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Acquisition of Local Service Carrier by Truckline Carrier

JUDICIAL AND REGULATORY DECISIONS

ACQUISITION OF LOCAL SERVICE CARRIER BY TRUNKLINE CARRIER

IN the *Continental-Pioneer Acquisition* case,[1] a sharply divided Civil Aeronautics Board approved the first merger of a trunkline carrier and a local service carrier. The dissenters strongly attacked the decision as being an intentional departure from the policy of separation of these carriers constituting a direct threat to the future of the local service industry.[2] While the majority's "exception" rationale is subject to criticism, the decision would not seem to indicate any intentional modification of the local service theory. The effect that the decision will have on the future of the new Continental-Pioneer Airlines and the local service industry in general would seem to turn on whether the Board will consider the new carrier to be a trunkline, a local service carrier, or a new and special class of hybrid.

In the instant case, Continental Air Lines, a regional trunkline carrier operating from Colorado and Kansas throughout the Southwest, and Pioneer Air Lines, a local service carrier operating in Texas and New Mexico, applied to the CAB for approval of an agreement to merge.[3] In spite of the long standing policy of separation of trunkline and local service carriers, the merger was approved.[4] The Board unequivocally denied any intention to depart from its previous policy, stating that the decision was an exception to the policy of separation and was based on the substantial degree of similarity in the operational[5] and economic[6] characteristics of the carriers[7] together with the fact that the other aspects of the transaction were consistent or affirmatively beneficial to the public interest.[8]

In order to evaluate the rationale and significance of the opinion it is

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[1] CCH AVIATION L. REP., ¶ 21,782 (Dec. 7, 1954); *reconsideration denied* ¶ 21,811 (Mar. 17, 1955.)

[2] See dissenting opinions of Members Lee and Adams. Dissenters also disagreed on the issues of: 1. improvement in service, 2. purchase price set-off against mail pay, 3. rental allowance in mail pay for leased aircraft, 4. effect on Continental's financial position and 5. elimination of local carrier.

[3] 52 STAT. 987-1030 (1938), 49 U.S.C. §408(a)(2), 412(a), 401(i) (1953).

[4] Approval of a merger is required unless it is inconsistent with the public interest, creates a monopoly, restrains competition, or jeopardizes another carrier. *Supra*, note 3, at §408(b).

[5] *Operational Characteristics*:

	CAL	PAL
Average length of haul	77.4	69.3
Average length of flight	143	100
Average length of passenger journey	395	280

Source: Initial Decision of Thomas L. Wren, Examiner, Served July 15, 1954, Docket #6457, p. 23.

[6] *Financial Ratios*:

	CAL	PAL
Mail revenue per mail ton mile	$2.07	$13.71
Percentage mail rev. of total operating revenues	9.70%	43.02%
Operating cost/revenue ton mile flown	65.55c	101.36c

Source: *Supra*, note 5.

[7] In addition similiar characteristics were found in geographic and size factors and traffic characteristics. *Supra*, note 5.

[8] The Board found that the merger would not result in a monopoly or injure any other carrier; it would result in a rational, integrated and economical route pattern; the labor conditions and purchase price were satisfactory; the affirmative benefits would result in improved service to the public; substantial savings would be obtained through integration and elimination of facilities; reduction in mail pay. *Supra*, note 1.

necessary to consider the theory underlying the local service,[9] from which arises the distinction between trunkline and local service carriers and the policy of separation.

The local service branch of the domestic air transportation system was established after the adoption of the Civil Aeronautics Act at a time when the existing air routes of the country served only relatively large population centers. The carriers performing air transportation then have become, for the most part, the trunklines of today. The local service was intended to extend air transportation to the smaller communities of the nation, and in so doing was to serve a dual purpose. In its "local" aspect[10] it was to offer air transportation among the smaller communities and their large metropolitan centers; in its "feeder" aspect[11] it was to serve in bringing the long-haul trunkline traffic into the major terminals by air. In initiating[12] the local service[13] the Board was faced with two problems: 1) the selection of an appropriate carrier to perform the new service and 2) the adoption of measures to insure the proper operation of the service, and to prevent potential competition.

