than the CAB regulated industry. He concludes, however, that the smaller volume of traffic for the California carriers probably makes it improper to compare the two fatality rates.⁷¹ Studies of the air taxi industry

⁶⁸ Rasenberger, *supra* note 65, at 857.

⁶⁹ REPORT OF CAB SPECIAL STAFF, *supra* note 22, at 109.

⁷⁰ S. 2493 & H.R. 12611, 95th Cong., 2d Sess. (1978).

⁷¹ JORDAN, *supra* note 40, at 49-53. He also concludes, however, that the com-

in recent years have also purported to disclose a correlation between a carrier's financial condition and the level of safety at which it operates. If profits were marginal and management was inexperienced, some air taxi operators apparently scrimped on their expenses, resulting in substandard maintenance and operating procedures.⁷²

Admittedly, expenditures to preserve high maintenance and flight standards impose significant economic burdens on a carrier, but it is doubted sufficient evidence exists to establish whether safety depends on economic stability rather than direct safety controls. Even if financial stability were the paramount consideration, however, the restrictions on entry and pricing imposed by the present Act are still not justified. Under the deregulation proposals pending before Congress, financial fitness and ability remain a prerequisite to entry into the industry and the CAB is still required to promote safety in air commerce as one of its policy objectives. Before the Board may certificate a new carrier or exempt it from the provisions of the Act, the applicant must demonstrate that it is fit, willing, and able to provide the proposed service. Economic regulation of routes or fare levels does not effect safety. In the pharmaceutical and meat processing industries, for example, the government closely regulates product safety, yet makes no attempt to regulate who enters the market or what prices they will charge for their goods. The opponents of regulatory reform have made no adequate showing why the air transport industry should be treated differently.

In addition, airline safety is regulated by the FAA, not the CAB, and the responsibility and functions of the FAA are in no way affected by the regulatory reform proposal. All carriers operating under Part 121 (commercial operators utilizing heavy aircraft) of the Federal Aviation Regulations, such as PSA, Air Cal, Southwest Airlines, and the CAB's trunk and regional carriers, must comply with the same safety standards, regardless of whether they are certificated by the CAB or not. The air taxi operators are

plete absence of fatal accidents by PSA during 16 years of unregulated operations demonstrated that economic regulation is not a necessary condition for airline safety.

⁷² NATIONAL TRANSPORTATION SAFETY BOARD, AIR TAXI SAFETY STUDY, REPORT NO. NTSB-AAS-72-9, September 1972; ILLINOIS LEGISLATIVE INVESTIGATING COMMISSION, INTRASTATE AIR OPERATIONS IN ILLINOIS, July, 1972.

already exempt from CAB certification and their safety is regulated under Part 135 of the Federal Aviation Regulations. If safety regulation over the third level carriers is considered inadequate, then the FAA can impose stricter requirements.

The experience of large intrastate carriers provides the best evidence that safety will not deteriorate under deregulation. Before initiating operations in Texas in 1971, Southwest hired experienced personnel drawn from major airlines to staff its flight maintenance and ground operations. It based its operating manuals on those of major carriers and subcontracted for such functions as pilot training and engine overhaul with such carriers as United and TWA. The FAA would never have certificated Southwest unless it had been fully satisfied that it had the financial resources to maintain a safe operation and that its procedures fully complied with Federal Aviation Regulations. In the interim, the FAA has continually monitored, audited, and inspected Southwest's operations, assigning two inspectors to observe its maintenance and flight standards on a full-time basis. In its six year history, Southwest has carried more than five million passengers, operated more than 1.5 billion revenue passenger miles, made more than 100,000 takeoffs and landings, and flown its equipment more than twenty-four million plane miles without a single safety incident of any significance.⁷³

Furthermore, no new entrant could expect to obtain consumer acceptance of its services in competition with experienced carriers unless its operations were of the highest caliber. Any accident involving aircraft flown by a young company would drive potential passengers away. And any suggestion that an airline manager would purposely endanger his passengers and own personnel by adopting unsatisfactory safety standards is simply unthinkable.

Finally, as administrative scrutiny of "public convenience and necessity" recedes, the lawyers for incumbent carriers may be expected to rush to fill the vacuum with prodigious and prolonged contentions as to the fitness of new applicants.

