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# DEVELOPMENT OF THIRD LEVEL AIR TRANSPORTATION

BY TIMOTHY SCHUYLER ELLIOTT†

## I. THE PROBLEM AT PRESENT

THE concept of third level air transportation presents the CAB with an apparent dilemma. While following a policy of reducing subsidies by eliminating service at small cities, the CAB is faced with the fact that these same cities do present a limited market for air service. Certification of third level air transportation means the institution by the Board of virtually a new airline system. If a comprehensive, certificated third level system requires a subsidy in order to survive, the policy of providing an adequate air transportation system seems wholly at odds with the goal of a self-sufficient air system.<sup>1</sup>

In the *Investigation of Local, Feeder, and Pick-Up Air Service*,<sup>2</sup> the Board considered the proposal of certifying a new air system to serve smaller communities. Rejecting the suggestion of the examiners that "an inclination to grow in the other direction, that is, to nonstop smaller cities and reach out for the big city traffic to the detriment of other carriers should be discouraged at the outset,"<sup>3</sup> the CAB refused to set any standards for the new carriers and authorized service on an *ad hoc* basis. Although the Board failed to express a definite policy as to the character of the new service, in later cases the CAB emphasized the necessity for "economies in operation" and managerial ingenuity in the development of traffic at the authorized points.<sup>4</sup> In response to this "policy" many applicants for routes proposed to use small aircraft.<sup>5</sup>

Yet in spite of apparent agreement by all the principals as to the operation of local air service, the CAB again finds itself in a position of deciding whether there should be certificated service to the smaller communities of the United States. This situation has arisen from several factors other than the original local certification by the Board. Technological advancement, later Board policies and the attitude of airline management have all contributed to the creation of the void in the industry which the third level idea is designed to fill.

While the trunks have been changing over to long-range, high capacity, pure jets, the locals likewise have been acquiring larger aircraft. Along with the equipment change has come the deletion of cities and routes which

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<sup>1</sup> Cook, *Air Taxis Offer Service to Cities Unable to Support Air Service*, *Aviation Week*, Sept. 4, 1961, p. 40.

<sup>2</sup> 6 C.A.B. 1 (1944).

<sup>3</sup> *Id.* at 55.

<sup>4</sup> *Service in the Rocky Mountain States Area*, 6 C.A.B. 695 (1946); *West Coast Case*, 6 C.A.B. 961 (1946).

<sup>5</sup> E.g., in the *Rocky Mountain States Area* case, *supra* note 4, two of three applicants awarded routes, Ray Wilson, Inc. and Summit Airways, Inc., anticipated beginning service with Beechcraft 18-S airplanes (six passengers); in the *Texas-Oklahoma* case, 7 C.A.B. 481 (1946), Central Airlines proposed to use the same aircraft.

have been unable to give support to the new equipment. The obsolescence of the DC-3 justified a search for new equipment; however, the ordering of rather large, pure jet aircraft<sup>6</sup> contradicts the original local service idea. It is not only a change in the size of the aircraft flown which is striking, but there is also a transformation in the thinking of the locals. By assuming longer, more lucrative routes, either in competition with trunks or which the trunks have dropped, some of the locals have begun to think of themselves as "regional" airlines.<sup>7</sup>

With a view to lowering the subsidy payments, the CAB has encouraged the locals in their growth away from the very purpose for which they were originally certified. Substitution of a local for a trunk over a route which has not earned a profit is thought to be one method of reducing subsidies.<sup>8</sup> Despite the cost of DC-3 operation, the locals have continued to use these planes to serve small cities which are understandably low in traffic production. With high costs and low traffic, the locals have felt justified in reducing service to as low as one flight per day thus further reducing traffic. The net result from this is a subsidy figure of 67.9 million dollars.<sup>9</sup> The policy of the CAB in this respect was announced in the *Seven States Area Investigation*<sup>10</sup> as the "use it or lose it" policy, setting arbitrary limits for traffic generation by cities and routes served by local service airlines. In order to reconcile the elimination of uneconomic service with the statutory direction to provide service for the public convenience and necessity, the Board considered other factors such as isolation, in addition to traffic figures.<sup>11</sup>

A large number of cities now being served by the local airlines are unable to meet the "use it or lose it" standards.<sup>12</sup> Since it is likely that the better traffic-producing cities have long had service, many of those falling below the standard have only recently received certification with a finding that air transportation was warranted by public convenience and necessity. The blame for this situation lies both with the Board because of its poor traffic predictions and with the locals for a lack of desire or business sense in providing the service.

It is at this point that one sees the impetus of a third level air system. The concept proposes the use of light, twin-engined aircraft in scheduled air service to the small cities. The failure by the Board to control service, and inefficient scheduling and service by local airlines simply are not sufficient bases for showing that cities once found to need service under statutory standards no longer come within the public convenience and necessity.

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<sup>6</sup> Aviation Week, March 4, 1963, p. 34.

<sup>7</sup> Peach (president of Mohawk Airlines), *The Future of Short and Medium Haul Air Transportation*, an advance paper prepared for reference background for Panel III; *The Future Air Transport Industry* prepared for the Connecticut General Life Insurance Company Symposium of *The Issues and Challenges of Air Transportation*, Nov. 1-3, 1961.

<sup>8</sup> Wyoming-South Dakota-Chicago Air Service Investigation, 1A Av. L. Rep. ¶ 21,302 (1962). Ozark Airlines was selected to replace Braniff in the Sioux Falls-Chicago market.

<sup>9</sup> Airlift, May 1963, p. 78.

<sup>10</sup> 28 C.A.B. 680 (1958).

<sup>11</sup> North Central Use It or Lose It Investigation, 1A Av. L. Rep. ¶ 21,306 (1962). In this case the isolation of cities below the minimum standard was said to preclude deletion of service. In Use It or Lose It Investigation: Trans-Texas Airways, Inc., 1A Av. L. Rep. ¶ 21,318 (1962), however, the Board seems to have given no more than cursory consideration to the factor of isolation.

<sup>12</sup> Airlift, May 1963, pp. 84-86 (lists 116 "use it or lose it" cities).

While it is true that at least one local airline (Mohawk) is a proponent of the third level system, generally the locals have found themselves forced to use the arguments employed by the trunks against them, and are now subject to the arguments they successfully made in the 1940's. The locals are basing their contentions on their experience with small planes and with the areas they serve. They also believe that third level certification would mean the subsidization of competing carriers.<sup>13</sup> Lastly, it is thought that the new system will merely be a repeat of the locals.<sup>14</sup>

In its opinion in *C. E. Walts d/b/a Hi-Plains Airways*,<sup>15</sup> the Board agreed with the argument made by Central Airlines,<sup>16</sup> that if the CAB should decide to start an experimental service, the locals were the most obvious choice because there would be less of a financial shock if the experiment should prove unsuccessful and be suddenly terminated. Apparently, the CAB failed to consider the fact that there are third levels in operation. Furthermore, they took no cognizance of the old argument by the locals that a new company may be preferable since, in struggling for its financial life, it will devote all of its energies to making the experiment profitable.

Until recently the locals have shown a decided lack of interest in supplying service to the smaller communities. It was not until there were third level applications that they began to show interest in the use of an aircraft smaller than the DC-3. Even then their defensive maneuver against proposals for immediate operation was to plan for the development of an entirely new airplane.<sup>17</sup> The locals have formerly contended against the trunks that a single airline cannot economically operate two different phases of an airline system. In 1953, Leslie O. Barnes said, "The two types of operation do not mix in an operational sense, and the concept is growing that an airline must specialize in either one or the other."<sup>18</sup> Probably the validity of this contention has been shown by the operations and attitude of the locals in the third level problem. A different psychology is required for serving small communities. Lucrative routes tend to stifle managerial imagination. Ingenuity in developing new markets and cutting operation costs seems to have diminished among the local service airlines. Applicants for third level service seem to demonstrate the desired management insight.

There are at least four varieties of third level service presently in operation. One variety provides service to one or two isolated cities from a large central city. Aspen Airways,<sup>19</sup> between Denver and Aspen, Colorado, and Scheduled Skyways,<sup>20</sup> between Little Rock and Fayetteville, Arkansas, are excellent examples of air service which reduces long, slow surface trips by several hours. Similar in structure is the service which provides a commuter service between a small city with an alleged inadequate certificated

<sup>13</sup> Brief for Central Airlines, Inc., pp. 2-7, filed March 5, 1962, before CAB Examiner, Richard A. Walsh, In the Matter of the Application of C. E. Walts d/b/a Hi-Plains Airways for a Certificate of Public Convenience and Necessity (hereinafter cited as the Hi-Plains Case), CAB Docket 12258, (Initial Decision, July 2, 1962).

<sup>14</sup> Business Week, Jan. 13, 1962, p. 109.

<sup>15</sup> CAB Order No. E-19343 (March 1, 1963).

<sup>16</sup> *Op. cit. supra* note 13, at 2.

<sup>17</sup> Doty, *New Local Carrier Aircraft Drive Begins*, Aviation Week, Dec. 24, 1962, p. 28.

<sup>18</sup> Barnes, *The Case for the Local Service Airlines*, 20 J. Air L. & Com. 197, 199 (1953).