As to the first problem, the board adopted the policy of favoring independent carriers rather than existing trunkline carriers for the certification of these routes. This decision involved an evaluation of the probability of effective development and successful performance of the service by each class of carrier. Recognizing that an unusually intensive effort would be required to develop this new and admittedly inadequate market, the Board thought that the independent was the better choice because it could devote all of its time to the service and would be dependent solely upon it for continued existence.[14] It was believed that the trunkline would probably not expend the necessary effort because of its long-haul commitments, and that if it did attempt to perform the service it would jeopardize its development of long-haul traffic and indirectly its attainment of self-sufficiency.[15] Moreover, it was thought that through necessity or design, the trunkline might neglect the local service for the more profitable long-haul service, or concentrate on only the more profitable segments of the local routes.[16]

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[9] For detailed history and development of the local-feeder experiment see, Zook, *Certification of Local and Feeder Air Carriers*, 7 Sw.L.J. 185 (1953); Grunder, *Experimental Certificates Under the Civil Aeronautics Act*, 17 J. Air L. 236 (1950); Ray, *The Feeder Airline Story*, 16 J. Air L. 379 (1949).

[10] For discussion of this aspect see, 1950 Report of American Bar Association Standing Committee on Aeronautical Law, 17 J. Air L. 467 (1950).

[11] See, B. E. Cole, *Feeder Air Routes*, 11 J. Air L. 17 (1940) for discussion stressing this aspect.

[12] The CAB originally authorized experimentation with one route in order to study the results of the proposed service. Continental Air Lines, Inc., Texas Air Service, 4 CAB 478 (1943). The following year it approved the concept. Investigation of Local, Feeder, and Pick-up Air Service, 6 CAB 1 (1944).

[13] The Board found its authority for establishing the service under §401(a) of the C.A.A., and its duty to regulate the new service under §401(b) of the act. *Supra*, note 3.

[14] "Greater effort and the exercise of managerial ingenuity may be expected from an independent local operator whose continuation in the air transportation business will be dependent upon the successful development of traffic . . . and the operation of the service on an adequate economical basis." Service in the Rocky Mountain States Area, 6 CAB 695, 736-7.(1946); See also, West Coast Case, 6 CAB 961 (1946).

[15] "While recognizing that existing scheduled carriers could provide service to additional cities through amendment of their certificates, we do not believe that it is in the public interest for a trunkline carrier to handicap the direct fast service which its long-haul passengers require by attempting to fulfill functions peculiarly adapted to a feeder operation. Texas-Oklahoma Case, 7 CAB 481, 495 (1946).

[16] See: Florida Case, 6 CAB 765, 786 (1946); Wisconsin Central Renewal Case, Order Ser. No. E-5951 (1951); Reopened Additional California-Nevada Service Case, Order Ser. No. E-6040 (1952).

Another factor favoring the independent was their interest and experience in the areas which would result in a more intimate knowledge of the area and its transportation needs.[17] Finally, with respect to the "feeder" aspect of the service, the Board desired all trunklines to derive benefit and an equal opportunity to obtain the traffic destined for further long-haul transportation, and thought that a trunkline performing the local service might be inclined to discriminate in favor of itself in obtaining this traffic.[18]

The second problem arose after and as a consequence of the decision to favor independents for the local service. The CAB recognized that the local carriers would be able to operate as trunklines by the simple expedient of skipping the intermediate stops between major terminals. This would not only defeat the purpose of providing local service, but would also constitute a competitive threat to the trunklines.[19] The Board resolved this problem by imposing certain restrictions on the local service carriers. The condition was imposed in their certification that they serve each intermediate point and each terminal point on each schedule operated.[20] In addition, the local was directed to concentrate on developing the traffic at intermediate points and not to attempt to eliminate or minimize the elapsed time between terminals.[21] Finally the Board has generally required the local carrier to use DC-3 equipment in performing its operations.[22]

Thus it is apparent that there are two basic distinctions between a trunkline carrier and a local service carrier. The first lies in the physical characteristics of its routes and the city populations served, and the second, in the operational restrictions which are imposed upon the local carrier.

With few exceptions, the Board has followed a strict policy of separation of these two classes of carriers. While the general purpose underlying the policy is to insure the operation of each type of service by the appropriate carrier, the policy necessarily embodies all of the considerations underlying the local service theory[23] from which the distinctions between the classes arose.

In the instant case, the majority found that unique similarity in the operational and economic characteristics of a trunkline carrier and local service carrier warranted exception to the policy of separation. In other words, the Board reasoned that since Continental was not a clear cut trunk-

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[17] "In establishing local feeder service it is our policy to authorize operations by local companies whose interests are centered in the area in which they will provide service." West Coast Case, 6 CAB 961, 996 (1946). In the case of an organized independent the Board considered its established good will in the area as an inducing factor. See, Middle Atlantic Area Case, 9 CAB 131, 178 (1948).

