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## Recent Trends in Domestic Airmail Rate Cases

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# JUDICIAL AND REGULATORY DECISIONS

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## RECENT TRENDS IN DOMESTIC AIRMAIL RATE CASES

For the past eight years the Civil Aeronautics Board has consistently lowered the airmail pay of most of the domestic air carriers. However, the recent ten percent increase in passenger rates<sup>1</sup> and the numerous requests by the airlines for increases in airmail compensation indicate that an examination of the principles which have guided the Board in its mail rate decisions would be appropriate at this time in an effort to test the validity of these principles.

Under Section 406(b) of the Civil Aeronautics Act of 1938, the Board is directed in fixing mail rates to consider, among other factors, (1) the adequacy of the transportation service supplied by the carrier, (2) the need of the carrier for mail compensation sufficient to insure the performance of such service, and (3) together with other income, the need for such compensation sufficient to enable the carrier under honest, economical and efficient management to continue the development of air transportation to the extent required for commerce, the Postal Service, and the national defense.<sup>2</sup> Carriers which in general have been operating at a loss in their non-mail services are classified as "need rate" carriers by the Board and receive higher mail pay than the "service rate" carriers, who theoretically receive merely enough mail pay to compensate them for the actual expenses plus a reasonable profit in carrying the mail. The service rate concept is somewhat comparable to the "real value of the service" doctrine in railroad cases, and satisfies the Constitutional guarantee of a fair profit.<sup>3</sup> But it is different from that doctrine in that the air transportation industry is singular in that mail payments are used for the accomplishment of national objectives that transcend the interests of the postal service.<sup>4</sup> Beginning with Eastern Air Lines in October 1942,<sup>5</sup> twelve domestic carriers have

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<sup>1</sup> *Order Approving Agreement Relating to Passenger Fares, Agreement No. 996*, CAB Order, Serial E-389 (Mar. 21, 1947).

<sup>2</sup> 52 Stat. 998 (1938), 49 U.S.C. §486 (1940).

For analyses of airline cost and financial problems, see Nicholson, *Possibilities for Lower Airline Costs* (1946) 11 Law and Contemp. Prob. 452; STANDARD & POOR'S INDUSTRY SURVEYS—AIR TRANSPORT, Vol. 115, No. 3, Sec. 1 (Jan. 8, 1947); and *What's Wrong With the Airlines*, 34 Fortune Magazine 73 (Aug. 1946). According to the CAB press release of Feb. 27, 1947, for the first eleven months of 1946 the 20 domestic air carriers operated at a net loss from operations of \$1,211,299 compared with a net profit of \$37,226,656 for the same period in 1945. For the entire year of 1946, mail ton-miles increased 73.94%, revenue miles increased 48.73%, and revenue passenger-miles increased 76.87% compared with 1945. Also for the entire year of 1946, 78.74% of the 25.26 average available seats per mile were occupied by revenue passengers compared with 88.12% for 1945.

The railroads have recently requested a 45% increase in mail transportation rates: 50 American Aviation Daily 124 (Mar. 27, 1947).

<sup>3</sup> See WILSON, *TRAFFIC LAW AND PROCEDURE*, C. 26 (1944).

<sup>4</sup> *American Air., Mail Rates*, 3 CAB 323, 335 (1942), "Section 406(b) . . . discloses the basic differences between the dual developmental and regulatory objective of this Act and the regulatory objective of the ordinary statute designed for the control of public utility rates. This Board would not be able to approach soundly its rate-making function in disregard of this essential difference during the period the carriers are building to a position sufficient to enable them to accomplish their broad objectives without including payment therefore in the mail rates."

<sup>5</sup> *Eastern A.L., Mail Rates*, 3 CAB 733 (1942).

been put in the "service rate" class. The four largest of these carriers now have a uniform rate of 45c per mail ton-mile,<sup>6</sup> and the other eight have a uniform rate of 60c per mail-ton-mile or its equivalent.<sup>7</sup>

One of the most recent decisions illustrative of the Board's policies is *The National Airlines Mail Rate Case*.<sup>8</sup> In this opinion National was taken out of the need class and given the 60c uniform service rate. Uniformity in service rates is believed to be desirable by the Board because of its belief that fixing rates based on the costs of the average carrier will provide additional competitive incentives for economy and efficiency between carriers. The Board believes that to the extent that air carriers are of the same size and volume of operation,<sup>9</sup> the level of operating costs should be about the same except in unusual cases where cost differences are obviously inherent in the type of character of service or in the area served. Thus with this uniformity policy, for the current transitional period at least the Board is supposedly not restricting the rate of return on the investment devoted to airmail to any predetermined percentage for the self-sufficient carriers.

#### RATE OF RETURN AND THE INVESTMENT BASE

During the war the Board announced, although did not strictly follow, a policy of putting the primary emphasis upon the rate of return on investment.<sup>10</sup> For need rate carriers, the rate of return is calculated on the entire recognized investment and has varied up to about 15%. During the war 8% seemed to be the predominate need rate figure.<sup>11</sup> However,

<sup>6</sup> These carriers are Eastern, American, United, and TWA. *Eastern A.L., Mail Rates*, 6 CAB 551 (1945); *American Air., Mail Rates*, 6 CAB 567 (1945); *United A.L., Mail Rates*, 6 CAB 581 (1945); and *Transcontinental & W.A., Mail Rates*, 6 CAB 594 (1945). These four separate opinions are largely identical in wording.