Airport Financing and Construction. Regulatory reform has been opposed by some airport operators on the grounds that it would undermine the stability of the financial arrangements be-

⁷³ *Airline Deregulation and Safety Hearing, Government Activities and Transportation Subcomm. of the House Comm. on Government Operations, 95th Cong., 1st Sess. (1977) (Testimony of M. Lamar Muse).*

tween airlines and airport authorities. A substantial portion of recent airport construction has been funded with revenue bonds underwritten by long-term financial guarantees made by the carriers serving the airport. Opponents of regulatory reform claim that because freer entry and pricing will force mass market abandonment and carrier bankruptcies, existing guarantees will be destroyed and future airport financing will be impossible. According to the senior vice president of one major carrier, "No longer will [the airlines] be willing to invest enormous sums in airport improvement, ticket counters, passenger facilities, and the like when the state of the industry is so uncertain under the conditions of deregulation."⁷⁴

These arguments are predicated upon several faulty assumptions. The first is that regulatory reform will result in massive dislocations in the industry—an assumption that is unsupported by any independent economic analysis⁷⁵ of the effects of freer entry and pricing and which seems to be simply a component of the self-serving rhetoric which the industry has used for forty years to justify strict controls. The second premise, even less intellectually valid than the first, pervades every discussion of the reform issue: the premise that airline management is either insulated from, or unaffected by, the normal business principles which influence decisions by every other enterprise in this country. In the words of John W. Snow, former Deputy Under Secretary of Transportation:

The contention that a lessening of economic controls will result in erratic service reflects a lack of perspective or unfamiliarity with unregulated markets. Most industries are not regulated, yet they provide stable and dependable service at known prices. They do so because it is in their self-interests to supply orderly and dependable service. A direct comparison also can be made with intrastate airlines and airport concession holders. They are not regulated by the board and they make long-run commitments for airport facilities.⁷⁶

⁷⁴ Lloyd-Jones, *supra* note 65, at 824.

⁷⁵ See e.g., Simat, Helliesen and Eichner, Inc., *The Effects of Route Restriction Removal and Discretionary Authority*, REGULATION OF PASSENGER FARES AND COMPETITION AMONG THE AIRLINES 169 (MacAvoy and Snow ed. 1977).

⁷⁶ Snow, *The Problems of Airline Regulation and the Ford Administration Proposal for Reform*, REGULATION OF PASSENGER FARES AND COMPETITION AMONG THE AIRLINES 3, 36 (MacAvoy and Snow ed. 1977).

A retail business which has spent years building goodwill for itself in a community does not pack up and move in the middle of the night simply because a department store moves in next door or one of its competitors lowers its prices. If it did, it would still face rental payments on the building it has leased, as vacating premises does not vacate liability. Why then is it assumed that greater competition will induce an airline—which has spent thousands of dollars to promote market identity at a city—to suddenly cease service, leaving behind a fifteen-year airport lease under which it is still financially obligated?

Moreover, why must airport financing be guaranteed by the airlines? It is recognized that such arrangements are advantageous for city fathers, but government authorities finance thousands of highways, college dormitories, and sewer projects every year through general bond issues without requiring users to co-sign the note. If the airlines were regarded more as simple customers of an airport authority, it is suggested there would be much more efficient use of existing facilities. As Michael Levine, newly appointed Director of the CAB's Bureau of Pricing & Domestic Aviation, has pointed out, one result of the current system "is that some localities have been enabled to indulge in a penchant for monument-building by relying on the ability of airline guarantors to generate the necessary revenues from CAB protected fares."⁷⁷ These mammoth new facilities (Levine cites Dallas-Fort Worth Airport as the most "striking example of this phenomenon") have been located away from population centers, reducing the attractiveness of short-haul service, and often have a capital investment several times that justified by reasonably foreseeable levels of traffic. If deregulation decreases the airlines' willingness to finance such civic monuments and increases the incentive to improve present facilities, then it has much to recommend it.

In addition, airport efficiency could be improved considerably in an environment of freer entry and pricing. Airport managers could follow the lead of intrastate carriers by using peak load pricing in their landing fee schedules to encourage a more even distribution of flights during the day. Congestion fees at major hub airports would promote greater use of satellite, close-in, or

⁷⁷ Levine, *Financial Implications of Regulatory Change in the Airline Industry*, 49 S. CAL. L. REV. 645, 652 (1976).

other under-utilized facilities; the airlines could also ease the need for new airports by increasing connections at smaller hubs instead of channeling all their traffic through congested facilities such as Atlanta and O'Hare as many do now. Terminal arrangements could also be made more flexible so as to permit gates and boarding lounges to be shifted easily from one carrier to another in response to changes in schedules and traffic volume. As the airlines begin to compete more on the basis of price and service options, they will be less inclined to design their departure gates as elaborate and luxurious marketing tools and more as realistic accommodations for expediting greater numbers of passengers. In summary, new airport facilities and improvements will continue to be built in a less-regulated environment and may, as a result of competitive market pressures, be less expensive and more efficient.