[18] Investigation of Local, Feeder, and Pick-up Air Service. *Supra* note 12.

[19] *Supra*, note 18.

[20] Continental Air Lines, Inc., Texas Air Service, 4 CAB 478 (1943). The CAB has modified these conditions under certain circumstances. See, Poineer Air Lines, Inc., Amendment, 7 CAB 469 (1946); Middle Atlantic Area Case, 10 CAB 41 (1949).

[21] *Supra*, note 20 at 485.

[22] While the CAB does not expressly require the use of DC-3 equipment, this is achieved through authorization for mail pay, which is withheld if an economical aircraft is not operated. Pioneer Air Lines, Mail Rate, Order Serial No. E-7225, 13 Mar. 1953. For recent exception however, see Southwest Airways Co., Mail Rate, Order Serial No. E-8757, 10 Nov. 1954.

[23] In the instant case the dissenters contend that one of the reasons for maintaining the separation is as a concession to the trunklines for their co-operation in surrendering segments of their routes in aid of the local feeder experiment. The assertion does not seem to be substantiated by the cited authority, Bonanza-TWA Route Transfer, 10 CAB 895 (1949). For a contra view on the issue of trunkline co-operation see, Netterville, *Local Service Airlines: Trunkline Suspensions in Aid of the Local Service Experiment*, 26 So. Calif. L. Rev. 229 (1953).

line carrier[24] and Pioneer not a clear cut local service carrier,[25] and further since the carriers had such uniquely similar characteristics, the policy of separation was not applicable. It is submitted that the fallacy in the Board's reasoning lies in its assumption that the distinction between a trunkline carrier and a local service carrier lies in operational and economic characteristics. In so far as these factors are affected by physical route characteristics and structure they do bear on the distinction between the two classes, but this is not the only distinction between the trunkline and local carrier. In making this assumption the factor of operational restrictions is overlooked, and this factor constitutes as significant a distinction between the classes as basic route structure. In ignoring this factor, which is an integral part of the local service theory and the policy of separation, the soundness of the Board's conclusion that an exception to the policy of separation was warranted is subject to question.

Apart from any technical departure from policy, the Board's rationale in the instant case also subjects its findings of public interest to question. Having concluded that the carriers were *similar*, the Board treated the case as it would any other merger,[26] considering whether it would: (1) result in an integrated, rational and economical route pattern, (2) suppress competition and injure another carrier, (3) involve a satisfactory transfer price and (4) protect the interests of labor, but the Board did not consider the effect of retaining the local carrier restrictions on the old Pioneer routes.[27] This failure is understandable in view of the rationale of the decision, but adherence to Board policy would seem to have required consideration of the following additional factors: (1) the losses which may be sustained through presumptively less efficient operations of the Continental trunkline routes, (2) the effect of reducing the average length of haul of routes, (3) the competitive effect of discriminative "feeding" and (4) benefits derived from discriminative "feeding." With respect to the first point, the decision announces that the old Continental routes were very similar to the old Pioneer routes, but yet the latter will be operated under local service restrictions. Underlying the policy of favoring the independent for local service routes is the presumption that a trunkline will jeopardize its long-haul operations by attempting to perform both trunkline and local service operations. Continental does have some long-haul routes, and those routes which are relatively short could be operated on a non-stop trunkline basis. In this case, with the economic condition of Continental far from

[24] Continental had 8 round-trips that should be classified as trunkline-type service. The average length per hop on these flights is 358 miles. It has 11 round-trip flights with an overall average length per hop of 97 miles. This compares with the average length per hop of 82 miles for Pioneer's 10 round-trip local service flights. "Bureau Counsel asserts that Continental is more nearly akin to the larger local service carriers than to a trunkline carrier. He points out that in 1953 Continental's revenue plane miles exceeded the average of the 3 largest feederlines by 68% while the next largest trunkline's average exceeded Continental's total by 116%." *Supra*, note 5 at 24.

[25] The average length of haul and city population served exceeded the average of the local service carrier. *Supra*, note 5.

[26] These have been the factors considered by the Board in all cases of proposed mergers. See in general, Zook, *Recasting Air Route Pattern by Airline* Consolidation and Mergers, 21 J. Air L. 293 (1954).