<sup>7</sup> The decisions for these carriers are *Pennsylvania-Cent. Air., Mail Rates*, 4 CAB 22 (1942); *Chicago and Sou. A.L., Mail Rates*, 4 CAB 419 and 4 CAB 529 (1943); *Western A.L., Mail Rates*, 4 CAB 441 (1943); *Hawaiian A.L., Mail Rates*, 4 CAB 463 (1943); *Delta Air., Mail Rates*, 4 CAB 501 (1943); *Northwest Air., Mail Rates*, 4 CAB 515 (1943); *Braniff Air., Mail Rates*, 4 CAB 588 (1944); and *National Air., Mail Rates*, — CAB — (Docket 824, Sept. 19, 1946). Some of the rates are 0.3 mil per mail pound-mile, which is equivalent to 60c per mail ton-mile.

Domestic carriers in the need rate class are Caribbean-Atlantic, Colonial, Continental, Inland, Mid-Continent and Northeast. All local and feeder lines have need rates.

<sup>8</sup> *National Air., Mail Rates*, — CAB — (Docket 824, Sept. 19, 1946).

<sup>9</sup> Actually for the four largest carriers, the total revenue passenger miles in thousands for 1946 varied as follows: American—1,307,909, United—1,067,938, Eastern—803,026, TWA—744,291. For the eight "medium sized" carriers this figure in thousands was: Northwest—378,440, PCA—373,331, Braniff—212,922, Delta—209,583, Western—191,660, National—173,175, Chicago & Sou.—137,844, and Hawaiian—35,001. For other domestic carriers, this figure was: Northeast—83,849, Continental—75,623, Mid-Continent—75,570, Colonial—45,593, Inland—22,362, Pioneer—5,902, Caribbean Atl.—3,029. See the conclusion, *infra*, for further discussion of uniformity.

Another possible reason for uniformity of rates is the theory that for equal services the carriers should get equal pay.

<sup>10</sup> *Pan Am.-Grace Air., Mail Rates*, 3 CAB 550, 590 (1942), "We conclude that during the war, and solely because of the conditions that war creates, the rate of return upon investment, which has heretofore been only one of a number of elements taken into account in determining the net operating income that it has seemed reasonable to anticipate in the setting of a mail rate for the individual carriers, should now become the primary and controlling element in that determination." *And see*, SPENCER, AIR MAIL PAYMENTS AND THE GOVERNMENT, 272 *et seq.* (Brookings Institution, 1941) for an analysis of this problem before the war.

<sup>11</sup> *National Air., Mail Rates*, 4 CAB 567, 570 (1944), "In accordance with our decision in previous cases involving domestic carriers which were in need of amounts in their mail rates to cover deficiencies in non-mail revenues, we will

for service rate carriers the situation is more complex. In most of the cases a rate of return on the total recognized investment is indicated, although in some opinions the Board simply stated the anticipated amount of profit but not the percentage of return.<sup>12</sup> In the recent *National Airlines Case*, the Board holds that the average return of 14.53% on the recognized investment was a fair and reasonable return for the period ending September 30, 1946, and that about 10% was sufficient for the future period. Beginning with the first service rate opinion,<sup>13</sup> Mr. Branch of the CAB has dissented or specially concurred in practically all such cases because of his belief that the rate of return for service rate carriers should be limited to 10%.<sup>14</sup> The majority of the Board, however, recognized that the carriers would be subject to severe financial demands at the close of the war,<sup>15</sup> and actually often allowed returns on total investment of around 20% and over. That this policy was justified is evidenced by the present poor financial status of the airlines despite such war time returns.

The determination of the rate base or average investment has been made clearer by the Board's decisions in the past few years.<sup>16</sup> During the war several special problems arose in connection with army contract operations. The Board held that fixed assets and working capital allocated for such activities would not be included in the recognized investment.<sup>17</sup> On the sale of equipment to the Government, profit on involuntary sales was not considered by the Board but profit on voluntary sales was allowed

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make provision in the rate of earnings sufficient to yield a return of 8% after federal income taxes on the recognized investment in scheduled air transport operations." *Accord: National Air., Mail Rates—Route No. 27*, 3 CAB 631 (1942) and 4 CAB 181 (1943); *Pennsylvania-Cent. Air., Mail Rates*, 4 CAB 22 (1942); *All American Aviation, Mail Rates—Route No. 49*, 4 CAB 354 (1943); *Continental A.L., Mail Rates*, 6 CAB 97 (1944) ("An 8% return on recognized investment will provide earnings sufficient to insure its credit and to keep it in a position to attract additional capital."). *And see note 64, infra.*

<sup>12</sup> *E.g., Northwest Air., Mail Rates*, 4 CAB 515 (1943) and *Pennsylvania-Cent. Air., Mail Rates*, 4 CAB 22 (1942).