<sup>19</sup> See generally, Pickering, *Third Level Air Service for Resort Area*, Flight, Oct. 1962, pp. 52-54.

<sup>20</sup> See generally, Pickering, *Scheduled Skyways' Ticket to Success*, Flight, Dec. 1961, pp. 69, 70, 78.

airline service and a major hub city. Reading Aviation Service<sup>21</sup> has built a rather large business on scheduled flights between Reading and Philadelphia, Pennsylvania, and Newark, New Jersey. Similarly, Yankee Airlines flies two daily round trips between Pittsfield, Massachusetts, and La Guardia Airport.<sup>22</sup> As a subsidiary of a fixed-base operator in Hagerstown, Maryland, The Hagerstown Commuter provides service to Washington, D. C., with three daily round trips.<sup>23</sup>

Although not within the "normal" concept of third level airlines, a third theory is operation between two large cities. An operation of this type will be in competition with certificated airlines, and thus must offer service which is sufficiently advantageous to the traveler to prompt him to prefer the small operation. Apache Airlines<sup>24</sup> gained control of the Phoenix-Tucson market by offering high-frequency service when the established airlines provided relatively little service. Passenger loyalty built at that time continued after the certificated airlines added more flights. Another successful operator on this theory has been TAG Airlines<sup>25</sup> which has the advantage of operating between Detroit City Airport and Cleveland Lakefront Airport, thereby saving a round-trip traveler three and one-half hours over other airlines which serve outlying airports.

Lastly, there is the so-called "traditional" type of third level airlines, *i.e.*, a network route structure covering most of the small towns in an area. While the proposal of Hi-Plains Airways<sup>26</sup> exemplifies the concept in some respects, Trans Air Lines in Louisiana is a better example.<sup>27</sup> In addition to a route from New Orleans to Houston, Trans Air Lines flies to a dozen Louisiana cities,<sup>28</sup> many of which are isolated in the marshes and bayous of the state.

Although the New England Council Report found favorable public reception of small planes,<sup>29</sup> the public probably believes that a smaller plane should mean lower fares. The public fails to realize, however, that a higher fare is justified by higher seat-mile costs.<sup>30</sup> Nevertheless third level airlines must present a good public image. The problem of a good public image is at least partially answered by a policy of looking and acting like a certificated airline. Uniformed personnel, the airline name painted on the aircraft, and operating "No Smoking: Fasten Seat Belt" signs may appear to be minor matters, but familiar symbols such as these generate confidence which inspires repeat business.<sup>31</sup> Many third levels have already achieved a certain sophistication in low-cost imitation of the larger airlines, *e.g.*, in the maintenance of ticket counters and the handling of interline tickets. The primary danger in imitating the certifi-

<sup>21</sup> See generally, McClintock, *Reading's Scheduled Air Taxi*, Flight, Jan. 1962, p. 36.

<sup>22</sup> Official Airline Guide, Table 468, p. c-426 (Feb. 1963).

<sup>23</sup> See generally, Pickering, *Third-Level Airline for Commuters*, Flight, Nov. 1962, p. 39.

<sup>24</sup> See generally, Pickering, *Arizona's Third-Level Airline*, Flight, May 1962, p. 56.

<sup>25</sup> See generally, Wright, *TAG Airlines Gets High Dove Utilization*, Aviation Week, Nov. 26, 1962, p. 40.

<sup>26</sup> Part II, this article, *infra*.

<sup>27</sup> See generally, Pickering, *Louisiana's Third-Level Airline Service*, Flight, Aug. 1962, p. 32.

<sup>28</sup> Trans Air Lines, Official Airline Guide, Table 477, p. c-432 (Feb. 1963).

<sup>29</sup> Report of the Air Transportation Committee of the New England Council, New England Feeder Experiment, p. 2-3, July 31, 1962.

<sup>30</sup> Interview with Mr. George Hamilton, General Manager of Executive Airlines, on Feb. 25, 1963 (hereinafter cited as Hamilton interview).

<sup>31</sup> Holland, Mastin, and Murtaugh, unpublished Report on Executive Airlines in fulfillment of the requirement for the Sales Management Course at the Harvard Business School 26 (1963).

cated airlines is that the third levels will begin thinking like a large airline.

The most important concern of the third level airlines is the market to be served. In many cases an entirely new market must be built. By the use of pre-operation surveys and letters, The Hagerstown Commuter and Reading Aviation Service built relatively large markets at low cost. Their advantage was operation in an area already accustomed to air service. It is possible that similar methods will build markets in areas which previously have had no service, but it is more likely that extra effort and money will be needed by virtue of the fact that the third level must induce the traveler to change his mode of transportation. Community assistance in defraying the huge cost of public relations can therefore be an extremely valuable consideration for third level operators.

During June, 1962, the New England Council operated an experimental feeder air service from Maine and New Hampshire to Boston in order to test its master plan for regional airports. With a load factor of 15.5 per cent, it was concluded that public support, probably in the form of government aid, would be necessary if service were to be provided by private operators. From this operation and the subsequent private operation by National Executive Flight Service until Labor Day, 1962, there has grown a relatively new concept of governmental participation which may bypass the CAB.<sup>32</sup> Interest has been shown in New Hampshire at the prospect of scheduled flights from small New Hampshire cities into Boston.<sup>33</sup> It is possible that in the future, states may be willing to offer subsidy to a small airline in conjunction with aid from the cities to be given in the form of publicity and manned ticket counters.

Executive Airlines commenced scheduled service between Bedford, Massachusetts, and La Guardia in October, 1962.<sup>34</sup> Similar in theory to the service offered by TAG (Cleveland-Detroit), Executive Airlines service was terminated after five months of operation, ostensibly due to an increase in charter business and lack of passengers.<sup>35</sup> Executive still continues to operate year-round service between Boston and Nantucket and Martha's Vineyard Islands with apparent success.<sup>36</sup>

The contrast of these two operations shows what should be the basic route philosophy of third level airlines. That philosophy is grounded in the factor of isolation. The Bedford-La Guardia service failed because of competition from certificated airlines, plus the fact that Boston's Logan Airport is located only 5-10 minutes from downtown on a superhighway system.<sup>37</sup> Thus the excellent airport location and frequent certificated service make it hardly surprising that Executive's service lacked patronage. TAG has been successful because it operates from downtown airports in both termini and can eliminate up to three hours from the ground time on a round trip. Executive faces very little competition in its island routes. Also, travel to the islands is very slow unless done by air.

Apparently there is now an acute awareness by Executive and other authorities that isolation is the primary factor of traffic generation for

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<sup>32</sup> Hamilton interview, *supra* note 30.

<sup>33</sup> Interview with Mr. Nelson B. Lee, Vice-president of Executive Airlines, Feb. 25, 1963 (hereinafter cited as Lee interview).

<sup>34</sup> Holland, Mastin, and Murtaugh, *op. cit. supra* note 31, at '2.

<sup>35</sup> Lee interview, *supra* note 33.

<sup>36</sup> *Ibid.*

<sup>37</sup> Official Airline Guide, b-3 (Feb. 1963).

third level airlines.<sup>38</sup> Superhighways have produced a marked tendency to travel relatively short distances by private automobile.<sup>39</sup> Because the United States lacks a large number of isolated cities, a third level operation should be based on the factor of isolation under the general concept of feeding passengers to cities served by certificated airlines. Such a concept might prompt the use of a population factor. One study has found that "there is no appreciable difference in annual levels of passenger originations over a wide range of population levels."<sup>40</sup> If this is true, population will be only of minor consideration. Certainly if a city, regardless of size, cannot approach the break-even need of the third levels, it should not have the service without some extraneous factor which outweighs the high cost of service.

In dissecting "commercial factors" the study used the *Sales Management Magazine Index* which is developed by weighting the buying income, retail sales, and population of individual cities.<sup>41</sup> The study concluded that commercial activity has very little effect on air travel. The main fallacy with this conclusion is that when the CAB, or its examiners, speaks of the business or commerce in an area, they are interested in manufacturing as an indicator of travel potential, rather than consumer buying and selling.<sup>42</sup> Therefore, as a general rule, it is safe to assume that the cities with the highest traffic potential for third level airlines are those which are isolated and which have some manufacturing activity. In other cities the factors of higher population, long distances to major cities and low relative costs in serving an extra city should justify a lessening of the weight to be accorded isolation. The possibility of more frequent service due to lower operating costs<sup>43</sup> suggests that more traffic can be generated at some cities.

Finally, the use of light planes gives third levels a flexibility of operation which offers an advantage over present local operation. It has been shown that an Aero Commander 500B can make two flights at less cost per aircraft mile than one DC-3 flight.<sup>44</sup> Therefore, as to the service advantage offered by a third level operation these conclusions are warranted: (1) in low density areas the extra convenience of an additional flight each day probably would generate a few extra passengers; (2) on those occasions when a single plane would be insufficient to handle existing traffic, a system with relatively short routes could employ extra sections; and (3) where traffic is sufficient, cities farther out from a metropolitan center could receive direct service while cities closer to the center could receive separate similar flights.<sup>45</sup>

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<sup>38</sup> Hamilton interview, *supra* note 30. Also, Aero Commander, Inc., Petition for Investigation of "Third Level" Air Service, CAB Docket 13733, App. A—Systems Analysis and Research Corporation, An Investigation of the Feasibility of Using Aero Commander Type Aircraft in Scheduled Short Haul Services 22 (1962). (The appendix article above cited shall hereinafter be cited without reference to the Aero Commander Petition).