[27] The implication from the instant case is that the old Pioneer routes will continue to be operated under local service restrictions. The diversionary effect evidence of Trans-Texas and Central was considered irrelevant because based on anticipated changes in Pioneer's operations. Also, the justification for allowing Continental access to the Dallas-Fort Worth market after having refused it in the Wichita Falls-Dallas case was that Continental was now operating it on a local service basis.

favorable,[28] the possibility of losses in the trunkline routes should be a major consideration. Secondly, since long-haul operations are more profitable than short it seems that Continental is apt to sustain further losses through the reduction in overall average length of haul caused by the merger.[28a] Third, another reason for favoring the operation of local routes by independents was to preclude the possibility of discriminate "feeding." With Continental operating the local service route, it will obviously route the further trunkline traffic over its own system. This factor should be considered in relation to the issue of the competitive impact of the merger on other carriers.[29] Fourth, while discriminative "feeding" will take place, it will have a beneficial effect on the trunkline segments and may offset, through increased traffic density, any losses occasioned by presumptive losses considered in 1 and 2 above. If the reasons for the Board's original local service theory had basis in fact, the criticism of the majority's decision in the instant case is that it overlooks pertinent factors bearing on the public interest.[30] It may well be that under the particular facts of this case these considerations are negligible or cancel themselves out, but the fact remains that they should have been considered in reaching a reliable determination on public interest.

Accepting the majority's finding that the merger was in the public interest, the decision can be criticized for its failure to anticipate the problems which it raises and their possible effect on the future of Continental-Pioneer and the local service industry in general. In effect, the majority decision has created a hybrid — a carrier whose route structure and operational characteristics are so "unique" as to warrant its performance as both a trunkline and local service carrier. This involves an immediate effect on Continental-Pioneer because of the consequences of classification. While the Board may be creating an artificial distinction between trunkline and local service carriers through the imposition of operational restrictions on the local service carriers, the fact remains that these restrictions exist and will have to be reckoned with. The local service carriers are required to make all stops on their routes — the trunklines need not; the local carriers are directed not to minimize the elapsed time between terminals — the trunklines are encouraged to minimize these periods; the local carriers have been limited to the use of DC-3 equipment — the trunklines have no restrictions on equipment. Being a hybrid carrier, will Continental-Pioneer be eligible in the future for a clear-cut trunkline or a clear-cut local service route extension, or will it be limited to those routes which are consistent with its present "unique" structure? If a new route is granted what type

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[28] "The inability of Continental to attain self-sufficiency despite the currently high level of earnings prevailing throughout virtually the entire domestic trunkline industry may be an impediment to the development of the sound air transportation system envisaged by Congress in the Civil Aeronautics Act." Continental Air Lines, Inc. and Pioneer Air Lines, Inc., Order Serial No. E-7977, 17 Dec. 1953.

[28a] Operating Results, Calendar 1954

	CAL	PAL
Traffic Density—Rev. Ton-Miles:		
Per route mile per Day	16.6	8.5
Per Station per Day	1267.0	583.0
Length of Passenger Haul (miles)	401	277

Source: Dissenting Opinion Member Adams

[29] While the Board did not consider the discriminative "feeding" issue as such it did consider diversion which it estimated at a total of $103,401. Also it noted that only 3 carriers requiring subsidies would be effected—Braniff, Trans-Texan and Central. *Supra*, note 5 at 26 and 54.

[30] There have only been two instances of exception to the local service theory in the past where trunklines were permitted to operate local routes and both had unfavorable results. Great Lakes Area Case, 8 CAB 360, (1947); Parks Investigation Case, 11 CAB 779 (1950).

of equipment will be authorized for its operation? Will the decision turn on whether the new route is a logical extension of an existing trunkline or local service route? If the logical extension criterion is adopted then the carrier will be moving toward one classification, and as soon as this occurs the basis for the exception of the case is destroyed, for no longer are its characteristics so "unique" as to justify both trunkline and local service operations by the same carrier. When the carrier begins to take on the characteristics of either a trunk or local will it be required to surrender its other class routes? It would seem that the only way it can retain its present status as a hybrid is by keeping its present structure constant. To stunt the future development of the carrier by not allowing any change would obviously neither be in the carrier's nor public's interest. The alternate solution to allowing growth without destroying the peculiar characteristics of the carrier, would be through the authorization of only special "hybrid-type" routes or the granting of a compensatory local service route whenever a trunkline route is granted.