<sup>13</sup> See note 5, *supra*.

<sup>14</sup> Mr. Branch suggested that a limit of 15% on the recognized investment be established, but that with the usual fluctuations and errors this would amount to about 10%. *Pennsylvania-Cent. Air., Mail Rates*, 4 CAB 22 (1942). For other dissents of Mr. Branch see *Northwest Air., Mail Rates*, 4 CAB 515 (1943); *Delta Air., Mail Rates*, 4 CAB 501 (1943); *Hawaiian Air., Mail Rates*, 4 CAB 463 (1943); *Western A.L., Mail Rates*, 4 CAB 441 (1943); *Transcontinental & W.A., Mail Rates*, 4 CAB 139 (1943); *United A.L., Mail Rates*, 4 CAB 128 (1943); *American Air., Mail Rates*, 3 CAB 770 (1942); *Eastern Air., Mail Rates*, 3 CAB 733 (1942). Mr. Branch excluded the Excess Profits Tax from his calculations.

<sup>15</sup> "The present respondent shares with all other carriers a need for earnings sufficient to insure its credit, and to keep it in a position to attract capital readily, when it again becomes possible to secure new equipment and enlarge the existing operations or inaugurate new ones." *Pan Am.-Grace Air., Mail Rates*, 3 CAB 550, 590 (1942). *Accord: Pan Am. Air., Latin American Mail Rates*, 3 CAB 657, 669 (1942). Mr. Pogue agreed with the majority in these cases but requested that Congress give the CAB power to require the carriers to set up these extra funds in special reserves. *American Air., Mail Rates*, 3 CAB 323, 362-363 (1942). This power would be an excellent improvement in the Civil Aeronautics Act.

<sup>16</sup> For a discussion of this problem before the war, see SPENCER, *op. cit. supra*, note 10, at 267 *et seq.*, ". . . although the CAA and CAB have not definitely said in so many words that a rate base was and is employed, they have made use of a rate base, and that base up to now has been made up of: (1) original cost of real property and equipment less accrued depreciation for over or under depreciation; (2) an allowance for working capital, the method for computing which seems to have been subject to considerable variation; and (3) an allowance, to be eventually amortized, for development expenses upon proof that such expenses were actually incurred."

<sup>17</sup> *Colonial A.L., Mail Rates*, — CAB —, (Docket 842, Oct. 17, 1946); *Pennsylvania-Cent. Air., Mail Rates*, 4 CAB 22 (1942).

in the recognized investment for rate-making purposes.<sup>18</sup> Advances by the Government on war contracts<sup>19</sup> and reserves for war contract disallowance<sup>20</sup> were also excluded. The Board reaffirmed the principle that the original cost of equipment would be used rather than reproduction cost.<sup>21</sup> Working capital equivalent to three months' operating expenses exclusive of depreciation now seems to be all that is allowed, although as indicated in *The National Airlines Case*,<sup>22</sup> money needed for the replacement of aircraft will not be eliminated and in special cases other concessions are made. The Board has been rather liberal in following its rule that assets not required or essential to the air transport operations of the carrier will not be considered in the recognized investment. In individual cases, however, the Board has excluded under this policy stock of another airline,<sup>23</sup> stock of affiliated companies,<sup>24</sup> an amount representing the purchase price of an airmail contract,<sup>25</sup> goodwill,<sup>26</sup> and an airport food service.<sup>27</sup> In *The National Airlines Case*, non-operating property and equipment, and stock discount and expense were eliminated from the recognized used and useful investment on this reasoning.<sup>28</sup>

#### EXPENSE ITEMS

Also excluded in the principal case was a sum representing extension and development projects, which the Board held not reasonable because of insufficient showing by National that these projects were of benefit to air transport operations. The allowance of developmental and other expenses has proved to be one of the major problems in determining investments as related to airmail compensation. Actually there are two categories of developmental costs: experimental expenses and costs incurred in the development of new routes, and expenses involved in re-training personnel and changing facilities and equipment.<sup>29</sup> The former are simply a question

<sup>18</sup> *Transcontinental & W.A., Mail Rates*, 4 CAB 139 (1943); *Colonial Air., Mail Rates*, 4 CAB 71 (1942); *Pennsylvania-Cent. Air., Mail Rates*, 4 CAB 22 (1942). In addition, taxes on such involuntary sales are not included in expenses by the Board. *United A.L., Mail Rates*, 4 CAB 128 (1943).

<sup>19</sup> *Colonial A.L., Mail Rates*, — C.A.B. — (Docket 842, Oct. 17, 1946).

<sup>20</sup> *American Overseas A.L., Mail Rates*, — C.A.B. — (Docket 1666, July 15, 1946).

<sup>21</sup> *American Air., Mail Rates*, 3 C.A.B. 770, 788-789 (1942).