<sup>39</sup> Lethbridge, *What Are the Implications of Air Travel Potential for the Future Structure of the Airline Industry*, Panel I, Conn. Gen. Life Ins. Co. Symposium, *supra* note 7.

<sup>40</sup> Systems Analysis and Research Corp., *op. cit. supra* note 38, at 15. The study is remiss in its failure to analyze factors from different angles, but it is apparently the only analytical work which has been done on the economic aspects of a third level system.

<sup>41</sup> *Id.* at 18.

<sup>42</sup> Interview with Richard A. Walsh, CAB Hearing Examiner, on Dec. 10, 1962 (hereinafter cited as Walsh interview).

<sup>43</sup> Systems Analysis and Research Corp., *op. cit. supra* note 38, at 23.

<sup>44</sup> *Id.* at 32.

<sup>45</sup> *Id.* at 34-35.

## II. THE HI-PLAINS CASE

On April 17, 1954, C. E. Walts, d/b/a Hi-Plains Airways<sup>46</sup> (Hi-Plains) filed an application for a certificate of public convenience and necessity with the CAB, proposing to operate routes in Kansas, Colorado, and Missouri.<sup>47</sup> This application was denied by the Board in the *Kansas-Oklahoma* case.<sup>48</sup> On April 1, 1961, a new application was filed.<sup>49</sup> The new proposal contained four routes in six states serving forty-five cities over some 2774 miles.<sup>50</sup> Hi-Plains is a fixed-base operator with an FAA Air Taxi Certificate at Hill City, Kansas, and has previously operated a scheduled air taxi service in Kansas.<sup>51</sup>

Hi-Plains petitioned the Board for an expedited hearing on April 13, 1961. The CAB denied the petition saying there was "no urgent need." However, one month later a second petition for expedited hearing was filed, with copies being served on Senator Monroney of Oklahoma, Senators Schoeppel and Carlson of Kansas, Congressman Dole of Kansas (Sixth District), and the Nebraska Congressional delegation. Interestingly enough, in Order E-17306, the CAB granted the petition on June 28, 1961.<sup>52</sup> With no direct proof there can only be the strong inference that congressional pressure was put on the Board to expedite the hearing. It is possible, therefore, that there will be a good deal of support from Congress for a third level of air service.

Segment A of Hi-Plains is similar in comparison to Segment 13 of Frontier Airlines. Frontier was authorized to discontinue the Segment 13 service in a "use it or lose it" investigation.<sup>53</sup> Segment 11 of Frontier is similar to Hi-Plains' Segment B and is presently under investigation for suspension or elimination.<sup>54</sup> Segment D traverses northern Kansas between the terminal points Kansas City, Missouri, and Denver, Colorado, with thirteen intermediate points. Segment C from Bismark/Mandan, North Dakota, to Wichita, Kansas, is designed to provide direct north-south service, linking the Kansas oil area with that of North and South Dakota. This segment connects with each of the others.

Hi-Plains planned a commuter service to the large terminal cities, based on surveys indicating at what point on a segment the travel divides between east and west. The service was planned primarily for the convenience of the persons at the intermediate stops.<sup>55</sup> This was in response to complaints by the residents concerning the inadequacy of the local service airlines whose schedules are planned for the needs of the large cities.

<sup>46</sup> Hi-Plains was incorporated as Hi-Plains Airways, Inc. on Sept. 6, 1961.

<sup>47</sup> Evidence and Exhibits in Support of Hi-Plains Airways, Inc., 19, pt. II, exhibit HP-7, filed Oct. 18, 1961, Hi-Plains Case, CAB Order No. E-19343 (March 1, 1963).

<sup>48</sup> *Kansas-Oklahoma Local Service Case*, 1A Av. L. Rep. ¶ 21,087, 21,087.04 (Oct. 31, 1960). In this case the Board awarded a route across northern Kansas between Denver and Kansas City to Central Airlines.

<sup>49</sup> CAB Docket 12258, Hi-Plains Case, Vol. I (1961).

<sup>50</sup> Evidence and Exhibits in Support of Hi-Plains Airways, Inc., 49 Rev., pt. III, exhibit HP-15, filed Oct. 18, 1961, Hi-Plains Case, CAB Order No. E-19343 (March 1, 1963).

<sup>51</sup> *Op. cit. supra* note 47, at 19, pt. II, exhibit HP-7.

<sup>52</sup> CAB Docket 12258, Hi-Plains Case, Vol. I (1961).

<sup>53</sup> *Frontier Airlines, Inc. Segment 13 Case*, 1A Av. L. Rep. ¶ 21,216 (1961). The cities affected were Chadron, Valentine, Ainsworth, Norfolk, Columbus, Lincoln, and Omaha, Nebraska. Since service had not begun at Columbus, Nebraska, the Board agreed to consider its needs in a later proceeding.

<sup>54</sup> *Frontier Airlines, Inc., Use It or Lose It Investigation*, CAB Docket 12078 (Feb. 28, 1963).

<sup>55</sup> Brief of Hi-Plains Airways, Inc., pp. 7-9, filed March 21, 1962, before CAB Examiner, Richard A. Walsh, Hi-Plains Case, CAB Docket 12258 (Initial Decision July 2, 1962).



Two round-trips were proposed for most of the towns. In addition shuttle service was contemplated from Norfolk east on Segment A and Hastings east on Segment B.<sup>56</sup> The equipment proposed for use on all segments was Aero Commander 500B aircraft with a seven-place configuration (one pilot and six passengers).<sup>57</sup> Hi-Plains estimated it would need twelve of such aircraft in order to fulfill its schedules.<sup>58</sup> The planes would be equipped for night and instrument flying (IFR), but operation was anticipated only under visual flight rules (VFR) except in emergencies.<sup>59</sup>

Central Airlines, Inc., a local service carrier, intervened<sup>60</sup> with an application to provide service over Hi-Plains Segment D and the southern portion of Segment C using light, twin-engined aircraft. Central proposed that the service be experimental in order to determine the economic feasibility of third level service.<sup>61</sup> Due to the historic inability of the local service lines to generate traffic at small communities such as those proposed to be served in Hi-Plains' application, Central apparently felt the venture highly speculative. Therefore in order to prevent Hi-Plains from competing with it and because of its previous experience as a scheduled operator of light planes, Central believed it should receive any route award made.<sup>62</sup>

Assuming a high (sixty per cent) load factor, Central predicted that its proposed service would lose nearly 210,000 dollars annually on a two round-trip basis.<sup>63</sup> In addition its capital outlay for equipment would have been some 26,000 dollars more per plane than Hi-Plains.<sup>64</sup> The most important criticism Central had of Hi-Plains was its optimistic revenue prediction combined with a gross understatement of costs. For example, of its total annual mileage, Hi-Plains allowed only 15,000 miles above the scheduled flight for charters and extra sections.<sup>65</sup> It was determined that with the high load factor predicted by Hi-Plains,<sup>66</sup> many route segments necessarily would carry over one hundred per cent load factors.<sup>67</sup> Using Hi-Plains traffic forecast, Central predicted that Hi-Plains operation of the routes for which Central had applied would require (assuming a figure of 350 operating days) extra sections to operate 355,250 plane miles annually.<sup>68</sup> While this is probably exaggerated, it does indicate the understatement Hi-Plains made of its costs.

Hi-Plains made no provision for cost of sales personnel, contending that sales and a good deal of public relations work would be done by the pilots

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<sup>56</sup> *Op. cit. supra* note 50, at 16-19, pt. III, exhibit HP-11.

<sup>57</sup> *Op. cit. supra* note 55, at 15.

<sup>58</sup> *Op. cit. supra* note 55, at 10.

<sup>59</sup> Initial Decision, Hi-Plains Case, CAB Docket 12258 (July 2, 1962).

<sup>60</sup> CAB Order No. E-17303, CAB Docket 12258, Vol. I.

<sup>61</sup> Brief on Behalf of Central Airlines, Inc., p.1, filed March 5, 1962, before CAB Examiner, Richard A. Walsh, Hi-Plains Case, CAB Docket 12258 (Initial Decision, July 2, 1962).

<sup>62</sup> *Id.* at 2.

<sup>63</sup> Direct Exhibits of Central Airlines, Inc., § II, exhibits CN-12, CN-13, filed Oct. 19, 1961, Hi-Plains Case, CAB Order No. E-19343 (March 1, 1963).

<sup>64</sup> *Op. cit. supra* note 61, at 17.

<sup>65</sup> Testimony by C. E. Walts, president of Hi-Plains Airways, Inc., at the Hearing in North Platte, Nebraska. CAB Docket 12258, Vol. II, pp. 164-165.