Consumer Protection. The services rendered by the airlines have always received high marks with the public. Several recent public opinion polls have rated the air transport industry among the highest in the nation in terms of consumer approval of the quality of service which it provides.⁷⁸ Regulatory reform will not diminish that quality; the increased competition between carriers resulting from freer entry will probably result in many improvements in the way airlines treat their passengers. Yet, ironically, there is going to be constant pressure on the Board to impose more "consumer protection" controls, even as the industry experiments with price and quality options in a deregulated environment.

The basic premise of deregulation is that market forces rather than government controls provide the highest quality product to the consumer. Yet some advocates of deregulation have trouble accepting that premise fully. One of the foremost advocates of freer entry and pricing in the airline industry is Ralph Nader's Aviation Consumer Action Project (ACAP), a member of the Ad Hoc Committee on Regulatory Reform. The ACAP supports amending the 1958 Act on the grounds that it will result in lower prices for the consumer. Yet ACAP has also been one of the most persistent advocates of increased CAB supervision over industry practices.

In 1972, the ACAP petitioned the CAB for a regulation which

⁷⁸ AVIATION DAILY, February 8, 1978, at 211.

would impose penalties on carriers for failure to operate flights within schedules printed on timetables and passenger tickets, arguing that many flight delays are caused not by safety factors or airport congestion, but by deceptive scheduling practices or employee negligence. The CAB wisely dismissed the petition on the ground that any regulation requiring scheduled airlines to operate according to published schedules would jeopardize airline safety.⁷⁹ More recently, the ACAP has urged the Board to insist on more stringent rules regarding overbooking, baggage mishandling, flight delays, lost tickets, overcharges, and fare-refund problems, and to require airlines to settle passenger grievances by Board-imposed arbitration.⁸⁰ Such petitions are obviously predicated on the assumption that only law and government controls constrain a business firm from treating its customers unfairly, an assumption that directly conflicts with the entire premise of deregulation.

No airline—regardless of its size or market share—can ignore the fact that it sells products or services in competition with others. If its flights are consistently late, if reservations are not honored, or if it overcharges for its services, then its passengers will not be back. While there is a need for outlawing fraudulent practices, attempting to cover every conceivable aspect of carrier misconduct by Board regulation not only runs counter to the purpose of regulatory reform, it is undesirable for a number of other important reasons. It contributes to the overloading of the legal system, the social disease former Stanford Law School Dean Bayless Manning has called “hyperlexis”—too much law.⁸¹ It imposes enormous expense on the government in terms of enforcement and on the carrier in terms of compliance (the latter ultimately reflected in higher passenger fares). More important, it stifles carrier incentive to deal with consumer problems in an imaginative, innovative way. Despite our current belief that legal institutions are the most effective way to solve any problem, many instances of perceived consumer mistreatment are simply better left unregulated for the benefit of society as a whole.

There would appear to be, however, little hope that either con-

⁷⁹ CAB Order No. 73-6-28 (June 8, 1973).

⁸⁰ *Wall St. J.*, Jan. 31, 1978, at 33, col. 4.

⁸¹ See Manning, *Too Much Law: Our National Disease*, 33 *BUS. LAW* 435 (1977).

sumer groups or the Board itself will be able to resist the temptation to increase "consumer protection" regulation in a deregulated environment. As Dean Manning has pointed out, there is a "rising feeling among many members of the public today that the society as a whole should in some way compensate the individual for almost any loss he sustains," that we should be striving to create "a riskless society."⁸² In addition, the legal profession has gone to substantial lengths to promote the notion that government regulation or a lawsuit should be used to rectify almost every instance of undesirable conduct. Thus, simple economic disputes are transformed into battles between the just and the evil. Under freer entry and pricing, there will exist a regulatory vacuum which the Board has never experienced before. Since regulators usually have a propensity to regulate, "consumer protection" unfortunately seems an excellent target.

Administrative Law and Procedure. The regulatory reform bills being debated by Congress contain provisions which run counter to certain entrenched attitudes concerning transportation regulation and administrative law in general. Lawyers steeped in these traditions may find the consequences discomfoting.

This legislation is the first American attempt to loosen the restraints imposed on a regulated industry, although it may be the forerunner of similar proposals to deregulate surface transportation and the natural gas industry. Air transport regulation, long the handmaiden of regulatory concepts developed for the railroads in the nineteenth century, will now be governed by statutory policies that are unfamiliar to the courts in the context of the industry. No doubt many of the provisions of the Act will be litigated for years until a clear interpretation emerges. Because the resulting legislation will probably be a compromise between the advocates of complete freedom of entry and pricing and the proponents of the status quo, the final bill will possibly contain provisions inconsistent with the broad liberalization manifested in most of the proposed new policy statements.