<sup>22</sup> *Supra*, note 8, at 31 (mimeographed opinion). *Accord: Pan Am. Air., Transatlantic Services*, — C.A.B. — (Docket 1706, July 15, 1946); *National Air., Mail Rates*, 4 C.A.B. 567 (1944); *Chicago and Sou. A.L., Mail Rates*, 4 C.A.B. 529 (1943); *Continental A.L., Mail Rates*, 6 C.A.B. 97 (1944); and *American Air., Mail Rates*, 3 C.A.B. 770, 787 (1942) "Working capital is necessary to provide a carrier with liquid assets with which to meet expenses incident to its operations. Since current depreciation does not require any expenditures, it would be improper to include depreciation as a basis for computing working capital." But this case is *contra* in that it allowed excess working capital to remain in the investment base as it was "obtained in the exercise of proper managerial discretion and . . . will be needed in the future for the purpose of expansion."

It should be noted that the Board recognizes that it is not feasible to follow strictly this three months' requirement.

<sup>23</sup> *Colonial Air., Mail Rates*, 4 C.A.B. 71 (1942).

<sup>24</sup> *Transcontinental & W.A., Mail Rates*, 4 C.A.B. 139 (1943).

<sup>25</sup> *Northwest Air., Mail Rates*, 4 C.A.B. 515 (1943).

<sup>26</sup> *Pan Am.-Grace Air., Mail Rates*, 3 C.A.B. 550 (1942).

<sup>27</sup> *American Air., Mail Rates*, 3 C.A.B. 770 (1942).

<sup>28</sup> *Supra*, note 8, Appendix No. 2.

<sup>29</sup> *Pan Am. Air., Transatlantic Rates*, 1 C.A.A. 220 (1939). After a lengthy analysis of developmental costs, the Board stated in this case that while such costs should be amortized, it would not be required until Pan American had begun flying the route and experience was gained which would enable a determination of the proper amortization. Also see *Chicago and Sou. A.L., Mail Rates*, 3 C.A.B. 161 (1941); *Delta Air., Mail Rates*, 3 C.A.B. 261 (1942); *Pennsylvania-Cent. Air., Mail Rates*, 4 C.A.B. 22 (1942); *Transcontinental & W.A., Mail Rates*, 4 C.A.B. 139 (1943); *National Air., Mail Rates*, 4 C.A.B. 567 (1944).

of proof and are usually allowed if satisfactorily explained. But the Board has always insisted on the amortization of the latter expenses. The recent *National Airlines Case*<sup>30</sup> extends this approach to the transitional expenses as well and goes even further to blame much of airline losses since the war on such pre-operating expenses.<sup>31</sup> Inasmuch as such expenses are not relatively large and a number of carriers do amortize them, the Board's statement seems to be a somewhat superficial analysis of current difficulties. Certainly the Board would not even consider raising mail compensation if the present financial status of many carriers was simply due to developmental costs. Nor did the Board consider the argument that air transportation is still in the developmental stage; that new aircraft are constantly being developed; and that from a financial standpoint the expense of such constant change should perhaps be paid during the period it is incurred.

As to other expense items, the Board as a general principle excludes for rate making purposes any costs which are excessive as compared to similar airlines.<sup>32</sup> While costs are usually compared simply on a per plane mile basis, the Board also determines whether the particular type of expense is proportionately out of line to total expenses.<sup>33</sup> Among the expenses considered in individual cases to be excessive or not allowable at all by the Board have been food,<sup>34</sup> travel,<sup>35</sup> stewardess salaries,<sup>36</sup> traffic and advertising,<sup>37</sup> insurance,<sup>38</sup> charitable contributions,<sup>39</sup> maintenance,<sup>40</sup> legal

<sup>30</sup> *Supra* note 8 at 10 *et seq.* (mimeographed opinion).

<sup>31</sup> "During recent months practically all the carriers receiving either of the service rates have reported losses, some of substantial amount and over an extended period. . . . In large part the reported losses appear to be the result of large non-recurring costs incurred in extensive preparations for the inauguration of new services, often with larger and more modern equipment, and the consequent cost of retraining old personnel, and extensive expansion and revamping of ground facilities." *Id.* at 35. And see *id.* at 13, "During recent months, this practice in the industry has been reflected by the reporting of substantial net losses by most carriers." Also see *id.* at 14, "There is little doubt that the costs which occasion the current losses are costs in large part attributable to activities related to anticipated expansion of operations and to conversion to new types of equipment." The Board does not specifically indicate the period over which such expenses should be amortized.

It is probably true that many carriers commingled most of their transitional expenses with current expenses rather than capitalizing them. What seems to be most significant is that losses are continuing while extraordinary expenses for transition purposes usually have only a temporary effect on operating expenses and are absorbed when traffic catches up.

<sup>32</sup> The Board analyzes such costs on a per plane mile basis to enable such comparisons. When relating costs and economies of different aircraft, the Board uses a per seat mile basis. See *supra* note 8 at 24-25 (mimeographed opinion). The recent mail rate show cause order for Chicago and Southern's Routes 8 and 53 is a current example of alleged "unreasonably high costs" in comparison with similar carriers.