<sup>66</sup> The load factor based on a six-passenger airplane was somewhat over 74%. Evidence and Exhibits in Support of Hi-Plains Airways, Inc., pt. III, 26, exhibit HP-13, filed Oct. 10, 1961, Hi-Plains Case, CAB Order No. E-19343 (March 1, 1963).

<sup>67</sup> Supplemental and Rebuttal Exhibits of the Bureau of Economic Regulation, exhibit BER-R-2, 1961, Hi-Plains Case, CAB Order No. E-19343 (March 1, 1963).

<sup>68</sup> *Op. cit. supra* note 61, at 15-16 (Table II).

on days off. Central complained that this was an unrealistic innovation.<sup>69</sup> It is probably true that Hi-Plains' proposals were indeed overly optimistic, but Central's criticism of the innovations serves only to indicate the narrow attitude of the established airlines and to provide grounds for not certifying locals for third level service. Many of the operating third levels already employ a duplication of effort by personnel, thereby proving the feasibility of this innovation. Central offered evidence of its own experience as a light plane operator.<sup>70</sup> Although Central concluded that the small aircraft could operate with safety and maintain its schedules, it found that the plane's usefulness is limited on operation over a linear route because of the small carrying capacity.<sup>71</sup> Assuming the validity of Hi-Plains' criticism that the operation of small planes just after World War II is of doubtful value as evidence for the present,<sup>72</sup> the operation nonetheless has validity as support for the logical argument that over a linear route with many stops, a plane with small capacity will have a marked tendency to "block off" passengers. Third levels have found it necessary to operate extra sections over linear routes.<sup>73</sup>

Frontier Airlines was in basic agreement with Central as to the overstatement of revenues and the understatement of costs by Hi-Plains.<sup>74</sup> One important consideration was the method used to determine traffic potential. Hi-Plains admitted its traffic forecasts were partially based on personal visits to the cities and personal knowledge of the area.<sup>75</sup> Frontier contended that the persons making the computations had no understanding of the meaning of "community of interest" and they weighted factors based on nothing more than "judgment."<sup>76</sup> The examiner also was dismayed at the inability to provide a factual basis for the existence of community of interest data, especially on Segment C.<sup>77</sup> Hi-Plains forecast a gross operating profit of 684,159 dollars a year.<sup>78</sup> Frontier contended that the adjusted revenue and cost figures showed a subsidy need of 1,620,000 dollars, which is three subsidy dollars for every revenue dollar, *i.e.*, more than the need found in the Segment 13 case, in which the service was held to be uneconomic.<sup>79</sup>

Frontier further argued that there was no need for third level air service.<sup>80</sup> The argument is based on Frontier's experience in the area with an entirely different type of service. Frontier's contention as to need

<sup>69</sup> *Op. cit. supra* note 61, at 19.

<sup>70</sup> From Sept. 15, 1949, to Nov. 15, 1950, Central operated its routes using only single-engined Beechcraft Bonanza A-35 airplanes. At the request of the Bureau of Economic Regulation, data concerning this operation was furnished for the *Hi-Plains* case. Information Exhibits of Central Airlines, Inc., 11-12, 1961, Hi-Plains Case, CAB Order No. E-19343 (March 1, 1963).

<sup>71</sup> *Op. cit. supra* note 63, at § I, exhibit CN-2.

<sup>72</sup> Brief of Hi-Plains Airways, Inc., p. 58, filed March 21, 1962, before CAB Examiner, Richard A. Walsh, Hi-Plains Case, CAB Docket 12258 (Initial Decision, July 2, 1962).

<sup>73</sup> Bulban, *Light-Twin Carrier Gains Public Approval*, Aviation Week, July 23, 1962, p. 28.

<sup>74</sup> Brief of Frontier Airlines, Inc., pp. 7-20, filed March 19, 1962, before CAB Examiner, Richard A. Walsh, Hi-Plains Case, CAB Docket 12258 (Initial Decision July 2, 1962).

<sup>75</sup> *Op. cit. supra* note 66, at 1, exhibit HP-9.

<sup>76</sup> *Op. cit. supra* note 74, at 8-9. As an illustration, Frontier points out that Hi-Plains' witness at the hearing "stated that there is 'not so much' community of interest between those two towns . . . [Russell and Great Bend, Kansas], even though they are only 35-40 miles apart and last year there were 7833 business trips made from Russell to Great Bend!"

<sup>77</sup> Initial Decision, *supra* note 59, at 13-14.

<sup>78</sup> Evidence and Exhibits in Support of Hi-Plains Airways, Inc., pt. III, 26, exhibit HP-13, filed Oct. 10, 1961, Hi-Plains Case, CAB Order No. E-19343 (March 1, 1963).

<sup>79</sup> *Op. cit. supra* note 74, at 19-20.

<sup>80</sup> *Op. cit. supra* note 74, at 24.

indicates that the airline has no grasp of the problem of third level service. It fails to acknowledge the existence of operating third levels and apparently has forgotten the original basis for local service certification.

Assuming one-pilot operation with an average of two and one-half passengers and using Aero Commander's estimated operating costs, the Bureau of Economic Regulation predicted a subsidy need of over one million dollars.<sup>81</sup> This figure was found by the examiner to be the minimum need for the operation.<sup>82</sup> Since it adopts most of the aspects of the third level concept, the Hi-Plains proposal on its face would appear to present an excellent opportunity for the Board to initiate an experiment to determine the feasibility of a third level system. Yet the examiner rejected the application and was later upheld by the Board.<sup>83</sup> Without reaching the question of whether either of the carriers was fit, willing, or able to provide the service, CAB Examiner, Richard A. Walsh, found no need for the service.<sup>84</sup> Analysing the proposals of the two applicants and the cost to the government of certifying a third level service, examiner Walsh concluded that there had been no showing of a need for air service to the area and the proposal by Hi-Plains was too costly to warrant certification.

The analysis of the proposals is especially helpful in that it points up what may only be defects in the presentation of Hi-Plains. Hi-Plains was unduly optimistic concerning the success of the operation. Its predicted load factor of 74.2 per cent was too high to be realistic. Translated into more sobering terms, prediction of a 74.2 per cent load factor means that using a six-passenger airplane, an airline "would have to operate within an average of 1½ passengers of capacity over every mile of its route throughout the entire year."<sup>85</sup> Although the flying was to be done on VFR only, Hi-Plains contemplated a 95.89 per cent completion factor.<sup>86</sup> This prediction is highly unrealistic. It is not likely that an airline in the area to be serviced by Hi-Plains would find itself grounded the equivalent of only fifteen days a year.

Granting that there was a difficulty in obtaining community of interest data, there should have been more than a mere stating of its existence. Kansas City provided evidence as to its linkage with the cities on Segment D,<sup>87</sup> but such evidence could not overcome a general lack of data. Furthermore, in the surveys which were made, there was no determination of the trips which would have been made by air had air service been available.<sup>88</sup> Other factors tending to indicate that Hi-Plains was not fully apprised of the costs involved in running an airline were the provision for only two reservation clerks stationed at Hill City to handle the entire system (a system operating with near-capacity loads on each flight) and the failure to provide for a full-time sales or public relations organization, especially at the commencement of operation when public contact is most important.<sup>89</sup>

<sup>81</sup> Supplemental and Rebuttal Exhibits of the Bureau of Economic Regulation, exhibit BER-R-4, 1961, Hi-Plains Case, CAB Order No. E-19343 (March 1, 1963).

<sup>82</sup> Initial Decision, *supra* note 59, at 32.

<sup>83</sup> Hi-Plains Case, CAB Order No. E-19343 (March 1, 1963).

<sup>84</sup> Initial Decision, *supra* note 59, at 54.

<sup>85</sup> *Id.* at 20.

<sup>86</sup> Brief of Hi-Plains Airways, Inc., *op. cit. supra* note 55, at 13.

<sup>87</sup> Exhibits of the City of Kansas City, Missouri, filed Oct. 16, 1961, Hi-Plains Case, CAB Order No. E-19343 (March 1, 1963).

<sup>88</sup> Walsh interview, *supra* note 42.

<sup>89</sup> Initial Decision, *supra* note 59, at 27-28.

Furthermore, Hi-Plains' route structure and flight pattern was almost solely linear. Operating at the predicted traffic potential without any provision for extra sections would cause a continual blocking of passengers.<sup>90</sup> Although Hi-Plains predicted a gross operating profit of 684,000 dollars, examiner Walsh and the Board found that the minimum required subsidy would be one million dollars.<sup>91</sup> The salient point in this is the large difference between the figures.

Emphasis on these points as well as many others indicates that by using a different approach, subsequent applicants will have a better chance for success in their presentations. For example, a third level might do better were it not to anticipate a large profit. Many authorities and operators doubt whether third levels can be operated without subsidy.<sup>92</sup> In a case in which a third level is not in operation and is attempting to receive a certificate to serve "use it or lose it" points, the financial operations should be presented on the basis of the local service experience and probably should indicate the possibility of some subsidy rather than a profit. There is some indication that the subsidy is not always the overriding concern in a certification case. If an applicant is insistent that it will make a profit in an area where previously a large subsidy was required, the conclusion may be that in cutting costs the applicant will sacrifice safety. Clearly, the CAB would not compromise safe operation in the interest of eliminating subsidy.