The Act will probably also contain terms which have never played a significant role in transportation regulation. For example, how will the Board and the courts define "efficiency"? Will this

⁸² *Id.* at 437.

require the Board, as William Fruhan suggested several years ago, to "rate" the quality of individual carrier management?⁸³ Will the courts adopt an economist's definition of such terms or impose one of their own, as they have with the term "price discrimination"? Are the lawyers who will dominate the resolution of these issues (as legislators, CAB staff members, airline counsel, and, in particular, appellate judges) equipped to deal with a regulatory scheme dependent on economic theory rather than traditional concepts of public convenience and necessity? Most of the issues handled by the Board today, of course, involve questions of transportation economics—e.g., rate making, demand elasticity, and traffic forecasts. Richard Posner, writing a decade ago about the forces which have shaped the regulatory process, suggested there may be problems in the transition:

A lawyer's training and experience are indispensable to the practical implementation of social policy. What is too readily assumed is that lawyers are also expert in the underlying policies themselves, a view that lawyers, who are among the most facile of "generalists," eagerly promote. Unhappily, the overwhelming majority of lawyers involved with regulation are largely ignorant of the principles of economics. Most lawyers have had undergraduate economics courses, yet my experience (and that of others) has been that such courses generally fail to make a lasting impression so far as aiding later insight into regulatory problems is concerned, partly, perhaps, because the treatment of regulated industries in economics textbooks tends to be bland and uncritical. Most law schools do little to remedy this deficiency. A law student's exposure to the regulated industries is normally limited to the administrative law class, which deals with procedural questions, not with economic policies. What law schools principally instill in their students is sensitivity to the formal processes of the law and to consideration of fairness and equity, emphases that go far to explain the continuing preoccupation of both practicing lawyers and legal scholars with the procedural and distributional questions in the regulatory field—such as how much of the pie should investors get and how much consumers. Issues as or more important to the welfare of society—issues of economic efficiency in the broadest sense of the term—are usually ignored because they are the province of a different discipline. In this fashion, the compartmentalization of

⁸³ FRUHAN, *supra* note 32, at 137.

scholarly and professional interest in regulatory problems has retarded an adequate understanding of those problems.⁸⁴

If regulatory reform is to work in practice, then the courts will have to recognize and understand the economic theory on which it is premised. No doubt the legislative history of the bill will be consulted continuously, but it may be some time before legal practitioners and the courts feel comfortable with the statute.

Another feature of the proposed legislation which harbors unforeseen consequences is the section which would require the Board to reduce regulatory lag and streamline its hearing processes. The present delay in CAB decisions exists for a number of reasons. Delays of only a few months can mean many thousands of dollars in additional profits to an incumbent carrier while the route case remains pending. Consequently, carriers often use a variety of tactics to postpone a Board decision allowing competitors to enter a market. For example, in 1973, National Airlines invoked the National Environmental Policy Act to delay for almost three years a final CAB decision which would end its monopoly in the lucrative Miami-Los Angeles market.⁸⁵ Thus, as former CAB Chairman John Robson, a strong advocate of regulatory reform, has observed, while "there are no more vocal critics of regulatory lag than regulatory litigators and their clients," the same individuals are the most "skillful wielders of the levers of administrative delay when expedition does not seem to be called for."⁸⁶

Actually the CAB is more efficient than many other administrative agencies because of its use of prehearing conferences and prior exchange of testimony and exhibits. The proposed statutory mandate to further streamline its procedures and make greater use of show cause proceedings will force the Board to experiment with new methods of administrative process; *e.g.*, broader use of rule making, policy pronouncements, exemptions, and the like. The Board, for example, might attempt to use rule-making to establish the need for new service in a market and then exclude that issue

⁸⁴ Posner, *supra* note 12, at 623-624.

⁸⁵ For an excellent discussion of this incident see Burger, *Miami-Los Angeles and NEPA: The Use of the National Environmental Policy Act of 1969 as an Anticompetitive Weapon*, 42 J. AIR L. & COM. 529 (1976).

⁸⁶ Address by John E. Robson to the annual meeting of the ABA Section of Public Utilities, Chicago, Ill. (Aug. 10, 1977).

from a subsequent adjudicatory hearing to decide which of several competing applicants is to receive the authority. During the past several years, practitioners and scholars of administrative law have demanded greater and greater guarantees of procedural due process on almost every issue that comes before the government. Few seem to realize that independent governmental agencies are fundamentally policy-making bodies and that exaggerated procedural "due process" inevitably produces a denial of substantive due process to one side of the docket or the other. If the Board can devise methods to reduce regulatory lag and still satisfy the courts, it may be making a significant contribution to the resolution of an important issue in administrative law .