The effect of this decision on the future of the local service industry would seem to turn on the manner in which the Board treats Continental-Pioneer. Assuming the Board will continue to adhere to its local service theory it would seem that it will have to treat Continental-Pioneer as a trunkline or local service carrier temporarily, or attempt to create a new and special class of hybrid carrier. The most undesirable position for the Board to take would be to continue to treat the new carrier as a hybrid allowing unrestricted growth toward trunk or local service carrier overlooking the theoretical conflict of the local service theory. The trunklines have always been concerned with the potential threat of the local growing into another competitive trunkline and the decision here would seem to offer the precedent for a particular trunkline eliminating the threat of a potentially competing local carrier through merger. The Board's criterion for such a merger is "similarity of economic and operational[31] characteristics" plus affirmative benefits.[32] It would seem that a merger of any trunk and local carrier operating in the same general region with some common cities would result in savings and economies through integration and elimination of duplicative facilities. This would leave only the "similarity" factor to be contended with. Since most of the trunklines have some local carrier characteristics perhaps the elimination of some segment along the trunk route would bring about operational and economic characteristics sufficiently similar to meet the standard of this case. Then too, since there is no definite standard of how similar the carriers have to be in order to warrant the doctrine of the instant case, perhaps the economic benefits of a particular merger might subordinate the similarity factor. Any sacrifice which would be made by a trunk initially would seem to be outweighed by the advantages of eliminating a local service carrier and achieving the coveted position of hybrid — which allows optional development as either a trunkline or local service carrier and the advantages of discriminative "feeding."

It seems certain that the Board will have to define the status of Continental-Pioneer in the near future. As a possible solution, it is submitted that the most reasonable position for the Board to take is to treat the carrier temporarily as either a basic trunkline or local service carrier, allowing changes to be made on the basis of a "logical extension of an existing route" test. When the hybrid carrier begins to move toward one classification or the other it should be required to surrender the other class of

[31] *Supra* notes 5, 6 and 7.

[32] *Supra* note 8.

routes. While this may conceivably create some problems in the future,[33] and it would seem should have been provided for as a condition in the approval of the merger, it would seem more favorable than attempting to create and maintain a special classification of hybrid.

Northwest Airlines Inc. et al. v. Glenn L. Martin Company
3 Avi. 17,683

Facts: The facts of this case were as follows: Northwest Airlines Inc., hereinafter referred to as "Northwest," purchased from Glenn L. Martin Company, hereinafter referred to as "Martin," a number of "Model 202" aircraft designed and manufactured by Martin. After these aircraft had flown approximately five per cent of their expected service life a structural defect resulted in the total destruction of one of the aircraft with all persons aboard and the grounding of all Models 202 for the required structural changes. It was shown conclusively that the defective part was a joint in the front spar of the wings. This defect was caused by what is known as metal fatigue which is governed by the type of metal, its configuration and surface condition and the amount of repeated load as related to the strength of the material for one load. The agreement covering the purchase of the aircraft in effect limited Martin's liability to that "imposed on it by law for its negligence."

The Trial Court heard Northwest's claim for damages resulting from the loss of the crashed aircraft and the loss of use of certain other aircraft while the structural fault was being eliminated. This claim was based on certain allegations of misfeasance and nonfeasance by Martin amounting to negligence in the design and manufacture of the aircraft. Martin's defense was that it had used great care but that if negligence was found then Northwest had assumed the risk or had been guilty of contributory negligence. These alternate defense pleas were based on the opportunity Northwest had to inspect the aircraft in the process of production, Martin arguing that the difference between assumption of risk and contributory negligence as delineated in the cases was merely one of degree—between risks so obvious they must be taken to have been known to the plaintiff and those slightly less obvious which the plaintiff might have discovered by the exercise of ordinary care. Martin also alleged contributory negligence by Northwest for not installing airborne radar which might have prevented the accident. The jury returned general verdicts in favor of Martin.

Northwest appealed on the following grounds:

1. That the Trial Court should have found Martin negligent as a matter of law and therefore that the question of negligence should not have been submitted to the jury. 2. That the Trial Court was in error in submitting to the jury the issue as to whether Northwest was barred from recovery because of its assumption of risk as there was no evidence to support such a contention. 3. That for the same reason the issue of contributory negligence by Northwest should not have been submitted to the jury, either with respect to Northwest's failure to observe the defect or to install radar in its aircraft.

The Appeal Court held that the question of lack of ordinary care by Martin was certainly sufficiently doubtful to warrant its submission to the jury. On the second plea raised by Northwest it held, with one judge dissenting, that as there was a complete absence of evidence that Northwest

[33] Apart from possible objections on the part of the carrier to surrendering routes there would be the legal question of whether a suspension would be warranted under the Act. *Supra*, note 3 at §401(h).