The basic reason for finding that the service was not needed is to be found in the characteristics of the area proposed to be served. The economy of the area is based on agriculture rather than manufacturing, and very few of the towns have manufacturing establishments.<sup>93</sup> Generally it is thought that manufacturing generates traffic of a type which is interested in speed. On the other hand, agriculture is not the type of industry which will generate a large amount of traffic and that which it does generate is not so concerned about time spent in travel. In addition the area has highways of good construction. Flat land and sparse population enable relatively rapid travel by automobile.<sup>94</sup> Ordinarily it is more convenient to use one's own automobile in making relatively short trips. On the proposed route system, the average hop is fifty miles except for Segment C.<sup>95</sup> It would seem highly speculative, therefore, to find that there would be much air travel over one or two stage lengths, even with a high frequency of flights offered. "It appears beyond dispute that travel by private automobile was one of the factors which inhibited Frontier in its development of traffic on Segment 13."<sup>96</sup> Despite this rather obvious factor, Hi-Plains estimated that Ainsworth and Valentine, Nebraska, on Segment A would

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<sup>90</sup> *Id.* at 33. In the interview with the author, examiner Walsh expressed a great deal of concern over the failure of Hi-Plains to recognize this problem. In a plane limited to six passengers, if there are four passengers on the aircraft coming into an intermediate stop and a group of three businessmen wants to enplane, the airline will not be able to accommodate them, and both revenue and good will are lost to the airline. Examiner Walsh employed this illustration to demonstrate the difficulties of using a small aircraft over a linear route. Walsh interview, *supra* note 42.

<sup>91</sup> Hi-Plains Case, CAB Order No. E-19343 (March 1, 1963).

<sup>92</sup> Pickering, *Needed: A Third Level of Air Service*, Flight, Aug. 1961-March 1962, an VIII-part series. Also Hamilton interview, *supra* note 30.

<sup>93</sup> Evidence and Exhibits in Support of Hi-Plains Airways, Inc., pt. II, pp. 1-7, exhibit HP-2, filed Oct. 10, 1961, Hi-Plains Case, CAB Order No. E-19343 (March 1, 1963).

<sup>94</sup> Walsh interview, *supra* note 42.

<sup>95</sup> Initial Decision, *supra* note 59, at 46.

<sup>96</sup> Initial Decision, *supra* note 59, at 45.

exchange 800 air passengers annually, even though the cities are only 34 miles apart.<sup>97</sup>

The CAB, in the *Segment 13* case,<sup>98</sup> acknowledged that some of the northern Nebraska towns could be classified as isolated. Examiner Walsh found that the economy of the area was such that travel tended to be local instead of national and therefore, the isolation of the cities in the area was not entitled to what might be termed normal weight.<sup>99</sup>

Examiner Walsh touched on what may eventually be the most important factor hindering the growth of the third level concept, *i.e.*, the danger that the small airlines will expand to become a second local service system, subsidized and in competition with the second. In considering this problem of growth to a position competitive with the locals, examiner Walsh failed to consider the fact that when the locals were certified, there was no small plane comparable to the present-day light-twins. The economical operation of these planes<sup>100</sup> should inhibit to some extent any desire for expansion by the third levels. Although Hi-Plains agreed to condition its certificate on the use of small planes, Walsh said there would be nothing to prevent Hi-Plains from later having the condition removed for justification.<sup>101</sup> The Board decided that since the service was not needed, there was no necessity to consider the point.<sup>102</sup> Section 401(e) of the Federal Aviation Act of 1958<sup>103</sup> provides:

no term, condition, or limitation of a certificate shall restrict the right of an air carrier to add to or change schedules, equipment, accommodations, and facilities for performing the authorized transportation and service as the development of the business and the demands of the public shall require.

Unless some other method of restriction is developed, conditions in issued certificates must be approached by the Board with caution.

The examiner did, however, express the opinion that eventually the United States may need a third level of air service.<sup>104</sup> In the Board's opinion Chairman Boyd implied that in other cases a need for third level air transportation might be shown.<sup>105</sup> On this basis the *Hi-Plains* case is best read as being limited to its facts. If such is the case, it is unfortunate from Hi-Plains' viewpoint and that of the industry that Hi-Plains found it necessary to expedite the case and have its application heard first. Since the case was decided against the applicant, later applicants may find it more difficult to be successful, even if the case is expressly limited to its facts. The suggestion is that there are applicants who can show a more

<sup>97</sup> Evidence and Exhibits in Support of Hi-Plains Airways, Inc., pt. III, 2, exhibit HP-10, filed Oct. 10, 1961, Hi-Plains Case, CAB Docket 12258, Order Serial No. E-19343 (March 1, 1963).

<sup>98</sup> Frontier Airlines, Inc., Segment 13 Case, 1A Av. L. Rep. § 21,216 (1961).

<sup>99</sup> Initial Decision, *supra* note 59, at 48.

<sup>100</sup> Wallace, Direct Cost of Operation for Model 500B Aero Commander (1962).

<sup>101</sup> Initial Decision, *supra* note 59, at 48-49.

<sup>102</sup> Hi-Plains Case, CAB Order No. E-19343 (March 1, 1963). In its opinion the Board made very little modification of the examiner's decision, adopting specifically his finding as to: (1) the ease of travel by automobile in the area, (2) small plane operation, (3) diversion from the locals, and (4) the minimum subsidy of one million dollars. The Initial Decision will be printed as an appendix to the Board's opinion in the CAB Official Reports.

<sup>103</sup> 49 U.S.C. § 1371.

<sup>104</sup> Walsh interview, *supra* note 42.

<sup>105</sup> Hi-Plains Case, CAB Order No. E-19343 (March 1, 1963). The opinion indicated that if a need were shown, an existing local carrier rather than a new carrier would receive the certificate. This apparently does not completely foreclose the issuance of a certificate to a strong third level operator.

pressing need for the service, an isolation factor which is not so easily discounted, and can present revenue and cost data of a more reliable nature (actual operation with relative success of some third levels leaves little doubt in this matter). Once a strong representative of the third levels received certification, it might have been easier for others to process their applications to success. As it is, the present applicants can profit only by the mistakes of Hi-Plains.

### III. ALTERNATE SERVICE PROPOSALS

There are a variety of proposals for third level service being studied in the aviation industry today. In addition to the idea of a separate system of carriers and the proposal offered by Central Airlines in the *Hi-Plains* case, the Association of Local Transport Airlines (ALTA) has set up a committee to discuss the production of an aircraft to serve low density areas,<sup>106</sup> ostensibly to replace the DC-3. Leslie O. Barnes, chairman of the committee, has indicated that the planes under consideration are contemplated in order to bring local service airlines back to the original purpose for which they were certificated, *i.e.*, providing service to small intermediate cities.<sup>107</sup> Of course the proposal has its critics. Aero Commander Vice-president Thomas J. Harris contends that "the problem is not the development of additional equipment but the proper use of what is now available."<sup>108</sup> He says that three Aero Commanders would be able to operate at a direct operating cost figure just above that named for the desired plane, carrying twenty-one passengers with more schedule flexibility, and with an initial cost of less than the ideal cost mentioned for the new aircraft. In addition the Aero Commander is already operating.<sup>109</sup> While the argument is a bit optimistic as to the performance costs of the Aero Commander, it does expose some of the defects in the thinking of the local service airlines. There is one area in which the new plane proposed by the locals would be extremely useful. A small plane is highly unsuitable for use over linear routes because of the tendency to "block off" passengers. Treating this question in the *Hi-Plains* case, examiner Walsh concluded that the answer was not the small aircraft proposed by Hi-Plains, but rather an airplane with capacity between the Aero Commander 500B and the DC-3.<sup>110</sup>

While the use of a new plane is plausible, its very suggestion at a time when other aircraft can be used raises more questions than it answers and makes the entire idea unrealistic. If the Board should certify a third level of air carriers, primarily feeding persons from small communities into large cities, with no more than two or three intermediate stops, then upon development of a new aircraft, it would be forced to reconsider the structure of the industry. Should the third levels use the new plane, they would then begin the pattern of growth of the locals. On the other hand, use by the locals would be disastrous to the third level operators because economies of operation would compel the locals to make intermediate stops at third level cities. Use by both would only foster direct competition

<sup>106</sup> Doty, *New Local Carrier Aircraft Drive Begins*, Aviation Week, Dec. 24, 1962, p. 28.

<sup>107</sup> *Ibid.*

<sup>108</sup> Speech by Thomas J. Harris, Vice-president of Aero Commander, Inc., at the Annual Aviation Conference of the American Society of Mechanical Engineers, June 26, 1962, at 11 (hereinafter cited as Harris speech).

<sup>109</sup> *Ibid.*

<sup>110</sup> Initial Decision, *supra* note 59, at 51.

between the two subsidized systems. The low capacity of existing equipment might require the purchase of duplicate small aircraft for use as extra sections. On low traffic days, the planes could operate on charter, training, or taxi flights instead of standing idle.