<sup>33</sup> *E.g.*, *Chicago and Sou. A.L., Mail Rates—Routes Nos. 8 and 53*, 3 C.A.B. 161, 179 (1941) ("The total compensation paid to the carrier's general officers is in excess of that paid by carriers with comparable mileage and operating conditions. Unless, however, the relationship of general and administrative expenses to total expenses appears distinctly out of line with that in the industry as a whole, this question would appear to be one for managerial discretion rather than approval or disapproval by us").

<sup>34</sup> *Colonial Air., Mail Rates*, 4 C.A.B. 71 (1942).

<sup>35</sup> *Id.*

<sup>36</sup> *Mid-Cont. Air., Mail Rates—Routes Nos. 26 and 43*, 3 C.A.B. 464 (1942) (For a heavy need carrier, stewardesses are an unnecessary expense and luxury).

<sup>37</sup> *Continental A.L., Mail Rates—Routes Nos. 29 and 43*, 3 C.A.B. 395 (1942) (20% of the non-mail revenues represents a fair and reasonable figure for traffic and advertising costs).

<sup>38</sup> *Pan Am.-Grace, Mail Rates*, 3 C.A.B. 550 (1943).

<sup>39</sup> *Delta Air., Mail Rates*, 4 C.A.B. 501 (1942).

<sup>40</sup> *American Overseas Air., Mail Rates*, — C.A.B. — (Docket 1666, July 15, 1946).

fees,<sup>41</sup> engine overhaul reserves,<sup>42</sup> and such general accounts as indirect flying expenses,<sup>43</sup> ground expenses,<sup>44</sup> and general and administrative costs.<sup>45</sup> The Board also has consistently regulated the depreciation allowed on the different types of aircraft. Since the Air Mail Act of 1934, the government in determining mail compensation has been able to limit salary expenses of air carriers. However, only on a few occasions has the Board applied its policy of not allowing executive salaries to be much higher than those for other air carriers of comparable mileage and operating conditions.<sup>46</sup> In view of the airlines' reputation for relatively low wages,<sup>47</sup> it may be readily seen that a better comparison would be with salaries of comparable utilities rather than with other air carriers. The Board also has refused to allow for expenses due to keeping an excessive number of employees even if these employees are believed necessary by the company because of personnel turnover.<sup>48</sup>

From the very first decisions of the war, the Board because of war period earnings was remarkably optimistic about the question of cost trends. In March 1942, the Board allowed for a general increase of only 2% in all costs except depreciation of flying equipment, although Mr. Pogue in a concurring opinion thought the figure should be at least 5%.<sup>49</sup> Later the Board declared that the greatly expanded volume of operations would substantially offset the influence of increased base costs.<sup>50</sup> In new route cases, diversion of revenue due to the new certificates was allowed partly because the Board believed that expanded business after the war would more than compensate for such losses.<sup>51</sup> And the Board even announced a policy of making no allowance for general price increases in the future inasmuch as the Government had adopted a price control policy, leaving any such increases which were later actually experienced to be reconsidered in later hearings.<sup>52</sup> The more recent expressions of the Board, as in *The National Airlines Case*, are to the effect that the use of new equipment and more efficient utilization of personnel made possible by the end of the war will result in operating economies which "should overcome in large part or in whole the current trend toward higher costs as a result of general price and wage increases."<sup>53</sup>

<sup>41</sup> *National Air., Mail Rates*, — C.A.B. — (Docket 824, Sept. 19, 1946).

<sup>42</sup> *Pan Am. Air., Transatlantic Services, Mail Rates*, — C.A.B. — (Docket 1706, July 15, 1946).

<sup>43</sup> *Mid-Cont. Air., Mail Rates—Routes No. 26 and 48*, 3 C.A.B. 464 (1942).

<sup>44</sup> *Pan Am. Air., Latin American Mail Rates*, 3 C.A.B. 657 (1942).

<sup>45</sup> *Supra* note 43.

<sup>46</sup> *National Air., Mail Rates*, 4 C.A.B. 567 (1944); *Chicago and Sou. A.L.*, *supra* note 33. The discretionary policy followed in the latter case does not appear to have been followed in subsequent opinions.

<sup>47</sup> Fortune magazine, *supra* note 2 (Airlines have been able to secure competent personnel in the past at low wage scales largely because of the alleged glamor of the industry, but are having a much more difficult time in the post-war labor market).

<sup>48</sup> *Northwest Air., Mail Rates*, 4 C.A.B. 567 (1944); *Delta Air., Mail Rates*, 4 C.A.B. 501 (1943).

<sup>49</sup> *American Air., Mail Rates*, 3 C.A.B. 323, 355, 360 (1942).

<sup>50</sup> *Pan Am.-Grace Air., Mail Rates*, 3 C.A.B. 550, 586 (1942). But see in the same opinion at 564 this contrary philosophy, "To reduce the financial resources of a carrier under such circumstances and at a time when costs are rising and commercial revenues are unpredictable would clearly lack that justification which should accompany a policy vitally affecting air transportation."

<sup>51</sup> *American Air. et al., East-West California*, 4 C.A.B. 278 (1943); *Eastern A.L. et al., Washington Service*, 4 C.A.B. 325 (1943).

<sup>52</sup> *Eastern A.L., Mail Rates*, 3 C.A.B. 733 (1942).