Another proposal is certification *en masse* of the existing scheduled air taxi operators as third level carriers.<sup>111</sup> Immediate certification of this nature is extremely unwise because it fails to allow consideration of just what is desirable for the industry, such as the amount of competition between third levels and locals. It completely negates the advantage of an overall consideration of the industry which could be accomplished by an investigation of the need for the service. On the other hand, there is some indication that the air taxi operators are not interested in a scheduled third level of air transportation which is certified by the Board. The primary contention is that more advantages can be taken of the flexibility derived from operating small airplanes if the air taxis continue under their exemption<sup>112</sup> than if they are restricted by a scheduled operation.<sup>113</sup> The presumption of the position is that if some areas can supply enough traffic to support a scheduled service with small planes, the air taxi operators will offer the service without CAB certification, as is now being done.<sup>114</sup> A further advantage is that if a scheduled route proves to be unprofitable, as did the Bedford-La Guardia service of Executive, the operator can simply discontinue the route without a lengthy proceeding before the Board.

It is doubtful whether the realities of political life will permit the last proposal. That proposal tends to maintain the status quo and as service of a scheduled nature is deleted at more and more cities, heavier pressure will be put on the congressmen representing those areas to remedy the situation. The basic position of Senator Monroney seems to be that by one means or another service must be provided to the smaller communities. In commenting on the Aero Commander Petition,<sup>115</sup> Senator Monroney is quoted as saying:

It is my belief that the need for the so called third level air service is most urgent and for some time I have favored the development of scheduled service using modern light twin-engined aircraft. It seems to me that opportunities exist for such services whether operated by our present local service carriers or by air taxi type operators, or even by the development of a new form or type of operator.<sup>116</sup>

<sup>111</sup> Letter from William C. Wallace, Fleet Sales Manager of Aero Commander, Inc., to the author, Jan. 31, 1963. The plan of Aero Commander is to present an amendment to its petition for a third level investigation, so that the proposal for an investigation may still be the uppermost consideration.

<sup>112</sup> 14 C.F.R. § 298.

<sup>113</sup> Air Travel (News Supplement of the Official Airlines Guide), Feb. 1963, pt. 2, p. 15.

<sup>114</sup> The Board acknowledged this argument in its opinion in the *Hi-Plains* case, *supra* note 105. The contention against this opinion is that if there is controlled certification by the CAB, the third levels will be protected from destructive competition.

<sup>115</sup> Aero Commander, Inc., Petition for Investigation of "Third Level" Air Service, CAB Docket 13733 (June 26, 1962).

<sup>116</sup> Quoted in a news release reporting a speech by Thomas J. Harris, Vice-president of Aero Commander, Inc., at the Annual Aviation Conference of the American Society of Mechanical Engineers, p. 4. Sent to the author by William C. Wallace of Aero Commander, Inc. The assertion that the quotation was a comment on the Aero Commander Petition is of doubtful validity as the first paragraph of the quotation is set out at page 3 of the Aero Commander Petition itself as having been made by Senator Monroney during oral argument of the *Southwestern Area Local Service* case, CAB Docket 10758.

Yet during oral argument in the *Southwestern Area Local Service* case,<sup>117</sup> Senator Monroney is reported to have said that the local service carriers originally received their certificates in order that the small cities might receive scheduled air service, and it is the duty of these carriers to continue this service with light, twin-engined planes.<sup>118</sup>

#### IV. THE NEED FOR SUBSIDY AND SOLUTION OF THE GROWTH PROBLEM

With present Board policy concentrated on subsidy reduction, certification of an entirely new transportation system seems paradoxical. Some observers in the industry contend that the third level applicants are calling for a reversal of Board policy. This would place the CAB in precisely the position it occupied when the locals were first expanding to larger and faster equipment.<sup>119</sup> Proponents of a third level system say that the system probably will need a subsidy,<sup>120</sup> and indeed operators themselves believe that a subsidy may be necessary for the operation of a scheduled third level service.<sup>121</sup> It is further contended, however, that if local service is deleted at marginal points and third level carriers substituted for it, there will be a resulting overall subsidy reduction.<sup>122</sup> Should this last contention have merit, the advantage to the Board is obvious in that it will be able to reduce the cost to the government of airlines operation, while at the same time granting scheduled air service to more cities.

Assuming that subsidy payments will be necessary for third level service, an investigation by the Board could determine whether there would be a savings over the present subsidy level. If so, the Board must then determine whether the savings is sufficient to warrant recertification to areas unable to support locals, and possibly to areas previously not served. Once the Board reaches this position, it is to its advantage to determine a method of controlling the operation of the third level system so as to prevent a repetition of the growth pattern of the locals.

The study of the Systems Analysis and Research Corporation<sup>123</sup> found that in 106 low traffic communities a minimum of four million dollars in subsidy payments would be saved annually. Estimated costs of operating the Aero Commander have been given in varying figures. In the *Hi-Plains* case Central Airlines anticipated a total of over 49 cents per plane mile,<sup>124</sup> while Hi-Plains figured its costs at 26.59 cents per mile.<sup>125</sup> The Systems Analysis and Research Corporation figure was between these two and may have been high.<sup>126</sup> Using these latter cost figures, without making allowances for increased traffic due to schedule frequency, the study determined that the subsidy savings would be 15.3 cents per aircraft mile if two Aero

<sup>117</sup> CAB Docket 10758.

<sup>118</sup> Bramley, 1961 *Marks Profit Breakthrough*, Airlift, May 1962, p. 83, 84.

<sup>119</sup> Cook, *Air Taxis Offer Service to Cities Unable to Support Local Airlines*, Aviation Week, Sept. 4, 1961, p. 40.

<sup>120</sup> Pickering, *Needed: A Third Level of Air Service*, Flight, Oct. 1961, p. 36, pt. III of an VIII-part series.

<sup>121</sup> Hamilton interview, *supra* note 30.

<sup>122</sup> Systems Analysis and Research Corp., *An Investigation of the Feasibility of Using Aero Commander Type Aircraft in Scheduled Short Haul Services 1* (1962).

<sup>123</sup> *Ibid.*

<sup>124</sup> Direct Exhibits of Central Airlines, Inc., § II, exhibits CN-11, CN-13, filed Oct. 19, 1961, *Hi-Plains* Case, CAB Order No. E-19343 (March 1, 1963).

<sup>125</sup> Evidence and Exhibits in Support of Hi-Plains Airways, Inc., pt. III, 50 rev., exhibit HP-15, filed Oct. 16, 1961, *Hi-Plains* Case, CAB Order No. E-19343 (March 1, 1963).

<sup>126</sup> *Op. cit. supra* note 122, at 30, 32, (Their figure is 42.6 cents per mile).



Commanders replaced one DC-3 and 57.9 cents per mile on an even substitution.<sup>127</sup> The figures are apparently conservative because in the short haul markets, the airplane has little advantage over the automobile. If one flight per day is offered, it follows that only a minimum number of passengers is generated. On the other hand, with greater frequency, the flights have a better chance of departing at the time the prospective passenger plans to leave and therefore will probably generate more traffic.<sup>128</sup> Each revenue passenger thereby generated will increase the subsidy savings.

One basic contention by third level advocates is that the institution of the service will effect an overall subsidy reduction. The argument is grounded on the apparent assumption that scheduled third level will be only to those cities which are deleted from local service routes by enforcement of the "use it or lose it" policy. Yet the Hi-Plains structure illustrates that it is not only those particular cities which the third levels will anticipate serving. Each additional city will add to the subsidy to be paid to the new system. Systems Analysis and Research Corporation,<sup>129</sup> by using conservative calculations, left room in its figures to argue that: (1) actual subsidy savings in its study would actually be much higher and thus the savings would account for any additional service or (2) even if the actual savings were that determined, subsidy for additional service would not be so high as to consume the savings.

It is probably this fact of service to more cities which prompts the opposition to the third levels on the basis that it will reverse the Board's policy. The certification of additional cities logically means the subsidy payments will be higher because the assumption is that each new city receiving service will be a poorer traffic generator than those already on a scheduled route. The argument, however, is much stronger when applied to the locals rather than to the third levels, because the aircraft utilized by the latter airlines do not require so high a passenger load to break even.

One expert determined that even with more frequent flights to the deleted cities, it would be possible to offer service to more small communities and still have an overall reduction of subsidy.<sup>130</sup> Naturally this should be a major consideration of the Board in determining the existence of a need for the service and the prospect of an addition to the subsidy may have been the major reason for denial of the Hi-Plains application. Hi-Plains proposed service to a large number of small cities,<sup>131</sup> many of which had never before had air service, and failed to show an adequate traffic potential should they receive service. The very suggestion of the predicted one million dollar subsidy would be sufficient to foreclose certification by an economy-minded Board. Provided the cost of service to new cities is not great and a reasonable traffic potential is possible, applicants, using prudent route structuring, should propose to serve these cities. Once the above qualifications are met, proponents of the third level system will be able to show the Board that an overall reduction of subsidy can be effected.

The Board apparently made a mistake in the certification of the local

<sup>127</sup> *Op. cit. supra* note 122, at 39.

<sup>128</sup> *Op. cit. supra* note 122, at 27-28.

<sup>129</sup> *Op. cit. supra* note 122.

<sup>130</sup> Pickering, *supra* note 120.