<sup>53</sup> *Supra* note 8 at 33-34 (mimeographed opinion). And see *Transcontinental & W.A., Transatlantic Services, Temporary Mail Rate*, — C.A.B. — (Docket 842, Oct. 17, 1946) (Although the carrier has reported operating losses, this result appears to reflect increased costs incurred in preparation for inauguration

## HONEST, ECONOMICAL AND EFFICIENT MANAGEMENT

The problem of wages and other costs is closely tied up with the Civil Aeronautics Act requirement of honest, economical and efficient management. Whether losses suffered by TWA during the recent pilots' strike, for example, should be considered by the Board as a reflection on management would appear to be extremely doubtful. In the recent *National Airlines Case*, losses suffered by the company because of a series of accidents were eliminated from consideration because of this requirement, the Board stating that the curtailment of service was due to the carrier's failure to maintain CAA operating standards.<sup>54</sup> Comparatively high costs are usually considered by the Board to result from uneconomical management.<sup>55</sup> With the current change by practically all airlines to new types of equipment, it is important to note that the Board considers as uneconomical management expenses those costs which result from the use of larger aircraft than the load factors require.<sup>56</sup> Another management policy criticized has been inventory obsolescence expense.<sup>57</sup> The Board also has refused to take into consideration non-mail schedules unless required in the public interest,<sup>58</sup> and this policy will undoubtedly become increasingly important now that the Post Office Department has many more schedules and routes from which to choose. Under the policy provisions of Section 2 of the Civil Aeronautics Act, the Board is directed to interpret the public interest as the concern of the nation as a whole in an economically sound, efficient, and reasonably competitive air transportation system properly adapted to the present and future needs of foreign and domestic commerce, of the Postal Service, and of the national defense.<sup>59</sup> Losses of traffic and the downward trend of other non-mail revenue are regarded by the Board as important measures of the efficiency of management.<sup>60</sup> In addition, the Board has discounted an abnormally low performance factor during the winter as inefficient management.<sup>61</sup> In view of the great importance of safety requirements, such a policy would seem to be of questionable value.

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of services on the new routes rather than an adverse change of trend in operations).

<sup>54</sup> *Supra* note 8 at 12-13 (mimeographed opinion).

<sup>55</sup> "In past mail rate proceedings, when it has appeared to us that the air carrier's anticipated expenses represented extravagance or poor managerial efficiency, we have scaled the estimates down to the level it has appeared to us to be a reasonable one under the Civil Aeronautics Act's standards of 'honest, economical and efficient management.'" *Eastern A.L., Mail Rates*, 3 C.A.B. 733, 759 (1942).

<sup>56</sup> "Except where requirements of safety are involved, the use of larger equipment than the traffic volume appears to require can only be justified by the anticipation that the larger equipment will attract increased gross revenues at least equal to the gross cost increase involved, and that increase in size of equipment should improve the economic position of the carrier and not result in increased net burden to the Government. . . ." *Chicago and Sou. A.L., Mail Rates—Routes Nos. 8 and 53*, 3 C.A.B. 161, 169 (1941). *Accord: Mid-Cont. Air., Mail Rates—Route No. 48*, 2 C.A.B. 392 (1940); *Delta Air., Mail Rates*, 3 C.A.B. 261 (1942); *Pennsylvania-Cent. Air.*, 4 C.A.B. 22 (1942).

<sup>57</sup> "We believe that reasonably prudent management and foresight will enable the carrier to anticipate in very large degree the time when its stocks are maintained, will be replaced, and to reduce the amount of such stocks by use thereof accordingly. Therefore we believe the present reserve to be adequate, and no allowance for obsolescence of materials and supplies is included in the forecast." *American Air., Mail Rates*, 3 C.A.B. 770 (1942).

<sup>58</sup> *Pennsylvania-Cent. Air., Mail Rates*, 4 C.A.B. 22 (1942); *Colonial Air., Mail Rates*, 4 C.A.B. 71 (1942); *Mid-Cont. Air., Mail Rates—Routes Nos. 26 and 48*, 3 C.A.B. 464, 468 (1942); *Chicago and Sou. A.L., Mail Rates—Routes Nos. 8 and 53*, 3 C.A.B. 161 (1941).

<sup>59</sup> 52 Stat. 980 (1938), 49 U.S.C. §402 (1940).

<sup>60</sup> *Inland A.L., Mail Rates—Routes Nos. 28 and 35*, 3 C.A.B. 491, 498, (1942).

<sup>61</sup> *Western A.L., Mail Rates*, 4 C.A.B. 441, 446 (1943). (Performance factor means the percent of scheduled miles actually fulfilled.)