<sup>131</sup> Sixteen of the cities had population figures of less than five thousand people. Evidence and Exhibits in Support of Hi-Plains Airways, Inc., pt. II, 1-7, exhibit HP-2, Hi-Plains Case, CAB Order No. E-19343 (March 1, 1963).

service airlines by failing to restrict the type of aircraft used. In some individual situations operation of a larger airplane would be more economical but its repercussions are not desirable. If one third level airline employed a large aircraft, other third levels would demand lucrative routes over which to use a similar plane. Should the other third levels ask for new routes, the chances of competition with locals would be greater and the small airlines would attempt to slough off the poorer traffic routes. In other words, the situation of the locals would be repeated. At present the third levels have for the most part, disclaimed any designs of such nature. TAG Airlines appears to be the only one whose plans for the future call for larger equipment.<sup>132</sup> While calling itself a third level, its plans to purchase larger airplanes do more harm than good for the third level concept because the very plans thwart the strongest arguments of the proponents.

Section 401(e) of the Federal Aviation Act of 1958<sup>133</sup> restricts the power of the CAB to grant certificates with conditions. Recently, however, the Board has undertaken to employ subsidies in a manner such as to give a reasonable assurance of economy of operation,<sup>134</sup> and Chairman Boyd has even warned one carrier that there will be no subsidy for costs resulting from a new plane the carrier is purchasing.<sup>135</sup> Assuming, therefore, that the institution of a third level service will at least not raise the present subsidy requirements, and possibly will reduce the payments, the problem for the Board is whether the statutory authority under which it operates will permit it to fashion a plan of subsidy payments in such a manner that there will be an incentive for management to operate efficiently and economically. Further, the subsidy must not let third levels fall into the growth pattern which has been characteristic of the existing airlines.

The sections of the Federal Aviation Act which provide the power and standards for granting subsidy are 406(a) and 406(b).<sup>136</sup> Part three of section 406(b) is the most important of the standards and on its face allows the CAB rather wide latitude in the use of subsidy. In *Western Air Lines, Inc. v. CAB*,<sup>137</sup> the court was rather emphatic in holding that the subsidy need of carriers was to be for the "development of air transporta-

<sup>132</sup> Wright, *TAG Gets High Dove Utilization*, Aviation Week, Nov. 26, 1962, p. 40, 41.

<sup>133</sup> 49 U.S.C. § 1371(e).

<sup>134</sup> Local Service Class Subsidy Rate Investigation, 1A Av. L. Rep. ¶ 21,134 (Mar. 7, 1961), making final the Statement of Provisional Findings and Conclusions, CAB Order No. E-16380 (Feb. 16, 1961).

<sup>135</sup> Aviation Week, Dec. 24, 1962, p. 28.

<sup>136</sup> 49 U.S.C. § 1376(a) & (b). Subsection (b) contains the standards to be followed by the Board and reads:

In fixing and determining fair and reasonable rates of compensation under this section, the Board considering the conditions peculiar to transportation by aircraft and to the particular air carrier or class of air carriers, may fix different rates for different air carriers or classes of air carriers, and different classes of service. In determining the rate in each case, the Board shall take into consideration, among other factors, (1) the condition that such air carriers may hold and operate under certificate authorizing the carriage of mail only by providing necessary and adequate facilities and service for the transportation of mail; (2) such standards respecting the character and quality of service to be rendered by air carriers as may be prescribed by or pursuant to law; and (3) the need of each such air carrier for compensation for the transportation of mail sufficient to insure the performance of such service, and, together with all other revenue of the air carrier, to enable such carrier under honest, economical, and efficient management, to maintain and continue the development of air transportation to the extent and of the character and quality required for the commerce of the United States, the Postal Service, and the national defense.

<sup>137</sup> 347 U.S. 67 (1954).

tion" in addition to compensation for the carriage of mail. Since mail transportation is only a minor part of the operation of an airline, most of the concern is with the transportation of passengers. Therefore, the Act says that in the development of air transportation the CAB is to consider "the commerce of the United States, the Postal Service, and the national defense." The court interpreted this to mean that the adequacy of the air transportation system as it especially involves the transport of passengers must be the major concern of the Board. A later case<sup>138</sup> further corroborates this. In upholding a CAB action fixing subsidy for international operations, the court held, "considerations of administrative flexibility apply to airline subsidy as well as licensing proceedings, for the Board, like the Federal Communications Commission, is required 'at all times' to gauge its actions by the public interest standard."<sup>139</sup>

While the "public interest" standard is a vague one, it seems clear that the courts have ruled that the Board's determination of subsidy in the context of public interest will be given a good deal of weight. It is the Board's duty to find primarily what is in the public interest. Thus, if a carrier's service is required by the public interest, the CAB must next consider the financial needs of the carrier and meet them. The amount of subsidy required to sustain an efficient operation will be compared with the public interest to see if the subsidy outweighs the public interest.

By so reading the courts' construction of Section 406(b), that Section is more easily reconciled with the general statutory policy declaration of Section 102 of the Act.<sup>140</sup> It was the intent of Congress that the subsidy should be the means by which the CAB is to guide the development of air transportation. Under Section 401(e)<sup>141</sup> the Board may not prescribe the times of day each flight must leave nor indeed the aircraft to fly the flight. If, however, a carrier operates outside of the bounds of what the Board determines to be the public interest, the subsidy is the means by which an airline will be required to operate in furtherance of an air transportation system adapted to the needs of the United States.

Generally the CAB has failed to exercise a restrictive power over the locals with subsequent high subsidy payments being a result. In the inter-

<sup>138</sup> *Delta Air Lines, Inc. v. CAB*, 280 F.2d 636 (D.C. Cir. 1960); *cert. denied*, 364 U.S. 870 (1961).

<sup>139</sup> *Id.* at 640 (citing § 406 of the Act).

<sup>140</sup> 49 U.S.C. § 1302:

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

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

(b) The 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 services by air carriers at reasonable charges, without unjust discrimination, undue preferences or advantages, or unfair or destructive competitive practices;

(d) Competition to the extent necessary to assure the sound development of an air-transportation system properly adapted to the needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense;

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

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

<sup>141</sup> 49 U.S.C. § 1371(e).

est of reducing the subsidy required to provide an adequate air transportation system, it is virtually a duty of the Board to implement a subsidy formula, applying to the third levels, that will grant them a certain freedom of operation, but will act to prevent them from upsetting any balance of the system.

One subsidy formula for the third levels has been devised by Mr. Pickering of *Flight Magazine*. After calculating an average direct operating cost for light, twin-engined planes of 29.2 cents per mile at an average speed of 170 mph, he contends that by prudent management, a third level airline could hold the indirect costs to as low a figure as 30 cents per mile.<sup>142</sup> This figure may be somewhat high since even the figure of Central Airlines in the *Hi-Plains* case was only 23.5 cents per mile.<sup>143</sup>

For revenue, Pickering believes that passenger revenue averaging 10 cents a passenger mile is not too unrealistic since there are quite a few trunk and local routes which presently exact a fare that high or higher. Some third levels already charge a fare of 10 cents a mile or more.<sup>144</sup> In determining a subsidy formula, Pickering aimed for a subsidy which "will be used only to support services that will provide a reasonable commercial revenue."<sup>145</sup> The basic standard devised was aircraft miles flown, with a decreasing payment for miles above an arbitrary figure. The subsidy would average 27.5 cents per mile for each mile up to 100,000 miles per month. Between 100,000 and 150,000 miles, the figure is 15 cents per mile; it is 10 cents a mile for the next 100,000 miles and above a quarter of a million miles per month, the subsidy is nothing. In order to make some profit, the formula requires an average passenger load of three to four passengers per flight, using a small plane.<sup>146</sup>

The flat rate to 100,000 miles is an incentive to management to cut operation costs; the variable payments being designed to prevent the airline from growing too large. One presumption raised by this formula is that certification by the Board of a rather large route system (such as *Hi-Plains*)<sup>147</sup> means that the CAB has found that costs are reduced as the system is lengthened or that there is at least one lucrative short haul route within the structure.

The formula fails, however, to solve a primary problem presented by the local service airlines. Graduation to larger equipment is a common tendency among airlines. Under this formula, if one particular route of a third level should be in high demand, the operator might determine that it could operate better by use of a larger airplane. The advantage to the airline is that if it flew more than 100,000 aircraft miles per month, it would be able to transport more passengers at the higher subsidy rate.

Another subsidy formula is to calculate an average or desired passenger load per flight. On the basis of a projected figure of revenue per passenger mile, the subsidy would be a figure based on the revenue seat miles

<sup>142</sup> Pickering, *supra* note 120.

<sup>143</sup> Direct Exhibits of Central Airlines, Inc., exhibits CN-11 and CN-13, filed Oct. 19, 1961, *Hi-Plains* Case, CAB Order No. E-19343 (March 1, 1963).

<sup>144</sup> Apache charges \$8.00 for the 62-mile trip from Tuscon to Fort Huachuca, and Aspen charges \$22.50 for the 113-mile (direct route) ride from Denver to Aspen. Official Airline Guide, Tables 470 & 472 (Feb. 1963).