Operating a cafeteria at a loss has been held beyond the bounds of managerial discretion.<sup>62</sup>

The lack of authority in the Civil Aeronautics Act to regulate the financial structure of carriers has prevented the Board from taking any direct action on this important management problem.<sup>63</sup> But it is submitted that under the requirement of honest, economical and efficient management, the Board could in some instances discourage financing by bonds and debentures rather than common stock, which has contributed to the poor financial picture of several air carriers, by not allowing interest payments to be considered as a necessary expense, or the Board could also use the rate of return to influence the mode of capitalization, as suggested by Mr. Pogue. The Board's policy toward enabling carrier management to secure funds for new equipment and expansion is now clear. It has consistently been held that while the rate of return does not have to be sufficient to enable such development from the funds of the carrier, it does have to be enough to attract private capital.<sup>64</sup> The fact that airline stocks have fared worse

<sup>62</sup> "While the operation of a cafeteria is certainly within the bounds of managerial discretion, the record is not convincing that operation of the cafeteria at a loss to the carrier is essential to the air carrier operations. Accordingly, we will give no consideration to the estimated loss." *Chicago and Sou. A.L., Mail Rates—Routes Nos. 8 and 53*, 3 C.A.B. 161, 181 (1941).

<sup>63</sup> However, in a concurring opinion in *American Air., Mail Rates*, 3 C.A.B. 323, 361 (1942), Mr. Pogue stated, "I think that the Board should take the position that it will, as a matter of general policy in fixing rates, take reasonable steps to encourage the preservation of simple common stock capital structures as far as possible. It is common knowledge that some public utility enterprises have in the past developed involved capital structures complicated with bonds, debentures, convertible debentures, preferred stock, and various other securities ranking prior to the equity stockholders who bear the fundamental risks of the business. This pyramiding of capital structures is admittedly undesirable where some simpler form of financing is feasible. . . . It seems self-evident that this practice should be discouraged. . . . Certainly any trend toward involved capital structures is a trend away from sound economic conditions in the industry." Mr. Pogue believed that American's rate of return upon investment should be lower because of its cumulative preferred stock.

<sup>64</sup> *American Air., Mail Rates*, 3 C.A.B. 323, 333, 338-339 (1942): "These developments will involve capital requirements of great magnitude, which in all likelihood will have to be met with great rapidity. They cannot be satisfactorily met unless those who supply the necessary funds are convinced that the enterprise will have a fair opportunity to secure earnings commensurate with the risk of the undertaking. The final measure of that risk will be determined by a number of factors, not least of which will be the economic results of the present regulatory policy now developing in the administration of the Civil Aeronautics Act.

"While the Act requires us to take into consideration the encouragement and development of an air transportation system properly adapted to fulfill the stated purposes of the Act, we are unable to find any intent on the part of Congress to provide, in the airmail rates, capital for the carrier expansion in addition to compensation sufficient to enable the carrier to fulfill the purposes of the Civil Aeronautics Act. The purpose of the Act is not to provide capital as such, but to provide a profit sufficient to enable the carrier, among other things, to obtain from private investors the capital it needs." *But see* the opinion of Mr. Pogue at 363, "To say that rate-making procedures under the Act are always available to meet any new needs of the air carrier is to ignore the admitted impossibility of deciding rate cases fast enough to keep current with changing conditions. All Governmental experience rises to testify eloquently to the lag between the impact of events and the rectification of rates through the regulatory process."

*And see Delta Air., Mail Rates*, 4 C.A.B. 501 (1943) (C.A.B. does not have to furnish funds for capital purposes beyond those provided incidentally to the fixing of a rate of return sufficient to attract private capital. Planes embodying substantial improvements are not merely replacements, and the C.A.B. does not have to provide a return which will enable the purchase of such aircraft out of earnings by substantial cash payments to banking affiliations). *Also see Chicago and Sou. A.L., Mail Rates*, 4 C.A.B. 419 (1942) and *Braniff Air., Mail Rates*, 4 C.A.B. 588 (1943).

in recent months than the average securities seems to be some evidence that this policy has not been entirely successful, although the decline is also due to the fact that investors had been unduly optimistic and had but recently realized this.

#### CONCLUSION

A review of these principles and rules which apparently guide the Board in its mail rate decisions makes it evident why the CAB could now raise rates without avowedly changing any of its stated policies. As once stated by Mr. Branch, "Every reason that has been advanced in its justification and all the considerations and factors which have been brought to bear just as reasonably could lead to and justify a mail rate which on the one hand would be much lower than 0.3 mil or on the other hand substantially higher than 0.3 mil."<sup>65</sup> The uniform service rate concept is theoretically based on assigning a median rate to a group of operationally similar air carriers. But it can hardly be contended that this theory has been carried out in practice in actually determining a median. The Board doesn't even make a pretense of doing so. Similarly the Board has definitely not made a comprehensive effort to group the air carriers.<sup>66</sup> For the 45c uniform rate group, the Board simply came to the conclusion that the cost and operating patterns of the four largest carriers showed somewhat the same trends, and that the range between the high carrier and low carrier in unit revenue ton-mile costs decreased from 15.77c for 1941 to 3.99c for the year ended May 31, 1945.<sup>67</sup> Not even this much was considered in determining the 60c uniform service rate. No effort was made to compare profit and route positions or traffic potentials of these four carriers, nor did the Board attempt to indicate whether the trends for these carriers differed from the trends of most of the industry.