<sup>145</sup> Pickering, *supra* note 120.

<sup>146</sup> Pickering, *supra* note 120.

<sup>147</sup> Evidence and Exhibits in Support of *Hi-Plains Airways, Inc.*, 49 rev. exhibit HP-15, filed Oct. 10, 1961, *Hi-Plains* Case, CAB Order No. E-19343 (March 1, 1963). Monthly aircraft miles were predicted at 337,770 miles.

of the airline calculated so as to allow a slight profit at the desired passenger level. This method contains an added incentive to generate more traffic because it is not only the passenger revenue which becomes a profit, but also the subsidy which is increased by the additional passengers. As in the class subsidy rate, there should be a provision engineered to hold down the profit level. As in the previous suggested subsidy, this would not prevent a third level airline from utilizing a larger airplane on more heavily traveled routes. The cost per seat mile of operation usually is lower in larger planes and therefore at some point it would be to the airline's advantage to switch to larger equipment.

A further method of subsidization is a variation of the last-mentioned one. The Board should make a determination of the most desired schedule over each route, the probable traffic to be carried, and the type of plane which could best fulfill the schedule. Subsidy would then be paid on the calculated preferred revenue seat miles to be flown.<sup>148</sup> If an airline should decide to use a larger airplane, it would nonetheless have to fly the same number of flights per day in order to generate the same number of passengers. Should one flight generate a large number of passengers, extra sections could provide service thereby warranting a request for extra subsidy if necessary, due to the added expense of flying more aircraft miles. It would be to the disadvantage of the operator to use a larger airplane in such a situation because the same aircraft miles would be flown. If, on the other hand, the airline decided to fly a large plane on the more lucrative flight, and eliminate a less-traveled one, the smaller number of aircraft miles might prompt the CAB to redetermine the subsidy.

The apparent advantage of this subsidy is to provide control over the size of the aircraft used and give a general direction to the ideal number of flights over a route. Direct control of the operation and necessity for continual redetermination of the subsidy payments to meet what the Board feels are the needs of the airline are some disadvantages. Furthermore, this subsidy would not aid in fulfilling the purpose of a third level service investigation. In an investigation the Board could do no more than verbalize a general standard for the formula, thereby precipitating argument in each certificate application as to the proper scheduling and traffic potential of each route segment the applicant proposes to serve.

For all of these proposed subsidies, one basic assumption must be made. It is not likely that the CAB will authorize a third level carrier over a route which regularly will generate more traffic at one time than a seven to nine-passenger plane can carry. The easiest method of controlling the third levels is merely to refuse as a policy to grant a subsidy to any carrier utilizing aircraft over a prescribed capacity. As a matter of practicality, however, this policy may be overstepping the limits of control which Congress has granted to the CAB.

## V. THE ROLE OF THE CAB

From the time Hi-Plains first applied for an expedited hearing, until the time of the Board's decision, nearly two years of gathering and filing

<sup>148</sup> For illustration, assume a determination by the CAB that a 100-mile route can generate an average load factor of 50% on a seven-place aircraft, if five round trips per day are provided. In one day 3500 revenue seat miles will be logged producing \$350 of revenue (at 10 cents per passenger mile). With a total cost of operation of 60 cents an aircraft mile, expenses for the day would be \$600, prompting a subsidy of approximately 7.1 cents per revenue seat mile.

exhibits, conferences, hearings, filing briefs, and argument intervened. In order to make a full presentation a great deal of time and money is required to employ experienced personnel to advise as to route structures, gather information to show a need, and to determine statistically the financial operation.<sup>149</sup> Because the entire operation of a third level airline is keyed to smallness, it can be anticipated that very few of the operators will have either the money or the time to make a full presentation to the Board. Similarly, few of the towns to be served by the third levels will be able to make complete presentations of the community of interest data. These are problems which will plague the airlines and towns so long as applications are heard on an *ad hoc* basis.

In order to remedy this acute problem it has been suggested by one authority that aircraft manufacturers aid the operators in the Board proceedings.<sup>150</sup> In 1962 Aero Commander, Inc., filed a petition with the CAB for investigation of third level air service.<sup>151</sup> Due to the existence of many applications for third level certificates, an investigation by the Board, similar to the *Local Service Investigation*,<sup>152</sup> seems to present from the view of all the parties, the best general solution to the problem of institution of a third level air system.

As the Board becomes more and more active in its enforcement of the "use it or lose it" policy, pressure will be heavier for a solution to the problem of lack of service to cities formerly found to need it. Senator Monroney, Chairman of the Aviation Subcommittee of the Senate Committee on Interstate and Foreign Committee, has said:

Aviation progress in America is moving in the direction of fewer manufacturers, employing fewer people, to produce fewer, bigger, faster, more expensive aircraft, operated by fewer crews, working for fewer airlines, to provide less frequent service at higher cost to fewer American cities. We are losing an important element of air power, that of variety, the capability of American aviation to provide the equipment and the managerial and operational skill to provide every needed type of air service.<sup>153</sup>

While there is no guarantee as to the outcome of an investigation, the Board by the institution of one would indicate that it is aware of the problem and has it under consideration. Such a move would show that the CAB is attempting to fulfill the statutory direction of all of Section 102 of the Act, and not just operating under a part thereof.<sup>154</sup>

Piecemeal determinations by the Board as in the *Hi-Plains* case accomplish little more than the expending of enormous amounts of time and energy both by the applicants and the Board. Considering the number of applications, it is to the Board's overwhelming advantage to determine the need for third level service and set the standards for an anticipated system in a single proceeding. As the Aero Commander petition demonstrates, various common problems can be given more efficient consideration by the CAB in a single investigation.<sup>155</sup> Otherwise, on an *ad hoc* basis, each

<sup>149</sup> Pickering, *supra* note 92.

<sup>150</sup> *Ibid.*

<sup>151</sup> Aero Commander, Inc., *supra* note 115.

<sup>152</sup> 6 C.A.B. 1 (1944).

<sup>153</sup> Remarks of Senator Monroney at oral argument in the *Southwestern Area Local Service* case, CAB Docket 10758, on Feb. 28, 1962, quoted in Aero Commander, Inc., *supra* note 115, at 3.

<sup>154</sup> 49 U.S.C. § 1302(a) & (b), *supra* note 140.

<sup>155</sup> Aero Commander, Inc., *supra* note 115, at 5-6.

applicant necessarily would present similar arguments of a need for the service and the Board would be subject to similar pressures in every case. Problems such as the operating costs of different aircraft, the type and amount of subsidy desired, ideal traffic achievement, and the most feasible route structure would be debated each time an application is heard.

At a time when the CAB is attempting to reduce subsidy, an investigation as proposed by Aero Commander is important not only because third level service may represent competition for the already highly-subsidized local service industry, but also the proponents contend with cogent arguments that the result of a third level air transportation system will be an overall reduction of subsidy payments.<sup>156</sup> Upon concluding an investigation of the industry, the Board could present an overall plan of the type of city and area which will best support third level service, the types of aircraft desired for use on different routes, an outline of preferred scheduling, a method of subsidy determination, and what the Board would expect as to later operation proposals by applicants. While it is arguable that determinations such as these are difficult without experimentation, enough air taxis are operating on a scheduled basis in a variety of areas so as to provide concrete bases for consideration of the above factors.

The dilemma in which the Board now finds itself indicates the mistakes of the CAB in not following the hearing examiners' suggestions in the *Local Service Investigation*. Excluding consideration of the proposed amendment of the Aero Commander petition, there is a most important implication to be drawn from the proposal for an investigation. It presents the CAB with an opportunity to review the entire United States air transportation system. "Such a broad-gauge approach is needed because the question of 'third level' service is a broad one of far-reaching consequence. It is a matter of too great impact to be left to the vagaries of determination on an *ad hoc* basis."<sup>157</sup> Third level air service is not only involved with itself, but the very concept has arisen from changes in the national transportation pattern which have evolved in the past few years. Each new change, coupled with the inability of the Board to foresee or cope with the alteration, has merely confused the situation. Commencement of a third level investigation with the avowed purpose of determining the present status of air transportation and the future goal of directing its relations to the nation's system of travel can result only in progress.

Policy determinations on an *ad hoc* basis have previously precluded the Board's resolving many major problems of the air system. By inspecting the industry in its present state, the CAB can assume leadership in fulfillment of the statutory directive of Section 102 of the Act. Consideration should be given not only to air transportation within itself, but also its relationship to other modes of transportation, especially surface movement by private automobile. With the construction of a high-speed super-highway network in progress, relating the short haul air system to it so as to minimize inefficient competition would be particularly beneficial to the industry.

Having failed on previous occasions to give general consideration to

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<sup>156</sup> Pickering, *supra* note 120. Also speech by Thomas J. Harris, Vice-President of Aero Commander, Inc. at the Annual Aviation Conference of the American Society of Mechanical Engineers, June 26, 1962, at 4.

<sup>157</sup> Aero Commander, Inc., *supra* note 115, at 6.

the air system, it is especially important that the Board exercise its power with this opportunity. This may be the last outside presentation to the CAB which warrants consideration by the CAB of such broad issues and allows it to formulate standards for the future development of the air system.