In view of this uniform service rate policy, the long rigmarole the Board goes through is little more than window dressing, and if the carrier is making a profit or the Board thinks it should be making a profit, the chances are excellent that the carrier will be given the current uniform rate. Of course, in some opinions the Board has not gone through the entire process but has simply and directly stated that a uniform rate has been decided on and will be given.<sup>68</sup> While such opinions might be classified as arbitrary, it is extremely doubtful that they would be overturned judicially for that reason. The chief virtue of uniformity is its simplicity, but it is doubtful whether uniformity actually does provide any sort of competitive incentive for air carriers. It will be interesting to see how close the Board will stick to its uniformity policy when it decides some of the airmail rate increase cases now pending before it.

On the other hand, the practice occasionally followed in granting temporary mail rates, wherein the actual rate allowed will be decreased if the carrier makes more than a modest profit, or raised if less, obviously discourages efficiency incentives. The proposal for recapture mail payments is equally bad from an efficiency incentive standpoint, although it might have some value in emergency situations as a temporary administrative expedient. This proposal would require the carrier to return all profits on mail operations over a certain percentage.

Actually the Board to date has made no comprehensive cost studies, probably because it lacks the personnel and data to do so. The present investigations of the Board into the financial, route and operating condi-

<sup>65</sup> *American Air, Mail Rates*, 3 C.A.B. 770, 795 (1942).

<sup>66</sup> Under Sec. 406 (a) (2) of the Civil Aeronautics Act, the Board is directed to prescribe the methods "for ascertaining such rates of compensation for each air carrier or class of air carrier." 52 Stat. 998 (1938), 49 U.S.C. §486 (1940).

<sup>67</sup> *Supra* note 6. And see *supra* note 9.

<sup>68</sup> *Supra* note 6.

tions of Colonial, Northeast, and Chicago and Southern in order to determine ways and means of reducing need payments is an important step in the right direction.<sup>69</sup> But the Board has indicated at times that it is capable of examining every feature of the carrier's operations and strictly applying the rule of honest, economical and efficient management. The enforcement of this rule seems to be a sufficient safeguard against any laxities on the part of the carriers.

Finally, it must be pointed out that the correlation of mail rate policies with passenger and express rate policies is essential in these determinations. It is obviously not possible to determine adequately whether mail compensation should be increased into possibly subsidy proportions without at the same time examining whether the public should more directly bear the load of increased costs in the form of higher passenger fares, and whether increased passenger fares would retard the development of the air transportation system envisioned by the Civil Aeronautics Act of 1938.<sup>70</sup> Although the Board has not enunciated its considerations of this problem, the establishment of the 45c uniform service rate for mail on a somewhat similar basis as the tariff rates, and the scope of the opinion in the recent passenger fare increase order<sup>71</sup> indicates that the Board is giving increasing consideration to such correlations.

E. V., JR.

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<sup>69</sup> *Northeast Air., Order Instituting Investigation*, Docket 2853, Serial E-375 (Mar. 18, 1947); *Colonial Air., Order Instituting Investigation*, Docket 2852, Serial E-373 (Mar. 18, 1947); and *Chicago and Southern, Order Instituting Investigation*, Docket 2862, Serial E-401 (Mar. 24, 1947). The Board has also just recently authorized a somewhat similar investigation of PCA. *Pennsylvania-Cent. Air., Order Instituting Investigation*, Docket 2883, Serial E-437 (April 7, 1947).

In addition the bill introduced by Rep. Boykin on April 17, H.R. 3096, 80th Cong., 1st Sess. (1947), would seem to provide more accurate data in directing the General Accounting Office to make a periodical audit of accounts of carriers receiving a mail rate in excess of 50c per ton mile in order to determine whether such carriers are providing the quality of service and efficient and economical management required by Sec. 406(b) of the Civil Aeronautics Act.

<sup>70</sup> Sec. 1002e, 52 Stat. 1019 (1938), 49 U.S.C. §642 (1940): "In exercising and performing its powers and duties with respect to the determination of rates for the carriage of persons or property, the Board shall take into consideration, among other factors—(1) The effect of such rates upon the movement of traffic; (2) The need in the public interest of adequate and efficient transportation of persons and property by air carriers at the lowest cost consistent with the furnishing of such service; (3) Such standards respecting the character and quality of service to be rendered by air carriers as may be prescribed by or pursuant to law; (4) The inherent advantages of transportation by aircraft; and (5) The need of each air carrier for revenue sufficient to enable such air carrier, under honest, economical, and efficient management, to provide adequate and efficient air carrier service." For a discussion of the regulation of air tariff rates, see Burt and Highsaw, *Regulation of Rates in Air Transportation*, (1946) 7 La. L. Rev. 1, 7 et seq.

<sup>71</sup> "On the basis of present operating results, an increase in the rates, fares and charges for the transportation of passengers as proposed . . . appears reasonably likely to bring about a more nearly normal relationship between non-mail expenses and non-mail revenues and between mail and non-mail net revenues." Note 1 *supra* at 4 (mimeographed opinion). This order applies to American, Braniff, Chicago and Southern, Colonial, Continental, Delta, Eastern, Inland, Mid-Continent, National, Northeast, Northwest, PCA, TWA, United and Western.